

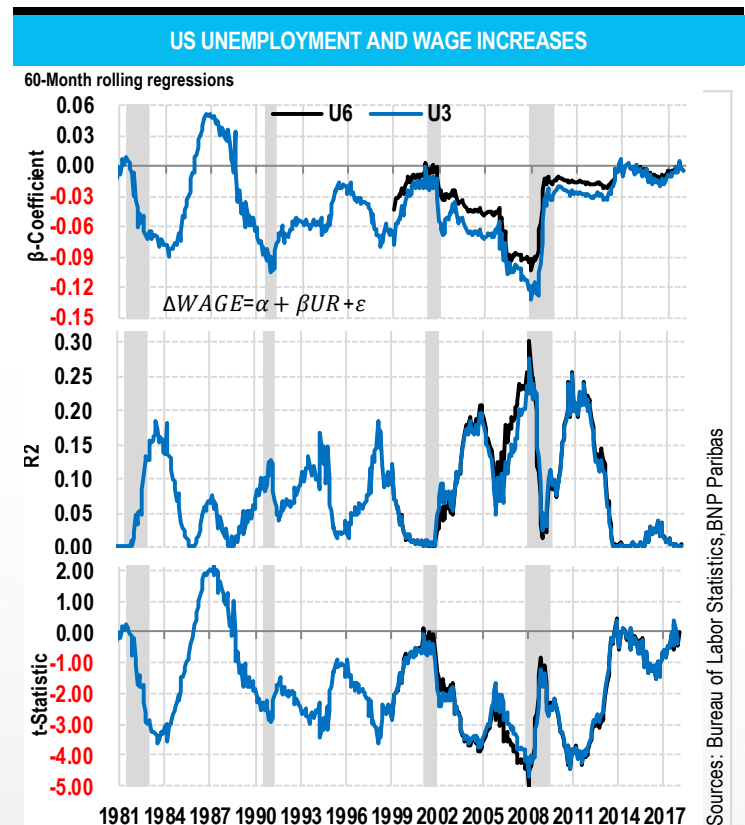
ECOWEEK

No. 18-07, 16 February 2018

US: inflation unease

■ After the upside surprise to hourly wages earlier this month, the consumer and producer price inflation numbers have also come in higher than expected ■ Anticipating inflation dynamics has become very difficult, as the Phillips curve has become less apparent ■ This forces investors and policy makers to pay more attention to recent data than to long-term relationships

When you're desperate to get something, the marginal utility of receiving what you want is huge. In economics classes, teachers tend to illustrate this with the relief of a pint of beer when you're thirsty. The opposite also applies: getting more and more of something you don't like generates mounting despair. Think of homework after school or of inflation. Except for those who would have found the perfect hedge, inflation at some point in the cycle turns into a headache: the outlook for monetary policy changes and with some delay the growth outlook as well (downward revisions). Are we in the very early stages of such a path in the US considering that hourly wages, consumer and producer price inflation have surprised to the upside? How will the Fed react to such a "Three in a row"? The data in the run-up to its March 20-21 meeting will be particularly important as well as the post-meeting press conference of the new Fed chair, Jerome Powell. Central bank guidance has become particularly important considering that the traditional paradigm, the Phillips curve – a trade-off between unemployment and wages, has broken down. The upper part of the chart shows the evolution of the beta coefficient of rolling regressions (60-month window) of the monthly change in hourly wages as a function of the unemployment rate (for the narrow and broad definition: U3 and U6). It's a very basic version of the Phillips curve but judging by the R² and the t-statistic, it quite often did a satisfactory job in the past. However, since the Great Recession the beta has collapsed, implying little reaction of wage growth to changes in unemployment. In addition, the R² has basically dropped to zero in recent years. Perhaps more sophisticated estimations could do a better job in terms of fit although research by the BIS has shown that the beta coefficient has indeed become very small. This is a challenge for markets as much as for central banks: if long-term relationships are no longer statistically significant, one is left with scrutinising the recent data even more. And greater data-dependency also implies more room for surprises as the past two weeks have shown.



William De Vijlder

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ECONOMIC RESEARCH DEPARTMENT



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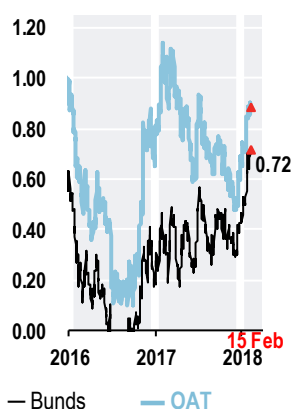
Markets overview

The essentials

Week 9-2 18 > 15-2-18

↗ CAC 40	5 079	▶ 5 223	+2.8 %
↗ S&P 500	2 620	▶ 2 731	+4.3 %
↘ Volatility (VIX)	29.1	▶ 19.1	-9.9 pb
↗ Euribor 3M (%)	-0.33	▶ -0.33	+0.1 bp
↗ Libor \$ 3M (%)	1.82	▶ 1.85	+3.0 bp
↗ OAT 10y (%)	0.87	▶ 0.89	+1.3 bp
↗ Bund 10y (%)	0.69	▶ 0.72	+2.6 bp
↗ US Tr. 10y (%)	2.85	▶ 2.93	+8.5 bp
↗ Euro vs dollar	1.22	▶ 1.25	+1.9 %
↗ Gold (ounce, \$)	1 313	▶ 1 352	+2.9 %
↗ Oil (Brent, \$)	63.4	▶ 63.8	+0.5 %

