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"AS ONE APPROACHES THE FINISH LINE OF THE INFLATION-FIGHTING MARATHON OF CENTRAL BANKS -INFLATION IS BACK TO TARGET-, THE NEED TO PREPARE FOR WHAT FOLLOWS INCREASES CONSIDERING THE MONETARY TRANSMISSION LAGS. ALREADY TODAY, THE REAL QUESTION IS WHEN AND ON WHAT BASIS WILL CENTRAL BANKS START CUTTING RATES EVEN BEFORE THE FINISH LINE IS CROSSED."

ECONOMIC RESEARCH

BNP PARIBAS

The bank
for a changing
world

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EDITORIAL

THE LAST MILE OF DISINFLATION

Several central bankers have recently insisted that the 'last mile' in the marathon towards the inflation target may be the most challenging. After an initial swift decline of headline inflation on the back of favourable base effects due to lower energy prices, further disinflation may take more time. Corporate pricing power, inflation expectations and wage growth play a key role in this respect. By insisting on the 'last mile', central bankers probably want to avoid sounding too optimistic on disinflation. Otherwise, financial markets might price in early rate cuts, which would cause an easing of financial conditions in capital markets that would neutralize part of the monetary tightening. However, as one approaches the finish line -inflation converging back to target- and considering the monetary transmission lags, the need to prepare for what follows thereafter increases. Already today, the real question is when and on what basis will central banks start cutting rates even before the finish line is crossed.

Central bankers as well as their watchers like using metaphors to express their views. Lately, drawing a parallel between a monetary policy tightening cycle and running a marathon has become popular. Given where we are in this cycle, the focus has been shifting to the 'last mile' of the marathon. Earlier this year, the BIS annual report described why this phase is challenging[1]. In a recent speech, Isabel Schnabel of the ECB mentioned that *"in long-distance running, the last mile is often said to be the hardest. With the finish line within reach, one must push even harder to achieve the long-held goal. The same could be said about tackling the last mile of disinflation."*[2] Bundesbank President Joachim Nagel also used this metaphor in a speech in London[3] and during his press conference following the latest FOMC meeting, Federal Reserve Chairman Jerome Powell replied to a journalist that *"as you get further and further from those highs [in terms of inflation], it may actually take longer time."*[4]

The 'last mile' thesis implies that inflation initially declines swiftly and subsequently more slowly. The swift drop in inflation in the early phase of the 'disinflation marathon' is intuitively clear when the initial increase in inflation was caused by a negative supply shock, such as a jump in energy prices. When the latter stabilise or even decline, favorable year-over-year comparisons -base effects- can cause a quick drop in inflation. In the US and the Eurozone, this phenomenon has been at work since the middle of 2022, a point that has been emphasized by Isabel Schnabel in her speech.

However, the thesis looks less clearcut when thinking in terms of core inflation. Monetary transmission works with long and variable lags, which means that some degree of cumulative tightening is necessary before the impact on activity and demand starts to become visible. During this phase, it is unlikely that inflation would decline significantly, and further increases can't be excluded.

EUROZONE: CONFIDENCE AND EXPECTATIONS IN THE INDUSTRY

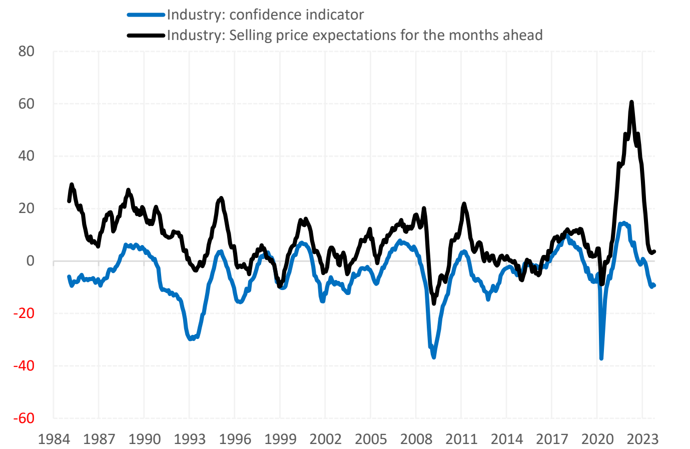


CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

Beyond a certain point, the downturn in activity and demand gathers pace, so one would expect that disinflation would also accelerate. However, reality may be more nuanced. Some companies may continue to benefit from pricing power even though the economy is slowing. Wage growth may remain high because of a still tight labour market and because wage demands try to make up for the loss in purchasing power when inflation was accelerating[5]. In such case, services would see a slower disinflation considering that the wage bill represents a bigger share of their cost base. In this respect, charts 1-4 suggest that

1 Navigating the disinflation journey, BIS Annual Economic Report, June 2023.
2 The last mile, Keynote speech by Isabel Schnabel, Member of the Executive Board of the ECB, at the annual Homer Jones Memorial Lecture, St. Louis, 2 November 2023.
3 Maintaining price stability – The role of the Eurosystem and other economic agents, Speech of Joachim Nagel, President of the Deutsche Bundesbank at the European Economic and Financial Centre, London, 8 November 2023.
4 Federal Reserve, Transcript of Chair Powell's Press Conference, 1 November 2023.
5 Iinflation expectations may also play a role in price setting behaviour as well as in wage demands.

