

ECOWEEK

No. 18-05, 2 February 2018

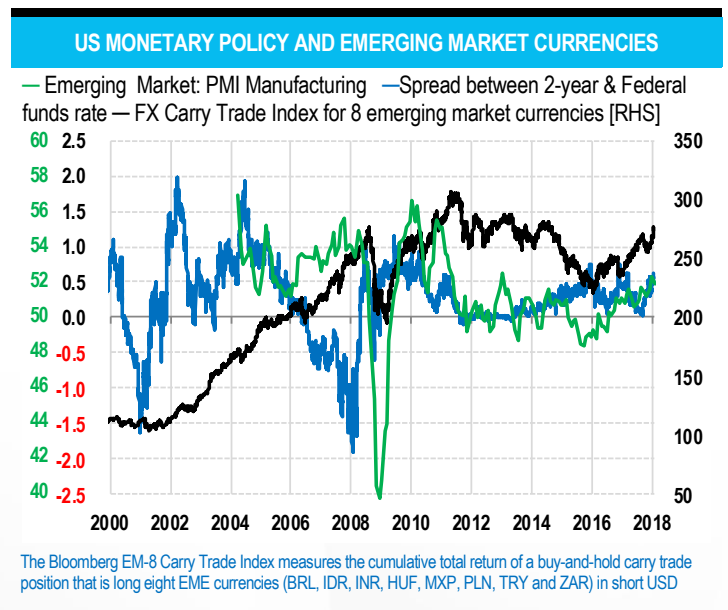
US rates and emerging markets – no spillover yet

■ Historically, a rising rate environment in the US has been a matter of concern for developing economies ■ It seems that this time is different: despite rising US yields, emerging market currencies have strengthened ■ This has contributed to a weakening of the effective exchange rate of the dollar and an easing of financial conditions in the US

Back in 2015, BIS research based on a sample of 22 emerging market economies and 8 small developed economies showed that between 2000 and 2014, US interest rates (policy rate, short and long term rates) had significant spillovers. This means that, a priori, recent US rate developments should have triggered some discomfort, all the more so given the build-up of emerging corporate debt in USD in recent years. In reality the opposite happened. The spread between emerging corporate debt yields in dollar and US treasury yields has narrowed and, as shown in the chart, after a dip last autumn, the Bloomberg FX Carry Trade Index, which tracks the performance of deposits in emerging markets currencies funded by borrowing in USD, has also increased. This has happened despite rising US bond yields and an increasing differential between the 2 year US treasury yield and the federal funds rate, a development which reflects market expectations of a more hawkish Fed stance. This is quite different from what happened in 2014 and 2015 when an increase of the same differential was accompanied by a weakening of emerging market currencies, thereby extending a trend which started back in 2011. Judging by the Markit PMI for the manufacturing sector in emerging markets, the economic environment had weakened a lot in 2011 and remained rather subdued until the end of 2015 so it shouldn't come as a surprise that this weighed on the currencies, especially when the US rate outlook was changing. Since the end of 2015, the emerging markets PMI has been on a rising trend and, starting early 2016, when oil prices bottomed out, the FX carry trade index has shown a similar evolution. Several conclusions

can be drawn from this: 1/ whether rising US yields will cause spillovers in emerging markets very much depends on the economic environment in these countries (the bullish environment between 2002 and 2007 enabled a relentless rise of the FX carry trade index irrespective of US rate developments). At present, yield hungry international investors are happy to have exposure given the better economic situation 2/ this, in combination with a stronger euro fuelled by speculation that the ECB may toughen its tone, has caused a weakening of the effective exchange rate of the dollar. This implies an easing of US financial conditions (via its impact on US exports and hence growth) 3/ this in turn may require a more hawkish Fed stance in order to 'slow the train'. Ironically, the absence of international spillovers, while creating relief in the short run, may confront us with more rate hikes in the medium run.

