ECO PERSPECTIVES

2nd quarter 2022

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EDITORIAL

ECONOMIC RESEARCH

BNP PARIBAS

The bank for a changing world

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

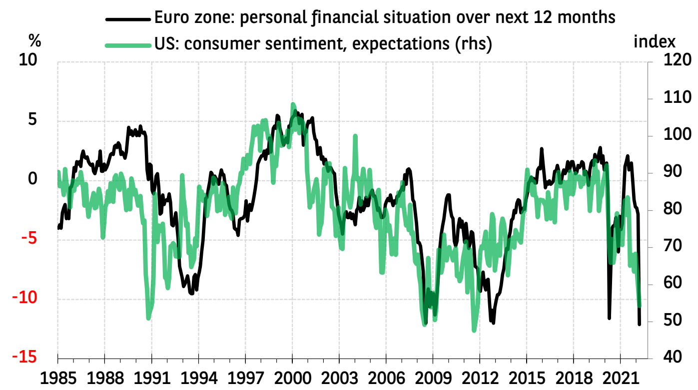

CHART 1 SOURCE: EUROPEAN COMMISSION, UNIVERSITY OF MICHIGAN

EUROZONE: LABOUR MARKET CONFIDENCE INDICATORS

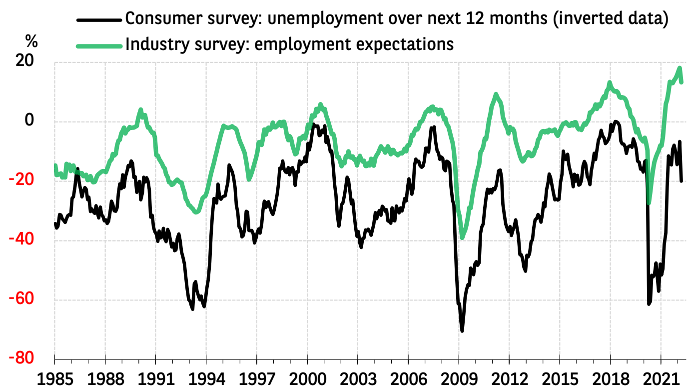

CHART 2 SOURCE: EUROPEAN COMMISSION (SURVEYS)

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.

14 April 2022

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UNITED STATES

STRESS TEST

With inflation soaring, the US Federal Reserve announced that it would accelerate the process of normalising its monetary policy. Held near the lower zero bound until March, the key policy rate should rise to roughly 2% or even higher by the end of the year. The Fed will also reduce the size of its balance sheet. Operating at full employment, the US economy seems to have recovered sufficiently from the health crisis to pass muster. Yet it is still sensitive to credit conditions and is not immunised against the impact of the war in Ukraine.

The most recent economic surveys were not as good for the United States, which shows that the world's number one economy is not immunised against the consequences of the Russian war in Ukraine. It also proves that the Covid-19 pandemic, which has just triggered new lockdown measures in China, has not finished causing supply chain disruptions. Although it is still too early to talk about recession, industrial orders were hard hit in March, and the regional business climate indexes, like the New York and Philadelphia indexes (for the future expectations component), are poor.

FIGHTING INFLATION: THE TOP PRIORITY

The surge in input costs – energy, metals, agricultural commodities, etc. – has not ended yet and will continue to drive up inflation in the short term. February's record of 7.9% y/y is likely to be broken soon, especially since the housing market is also overheating, which in turn is pushing up rent, which accounts for a third of the price index.

With the unemployment rate dropping to 3.6% of the active population in March, and with the participation rate in the 20-64 age group near pre-pandemic records, the job market has reached full employment. Wage pressures are growing, especially in the sectors where most of the post-crisis hiring difficulties can be found: hotel & restaurant services, transport & storage, and retailing, among others. Wage growth is also higher than average in professional business services, which account for nearly a quarter of employment in the private tertiary sector, and are at the heart of the digital transformation.

On the whole, wage growth is counterbalanced by major productivity gains, which is a break from the pre-pandemic trend (chart 2). Unit labour costs (wages and benefits as a share of production volumes) are not exploding (+3.7% y/y in Q4 2021) and are nowhere near the double-digit figures of the early 1980s. In the breakdown provided by the Bureau of Economic Analysis (BEA), they do not even appear as a key motor of the rebound in the prices of value added in 2021, which was due more to taxes on production and imports (which in turn were driven up by higher commodity prices) as well as to higher corporate margins.

For the US Federal Reserve, however, wage growth seemed to be "incompatible with its price stability target", and the monetary tightening phase launched on 16 March is bound to continue. Assuming the Fed raises its key rates by a quarter point at each of the Open Market Committee meetings, the Fed funds target rate would reach 1.75% to 2% by the end of the year. Starting in May, the Fed will also begin to reduce the size of its balance sheet, at a peace that could reach USD 95 billion per month. This leaves us with a big unknown: the aptitude of the US economy – whose recovery has been largely debt-financed – to pull off this policy change.

.4 April 2022

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GROWTH & INFLATION

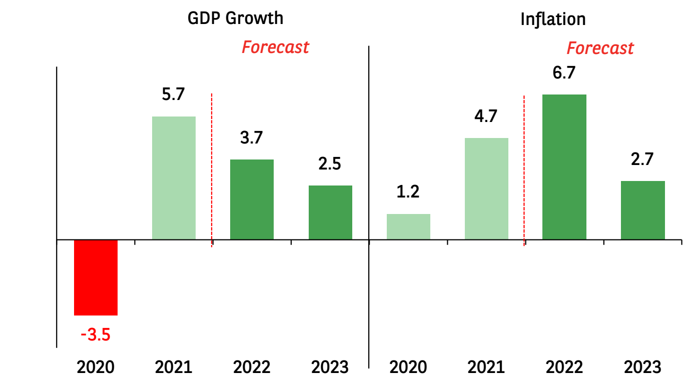

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

HOURLY LABOR PRODUCTIVITY

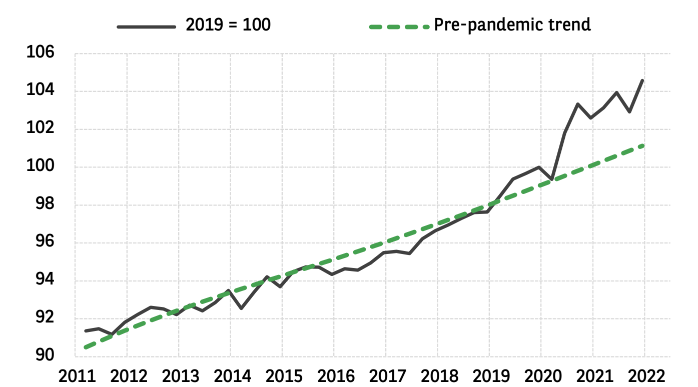

CHART 2 SOURCE: BLS

CHINA

NEW DISRUPTIONS

After a strong start in 2022, China's economic growth slowed in March. Headwinds are expected to persist in the very short term. Firstly, the rapid surge in the number of Covid-19 cases has led many regions to impose severe mobility restrictions. Secondly, the property market correction continues. Thirdly, producers and exporters will be affected by the impact of the war in Ukraine on commodity prices and world trade. The Chinese authorities are bound to accelerate the easing of economic policy

After improving in the first two months of 2022, China's economic growth slowed again in March. According to the latest purchasing managers' indexes (PMI), activity has been eroding in the manufacturing and non-manufacturing sectors, and expectations for domestic and international demand have also deteriorated. The corresponding PMIs and their components all declined and dropped below the 50 threshold in March. The slowdown is bound to continue in the very short term due, domestically, to a new wave of the Covid-19 pandemic and the ongoing correction in the property market and, externally, to the impact of the war in Ukraine on commodity prices and world trade.

In the services sector, activity began to pick up in January-February, and growth in retail sales volumes also accelerated (+4.9% y/y vs. less than 2% in Q4 2022). Yet this rebound was cut short. Many provinces have introduced strict mobility restrictions to counter a very strong surge in the number of Covid-19 cases, as China maintains a zero-Covid strategy while vaccination coverage is insufficient (86% of the population was vaccinated at the end of March, but the ratio is much lower among the elderly). On March 24th, the cities and regions imposing strict lockdown measures (such as Jilin and Dongguan) accounted for about 9% of China's GDP while those imposing less restrictive measures accounted for more than 30% of GDP; the situation has worsened in recent days. Although the authorities should seek to limit the impact of these restrictions on factory output, some production sites are currently reporting disruptions. Above all, merchandise transport and a number of other services sectors (leisure, retail, mobility, etc.) are being hard hit, a situation that could last for several more weeks. This situation is not helping the property market, which is still in the midst of a correction. Average house prices are falling slowly (the average price for the 70 biggest cities has dropped by about 2% since July 2021) and transaction volumes continue to fall (-10% y/y in January-February), which is adding to the troubles of property developers.

