

ECOWEEK

No. 18-03, 19 January 2018

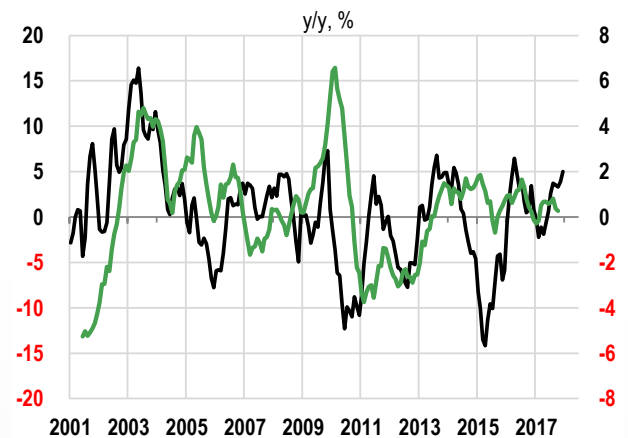
Eurozone: the strengthening of the euro, a cause for concern?

■ The euro has strengthened as of late despite the widening interest rate differential with the US ■ Several ECB Governing Council members have expressed unease about this appreciation ■ The impact on inflation and growth should be small

"Do you think at its current level the euro is a problem?" This and six similar questions about the strong euro were asked to Mario Draghi during the press conference after the Governing Council meeting of 7 September 2017. Undoubtedly it will again be a frequently asked question on 25 January if only because of statements on this topic earlier this week. Vice President Vitor Constancio expressed concern about sudden movements in the exchange rate which don't reflect changes in fundamentals. Austria's central bank president Ewald Nowotny argued that the euro's recent strength against the dollar is "not helpful" and the governor of the Banque de France, François Villeroy de Galhau, stated that "the recent evolution of the exchange rate is a source of uncertainty which requires monitoring with regard to its possible downward effects on imported prices." The references to fundamentals and import prices are important. On the former, analysts are wondering why a combination of the Fed in tightening mode and fiscal reflation via tax cuts - a textbook case of a policy mix which should support the dollar - has seen a weakening of the dollar against the euro. This is all the more surprising considering that the 2 and 10 year interest rate differentials between the US and Germany have moved in favour of the US. It is as if investors try to force the hand of the ECB to provide clarity sooner rather than later on its plans for the end of QE. One shouldn't be surprised that such clarity, once provided, would be followed by a typical "buy the rumour, sell the fact" reaction, i.e. profit taking. Is the recent evolution of the euro cause for concern? In terms of inflation a useful reference point is the difference with the hypotheses underpinning the December 2017 Eurosystem staff projections for the eurozone inflation. Against the dollar the difference is 4%, on a nominal effective exchange rate basis it is tiny (1%) so it looks premature to get worried about the disinflationary impact. What about a headwind to growth via exports? The chart shows that a positive change (i.e. appreciation) of the real effective exchange rate tends to slow eurozone export growth in comparison to world export growth. However since 2013 the effect is small. In addition one should keep in mind that euro strength is a sign of robust eurozone growth. Given the outlook for the drivers of final demand, the eurozone should be able to easily cope with a somewhat stronger currency.

EURO'S REAL EFFECTIVE EXCHANGE RATE VS REAL EXPORTS

— Euro's real effective exchange rate (broad) (LHS)
— World exports minus Eurozone exports (6-month moving average)



Sources: ECB, CPB, BNP Paribas

William De Vijlder

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ECONOMIC RESEARCH DEPARTMENT

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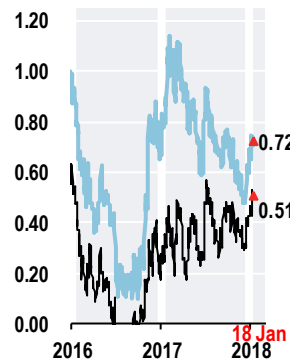
Markets overview

