

# ECOWEEK

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“

THE DOVISH SHIFT IN THE FEDERAL RESERVE'S MESSAGE HAS BEEN EXPLICIT WHEREAS THE CHANGE IN THE ECB'S MESSAGE SHOULD BE READ BETWEEN THE LINES.

”

ECONOMIC RESEARCH



**BNP PARIBAS**

The bank  
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## RESILIENCE, UNCERTAINTY AND ROBUST MONETARY POLICY

Recent data in the US show a resilient economy despite the significant and fast tightening of monetary policy. In the Eurozone, the services sector is a source of resilience. Frustratingly for central banks, inflation has also been resilient. This would call for a strong message of further monetary tightening, were it not that uncertainty about the outlook is high. More than ever, central banks need a robust strategy which takes into account a range of possible outcomes. As a consequence, the message from the FOMC has taken a dovish twist. Reading between the lines, the ECB's message is also softening, as witnessed by the strong emphasis on data-dependency and the role of financial conditions.

Despite weakness in certain areas -most notably housing-, overall economic data in the US show a resilient economy despite the significant and fast tightening of monetary policy in this cycle. Based on recent data releases, the Federal Reserve Bank of Atlanta's model-based estimate for real GDP growth (seasonally adjusted annual rate) in the first quarter of 2023 was 3.2 percent on 24 March. Monthly job creations -a key indicator for monetary policy- remain elevated and S&P Global's flash composite PMI for March rebounded strongly on the back of an improvement in manufacturing and services.

In the Eurozone, resilience has been concentrated in services, as witnessed by the flash PMIs for March that show a mixed picture with a decline in manufacturing but a strong increase in services. On balance, the composite PMI rose for the fifth month in a row, reaching 54.1, which corresponds to a ten-month high<sup>1</sup>. Such a high reading suggests that first quarter growth could surprise to the upside.

Frustratingly for central banks, inflation has also been resilient. Federal Reserve chairman Jerome Powell recently unambiguously stated that *"inflation remains too high"*<sup>2</sup> and ECB president Christine Lagarde has argued that *"inflation is projected to remain too high for too long."*<sup>3</sup>

This would call for a strong message of further monetary tightening, were it not that uncertainty about the outlook is high. In the US, the latest economic projections of Federal Reserve Board members and Federal Reserve Bank presidents show a shift to the left of the range of real GDP growth projections for this year to -0.5%/+1.0%. The range of projections for the unemployment rate has widened, with an upper end at 5.3%<sup>4</sup>. Christine Lagarde has also emphasized that *"the level of uncertainty will most likely remain high."*

A key source of uncertainty is the speed and strength of transmission from monetary policy measures to financial and monetary conditions -the first leg of monetary transmission- and from the latter to demand and inflation -the second leg of monetary transmission<sup>5</sup>.

<sup>1</sup> Source: Fastest uptick in US private sector business activity for almost a year, as new orders return to growth, but selling price inflation accelerates, S&P Global, 24 March 2023. Service sector revival powers eurozone growth higher in March, S&P Global, 24 March 2023.

<sup>2</sup> Source: Transcript of Chair Powell's Press Conference, 22 March 2023, Federal Reserve.

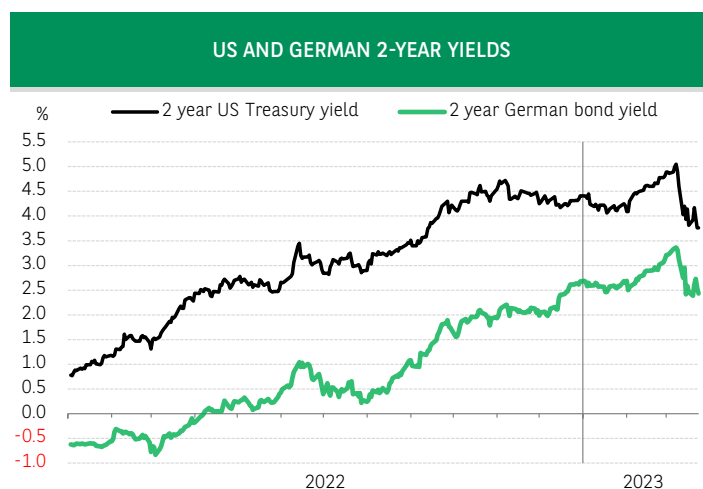
<sup>3</sup> Source: Press conference, Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB, Frankfurt am Main, 16 March 2023.

