ECOWEEK

No. 18-20, 18 May 2018

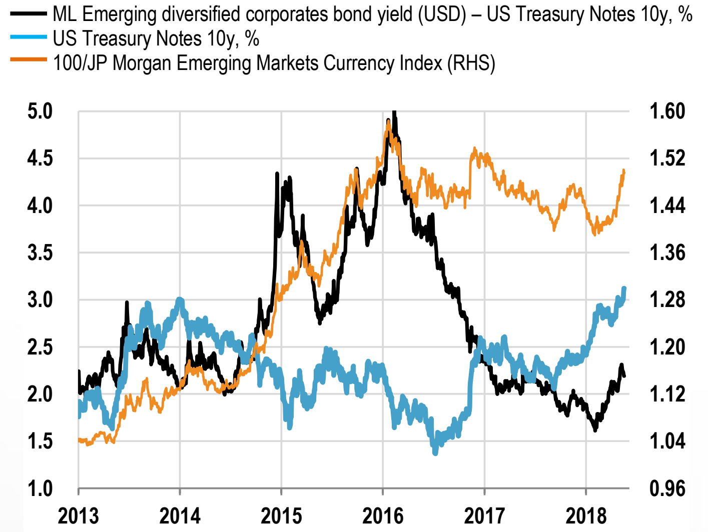
Emerging markets: a sudden chill

■ In recent years, emerging market issuers, in particular corporates, have raised huge amounts of USD debt, thereby increasing their sensitivity to an appreciation of the dollar ■ Rising US treasury yields, a sudden strengthening of the dollar and country-specific issues have triggered considerable portfolio outflows and a weakening of emerging currencies

Emerging markets have gone through rough times in the past four months. This is quite a change from last year when, as reported by the BIS, there was an unprecedented 22% increase in debt issuance in USD.

Since 2013, debt in USD contracted by emerging market issuers, in particular corporates, has risen considerably so as to benefit from low US rates but at the risk of creating problems further down the road if the dollar were to rise. This is exactly was has happened as of late and the sudden strengthening of the dollar (as shown by the rise of the orange line) has become the proverbial straw that broke the camel's back. Interestingly, rising US treasury yields as of the fall of 2017 initially did not cause a spread widening (black line). Sentiment started to deteriorate when market volatility in general picked up in February. More recently, the combination of dollar strength, rising US yields, concern about trade wars and specific issues in several countries (Turkey, election uncertainty in Brazil and Mexico, Russia, Argentina) created a kind of perfect storm, including contagion effects to other emerging countries. However it is worth emphasizing that the emerging corporate bond spread is still below the level reached after the taper tantrum in May 2013 when Ben Bernanke mentioned that at some point QE would need to be scaled back. The 2013 experience also reminds us that after a number of months, things calmed down. Whether history will repeat itself will depend on five factors: 1) US rates. Our base scenario of 3 more hikes this year and one in 2019 is benign because it would limit the rise in US treasury yields and sustain investor appetite for carry strategies such as emerging debt; 2) The dollar. We expect a renewed weakening of the dollar versus the euro, which should be beneficial for emerging currencies and will alleviate the debt burden of USD-indebted countries; 3) A weaker dollar should support commodity prices which is good news for commodity exporters (though the net gain may be negative); 4) The growth environment in emerging markets (although the PMIs in general have softened a bit, certain countries did see an improvement recently); 5) Policy credibility in individual emerging markets (sustainability of public finances, central bank autonomy). Based on these points one would expect that calm will return.

EMERGING MARKET DEBT AND CURRENCIES



Source: Thomson Reuters, BNP Paribas

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ECONOMIC RESEARCH DEPARTMENT

