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ECONOMIC RESEARCH

BNP PARIBAS

The bank for a changing world

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EDITORIAL

FEDERAL RESERVE: HIGH FOR LONGER, THE SEQUEL

The message following the FOMC meeting of 30 April-1May, was unambiguous. It will take longer than expected to reach the point of confidence on the inflation outlook that would warrant a cut in the federal funds rate. Consequently, we are back in a 'high for long' environment for the federal funds rate, like in the fall of last year. At the current juncture the key question is whether the economy can remain as resilient if the federal funds rate stays at its current level until the latter part of the year, or even longer, or whether the risk of a hard landing is increasing. The latest Federal Reserve's Financial Stability Report gives some comfort – private sector balance sheets are sound- but also comes with a warning about the debt-servicing capacity of smaller, riskier businesses in case of a sharp downturn in economic activity. More than ever, the focus will remain on the economic data, in terms of inflation -in view of its influence on the monetary policy outlook- and, in order to gauge the resilience of the economy, demand and activity.

At some point in a monetary policy cycle, the word confidence takes a central role in the communication and press conferences of central banks: confidence that the restrictive policy stance will succeed in bringing inflation under control, confidence that there will be room to lower official interest rates. In the US, in Jerome Powell's press conferences that follow the FOMC meetings, the number of references to 'confidence' -by journalists as well as the Fed Chair- has jumped this year (chart 1). It reflects an expectation that, with the target range of the federal funds rate having been raised to 5.25% to 5.50% more than 6 months ago[1] , the time would soon be ripe for the Federal Reserve to start cutting rates. The statement of the January 2024 FOMC meeting hinted in that direction[2], hence the numerous questions of journalists during the press conference about when and why the FOMC would be sufficiently confident that the decline of inflation would warrant a lowering of the policy rate. In March, Jerome Powell's comments before the Senate Banking Committee reinforced the expectation that rate cuts were coming[3]. However, more recently, the pendulum has swung back in the opposite direction, on the back of disappointing inflation data. At the post-FOMC press conference on 20 March, a journalist asked whether the recent inflation data had dented the Fed's confidence that inflation was continually moving down. Unsurprisingly, the Fed Chair replied "*It certainly hasn't improved our confidence—it hasn't raised anyone's confidence.*[4]"

The message following the FOMC meeting of 30 April-1May, was even stronger: "*What we said is that we need to be more confident and we've said, my colleagues and I today said that we didn't see progress in the first quarter and I've said that it appears then that it's going to take longer for us to reach that point of confidence, so I don't know how long it'll take, I can just say that when we get that confidence, then rate cuts will be in scope and I don't know exactly when that will be.*[5]"

Consequently, we are back in a 'high for long' environment for the federal funds rate. Previously, we had entered in such a regime in the fall of 2023, reflecting a view that the policy rate was probably at its cyclical peak -the terminal rate- but that it would take considerable time before an easing could be envisaged[6]. It feels like watching the sequel of a movie, including the question whether it will be as good as the first one. In the US, the first 'high for longer' era saw a resilient economy -labour market, GDP growth in the fourth quarter of 2023- but at the current juncture the key question, which was not asked during the latest press conference, is whether the economy can remain as resilient if the federal funds rate stays at its current level until the latter part of the year, or even longer, or whether the risk of a hard landing is increasing. To a large degree, the answer depends on the interest rate sensitivity of the US economy, which in turn is influenced by the degree of leverage of businesses and households, whether debt is at fixed or variable rates as well as the resilience of earnings and income. The Federal Reserve's Financial Stability Report which was published in April, gives some comfort – "*balance sheets in the nonfinancial business and household sectors remained sound*" but also warns that "*a sharp downturn in economic activity would depress business earnings and household incomes and could reduce the debt-servicing capacity of smaller, riskier businesses with already low ICRs as well as particularly financially stretched households.*[7]" Clearly, more than ever, the focus will remain on the economic data, in terms of inflation -in view of its influence on monetary policy- and, in order to gauge the resilience of the economy, demand and activity.

