

ECOWEEK

No. 19-33, 13 September 2019

ECB: Mario Draghi passes the baton

■ Market expectations were elevated but the Governing Council did not disappoint. The comprehensive nature of the package, with the introduction of state-dependent forward guidance, take away the need to envisage additional measures in the foreseeable future ■ ECB watching has been narrowed to monitoring the gap between inflation and the ECB target ■ Given certain negative side effects of the current monetary mix, which are acknowledged by the Governing Council, fiscal policy, where leeway is available, is now requested to step up to the plate, so as to foster growth and speed up convergence of inflation to target ■ The policy baton has been passed

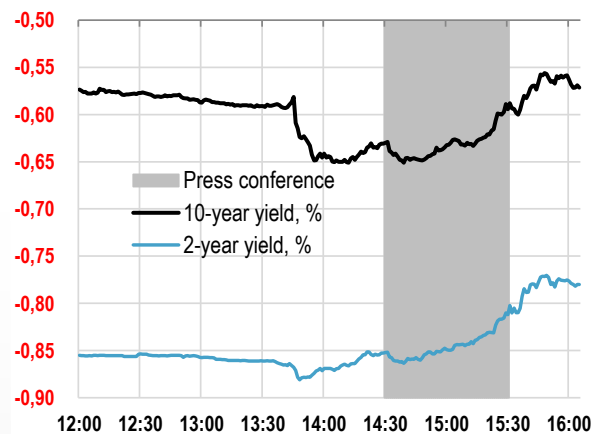
The next couple of years risk being boring for ECB watchers. The package of measures decided by the Governing Council on Thursday was very comprehensive and, hopefully, takes away the need to do more anytime soon. In addition, the forward guidance was particularly strong, both in terms of interest rate policy and as far as the asset purchase program is concerned. The latter will be resumed without an end date.

Whether this degree of monetary accommodation is maintained for some or a very long time depends on how inflation evolves. The hurdle is high: the inflation outlook needs to robustly converge to the ECB's target and this must be consistently reflected in the underlying inflation dynamics. Spikes, which are by definition short-lived don't pass the test. Given the sluggishness of the inflation process, meeting these requirements will take time, which makes it very likely that the current policy will remain in place for a long time. The fact that bond yields, after a dip following the press release, moved higher shouldn't be interpreted as an anticipation of monetary tightening, but is a reflection of a less negative term premium¹. This in turn would reflect that investors give some credence to the effectiveness of the package. This is indeed the key question in the coming months for markets, households, companies and indeed the ECB, because it will determine whether inflation expectations can re-anchor at a higher level. As emphasised by Mario Draghi during the press conference, these expectations didn't become unanchored, they re-anchored at too low a level compared to the ECB's inflation aim.

.../...

¹ The term premium is the risk premium which the investor receives when buying a bond of a given maturity rather than investing in short-dated government paper over the same period by constantly reinvesting as this paper matures. This premium is a reward for taking duration risk. However, this premium can be negative, as has been the case in the eurozone and the US for quite some time. The term premium should not be confused with the term spread, which corresponds to the difference between the yield on a long-term bond and a shorter-term bond (or the rate on short-dated government paper).

GERMAN BOND YIELDS, INTRADAY, 12 SEPTEMBER 2019



Source: Bloomberg, BNP Paribas

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ECONOMIC RESEARCH DEPARTMENT



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Theoretically, and given the current environment, some scepticism is warranted and this was discussed in earlier contributions². In addition, although the current policy should have positive effects in the aggregate, concern about the negative side effects is on the rise: overheated property markets in certain countries; negative rates impact pension funds and insurance companies; certain households may decide to save more and spend less considering that, when bond yields are low to negative, wealth accumulation depends on the amount of saving, rather than on the reinvestment of, what has become in yield terms, a meagre financial income.

The repeated insistence by the ECB President on side effects was one of the surprises of the press conference and shows monetary policy is approaching the end of the road. The other surprise was that he and his colleagues of the Governing Council are basically passing the baton to fiscal policy: *"There was unanimity that fiscal policy should become the main instrument to support growth"*, *"It's high time for fiscal policy to take charge"*, *"If fiscal policy is appropriate the monetary package will be effective more quickly"*.

