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ECONOMIC RESEARCH

BNP PARIBAS

The bank
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world

ECB: TOUGH TALK AND PUZZLING PROJECTIONS

During the press conference following the latest governing council meeting, Christine Lagarde insisted repeatedly that moving to a 50 bp rate hike versus 75 bp previously did not represent a pivot, adding that rates still have to rise significantly and at a steady pace. Consequently, the likelihood of a terminal rate higher than 3.00% has increased, which explains the jump in bond yields. The large upward revision of the inflation projections is probably another factor behind the hawkish message. Forecasting inflation several years into the future is a difficult task, even more so in the current environment. It will be interesting to see how the governing council will strike a balance between reacting to inflation data, once they have started to decline, and focusing on the ECB's medium-term inflation projections in setting its policy.

The latest press conference following the ECB's governing council meeting brought tough talk. In the word cloud (chart 1), the 'usual suspects' again take a central position -inflation, rates, energy, etc.- but there are some notable others -will, steady, pace- that reflect the determination to send a strong message. 'Significant' or 'significantly' appear 16 times in the comments of Christine Lagarde, who also mentioned 'steady' 13 times. Policy rates will continue to move higher because the monetary stance needs to become sufficiently restrictive to bring inflation back to the two percent medium-term target[1]. The repeated insistence on 'steady pace' of raising the policy rates can be considered as a near-term forward guidance, despite the usual insistence on a data-dependent, meeting-by-meeting approach. Having in mind what was said at last week's press conference, one should expect further 50 basis points rate hikes at the next two meetings -2 February 2023, 16 March 2023-, whereby the latter will be particularly important, considering that new staff projections will be published on that occasion. As mentioned by the ECB president, "*On the issue of interest rates, we will be looking at data. We will be data-dependent, and we will review data, particularly when we have projection meetings that are every three months or so*[2]." Under the assumption that at the March 2023 governing council meeting, the deposit rate would be hiked to 3.00%[3], this meeting might see a change in language, which would become less hawkish, provided that inflation projections would have been revised downwards. Such a change would be considered by markets as a pivot, a clear change in policy orientation, whereby possible additional moves beyond 3.00% would come in smaller steps and more slowly. At the current juncture, the conditions for such a pivot are not met and on four occasions during the press conference, Christine Lagarde insisted that the ECB was not pivoting. It was a clear effort to avoid that markets would draw the wrong conclusion from moving from 75 bp increases previously to 50 bp. Undoubtedly the hawkish tone -the repeated reference to a sustained pace of tightening- serves the same purpose.

Another factor that has played an important role in the messaging is the large upward revision of the inflation projections, by 0.3 percentage points (pp) in 2022, 0.8 pp in 2023 and 1.1 pp in 2024. At first glance, there is something puzzling about the extent of the upward revision. Compared to the September projections, there are several areas of improvement: lower oil, gas and electricity price assumptions, a faster easing of supply bottlenecks, the recent appreciation of the euro, a weaker growth outlook. The impact of these factors is however dominated by "*recent data surprises, a reassessment of the strength and persistence of pipeline price pressures and their pass-through, stronger wage growth and higher food commodity prices.*[4]"

1. "*In particular, we judge that interest rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive to ensure a timely return of inflation to our two per cent medium-term target.*" (Source: ECB, Monetary policy statement and press conference, Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB, 15 December 2022.
2. Source: see footnote 1.
3. Following last week's meeting, the current level is 2.00%.

4. Source: ECB, Eurosystem staff macroeconomic projections for the euro area, 15 December

WORD CLOUD OF THE ECB PRESS CONFERENCE OF 15 DECEMBER 2022

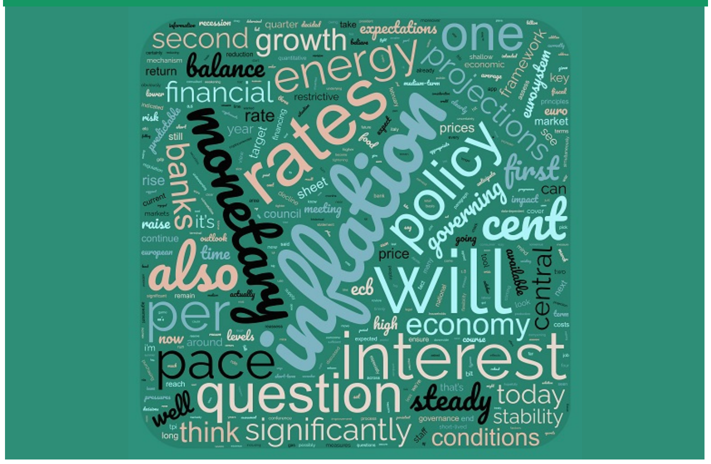


CHART 1 SOURCE: ECB, WORDCLOUDS.COM, BNP PARIBAS

> At a time when forecasting inflation is more difficult than ever, having good forecasts is more important than ever when they are a key input in determining the appropriate level of monetary restraint.

Headline inflation, after dropping in 2023, would stabilise in 2024, but stay above the ECB's target, before declining again in 2025, when it would reach the ECB's 2% inflation target in the second half of that year (chart 2). Core inflation would remain above this target for the entire forecast horizon, which runs until the end of 2025.Forecasting inflation several years into the future is a difficult task. A Bundesbank research paper of 2018[5] has shown that for the euro area, consensus forecasts of inflation are informative up to a horizon of 3 to 5 quarters. The authors nevertheless argue that "*despite what our results say, it can make sense to produce macroeconomic projections for three years ahead, as the Eurosystem does*." However, over longer horizons "*the projections should be regarded less as forecasts and more as scenario analyses which shed light on the interrelationships influencing economic developments*." This point seems very relevant in the current environment, where inflation is the result of multiple supply and demand shocks that make it very challenging to assess the pass-through of these shocks but also to assess how fast it will react to monetary policy tightening and an economic downturn. It will be interesting to see how the governing council will strike a balance between reacting to inflation data, once they have started to decline, or focusing on the ECB's medium-term inflation projections in setting its policy. At a time that forecasting inflation is more difficult than ever, having good forecasts is more important than ever when they are a key input in determining the appropriate level of monetary restraint.

William De Vijlder

ECB PROJECTION OF EUROZONE HICP

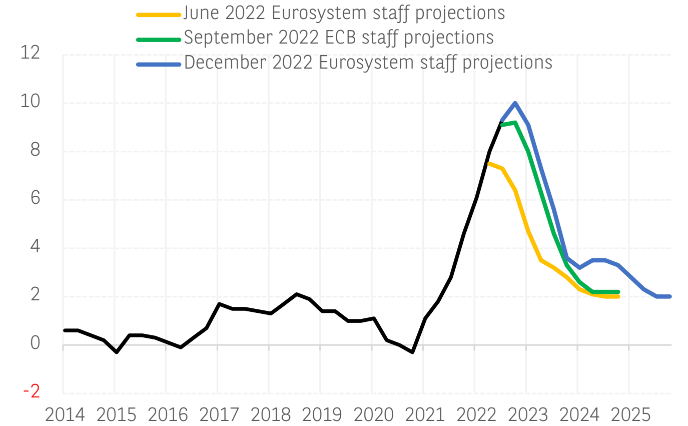


CHART 2

SOURCE: EUROSTAT, ECB, BNP PARIBAS

2022. In addition, "new fiscal measures decided since the September 2022 projections, most of which aim at reducing energy price increases in 2023, dampen the upward revision to inflation in 2023, but contribute significantly to the upward revision in 2024 as many of the measures expire."

