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Eco PERSPECTIVES by BNP PARIBAS

EDITORIAL

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2022: towards the big normalisation

After last year's sudden, deep and a-typical recession, caused by the Covid-19 pandemic, this year has also been a-typical in several respects. Supply bottlenecks and supply disruption have been dominant themes throughout the year, acting as a headwind to growth, both directly but also indirectly, by causing a pick-up in inflation to levels not seen in decades. Under the assumption that the pandemic is gradually becoming less of an issue thanks to the vaccination levels, 2022 should see a normalisation in terms of growth, inflation and monetary policy.

2022: TOWARDS THE BIG NORMALISATION

After last year's sudden, deep and a-typical recession, caused by the Covid-19 pandemic, this year has also been a-typical in several respects. Supply bottlenecks and supply disruption have been dominant themes throughout the year, acting as a headwind to growth, both directly but also indirectly, by causing a pick-up in inflation to levels not seen in decades. Under the assumption that the pandemic is gradually becoming less of an issue thanks to the vaccination levels, 2022 should see a normalisation in terms of growth, inflation and monetary policy.

In the advanced economies, we expect above potential growth in real GDP, with household spending underpinned by cheap financing conditions, a further improvement in the labour market and faster wage growth. Company investments should benefit from improved profitability, very attractive financing conditions, increased capacity utilization and a favourable demand outlook.

In the euro area, fiscal policy should also support growth with the Recovery and Resilience Facility playing a key role. Yet, growth should gradually slow down. The mechanical recovery in sectors that followed the lifting of the Covid-19-related restrictions, has run its course. Concern about the Omicron variant may lead to precautionary behaviour, weighing on certain household spending categories. Supply bottlenecks should continue to act as a drag on growth in the near term. In the US and the UK, fiscal policy may act as a headwind as well. Finally, in several countries, household surveys reflect a growing concern about elevated inflation, which is eroding real disposable income. This is particularly an issue for lower income households.

However, after surprising so much to the upside this year, inflation should decline in 2022. Base effects will play a role – the expected stabilization of oil prices should cause a decline in annual inflation in the course of the year – and supply bottlenecks should ease due to increased supply and somewhat slower demand growth. However, the underlying dynamics of inflation are upwards, with tight labour markets causing an acceleration of wage growth, which could push companies to increase their sales prices. In the US, companies are paying significantly higher wages to fill vacancies and, judging by labour shortages, wage growth should also accelerate in the euro area.

This implies that monetary policy will normalize as well, albeit with important differences in timing. In the US, the Federal Reserve has started to slow down the pace of monthly asset purchases. This tapering should be followed by several rate hikes, starting around the middle of next year, in order to cool down the economy and bring inflation back in line with the objective. This may end up leading to a more volatile market environment, considering that research shows that the federal funds rate is a key driver of the global financial cycle and investor risk appetite. In the euro area, monetary policy should remain very accommodative. The net purchases under the Pandemic Emergency Purchase Programme are expected to end in March 2022 but it will take more time for the conditions for hiking the policy rate to be met. We expect a first increase of the deposit rate in June 2023. The monetary divergence between the Fed and the ECB should cause a further strengthening of the dollar versus the euro.

More than ever, surprises could lead to an economic outcome that is different from what is currently expected. Potential upside surprises are the pandemic being brought fully under control and inflation declining more quickly than anticipated. The list of downside risks is longer: pandemic-related uncertainty could become endemic, supply disruption could continue, inflation could stay high for longer due to second round effects and concerns about rate hikes in the US could weigh on equity and corporate bond markets, thereby impacting confidence and the real economy.

UNITED STATES: CORE INFLATION

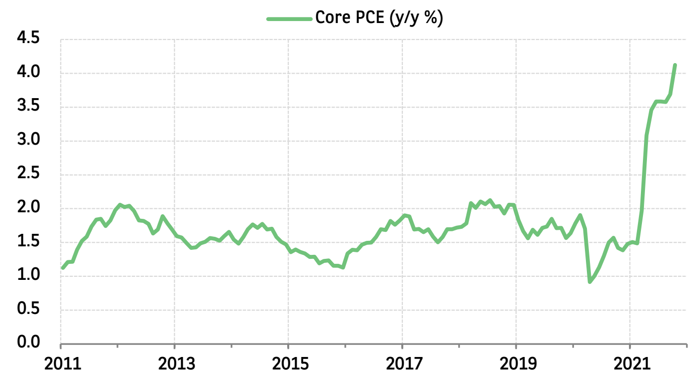

CHART 1 SOURCE: BEA, BNP PARIBAS

EUROZONE: CONSUMERS SURVEY

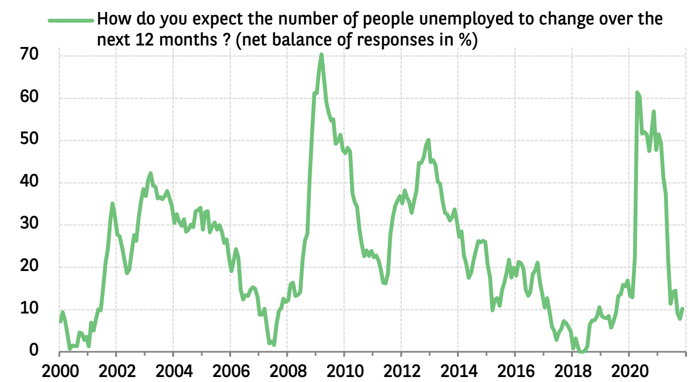

CHART 2 SOURCE: EUROPEAN COMMISSION SURVEYS, BNP PARIBAS

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UNITED STATES

THE FED ABOUT TO CALM THINGS DOWN

With the inflationary surge in the US showing no signs of stopping, the Federal Reserve is no longer taking an accomodative stance and could accelerate the tapering of quantitative easing. Inflation has also spread to asset prices: real estate and stock prices have climbed to peak levels. Unless the emergence of the Omicron variant radically changes the situation, everything points to a key rate hike in 2022, possibly as early as next summer.

Long seen as only a transitory phenomenon in the United States, inflation has become a veritable source of concern. In October 2021, US inflation surged above 6% for the first time in 31 years. Core inflation, which excludes energy and food prices, also soared to a record high of 4.6%, well above the 2% target set by the Federal Reserve (the Fed), which finally took action.

PRICES PRESSURES

The Fed began by adopting a harsher tone. At the traditional Congressional hearings in late November, Fed chairman Jerome Powell said that the surge in prices could no longer be qualified as "transitory". He also lent credibility to the idea of a more rapid tapering of quantitative easing, raising the option of a key rate increase, possibly as early as summer 2022.

Unless the emergence of the Omicron variant radically changes the situation, everything points to a tightening of US monetary policy. Inflation is not only accelerating, but it is also spreading, and has now spilled over to rent, one of the biggest items on the price index. Rent is already up 3.5% for the year, and this trend is bound to accelerate following the sharp upturn in house prices, which are under pressure from the boom in mortgage loans (chart 2).

The business climate is euphoric, a little less so in industry, where production continues to be hampered by the global shortage of components, but more than ever in services, where business is returning to normal, and growth and job prospects have yet to show any signs of faltering.

The labour market is robust again. More than 6 million jobs were created in 2021, out of the 9.4 million jobs lost in 2020. In November, the unemployment rate dropped to 4.2% of the active population, far below the Fed's expectations. Although the labour market participation rate is still rather low, it is easily explained by the discouragement of workers with the highest exposure to the pandemic, as well as to demographic influences. Unbiased by an aging population, the share of Americans in the 20-64 age group who are active in the job market (employed or actively seeking employment) continues to rise. This figure can be estimated at 77%, and is now just short of the 2019 average of 77.6%.

Following a series of record stock-market highs and the unprecedented compression of yield spreads in 2021, financial stability has finally become a subject of concern. The Fed's financial stability reports regularly point out that stock market valuations and corporate debt have reached historically high levels, which have been fuelled at least in part by very low interest rates. This message not only sounds like an admission of responsibility, it also serves the double purpose of calming things down.