In a way there is something tragic about it: as explained by the ECB president, monetary policy has played a crucial role in creating an environment leading to 11 million new jobs. It has also led to a solid increase in wage growth as the unemployment rate declined. The final step however hasn't really materialised: the transmission of faster wage growth into higher inflation has been interrupted because of the negative demand shock coming from China and international trade; tariff uncertainty; Brexit uncertainty. Fiscal policy is then requested to step in, at least in these countries which have leeway, that is fiscal space. We now have to see whether the call will be heard.

William De Vijlder

² Exogenous versus endogenous uncertainty and monetary policy (BNP Paribas, Ecoweek, 5 July 2019), Monetary easing at full employment: how effective? (BNP Paribas, Ecoweek, 12 July 2019)



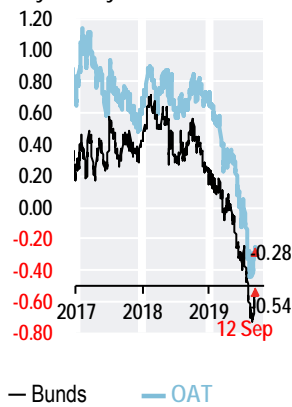
Markets overview

The essentials

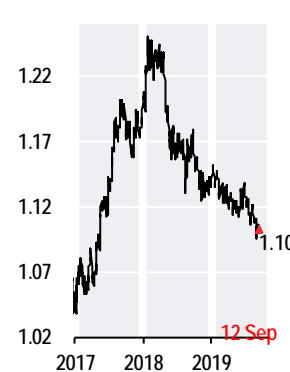
Week 6-9 19 > 12-9-19

➔ CAC 40	5 604	➔ 5 643	+0.7 %
➔ S&P 500	2 979	➔ 3 010	+1.0 %
➘ Volatility (VIX)	15.0	➔ 14.2	-0.8 pb
➔ Euribor 3M (%)	-0.44	➔ -0.43	+0.4 bp
➘ Libor \$ 3M (%)	2.13	➔ 2.13	-0.7 bp
➔ OAT 10y (%)	-0.34	➔ -0.28	+5.3 bp
➔ Bund 10y (%)	-0.63	➔ -0.54	+9.5 bp
➔ US Tr. 10y (%)	1.55	➔ 1.79	+24.1 bp
➘ Euro vs dollar	1.10	➔ 1.10	-0.2 %
➘ Gold (ounce, \$)	1 521	➔ 1 513	-0.5 %
➘ Oil (Brent, \$)	60.8	➔ 60.1	-1.1 %

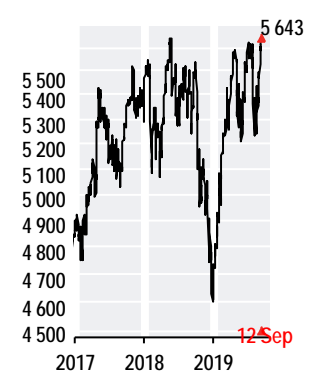
10y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

Interest Rates	highest' 19	lowest' 19
€ ECB	0.00 at 01/01	0.00 at 01/01
Eonia	-0.37 at 07/06	-0.38 at 19/06
Euribor 3M	-0.43 at 01/01	-0.45 at 03/09
Euribor 12M	-0.37 at 06/02	-0.40 at 21/08
\$ FED	2.25 at 01/01	2.25 at 01/08
Libor 3M	2.13 at 01/01	2.10 at 05/09
Libor 12M	2.01 at 21/01	1.89 at 05/09
£ BoE	0.75 at 01/01	0.75 at 01/01
Libor 3M	0.78 at 29/01	0.75 at 29/08
Libor 12M	0.93 at 11/01	0.81 at 03/09

