EDITORIAL

A LIMITED ECONOMIC TURNAROUND, ON BOTH THE DOWNSIDE AND THE UPSIDE

In the major OECD economies, the slow pace of disinflation is expected to continue, while the slow slowdown in growth will eventually lead, because of the monetary tightening (particularly rapid and significant), to a recession in the United States and stagnation in eurozone GDP. Various supportive factors should limit the extent of the reversal, but the ensuing recovery would be equally limited. The slow convergence of inflation towards its 2% target would force central banks to maintain a restrictive policy despite the start of rate cuts in the first half of 2024.

In the middle of the year, there is a relative consensus on expectations of a slowdown in activity in 2023 in the major OECD economies – as a result of the inflationary shock and the subsequent sharp monetary tightening – before a recovery in 2024. Uncertainty relates to the extent of each of these movements. At present, most economic developments, observed or anticipated, have in common their slowness and limited scope[1]. That is quite clear on the disinflation side, and it is also clear on the growth side, where we have seen a slow deceleration so far. We expect the downturn to intensify but it would, in our scenario, lead to a shallow recession in the United States and stagnation in the eurozone from the 3rd quarter of 2023 to the 1st quarter of 2024[2] . This awaited US recession, however, does not seem to be a foregone conclusion as of today, as the early warning signs are still not very tangible, while the risk to the eurozone seems to be the opposite. Indeed, the euro area would narrowly escape the recession, and it would take little for the economy to swing; in that case, the recession would nonetheless be limited for the same reasons as in the US.

WHY A RECESSION?

The main element underlying our forecasts of recession or near recession is the extent of the monetary tightening, which is somewhat larger in the US than in the eurozone, with a cumulative increase of 500 bp for the Fed and 400 bp for the ECB so far, which would reach 525 and 450 bp, respectively, at the end of the tightening cycle, as we expect.

The tightening of lending standards is also stronger across the Atlantic – and is reaching levels consistent with a possible recession by historical standards– while the vulnerability of the euro area comes from the greater role of bank financing in the economy. In the United States, real interest rates are set to return to positive levels, reinforcing the restrictive nature of monetary policy. We also consider the clear recessive signal, sent for several months, by the Conference Board's composite leading indicator through, in particular, the sharp inversion of the yield curve.

However, the United States benefits from a higher growth carry-over for 2023 than the eurozone (+0.9% compared to +0.2% in the 1st quarter and +1.6% compared to 0.4% in the 2nd quarter according to our forecasts). If it does not prevent them from slipping into recession, it explains why, on an annual average basis, our growth forecast for the US reaches 1.5% in 2023 compared to only 0.4% for the eurozone. Admittedly, US growth is weakened by the sharp decline in residential investment over the past eight quarters, but this has not, at this stage, spilled over the US economy as a whole. US GDP growth remains supported by its largest engine, household consumption, which did not experience a single quarter of decline despite the inflationary shock, while the eurozone recorded two (4th quarter 2022 and 1st quarter 2023). The situation on the inflation front is also likely to turn slightly to the advantage of the US, although this remains to be confirmed. Headline inflation is significantly lower (4% year-on-year in May compared with 6.1% for the eurozone), and if core inflation figures were at the same level in May (5.3%[3]), it could fall faster in the US in the coming months if the contribution of the shelter component, which is very important today (two-thirds of headline inflation in May), falls as expected.

EUROZONE: GROWTH FORECASTS (ANNUAL AVERAGE)

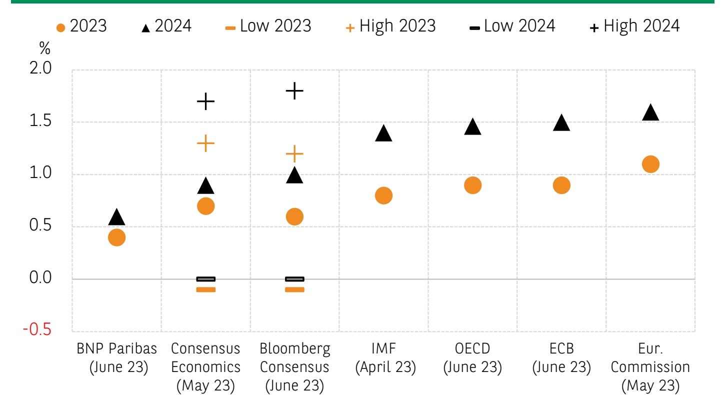

CHART 1 SOURCE: IMF, ECB, OECD, EUROPEAN COMMISSION, BLOOMBERG CONSENSUS, CONSENSUS ECONOMICS, BNP PARIBAS

US: GROWTH FORECASTS (ANNUAL AVERAGE)

