Economic surveys in September are sending out mixed signals. Consumer confidence is falling in most countries, which in some cases (France, Spain) underlines a slight rise in inflation. This loss of confidence is also accompanied, in general, by a decline in purchasing intentions for durable goods, which can be linked to high interest rates and an expectation of a moderate downturn on the labour market. Lower consumer demand is affecting companies’ order books, with an impact that varies according to sector. In industry, economic surveys are more affected, while in services, activity remains dynamic in the US and Japan, while being more modest in Europe.

Regarding inflation, developments remain ambivalent. Inflation in the eurozone fell sharply in September (-0.9 points to 4.3% y/y), driven down by German inflation (-2.1 points to 4.3%), while momentum was less favourable elsewhere. Inflation in the UK and US remained unchanged (6.7% and 3.7%, respectively). In addition, in the US, the rise in gasoline prices promptly led to a sharp upturn in consumer expectations for inflation in October, for the year-ahead and for 5 years (according to the University of Michigan survey). This change is a reminder of the upside risks still surrounding the disinflation trajectory, which itself underpins our expectation that the Federal Reserve, the European Central Bank and the Bank of England will stop raising their key rates (so, further hikes cannot be completely ruled out).

The labour market is gradually easing, but not to the same extent in each region. In the US, job creation remained significant in September. This was more measured in the eurozone in Q2, an indication of less tensions than in the past, although said tension remains significant. This suggests that wages growth should remain steady in the coming months, which, with more moderate inflation, would allow a rebound in consumer purchasing power. In the UK, however, the available employment indicators show that the number of employees fell in September for the second month in a row. In Japan by contrast, the labour market is marked by a historic labour shortage.

In terms of growth prospects, the US is continuing to stand out in Q3, with clearly positive growth forecast (0.9% q/q), while growth should be very modest in the UK and Japan (0.1% q/q), and zero at aggregated eurozone level.
EUROZONE: FROM WEAK GROWTH TO NO GROWTH?

GERMANY: AND NOW, DISINFLATION

FRANCE: SMOOTHING THE IMPACT OF A SHOCK ALSO MEANS DELAYING SOME OF ITS EFFECTS

ITALY: EMPLOYMENT CONTINUES TO RISE

SPAIN: THE INFLATIONARY RISK IS EMERGING AGAIN

UNITED STATES: HOUSEHOLD SENTIMENT IS ERODING

UNITED KINGDOM: THE LABOUR MARKET IS DETERIORATING

JAPAN: LABOUR SHORTAGES ARE WEIGHING ON ACTIVITY
**EUROZONE**

**From weak growth to no growth?**

The inflation situation, in the Eurozone, is cooling. Added to this good news is the surprising continued drop in the unemployment rate (6.4% in August compared with 6.7% at the beginning of the year). But these positive developments are offset by a cooling also being seen in the European Commission Economic Sentiment Indicator (ESI). Given the weakness of confidence surveys, real GDP growth – only just positive in Q1 and Q2 2023 (+0.1% q/q each quarter) – is expected to be close to zero. We expect nil growth in both Q3 and Q4 2023, a forecast aligned with our nowcast estimate, also at zero.

Other hard data available are also negative: drop in retail sales (moderate in July [-0.2% m/m], large in August [-1.2% m/m]); marked decline in industrial production in July (-1.4% m/m), followed by a partial rebound in August (+0.6% m/m) and a very unfavorable base effect sharply deepening the drop year-on-year (-5%); contraction of exports by 3.9% y/y in August.

In September, the ESI deteriorated again, albeit slightly (-0.3 points, to 93.3). It is now at its lowest level since end-2020, comparable to levels at the end of 2011, midway through the European sovereign debt crisis. This is its fifth decline in a row, and this month only one sector avoided a drop, that of industry. Confidence in services, retail trade and construction all deteriorated, and consumer confidence even more so (because of a more negative assessment of the outlook for inflation and unemployment, which will need to be monitored).