The essentials

Week 12-1 18 > 18-1-18

↘ CAC 40	5 517	▶ 5 495	-0.4 %
↗ S&P 500	2 786	▶ 2 798	+0.4 %
↗ Volatility (VIX)	10.2	▶ 12.2	+2.1 pb
↗ Euribor 3M (%)	-0.33	▶ -0.33	+0.1 bp
↗ Libor \$ 3M (%)	1.72	▶ 1.74	+1.8 bp
↘ OAT 10y (%)	0.74	▶ 0.72	-1.5 bp
↘ Bund 10y (%)	0.53	▶ 0.51	-2.2 bp
↗ US Tr. 10y (%)	2.55	▶ 2.61	+6.0 bp
↗ Euro vs dollar	1.21	▶ 1.22	+0.8 %
↘ Gold (ounce, \$)	1 331	▶ 1 329	-0.1 %
↗ Oil (Brent, \$)	69.2	▶ 69.4	+0.2 %

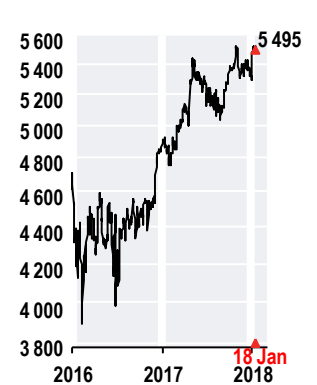
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



— Bunds — OAT

Money & Bond Markets

Interest Rates	highest' 18	lowest' 18
€ ECB	0.00 at 01/01	0.00 at 01/01
Eonia	-0.37 at 01/01	-0.37 at 02/01
Euribor 3M	-0.33 at 17/01	-0.33 at 01/01
Euribor 12M	-0.19 at 01/01	-0.19 at 18/01
\$ FED	1.50 at 01/01	1.50 at 01/01
Libor 3M	1.74 at 17/01	1.69 at 01/01
Libor 12M	2.21 at 17/01	2.11 at 01/01
£ BoE	0.50 at 01/01	0.50 at 01/01
Libor 3M	0.52 at 10/01	0.52 at 04/01
Libor 12M	0.77 at 15/01	0.76 at 03/01

At 18-1-18

Yield (%)	highest' 18	lowest' 18
€ AVG 5-7y	0.54 at 18/01	0.43 at 01/01
Bund 2y	-0.62 at 11/01	-0.66 at 01/01
Bund 10y	0.51 at 12/01	0.42 at 01/01
OAT 10y	0.72 at 11/01	0.65 at 08/01
Corp. BBB	1.22 at 12/01	1.17 at 08/01
\$ Treas. 2y	2.05 at 18/01	1.89 at 01/01
Treas. 10y	2.61 at 18/01	2.41 at 01/01
Corp. BBB	3.70 at 18/01	3.59 at 01/01
£ Treas. 2y	0.56 at 12/01	0.40 at 01/01
Treas. 10y	1.37 at 12/01	1.23 at 01/01

At 18-1-18

10y bond yield & spreads

4.36%	Greece	385 pb
1.94%	Italy	143 pb
1.78%	Portugal	126 pb
1.49%	Spain	98 pb
0.72%	France	21 pb
0.70%	Belgium	19 pb
0.69%	Ireland	18 pb
0.68%	Finland	17 pb
0.68%	Austria	16 pb
0.61%	Netherlands	10 pb
0.51%	Germany	

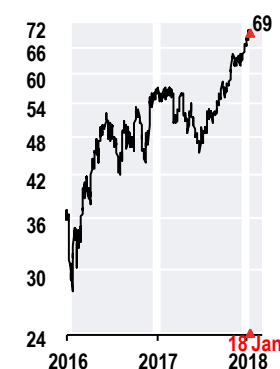
Commodities

Spot price in dollars	lowest' 18	2018(€)
Oil, Brent	66.4 at 02/01	+2.2%
Gold (ounce)	1 303 at 01/01	+0.1%
Metals, LMEX	3 383 at 09/01	-2.9%
Copper (ton)	7 032 at 17/01	-4.3%
CRB Foods	337 at 01/01	-1.7%
wheat (ton)	158 at 16/01	-2.3%
Corn (ton)	129 at 08/01	-0.7%

