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“UNDER REALISTIC ASSUMPTIONS, THE GERMAN PUBLIC DEBT RATIO SHOULD DECLINE SIGNIFICANTLY IN THE LONGER RUN AND CREATE FISCAL POLICY LEEWAY. THIS GIVES RISE TO A DEBATE WHETHER THE DEBT BRAKE SHOULD BE MAINTAINED IN ITS CURRENT FORM OR WHETHER PART OF THE LEEWAY SHOULD BE USED TO FINANCE INVESTMENTS THAT ENHANCE STRUCTURAL GROWTH AND/OR ACCELERATE THE GREEN TRANSITION.”

ECONOMIC RESEARCH

BNP PARIBAS

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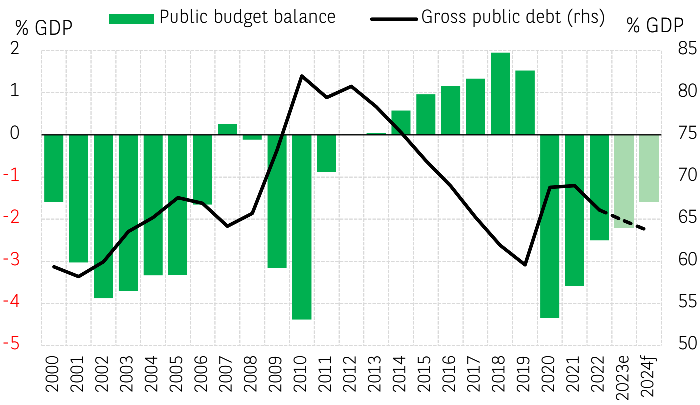
EDITORIAL

THE GERMAN DEBT BRAKE: THE MERITS AND LIMITATIONS OF FISCAL RULES.

The recent decision of the German Federal Constitutional Court has fueled the debate on the debt brake, which imposes strict limits in terms of budget deficit. At the risk of oversimplifying, the question is whether fiscal policy should be based on an iron rule or a golden rule. The debt brake imposes fiscal discipline on future governments, which enhances fiscal policy credibility. However, its focus on the budget deficit implies that under realistic assumptions, public debt in percent of GDP will decline significantly. Proponents of the golden rule argue that, given the huge investment needs -green and digital transition, public support to innovation, etc.-, any leeway should be used to finance these investments, thereby enhancing structural growth and/or accelerating the green transition. The outcome of this debate also matters for Europe given Germany's economic weight.

In 2013 the German government launched Industrie 4.0, a program focusing on the intelligent networking of machines and processes for industry with the help of information and communication technology[1]. In a recent article, Der Spiegel has extended the use of 'x.0' to the domain of public finances by referring to *Schuldenbremse 2.0*[2]. The debt brake -which applies to the central government- was introduced in 2009 following the global financial crisis in order to bring public finances back under control (chart). It is enshrined in Germany's Basic Law and its reform or abolition would require a constitutionally amended two-thirds majority in the Bundestag. It has a structural component, which limits net borrowing -i.e. adjusting for financial asset acquisitions and cyclical effects- to 0.35% of GDP per year and a cyclical component. According to the latter, the deficit can be bigger during a downturn, but this must be compensated when the economy improves again. Finally, there is an escape clause, "*which allows the Bundestag to suspend the debt brake by a simple majority in the event of a natural disaster or other extraordinary emergency situations beyond the control of the state*[3]." It was the interpretation of this escape clause that on 15 November last year put the German government in a difficult position because the Federal Constitutional Court declared that "*credit authorisations established within the scope of the exception clause can only be used until the end of the relevant financial year and then expire without replacement*." This blocked the Federal Government's plan to use credit authorisations obtained in previous years but not yet used, to finance spending in the upcoming years because these authorisations had been declared void[4]. This forced it to reduce expenditures with EUR 17 bn to bring the 2024 budget back within the limit set by the debt brake[5].

GERMANY: PUBLIC BUDGET BALANCE AND DEBT



CHART

SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

These developments fueled the debate about the need to update the debt brake. A survey of economics professors by the Ifo Institute and the FAZ showed that 44% want to keep it but reform it, 6% want to abolish but 48% want to retain it in its current form whereas 2% don't know[6]. Those in favour of change consider it is necessary given the huge investment needs for infrastructure and the ecological transition whereas those arguing for the status quo see the current debt brake as essential for budgetary discipline and debt sustainability.