> As one approaches the finish line of the inflation-fighting marathon of central banks -inflation is back to target-, the need to prepare for what follows increases considering the monetary transmission lags. Already today, the real question is when and on what basis will central banks start cutting rates even before the finish line is crossed.

in the eurozone, selling price expectations and the assessment of output prices in industry react more swiftly to a decline in confidence than in services. Moreover, in industry, these metrics are back in line with or even below their long-term average, whereas in services, they remain elevated despite their recent decline. The 'last mile' concern is clearly more of an issue in services that in industry because of a more sticky inflation in the former sector than in the latter[6].

The starting level of inflation also matters. Recent research by the Federal Reserve Bank of Kansas City concluded that between 1970 and 2021, the US economy *"reacts more slowly and with more volatility to a change in monetary policy in a high-inflation state—that is, when our measure of inflation expectations exceeds a value of around 4 percent—than in a low-inflation state."*[7] Moreover, *"in a high-inflation state, interest rates must be held higher for longer to bring inflation back down relative to a low-inflation state."* These results lend support to the slow core disinflation thesis.

The insistence on the 'last mile' may also reflect a high degree of caution of central bankers -avoiding to sound too optimistic on disinflation- in combination with an effort to avoid that financial markets would price in early rate cuts -something that was called 'premature celebration' in a recent IMF paper[8]: it seems central banks prefer investors to keep the champagne on ice, otherwise, the easing of financial conditions in capital markets would neutralize part of the monetary tightening.

Metaphors have their limitations. In a marathon, the race stops when you cross the finish line whereas economic activity continues when central banks reach their inflation target. The focus then shifts to the state economies are in. What has been the cost of disinflation? Has a recession been avoided?

EUROZONE: CONFIDENCE AND EXPECTATIONS IN THE SERVICES

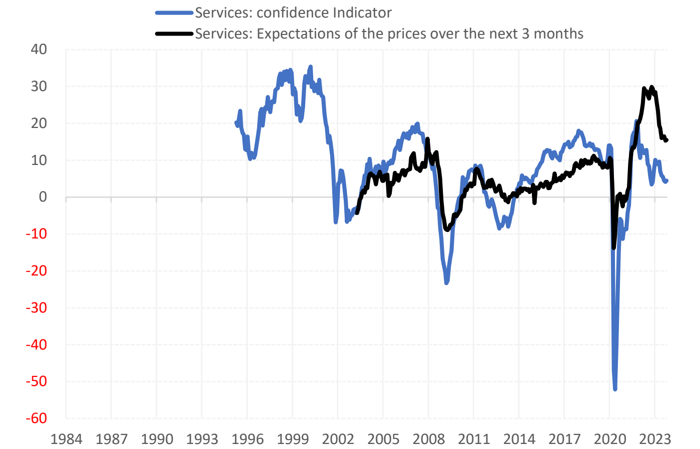


CHART 2 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

As one approaches the finish line, the need to prepare for what follows thereafter increases considering that the monetary transmission lags are long and variable: one should avoid that policy would remain restrictive for too long. This means that already today, the real question is when and on what basis will central banks start cutting rates even before the finish line is crossed, *i.e.* before inflation is back at target.

William De Vijlder

EUROZONE: MANUFACTURING PMI

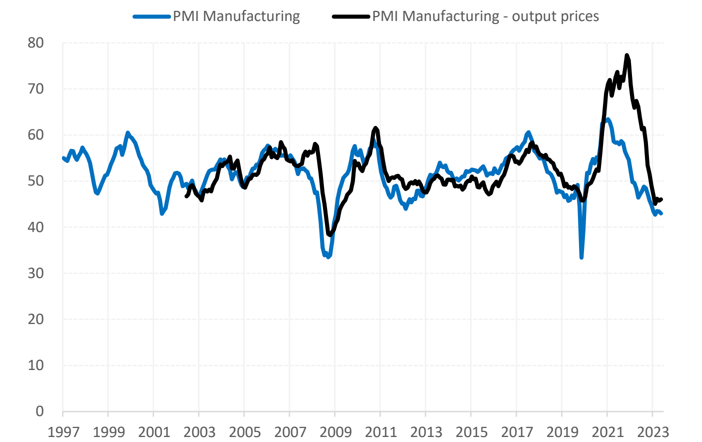


CHART 3 SOURCES : S&P GLOBAL PMI, BNP PARIBAS

EUROZONE: SERVICES PMI

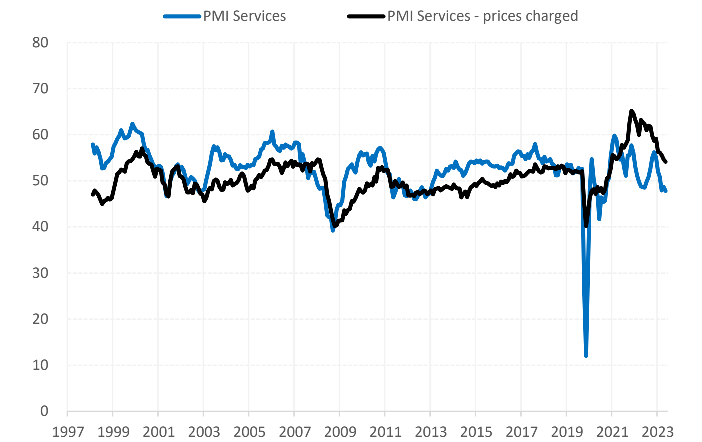


CHART 4 SOURCES : S&P GLOBAL PMI, BNP PARIBAS

6 For more detail, see Eco Charts, Inflation tracker, BNP Paribas, November 2023.
7 Dimitris Christopoulos, Peter McAdam, and Elias Tzavalis, Do the Effects of Interest Rate Changes Depend on Inflation, Federal Reserve Bank of Kansas City Economic Review, forthcoming.
8 Ari, A., Mulas-Granados, C., Mylonas, V., Ratnovski, L., & Zhao, W., One Hundred Inflation Shocks: Seven Stylized Facts. IMF Working Paper WP/23/190, 2023.