5. Jörg Breitung and Malte Knüppel, The trouble with predictions, Deutsche Bundesbank research brief, April 2018.

MARKETS OVERVIEW

OVERVIEW

Week 9-12 22 to 16-12-22

↘ CAC 40	6 678	▶ 6 453	-3.4	%
↘ S&P 500	3 934	▶ 3 852	-2.1	%
↘ Volatility (VIX)	22.8	▶ 22.6	-0.2	pb
↗ Euribor 3M (%)	2.01	▶ 2.05	+4.2	bp
↗ Libor $ 3M (%)	4.73	▶ 4.75	+1.3	bp
↗ OAT 10y (%)	2.39	▶ 2.68	+29.4	bp
↗ Bund 10y (%)	1.93	▶ 2.16	+23.4	bp
↘ US Tr. 10y (%)	3.57	▶ 3.48	-8.5	bp
↗ Euro vs dollar	1.05	▶ 1.06	+0.7	%
↘ Gold (ounce, $)	1 798	▶ 1 790	-0.5	%
↗ Oil (Brent, $)	76.4	▶ 79.2	+3.6	%

MONEY & BOND MARKETS

Interest Rates		highest 22		lowest 22	
€ ECB	2.00	2.00 at	02/11	0.00 at	03/01
Eonia	-0.51	-0.51 at	03/01	-0.51 at	03/01
Euribor 3M	2.05	2.08 at	14/12	-0.58 at	05/01
Euribor 12M	2.99	2.99 at	16/12	-0.50 at	05/01
$ FED	4.50	4.50 at	15/12	0.25 at	03/01
Libor 3M	4.75	4.78 at	30/11	0.21 at	03/01
Libor 12M	5.48	5.67 at	04/11	0.58 at	03/01
£ BoE	3.50	3.50 at	15/12	0.25 at	03/01
Libor 3M	3.78	3.82 at	13/12	0.26 at	03/01
Libor 12M	0.81	0.81 at	03/01	0.81 at	03/01

At 16-12-22

Yield (%)		highest 22		lowest 22	
€ AVG 5-7y	2.64	2.79	at 28/09	-0.04	at 03/01
Bund 2y	2.35	2.35	at 16/12	-0.83	at 04/03
Bund 10y	2.16	2.44	at 21/10	-0.14	at 24/01
OAT 10y	2.68	3.00	at 21/10	0.15	at 04/01
Corp. BBB	4.39	5.14	at 21/10	0.90	at 05/01
$ Treas. 2y	4.30	4.78	at 07/11	0.70	at 04/01
Treas. 10y	3.48	4.23	at 24/10	1.63	at 03/01
High Yield	8.71	9.97	at 13/10	5.07	at 03/01
£ gilt. 2y	3.55	4.59	at 27/09	0.69	at 03/01
gilt. 10y	3.33	4.50	at 27/09	0.97	at 03/01

At 16-12-22

EXCHANGE RATES

1€ =		highest 22		lowest 22		2022
USD	1.06	1.15 at	10/02	0.96 at	27/09	-6.7%
GBP	0.87	0.90 at	28/09	0.83 at	14/04	+4.1%
CHF	0.99	1.06 at	10/02	0.95 at	28/09	-4.5%
JPY	145.08	147.34 at	26/10	125.37 at	04/03	+10.8%
AUD	1.59	1.62 at	04/02	1.43 at	25/08	+1.6%
CNY	7.40	7.49 at	28/11	6.75 at	14/07	+2.1%
BRL	5.61	6.44 at	06/01	4.98 at	03/11	-11.5%
RUB	68.79	164.76 at	07/03	55.60 at	26/09	-19.4%
INR	87.97	88.14 at	15/12	78.49 at	27/09	+4.1%

At 16-12-22 *Change*

COMMODITIES

Spot price, $		highest 22		lowest 22		2022	2022(€)
Oil, Brent	79.2	128.2 at	08/03	76.3 at	08/12	+1.0%	+8.2%
Gold (ounce)	1 790	2 056 at	08/03	1 628 at	03/11	-1.8%	+5.2%
Metals, LMEX	3 915	5 506 at	07/03	3 453 at	27/09	-13.0%	-6.8%
Copper (ton)	8 234	10 702 at	04/03	7 160 at	14/07	-15.5%	-9.4%
wheat (ton)	271	4.7 at	17/05	254 at	06/12	+14.1%	+22.2%
Corn (ton)	253	3.2 at	28/06	226 at	03/01	+1.1%	+18.8%

At 16-12-22 *Change*

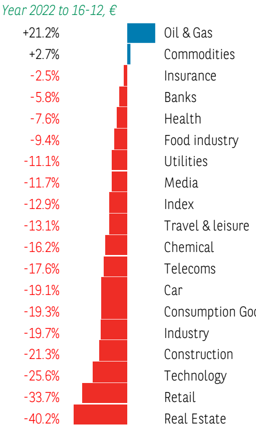
EQUITY INDICES

	Index	highest 22		lowest 22		2022
World						
MSCI World	2 606	3 248 at	04/01	2 368 at	12/10	-19.4%
North America						
S&P500	3 852	4 797 at	03/01	3 577 at	12/10	-19.2%
Europe						
EuroStoxx50	3 804	4 392 at	05/01	3 279 at	29/09	-11.5%
CAC 40	6 453	7 376 at	05/01	5 677 at	29/09	-1.0%
DAX 30	13 893	16 272 at	05/01	11 976 at	29/09	-12.5%
IBEX 35	8 113	8 934 at	27/05	7 261 at	12/10	-0.7%
FTSE100	7 332	7 672 at	10/02	6 826 at	12/10	-0.1%
Asia						
MSCI, loc.	1 096	1 165 at	05/01	1 012 at	30/09	-0.4%
Nikkei	27 527	29 332 at	05/01	24 718 at	09/03	-4.4%
Emerging						
MSCI Emerging ($)	957	1 267 at	12/01	843 at	24/10	-2.2%
China	64	86 at	20/01	47 at	31/10	-22.7%
India	778	891 at	13/01	699 at	17/06	+2.7%
Brazil	1 374	2 003 at	04/04	1 311 at	14/07	-9.3%

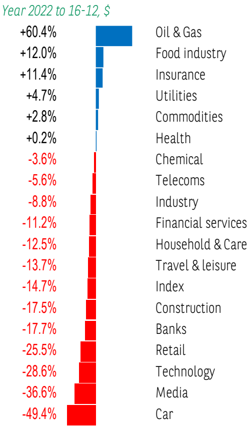
At 16-12-22 *Change*

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

Year 2022 to 16-12, €



Year 2022 to 16-12, $

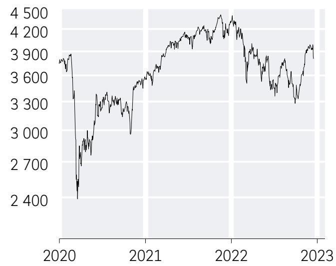


SOURCE: REFINITIV, BNP PARIBAS,

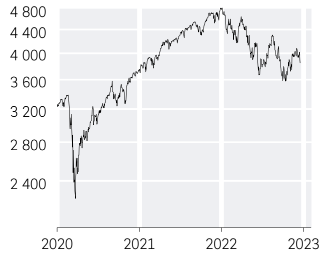
MARKETS OVERVIEW

EURO-DOLLAR

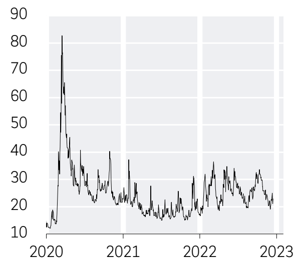
EUROSTOXX50



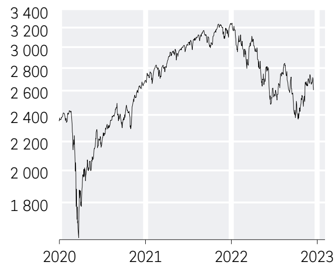
S&P500



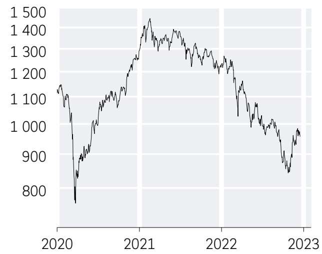
VOLATILITY (VIX, S&P500)