<sup>4</sup> Source: Summary of Economic Projections, 22 March 2023, Federal Reserve.

<sup>5</sup> Source: The path ahead, Speech by Christine Lagarde, President of the ECB, at "The ECB and Its Watchers XXIII" conference, Frankfurt am Main, 22 March 2023.

<sup>6</sup> For more details on the Eurozone, see Monetary policy's long and variable lags: the case of the Eurozone, Ecoweek, BNP Paribas, 27 February 2023. For the US, see Monetary policy's long and variable lags: the case of the United States, Ecoweek, BNP Paribas, 13 March 2023.

<sup>7</sup> Source: see footnote 2.



SOURCE: FEDERAL RESERVE, REFINITIV, BNP PARIBAS

The latest ECB Bank Lending Survey and the Federal Reserve's Senior Loan Officers Survey show a clear tightening in credit conditions -the level of interest rates and the conditions that are applied- and an increasing number of banks report weakening loan demand<sup>6</sup>. In the past, similar developments have been followed by a negative impact on growth and this cycle should be no exception.

One can also assume that the full effect of past rate hikes on credit conditions hasn't yet fully materialized. In addition, as stated by Jerome Powell, *"events in the banking system over the past two weeks are likely to result in tighter credit conditions for households and businesses, which would in turn affect economic outcomes."*<sup>7</sup>

” The dovish shift in the Federal Reserve's message has been explicit whereas the change in the ECB's message should be read between the lines. In both cases, incoming data credit conditions will play a key role.



# EDITORIAL

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Christine Lagarde has warned that the latest ECB staff forecasts “do not incorporate the effects of the recent financial market tensions. Those tensions have added new downside risks and have made the risk assessment blurrier.”<sup>8</sup>

As a consequence, the message from the FOMC has taken a dovish twist. The statement “we anticipate that ongoing rate increases will be appropriate to quell inflation” has been replaced with “some additional policy firming may be appropriate.” The course of action is no longer pre-set and will depend on incoming data and the assessment of “the actual and expected effects of tighter credit conditions on economic activity, the labor market, and inflation.”<sup>9</sup>

For the ECB, as explained by its president, policy will depend on the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary transmission. To achieve the goal of price stability “we need a robust strategy, which takes into account the high levels of uncertainty we are facing today.” Compared to the Federal Reserve, the change in the ECB’s message should be read between the lines. It is articulated through an emphasis on data-dependency and the role of financial conditions.

**William De Vijlder**

<sup>8</sup> Source: see footnote 5.

<sup>9</sup> Source : see footnote 2.



# MARKETS OVERVIEW

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## OVERVIEW

Week 17-3-23 to 24-3-23

↗ CAC 40	6 925	↗ 7 015	+1.3 %
↗ S&P 500	3 917	↗ 3 971	+1.4 %
↘ Volatility (VIX)	25.5	↘ 21.7	-3.8 pb
↗ Euribor 3M (%)	2.75	↗ 3.03	+27.5 bp
↗ Libor \$ 3M (%)	5.00	↗ 5.10	+10.3 bp
↘ OAT 10y (%)	2.66	↘ 2.66	+0.0 bp
↘ Bund 10y (%)	2.13	↘ 2.12	-0.9 bp
↘ US Tr. 10y (%)	3.43	↘ 3.38	-5.1 bp
↗ Euro vs dollar	1.06	↗ 1.08	+1.1 %
↗ Gold (ounce, \$)	1 961	↗ 1 993	+1.6 %
↗ Oil (Brent, \$)	72.6	↗ 75.2	+3.6 %