The bank for a changing world

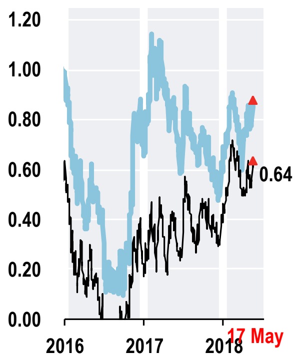
Markets overview

The essentials

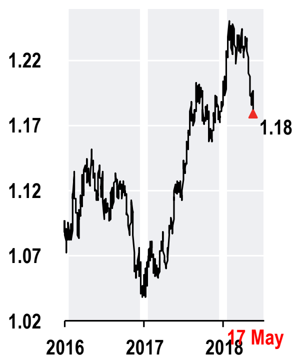
Week 11-5 18 > 17-5-18

↗ **CAC 40**	5 542	▸	**5 622**	**+1.4**	%
↘ **S&P 500**	2 728	▸	**2 720**	**-0.3**	%
↗ Volatility (VIX)	12.7	▸	13.4	+0.8	pb
↗ **Euribor 3M** (%)	-0.33	▸	**-0.33**	**+0.1**	bp
↘ Libor $ 3M (%)	2.34	▸	2.33	-1.7	bp
↗ OAT 10y (%)	0.79	▸	0.88	+8.7	bp
↗ Bund 10y (%)	0.56	▸	0.64	+7.6	bp
↗ US Tr. 10y (%)	2.98	▸	3.13	+14.3	bp
↘ **Euro vs dollar**	1.19	▸	**1.18**	**-1.3**	%
↘ Gold (ounce, $)	1 321	▸	1 288	-2.5	%
↗ **Oil (Brent, $)**	77.5	▸	**80.5**	**+3.9**	%

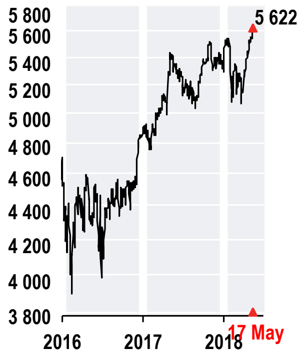
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

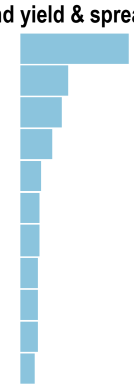
Interest Rates		highest' 18			lowest' 18		
€ ECB	**0.00**	0.00	at	01/01	0.00	at	01/01
Eonia	**-0.37**	-0.35	at	01/01	-0.37	at	02/01
Euribor 3M	**-0.33**	-0.33	at	10/05	-0.33	at	01/01
Euribor 12M	**-0.19**	-0.19	at	01/01	-0.19	at	19/02
$ FED	**1.75**	1.75	at	22/03	1.50	at	01/01
Libor 3M	**2.33**	2.37	at	04/05	1.69	at	01/01
Libor 12M	**2.76**	2.78	at	27/04	2.11	at	01/01
£ BoE	**0.50**	0.50	at	01/01	0.50	at	01/01
Libor 3M	**0.63**	0.79	at	19/04	0.52	at	04/01
Libor 12M	**0.93**	1.06	at	17/04	0.76	at	03/01

At 17-5-18

Yield (%)		highest' 18			lowest' 18		
€ AVG 5-7y	**0.57**	0.66	at	15/02	0.41	at	18/04
Bund 2y	**-0.57**	-0.55	at	07/03	-0.66	at	01/01
Bund 10y	**0.64**	0.72	at	15/02	0.42	at	01/01
OAT 10y	**0.88**	0.91	at	08/02	0.60	at	30/03
Corp. BBB	**1.56**	1.56	at	17/05	1.17	at	08/01
$ Treas. 2y	**2.57**	2.59	at	16/05	1.89	at	01/01
Treas. 10y	**3.13**	3.13	at	17/05	2.41	at	01/01
Corp. BBB	**4.42**	4.42	at	17/05	3.59	at	01/01
£ Treas. 2y	**0.77**	0.85	at	21/03	0.40	at	01/01
Treas. 10y	**1.60**	1.67	at	15/02	1.23	at	01/01

At 17-5-18

10y bond yield & spreads



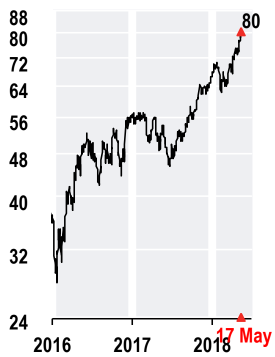
4.74%	Greece	410 pb
2.11%	Italy	147 pb
1.80%	Portugal	116 pb
1.41%	Spain	77 pb
0.91%	Belgium	27 pb
0.88%	France	24 pb
0.87%	Austria	23 pb
0.78%	Netherlands	13 pb
0.76%	Ireland	12 pb
0.75%	Finland	11 pb
0.64%	Germany	