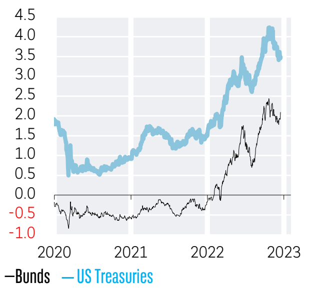
MSCI WORLD (USD)



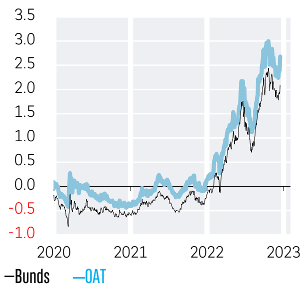
MSCI EMERGING (USD)



10Y BOND YIELD, TREASURIES VS BUND

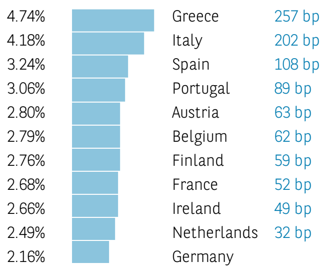


10Y BOND YIELD

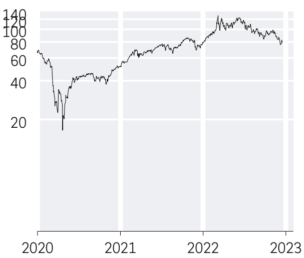


10Y BOND YIELD & SPREADS

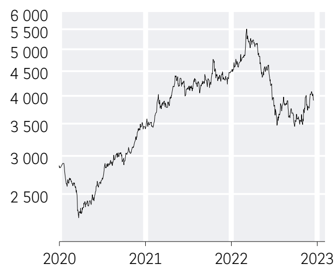
Year 2022 to 16-12



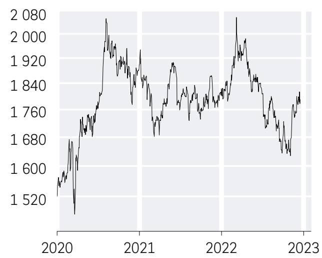
OIL (BRENT, USD)



METALS (LMEX, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS

ECONOMIC PULSE

JAPAN: CONSUMER CONFIDENCE PLUNGES, THE TANKAN EDGES HIGHER

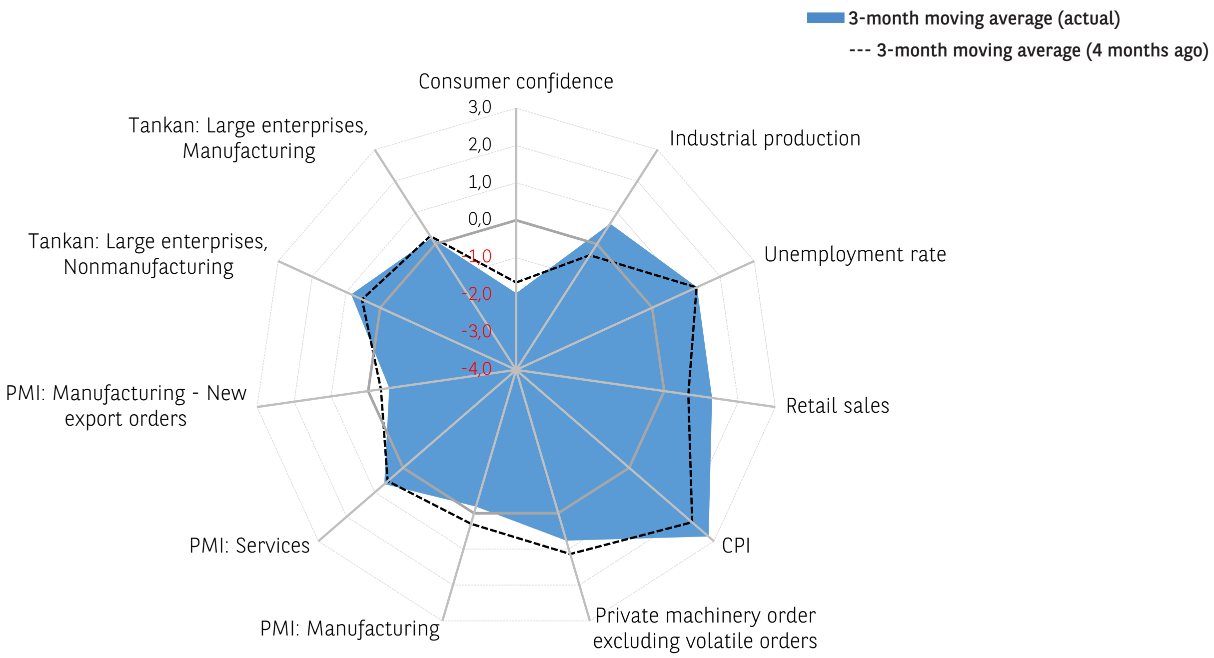
Confidence amongst Japanese consumers dropped sharply this autumn, reflecting the difficulties they are experiencing in the face of inflation rising to its highest level for more than thirty years (3.8% y/y in October). According to the Cabinet Office, consumer confidence has fallen back to its level from the summer of 2020, when the pandemic was in full swing. Meanwhile, the Tankan survey for the fourth quarter of 2022 surprised on the upside: the overall balance climbed from 3 to 6, whilst the forecast contained in the previous survey was for a one-point fall. The index has now returned to pre-Covid levels, illustrating the economy's slow and difficult recovery from the pandemic. The PMI survey for December was hardly more optimistic: the composite index rose from 48.9 to 50, taking it just into expansionary territory. Moreover, the new export orders component dipped by 1 point to 48.9.

Looking in detail at the Tankan survey, the balance of opinion has improved in manufacturing (up 2 points to 2), driven by steel (up 8 points) and textiles (up 5 points). However, the energy crisis continues to hit the chemicals and paper industries (which both saw 4-point falls). There was a bigger improvement in services (up 5 points to 10), thanks to a rebound in restaurants and accommodation (up 27 points) that can be partly attributed to the ending of Covid restrictions in mid-October. The balance of opinion on employment fell by 3 points, reflecting the continued strong pressure on recruitment (a negative balance indicates that more companies are experiencing a deficit of labour than a surplus). This is no surprise: at 2.6% in October, the unemployment rate remains at an historically low level for the country. Prior to 2016, this rate had not fallen below 3% for more than twenty years.

With regards to external balances, the trade balance improved, after an almost uninterrupted deterioration since early 2020. The deficit shrank again in November, from JPY2,207 billion to JPY1,732 billion. This improvement in the goods balance mainly reflected volume effects; last month saw a bigger fall in real imports (-6.6% m/m) than in exports (-0.1% m/m).

Guillaume Derrien

JAPAN: QUARTERLY CHANGES



SOURCE: REFINITIV, BNP PARIBAS

The indicators in the radar are all transformed into 'z-scores' (deviations from the long-term average, as standard deviations). These z-scores have mean zero and their values are between -4 and +3. In the radar chart, the blue area shows the actual conditions of economic activity. It is compared with the situation four months earlier (dotted-line). An expansion of the blue area compared to the dotted area signals an increase in the variable.

ECONOMIC PULSE

SPAIN: A WIDESPREAD EASING OF INFLATION IN SIGHT?

In its second estimate, the Spanish statistical institute (INE) raised slightly the harmonised inflation rate (HICP) for November from 6.6% y/y to 6.7% y/y. This is still a significant decline from the 10.7% y/y figure reported in July, as Spain now reports the smallest rate of inflation in the Eurozone. Energy prices, the main contributor to this deceleration, are falling back sharply, dropping from an 8% y/y increase in October to 4.5% y/y in November. The 3m/3m measure provides an even better illustration of the size of the recent decline: it dropped to -49.3%, the steepest decline since the current statistical series began in 2002. Although the core HICP (excluding energy and fresh food prices) picked up from 6.2% to 6.3% y/y, the 3m/3m (4.4%) declined for the third consecutive month, suggesting the year-on-year rate will head downward this winter.

