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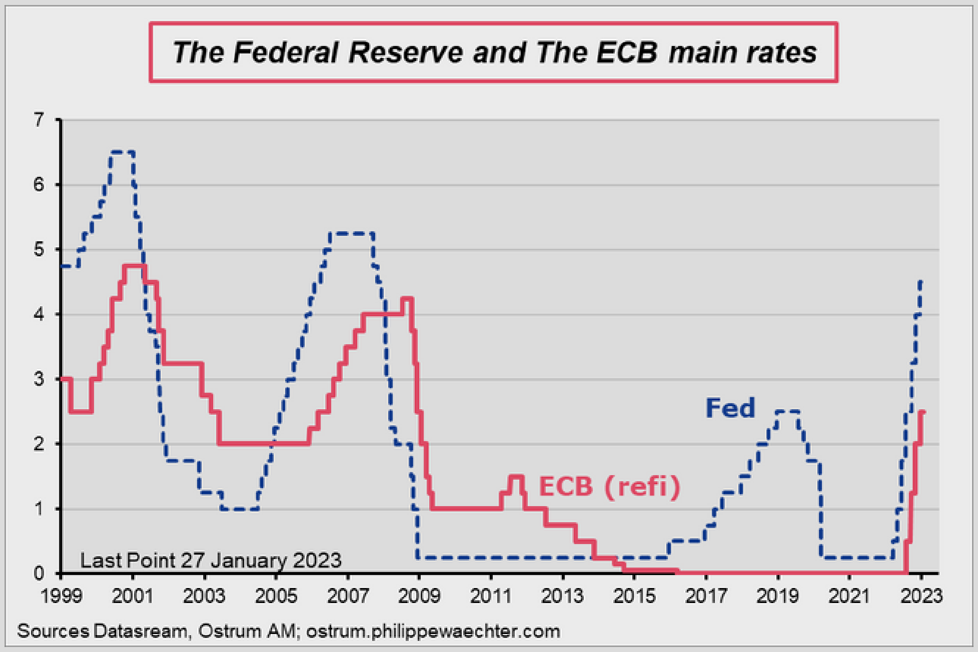
Ostrum ASSET MANAGEMENT

Keys of the week

- **The Business Cycle Profile in the Euro Area (Page 2)**
- **Business Cycle and Real Estate in France (Page 3)**
- **Growth in the US (Page 4)**
- **Fed policy and Inflation, International Trade and Spain (Page 5)**
- **This week: ECB and Fed meetings, GDP in France and the Euro Area**