At 12-9-19

Yield (%)	highest' 19	lowest' 19
€ AVG 5-7y	-0.26 at 09/01	-0.36 at 03/09
Bund 2y	-0.73 at 05/03	-0.92 at 02/09
Bund 10y	-0.54 at 01/01	-0.72 at 28/08
OAT 10y	-0.28 at 08/01	-0.44 at 28/08
Corp. BBB	0.78 at 08/01	0.64 at 30/08
\$ Treas. 2y	1.73 at 18/01	1.44 at 04/09
Treas. 10y	1.79 at 18/01	1.46 at 04/09
Corp. BBB	3.39 at 01/01	3.15 at 04/09
£ Treas. 2y	0.51 at 27/02	0.32 at 03/09
Treas. 10y	0.57 at 18/01	0.33 at 03/09

At 12-9-19

10y bond yield & spreads

2.00%	Greece	253 pb
0.85%	Italy	139 pb
0.23%	Portugal	76 pb
0.23%	Spain	76 pb
-0.19%	Belgium	34 pb
-0.24%	Ireland	29 pb
-0.25%	Finland	29 pb
-0.26%	Austria	28 pb
-0.28%	France	25 pb
-0.43%	Netherlands	11 pb
-0.54%	Germany	

Commodities

Spot price in dollars	lowest' 19	2019(€)
Oil, Brent	53.1 at 01/01	+17.3%
Gold (ounce)	1 268 at 02/05	+22.4%
Metals, LME	2 718 at 07/08	+4.9%
Copper (ton)	5 585 at 03/09	+1.1%
CRB Foods	312 at 11/09	-0.1%
wheat (ton)	166 at 30/08	-6.0%
Corn (ton)	128 at 24/04	+6.6%

At 12-9-19

Variations

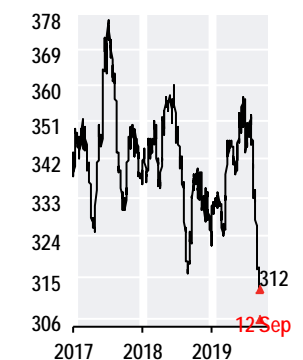
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

1€ =	highest' 19	lowest' 19	2019
USD	1.15 at 10/01	1.10 at 03/09	-3.5%
GBP	0.93 at 12/08	0.85 at 14/03	-0.3%
CHF	1.14 at 23/04	1.08 at 04/09	-3.0%
JPY	127.43 at 01/03	116.08 at 03/09	-5.1%
AUD	1.66 at 07/08	1.57 at 18/04	-1.2%
CNY	7.96 at 27/08	7.51 at 25/04	-0.4%
BRL	4.63 at 27/08	4.18 at 31/01	+0.9%
RUB	79.30 at 01/01	70.26 at 24/07	-9.7%
INR	82.00 at 04/02	76.37 at 01/08	-1.7%

At 12-9-19

Variations

Equity indices

Index	highest' 19	lowest' 19	2019	2019(€)
CAC 40	5 643 at 12/09	4 611 at 03/01	+19.3%	+19.3%
S&P500	3 010 at 26/07	2 448 at 03/01	+20.1%	+24.4%
DAX	12 630 at 04/07	10 417 at 03/01	+17.5%	+17.5%
Nikkei	21 760 at 25/04	19 562 at 04/01	+8.7%	+14.6%
China*	86 at 09/04	68 at 03/01	+11.0%	+14.9%
India*	544 at 03/06	526 at 22/08	-0.6%	+1.1%
Brazil*	2 157 at 10/07	1 862 at 17/05	+16.1%	+15.0%
Russia*	714 at 04/07	572 at 01/01	+17.8%	+29.4%

