

ECOWEEK

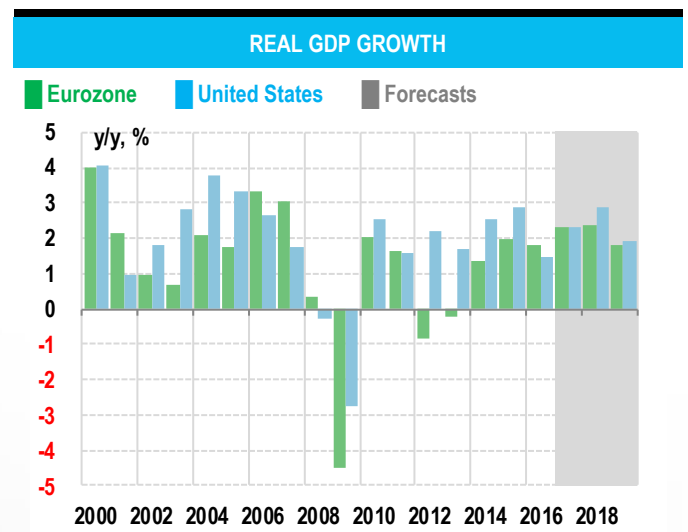
No. 17-47, 22 December 2017

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 "Abnormal" refers to the historical reference points.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

William De Vijlder

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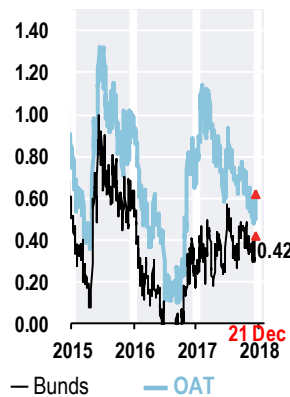
Markets overview

The essentials

Week 15-12-17 > 21-12-17

| | | | |
|--------------------|-------|---------|----------|
| ➤ CAC 40 | 5 349 | ➤ 5 386 | +0.7 % |
| ➤ S&P 500 | 2 676 | ➤ 2 685 | +0.3 % |
| ➤ Volatility (VIX) | 9.4 | ➤ 9.6 | +0.2 pb |
| ➤ Euribor 3M (%) | -0.33 | ➤ -0.33 | +0.0 bp |
| ➤ Libor \$ 3M (%) | 1.61 | ➤ 1.67 | +6.1 bp |
| ➤ OAT 10y (%) | 0.50 | ➤ 0.62 | +11.9 bp |
| ➤ Bund 10y (%) | 0.30 | ➤ 0.42 | +11.7 bp |
| ➤ US Tr. 10y (%) | 2.36 | ➤ 2.48 | +12.7 bp |
| ➤ Euro vs dollar | 1.18 | ➤ 1.19 | +0.8 % |
| ➤ Gold (ounce, \$) | 1 255 | ➤ 1 266 | +0.9 % |
| ➤ Oil (Brent, \$) | 63.5 | ➤ 64.6 | +1.9 % |

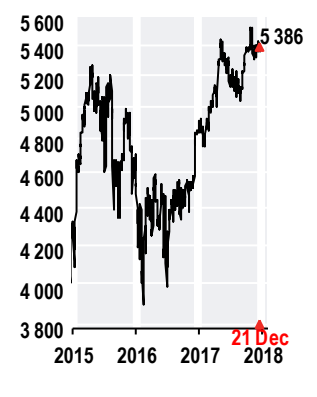
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

| Interest Rates | highest' 17 | lowest' 17 |
|----------------|----------------|----------------|
| € ECB | 0.00 at 02/01 | 0.00 at 02/01 |
| Eonia | -0.35 at 30/11 | -0.37 at 05/06 |
| Euribor 3M | -0.33 at 02/01 | -0.33 at 10/04 |
| Euribor 12M | -0.19 at 02/01 | -0.19 at 18/12 |
| \$ FED | 1.50 at 14/12 | 0.75 at 02/01 |
| Libor 3M | 1.67 at 21/12 | 1.00 at 02/01 |
| Libor 12M | 2.09 at 21/12 | 1.68 at 06/01 |
| £ BoE | 0.50 at 02/11 | 0.25 at 02/01 |
| Libor 3M | 0.52 at 13/11 | 0.28 at 01/09 |
| Libor 12M | 0.77 at 02/11 | 0.59 at 06/09 |