William De Vijlder



Sources: Bloomberg, Markit, BNP Paribas

p. 2

Markets Overview

p. 3

Pulse & Calendar

p. 4

Economic scenario

ECONOMIC RESEARCH DEPARTMENT



BNP PARIBAS

The bank
for a changing
world



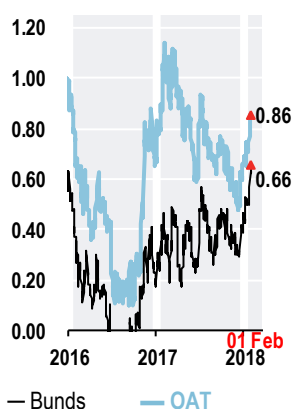
Markets overview

The essentials

Week 26-1 18 > 1-2-18

↘ CAC 40	5 529	▶ 5 455	-1.3 %
↘ S&P 500	2 873	▶ 2 822	-1.8 %
↗ Volatility (VIX)	11.1	▶ 13.5	+2.4 pb
↗ Euribor 3M (%)	-0.33	▶ -0.33	+0.0 bp
↗ Libor \$ 3M (%)	1.77	▶ 1.78	+1.1 bp
↗ OAT 10y (%)	0.79	▶ 0.86	+6.9 bp
↗ Bund 10y (%)	0.57	▶ 0.66	+9.2 bp
↗ US Tr. 10y (%)	2.66	▶ 2.77	+11.1 bp
↗ Euro vs dollar	1.24	▶ 1.25	+0.3 %
↘ Gold (ounce, \$)	1 353	▶ 1 343	-0.7 %
↘ Oil (Brent, \$)	70.4	▶ 69.1	-1.9 %

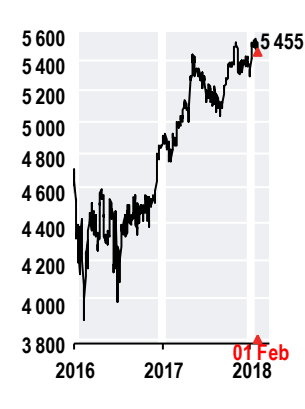
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

Interest Rates	highest' 18	lowest' 18
€ ECB	0.00	0.00 at 01/01
Eonia	-0.36	-0.35 at 01/01
Euribor 3M	-0.33	-0.33 at 25/01
Euribor 12M	-0.19	-0.19 at 01/01
\$ FED	1.50	1.50 at 01/01
Libor 3M	1.78	1.78 at 31/01
Libor 12M	2.27	2.27 at 31/01
£ BoE	0.50	0.50 at 01/01
Libor 3M	0.52	0.53 at 25/01
Libor 12M	0.80	0.81 at 29/01

At 1-2-18

Yield (%)	highest' 18	lowest' 18
€ AVG 5-7y	0.63	0.63 at 01/02
Bund 2y	-0.56	-0.56 at 01/02
Bund 10y	0.66	0.66 at 01/02
OAT 10y	0.86	0.86 at 01/02
Corp. BBB	1.29	1.29 at 01/02
\$ Treas. 2y	2.17	2.17 at 01/02
Treas. 10y	2.77	2.77 at 01/02
Corp. BBB	3.79	3.79 at 01/02
£ Treas. 2y	0.64	0.65 at 31/01
Treas. 10y	1.56	1.56 at 01/02

At 1-2-18

10y bond yield & spreads

4.29%	Greece	363 pb
1.93%	Italy	126 pb
1.73%	Portugal	107 pb
1.41%	Spain	75 pb
0.99%	Belgium	33 pb
0.93%	Austria	27 pb
0.86%	France	19 pb
0.85%	Ireland	19 pb
0.82%	Finland	16 pb
0.75%	Netherland	8 pb
0.66%	Germany	

Commodities

Spot price in dollars	lowest' 18	2018(€)
Oil, Brent	69.1	66.4 at 02/01
Gold (ounce)	1 343	1 303 at 01/01
Metals, LMEX	3 433	3 344 at 09/01
Copper (ton)	7 078	6 883 at 23/01
CRB Foods	346	336 at 01/01
wheat (ton)	168	155 at 16/01
Corn (ton)	134	126 at 08/01

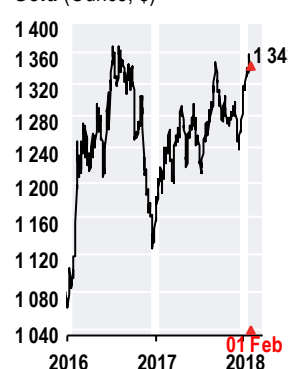
At 1-2-18

Variations

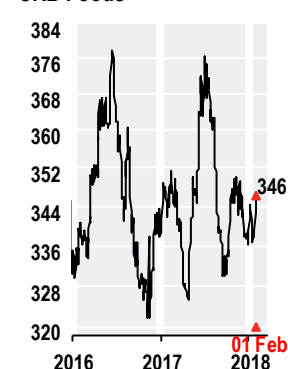
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