At 12-9-19

Variations

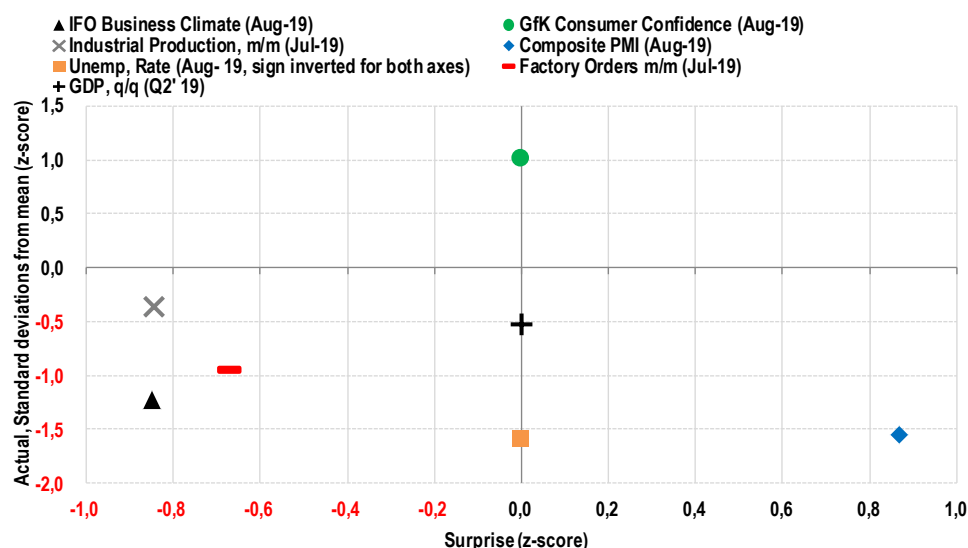
* MSCI index



Pulse

Germany: slowdown is spreading

Business cycle indicators mostly disappointed during the summer months and ended up below the already subdued expectations. In July, both industrial production and orders fell sharply. This could be partly attributed to the early start of the summer holidays. In that case, an opposite effect can be expected in August. More worrying was the more-than-expected decline of the IFO climate index in August, as business conditions in trade and services fell sharply. It is a sign that the deterioration of the business climate is not anymore confined to only manufacturing, something which has been emphasized by the Bundesbank. But this was contradicted in early September by the PMI composite. The indicator was actually stronger than expected, as services growth remained solid.



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, μ : mean, σ : standard deviation.

On the X-axis, x corresponds to the last known surprise for each indicator 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 to 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

The highlight of next week is the meeting of the FOMC (a rate cut is widely expected) although the meetings of the Bank of England and the Bank of Japan will also be important for the information they may provide on the assessment of the economic situation. In the US, several data will be released concerning the housing market and construction activity. This is of particular importance given the negative contribution of residential investment to GDP in recent quarters. The US index of leading indicators will be watched closely given the concern about slowing growth. In the eurozone, consumer confidence will be watched closely, in particular the unemployment expectations component.

Date	Country/Region	Event	Period	Survey	Prior
09/16/2019	United States	Empire Manufacturing	Sept.	2.0	4.8
09/17/2019	Germany	ZEW Survey Expectations	Sept.	--	-44.1
09/17/2019	Eurozone	ZEW Survey Expectations	Sept.	--	-43.6
09/17/2019	United States	Industrial Production MoM	Aug.	0.1%	-0.2%
09/17/2019	United States	Capacity Utilization	Aug.	77.6%	77.5%
09/17/2019	United States	NAHB Housing Market Index	Sept.	66	66
09/18/2019	Japan	Trade Balance	Aug.	--	-2.496e+11
09/18/2019	Eurozone	EU27 New Car Registrations	Aug.	--	-7.8%
09/18/2019	United Kingdom	CPI MoM	Aug.	--	0.0%
09/18/2019	Eurozone	CPI MoM	Aug.	--	-0.5%
09/18/2019	United States	MBA Mortgage Applications	Sept-13	--	--
09/18/2019	United States	Building Permits MoM	Aug.	-0.9%	8.4%
09/18/2019	United States	Housing Starts MoM	Aug.	5.0%	-4.0%
09/18/2019	United States	FOMC Rate Decision (Upper Bound)	Sept-18	2.00%	2.25%
09/19/2019	United Kingdom	Retail Sales Ex Auto Fuel MoM	Aug.	--	0.2%
09/19/2019	United Kingdom	Bank of England Bank Rate	Sept-19	--	0.750%
09/19/2019	United States	Philadelphia Fed Business Outlook	Sept.	--	16.8
09/19/2019	United States	Leading Index	Aug.	--	0.5%
09/19/2019	United States	Existing Home Sales MoM	Aug.	-0.9%	2.5%
09/19/2019	Japan	BOJ Policy Balance Rate	Sept-19	--	-0.100%
09/19/2019	United Kingdom	CBI Trends Total Orders	Sept.	--	-13
09/20/2019	France	Wages QoQ	2Q	--	0.5%
09/20/2019	Eurozone	Consumer Confidence	Sept.	--	-7.1

Source: Bloomberg, BNP Paribas



Economic scenario

UNITED STATES

- Growth is slowing and this trend is expected to continue under the influence of corporate investment (slower profits growth, uncertainty) and housing (declining trend of affordability). Consumer spending should be more resilient. The trade dispute with China acts as an additional drag. Inflation is expected to decline, due to softer growth and weaker oil prices.
- We expect two more Fed Funds target rate cuts of 25bp this year and two additional cuts in 2020.