After accelerating since October, industrial growth slowed again in March. It is hampered by anti-Covid measures and sluggish domestic demand, as well as by the slowdown in world demand and new supply chain disruptions triggered by the war in Ukraine. After an extremely solid performance in 2020 and 2021, exports are expected to slow down significantly in 2022.

The direct impact of the war in Ukraine on China's economic activity should be moderate. On the one hand, Chinese exports to Russia and Ukraine account for only 2.3% of total exports, while its imports from these two countries account for less than 3% of total imports. On the other hand, the surge in global commodity prices should have only a mild impact on the consumer price index and households' purchasing power in the short term, thanks notably to the existence of partial controls on energy and grain prices.

In contrast, producer price inflation is expected to stay high (it averaged 8.1% in 2021), which should restrain industrial activity. Moreover, some sectors may also experience supply-chain problems, at least for products coming from Ukraine. China is dependent on Russia and/or Ukraine for supplies of oil (14% of its total oil imports), wood (19%), industrial metals (about 7%), certain grains (50% for corn, less than 1% for wheat) and fertilizers (22%).

GROWTH & INFLATION

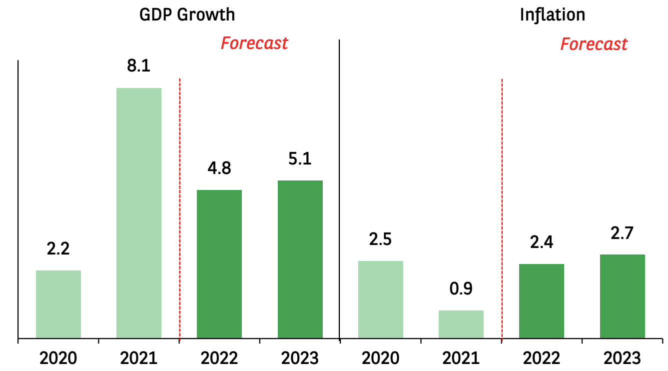

CHART 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHINA: ECONOMIC GROWTH SLOWING AGAIN IN MARCH

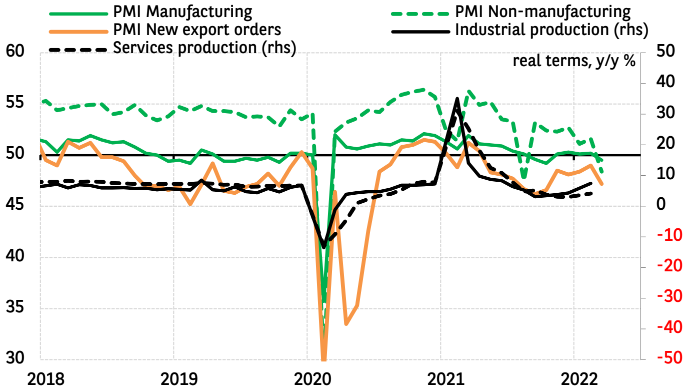

CHART 2 SOURCE: NBS

In this environment, China's official economic growth target, which has been set at 5.5% for 2022, seems to be very ambitious. The authorities are currently ramping up fiscal and monetary policy easing measures.

4 April 2022

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JAPAN

THE BANK OF JAPAN IS IN AN UNCOMFORTABLE SPOT

While the US Federal Reserve has begun raising its policy rate, the Bank of Japan continues to pursue a very accommodating monetary policy. The sharp depreciation of the yen leaves the BoJ less manoeuvring room to pursue its yield curve control policy. Some adjustments in its policy are expected. Economic support – both monetary and fiscal – will be maintained in 2022 in an environment that is especially tough for Japanese industrial companies, hard hit by global supply chain disruptions and the economic slowdown in China.

The latest Tankan survey reflects the concerns of Japanese business leaders. Although the overall diffusion index declined slightly, from 2 to 0 – indicating a balance between the number of respondents saying their situation had deteriorated with those saying it had improved – expectations for the next quarter deteriorated significantly in the sectors hit hardest by the increase or shortages of commodity prices. This is the case for major corporations in steel manufacturing, lumber and industrial machinery. Business confidence also declined in the paper and ceramics industries. Given industry's heavy weighting in the economy (21% of GDP in 2019) and its strong imbrication in global supply chains, Japan is highly affected by supply chain disruptions, notably in China, its biggest export market.

Moreover, the Japanese economy still has not fully recovered from the health crisis: last winter the country was hit by a new wave of Covid-19 cases due to the Omicron variant. After a very slow start, the vaccination campaign has accelerated. The vaccination rate is now high at 80%, which means that the economic recovery should become less erratic. Even so, Q1 activity was hampered not only by the pandemic but also by the first economic repercussions of the war in Ukraine. The economic rebound was already fairly sluggish at 1.7% in 2021, after a contraction of 4.5% in 2020.

GROWTH & INFLATION

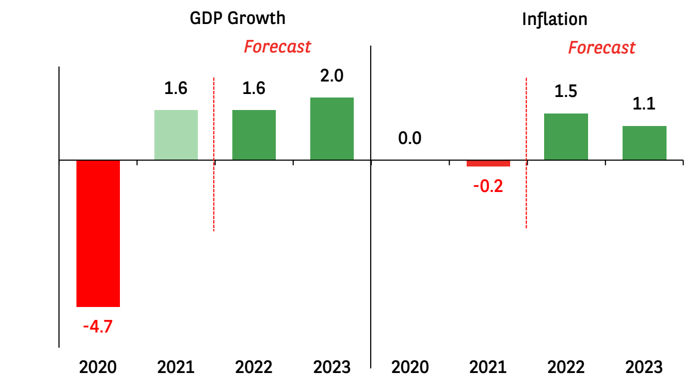

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

USD/JPY EXCHANGE RATE

CHART 2 SOURCE: REFINITIV

THE YEN PLUNGES: A DILEMMA FOR THE BOJ?

The Japanese yen depreciated sharply at the end of March, falling below JPY 120 to the dollar for the first time in seven years. A key part of Abenomics, a reflation strategy launched in 2012, was based on the economic support provided by a weaker yen. The Japanese currency fell already sharply between September 2012 and May 2015 (see chart 2). Although this seems to have bolstered economic growth (the output gap has narrowed in recent years), the strategy may have reached its limits in the current situation. The major divergence between US and Japanese monetary policies is leading to a decline in JPY purchases. A weaker yen amplifies the increase in import prices, which are already very high, adding to inflation and the erosion of household purchasing power. The Bank of Japan is thus faced with a dilemma: it can maintain the status quo with its policy of controlling interest rates (which is very accommodating, but which is likely to extend the yen's decline) or proceed with a policy adjustment (halting the yen's depreciation, but at the cost of less advantageous borrowing conditions). It is anticipated that the BoJ will raise the yield cap, currently at 0.25 for 10-year bonds.

Inflation should accelerate sharply in April, approaching or even exceeding the BoJ target rate of 2%. This increase can be attributed to three factors: (1) a base effect on telephone rates (which dropped by nearly 40% in April 2021); (2) higher energy costs, which will have a more lasting impact on inflation throughout 2022; and (3) pricing pressures on other spending items (notably food products), which will pick up gradually. It remains to be seen whether Japanese companies will be able to absorb these higher production costs and limit the pass-through to sales prices. Japanese companies still benefited from high margins in 2021[1], but they will have to cut them more drastically this year.

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1 This is shown in both the finance ministry's quarterly survey (r3.10-12e.pdf (mof.go.jp)) and in the Tankan survey (https://www.boj.or.jp/en/statistics/tk/gaiyo/2021/tka2203.pdf).

TO WHAT EXTENT SHOULD WE WORRY ABOUT THE RISK OF STAGFLATION?

The war in Ukraine compounds the ECB's task of balancing the fight against inflationary risks with the need to support growth. At the monetary policy meeting on 10 March, inflation was the predominant concern and the central bank announced that net securities purchases under the Asset Purchase Programme (APP) would probably end in Q3. This paves the way for the first increase in the key deposit rate, although the timing of the move is still highly uncertain. The inflationary shock is spreading while growth faces ever greater threats. Even so, pre-existing cyclical momentum, excess savings, investment needs and fiscal support measures should all help ease the risk of stagflation.

