



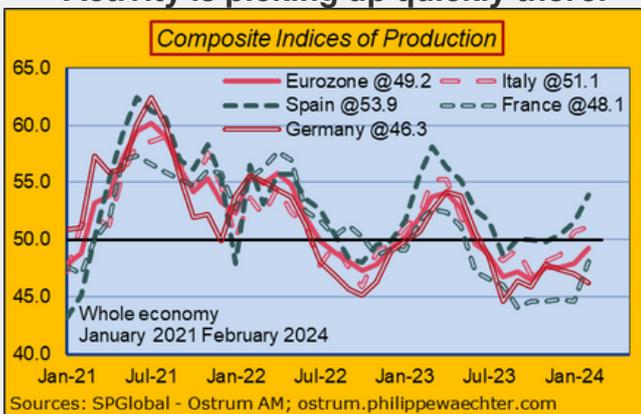
# THE KEYS OF THE WEEK

March 11, 2024



**The graph that I like or concern me this week:**

The good surprise from Spain and Italy at the start of the year. Activity is picking up quickly there.



**To be continued this week**

US inflation - Excluding the housing component that no one pays, inflation has been less than 2% since June 23



## • What if inflation did not fall in the Eurozone? Page 2

The ECB projects an inflation rate of 2% in 2025. Can we be so optimistic? And what would the ECB do if inflation remains high?

## • Global Activity Page 3

Survey indicators are above the threshold of 50 worldwide and in the US and China. Europe is converging from below towards this level.

## • The importance of southern countries in the Euro zone Page 3

The rebound in the Euro zone comes from Italy and especially Spain.

## • No pressure on prices Page 3

Price pressures in the manufacturing sector are reduced. No signals that would fuel inflation again.

## • Impact of the Suez Canal Page 3

Very limited at the moment

## • The American dynamic Page 4

Strong job creation removes the risk of US recession

## • Claudia Sahm's measure and the indicators tracked by the NBER do not indicate near-term recession risk Page 4

## • US nominal pressures are fading Page 4

## • OECD investment should be better oriented in 2024. Page 4

## • ECB projections Page 5

Looking forward to 2025 when all indicators in the Euro zone finally return to a satisfactory trend

## • Consumers have not yet noticed the slowdown in inflation in the Euro zone Page 5

## • Germany still suffers from limited trade with China - Page 5

## • Video - China - Revenge on history Page - 6

China, which missed the industrial revolution of the 18th century, now has a manufacturing power that could allow it to define the technological standards of tomorrow.



## The question of March 11, 2024 - What if inflation did not fall in the Euro zone?

*The inflation rate must fall for the ECB to relax its monetary strategy. By setting, in its forecasts, an average inflation rate at 2% in 2025, the central bank sent the signal expected by investors. However, the question of inflation has not been resolved. The sharing of value, in the absence of growth or recession, is conflictual because no economic agent has the perception of taking advantage of the situation. Especially since tensions in the labor market maintain strong bargaining power for employees. Therefore, if inflation remains higher than the ECB's forecasts, should the tone in Frankfurt be toughened further? The ECB does not appear to have a theory of inflation that goes beyond the figures put in the projections. This seems a little precarious.*

At the **ECB** meeting on March 7, investors were relieved by the central bank's **new inflation forecast**. In 2025, this should return on average to **2%**, the target defined by the ECB, opening the **possibility of a reduction in its interest rates** before the summer.

This standard of price stability thus signals a return to an **already known form of macroeconomic balance** and a reduction in overall concern.

However, we can ask ourselves whether setting the projections at 2% is an **objective forecast** or whether it reflects the ECB's intention **to comply with investors' expectations** in the hope that the forecast will come true ex post? Or that the reduction in forecasts validates the future reduction in interest rates necessary given the economic situation so that mediocre growth does not turn into recession?

### *Inflation and lack of growth raise the question of sharing value*

Two remarks

The idea of a **temporary increase in inflation** has often been mentioned in 2021 and 2022 as a consequence of the health crisis and the need for a new match between supply and demand. The discontinuity during the pandemic caused us to lose our bearings.

Stronger demand, the rise in energy prices, even before the Ukrainian crisis, and disruptions in production processes during the recovery (not enough semiconductors to build cars for example) explain the surge prices. These **phenomena have faded**, causing inflation to fall. In the US, **the inflation rate excluding housing has increased from 1.5% to 2% since June 2023**.