€ =	highest' 18	lowest' 18	2018
USD	1.25	1.25 at 25/01	+3.9%
GBP	0.88	0.89 at 04/01	-1.3%
CHF	1.16	1.18 at 15/01	-1.1%
JPY	136.41	136.41 at 01/02	+0.8%
AUD	1.55	1.55 at 01/02	+1.2%
CNY	7.85	7.92 at 25/01	+0.4%
BRL	3.95	3.98 at 01/01	-0.9%
RUB	69.98	70.09 at 31/01	+1.2%
INR	79.62	79.62 at 01/02	+3.9%

At 1-2-18

Variations

Equity indices

Index	highest' 18	lowest' 18	2018	2018(€)
CAC 40	5 455	5 542 at 22/01	5 289 at 02/01	+2.7%
S&P500	2 822	2 873 at 26/01	2 674 at 01/01	+5.5%
DAX	13 004	13 560 at 23/01	12 871 at 02/01	+0.7%
Nikkei	23 486	24 124 at 23/01	22 765 at 01/01	+3.2%
China*	98	101 at 26/01	88 at 01/01	+10.7%
India*	628	642 at 29/01	606 at 01/01	+2.8%
Brazil*	2 377	2 393 at 26/01	2 023 at 01/01	+12.1%
Russia*	685	691 at 25/01	604 at 01/01	+11.0%

At 1-2-18

Variations

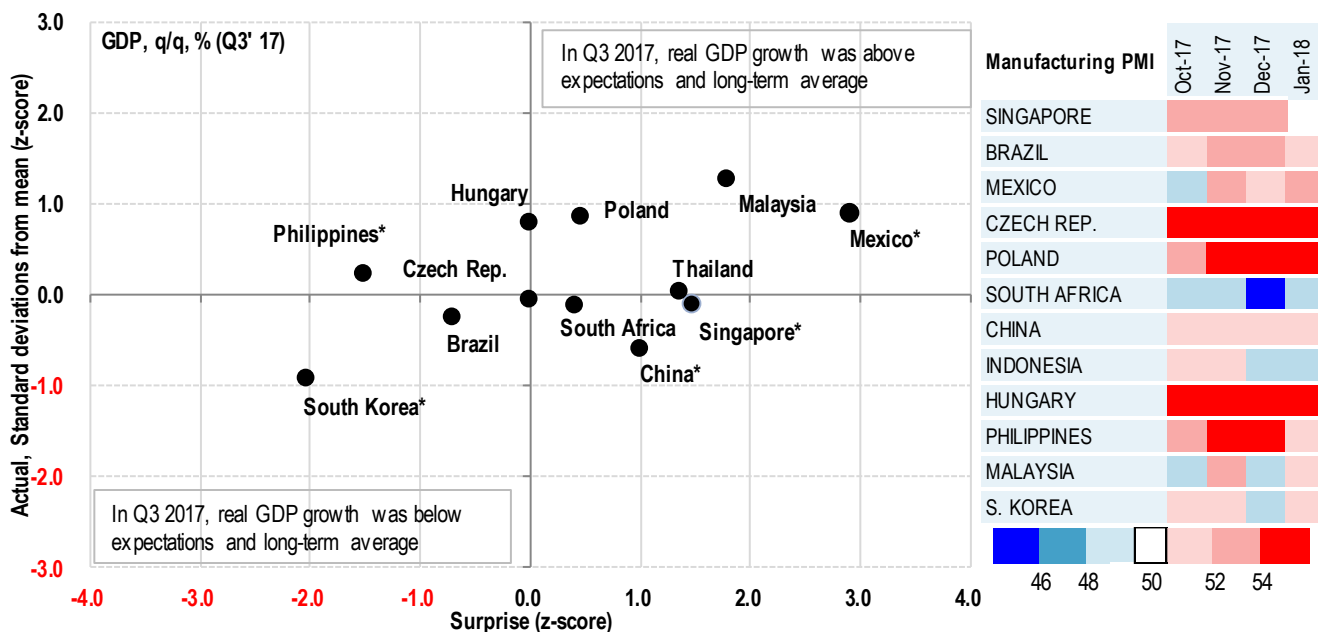
* MSCI index



Pulse

Emerging countries: A rebound in Mexico's GDP

A rebound in Mexico's GDP was expected in Q4 '17, in the aftermath of the Q3 contraction mostly due to natural disasters. Preliminary figures for Q4 GDP growth have even surprised on the upside, driven by agriculture and services, while the oil and mining sector was still a drag on industrial production.