Although peak inflation seems to have been reached, price pressures are likely to stay at a high level in 2023. To limit this risk, the government plans to expand its anti-inflation package – which proved to be effective on energy prices – to include measures to contain food prices. The specifics of this package have not been released yet[1].

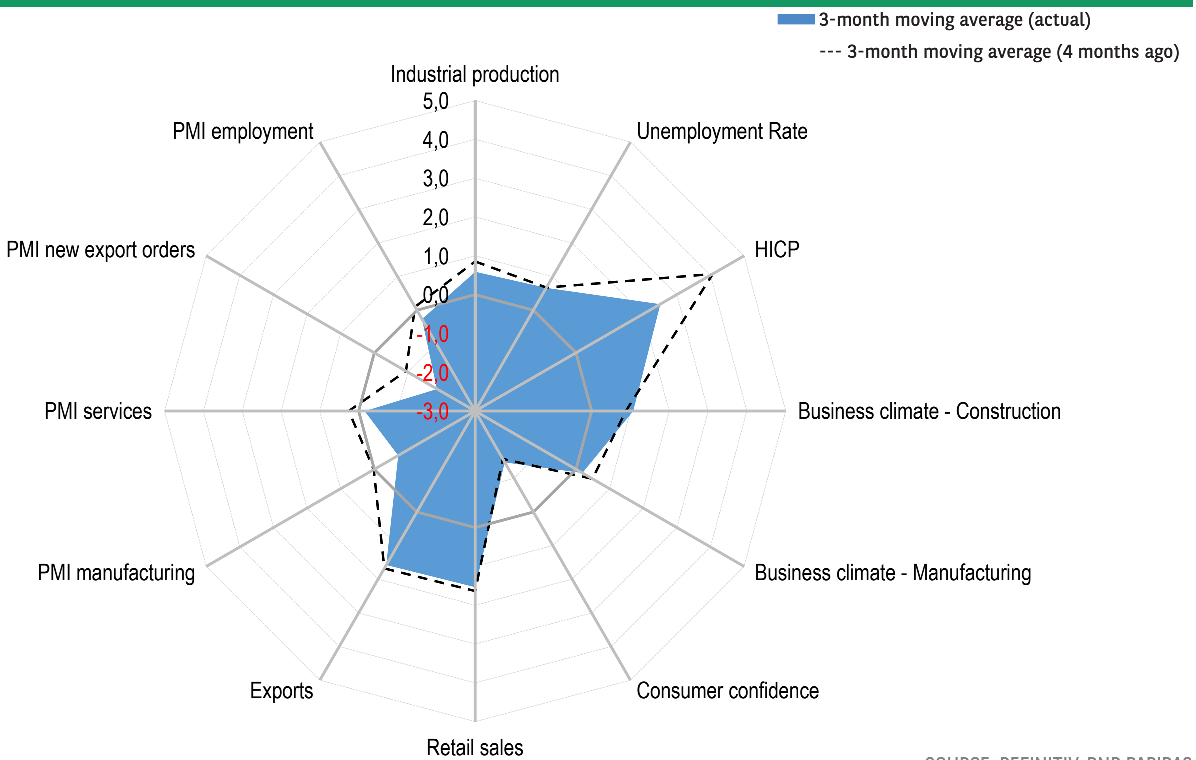
With wage growth holding below inflation, household purchasing power continues to erode. According to INE, nominal wages rose 0.7% q/q in the third quarter and 2.9% over the past 12 months. Excluding the INE category "bonuses and late payments", the increase of salaries was even smaller, up 0.3% q/q and 2.3% y/y, respectively.

Yet the level of wage increases that companies are willing to give could be hampered by the deterioration of the economic environment (as shown in our barometer). According to the European Commission survey, business confidence in Spain deteriorated in November, down 3.4 points to 7.7. This mainly reflects the increasingly clear decline in demand. The indicators for order books, export orders and production have continued to fall since spring. Although the manufacturing PMI rose slightly in November, up 1 point to 45.7, it is still largely mired in contraction territory. According to these surveys, industrial output should drop after holding flat since the beginning of the year. This is already the case in certain industries hard hit by the energy crisis, including chemicals (-10.1% since the beginning of the year), paper (-4.7%) and lumber (-15.9%).

Guillaume Derrien

1. See *El Gobierno presentará antes de fin de año un nuevo paquete de medidas para contener el precio de los alimentos* (Before year-end, the government will present a new package to contain food prices), El País, 7 December 2022.

SPAIN: QUARTERLY CHANGES



SOURCE: REFINITIV, BNP PARIBAS

The indicators in the radar are all transformed into 'z-scores' (deviations from the long-term average, as standard deviations). These z-scores have mean zero and their values are between -3 and +5. In the radar chart, the blue area shows the actual conditions of economic activity. It is compared with the situation four months earlier (dotted-line). An expansion of the blue area compared to the dotted area signals an increase in the variable.

ECONOMIC PULSE

UNITED KINGDOM: PEAK INFLATION?

UK inflation finally fell in November to +10.7% y/y (+0.4% m/m), compared with +11.1% in October (+2% m/m). Other good news is that core inflation is also falling, for the first time since September 2021 (-0.2 points, i.e. 6.3% y/y). In the face of still very high inflation, however, the Bank of England (BoE) Monetary Policy Committee (MPC) decided to raise its key rate further by 50 basis points, thus bringing it to 3.5%. The rise is less significant than in November (+75 bp) as the BoE must also reconcile it with the risk of recession.

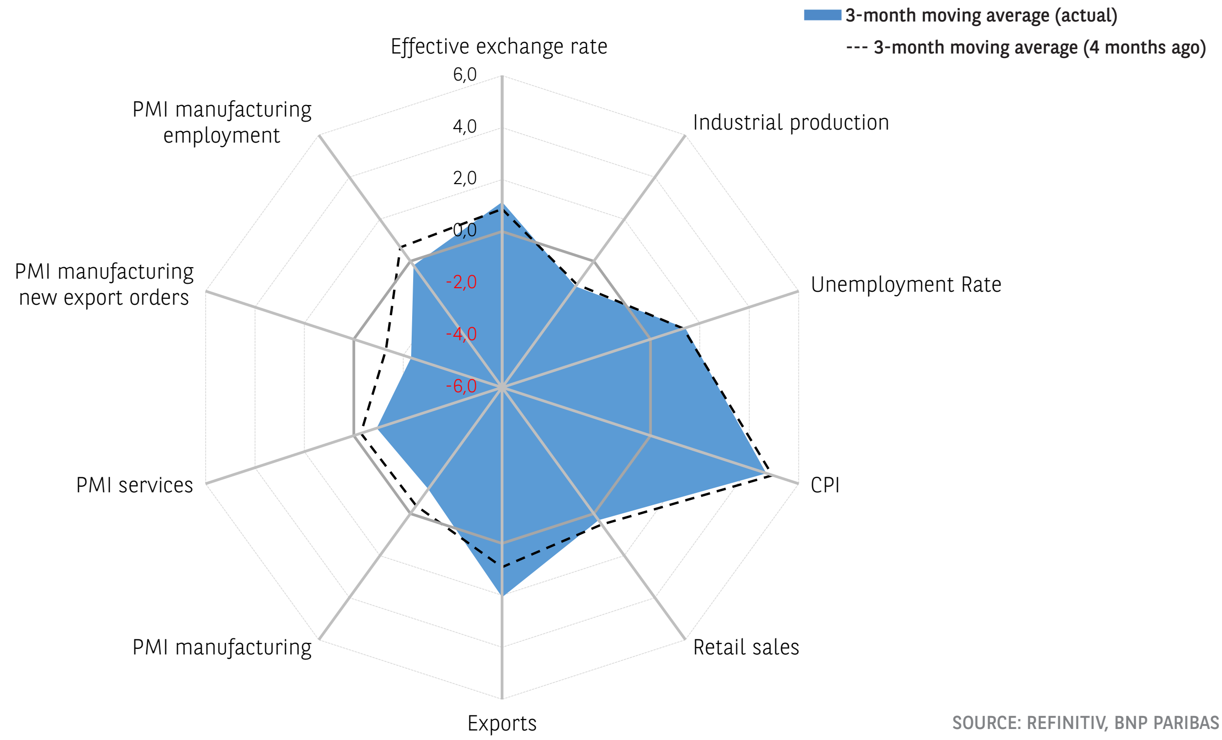
While BoE Governor Andrew Bailey said inflation had peaked, he expressed concern that UK companies would keep raising prices too fast for too long, for two reasons. In October, the upturn in inflation was mainly driven by the increase in electricity prices (+17% m/m) and gas prices (+37% m/m), despite the implementation of the energy price guarantee. This cap on energy prices did have an effect in November and mechanically helped to limit the rise in inflation. However, it is not expected to be renewed for companies from the end of March 2023. And yet the lifting of this measure should expose them to a sharp increase in their operating costs, which is likely to have a repercussion on sale prices.

