Summary of macroeconomic forecasts

- In the US, economy, especially in the manufacturing sector, has shown some signs of weakness recently, prompting the US Federal Reserve to cut rates “preventively.” The materialization of US “trade war” through tariffs increases on worth $300bn of imports is likely to weigh on firms profitability, then activity. The inverted yields curve is a bearish signal. It could be followed by sizeable downward adjustments in highly leveraged sectors such as energy and IT. As a consequence, the monetary policy would continue to ease.

- The Euro area, growth is sharply decelerating, with some countries like Italy and Germany now close to recession. Extra EU trade is less dynamic, in line with fading external demand, in particular coming from EMEs. Inflation is expected to come-back near the 1pct level, as a consequence of falling oil prices. The ECB has consequently restarted its Asset Purchases Program (APP) and plan to buy EUR20bn per month (net) over an indefinite period of time. The deposit rate was cut to -0.5%, could reach -0.6% by year-end.

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Source: BNP Paribas Group Economic Research (e: Estimates & forecasts,)
Summary of financial forecasts

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Exchange Rates

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</table>

Source: BNPP GlobalMarkets (e: Estimates & forecasts)
The business climate is now deteriorating, in a context of weakening demand for manufactured products.

The number of drillings is now peaking, at a time when US oil production matches all times high.

The NAHB index is down from peak

First signs of peaking. Inventories are up in month of sales.
United States

13 US, non-farm payrolls vs unemployment rate

- Nonfarm payrolls, monthly change, x1000 [LHS]
- Unemployment rate [RHS]

The US unemployment rate stands at 3.6%/3.7%, an historical low. But nonfarm payrolls are less dynamic.

14 US, labour force participation rate

- Participation rate
  - 20-64 aged population

The participation rate among the working age population (20-64 year) has reverted upward.

15 US, muted tensions over prices

- CPI Headline, yy
- CPI Core, yy
- CPI Energy, yy [RHS]

Energy prices are down. Core inflation stable.

16 US, some (limited) tensions over wages

- XAxis: Unemployment rate
- YAxis: Employment Cost Index, yy
- R² = 0.69

Wage costs have increased in the wake of low unemployment rate, but not as such as a traditional Phillips Curve would have suggested.

17 US, credit to corporates keeps healthy

- Credit to corporate*, net flows, an $bn [LHS]
- Banks tightening credit, % [RHS]

* Bonds and loans

Still healthy.

18 US, profits and investment cycles

- Corporate Fixed investment, % of GVA [RHS]
- Corporate Profits after tax, % GVA [LHS]

Profits and investment cycles are peaking
A cause for future concern? US companies are in debt again, while their profitability is peaking, a configuration that has often preceded recessions.

Corporate spreads have become sensitive to oil prices in the US. One explanation is the size of the highly-leveraged shale oil sector.

The Fed funds rate has ticked upwards, coming close to the core inflation level.

The yields curve is now inverted, a bearish signal for economy.

Looking at the real effective exchange rate (trade weighted & adjusted for inflation), the dollar looks to be on the expensive side.

Tariffs increases did not help to curb external deficits, which have tend to widen recently.
EcoCharts // September 19
economic-research.bnpparibas.com

China

25. **China, various activity indicators**

- GDP, yy
- Electr. Output, yy
- Industrial Output

Electricity and industrial output both consistent with a slowdown in GDP, currently expanding at a less than 6% annual path.

26. **China, change in growth determinants**

- US Households Debt Ratio, % GDI [LHS]
- China, Exports, % GDP [RHS]

Bent on deleveraging, US consumers are importing less from China.

27. **China, investment has come down**

- Fixed investment, % GDP
- Private consumption, % GDP

Consumption is still relatively low in terms of GDP (less than 40%)

28. **China, credit**

Credit outstanding as % of GDP

China has the highest internal debt ratio of the emerging countries.

29. **China, trade surpluses remain large**

Trade balance (% GDP)

External surpluses are still huge, even though they have narrowed somewhat since mid-2016 (rebound in oil prices).

