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“ THE FEDERAL RESERVE IS TORN BETWEEN INFLATION THAT IS STILL WELL ABOVE TARGET AND THE PROSPECT THAT PAST RATE HIKES AND TIGHTER CREDIT STANDARDS SHOULD WEIGH ON ACTIVITY IN THE COMING MONTHS. ”



ECONOMIC RESEARCH



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WHEN WILL THE FEDERAL RESERVE STOP TIGHTENING? INSIGHTS FROM PREVIOUS CYCLES.

In his latest press conference, Federal Reserve Chair Powell argued that monetary policy might already be sufficiently restrictive. In future decisions, economic data will be particularly important but this does not imply that the latest data are the only thing that matters. The delayed effects of past rate hikes need to be taken into account, considering that they will only show up in the data published over the following months. This is why in past tightening cycles, the Fed has tended to stop hiking rates although the pace of job creation was still rather healthy and well before the unemployment rate picked up significantly. Today it is torn between inflation that is still well above target and the prospect that past rate hikes and tighter credit standards should weigh on activity in the coming months.

*"But the labor market is very, very strong, whereas inflation is, you know, running high, well above our - well above our goal."*¹ Judging by the very strong labour market report that was released two days later, Fed Chair Powell's comment during his post-FOMC press conference almost sounded prescient.

Nonfarm payrolls increased 253,000 in April -the Bloomberg consensus had expected an increase of 180,000- and the unemployment rate declined to 3.4% from 3.5%. Moreover, growth in average hourly earnings picked up to 4.4% from 4.3% (consensus 4.2%). The two-year Treasury yield jumped 10 basis points and the 10-year yield moved 5 basis points higher, but this didn't stop equity indices of reacting positively, reflecting a belief that the resilient labour market implies that the economy will not be in recession anytime soon. The rise in bond yields partly corrected their drop during Jerome Powell's press conference earlier that week, following his acknowledgment that after the latest rate hike, the policy stance may be sufficiently restrictive: *"I think - I think you feel like, you know, we're - we may not be far off for. We're possibly even at that level."* The Fed Chair's assessment is based on, firstly, the cumulative increase in the policy rate (500 basis points), which has brought real rates clearly above the neutral rate². Secondly, interest-sensitive activities have started to react to the increase in rates. Thirdly, access to credit is being tightened. Finally, quantitative tightening reinforces the effect of higher official interest rates.

Going forward, economic data will be particularly important: as mentioned repeatedly in the past by Fed officials, monetary policy is data dependent. However, this does not imply that the latest data are the only thing that matters, because the delayed effects of past rate hikes need to be taken into account, considering that they will only fully show up in the data published over the following months.

This may imply that, despite inflation still being above target and/or a rather strong labour market, the central bank might stop hiking rates based on the view that, given past rate hikes, the labour market will weaken, and inflation will decline sufficiently. In this respect, the data line-up when, in the past tightening cycles, the FOMC stopped raising rates may provide insights that are relevant for the present situation. The accompanying table³ provides information on inflation using the Federal Reserve's preferred measure -the change in the price index of personal consumption expenditures excluding food and energy (core PCE)-, the unemployment rate, the creation of new jobs⁴, a financial conditions index⁵, the layoff and discharges rate and the job openings rate⁶.

In May 1989, inflation had been declining but was still above the previous low of 2.8% y/y reached at the start of 1987. The unemployment rate was stable and there was ongoing job creation although with a clear loss of momentum. Financial conditions were tightening. In 1995, the Federal Reserve succeeded in engineering a soft landing: monetary tightening cooled down inflation but did not cause a recession. The unemployment rate had declined the year before and stabilised thereafter, job creation was strong, credit standards were loose and inflation low, which enabled the Fed to stop raising its policy rates. In May 2000, inflation was below target, the labour market was still in good shape, financial conditions were close to neutral but credit standards had tightened significantly. In June 2006, the unemployment rate was stable but the pace of job creation was slowing. Access to credit was easy, financial conditions were accommodative and inflation at 2.6% must have been considered sufficiently close to target to justify no further rate increases. In December 2018, inflation was in line with target and the unemployment rate was low. The rate of job openings was still high but the pace of job creation was slowing. With inflation at target, there was no need to hike further.

¹ Source: Federal Reserve, Transcript of Chair Powell's Press Conference, 3 May 2023.

² The neutral rate is the real short-term interest rate whereby monetary policy is neither contractionary nor expansionary.

