ECOWEEK

No. 18-12, 23 March 2018

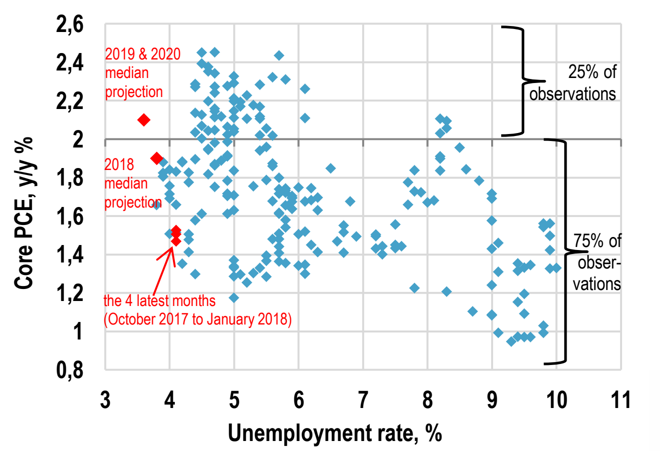
US: FOMC (a)symmetries

■ The FOMC has an asymmetrical loss function: avoiding a recession is more important than avoiding the risk of overheating ■ With this comes the necessity of a symmetrical inflation objective: a temporary overshooting is acceptable ■ Given the unclear relationship between unemployment and inflation, the Fed's tone remains cautious despite upbeat growth projections

The Federal Reserve faces two asymmetries. The first is the asymmetric loss function. This is largely by choice because it wants to avoid triggering a recession (fighting recessions has become increasingly difficult). Chairman Powell insisted in his press conference on Wednesday on the need not to tighten too quickly. Otherwise inflation would rise insufficiently which would make it more difficult to tackle the next recession when it comes. The second asymmetry is imposed on the central bank. At the same time, we note that since 2000, 75% of observations of core inflation were below 2% (see Chart). Engineering an uplift in inflation towards the 2% target looks like a huge task.

Faced with these two asymmetries, insisting that the inflation objective is symmetrical, like Jerome Powell re-iterated on Wednesday, becomes an obvious, not to say inevitable, conclusion: allowing a temporary inflation overshoot is the price to pay for the wish to avoid the most uncomfortable part of the loss function (a recession) that could ensue from what would turn out to be a prematurely restrictive policy stance. This is all the more rational given the difficulty of assessing the level of the natural rate of unemployment and the uncertainty about the relationship between the unemployment rate and inflation. Taking the risk that the Phillips curve re-emerges then makes sense. What also makes sense is avoiding creating the impression that one firmly believes that it will re-emerge. That explains the, on the surface, puzzling changes to the FOMC members' projections: the median unemployment rate in 2020 is now put at 3,6%, far below the longer run projection of 4,5% whereas PCE inflation in 2020 is projected at 2,1%, a tad above the longer run projection of 2,0%. Nobody seems to believe in the resurrection of the Phillips curve. All this helps explaining the relaxed reaction of bond markets: a temporary inflation overshoot won't stop the Fed from sticking to a gradualist approach and if the FOMC has doubts about the Phillips curve, why speculate against this? At the end of the day, financial market positioning has become as data-dependent as central bank policy.