## Interest Rates

		highest 23	lowest 23	Yield (%)	highest 23	lowest 23
€ ECB	3.50	3.50 at 22/03	2.50 at 02/01	€ AVG 5-7y	2.64	2.64 at 02/01
Eonia	-0.51	-0.51 at 02/01	-0.51 at 02/01	Bund 2y	2.43	3.36 at 08/03
Euribor 3M	3.03	3.03 at 24/03	2.16 at 02/01	Bund 10y	2.12	2.75 at 02/03
Euribor 12M	3.53	3.98 at 09/03	3.30 at 19/01	OAT 10y	2.66	3.23 at 03/03
\$ FED	5.00	5.00 at 23/03	4.50 at 02/01	Corp. BBB	4.41	4.75 at 03/03
Libor 3M	5.10	5.15 at 09/03	4.77 at 02/01	Treas. 2y	3.86	5.12 at 08/03
Libor 12M	4.81	5.88 at 08/03	4.70 at 20/03	Treas. 10y	3.38	4.06 at 02/03
£ BoE	4.25	4.25 at 23/03	3.50 at 02/01	High Yield	9.03	9.16 at 20/03
Libor 3M	4.35	4.39 at 22/03	3.87 at 02/01	£ gilt. 2y	3.66	4.10 at 09/03
Libor 12M	0.81	0.81 at 02/01	0.81 at 02/01	gilt. 10y	3.15	3.78 at 02/03

At 24-3-23

At 24-3-23

## EXCHANGE RATES

1€ =		highest 23	lowest 23	2023
USD	1.08	1.09 at 02/02	1.05 at 05/01	+0.8%
GBP	0.88	0.90 at 03/02	0.87 at 19/01	-0.8%
CHF	0.99	1.00 at 24/01	0.97 at 15/03	+0.0%
JPY	140.60	145.27 at 01/03	138.02 at 03/01	-0.2%
AUD	1.62	1.62 at 23/03	1.53 at 27/01	+2.9%
CNY	7.39	7.44 at 10/03	7.23 at 05/01	-0.4%
BRL	5.65	5.79 at 04/01	5.40 at 08/03	+0.2%
RUB	83.01	83.15 at 22/03	73.32 at 12/01	+6.5%
INR	88.77	89.91 at 02/02	86.58 at 08/03	+0.5%

At 24-3-23

Change

## COMMODITIES

Spot price, \$		highest 23	lowest 23	2023	2023(€)
Oil, Brent	75.2	88.2 at 23/01	72.6 at 17/03	-11.4%	-12.2%
Gold (ounce)	1 993	1 993 at 24/03	1 810 at 24/02	+9.8%	+8.9%
Metals, LMEX	3 981	4 404 at 26/01	3 824 at 15/03	-0.1%	-0.9%
Copper (ton)	8 912	9 331 at 23/01	8 236 at 04/01	+6.5%	+5.6%
wheat (ton)	252	2.9 at 13/02	241 at 09/03	-11.7%	-12.5%
Corn (ton)	253	2.7 at 13/02	239 at 09/03	-0.3%	-3.7%