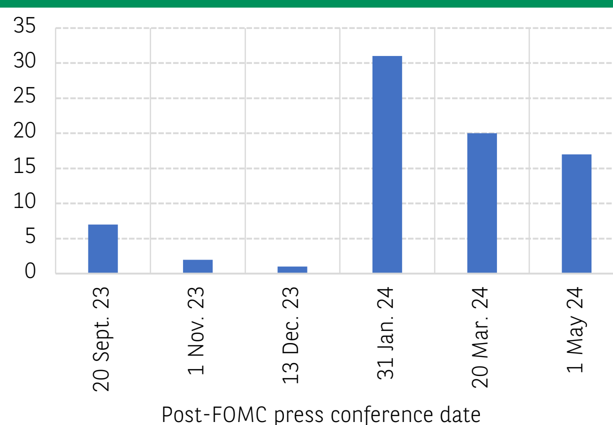


CHART 1

SOURCE: FEDERAL RESERVE, BNP PARIBAS

William De Vijlder

1 On 26 July 2023, the FOMC decided to raise the target range for the federal funds rate to 5.25% to 5.50%.
2 *"We believe that our policy rate is likely at its peak for this tightening cycle and that, if the economy evolves broadly as expected, it will likely be appropriate to begin dialing back policy restraint at some point this year."* Source: Federal Reserve.
3 *"We're waiting to become more confident that inflation is moving sustainably at 2%... When we do get that confidence — and we're not far from it — it'll be appropriate to begin to dial back the level of restriction."* Source: *Fed Is 'Not Far' From Confidence Needed to Cut Rates, Powell Says*, Bloomberg, 7 March 2024
4 The question was from Michael McKee of Bloomberg Radio and Television.
5 Source: Federal Reserve, Press conference of Jerome Powell, 1 May 2024.
6 See Federal Reserve: high(er) for longer (bnpparibas.com), 25 September 2023.
7 Source: *Financial Stability Report, Board of Governors of the Federal Reserve System*, April 2024.

MARKETS OVERVIEW

OVERVIEW

Week 26-4 24 to 3-5-24					
↘ CAC 40	8 088	▸	7 958	-1.6	%
↗ S&P 500	5 100	▸	5 128	+0.5	%
↘ Volatility (VIX)	15.0	▸	13.5	-1.5	pb
↘ Euribor 3M (%)	3.87	▸	3.83	-3.8	bp
↘ Libor $ 3M (%)	5.59	▸	5.59	-0.2	bp
↘ OAT 10y (%)	3.06	▸	3.00	-6.5	bp
↘ Bund 10y (%)	2.55	▸	2.49	-6.4	bp
↘ US Tr. 10y (%)	4.67	▸	4.50	-16.8	bp
↗ Euro vs dollar	1.07	▸	1.08	+0.8	%
↘ Gold (ounce, $)	2 333	▸	2 294	-1.7	%
↘ Oil (Brent, $)	89.6	▸	83.5	-6.8	%

MONEY & BOND MARKETS

Interest Rates			highest 24			lowest 24		
€	ECB	4.50	4.50	at	01/01	4.50	at	01/01
	Eonia	-0.51	-0.51	at	01/01	-0.51	at	01/01
	Euribor 3M	3.83	3.97	at	18/01	3.83	at	30/04
	Euribor 12M	3.69	3.76	at	19/03	3.51	at	01/02
$	FED	5.50	5.50	at	01/01	5.50	at	01/01
	Libor 3M	5.59	5.60	at	27/02	5.53	at	01/02
	Libor 12M	6.04	6.04	at	01/01	6.04	at	01/01
£	BoE	5.25	5.25	at	01/01	5.25	at	01/01
	Libor 3M	5.30	5.33	at	06/03	5.30	at	22/03
	Libor 12M	0.81	0.81	at	01/01	0.81	at	01/01