UNEMPLOYMENT VS INFLATION



Sources: BLS, BEA, Federal Reserve, BNP Paribas

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Eco WEEK

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

The bank for a changing world

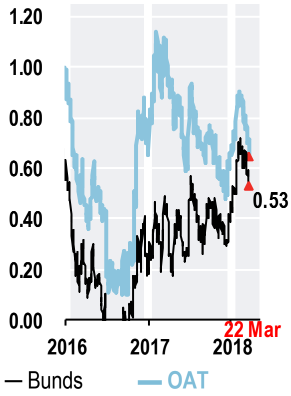
Markets overview

The essentials

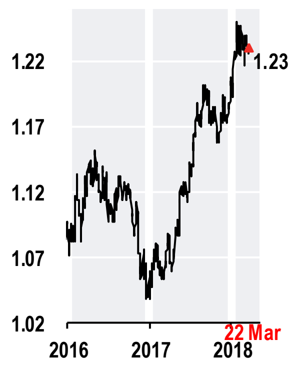
Week 16-3 18 > 22-3-18

↘	**CAC 40**	5 283	▶ **5 167**	**-2.2**	%
↘	**S&P 500**	2 752	▶ **2 644**	**-3.9**	%
↗	Volatility (VIX)	15.8	▶ 23.3	+7.5	pb
↘	**Euribor 3M** (%)	-0.33	▶ **-0.33**	**-0.1**	bp
↗	Libor $ 3M (%)	2.20	▶ 2.27	+6.9	bp
↘	OAT 10y (%)	0.70	▶ 0.65	-5.6	bp
↘	Bund 10y (%)	0.57	▶ 0.53	-3.9	bp
↘	US Tr. 10y (%)	2.85	▶ 2.83	-1.6	bp
↗	**Euro vs dollar**	1.23	▶ **1.23**	**+0.2**	%
↗	Gold (ounce, $)	1 314	▶ 1 327	+1.0	%
↗	**Oil (Brent, $)**	66.1	▶ **69.2**	**+4.8**	%

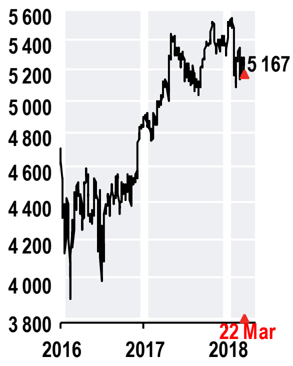
10 y **bond yield, OAT vs Bund**



Euro-dollar



CAC 40



Money & Bond Markets

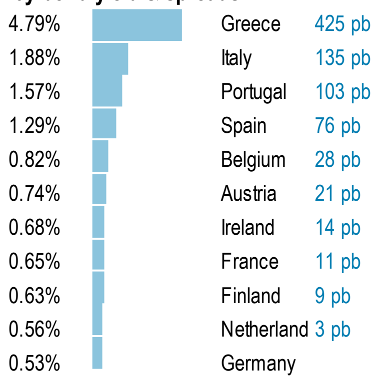
Interest Rates		highest' 18		lowest' 18	
€ ECB	**0.00**	0.00	at 01/01	0.00	at 01/01
Eonia	**-0.37**	-0.35	at 01/01	-0.37	at 02/01
Euribor 3M	**-0.33**	-0.33	at 25/01	-0.33	at 01/01
Euribor 12M	**-0.19**	-0.19	at 01/01	-0.19	at 19/02
$ FED	**1.75**	1.75	at 22/03	1.50	at 01/01
Libor 3M	**2.27**	2.27	at 21/03	1.69	at 01/01
Libor 12M	**2.68**	2.68	at 21/03	2.11	at 01/01
£ BoE	**0.50**	0.50	at 01/01	0.50	at 01/01
Libor 3M	**0.64**	0.64	at 21/03	0.52	at 04/01
Libor 12M	**0.97**	0.97	at 21/03	0.76	at 03/01

At 22-3-18

Yield (%)		highest' 18		lowest' 18	
€ AVG 5-7y	**0.48**	0.66	at 15/02	0.43	at 01/01
Bund 2y	**-0.60**	-0.55	at 07/03	-0.66	at 01/01
Bund 10y	**0.53**	0.72	at 15/02	0.42	at 01/01
OAT 10y	**0.65**	0.91	at 08/02	0.65	at 22/03
Corp. BBB	**1.39**	1.43	at 21/03	1.17	at 08/01
$ Treas. 2y	**2.29**	2.34	at 20/03	1.89	at 01/01
Treas. 10y	**2.83**	2.94	at 21/02	2.41	at 01/01
Corp. BBB	**4.14**	4.16	at 21/03	3.59	at 01/01
£ Treas. 2y	**0.81**	0.85	at 21/03	0.40	at 01/01
Treas. 10y	**1.47**	1.67	at 15/02	1.23	at 01/01