At 24-3-23

Change

## EQUITY INDICES

Index	highest 23	lowest 23	2023	
<b>World</b>				
MSCI World	2 693	2 848 at 02/02	2 595 at 05/01	+3.5%
<b>North America</b>				
S&P500	3 971	4 180 at 02/02	3 808 at 05/01	+3.4%
<b>Europe</b>				
EuroStoxx50	4 131	4 314 at 06/03	3 856 at 02/01	+8.9%
CAC 40	7 015	7 373 at 06/03	6 595 at 02/01	+0.8%
DAX 30	14 957	15 654 at 06/03	14 069 at 02/01	+7.4%
IBEX 35	8 793	9 511 at 06/03	8 370 at 02/01	+0.7%
FTSE100	7 405	8 014 at 20/02	7 335 at 17/03	-0.1%
<b>Asia</b>				
MSCI, loc.	1 088	1 143 at 09/03	1 065 at 04/01	+0.2%
Nikkei	27 385	28 623 at 09/03	25 717 at 04/01	+4.9%
<b>Emerging</b>				
MSCI Emerging (\$)	972	1 052 at 26/01	941 at 16/03	+0.2%
China	65	75 at 27/01	62 at 20/03	+2.7%
India	704	786 at 18/01	703 at 16/03	-9.0%
Brazil	1 310	1 574 at 25/01	1 296 at 23/03	-10.7%

At 24-3-23

Change

## PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

Year 2023 to 24-3, €	Year 2023 to 24-3, \$
+15.7%	+33.7%
+15.2%	+19.9%
+13.8%	+6.7%
+13.5%	+5.8%
+12.8%	+4.7%
+10.9%	+3.0%
+9.8%	+2.4%
+8.9%	-0.4%
+7.2%	-1.5%
+3.6%	-1.8%
+2.8%	-1.9%
+2.2%	-2.1%
+2.0%	-2.3%
+0.1%	-3.6%
-1.1%	-6.7%
-2.9%	-7.2%
-6.9%	-7.6%
-9.2%	-11.7%
-9.5%	-17.6%

SOURCE: REFINITIV, BNP PARIBAS,

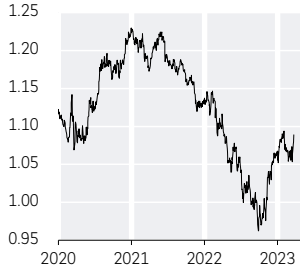


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# MARKETS OVERVIEW

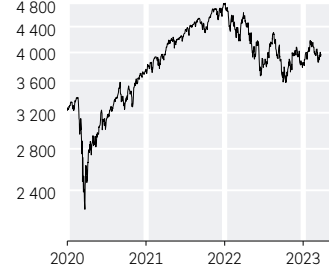
**EURO-DOLLAR**



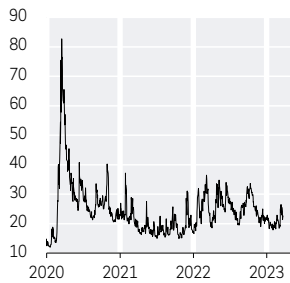
**EUROSTOXX50**



**S&P500**



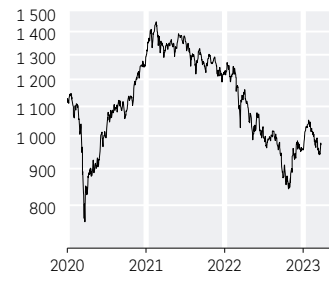
**VOLATILITY (VIX, S&P500)**



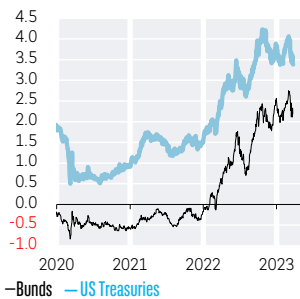
**MSCI WORLD (USD)**



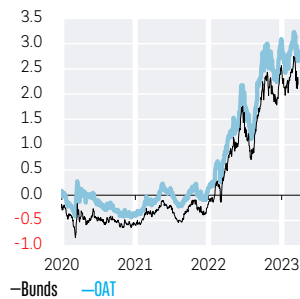
**MSCI EMERGING (USD)**



**10Y BOND YIELD, TREASURIES VS BUND**



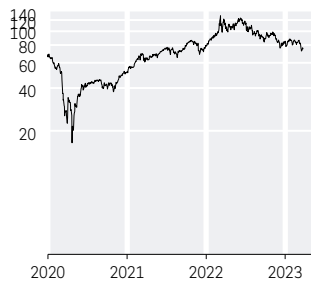
**10Y BOND YIELD**



**10Y BOND YIELD & SPREADS**

Year 2023 to 24-3		
4.57%	Greece	244 bp
3.92%	Italy	179 bp
3.13%	Spain	100 bp
2.92%	Portugal	79 bp
2.80%	Austria	67 bp
2.76%	Belgium	64 bp
2.71%	Finland	58 bp
2.66%	France	53 bp
2.53%	Ireland	40 bp
2.52%	Netherlands	39 bp
2.12%	Germany	

