ECOPULSE

January 2023

MONTHLY PULSE OF ECONOMIC INDICATORS

BNP PARIBAS

The bank for a changing world

EUROZONE: WILL A GDP CONTRACTION BE AVOIDED AGAIN IN Q4?

GERMANY: RECESSION LESS SEVERE THAN ANTICIPATED

FRANCE: WINTER SPLEEN

ITALY: WAGE GROWTH NOT TAKING OFF

SPAIN: ACTIVITY TREADS WATER

UNITED STATES: RESILIENCE

UNITED KINGDOM: FURTHER CONTRACTION IN GDP ON THE HORIZON

JAPAN: INFLATION CONTINUES TO RISE

EUROZONE

Will a GDP contraction be avoided again in Q4?

In December 2022, according to the European Commission surveys as well as the S&P Global PMIs, the business climate improved quite significantly, surprising positively despite the accumulation of shocks. The improvement was evident in all sectors as well as in the leading sub-components (those related to new orders). However, the level of the surveys remains relatively depressed.

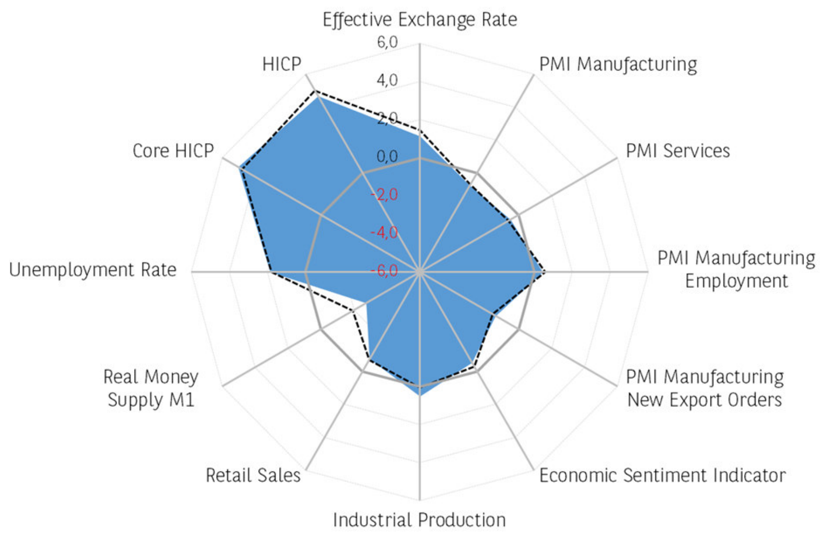
In December, consumer confidence continued its recovery for the third month in a row. While starting from a very low level, this improvement is nonetheless encouraging, driven by smaller concerns about unemployment and inflation.

The sharp fall in inflation in December (down around 1 point, at 9.2% year-on-year), which surprised expectations very favourably, is the most positive news in this month's economic picture, although it should be put into perspective by the absence of a fall in core inflation. The latter actually increased further to 5.2% (+0.2 points), due to the acceleration in the prices of manufactured products and of services. However, inflationary pressures are continuing to diminish, and this should ultimately drive core inflation down.

Given the signs of resilience in the economy and core inflation, the ECB shows its determination to continue with the tightening of its monetary policy. We are now expecting policy rate increases to be extended beyond Q1, driving the terminal point a little higher (3.25% instead of 3% for the deposit rate).

Thanks to favourable surprises in a number of Q4 indicators, including in the hard data (production and consumption in November), growth prospects appear much less negative than had been feared. The supporting factors appear to be stronger (fewer supply problems, fiscal measures) and the headwinds not so severe (energy crisis less acute). According to our Nowcast estimate, Eurozone GDP is even expected to avoid a contraction and growth would be zero. We have also raised our forecast, but it remains slightly negative (-0.1% q/q instead of -0.4%).

Economic indicators quarterly changes



Source: Refinitiv, BNP Paribas.

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GDP growth q/q: actual, carry-over and forecasts

Actual			Nowcast	Forecast	Carry-over	Forecast		Carry-over	Annual growth forecasts (y/y)		
Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q4 2022	end 2022	Q1 2023	Q2 2023	mid 2023	2022	2023	2024
0,6	0,9	0,3	0,0	-0,1	0,3	-0,3	0,1	0,1	3,4	0,2	1,3

See the Nowcast methodology page 11

GERMANY

Recession less severe than anticipated

Business climate indicators in recent months have been affected by the significant impact of the energy shock, as well as by fears that this shock will get worse during the winter. The difficulties linked to the international context (before China's economy opened up again) have also hurt the German economy.