At 18-1-18

Variations

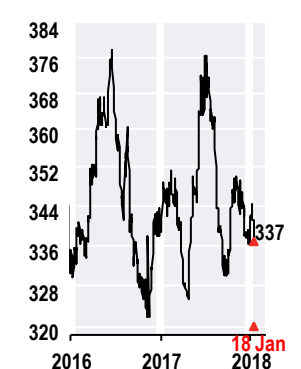
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

€ =	highest' 18	lowest' 18	2018
USD	1.22 at 15/01	1.19 at 09/01	+1.9%
GBP	0.88 at 04/01	0.88 at 18/01	-0.7%
CHF	1.17 at 15/01	1.17 at 08/01	+0.3%
JPY	135.80 at 05/01	133.42 at 10/01	+0.4%
AUD	1.53 at 12/01	1.53 at 09/01	-0.2%
CNY	7.86 at 15/01	7.78 at 08/01	+0.6%
BRL	3.93 at 01/01	3.87 at 08/01	-1.3%
RUB	69.21 at 17/01	68.06 at 09/01	+0.1%
INR	78.14 at 16/01	75.92 at 08/01	+1.9%

At 18-1-18

Variations

Equity indices

Index	highest' 18	lowest' 18	2018	2018(€)
CAC 40	5 524 at 09/01	5 289 at 02/01	+3.4%	+3.4%
S&P500	2 803 at 17/01	2 674 at 01/01	+4.7%	+2.7%
DAX	13 386 at 09/01	12 871 at 02/01	+2.8%	+2.8%
Nikkei	23 763 at 16/01	22 765 at 01/01	+4.4%	+4.0%
China*	96 at 18/01	88 at 01/01	+8.7%	+6.7%
India*	625 at 15/01	606 at 01/01	+2.3%	+0.3%
Brazil*	2 218 at 18/01	2 023 at 01/01	+6.1%	+7.6%
Russia*	674 at 18/01	604 at 01/01	+9.9%	+9.4%

At 18-1-18

Variations

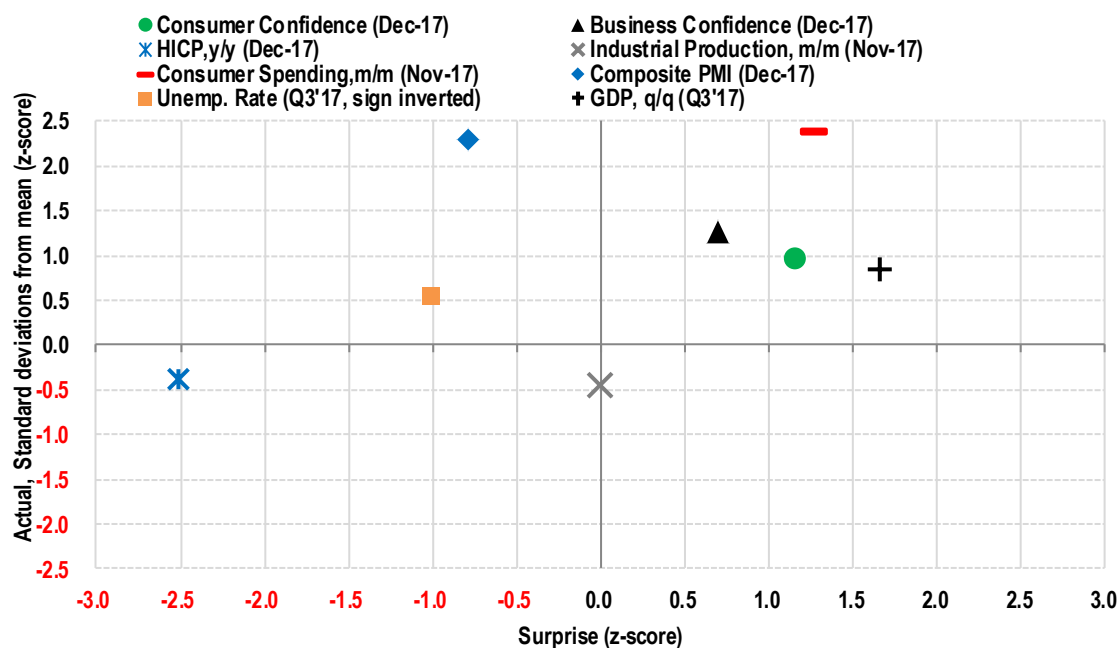
* MSCI index



Pulse

France: will core inflation make a come-back in 2018?