³ The analysis starts with the tightening cycle that ended in 1989. During the tightening under Volcker in the early 80s, the federal funds rate was very volatile, which is why this episode has not been taken into account.

⁴ A 3- and 12-month moving average of the monthly change in nonfarm payrolls is shown. The comparison allows to assess the momentum in terms of job creations.

⁵ The Chicago Fed's National Financial Conditions Index (NFCI) provides a comprehensive weekly update on U.S. financial conditions in money markets, debt and equity markets and the traditional and "shadow" banking systems. Positive values of the NFCI indicate financial conditions that are tighter than average, while negative values indicate financial conditions that are looser than average. (Source: FRED). Tighter financial conditions are expected to weigh on economic growth through a variety of transmission channels.

⁶ The layoff and job openings rate are included based on the view that as the economy slows down, there will be fewer job openings and an increase in layoffs.

” The Federal Reserve is torn between inflation that is still well above target and the prospect that past rate hikes and tighter credit standards should weigh on activity in the coming months.



At the current juncture, the labour market remains very strong (the unemployment rate, the job openings rate -although this has been declining from exceptionally high levels-, the pace of job creation -although here again it is down). Financial conditions remain easy whereas credit standards have tightened strongly. Inflation is still well above target.

Based on past experience -admittedly with a small number of observations-, it seems that each end of the hiking cycle was different: tight financial conditions and a slowing job growth in 1989, the feeling of 'mission accomplished' in 1995 (soft landing), the credit crunch in 2000, a clear worsening of the labour market (job growth) in 2006 and slowing job creation with low inflation in 2018. Moreover, the Fed has tended to stop hiking rates although the pace of job creation was still rather healthy and well before the unemployment rate picked up significantly. Today, the challenge is huge, also compared with history, with still high inflation, still strong job creation -though less than before- and a huge tightening in credit standards. Reading between the lines, this last point -which has been mentioned on several occasions- in combination with the cumulative tightening is what pushes Powell to hint at conditions being sufficiently tight. This is also what the market is pricing in.

William De Vijlder

US DATA WHEN FED FUNDS REACH CYCLICAL PEAK

	Month in which terminal rate of federal funds rate was reached					Latest observation
	May 1989	February 1	May 2000	June 2006	December 2018	
Core PCE	4.4%	2.3%	1.7%	2.6%	2.1%	4.6%*
Unemployment rate	5.2%	5.4%	4.0%	4.6%	3.9%	3.4%**
Nonfarm payrolls (3MMAV)	162	273	329	96	148	222**
Nonfarm payrolls (12MMAV)	246	326	275	199	190	333**
Chicago Fed national financial conditions	0.26%	-0.63%	-0.04%	-0.59%	-0.41%	-0.23%
Layoffs and discharges rate	N.A.	N.A.	N.A.	1.3%	1.2%	1.2%*
Job openings rate	N.A.	N.A.	N.A.	3.3%	4.8%	5.8%*
Net percentage of domestic banks tightening standards for commercial and industrial loans to large and middle-market firms (quarterly data)	N.A.	-10.2	24.6	-12.3	-15.9	46.0***

TABLE 1

*March 2023 **April 2023 ***Q2 2023

SOURCE: FRED, FEDERAL RESERVE OF ST. LOUIS, BNP PARIBAS



MARKETS OVERVIEW

OVERVIEW

Week 28-4 23 to 5-5-23

▼ CAC 40	7 492	▶ 7 433	-0.8 %
▼ S&P 500	4 169	▶ 4 136	-0.8 %
↑ Volatility (VIX)	#N/A	▶ #N/A	#N/A pb
↔ Euribor 3M (%)	3.27	▶ 3.28	+1.5 bp
↔ Libor \$ 3M (%)	5.30	▶ 5.34	+3.4 bp
▼ OAT 10y (%)	2.84	▶ 2.82	-2.3 bp
▼ Bund 10y (%)	2.32	▶ 2.30	-2.6 bp
↔ US Tr. 10y (%)	3.43	▶ 3.44	+0.7 bp
▼ Euro vs dollar	1.10	▶ 1.10	-0.3 %
↔ Gold (ounce, \$)	1 990	▶ 2 012	+1.1 %
▼ Oil (Brent, \$)	79.5	▶ 75.4	-5.2 %