1 Source: Plattform Industrie 4.0.
2 Schuldenbremse, aber modern. Der Spiegel, 2 December 2023.
3 Source for this description and the quote: *The German Debt Brake – Anchor of Stability or Blocker of Investments?* ifo Institute, 8 December 2023.
4 More specifically, *"credit authorisations established within the scope of the exception clause can only be used until the end of the relevant financial year and then expire without replacement. The Federal Government's practice of recording credit authorisations from years with an emergency situation (2020 to 2022) in special funds and using them to borrow in subsequent years (2023 to 2027) has thus been declared void."* Source: Sachverständigenrat - German Council of Economic Experts (GCEE), The debt brake after the federal constitutional court judgement: increase flexibility – maintain stability, Policy Brief 1/2024.
5 Source: https://www.bundesregierung.de/breg-en/news/agreement-budget-scholz-lindner-habeck-2249290, 13 December 2023.
6 The survey was conducted from 28 November to 5 December 2023. 187 economics professors participated. For more detail, see the source mentioned in footnote 3.

> **Under realistic assumptions, the German public debt ratio should decline significantly in the longer run and create fiscal policy leeway. This gives rise to a debate whether the debt brake should be maintained in its current form or whether part of the leeway should be used to finance investments that enhance structural growth and/or accelerate the green transition.**

The Sachverständigenrat - German Council of Economic Experts (GCEE)- recently argued for a pragmatic reform, which would increase the flexibility of fiscal policy without putting debt sustainability at risk[7]. Firstly, after the application of the exception clause, bringing the structural deficit back to the regular limit could be spread over several years. Secondly, the annual structural deficit limit would depend on the debt level. If the latter is below a certain threshold, a higher structural deficit would be permitted. Finally, the experts propose methodological improvements in the estimation of potential output. This matters for the calculation of the structural deficit. German Finance Minister Christian Lindner has proposed a reform of the debt brake to enhance fiscal policy flexibility, but this should remain neutral in terms of debt dynamics. "*Additional leeway in times of economic downturn would be balanced by stricter criteria in times of economic upturn*." However, he is against exempting investments in climate protection from the spending restrictions[8].

At the current juncture, the debate in Germany boils down, to a large degree, to the question whether fiscal policy should be based on an iron rule or a golden rule. In case of the former, strict limits are set and by enshrining them in the Basic Law, they impose fiscal discipline on future governments, whatever their composition.

In terms of credibility, this has huge benefits considering that in the absence of such an iron rule, a commitment of fiscal discipline of the current government is not binding for future governments. Proponents of the golden rule argue that, given the huge investment needs -green and digital transition, public support to innovation, etc.-, any leeway should be used to that end[9]. The GCEE has noted that the debt brake is more restrictive than the European fiscal rules. Moreover, its focus on the budget deficit implies that under realistic assumptions, public debt in percent of GDP will decline. Based on various simulations, the GCEE concludes that "*as a median result, the debt-to-GDP ratio falls below 60 % of GDP by 2031 and to just under 42 % of GDP by 2070. In the long term, it converges towards around 30 % of GDP according to the simulation*." Aiming for a stabilization at a still low but higher level than these longer-term projections -which would require a change to the debt brake- would create leeway to finance investments that would enhance structural growth and/or accelerate the green transition[10]. The outcome of this debate also matters for Europe given Germany's economic weight.

William De Vijlder

7 Source : see footnote 4.
8 Source: Germany plans partial reform of its debt brake, Lindner says – POLITICO, 16 December 2023.
9 See e.g. Chris Bryant, *Germany has forgotten the golden rule of finance,* Bloomberg, 8 January 2024.
10 The Bundesbank has already analysed in the past how a 'capped golden rule' would work. See *Central government's debt brake: options for stability- oriented further development,* Deutsche Bundesbank, Monthly report, April 2022.

MARKETS OVERVIEW

OVERVIEW

Week 2-2 24 to 9-2-24

↗ CAC 40	7 592	▸	7 648	+0.7	%
↗ S&P 500	4 959	▸	5 027	+1.4	%
↘ Volatility (VIX)	13.9	▸	12.9	-0.9	pb
↘ Euribor 3M (%)	3.90	▸	3.89	-0.9	bp
↗ Libor $ 3M (%)	5.55	▸	5.57	+1.9	bp
↗ OAT 10y (%)	2.66	▸	2.81	+15.3	bp
↗ Bund 10y (%)	2.20	▸	2.35	+15.4	bp
↗ US Tr. 10y (%)	4.03	▸	4.19	+16.3	bp
↘ Euro vs dollar	1.08	▸	1.08	-0.1	%
↘ Gold (ounce, $)	2 035	▸	2 021	-0.7	%
↗ Oil (Brent, $)	77.5	▸	81.7	+5.4	%

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	3.89	3.97	at	18/01	3.88	at	01/02
Euribor 12M	3.66	3.68	at	24/01	3.51	at	01/02
$ FED	5.50	5.50	at	01/01	5.50	at	01/01
Libor 3M	5.57	5.59	at	01/01	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	5.32	5.33	at	24/01	5.31	at	16/01
Libor 12M	0.81	0.81	at	01/01	0.81	at	01/01

