



ECONOMIC RESEARCH DEPARTMENT

Summary

Global

Updated economic forecasts: The challenge of 2017

Upward revision of the growth outlook for 2016 in the Euro area and emerging markets, downward revision in the US. Major challenges for 2017 are Federal Reserve policy and the impact of the already observed increase in oil prices.

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Eurozone

A reverse snowball effect

With the exception of Greece and Portugal, all Eurozone member states can issue long-term bonds at lower interest rates than their nominal trend growth rates.

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Also in :



France: a series of upbeat figures

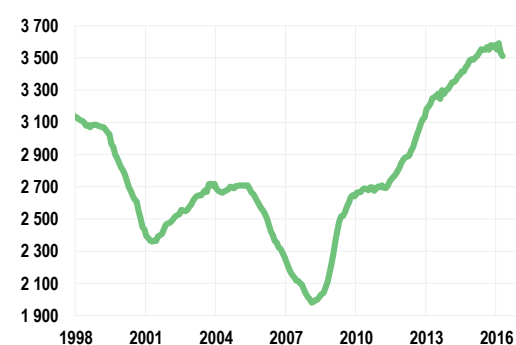
■ Business climate improves ■ Household confidence picks up ■ Another decline in the number of jobseekers

French economic indicators released this week are upbeat. The INSEE's composite business climate index rose another point in May to 102, slightly above its benchmark average of 100. The cyclical environment has moved from uncertain to favourable according to the turnaround indicator. At this level, business confidence is consistent with a quarterly growth rate of about 0.4%. The driving forces behind this improvement are the services and retail trade sectors. The construction index is stable while industry shed 1 point to 104, although this follows on April's 3-point gain.

Household confidence also picked up in May, with an unusually strong increase in the INSEE composite (+4 points to 98), which brings it to the highest level since October 2007. This improvement reflects a significantly less pessimistic assessment of past and future living standards in France, and a sharp decline in unemployment fears. These dwindling fears are backed by the latest statistics from the French Employment Agency for April. For the first time since early 2011, the number of category A jobseekers (those who have not worked for the past month) declined two months in a row. And for the first time since September 2008, this same number of jobseekers is slightly down in year-on-year terms (-0.6%). Although the signs of improvement in France's economic situation are still mild and fragile, they are nonetheless very real.

INVERSION?

— Number of category A jobseekers, Metropolitan France, '000s



Source: Pôle emploi

THE WEEK ON THE MARKETS

Week 20-5 16 > 26-5-16

➤ CAC 40	4 354	➤ 4 513	+3.6 %
➤ S&P 500	2 052	➤ 2 090	+1.8 %
➤ Volatility (VIX)	15.2	➤ 13.4	-1.8 %
➤ Euribor 3M (%)	-0.26	➤ -0.26	+0.0 bp
➤ Libor \$ 3M (%)	0.66	➤ 0.67	+0.5 bp
➤ OAT 10y (%)	0.51	➤ 0.48	-2.7 bp
➤ Bund 10y (%)	0.17	➤ 0.14	-2.8 bp
➤ US Tr. 10y (%)	1.85	➤ 1.82	-2.6 bp
➤ Euro vs dollar	1.12	➤ 1.12	-0.3 %
➤ Gold (ounce, \$)	1 253	➤ 1 223	-2.4 %
➤ Oil (Brent, \$)	49.0	➤ 49.9	+2.0 %

Source: Thomson Reuters



Global

Updated economic forecasts: The challenge of 2017

- 2016 sees upward revisions to our GDP growth in the Eurozone and in emerging and developing economies. Downward revision in the US.
- Slight downward revision to the growth forecasts for the Eurozone in 2017. Upward revisions in emerging economies.
- Our US growth outlook, in particular for 2017, is lower than the consensus forecasts.

