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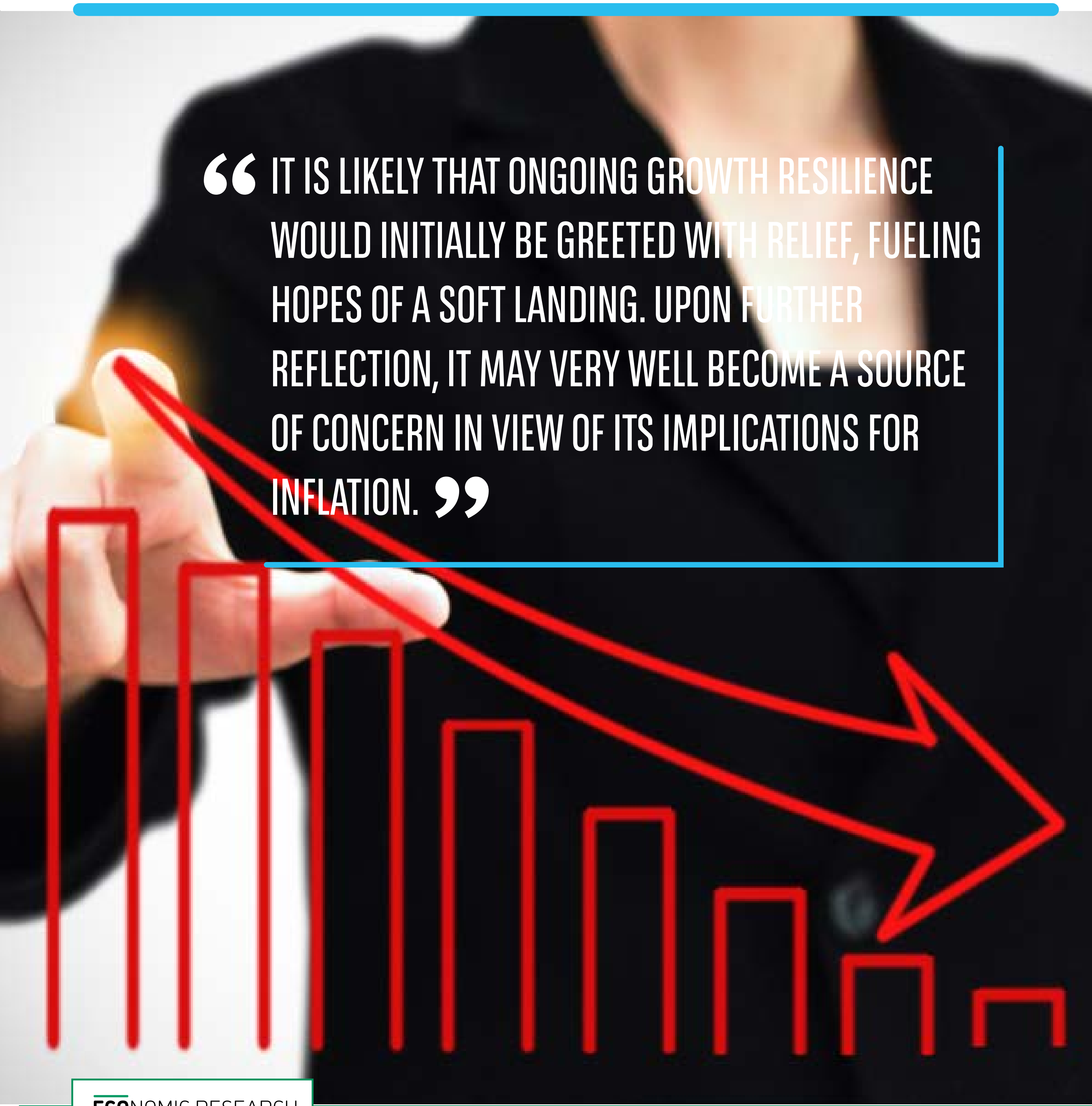

“IT IS LIKELY THAT ONGOING GROWTH RESILIENCE WOULD INITIALLY BE GREETED WITH RELIEF, FUELING HOPES OF A SOFT LANDING. UPON FURTHER REFLECTION, IT MAY VERY WELL BECOME A SOURCE OF CONCERN IN VIEW OF ITS IMPLICATIONS FOR INFLATION.”