At 9-2-24

Yield (%)		highest 24			lowest 24		
€ AVG 5-7y	2.64	2.64	at	01/01	2.64	at	01/01
Bund 2y	2.82	2.99	at	19/01	2.53	at	01/02
Bund 10y	2.35	2.35	at	09/02	2.02	at	03/01
OAT 10y	2.81	2.81	at	09/02	2.47	at	01/01
Corp. BBB	4.03	4.06	at	17/01	3.75	at	01/01
$ Treas. 2y	4.49	4.50	at	05/02	4.22	at	15/01
Treas. 10y	4.19	4.19	at	09/02	3.86	at	01/02
High Yield	7.88	8.10	at	05/01	7.82	at	01/01
£ gilt. 2y	4.59	4.59	at	09/02	3.98	at	01/01
gilt. 10y	4.16	4.16	at	09/02	3.60	at	01/01

At 9-2-24

EXCHANGE RATES

1€ =		highest 24			lowest 24			2024
USD	1.08	1.10	at	01/01	1.07	at	05/02	-2.4%
GBP	0.85	0.87	at	02/01	0.85	at	07/02	-1.5%
CHF	0.94	0.95	at	22/01	0.93	at	08/01	+1.5%
JPY	161.07	161.18	at	19/01	155.33	at	02/01	+3.4%
AUD	1.65	1.66	at	17/01	1.62	at	02/01	+2.2%
CNY	7.76	7.86	at	10/01	7.72	at	05/02	-1.0%
BRL	5.36	5.41	at	22/01	5.32	at	12/01	-0.2%
RUB	98.32	100.17	at	03/01	95.72	at	19/01	-0.4%
INR	89.56	91.92	at	01/01	89.09	at	05/02	-2.6%

At 9-2-24 — *Change*

COMMODITIES

Spot price, $		highest 24			lowest 24			2024	2024(€)
Oil, Brent	81.7	82.8	at	30/01	75.8	at	08/01	+5.2%	+7.7%
Gold (ounce)	2 021	2 067	at	02/01	2 010	at	17/01	-2.1%	+0.2%
Metals, LMEX	3 558	3 762	at	01/01	3 558	at	09/02	-5.4%	-3.1%
Copper (ton)	8 065	8 512	at	30/01	8 065	at	09/02	-4.7%	-2.4%
wheat (ton)	223	2.3	at	01/01	216	at	16/01	-4.1%	-1.8%
Corn (ton)	160	1.7	at	01/01	160	at	09/02	-0.8%	-5.9%

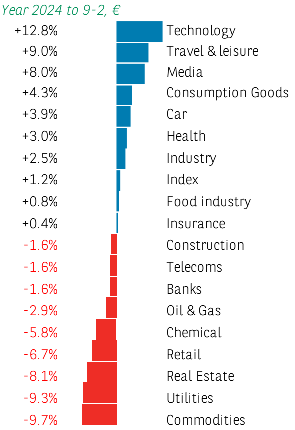
At 9-2-24 — *Change*

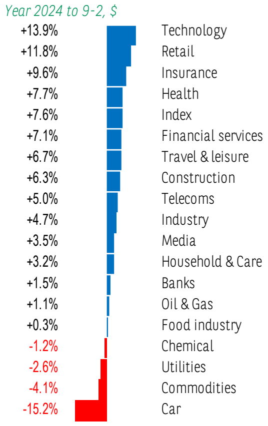
EQUITY INDICES

	Index	highest 24			lowest 24			2024
World								
MSCI World	3 281	3 281	at	09/02	3 114	at	04/01	+3.5%
North America								
S&P500	5 027	5 027	at	09/02	4 689	at	04/01	+5.4%
Europe								
EuroStoxx50	4 716	4 716	at	09/02	4 403	at	17/01	+4.3%
CAC 40	7 648	7 677	at	30/01	7 319	at	17/01	+0.1%
DAX 30	16 927	17 033	at	06/02	16 432	at	17/01	+1.0%
IBEX 35	9 897	10 209	at	08/01	9 858	at	19/01	-0.2%
FTSE100	7 573	7 733	at	01/01	7 446	at	17/01	-0.2%
Asia								
MSCI, loc.	1 317	1 318	at	08/02	1 242	at	03/01	+0.6%
Nikkei	36 897	36 897	at	09/02	33 288	at	04/01	+10.3%
Emerging								
MSCI Emerging ($)	996	1 025	at	01/01	958	at	17/01	-0.3%
China	51	55	at	01/01	49	at	22/01	-7.6%
India	955	960	at	07/02	915	at	03/01	+3.4%
Brazil	1 689	1 800	at	01/01	1 665	at	22/01	-4.1%