In Europe, the **phenomenon took longer** to resolve due, after the invasion of Ukraine, to the energy crisis which spread throughout the economy, causing a tightening of the policy pursued by the ECB.

As governments ceased to be expansionary in 2023, **global economic policy has been restrictive** causing activity to stagnate. Since the summer of 2022, the annualized growth rate in the Euro zone is only 0.05%. **American growth** (3% over the same period) after the pandemic was synonymous with **fiscal stimulus** and **higher incomes** with a much faster rise in low wages than in higher pay. This last aspect is the **virtuous side of the American cycle**.

In the Eurozone, growth is not taking over and is not offering strong opportunities. It is generally expected that **inflation will dissipate** either in **growth**, with increased activity stimulating competitive conditions, or in **recession** with a strong downward adjustment in activity. In **the Eurozone, there is neither**.

This in-between then raises questions about **the sharing of value** since **no economic agent really benefits from the current situation**.

### *Inflation slows but prices remain high*

The **normalization towards 2%** of the inflation rate is **not associated** with a normalization of price levels. Since the first quarter of 2021, just before the rise in prices took off, the price of **energy** in the euro zone increased, in February 2024, by **43.8%**, the prices of **food** by **24.8%**.

The battle for the **sharing of value is underway on this side too**. We see this in Germany with the wage demands which mark the desire and the need to catch up.

The situation is **more complex than in the past** since, despite very **weak growth, the labor market remains very tight**. The employment level should have adjusted downwards. This is not the case.

Since the summer of 2022, employment has increased by **1.3%** compared to the 0.05% cited above on growth. Business surveys suggest that although the **desire to hire is less** than after the end of the pandemic, it has **not disappeared**.

As a result, the **asymmetry in salary negotiations** remains rather on the side of the **employees since companies do not want to part with their employees** despite the poor economic cycle. Therefore, **companies cannot influence wages as much as they would like and adjust to prices, creating persistence in inflation**.

The battle for the **sharing of value** could thus result in more **persistent inflation in the euro zone**.

### *And the ECB, if inflation lasts?*

As the **ECB's monetary policy** is conditioned by data, it must wait until **inflation falls before lowering its interest rates**.

But if the question of **sharing value becomes conflicting and results in a more lasting increase in prices then its strategy will have to remain restrictive**.

This would then take the risk of transforming the stagnation of the economy into a recession.

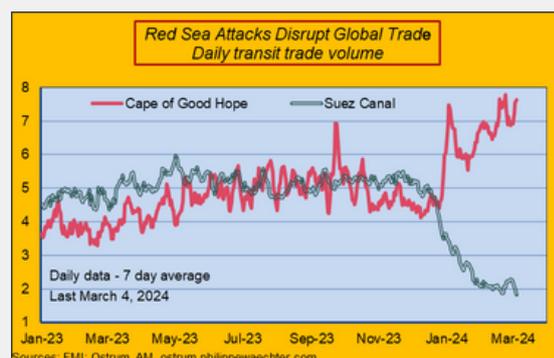
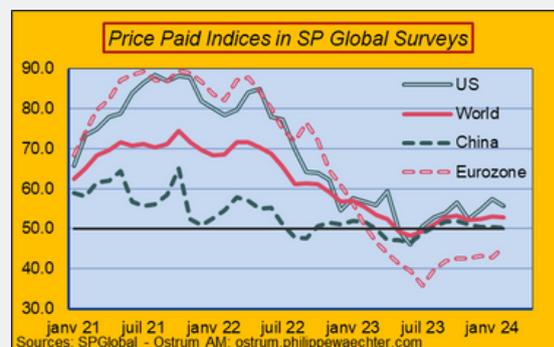
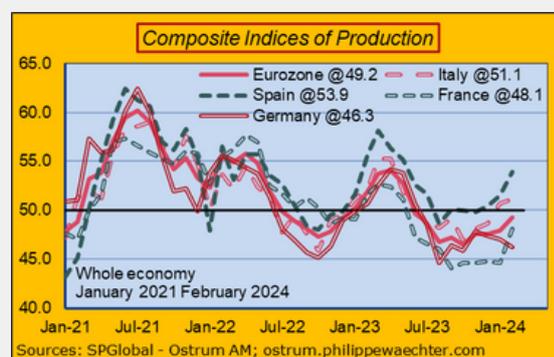
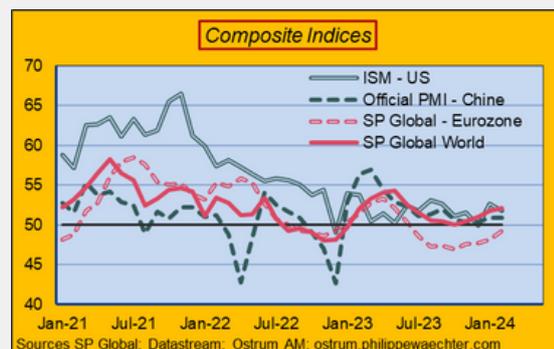
By indicating that its policy is conditioned by data, the ECB **suggests that it does not have a clear model in mind on the causes of inflation and the underlying model for reducing it**. Increasingly detailed statistics on the measurement of inflation are useful but they do not inform decisions if there is no coherent model into which they fit.