Admittedly, S&P Global’s PMI composite index recovered slightly in September (+0.5 points, at 47.2), thanks to services (+0.8, at 48.7), but it remained firmly in the contraction zone (which is also true for the entire Q3). The index was driven down by the manufacturing sector, whose PMI stands at a very poor level (43.4, -1.3 points compared to August) and it remains to be confirmed that it has bottomed.

Inflation fell clearly in September. Headline inflation declined by 0.9 percentage points, to 4.3% y/y, the lowest since October 2021, as deflation on energy prices increased (-1.3 pp to -4.6% y/y, subtracting 0.6 pp to inflation), but not just this. Food inflation continued to moderate (-0.9 pp to 8.8% y/y) and its contribution to inflation is now close to, but below, 2 pp (1.8). Above all, core inflation finally fell significantly (-0.8 pp to 4.5% y/y, its lowest rate since August 2022). Over the coming months, tensions on oil prices and emerging tensions on gas prices are likely to slow the disinflation process without calling it into question. For the ECB, the status quo on its policy rates should prevail, but the situation remains uncomfortable.

Hélène Baudchon (completed on 18 October 2023)

1 The 25% y/y drop in imports should be put into perspective, bearing in mind the base and price effect causing this, but it nevertheless raises concerns.

**Eurozone: economic indicators monthly changes**

<table>
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<td>-0.6</td>
<td>-0.4</td>
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<td>ESI - Retail sales</td>
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<td>0.0</td>
<td>0.4</td>
<td>0.7</td>
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<td>Retail Sales</td>
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<td>-0.9</td>
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<td>-0.9</td>
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<td>New Car registrations</td>
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<td>0.6</td>
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<td>3.9</td>
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<td>1.8</td>
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**GDP growth**

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<tr>
<th>Actual</th>
<th>Carry-over</th>
<th>Nowcast</th>
<th>Forecast</th>
<th>Annual forecasts (y/y)</th>
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<tr>
<td>Q3 2022</td>
<td>0.3</td>
<td>0.1</td>
<td>0.1</td>
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<td>Q4 2022</td>
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<td>Q1 2023</td>
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<td>Q2 2023</td>
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<td>0.3</td>
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<td>2022 (observed)</td>
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<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>2023</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
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<tr>
<td>2024</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
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</table>

The indicators are all transformed into “z-scores”, i.e. deviations from the long-term average value (expressed in standard deviation), the average of which is zero (except for the PMI/ISM indices where the average is 50, the threshold between the expansion zone and the contraction zone of the activity). Positive (negative) values indicate the number of standard deviations above (below) the mean value. Leading note: the red colour indicates dynamic activity, high inflation and low unemployment, the blue colour indicates slower activity, low inflation and high unemployment.

See the Nowcast methodology, Contact: Tarik Rharrab
Source: Refinitiv, BNP Paribas
And now, disinflation

German inflation resumed its downward trend, after stabilising between May and August (6.4% y/y in August according to the harmonised index), to reach 4.3% in September, due, firstly, to base effects (seasonally adjusted inflation was 2.3% m/m in September 2022, compared to a more normal 0.3% in September 2023). We expect a further drop in inflation of nearly 1 pp in October for the same reason (+1.1% m/m in September 2022 1 pp above the average for October over the last 15 years). Underlying inflation also fell to 4.8% y/y in September after a high of 6.3% in August 2023. In September–October 2022, energy inflation had been clearly passed onto underlying inflation, and the drop in the former has since an impact on the latter (average monthly rise in seasonally adjusted underlying inflation of 0.2% over the last 3 months, compared to 0.4% over the previous 6 months and 0.6% in H2 2022).

This drop in inflation can also be explained by the slowdown in demand. Household consumption has not supported growth since Q3 2022 (down in Q4 2022 and Q1 2023, stabilisation in Q2 2023). The GfK Consumer Confidence Index stood at -26.5 in October, having remained close to this level for 6 months now, well below its pre-Covid average (+6 between 2001 and 2019). For the time being, the opportunity to make major purchases has hit an all-time low, at 5.8% of respondents in August 2023 according to the European Commission: since April 2022, this has been under 10%, a level below which it had not fallen during the 2008 crisis.