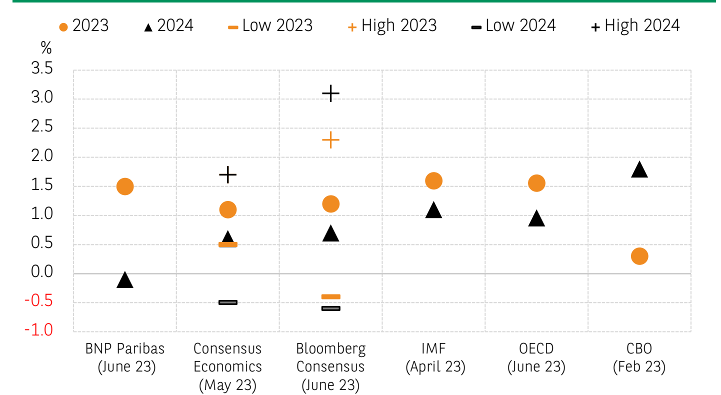

CHART 2 SOURCE: IMF, CBO, OECD, BLOOMBERG CONSENSUS, CONSENSUS ECONOMICS, BNP PARIBAS

1 Cf. William De Vijlder, EcoTV week, A slow business cycle (bnpparibas.com), 22 June 2023
2 Cf. Hélène Baudchon, EcoTV week, Comparative recession prospects in the US and the euro area (bnpparibas.com), 30 June 2023
3 According to the BLS CPI measure, but 4.6% according to the core consumer expenditure price index published by the BEA. This gap illustrates the role that differences in the composition of price indices can play in the comparability of inflation rates between the United States and the euro area.

WHY A LIMITED RECESSION AND RECOVERY?

The two areas also receive substantial budgetary support, notably for investment, with the Inflation Reduction Act (IRA) in the United States and NextGenEU (NGEU) for the euro area, amounting to USD 390 bn and EUR 720 bn respectively. On the US side, the first effects of the IRA may be seen behind the recent strong growth of non-residential investment in structures as well as that of construction spending by the manufacturing sector. On the European side, such a momentum is more difficult to identify, in the absence of the same type of statistics, but we rest assured that the positive impact of the NGEU and national plans will continue to grow. The labour market, which is still positive on both sides of the Atlantic, and business confidence, where the deterioration in surveys is comparable, are areas where the US and the euro area converge

We expect a limited downturn which would rest on several support factors, in addition to the above-mentioned fiscally supported private investment efforts (in digital technology, energy and green transition and industrial sovereignty): easing supply constraints (helping to meet the backlog of orders); post-Covid-19 catching-up dynamics in tourism; disinflation and wage increases (that will ease the squeeze on purchasing power); lower energy and commodity prices; labour hoarding in the face of hiring difficulties (which should limit the deterioration of the labour market despite the cyclical downturn); level of profit margins; expected end of the hiking cycles that would ultimately reduce uncertainty.

These various supportive factors should also encourage a pick-up in activity, which should nevertheless be limited, given the shallow downturn that we expect in the coming quarters. The recovery would also be limited, in our scenario, because monetary policy would remain restrictive despite the start of the easing cycle at the beginning of the year: the slow convergence of inflation towards the 2% target also implies some slowness in the coming rate cuts. The modest recovery, combined with the negative carry-over of -0.4% in the 1st quarter of 2024, explains why our forecast of 2024 growth for the United States is a touch below zero on an annual average basis, which makes a clear distinction between our scenario and that of international organizations (cf. Figure 2). For the eurozone, our scenario stands out by the absence of a significant rebound from 2023 (cf. Figure 1). The risks surrounding our forecasts seem balanced.

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