At 9-2-24 — *Change*

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

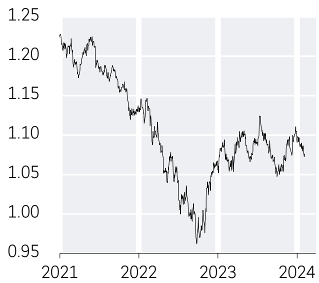




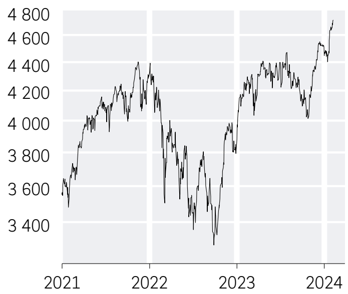
SOURCE: REFINITIV, BNP PARIBAS

MARKETS OVERVIEW

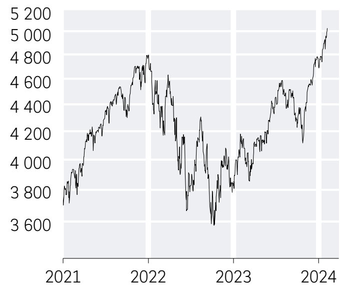
EURO-DOLLAR



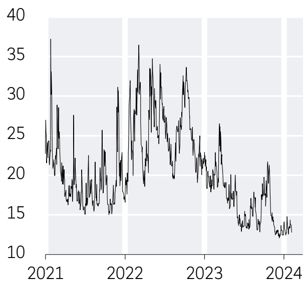
EUROSTOXX50



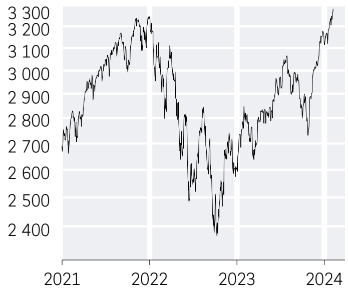
S&P500



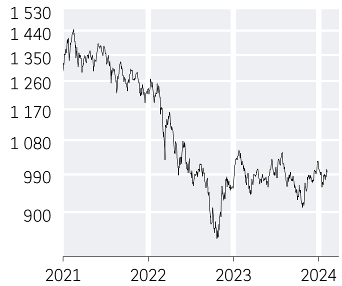
VOLATILITY (VIX, S&P500)



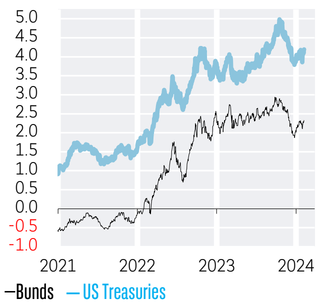
MSCI WORLD (USD)



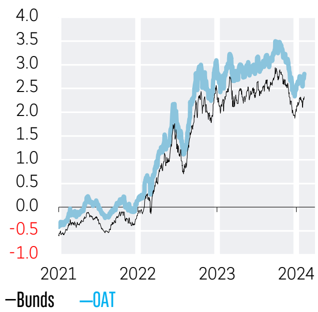
MSCI EMERGING (USD)



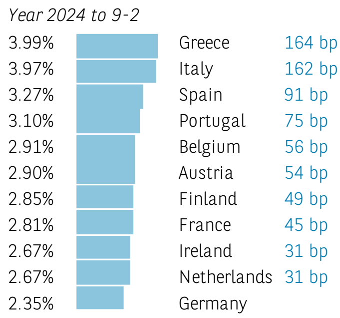
10Y BOND YIELD, TREASURIES VS BUND



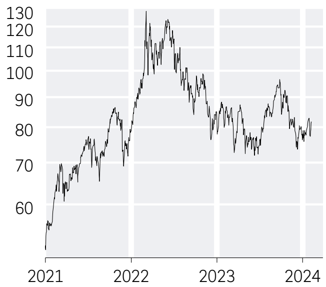
10Y BOND YIELD



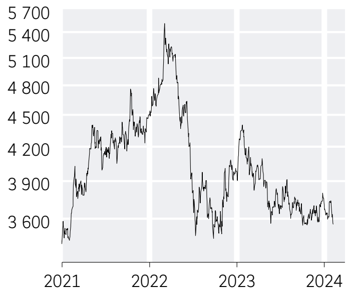
10Y BOND YIELD & SPREADS



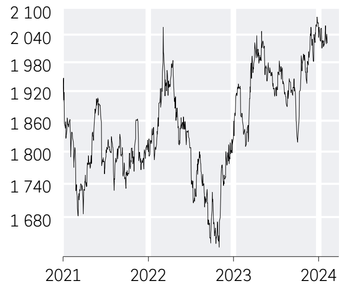
OIL (BRENT, USD)