MARKETS OVERVIEW

OVERVIEW

Week 3-11 23 to 10-11-23				
↘ CAC 40	7 048	▸	7 045	-0.0 %
↗ S&P 500	4 358	▸	4 415	+1.3 %
↘ Volatility (VIX)	14.9	▸	14.2	-0.7 pb
↗ Euribor 3M (%)	3.96	▸	3.99	+3.6 bp
↘ Libor $ 3M (%)	5.64	▸	5.64	-0.3 bp
↗ OAT 10y (%)	3.15	▸	3.21	+5.6 bp
↗ Bund 10y (%)	2.60	▸	2.68	+7.8 bp
↗ US Tr. 10y (%)	4.57	▸	4.64	+6.2 bp
↘ Euro vs dollar	1.07	▸	1.07	-0.6 %
↘ Gold (ounce, $)	1 995	▸	1 947	-2.4 %
↘ Oil (Brent, $)	85.6	▸	81.6	-4.7 %

MONEY & BOND MARKETS

Interest Rates		highest 23			lowest 23		
€ ECB	4.50	4.50	at	20/09	2.50	at	02/01
Eonia	-0.51	-0.51	at	02/01	-0.51	at	02/01
Euribor 3M	3.99	4.00	at	19/10	2.16	at	02/01
Euribor 12M	4.04	4.23	at	29/09	3.30	at	19/01
$ FED	5.50	5.50	at	27/07	4.50	at	02/01
Libor 3M	5.64	5.69	at	10/10	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	5.36	5.60	at	30/08	3.87	at	02/01
Libor 12M	0.81	0.81	at	02/01	0.81	at	02/01

At 10-11-23

Yield (%)		highest 23		lowest 23	
€ AVG 5-7y	2.64	2.64	at 02/01	2.64	at 02/01
Bund 2y	3.26	3.38	at 28/09	2.39	at 20/03
Bund 10y	2.68	2.94	at 28/09	1.98	at 18/01
OAT 10y	3.21	3.50	at 28/09	2.42	at 18/01
Corp. BBB	4.67	5.00	at 19/10	3.95	at 02/02
$ Treas. 2y	5.06	5.28	at 18/10	3.85	at 04/05
Treas. 10y	4.64	4.98	at 19/10	3.30	at 06/04
High Yield	9.00	9.48	at 20/10	7.94	at 02/02
£ gilt. 2y	4.67	5.51	at 06/07	3.15	at 02/02
gilt. 10y	4.42	4.74	at 17/08	3.00	at 02/02

At 10-11-23

EXCHANGE RATES

1€ =		highest 23			lowest 23			2023
USD	1.07	1.12	at	14/07	1.05	at	03/10	-0.0%
GBP	0.87	0.90	at	03/02	0.85	at	11/07	-1.4%
CHF	0.96	1.00	at	24/01	0.94	at	20/10	-2.4%
JPY	161.63	161.75	at	09/11	138.02	at	03/01	+14.8%
AUD	1.68	1.70	at	21/08	1.53	at	27/01	+6.8%
CNY	7.78	8.08	at	19/07	7.23	at	05/01	+4.9%
BRL	5.25	5.79	at	04/01	5.18	at	18/09	-6.9%
RUB	98.46	110.46	at	14/08	73.32	at	12/01	+26.4%
INR	88.95	92.37	at	14/07	86.58	at	08/03	+0.7%

At 10-11-23 *Change*

COMMODITIES

Spot price, $		highest 23			lowest 23			2023	2023(€)
Oil, Brent	81.6	96.6	at	27/09	71.9	at	12/06	-4.0%	-3.9%
Gold (ounce)	1 947	2 047	at	04/05	1 810	at	24/02	+7.2%	+7.2%
Metals, LMEX	3 588	4 404	at	26/01	3 551	at	05/10	-9.9%	-9.9%
Copper (ton)	7 955	9 331	at	23/01	7 824	at	05/10	-4.9%	-4.9%
wheat (ton)	220	2.9	at	13/02	168	at	29/09	-23.0%	-23.0%
Corn (ton)	171	2.7	at	13/02	161	at	21/08	-3.4%	-34.2%