30. **China, leading the Commodity cycle**

- Cement output in China, yy [LHS]
- CRB World Commodity Prices Index, yy [RHS]

The Chinese cement industry seems to edge back toward recession, which has negative implication for commodity markets.
Euro Area

Although growth has accelerated, it still lags behind the US.

Surveys show big discrepancy between manufacturing and services.

Deep recession in the manufacturing area.

Lean against the wind, as a major service-oriented economy. Early 19’ tax cuts are also helping.

After having returned to cyclical peaks (more than 400K annual starts) the housing activity in France is set to normalize.

August data distorted by inventories adjustments. The market has probably passed its peak.
Euro Area

37 Italy, GDP growth vs business surveys

38 Spain, GDP growth vs business surveys

39 Euro area, fixed investment vs cap. utilization rate

40 Euro area, corporate fixed investment vs profits

41 France, fixed investment vs corporate profit

42 France, fixed investment vs corporate debt

In recession territory…

Still good, albeit losing some momentum

Higher capacity utilisation rates…

… and upward profit margins have triggered an upturn in corporate investment. Now peaking?

Investment in France has been rather resilient compared to other countries, and despite various trends in corporate profits. Early 19 surge is due to the transformation of CICE into tax cut.

Credit has been a support factor for investment in France.
The French corporate debt has surged over the past decade. However, this is largely due to big companies, which are also cash rich. The net debt ratio is not so high.

Corporate investment revives in keeping with profit margins, but not at the same pace across the board.

At a record high.

The ECB bank lending surveys are improving as lending standards return to normal. Corporate credit has slowly recovered since 2015.

Credit to corporates (under 1 year and EUR 1mn) is stable in Spain.
Euro area, financing conditions have improved

The convergence of lending rates signals a reduction in fragmentation.

Euro area, consumer credit

Consumer credit is firmly back in positive territory.

Euro area, base money surge with the QE

The ECB's TLTRO programme temporarily inflated the money base (bank holdings with the ECB), then growing with QE.

Euro area, M3 growth vs core inflation

M3 growth is decelerating.

Euro area, inflation still subdued

The core inflation rate is trending around 1% per year. The fluctuation in headline figure is mainly caused by energy.

Euro Area, ECB “refi” rate vs determinants

The refi has held at 0.0% since March 16, 2016, while the deposit facility rate (DFR) is negative at -0.40%. The decline in UR normally calls for normalisation, but not this time…
Markets

**Italian 10 year rates**

- Italy, 10y Government Bond Yield
- Italy, 2y Government Bond Yield

Rebounding, amid political uncertainties.

**Spanish 10 year rates**

- Spain, 10y Government Bond Yield
- Spain, 2y Government Bond Yield

Still relatively low.

**France, over several maturities**

France, Government Bond Yields

- 10y
- 5y
- 2y

Still very low by historical standard, at all maturities.

**Euro-dollar**

- Euro vs Dollar, 2017=100
- Euro Nominal Effective Exchange rate, 2017=100

Correcting from the 2017’ rebound.

**Euro-dollar vs capital flows**

- EUR vs USD [RHS]
  - Direct & Portfolio Investments to/from (+/-) EMU, EURbn

Capital outflows from the EMU (direct and portfolio investments) have stopped, replaced by net inflows (Brexit effect?). Correlation with EURUSD is lost.

**Euro-dollar vs ECB’s balance sheet**

- ECB’s Balance Sheet, Total Assets, EURbn [LHS]
- Euro vs Dollar

Lower range of fluctuation after QE.
Markets & public finances

Earnings per share are now far above their long-term trend.

Correcting at the turn of the year.

Based on trend EPS, the market valuation looks rather expensive

... with some details (European Commission estimates)

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Internet : www.group.bnpparibas.com - www.economic-research.bnpparibas.com
Publisher: Jean Lemierre
Editor : William De Vijlder

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