At 21-12-17

| Yield (%) | highest' 17 | lowest' 17 |
|--------------|----------------|----------------|
| € AVG 5-7y | 0.68 at 17/03 | 0.18 at 21/06 |
| Bund 2y | -0.68 at 27/06 | -0.96 at 24/02 |
| Bund 10y | 0.42 at 06/07 | 0.18 at 18/04 |
| OAT 10y | 0.62 at 06/02 | 0.48 at 07/12 |
| Corp. BBB | 1.22 at 01/02 | 1.06 at 07/11 |
| \$ Treas. 2y | 1.88 at 21/12 | 1.14 at 24/02 |
| Treas. 10y | 2.48 at 13/03 | 2.05 at 08/09 |
| Corp. BBB | 3.65 at 14/03 | 3.38 at 05/09 |
| £ Treas. 2y | 0.41 at 29/11 | 0.01 at 28/02 |
| Treas. 10y | 1.29 at 26/01 | 0.87 at 14/06 |

At 21-12-17

10y bond yield & spreads

| | | |
|-------|-------------|--------|
| 4.68% | Greece | 425 pb |
| 1.87% | Italy | 144 pb |
| 1.77% | Portugal | 134 pb |
| 1.47% | Spain | 105 pb |
| 0.62% | France | 20 pb |
| 0.61% | Ireland | 19 pb |
| 0.60% | Belgium | 17 pb |
| 0.59% | Austria | 17 pb |
| 0.58% | Finland | 16 pb |
| 0.53% | Netherlands | 11 pb |
| 0.42% | Germany | |

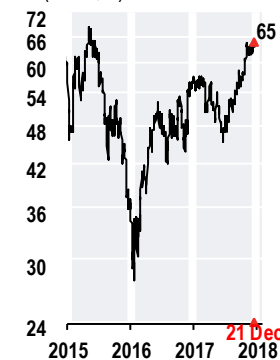
Commodities

| Spot price in dollars | lowest' 17 | 2017(€) |
|-----------------------|----------------|---------|
| Oil, Brent | 64.6 at 26/06 | +1.4% |
| Gold (ounce) | 1 266 at 03/01 | -2.7% |
| Metals, LMEX | 3 314 at 03/01 | +10.8% |
| Copper (ton) | 7 043 at 08/05 | +13.4% |
| CRB Foods | 337 at 24/04 | -11.4% |
| wheat (ton) | 159 at 02/10 | -3.5% |
| Corn (ton) | 127 at 18/09 | -15.0% |

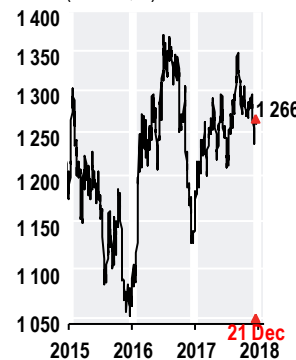
At 21-12-17

Variations

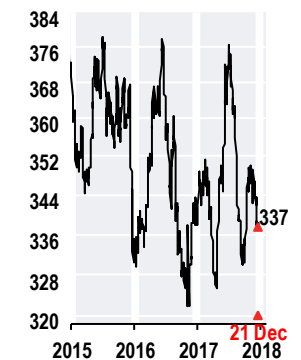
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

| € = | highest' 17 | lowest' 17 | 2017 |
|-----|-----------------|-----------------|--------|
| USD | 1.19 at 29/08 | 1.04 at 03/01 | +12.4% |
| GBP | 0.89 at 29/08 | 0.84 at 19/04 | +4.0% |
| CHF | 1.17 at 21/12 | 1.06 at 08/02 | +9.4% |
| JPY | 134.61 at 20/12 | 115.57 at 17/04 | +9.4% |
| AUD | 1.54 at 30/11 | 1.37 at 23/02 | +5.8% |
| CNY | 7.81 at 03/08 | 7.22 at 03/01 | +6.6% |
| BRL | 3.93 at 21/12 | 3.24 at 15/02 | +14.4% |
| RUB | 69.42 at 02/08 | 59.66 at 17/04 | +7.8% |
| INR | 75.99 at 22/09 | 68.18 at 07/04 | +6.2% |