Our latest quarterly update of the outlook for the world economy has taken place against the background of significant change in key macro variables since the start of the year. Oil prices have rebounded very significantly after reaching a trough around mid-January and this has had a positive impact on emerging markets as well as on risk appetite of financial market investors. The stimulus efforts in China have brought relief after the nervousness in the second part of last year. They have caused an improvement in the economic data as well as a better sentiment in commodity markets and towards developing economies. The ECB has stepped up its effort to boost inflation, notably by extending the scope of its asset purchase programme. The Federal Reserve on the other hand has adopted a cautious stance. Its policy has been on hold though recent statements have shown an eagerness to proceed with a new tightening if the data allow. Finally, the Bank of Japan has grabbed headlines by introducing a negative deposit rate, a decision which caused quite some market turmoil.

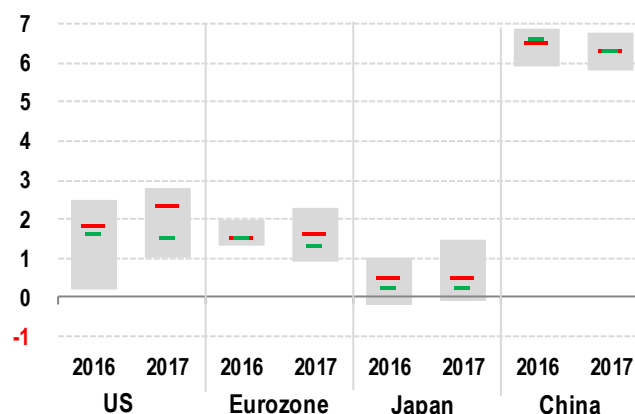
In addition to the monetary divergence (Fed policy unchanged, more easing by the ECB and the Bank of Japan), we have also seen divergence in the real economy. Eurozone growth has been surprisingly strong in the first quarter, at least in terms of European standards; Japan has also seen growth, although this was related to the leap year for which no correction is made in the data, whereas the US saw very weak growth.

Advanced economies

For the US we expect 1.6% real GDP growth this year (coming from an earlier estimate of 1.8%) and 1.5% next year. The downward revision for 2016 is driven by a disappointing performance in the first quarter (+0.5% quarter on quarter, annualised). The Bloomberg consensus is respectively 1.8% and 2.3%. The IMF in its April World Economic Outlook has an estimate for 2016 of 2.4% and is forecasting 2.5% for next year. Growth this year will be driven by private consumption and residential investment with net exports and corporate investments acting as a drag. We expect corporate capital expenditures to suffer from the delayed effect of the tightening of financial and monetary conditions (the appreciation of the effective exchange rate of the dollar, wider credit spreads), although more recently these conditions have eased a bit. Even more important is the downward pressure on corporate profits which should act as a drag on investments. Next year, private consumption growth should slow a bit on the back of higher headline inflation (higher oil prices)

GDP growth, BNP Paribas vs Bloomberg Consensus

— Bloomberg Consensus (May 2016) — BNP Paribas
■ Min/Max Forecasts (May 2016)



Chart

Source: BNP Paribas, Bloomberg

which should dent purchasing power. Residential investments should see some slower growth, all the more so if the Fed were to tighten (which is not our base scenario) and corporate investments should see a slight pick-up. All in all, growth next year should be more or less in line with this year's performance. The bigger picture is that the US is close to full employment but that wage growth is nevertheless rather limited, which is capping the growth rate of household spending. Wage growth is a reflection of very slow productivity growth but nevertheless, unit labour costs are rising, which is impacting profits and hence investments. In such an environment we do not share the consensus view of a significant acceleration in growth next year. Inflation should accelerate from 1.2% to 2.1% but the core personal consumption expenditures deflator, a preferred metric of the Fed, should basically be stable (+1.6% this year, +1.7% next).

The Eurozone has been the surprising factor this year, in a positive sense that is. After a strong first quarter, survey indicators point towards somewhat slower growth but for the year as a whole we expect growth of 1.5% in 2016 and 1.3% in 2017 (Bloomberg consensus: 1.5% and 1.6%). The slower growth next year, albeit still above potential, is explained by the impact of higher oil prices and hence inflation on household consumption, somewhat slower corporate investment growth, the delayed impact of a stronger euro (on an effective exchange rate basis) and a less expansionary fiscal policy. Headline inflation should accelerate from 0.0% to 1.3% on the back of higher oil prices. Core inflation should remain stable (0.8% this year, 0.9% next): the negative output gap takes time to narrow significantly and euro strength weighs on inflation as well.