At 22-3-18

10y bond yield & spreads

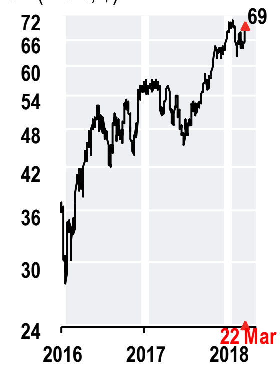


Commodities

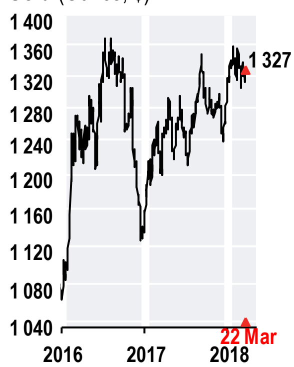
Spot price in dollars		lowest' 18			2018(€)
Oil, Brent	**69.2**	62.2	at	13/02	**+1.4%**
Gold (ounce)	**1 327**	1 303	at	01/01	**-0.7%**
Metals, LMEX	**3 250**	3 227	at	20/03	**-7.3%**
Copper (ton)	**6 653**	6 653	at	22/03	**-9.9%**
CRB Foods	**341**	336	at	01/01	**-1.1%**
wheat (ton)	**168**	155	at	16/01	**+3.0%**
Corn (ton)	**134**	126	at	08/01	**+3.0%**

At 22-3-18 *Variations*

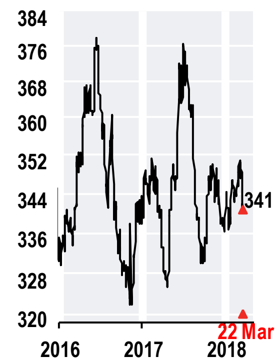
Oil (Brent, $)



Gold (Ounce, $)



CRB Foods



Exchange Rates

1€ =		highest' 18			lowest' 18			2018
USD	**1.23**	1.25	at	25/01	1.19	at	09/01	**+2.5%**
GBP	**0.87**	0.89	at	02/03	0.87	at	24/01	-1.6%
CHF	**1.17**	1.18	at	15/01	1.15	at	27/02	-0.2%
JPY	**129.66**	137.29	at	02/02	129.66	at	22/03	-4.1%
AUD	**1.60**	1.60	at	19/03	1.53	at	09/01	+4.2%
CNY	**7.78**	7.92	at	25/01	7.70	at	07/02	-0.5%
BRL	**4.07**	4.08	at	13/02	3.87	at	08/01	+2.1%
RUB	**70.41**	71.44	at	09/02	68.06	at	09/01	+1.9%
INR	**80.16**	80.70	at	06/03	75.92	at	08/01	+4.6%

At 22-3-18 *Variations*

Equity indices

	Index	highest' 18			lowest' 18			2018	2018(€)
CAC 40	**5 167**	5 542	at	22/01	5 079	at	09/02	-2.7%	**-2.7%**
S&P500	**2 644**	2 873	at	26/01	2 581	at	08/02	-1.1%	**-3.5%**
DAX	**12 100**	13 560	at	23/01	11 914	at	02/03	-6.3%	**-6.3%**
Nikkei	**21 592**	24 124	at	23/01	21 042	at	05/03	-5.2%	**-1.1%**
China*	**93**	101	at	26/01	88	at	09/02	+6.0%	**+3.1%**
India*	**568**	642	at	29/01	566	at	19/03	-5.1%	**-9.3%**
Brazil*	**2 244**	2 393	at	26/01	2 023	at	01/01	+10.5%	**+8.2%**
Russia*	**671**	707	at	26/02	604	at	01/01	+10.5%	**+8.3%**