Consumer and business confidence surveys in the Eurozone deteriorated only mildly through February 2022 despite inflationary pressures and supply chain disruptions. Yet the outbreak of the war in Ukraine on 24 February has changed the situation. The impact on household confidence of surging inflation turned brutal, while the business climate has not been hit as hard so far according to confidence surveys[1]. In the months ahead, household confidence might not erode quite as fast while the decline in the business climate could accelerate.

It also remains to be seen to what extent the erosion of confidence and the inflationary shock will reduce growth. Looking solely at the impact of the oil shock, and assuming that a USD 10/barrel increase in oil prices slashes growth by 0.2-0.3 percentage points at a one-year horizon, then the USD 50 increase in the price of Brent crude oil between January 2021 and March 2022 could slash Eurozone growth by between 1 and 1.5 points in 2022. This is a substantial shock, and it comes on top of big increases in gas and electricity prices as well as numerous other commodity prices. The economy, however, is still in a post-Covid rebound phase with strong momentum (growth carry over was 1.9% in Q4 2021). Before the outbreak of the war, we were looking for growth of about 4% in 2022. Thanks to this very high starting point, we are able to conserve a positive post-war growth forecast, with a relatively high average annual growth rate of 2.8% based on our central scenario[2]. Yet this overall figure masks feeble quarterly growth rates, and we cannot rule out the possibility of several quarters of negative growth.

In this context, to what extent should we worry about the risk of stagflation? We are not there yet, if we consider that stagflation is a multiannual phenomenon that combines high unemployment with strong inflation (see chart 2). Although inflation is surging (7.5% y/y in March according to the Eurostat Flash estimate), the unemployment rate continues to fall (6.8% of the labour force in February). We also found it reassuring that business leaders' assessments of job prospects did not deteriorate much in March. In our baseline scenario, the war's impact on growth is offset by fiscal support measures, the mobilisation of excess savings inherited from the Covid-19 crisis, and investment needs (both pre-existing ones and new ones revealed by the conflict). We expect the shock to prove temporary (2023 growth is forecast at 2.7%), which should limit the upturn in the unemployment rate. In other words, higher inflation does not degenerate into stagflation. Yet there is a real risk given the downside risks to growth (it is worth monitoring the deterioration in households' assessments of unemployment prospects) and the upside risks to inflation. Although the latter remains mainly energy-related, the shock is spreading (core inflation was 3% y/y in March), and the level and timing of the inflation peak is still highly uncertain. Although there are still no signs of a price-wage loop, the environment is clearly more inflationary, which explains why the ECB tightened its tone at the 10 March meeting. Yet it was also based on growth forecasts that were probably overly optimistic (3.7% in 2022 and 2.8% in 2023 according to the ECB's central scenario). Although, on this basis, the ECB is preparing to halt net securities purchases as part of its Asset Purchasing Programme (APP) as of Q3 2022, this decision continues to be data-dependent. And although the halting of net securities purchases opens the door to an increase in the key deposit rate before the end of the year, the timing is still uncertain.

GROWTH & INFLATION

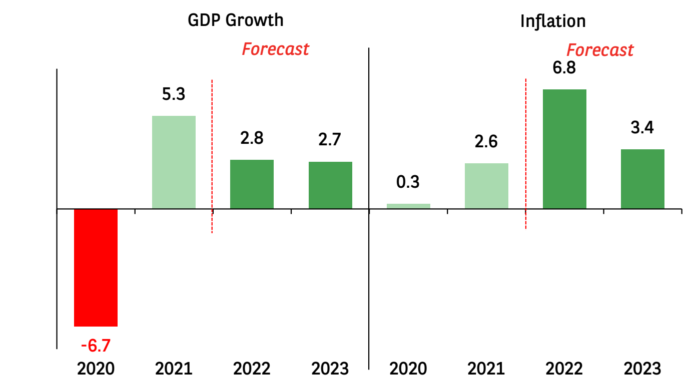

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

A MEASURE OF STAGFLATION: THE MISERY INDEX (SUM OF THE UNEMPLOYMENT RATE AND INFLATION)

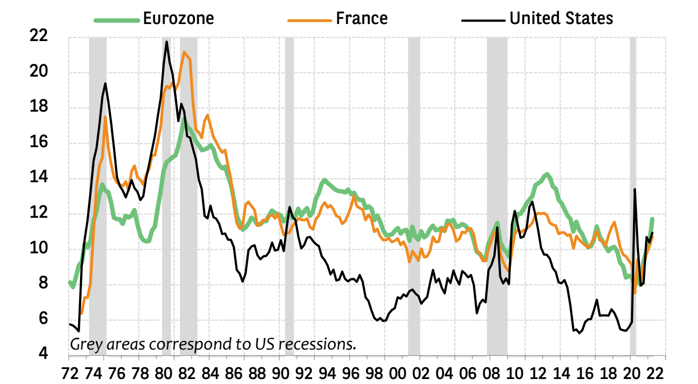

CHART 2 SOURCE: EUROSTAT, OECD, INSEE, BLS, BNP PARIBAS

5 April 2022

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1 See Ecoweek n°22-14, Eurozone Barometer and editorial.
2 Our central scenario, which dates from 13 March, is based on the following working assumptions: no escalation in the Russian-Ukrainian conflict, but an extended period of uncertainty; sanctions will be maintained; oil is expected to peak at USD 150/barrel before easing to USD 120/barrel by the end of the year; and a partial disruption of oil and gas supplies.

GERMANY

RECESSION LURKING BEHIND GROWTH?

Of the Eurozone's four major economies, Germany has the least positive growth outlook for 2022. Its economy is expected to grow by around 2% this year, whereas we are forecasting around 3% in Italy and France, and around 5% in Spain. Germany also has a lower Q4 2021 growth carry-over, greater exposure to the economic repercussions of the war in Ukraine, and pre-existing supply-chain problems in its manufacturing industry. The fall in the ifo index in March, particularly the business expectations component, illustrates well these headwinds, and this decline serves as a recession alert.

Among the Eurozone's big four economies, Germany has the greatest exposure to the economic repercussions of the war in Ukraine that Russia has been waging since 24 February. According to our dependency indicator[1], Germany's average score is 15.5, as opposed to 11.7 for France, 13.3 for Italy and 12.1 for Spain. The most dependent country is Lithuania (average position of 20.2) and the least dependent is Ireland (9). Germany's dependency stems in particular from the large proportion of its gas imports that come from Russia. Germany's openness to trade also means that its exports are more vulnerable to retroactive effects caused by problems in the worst-affected countries and by the recessionary shock in Russia and Ukraine themselves. Energy also makes up a relatively large proportion of Germany's HICP (11.7% in 2019 as opposed to 10.5% for the EU, 9.2% for France and Italy and 11.6% for Spain). This partly explains why inflation is much higher in Germany (7.6% year-on-year in March according to Eurostat's preliminary estimates) than in France (5.1%). Although the forthcoming rise in food prices also needs to be monitored, food makes up only 9.8% of Germany's HIPC, making Germany less exposed to this source of inflationary pressure than France (14.6%), Italy (15.9%) or Spain (17%).

The impact of Germany's dependency can be seen in the most recent business climate surveys, and it comes in addition to the difficulties arising from Germany's higher exposure to manufacturing, which was already suffering from supply-chain problems before the war in Ukraine broke out. In particular, the ifo index fell sharply in March, to the extent that the "business cycle clock" now shows the economy nearing recession because of deteriorating business expectations (chart 2).

It is possible that this large decline in the business climate indicator is sending an excessively pessimistic signal. Reassuringly, the labour market is unaffected so far, with recruitment remaining difficult and hiring intentions robust. Germany's fiscal policy also provides significant protection against the impact of the war. The 22% increase in Germany's minimum wage – to EUR 12 per hour from 1 October this year – will arrive late relative to the current inflationary shock, but will still cushion the blow to households' real incomes caused by higher prices.

The recession risk is higher in Germany than in France, for example, because of Germany's aforementioned greater dependency and because its economy already contracted in Q4 2021 (-0.3% q/q). However, if a recession happens, it may only be a "technical" one, i.e. two or three consecutive quarters of falling GDP, and not a prolonged one. This is the best that can be hoped for at the moment, but the risk should be monitored carefully.