This reduced consumer demand is being reflected in new factory orders, the 6-month average of which, at end-August 2023 was 6% lower than the average seen in August 2022. This reduction can be primarily explained by lower domestic orders (-6%, including -19% on durable goods) and foreign orders outside the eurozone (-6.5%, including -18% on durable goods). Demand constraints also weighed on the business climate, with the IFO current conditions index reaching a new low of 88.7 in September 2023 (-5 points in 3 months).

These developments, along those seen in the IFO’s Employment Barometer (95.8 in September), which has been below its long-term average for 3 months now, suggest a downward risk for growth: H2 2023 should, according to our forecasts, mark a new recession (-0.1% q/q in Q3 and Q4) after already negative growth in Q4 2022 and Q1 2023 and zero growth in Q2 2023.

Stéphane Colliac (completed on 19 October 2023)
Smoothing the impact of a shock also means delaying some of its effects

The hierarchy has changed: French inflation, which was well below inflation in the eurozone, is now higher (5.7% in September compared to 4.3% y/y, according to the harmonised index). On average, French inflation even exceeded its June-July level by nearly 0.5 points in August-September (compared to a drop of 0.6 points in the euro zone). This was due to the rebound in energy prices, which was stronger in France, particularly with the increase in the regulated electricity tariff in August 2023 (+10%). Conversely, the drop in underlying inflation continued (3.6% y/y in September compared to 4.3% in July).

This is mainly due to stabilisation of the (seasonally adjusted) index for manufactured goods prices between April and September.

Consumer confidence fell in September to 83, after standing at 85 for three months. The rise in inflation affected consumers’ perception of their personal financial situation and standard of living. The opportunity to save returned to its highest levels (excluding the Covid period) seen in February 2023 - standing at 37 in September - indicating that the household savings rate (18.8% of gross disposable income in Q2, almost 4 points above the average observed in 2019) should remain high.

The continuation of more moderate consumer demand for several quarters now, is starting to affect order books in industry: for example, according to the European Commission, order books in the automotive sector fell to 3.5 months in July, their average level in 2019 (compared to an average of 4.3 months in H1 2023). This lower demand has also impacted production: September’s past production figure in the INSEE survey in industry (which refers to the previous three months, i.e., Q3) is negative, at -6 (compared to +3 in June and +5 as the historic average). This can be explained by the figures for the automotive, other transport equipment and cyclical sectors (chemicals, plastics, metals).

The more positive elements (recovery in production and exports of transport equipment, investment by companies) allowed positive growth to be maintained until Q2. We had expected negative elements to drive negative growth in Q3 (growth forecast at -0.2% q/q). However, our nowcast suggests that growth may have remained in positive territory (0.1% q/q), in line with a more moderate INSEE employment climate than before, but still above its long-term average in Q3 (at 104 on average). If this were the case, it could simply mean a delayed slowdown, which might happen, for example, in Q4.

Stéphane Colliac (completed on 19 October 2023)
Employment continues to rise

Household confidence has dropped slightly since April. This reflects a decline in purchasing intentions for durable goods and a deterrioration in the outlook for unemployment. Nevertheless, the Italian labour market remains on track. Unemployment fell to 7.3% in August, its lowest rate in fifteen years. As a result of this drop, recruitment problems are intensifying: the proportion of companies citing labour shortages as a factor limiting production was, in Q2 2023, the largest seen since the early 1990s. Although the working population is far from having closed the gap between the levels seen in 2019 (the deficit was 1.3% in August compared to the peak in April 2019), employment has continued to rise very significantly. This has helped to raise the employment rate (to 61.5% for 15–64-year-olds) to a level not seen in at least twenty years, the current statistics going back only to 2004).

Despite a tighter labour market, the increase in wages remains limited. The latter was up 3.2% y/y and is still significantly below inflation, which rose almost twice as fast in September, to 5.6%. Italian household purchasing power thus continues to contract, which is holding back private consumption. While not having fallen, private consumption is hovering just above its 2019 levels. There is also significant divergence in trajectory between the various consumption items; On the one hand, spending on services and durable goods are relatively high, having risen since the beginning of the year. On the other hand, consumption of non-durable goods is falling. This decline corroborates the drop seen in retail sales for several months now, mainly due to lower food consumption, which touched a twenty-year low in September.