Christine Lagarde can throw barbs at the clique of economists who do not understand the changing world. **Economists could return the compliment to the central bank**.



## Global activity

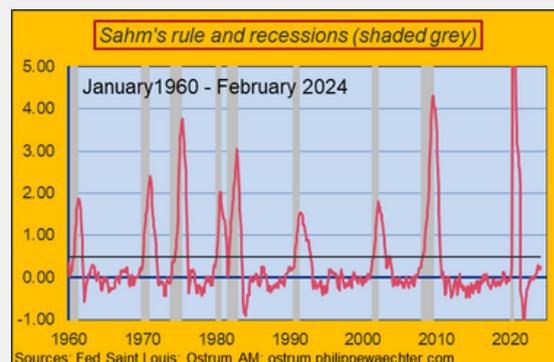
- **Activity indicators**, measured through business surveys, are **converging**. The **global index** is robust, **well beyond** the separator at **50**. Global activity is returning to a more solid trajectory.
- In detail, the **Chinese and American** indices are above the separator at 50 while the synthetic index of the **Euro zone converges towards it**.
- The **scale of the graph is slightly distorted** by the very strong figures for the end of the pandemic in 2021.
- Within the **Eurozone**, the **southern countries are very dynamic**. **Spain and Italy** on the graph are progressing quickly.
- The **effects of the energy crisis have been less penalizing** there and the persistence effects are less marked than in France and Germany.
- However, we note the **change in trend in France** via the improvement of the two components of industry and services.
- **Price tensions are limited**. I took here the **prices paid in the manufacturing sector** because they are the ones that are the most **sensitive to the prices of raw materials and energy**. On this point, the high profile of 2021/2022 is a thing of the past.
- These trajectories are **consistent** with those, in decline, of **production prices**, the latest data of which are those for January.
- The other point that interested me is to observe if there was an **impact of tensions on the Suez Canal**. The last graph shows that **maritime traffic**, which passed through the canal, was **frankly diverted towards the Cape of Good Hope**. This results in longer delays (around ten days) and higher costs. Volumes to the Cape increased by **74%** year-on-year during the first two months of the year, those to the Canal fell by **50%**.
- Despite the **increase in costs** (containers which are less available due to longer travel times), the impact on the **prices paid is barely perceptible**.





## The American Momentum

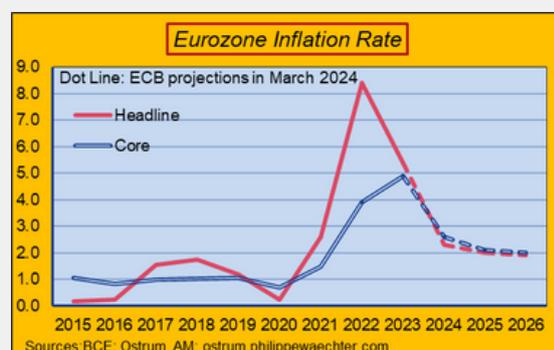
- The **US economy continues to create jobs**. 275,000 new jobs were created in February. The **average figure for the first two months** of the year is **higher than the monthly average** for the whole of **2023**. There is no danger. Employment in the manufacturing sector appears a little fragile.
- When we look at the American economy, the persistent **question is that of the risk of recession**. A **higher recession risk would prompt the Fed to act more quickly**. So far, the **usual indicators do not show such a situation**.
- The **measure created by Claudia Sahm** is not close to the threshold of 0.5, thus announcing no recession. This is what we see in the first graph (the measure compares the difference in the average unemployment rate over the last 3 months to the minimum of this measure over the last 12 months. An indicator at 0.5 and above is a recession signal)
- The **indicators monitored by the NBER** (2nd graph) do not show a pattern of decline over time. **No recession in sight**. Household consumption, employment and even income excluding inflation are growing rapidly.
- These elements are **consistent with the caution of Jay Powell** who does not want to rush to reduce the rates of the American central bank.
- The **trend in wage rates is still rather downward** but without further acceleration. The nominal pressures fall.
- One of the questions, when we observe the global economic cycle, is that of the **pace of investment**. To understand the shape of this indicator, I look at the **orders for capital goods sent to Germany**. Historically, **these orders are well correlated with investment within OECD countries**.
- After the plunge in orders at the turn of 2023, the **recovery suggests a certain robustness in investment**.





