

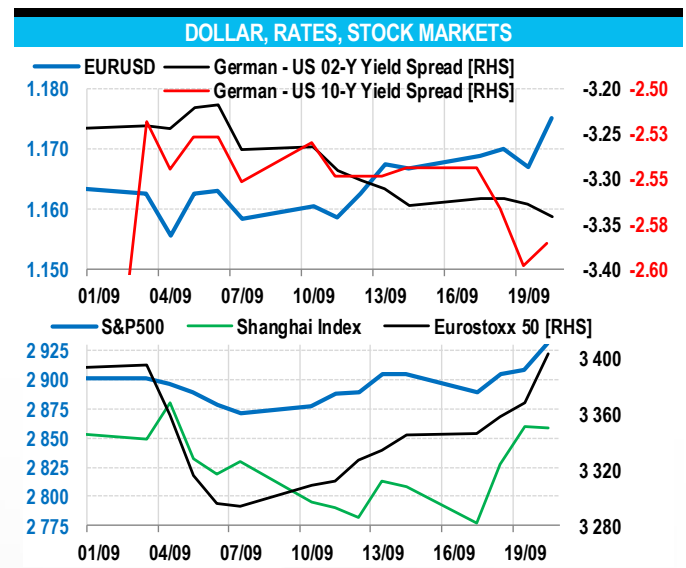
# ECOWEEK

No. 18-34, 21 September 2018

## Markets feeling better though nothing has changed

■ Judging by the recent developments in financial markets, investors feel more upbeat ■ On the economic front (growth and the outlook for monetary policy) nothing has really changed ■ The euro has benefitted from the 'risk-on' environment despite a widening interest rate differential with the US

Looking at the recent developments in equity markets it seems investors are feeling better. At first sight one wonders why. President Trump has announced that 10% tariffs would be imposed on USD 200 bn of Chinese imports. These could be increased further to 25% in the absence of a satisfactory outcome of the bilateral negotiations. China reacted promptly with tariffs targeting USD 60 bn of US imports. Surprisingly, the Shanghai stock market moved higher, a reflection that a lot of bad news was already priced in, as well as a sign of hope that in the end common sense will prevail and a deal will be reached. On the data front, the US economy continues to do very well and this has been a support for Wall Street. In recent weeks, the Federal Reserve Bank of Atlanta's nowcast, a real-time estimate for growth, has fluctuated between 3.8 and 5.0% annualised quarterly growth for the third quarter. Currently it is at 4.4%. Unsurprisingly, US treasury yields have increased, crossing the psychologically important 3.00% mark on the back of a higher term premium (the risk premium required by investors to buy long-dated paper), but also a higher likelihood (77.8% at the time of writing) that, at the December meeting of the FOMC, the federal funds rate would be raised again (markets are pricing in a 100% probability that at next week's meeting there will be a hike). In the eurozone on the other hand, the story is more about growth stabilisation after a slowdown in the first half. The Markit PMI composite indicator for September declined but only slightly so (54.2 versus 54.5 in August). The message from last week's ECB meeting didn't really change either. The difference in economic momentum has contributed to a widening of the interest rate differential between the US and Germany but this didn't stop the euro from strengthening against the dollar. This at first sight counterintuitive development is another illustration that investor risk appetite has picked up. One can expect that in due course the focus will shift back to sources of uncertainty like Brexit negotiations, US mid-term elections, the protectionist threat and the situation in certain emerging markets.



Source: Bloomberg, BNP Paribas.

William De Vijlder

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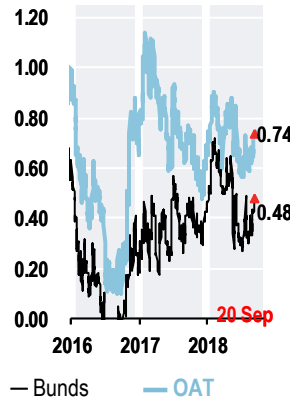
## Markets overview