* Q4 2017

Indicators preview

Next week the release of the Markit PMI for the services sector, the composite PMI and the US non-manufacturing ISM index will allow an assessment of how major economies started the new year. The European Commission will publish its economic forecasts and the ECB its Economic Bulletin. To be noted as well is the meeting of the Bank of England.

Date	Country/Region	Event	Period	Survy	Prior
02/05/18	France	Markit France Services PMI	Jan	--	59.3
02/05/18	France	Markit France Composite PMI	Jan	--	59.7
02/05/18	Eurozone	Markit Eurozone Services PMI	Jan	--	57.6
02/05/18	Eurozone	Markit Eurozone Composite PMI	Jan	--	58.6
02/05/18	Eurozone	Retail Sales MoM	Dec	--	1.5%
02/05/18	United States	ISM Non-Manf. Composite	Jan	56.5	55.9
02/06/18	France	Survey of Industrial Investment			
02/07/18	Eurozone	European Commission Economic Forecasts			
02/08/18	Eurozone	ECB Publishes Economic Bulletin			
02/08/18	United Kingdom	Bank of England Bank Rate	Feb	0.50%	0.50%
02/08/18	Japan	Eco Watchers Survey Current SA	Jan	--	53.9
02/08/18	France	Bank of France Ind. Sentiment	Jan	--	110
02/09/18	France	Industrial Production MoM	Dec	--	-0.5%

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	2.2	2.7	1.9	1.7	2.1	1.8
United-States	2.3	3.1	2.1	2.1	2.5	2.0
Japan	1.8	1.5	0.6	0.5	1.5	0.9
United-Kingdom	1.5	1.2	1.8	2.7	2.8	2.2
Euro Area	2.4	2.8	2.1	1.5	1.7	1.7
Germany	2.6	2.8	2.1	1.7	1.7	1.8
France	1.9	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
Netherlands	3.2	2.3	1.7	1.4	1.7	1.8
Emerging	4.5	4.8	4.9			
China	6.9	6.4	6.5	1.6	2.3	2.5
India	6.6	7.5	7.8	3.6	4.4	4.6
Brazil	1.0	3.0	2.5	3.5	3.5	3.7
Russia	1.7	1.6	1.5	3.7	4.0	4.4

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

INTEREST RATES & FX RATES

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

Exchange Rates		2018				2018e	2019e
End of period		Q1e	Q2e	Q3e	Q4e		
USD	EUR / USD	1.27	1.23	1.26	1.28	1.28	1.30
	USD / JPY	106	108	106	107	107	103
	GBP / USD	1.40	1.37	1.42	1.45	1.45	1.48
	USD / CHF	0.92	0.96	0.94	0.94	0.94	0.96
EUR	EUR / GBP	0.91	0.90	0.89	0.88	0.88	0.88
	EUR / CHF	1.17	1.18	1.19	1.20	1.20	1.25
	EUR / JPY	135	133	134	137	137	134

Source : GlobalMarkets (e: Estimates & forecasts)



GROUP ECONOMIC RESEARCH

■ **William DE VIJLDER**
Chief Economist

+33(0)1 55 77 47 31

william.devijlder@bnpparibas.com

ADVANCED ECONOMIES AND STATISTICS

■ **Jean-Luc PROUTAT**
Head

+33.(0)1.58.16.73.32

jean-luc.proutat@bnpparibas.com

■ **Alexandra ESTIOT**

Works coordination - United States - United Kingdom - Globalisation

+33.(0)1.58.16.81.69

alexandra.estiot@bnpparibas.com

■ **Hélène BAUDCHON**

France (short-term outlook and forecasts) - Labour markets

+33.(0)1.58.16.03.63

helene.baudchon@bnpparibas.com

■ **Frédérique CERISIER**

Euro Area (European governance and public finances), Spain, Portugal

+33.(0)1.43.16.95.52

frederique.cerisier@bnpparibas.com

■ **Thibault MERCIER**

Euro Area (short-term outlook and monetary policy), France (structural reforms)

+33.(0)1.57.43.02.91

thibault.mercier@bnpparibas.com

■ **Catherine STEPHAN**

Nordic countries - World trade - Education, health, social conditions

+33.(0)1.55.77.71.89

catherine.stephan@bnpparibas.com

■ **Raymond VAN DER PUTTEN**

Germany, Netherlands, Austria, Switzerland - Energy, climate - Long-term projections