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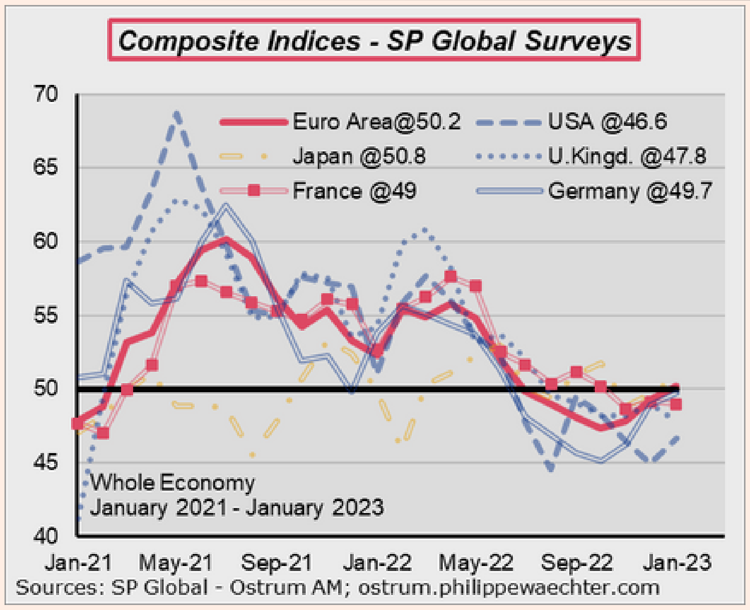
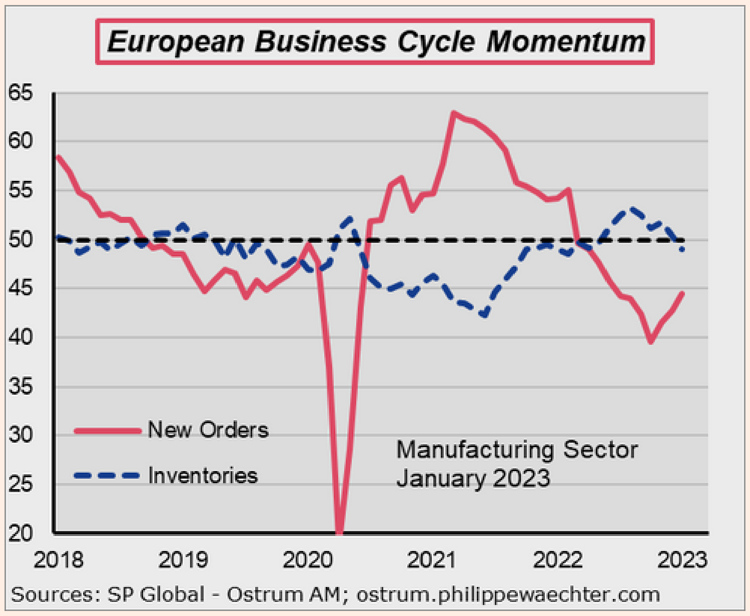
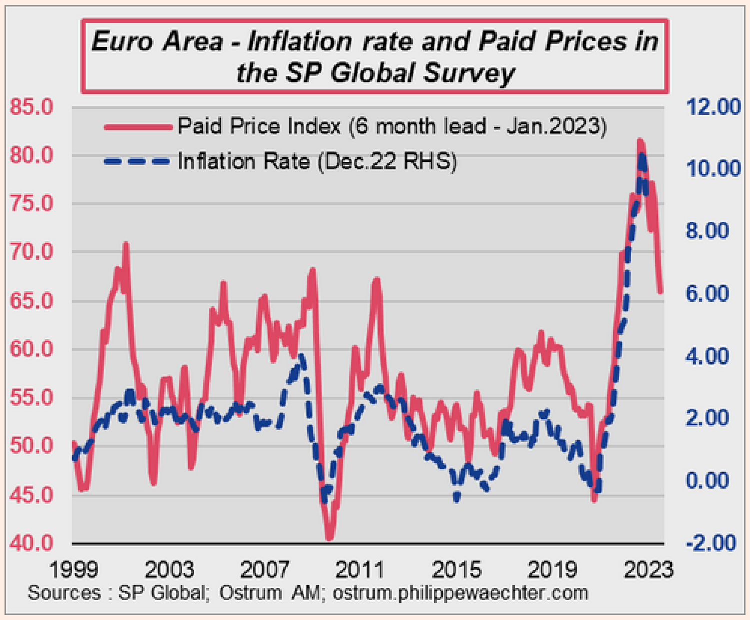
The Business Cycle Profile in the Euro Area







For the first time since last June, that the composite index of **economic activity** in the **Euro Area** is returning to the territory of expansion at 50.2 in January 2023.

The index plunged below the threshold of 50 in June with the tensions on energy price notably on gas.
Now **tensions have eased** and the outlook has **improved**.
In a nutshell, new **orders** indices have **strengthened** since last October and **price pressures have receded** at the beginning of this year.

The **energy price drop** and the proactive **economic policy** are the sources of this improvement. The former in avoiding strong and brutal adjustments and the latter by fuelling internal demand.

The momentum is stronger in the **manufacturing** sector than in the services sector. This is probably related to the beginning of the recovery in international trade.

In **Germany**, the composite index is faring stronger. It is also the case with the IFO survey (see next page). In **France**, the composite index is steady, slightly below 50.

In the **United Kingdom**, the momentum is a bit lower. The risk for the economy is to be decoupled from the global economic cycle.

In the **US**, the SP Composite Index has been lower than 50 since last July. We prefer the ISM survey which looks more reliable on the business cycle momentum. In December, the ISM global index was below the 50 threshold for the first time since May 2020.

The **price paid index** for the whole economy **dropped** again in January. It is a leading indicator for milder inflation figures in coming months.
For the **manufacturing** sector, the price paid index was at 55.8 which compare with the 2013-2019 average at 53.6. There is **no panic** even with the effects of **China's recovery** on commodities.