### The essentials

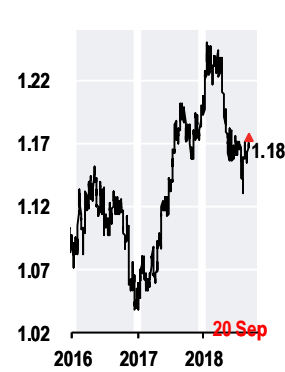
Week 14-9 18 > 20-9-18

↗ CAC 40	5 353	▶ 5 452	+1.8 %
↗ S&P 500	2 905	▶ 2 931	+0.9 %
↘ Volatility (VIX)	12.1	▶ 11.8	-0.3 pb
↗ Euribor 3M (%)	-0.32	▶ -0.32	+0.0 bp
↗ Libor \$ 3M (%)	2.34	▶ 2.35	+1.6 bp
↗ OAT 10y (%)	0.70	▶ 0.74	+3.3 bp
↗ Bund 10y (%)	0.45	▶ 0.48	+2.8 bp
↗ US Tr. 10y (%)	2.99	▶ 3.06	+7.0 bp
↗ Euro vs dollar	1.17	▶ 1.18	+0.7 %
↗ Gold (ounce, \$)	1 197	▶ 1 204	+0.6 %
↗ Oil (Brent, \$)	78.2	▶ 78.7	+0.7 %

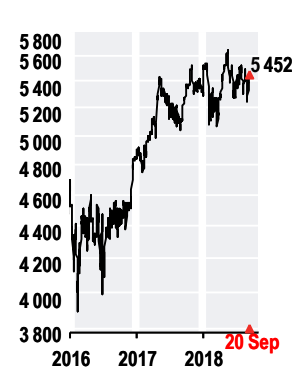
10 y bond yield, OAT vs Bund



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	-0.37 at 31/08	-0.37 at 18/05
Euribor 3M	-0.32 at 19/09	-0.33 at 01/01
Euribor 12M	-0.17 at 29/08	-0.19 at 19/02
\$ FED	2.00 at 14/06	1.50 at 01/01
Libor 3M	2.35 at 04/05	1.69 at 01/01
Libor 12M	2.89 at 19/09	2.11 at 01/01
£ BoE	0.75 at 02/08	0.50 at 01/01
Libor 3M	0.80 at 06/08	0.52 at 04/01
Libor 12M	1.06 at 02/08	0.76 at 03/01

At 20-9-18

Yield (%)	highest' 18	lowest' 18
€ AVG 5-7y	0.69 at 08/06	0.41 at 18/04
Bund 2y	-0.53 at 18/09	-0.79 at 29/05
Bund 10y	0.48 at 15/02	0.27 at 19/07
OAT 10y	0.74 at 08/02	0.57 at 13/07
Corp. BBB	1.68 at 05/09	1.17 at 08/01
\$ Treas. 2y	2.81 at 20/09	1.89 at 01/01
Treas. 10y	3.06 at 17/05	2.41 at 01/01
Corp. BBB	4.41 at 19/09	3.59 at 01/01
£ Treas. 2y	0.82 at 21/03	0.40 at 01/01
Treas. 10y	1.50 at 15/02	1.23 at 01/01

At 20-9-18

10y bond yield & spreads

4.63%	Greece	414 pb
2.71%	Italy	222 pb
1.88%	Portugal	140 pb
1.53%	Spain	105 pb
0.81%	Belgium	32 pb
0.74%	France	25 pb
0.67%	Austria	19 pb
0.67%	Ireland	18 pb
0.64%	Finland	16 pb
0.59%	Netherland	10 pb
0.48%	Germany	

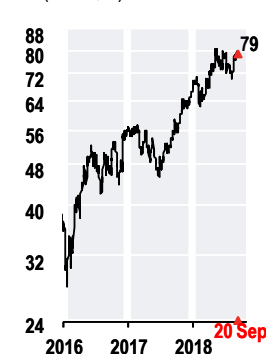
### Commodities

Spot price in dollars	lowest' 18	2018(€)
Oil, Brent	62.2 at 13/02	+20.8%
Gold (ounce)	1 179 at 17/08	-5.6%
Metals, LME	2 820 at 15/08	-12.7%
Copper (ton)	5 759 at 15/08	-13.9%
CRB Foods	316 at 30/08	+1.3%
wheat (ton)	155 at 16/01	+14.5%
Corn (ton)	115 at 18/09	-3.2%