+33.(0)1.42.98.53.99

raymond.vanderputten@bnpparibas.com

■ **Tarik RHARRAB**

Statistics and Modelling

+33.(0)1.43.16.95.56

tarik.rharrab@bnpparibas.com

BANKING ECONOMICS

■ **Laurent QUIGNON**
Head

+33.(0)1.42.98.56.54

laurent.quignon@bnpparibas.com

■ **Céline CHOLET**

+33.(0)1.43.16.95.54

celine.choulet@bnpparibas.com

■ **Thomas HUMBLLOT**

+33.(0)1.40.14.30.77

thomas.humblot@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

■ **François FAURE**
Head - Argentina

+33.(0)1 42 98 79 82

francois.faure@bnpparibas.com

■ **Christine PELTIER**

Deputy Head - Greater China, Vietnam, other North Asian countries, South Africa

+33.(0)1.42.98.56.27

christine.peltier@bnpparibas.com

■ **Stéphane ALBY**

Africa (French-speaking countries)

+33.(0)1.42.98.02.04

stephane.alby@bnpparibas.com

■ **Sylvain BELLEFONTAINE**

Turkey, Latin America

+33.(0)1.42.98.26.77

sylvain.bellefontaine@bnpparibas.com

■ **Sara CONFALONIERI**

Africa (Portuguese & English-speaking countries)

+33.(0)1.42.98.43.86

sara.confalonieri@bnpparibas.com

■ **Pascal DEVAUX**

Middle East, Balkan countries

+33.(0)1.43.16.95.51

pascal.devau@bnpparibas.com

■ **Anna DORBEC**

CIS, Central European countries

+33.(0)1.42.98.48.45

anna.dorbec@bnpparibas.com

■ **Hélène DROUOT**

Korea, Thailand, Philippines, Andean countries

+33.(0)1.42.98.33.00

helene.drouot@bnpparibas.com

■ **Johanna MELKA**

India, South Asia, Russia

+33.(0)1.58.16.05.84

johanna.melka@bnpparibas.com

■ **Michel BERNARDINI**
Contact Média

+33.(0)1.42.98.05.71

michel.bernardini@bnpparibas.com



BNP PARIBAS

The bank
for a changing
world

OUR PUBLICATIONS



CONJONCTURE

Structural or in news flow, two issues analysed in depth



EMERGING

Analyses and forecasts for a selection of emerging economies



PERSPECTIVES

Analyses and forecasts for the main countries, emerging or developed



ECOFASH

Data releases, major economic events. Our detailed views...



ECOWEEK

Weekly economic news and much more...



ECOTV

In this monthly web TV, our economists make sense of economic news



ECOTV WEEK

What is the main event this week? The answer is in your two minutes of economy

The information and opinions contained in this report have been obtained from, or are based on, public sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate, complete or up to date and it should not be relied upon as such. This report does not constitute an offer or solicitation to buy or sell any securities or other investment. It does not constitute investment advice, nor financial research or analysis. Information and opinions contained in the report are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient; they are subject to change without notice and not intended to provide the sole basis of any evaluation of the instruments discussed herein. Any reference to past performance should not be taken as an indication of future performance. To the fullest extent permitted by law, no BNP Paribas group company accepts any liability whatsoever (including in negligence) for any direct or consequential loss arising from any use of or reliance on material contained in this report. All estimates and opinions included in this report are made as of the date of this report. Unless otherwise indicated in this report there is no intention to update this report. BNP Paribas SA and its affiliates (collectively "BNP Paribas") may make a market in, or may, as principal or agent, buy or sell securities of any issuer or person mentioned in this report or derivatives thereon. BNP Paribas may have a financial interest in any issuer or person mentioned in this report, including a long or short position in their securities and/or options, futures or other derivative instruments based thereon. Prices, yields and other similar information included in this report are included for information purposes. Numerous factors will affect market pricing and there is no certainty that transactions could be executed at these prices. BNP Paribas, including its officers and employees may serve or have served as an officer, director or in an advisory capacity for any person mentioned in this report. BNP Paribas may, from time to time, solicit, perform or have performed investment banking, underwriting or other services (including acting as adviser, manager, underwriter or lender) within the last 12 months for any person referred to in this report. BNP Paribas may be a party to an agreement with any person relating to the production of this report. BNP Paribas, may to the extent permitted by law, have acted upon or used the information contained herein, or the research or analysis on which it was based, before its publication. BNP Paribas may receive or intend to seek compensation for investment banking services in the next three months from or in relation to any person mentioned in this report. Any person mentioned in this report may have been provided with sections of this report prior to its publication in order to verify its factual accuracy.