At 10-11-23 *Change*

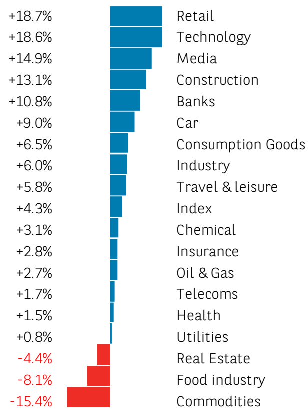
EQUITY INDICES

	Index	highest 23			lowest 23			2023
World								
MSCI World	2 901	3 064	at	31/07	2 595	at	05/01	+11.5%
North America								
S&P500	4 415	4 589	at	31/07	3 808	at	05/01	+15.0%
Europe								
EuroStoxx50	4 197	4 471	at	31/07	3 856	at	02/01	+10.6%
CAC 40	7 045	7 577	at	21/04	6 595	at	02/01	+0.9%
DAX 30	15 234	16 470	at	28/07	14 069	at	02/01	+9.4%
IBEX 35	9 372	9 695	at	27/07	8 370	at	02/01	+1.4%
FTSE100	7 361	8 014	at	20/02	7 257	at	07/07	-0.1%
Asia								
MSCI, loc.	1 209	1 256	at	15/09	1 065	at	04/01	+1.3%
Nikkei	32 568	33 753	at	03/07	25 717	at	04/01	+24.8%
Emerging								
MSCI Emerging ($)	948	1 052	at	26/01	911	at	26/10	-0.1%
China	56	75	at	27/01	55	at	24/10	-11.2%
India	819	843	at	15/09	703	at	16/03	+7.1%
Brazil	1 628	1 733	at	26/07	1 296	at	23/03	+4.0%

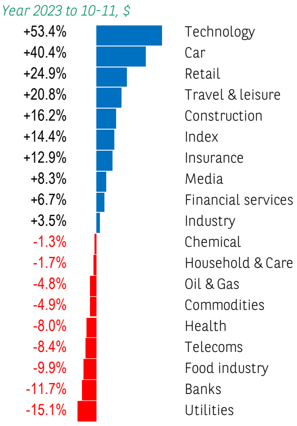
At 10-11-23 *Change*

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

Year 2023 to 10-11, €



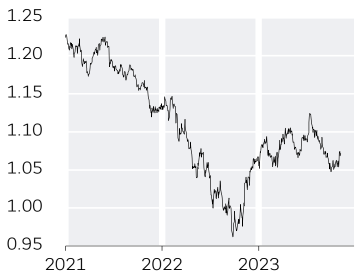
Year 2023 to 10-11, $



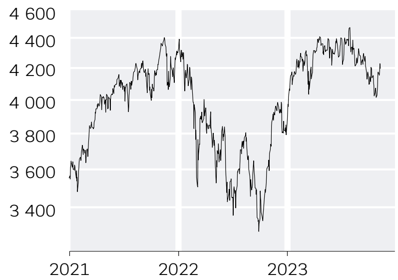
SOURCE: REFINITIV, BNP PARIBAS

MARKETS OVERVIEW

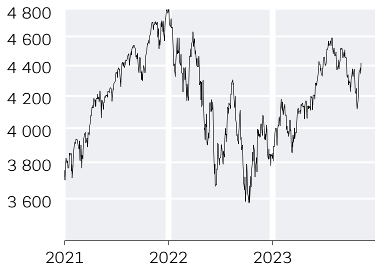
EURO-DOLLAR



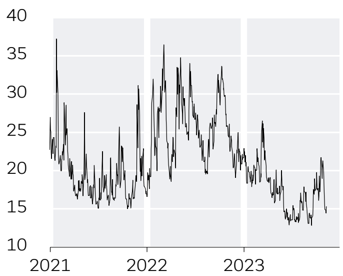
EUROSTOXX50



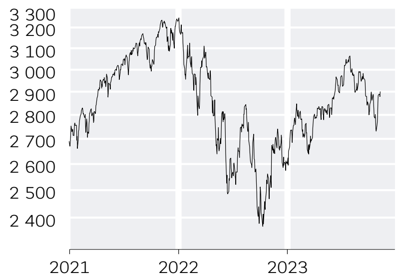
S&P500



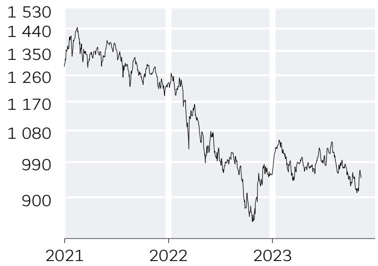
VOLATILITY (VIX, S&P500)



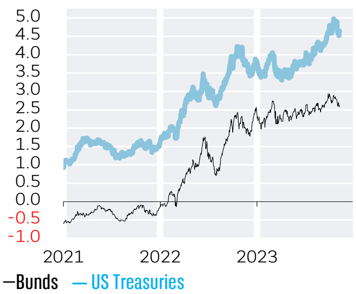
MSCI WORLD (USD)



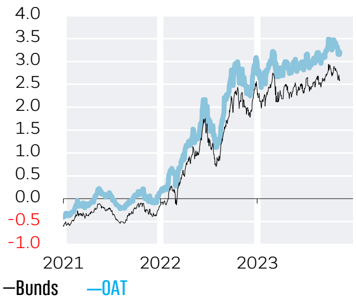
MSCI EMERGING (USD)



