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“TO FRAGMENT OR NOT TO FRAGMENT (THE GLOBAL ECONOMY), THAT IS THE QUESTION”

ECONOMIC RESEARCH

BNP PARIBAS

The bank for a changing world

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TO FRAGMENT OR NOT TO FRAGMENT (THE GLOBAL ECONOMY), THAT IS THE QUESTION

Would you expect a politician who promises to raise taxes on both households and corporates as a key plank of their growth strategy to get elected? Or the Parliament of an EU member state to vote against an EU initiative to cut such taxes? Probably not. And yet both just happened, with Donald Trump and fellow Republicans taking control of both the White House and Congress, and the French Parliament voting against the EU-Mercosur trade deal.

Tariffs are taxes, but unlike taxes, they and other trade restrictions have a mysterious and, these days, wide appeal in public opinion and the political class. Mysterious because they nearly always do more harm than good: in the near-term, causing price increases that transfer money from domestic consumers and corporates to the government (in the case of tariffs) or to domestic producers of the tariffed goods (in the case of non-tariff barriers); in the longer term, by incentivizing an inefficient allocation of productive resources (both labour and capital) and reducing the scope for technology transfers, both of which lead to productivity losses, as well as by reducing choice for buyers and growth opportunities for producers. This is not just what economic theory predicts, but also what an ocean of empirical research confirms.[1]

Why, then, are trade restrictions back in fashion (see *chart*)? A longstanding reason is that trade liberalization, while economically beneficial to the vast majority, sometimes does hurt some segments of society, notably companies facing little competition and less efficient ones, along with the workers they employ; that is a feature, not a bug. But these minorities tend to be more vocal and better-organized than the beneficiaries. They can be compelling in drawing sympathy from the broader population and hence win support from part of the political class, notably self-branded anti-establishment politicians, who have been on the rise across the world. In addition, more recently, the unprecedented supply-chain disruptions experienced during the COVID pandemic brought to light the vulnerabilities created by the long and intricate supply chains that have come to dominate production processes for large swathes of industry.

THE NUMBER OF GLOBAL CURRENT TRADE RESTRICTIONS WORLDWIDE

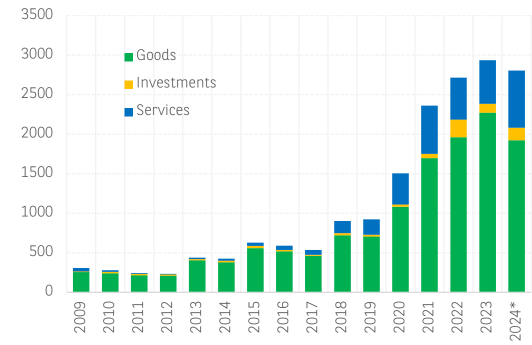


CHART 1

* JAN. 2024 -NOV. 2024
SOURCE: GLOBAL TRADE ALERT, BNP PARIBAS

Economic security became a new policy priority for governments around the world, soon followed by economic sovereignty in the wake of Russia's invasion of Ukraine and the US's new doctrine for managing its rivalry with China. While legitimate conceptually, these two motives have an ill-defined scope and, as such, have provided new fertile ground for trade barriers, on top of the longstanding internationally recognized allowance for remedial tariffs in the face of unfair practices such as dumping or subsidies, back in vogue too.

1 See Geoeconomic Fragmentation and the Future of Multilateralism, IMF Staff Discussion Note, 2023, for a discussion of the global evidence and bibliography. The Economic Impacts of the US-China Trade War, NBER, December 2021; and the Brexit Analysis section of the website of the Office for Budget Responsibility.

> Unsurprisingly, unelected policymakers have been the first to plead against trade retaliation, and deserve credit for doing it so soon and so clearly in recent days.

Against this backdrop, what is the best response to the new tariffs that the US President may decide to impose? Let's leave aside here the question of negotiating posture. It has been argued, including by the nominee for Treasury Secretary-- that President-elect Trump holds the threat of tariffs as a useful negotiating tool to achieve other aims, e.g., related to immigration or security policy, more than a goal in themselves. It's also been argued, from the other side, that a threat of tariff must be met by an equally strong threat of retaliation, as a matter of both negotiation strategy and meeting the presumed expectations of voters. But let's assume additional tariffs are actually imposed by the US. What, then, is the best response? Again, the analytical evidence points overwhelmingly to not retaliating via trade restrictions, as doing so would only fragment the global economy, whether wholly or even into blocks, and such fragmentation would have tremendous costs for all parties involved.