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GROWTH AND INFLATION

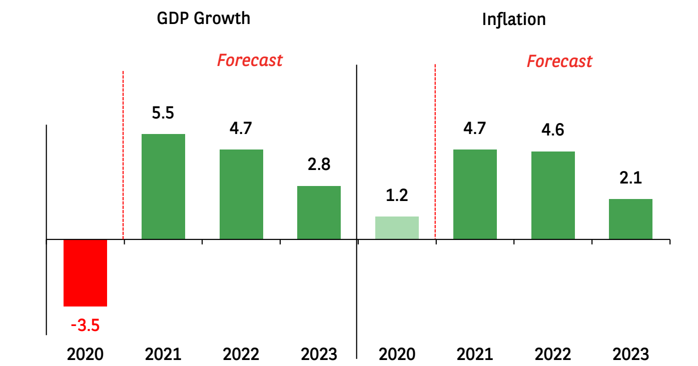

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

HOUSING MARKET FRENZY

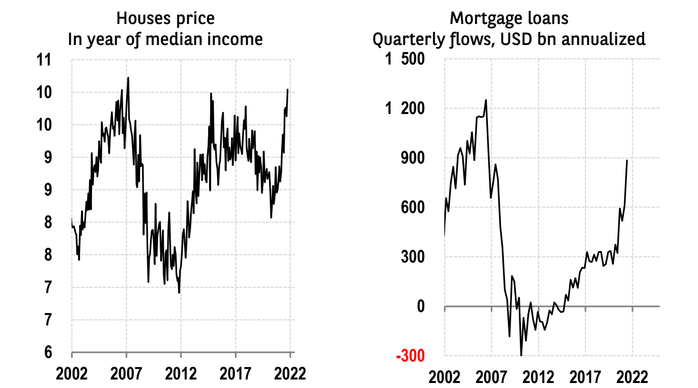

CHART 2 SOURCE: CENSUS BUREAU, FEDERAL RESERVE

CHINA

MANAGING THE RISKS THAT ARE HAMPERING GROWTH

The crisis in the real estate sector, the "zero Covid" strategy in the midst of a resurgent pandemic, and the persistent fragility of household consumption are some of the main risk factors straining China's economic growth. In the short term, the authorities are expected to cautiously step up monetary and fiscal policy support while maintaining their focus on rebalancing the property market, reducing financial risks and tightening the regulatory environment.

THE PROPERTY CRISIS SPREADS THROUGHOUT THE ECONOMY

Economic growth has stalled since the summer months. Industrial activity has been hampered by major supply constraints resulting from both supply-chain disruptions and the electrical power outages that hit factories in September and October. The authorities have reacted swiftly, ordering coal mines to boost production and allowing energy producers to increase consumer sales prices by up to 20% above regulated prices. This has stimulated electricity production, and industrial growth was able to accelerate again before the end of October. The recovery is expected to continue. In the manufacturing sector, production and investment remain supported by the still solid performance of exports. Export growth averaged 26% year-on-year in the six-month period May to October, driven by the rebound in global demand and China's market share gains.

In the services sector, activity has initially been handicapped by the regulatory tightening in what Beijing considers to be the most sensitive sectors (such as digital services and tutoring). Moreover, activity was hit again by new restrictions introduced in August to combat a new wave of the pandemic. Most importantly, the property market crisis has spilled over to the rest of the economy. Because of the tightening in prudential regulations and credit conditions, property developers began encountering rising financing and cash-flow problems in recent months. Real estate investment has contracted. Construction projects, new building starts and real estate transactions have all collapsed since July. Average house prices have begun to decline, and this trend is expected to continue in the short term.

Under this environment, private consumption remains sluggish. Retail sales volumes increased by less than 2% year-on-year in the period August-October, curbed by the "zero Covid" strategy and the impact of declining house sales. Moreover, the difficulties encountered by some service-sector companies (notably SMEs) and the real estate crisis have strained the labour market and constrained household income growth in Q3 2021.

CAUTIOUS FISCAL AND MONETARY POLICY EASING

The economic slowdown can be largely attributed to the tightening of economic policy, the regulatory environment and prudential rules in the real estate sector over the past year. These measures fit within the authorities' medium-term strategy of corporate deleveraging, reducing financial risks, cleaning up the real estate market and promoting "common prosperity". These objectives should be maintained by Beijing going forward, despite their impact on economic growth. Yet without changing the prudential limits imposed on developers, the authorities are expected to proceed with some policy adjustments in order to avoid a devastating collapse in the real estate market. In the past few days, mortgage lending conditions and developers' access to certain types of short-term financing have already started to be eased. Moreover, the authorities are expected to increase cautiously their monetary and fiscal support measures in order to stimulate domestic demand, mainly via a moderate rebound in public investment and targeted measures to ease credit conditions. For example, the authorities have recently launched special lending programmes benefiting SMEs and others aimed at accompanying corporate efforts to reduce greenhouse gas emissions. Domestic credit growth, which had slowed between year-end 2020 and September 2021, levelled off in October and is projected to pick up slightly again in the short term.

GROWTH AND INFLATION

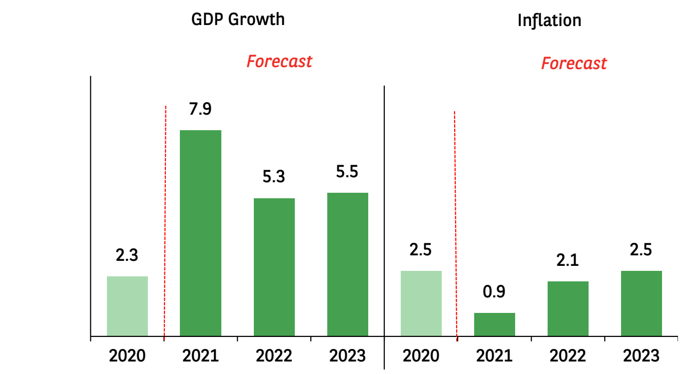

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

ECONOMIC GROWTH LOSING MOMENTUM

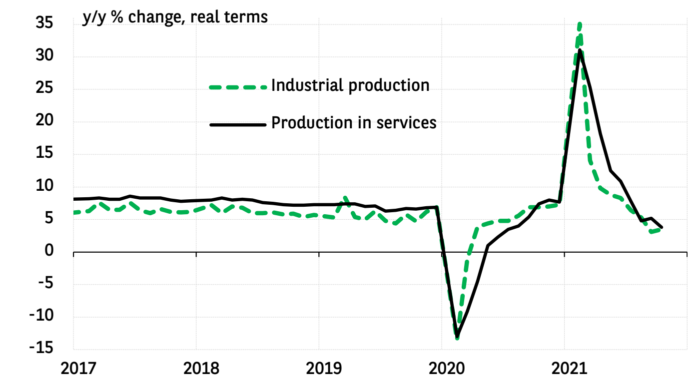

CHART 2 SOURCE: NBS

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THE GOVERNMENT OPENS THE FISCAL FLOODGATES

The victory of the Liberal Democratic Party in the October general election allows prime minister Kishida to implement his policies. In November, he presented an unprecedented fiscal package amounting to some JPY 55.7 trn or 10% of GDP. In 2022, GDP growth could rise to 2.6% after 1.7% in 2021, largely driven by private consumption.

In Q3 2021, the economy contracted by 0.9% on the previous quarter, as supply disruptions seriously hit exports and lockdown restrictions depressed private consumption. The lifting of the state of emergency in October allowed business conditions to improve, in particular in the services sector. In manufacturing, business conditions have remained very severe. Industrial production is hampered by delays in arrivals of components from overseas and the semiconductors shortage. Moreover, profit margins are being squeezed substantially, as manufacturers have difficulties in passing on price hikes for raw materials to their customers. Inflation has remained very tame, mainly due to a sharp cut in mobile phone fees in April 2021, which has deducted 1 percentage point from core inflation. In November, the Tokyo CPI was only 0.5% higher from a year earlier and core prices were even 0.3% lower.

AN UNPRECEDENTED FISCAL STIMULUS

The Liberal Democratic Party won the general election in October, although with a slim majority, allowing prime minister Fumio Kishida to put his policies in place. His priority is to narrow the gap between the rich and the poor, created by the deregulation and structural reforms since the early 2000s, the so-called Abenomics, and exacerbated by the coronavirus pandemic. One measure is to reduce taxes for companies that raise wages. The employers' organisation Keidanren has already rejected calls for across-the-board salary hikes. The second course of action will be to strengthen the incomes of workers in the health and care sector. In addition, the government is committed to achieving carbon neutrality by 2050, although it has not announced yet how to achieve it.

Fiscal prudence is not on the programme. In November, Mr Kishida presented a record breaking single fiscal package amounting to some JPY 55.7 tn or 10% of GDP, of which JPY 36 tn for FY2021. This year the programme will be for JPY 20 tn financed by government bonds (JGBs), thus increasing the the total JGB issuance to JPY 65 tn, unspent budget allocations and the expected increase in tax revenues. The package includes very sizeable handouts to families with children for example, which may help the ruling coalition at next summer's upper house election. The government might remain in campaign mode as local government elections are on the calendar for spring 2023.

The accommodative policy is supported by the Bank of Japan (BoJ), which is buying as many JGBs as necessary to keep the yield on the 10-year JGB at around zero percent. Through its special loan programme, the BoJ has also been supporting lending to businesses affected by the coronavirus. The programme was recently extended to end March 2022. Finally, the BoJ introduced the Climate Response Financing Operations through which it provides funds to banks against investment or loans in green projects.