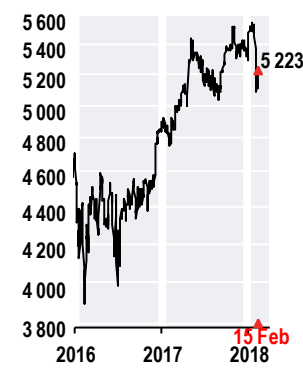
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

Interest Rates	highest' 18	lowest' 18
€ ECB	0.00 at 01/01	0.00 at 01/01
Eonia	-0.36 at 01/01	-0.37 at 02/01
Euribor 3M	-0.33 at 25/01	-0.33 at 01/01
Euribor 12M	-0.19 at 01/01	-0.19 at 24/01
\$ FED	1.50 at 01/01	1.50 at 01/01
Libor 3M	1.85 at 14/02	1.69 at 01/01
Libor 12M	2.34 at 14/02	2.11 at 01/01
£ BoE	0.50 at 01/01	0.50 at 01/01
Libor 3M	0.54 at 14/02	0.52 at 04/01
Libor 12M	0.86 at 14/02	0.76 at 03/01

At 15-2-18

Yield (%)	highest' 18	lowest' 18
€ AVG 5-7y	0.66 at 15/02	0.43 at 01/01
Bund 2y	-0.57 at 02/02	-0.66 at 01/01
Bund 10y	0.72 at 15/02	0.42 at 01/01
OAT 10y	0.89 at 08/02	0.65 at 08/01
Corp. BBB	1.40 at 14/02	1.17 at 08/01
\$ Treas. 2y	2.19 at 15/02	1.89 at 01/01
Treas. 10y	2.93 at 14/02	2.41 at 01/01
Corp. BBB	3.99 at 14/02	3.59 at 01/01
£ Treas. 2y	0.67 at 14/02	0.40 at 01/01
Treas. 10y	1.67 at 15/02	1.23 at 01/01

At 15-2-18

10y bond yield & spreads

5.00%	Greece	428 pb
2.15%	Italy	143 pb
1.88%	Portugal	116 pb
1.51%	Spain	79 pb
1.03%	Belgium	31 pb
0.97%	Austria	24 pb
0.89%	France	16 pb
0.88%	Ireland	16 pb
0.87%	Finland	15 pb
0.79%	Netherland	7 pb
0.72%	Germany	

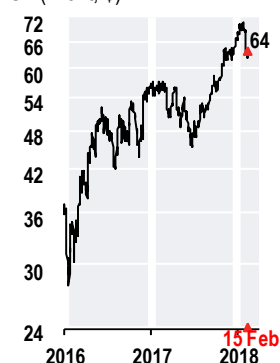
Commodities

Spot price in dollars	lowest' 18	2018(€)
Oil, Brent	62.2 at 13/02	-7.9%
Gold (ounce)	1 303 at 01/01	-0.2%
Metals, LMEX	3 271 at 09/02	-3.2%
Copper (ton)	6 712 at 09/02	-4.6%
CRB Foods	336 at 01/01	-1.7%
w wheat (ton)	155 at 16/01	+4.5%
Corn (ton)	126 at 08/01	+3.1%

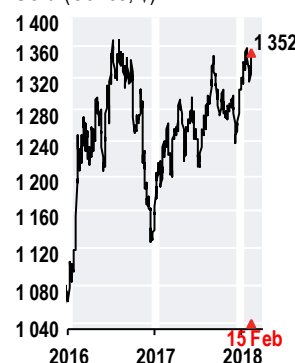
At 15-2-18

Variations

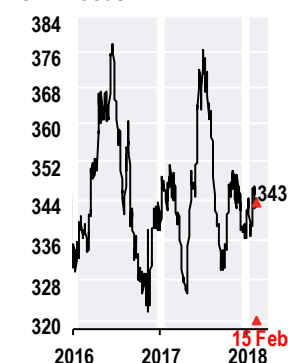
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

1€ =	highest' 18	lowest' 18	2018
USD	1.25 at 25/01	1.19 at 09/01	+3.9%
GBP	0.89 at 04/01	0.87 at 24/01	+0.0%
CHF	1.15 at 15/01	1.15 at 08/02	-1.5%
JPY	132.60 at 02/02	132.54 at 14/02	-2.0%
AUD	1.58 at 15/02	1.53 at 09/01	+2.9%
CNY	7.92 at 25/01	7.70 at 07/02	+1.2%
BRL	4.04 at 13/02	3.87 at 08/01	+1.4%
RUB	70.60 at 09/02	68.06 at 09/01	+2.1%
INR	79.79 at 15/02	75.92 at 08/01	+4.1%

