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“

EUROZONE: WHAT'S
BEHIND THE REBOUND
IN THE SERVICES SECTOR
BUSINESS CLIMATE?

”

ECONOMIC RESEARCH



BNP PARIBAS

The bank
for a changing
world

TABLE OF CONTENT

3

EDITORIAL

Eurozone: what's behind the rebound in the services sector business climate?

5

MARKETS OVERVIEW

Recent market developments (foreign exchange, stock markets, interest rates, commodities, etc.)

7

ECONOMIC PULSE

Analysis of some recent economic data: uncertainty

8

ECONOMIC SCENARIO

Main economic and financial forecasts

9

FURTHER READING

Latest articles, charts, videos and podcasts of Economic Research



EUROZONE: WHAT'S BEHIND THE REBOUND IN THE SERVICES SECTOR BUSINESS CLIMATE?

In the longer run, the business climate in industry and services are highly correlated but in the short run large divergences can at times be observed. This has been the case in recent months following a strong rebound in services and a far weaker improvement in industry. Services cover a variety of activities and those that are very correlated with manufacturing have seen a weaker performance as of late. Tourism and recreation have low correlation with manufacturing and have been very dynamic. This may reflect there is still post-Covid-19-related pent-up demand and/or a combination of a pick-up in wage growth and a still strong labour market. Whether this can last will to a large degree depend on how the overall economic environment influences the labour market outlook.

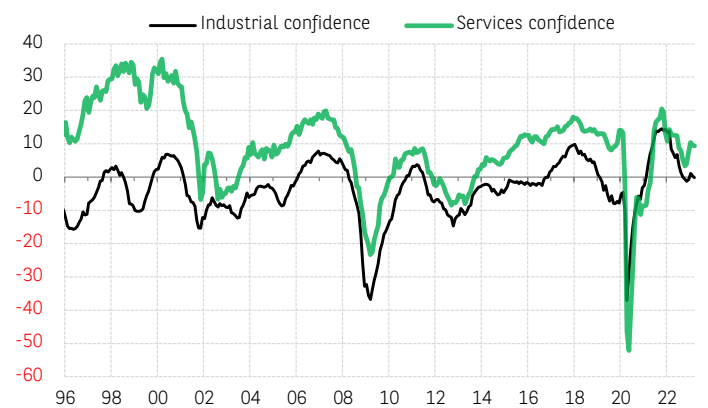
Despite a high correlation in the longer run between the business climate in industry and services, in the short run large divergences can at times be observed. The European Commission's business surveys show a widening gap in recent months between services and industrial confidence (chart 1) on the back of a strong improvement in the former between November last year and January 2023 whereas the recovery in industrial confidence was far more subdued. The purchasing managers' index in services has rebounded significantly since its low point in November 2022 -from 48.5 to 55.6 in March- but the rebound in the manufacturing PMI has been shortlived -from 46.4 in October to 48.8 in January and 47.1 in March.

The dynamism in services -which is more outspoken in the PMI data than in the European Commission survey- is a welcome development from the perspective of GDP growth¹ but one wonders whether it can last in view of the weakness in manufacturing. Services cover a variety of activities, some are very correlated with manufacturing, others far less. Based on data for February, the latest month for which these data are available, chart 3 shows a negative relationship between the value of the PMI output index for a given sector in services and its correlation with the manufacturing PMI: within services, sectors that are closely correlated with manufacturing have a lower output PMI than sectors that are less correlated².

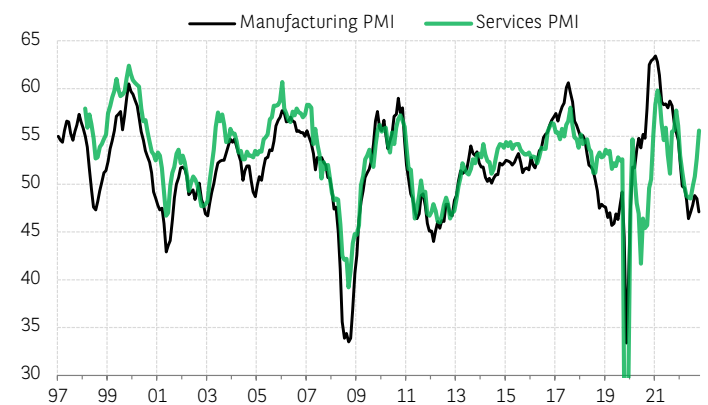
In its comment on the March PMI release, S&P Global reported that backlogs of work have been accumulating in services on the back of new business but have been declining in manufacturing due to a fall in orders³. The latter point is a source of concern and suggests that in the absence of an improvement in the business climate in manufacturing, the industry-sensitive parts of services could see a weakening of activity.