MONEY & BOND MARKETS

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	2.72	3.36 at 08/03
Euribor 3M	3.28	3.29 at 24/04	2.16 at 02/01	Bund 10y	2.30	2.75 at 02/03
Euribor 12M	3.77	3.98 at 09/03	3.30 at 19/01	OAT 10y	2.82	3.23 at 03/03
\$ FED	5.25	5.25 at 04/05	4.50 at 02/01	Corp. BBB	4.42	4.75 at 03/03
Libor 3M	5.34	5.34 at 05/05	4.77 at 02/01	\$ Treas. 2y	3.98	5.12 at 08/03
Libor 12M	5.20	5.88 at 08/03	4.70 at 20/03	Treas. 10y	3.44	4.06 at 02/03
E BoE	4.25	4.25 at 23/03	3.50 at 02/01	High Yield	8.78	9.16 at 20/03
Libor 3M	4.63	4.64 at 02/05	3.87 at 02/01	£ gilt. 2y	3.77	4.33 at 19/04
Libor 12M	0.81	0.81 at 02/01	0.81 at 02/01	£ gilt. 10y	3.78	3.86 at 19/04

EXCHANGE RATES

1€ =	highest 23	lowest 23	2023
USD	1.10	1.11 at 03/05	1.05 at 05/01 +3.1%
GBP	0.87	0.90 at 03/02	0.87 at 05/05 -1.7%
CHF	0.98	1.00 at 24/01	0.97 at 15/03 -0.5%
JPY	148.47	150.77 at 01/05	138.02 at 03/01 +5.4%
AUD	1.63	1.67 at 26/04	1.53 at 27/01 +3.7%
CNY	7.61	7.66 at 03/05	7.23 at 05/01 +2.5%
BRL	5.47	5.79 at 04/01	5.40 at 08/03 -3.0%
RUB	85.05	91.39 at 26/04	73.32 at 12/01 +9.2%
INR	90.04	90.45 at 03/05	86.58 at 08/03 +2.0%

At 5-5-23 Change

COMMODITIES

Spot price, \$	highest 23	lowest 23	2023	2023(e)
Oil, Brent	75.4	88.2 at 23/01	72.4 at 03/05	-11.3% -14.0%
Gold (ounce)	2 012	2 047 at 04/05	1 810 at 24/02	+10.8% +7.4%
Metals, LME	3 894	4 404 at 26/01	3 824 at 15/03	-2.2% -5.2%
Copper (ton)	8 560	9 331 at 23/01	8 236 at 04/01	+2.3% -0.8%
wheat (ton)	241	2.9 at 13/02	219 at 02/05	-15.7% -18.3%
Corn (ton)	242	2.7 at 13/02	237 at 27/04	-0.7% -9.8%

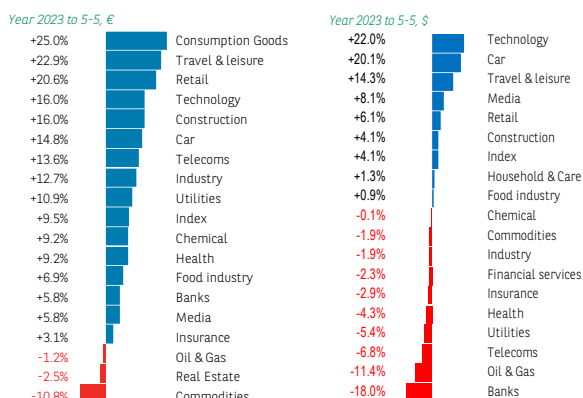
At 5-5-23 Change

EQUITY INDICES

Index	highest 23	lowest 23	2023
World			
MSCI World	2 822	2 848 at 02/02	2 595 at 05/01 +8.4%
North America			
S&P500	4 136	4 180 at 02/02	3 808 at 05/01 +7.7%
Europe			
EuroStoxx50	4 340	4 409 at 21/04	3 856 at 02/01 +14.4%
CAC 40	7 433	7 577 at 21/04	6 595 at 02/01 +1.5%
DAX 30	15 961	15 961 at 05/05	14 069 at 02/01 +14.6%
IBEX 35	9 147	9 511 at 06/03	8 370 at 02/01 +1.1%
FTSE100	7 778	8 014 at 20/02	7 335 at 17/03 +0.4%
Asia			
MSCI, loc.	1 141	1 147 at 01/05	1 065 at 04/01 +0.7%
Nikkei	29 158	29 158 at 02/05	25 717 at 04/01 +11.7%
Emerging			
MSCI Emerging (\$)	982	1 052 at 26/01	941 at 16/03 +0.3%
China	64	75 at 27/01	62 at 20/03 +0.4%
India	755	786 at 18/01	703 at 16/03 -3.1%
Brazil	1 437	1 574 at 25/01	1 296 at 23/03 -7.3%