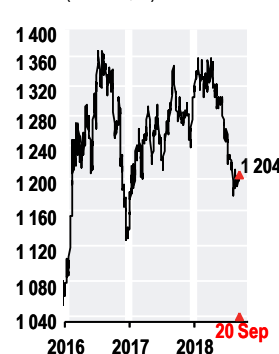
At 20-9-18

Variations

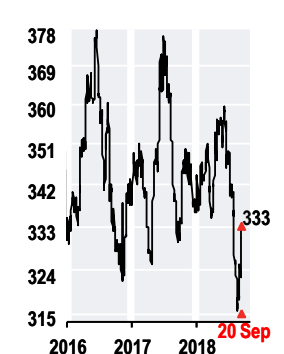
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



### Exchange Rates

€ =	highest' 18	lowest' 18	2018
USD	1.25 at 25/01	1.13 at 15/08	-2.1%
GBP	0.91 at 28/08	0.86 at 17/04	-0.1%
CHF	1.20 at 19/04	1.12 at 07/09	-3.5%
JPY	132.14 at 02/02	124.96 at 15/08	-2.3%
AUD	1.62 at 11/09	1.53 at 09/01	+5.2%
CNY	8.05 at 20/09	7.42 at 29/05	+3.0%
BRL	4.83 at 14/09	3.87 at 08/01	+21.3%
RUB	78.21 at 10/09	68.06 at 09/01	+13.1%
INR	85.23 at 20/09	75.92 at 08/01	+11.2%

At 20-9-18

Variations

### Equity indices

Index	highest' 18	lowest' 18	2018	2018(€)
CAC 40	5 640 at 22/05	5 066 at 26/03	+2.6%	+2.6%
S&P500	2 931 at 20/09	2 581 at 08/02	+9.6%	+12.0%
DAX	13 326 at 23/01	11 787 at 26/03	-4.6%	-4.6%
Nikkei	23 675 at 23/01	20 618 at 23/03	+4.0%	+6.5%
China*	78 at 26/01	74 at 12/09	-11.1%	-9.5%
India*	565 at 29/01	547 at 23/05	+5.0%	-5.6%
Brazil*	1 654 at 26/01	1 561 at 11/09	+1.3%	-16.5%
Russia*	600 at 26/02	551 at 23/08	+12.5%	+1.4%