ECONOMIC RESEARCH

BNP PARIBAS

The bank
for a changing
world

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GLOBAL ECONOMY: THE LONG WAIT

In the coming quarters, economic growth in the United States and the Eurozone should slow down and core inflation should move significantly lower. Monetary policy works with long and variable lags, so part of the impact of higher rates still needs to manifest itself. This is taking more time than expected. It has been a long wait thus far. In the US, the economy in general has been particularly resilient although some data have softened as of late. In the Eurozone, the labour market remains strong, yet, many data have weakened, including in services. A factor that will also play a role in coming months are the developments in China where activity indicators published during the summer confirmed the rapid slowdown in growth. Eurozone core inflation has hardly declined from an exceptionally high level and in the US it also remains sticky, albeit to a slightly lesser extent. Quoting Jerome Powell at Jackson Hole, central banks will have to "*keep at it until the job is done.*"

In the coming quarters, economic growth in the US and the Eurozone should slow down and core inflation should move significantly lower. Considering the cumulative monetary tightening seen thus far, it is hard to imagine otherwise. In addition, although we think that the terminal rate in both jurisdictions has been reached, they could move higher still, or the respective central banks might decide to keep rates high for longer.

This would imply a bigger headwind to growth. Monetary policy works with long and variable lags, so part of the impact of higher rates still needs to manifest itself. This is taking more time than expected. It has been a long wait. A key factor behind the resilience of the economy is the dynamism of the labour market and the very low rate of unemployment, which benefit from the elevated order book levels of companies. In addition, pent-up demand has boosted activity in the tourism and recreation sector and energy transition related investments are also supporting growth. The latter point was emphasized by ECB President Christine Lagarde in her Jackson Hole speech[1].

In the US, the economy in general has been particularly resilient faced with the aggressive monetary tightening by the Fed. The positive surprise of second quarter GDP[2] and recent strong data have led the participants of the Philadelphia Fed's quarterly survey of professional forecasters to revise upwards their forecasts for the next three quarters and downward their forecasts for the unemployment rate[3]. For the current quarter, the Atlanta Fed's nowcast projects an impressive growth rate of 5.9% (seasonally adjusted annualized rate), underpinned by strong retail sales and housing starts data for the month of July. Although this number can fluctuate a lot depending on the data releases, it does seem to imply that the US is not about to enter a recession soon, at least according to the GDP metric.

PMI : LEVEL AND MOMENTUM

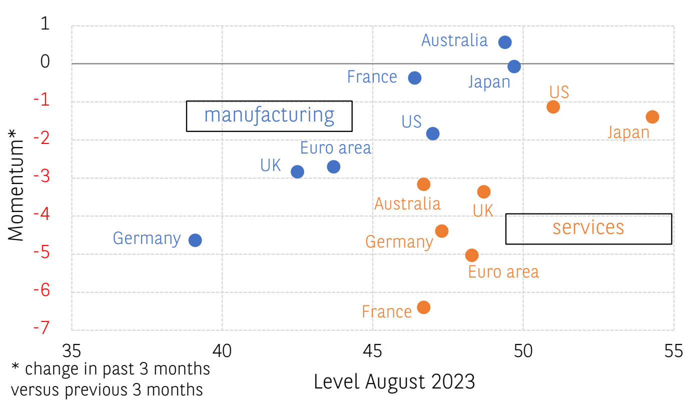


CHART 1 SOURCE: S&P GLOBAL, BNP PARIBAS

Nevertheless, some data have softened as of late. Job openings and the pace of hiring continue to trend down and the number of voluntary departures (quits rate) is also declining. Importantly, the manufacturing ISM, although edging higher in July (from 46.0 to 46.4), remains well in contraction territory. The situation is less bad in services where the ISM index was at 52.7 in July but that represents a decline from 53.9 the month before. The S&P Global flash composite PMI for August dropped to 50.4 (52.0 in July) on the back of weaker data in services and particularly manufacturing.