At 5-5-23 Change

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

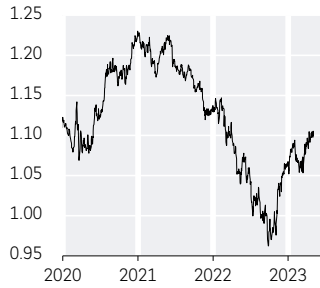


SOURCE: REFINITIV, BNP PARIBAS

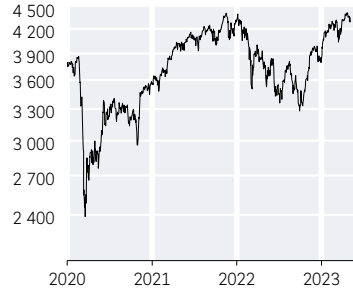


MARKETS OVERVIEW

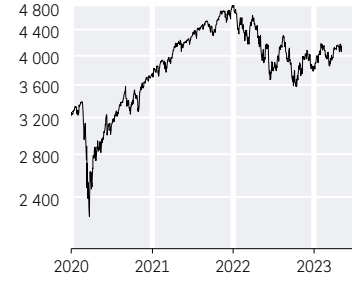
EURO-DOLLAR



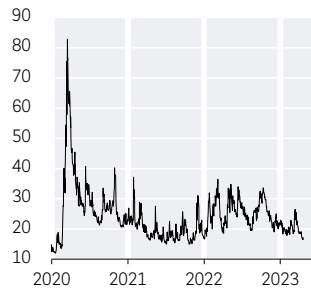
EUROSTOXX50



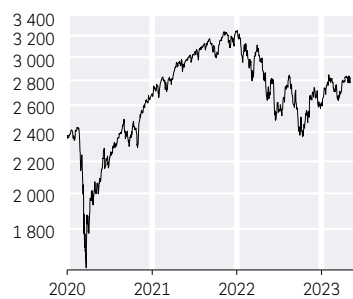
S&P500



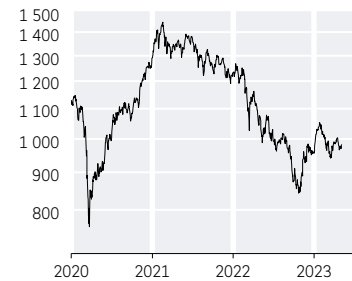
VOLATILITY (VIX, S&P500)



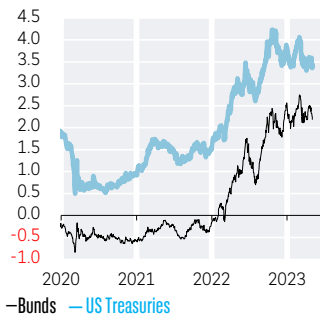
MSCI WORLD (USD)



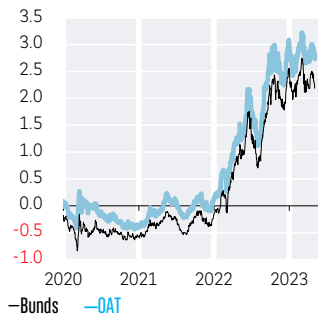
MSCI EMERGING (USD)



10Y BOND YIELD, TREASURIES VS BUND



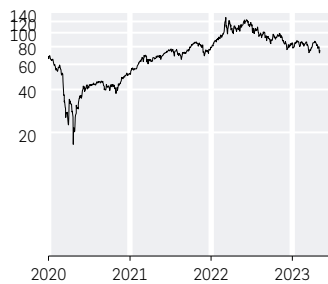
10Y BOND YIELD



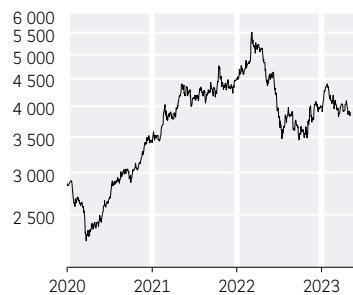
10Y BOND YIELD & SPREADS

Year 2023 to 5-5		
5.10%	Greece	280 bp
4.13%	Italy	183 bp
3.38%	Spain	108 bp
3.03%	Portugal	73 bp
2.98%	Belgium	68 bp
2.95%	Austria	65 bp
2.89%	Finland	59 bp
2.82%	France	52 bp
2.73%	Ireland	43 bp
2.66%	Netherlands	36 bp
2.30%	Germany	