At 21-12-17

Variations

Equity indices

| Index | highest' 17 | lowest' 17 | 2017 | 2017(€) |
|---------|-----------------|-----------------|--------|---------|
| CAC 40 | 5 386 at 03/11 | 4 749 at 31/01 | +10.8% | +10.8% |
| S&P500 | 2 685 at 18/12 | 2 239 at 02/01 | +19.9% | +6.6% |
| DAX | 13 110 at 03/11 | 11 510 at 06/02 | +14.2% | +14.2% |
| Nikkei | 22 866 at 11/12 | 18 336 at 14/04 | +19.6% | +9.3% |
| China* | 88 at 22/11 | 59 at 02/01 | +50.6% | +33.1% |
| India* | 601 at 19/12 | 445 at 03/01 | +27.0% | +19.6% |
| Brazil* | 2 002 at 05/10 | 1 639 at 21/06 | +21.8% | +6.5% |
| Russia* | 591 at 03/01 | 497 at 22/06 | -5.2% | -12.8% |

At 21-12-17

Variations

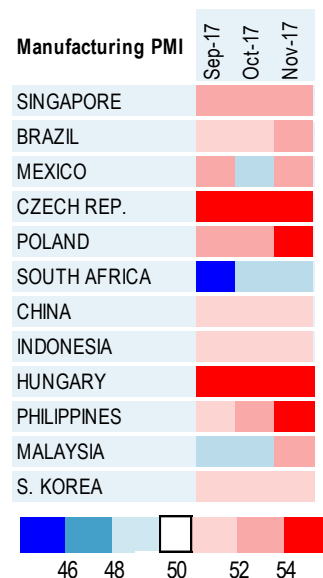
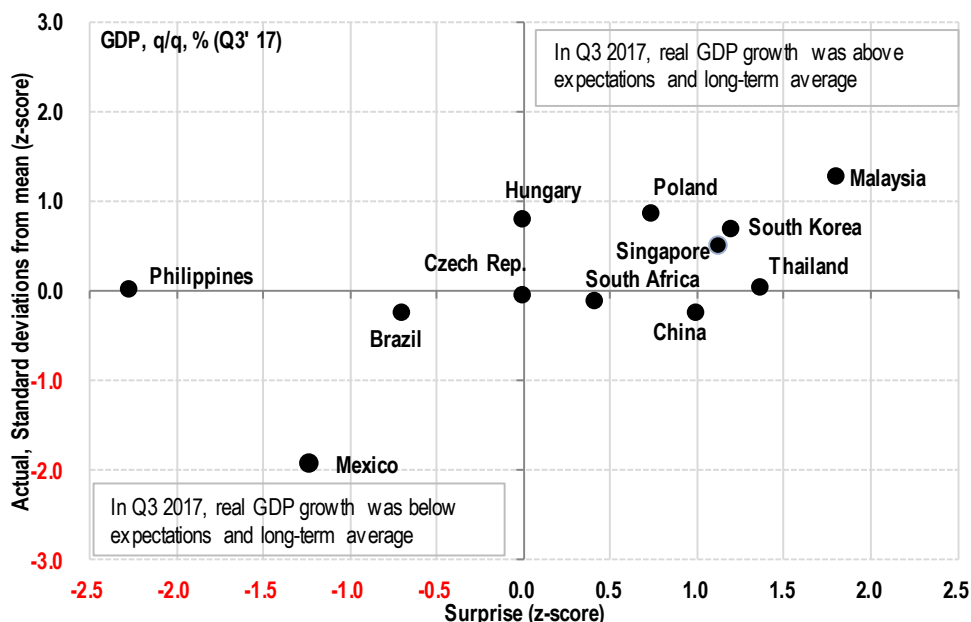
* MSCI index



Pulse

Emerging countries: Real GDP growth in Q3 2017

In Q3 2017, the Philippines' quarter-on-quarter real GDP growth was below expectations but yet remained strong. Domestic demand has lost steam but exports have recovered, helping real GDP growth to be close to 7% year-on-year.