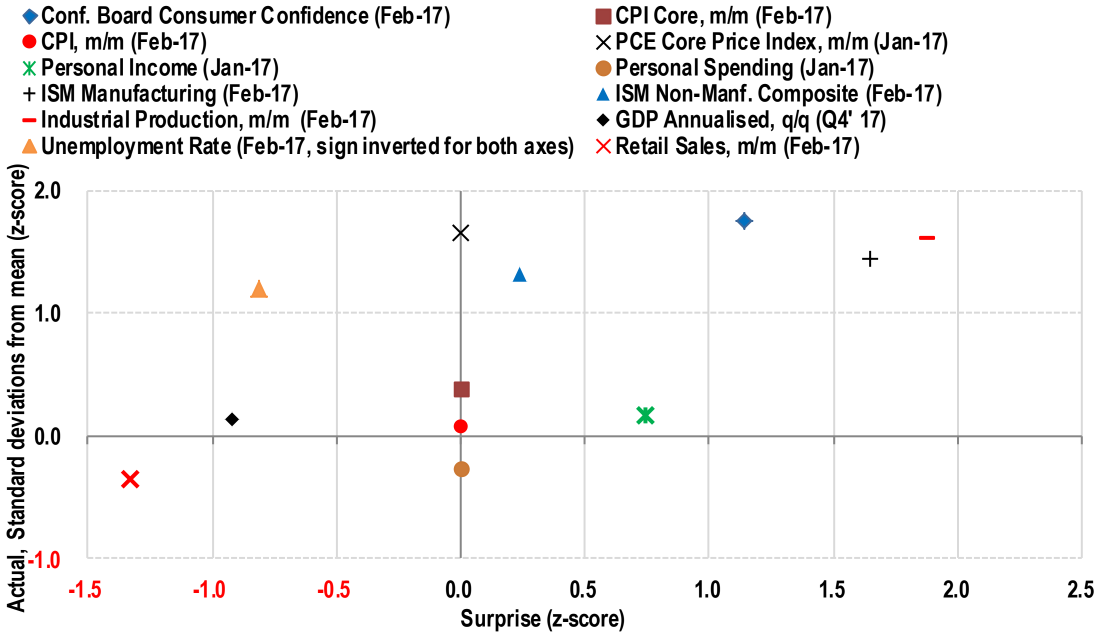
At 22-3-18 *Variations*

* MSCI index

Pulse

United States: Growth to remain strong this year

In terms of surprises, recent data offer a mixed picture although sentiment data (the two ISM indicators and consumer confidence) came in higher than expected. Most indicators are doing better than their long-term average. This even applies to core inflation in February. All in all this reflects an economy which is doing very well and which, looking at the 'soft indicators' and the drivers of final demand, should see strong growth this year. Tax cuts should also contribute in this respect.



Sources: Bloomberg, Markit, BNP Paribas

Indicators preview

Next week will provide a more precise reading of how we finished 2017 with updated estimates for 4th quarter GDP growth in France, the US, the UK. More importantly, consumer confidence and sentiment indicator will be published in the eurozone, the US, Germany, France, the UK. Markets will also be interested by inflation numbers in France, Germany and the US (core PCE deflator).

Date	Country	Event	Period	Prior
03/26/18	France	GDP QoQ	4Q	0.6%
03/27/18	Eurozone	Economic Confidence	March	114.1
03/27/18	Eurozone	Consumer Confidence	March	--
03/27/18	United States	Conf. Board Consumer Confidence	March	130.8
03/28/18	Germany	GfK Consumer Confidence	April	10.8
03/28/18	France	Consumer Confidence	March	100
03/28/18	United States	GDP Annualized QoQ	4Q	2.5%
03/29/18	United Kingdom	GfK Consumer Confidence	March	-10
03/29/18	United Kingdom	GDP QoQ	4Q	0.4%
03/29/18	Germany	CPI EU Harmonized MoM	March	0.5%
03/29/18	United States	Personal Income	February	0.4%
03/29/18	United States	Personal Spending	February	0.2%
03/29/18	United States	University of Michigan Sentiment	March	--
03/30/18	France	Consumer Spending MoM	February	-1.9%
03/30/18	France	CPI EU Harmonized MoM	March	0.0%

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. Tax cuts would add +0.5 pp to the GDP growth this year, that would trend near 3%.
- The labour market is as buoyant as ever, showing its first signs of tension (participation rates and real wages are up).
- Fed Funds rates: 1.75% in Q1 2018, 2% by mid-2018.