Another negative for Germany is that its Q4 2021 growth carry-over (1.1%) is much lower than that of France (2.4%), Italy (2.3%) or Spain (3.2%), which will automatically drag down Germany's average annual growth in 2022. Overall, we expect Germany's economy to grow by around 2% this year, whereas growth should be close to 3% in France and Italy and around 5% in Spain. By comparison, our forecast for Germany is lower than the ifo's baseline scenario (3.1%) but similar to the ifo's alternative scenario (2.2%) and that of the German government's panel of "wise men" (1.8%). However, large carry over effects mean that the various economies' growth figures are less comparable than usual, including for 2023 when growth should strengthen in Germany (3.4%) and exceed that of the other three countries, where it is likely to continue falling to 2-3% according to our forecasts.

GROWTH & INFLATION

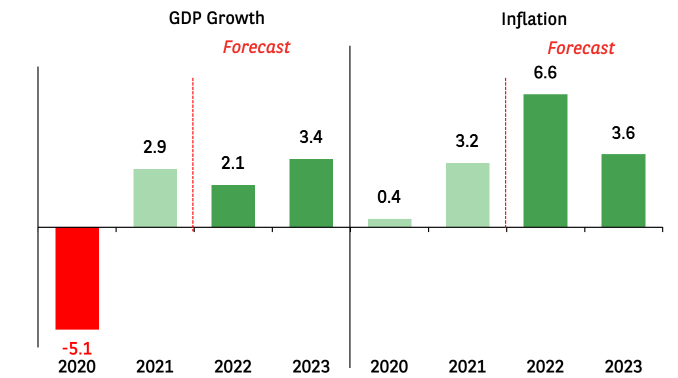

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

GERMANY: IFO BUSINESS CYCLE CLOCK SINCE 2017
(BALANCES ADJUSTED FOR MEAN VALUE, SEASONALLY ADJUSTED)

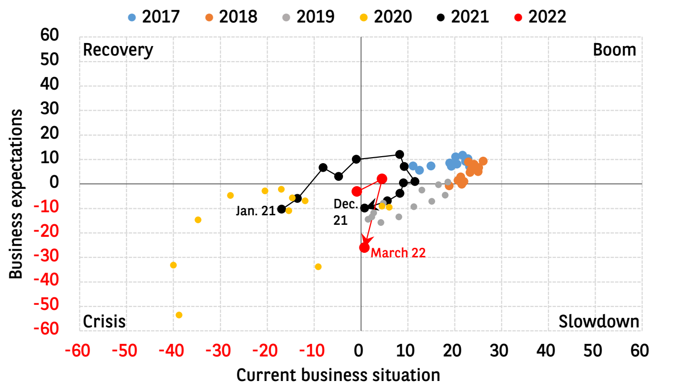

CHART 2 SOURCE: IFO, BNP PARIBAS

11 April 2022

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1 The higher the figure, the greater the dependency. These scores represent averages of each country's positions across each of the 23 variables we consider in our mapping (see EcoFlash 22-07).

FEEBLE GROWTH BUT NO RECESSION

Inflation continued to rise in early 2022 to the point that it began to erode household confidence in March. These purchasing power problems foreshadow a decline in consumer spending. With fiscal support measures limiting the increase in inflation (by nearly 2 percentage points in April), growth is expected to remain slightly positive (0.3% in Q1 and 0.1% in Q2 according to our estimates).

Since early 2021, the French economy has been buffeted by a series of headwinds and tailwinds, which have made economic trends more uncertain. The resurgence of the Covid-19 pandemic hit the services sector first as health restrictions were tightened in December and January. The lifting of these measures in February triggered a rebound in the services sector confidence index, suggesting a return to the dynamic growth rates of fall 2021. Yet the shock caused by the Russian war in Ukraine undercut this momentum and fuelled the acceleration of inflation with much higher pump prices in March. This trend is bound to continue in Q2 due to second round effects on the prices of manufactured goods, services and most food items.

HOUSEHOLDS ANTICIPATE MORE INFLATION

According to the INSEE, household confidence fell by 6 points in March 2022 compared to February, the biggest decline since the recession of 1993 and the lockdown of April 2020. Household assessments of past inflation deteriorated in March, but did not change much compared to February. To the contrary, many more households are now anticipating further price increases over the next 12 months, with the balance of opinions deteriorating by 50 points in March to unprecedented levels. Initially hoping the shock would be only temporary, households now see it as a more lasting trend that will probably have an impact on consumer spending. According to our estimates, the share of energy-related spending (housing and transport) could reach 10.3% of household consumption in 2022 (assuming oil prices hold above USD 100 per barrel throughout 2022), the highest proportion since 1986.

Fiscal support helps buffer the shock. Without this support, the share of energy-related spending would temporarily approach the absolute record of 11.6% reported during the cold wave of early 1985. Purchasing power gains amounted to 0.8% q/q in Q4 2021, three quarters of which corresponds to the EUR 100 inflation premium distributed to nearly 23 million French citizens in late 2021 (as well as to another 15 million eligible citizens, who will receive the inflation premium in early 2022).

Other household support measures include a freeze on regulated prices for gas (since October 2021, recently extended to year-end 2022) and electricity (through year-end 2022, after an increase limited to 4% in February), as well as a EUR 0.18 per litre reduction on pump prices applicable between 1 April and 31 July (with an additional pricing effort at the discretion of service stations). Without these measures, April's inflation rate would have been nearly 2 percentage points higher than our forecast of 4.7% (1.5 points for gas and electricity prices based on the INSEE's calculations in February, and 0.5 points based on our estimates for the fuel price subsidy starting in April).

These measures also reduce by as much the negative impact on household purchasing power, albeit for a net overall cost for public finances that we estimate at EUR 21.5 bn (EUR 26 bn for additional measures offset by additional revenue of EUR 4.5 bn). In addition to measures dedicated to protect households, this also includes support measures for companies (coverage of half of higher energy costs for companies whose energy expenditures exceed 3% of turnover; a higher ceiling on state-backed loans, which was raised from 25% to 35% of turnover; and targeted sector measures).

GROWTH & INFLATION

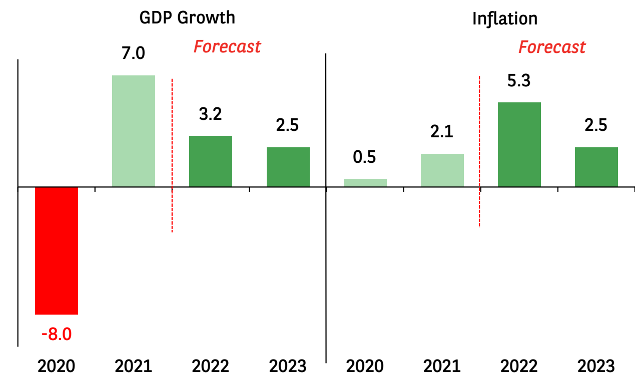

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

COMPANIES OPT FOR CAUTION

The AFTE/Rexecode survey on corporate cash flows shows that companies are also feeling the strain of inflationary pressures, with a 12-point deterioration in the balance of opinions concerning operating cash flow in March. According to the INSEE business climate surveys, companies are also increasingly constrained to pass through higher costs to sales prices, especially for household goods (including food products).

We must add the expected impact of the inflationary shock on household consumption to the difficulties companies are encountering, which is leading them to scale back production, especially in the automobile, chemical and IT & electronics sectors. Another reason to be cautious is the uncertainty over foreign demand and the security of industrial supply chains for energy and metals.

Consequently, we expect growth to slow to an estimated 0.3% q/q in Q1 (from 0.7% q/q in Q4 2021) and to 0.1% q/q in Q2, as economic policy buffers the price shock, helping to avoid recession in the short term. We have revised downwards our full-year 2022 growth forecast by 1 percentage point to an average annual rate of 3.2%.

4 April 2022

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SLOWER GROWTH IN A MORE UNCERTAIN ENVIRONMENT

In Q4 2022, real GDP rose by 0.6%, after having increased by 2.7% and 2.5% in Q2 and Q3 respectively. This slowdown was widespread. Manufacturing stagnated and services suffered from the upsurge of Covid-19 cases. Uncertainty is fostered by inflation which turns out to be more persistent than expected. In March 2022, the consumer price index rose by 6.7% y/y. The deterioration of the economic environment has not affected the labour market yet. In the three months to February 2022, employment increased by 100,000 units almost completely recovering the pre-pandemic level. In the coming months, the economy is expected to benefit from the easing of social restrictions, while suffering from the negative impact of the international crisis, which is estimated to weigh on GDP growth both in Q1 and in Q2.