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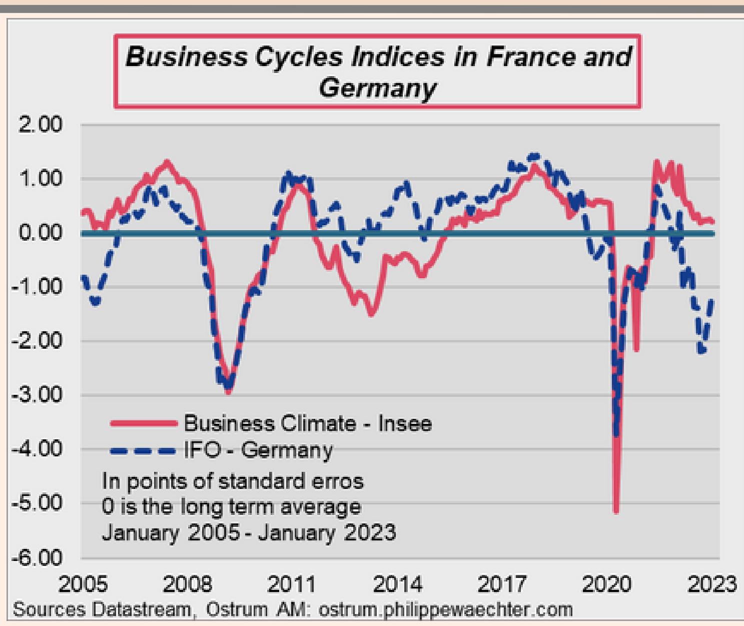
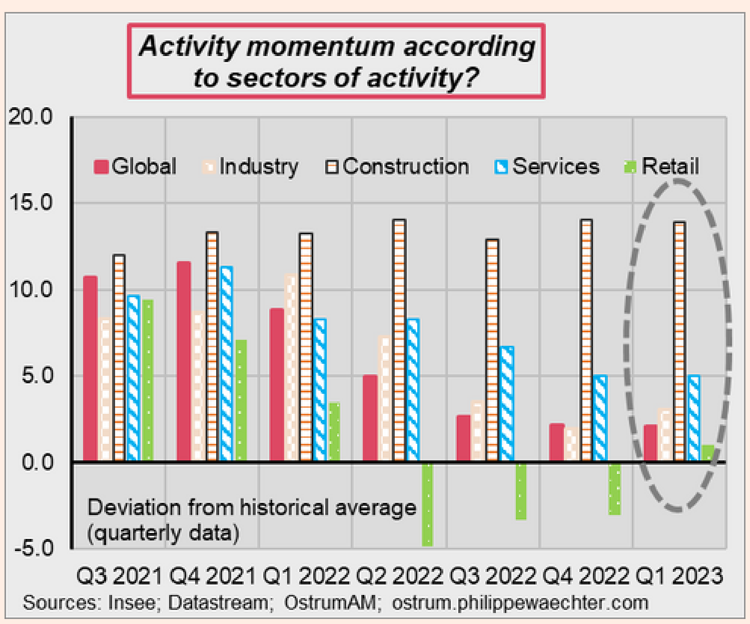
Business Cycle and Real Estate in France



The **French Business Climate** index at **102** in January remained above its historical average at 100 (0 on the graph). It is at this level since last September. At the end of 2021, it was close to 110.
The dynamism of the economy is slightly above its average.

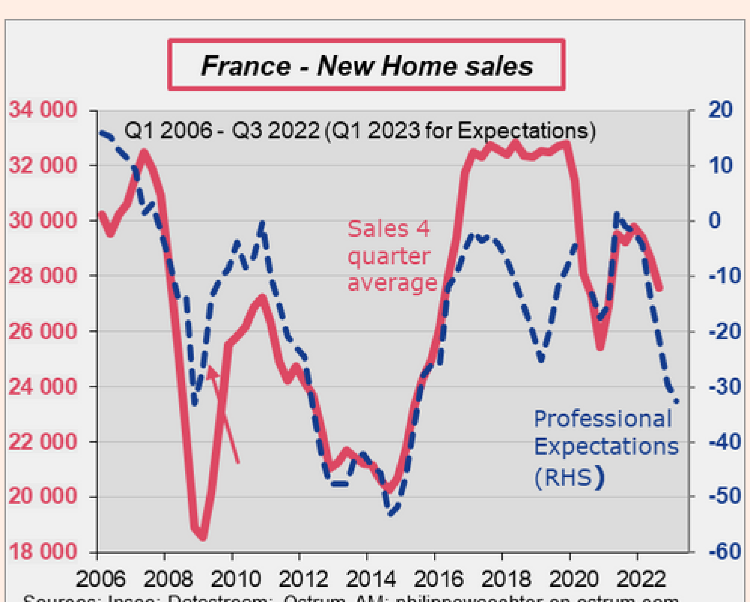
The **IFO index** in **Germany** is improving since the bottom seen last September. Nevertheless, the index remains way **below its average** (0 on the graph)
Expectations are more positive at a 6 month horizon. Current conditions are still difficult.