At 3-5-24

Yield (%)			highest 24			lowest 24		
€	AVG 5-7y	2.64	2.64	at	01/01	2.64	at	01/01
	Bund 2y	3.09	3.18	at	30/04	2.53	at	01/02
	Bund 10y	2.49	2.61	at	25/04	2.02	at	03/01
	OAT 10y	3.00	3.13	at	25/04	2.47	at	01/01
	Corp. BBB	4.01	4.11	at	25/04	3.75	at	01/01
$	Treas. 2y	4.80	5.10	at	30/04	4.22	at	15/01
	Treas. 10y	4.50	4.70	at	25/04	3.86	at	01/02
	High Yield	7.96	8.24	at	16/04	7.73	at	13/03
£	gilt. 2y	4.75	4.89	at	01/05	3.98	at	01/01
	gilt. 10y	4.23	4.37	at	01/05	3.60	at	01/01

At 3-5-24

EXCHANGE RATES

1€ =		highest 24			lowest 24			2024
USD	1.08	1.10	at	01/01	1.06	at	15/04	-2.5%
GBP	0.86	0.87	at	02/01	0.85	at	13/02	-1.0%
CHF	0.97	0.98	at	04/04	0.93	at	08/01	+4.8%
JPY	164.62	168.43	at	01/05	155.33	at	02/01	+5.7%
AUD	1.63	1.67	at	28/02	1.62	at	02/01	+0.6%
CNY	7.80	7.88	at	08/03	7.69	at	15/04	-0.5%
BRL	5.46	5.61	at	16/04	5.31	at	13/02	+1.8%
RUB	98.50	102.67	at	23/02	95.72	at	19/01	-0.3%
INR	89.84	91.92	at	01/05	88.68	at	12/04	-2.3%

At 3-5-24 *Change*

COMMODITIES

Spot price, $		highest 24			lowest 24			2024	2024(€)
Oil, Brent	83.5	91.6	at	12/04	75.8	at	08/01	+7.5%	+10.2%
Gold (ounce)	2 294	2 413	at	12/04	1 989	at	14/02	+11.0%	+13.9%
Metals, LMEX	4 267	4 354	at	29/04	3 558	at	09/02	+13.4%	+16.4%
Copper (ton)	9 790	10 064	at	29/04	8 065	at	09/02	+15.7%	+18.7%
wheat (ton)	220	2.3	at	01/01	191	at	15/03	-5.5%	-3.1%
Corn (ton)	169	1.7	at	01/01	148	at	23/02	-0.3%	-0.9%

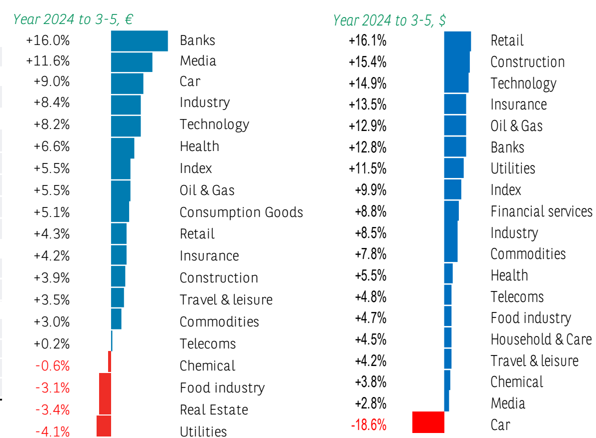
At 3-5-24 *Change*

EQUITY INDICES

	Index	highest 24			lowest 24			2024
World								
MSCI World	3 361	3 438	at	29/03	3 114	at	04/01	+6.1%
North America								
S&P500	5 128	5 254	at	28/03	4 689	at	04/01	+7.5%
Europe								
EuroStoxx50	4 921	5 083	at	28/03	4 403	at	17/01	+8.8%
CAC 40	7 958	8 206	at	28/03	7 319	at	17/01	+0.5%
DAX 30	18 002	18 492	at	28/03	16 432	at	17/01	+7.5%
IBEX 35	10 855	11 155	at	26/04	9 858	at	19/01	+0.7%
FTSE100	8 213	8 213	at	03/05	7 446	at	17/01	+0.6%
Asia								
MSCI, loc.	1 382	1 415	at	22/03	1 242	at	03/01	+1.1%
Nikkei	38 236	40 888	at	22/03	33 288	at	04/01	+14.3%
Emerging								
MSCI Emerging ($)	1 061	1 061	at	03/05	958	at	17/01	+0.4%
China	60	60	at	03/05	49	at	22/01	+8.8%
India	997	1 003	at	02/05	915	at	03/01	+8.5%
Brazil	1 616	1 800	at	01/01	1 523	at	16/04	-6.3%