Unsurprisingly, unelected policymakers have been the first to plead against trade retaliation, and deserve credit for doing it so soon and so clearly in recent days. Building on extensive work done by the International Monetary Fund (IMF) already for a couple of years, Andrew Bailey, Governor of the Bank of England, went on the record first[2], soon followed by the ECB's Philipp Lane[3] and Christine Lagarde[4]. One must hope many will follow and that their voices will be amplified by those most at risk from economic fragmentation (notably globally-engaged manufacturers), and ultimately heard by the elected policy-makers who will determine the actual response.

Estimates of the costs of fragmentation vary in amplitude, but they are invariably large. The ECB[5] estimates the costs of fragmentation of global trade range from 2% of global GDP in a scenario of mild decoupling (partial barriers on all sectors) to 5.5% if full trade bans are added in selective sectors and 9% in the case of full trade ban on all sectors. The orders of magnitude are the same in terms of impact on Europe's GDP. Earlier work by the IMF[6] found similarly large output losses in the event of a fragmentation of global trade into four blocks, with the more open economies most negatively impacted. Estimates in the broader economic literature surveyed by the IMF are wide-ranging but could be as high as 12% of global GDP over the long run.[7]

Much better for the US's trading partners to pursue self-help instead of self-harm, i.e., forego retaliatory tariffs and instead deepen trade integration with willing counterparts. They should also pursue the domestic policies they know they need to boost their growth and competitiveness. For Europe and the UK, this means reducing internal barriers (both within EU –recent IMF estimates indicate reducing internal market barriers to the level of the US would boost productivity by 7%[8]--and between UK and EU) and boosting investment, both public and private. For China, this means strengthening domestic demand, especially consumption, to counter the fast-declining rate of return of capital investment.

Isabelle Mateos y Lago

2 Trump Tariffs Should Not Prompt UK Retaliation in Kind, Warns BOE's Bailey - Bloomberg.
3 Navigating a fragmenting global trading system: insights for central banks, 21 November 2024.
4 Christine Lagarde interview, Financial Times, 28 November 2024.
5 Navigating a fragmenting global trading system: insights for central banks, op. cit.
6 Geoeconomic Fragmentation: What's at Stake for the EU, IMF Working Papers, November 2023.
7 Geoeconomic Fragmentation and the Future of Multilateralism, op cit.
8 Europe's Declining Productivity Growth: Diagnoses and Remedies, IMF Regional Economic Outlook, November 2024, Note One.

ECO NEWS

EUROZONE: The European Commission's economic sentiment index rose very slightly in November (+0.1 point to 95.8). Significant differences persist between countries, with 11 countries below the long-term average and 9 countries above it. The situation in Spain is still positive. Italian consumer confidence improved when it deteriorated markedly in France and Germany.

FRANCE-GERMANY: Rising unemployment fears contributed to a decline in the confidence of French and German households in November. For the time being, labour market indicators are more mixed than negative: a decline in employment in Germany but a slight rise in France in Q3; a still limited rise in unemployment rates since a low level. But fear of unemployment can fuel precautionary savings (the French household saving rate rose again in Q3 to 18.2%), raising the odds of further delaying the expected rebound in consumption.

EUROZONE: According to Eurostat's flash estimate, harmonized inflation rose to 2.3% y/y in November (+0.3 pp). This increase was expected and is due to unfavourable base effects on energy. Of the 20 Member States, only 3 have seen their inflation fall (Estonia, Greece, Malta). Inflation remained stable in Germany (2.4%) and rose very little in France (1.7%, +0.1 pp). The increase was more marked (+0.6 pp) in Spain (additional effect of VAT increases on food prices) and in Italy (inflation nevertheless remained below 2%).

FRANCE: On 29 November, the S&P rating agency opted for stability, keeping unchanged France's rating (AA-) and the outlook (stable). For the agency, France should be able to "gradually consolidate its public finances in the medium term". It also highlights the risk that political uncertainty poses to this trajectory.

EUROPE: The European Parliament has validated the composition of the new European Commission, which officially takes office on 1st December. The Commission also unveiled its assessments of the Member States' medium-term national budgetary and structural plans, including the extension of the budgetary adjustment period from four to seven years for five countries (Spain, Finland, France, Italy and Romania).

UNITED KINGDOM: According to the CBI's retail survey, consumption prospects are looking gloomier by the end of the year. Activity in the motor vehicle industry remained depressed (15.3% y/y decline in October motor vehicle production; 6.1% y/y decline in new registrations).