10Y BOND YIELD, TREASURIES VS BUND

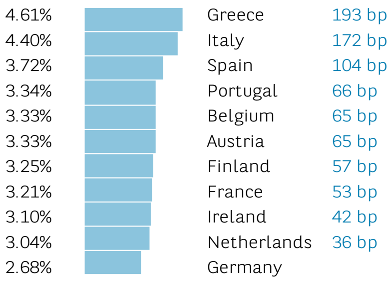


10Y BOND YIELD

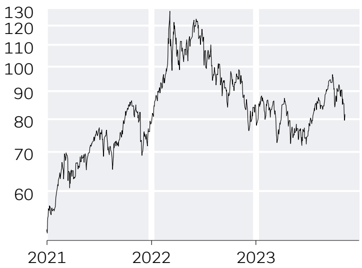


10Y BOND YIELD & SPREADS

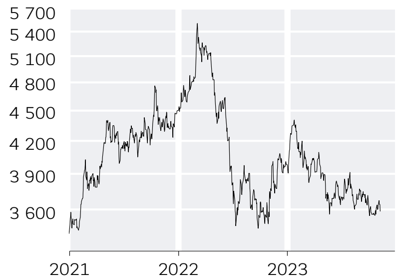
Year 2023 to 10-11



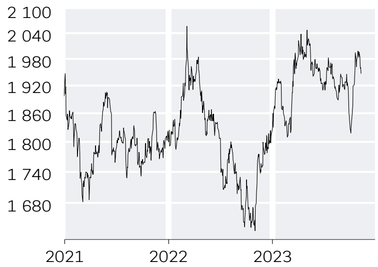
OIL (BRENT, USD)



METALS (LMEX, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS

PMI: GLOBAL ECONOMIC ACTIVITY STAGNATES IN OCTOBER

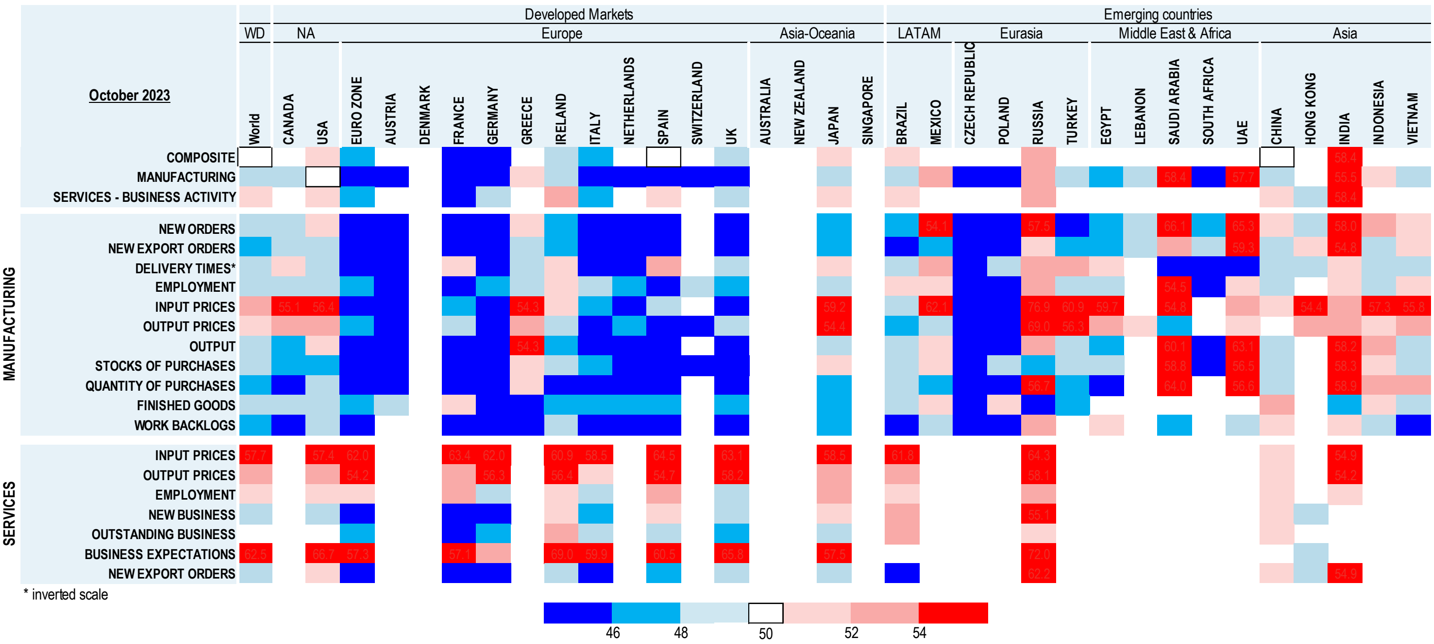
The fall in the global composite PMI index continued in October. It hit the dividing line between the expansionary and contractionary zones (50.0, from 50.5 in September). This is a sign that global economic activity is flatlining in this early part of the fourth quarter of 2023.

The manufacturing PMI resumed its downward movement in October, slipping a little further into contraction territory (to 48.8), and the picture from the services PMI continued to deteriorate. It marked its seventh consecutive monthly fall, reaching its lowest level since January 2023 (50.5 in October). Business climate in the sector is driven down by the deterioration of the "new business" and the "business expectations" components. The employment component stagnated in October, but remained above the 50 threshold, whilst input price inflation and output prices continued to ease. The "new export orders" component improved but remained in contraction territory for the second month in a row. Of the 16 countries for which October's data are available, eleven reported a fall in the index relative to September: the drop was marked in Japan, Italy, India, Ireland and Russia, and more measured in Canada and the Eurozone. In Germany, the index gave up 2.1 points, moving it back into the contraction zone (48.2, from 50.3 in September). However, the index improved in the USA, China and Spain. Despite the increase in France in October (45.2, from 44.4 in September), the index remains deep in the contraction zone. It should be noted that the French index is the lowest of the 16 sampled.