At 3-5-24 *Change*

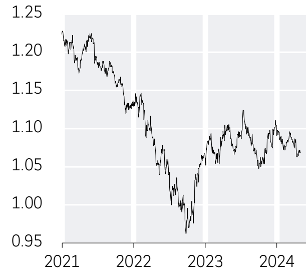
PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)



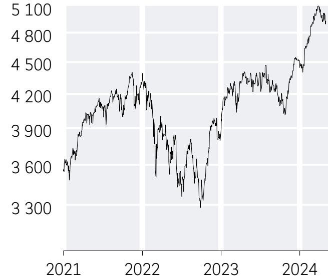
SOURCE: REFINITIV, BNP PARIBAS

MARKETS OVERVIEW

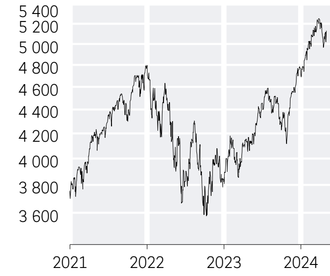
EURO-DOLLAR



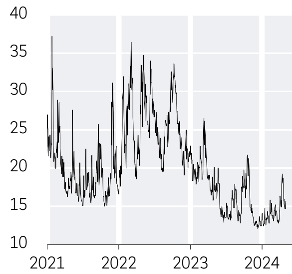
EUROSTOXX50



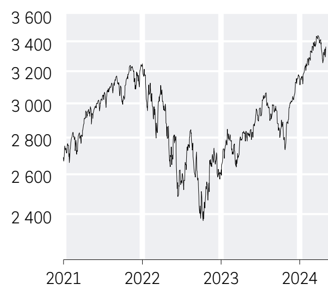
S&P500



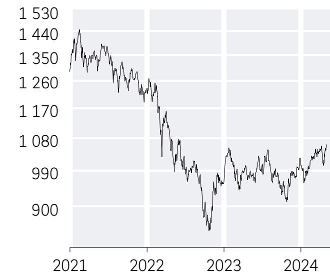
VOLATILITY (VIX, S&P500)



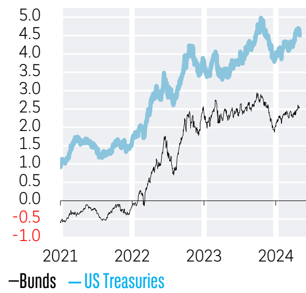
MSCI WORLD (USD)



MSCI EMERGING (USD)

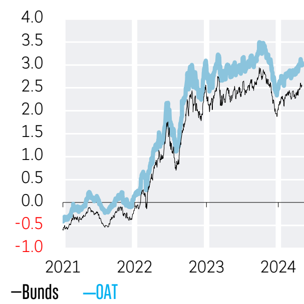


10Y BOND YIELD, TREASURIES VS BUND



—Bunds — US Treasuries

10Y BOND YIELD



—Bunds —OAT

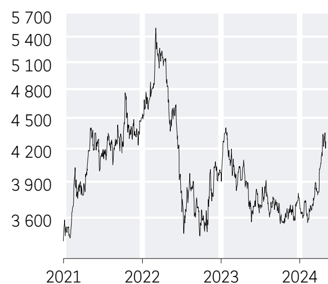
10Y BOND YIELD & SPREADS

Year 2024 to 3-5

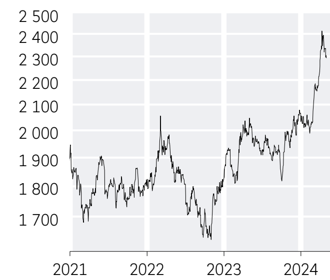
Yield	Country	Spread
3.99%	Greece	150 bp
3.79%	Italy	129 bp
3.27%	Spain	78 bp
3.07%	Portugal	58 bp
3.00%	France	50 bp
2.98%	Austria	49 bp
2.95%	Belgium	45 bp
2.95%	Finland	45 bp
2.81%	Netherlands	32 bp
2.77%	Ireland	27 bp
2.49%	Germany	

OIL (BRENT, USD)

METALS (LMEX, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS

EUROZONE: PEAK OF MONETARY POLICY'S RESTRICTIVE EFFECTS ON BANK LENDING IS BEHIND US

In line with previous months, the recovery in the private sector credit impulse continued in the first quarter of 2024, after the dip seen in the third quarter of 2023. This said, the recovery was slightly slower than at the end of 2023 and the overall trend is still negative.