In Japan we expect 0.2% real GDP growth this year and next (Bloomberg consensus has 0.5% for 2016 and 2017) with government consumption being the fastest growing demand component. This illustrates the effort of the government to boost growth in an environment where monetary policy is having less and less of an impact on activity. The real issue for Japan however is the supply side: trend GDP growth is virtually zero in an economy with a shrinking labour force and hardly any productivity growth.

Emerging and developing economies

This universe has seen the bigger changes compared to our February forecasts. We have revised our China forecast for this year from 6.4% to 6.6% and for next year we expect +6.3% coming from +6.1% (Bloomberg consensus: +6.5% and +6.3%). We have an upward revision of our forecasts for Russia to -0.5% (+1.3%) and +2.0% (+1.3%). For Brazil we have -4.0% for this year (unchanged compared to our previous forecast) and +2.0% for next (0.0% before).

The improved picture in China is the result of the fiscal stimulus efforts of the government although the significant acceleration of M1 growth also plays a role. The latter has helped the property market and construction activity. The ensuing acceleration of growth should however be short-lived and faced with structural challenges (excess capacity, debt, credit quality), we expect growth to slow again next year.

We think that the worst is over in Russia. Leading indicators signal an upturn which is related to the rise in oil prices. Lower inflation should underpin private consumption and together with a stronger RUB should allow an easing of monetary policy with a positive impact on growth.

In Brazil, the new government has brightened the policy outlook. Falling inflation on the back of a huge negative output gap paves the way for significant interest rate cuts starting later this year and this will contribute to growth turning positive.

The challenges of 2017

It looks like 2017 will be challenging in several ways. Our US growth forecast is well below the consensus forecast as well as the Federal Reserve's own median projection of 2.1% real GDP growth. It is clear that depending on the outcome, the outlook for monetary policy will be quite different. Soft growth would imply a Federal Reserve which is on hold. If growth would be more in line with the Fed's projection or the consensus forecast, concern about monetary policy tightening would be a recurring theme, weighing on the market environment, domestically and abroad, all the more so considering that financial markets have adopted a very dovish stance in terms of pricing in rate hikes. A more volatile market environment could very well have negative feedback effects to the real economy, in particular corporate investments, because of the uncertainty it would entail.

Another challenge will be gauging the impact of the rise in headline inflation on the back of a base effect related to the increase in oil prices. Not only will this weigh on households' real disposable income and hence consumer spending, but it should also impact

BNP Paribas updated forecasts

	2016		2017	
	Current	Prior	Current	Prior
US	1,6	1,8	1,5	1,5
Eurozone	1,5	1,3	1,3	1,4
Japan	0,2	0,3	0,2	0,2
China	6,6	6,4	6,3	6,1
Brazil	-4,0	-4,0	-2,0	0,0
Russia	-0,5	-1,8	2,0	0,7

Table

Source: BNP Paribas

inflation expectations. A key question will be whether this will influence the stance of monetary policy. When oil prices were declining, the dominating view was that the spill over effects on core inflation would be limited. Will the same thinking apply now that oil prices are going up? This question is of course particularly relevant for the Eurozone and ECB policy.



Eurozone

A reverse snowball effect

- With the exception of Greece and Portugal, all Eurozone member states can now issue long-term bonds at a lower interest rate than their nominal trend growth rates.
- This situation is linked to the ECB loose monetary policy. It eases the debt reduction efforts of member states.
- When GDP growth is higher than the interest rate on the debt, the public debt ratio can decline even when there is a primary deficit.

In 2016, the public debt-to-GDP ratio should decline for the second consecutive year in the eurozone. Even though this figure is an average masking contrasting trends – between one group of countries in which debt is declining, dominated by Germany, the Netherlands, Austria and Portugal, and other countries, like France, Italy and Spain, where debt continues to rise – a general trend is nonetheless taking shape. With the exception of Greece¹ and Portugal, all Eurozone member states can issue long-term bonds at lower interest rates than their nominal trend growth rates (see chart 1).