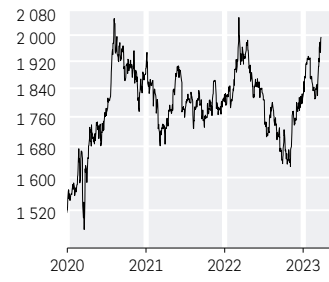
**OIL (BRENT, USD)**



**METALS (LME, USD)**



**GOLD (OUNCE, USD)**



SOURCE: REFINITIV, BNP PARIBAS,



# ECONOMIC PULSE

## INTERNATIONAL TRADE: FROM SHORTAGE TO SURPLUS?

International trade data show quite clearly that the slowing of activity has been accentuated over recent months. Global export volumes (Chart 1), have continued to fall, according to the latest figures (December 2022). Health restrictions in China, which were only relaxed in mid-December, weighed on this dynamic. Nevertheless, global exports saw a 2.6% increase over the whole of 2022, relative to 2021.

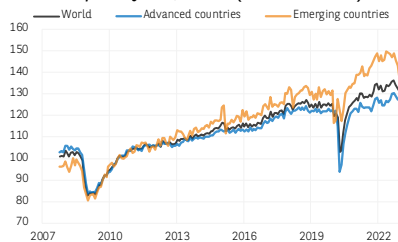
The semiconductor sector, considered a good barometer of global activity, has seen falls in production levels and exports, which were amplified at the beginning of the year. This can be seen in particular in South Korea's export figures, which are viewed as leading indicators: over the first 20 days of February exports, smoothed over three months, fell to their lowest level since October 2017. Although the risk of semiconductor shortages seems to have eased overall, supply in certain sectors, particularly the automotive industry, remains limited.

The slowdown in demand has eased further global production chains, in which bottlenecks had already largely cleared in the second half of 2022. The aggregate index of pressure on global supply chains (Chart 3) fell significantly in February as did the PMI delivery times component (Chart 6). Indeed, in February delivery times were the shortest since May 2009. Maritime freight (Chart 5) saw another fall of nearly 20% over the first half of March. Prices for container ship (Harper index) were stable following a fall of 80% from its peak twelve months ago. However, the Baltic Dry Index of shipping costs (Chart 4) bounced back at the beginning of the year, due primarily to higher shipping costs for crude oil.

**Guillaume Derrien**

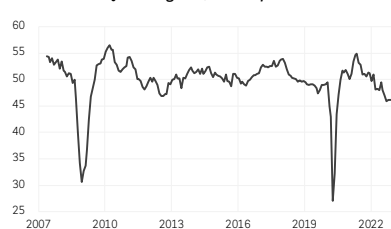
### GLOBAL TRADE INDICATORS

1. World exports by area, volume (index 2010 = 100)



Source: CPB, BNP Paribas

2. Global manufacturing PMI, new export orders



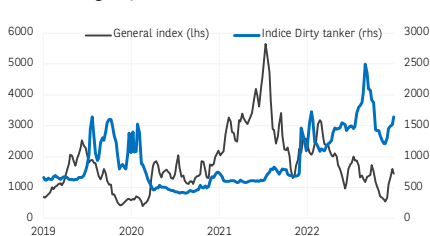
Source: S&P Global (Markit), BNP Paribas