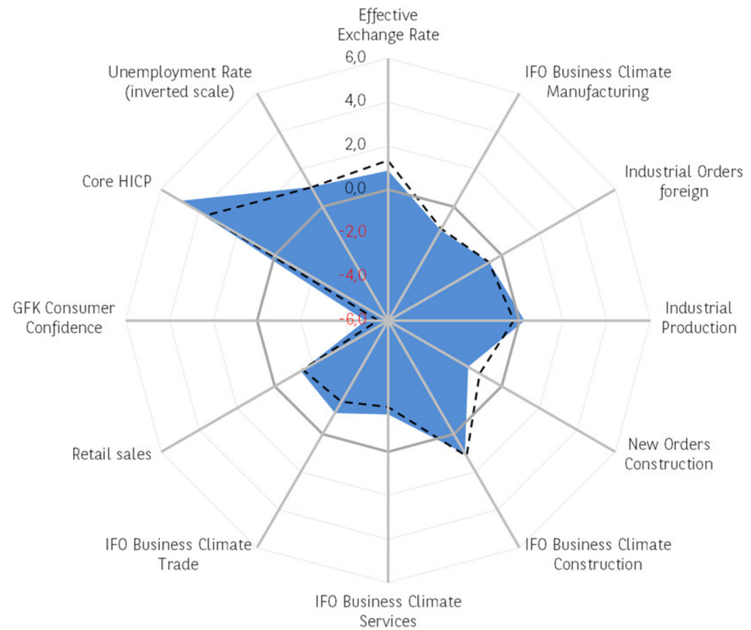
A gap has emerged between the data for consumer confidence, which in 2022 was significantly affected by the rise in inflation, and consumer spending, which managed to grow over the first three quarters. However, the annual consumption data published on 13 January suggests a decline in Q4.

Inflation registered a significant fall in December (8.6% y/y after 10% in November), due to the freeze in energy prices by the federal government. However, core inflation has continued to rise, to 5.4% in December after 5.1% in November (harmonised index).

At the same time the tightness in the labour market continued, against a backdrop of low unemployment (5.5%). This tightness penalised production to a significant degree and this increased in 2022 (according to the European Commission survey), affecting one in three companies in industry and three out of 10 in the services sector at the end of 2022.

German growth is not expected to be as bad in the 4th quarter as might have been expected based on the various surveys. These surveys incorporated uncertainties linked to the extent of the shock on energy during the winter, uncertainties which have been partially removed as shown by the relative resilience of industrial production (a factor which the reopening of the Chinese economy should help to strengthen). Annual growth, published at 1.9%, is consistent with our expectation of a decline in growth, which is expected to remain limited to -0.2% q/q in the 4th quarter.

Economic indicators quarterly changes



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GDP growth q/q: actual, carry-over and forecasts

Actual			Forecast	Carry-over	Forecast		Carry-over	Annual growth forecasts (y/y)		
Q1 2022	Q2 2022	Q3 2022	Q4 2022	end 2022	Q1 2023	Q2 2023	mid 2023	2022	2023	2024
0,8	0,1	0,4	-0,1	0,2	-0,4	0,0	-0,3	1,9	-0,2	1,2

FRANCE

Winter spleen

The gradual deterioration in the business climate suggests a slowdown in French growth, which may even have fallen into negative territory in the 4th quarter, a contraction which would be consistent with the decline in the balance of opinions about production in the economic survey in industry.