Sources: Markit, Bloomberg, BNP Paribas calculations

Indicators preview

Next week will be rather light in terms of data. Noteworthy are Conference Board consumer confidence in the US and inflation in Germany. The ECB will publish its economic bulletin. The schedule is very heavy for the first week of 2018: PMI in several countries, ISM in the US, the minutes of the FOMC and the US labour market report.

| Date | Country | Event | Period | Survey | Prior |
|----------|---------------|--------------------------------------|--------|---------|---------|
| 12/27/17 | United States | Conference Board Consumer Confidence | Dec | 128.0 | 129.5 |
| 12/28/17 | Eurozone | ECB Publishes Economic Bulletin | | | |
| 12/29/17 | Germany | CPI EU Harmonized MoM | Dec | 0.6% | 0.3% |
| 01/02/18 | France | Markit France Manufacturing PMI | Dec | 59.3 | 59.3 |
| 01/02/18 | Germany | Markit/BME Germany Manufacturing PMI | Dec | 63.3 | 63.3 |
| 01/02/18 | Eurozone | Markit Eurozone Manufacturing PMI | Dec | 60.6 | 60.6 |
| 01/03/18 | United States | ISM Manufacturing | Dec | 58.0 | 58.2 |
| 01/03/18 | United States | FOMC Meeting Minutes | Dec 13 | -- | -- |
| 01/04/18 | France | Markit France Services PMI | Dec | 59.4 | 59.4 |
| 01/04/18 | Eurozone | Markit Eurozone Composite PMI | Dec | 58.0 | 58.0 |
| 01/05/18 | France | Consumer Confidence | Dec | 103 | 102 |
| 01/05/18 | France | CPI EU Harmonized MoM | Dec | 0.4% | 0.1% |
| 01/05/18 | United States | Change in Nonfarm Payrolls | Dec | 185 000 | 228 000 |
| 01/05/18 | United States | Unemployment Rate | Dec | 4.0% | 4.1% |
| 01/05/18 | United States | ISM Non-Manf. Composite | Dec | 57.3 | 57.4 |

Sources: Bloomberg, BNP Paribas



Economic scenario

UNITED STATES

- GDP growth is accelerating along with the recovery in the emerging countries and reinforcing world trade. However the fiscal outlook remains uncertain. A fiscal stimulus still is possible, but it would not be implemented very rapidly. Potential effects are thus uncertain.
- The labour market is as buoyant as ever. Still, the support to households' disposable income is not as strong as it looks as wage inflation remains limited.
- With inflation relatively muted at this stage of the cycle, the Fed is in no rush to increase rates. We forecast the Fed Funds target rates to come at 1.50% by year-end, 2.00% by mid-2018.

CHINA

- Economic growth has started to moderate during the fall and this trend should continue in the coming quarters.
- Despite the slowdown, the central bank will have to continue to act to encourage the deleveraging of financial institutions and corporates and reduce financial instability risks. The authorities should maintain an expansionist fiscal policy in the short term.
- The tightening of domestic credit conditions, restructuring measures in the industry and the correction in the property market will weigh on economic activity. Meanwhile, exports and private consumption should be supporting factors.

EUROZONE

- The recovery is getting stronger and broader: the dispersion of economic performances among member states is receding.
- Despite the cyclical recovery, core inflation still shows no sign of a convincing upward trend. For the recovery to enter its inflationary phase the economy has to improve further, until the point at which wages will tend to increase.

The level of slack remains uncertain though. Broader measures of labor underutilization reach 18%, double the level of the current unemployment rate. The ECB is expected to remain cautious.

FRANCE

- A clear growth acceleration is underway. Higher rates of growth should resume. Households' consumption is supported by the jobs recovery but restrained by the upturn in inflation. Investment and exports dynamics are favourable. Risks lie slightly on the upside.
- We expect the output gap to slowly narrow and the unemployment rate to progressively decline, containing the rise in inflation.

Fiscal policy should continue to combine growth supportive measures and consolidation ones. The fiscal deficit should not be a lot more reduced but it should remain below the 3% threshold.