There is still a **risk of recession in Germany**. The ratio of the IFO's two components is a good leading indicator of a recession. This is still in a recession zone.



In **France,** the survey shows that **every sector of activity is optimistic**. They are all above their historical average. This is notably the case for the retail sales sector. Expectations were negative for almost all 2022. This is no longer the case.

The **industrial sector** appears **stronger** than at the end of 2022. This signal is common with the SP Global survey and can reflect a stronger external demand associated withe the **recovery** in **international trade**.



The survey of **real estate** developers in **France** remains **pessimistic** about the development of new home sales. The prices of these new homes will change but remain rather high
Uncertainty and funding issues explain this further decline. Nevertheless, it is noted that the cash needed for a sale is higher than they were a few months ago. There is a rebalancing after remarks from the Banque de France which said that this cash was too low and paid with a loan attached to the home sale.
Housing starts are expected to be stable at a low level.

January 30, 2023

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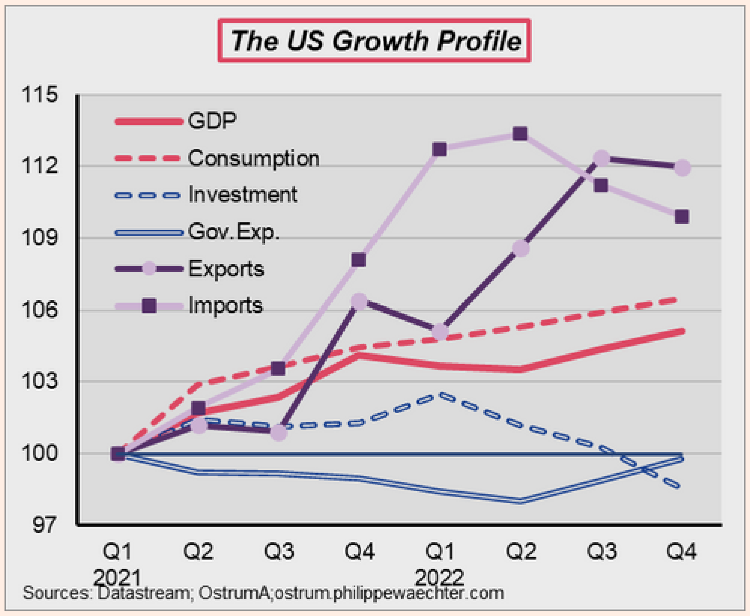
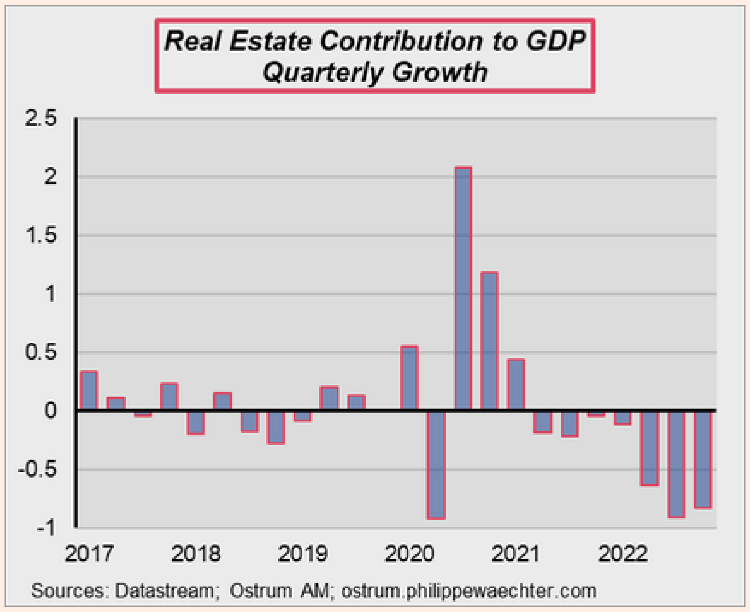
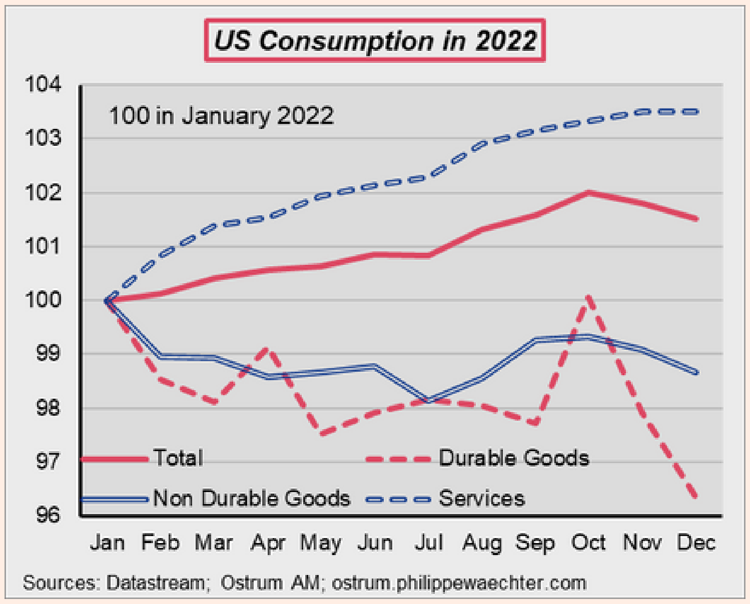
Growth in the US