GROWTH AND INFLATION

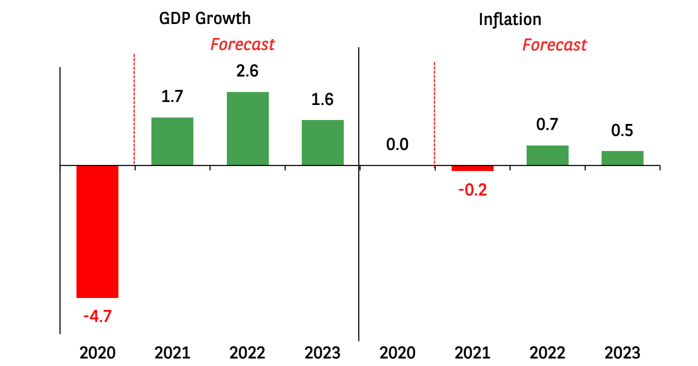

CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

ROBUST GROWTH AHEAD

In the coming months, the effects of the Covid-19 will continue to shake the economy, although to a diminishing degree as the vaccination rate increases. In 2022, GDP could attain 2.6%, largely driven by private consumption. Despite the loss in purchasing power due to rising energy prices and poor wage growth, households are likely to draw down from the sizeable savings accumulated during the lockdown period.

The shortage of semiconductors and parts will continue to weigh on industrial production. The fall in profits related to the hike in prices for raw materials and energy is likely to depress business investment and wage growth in the early part of 2022. The summer bonuses are likely to fall further. In the course of the year, as the bottlenecks in manufacturing production will diminish progressively, exports and business investment could gain momentum. In 2023, as private consumption is slowing down, GDP growth is projected to fall to 1.6%, which is still well above Japan's potential growth rate. Core inflation might pick up in 2023, as the output gap closes.

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AS INFLATION SOARS AND THE PANDEMIC RESURGES, GROWTH EASES

The resurgence of the Covid-19 pandemic and the emergence of the new Omicron variant make the ECB's task even harder. Although growth should hold at a high level, it is expected to ease, and this trend could worsen, at least in the short term. Meanwhile inflation continues to soar, while becoming more broadbased, and the risk in the coming months is on the upside. Faced with greater uncertainty, the ECB is arguing in favour of patience and constancy while saying it is ready to act in any direction. According to our scenario, which is somewhat optimistic in terms of growth and calls for persistent inflation, the ECB would end its Pandemic Emergency Purchase Programme (PEPP) in March 2022 and begin raising its key deposit rate in mid-2023.

Just how high will inflation climb? To what extent will growth ease under the combined impact of this inflationary surge, supply-side constraints (which continue to crescendo), a new wave of the pandemic compounded by the emergence of a new variant, and the simple normalisation of the growth rate?

Numerous headwinds are straining growth prospects in the Eurozone. Yet our scenario is still somewhat optimistic. Business sentiment was strong through November, which argues in our favour, and there is no lack of support factors to lift growth. The policy mix is still accommodative: although there is talk about reducing monetary and fiscal support, there is no question of eliminating them, much less tightening them. We estimate that NextGeneration EU, the European recovery package, will generate an additional 0.5 points of growth in 2022. Other support factors include the unblocking of excess household savings – at least partially – and a catching-up movement in the services sector as it returns to pre-pandemic levels. Lastly, there are major restocking and investment needs (to fund the energy and digital transitions, and to secure supply chains), and financing conditions are still advantageous. Our scenario also assumes that supply chain disruptions will begin to fade as of H2 2022.

After another quarter of vigorous growth (2.2% q/q in Q3), the Q4 outlook is much less attractive (0.4% q/q according to our forecasts). We nonetheless estimate that full-year growth will average 5% in 2021, the same as in our September forecast. Stronger supply chain disruptions and inflationary pressures have a negative impact on 2022, explaining the 1-percentage point downgrade of our growth forecast, to 4.2% (essentially due to weaker German growth). Yet the main characteristic of growth in 2022 is that it will hold well above its long-term trend. In 2023, growth is expected to remain strong (3% compared to our September forecast of 2.3%), as the abovementioned support factors continue to have an impact, albeit a smaller one. Downside risks predominate from a 6-month horizon, but they seem to balance out with upside risks in the longer term.

INFLATION IS NOT SO "TRANSITORY" ANYMORE?

Inflation continues to soar (4.9% y/y in November according to Eurostat flash estimate, near the all-time high of 5% in July 1991). Moreover, it is becoming more widespread. Core inflation is now high at 2.6%, and about 45% of its components are growing at a rate equal to or higher than 2% y/y. Most of this inflationary surge is still transitory, but that does not mean that we expect it to ease rapidly. Inflationary pressures due to supply-demand imbalances will take a while to dissipate. Moreover, conditions are propitious for slightly stronger wage inflation and for non-negligible indirect and second-round effects. This explains our rather high inflation outlook (average of 3.1% in 2022, after 2.5% in 2021, and 2% in 2023), which masks however an expected decline over

GROWTH AND INFLATION

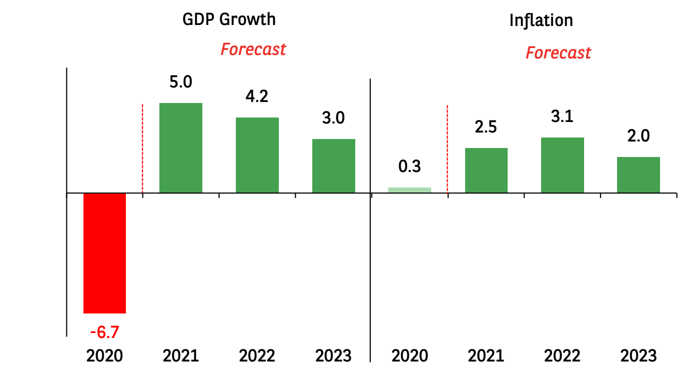

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

the course of 2022. According to ECB President Christine Lagarde, inflation probably peaked in November 2021. Our scenario makes the same assumption, but unlike the ECB, we expect inflation to hold just above the 2% target by year-end 2022 and not to drop below this threshold[1].

The resurgence of the pandemic coupled with the emergence of the new Omicron variant makes the ECB's task even harder. Greater uncertainty alone will have a negative impact on growth, even if the spread of the Omicron variant proves to be limited[2]. A significant deterioration in the health situation could ease inflation (by placing a greater strain on demand) as much as fuel it (by placing a greater strain on supply). We think the balance of risks leans towards a net inflationary effect.

Under this environment, the ECB's 16 December meeting takes on even greater importance. The ECB is expected to announce the end of the Pandemic Emergency Purchasing Programme (PEPP) according to the planned timeline, i.e., in March 2022, as well as the conditions under which the Asset Purchase Programme (APP) will pick up the slack (amount of monthly purchases, flexibility). The ECB is hardly likely to make any further commitments thereafter, arguing for the need for caution and consistency while insisting that it is standing by, ready to act, in a more or less accommodating manner. Based on our scenario of high growth and inflation, we expect the end of the TLTRO rebate at 50 bp below the deposit rate in June 2022, net purchases to be halted in Q1 2023, and the key deposit rate to be raised for the first time in June 2023 (+10 bp), followed by two more rate hikes of 15 bp each in September and December.

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1 Granted, we do not know the ECB's new inflation forecast, which will be released at the 16 December meeting. It seems highly likely, however, that it will be lower than our forecast, even though revised upwards from the September projections (2.2% in 2021, 1.7% in 2022 and 1.5% in 2023).
2 Yet the news concerning the health situation is not all bad: in addition to higher vaccination coverage rates, the arrival of the first treatments should help limit the number of severe cases and overloaded hospitals.

CREW CHANGE DURING TURBULENCE

After strong growth in Q2 and Q3, the business climate deteriorated due to supply problems, the increase in prices and the surge in Covid-19 infections. Output is likely to stagnate around the turn of the year. The new government will put the emphasis on social and environmental policies, while fully respecting the fiscal framework, important for Germany. Private consumption will be the major engine for growth in 2022.

Following the lifting of the lockdown restrictions, GDP rebounded strongly in Q2 and Q3, taking activity close to the pre-crisis level. Business cycle indicators point to a further slowdown or even stagnation in Q4. In November, the ifo climate indicator declined for the fifth consecutive month, as supply problems continued to weigh on activity in manufacturing. In services, business sentiment has been affected by the fourth wave of the coronavirus pandemic. Moreover, rising inflation has been weighing on purchasing power. Harmonised inflation reached 6% in November, largely because of hikes in energy and food prices. Against this backdrop, it is not surprising that consumer confidence is crumbling and the propensity to buy fell in November to a nine-month low. The government has taken action to limit the spreading of the virus. By blocking access for the unvaccinated to the non-essential shops, the government hopes to speed up the vaccination uptake, which is relatively low compared with neighbouring countries.

AMBITIONS WATERED DOWN BY NEED FOR COMPROMISE

After two months of intense negotiations following the general election end September, the SPD (social democrats), the Greens and the FDP (liberals) reached agreement on forming the next government headed by Olaf Scholz (SPD). Even though the coalition programme emphasises the need for audacious progress, the economic proposals should not be viewed as a radical break, but rather as a correction of the policies of the Merkel years. It is a carefully crafted compromise that reflects the different sensibilities of coalition partners. All parties agreed on boosting investment in infrastructure to accelerate the energy transition and digitalisation, partly funded by the Next Generation EU programme. However, in particular for the FDP, the European programme should be limited in time and size. The SPD has obtained that the minimum hourly wage will be raised from EUR 9.60 to EUR 12.00. For the Greens, the priority is meeting the climate targets of the Paris agreement through an early exit from coal-powered energy plants and the closure of coal mines, if possible, by 2030. The new finance minister, Christian Lindner (FDP), is expected to uphold the budgetary rules in Germany and at the European level. However, the first challenge for the incoming government is to deal with the fourth wave of corona infections. The fiscal stance is likely to become less accommodative in 2022, as the government withdraws progressively the special support measures.