Commodities

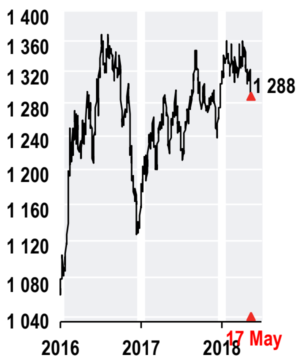
Spot price in dollars		lowest' 18			2018(€)
Oil, Brent	**80.5**	62.2	at	13/02	**+23.1%**
Gold (ounce)	**1 288**	1 288	at	17/05	**+0.7%**
Metals, LMEX	**3 346**	3 184	at	26/03	**-0.3%**
Copper (ton)	**6 857**	6 556	at	26/03	**-3.1%**
CRB Foods	**354**	335	at	04/04	**+7.2%**
wheat (ton)	**181**	155	at	16/01	**+16.2%**
Corn (ton)	**144**	126	at	08/01	**+15.4%**

At 17-5-18 *Variations*

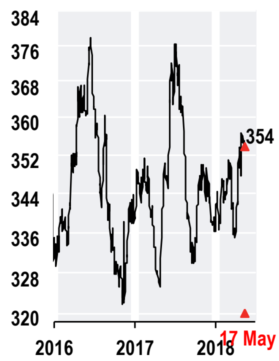
Oil (Brent, $)



Gold (Ounce, $)



CRB Foods



Exchange Rates

1€ =		highest' 18			lowest' 18			2018
USD	**1.18**	1.25	at	25/01	1.18	at	16/05	**-1.8%**
GBP	**0.87**	0.89	at	02/03	0.86	at	17/04	-1.6%
CHF	**1.18**	1.20	at	19/04	1.15	at	27/02	+1.0%
JPY	**130.68**	137.29	at	02/02	129.50	at	08/05	-3.4%
AUD	**1.57**	1.61	at	26/03	1.53	at	09/01	+2.2%
CNY	**7.51**	7.92	at	25/01	7.51	at	16/05	-4.0%
BRL	**4.35**	4.36	at	15/05	3.87	at	08/01	+9.1%
RUB	**72.92**	79.12	at	11/04	68.06	at	09/01	+5.5%
INR	**79.83**	81.39	at	25/04	75.92	at	08/01	+4.2%

At 17-5-18 *Variations*

Equity indices

	Index	highest' 18			lowest' 18			2018	2018(€)
CAC 40	**5 622**	5 622	at	17/05	5 066	at	26/03	+5.8%	**+5.8%**
S&P500	**2 720**	2 873	at	26/01	2 581	at	08/02	+1.7%	**+3.6%**
DAX	**13 115**	13 560	at	23/01	11 787	at	26/03	+1.5%	**+1.5%**
Nikkei	**22 838**	24 124	at	23/01	20 618	at	23/03	+0.3%	**+3.8%**
China*	**93**	101	at	26/01	88	at	09/02	+5.1%	**+6.7%**
India*	**567**	642	at	29/01	563	at	23/03	-1.5%	**-5.5%**
Brazil*	**1 988**	2 393	at	26/01	1 988	at	17/05	+9.2%	**+0.1%**
Russia*	**627**	707	at	26/02	571	at	16/04	+10.4%	**+5.6%**