Furthermore, the slowdown in the price of goods remained limited in November. The prices of food, alcoholic beverages and tobacco (+12.7% y/y, compared to 13.2% in October) and industrial goods (+14.6%, compared to 15.4%) are decelerating, but the pace of the rise remains higher than in September. Although inflation in general is expected to move gradually lower, in retail trade this evolution will probably be more limited. According to the Confederation of British Industry's (CBI) Distributive Trades Survey (DTS), the vast majority of wholesale and retail trade companies are expecting short-term price increases, which would dampen disinflation. Inflation in services remained stable, at 6.3% year-on-year (i.e. +0.2% m/m). The CBI's Service Sector Survey (SSS) suggests that the slower price increase is likely to continue, although the balance of responses expecting a price increase in the next three months remains particularly high.

The new hike in the BoE's key interest rate is also increasing pressure on households: already penalised by the increase in the cost of living, their financial situation is also deteriorating due to the effect of the rise in interest rates on mortgages. However, in its Financial Stability Report (FSR), the BoE's Financial Policy Committee (FPC) indicates that households are more resilient than during the 2007 financial crisis and the recession in the early 1990s: the proportion of disposable income spent on mortgage payments is expected to rise but remain below the record levels reached in 2007 and the 1990s.

Félix Berte

UK: QUARTERLY CHANGES



SOURCE: REFINITIV, BNP PARIBAS

The indicators in the radar are all transformed into 'z-scores' (deviations from the long-term average, as standard deviations). These z-scores have mean zero and their values are between -6 and +6. In the radar chart, the blue area shows the actual conditions of economic activity. It is compared with the situation four months earlier (dotted-line). An expansion of the blue area compared to the dotted area signals an increase in the variable.

COVID-19: NINTH WAVE OF THE PANDEMIC

3.9 million new cases were counted between 7 and 13 December, compared with approximately 3.6 million the previous week, representing an increase of 8.3%. This is the fifth consecutive week of rising infections, a development that is all the more noteworthy as all regions reported an increase in weekly cases, with the exception of Africa, which reported a fall of 17%. North America stood out with a markedly higher increase (25%), followed by South America (13%), Europe (6%) and Asia (2%) (figure 1). Asia alone accounted for 43.6% of the 3.9 million new cases around the world, with 1.7 million infections.

On a weekly basis, Japan once again recorded the highest number of new cases (931,313, +9% compared to the previous week), followed by the United States (505,152, +26%), France (480,713, +16%), South Korea (472,954, +11%), Brazil (242,511, +15%), Germany (226,241, +9%), Australia (123,488, +8%) and Hong Kong (94,115, +35%). In China (183,960, -35%), Italy (165,971, -37%) and Taiwan (114,430, -2%), the number of new cases fell compared to the previous week, but they remain at a high level.

Vaccination coverage also continues to increase, but at a progressively slower rate. To date, 13 billion doses of vaccine have been administered worldwide since the start of the campaigns in Q4 2020, including 2.65 billion booster doses. As a consequence, almost 68.6% of the global population have received at least one dose of vaccine (figure 2).

Tarik Rharrab

DAILY CONFIRMED COVID-19 CASES (7-DAY MOVING AVERAGE)

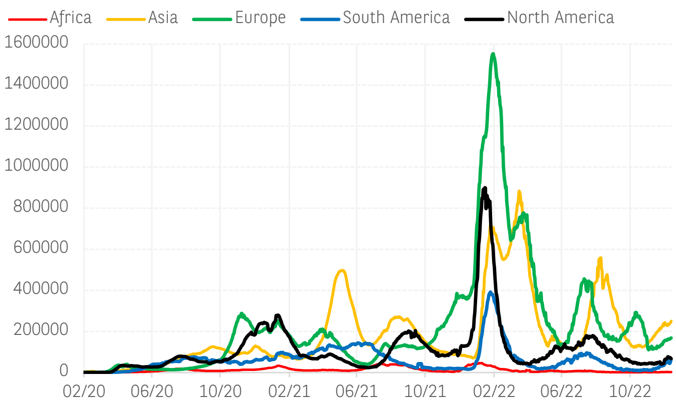


CHART 1 SOURCE: JOHNS-HOPKINS UNIVERSITY (14/12/2022), BNP PARIBAS

SHARE OF PEOPLE WHO RECEIVED AT LEAST ONE DOSE OF VACCINE

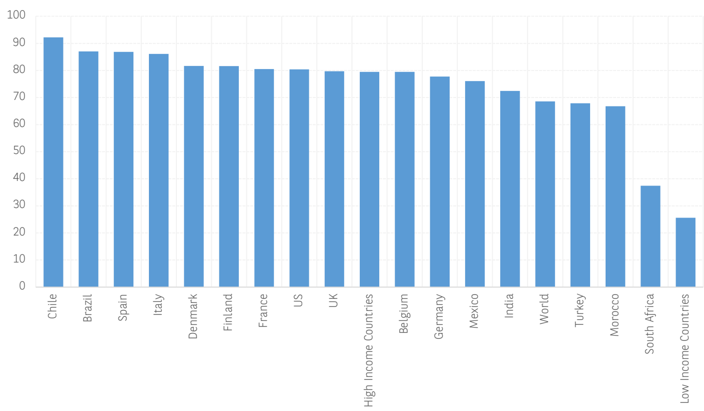
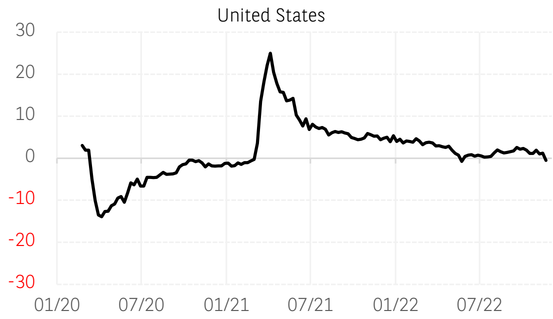
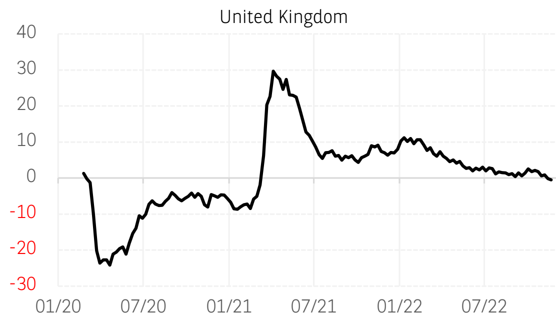


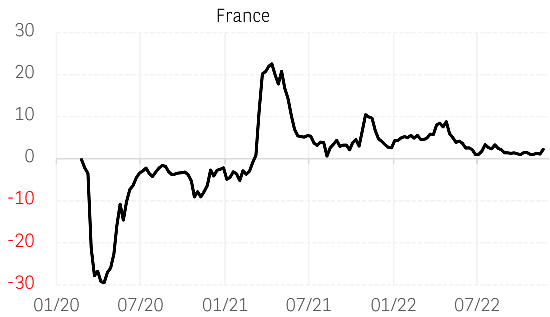
CHART 2 SOURCE: OUR WORLD IN DATA (15/12/2022), BNP PARIBAS