¹ Services (including non-market services) represent 73.3% of value added in the Eurozone (data for 2021). Source: European Commission
² Sector data are shown for Europe considering they are not available for the Eurozone. The correlation has been calculated with the manufacturing PMI for the Eurozone covering the period January 2022-February 2023.
³ Source: Service sector revival powers eurozone growth higher in March, S&P Global Flash Eurozone PMI, 24 March 2023.

EUROZONE: CONFIDENCE IN INDUSTRY AND SERVICES



EUROZONE: MANUFACTURING AND SERVICES PMI



In the absence of an improvement in the business climate in manufacturing, the industry-sensitive parts of services could see a weakening of activity.



EDITORIAL

Admittedly, other sectors within services are very dynamic, most notably tourism and recreation. This may reflect there is still post-Covid-19-related pent-up demand and/or a combination of a pick-up in wage growth and a still strong labour market. Whether this can last will to a large degree depend on how the overall economic environment influences the labour market outlook. Slow disinflation, rising interest rates and tighter lending conditions imply some caution is warranted in this respect.

William De Vijlder

EUROPE: SECTOR PMIS AND CORRELATION WITH MANUFACTURING PMI

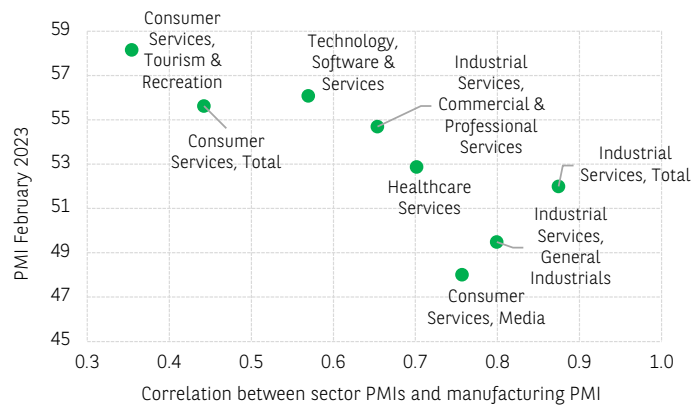


CHART 3

SOURCE: S&P GLOBAL, BNP PARIBAS



MARKETS OVERVIEW

5

OVERVIEW

Week 24-3-23 to 31-3-23			
➔ CAC 40	7 015	▶ 7 322	+4.4 %
➔ S&P 500	3 971	▶ 4 109	+3.5 %
➔ Volatility (VIX)	21.7	▶ 18.7	-3.0 pb
➔ Euribor 3M (%)	3.03	▶ 3.04	+1.3 bp
➔ Libor \$ 3M (%)	5.10	▶ 5.19	+9.1 bp
➔ OAT 10y (%)	2.66	▶ 2.83	+16.6 bp
➔ Bund 10y (%)	2.12	▶ 2.30	+17.5 bp
➔ US Tr. 10y (%)	3.38	▶ 3.48	+10.3 bp
➔ Euro vs dollar	1.08	▶ 1.09	+0.9 %
➔ Gold (ounce, \$)	1 993	▶ 1 977	-0.8 %
➔ Oil (Brent, \$)	75.2	▶ 79.8	+6.0 %

Interest Rates

		highest 23	lowest 23	
€ ECB	3.50	3.50 at 22/03	2.50 at 02/01	
Eonia	-0.51	-0.51 at 02/01	-0.51 at 02/01	
Euribor 3M	3.04	3.05 at 30/03	2.16 at 02/01	
Euribor 12M	3.62	3.98 at 09/03	3.30 at 19/01	
\$ FED	5.00	5.00 at 23/03	4.50 at 02/01	
Libor 3M	5.19	5.19 at 31/03	4.77 at 02/01	
Libor 12M	5.31	5.88 at 08/03	4.70 at 20/03	
£ BoE	4.25	4.25 at 23/03	3.50 at 02/01	
Libor 3M	4.42	4.42 at 31/03	3.87 at 02/01	
Libor 12M	0.81	0.81 at 02/01	0.81 at 02/01	