In the manufacturing sector, the Asian countries in our sample saw their indices fall. China, in particular, saw a return to the contraction zone (49.5, from 50.6 in September). In the Eurozone, the index was down slightly, dropping 0.4 of a point to 43.0, standing below the 50 mark for the sixteenth month in a row and reflecting the weakness of the industrial sector. Amongst Eurozone nations, the survey revealed steep drops in Spain and Italy and smaller falls in France and Ireland; the index rose in both Austria and Germany. In the USA, the manufacturing index climbed slightly and is now at 50. Looking in more details at the components of the index, we can see sharp falls in new orders in Spain, India, Turkey, Italy and France. At the world level, the output prices sub-component is slightly down (51.5 compared to 51.7 in September), the good news being offset by higher input prices (53.1 compared to 52.2) against a background of rising oil prices. When it comes to employment, the PMI sub-index fell in China, India and most developed economies, with particularly steep drops in the USA, France and Germany.

Tarik Rharrab

S&P GLOBAL PMI (OCTOBER 2023)



SOURCE: S&P GLOBAL, BNP PARIBAS

S&P GLOBAL PMI (OCTOBER VERSUS SEPTEMBER 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	-0.5		0.5	-0.7			0.5	-0.5		-2.4	-2.2		-0.1		0.1			-1.6	
	MANUFACTURING	-0.4	1.1	0.2	-0.4	2.1		-1.4	1.2	0.5	-1.4	-1.9	0.2	-2.6	-4.3	0.5			0.2	
	SERVICES - BUSINESS ACTIVITY	-0.3		0.5	-0.9			0.8	-2.1		-1.9	-2.2		0.6		-0.1			-2.2	
MANUFACTURING	NEW ORDERS	0.1	1.4	1.4	-0.5	4.5		-1.7	1.5	1.3	-0.4	-2.8	0.4	-4.6		1.0			0.7	
	NEW EXPORT ORDERS	-0.2	0.5	-0.2	-0.4	2.0		-1.3	1.3	0.1	-1.7	-0.2	2.1	-3.5		-1.4			-0.7	
	DELIVERY TIMES	-0.5	-1.1	-1.5	-1.7	-0.1		-0.5	-3.6	0.8	-1.4	-0.5	-1.4	0.6		-2.1			-1.2	
	EMPLOYMENT	-1.0	1.1	-2.9	-2.3	1.3		-3.2	-2.5	-2.6	-2.8	-1.8	2.6	-0.4	-1.3	0.7			-0.5	
	INPUT PRICES	0.4	4.7	1.5	0.3	1.8		1.9	-0.4	1.2	2.4	0.8	0.6	0.5		1.0			-1.1	
	OUTPUT PRICES	-0.2	0.3	0.3	0.3	-1.2		1.3	0.6	1.1	2.8	0.5	0.6	-2.0	-8.1	-2.5			0.0	
	OUTPUT	-0.9	1.3	0.5	0.0	2.0		-0.7	2.6	2.9	-2.8	-2.6	-2.5	-2.6		-0.3			-0.5	
	STOCKS OF PURCHASES	-0.9	0.4	-0.7	-0.5	-0.5		-2.1	0.8	0.8	-2.1	-1.2	-0.9	-4.7	0.6	-2.2			0.6	
	QUANTITY OF PURCHASES	-0.2	0.4	1.7	-0.4	3.5		-1.6	1.6	1.3	-2.0	-0.7	-2.7	-4.6		-0.7			1.1	
	FINISHED GOODS	0.8	1.4	3.3	-1.1	-1.7		2.1	-1.1	0.3	-3.3	-1.7	-3.5	-2.3		0.0			-2.8	
	WORK BACKLOGS	0.3	-2.2	2.0	-0.4			-3.5	1.3	-2.4	-2.0	-0.4	-1.3	-3.9		1.5			-0.2	
SERVICES	INPUT PRICES	-2.0	1.9	-3.4	-0.2			3.3	-1.9		-2.3	-3.3		1.8		-5.4			-2.7	
	OUTPUT PRICES	-0.8		-2.3	-0.5			-0.6	-0.9		-0.8	-0.5		0.8		1.2			-0.2	
	EMPLOYMENT	0.0		-0.1	-0.4			-0.4	0.0		-1.2	-1.3		0.1		1.2			3.0	
	NEW BUSINESS	-0.3		0.5	-0.7			0.5	-0.4		-4.4	-3.1		0.2		-0.9			-1.0	
	OUTSTANDING BUSINESS				0.2			-1.4	2.1		-4.0	-1.0		1.2		0.5			-0.4	
	BUSINESS EXPECTATIONS	-0.2		1.3	1.5			2.7	3.0		0.6	-2.5		0.9		-2.3			-0.2	
	NEW EXPORT ORDERS	0.8		2.3	-0.2			0.4	1.6		-3.5	-4.2		0.6		1.4			-1.0	