METALS (LMEX, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS

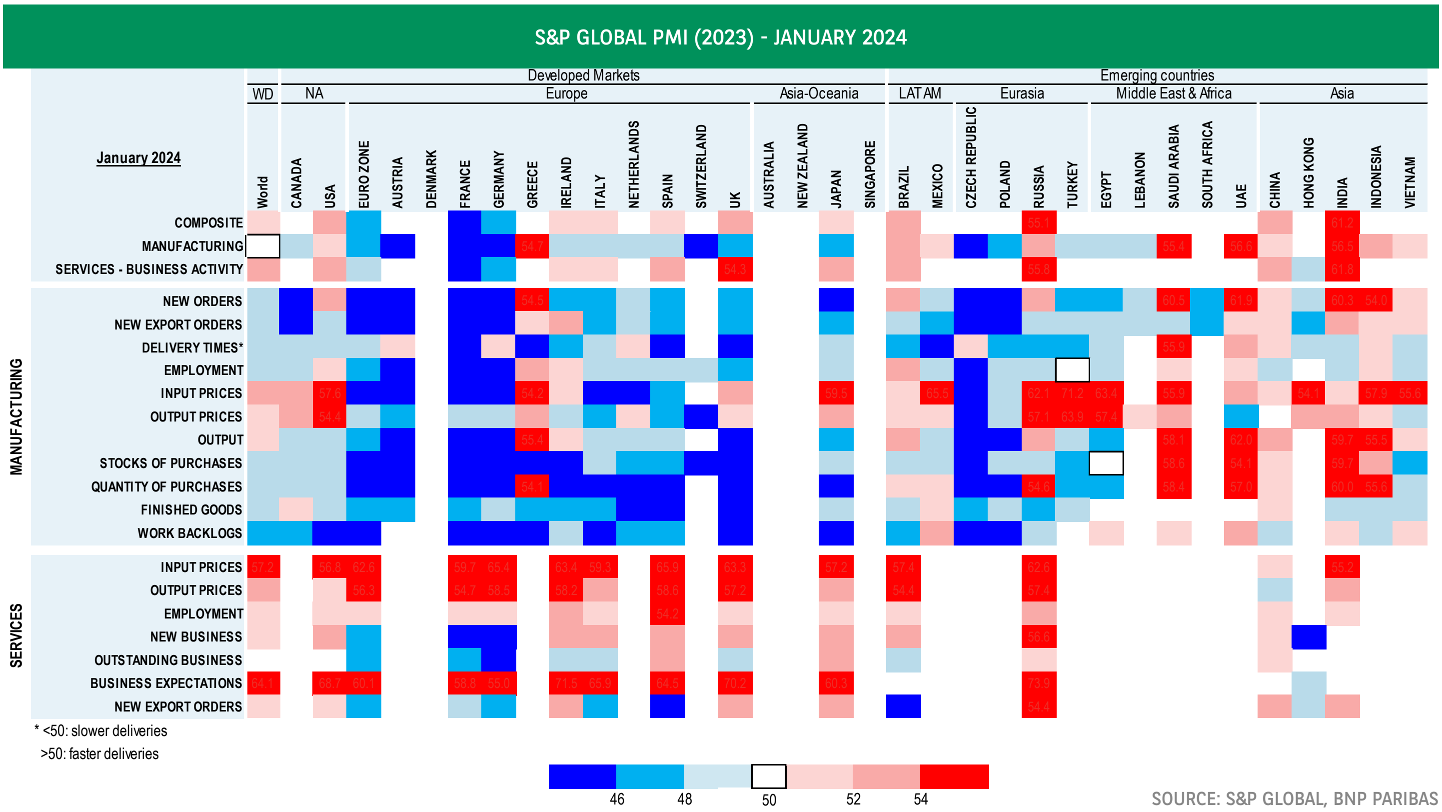
LONGER DELIVERY TIMES WORLDWIDE IN JANUARY

The global composite PMI rose for the third consecutive month in January (up to 51.8 from 51 in December), reaching its highest level since June 2023. All sectors have contributed to this improvement in global activity. In January, the global manufacturing and services PMIs hit their highest levels since August 2022 and July 2023, respectively.

The most significant development for January was the rise in the global manufacturing index, taking it back to the 50 threshold for the first time since August 2022. 22 out of the 31 countries for which January data are available showed an improvement in the manufacturing sector, driven by the "new orders" and "production" components, including in Canada, the United States, Greece, Italy, the Netherlands, Spain, India and Brazil. In China, the manufacturing index stagnated as the "new orders" component declined and the "production" component plateaued. The "delivery times" component continued to deteriorate, for the eighth consecutive month, with the recent troubles in the Red Sea resulting in longer delivery times in most of the countries surveyed. As a result, the input prices index rose in January, particularly in Turkey, the United States, the UK and the Netherlands, while the "output prices" component, which had been edging higher since last July, stagnated globally. There has been reassuring news on the employment side, with the index recovering in most developed countries, with the exception of Italy, Japan, Switzerland and France. The index also improved in China, Brazil and Poland.

In services, half of the countries in our sample posted an improvement in the index from the previous month. There were sharp increases in India and Brazil, as well as smaller ones in the United States, Japan and Italy, where the index has returned to expansion mode. Conversely, while it is only slightly lower in China, France and the Eurozone, the services index plummeted in Ireland and Germany. Overall, the service sector index is being driven up by the rise in its six components, most notably in the "new export orders" and "output prices" components.