At 31-3-23

MONEY & BOND MARKETS

Yield (%)	highest 23	lowest 23
€ AVG 5-7y	2.64	2.64 at 02/01
Bund 2y	2.75	3.36 at 08/03
Bund 10y	2.30	2.75 at 02/03
OAT 10y	2.83	3.23 at 03/03
Corp. BBB	4.52	4.75 at 03/03
\$ Treas. 2y	4.15	5.12 at 08/03
Treas. 10y	3.48	4.06 at 02/03
High Yield	8.71	9.16 at 20/03
£ gilt. 2y	3.90	4.10 at 09/03
gilt. 10y	3.38	3.78 at 02/03

At 31-3-23

EXCHANGE RATES

1€ =	highest 23	lowest 23	2023
USD	1.09	1.09 at 02/02	1.05 at 05/01
GBP	0.88	0.90 at 03/02	0.87 at 19/01
CHF	0.99	1.00 at 24/01	0.97 at 15/03
JPY	144.60	145.27 at 01/03	138.02 at 03/01
AUD	1.62	1.63 at 30/03	1.53 at 27/01
CNY	7.47	7.51 at 30/03	7.23 at 05/01
BRL	5.51	5.79 at 04/01	5.40 at 08/03
RUB	84.42	84.42 at 31/03	73.32 at 12/01
INR	89.29	89.91 at 02/02	86.58 at 08/03

At 31-3-23

Change

COMMODITIES

Spot price, \$	highest 23	lowest 23	2023	2023(€)
Oil, Brent	79.8	88.2 at 23/01	72.6 at 17/03	-6.1% -7.7%
Gold (ounce)	1 977	1 993 at 24/03	1 810 at 24/02	+8.9% +6.9%
Metals, LMEX	4 038	4 404 at 26/01	3 824 at 15/03	+1.4% -0.4%
Copper (ton)	9 004	9 331 at 23/01	8 236 at 04/01	+7.6% +5.7%
wheat (ton)	254	2.9 at 13/02	241 at 09/03	-11.2% -12.8%
Corn (ton)	259	2.7 at 13/02	239 at 09/03	-0.1% -2.4%

At 31-3-23

Change

EQUITY INDICES

Index	highest 23	lowest 23	2023	Year 2023 to 31-3, €
World				+21.7%
MSCI World	2 791	2 848 at 02/02	2 595 at 05/01	+7.3%
North America				+20.6%
S&P500	4 109	4 180 at 02/02	3 808 at 05/01	+7.0%
Europe				+17.3%
EuroStoxx50	4 315	4 315 at 31/03	3 856 at 02/01	+13.7%
CAC 40	7 322	7 373 at 06/03	6 595 at 02/01	+1.3%
DAX 30	15 629	15 654 at 06/03	14 069 at 02/01	+12.2%
IBEX 35	9 233	9 511 at 06/03	8 370 at 02/01	+1.2%
FTSE100	7 632	8 014 at 20/02	7 335 at 17/03	+0.2%
Asia				+6.8%
MSCI, loc.	1 116	1 143 at 09/03	1 065 at 04/01	+0.4%
Nikkei	28 041	28 623 at 09/03	25 717 at 04/01	+7.5%
Emerging				+3.6%
MSCI Emerging (\$)	990	1 052 at 26/01	941 at 16/03	+0.4%
China	67	75 at 27/01	62 at 20/03	+5.0%
India	720	786 at 18/01	703 at 16/03	-7.2%
Brazil	1 397	1 574 at 25/01	1 296 at 23/03	-8.0%