CHINA

- Economic growth will decelerate in 2018. 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. Fiscal policy should remain expansionist.
- The outlook for exports and household spending is rather favourable in the short term, but the tightening of domestic credit conditions, restructuring measures in the industry and less buoyant property market will weigh on economic activity.

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 ECB is expected to remain cautious. Possible extension of APP after Sept. no rates hike before mid-2019.

FRANCE

- A clear growth acceleration is underway. Households' consumption is supported by the jobs recovery but restrained by the upturn in inflation. Investment and exports dynamics are favourable.
- A slight rise in inflation is appearing but remains to be confirmed.

INTEREST RATES AND FX RATES

- In the US, ongoing strong growth and a very low unemployment rate pave the way for several rate hikes (we expect 4 this year and 1 next). This will put upward pressure on bond yields in 2018. The ECB is expected to stop its QE programme at the end of 2018 and to hike its rates by the middle of 2019. As a consequence, bond yields should follow a rising trend, including in 2019. No change expected in Japan
- The narrowing bond yield differential between the US and the eurozone should cause a strengthening of the euro, all the more so considering it is still below its long-term fair value (around 1.34).

SUMMARY

	GDP Growth			Inflation		
%	2017	2018 e	2019 e	2017	2018 e	2019 e
Advanced	**2.2**	**2.7**	**1.9**	**1.7**	**2.0**	**1.8**
United-States	2.3	3.1	2.1	2.1	2.3	2.1
Japan	1.7	1.3	0.6	0.5	1.1	1.0
United-Kingdom	1.7	1.5	1.8	2.7	2.6	2.1
Euro Area	**2.5**	**2.8**	**2.1**	**1.5**	**1.7**	**1.7**
Germany	2.5	3.1	2.1	1.7	1.8	1.9
France	2.0	2.4	1.9	1.2	1.6	1.7
Italy	1.5	1.7	1.2	1.3	1.4	1.5
Spain	3.1	2.9	2.2	2.0	1.6	1.6
Netherlands	3.2	2.3	1.7	1.4	1.7	1.8
Emerging						
China	6.9	6.4	6.4	1.6	2.3	2.5
India	6.6	7.4	7.6	3.6	4.5	4.2
Brazil	1.1	3.0	3.5	3.4	3.3	3.8
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						
End of period		Q1e	Q2e	Q3e	Q4e	**2017**	**2018e**	**2019e**
US	Fed Funds	1.75	2.00	2.25	2.50	1.50	2.50	2.75
	Libor 3m $	2.01	2.15	2.35	2.55	1.69	2.55	2.55
	T-Notes 10y	3.00	3.10	3.20	3.25	2.41	3.25	3.00
Ezone	ECB Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.25
	Euribor 3m	-0.33	-0.33	-0.33	-0.33	-0.33	-0.33	0.07
	Bund 10y	0.70	0.85	1.20	1.50	0.42	1.50	1.80
	OAT 10y	1.00	1.10	1.40	1.70	0.66	1.70	2.05
UK	Base rate	0.50	0.75	0.75	1.00	0.50	1.00	1.50
	Gilts 10y	1.55	1.65	1.75	1.90	1.23	1.90	2.25
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10	-0.04	-0.10	-0.10
	JGB 10y	0.06	0.08	0.08	0.08	0.05	0.08	0.00

Exchange Rates		2018						
End of period		Q1e	Q2e	Q3e	Q4e	**2017**	**2018e**	**2019e**
USD	EUR / USD	1.26	1.27	1.28	1.28	1.20	1.28	1.34
	USD / JPY	106	105	104	102	113	102	98
	GBP / USD	1.38	1.41	1.44	1.45	1.35	1.45	1.52
	USD / CHF	0.93	0.93	0.93	0.94	0.97	0.94	0.93
EUR	EUR / GBP	0.91	0.90	0.89	0.88	0.89	0.88	0.88
	EUR / CHF	1.17	1.18	1.19	1.20	1.17	1.20	1.25
	EUR / JPY	134	133	133	131	135	131	131

Source: GlobalMarkets BNP Paribas (e: estimates & forecasts)

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