CHINA

- Economic growth continues to slow and our GDP forecasts have been revised down since June. Industrial activity and exports have been hard hit by US tariff hikes. Domestic demand has also decelerated.
- The central bank is easing liquidity and credit conditions, though the reduction in financial-instability risks should remain a priority and banks seem to remain prudent. Fiscal policy is expansionary through increased infrastructure spending and a rising number of household/corporate tax cuts.
- In the short term, exports and private domestic investment should continue to decelerate. Tax measures should have some success in supporting consumer spending.

EUROZONE

- The economic slowdown is continuing in the eurozone, especially in Germany, due to notably international environment uncertainties and a slowdown of the Chinese economy. Activity in the manufacturing sector continues to decline but services still show resilience.
- Inflation is now expected to decrease while core CPI is hardly moving. The activity slowdown also implies that the pick-up in core inflation should be slower than expected until recently.
- Faced with an outlook of subdued inflation, the Governing Council has eased policy at its meeting on 12 September. This very accommodative environment will be maintained as long as inflation hasn't converged sufficiently, in a convincing and lasting way, towards the ECB's objective.

FRANCE

- Growth is slowing although the economy shows resilience. Households' consumption should get a boost from the 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, we expect the Fed to cut rates twice in the second semester in reaction to a slowing economy, subdued inflation and heightened uncertainty. 2020 should see two more cuts. Treasury yields are to decline further in the coming months. Eventually, in the course of 2020 they should move up again in anticipation of a pick-up in growth.
- In the eurozone, the ECB's state-dependent forward guidance and the sluggishness of the inflation process imply that the very accommodative environment will remain in place for a long time. This will exert downward pressure on bond yields.
- No policy rate change expected in Japan.
- With the Fed in easing mode and given the very accommodative ECB policy, we expect little change in EUR/USD even though euro's fair value is quite higher than current pricing. The yen should strengthen on the back of stable BoJ policy and high market volatility.

%	GDP Growth			Inflation		
	2018	2019 e	2020 e	2018	2019 e	2020 e
Advanced	2.2	1.6	1.0	2.1	1.4	1.3
United-States	2.9	2.2	1.5	2.4	1.8	1.8
Japan	0.8	1.2	0.2	1.0	0.6	0.3
United-Kingdom	1.4	1.1	0.6	2.5	1.9	1.8
Euro Area	1.9	1.1	0.7	1.8	1.1	0.8
Germany	1.4	0.4	0.2	1.9	1.4	1.0
France	1.7	1.2	1.0	2.1	1.2	1.0
Italy	0.7	0.1	0.0	1.2	0.6	0.5
Spain	2.6	2.2	1.6	1.7	0.8	0.7
Emerging	4.4	3.8	4.2	4.7	4.8	4.5
China	6.6	5.9	5.6	2.1	2.4	2.8
India*	6.8	6.5	6.3	2.9	3.0	3.3
Brazil	1.1	0.5	2.0	3.7	3.7	3.5
Russia	2.3	1.2	2.0	2.9	4.8	3.8

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

* Fiscal year from April 1st of year n to March 31st of year n+1

Interest rates, %	2019				2018	2019e	2020e
	Q1	Q2	Q3e	Q4e			
US							
Fed Funds	2.50	2.50	2.00	1.75	2.50	1.75	1.25
Libor 3m \$	2.60	2.32	1.90	1.70	2.81	1.70	1.25
T-Notes 10y	2.42	2.00	1.35	1.00	2.69	1.00	1.50
Ezone							
Deposit rate (%)	-0.40	-0.40	-0.50	-0.60	-0.40	-0.60	-0.60
Bund 10y	-0.07	-0.32	-0.50	-0.80	0.25	-0.80	-0.50
OAT 10y	0.26	-0.01	-0.20	-0.55	0.71	-0.55	-0.30
UK							
Base rate	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Gilts 10y	1.00	0.84	0.75	0.55	1.27	0.55	0.75
Japan							
BoJ Rate	-0.06	-0.08	-0.10	-0.10	-0.07	-0.10	-0.10
JGB 10y	-0.09	-0.16	-0.30	-0.40	0.00	-0.40	-0.25