Developments in lending to business are traditionally more volatile over the cycle than those in lending to households. Recent ones have not deviated from this rule: in the autumn of 2023, at a time when the effects of the tightening of monetary policy were at their strongest, the impulse of lending to households did not fall as far, in absolute terms, as that for lending to businesses. Conversely, its recovery since then has been less vigorous. Taking a longer-term view introduces an additional observation: the impulse of lending to households are still close to those seen at the historic low at the beginning of 2009, whilst that of lending to business have not returned to such levels since.

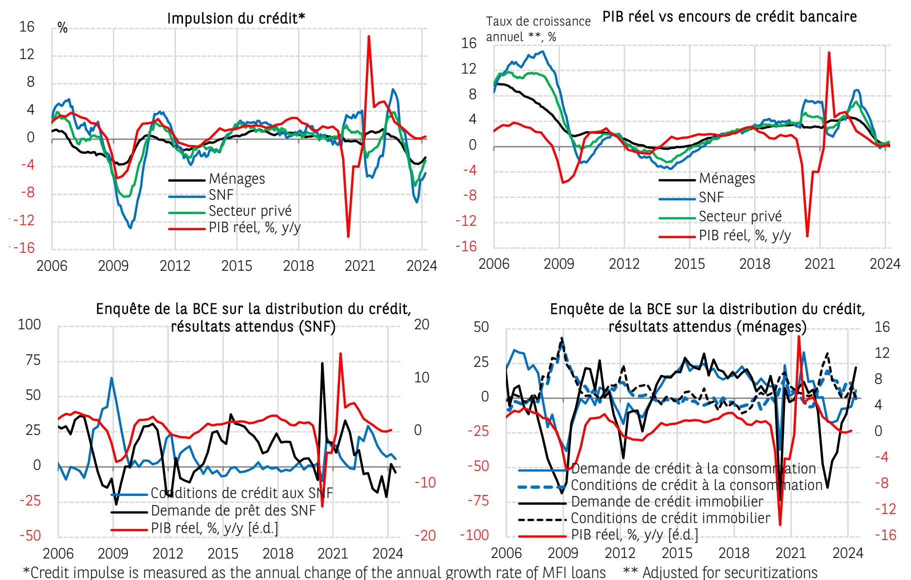
Meanwhile, movements in real GDP and in outstanding loans have been relatively tightly synchronised. The former saw a modest upturn in the first quarter (0.4% year-on-year) after two quarters of barely positive growth in the third and fourth quarters of 2023 (0.1% in both cases). At the same time, and for the first time since the summer of 2022 and the beginning of the ECB cycle of rate increases, outstanding credit in the private sector has stopped slowing down (+0.6% year-on-year in December 2023, +0.8% in March 2024). However, these overall trends need to be put in perspective since they are due solely to lending to the financial sector, with outstanding loans to households (+0.4% and +0.2% respectively) and to a lesser extent loans to non-financial companies (+0.5% and +0.4%) continuing to slow, albeit less markedly than in previous quarters.

The 157 banks surveyed in the first fortnight of March for the ECB's Bank Lending Survey indicated that they had only very slightly tightened their credit standards applied to the approval of loans for businesses in the first quarter of 2024 and, more importantly, by less than they had expected at the time of the previous survey. At the same time, and for the first time in three years, they had eased their credit standards for mortgages. They also continued to tighten lending standards for consumer loans, where the share of new production considered as higher risk has increased. Overall, the increase in perceived risk has encouraged a tightening of terms and conditions, whilst stiffer competition, particularly for mortgages, and greater risk tolerance have pushed towards an easing of lending conditions.