OUTPUT REBOUNDS AS SHORTAGES DIMINISH

The pandemic is likely to depress growth in early 2022, but as the vaccination process advances, its effect on the economy is likely to diminish, allowing a strong rebound in activity. This will initially be led by private consumption, as lockdown restrictions are lifted and the purchasing power losses associated with the rise in energy prices is softened by a rapid expansion of employment. Moreover, consumption is also supported by households reducing their savings accumulated during the crisis. Exports of manufacturing goods are likely to pick up in the course of 2022 as shortages of parts and semiconductors are diminishing. The improving outlook for the manufacturing sector should stimulate business investment, which is also supported by government policies to step up the energy transition and digitalisation of the economy. Headline inflation will remain at rather elevated levels in particular in the first half of 2022, mainly because of a hike in energy prices. In the coming years, the decarbonisation of the economy will add further to the rate of inflation. Against the backdrop of a tightening labour market, a major risk is that this would trigger a wage-price spiral.

GROWTH AND INFLATION

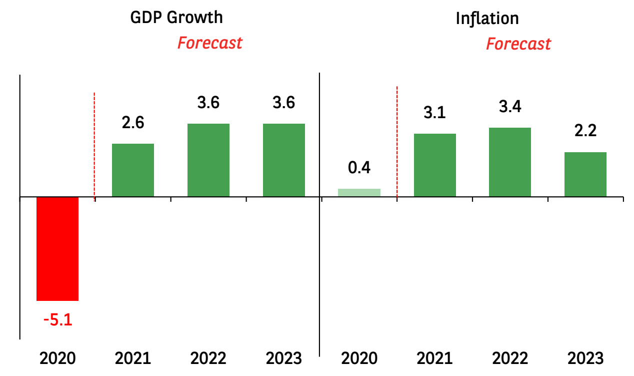

CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

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FRANCE

DESPITE GREATER HEADWINDS, GROWTH IS LIKELY TO REMAIN STRONG

Factors hampering growth in the short term are gaining strength (supply chain disruptions, surging inflation, and the resurgence in the Covid-19 pandemic), but the resilience of business sentiment through November as well as numerous targeted measures to support household purchasing power help allay fears. In Q4 2021, we are forecasting growth of 0.6%, although the risk is on the downside. In full-year 2021, growth is expected to average 6.7%. In 2022, it will remain a robust 4.2%, bolstered by the accommodative policy mix, the unblocking of excess savings, the catching-up of the services sector as well as strong investment and restocking needs.

In mid-November, the services sector seemed to be able to return to its usual role as a support factor for French growth. Among the favourable factors, the services sector is not impacted as much by current supply chain disruptions and upward pricing pressures on a number of inputs, at least compared to industry and construction. Since the end of the third lockdown in May-June, there has also been a powerful catching-up movement in the services hit hardest by the crisis (hotel and restaurant services, transportation services and leisure activities). Positive signals can also be seen in terms of investment in market services, production[1] and the business climate. This picture of a recovery in services was reinforced by the optimistic tone of the Bank of France's November economic update and of November business sentiment surveys (INSEE and PMI).

In the span of a few weeks, the situation has changed a lot with a major deterioration in the health situation, the emergence of the Omicron variant, and greater risk that activity restrictions will have to be introduced again. The services sector is not without troubles of its own: it faces strong hiring problems and is not sheltered from the negative impact of surging inflation (through the erosion of purchasing power which undermines household consumption). But above all, business momentum in the services sector, at least those implying a close contact with the general public, is at the mercy of the health situation. We should expect business sentiment to fall significantly in December and business leaders to express greater economic uncertainty, as newly measured by the INSEE.

Our Q4 growth forecast of 0.6% q/q now comes with a downside risk. Our forecast is deliberately lower than the Bank of France's outlook dated early November (0.75% q/q), to take into account a less positive cyclical situation in Germany and its spillover on France, as well as the expected normalisation of growth and the negative impact of supply chain disruptions and inflationary pressures. The resilience of the business climate through November as well as various measures to support household purchasing power (energy cheque, gas and electricity tariff shield, advanced minimum wage hike, and inflation compensation) should nonetheless help allay these fears. Another positive factor is the stability of purchasing power in Q3 (nominal gross disposable income rose about the same as the consumption deflator). Activity would have to deteriorate sharply in December to significantly reduce Q4 growth. As long as no new restrictive measures are introduced[2], however, activity should continue to show proof of resilience.

Meanwhile, inflation continues to surge. According to the November flash estimate, it amounted to 2.8% y/y, the highest since 2008. Inflation is expected to climb even higher, at least in December, before levelling off at about 3% according to our forecasts, then easing towards 2% over the course of H2 2022. In the manufacturing sector, inflationary pressures are sharply up as evidenced by the uptrend in the balance of opinions on price expectations. The input price components of the PMIs are also trending upwards in both industry and services. The balance of household opinions concerning past inflation has also risen very sharply, while inflation expectations are still largely above the long-term average, despite November's surprising decline.

GROWTH AND INFLATION

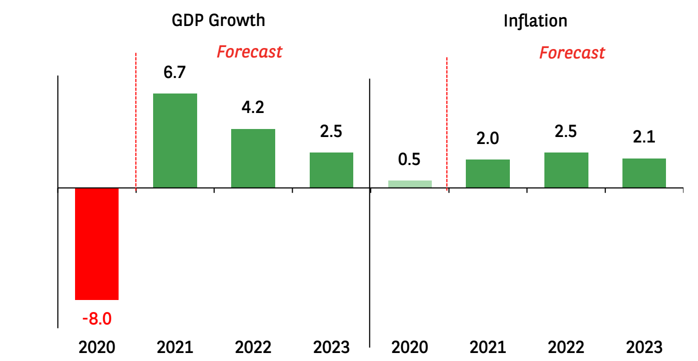

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

Despite greater headwinds (more inflation and supply chain disruptions), and thanks to stronger growth carry-over after a better-than-expected Q3, our 2021 growth forecast has been revised upwards relative to our September outlook. Our 2022 forecast, in contrast, is virtually unchanged. We have nonetheless adjusted the infra-annual profile by lowering H1 growth to take into account more negative factors, and raising H2 growth, as we expect these headwinds to dissipate. A number of support factors are still at play too. They are the same as for the Eurozone as a whole: the accommodative policy mix, the unblocking of at least part of accumulated forced savings, the catching-up of the services sector, and strong investment and restocking needs.

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1 In September, production in the services sector was nearly 3% above the pre-pandemic level of February 2020, while industrial production was nearly 5% lower.
2 Any measures introduced are unlikely to be as strict as during April's lockdown, thanks to the advancement of the vaccination campaign. Assuming that December's lockdown will be similar to the one in April in terms of its negative impact on activity, it would remove about 0.3 points from Q4 growth.

ITALY

A STABLE AND SUSTAINED RECOVERY

After a modest expansion in Q1 2021, real GDP rose by more than 2.5% q/q in both Q2 and in Q3. This recovery was widespread. In Q3, net exports added 0.5 percentage point to GDP growth thanks to a stronger rise in exports than imports. Thanks to the easing of social restrictions, consumption has further increased, while favourable financing conditions and fiscal incentives have supported investment. During the summer, the recovery expanded to the services sector, which benefitted from higher tourist receipts. Manufacturing production has recovered entirely from the 2020 decline, ending up 2% higher than in Q4 2019. Labour market conditions are not as good as the recovery would suggest.

A MORE WIDESPREAD GROWTH

The Italian economy resumed growing at the beginning of 2021. After a modest expansion in Q1, the recovery has accelerated significantly, with real GDP rising by more than 2.5% q/q in both Q2 and in Q3. The growth carryover for 2021 as a whole is 6.2%. The speed of the Italian recovery is similar to that of other eurozone countries, which is different from past episodes when the Italian economy underperformed its partners. At the end of 2019, real GDP in Italy was about 5% lower than in 2007, while real GDP in Germany was almost 15% higher. In Q3 2021, Italy's real GDP was 1.3% lower than the pre-pandemic level, a gap similar to that of Germany.

In Q3, the recovery of the Italian economy was widespread. Final domestic demand added 2 percentage points to GDP growth after a 3-points contribution in Q2. Net exports contributed 0.5 percentage point, with exports rising by 3.4% q/q and imports by 2.1% q/q. Since the beginning of the recovery, Italian exports rebounded strongly, reaching their highest level in history. From January to September 2021, exports rose by 20% with an expansion widespread across sectors and countries.