## The ECB and growth in the Euro zone

- The **projections published by the ECB** present another **difficult year in 2024** with a growth rate not very different from that of 2023. It is expected at **0.6% after 0.5%** in 2023.
- The **inflation rate** should converge towards the target of **2% in 2025** and 1.9% in 2026. The reduction in wage pressures will help to change the trend in the underlying inflation rate.
- In the question of the week (page 2) I wonder about the good looks of the inflation forecasts at 2% in 2025. This choice is essential in the activity profile published by the BCE.
- Indeed, the **slowdown in inflation** will generate **gains in purchasing power** and **will allow the ECB to relax its monetary policy**. This will help **boost internal demand**. Due to global demand that remains robust and supports exports, **growth will converge from 2025 towards its long-term trend of 1.5%**.
- In fact, each year that begins is always difficult but afterwards the **economy always converges quickly towards its long-term trend. (sic)**
- For the moment and based on retail sales data, **European consumers do not seem to be clearly aware that inflation is slowing** and that their purchasing power is improving. The Euro zone indicator has been stable since the start of 2023, the same for France. The Spanish index is still on the rise while in Italy and Germany consumers remain cautious. The question of the perception of inflation and the sharing of value is not over.
- Yet another month where, for **Germany**, the **contribution of trade with China weighs negatively on exports**. The nice mechanism which worked well, and which had supported the economy across the Rhine, is **no longer operational** sufficiently strongly **to support growth**. Questions about the sources of momentum in Germany are still important.





## Video of this week 7 Mars 2024

### China - Revenge on history (in French)

Click here or on the image to watch the video



#### Transcription

China had missed the industrial revolution of the 18th century. Despite a level of development comparable to that of Great Britain, the Lower Yangtze region, that of Shanghai, which was the most developed in China at the time, did not enter into the industrial revolution. .

To understand this great divergence, numerous works which have been produced at the university scale and the reasons generally given are reasons of energy availability of coal more available in England than in China, cultural reasons and colonial reasons.

But China has since taken its revenge.

After the liberal measures taken by Den Xiaoping from 1978 which made this economy more sensitive to market signals whatever they may be.

The Chinese economy has changed its reference. It has developed particularly on the industrial level. The very low-end products of the 90s were followed by a whole series of upgrades making Chinese products very attractive. This development took place in exports but it mainly benefited from a very dynamic domestic market.

So today when we look at this Chinese manufacturing economy we see that it represents approximately 35% of global manufacturing production. This is considerable. The United States only makes 12% and the Eurozone 13%. So we have an economy which in this respect has become extremely powerful and whose interweaving in all value chains in Asia is quite considerable.

Asia and China are in some ways common cause.

The final point of analysis is to observe that Chinese dependence on the United States is today less important than that of the United States on China.

There is a change, an inversion of dynamics which is quite spectacular and which reflects the capacities for innovation and the means implemented for a very long time within the Chinese economy.

Two concluding remarks The first is that in view of Chinese power, the United States and Europe must question the right strategy to be competitive in the face of this manufacturing development in China.

A major question: if China accounts for 35% of manufacturing production, if it is very innovative, if it moves upmarket, it could define the technological standard and there the countries developed in the United States or Europe would be in a position of fragility in relation to Chinese development

The second remark and this is probably the point of weakness of this Chinese economy today is that all decisions are centralized and we saw this at the time of the annual meeting of the Chinese Parliament. All decisions revolve around President Xi Jinping.

The Prime Minister is quite transparent. This means that China is taking the opposite path to that which was taken by Den Xiaoping in 1978. We know that centralizing all information and all decisions is generally not very effective. This is probably the point of fragility of this Chinese economy. However, European countries and America must react so as not to be too conditioned by what is happening in China. The situation is changing and from this point of view it is very spectacular



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