The fall in demand for loans and the drawing down of credit lines by businesses has surprised in terms of its scale, with banks expecting a stabilisation, on average, in the survey conducted during the fourth quarter of 2023. Demand for mortgages has seen a more modest contraction. Demand for consumer loans has stayed more or less stable. As in previous quarters, demand for bank financing was negatively affected by higher interest rates, a reduction in productive investment by companies and the weakness of consumer confidence.

Banks have reported reduced ability to collect resources from their retail banking clients, but also better access to bond market and, to a lesser extent, to the money market. The continued reduction of Eurosystem's securities portfolio had negative effects on financing conditions and liquidity positions over the last six months, which contributed to the tightening of lending conditions and the contraction of new production. Banks believe that this process has not yet had an effect on lending conditions but that they could be affected over the next six months.

CREDIT IMPULSE IN THE EUROZONE



*Credit impulse is measured as the annual change of the annual growth rate of MFI loans ** Adjusted for securitizations

SOURCE ECB, ECB SURVEY ON THE DISTRIBUTION OF CREDIT, BLS, BNP PARIBAS CALCULATIONS

Repayments under TLTRO III continued to weigh on the liquidity positions of lending establishments. However, because of the significant repayments since November 2022 and the now modest residual outstandings from these operations, the impact on their own financing conditions is considered negligible and the effect on conditions applied to clients is considered neutral.

Banks reported a positive impact from the increase in key policy rates on interest margins over the past six months, but they now expect this to diminish over the next six months. Conversely, they highlight the depressive effect on financing volumes, that they expect to persist over the next six months. Lastly, they believe that the overall effect of higher rates on levels of banking profitability will be negative over that period, due to the increase in the cost of risk. This assessment holds true for banking systems where the share of variable-rate loans is relatively high (Portugal, Finland and, to a lesser extent, Italy and Spain), which is not the case for France, Belgium and Germany.

For the second quarter of 2024 the banks expect a modest fall in demand for financing from business and an increase in demand from households. They expect lending conditions (rates, guarantees, etc.) to be tightened slightly on loans to companies and to stay more or less the same for households. We believe that demand for borrowing will continue to be constrained by financing costs, which will remain lastingly higher than those seen up until 2022 and be penalised by expectations of adjustments in real estate markets. Amongst other factors, this will support the disinflationary trend in the euro zone (annual inflation stable at 2.4% in March and April, from 2.9% in December 2023), opening the way to the first cut in ECB policy rates next month.

Laurent Quignon

ECONOMIC SCENARIO

UNITED STATES

The US economy showed surprising vigour in 2023, illustrated by +2,5% yearly annual growth driven by the resilience of household consumption and the good figures of business investment. Thus, we have gradually ruled out the event of a recession induced by the cumulative monetary tightening. Despite a slowdown (+0.4% q/q v. +0.8% in Q4 2023), the GDP has expanded again in Q1 2024, driven by contributions from household consumption and investment. Our baseline scenario implies a +2.8% rate of growth for 2024, enabled by the very positive carryover effect from 2023 and an expected increase in real incomes.. While the inflation peak was reached in mid-2022, Q1 2024 data have not allowed to gain more confidence regarding a rapid return of the CPI to its target. We forecast inflation to stand at +3.2% y/y in Q4 2024. This picture paves the way for a modest easing of its monetary policy by the Fed, which could start cutting rates progressively as the end of the year, with one rate cut in 2024.

CHINA

Economic growth was stronger than expected in Q1 2024 (+5.3% year-on-year), principally driven by the manufacturing export sector. On the contrary, domestic demand and activity in the services sector continued to lack momentum, still held back by the crisis in the property sector, regulatory uncertainties, and low confidence of consumers and private investors. To support activity, the authorities have been strengthening their industrial policy while maintaining a prudent demand policy. This economic policy mix risks amplifying the divergence in performance between sectors and the imbalance between domestic demand and supply, which have been apparent for several months. The real GDP growth target of "around 5%" set for this year is projected to be reached. Consumer price inflation is expected to remain very low; it averaged zero y/y in Q1 2024.