UNITED STATES: Household confidence and inflation up. Caution at the Fed. According to the Conference Board index, US household confidence rose again in November, in line with the University of Michigan survey. Inflation also rose (+0.2 point, to 2.3% y/y in October for the PCE deflator and +0.1 point, to 2.8% for the core PCE). The November FOMC minutes showed less concern about growth and continued vigilance over inflation, suggesting a gradual easing of interest rates (no urgency to move closer to the neutral rate, which may not be as far from the current level of Fed funds).

BRAZIL: Brazil and China strengthen strategic ties. In the wake of the G20 meeting in Rio de Janeiro, Brazil signed 37 new cooperation agreements with China in agriculture, sustainable infrastructure, energy transition, artificial intelligence, health and aerospace, amongst others. Some agreements are aimed at aligning Chinese investment with major Brazilian development projects (New Growth Acceleration Pact and New Industry Brazil plan).

SOUTH AFRICA: SARB continued its monetary easing cycle begun in September, with a second 25bp cut in its key rate to 7.75%. The SARB inflation forecast is unchanged for 2025 but revised slightly upwards for 2026 (+0.2pp). The Governor stressed the need for caution in future policy committees. Between 5 and 27 November, the South African rand depreciated by 3.6%.

MEXICO: Donald Trump announced on Monday 25 November that he would impose 25% tariffs on all imports from Mexico and Canada (and a 10% increase in existing tariffs on Chinese products) on the first day of his term. The review of the UMSCA trade agreement is scheduled for mid-2026, but this announcement effectively opens negotiations. The Canadian Prime Minister and the Mexican President reacted immediately. Sheinbaum spoke about the immigration and drug-trafficking policies that have been in place for several years in Mexico (Donald Trump's main arguments) and of possible retaliation. After Donald Trump's first telephone conversation with the Mexican president, which was described as "positive" on both sides, the tension eased somewhat. To this day, it is impossible to say what position will ultimately be taken. It seems unlikely that such tariffs will finally be applied, given the integration of the three economies. The economic consequences would be highly negative, including for the US economy. The mexican peso depreciated by 1% since the beginning of the week and by less than 2% since Donald Trump's election.

INDIA: Economic growth slowed sharply in the second quarter of the current fiscal year (July to September), the third consecutive quarterly slowdown. Real GDP grew by 5.4% yoy compared with 6.7% in the previous quarter. This figure is well below expectations, including those of Reserve Bank of India (RBI). The slowdown can be explained by lower growth in manufacturing and mining industries while activity in the agricultural sector remained solid due to favourable monsoon. In the full fiscal year, real GDP growth is expected to be well below the RBI's forecast of 7.2% even though economic activity is expected to rebound in the second half of the fiscal year thanks to festive season and the expected rise in public investment. Pressures on the central bank to cut its policy rates this week will be strong but its room for manoeuvre will be limited due to downward pressures on the rupee and persistent inflationary pressures.

MARKETS OVERVIEW

Bond Markets

	in %	in bps			
	29-nov.-24	1-Week	1-Month	Year to date	1-Year
Bund 2Y	1.99	-4.8	-18.5	-69.0	-103.9
Bund 5Y	1.91	-12.9	-21.7	-3.1	-44.1
Bund 10Y	2.09	-16.3	-24.6	+8.8	-30.0
OAT 10Y	2.84	-15.1	-14.4	+37.7	-6.1
BTP 10Y	3.16	-23.1	-28.5	-37.4	-84.0
BONO 10Y	2.75	-18.7	-24.6	-19.9	-63.1
Treasuries 2Y	4.21	-18.1	+6.7	-12.6	-47.3
Treasuries 5Y	4.09	-22.5	-0.5	+23.0	-15.7
Treasuries 10Y	4.20	-22.4	-6.9	+33.1	-8.0
Gilt 2Y	4.08	-6.9	+4.0	+10.7	-46.6
Treasuries 5Y	4.10	-14.8	-9.7	+78.6	+13.2
Gilt 10Y	4.25	-14.1	-6.9	+64.5	+6.2