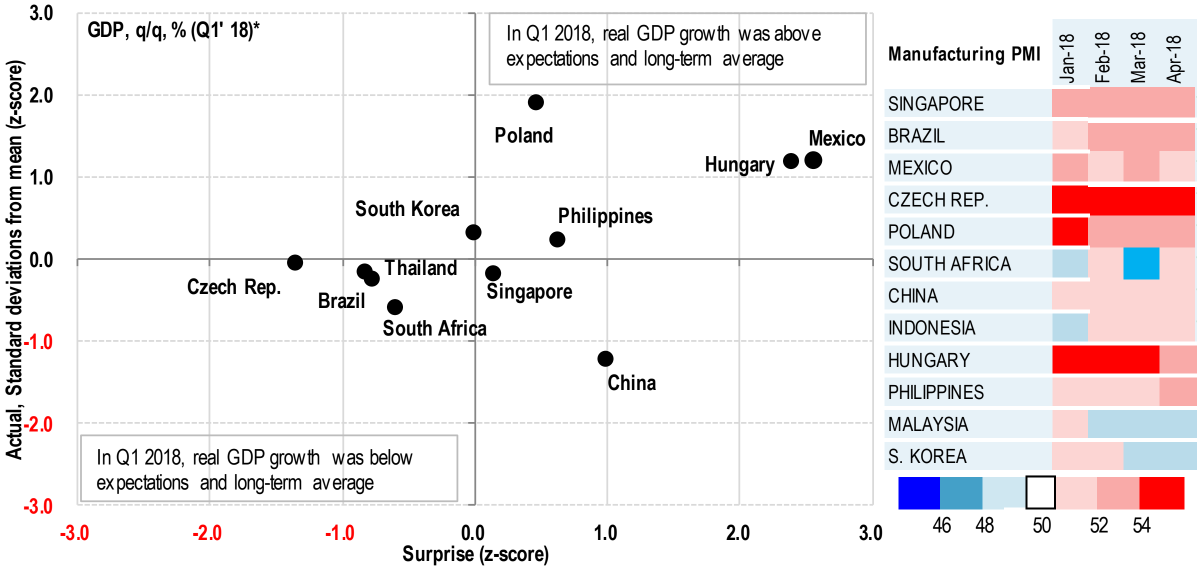
At 17-5-18 *Variations*

* MSCI index

Pulse

Mexico: A good start to the year

Preliminary data for Mexico's growth in 1Q 2018 surprised to the upside, with real GDP expanding 1.1% q/q, the highest level since 3Q 2016. It was driven by the good performance of services and a pick-up in industrial production supported by a recovery in the construction sector. Nonetheless, on a yearly basis GDP growth has maintained its downward trend over the past year (+1.2% in Q1).



* Except: Brazil, Singapore, Thailand, South Africa

Note: z-score is a score which indicates how many standard deviations an observation is from the mean: z=(x-μ)/σ where x: observation, μ: mean, σ: standard deviation. On the X-axis, x corresponds at the last known surprise for each indictor represented on the graph, μ and σ corresponds respectively to the mean and the standard deviation of the last 24 value for monthly data and the last 8 quarters for quarterly data. On the Y-axis, x corresponds at the last known value of indicator, μ and σ corresponds respectively to the mean and the standard deviation for this indicator since 2000 (for China since 2011).

Indicators preview

An important week ahead of us: Markit PMIs in several countries; consumer confidence for the eurozone, France, Germany, the US; IFO business climate in Germany, business confidence in France. These data will allow a first assessment of the cyclical momentum for the month of May so as to check whether the softening of sentiment indicators in previous months continues. From that perspective the updated OECD forecasts for the eurozone will also be interesting. Given the recent rise in US bond yields, markets will pay particular attention to the FOMC minutes.

Date	Country	Event	Period
05/23/18	France	Markit France Manufacturing PMI	May
05/23/18	France	Markit France Composite PMI	May
05/23/18	Eurozone	Markit Eurozone Manufacturing PMI	May
05/23/18	Eurozone	Markit Eurozone Composite PMI	May
05/23/18	United Kingdom	Retail Price Index	April
05/23/18	United States	New Home Sales	April
05/23/18	Eurozone	Consumer Confidence	May
05/23/18	United States	FOMC Meeting Minutes	May 2
05/24/18	Germany	GDP SA QoQ	1Q
05/24/18	Germany	GfK Consumer Confidence	June
05/24/18	France	Business Confidence	May
05/24/18	United Kingdom	Retail Sales Ex Auto Fuel MoM	April
05/25/18	France	Consumer Confidence	May
05/25/18	Germany	IFO Business Climate	May
05/25/18	United Kingdom	GDP QoQ	1Q
05/25/18	United States	Cap Goods Orders Nondef Ex Air	April
05/25/18	United States	U. of Mich. Sentiment	May
05/25/18-06/06/18	Eurozone	OECD Economic Forecasts	

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**	**2.6**	**1.9**	**1.8**	**1.9**	**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	0.9	0.9
United-Kingdom	1.8	1.5	1.8	2.7	2.6	2.1
Euro Area	**2.5**	**2.6**	**2.1**	**1.5**	**1.7**	**1.7**
Germany	2.5	2.4	2.0	1.7	1.8	1.9
France	2.0	2.3	1.9	1.2	1.6	1.7
Italy	1.5	1.5	1.2	1.3	1.4	1.5
Spain	3.1	2.8	2.2	2.0	1.6	1.6
Netherlands	3.3	2.3	1.7	1.3	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	1.0	3.0	3.5	3.4	3.3	3.8
Russia	1.5	1.8	1.7	3.7	3.0	4.0

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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