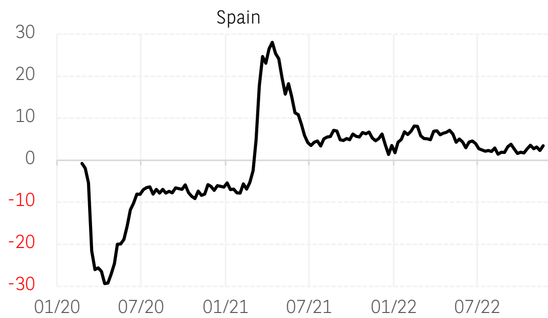
OECD WEEKLY TRACKER

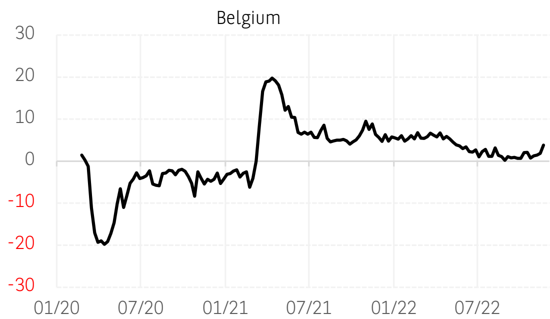
OECD Weekly tracker, y/2y GDP growth [RHS]







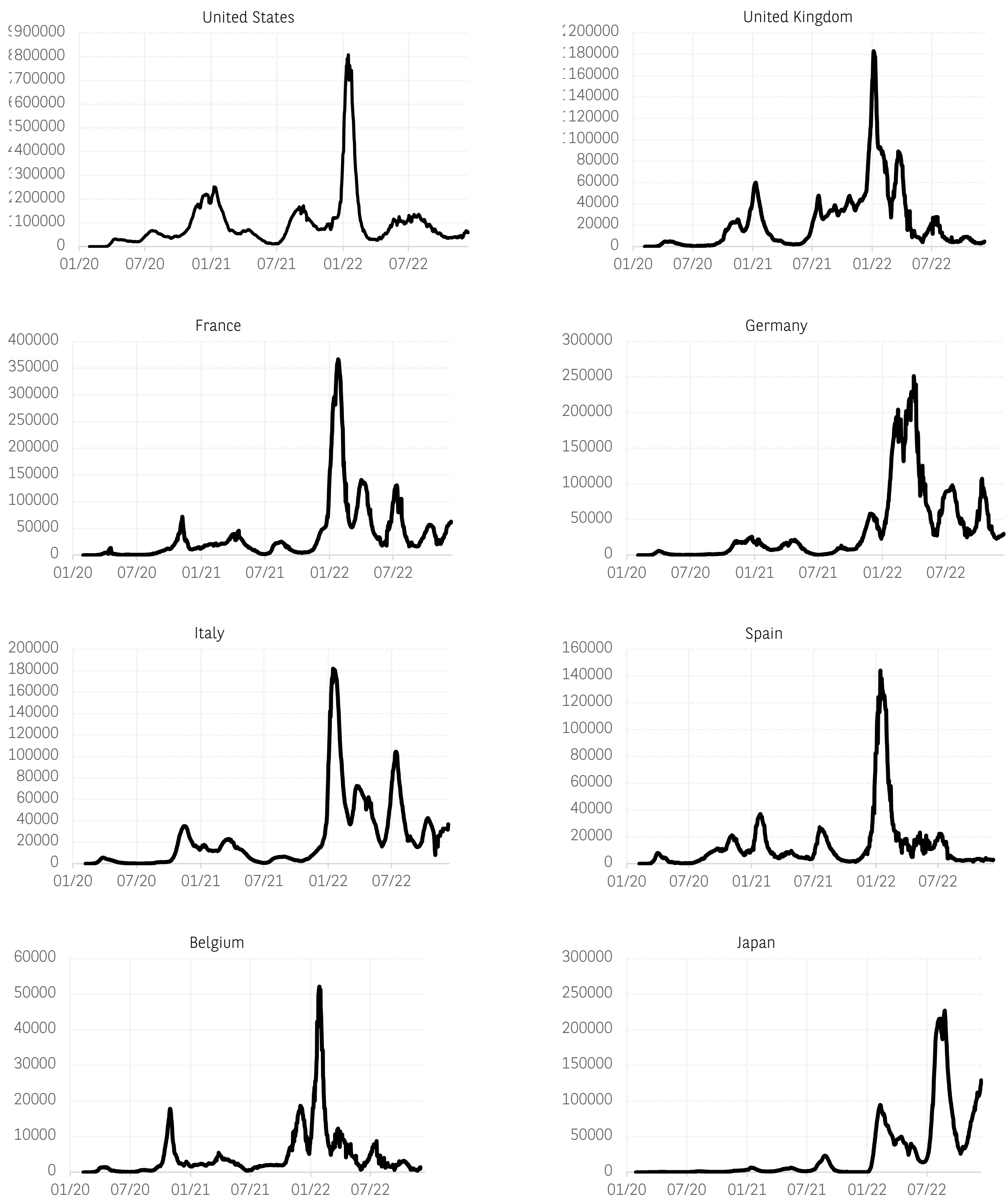




SOURCE: OECD, BNP PARIBAS (01/12/2022),

DAILY NEW CASES

Daily new confirmed cases of Covid-19 (7-day moving average)



SOURCE: JOHNS-HOPKINS UNIVERSITY, BNP PARIBAS (14/12/2022)

ECONOMIC SCENARIO

UNITED STATES

The US economy rebounded strongly during Q3, following two quarters of negative growth, thanks to healthy performances in corporate investment, household spending and, in particular, exports. The labour market is showing very early signs of a slowdown, but job creation remains high, the unemployment rate is still low and wages are still buoyant. Inflation seems to have peaked in the middle of the year and should continue to fall while remaining significantly above the target of 2% by late 2023. Following the mid-term elections, the Democrats retained a narrow majority in the Senate and the Republicans won a very tiny majority in the House of Representatives. This should limit what President Joe Biden can do over the remainder of his term, but, at the same time, compromises could also be reached.

CHINA

The recovery of the Chinese economy since its Q2 2022 contraction has been sluggish and unbalanced. Industrial production has been the main growth driver, but it is expected to lose steam in the short term, largely due to the weakening in external demand and slower export growth. Meanwhile, activity driven by the domestic market and the services sector still struggle to strengthen. The authorities are enhancing fiscal and monetary easing measures. However, the drags on domestic demand remain powerful: the correction in the property sector continues, and the deterioration in the labour market, the still tight Covid policy in spite of small adjustments, and weak household confidence weigh on private consumption. Consumer price inflation is very moderate.

EUROZONE

Growth in the euro zone in the third quarter was weak, but at least it remained positive, while the survey data (business and consumer confidence) seemed to be clearly pointing to a decline. Although a contraction was avoided in the third quarter, the euro zone is unlikely to avoid recession. The combination of the inflationary shock, the energy crisis and the enforced monetary tightening and their increasingly negative effects are likely to overcome the resistance seen to date. However, the recession should remain shallow (a cumulative fall in GDP of 1.1% between Q4 2022 and Q2 2023) thanks to the fiscal policy cushion and the current tightness of the labour market. In annual average terms, real GDP growth in the euro zone is expected to reach 3.2% in 2022 but then turn negative in 2023 (-0.5%). The subsequent recovery is likely to be weak. Although it should start to decline towards the end of this year or the beginning of next year, inflation is likely to remain elevated, well above the 2% target at the end of next year and only falling back to it at the end of 2024, which will keep monetary policy in restrictive territory.