After a contraction in Q2 (-0.4% q/q), real GDP should nevertheless pick up again in Q3, helped by a slightly more favourable inflationary environment. A further slowdown is expected in Q4. Growth for 2023 will remain moderate at 0.8% but higher than our expectations for the euro zone as a whole (+0.5%).

Guillaume Derrien (completed on 16 October 2023)
The inflationary risk is emerging again

In September, the European Commission’s economic sentiment indicator fell to its lowest level of the year in Spain. This reflects a slowdown in activity which, according to our forecasts, will result in a slowdown in growth to 0.3% q/q in Q3 and 0.2% q/q in Q4. Inflation also is regaining ground and is again weighing on household confidence, as is the modest deterioration in the unemployment expectations index. It should be noted that the outlook for price developments differs quite significantly depending on the sector, according to the European Commission’s survey; it indicates a new pullback in price pressures in construction (-1.9 pts) and industry (-1.6 pts, the lowest since January 2021), while an upturn is observed in services (+3.1 pts), and more particularly, retail sales (+10 pts).

The consumer price index (CPI) rose 3.3% year-on-year in September on a harmonised basis (3.5% for the national measure), i.e. the third consecutive month of increase. Deflation in the energy component remains significant (-14.0% y/y), but its magnitude will decrease significantly in the coming months, before returning to positive territory, due to the current rise in oil prices and unfavourable base effects. Inflation in most major food items (eggs, milk, fresh vegetables) remains above 10% y/y; despite its small weight in the CPI basket – only 0.5% – olive oil, for example, continues to record impressive price increases (+41.9% y/y) and thus contributed 0.22 percentage points to headline inflation in September. Inflation in services has stabilised at a high level (4.7% y/y).

Job creation slowed significantly this summer compared to the previous quarter (+15,651 net creations per month on average in Q3 after +52,196 in Q2), but the labour market has been able to withstand the interest rate shock and the slowdown in activity in the euro zone up until now. This job resilience should support household consumption, in addition to likely new government measures to protect purchasing power. While some decisions have already been announced in the 2024 budget plan, sent to the European Commission on 15 October (rise in retirement pensions, 2% increase in public service remuneration), others may be added once the new government is in place, which may, however, take some time.

Guillaume Derrien (completed on 16 October 2023)
Household sentiment is eroding

Business climate has marginally weakened in September in the United States due to diverging developments in the Manufacturing and Non-Manufacturing sectors. The latter has slowed to 53.6 (-0.3pp) in the ISM survey, torn between a vigorous activity (‘Business Activity’ component standing at 58.8) and a large drop in ‘New Orders’ (51.8, -6.7pp). On the other hand, the ISM Manufacturing index rose for a third month in a row and reached 49.0 (+1.4pp), thereby reaching a 10-month high despite remaining in the contraction area.

Household sentiment remained on a downward trend. Consumer confidence as measured by the Conference Board dipped to 103.0 (-5.7 pts) in September, driven down by the deterioration of expectations (73.7, -9.6 pts). The survey exhibits a double recessionary signal, with a below-80 result in the Expectations index adding to the existing and pursuing divergence with the assessment of Current Conditions (147.1, +0.4pp). As for the University of Michigan sentiment index, it decreased in October for the third month in a row (63.0, -1.3pts), and contrasts with the Conference Board index by the low level of the Current Conditions component (68.7). Furthermore, the survey reported a sharp rebound in 1-year ahead inflation expectations (3.8%, +0.6pp). These negative developments are to be linked with the summer spike in gasoline prices.