Currencies & Commodities

	Level	Change, %			
	29-nov.-24	1-Week	1-Month	Year to date	1-Year
EUR/USD	1.06	+1.5	-2.2	-4.4	-3.8
GBP/USD	1.27	+1.5	-2.3	-0.3	+0.1
USD/JPY	150.19	-3.0	-2.1	+6.5	+1.9
DXY	111.99	+7.9	+11.5	+10.5	+6.1
EUR/GBP	0.83	-0.0	+0.1	-4.1	-3.9
EUR/CHF	0.93	+0.0	-0.8	+0.1	-3.1
EUR/JPY	158.63	-1.6	-4.3	+1.9	-1.9
Oil, Brent ($/bbl)	73.20	-2.3	+3.1	-5.8	-11.9
Gold ($/ounce)	2659	-1.7	-3.9	+28.8	+30.3

Equity Indicies

World					
MSCI World ($)	3810	+1.2	+2.5	+20.2	+26.4
North America					
S&P500	6032	+1.1	+3.4	+26.5	+32.6
Dow Jones	44911	+1.4	+6.3	+19.2	+26.8
Nasdaq composite	19218	+1.1	+2.7	+28.0	+34.8
Europe					
CAC 40	7235	-0.3	-3.7	-4.1	-0.4
DAX 30	19626	+1.6	+0.8	+17.2	+21.4
EuroStoxx50	4804	+0.3	-2.9	+6.3	+9.9
FTSE100	8287	+0.3	+0.8	+7.2	+11.6
Asia					
MSCI, loc.	1404	-0.2	+0.3	+12.6	+15.0
Nikkei	38208	-0.2	-1.8	+14.2	+14.7
Emerging					
MSCI Emerging ($)	1079	-0.8	-5.1	+5.4	+9.7
China	63	+0.7	-6.7	+13.3	+11.2
India	1054	+1.5	-1.6	+14.4	+24.1
Brazil	1305	-6.0	-9.3	-27.5	-22.8

Performance by sector

Eurostoxx600

Year 2024 to 29-11, €

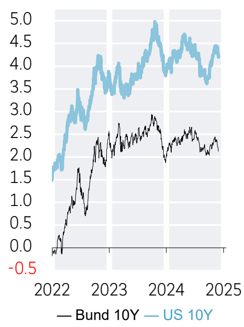
+23.2%	Banks
+18.1%	Telecoms
+17.4%	Media
+16.9%	Industry
+15.8%	Insurance
+12.0%	Travel & leisure
+11.6%	Retail
+9.0%	Health
+8.5%	Construction
+7.0%	Index
+1.7%	Technology
-0.2%	Utilities
-1.6%	Real Estate
-4.2%	Chemical
-5.8%	Food industry
-5.8%	Oil & Gas
-7.9%	Commodities
-8.3%	Consumption Goods
-13.6%	Car

S&P500

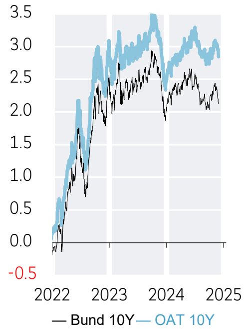
Year 2024 to 29-11, $

+42.8%	Banks
+41.4%	Construction
+41.0%	Technology
+37.3%	Financial services
+36.6%	Retail
+36.4%	Car
+35.5%	Insurance
+30.3%	Utilities
+30.3%	Index
+29.9%	Telecoms
+28.6%	Industry
+24.7%	Travel & leisure
+17.3%	Oil & Gas
+13.4%	Health
+13.0%	Media
+12.4%	Household & Care
+8.7%	Commodities
+7.9%	Chemical
+1.9%	Food industry

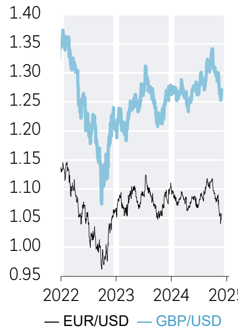
Bund 10Y vs US Treas. 10Y



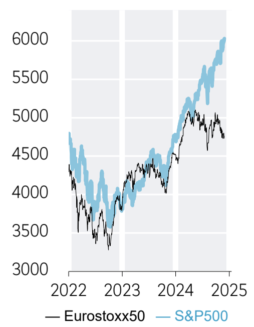
Bund 10Y vs OAT 10Y



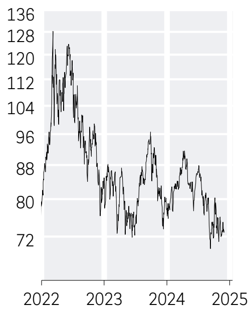
EUR/USD vs GBP/USD



EUROSTOXX 50 vs S&P500

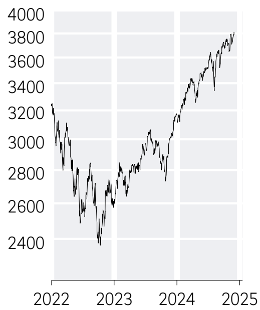


Oil, Brent ($/bbl)