A MORE UNCERTAIN SCENARIO

In 2021, the Italian economy almost totally recovered the loss incurred in the previous year, with GDP increasing by 6.6% after -9% in 2020. The quarterly GDP profile reflected the evolution of the pandemic, persisting supply disruptions and increasing energy prices: after accelerating during the summer (+2.7% q/q in Q2 and +2.5% in Q3), economic activity significantly decelerated in Q4 (+0.6%). The slowdown was widespread among sectors, with manufacturing stagnating, services suffering from the new rise of Covid-19 cases and a tourism industry struggling to recover. Private consumption, which had been the main driver of growth in Q2 and Q3, remained unchanged in Q4, while investment increased by almost 3%. From October to December, net exports subtracted more than 1% from the overall growth, as imports rose more than exports.

The Italian economy entered 2022 on a slower dynamic. In January, manufacturing production fell by almost 3.5% m/m. Both business and consumer confidence worsened, with consumption slowing as increasing inflation was reducing households' purchasing power. In the coming months, the economy is expected to benefit from the easing of Covid-19 sanitary measures, while suffering from the negative impact of the international crisis, which is estimated to curb GDP growth both in Q1 and in Q2.

GROWTH AND INFLATION

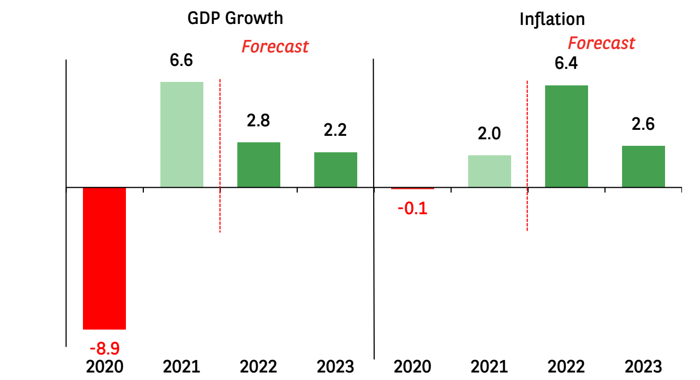

CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

INCREASING INFLATION

In Italy, uncertainty is fostered by an increase in the inflation rate that is more persistent than expected. In March 2022, the consumer price index rose by 1.2% m/m and by 6.7% y/y (from +5.7% in February). The annual increase was mainly due to energy supply prices (from +45.9% in February to +52.9%), and to a lesser extent, to processed food products (from +3.1% to +4.0%) and unprocessed food products prices (from +6.9% to +8.0%). Services prices in the transport sector slowed down (from +1.4% to +1.0%). In March, core inflation increased by 2.0% y/y (from +1.7% in February). In Italy, the annual rate of price changes in goods was +10.2% (+8.6% in February) while that of services was +1.8%. Accordingly, the inflationary gap between services and goods widens to -8.4 p.p. (from -6.8 in February). In March 2022, the Italian harmonized index of consumer prices increased by 2.6% m/m and by 7.0% y/y.

UNCERTAINTY HAS NOT AFFECTED THE LABOUR MARKET

The deterioration of the economic environment due to geopolitical tensions and the persistent inflation have not affected the labour market yet. According to the most recent data, from December 2021 to February 2022, employment increased by 100,000 units, while unemployed and inactive people's numbers declined by respectively 98,000 and 87,000 units. Seasonally adjusted data show that the employed in Italy were about 92,000 less in February 2022 than in December 2019 (before the pandemic hit Italy), recovering from a maximum gap of 986,000 recorded in June 2020. The gap with respect to the December 2019 employment level is almost completely due to the female component.

The post-pandemic recovery in the labour market has mostly favoured the elderly: in February 2022, the employed aged over 50 were 279,000 more than in December 2019, while in the same period, those aged 35-49 were about 421,000 less.

Over the same period, employees in Italy increased by 78,000 units. The recovery has been highly unbalanced among them: while the number of employees with temporary contracts increased by about 146,000 units, the number of those with permanent contracts and that of self-employed people declined respectively by 67,000 and 170,000 units. Compared to the pre-pandemic period, the percentage of the self-employed slightly decreased (from 29 to 28%).

4 April 2022

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SPAIN

EMPLOYMENT HOLDS UP, BUT SOCIAL TENSIONS ARE RISING

Although Spain is not the European country with the highest "structural" exposure to the war in Ukraine, it has been hard hit by the energy price shock. Inflation will certainly exceed 10% year-on-year this spring. Higher petrol prices have triggered protests that have spread across the country, disrupting economic activity even though the impact on growth should be modest. Job creations were still resilient in Q1. Household confidence as well as business expectations of future orders both dropped sharply with the outbreak of the war in Ukraine, which will have an impact the dynamics of hiring. The recovery of the tourism industry will partially offset the loss of consumer spending due to the erosion of household purchasing power in Spain.

Spain is facing an intense energy shock, even though the country is not very dependent on Russian oil and gas imports[1]. Inflation accelerated to 9.8% in March and is likely to rise even higher. Producer prices have rebounded sharply (+40.7% y/y in February), and companies will struggle to fully absorb the rise in costs. Core inflation has also fastened (+2.5% in February), signalling that price increases are steadily spreading to the rest of the economy. Demand for higher wages coming from professions severely impacted by the rise in fuel prices, illustrates the social risks that accompany a context of higher inflation. It is also reflected in household confidence, which posted its biggest decline ever in March, plummeting even more than during the first lockdown in April 2020.

In response to social unrest, and to face up to the economic consequences of the war in Ukraine, the government set up a temporary aid package of EUR 16 bn at the end of March. For the moment, these support measures are expected to extend through 30 June and are comprised of two parts: a EUR 6 bn fund to provide direct aid to households and companies (including a fuel subsidy of EUR 0.2 per litre) and tax cuts. A new EUR 10 bn credit line will also be released. These measures follow on two structural reform measures that Parliament introduced last winter that will support economic growth: the housing law (which tightens regulations on the rental market) and the labour market reform law (which tightens the rules on the use of temporary job contracts).

GROWTH & INFLATION

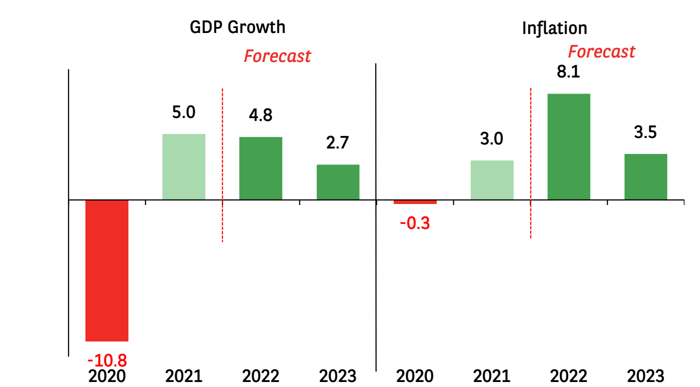

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

THE JOB MARKET IS STILL DYNAMIC

The job market continued to be surprisingly resilient in the first quarter of 2022. The number of new social security affiliations rose 0.9% (+171,716) in Q1. Job growth is robust in certain high value-added sectors, such as information & communications and the scientific & technical professions, while recruitment in restaurant and hotel services continues to rebound with the easing of health restrictions. Hiring under open-ended job contracts also increased in Q1 as companies anticipated changes in regulations, which officially took effect on 1 April. The unemployment rate declined to 12.6% in February, the lowest level since 2008.

Considering the deterioration in the PMI and European Commission surveys, the job market improvement could stall this spring. Greater wage demands due to inflation could also put a lid on hiring. The Bank of Spain does not think the risk as very high in 2022, although it points out the possibility of stronger wage growth in 2023, as more workers add inflation-adjustment clauses to their job contracts[2].

The political scene was turbulent at the beginning of the year, with the breakthrough of the far-right party Vox in the regional elections of Castile and Leon, and the replacement of the head of the Conservative party[3]. Relations are also tense within the ruling coalition and between the government and the Catalonia (ERC) and Basque (PNV) nationalist parties, whose support (or abstention) is often necessary to achieve a parliamentary majority. The ERC's last-minute support to the housing law is a striking example. The political climate could become even tenser over the next twelve months under a more difficult social climate and the approach of the December 2023 legislative elections, the outcome of which is still highly uncertain according to recent polls.

4 April 2022

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1 For Spain, the main suppliers of gas are Algeria and the United States, and the main oil suppliers are Nigeria and Mexico.
2 Mario Izquierdo and Isabel Soler, An initial analysis of the impact of inflation on collective bargaining in 2022, Bank of Spain, April 2022.
3 Pablo Casado resigned and was replaced by Alberto Núñez Feijóo, the current president of the Galicia autonomous region.