The **US GDP growth** was **2.9%** in the fourth quarter (annual rate). For the **whole year**, the growth rate was **2.1%** after 5.9% in 2021.
The **carryover** growth for 2023 at the end of 2022 is **0.9%.**
(The Q4 GDP level is 0.9% above the 2022 average level. This is also the starting point for 2023. GDP average growth would be 0.9% in 2023 il GDP level remains at Q4 2022 level for every quarter of 2023)

After the pandemic, GDP growth was pulled up by **households' consumption**. The red dotted line is above the GDP line on the graph.
This momentum in expenditures is a **catch up effect** after the lockdown. People buy the goods they were not able to purchase during the pandemic. Shops were closed or uncertainty prevented them to buy goods notably durable goods.

This behavior is not a surprise. When there is **large uncertainty**, durable goods **expenditures are delayed**. People are not comfortable by buying expensive goods usually with a credit.
But when uncertainty falls, the catch up is important. That's the story of the current US recovery.
Nevertheless, after a while, this impulse decelerates, notably when interest rates are on the upside.

The **main source of GDP weakness is the real estate** sector. As mentioned by Ed Leamer (UCLA professor) in September 2007, 8 of the 10 recessions since WWII were preceded by a real estate crisis.
Real estate **contribution** to GDP growth has been **negative** for the **seventh quarter in a row** at the end of 2022. And the crisis is not over. I developed this point last week (**Keys of the week - January 23**). Transactions are down as are prices all over the US. This could have a negative wealth effect on households' consumption.

Investment is on the upside for equipment and intellectual property products but negative for structures (office, mall) and for real estate. **This latter is with consumption the Achilles' heel of the US GDP growth**.