1 "In the euro area, for instance, investment rose in the first quarter of this year amid stagnant output, in part because of pre-planned investment spending under the Next Generation EU programme." Source: Policymaking in an age of shifts and breaks, Speech by Christine Lagarde, President of the ECB, at the annual Economic Policy Symposium «Structural Shifts in the Global Economy» organised by Federal Reserve Bank of Kansas City in Jackson Hole, Jackson Hole, 25 August 2023.
2 On a seasonally adjusted annual rate, real GDP grew 2.4% in the second quarter (+2.0% in the first quarter), against a Bloomberg consensus forecast of 1.8%. Source: Bloomberg.
3 For quarterly real GDP growth (annualized rate), the forecasts are (previous survey data shown between brackets): 1.9% (0.6%) in the third quarter and 1.2% (0.0%) and 1.1% (1.0%) in the two following quarters. The unemployment rate forecasts are respectively 3.6% (3.8%), 3.7% (4.0%), 3.9% (4.2%). Source: Federal Reserve Bank of Philadelphia, Third Quarter 2023 Survey of Professional Forecasters, 11 August 2023.

> It is likely that ongoing growth resilience would initially be greeted with relief, fueling hopes of a soft landing. Upon further reflection, it may very well become a source of concern in view of its implications for inflation.

EDITORIAL

In the Eurozone the labour market remains strong and core inflation has hardly declined from an exceptionally high level. Yet, many data have weakened. Admittedly, GDP growth in the second quarter of +0.3% (quarterly rate, non-annualized) was satisfactory but it is masking big differences at the country level. The sizeable gap between the manufacturing and the services PMI has narrowed following the significant decline of the latter and business surveys in Germany and France were weak in August. A factor that will also play a role in coming months and in Germany in particular, are the developments in China where activity indicators published during the summer confirmed the rapid slowdown in growth. Exports continue to decline as a result of slowing world demand and tensions with the United States, and domestic demand remains weak, partly dampened by falling consumer and investor confidence. The housing crisis is getting worse, with new developer payment defaults, and there are growing signs that some financial institutions are becoming more fragile.

As mentioned before, given the extent of monetary tightening, growth as well as core inflation are bound to slow down in the coming quarters. The real question is the timing and, above all, the speed. Thus far it has, on the whole, been a long wait, in particular in terms of core inflation, which remains very sticky in the Eurozone and, to a slightly lesser extent, in the US. It is likely that ongoing growth resilience would initially be greeted with relief by households, firms and financial market participants, fueling hopes of a soft landing and immaculate disinflation. Upon further reflection, it may very well become a source of concern, because of its implications for inflation -slower disinflation- and monetary policy, i.e. higher rates. Too slow a pace of disinflation could unnerve market participants and central banks alike considering that the latter will, to quote Jerome Powell at Jackson Hole, *"keep at it until the job is done."*[4]

William De Vijlder

4 Source: "Inflation: Progress and the Path Ahead", Remarks by Jerome H. Powell, Chair Board of Governors of the Federal Reserve System at "Structural Shifts in the Global Economy," an economic policy symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, 25 August 2023.

MARKETS OVERVIEW

OVERVIEW

Week 18-8 23 to 25-8-23				
↗ CAC 40	7 164	▶ 7 230	+0.9	%
↗ S&P 500	4 370	▶ 4 406	+0.8	%
↘ Volatility (VIX)	17.3	▶ 15.7	-1.6	pb
↘ Euribor 3M (%)	3.82	▶ 3.79	-2.8	bp
↗ Libor $ 3M (%)	5.64	▶ 5.67	+2.1	bp
↘ OAT 10y (%)	3.12	▶ 3.06	-6.2	bp
↘ Bund 10y (%)	2.60	▶ 2.53	-6.8	bp
↘ US Tr. 10y (%)	4.26	▶ 4.25	-1.2	bp
↘ Euro vs dollar	1.09	▶ 1.08	-0.9	%
↗ Gold (ounce, $)	1 892	▶ 1 905	+0.7	%
↘ Oil (Brent, $)	84.8	▶ 84.6	-0.3	%

MONEY & BOND MARKETS

Interest Rates			highest 23			lowest 23		
€	ECB	4.25	4.25	at	02/08	2.50	at	02/01
	Eonia	-0.51	-0.51	at	02/01	-0.51	at	02/01
	Euribor 3M	3.79	3.83	at	23/08	2.16	at	02/01
	Euribor 12M	4.05	4.19	at	07/07	3.30	at	19/01
$	FED	5.50	5.50	at	27/07	4.50	at	02/01
	Libor 3M	5.67	5.67	at	25/08	4.77	at	02/01
	Libor 12M	6.04	6.04	at	30/06	4.70	at	20/03
£	BoE	5.25	5.25	at	03/08	3.50	at	02/01
	Libor 3M	5.58	5.59	at	22/08	3.87	at	02/01
	Libor 12M	0.81	0.81	at	02/01	0.81	at	02/01