3. Global supply-chain pressures index



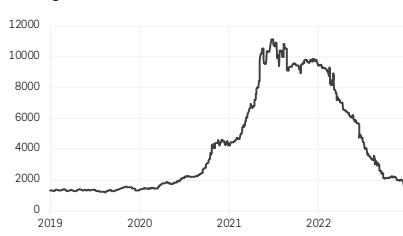
Source: Federal Reserve of New York

4. Baltic Exchange Dry Index



Source: Baltic Exchange, BNP Paribas

5. Freight rate index



Source: Freightos, BNP Paribas

6. Global manufacturing PMI, delivery times (Inverted line)



Source: S&P Global (Markit), BNP Paribas

# ECONOMIC SCENARIO

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## UNITED STATES

The U.S. economy continued to grow in Q4, although it slowed slightly compared to Q3. However, the main drivers of growth, namely household consumption and private inventories, are fragile, suggesting that the economy should continue to slow. The labour market is still very tight, with job creation remaining high, the unemployment rate low and wage growth buoyant. Inflation seems to have peaked in the middle of 2022, but disinflation remains gradual and the inflation rate should remain significantly above the target of 2% by the end of 2023. From this point of view, the Fed is probably not quite done with raising its policy rates yet. The ongoing monetary tightening is expected to drive the US economy into recession in the second half of 2023 and limit the expected recovery in 2024.

## CHINA

Economic growth, which was sluggish and unbalanced in 2022, is projected to strengthen in 2023. The end of the zero Covid policy has led to a rebound in private demand and activity in the services sector since late January, and household consumption will continue to benefit from large catch-up effects in the short term. However, while export and industrial production prospects are darkened by the weakening in global demand, activity driven by the domestic market remains constrained by important drags. In fact, the recovery in the labour market remains uncertain, the improvement in the property and construction sectors is likely to be limited, and the worrying financial situation of local governments should constrain public investment. Fiscal and monetary support is expected to be prudent. Consumer price inflation, which averaged 2% in 2022, should accelerate only mildly in 2023.

## EUROZONE

Economic growth in the eurozone was zero in the fourth quarter of 2022, but better than expected for 2022 as a whole, at 3.5%. It continued to surprise favorably in the early months of 2023 judging by the improvement in survey data (business confidence and, to a lesser extent, consumer confidence). However, the combination of the inflationary shock, the energy crisis and forced monetary tightening and the build-up of their negative effects will weaken activity in 2023. Real GDP growth should be weakly positive in 2023 and 2024, at 0.6% and 0.5% respectively. Although it is expected to decline throughout 2023, inflation will remain elevated and well above the 2% target at the end of this year and still a bit above at the end of 2024, forcing monetary policy to remain in restrictive territory.

## FRANCE

Real GDP growth has decreased in H2 2022 (0.2% q/q in Q3 and 0.1% in Q4, after +0.5% in Q2). Corporate investment and inventory rebuilding have remained the main growth drivers, whereas household demand has played on the downside: household consumption has decreased by 1.2% q/q in Q4 and their investment by 0.9%. As inflation has reached a new peak in February 2023 (7.2% y/y according to the harmonized measure) and because of rising interest rates, household demand should remain subdued in 2023, weighing on our GDP growth forecast (0.5% in 2023, compared to 2.6% in 2022).

## RATES AND EXCHANGE RATES

In the US, the Federal Reserve should continue its tightening policy, but the terminal rate remains uncertain. Our March 7 forecasts see the federal funds rate at 5.75% (upper end of the target range) in July of this 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, in view of the Fed's bias, albeit somewhat less pronounced, to continue hiking, but subsequently yields should move lower as the inflation outlook improves and the market starts anticipating policy easing in 2024.

