MULTIPLE SHOCKS TEST RESILIENCE

The resilience of the global economy is tested by multiple shocks: rising Covid-19 infections in China, the war in Ukraine, the huge increase of several commodity prices, the prospect of aggressive monetary tightening in the US. The significant carry-over effect from last year is an element of support when assessing the outlook for annual growth this year. In addition, the drivers of final demand were supportive at the start of the year and in many cases still are. High inflation is weighing on consumer sentiment in the US and the Eurozone but fortunately, thus far, employment expectations of Eurozone companies remain at a very high level and in the US, the labour market remains very strong. It will play a fundamental role in shaping expectations about the growth and hence monetary policy outlook.

The global economy is undergoing several, simultaneous shocks that, taken together, represent a major test of its resilience. This situation is rather unique in terms of the number of shocks and their diversity. The Covid-19 shock still exerts its influence and has become a renewed source of concern in China, with global repercussions via the supply chains. The war in Ukraine is a geopolitical shock that creates huge uncertainty about its economic consequences. It has triggered a shock in a large number of commodities (oil, gas, metals, agricultural), giving an extra boost to already elevated inflation. Finally, there is a monetary shock, related to the prospect of aggressive tightening by the Federal Reserve in order to bring inflation back under control.

Despite these headwinds, business confidence remains high in the US and the Eurozone. This probably reflects an assumption that the geopolitical situation will not deteriorate further. Another factor is that, with the exception of the commodity price shock, which is truly global in nature, the other shocks have more local origins, even if they also have global repercussions. Geopolitical uncertainty is concentrated in Europe. Rising Covid-19 infections in China should have some worldwide impact but nothing compared to 2020. Federal Reserve rate hikes will influence first the US economy, with less of an impact abroad, although in a second stage, global spillover effects will follow. What also helps to support positive annual average growth rates for this year is the carry-over effect from last year's GDP growth. For the Eurozone, this is estimated at 1.9% and for France, at the end of the first quarter, at 2.7% (INSEE estimate). Finally, resilience also benefits from the fact that key drivers of final demand were supportive at the start of the year and in many cases still are. Job creation has been significant, wage growth has accelerated – gradually in the Eurozone, strongly in the US –, the assessment of order books is very positive, corporate profits have increased.

However, delivery times were lengthening again in March and prices of inputs continue to rise. Fortunately, companies, thanks to strong demand, have more leeway than normal to reflect this cost increase in their sales prices. This explains why business sentiment is suffering less, for the time being, from high inflation than households' sentiment, which in the US as well as in the Eurozone, has suffered from the relentless rise of inflation. Consumers feel gloomy not because of the labour market outlook – unemployment expectations for the next 12 months have only seen a moderate increase – but because of high and rising inflation, which has become widespread. As a consequence, central banks have adopted a tougher tone since the start of the year and the outlook for monetary policy has changed significantly. The ECB will stop its net asset purchases in the third quarter and in all likelihood a first rate hike will follow before year-end. The Federal Reserve's stance is far more hawkish and monetary tightening will be implemented through a combination of multiple rate hikes and a reduction in the size of the balance sheet (quantitative tightening). In combination with rising inflation expectations, this prospect has caused a significant increase in bond yields, both in the US and the Eurozone.

CONSUMER CONFIDENCE EXPECTATIONS

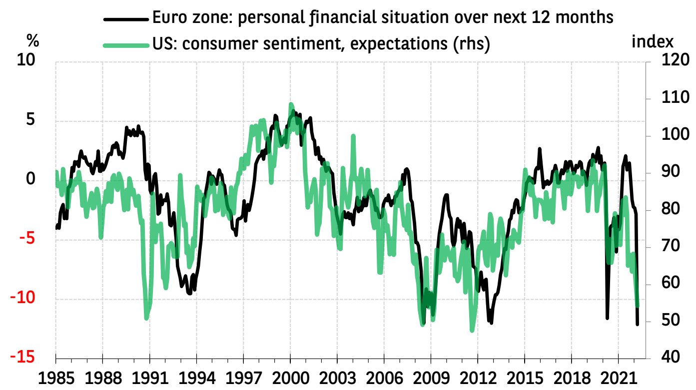

CHART 1 SOURCE: EUROPEAN COMMISSION, UNIVERSITY OF MICHIGAN

EUROZONE: LABOUR MARKET CONFIDENCE INDICATORS

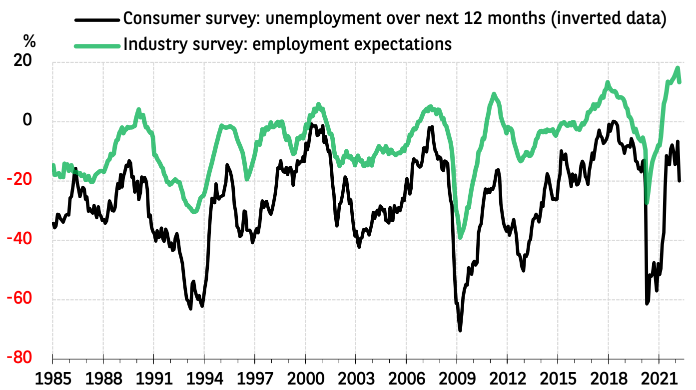

CHART 2 SOURCE: EUROPEAN COMMISSION (SURVEYS)

The near-term prospects remain dominated by the situation in Ukraine, elevated commodity prices, high inflation and its impact on households' purchasing power, supply chain disruptions. To this list of headwinds to growth, we should add the prospect of tighter financial and monetary conditions. On the other hand, various fiscal support measures are implemented here and there in the Eurozone in particular to cushion the inflationary shock. And, fortunately, thus far, employment expectations of Eurozone companies have remained at a very high level. This is reassuring in view of their historical correlation with corporate investments. It is a key factor to monitor going forward. The same comment applies to the US where the labour market, which remains very strong, plays a fundamental role in shaping expectations about the growth and hence monetary policy outlook.

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