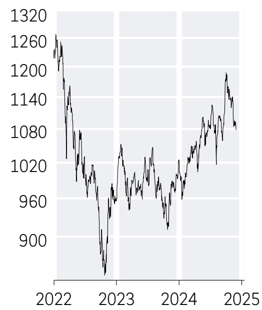


Gold ($/ounce)

MSCI World ($)



MSCI Emerging ($)



SOURCE: REFINITIV, BNP PARIBAS

ECONOMIC SCENARIO

UNITED STATES

In the US, the prospect of a recession triggered by the monetary tightening still appears as ruled out, given the resilience on the economy illustrated by a +2.9% yearly annual GDP growth in 2023. In the wake of a slowdown in Q1 2024 (+0.3% q/q, following +0.8% in Q4 2023), GDP growth accelerated again at +0.7% q/q in Q2 and Q3, mainly driven by household consumption. Our baseline scenario implies a +2.7% yearly annual growth rate in 2024, enabled by the 2023 carryover effect, as well as an increase in real income. The inflation peak was reached in mid-2022 and, while Q1 2024 data had raised concerns, Q2 and early-Q3 data indicate that the disinflation path has markedly resumed. This picture, together with the softening of the labour market, paved the way for the Fed to undertake monetary easing. This has started in September, with a jumbo 50bps cut, followed by a 25bps cut in November. A further -25bps is expected in December, thereby bringing the target rate to +4.25% - +4.5% by year-end.

CHINA

Economic growth accelerated in Q3 2024 (+0.9% y/y vs. +0.5% in Q2) and stood at 4.8% y/y in the three quarters of 2024. To reach the official growth target of "about 5%" set for 2024, activity will have to rebound strongly in Q4. This requires the fast implementation of all the fiscal and property policy measures announced over the past few weeks. Economic growth gained some momentum in October, notably supported by the strengthening in household consumption and the strong performance of exports. However, the 2025 outlook remains uncertain. On the one hand, the manufacturing sector will face a rising number of protectionist measures. On the other hand, domestic demand remains held back by significant brakes, including the crisis in the property sector, slower growth in household income, and low confidence of the private sector. Consumer price inflation remains very low (+0.3% y/y in October 2024) and production prices have been falling for two years.

EUROZONE

Real GDP growth in the euro area surprised on the upside in the third quarter of 2024, expanding 0.4% q/q. Activity would strengthen somewhat in 2025 supported by the moderation in inflation, the continuation of the ECB's cycle of interest rate cuts, as well as the greater deployment of NGEU funds. The difficulties in the industrial sector, highlighted by the current low PMI figures, and the uncertainty about the Chinese economy, increase the downside risks to our forecasts. While Spain is expected to record more solid gains in activity in the coming quarters, the gaps would narrow between Germany, France, and Italy.

FRANCE

GDP growth strengthened to 0.4% q/q growth in Q3 (after 0.2% q/q in Q2 2024), mainly supported by the positive impact of the Olympics and despite lower business and household investment (-1.2% and -0.6% q/q respectively). Disinflation is now visible (the harmonized index grew by 1.7% y/y in November 2024, compared to 3.9% y/y a year ago) but household consumption growth remains disappointing (excluding the positive impact of the Olympics). As a result, we except no visible growth acceleration in 2025 compared with 2024 (with a growth forecast of 1.2%, after 1.1% in 2023 and 2024).

INTEREST RATES AND EXCHANGE RATES

The US Federal Reserve started its monetary easing cycle in September, with a first 50bps cut in the Fed funds rate, followed by a 25bps cut in November. The cutting cycle would continue at this pace at each Fed meeting until March 2025, before a more gradual 25bps per quarter decline, bringing the Fed Funds target range to 3.00-3.25% by the end of 2025. Regarding the ECB, we also expect successive 25bps cuts in key rates at each meeting, until the deposit rate reaches 2% in June 2025, and then stabilises at that level, which is the middle of our range of neutral rate estimates. In December 2024, the Bank of England, for its part, would opt for the *status quo*, before restarting the downward cycle in early 2025. However, on both sides of the Atlantic, policy rates in real terms – which is a better indication of the degree of monetary tightening – would remain positive, at least until the second half of next year. The resulting decline in Government bond yields should be limited by the size of bond issuance against a backdrop 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%, before a new +15bps upward movement in July. At the same time, it was announced that the volume of JGBs purchases was to be halved.