At 25-8-23

Yield (%)			highest 23			lowest 23		
€	AVG 5-7y	2.64	2.64	at	02/01	2.64	at	02/01
	Bund 2y	3.09	3.36	at	08/03	2.39	at	20/03
	Bund 10y	2.53	2.75	at	02/03	1.98	at	18/01
	OAT 10y	3.06	3.23	at	03/03	2.42	at	18/01
	Corp. BBB	4.59	4.77	at	10/07	3.95	at	02/02
$	Treas. 2y	5.16	5.16	at	25/08	3.85	at	04/05
	Treas. 10y	4.25	4.35	at	21/08	3.30	at	06/04
	High Yield	8.76	9.16	at	20/03	7.94	at	02/02
£	gilt. 2y	4.98	5.51	at	06/07	3.15	at	02/02
	gilt. 10y	4.44	4.74	at	17/08	3.00	at	02/02

At 25-8-23

EXCHANGE RATES

1€ =		highest 23			lowest 23			2023
USD	1.08	1.12	at	14/07	1.05	at	05/01	+0.9%
GBP	0.86	0.90	at	03/02	0.85	at	11/07	-3.3%
CHF	0.96	1.00	at	24/01	0.95	at	23/08	-3.2%
JPY	157.87	159.29	at	21/08	138.02	at	03/01	+12.1%
AUD	1.69	1.70	at	21/08	1.53	at	27/01	+7.2%
CNY	7.85	8.08	at	19/07	7.23	at	05/01	+5.8%
BRL	5.27	5.79	at	04/01	5.20	at	23/06	-6.5%
RUB	102.43	110.46	at	14/08	73.32	at	12/01	+31.5%
INR	89.03	92.37	at	14/07	86.58	at	08/03	+0.8%

At 25-8-23 *Change*

COMMODITIES

Spot price, $		highest 23			lowest 23			2023	2023(€)
Oil, Brent	84.6	88.2	at	23/01	71.9	at	12/06	-0.4%	-1.3%
Gold (ounce)	1 905	2 047	at	04/05	1 810	at	24/02	+4.9%	+4.0%
Metals, LMEX	3 684	4 404	at	26/01	3 564	at	24/05	-7.5%	-8.4%
Copper (ton)	8 319	9 331	at	23/01	7 852	at	24/05	-0.5%	-1.4%
wheat (ton)	201	2.9	at	13/02	201	at	25/08	-29.6%	-30.2%
Corn (ton)	194	2.7	at	13/02	161	at	21/08	-2.5%	-26.1%

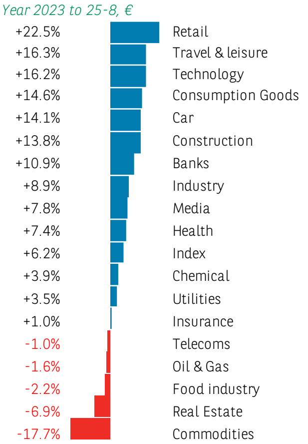
At 25-8-23 *Change*

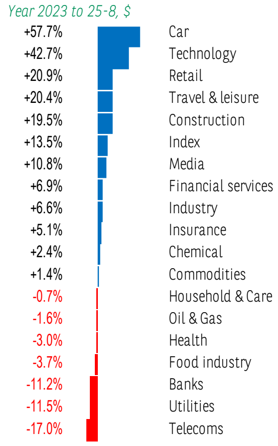
EQUITY INDICES

	Index	highest 23			lowest 23			2023
World								
MSCI World	2 912	3 064	at	31/07	2 595	at	05/01	+11.9%
North America								
S&P500	4 406	4 589	at	31/07	3 808	at	05/01	+14.7%
Europe								
EuroStoxx50	4 236	4 471	at	31/07	3 856	at	02/01	+11.7%
CAC 40	7 230	7 577	at	21/04	6 595	at	02/01	+1.2%
DAX 30	15 632	16 470	at	28/07	14 069	at	02/01	+12.3%
IBEX 35	9 339	9 695	at	27/07	8 370	at	02/01	+1.3%
FTSE100	7 339	8 014	at	20/02	7 257	at	07/07	-0.2%
Asia								
MSCI, loc.	1 188	1 246	at	01/08	1 065	at	04/01	+1.1%
Nikkei	31 624	33 753	at	03/07	25 717	at	04/01	+21.2%
Emerging								
MSCI Emerging ($)	971	1 052	at	26/01	941	at	16/03	+0.2%
China	58	75	at	27/01	57	at	21/08	-7.7%
India	810	835	at	20/07	703	at	16/03	+5.0%
Brazil	1 574	1 733	at	26/07	1 296	at	23/03	-0.1%