Most of French economic indicators continue to stand above their long-term average (z-score positive on the y-axis) and to surprise on the upside (z-score positive on the x-axis). Inflation remains the notable exception. Granted, it has picked up in 2017, broadly as expected, rising to 1.2% from 0.3% in 2016 in annual average terms. But this moderate acceleration is essentially due to energy prices: a similar upturn in core inflation is not yet visible (0.6% both in 2017 and 2016, in annual average terms). It is nonetheless expected to materialize in 2018, supported by the cyclical improvement.



Sources: Markit, Bloomberg, BNP Paribas calculations

Indicators preview

An important week ahead of us with the Bank of Japan and ECB meetings, the Markit PMI and confidence data in several countries and 4th quarter GDP growth in the US.

Date	Country	Event	Period	Survey	Prior
01/23/18	Germany	ZEW Survey Current Situation	Jan	89.9	89.3
01/23/18	United Kingdom	CBI Business Optimism	Jan	--	-11
01/23/18	Eurozone	Consumer Confidence	Jan	0.6	0.5
01/23/18	Japan	BOJ Meeting	Jan 23		
01/24/18	France	Markit France Manufacturing PMI	Jan	--	58.8
01/24/18	France	Markit France Composite PMI	Jan	--	59.6
01/24/18	Eurozone	Markit Eurozone Manufacturing PMI	Jan	60.3	60.6
01/24/18	Eurozone	Markit Eurozone Composite PMI	Jan	57.9	58.1
01/24/18	France	Jobseekers Net Change	Dec	--	-29.5
01/25/18	Germany	IFO Business Climate	Jan	117.0	117.2
01/25/18	Eurozone	ECB Main Refinancing Rate	Jan 25	0.000%	0.000%
01/26/18	France	Consumer Confidence	Jan	--	105
01/26/18	France	Business Confidence	Jan	--	112
01/26/18	United States	GDP Annualized QoQ	4Q	2.9%	3.2%

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 1.75% in Q1 2018 and at 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, %		2018				2019
End of period		Q1e	Q2e	Q3e	Q4e	Q4e
US	Fed Funds	1.75	2.00	2.25	2.25	2.25
	Libor 3m \$	1.55	1.70	1.80	1.85	1.75
	T-Notes 10y	2.60	2.75	2.75	3.00	2.90
Ezone	ECB Refi	0.00	0.00	0.00	0.00	0.25
	Euribor 3m	-0.30	-0.30	-0.30	-0.30	0.10
	Bund 10y	0.65	0.75	1.10	1.50	1.80
	OAT 10y	0.95	1.00	1.30	1.70	2.00
UK	Base rate	0.50	0.50	0.50	0.75	1.25
	Gilts 10y	1.45	1.55	1.90	2.30	2.30
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10	-0.10
	JGB 10y	0.08	0.08	0.08	0.08	0.00

Exchange Rates		2018				2019
End of period		Q1e	Q2e	Q3e	Q4e	Q4e
USD	EUR / USD	1.14	1.13	1.18	1.22	1.30
	USD / JPY	116	117	115	112	105
	GBP / USD	1.25	1.26	1.33	1.39	1.48
	USD / CHF	1.03	1.04	1.01	0.98	0.96
EUR	EUR / GBP	0.91	0.90	0.89	0.88	0.88
	EUR / CHF	1.17	1.18	1.19	1.20	1.25
	EUR / JPY	132	132	136	137	137

Source : GlobalMarkets (e: Estimates & forecasts)



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