Thanks to the easing of social restrictions, consumption has further increased. In Q3, private expenditures rose by 3% q/q (after a 5% q/q increase in Q2). They remain however 3.6% below their Q4 2019 level, while gross disposable income has recovered in full. On the one hand, Italian households benefited from fiscal stimulus packages that were implemented during the crisis. But, on the other hand labour market conditions are not as good as the recovery would suggest. Employment sits at around 250 thousand less than in January 2020, while the number of people out of work has increased by around 75 thousand.

In Q3, financing conditions remained extremely favourable, supporting gross fixed capital formation, which rose by 1.6% q/q (after increases of 4.2% q/q in Q1 and 2.4% q/q in Q2). Contrary to private consumption, investment is back above its pre-crisis level: it is even 7% higher. Thanks to various fiscal measures, capital expenditures on construction and machinery and equipment rose by more than 10% compared to Q4 2019, while investment in transport equipment remains about one third below.

FROM MANUFACTURING TO SERVICES

At the beginning of the recovery, economic growth in Italy was mainly supported by the rapid rebound in the manufacturing sector, which recovered all of the lost ground during the 2020 crisis. The robust increase in exports contributed to this manufacturing performance. In Q3 2021, manufacturing production was almost 2% higher than in Q4 2019, with a strong increase in the sectors for electrical equipment, metal products, rubber, plastic and non-mineral products. By contrast, transport production declined significantly undermined by the global shortages in chips in particular, which led to an approximately 8% decrease in Q3 2021 compared to Q4 2019.

GROWTH AND INFLATION

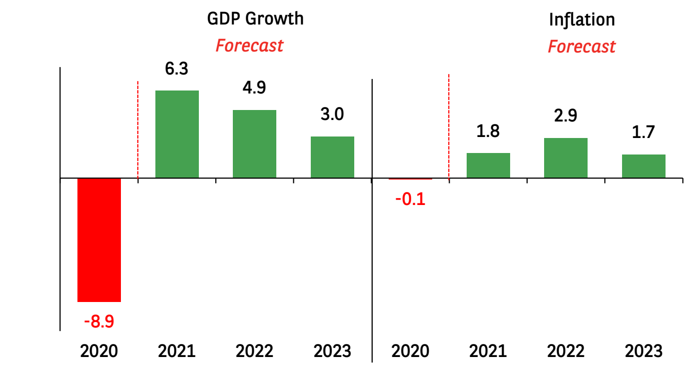

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

During the summer, the economic recovery gradually became more diffuse throughout the sectors, with services being the primary driver of economic growth. Gross value added (GVA) rose by 3.4% q/q (compared to +2.9% q/q in Q2), accounting for almost 2.5 percentage point of the overall increase. The services sector benefited from the recovery of the tourism industry: in Q3, purchases on domestic territory by non-residents more than tripled in real terms, despite remaining one third below Q4 19 level. GVA in the trade, transportation and accommodation sectors increased strongly too, by almost 10% q/q in Q2 and 8.6% q/q in Q3.

The construction sector's recovery continued, albeit at a slower pace. GVA here rose by 0.6% q/q (following +5.4% q/q in Q1 and +3.4% q/q in Q2), equating to a 12% increase compared to Q4 19. The sector has benefitted from the fiscal incentives aimed to improve energy efficiency of buildings. Despite this recovery however, GVA is still nearly 30% below the 2008 level.

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SPAIN

ECONOMIC SUPPORT ABOVE ALL ELSE

Despite a rather weak recovery in GDP, the Spanish economy has been much more resilient on the labour market front in 2021. Employment (November) and the participation rate (Q3) are at record levels. Inflation will be one of the biggest obstacles in 2022, the increase in production prices having accelerated markedly this autumn. Support for growth will remain a government priority in 2022. The country will benefit from a larger transfer of European funds that will help finance a record budget of EUR196 billion. The reduction in the government deficit will be again pushed into the background, the authorities mainly betting on economic growth to reduce the deficit-to-GDP ratio.

Our growth forecasts for 2021 have been downgraded since our last publication, due to the smaller-than-expected increase in real GDP in Q3 2021 (2.0% q/q). Up until this autumn, the recovery in Spanish GDP had been the weakest among eurozone countries. Significant revisions are possible, with the INE stressing that "*the volume of information available in this advance report [for Q3] is less than in previous [reports].*" Indeed, the change in GDP was in marked contrast with the much better performance of the labour market. The increase in employment[1] has shown no sign of slowing down this autumn, and reached a record level at the end of November. It will be hard to match 2021's pace of hiring in 2022, but job creation should continue to increase. The unemployment rate is still high (14.5% in October 2021) and thus Spain has a substantial pool of available workers. Opinion surveys have shown a deterioration of confidence (and of hiring intentions) in industry, due to the factors currently holding back activity in the sector (rising production costs, shortage of inputs and so on). Conversely, hiring trends in the service sector remain encouraging. Employment in sectors hit hard by the health crisis (accommodation and food services, retail trade, artistic and leisure activities) are still well below their end-2019 levels and thus have significant room for improvement.

Inflation will remain as one of the biggest obstacles in 2022. The sharp increase in consumer prices (5.6% y/y in November) could persist this winter, as the rise in production input prices and transport costs showed few signs of slowing. The combined 11.7% jump in production prices in September and October was, by far, a new record. All of this will clearly hurt margins at companies, which could then seek to pass on these increases in the selling prices of their products. On the health front, the risks from the spread of new variants and their impact on economic activity will remain present in 2022. The success of the initial vaccination campaigns in Spain nevertheless reduces concerns of a wave of infection that would be as 'dangerous' as that in 2020, and would therefore result in restrictions affecting economic activity.

Against this still unstable situation, a better balancing of public finances is not a priority for the Spanish government, which should continue to benefit from very favourable borrowing conditions in 2022. The government will also have to maintain high levels of social spending (VAT reductions on energy products, increases in pensions and the minimum wage, support for access to housing, etc.) in the face of the energy crisis and rising consumer prices and rents. The government expects the deficit to be large again in 2021 (8.4%) and to drop back below the 3% of GDP mark in 2024 at the earliest. Indeed a record budget of EUR196 billion is planned for 2022. Pedro Sanchez's coalition managed to get this budget approved by parliament thanks to the support of two nationalist parties (ERC and EH Bildu). This budget, which includes a big increase in social spending (+3.9% on 2021) will be partly financed, via EUR27.6 billion coming from the European

GROWTH AND INFLATION

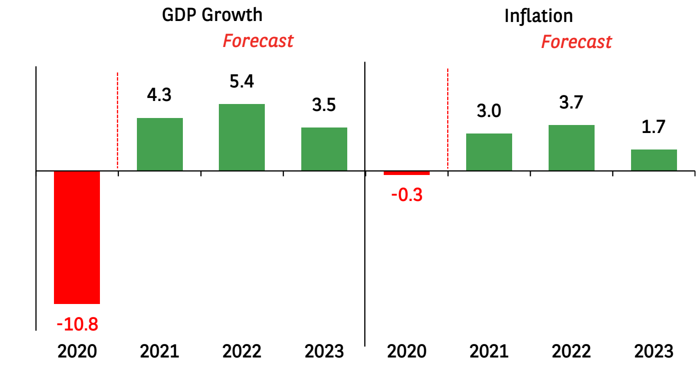

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

Recovery Fund. This financing will be used, amongst other things, for strengthening industrial policies, supporting SMEs and energy efficiency upgrades to buildings.

Meanwhile the banking sector, on the whole, resisted well to the recession of 2020, thanks in particular to the extension of government measures introduced at the beginning of the pandemic (short-time working, moratoria on loans and social security contributions, government guaranteed loans (GGL), etc.). These measures have cushioned the economic shock and limited companies' loan books from deteriorating too significantly The non-performing loans (NPLs) ratio continued to fall throughout 2021, reaching 4.35% of total loans outstanding in September 2021, its lowest level since the spring of 2009. The level of NPLs is likely to increase in 2022, due in particular to the end of the postponement period for the repayment of certain GGLs, (the payment holiday was extended, at the end of 2020, from 12 to 24 months). This said, the risks are likely to remain contained in 2022: the volume of loans covered by a moratorium represented less than 6% of total loans to the non-financial private sector at the end of 2020, whilst GGLs accounted for a relatively small share (14.5%) of the total stock of loans in June 2021 (EBA data).

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1 More precisely, the data given corresponds to the number of active workers registered with the social security system (source: Spanish employment agency).

BELGIUM

AFTER THE RECOVERY SPRINT, THE MARATHON OF FISCAL CONSOLIDATION

Q3 Belgian GDP growth came in at 2% q/q, which is well above consensus. GDP thus exceeded its pre-Covid level for the first time since the start of the pandemic. For this year, we estimate the growth rate to reach 6.1% in annual average terms, with a slower but still above-potential growth rate of 3.1% expected for next year. As it stands, the Belgian economy looks to have avoided additional scarring; however, with elevated public debt levels entering the limelight once again, the De Croo government has its work cut out.