At 25-8-23 *Change*

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

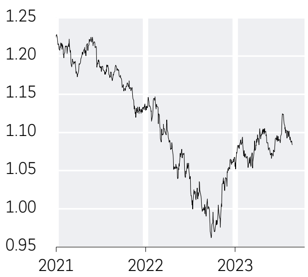




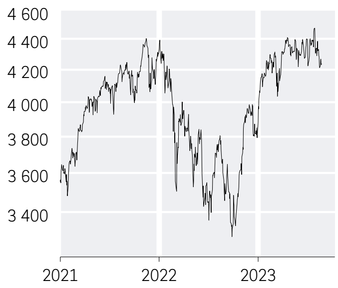
SOURCE: REFINITIV, BNP PARIBAS

MARKETS OVERVIEW

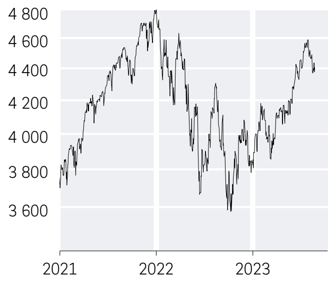
EURO-DOLLAR



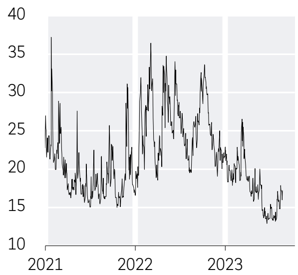
EUROSTOXX50



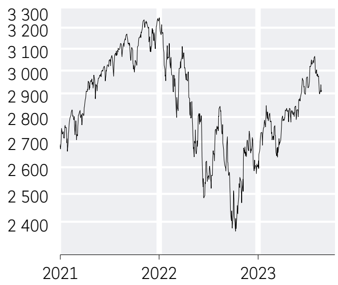
S&P500



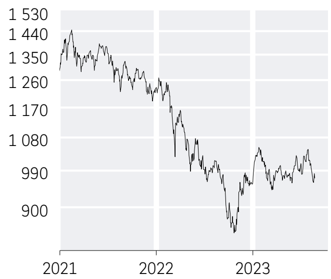
VOLATILITY (VIX, S&P500)



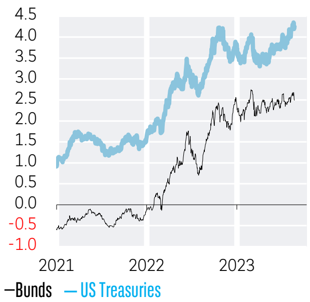
MSCI WORLD (USD)



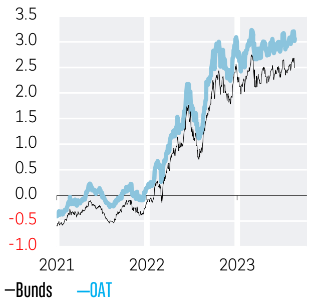
MSCI EMERGING (USD)