Source : BNP Paribas GlobalMarkets (e: Forecasts)

Exchange Rates	2019				2018	2019e	2020e
	Q1	Q2	Q3e	Q4e			
USD							
EUR / USD	1.12	1.14	1.10	1.11	1.14	1.11	1.14
USD / JPY	111	108	105	102	110	102	96
GBP / USD	1.30	1.27	1.20	1.23	1.27	1.23	1.36
USD / CHF	1.00	0.98	0.99	0.99	0.99	0.99	1.00
EUR							
EUR / GBP	0.85	0.89	0.92	0.90	0.90	0.90	0.84
EUR / CHF	1.12	1.11	1.09	1.10	1.13	1.10	1.14
EUR / JPY	124	123	116	113	125	113	109

Source : BNP Paribas GlobalMarkets (e: Forecasts)



GROUP ECONOMIC RESEARCH

William De Vijlder
Chief Economist

+33 1 55 77 47 31 william.devijlder@bnpparibas.com

ADVANCED ECONOMIES AND STATISTICS

Jean-Luc Proutat

Head – United States, United Kingdom

+33 1 58 16 73 32 jeanluc.proutat@bnpparibas.com

Hélène Baudchon

France – Labour markets

+33 1 58 16 03 63 helene.baudchon@bnpparibas.com

Louis Boisset

European Central Bank watch, Euro area global view, Japan

+33 1 57 43 02 91 louis.boisset@bnpparibas.com

Frédérique Cerisier

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

+33 1 43 16 95 52 frederique.cerisier@bnpparibas.com

Catherine Stephan

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

+33 1 55 77 71 89 catherine.stephan@bnpparibas.com

Raymond Van Der Putten

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

+33 1 42 98 53 99 raymond.vanderputten@bnpparibas.com

Tarik Rharrab

Statistics

+33 1 43 16 95 56 tarik.rharrab@bnpparibas.com

BANKING ECONOMICS

Laurent Quignon

Head

+33 1 42 98 56 54 laurent.quignon@bnpparibas.com

Laure Baquero

+ 33 1 43 16 95 50 laure.baquero@bnpparibas.com

Céline Choulet

+33 1 43 16 95 54 celine.choulet@bnpparibas.com

Thomas Humblot

+ 33 1 40 14 30 77 thomas.humblot@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

François Faure

Head

+33 1 42 98 79 82 francois.faure@bnpparibas.com

Christine Peltier

Deputy Head – Greater China, Vietnam, South Africa

+33 1 42 98 56 27 christine.peltier@bnpparibas.com

Stéphane Alby

Africa (French-speaking countries)

+33 1 42 98 02 04 stephane.alby@bnpparibas.com

Sylvain Bellefontaine

Turkey, Ukraine, Central European countries

+33 1 42 98 26 77 sylvain.bellefontaine@bnpparibas.com

Sara Confalonieri

Africa (Portuguese & English-speaking countries)

+33 1 42 98 43 86 sara.confalonieri@bnpparibas.com

Pascal Devaux

Middle East, Balkan countries

+33 1 43 16 95 51 pascal.devaux@bnpparibas.com

Hélène Drouot

Korea, Thailand, Philippines, Mexico, Andean countries

+33 1 42 98 33 00 helene.drouot@bnpparibas.com

Salim Hammad

Latin America

+33 1 42 98 74 26 salim.hammad@bnpparibas.com

Johanna Melka

India, South Asia, Russia, Kazakhstan, CIS

+33 1 58 16 05 84 johanna.melka@bnpparibas.com

CONTACT MEDIA

Michel Bernardini

+33 1 42 98 05 71 michel.bernardini@bnpparibas.com



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