At 31-3-23

Change

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

Year 2023 to 31-3, \$	Year 2023 to 31-3, €
+43.5%	+21.7%
+22.3%	+21.0%
+11.4%	+20.6%
+10.6%	+19.9%
+8.3%	+17.3%
+6.5%	+15.0%
+5.1%	+14.4%
+2.7%	+12.2%
+2.0%	+12.2%
+1.8%	+7.8%
+0.8%	+6.8%
+0.3%	+6.7%
-0.2%	+3.9%
-2.3%	+3.6%
-4.7%	+3.4%
-5.6%	+0.9%
-5.9%	-2.2%
-7.1%	-5.1%
-14.7%	-5.4%

SOURCE: REFINITIV, BNP PARIBAS,

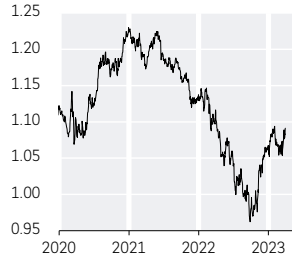


BNP PARIBAS

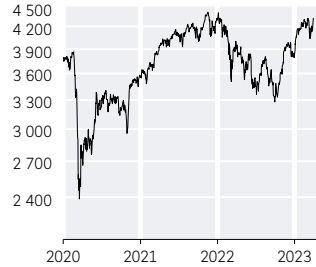
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MARKETS OVERVIEW

EURO-DOLLAR



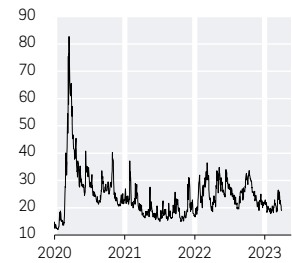
EUROSTOXX50



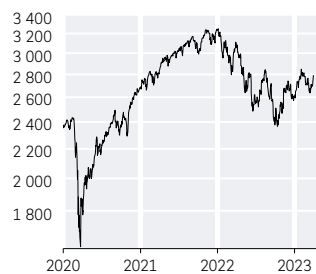
S&P500



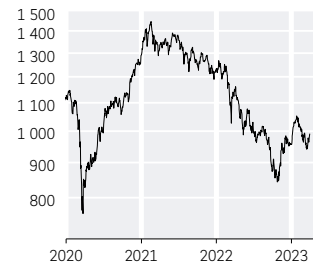
VOLATILITY (VIX, S&P500)



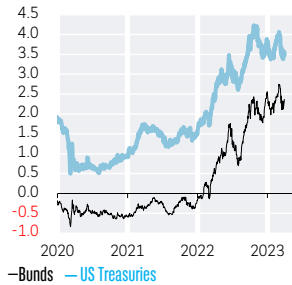
MSCI WORLD (USD)



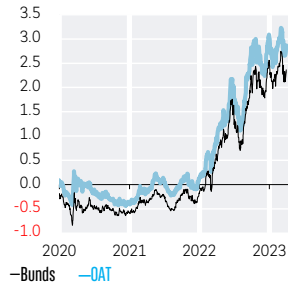
MSCI EMERGING (USD)



10Y BOND YIELD, TREASURIES VS BUND



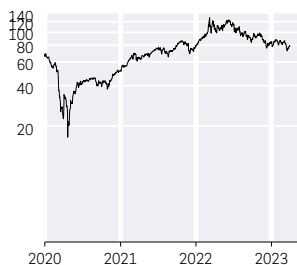
10Y BOND YIELD



10Y BOND YIELD & SPREADS

Year 2023 to 31-3		
4.63%	Greece	233 bp
4.01%	Italy	171 bp
3.25%	Spain	95 bp
3.04%	Portugal	74 bp
2.94%	Austria	64 bp
2.90%	Belgium	60 bp
2.86%	Finland	56 bp
2.83%	France	52 bp
2.74%	Ireland	43 bp
2.66%	Netherlands	36 bp
2.30%	Germany	

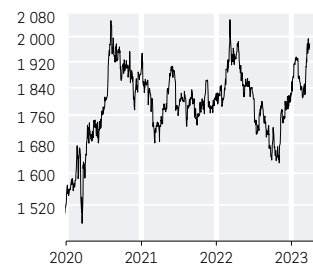
OIL (BRENT, USD)



METALS (LME, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS,



ECONOMIC PULSE

UNCERTAINTY HAS EASED SOMEWHAT IN MARCH

Our uncertainty indicators are complementary in terms of scope and methodology.