After shrinking by 5.7% in 2020, the Belgian economy completed its recovery to pre-Covid levels in Q3. Private consumption was the final component of GDP to exceed the level reached at the end of 2019. A new phase of the recovery, one of slowing but still above potential growth, seemed to be underway. However, the picture became much murkier following the emergence of the new Omicron variant , with the number of new daily cases rising strongly in Belgium and neighboring countries once again. The risks to our outlook are clearly skewed to the downside, even if it remains to be seen how much of a direct impact (increased social distancing measures) and indirect impact (confidence channel) the virus will have on activity. Our nowcast for Q4 implies a significant slowdown in growth, from 2.0% q/q to a meagre 0.3% q/q. The recent announcement of more stringent measures right before the Christmas holiday period puts the country in a situation similar to where it was one year ago. At that time, the economy shrunk in Q4 2020, a scenario that cannot be ruled out for this quarter.

Belgian inflation, as measured by the Eurostat Harmonised Index of Consumer Prices (HICP), reached 7.1% y/y in November (flash estimate). This is the highest number on record since the series was created in 1992. Like elsewhere, the bulk of the increase is the result of booming energy prices.

Consumer confidence in November came in at its lowest level since April, when more stringent social distancing measures were in place. Compared to early 2021, households are more worried about their financial situation. They are also reporting a decrease in their ability to save money. A recent study by the National Bank of Belgium (NBB) sheds light on the asymmetric impact of the Covid crisis on savings. On aggregate, forced saving and (to a lesser degree) precautionary saving led to an increased savings rate compared to the pre-Covid situation. But for those families with the lowest incomes, the savings rate did not increase during the crisis. This implies that the majority of the increase in savings was generated by high-income households. Their lower propensity to consume suggests that the much-anticipated "pent-up demand" may not be forthcoming.

Regarding the labor market, households are now more optimistic than they were at the beginning of this year. Concerns surrounding employment have almost completely disappeared in the latest consumer surveys. This is supported by the unemployment rate declining during most of the year and total employment reaching a record high of 5 million in Q3.

Business confidence remained stable in November, with construction being the most optimistic sector. The services sector meanwhile reported a slightly bleaker outlook, with an ad hoc survey by the Economic Risk Management Group (ERMG) last month showing that almost half of all surveyed companies are experiencing staff shortages. A lack of input material (40%) and higher input costs (22%) are also key worries for Belgian businesses.

GROWTH & INFLATION

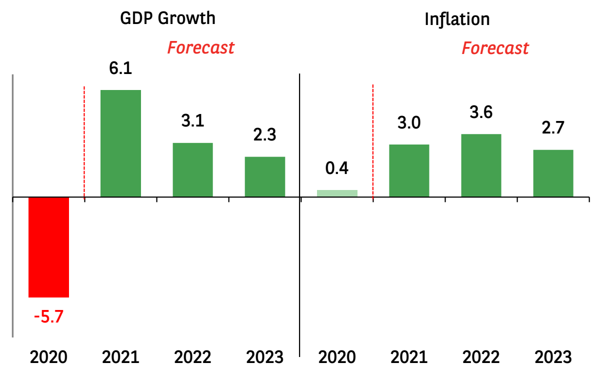

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

The budget deficit worsened from 1.9% of GDP in 2019 to 9.4% in 2020. With revenue more or less stable as a portion of (declined) GDP, the increased expenditure hit the Belgian budget hard. The situation improved somewhat this year, mostly as a consequence of lower outlay on fighting the economic impact of the Covid-19 crisis. However, even against a backdrop of declining debt service, the deficit remains stubbornly high. The NBB expects a primary deficit of more than 3% of GDP by 2023, compared to a balanced position in 2019. Reversing that situation will not be an easy task for the Government.

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AUSTRIA

CRISIS ATMOSPHERE

Once Covid-related restrictions are lifted, the economy is projected to rebound strongly in 2022, driven initially by household consumption. Next year, the fiscal stance is likely to tighten because of the gradual withdrawal of the special support measures. A major political risk is the possible falling apart of coalition between the conservative ÖVP and the Greens.

Following a mild recession at the beginning of the year, the gradual easing of lockdown measures allowed the economy to return to its pre-crisis level in Q3. The recovery was even held back by shortages of labour and material. That will be even more the case in the next months because of the measures announced by the government in response to the rapid increase in Covid-19 infections. A nationwide lockdown was decreed for a maximum of 20 days starting on 22 November, as well as the mandatory COVID-19 vaccination from 1 February 2022. After the announcement, the number of people in the unemployment and furlough schemes have been rising again.

AN AMBITIOUS TAX REFORM

Because of the withdrawal of special support measures, the fiscal stance is set to tighten next year. On the other hand, the government will implement a tax reform from July 2022. When fully implemented in 2024, the tax reduction will amount to EUR 7.8 bn per year (2% of GDP). The reduction should compensate the tax payer for the so-called "bracket creep", a situation in which inflation pushes tax payers into higher tax brackets. In 2024, the corporation tax rate will be lowered from 25% to 23%. From 1 July 2022, a carbon tax will be introduced for sectors that are not subjected to the EU ETS. Initially, the tax is fixed at EUR 30 per tonne of carbon and will rise to EUR 55 by 2025. The carbon price in the EU ETS is currently close to EUR 80 in recent months. The tax adds 10 cent to a litre of petrol and EUR130 on the annual heating costs of an average household. The receipts of the tax will be returned through a family tax credit, a special bonus for citizens living in rural areas and subsidies to firms to keep them competitive versus countries that have lower carbon prices.

ROBUST GROWTH IN THE COMING YEARS

The economy could quickly recover once these measures are lifted. Private consumption is likely to rebound strongly once lockdown measures are lifted, supported by the savings buffer build up during the Covid crisis and the tax reform from July 2022 onwards. Exports in goods will strengthen in the course of 2022 due to the easing of supply disruptions, in particular in the German car industry. Moreover, the export of tourism services may almost double in 2022. Investment is stimulated by the shift to low-carbon production technologies and persistent labour shortages, which will lead to further automation. Inflation is likely to increase temporarily to above 3% in 2022, in the first place due to higher energy prices. Moreover, from 1 January, VAT rates for catering, accommodation and events, representing around 13% of the consumption basket, will be raised from 5% to their original level of 8%. This hike is likely to be only partly passed through to consumers. On 1 July, the introduction of the carbon tax will contribute around 0.2 point to inflation.

GROWTH AND INFLATION

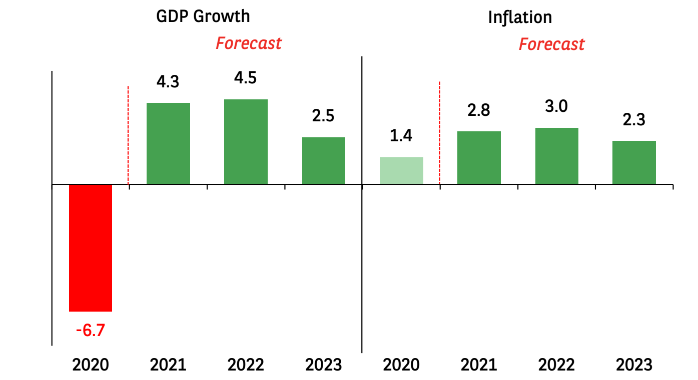

CHART 1 SOURCE: ECONOMIC RESEARCH BNP PARIBAS

MINISTERIAL WALTZ

A major uncertainty is the corruption scandal, in which the ÖVP (conservatives), the senior partner in the governing coalition, is entangled. In October, accused of funnelling EUR 1.2 bn of taxpayers' money between 2016 and 2017 to media outlets that served his interests, the ÖVP leader Sebastian Kurz resigned as Chancellor in October. He was temporarily replaced by the foreign minister Alexander Schallenberg. As in early December, Mr Kurz decided to quit politics altogether, Mr Schallenberg moved back to the foreign ministry and the interior minister Karl Nehammer took over as Chancellor. Moreover, finance minister Gernot Blümel resigned. For the moment, the Greens want to continue the coalition with the ÖVP in order to realise the green political agenda.

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FINLAND

GOOD STUDENT

Confronted like the rest of Europe by an upsurge in Covid-19 cases, Finland has reintroduced protective health measures that could temporarily dampen its recovery. Estimated at 3.4% in 2021, GDP growth could still reach 2.8% in 2022 according to the European Commission. After taking a reasonable approach to "whatever the cost", the government is now seeking to consolidate public finances.

Relatively sheltered so far, Finland reported a record number of new Sars-Cov-2 cases in early December 2021. Thanks to a high vaccination rate (77% of the total population), it was able to limit the upturn in severe cases and deaths, which were not as high as in most of the other EU member countries. At the same time, the government reintroduced protective health measures, such as the closing of bars and restaurants as of 6 p.m. in certain regions.

After the lockdown restrictions and forced savings of spring 2020, household consumption rebounded rapidly and became the main growth engine behind Finland's recovery. In 2021, it will be the biggest contributor to GDP growth, which the European Commission is estimating at 3.4% (see chart).

SUPPLY CHAIN DISRUPTIONS AND PRICING PRESSURES

Despite encouraging statistics for industrial orders and the high level of confidence expressed by business leaders, investment has been sluggish and even declined in Q3 2021. This is mainly due to the global shortage of inputs, notably components, resulting in supply chain disruptions in numerous business lines, and in the automotive industry in particular.