At 15-2-18

Variations

Equity indices

Index	highest' 18	lowest' 18	2018	2018(€)
CAC 40	5 542 at 22/01	5 079 at 09/02	-1.7%	-1.7%
S&P500	2 873 at 26/01	2 581 at 08/02	+2.2%	-1.7%
DAX	13 560 at 23/01	12 107 at 09/02	-4.4%	-4.4%
Nikkei	24 124 at 23/01	21 154 at 14/02	-5.7%	-3.8%
China*	101 at 26/01	88 at 09/02	+6.3%	+2.3%
India*	604 at 29/01	593 at 07/02	-1.1%	-5.0%
Brazil*	2 295 at 26/01	2 023 at 01/01	+10.6%	+9.2%
Russia*	671 at 25/01	604 at 01/01	+9.4%	+6.8%

At 15-2-18

Variations

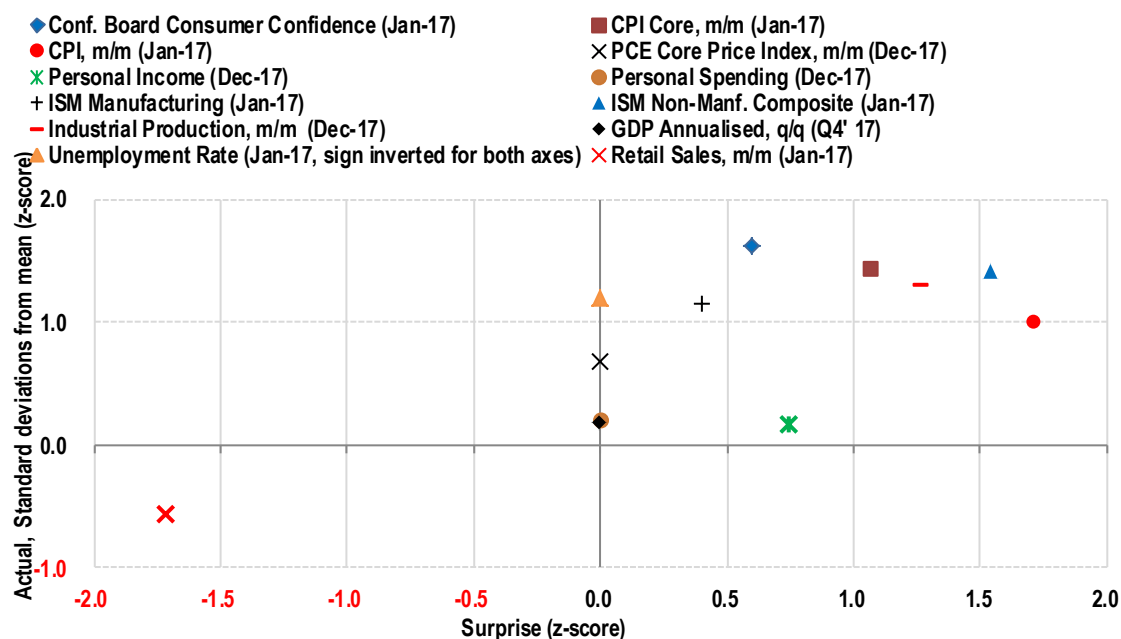
* MSCI index



Pulse

United States: How good can it get?

With the exception of retail sales, all indicators are above their long-term average (to facilitate the reading, unemployment is shown with an inverted sign: in reality it is well below the long term average as well). In addition, most indicators have surprised to the upside as of late. This also applies to inflation data. The additional boost coming from tax cuts implies that inflation is now the key variable to monitor for months to come.



Sources: Bloomberg, Markit, BNP Paribas

Indicators preview

Next week will allow to finetune our assessment of the economic situation based on the publication for the month of February of several sentiment and survey indicators: Markit PMI, eurozone consumer confidence, ZEW, IFO, business confidence in France. Given the recent upside surprises in US inflation, market participants will read with particular interest the FOMC minutes.

Date	Country	Event	Period	Prior
02/20/2018	Germany	ZEW Survey Current Situation	Feb	95.2
02/20/2018	Eurozone	Consumer Confidence	Feb	1.3
02/21/2018	France	Markit France Manufacturing PMI	Feb	58.4
02/21/2018	France	Markit France Services PMI	Feb	59.2
02/21/2018	France	Markit France Composite PMI	Feb	59.6
02/21/2018	Eurozone	Markit Eurozone Manufacturing PMI	Feb	59.6
02/21/2018	Eurozone	Markit Eurozone Services PMI	Feb	58.0
02/21/2018	Eurozone	Markit Eurozone Composite PMI	Feb	58.8
02/21/2018	United Kingdom	ILO Unemployment Rate 3Mths	Dec	4.3%
02/21/2018	United States	FOMC Meeting Minutes	Jan 31	--
02/22/2018	France	Business Confidence	Feb	110
02/22/2018	France	CPI EU Harmonized MoM	Jan	-0.1%
02/22/2018	Germany	IFO Business Climate	Feb	117.6
02/22/2018	United Kingdom	GDP QoQ	4Q	0.5%
02/23/2018	Germany	GDP SA QoQ	4Q	0.6%

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)



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