Emerging countries

		LATAM		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	1.3				-1.1							-0.9		-2.6		
	MANUFACTURING	-0.4	2.3	0.3	0.6	-0.7	-1.2	-0.8	-0.2	1.2	-0.9	1.0	-1.1		-2.0	-0.8	-0.1
	SERVICES - BUSINESS ACTIVITY	2.3				-1.8							0.2	-0.7	-2.6		
MANUFACTURING	NEW ORDERS	-1.2	4.2	1.2	2.0	0.9	-2.3	-0.4	-0.3	1.9	-2.0	0.6	-0.4	1.4	-2.9	-1.5	-1.3
	NEW EXPORT ORDERS	-2.2	-1.6	2.0	0.3	-1.3	0.3	-1.1	-0.3	3.1	2.1	0.6	0.2	1.8	-0.7	-1.6	-1.6
	DELIVERY TIMES	-1.7	0.0	2.4	-0.7	2.6	0.5	1.4		-3.9	0.4	-0.8	0.6	2.5	0.1	-0.2	-0.1
	EMPLOYMENT	0.3	1.9	0.4	1.1	-2.9	-0.8	-3.0		2.5	-3.2	0.5	-0.5		-1.2	-0.4	1.8
	INPUT PRICES	0.3	2.7	1.6	3.7	-7.8	-3.8	-1.8		0.3		0.9	0.1	0.4	0.6	0.6	1.1
	OUTPUT PRICES	-1.6	-0.7	-3.0	-0.9	-0.1	-0.5	-0.2	0.4	-0.8		1.6		-0.3	-0.6	-0.1	0.5
	OUTPUT	-1.6	1.4	0.8	-1.6	0.7	-1.3	0.6		-2.7	-2.8	0.3	-2.4		-2.7	-0.1	0.3
	STOCKS OF PURCHASES	-0.1	2.6	0.1	1.1	-2.7	0.9	-0.9		2.8	-0.3	5.2	-1.6		-2.0	-2.3	-1.4
	QUANTITY OF PURCHASES	1.6	-1.3	0.9	-0.5	-3.8	-2.0	4.1		4.7		-1.8	-1.4		-2.1	0.1	-0.2
	FINISHED GOODS	-2.8	2.1	-1.8	3.9	-2.2	0.3						1.8		-0.2	-0.1	-0.9
	WORK BACKLOGS	-4.0	-3.8	1.0	-1.0	3.6		-2.5		-0.2		-1.8	0.2		0.5	-0.1	-3.5
SERVICES	INPUT PRICES	0.1				-2.8							-1.3		-2.3		
	OUTPUT PRICES	1.0				-0.7							0.2		1.1		
	EMPLOYMENT	0.4				1.5							-0.9		-0.8		
	NEW BUSINESS	4.3				-1.2							-0.2	-0.1			
	OUTSTANDING BUSINESS	6.3				-1.5							0.9				
	BUSINESS EXPECTATIONS					2.0								-0.7			
	NEW EXPORT ORDERS	-2.2				-1.4							0.7	-0.7	0.8		

-3 -2 -1 0 1 2 3

SOURCE: S&P GLOBAL, BNP PARIBAS

ECONOMIC SCENARIO

UNITED STATES

US activity decelerated only slightly in the first half of 2023 (+0.5% q/q on average per quarter after +0.6% q/q during the second half of 2022), 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 it still limited on activity and employment growth. Q3 GDP growth was even stronger (+1.2% q/q according to the preliminary estimate). A sharp slowdown is expected, however, in Q4, because of the depleted excess savings and the ensuing loss of momentum of the household consumption engine, before the economy slides into recession in the first half of 2024. The peak in inflation was reached in mid-2022, core disinflation is becoming more significant, but it remains gradual. Inflation should approach the 2% target in 2024. However, the slow pace of disinflation argues in favor of keeping monetary policy in restrictive territory, despite the expected start of the easing cycle in mid-2024. This should limit the recovery in 2024.

CHINA

Economic growth started to accelerate in early 2023 following the end of the zero Covid policy, but the recovery has weakened very rapidly. Export momentum has stalled due to depressed global demand and tensions with the US. 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, new defaults of developers and growing difficulties of certain financial institutions. The government and the central bank have implemented new policy stimulus measures over the summer, aimed at supporting domestic demand and activity in the property sector. A slight improvement in real GDP growth thus appeared in Q3 2023 and is expected to continue in the short term. However, policy makers remain prudent, notably constrained by the debt excess of the economy and the weak financial situation of local governments.

EUROZONE

According to the latest figures available, Eurozone growth registered a small rebound in Q2 (+0.2% q/q) after two quarters of stagnation. The disparate performance between Member States weakens the overall result. France and Spain have been doing well, but Germany, Italy and the Netherlands are struggling. The rising negative effects of monetary tightening and the fading of the positive post-Covid-19 catching up effects and of the support from diminishing in supply-side constraints contribute to the deterioration of business confidence and are expected to lead to a new period of economic stagnation in the Eurozone in the second half of 2023, before starting a sluggish recovery. The fall in inflation is continuing. Although it remains slow – inflation is expected to remain above 2% y/y by the end of next year, forcing monetary policy to remain in restrictive territory – disinflation provides, along with wage and employment dynamics, a significant support to household purchasing power and consumption, whose expected slight rebound should avoid a recession of the Eurozone. Growth should also be supported by NGEU disbursements.

FRANCE

French growth significantly surprised on the upside in Q2 2023, with activity accelerating more than expected (+0.5% q/q, after stagnation in Q1 and a modestly positive Q4 2022). 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. After its August rebound, inflation remained at the same high rate in September (5.7% y/y according to the harmonized measure), a development due to energy prices. The disinflation process is not called into question, as evidenced by the fall in core inflation. However, because of rising interest rates, household demand should remain subdued in 2023, weighing on our GDP growth forecast (0.9% in 2023, compared to 2.5% in 2022).

RATES AND EXCHANGE RATES

In the US, the 25bp rate hike in July should be the last for the Fed. Some uncertainty remains, however, given the still elevated core inflation and the resilience of activity and the labour market to date. In any case, these factors argue against a rate cut before mid-2024. Among other factors, the residual uncertainty on the policy rate peak is reflected in long-term rates, which remained on an upward trend during the last days of October. However, as the prospect of monetary easing in 2024 rises, long-term rates should resume their decline.