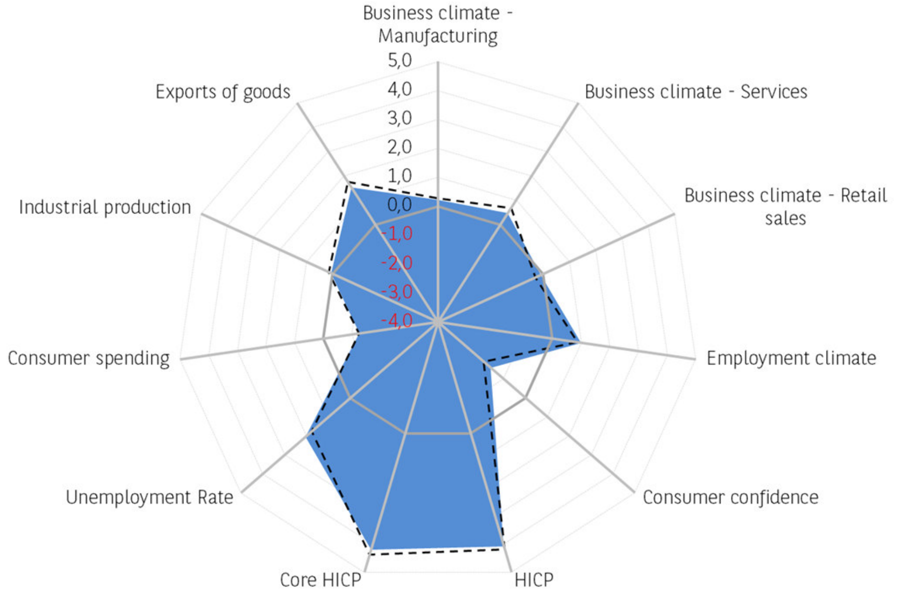
Consumer confidence has remained at a relatively low level for around 6 months. It has not improved, despite a significant upturn in purchasing power (+1% q/q in the 3rd quarter, and an estimate of +1.1% q/q in the 4th quarter). This suggests an increase in the savings rate and therefore a drop in spending.

Inflation has been fluctuating for almost 6 months around 6% year-on-year. In December, it fell to 5.9% y/y compared with 6.2% in November (in the context of the fall in energy prices). Energy prices are expected to increase from January (end of the rebate on fuel, increase in the regulated price of gas, then electricity): according to our forecasts, inflation is expected to reach 6.5% in February.

At this point the deterioration in the business climate has not affected the labour market, which continues to be dominated by recruitment difficulties which in turn support employment. Furthermore, wages are gradually increasing, and these increases are expected to strengthen further in 2023 (+5%, after +3.4% as an annual average in 2022 according to our forecasts).

In relation to the 4th quarter, our forecast anticipates negative growth (-0.2% q/q), underpinned by the fall in energy consumption (and the stagnation in other items) as well as in industrial production (after a good 3rd quarter). However, in the latest indicators (business climate, exports) we see somewhat positive surprises in November (after much more negative indicators in October), elements which are reflected by our growth proxy (nowcast), which would suggest a more modest fall (-0.1% q/q).

Economic indicators quarterly changes



Source: Refinitiv, BNP Paribas.

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GDP growth q/q: actual, carry-over and forecasts

Actual			Nowcast	Forecast	Carry-over	Forecast		Carry-over	Annual growth forecasts (y/y)		
Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q4 2022	end 2022	Q1 2023	Q2 2023	mid 2023	2022	2023	2024
-0,2	0,5	0,2	-0,1	-0,2	0,1	-0,4	0,2	-0,2	2,5	0,0	1,0

See the Nowcast methodology page 11

ITALY

Wage growth not taking off

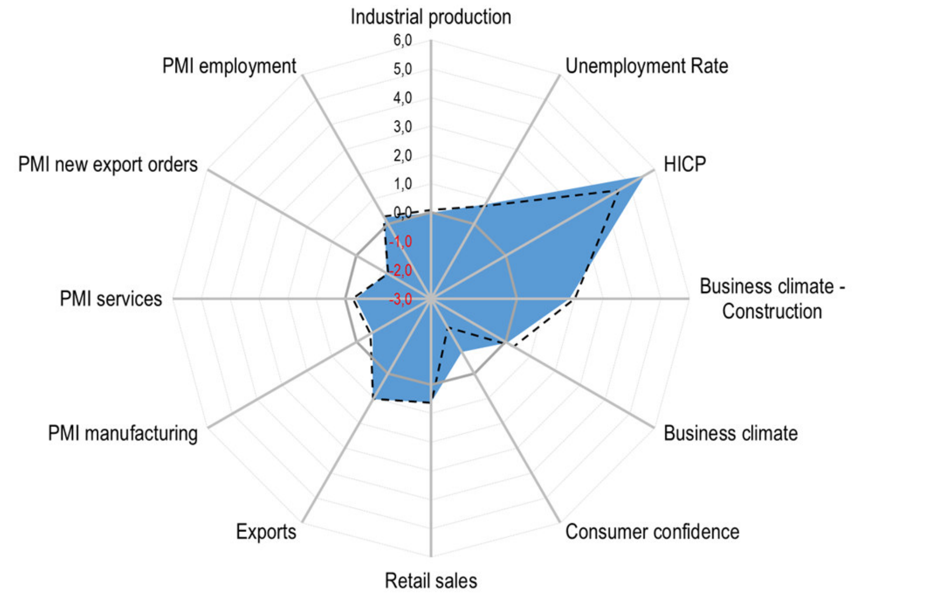
While the risk of energy shortages this winter seems to be receding, the obstacles which the Italian economy is facing remain significant. Unlike its European neighbours, inflation in Italy is not slowing down. It fell only slightly in December, from 12.6% to 12.3%, and remains the highest in Western Europe. Furthermore, prices over three months (3m/3m) soared to 19.8%, the highest level since current statistics began in 1996.