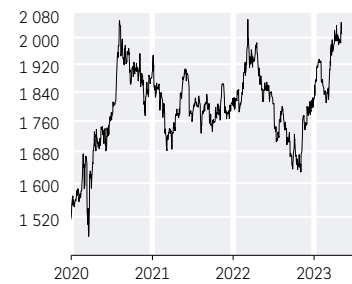
OIL (BRENT, USD)



METALS (LMEX, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS



ECONOMIC PULSE

CREDIT PULSE IN THE EUROZONE: MONETARY POLICY TIGHTENING IS CAUSING AN HISTORIC DROP IN DEMAND FOR BANK LOANS

Already noticeable in Q4 2022, the effects of monetary policy tightening on the distribution of bank credit in the eurozone intensified significantly in Q1 2023. The impulse of bank lending to the private sector has been negative since February 2023, for the first time since 2014, excluding 2021 (after-effects of Covid support measures and loans). Credit impulse to non-financial companies, albeit sharply down, remains positive for the time being, while that of household loans, negative since November 2022, is still decreasing.

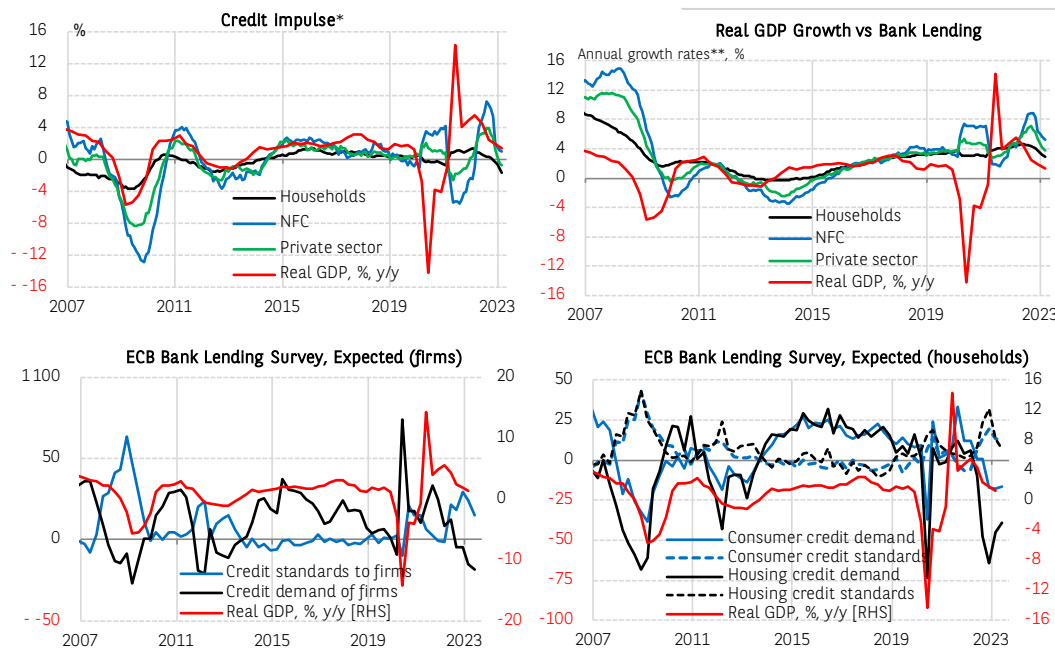
The year-on-year variation in private sector loan outstandings almost halved between September 2022 (+7.1%) and March 2023 (+3.8%). Starting from a much more sustained pace (+8.9%), loans to non-financial companies maintained a rate of growth (+5.2% in March) greater than that of loans to households (+2.9% in March compared to +4.6% in May 2022, the most recent peak). These developments should contribute to the decrease of inflation from summer 2023 (+7.0% in April), at the price of a sustained slowdown in activity over the coming months (expected GDP growth of +0.6% in 2023 after +3.5% in 2022). Banks surveyed between 22 March and 6 April 2023 report a particularly pronounced tightening of the criteria for granting loans to companies in the first quarter of 2023, unprecedented since the sovereign debt crisis in 2011. The main factors put forward are the economic outlook and companies' individual situations. Banks also indicated a substantial tightening of home loan criteria, justified by the increase in perceived risk. Consumer credit stands out due to a more moderate tightening.