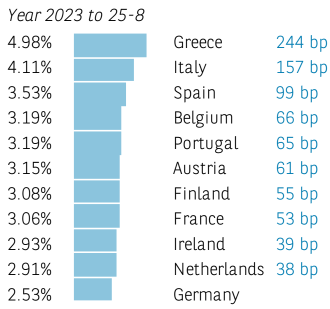
10Y BOND YIELD, TREASURIES VS BUND



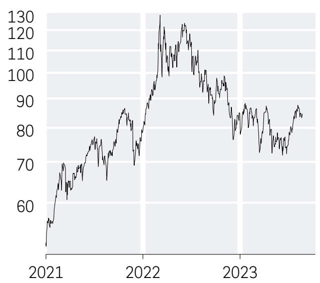
10Y BOND YIELD



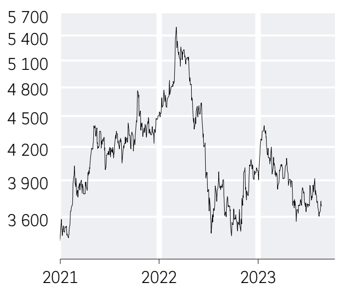
10Y BOND YIELD & SPREADS



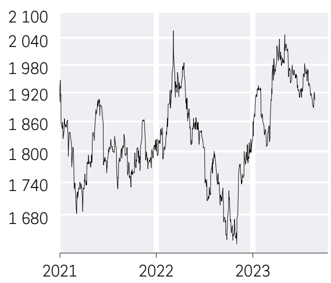
OIL (BRENT, USD)



METALS (LMEX, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS

THE EFFECTS OF RISING INTEREST RATES WILL CONTINUE TO WEIGH ON BANK LENDING IN THE SECOND HALF OF 2023

The effects of monetary policy tightening on the distribution of bank credit in the eurozone, which have been obvious since Q4 2022, further intensified during Q2 2023. The private-sector credit impulse has fallen constantly since autumn 2022. It dropped below zero in February 2023 and hit, in June 2023, its lowest level since 2010. The non-financial company credit impulse has experienced its biggest downturn since 2008, falling from its historic summer 2022 highs into negative territory in the space of eight months (April 2023). Despite declining less overall, household-credit impulse went into the red earlier on (November 2022), as it was starting out at a lower level.

At the same time, the year-on-year variation in private-sector loan outstandings fell by more than a third between September 2022 (+7.1%) and June 2023 (+2.0%). Loans to non-financial companies were particularly dynamic in September 2022 (+8.9%) and, in June 2023, continued to enjoy a far higher rate of growth (+3.0%) than loans to households (+1.7% compared to +4.6% in May 2022, the most recent peak). Banks surveyed by the ECB between 19 June and 4 July 2023, as part of its Bank Lending Survey, report that the criteria for granting loans to businesses continued to tighten during Q2 2023, albeit at a slower pace than during Q1. The risks associated with the economic outlook and companies' individual situations were the main factors behind this tightening trend. Banks also indicated that they had been tightening the criteria for granting loans to households during Q2, taking a more stringent approach towards consumer loans than towards home loans overall.

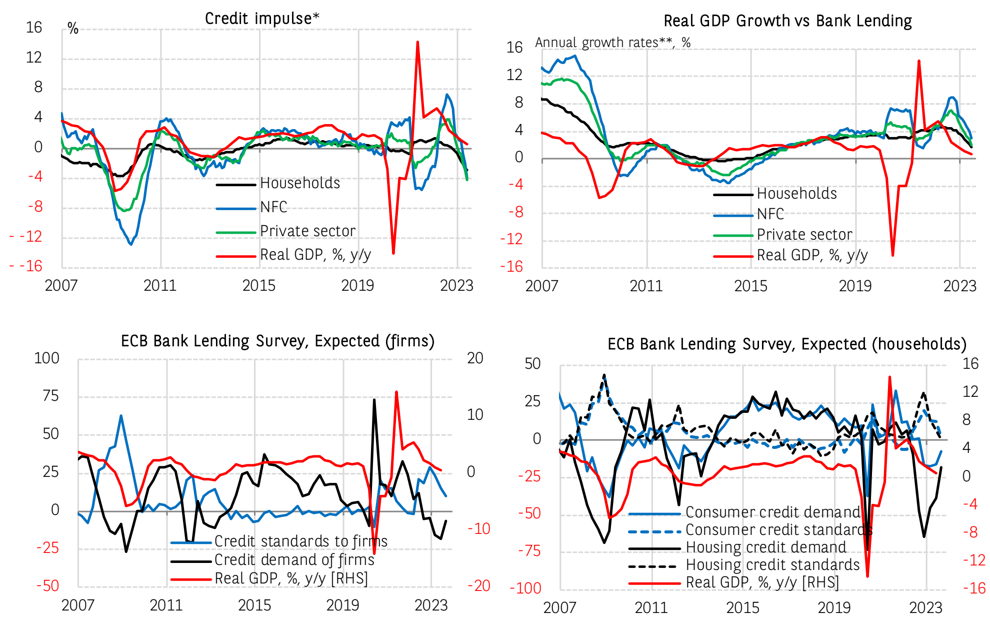
For the time being, falling energy and food prices are the sole factors driving the drop in inflation in the eurozone (+5.3% in July 2023, its lowest level since January 2022). By contrast, underlying inflation has barely budged (+5.5%) from its record level seen in March (+5.7%), even though, according to the ECB's economists, it has likely peaked[1]. The pronounced slowdown in bank lending should continue to have an effect over the coming months, which should confirm this view. As a result of these anticipated developments, business activity would stagnate between Q3 2023 and Q1 2024 (+0.5% GDP growth expected for the eurozone in 2023, with +0.6% in 2024). The banks surveyed indicated that they would continue to tighten their criteria for granting loans during Q3, but would do so more moderately than during Q2 (with the notable exception of home loans, where the criteria would remain unchanged). However, the impact of rising bank financing costs on customer rates will continue to weigh on demand, which is already plummeting sharply.

