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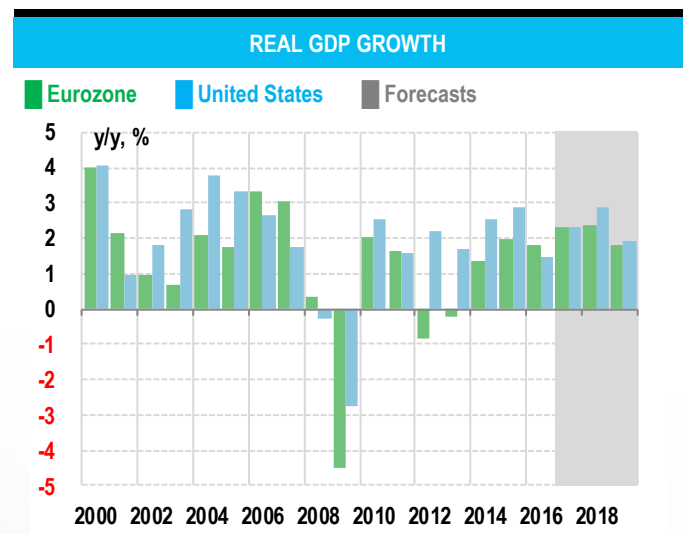
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Growth: 2018, the comfort and challenge of further normalisation

■ Growth in 2017 has surprised to the upside ■ The global, self-sustained upswing and a still accommodative monetary environment should lead to even faster growth in 2018 ■ The prospect of further monetary policy normalisation should be welcomed, but it also poses a challenge for markets that have become accustomed to very low policy rates

The current business cycle has been abnormal. After an abnormally deep recession followed an abnormally slow recovery necessitating an abnormally accommodative monetary policy. In combination with an abnormally high inflation inertia this has led to an abnormal market evolution with risk premia getting ever more compressed, witness the willingness of investors to pay for taking duration risk. "Abnormal" refers to the historical reference points. It does not mean "illogic". On the contrary, the reaction of central banks and investors has been very rational.

On the eve of the New Year, this leaves us with a fundamental question: will further normalisation in the real economy entail normalisation of monetary policy and normalisation of risk premia? Normalisation in the real economy brings comfort. It reflects the effectiveness of monetary policy, the strengthening of confidence of households and companies, the willingness to invest and to recruit staff, thereby triggering a self-reinforcing growth cycle. It is the story of 2017, a year of surprising strength. 2018 should see even stronger growth. In the US, the tax cuts which have been voted by Congress this week should contribute to an acceleration of growth from 2.3% this year to 2.9% next. For the eurozone we expect a pick-up from 2.3% to 2.4% and in France from 1.8% to 2.0%. Normalisation of the real economy will bring a closing of the output gap in the eurozone. Skill mismatches in the labour market imply that finding the right people to fill vacancies has become a key concern of corporate executives. This should contribute to faster wage growth and more generally as another sign of normalisation, inflation should increase, slowly but surely. This paves the way for monetary policy normalisation: the members of the Federal Reserve Open Market Committee are projecting 3 hikes in 2018. From the ECB we can expect a gradual shift of emphasis to forward guidance on rates, to be followed by stopping the asset purchase program at the end of 2018. This may cause some pick-up in market volatility though in addressing this challenge investors may find comfort in the gradualism and caution of central banks and in the prospect that although growth should slow in 2019, it should still remain above potential. Perhaps this cycle will also be abnormal in terms of length...



Source: Thomson Reuters, BNP Paribas

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