The ECB Governing Council is also expected to continue to raise its policy rates at its next two meetings, in May and June. However, the same uncertainty as for the Fed weighs on the terminal rate -i.e. the peak rate in this cycle. Our forecasts, updated on March 21, put the deposit rate at 3.50% in June (vs. 4% in July previously). In the near term, government bond yields could resume rising if the ECB continues to tighten 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 has increased the upper end of its target range for the 10-year JGB yield to 0.5% and further adjustments to the yield curve control policy cannot be excluded. Nevertheless, we do not expect the BoJ to proceed with 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. We expect the yen to remain around current levels in the near term before strengthening versus the dollar considering that the federal funds rate should have reached its terminal rate.

### GDP GROWTH AND INFLATION

%	GDP Growth*				Inflation*			
	2021	2022	2023 e	2024 e	2021	2022	2023 e	2024 e
United-States	5.9	2.1	1.5	0.0	4.7	8.0	4.4	2.6
Japan	2.2	1.0	1.2	0.8	-0.2	2.5	2.6	1.4
United-Kingdom	7.6	4.0	-0.4	1.0	2.6	9.1	6.2	1.9
Euro Area*	5.3	3.5	0.6	0.5	2.6	8.4	5.3	2.5
Germany*	2.6	1.8	0.1	0.8	3.2	8.6	5.6	2.2
France*	6.8	2.6	0.5	0.9	2.1	5.9	5.8	2.9
Italy*	7.0	3.8	0.9	0.9	1.9	8.7	6.8	2.4
Spain*	5.5	5.5	1.4	1.1	3.0	8.3	3.8	2.3
China	8.4	3.0	5.6	5.3	0.9	2.0	2.7	2.5
India**	8.7	7.0	5.7	6.0	5.5	6.7	5.4	4.5
Brazil	4.6	3.0	0.5	1.3	8.3	9.4	5.4	4.9

SOURCE: BNP PARIBAS (E: ESTIMATES &amp; FORECASTS)

\* LAST UPDATE 21 MARCH 2023

\*\*FISCAL YEAR FROM 1<sup>ST</sup> APRIL OF YEAR N TO MARCH 31<sup>ST</sup> OF YEAR N+1

### INTEREST AND EXCHANGE RATES

Interest rates, %		Q2 2023	Q3 2023	Q4 2023	Q4 2024
End of period					
US	Fed Funds (upper limit)	5.50	5.75	5.75	4.00
	T-Note 10y	4.30	4.10	3.90	3.65
Eurozone	deposit rate*	3.50	3.50	3.50	2.75
	Bund 10y	3.10	2.90	2.50	2.00
	OAT 10y	3.65	3.45	3.02	2.50
	BTP 10y	5.10	5.15	4.75	3.80
	BONO 10y	4.10	4.00	3.60	2.90
UK	Base rate	4.25	4.25	4.25	3.50
	Gilts 10y	3.70	3.50	3.25	2.85
Japan	BoJ Rate	-0.10	-0.10	-0.10	0.10
	JGB 10y	0.95	0.95	0.90	0.95
Exchange Rates		Q2 2023	Q3 2023	Q4 2023	Q4 2024
End of period					
USD	EUR / USD	1.10	1.12	1.14	1.18
	USD / JPY	133	130	127	121
	GBP / USD	1.24	1.26	1.28	1.33
EUR	EUR / GBP	0.89	0.89	0.89	0.89
	EUR / JPY	146	146	145	143
Brent		Q2 2023	Q3 2023	Q4 2023	Q4 2024
End of period					
Brent	USD/bbl	85	90	90	95

\* LAST UPDATE 21 MARCH 2023

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


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# FURTHER READING

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<a href="#">OECD pulse</a>	EcoPulse	24 March 2023
<a href="#">Towards a disinflationary reduction in the supply-demand imbalance</a>	EcoTVWeek	24 March 2023
<a href="#">China: A decent rebound in the first two months of 2023</a>	EcoPulse	22 March 2023
<a href="#">Eurozone: An unprecedented decline in new lending for house purchase</a>	Chart of the Week	22 March 2023
<a href="#">Business insolvencies in Western Europe: a worrying increase?</a>	EcoTVWeek	17 March 2023
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