Tarik Rharrab



SOURCE: S&P GLOBAL, BNP PARIBAS

S&P GLOBAL PMI (JANUARY 2024 VERSUS DECEMBER 2023)

		Developed Markets																		
		WD	NA		Europe												Asia-Oceania			
		World	CANADA	USA	EURO ZONE	AUSTRIA	DENMARK	FRANCE	GERMANY	GREECE	IRELAND	ITALY	NETHERLANDS	SPAIN	SWITZERLAND	UK	AUSTRALIA	NEW ZEALAND	JAPAN	SINGAPORE
	COMPOSITE	0.8		1.1	0.3			-0.2	-0.4		-0.8	2.1		1.1		0.8			1.5	
	MANUFACTURING	1.0	2.9	2.8	2.2	1.0		1.0	2.2	3.4	0.6	3.2	4.1	3.0	0.1	0.8			0.1	0.2
	SERVICES - BUSINESS ACTIVITY	0.7		1.1	-0.4			-0.3	-1.6		-2.7	1.4		0.6		0.9			1.6	
MANUFACTURING	NEW ORDERS	1.2	3.0	5.5	2.7	0.7		1.2	2.8	2.7	-0.4	5.2	5.3	2.8		-0.5			0.3	0.6
	NEW EXPORT ORDERS	0.7	0.1	-1.2	2.3	-1.5		3.4	1.5	1.4	2.7	3.4	4.9	0.6		0.6			0.8	0.7
	DELIVERY TIMES	-1.2	-2.1	-3.4	-4.5	-5.1		-4.7	-5.2	-8.7	-1.7	-3.9	-5.0	-3.5		-5.9			-1.0	-0.2
	EMPLOYMENT	0.8	2.3	1.2	0.5	2.0		-0.1	0.2	1.7	0.7	-1.2	2.8	2.2	-1.0	1.5			-1.1	
	INPUT PRICES	0.6	-0.8	2.3	-0.3	-1.2		-3.0	0.4	0.5	-2.4	-1.1	4.4	0.8		5.0			-0.3	0.2
	OUTPUT PRICES	0.0	-0.5	0.8	-0.3	0.1		0.7	-0.8	-0.4	0.6	-1.9	0.9	1.3	-4.5	0.8			-0.7	
	OUTPUT	0.9	3.2	1.2	2.2	0.2		0.4	1.9	2.1	1.4	3.8	3.5	3.0		0.0			0.9	-0.1
	STOCKS OF PURCHASES	0.9	4.3	0.8	1.3	-4.5		-0.4	1.0	-8.7	-0.9	3.7	3.7	5.2	-0.9	-3.0			-1.4	0.4
	QUANTITY OF PURCHASES	1.9	5.0	3.3	2.9	1.4		3.4	2.6	3.5	-1.2	5.6	2.1	5.0		1.9			1.8	
	FINISHED GOODS	-0.3	-0.3	-0.2	-0.6	-2.8		-2.8	0.2	-1.9	-0.6	-0.2	-1.1	0.9		-1.6			-2.0	0.1
	WORK BACKLOGS	0.6	3.1	0.6	1.2			0.3	1.7	0.9	-2.0	-0.4	3.2	4.6		0.5			-1.1	
SERVICES	INPUT PRICES	-0.3		-0.9	1.0			0.2	0.5		0.8	1.9		2.5		-1.3			0.1	
	OUTPUT PRICES	-1.2		-3.2	0.7			1.2	-0.2		1.7	0.5		1.8		-1.4			0.5	
	EMPLOYMENT	0.0		-0.5	0.4			0.0	0.8		0.8	0.1		0.3		1.7			0.3	
	NEW BUSINESS	0.2		0.6	0.8			1.3	-1.4		-0.1	4.3		0.6		0.5			0.2	
	OUTSTANDING BUSINESS				-0.4			1.3	-3.8		-2.4	1.5		2.2		0.4			2.0	
	BUSINESS EXPECTATIONS	0.7		2.2	1.8			1.0	1.9		-0.1	2.9		1.8		0.5			1.2	
	NEW EXPORT ORDERS	1.3		2.0	1.6			1.6	3.6		0.1	-0.4		-0.6		1.7			2.7	