FRANCE

Real GDP growth has continued during the 3rd quarter (0.2% q/q, after +0.5% during the 2nd quarter), driven by a growth of manufacturing production partly explained by a recovery of sectors exposed to supply-side problems (particularly the car sector) and partly related to growing inventories in order to avoid potential stronger constraints on production during the winter. This element should weigh on Q4 GDP growth, which should also suffer from the ongoing inflation acceleration (6.2% y/y in October) towards a new peak above 7% in February (before a gradual disinflation). These shocks should weigh on GDP growth in 2023 (0% according to our forecasts, after 2.5% in 2022).

RATES AND EXCHANGE RATES

In the US, the Federal Reserve will continue its tightening policy, bringing the federal funds rate to its terminal rate for this cycle at 5.25% (upper end of the target range) in the first quarter of next year. Given the expected slow decline in inflation and despite the economy entering recession, this level should be maintained through 2023 and only be followed by rate cuts in 2024. US Treasuries are largely pricing in the upcoming rate hikes. In the near term there is still some upward potential, but subsequently yields should move lower as the inflation outlook improves and the market starts anticipating policy easing in 2024.

The ECB Governing Council will continue to raise its policy rates at its next meetings. We expect the terminal rate -i.e. the peak rate in this cycle- to be reached by the end of the first quarter of next year. We expect a peak for the deposit rate at 3.00%. We expect quantitative tightening to start in the second quarter of 2023. Early on in 2023, we expect higher government bond yields on the back of important supply but thereafter yields should move lower, driven by a gradual decline in inflation. Lower US yields should also play a role in the decline of eurozone yields.

The Bank of Japan is expected to maintain its current policy stance and we do not envisage a rate hike.

We expect the dollar to weaken somewhat versus the euro. The dollar's valuation is expensive, positioning in the market is very long and the long-term interest rate differential should narrow.

The yen has already weakened significantly versus the dollar, reflecting the increased policy divergence between the Fed and the Bank of Japan. We expect the exchange rate to remain around current levels in the near term. In 2023, the yen should strengthen versus the dollar considering that the federal funds rate should have reached its terminal rate.

GDP GROWTH & INFLATION

	GDP Growth				Inflation			
%	2021	2022 e	2023 e	2024 e	2021	2022 e	2023 e	2024 e
United-States	5,7	1,9	-0,1	-0,2	4,7	8,1	4,4	2,4
Japan	1,7	1,5	0,9	0,3	-0,2	2,4	2,1	1,3
United-Kingdom	7,4	4,4	-0,9	0,8	2,6	9,1	6,9	2,1
Euro Area	5,3	3,2	-0,5	1,3	2,6	8,4	5,6	2,3
Germany	2,6	1,8	-1,0	1,1	3,2	8,8	5,7	2,0
France	6,8	2,5	0,0	1,0	2,1	6,0	6,4	2,7
Italy	6,6	3,8	-0,4	1,1	1,9	8,7	7,2	2,0
Spain	5,1	4,6	0,0	1,3	3,0	8,3	2,3	1,5
China	8,1	3,2	4,5	4,8	0,9	2,1	2,7	2,5
India*	9,3	8,3	6,2	6,5	5,4	7,9	5,9	5,5
Brazil	4,6	3,0	0,5	1,3	8,3	9,4	5,4	4,9
Russia	4,5	-7,0	0,8	0,3	7,1	14,0	10,5	7,6

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

INTEREST & EXCHANGE RATES

Interest rates, %

End of period		Q1 2023	Q2 2023	Q3 2023	Q4 2023	Q4 2024
US	Fed Funds (upper limit)	5.25	5.25	5.25	5.25	3.25
	T-Note 10y	4.30	4.00	3.75	3.50	3.25
Eurozone	Deposit rate	3.00	3.00	3.00	3.00	2.00
	Bund 10y	2.75	2.65	2.50	2.30	2.00
	OAT 10y	3.45	3.30	3.10	2.90	2.50
	BTP 10y	5.25	5.05	4.80	4.60	3.80
	BONO 10y	4.05	3.90	3.75	3.55	2.90
UK	Base rate	4.25	4.25	4.25	4.25	3.50
	Gilts 10y	4.00	3.75	3.60	3.35	3.15
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10	-0.10
	JGB 10y	0.25	0.25	0.25	0.25	0.25

Exchange Rates

End of period		Q1 2023	Q2 2023	Q3 2023	Q4 2023	Q4 2024
USD	EUR / USD	1.01	1.00	1.03	1.06	1.10
	USD / JPY	140	138	133	128	120
	GBP / USD	1.09	1.08	1.11	1.14	1.18
EUR	EUR / GBP	0.93	0.93	0.95	0.95	0.95
	EUR / JPY	141	138	137	136	132

Brent

End of period		Q1 2023	Q2 2023	Q3 2023	Q4 2023	Q4 2024
Brent	USD/bbl	95	93	95	92	95

SOURCES: BNP PARIBAS (E: ESTIMATES & FORECASTS) (MARKET ECONOMICS, INTEREST RATE STRATEGY, FX STRATEGY, COMMODITIES DESK STRATEGY)

CALENDAR

LATEST INDICATORS

In China, several data were published for the month of November. Home prices were down again, industrial production growth slowed down more than expected, whereas retail sales contracted significantly versus November last year and more than the already bearish consensus. The unemployment rate increased more than expected. Residential property sales are plummeting compared to the data one year ago and property investment is also shrinking. The ECB hiked its deposit rate with 50 bp but the move was accompanied by a strong message that rate increases will continue at a steady pace. The survey data (flash PMIs for manufacturing and services, ZEW survey) showed an improvement versus the previous month. In France, business confidence was stable in December. The manufacturing PMI created a positive surprise by moving higher but the services PMI was down a lot. In Germany, the ZEW expectations index recorded a big improvement, more than expected. The assessment of the current situation improved only slightly. The manufacturing and services PMIs created a positive surprise by moving significantly higher. In Japan, the Tankan survey of small companies showed an improvement in manufacturing and non-manufacturing. The large company survey of non-manufacturing companies was up as well but the survey was down in manufacturing. The manufacturing PMI hardly changed but the services PMI recorded a significant improvement. In the UK, employment data improved in the past three months versus the previous three months. Inflation eased, consumer confidence improved marginally from a very low level but retail sales were down unexpectedly in November versus the previous month. The services PMI improved quite a bit, reaching 50, but the manufacturing PMI dropped. The Bank of England increased its policy rate with 50 bp. In the US, inflation in November was down versus the previous month, creating a positive surprise. Retail sales dropped more than anticipated. The manufacturing and services PMIs recorded a significant decline. Finally, the FOMC increased its policy rate further, with a 50 bp move that was in line with expectations.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	ACTUAL	PREVIOUS
12/13/2022	France	Total Payrolls	3Q	0.4%	0.4%	0.3%
12/13/2022	United Kingdom	Employment Change 3M/3M	Oct	-17k	27k	-52k
12/13/2022	Germany	ZEW Survey Expectations	Dec	-26.4	-23.3	-36.7
12/13/2022	Germany	ZEW Survey Current Situation	Dec	-57.0	-61.4	-64.5
12/13/2022	Eurozone	ZEW Survey Expectations	Dec	--	-23.6	-38.7
12/13/2022	United States	CPI MoM	Nov	0.3%	0.1%	0.4%
12/13/2022	United States	CPI Ex Food and Energy MoM	Nov	0.3%	0.2%	0.3%
12/14/2022	Japan	Tankan Large Mfg Index	4Q	6,0	7,0	8,0
12/14/2022	Japan	Tankan Large Non-Mfg Index	4Q	17,0	19,0	14,0
12/14/2022	Japan	Tankan Small Mfg Index	4Q	-5,0	-2,0	-4,0
12/14/2022	Japan	Tankan Small Non-Mfg Index	4Q	5,0	6,0	2,0
12/14/2022	United Kingdom	CPI YoY	Nov	10.9%	10.7%	11.1%
12/14/2022	United Kingdom	CPI Core YoY	Nov	6.5%	6.3%	6.5%
12/14/2022	United States	FOMC Rate Decision (Upper Bound)	Dec	4.50%	4.50%	4.00%
12/15/2022	China	New Home Prices MoM	Nov	--	-0.25%	-0.37%
12/15/2022	China	Industrial Production YoY	Nov	3.5%	2.2%	5.0%
12/15/2022	China	Retail Sales YoY	Nov	-4.0%	-5.9%	-0.5%
12/15/2022	China	Fixed Assets Ex Rural YTD YoY	Nov	5.6%	5.3%	5.8%