The sharp rise in financing costs caused by the tightening of monetary policy and the drop in investment spending led to the sharpest drop in demand for corporate financing recorded since the 2008 crisis, which was much higher than expected in Q4 2022. Demand for home loans suffered from weak consumer confidence and, above all, rising borrowing rates. Its contraction was close to that seen in Q4 2022, which was already the most significant since the start of the survey (2003). In comparison, the decline in demand for consumer loans appears limited.

For Q2 2023, banks are considering further tightening of lending criteria for businesses and housing, albeit at more moderate rates than in Q1 as we foresee the end of monetary policy tightening during the summer. Consumer loans, on the other hand, should see their criteria tighten at the same pace – rather contained – as in Q1. At the same time, banks are anticipating less pronounced declines in demand from both companies and households.

Laurent Quignon

CREDIT IMPULSE IN THE EUROZONE



* Credit impulse is measured as the annual change of annual growth rate of MFI loans.

** Adjusted for securitizations.

SOURCES : ECB, ECB SURVEY ON THE DISTRIBUTION OF CREDIT, BLS, 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. This slowdown remains progressive however as evidenced by the slow puncture of the labour market, with job creation remaining high, the unemployment rate low and wage growth buoyant. Inflation seems to have peaked in the middle of 2022, but core disinflation remains gradual in such a way that headline inflation should stay 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, will 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 0.8% and 0.5% respectively. Although it is expected to decline throughout 2023, inflation would 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 is still high (and has reached a new peak of 7.3% y/y in February 2023 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. 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. 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. If, for the Fed, we expect the hike in May to be the last one, for the ECB, the expected increase in May would be followed by two more, bringing the deposit rate at 3.75% in Q3. 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.

INFLATION* AND GDP GROWTH**

%	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	3,3	1,7
United-Kingdom	7,6	4,1	0,3	1,0	2,6	9,1	6,6	2,0
Euro Area	5,3	3,5	0,6	0,5	2,6	8,4	5,4	2,6
Germany	2,6	1,9	0,0	0,5	3,2	8,7	5,8	2,6
France	6,8	2,6	0,5	0,6	2,1	5,9	6,1	3,0
Italy	7,0	3,8	0,9	0,6	1,9	8,7	6,1	2,2
Spain	5,5	5,5	1,8	0,8	3,0	8,3	3,2	2,2
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	5,0	2,9	1,5	0,5	8,3	9,3	5,5	5,5

* LAST UPDATE 28 APRIL 2023: INFLATION JAPAN; 20 APRIL 2023: INFLATION EUROZONE, GERMANY, FRANCE, ITALY, SPAIN AND UK; 31 MARCH 2023: US GDP AND INFLATION

** LAST UPDATE 4 MAY 2023: GDP UK; 21 APRIL 2023: GDP EUROZONE, GERMANY, FRANCE, ITALY AND 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

Interest rates, %		Q2 2023	Q3 2023	Q4 2023	Q4 2024
End of period					
US	Fed Funds (upper limit)*	5.25	5.25	5.25	3.50
	T-Note 10y **	3.75	3.50	3.40	3.25
Eurozone	deposit rate*	3.50	3.75	3.75	2.75
	Bund 10y **	2.60	2.45	2.20	2.00
	OAT 10y	3.15	3.00	2.72	2.50
	BTP 10y	4.60	4.70	4.45	3.80
	BONO 10y	3.60	3.55	3.30	2.90
UK	Base rate*	4.50	4.50	4.50	3.50
	Gilts 10y **	3.75	3.50	3.35	2.80
Japan	BoJ Rate	-0.10	-0.10	-0.10	0.10
	JGB 10y**	0.45	0.60	0.65	0.80

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					
End of period					
Brent	USD/bbl	85	90	90	95

* DEPOSIT RATE: LAST UPDATE AT 27 APRIL 2023, FED FUNDS : 31 MARCH 2023, BOE RATE: 20 APRIL 2023

** BUND 10Y: LAST UPDATE AT 3 MAY, GILTS 10Y: 20 APRIL 2023, JGB 10Y: 28 MARCH, US 10Y: 12 APRIL

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