BNP Paribas is incorporated in France with limited liability. Registered Office 16 Boulevard des Italiens, 75009 Paris. This report was produced by a BNP Paribas group company. This report is for the use of intended recipients and may not be reproduced (in whole or in part) or delivered or transmitted to any other person without the prior written consent of BNP Paribas. By accepting this document you agree to be bound by the foregoing limitations.

Certain countries within the European Economic Area:

This report has been approved for publication in the United Kingdom by BNP Paribas London Branch. BNP Paribas London Branch is authorised and supervised by the Autorité de Contrôle Prudentiel and authorised and subject to limited regulation by the Financial Services Authority. Details of the extent of our authorisation and regulation by the Financial Services Authority are available from us on request.

This report has been approved for publication in France by BNP Paribas SA. BNP Paribas SA is incorporated in France with Limited Liability and is authorised by the Autorité de Contrôle Prudentiel (ACP) and regulated by the Autorité des Marchés Financiers (AMF). Its head office is 16, boulevard des Italiens 75009 Paris, France.

This report is being distributed in Germany either by BNP Paribas London Branch or by BNP Paribas Niederlassung Frankfurt am Main, a branch of BNP Paribas S.A. whose head office is in Paris, France. BNP Paribas S.A. – Niederlassung Frankfurt am Main, Europa Allee 12, 60327 Frankfurt is authorised and supervised by the Autorité de Contrôle Prudentiel and it is authorised and subject to limited regulation by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

United States: This report is being distributed to US persons by BNP Paribas Securities Corp., or by a subsidiary or affiliate of BNP Paribas that is not registered as a US broker-dealer. BNP Paribas Securities Corp., a subsidiary of BNP Paribas, is a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority and other principal exchanges. BNP Paribas Securities Corp. accepts responsibility for the content of a report prepared by another non-U.S. affiliate only when distributed to U.S. persons by BNP Paribas Securities Corp.

Japan: This report is being distributed in Japan by BNP Paribas Securities (Japan) Limited or by a subsidiary or affiliate of BNP Paribas not registered as a financial instruments firm in Japan, to certain financial institutions defined by article 17-3, item 1 of the Financial Instruments and Exchange Law Enforcement Order. BNP Paribas Securities (Japan) Limited is a financial instruments firm registered according to the Financial Instruments and Exchange Law of Japan and a member of the Japan Securities Dealers Association and the Financial Futures Association of Japan. BNP Paribas Securities (Japan) Limited accepts responsibility for the content of a report prepared by another non-Japan affiliate only when distributed to Japanese based firms by BNP Paribas Securities (Japan) Limited. Some of the foreign securities stated on this report are not disclosed according to the Financial Instruments and Exchange Law of Japan.

Hong Kong: This report is being distributed in Hong Kong by BNP Paribas Hong Kong Branch, a branch of BNP Paribas whose head office is in Paris, France. BNP Paribas Hong Kong Branch is registered as a Licensed Bank under the Banking Ordinance and regulated by the Hong Kong Monetary Authority. BNP Paribas Hong Kong Branch is also a Registered Institution regulated by the Securities and Futures Commission for the conduct of Regulated Activity Types 1, 4 and 6 under the Securities and Futures Ordinance.

Some or all the information reported in this document may already have been published on <https://globalmarkets.bnpparibas.com>

© BNP Paribas (2015). All rights reserved.

YOU WANT TO RECEIVE OUR PUBLICATIONS?
SUBSCRIBE ON OUR WEBSITE
<http://economic-research.bnpparibas.com>

OR

READ AND WATCH OUR ANALYSES ON **ECO NEWS**, OUR IPAD AND ANDROID APPLICATION

© BNP Paribas (2015). All rights reserved.
Prepared by Economic Research – BNP PARIBAS
Registered Office: 16 boulevard des Italiens – 75009 PARIS
Tel: +33 (0) 1.42.98.12.34 – Internet :
www.group.bnpparibas.com
Publisher: Jean Lemierre. Editor: William De Vijlder



BNP PARIBAS

The bank
for a changing
world