We expect monetary policy to normalise gradually in the country, with only one additional hike envisaged by the end of 2024 (-25 BPS), before two more cuts in 2025.

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. 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	2.5	2.9	2.7	2.1	8.0	4.1	2.9	2.3
Japan	1.1	1.7	-0.3	0.7	2.5	3.3	2.7	2.4
United Kingdom	4.8	0.3	0.9	1.5	9.1	7.3	2.6	2.9
Euro Area	3.4	0.5	0.8	1.5	8.4	5.4	2.4	2.1
Germany	1.4	-0.1	-0.1	0.9	8.7	6.0	2.5	2.4
France	2.6	1.1	1.2	1.2	5.9	5.7	2.3	1.2
Italy	4.2	1.0	0.5	1.1	8.7	5.9	1.1	2.0
Spain	6.2	2.7	3.0	2.5	8.3	3.4	2.8	1.7
China	3.0	5.2	4.9	4.5	2.0	0.2	0.4	1.3
India*	7.0	8.2	6.9	6.7	6.7	5.4	4.7	4.3
Brazil	2.9	2.9	3.1	2.0	9.3	4.6	4.4	4.2

Source : BNP Paribas (e: Estimates & forecasts)
Last update: 29 November 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		Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
US	Fed Funds (upper limit)	4.50	4.00	3.75	3.50	3.25
	T-Note 10y	3.80	3.70	3.70	3.65	3.65
Eurozone	deposit rate	3.00	2.50	2.00	2.00	2.00
	Bund 10y	2.15	2.10	2.10	2.15	2.25
	OAT 10y	2.88	2.80	2.85	2.85	2.95
	BTP 10y	3.60	3.40	3.45	3.55	3.65
	BONO 10y	2.93	2.85	2.85	2.88	2.98
UK	Base rate	4.75	4.50	4.25	4.00	3.75
	Gilts 10y	3.80	3.80	3.60	3.50	3.65
Japan	BoJ Rate	0.50	0.50	0.75	0.75	1.00
	JGB 10y	1.25	1.40	1.55	1.70	1.80

Exchange Rates						
End of period		Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
USD	EUR / USD	1.12	1.13	1.14	1.14	1.15
	USD / JPY	139	138	136	134	131
	GBP / USD	1.35	1.36	1.37	1.37	1.39
EUR	EUR / GBP	0.83	0.83	0.83	0.83	0.83
	EUR / JPY	156	156	155	153	151

Brent						
Quarter Average		Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Brent	USD/bbl	78	78	72	77	74

Sources: BNP Paribas (Market Economics, Interest Rate Strategy, FX Strategy, Commodities Desk Strategy)
Last update: 1 November 2024

FURTHER READING

November 2024 issue	EcoPulse	29 November 2024
Inflation Tracker - November 2024 | Service prices are holding up	EcoCharts	28 November 2024
The COP29 in Baku: neither a game changer, nor a dead end	Chart of the Week	28 November 2024
Endgame for "Basel 3 Endgame" in the US?	EcoTV	28 November 2024
France - Germany | Service prices: a pocket of inflation that is set to linger into 2025	EcoBrief	27 November 2024
Victims of a looming trade war	EcoEmerging	26 November 2024
Global Economy: Are We Still on Track for a Soft Landing?	EcoWeek	25 November 2024
United States and Mexico: special partners	Chart of the Week	22 November 2024
Southern Europe's Resurgence	EcoTV	21 November 2024
Economic scenario and Markets review of 18 November 2024	EcoWeek	18 November 2024
Southern Europe: bank profitability at its highest since 2007, but probably not for long	Chart of the Week	15 November 2024
Fiscal adjustment and public investment: the difficult balancing act of the UK Budget	EcoTV	14 November 2024
Interest rate cuts: what effects on the global economy?	Special Edition	14 November 2024
European Silver Linings	EcoWeek	12 November 2024
November FOMC Meeting: business as usual	EcoBrief	8 November 2024
November 2024 issue	French Economy Pocket Atlas	8 November 2024
France | Business investment: software outpaces bricks and mortar	Chart of the Week	6 November 2024
The state of global trade on the eve of the US presidential election	EcoWeek	4 November 2024
US presidential election: the underlying economic issues	EcoConjoncture	4 November 2024
EcoPulse | October 2024	EcoPulse	31 October 2024
In 2024, the 1.5°C global-warming threshold has been breached	Chart of the Week	30 October 2024

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