SOURCE: BLOOMBERG

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	ACTUAL	PREVIOUS
12/15/2022	China	Property Investment YTD YoY	Nov	-9.2%	-9.8%	-8.8%
12/15/2022	China	Residential Property Sales YTD YoY	Nov	--	-28.4%	-28.2%
12/15/2022	China	Surveyed Jobless Rate	Nov	5.6%	5.7%	5.5%
12/15/2022	France	Business Confidence	Dec	101,0	102,0	102,0
12/15/2022	United Kingdom	Bank of England Bank Rate	Dec	3,5%	3,5%	3,0%
12/15/2022	Eurozone	ECB Deposit Facility Rate	Dec	2.00%	2.00%	1.50%
12/15/2022	United States	Retail Sales Advance MoM	Nov	-0.2%	-0.6%	1.3%
12/15/2022	United States	Initial Jobless Claims	Dec	232k	211k	231k
12/16/2022	United Kingdom	GfK Consumer Confidence	Dec	-43,0	-42,0	-44,0
12/16/2022	Japan	Jibun Bank Japan PMI Mfg	Dec	--	48.8	49.0
12/16/2022	Japan	Jibun Bank Japan PMI Services	Dec	--	51.7	50.3
12/16/2022	United Kingdom	Retail Sales Ex Auto Fuel MoM	Nov	0.3%	-0.3%	0.7%
12/16/2022	United Kingdom	Retail Sales Ex Auto Fuel YoY	Nov	-5.8%	-5.9%	-6.4%
12/16/2022	France	S&P Global France Composite PMI	Dec	48.7	48.0	48.7
12/16/2022	France	S&P Global France Manufacturing PMI	Dec	48.0	48.9	48.3
12/16/2022	France	S&P Global France Services PMI	Dec	49.0	48.1	49.3
12/16/2022	Germany	S&P Global/BME Germany Manufacturing PMI	Dec	46.3	47.4	46.2
12/16/2022	Germany	S&P Global Germany Services PMI	Dec	46.3	49.0	46.1
12/16/2022	Eurozone	S&P Global Eurozone Manufacturing PMI	Dec	47.1	47.8	47.1
12/16/2022	Eurozone	S&P Global Eurozone Services PMI	Dec	48.5	49.1	48.5
12/16/2022	United Kingdom	S&P Global/CIPS UK Manufacturing PMI	Dec	46.5	44.7	46.5
12/16/2022	United Kingdom	S&P Global/CIPS UK Services PMI	Dec	48.5	50.0	48.8
12/16/2022	Eurozone	CPI YoY	Nov	10.0%	10.1%	10.0%
12/16/2022	Eurozone	CPI Core YoY	Nov	5.0%	5.0%	5.0%
12/16/2022	United States	S&P Global US Manufacturing PMI	Dec	47.8	46.2	47.7
12/16/2022	United States	S&P Global US Services PMI	Dec	46.5	44.4	46.2

SOURCE: BLOOMBERG

CALENDAR: THE WEEK AHEAD

COMING INDICATORS

Several survey will be released: IFO survey in Germany, consumer confidence for the Eurozone and Germany. In the US we will have the Conference Board consumer confidence and the University of Michigan survey. We will also have several releases concerning the housing market as well as data on personal income and spending. On the last day of the year, PMI data will be published in China.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	PREVIOUS
12/19/2022	Germany	IFO Business Climate	Dec	87.4	86.3
12/19/2022	Germany	IFO Current Assessment	Dec	93.5	93.1
12/19/2022	Germany	IFO Expectations	Dec	82.0	80.0
12/19/2022	Eurozone	Labour Costs YoY	3Q	--	4.0%
12/19/2022	United States	NAHB Housing Market Index	Dec	34	33
12/20/2022	United States	Housing Starts MoM	Nov	-1.8%	-4.2%
12/20/2022	United States	Building Permits MoM	Nov	-1.4%	-2.4%
12/20/2022	Eurozone	Consumer Confidence	Dec	-22.0	-23.9
12/20/2022	Japan	BOJ Policy Balance Rate	Dec	-0.100%	-0.100%
12/21/2022	Germany	GfK Consumer Confidence	Jan	-38.0	-40.2
12/21/2022	United States	Conf. Board Consumer Confidence	Dec	101.0	100.2
12/21/2022	United States	Conf. Board Present Situation	Dec	--	137.4
12/21/2022	United States	Conf. Board Expectations	Dec	--	75.4
12/22/2022	United States	GDP Annualized QoQ	3Q	2.9%	2.9%
12/22/2022	United States	Initial Jobless Claims	Dec	225k	211k
12/22/2022	United States	Leading Index	Nov	-0.4%	-0.8%
12/22/2022	France	Retail Sales SA YoY	Nov	--	--
12/23/2022	Japan	Natl CPI Ex Fresh Food, Energy YoY	Nov	2.8%	2.5%
12/23/2022	United States	Personal Income	Nov	0.3%	0.7%
12/23/2022	United States	Personal Spending	Nov	0.2%	0.8%
12/23/2022	United States	PCE Core Deflator MoM	Nov	0.2%	0.2%
12/23/2022	United States	Cap Goods Orders Nondef Ex Air	Nov P	0.1%	0.6%
12/23/2022	United States	U. of Mich. Sentiment	Dec	59.1	59.1
12/23/2022	United States	U. of Mich. Current Conditions	Dec	--	60.2
12/23/2022	United States	U. of Mich. Expectations	Dec	--	58.4
12/23/2022	United States	U. of Mich. 1 Yr Inflation	Dec	--	4.6%
12/23/2022	United States	U. of Mich. 5-10 Yr Inflation	Dec	--	3.0%
12/23/2022	United States	New Home Sales MoM	Nov	-5.1%	7.5%
12/31/2022	China	Composite PMI	Dec	--	47.1
12/31/2022	China	Manufacturing PMI	Dec	47.8	48.0
12/31/2022	China	Non-manufacturing PMI	Dec	--	46.7

SOURCE: BLOOMBERG

FURTHER READING

US disinflation: surely, but slowly	EcoTVWeek	16 December 2022
France: Bottlenecks at a historically high level in construction	Chart of the Week	14 December 2022
European Union: Will the energy transition cause an increase in interest rates?	EcoWeek	12 December 2022
Malaysia: A new prime minister but still high political instability	EcoTVWeek	9 December 2022
Turkey: consumption on credit	Chart of the Week	7 December 2022
Labour hoarding: a source of resilience during a recession	EcoWeek	5 December 2022
A 2023 budget facing moderate uncertainties	EcoFlash	2 December 2022
United States: Expanding US federal debt will require raising more foreign capital	EcoTVWeek	2 December 2022
UK: Foreign trade declines due to Brexit	EcoFlash	30 November 2022
The end of wage bargaining power?	Chart of the Week	30 November 2022
The sobering record of real gdp forecasts during recessions	EcoWeek	28 November 2022
Can Germany escape the recession?	EcoTVWeek	25 November 2022
US: The end of wage bargaining power?	Chart of the Week	23 November 2022
Eurozone: the surprising resilience of the labour market, will it last?	EcoWeek	21 November 2022
Gone with the wind: the erosion of real household wealth	EcoTVWeek	18 November 2022
Romania: a widening current account deficit in 2022	Chart of the Week	16 November 2022
US: Disinflation has started	EcoWeek	14 November 2022
Spain: national recovery plan, contrasted progresses	EcoTVWeek	10 November 2022
Italy: The increase in fixed rates for house purchase loans is favouring floating rates	Chart of the Week	9 November 2022
US : Federal Reserve: how much is enough?	EcoWeek	7 November 2022

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