SUMMARY

| % | GDP Growth | | | Inflation | | |
|------------------|------------|------------|------------|------------|------------|------------|
| | 2017 e | 2018 e | 2019 e | 2017 e | 2018 e | 2019 e |
| Advanced | 2,1 | 2,4 | 1,7 | 1,7 | 1,7 | 1,9 |
| United-States | 2,3 | 2,9 | 1,9 | 2,1 | 2,0 | 2,2 |
| Japan | 1,5 | 1,3 | 0,6 | 0,3 | 0,6 | 0,8 |
| United-Kingdom | 1,5 | 1,2 | 1,8 | 2,7 | 2,7 | 2,4 |
| Euro Area | 2,3 | 2,4 | 1,8 | 1,5 | 1,6 | 1,7 |
| Germany | 2,6 | 2,8 | 2,1 | 1,7 | 1,7 | 1,8 |
| France | 1,8 | 2,0 | 1,6 | 1,2 | 1,6 | 1,8 |
| Italy | 1,6 | 1,5 | 1,1 | 1,4 | 1,4 | 1,5 |
| Spain | 3,1 | 2,6 | 2,2 | 2,1 | 1,8 | 1,6 |
| Belgium | 1,6 | 1,6 | 1,5 | 2,1 | 1,9 | 1,9 |
| Emerging | 4,5 | 4,8 | 4,9 | 4,0 | 4,2 | 4,2 |
| China | 6,8 | 6,4 | 6,5 | 1,6 | 2,3 | 2,5 |
| India | 7,0 | 7,6 | 7,8 | 3,4 | 4,5 | 4,9 |
| Brazil | 1,0 | 3,0 | 2,5 | 3,5 | 3,5 | 3,9 |
| Russia | 1,8 | 1,6 | 1,5 | 4,0 | 4,3 | 4,5 |

Source : BNP Paribas Group Economic Research (e: Estimates & forecasts,)

INTEREST RATES & FX RATES

| Interest rates, % | | 2017 | 2018 | | | |
|-------------------|-------------|-------|-------|-------|-------|-------|
| End of period | | Q4e | Q1e | Q2e | Q3e | Q4e |
| US | Fed Funds | 1,50 | 1,75 | 2,00 | 2,25 | 2,25 |
| | Libor 3m \$ | 1,40 | 1,55 | 1,70 | 1,80 | 1,85 |
| | T-Notes 10y | 2,35 | 2,60 | 2,75 | 2,75 | 3,00 |
| Ezone | ECB Refi | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 |
| | Euribor 3m | -0,30 | -0,30 | -0,30 | -0,30 | -0,30 |
| | Bund 10y | 0,36 | 0,65 | 0,75 | 1,10 | 1,50 |
| | OAT 10y | 0,70 | 0,95 | 1,00 | 1,30 | 1,70 |
| UK | Base rate | 0,50 | 0,50 | 0,50 | 0,50 | 0,75 |
| | Gilts 10y | 1,30 | 1,45 | 1,55 | 1,90 | 2,30 |
| Japan | BoJ Rate | -0,10 | -0,10 | -0,10 | -0,10 | -0,10 |
| | JGB 10y | 0,03 | 0,08 | 0,08 | 0,08 | 0,08 |

| Exchange Rates | | 2017 | 2018 | | | |
|----------------|-----------|------|------|------|------|------|
| End of period | | Q4e | Q1e | Q2e | Q3e | Q4e |
| USD | EUR / USD | 1,15 | 1,14 | 1,13 | 1,18 | 1,22 |
| | USD / JPY | 115 | 116 | 117 | 115 | 112 |
| | GBP / USD | 1,28 | 1,25 | 1,26 | 1,33 | 1,39 |
| | USD / CHF | 1,01 | 1,03 | 1,04 | 1,01 | 0,98 |
| EUR | EUR / GBP | 0,90 | 0,91 | 0,90 | 0,89 | 0,88 |
| | EUR / CHF | 1,16 | 1,17 | 1,18 | 1,19 | 1,20 |
| | EUR / JPY | 132 | 132 | 132 | 136 | 137 |

Source : GlobalMarkets (e: Estimates & forecasts)



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