		Emerging countries															
		LAT AM		Eurasia				Middle East & Africa					Asia				
		BRAZIL	MEXICO	CZECH REPUBLIC	POLAND	RUSSIA	TURKEY	EGYPT	LEBANON	SAUDI ARABIA	SOUTH AFRICA	UAE	CHINA	HONG KONG	INDIA	INDONESIA	VIETNAM
	COMPOSITE	3.2				-0.6							-0.1		2.7		
	MANUFACTURING	4.4	-1.8	1.2	-0.3	-2.2	1.8	-0.4	1.0	-2.1	-7.3	-0.8	0.0	-1.4	1.6	0.7	1.4
	SERVICES - BUSINESS ACTIVITY	2.6				-0.4							-0.2	-1.4	2.8		
MANUFACTURING	NEW ORDERS	6.0	-3.7	1.2	-3.5	-2.6	1.3	-0.5	-0.7	-7.8	-0.9	-1.1	-1.1	-2.0	3.1	0.6	3.1
	NEW EXPORT ORDERS	4.6	-1.7	0.7	-3.5	-0.1	1.4	1.1	-0.7	-5.0	-0.4	0.0	1.2	-3.5	0.4	-0.1	1.8
	DELIVERY TIMES	-3.0	-1.0	-1.6	-2.8	0.9	-4.6	0.1		-5.3	-6.7	-0.8	1.2	-0.8	0.4	0.1	-0.9
	EMPLOYMENT	1.7	1.1	0.1	2.0	-4.4	0.0	-1.1		0.1	0.4	-0.5	1.6		-0.3	-0.4	-0.2
	INPUT PRICES	-4.1	0.8	-1.8	0.1	-3.5	12.3	3.0		1.5		1.6	-0.1	0.8	0.4	-0.4	0.1
	OUTPUT PRICES	2.4	-0.7	-3.0	1.7	-1.8	7.1	5.4	-0.1	-0.6		-0.2		-0.6	0.1	-0.2	-0.5
	OUTPUT	5.5	-2.2	0.2	-1.6	-1.4	2.9	-0.1		-3.0	-14.3	-1.9	0.0		2.3	2.0	2.2
	STOCKS OF PURCHASES	5.1	-5.2	5.0	2.9	-0.6	0.4	-0.1		2.2	-6.7	-0.3	1.7		2.6	0.8	-1.8
	QUANTITY OF PURCHASES	3.8	-1.9	4.2	-2.0	-5.2	1.4	0.5		-2.4		-0.8	1.3		3.8	0.9	-0.2
	FINISHED GOODS	2.0	0.1	-0.8	-2.0	-0.9	0.8						-0.2		1.0	-0.3	-0.2
	WORK BACKLOGS	2.5	1.2	-1.7	-1.0	0.6		0.0		2.3		2.0	0.4		1.0	-0.1	0.6
SERVICES	INPUT PRICES	1.1				-2.0							-1.6		3.0		
	OUTPUT PRICES	0.0				0.8							-1.0		-0.7		
	EMPLOYMENT	1.5				-0.9							-0.1		0.1		
	NEW BUSINESS	1.9				-0.2							-2.3	-2.0			
	OUTSTANDING BUSINESS	3.7				-1.1							1.2				
	BUSINESS EXPECTATIONS					4.3								-1.4			
	NEW EXPORT ORDERS	3.9				-6.1							-0.1	-1.4	1.2		

-3 -2 -1 0 1 2 3

SOURCE: S&P GLOBAL, BNP PARIBAS

ECONOMIC SCENARIO

UNITED STATES

The possibility of a US recession triggered by monetary tightening is looking less and less likely given the resilience of an economy that continued to grow by 0.8% q/q in Q4 2023 and by 2.5% on average over the year, thanks to the resilience of household consumption and the strength of nonresidential investment. Our central scenario is now that of a marked slowdown albeit without an economic recession in H1 2024. The peak in inflation was reached in mid-2022, and core disinflation is becoming more significant. Inflation should approach the 2% target in 2024. Progress on that front should be considered as sufficient by the Fed to now look forward to a soft landing and start cutting rates progressively, from May 2024.

CHINA

The post-Covid rebound in economic growth weakened rapidly in 2023 and proved to be weaker than initially expected. Domestic demand has remained held back by a significant loss in consumer and investor confidence. The crisis in the property sector has persisted, with the continued fall in sales, defaults of developers and growing difficulties of certain financial institutions. Export momentum stalled last year due to the weakening in global demand and tensions with the US. Yet, Chinese exports have recently regained strength and this trend is expected to continue in the short term. Moreover, the government and the central bank have implemented new policy stimulus measures since last summer. Economic activity has strengthened slightly while consumer price inflation has remained very low. The authorities will keep an accommodative policy mix in the short term, still being constrained by the debt excess of the economy and the weak financial situation of local governments.

EUROZONE

The euro area narrowly escaped economic contraction in the last quarter of 2023. Real GDP remained stable in Q4, with annual growth of 0.5% in 2023.The negative effects of monetary tightening are expected to continue to weigh on economic activity this winter. Activity is expected to inch higher in the first quarter of 2024, before a more pronounced recovery from spring onwards. This would be underpinned by a first rate cut by the ECB, which we expect to happen in April. This monetary easing would accompany the inflation decline, which is expected to come close to the 2% target during the second quarter. Disinflation, along with the dynamism of wages, is expected to support household purchasing power and consumption. Growth should also be supported by NGEU disbursements and its deployment on the ground.