Squeezed between strong demand and supply-side constraints, the situation in Finland, like elsewhere, resulted in higher prices. Inflation surged to 3.4% year-on-year in November 2021, the highest level since 2012, driven up by a higher energy bill, but other factors are also to blame. Core inflation, which excludes energy and food prices, has accelerated since spring 2021, notably in services, where the shortage of skilled labour has driven up wages and prices. According to the Chamber of Commerce surveys, the IT and communications, technology and retailing sectors were very sensitive to this phenomenon.

Thanks to major automatic stabilisers that were already in place, "whatever the cost" did not have to be taken as far in Finland as in most of the other countries. According to IMF estimates, direct fiscal transfers engaged to combat the Covid-19 pandemic (excluding state-backed loans) amounted to 4.8 points of GDP in 2020-21, which is high in absolute terms but relatively low compared to the European average (which is closer to 10 points of GDP). As a result, the public accounts did not deteriorate very much (debt was limited to 71% of GDP in 2021, while the deficit was less than 4% of GDP). Since most of the emergency measures have expired, the fiscal impulse to the economy has become negative (-0.5 points in 2022 according to the European Commission). Growth could slow this winter, and is estimated at 2.8% in 2022.

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GROWTH AND INFLATION

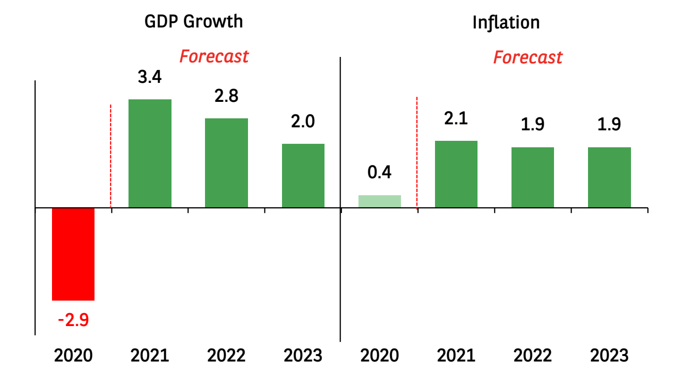

CHART 1 SOURCE: EUROPEAN COMMISSSION, BNP PARIBAS

CONTRIBUTIONS TO GROWTH

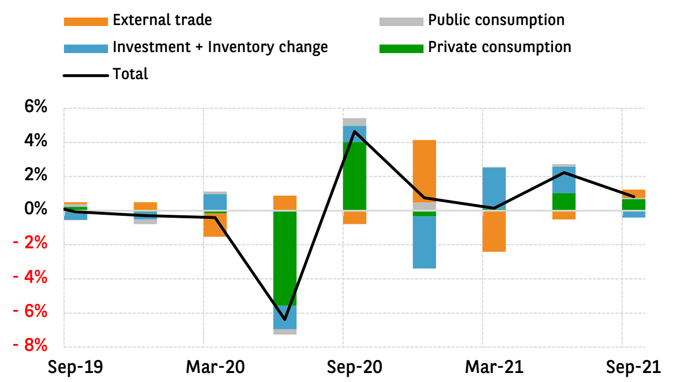

CHART 2 SOURCE: STATISTICS FINLAND

GREECE

ENTERING 2022 ON A MORE SOLID BASIS

The Greek economy has surprised on the upside so far in 2021. Real GDP growth is expected to exceed 7% this year. The unemployment rate has fallen to 13%. This improvement has allowed the banking sector to continue its clean-up, with a non-performing loan ratio close to the 20% threshold at the beginning of the summer. Difficulties on the economic, social and banking front remain amongst the most pressing in the European Union. This said, unless there is a further complication on the health front, Greece will go into 2022 on a much better basis than in previous years.

The Greek economy has recovered much more strongly than expected in 2021, which, incidentally, has led the European Commission to make significant increases in its growth forecasts for this year, up from 4.3% (July forecast) to 7.1%. Even though Greece has one of the lowest rates of Covid-19 vaccination coverage in the EU, the current wave of the epidemic in the country has not forced the government to introduce restrictions on the same scale as previously[1], which should allow economic activity to continue to grow.

The improvement on the economic front can be seen in both GDP and employment data. Real GDP grew in Q3 2021 (+2.7% q/q) for the fifth consecutive quarter, thus pushing economic activity above the levels recorded immediately before the pandemic. Meanwhile, as in many other countries, measures designed to protect employment, particularly short-time working schemes (in the form of Greece's Synergasia programme) have been highly effective, even though they have come at a substantial cost to the public finances. At the beginning of the autumn, the number of unemployed people was at its lowest since April 2010, whilst employment had moved well above its pre-pandemic level. Nevertheless, the country still has a huge task ahead of it, with GDP and employment levels roughly 25% and 10% lower respectively than in 2008.

Many of the measures introduced during the Covid-19 crisis to support households and companies will expire at the end of 2021. This will lead to a noticeable reduction in the government deficit in 2022. The deficit is expected to be 3.9% of GDP in 2022, down from -9.9% in 2021 (European Commission data). Some measures will, however, be maintained, including the reduction on VAT in certain 'vulnerable' sectors (to June 2022), the 3-point cut in social security contributions (end-2022) and the suspension of the fiscal solidarity tax (end-2022). Thus the government debt-to-GDP ratio should come down in 2021, but it is likely to remain above the 200% of GDP threshold.

However, sovereign risk will remain subdued in 2022, thanks to the continuation of the European Central Bank's very accommodating policy despite the inflationary risk. In addition, Greece's Central Government has increased its cash reserves in 2021 (to nearly EUR 40 bn in October), using notably the money allocated by the European Recovery Fund. For its part, Greece's public debt management agency (PDMA) aims to repay part of the country's debt earlier than expected (EUR 5.3 bn due to be repaid in 2022 and 2023), which would also send a positive signal to investors regarding Greece's ability and desire to reimburse its creditors.

The strong pace of growth expected in 2022 should ease the process of cleaning up the banking sector. Despite continued strong pressure, this is seeing improvements thanks to the Hercules programme, which underwrites banks' non-performing loans. This programme was introduced in October 2019 and will run until October 2022 (it was initially planned to end in April 2021). The non-performing loans (NPLs) ratio fell sharply in Q2 2021, taking it to 21.3% (on consolidated figures), just above half of its level in 2019 (40.0%). This drop was in part artificial and linked to exceptional subsidy measures on the redemption of certain loans to households and companies during the pandemic (the Gefyra and Gefyra II programmes). Hence there could be a rebound in NPLs when these measures come to an end. However, the aim of the four major systemic Greek banks (Eurobank, National Bank of Greece, Alpha Bank, Piraeus Bank) of achieving an NPL ratio below 10% by the end of 2022 still appears to be within reach[2].

GROWTH AND INFLATION

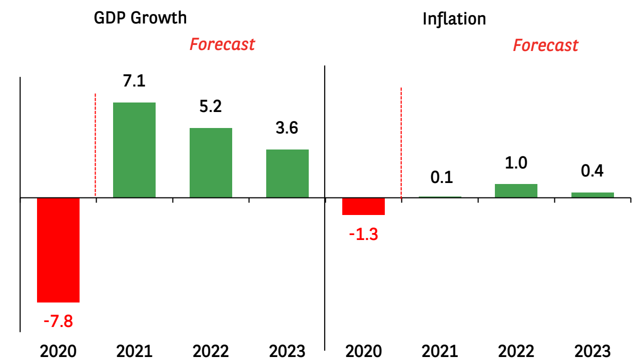

CHART 1

SOURCE: EUROPEAN COMMISSSION, BNP PARIBAS

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1 One recent measure was the introduction of mandatory vaccination for the over 60s.
2 This was reiterated by the European Commission in its most recent monitoring report on Greece, issued in November 2021.

UNITED KINGDOM

THE OLD LADY HESITATES

To raise or not to raise interest rates? That is the question facing the Bank of England as inflation accelerates and the number of Covid-19 cases surges again, this time with Omicron, the new Covid-19 "variant of concern". After rebounding strongly through summer 2021, economic growth has also lost the support of public spending, and is showing a few signs of levelling off.

Although the UK government showed no lack of determination in countering the Covid-19 pandemic (direct transfers to the economy as part of the health crisis were estimated at 20 points of GDP according to the IMF, more than double the European average), it was also one of the first to declare the end of "whatever the cost". In October 2021, it terminated the main job retention measures – the Coronavirus Job Retention Scheme (CJRS) and the Self-Employed Income Support Scheme (SEISS). About 1.5 million British workers on "leave" from their companies had to return to the labour market during the fall months. This could have an impact on the unemployment rate, which had fallen to 4.3% of the labour force last August. In addition to these job subsidies, other support measures also expired, including the universal credit (GBP20 per week), the reduced VAT rate for hotel and restaurant services and the special reduced transfer tax rate.