Although the latest figures show a few divergences, the overall trend in March is towards a slight reduction in uncertainty. Starting with the upper left chart, US economic policy uncertainty, which is based on media coverage, declined slightly in March. This probably reflects the latest press release by the Federal Open Market Committee (FOMC), which adopted a more moderate tone concerning future measures to tighten US monetary policy. This decline confirms a trend that has been taking shape since September 2022. Even so, this uncertainty indicator is still slightly higher than its long-term average.

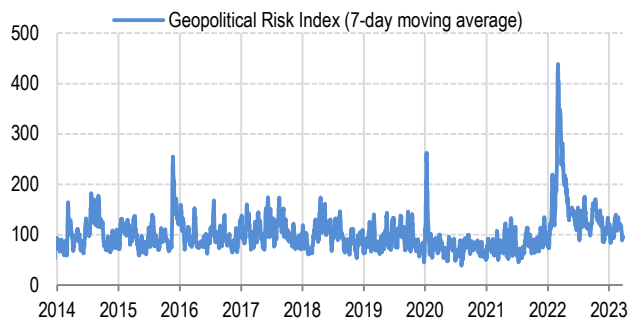
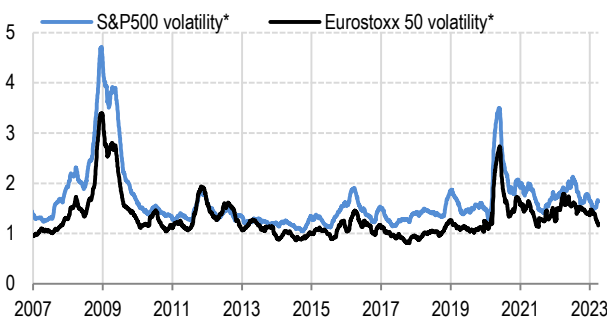
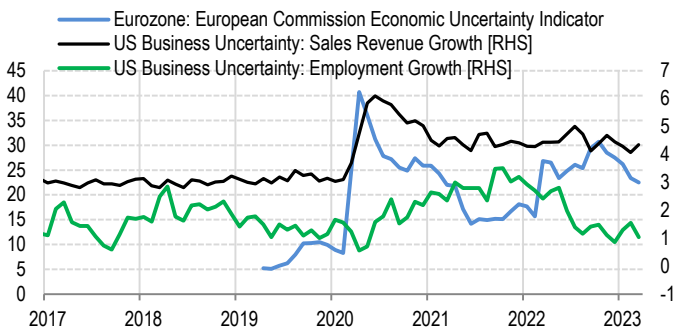
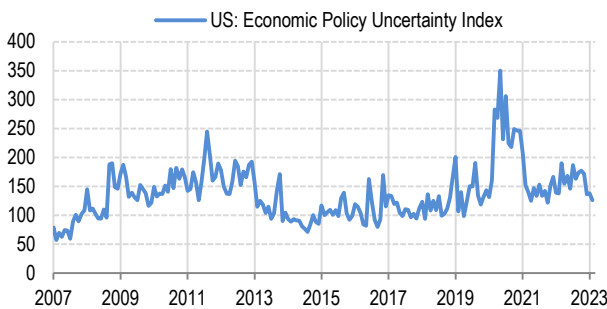
Moving clockwise to the next chart, US business uncertainty towards sales revenue growth ticked up in March after a 3-month decline. In contrast, US business uncertainty concerning job growth declined. While it is relatively low, this uncertainty indicator has been fluctuating more over the past 8 months, after having fallen significantly from October 2021 to July 2022.

The European Commission's economic uncertainty index declined slightly in March, continuing its easing trend since October 2022, in the various business sectors. The only exception is household uncertainty, which has picked up slightly.

The geopolitical risk index (lower right chart), which is also based on media coverage, declined sharply in March but remains volatile. Lastly, our equity market uncertainty index, based on the dispersion of the daily performances of individual companies, picked up slightly in the United States (probably due to the recent turmoil that shook the banking world), while it continues to trend downwards in the Eurozone.