FRANCE

France experienced 0% q/q growth in Q3 and Q4 2023 after a short-lived acceleration in Q2 2023 (+0.7% t/t, driven by exceptional factors, such as aeronautics). In Q4, corporate investment has decreased for the first time (after significant growth). In parallel, household consumption eroded and household investment decreased markedly. Disinflation is now visible (the harmonized index grew by 3.4% y/y in January 2024, compared to 5.7% y/y in September 2023), but the impact of higher interest rates should continue to be felt. As a result, we except 0.1% growth q/q during the Q1 2024. Going forward, we expect no clear growth acceleration this year (0.6% in 2024 after 0.9% in 2023).

RATES AND EXCHANGE RATES

The last meetings of 2023 confirmed that the 25bp rate hike of the Fed funds in July and of the ECB policy rates in September (deposit rate at 4.00%, refinancing rate at 4.50%) was very likely to be the last of an exceptional tightening cycle. The possibility of a further monetary tightening has still not completely and officially disappeared, but it has been a lot reduced by the fall in inflation, which is getting closer more visibly to the 2% target. Positive developments on the inflation front, together with the expected weakening of growth, pave the way for the first rates cuts in April for the ECB and May for the Fed. However, on both sides of the Atlantic, policy rates in real terms and the degree of monetary restriction would remain about unchanged. And the induced decline in long-term rates should be limited by the importance of bond issuance against a background of quantitative tightening. In this regard, we expect a halt in the spring of 2024 to the ECB's reinvestments under the PEPP.

On 31 October, 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 1%. Further adjustments to monetary policy are likely, given that the country currently faces the fastest rate of inflation since the early 1990s. We expect the BoJ to end its negative interest rate policy in March or April, while significantly easing its yield curve control policy. We remain bearish regarding the US dollar, particularly from Q2 2024 and especially versus the euro, given that we expect fewer rate cuts by the ECB than the Fed. We also expect the yen to strengthen versus the USD, based on the combination of the start of BoJ tightening, of the repatriation by Japanese investors of their foreign holdings, and of the fall in US bond yields.

GDP GROWTH AND INFLATION

	GDP Growth				Inflation			
%	2022	2023 e	2024 e	2025 e	2022	2023 e	2024 e	2025 e
United-States	1.9	2.5	2.0	1.4	8.0	4.1	2.7	2.3
Japan	0.9	2.1	0.8	0.9	2.5	3.2	2.1	1.9
United-Kingdom	4.4	0.3	-0.1	1.1	9.1	7.4	2.1	2.3
Euro Area	3.4	0.5	0.7	1.6	8.4	5.4	2.0	2.0
Germany	1.9	-0.1	0.2	1.3	8.7	6.1	2.2	2.0
France	2.5	0.9	0.6	1.4	5.9	5.7	2.2	1.6
Italy	3.9	0.7	0.9	1.5	8.7	6.0	1.5	2.5
Spain	5.8	2.5	1.8	2.1	8.3	3.4	2.4	1.5
China	3.0	5.2	4.5	4.3	2.0	0.4	1.5	1.7
India*	7.2	7.5	7.0	6.5	6.7	5.8	5.7	4.5
Brazil	2.9	3.1	1.8	1.8	9.3	4.6	3.6	3.9

Source : BNP Paribas (e: Estimates & forecasts)
Last update: 9 February 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		Q1 2024	Q2 2024	Q3 2024	Q4 2024	Q4 2025
US	Fed Funds (upper limit)	5.50	5.00	4.50	4.00	2.75
	T-Note 10y	4.15	4.00	3.95	3.95	4.00
Eurozone	deposit rate	4.00	3.50	3.00	2.75	2.50
	Bund 10y	2.45	2.35	2.20	2.20	2.50
	OAT 10y	3.02	2.91	2.75	2.75	3.05
	BTP 10y	4.25	4.00	3.95	3.90	4.20
	BONO 10y	3.45	3.25	3.10	3.05	3.30
UK	Base rate	5.25	5.00	4.75	4.25	3.00
	Gilts 10y	3.90	3.75	3.65	3.55	3.65
Japan	BoJ Rate	0.10	0.10	0.25	0.25	0.75
	JGB 10y	0.80	0.90	1.00	1.20	1.35

Exchange Rates End of period		Q1 2024	Q2 2024	Q3 2024	Q4 2024	Q4 2025
USD	EUR / USD	1.10	1.12	1.14	1.15	1.18
	USD / JPY	145	141	138	135	130
	GBP / USD	1.26	1.29	1.31	1.32	1.36
EUR	EUR / GBP	0.87	0.87	0.87	0.87	0.87
	EUR / JPY	160	158	157	155	153

Brent Quarter Average		Q1 2024	Q2 2024	Q3 2024	Q4 2024	Q4 2025
Brent	USD/bbl	78	81	86	83	82

Sources: BNP Paribas (Market Economics, Interest Rate Strategy, FX Strategy, Commodities Desk Strategy)
Last update: 9 February 2024

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