The CPI inflation rate was stable at +3.7% y/y in September. The less negative contribution of the Energy component (+0.6% q/q) was more than offset by the positive changes in food and core inflation. The latter has decreased to +4.1% y/y (−0.3pp) while stabilizing in monthly terms (+0.3% SA), despite the acceleration in housing services (+0.6% q/q). Anis Bensaidani (completed on 16 October 2023)
The labour market is deteriorating

The UK labour market has reached a tipping point. For the Bank of England (BoE), in addition to the slowdown in the housing market, this is a further indication of the wider transmission of the rise in interest rates to the real economy. The ONS labour market report for September was postponed until October 24th. Nevertheless, data from the HMRC indicated an 8,360 drop in employees last month; this is the second consecutive monthly fall and a steeper decline than in the previous month (-5,071). Furthermore, the PMI employment indices fell sharply in September, pulled down by services (-3.3 points to 47.9), which slipped below the rate of expansion for the first time since the beginning of the year.

In addition, inflation surprised on the upside in September, remaining at 6.7%. A drop is nevertheless expected in the coming months: on a 3m/3m annualised rate, the rise in consumer prices has slowed sharply below the 2% mark, to 1.9%). Nevertheless, the extent of disinflation remains uncertain due to the recent rebound in oil prices. Growth in regular pay fell slightly to 7.7% y/y in September, but is expected to remain above inflation, at least until the end of the year. With regards to the housing market, the y/y drop in prices intensified in September to -4.7% according to Halifax, while it stabilised at -5.3% according to the Nationwide Index.

Against this backdrop, the UK economy is expected to record very weak growth in Q3, which we currently forecast at 0.1% q/q. To achieve this figure however, the end of Q3 will need to be better than the start. According to ONS monthly figures, real GDP rose slightly by 0.1% m/m in August. However, this only partially offsets the 0.8% m/m contraction recorded the previous month (N.B. the monthly figures are based on value added and not real GDP).

Guillaume Derrien (completed on 18 October 2023)
Labour shortages are weighing on activity

Japanese economic surveys are sending out mixed signals. On the positive side, the business condition index from the Tankan survey improved from 8 in Q2 to 10 in Q3, driven by services: business confidence in the sector was the highest since 1991. The PMI for services is also proving resilient. Although down 0.5 points in September, it remains in expansionary territory at 53.8. Conversely, the manufacturing PMI fell further into the contraction zone for the fourth consecutive month (-1 point to 48.5). As a result, the composite PMI dipped to 52.1 in September. The Economy Watchers Survey dropped from 3.7 points to 49.9 points in September.

Japanese inflation fell slightly to 3.2% y/y in August (compared to 3.3% in the previous month). Food products remain the main contributor to price rises (+8.8% y/y for a contribution of 2.3 pp to headline inflation). Conversely, energy deflation is intensifying (-9.8% y/y), subtracting, as a result, nearly 1 pp from headline inflation. However, pressure on production prices is easing. The PMI index slowed by 1.3 pp to 2% y/y in September, suggesting a stabilisation or even a drop in consumer price inflation in the coming months. This signal is in line with the fall in inflation in the Tokyo region to under 3% in September. However, the yen's historic depreciation continues, and the exchange rate with the US dollar is now close to USD/JPY 150, which is likely to fuel more imported inflation.

The historic labour shortage represents a further challenge. The employment diffusion index from the Tankan survey dropped to -33 in Q3 and could reach -37 in Q4 according to the latest forecasts. If this were to happen, this would be the lowest level seen since 1991. At 2.7% in September, the unemployment rate remained stable and 0.5 pp above the 2.2% low posted in December 2019. Despite the tight labour market, nominal wages are still not rising, and real wages remain in negative territory, at -2.5% y/y in August. This is impacting household confidence, as well as household consumption, which fell year-on-year in August for the 6th consecutive month (-3.4% y/y), according to the monthly survey by the Ministry of Labour.

Against this backdrop, we anticipate a slowdown in activity in Q3 (growth of 0.1% q/q after reaching 1.0% on average per quarter in H1), before a slight recovery in Q4 (0.3% q/q). However, favourable carry-over effect in 2022 should keep growth at a relatively high level of 2.0% y/y for 2023 as a whole.

Guillaume Derrien (completed on 16 October 2023)
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