Tarik Rharrab

CHANGES IN UNCERTAINTY



*volatility = 60-day moving average of the cross-sectional standard deviation of daily returns of the index constituents

SOURCE: REFINITIV, ECONOMIC POLICY UNCERTAINTY, EUROPEAN COMMISSION, ATLANTA FED, GPR INDEX (MATTEIOACOVIELLO.COM), BNP PARIBAS

ECONOMIC SCENARIO

8

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 0.7% 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 of the federal funds seems to have moved closer given the ongoing tightening of monetary and financial conditions and lending standards remains uncertain. Our forecasts now see it sooner and 50 basis points lower, at 5.25% (upper end of the target range) in May 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. In the near-term, there is still some upward potential for long term rates, 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.

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	1.4	-0.1	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	0.7	0.5	2.6	8.4	5.4	2.6
Germany	2.6	1.9	-0.1	0.5	3.2	8.7	5.8	2.3
France	6.8	2.6	0.5	0.6	2.1	5.9	5.9	2.9
Italy	7.0	3.8	0.9	0.7	1.9	8.7	6.6	2.3
Spain	5.5	5.5	1.4	0.8	3.0	8.3	3.3	2.1
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	2.9	1.5	0.5	8.3	9.3	5.5	5.5

* LAST UPDATE 31 MARCH 2023: INFLATION EUROZONE, GERMANY, FRANCE, ITALY, SPAIN

** LAST UPDATE 28 MARCH: GDP EUROZONE, GERMANY, FRANCE, ITALY, SPAIN

*** FISCAL YEAR FROM 1ST APRIL OF YEAR N TO MARCH 31ST OF YEAR N+1

SOURCE: BNP PARIBAS (E: ESTIMATES & FORECASTS)

INTEREST AND EXCHANGE RATES

End of period		Q2 2023	Q3 2023	Q4 2023	Q4 2024
US	Fed Funds	5.25	5.25	5.25	3.50
	(upper limit)				
Eurozone	T-Note 10y	4.30	4.10	3.90	3.65
	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
UK	BONO 10y	4.10	4.00	3.60	2.90
	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**	0.45	0.60	0.65	0.80

Exchange Rates

End of period		Q2 2023	Q3 2023	Q4 2023	Q4 2024
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

End of period		Q2 2023	Q3 2023	Q4 2023	Q4 2024
Brent	USD/bbl	85	90	90	95

* LAST UPDATE 21 MARCH 2023

** LAST UPDATE 28 MARCH 2023

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



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FURTHER READING

9

Difficult times for the Egyptian economy	EcoTVWeek	31 March 2023
From the earth to the sky	Chart of the Week	29 March 2023
Resilience, uncertainty and robust monetary policy	EcoWeek	27 March 2023
OECD pulse	EcoPulse	24 March 2023
Towards a disinflationary reduction in the supply-demand imbalance	EcoTVWeek	24 March 2023
China: A decent rebound in the first two months of 2023	EcoPulse	22 March 2023
Eurozone: An unprecedented decline in new lending for house purchase	Chart of the Week	22 March 2023
Business insolvencies in Western Europe: a worrying increase?	EcoTVWeek	17 March 2023
Germany vs. France: German consumers have confidence in the recovery; the French, not yet	Chart of the Week	15 March 2023
Monetary policy's long and variable lags: the case of the US	EcoWeek	13 March 2023
What drives market short-termism?	EcoTVWeek	9 March 2023
Gulf countries and the challenge of the energy transition	EcoConjoncture	9 March 2023
Recent trends and short-term outlook in emerging countries	Special edition	8 March 2023
South Africa: the government still plans to hit optimistic fiscal consolidation targets	Chart of the Week	8 March 2023
Eurozone: the headache of slow disinflation	EcoWeek	6 March 2023
Inflation tracker - March 2023	EcoChart	3 March 2023
French foreign trade: hindered by deterioration in three areas	EcoFlash	3 March 2023
The European Emissions Trading System is powering up	EcoTVWeek	3 March 2023
European carbon price at an all-time high	Chart of the Week	1 March 2023
The link between global growth and international trade	Podcast-Macro Waves	27 February 2023
Eurozone: Monetary policy's long and variable lags: the case of the Eurozone	EcoWeek	27 February 2023



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