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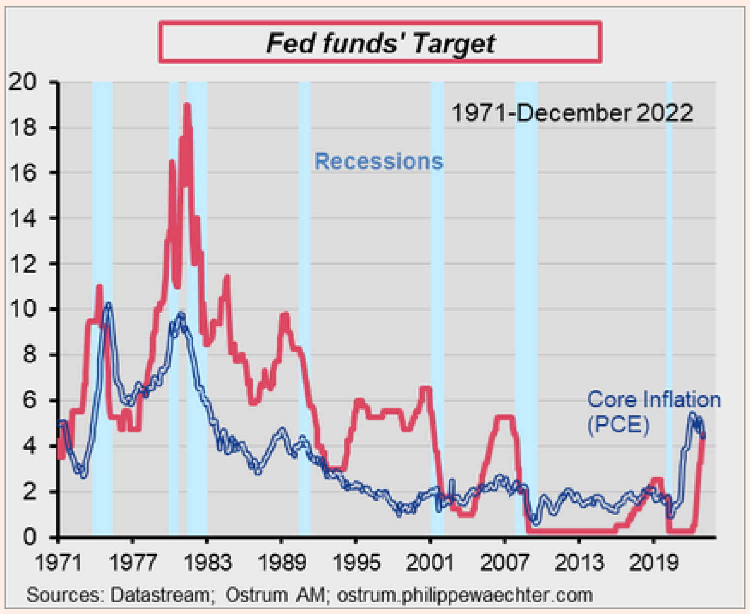
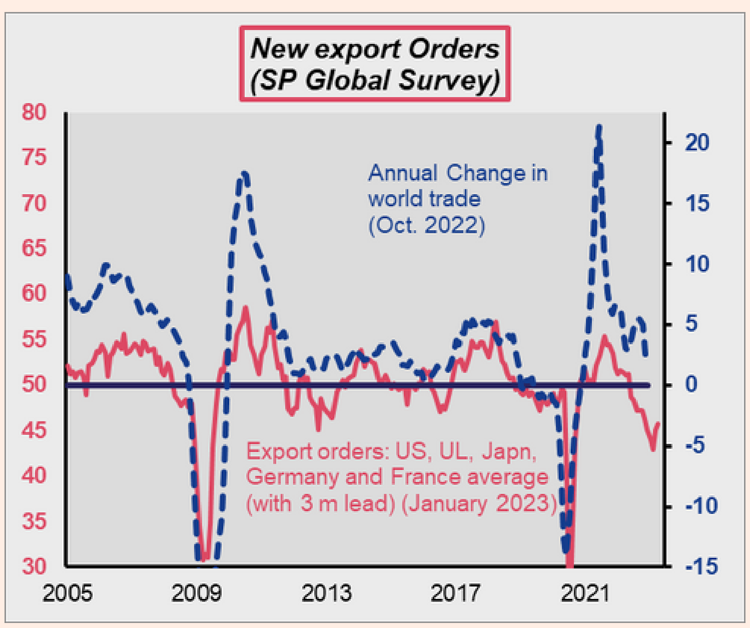
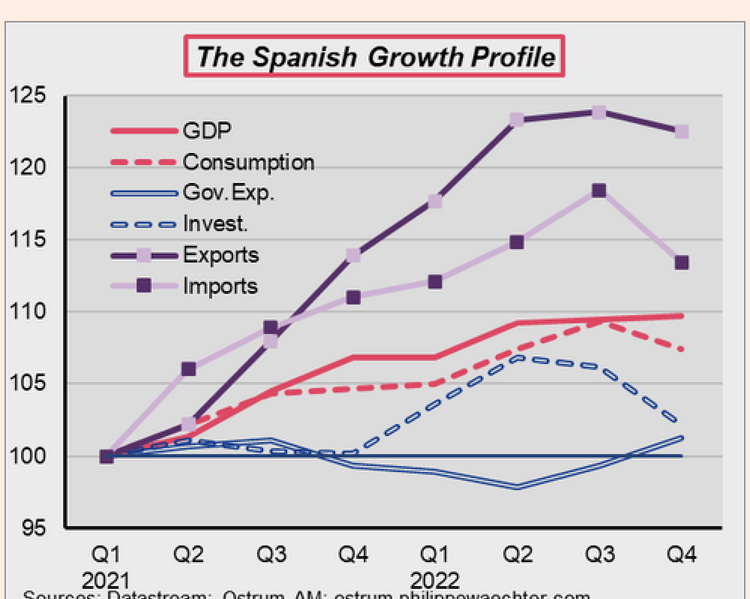
Fed policy and Inflation, International Trade and Spain







The **Federal Reserve** positioning **vis a vis inflation** will change after this week's meeting when it will decide to pull up its rate.

The **fed funds rate** will definitely be **above** the **core inflation rate**. Until now, the real rate was negative and the Fed had important possibilities to increase its preferred instrument. The situation will change as soon as the real rate will become positive. The tight monetary policy will further constrain the economy.

The core inflation rate is currently at 4.4% and the fed funds corridor at 4.25-4.5%. **A lower core inflation in the future will increase real interest rate and necessarily increase the Fed's grip on the economy.**

The **ECB is still far from these considerations**. The refi rate is at 2.5% and the core inflation rate at 5.2%. **Still a long way to go in Europe.**

* * *

Signals are negative again in January as the export orders index is below 50. Nevertheless, a rebound has taken place since the low of October.
In October, **international trade** was up 2.6% and could go lower at the end of the year before a recovery during the first half of 2023.

* * *

The **Spanish GDP** was up 5.5% in 2022, the same number than in 2021. At the end of 2022, the GDP level is still 1% its 2019 average. The catch up after the pandemic is not complete yet.
The carryover growth for 2023 at the end of 2022 is 0.8%.
Two negative points

- Imports are down at the end of 2022 which shows a feeble domestic demand
- Investment is decreasing at the end of 2022.

Negative purchasing power on wages is the main explanation. This weakness is not over as core inflation is increasing at 7.5% in January.