EUROZONE

Eurozone GDP picked up by 0.3% q/q in Q1 according to preliminary Eurostat data. The negative effects of monetary tightening on economic activity are expected to diminish in 2024. Growth would strengthen at 0.4% q/q in Q2 before stabilizing at this level during the second semester. This improvement would also be underpinned by a first rate cut by the ECB, which we expect to happen in June. This would be followed by two more cuts in the second half of the year, at a rate of one cut per quarter. This monetary easing would accompany the inflation decline, which is expected to come close to the 2% target during the third quarter. That said we expect continued stickiness in the more wage-sensitive parts of the inflation basket, like services. The disinflation process, along with the dynamism of wages, should support household purchasing power and consumption. Growth should also be boosted by NGEU disbursements and its deployment on the ground.

FRANCE

French economy experienced six months of stagnation during the second half of 2023. For the first time, there was no growth support from domestic demand items in Q4 2023: household consumption stagnated, and corporate and household investment declined. As disinflation is now visible (the harmonized index grew by 2.4% y/y in March 2024, compared to 5.7% y/y in September 2023), our scenario for 2024 envisages a gradual improvement, starting in Q2 rather than in Q1, with the return of two important pillars of French growth (household consumption and corporate investment), and heralds an even better 2025 (with a growth forecast of 1.4%, after 0.7% in 2023).

RATES AND EXCHANGE RATES

2024 should be the year of the start of the easing cycle by the Federal Reserve, the ECB and the Bank of England. However, the timing of the first cut remains uncertain, as does the number of expected cuts. The ECB seems closer than the Fed and the BoE to getting the data and necessary confidence to estimate that inflation is moving towards the 2% target on a sustainable basis. We expect the first ECB rate cut to occur in June and the first BoE cut in August, whereas the Fed would start cutting at the very end of the year, in December. The Fed would thereby undertake a single rate cut in 2024, while the first move would be followed by two more for the ECB and the BoE (presumably 25 basis points cut each). On both sides of the Atlantic, policy rates in real terms and the degree of monetary restriction would remain about unchanged. The induced decline in long-term rates should be limited by the importance of bond issuance against a background of quantitative tightening.

The Bank of Japan (BoJ) was the first central bank among G7 economies to act in 2024. The BoJ jointly announced the end of its negative interest rate policy and yield curve control policy at the March meeting. As a result, the policy rate target was raised from a corridor of -0.1-0.0% to 0.0-0.1%, although the volume of JGBs purchases remains broadly unchanged. We expect monetary policy to normalise very gradually in the country, with only one additional hike envisaged by the end of 2024 (probably in September).

We are fundamentally bearish regarding the US dollar, but it is so far supported by geopolitical tensions and diverging trends between the US and the Eurozone (with stronger growth and inflation and less monetary easing across the Atlantic). This leads us to push back and moderate the expected USD depreciation, especially versus the euro. The yen should also eventually strengthen versus the USD, partly as a result of the desynchronization of monetary policy, as the BoJ is tightening its monetary stance.

GDP GROWTH AND INFLATION

	GDP Growth				Inflation			
%	2022	2023	2024 e	2025 e	2022	2023	2024 e	2025 e
United States	1,9	2.5	2,8	1,8	8,0	4,1	3,4	2,8
Japan	0,9	1,9	0,4	0,9	2,5	3,2	2,9	2,3
United Kingdom	4,4	0,1	0,4	1,2	9,1	7,4	2,5	2,1
Euro Area	3,5	0,5	0,8	1,7	8,4	5,4	2,4	2,1
Germany	1,9	-0,1	0,2	1,4	8,7	6,1	2,6	2,3
France	2,5	0,9	0,9	1,4	5,9	5,7	2,5	1,8
Italy	4,2	1,0	1,1	1,4	8,7	6,0	1,1	1,8
Spain	5,8	2,5	2,4	2,1	8,3	3,4	3,0	2,1
China	3,0	5,2	5,2	4,3	2,0	0,2	-0,1	1,2
India*	7,1	7,6	6,5	6,4	6,7	5,4	4,7	4,3
Brazil	2,9	2,9	2,2	2,0	9,3	4,6	4,1	4,1