The ECB is aware that the effects of the cumulative 4.25% increase in key rates between July 2022 and July 2023 will continue to spread to financing demand and activity in the coming weeks. It is the reason why it softened its speech when it announced its decision on 27 July, suggesting that it may well not increase its key rates further at the Governing Council meeting on 14 September and at subsequent meetings.

Laurent Quignon

1ECB (2023), "Underlying inflation measures: an analytical guide for the euro area", ECB Economic Bulletin, Issue 5/2023, 4 August.

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, SURVEY ON THE DISTRIBUTION OF CREDIT, BNP PARIBAS CALCULATION

ECONOMIC SCENARIO

UNITED STATES

After a strong second half of 2022 (+0.7% q/q on average per quarter), US activity decelerated only slightly in the first half of 2023 (+0.5% q/q on average per quarter), thanks to the resilience of household consumption and the strength of nonresidential investment. The impact of the tighter monetary policy on lending standards is strong but still limited on activity and employment growth. We still expect a shallow recession but shorter than before considering that growth no longer should be modestly positive in Q3 this year. While the peak in inflation was reached in mid-2022, core disinflation remains gradual and headline inflation should not approach the 2% target before the end of 2024. The slow pace of disinflation argues in favor of keeping monetary policy in restrictive territory, despite the expected start of the easing cycle in spring 2024. This should limit the recovery in 2024.

CHINA

Economic growth, which was sluggish and unbalanced in 2022, started to accelerate in early 2023 following the end of the zero Covid policy. However, the post-Covid recovery has lost momentum very rapidly. Export momentum has stalled due to weak global demand and tensions with the US. Domestic demand remains held back by a significant loss in consumer and investor confidence. The crisis in the property sector is persisting, with the continued fall in sales, new defaults of developers and growing difficulties of certain financial institutions. The government and the central bank implement new policy stimulus measures, which yet remain of moderate magnitude. The weak financial situation of local governments should constrain public investment.

EUROZONE

The euro zone came close to technical recession at the turn of 2022-2023. After a slight contraction in GDP in Q4 2022, growth is now estimated to be zero (rather than slightly negative) in Q1 2023. There was a technical rebound in Q2 (+0,3% q/q) that masked a disparate performance between Member States, which tends to weaken the overall result. France and Spain have been doing well, but Germany, Italy and the Netherlands are struggling. The negative effects of monetary tightening should intensify causing growth to fall back. After three quarters of stagnation, a limited recovery would follow. 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

French growth surprised on the upside in Q2 2023, with activity accelerating more than expected (+0.5% q/q, after two quarters at +0.1%). While household consumption and investment remain depressed, this rebound has been supported by business investment and, above all, exports. A negative correction is likely in Q3. Inflation keeps falling but slowly so (5.1% y/y according to the harmonized measure in July, down 2.2 points from its February peak). Because of rising interest rates, household demand should remain subdued in 2023, weighing on our GDP growth forecast (0.8% in 2023, compared to 2.6% in 2022).

RATES AND EXCHANGE RATES

In the US, after having skipped the June meeting, the Federal Reserve proceeded, as expected, to a further 25bp rate hike in July. This increase would be the last in our view, but uncertainty remains given the still elevated core inflation and the resilience of the labour market to date. In any case, these factors argue against a rate cut before the beginning of 2024. The residual uncertainty on the policy rate peak is reflected in long-term rates, which remained on an upward trend at the end of August. As inflation falls further and the prospect of monetary easing in 2024 rises, long-term rates should resume their decline soon.