Regarding the ECB, the 25bp hike in September of its policy rates (deposit rate at 4.00%, refinancing rate at 4.50%) should mark the end of the tightening cycle, considering the effects of the monetary tightening already underway. But it is not yet certain that it will really be the last hike, given the still limited fall 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. The next step concerns the PEPP. The ECB intends to pursue the reinvestments until at least the end of 2024; we expect them to end in March 2024. European long-term rates remain on an uptrend, moving in line with US rates, but in a more muted way. They are expected to ease gradually as uncertainty dissipates over the continuation of monetary tightening.

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 are likely, 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 remain bearish regarding the US dollar versus the euro. The dollar's valuation is expensive and next year the Federal Reserve should ease 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	1.9	2.4	0.8	4.7	8.0	4.2	2.4
Japan	2.3	1.0	2.0	1.0	-0.2	2.5	3.2	2.6
United-Kingdom	8.7	4.3	0.5	-0.1	2.6	9.1	7.4	3.0
Euro Area	5.6	3.4	0.5	0.9	2.6	8.4	5.6	2.8
Germany	3.1	1.9	-0.1	0.4	3.2	8.6	6.2	3.0
France	6.4	2.5	0.9	0.7	2.1	5.9	5.8	2.7
Italy	7.0	3.8	0.8	1.0	1.9	8.7	6.2	2.2
Spain	5.5	5.5	2.4	1.5	3.0	8.3	3.5	2.8
China	8.4	3.0	5.1	4.5	0.9	2.0	0.5	2.0
India*	9.1	7.2	6.1	6.0	5.5	6.7	5.9	5.0
Brazil	5.0	2.9	3.1	1.8	8.3	9.3	4.7	4.2

Source : BNP Paribas (e: Estimates & forecasts)
Last update: 31 October 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		Q4 2023	Q1 2024	Q2 2024	Q3 2024	Q4 2024
US	Fed Funds (upper limit)	5.50	5.50	5.25	4.75	4.25
	T-Note 10y	4.20	4.05	3.95	3.90	3.90
Eurozone	deposit rate	4.00	4.00	3.75	3.50	3.25
	Bund 10y	2.60	2.45	2.40	2.30	2.35
	OAT 10y	3.17	2.99	2.93	2.85	2.92
	BTP 10y	4.50	4.25	4.10	4.10	4.25
	BONO 10y	3.70	3.45	3.35	3.30	3.40
UK	Base rate	5.25	5.25	5.00	4.50	4.00
	Gilts 10y	4.00	3.80	3.60	3.65	3.70
Japan	BoJ Rate	-0.10	-0.10	0.10	0.10	0.25
	JGB 10y	0.75	0.85	0.90	0.90	1.00

Exchange Rates End of period		Q4 2023	Q1 2024	Q2 2024	Q3 2024	Q4 2024
USD	EUR / USD	1.10	1.11	1.12	1.13	1.15
	USD / JPY	145	145	140	138	135
	GBP / USD	1.29	1.29	1.29	1.30	1.32
EUR	EUR / GBP	0.85	0.86	0.87	0.87	0.87
	EUR / JPY	160	161	157	156	155

Brent End of period		Q4 2023	Q1 2024	Q2 2024	Q3 2024	Q4 2024
Brent	USD/bbl	81	82	86	88	86

Sources: BNP Paribas (Market Economics, Interest Rate Strategy, FX Strategy, Commodities Desk Strategy)
Last update: 25 September 2023

FURTHER READING

Labour shortages in a receding labour market	EcoTVWeek	10 November 2023
French economy pocket atlas - October 2023	Ecobooklet	10 November 2023
Inflation tracker - November 2023	EcoChart	9 November 2023
French exports: if only one should remain...	EcoBrief	8 November 2023
United States: New home sales, a short-lived rebound?	Chart of the Week	8 November 2023
Japan: Yield curve out of control?	EcoWeek	6 November 2023
US: sprinting uphill	EcoTVWeek	3 November 2023
The economic consequences of geopolitical uncertainty	EcoWeek	30 October 2023
Latin America: shifting global winds dent portfolio inflows	EcoTVWeek	27 October 2023
Nigeria: remaining on course	EcoConjoncture	26 October 2023
Climate neutrality: beware of a two-speed transition!	Chart of the Week	25 October 2023
Eurozone: Looking for hopeful signs in the inflation data	EcoWeek	23 October 2023
OECD countries: EcoPulse of 20 October 2023	EcoPulse	20 October 2023
Japan: overseas subsidiaries a key driver of the Japanese industry	EcoTVWeek	20 October 2023
Resilience of capital flows in Central Europe	Chart of the Week	18 October 2023
The risk-bearing capacity of investors and bond markets	EcoWeek	17 October 2023
Emerging countries: Disparities and reshuffling	EcoEmerging	16 October 2023
Spain: The deterioration in borrowers' creditworthiness remains contained	EcoTVWeek	13 October 2023
OECD: The likely end of interest rate hikes but not of monetary restraint	EcoPerspectives	13 October 2023
Eurozone: Fixed rates are protecting borrowers from the effects of monetary policy tightening	Chart of the Week	11 October 2023
Episode 1 · Central banks and their fight against inflation. Job done ?	MacroWaves	11 October 2023

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