Source : BNP Paribas (e: Estimates & forecasts)
Last update: 2 May 2024
* Fiscal year from 1st April of year n to March 31st of year n+1

INTEREST AND EXCHANGE RATES

Interest rates, %

End of period		Q2 2024	Q3 2024	Q4 2024	Q2 2025	Q4 2025
US	Fed Funds (upper limit)	5.50	5.50	5.25	4.75	4.25
	T-Note 10y	4.25	4.20	4.20	4.20	4.20
Eurozone	deposit rate	3.75	3.50	3.25	2.75	2.50
	Bund 10y	2.35	1.95	2.00	2.25	2.50
	OAT 10y	2.87	2.50	2.52	2.80	3.05
	BTP 10y	3.70	3.35	3.45	3.80	4.00
	BONO 10y	3.19	2.82	2.85	3.15	3.38
UK	Base rate	5.25	4.75	4.50	4.00	3.50
	Gilts 10y	4.00	3.80	3.70	3.55	3.65
Japan	BoJ Rate	0.10	0.25	0.25	0.50	0.75
	JGB 10y	0.90	1.00	1.20	1.40	1.35

Exchange Rates

End of period		Q2 2024	Q3 2024	Q4 2024	Q2 2025	Q4 2025
USD	EUR / USD	1.05	1.05	1.06	1.08	1.10
	USD / JPY	155	154	153	150	148
	GBP / USD	1.25	1.27	1.28	1.30	1.33
EUR	EUR / GBP	0.82	0.83	0.83	0.83	0.83
	EUR / JPY	163	162	162	162	163

Brent

Quarter Average		Q2 2024	Q3 2024	Q4 2024	Q2 2025	Q4 2025
Brent	USD/bbl	90	92	87	81	82

Sources: BNP Paribas (Market Economics, Interest Rate Strategy, FX Strategy, Commodities Desk Strategy)
Last update: 29 April 2024

FURTHER READING

April issue	EcoAtlas	6 May 2024
French household's services consumption is in excellent shape	EcoTV	6 May 2024
Monetary sovereignty: beyond the mantra	EcoEmerging	3 May 2024
Footprints comparison	Chart of the Week	2 May 2024
United States: What to expect from this week's FOMC meeting?	EcoBrief	29 April 2024
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France: Corporations show renewed interest in money market funds and term deposits	Chart of the Week	17 April 2024
EcoPerspectives 2nd quarter 2024 | Each central bank has its own pace	EcoPerspectives	17 April 2024
World Economy: to cut or not to cut (simultaneously)?	EcoWeek	16 April 2024
Inflation Tracker - April 2024 | Inflation remains on a downward trend, except for the United States	EcoCharts	12 April 2024
Saudi Arabia: better growth prospects	EcoTV	11 April 2024
United States: don't fight the Fed!	Chart of the Week	10 April 2024
March survey data: US resilience and Eurozone getting ready for a recovery in growth	EcoWeek	10 April 2024
France: business insolvencies stabilised at a high level in Q1 2024	EcoBrief	8 April 2024

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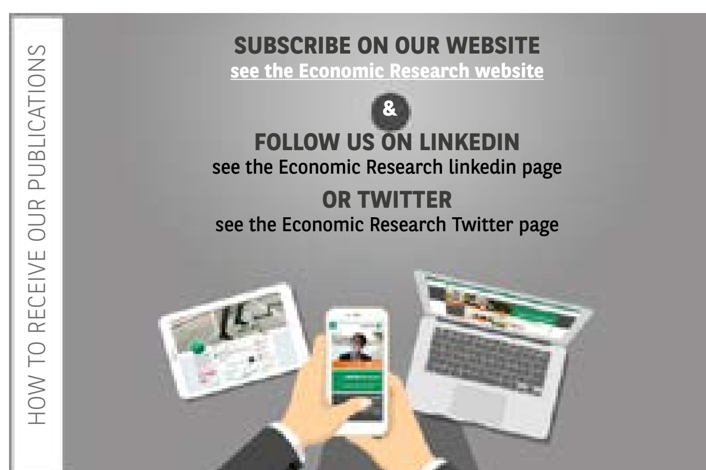

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