At 20-9-18

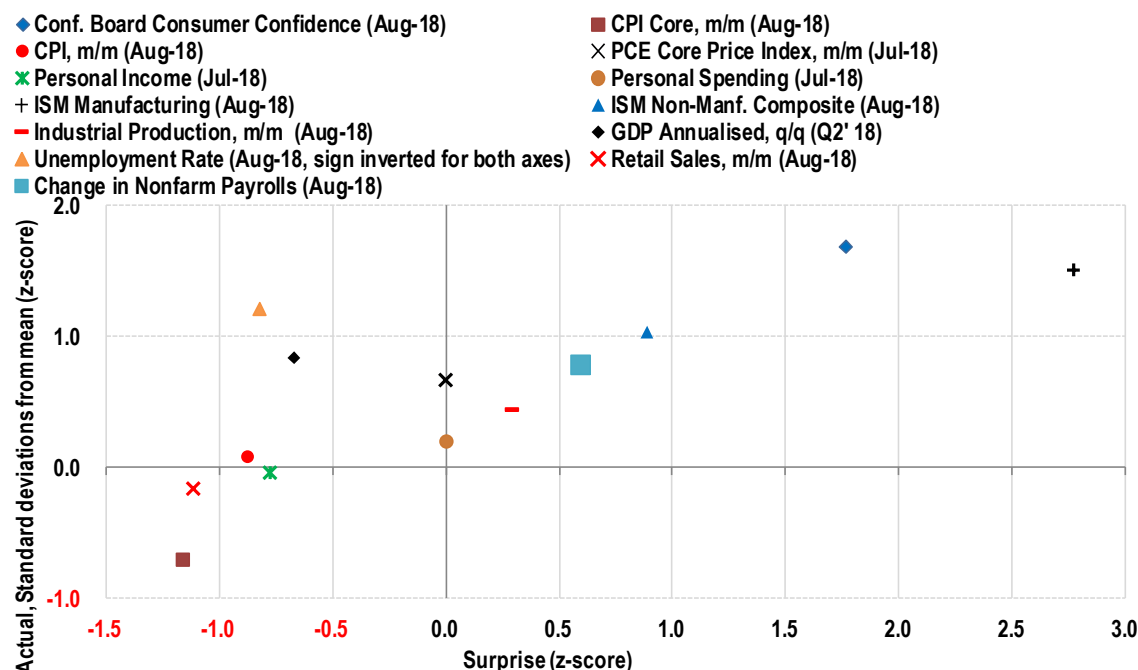
Variations

\* MSCI index

## Pulse

### US: strong data and inflation remains under control

With the notable exception of core inflation, all data are at or (well) above their long term average. In addition both ISM indices, consumer confidence and monthly payrolls have beaten expectations in August. It very much looks like a sweet spot. Sources of unease are the concern about the fall-out from import tariff increases and the risk that in view of supply constraints inflation might accelerate significantly after all, forcing the Fed to adopt a more aggressive stance.



Note: z-score is a score which indicates how many standard deviations an observation is from the mean:  $z=(x-\mu)/\sigma$  where  $x$ : observation,  $\mu$ : mean,  $\sigma$ : standard deviation. On the X-axis,  $x$  corresponds at the last known surprise for each indicator represented on the graph,  $\mu$  and  $\sigma$  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,  $\mu$  and  $\sigma$  corresponds respectively to the mean and the standard deviation for this indicator since 2000 (for China since 2011).

Source: Bloomberg, BNP Paribas

### Indicators preview

The highlight of next week is the meeting of the FOMC. In addition several data releases will improve our reading of the growth momentum in September. In Germany we have the IFO business climate index and consumer confidence. For France we have business confidence and consumer confidence. For the eurozone the important economic confidence index and its subseries will be published. In the US we have several regional indices as well as consumer and household confidence. Inflation data will be released for Germany and France.

Date	Country	Event	Period	Survey	Prior
09/24/18	Germany	IFO Business Climate	Sep	--	--
09/25/18	France	Business Confidence	Sep	--	--
09/25/18	United States	Conf. Board Consumer Confidence	Sep	--	--
09/26/18	France	Consumer Confidence	Sep	--	--
09/26/18	United States	FOMC Rate Decision (Upper Bound)	Sept-26	2.25%	2.00%
09/27/18	Germany	GfK Consumer Confidence	Oct	--	--
09/27/18	Eurozone	ECB Publishes Economic Bulletin			
09/27/18	Eurozone	Economic Confidence	Sep	--	--
09/27/18	Germany	CPI EU Harmonized MoM	Sep	--	--
09/27/18	United States	Durable Goods Orders	Aug	--	--
09/28/18	United Kingdom	GfK Consumer Confidence	Sep	--	--
09/28/18	France	CPI EU Harmonized MoM	Sep	--	--
09/28/18	United States	Personal Income	Aug	--	--
09/28/18	United States	Personal Spending	Aug	--	--
09/28/18	United States	U. of Mich. Sentiment	Sep	--	--

Source: Bloomberg, BNP Paribas



## Economic scenario

### UNITED STATES

- Economy is expected to expand at a 3% or so in 2018, thanks to tax cuts, booming profits and credit. However, the current weakening in external trade indexes puts the risk on the downside.
- Inflation is accelerating in the wake of higher oil prices and more evident tensions in the labour market.
- The Fed will keep on normalizing monetary conditions. We forecast the Fed Funds target rate to reach 2.75% in Q1 2019.

### CHINA

- Economic growth will decelerate in 2018-2019. The export outlook is significantly darkened by US protectionist measures. Private domestic demand should be affected by the worsening performance of the export manufacturing sector and the continued moderation in the property market.
- In order to contain the slowdown, the central bank has started to ease liquidity and credit conditions. At the same time, the reduction in financial instability risks should remain a top policy priority. Fiscal policy will also be expansionary and infrastructure spending is projected to rise.

### EUROZONE

- The recovery is continuing, although it has been weaker than expected at the start of the year. Intra-EU trade grows with domestic demand, especially corporate investment.
- Inflation has rebounded in the wake of higher oil prices, but the core CPI trend remains subdued. Along with renewed tensions over sovereign debt spreads (Italy) this argues for the ECB to maintain the status quo on the refinancing rate for a long period of time.