Despite the scale of the support measures introduced in 2022 – at a total cost, estimated by the Bank of Italy, of EUR 68 bn – these have been less effective at slowing down price increases than the measures introduced in France or Spain, for example. This was in part a choice made by the Italian authorities, who have preferred direct subsidy measures or concessions on social contributions for households and businesses, rather than intervention on prices. Nonetheless, faced with the modest rise in hourly wages (+1.6% y/y in November), the fall in the purchasing power of Italian households remains substantial.

While the Italian labour market continues to recover given the fall in the unemployment rate, this indicator masks underlying dynamics which are less positive for economic growth. The unemployment rate fell to 7.8% in November 2022, its lowest level since May 2009 if we exclude the April 2020 distortions linked to the introduction of furlough measures. Nonetheless, the active working population has stabilised at a much lower level than in 2019, down around 300,000 (-1.5%).

Private consumption recovered in Q3 2022 but is expected to have slowed down in Q4, resulting in a drop in activity which we estimate to be -0.4% q/q. Retail sales continued to fall in October and November, hindered by a significant drop in purchases of food products (-6.7% between January and November 2022).

Economic indicators quarterly changes



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GDP growth q/q: actual, carry-over and forecasts

Actual			Forecast	Carry-over	Forecast		Carry-over	Annual growth forecasts (y/y)		
Q1 2022	Q2 2022	Q3 2022	Q4 2022	end 2022	Q1 2023	Q2 2023	mid 2023	2022	2023	2024
0,2	1,1	0,5	-0,1	0,4	-0,4	0,1	0,1	3,9	0,2	1,2

SPAIN

Activity treads water

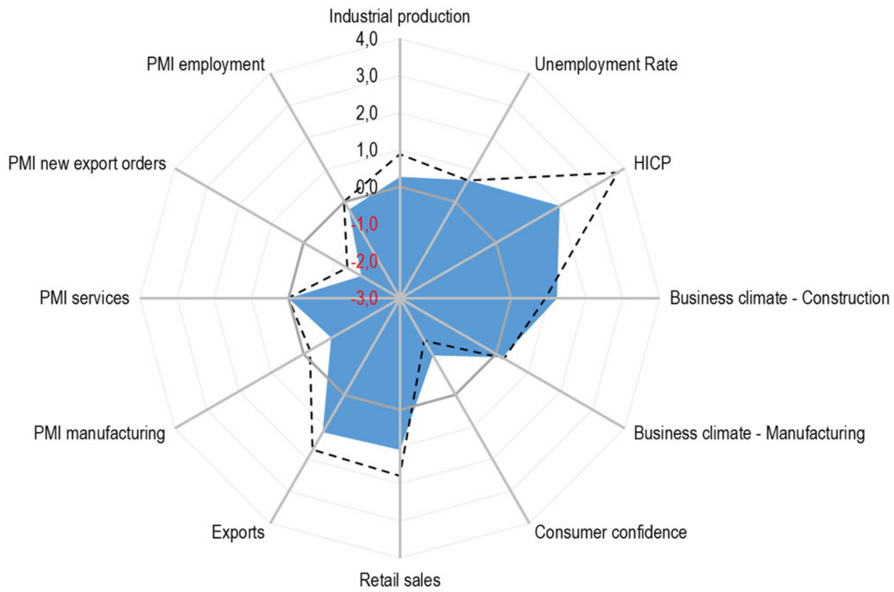
While still high, inflation has fallen sharply since its peak in July, thanks to measures to freeze energy prices, most of which will be maintained in 2023. At the end of December the Prime Minister Pedro Sanchez also unveiled a new budget of EUR 10 bn intended to support households and which includes the temporary abolition of VAT (from 4% to 0%) on a list of essential products.