BELGIUM

BRACE FOR IMPACT

Belgian GDP grew by 0.5% in the fourth quarter of last year, full-year growth amounting to 6.1%. Having completed a full recovery to pre-covid levels faster than expected, a gradual slowdown from above-potential growth was our base case scenario, even though (energy-)prices continued their upward trajectory and labour market pressures built up. The war in Ukraine will further derail these prospects. As a consequence, we lower our outlook for growth by 1 pp and increase that for inflation by more than 2 pp.

Belgian GDP exceeded its pre-covid level for the first time in the third quarter of last year. The year seemingly finished on a high note with a QoQ growth of 0.5%. However, beneath the headline numbers, exports and net inventory changes were the only GDP components making a positive contribution to this above-potential growth rate.

Private consumption, government spending and investment all receded on a quarterly basis, as some lockdown measures were reimposed towards the end of the year.

Since the start of the Russian invasion, the outlook has deteriorated significantly. With prices for fuel supplies and other commodities now expected to remain elevated and consumer confidence evaporating, we lowered our full year GDP outlook for 2022 from 3.1% to 2.1%. The prospect of higher inflation for longer looks inevitable. We foresee Belgian harmonized inflation to peak in the second quarter (only) and to remain above the ECB's 2%-target well into next year.

GROWTH AND INFLATION

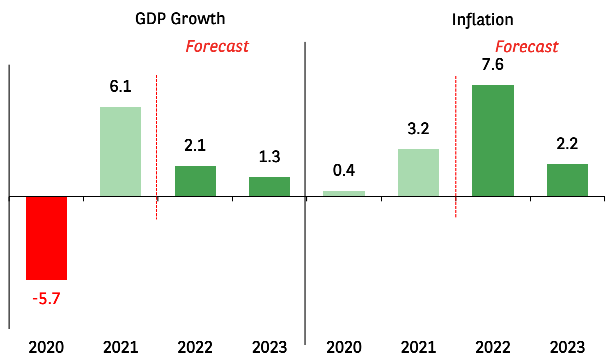

CHART 1 SOURCE: BNP PARIBAS FORTIS

HOUSEHOLDS CONFIDENCE IS DETERIORATING

In the wake of the war in Ukraine, the central bank's consumer confidence index has recorded in March its largest monthly decline ever, even more than at the start of the pandemic.

It remains to be seen what the impact will be on actual consumer spending. Our in-house metric for household expenditures, based on aggregated transaction volumes for our retail clients, suggests lower spending in February.

Worryingly, total spending on a nominal basis was still well below its pre-covid level. Given the strong increase in inflation since then, this implies that the volume of spending could be close to 10% lower than before the onset of the pandemic. We expect private consumption growth to remain below its long-term average throughout most of this year.

The Belgian labour market is holding on strong. In fact, the unemployment rate in January stood at 5.6%, its lowest level since the end of the first lockdown measures.

Other indicators confirm the healthy state of the labour market: total employment has exceeded the five million-threshold for the first time last year.

Meanwhile, the vacancy rate remains elevated, even if it came down somewhat near the end of last year to 5.8%. Hiring difficulties look more pressing than in neighbouring countries, which also saw an increase in vacancy rates.

BUSINESS: LABOUR AND SUPPLY SHORTAGES

One in every four Belgian manufacturers identified labour as a factor limiting production at the start of this year, up from just 10% twelve months before. The impact the competition for workers will have on wages, comes on top of the automatic wage-indexation. Consequently, the National Bank expects hourly wages in the private sector to increase by more than 10% over the next two years. This is well in excess of the expected average increase for the neighbouring countries, France, Germany and the Netherlands. The international competitiveness of Belgian firms could deteriorate as a result.

Equally worrying is the lack of supplies. 35% of producers report having insufficient materials, up from just one in ten a year before. Manufacturers of machinery, vehicles and other transportation equipment are hit the worst.

Business will partially buffer the impact of increased costs through lower profit margins. However, this will not suffice to bring down harmonized inflation, which came in at a record 9.5% in February. An eagerly anticipated resolution of the military conflict in Ukraine could speed up the normalization of commodities and fuels prices, but in most scenarios we expect core-inflation to continue its upward trajectory throughout this year. All in all this results in a full-year inflation of 7.1% for this year, up from 3.2% last year.

PUBLIC FINANCE AND BUDGET DEFICIT

The budgetary deficit came down last year from 9.1% in 2020 to a still worrying 5.6%, driven by a nominal increase in revenues. The National Bank expects the deficit to remain above 4% beyond 2024.

Recently announced measures to protect low-income groups from the impact of increased energy prices and additional investments as part of a push to decrease dependency on certain energy suppliers will further complicate fiscal consolidation. As a consequence, public debt is unlikely to come down anytime soon, having shot up by more than ten pp during the first year of the Covid-19 pandemic.

Up until recently, yearly interest charges on the outstanding government debt looked set to continue their downward trajectory. This was the result of the Belgian Debt Agency locking in the prevailing low interest rates at long maturities.

However, since the end of last year, Belgian 10-year yields have climbed by 100 basis points. With the ECB still likely to hike rates before the end of the year, reining in the budget deficit will need to become a policy priority.

4 April 2022

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PORTUGAL

A MORE CONTAINED INFLATIONARY SHOCK

The large victory of António Costa's Socialist party in February's legislative elections provides some welcome political stability in the current economic environment. Even though the inflationary shock in Portugal is not as strong as in most of the European countries, and despite support measures introduced by the government, confidence surveys declined sharply in March. It remains to be seen how much this deterioration will alter hiring dynamics. So far, the job market is still on a positive trajectory, with an unemployment rate this winter close to the levels reported in the early 2000s.

The economic repercussions of the war in Ukraine – and foremost the surge in producer prices (20.7% y/y in February) and consumer prices (5.3% y/y in March) – triggered a sharp drop in business sentiment and household confidence in March. Although energy prices have not risen as dramatically as for its close neighbours (the harmonised CPI for energy was up 10.6% y/y against an eurozone average of 18.9% y/y), the country has been hit by major price increases for food as well as for hotel and restaurant services. It remains to be seen how much these price increases will carry over to economic activity and the labour market. The rebound in employment was better than expected in 2021, and the recovery continued into this winter. In February, the unemployment rate dropped to the lowest level in twenty years (5.8%). At 19.9%, the youth unemployment rate has also declined, but it is still higher than the 2019 level. Employment is approaching the peak level of 2008, although there is still a shortfall of 2%.

The government announced several support measures to offset the impact of higher energy prices on households and companies: fuel subsidies were extended through the end of April (AUTOvoucher programme); new lines of financing were made available (EUR 400 million) to help industrial and transport companies impacted by the war in Ukraine; and it used part of the surplus of the Environmental Fund (EUR 150 million), whose revenues are derived essentially from auctioning carbon issue permits.

PUBLIC DEBT IS NO REAL CONCERN IN THE SHORT TERM

In September 2021, the lifting of moratorium measures introduced during the pandemic does not seem to have created a corporate solvency shock. The government also set up the Retomar programme to serve as a buffer during this transition period. Portugal is one of the European countries that resorted to moratoriums the most during the Covid-19 crisis, and at their peak, a third of corporate loans were covered by the mechanism. The current surge in production costs, however, increases the risk of corporate defaults and weakens the Portuguese banking system. The banks have continued to clean up their balance sheets and seem to be in a better position to absorb any difficulties in the future. The non-performing loan ratio dropped to 2.3% in February, which is the same level as in year-end 2008.

The public deficit shrank below the 3% threshold to 2.8% of GDP in 2021. Thanks to the rebound in growth, the public debt ratio declined sharply to 127.4% of GDP in 2021, from 135.2% in 2020, but Portugal is still the third most heavily indebted country in the Eurozone. In the short term, the country's sovereign risk will be largely contained. Portugal benefits from fiscal support provided by the new European mechanisms (SURE job support programme, European Recovery and Resilience Facility). The government also has major cash reserves (EUR15.6 bn or 7.2% of GDP in Q4 2021) that it can use to meet any future repayment deadlines.