A LESS EUPHORIC OUTLOOK

Unsurprisingly, the number of real-estate transactions plunged again in the wake of these measures, and cyclical indicators in general seem to be looking less euphoric (chart 2). Although purchasing manager surveys were still upbeat through November, there seems to be some erosion of household confidence and spending, the main growth engines behind the catching-up movement. 3m/3m path in retail sales showed a decline in purchases of manufactured goods, and cars in particular. At the time we went to press, statistics had not yet taken into account the outbreak of the new Omicron variant. Hit by numerous new cases of the Delta variant, the government opted to launch new restrictive measures (mandatory self-isolation for both vaccinated and unvaccinated contact cases), the first since restrictions were lifted in early July.

Driven up by higher regulated prices for energy, price inflation has accelerated a little faster than expected by the Bank of England. At 4.2% year-on-year in October, inflation continues to rise above the official 2% target, leading the bank's Governor Andrew Bailey to adopt a harsher tone concerning monetary policy. Initially set for the end of December, he confirmed the end of quantitative easing, with the goal of stabilizing the central bank's asset holdings at GBP 895 bn (40% of GDP). The BoE had intended to raise its key bank rate at the same time (held at 0.10% since March 2020), but the Old Lady now seems to be hesitating.

To tighten or not to tighten monetary conditions? That is the question at a time when the economy is less supported by fiscal policy (after emergency measures were halted, social welfare contributions will be raised as of April 2022), and new headwinds seem to be taking shape with a new wave of the Covid-19 pandemic.

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GROWTH AND INFLATION

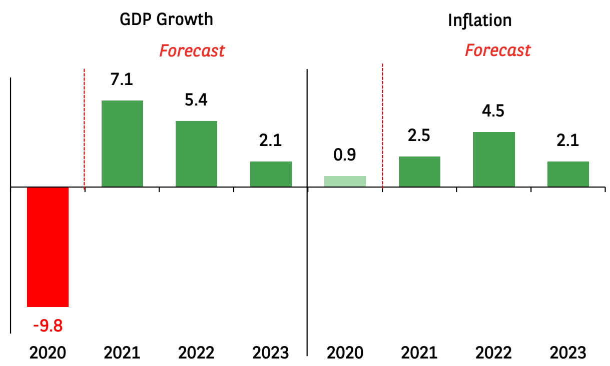

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

COMING IN FOR A LANDING

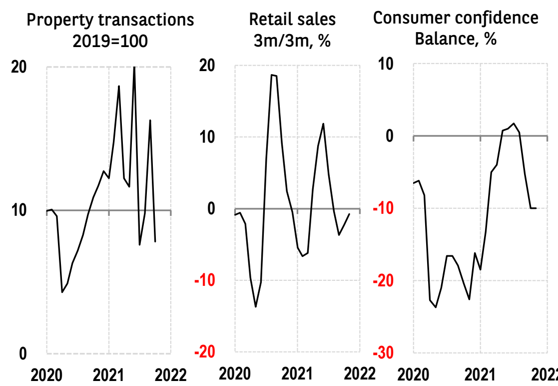

CHART 2 SOURCE: ONS, HMCE

NORWAY

SOLID FOUNDATIONS

Faced with the Covid-19 pandemic, Norway managed to minimise the human toll as well as its economic losses. In 2021, the country largely benefited from the rebound in natural gas and oil prices. Activity has already exceeded pre-pandemic levels, the housing market is booming, and the public accounts have swung back into their usual surpluses. One of the very first central banks to raise its key rates, Norges Bank esteems that the current situation is in keeping with the normalisation of monetary policy. Yet the roadmap still depends on the health situation, which like elsewhere in the world, is deteriorating.

Although Norway is no more sheltered than other countries from the resurgence in Covid-19 contaminations, it has a high vaccination rate (78% of the total population) which protects it from the worst. The uptick in the number of severe cases and deaths was contained by early December 2021, at least when comparing the situation with the one seen in the European Union. Norway has one of the lowest mortality ratios with regard to the Covid-19 pandemic, with just over a thousand deaths for a total population of 5.5 million (this ratio is 7 times lower than for neighbouring Sweden).

Economically, the country has recovered quickly, thanks above all to government measures. According to estimates by the International Monetary Fund (IMF), direct fiscal transfers to companies and households during the pandemic (excluding loans and guarantees) amounted to 7.4 points of GDP, the biggest effort within the Scandinavian region. The rare deficits shown on the public accounts in 2020 were rapidly covered by the boom in offshore natural gas and oil revenues, which account for 18% of GDP and 40% of exports (see chart 2).

Mainland GDP growth[1] was strong, following a path of more than 4% in 2021. By Q3, it had already exceeded pre-pandemic levels. Adjusted for seasonal variations, the unemployment rate dropped below 4%[2], and most sectors have signalled labour shortages. Certain sectors are already beginning to show signs of overheating, like housing, which has affirmed its role as a safe haven: prices have risen sharply since the beginning of the pandemic. Over the past 20 months, house prices per square meter have appreciated by nearly 15% in Oslo, and the national average is also up by a similar amount. Prices are being driven up not only by demand, but also by a shortage of building materials, which is a global phenomenon.

Thanks in part to the krone's appreciation, goods and services have not come under the same pricing pressure. Excluding the energy component, inflation has even tended to ease over the course of 2021, dropping to 0.9% in October, the lowest level in four years. Based on budding wage pressures, however, Norges Bank expects core inflation to rise. The central bank esteems that the economic situation has recovered sufficiently to justify the normalisation of monetary policy. On 24 September, it was one of the first central banks to raise its key rates, with a 25-basis point increase in the key policy rate to 0.25%. The roadmap for 2022 calls for further increases in the policy rate, which could rise as high as 1% by the end of next year.

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GROWTH AND INFLATION

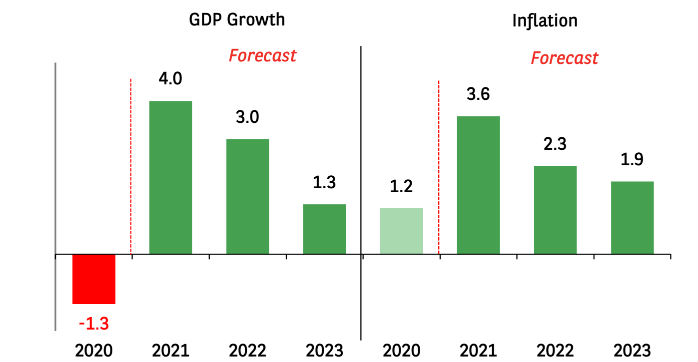

CHART 1

SOURCE: EUROPEAN COMMISSSION, BNP PARIBAS

1 Excluding oil and natural gas activities.
2 Only the gross series is available, on a quarterly basis. Adjusting for seasonal components (using X-12 ARIMA), the Q3 2021 unemployment rate is estimated at 3.9%.

FORECASTS

ECONOMIC FORECASTS

	GDP Growth			Inflation		
%	2021e	2022e	2023e	2021e	2022e	2023e
United-States	5.5	4.7	2.8	4.7	4.6	2.1
Japan	1.7	2.6	1.6	-0.2	0.7	0.5
United-Kingdom	7.1	5.4	2.1	2.5	4.5	2.1
Euro Area	5.0	4.2	3.0	2.5	3.1	2.0
• Germany	2.6	3.6	3.6	3.1	3.4	2.2
• France	6.7	4.2	2.5	2.0	2.5	2.1
• Italy	6.3	4.9	3.0	1.8	2.9	1.7
• Spain	4.3	5.4	3.5	3.0	3.7	1.7
China	7.9	5.3	5.5	0.9	2.1	2.5
India*	8.0	11.0	6.0	5.4	5.7	5.0
Brazil	4.8	0.5	2.0	8.3	8.3	4.3
Russia	4.5	3.0	1.8	7.0	6.3	4.1

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)"	0.25	0.25	0.75	1.00	2.00
	T-Notes 10y	1.70	1.80	1.90	2.00	2.30
Ezone	Deposit rate	-0.50	-0.50	-0.50	-0.50	-0.10
	Bund 10y	0.00	0.05	0.05	0.10	0.40
	OAT 10y	0.45	0.40	0.35	0.45	0.70
	BTP 10y	1.35	1.45	1.45	1.55	2.00
	BONO 10y	0.75	0.85	0.90	1.05	1.45
UK	Base rate	0.25	0.50	0.50	0.75	1.25
	Gilts 10y	1.10	1.20	1.30	1.45	1.75
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10	-0.10
	JGB 10y	0.12	0.14	0.15	0.18	0.20

Exchange rate

End of period		Q1 2022e	Q2 2022e	Q3 2022e	Q4 2022e	Q1 2023e
USD	EUR / USD	1.13	1.12	1.11	1.09	1.09
	USD / JPY	115	116	117	118	120
	GBP / USD	1.35	1.35	1.35	1.33	1.36
EUR	EUR / GBP	0.84	0.83	0.82	0.82	0.80
	EUR / JPY	130	130	130	129	131

Brent

End of period		Q1 2022e	Q2 2022e	Q3 2022e	Q4 2022e	Q1 2023e
Brent	USD/bbl	84	80	79	80	85

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

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