This will help to contain food price inflation and counteract the upward pressure on prices caused by the end of the fuel rebate since 1st January 2023. As household confidence is strongly correlated with inflation it rebounded in the second half of 2022, but is still well below what it was before the war in Ukraine.

The labour market has been resilient despite the multiple shocks in 2022. According to the Spanish state employment service (SEPE), employment in the country rose by 3.9% over 2022 as a whole. The momentum slowed very slightly in December: recruitment fell by 8,300, the first drop since April 2021. However, PMI surveys do not suggest that a decline in recruitment is on the horizon. The composite PMI index for employment rose in Q4 and moved back above the 50 threshold.

The clear slowdown in economic growth in Spain in Q3 2022 could continue this winter, resulting in a potential downturn in activity. Industrial production has been on a downward trend since autumn, impacted by the fall in activity in the energy sector. The decline was very much greater in November 2022 (-8.3% m/m), following on from an already significant contraction the previous month (-3.1% m/m). However, manufacturing activity remained at a stable level, thanks to an increase in the production of consumer goods.

Economic indicators quarterly changes



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GDP growth q/q: actual, carry-over and forecasts

Actual			Forecast	Carry-over	Forecast		Carry-over	Annual growth forecasts (y/y)		
Q1 2022	Q2 2022	Q3 2022	Q4 2022	end 2022	Q1 2023	Q2 2023	mid 2023	2022	2023	2024
0,1	2,0	0,1	0,1	0,6	-0,3	0,2	0,4	5,3	0,6	1,4

UNITED STATES

Resilience

According to January's *Beige Book* published by the Federal Reserve (Fed), economic activity has remained relatively unchanged in all 12 districts since the previous report. However, activity is slowing in the manufacturing sector, despite the mitigation of disruptions in the supply chain.

The decline in net real disposable income, combined with higher borrowing costs, is expected to moderate future consumer spending. According to the *Census Bureau*, retail sales fell by a further 1.1% m/m in December (after having already fallen -1% in November following revision).

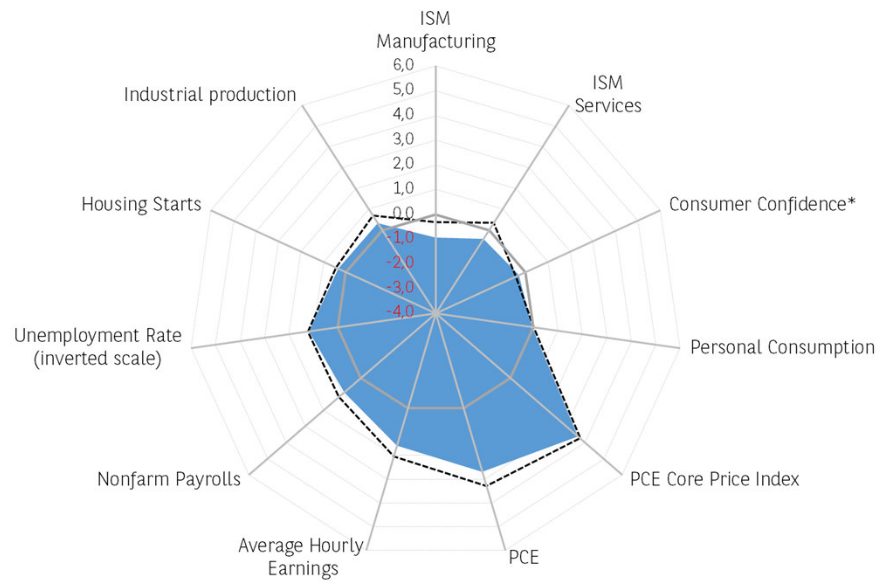
Inflation has continued to fall for several months (+6.4% year-on-year in December, compared to +7.1% in November) against a backdrop of a slowdown in growth. Although the slowdown in the price of goods continues, services excluding shelter prices continue to accelerate, which reflects the dynamics of wage-price spiral. Against this backdrop, the Federal Reserve is expected to continue to raise its key rates before leaving them at a restrictive level.

The slowdown in the labour market is also continuing, with a steady loss of momentum in non-farm payrolls (223k in December compared to 256k in November). The unemployment rate has also fallen (-0.1 points, or 3.5% in December), highlighting that workforce shortages still exist.