### FRANCE

- Growth slows down but remains above potential. Households' consumption should get a boost from the planned tax cuts and the jobs recovery but inflation reduces purchasing power gains. Business investment dynamics remain favourable. The global backdrop is less supportive. A slight rise in core 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 more rate hikes. We expect 2 more this year and 1 in the first half of 2019 after which the Fed will want to see how the economy reacts. As a consequence, US treasury yields should increase, although to a limited degree: the market expects that the tightening cycle is already well advanced. The ECB has announced it intends to stop its net asset purchases at the end of 2018. A first hike of the deposit rate is expected after the summer of 2019. As a consequence, bond yields should increase. 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
<b>Advanced</b>	<b>2.2</b>	<b>2.2</b>	<b>1.5</b>	<b>1.8</b>	<b>2.1</b>	<b>1.9</b>
United-States	2.2	2.8	1.8	2.1	2.5	2.1
Japan	1.7	0.9	0.6	0.5	1.0	1.0
United-Kingdom	1.7	1.3	1.6	2.7	2.4	2.1
<b>Euro Area</b>	<b>2.5</b>	<b>2.0</b>	<b>1.5</b>	<b>1.5</b>	<b>1.9</b>	<b>1.9</b>
Germany	2.5	1.9	1.6	1.7	1.9	2.1
France	2.3	1.7	1.6	1.2	2.2	1.8
Italy	1.6	1.2	1.0	1.3	1.5	1.9
Spain	3.1	2.7	2.0	2.0	1.8	1.8
Netherlands	3.0	2.3	1.7	1.3	1.7	1.8
<b>Emerging</b>	<b>5.9</b>	<b>5.8</b>	<b>5.8</b>	<b>2.4</b>	<b>2.9</b>	<b>2.8</b>
China	6.9	6.4	6.1	1.6	2.1	1.9
India	6.7	7.4	7.6	3.6	4.5	4.4
Brazil	1.0	1.5	3.0	3.4	3.7	3.7
Russia	1.5	1.8	1.6	3.7	2.6	3.5

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

### INTEREST RATES & FX RATES

Interest rates, %		2018	2019				2017	2018e	2019e
End of period		Q4e	Q1e	Q2e	Q3e	Q4e			
US	Fed Funds	2.50	2.75	2.75	2.75	2.75	1.50	2.50	2.75
	Libor 3m \$	2.36	2.80	2.85	2.65	2.55	1.69	2.36	2.55
	T-Notes 10y	3.10	3.15	3.20	3.10	3.00	2.41	3.10	3.00
Ezone	ECB Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Euribor 3m	-0.30	-0.30	-0.25	-0.20	-0.15	-0.33	-0.30	-0.15
	Bund 10y	0.75	0.85	1.00	1.10	1.20	0.42	0.75	1.20
	OAT 10y	1.00	1.10	1.25	1.35	1.45	0.66	1.00	1.45
UK	Base rate	0.75	0.75	1.00	1.00	1.25	0.50	0.75	1.25
	Gilts 10y	1.55	1.70	1.80	1.90	2.00	1.23	1.55	2.00
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.04	-0.10	-0.10
	JGB 10y	0.14	0.12	0.10	0.04	0.02	0.05	0.14	0.02

Exchange Rates		2019					2017	2018e	2019e
End of period		Q4e	Q1e	Q2e	Q3e	Q4e			
USD	EUR / USD	1.20	1.22	1.25	1.28	1.30	1.20	1.20	1.30
	USD / JPY	106	102	100	99	98	113	106	98
	GBP / USD	1.30	1.34	1.40	1.45	1.49	1.35	1.30	1.49
	USD / CHF	0.97	0.97	0.96	0.95	0.94	0.97	0.97	0.94
EUR	EUR / GBP	0.92	0.91	0.89	0.88	0.87	0.89	0.92	0.87
	EUR / CHF	1.16	1.18	1.20	1.22	1.22	1.17	1.16	1.22
	EUR / JPY	127	124	125	127	127	135	127	127

Source : GlobalMarkets (e: Estimates & forecasts)



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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](http://www.group.bnpparibas.com)  
Publisher: Jean Lemierre. Editor: William De Vijlder



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