GROWTH & INFLATION

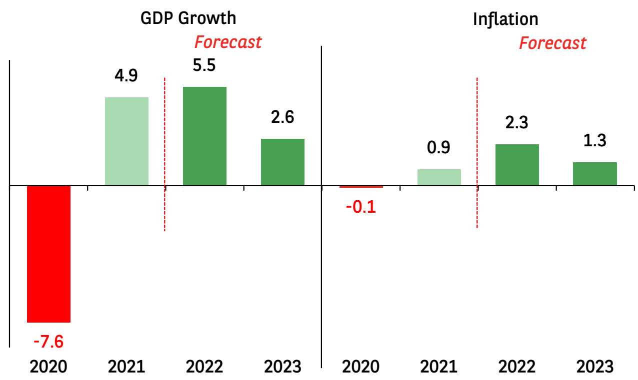

CHART 1 SOURCES: EUROPEAN COMMISSION, BNP PARIBAS

February's legislative election strengthened the position of the Socialist Prime Minister António Costa. Unlike the 2019 election, the Socialist party won a majority in parliament with 120 seats out of a total of 230 (up from 108 previously) to the detriment of the Social-Democrats, which lost 12 seats, and the leftist block, which lost 14 seats, bringing their total to 77 and 5, respectively. The election was also marked by the breakthrough of the far-right party Chega, which gained 11 seats, bringing its total to 12.

4 April 2022

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SWEDEN

GREEN PROTECTION

Sweden has bet heavily on renewable energy sources, a strategy that is now paying off at a time when oil and gas prices are soaring. Although accelerating, Sweden's inflation rate is still one of the lowest in Europe, at a little more than 4%. For Swedish households, the resulting loss of purchasing power has been mild, and partially offset by government support measures. But that is not the biggest worry: by invading Ukraine, Russia has shifted Swedish public opinion and rekindled the debate about joining NATO.

Often upheld as a model of a social market economy, Sweden also serves as a good example of a green energy policy. In the span of barely ten years, Sweden has reduced by 20% its dependence on fossil fuels (oil, gas and coal), which now account for less than 30% of its energy mix (compared to nearly 80% for Germany). The share of renewable energy sources (40%) and nuclear power (30%) have risen in correlation, making Sweden the OECD country with the lowest greenhouse gas emissions per inhabitant and per unit of GDP[1].

RESILIENT BUT WORRIED

Far advanced in the clean energy transition, Sweden seems to be better prepared than other countries to handle the energy shock triggered by Russia's war in Ukraine, even though it is not completely sheltered. As a member of the European Union, the country has to apply common market regulations, whereby electricity suppliers get the most expensive price (actually set by gas) lastly offered in the market.

As elsewhere, electricity (per kilowatt hour) and fuel prices are rising, and inflation is accelerating. But at 4.4% y/y in February 2022, Swedish inflation is among the lowest in Europe. A priori, the resulting loss of household purchasing power is bearable, especially since it is partially offset by tax cuts and gas "checks" for drivers. According to the National Institute of Economic Research (NIER), Swedish households, which already rank among the world's biggest savers, are likely to draw on the reserves accumulated during the pandemic to increase spending.

It remains to be seen what impact Russia's war in Ukraine will have on consumer behaviour, and a wait-and-see attitude could prevail for a while. Very concerned, public opinion has shifted in favour of joining NATO. Magdalena Andersson's Social Democrat government has admitted that this is a real possibility, and has already strengthened the Defence department's resources. The household confidence index, which is usually closely correlated to consumption, declined sharply in March (chart 2). Surveys of business leaders, especially the future orders component for industrial companies, also plummeted

4 April 2022

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GROWTH & INFLATION

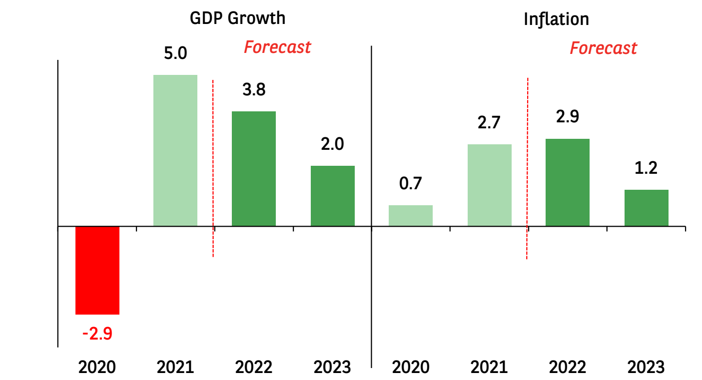

CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

SWEDEN: CONSUMER CONFIDENCE AND CONSUMPTION

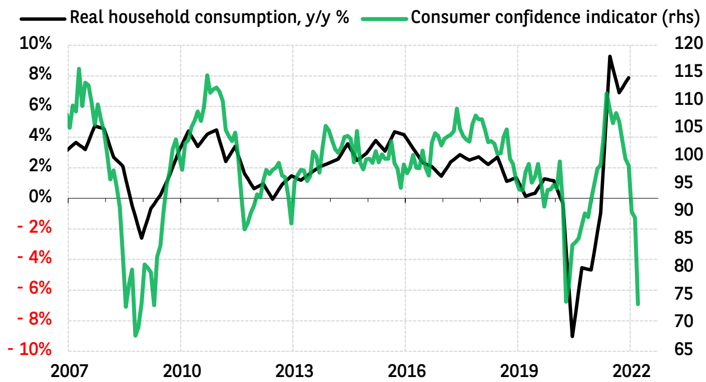

CHART 2 SOURCE: SCB, NATIONAL INSTITUTE OF ECONOMIC RESEARCH

1 Source: OECD, Database, Greenhouse gas emissions,

FINLAND

ON THE FRONT LINE

Thwarted since the beginning of the year by a strong surge in the Covid-19 pandemic, the economic recovery is now threatened by the repercussions of Russia's military offensive in Ukraine. Given its geographic location, Finland is highly dependent on Russia for its energy imports, and its energy bill has already risen considerably. After reporting GDP growth of 3.3% in 2021, Finland is unlikely to meet the European Commission's 2022 forecast of 3%.

Early in 2022, Finland has been hit by a very strong surge in Covid-19 cases, which led Sanna Marin's government to introduce restrictive measures, including limitations on the size of big events and early closing hours for restaurants. These measures were lifted on 1 March, but Finland, which shares a 1,340 km border with Russia, must now face up to the repercussions of the war in Ukraine.

ENERGY PRICES UNDER PRESSURE

The year 2021 ended on a strong note. Long hampered by a global shortage of components, investment rebounded by 3% q/q in Q4. Survey results on confidence and industrial orders confirmed this momentum. These strong figures can be attributed to fewer supply chain disruptions and a catching-up movement for the delayed shipment of transport equipment. This improvement also resulted in a 7.1% q/q increase in exports in Q4 2021. On average, Finland's external trade contributed 1.2 points to growth in 2021, which is estimated at 3.3%. In the last months of 2021, private consumption also benefited from strong momentum.

Yet how much longer can this go on? With Russia's invasion of Ukraine, the household confidence index collapsed in March 2022, with the biggest drop on record. The reassessment of political risk – which has already led public opinion to swing in favour NATO membership – is coupled with a serious economic threat. Given its dependence on Russian hydrocarbons (chart 2), Finland is one of the European Union countries that has the most to lose from an escalation of sanctions against Moscow.

The surge in inflation to 5.6% in March was already problematic, forcing the Finnish government to react. Finnish taxpayers can now deduct up to EUR 8,400 annually in travel expenses for commuting to work, up from a maximum of EUR 7,000 previously. These measures, combined with the increase in public spending on security and defence, call into question the authorities' plans to reduce the public debt ratio (66.9% of GDP in 2021). The European Commission will almost certainly have to revise downwards its growth forecast of 3% in 2022.