According to the Atlanta Federal Reserve's *GDPNow* estimate, quarterly growth in US GDP could be 3.5% year-on-year in Q4 2022, slightly up compared to Q3 (3.2% year-on-year), driven mainly by the positive contribution from household consumption and investments in equipment.

According to the first estimate of US GDP, quarterly growth was 2.9% annualized rate in Q4, mainly driven by household consumption.

Economic indicators quarterly changes



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Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q4 2022	end 2022	Q1 2023	Q2 2023	mid 2023	2022	2023	2024
-0,4	-0,1	0,8	0,9	0,7	0,9	0,0	-0,4	0,6	2,1	0,3	-0,2

UNITED KINGDOM

Further contraction in GDP on the horizon

According to the latest business surveys, economic activity in the UK continues to contract. According to the *Confederation of British Industry* (CBI), confidence balances in the industrial and distributive trades sectors (retail and wholesale sales) are clearly deteriorating while rebounding slightly in the services sector.

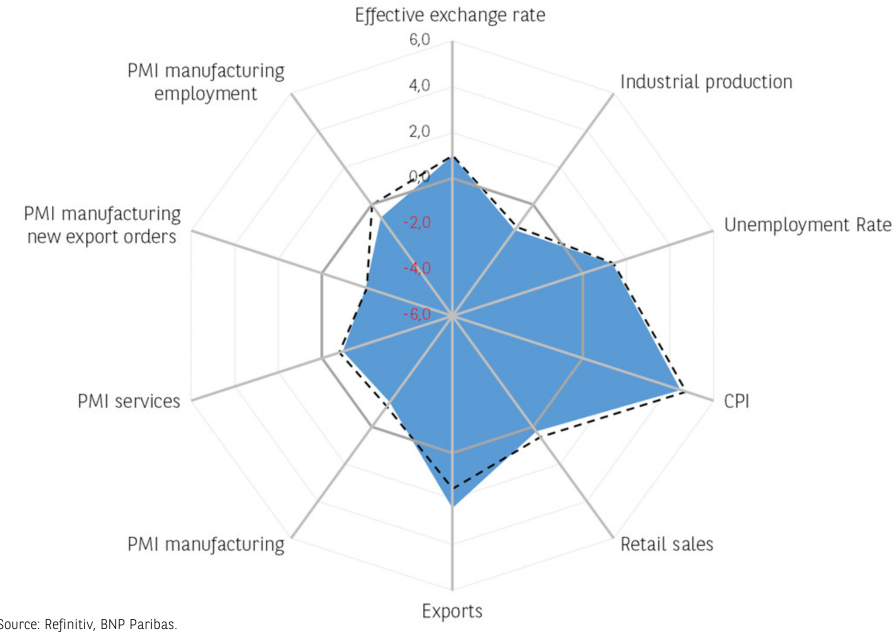
Against a backdrop of a cost of living crisis, consumer confidence again deteriorated in January (-45 points for the GfK index), close to its record low reached last September (-49 points). However, consumer confidence in the economic situation over 12 months was slightly less negative (-54 points) having reached its lowest level in September (-68 points).

Headline inflation fell for the second month in a row, standing at 10.5% year-on-year in December (compared to 10.7% in November) while core inflation was stable at 6.3%. The Monetary Policy Committee (MPC) of the Bank of England (BoE) is expected to raise its key interest rate further at its February meeting, particularly as business data provided a positive surprise in November.

The signs of easing in the labour market are still too limited to slow the momentum in wage growth. According to the latest employment figures, the unemployment rate remained stable in November (3.7%). The increase in employment (+27k) did not compensate for the increase in the number of unemployed (+56k).

Our forecasts suggest that UK GDP is likely to contract further in Q4 2022 (-0.3% q/q), despite the surprise upturn in growth in November. In the context of the cost of living crisis and significant uncertainties about economic activity, consumer spending and private investment are expected to make negative contributions to growth in Q4. This recession is expected to continue for much of 2023.