Unlike the Fed, the ECB did not pause in June but, like the Fed, it increased its key rates by 25bp in July (deposit rate at 3.75%, refinancing rate at 4.25%). We are of the view that this increase would mark the end of the ECB's tightening cycle, considering the effects of the monetary tightening already underway. But it is not yet certain that it will be the last, given the absence of a tangible fall at this stage of core inflation. As part of its monetary tightening, the ECB also announced a complete halt, starting in July 2023, of its reinvestments under the APP. European long-term rates move in line with US rates, but in a more muted way: their slight rise in late August should not last long and be followed by a gradual decline, fueled by the expected fall in core inflation which should step by step become more visible.

On 27 July, the Bank of Japan (BoJ) adjusted its yield curve control policy (YCC) by allowing a wider fluctuation in 10-year sovereign interest rates around the target of 0.5%Further adjustments to the YCC cannot be excluded, given that the country currently faces the fastest rate of inflation since the early 1990s. Nevertheless, the BoJ is unlikely to increase its policy rates this year, but a rise is expected in 2024.

We expect the dollar to weaken somewhat versus the euro. The dollar's valuation is expensive and next year the Federal Reserve should ease earlier and more than the ECB. We expect the yen to remain around current levels in the near term before strengthening versus the dollar based on the expected monetary divergence between the Fed and the BoJ in 2024.

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	1,9	0,3	4,7	8,0	4,1	2,5
Japan	2,2	1,0	2,0	0,9	-0,2	2,5	3,2	2,3
United-Kingdom	7,6	4,1	0,5	0,1	2,6	9,0	7,5	2,9
Euro Area	5,3	3,4	0,5	0,6	2,6	8,4	5,7	3,0
Germany	2,6	1,9	-0,2	0,4	3,2	8,6	6,2	2,9
France	6,8	2,6	0,8	0,6	2,1	5,9	5,7	2,7
Italy	7,0	3,8	0,9	0,8	1,9	8,7	6,2	2,3
Spain	5,5	5,5	2,4	1,5	3,0	8,3	3,6	3,1
China	8,4	3,0	5,3	4,8	0,9	2,0	0,5	2,0
India***	8,7	7,2	6,1	6,5	5,5	6,7	5,5	4,5
Brazil	5,0	2,9	2,5	1,8	8,3	9,3	4,7	4,0

Source : BNP Paribas (e: Estimates & forecasts)
Last update: 25 August 2023
*** Fiscal year from 1st April of year n to March 31st of year n+1

INTEREST AND EXCHANGE RATES

Interest rates, %				
End of period		Q3 2023	Q4 2023	Q4 2024
US	Fed Funds (upper limit)*	5.50	5.50	3.75
	T-Note 10y **	3.90	3.85	3.55
Eurozone	deposit rate*	3.75	3.75	3.00
	Bund 10y **	2.45	2.20	2.00
	OAT 10y	3.00	2.72	2.50
	BTP 10y	4.70	4.45	3.80
	BONO 10y	3.55	3.30	2.90
UK	Base rate*	5.50	5.50	4.00
	Gilts 10y **	4.40	4.25	3.80
Japan	BoJ Rate	-0.10	-0.10	0.25
	JGB 10y**	0.50	0.65	0.80

Exchange Rates				
End of period		Q3 2023	Q4 2023	Q4 2024
USD	EUR / USD	1.10	1.12	1.18
	USD / JPY	133	130	123
	GBP / USD	1.25	1.27	1.34
EUR	EUR / GBP	0.88	0.88	0.88
	EUR / JPY	146	146	145

Brent				
End of period		Q3 2023	Q4 2023	Q4 2024
Brent	USD/bbl	83	90	95

Sources: BNP Paribas (Market Economics, Interest Rate Strategy, FX Strategy, Commodities Desk Strategy)
* Deposit rate: Last update at 11 August 2023, Fed Funds : 2 June 2023, BoE rate: 11 August 2023
** Bund 10y: last update at 3 May 2023, Gilts 10y: 15 June 2023, JGB 10y: 22 June, US 10y: 5 June 2023

FURTHER READING

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