4 April 2022

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GROWTH & INFLATION

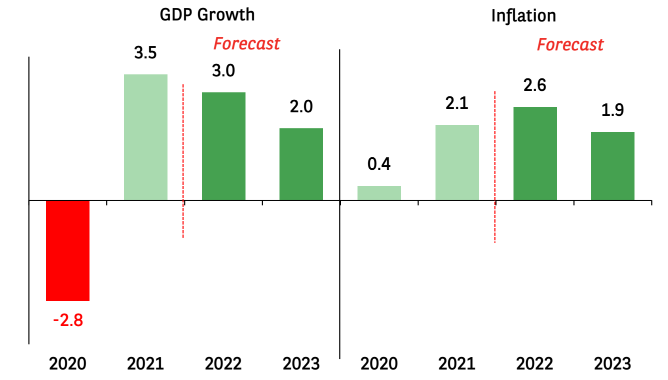

CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

RUSSIA'S SHARE OF OIL IMPORTS

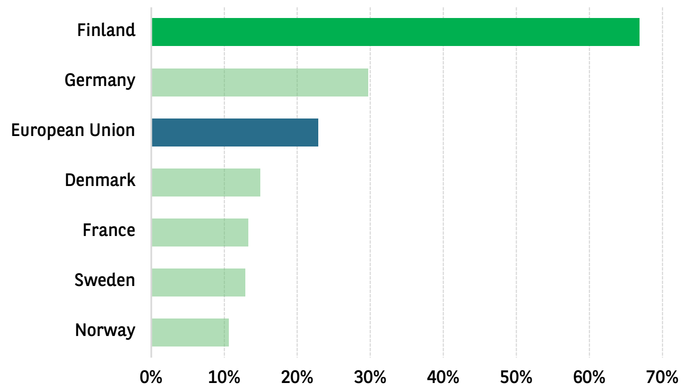

CHART 2 SOURCE: EUROSTAT, INTERNATIONAL TRADE CENTRE, BNP PARIBAS

UNITED KINGDOM

A SERIES OF SHOCKS

The time has passed for unlimited fiscal and monetary support in the UK, and priority is now being given to reducing deficits and lowering inflation. To counter the shock triggered by Russia's invasion of Ukraine, which promises to further increase the energy and food bills of UK households, the government's measures to boost purchasing power seem to be rather mild so far. Consequently, we foresee a significant economic slowdown in 2022.

The UK's exposure to Russian trade is not the highest: it purchases virtually no gas from Russia, which accounted for only 0.7% of UK merchandise exports in 2019 (compared to 2% for Germany). Yet in the UK, as in all of Europe, the sanctions and shortages triggered by the Russian war in Ukraine are exacerbating inflationary pressures and undermining economic prospects.

TOWARDS 9% INFLATION?

In its spring report, the Office for Budget Responsibility (OBR) lowered its 2022 growth forecast to 3.8% from 6%. Moreover, it esteems that the annual rate of inflation, which is already above 6%, could peak at 9% in the months ahead. Once again, energy is the driving force behind escalating prices, and the energy bill rose sharply in April due to the upward revision of regulated gas and electricity prices (+54%). Inflation is also maintained by persistent labour shortages in key sectors, such as agriculture and transportation, due not only to the Covid-19 pandemic, but also to Brexit.

The loss of purchasing power will accentuate (chart 2) for UK households, whose real revenues have begun to decline. For Rishi Sunak, Chancellor of the Exchequer, the time for "whatever the cost" as passed. Although the new finance bill that took effect in April took a more restrictive turn[1], a few corrective measures were nonetheless announced: the fuel tax will be reduced by 5 pence per litter (EUR 0.06), the VAT rate on solar panels will be 0%, and the Household Support Fund will be doubled. According to OBR, however, these measures are far from offsetting the increase in fiscal pressure programmed in 2022 and beyond.

As to monetary policy, there is no longer any room for complacency, as if it were necessary to offset the inaction after the inflation target was surpassed in 2021. On 16 March, the central bank raised its key policy rate for the third consecutive time, bringing it to 0.75%. Although the Monetary Policy Committee (MPC) expressed concern about the impact of the Russian war in Ukraine, it voted almost unanimously (8 votes to 1) for additional monetary tightening. Noting the upturn in inflation expectations in the short and medium term, the MPC esteems that another "moderate" rate increase is still appropriate in the months ahead.

The time has thus passed for unlimited fiscal and monetary support in the UK, and government measures to boost purchasing power have been mild so far. Consequently, we foresee a sharp economic slowdown in 2022.

4 April 2022

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GROWTH & INFLATION

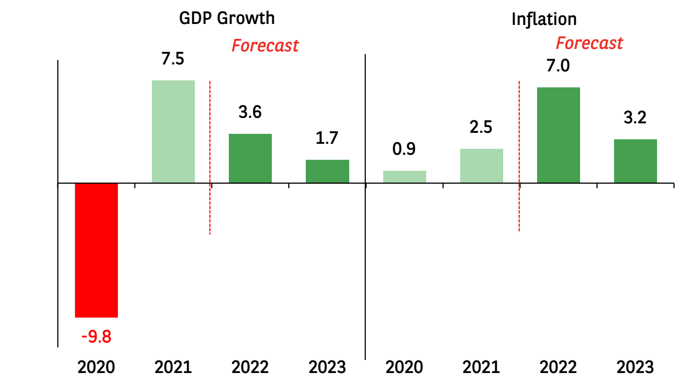

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

UNITED KINGDOM: REAL WAGES (Y/Y % CHANGE)

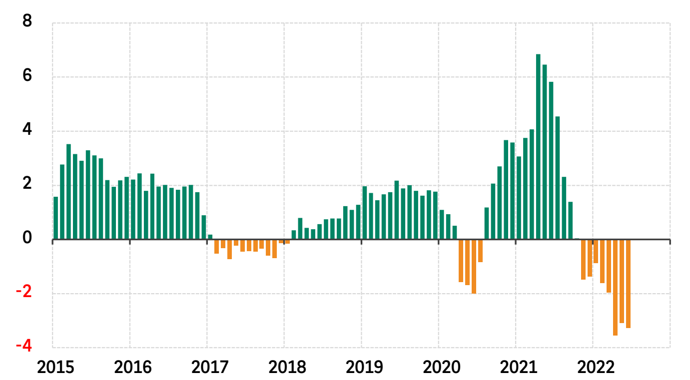

CHART 2 SOURCE: ONS, ESTIMATES BNP PARIBAS

1 Including, for example, a freeze on the income tax indexation rate and a 1.25 increase in the health insurance contribution rate, for additional annual revenues estimated at GBP 12 billion.

FORECASTS

ECONOMIC FORECASTS

	GDP Growth			Inflation		
%	2021	2022e	2023e	2021	2022e	2023e
United States	5.7	3.7	2.5	4.7	6.7	2.7
Japan	1.7	1.6	2.0	-0.2	1.5	1.1
United Kingdom	7.5	3.6	1.7	2.5	7.0	3.2
Euro Area	5.3	2.8	2.7	2.6	6.8	3.4
• Germany	2.9	2.1	3.4	3.2	6.6	3.6
• France	7.0	3.2	2.5	2.1	5.3	2.5
• Italy	6.6	2.8	2.2	2.0	6.4	2.6
• Spain	5.0	4.8	2.7	3.0	8.1	3.5
Emerging countries						
China	8.1	4.8	5.1	0.9	2.4	2.7
India*	8.9	7.3	6.0	5.5	6.6	5.5
Brazil	5.0	-0.5	0.0	8.3	9.0	5.7
Russia	4.5	-8.5	3.1	7.0	18.2	5.0

SOURCE: BNP PARIBAS (E: ESTIMATES, FORECASTS) * FISCAL YEAR FROM APRIL 1ST OF YEAR N TO MARCH 31ST OF YEAR N+1

FINANCIAL FORECASTS

Interest rate, %

End of period		Q1 2022e	Q2 2022e	Q3 2022e	Q4 2022e	Q1 2023e
US	"Fed Funds (upper limit)"	0.50	1.00	1.50	1.75	2.50
	T-Note 10y	2.33	2.50	2.60	2.70	2.60
Eurozone	Deposit rate	-0.50	-0.50	-0.50	-0.25	0.50
	Bund 10y	0.51	0.75	0.90	1.00	1.20
	OAT 10y	0.84	1.20	1.40	1.50	1.70
	BTP 10y	1.97	2.45	2.75	3.00	3.20
	BONO 10y	1.37	1.75	2.00	2.15	2.35
UK	Base rate	0.75	1.00	1.25	1.25	1.75
	Gilts 10y	1.59	1.75	1.90	2.00	2.00
Japan	BoJ Rate	-0.02	-0.10	-0.10	-0.10	0.10
	JGB 10y	0.21	0.25	0.25	0.25	0.45

Exchange rate

End of period		Q1 2022e	Q2 2022e	Q3 2022e	Q4 2022e	Q1 2023e
USD	EUR / USD	1.11	1.11	1.13	1.14	1.20
	USD / JPY	121	125	124	123	115
	GBP / USD	1.32	1.29	1.31	1.33	1.40
EUR	EUR / GBP	0.85	0.86	0.86	0.86	0.86
	EUR / JPY	135	139	140	140	138

End of period		Q1 2022e	Q2 2022e	Q3 2022e	Q4 2022e	Q1 2023e
Brent*	USD/bbl	107	135	135	125	104

SOURCE: BNP PARIBAS (E: ESTIMATES, FORECASTS) MARKET ECONOMICS, INTEREST RATE STRATEGY, FX STRATEGY * BASE CASE

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