Economic indicators quarterly changes



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0,6	0,1	-0,3	-0,3	-0,4	-0,6	-0,2	-1,1	4,4	-0,9	0,8

JAPAN

Inflation continues to rise

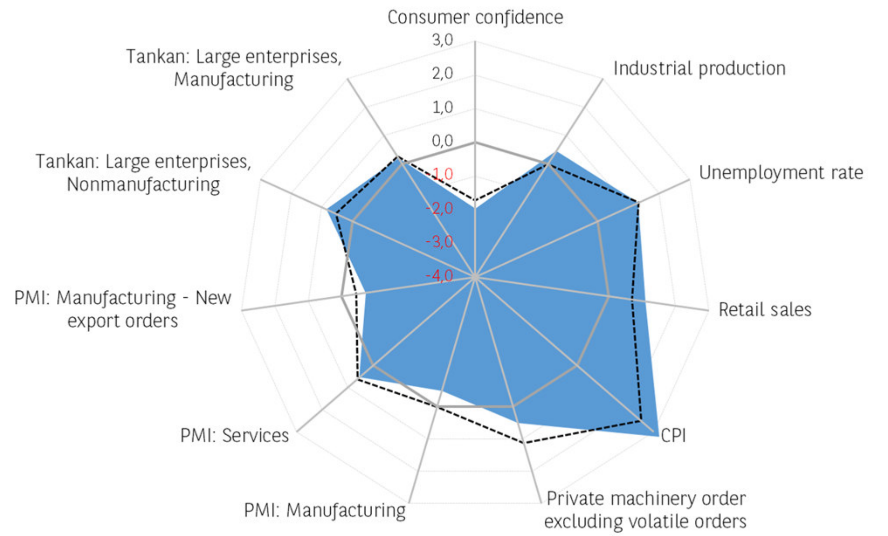
Despite some adjustments to its lending programmes, the Bank of Japan (BoJ) kept its monetary policy unchanged at the meeting on 18 January. However, the pressure on Government bond rates remains high and inflation is still rising. At 4.0% y/y in December, the rise in the CPI was the largest for over forty years (December 1981), while the underlying measure followed by the BoJ (CPI excluding energy only) accelerated even more significantly (4.1% y/y).

Inflation continues to weigh on consumer confidence, while a large proportion of Japanese households will see further increases in the price of electricity next March, with most suppliers having announced price increases from this month.

However, the labour market remains resilient, supported by more job openings (898,947 in November, the highest level since December 2019). Compared to the number of new jobseekers, job openings were at 2.42, close to the record high reached in April 2019 (2.49). The unemployment rate has been broadly stable since spring, even falling slightly in November from 2.6% to 2.5%. However, employment fell by 230,000 in November, the biggest monthly drop in four years, if we exclude the sharp contraction in April 2020 linked to the health crisis.

Prospects for growth in Japan remain low. After a contraction in real GDP of 0.2% q/q in Q3 2022, we are forecasting an increase of 0.7% q/q in Q4. GDP would therefore remain below the pre-Covid level, which, after the United Kingdom, would correspond to the least significant post-pandemic recovery in the G8 countries. Retail sales rose by 0.4% in the first two months of Q4 2022, compared to the Q3 average, while industrial production was up 1.9%.

Economic indicators quarterly changes



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-0,5	1,1	-0,2	0,7	0,7	0,2	0,1	1,0	1,2	0,9	0,3

NOWCAST METHODOLOGY

Near real-time forecasting ("nowcast") models, also labeled as GDP forecasting models through a direct approach, are commonly used by economic analysts who monitor developments in GDP growth on a daily basis before the publication of quarterly national accounts.

These models allow an estimation of GDP growth using data already published at the time of the nowcast. It offers the most reliable possible picture of the economy's dynamics for the current quarter, before the publication of quarterly national accounts. The sophistication of near real-time GDP forecasting models has increased significantly, and the data used has been enhanced with, in particular, the integration of Google queries, articles published in different media, satellite images, credit card spending data, etc.

We use a factor-augmented mixed-frequency approach based on real economic data (industrial production, retail sales, etc.), data from opinion and economic surveys (S&P Global's PMI, European Commission survey, etc.), international and financial data.

The factor-augmented mixed-frequency approach is estimated in two stages. First of all, we reduce the dimensionality of our monthly data through a principal component analysis (PCA). This statistical technique makes it possible to estimate, by linear combination of the initial variables, a monthly factor which represents the common dynamic. Then we use this monthly common factor to explain quarterly growth using mixed-frequency linear regression (MIDAS[1]).

[1] The MIDAS model makes it possible to estimate a low-frequency variable (quarterly in our case) with high-frequency variables (monthly).

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