This situation, linked to the ECB loose monetary policy, eases the debt reduction efforts of eurozone member countries. The change in the public debt to GDP ratio depends on two factors: 1) the critical spread, i.e. the spread between the interest rate on the debt and the nominal growth rate, and 2) the primary balance, i.e. the fiscal balance excluding interest payments.

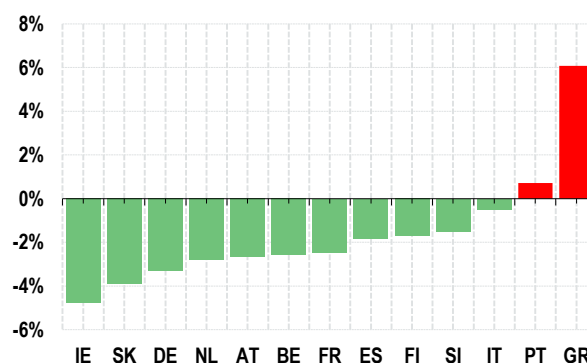
A positive critical spread automatically drives up the public debt-to-GDP ratio: each year, interest payments as a percentage of GDP are higher than nominal GDP growth. Unless a primary surplus can offset it, the debt-to-GDP ratio increases only because of interest payments. This is known as the snowball effect

Inversely, when the critical spread is negative, nominal GDP growth more than suffices to cover interest payments. The public debt to GDP ratio can decline even when there is a primary deficit as long as it does not exceed the surplus of revenues.

During the crisis, soaring risk premiums and the drop-off in activity triggered a major snowball effect in the peripheral countries. In Spain, for example, it accounted for nearly half of the increase in the public debt-to-GDP ratio between 2011 and 2014. At the time, major primary surpluses (4-4.5% of GDP) were needed to stabilise the debt. Today, thanks to renewed growth and the ECB's action, Spanish public debt – which has reached 100% of GDP – could level off with a primary deficit of 0.5% of GDP (see chart 2).

¹ Greece cannot issue bonds on the markets. As part of the EU-IMF programme, it receives loans at very low interest rates, which are lower than its potential growth rate.

Critical spread



* For each country, the chart shows the spread between the 10-year bond yield in May 2016 and the trend nominal growth rate. Trend nominal growth is calculated using the European Commission's estimated growth trend in volume, to which we have added 2% inflation.

Chart 1

Source: AMECO

Debt-stabilising primary balance

Spain

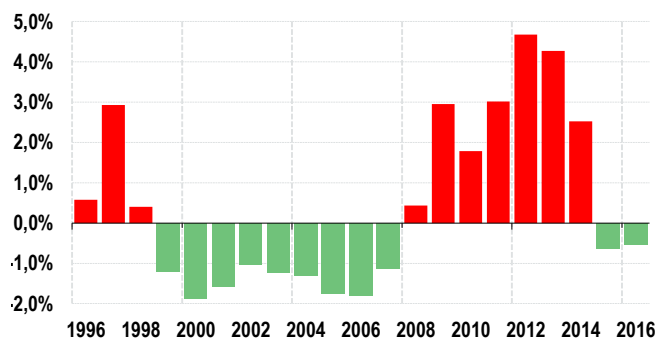


Chart 2

Source: AMECO

* The chart shows at each period the primary balance necessary to stabilise the debt-to-GDP ratio in Spain.



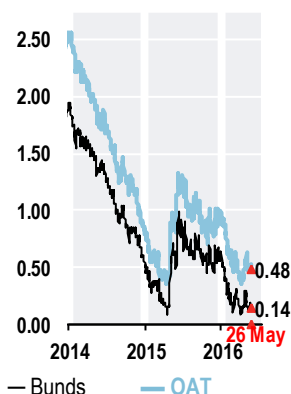
Markets overview

The essentials

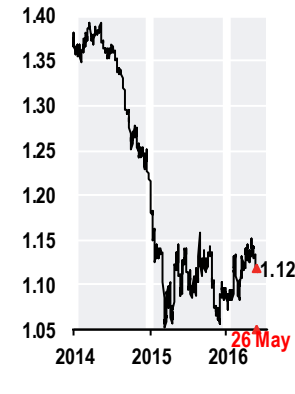
Week 20-5-16 > 26-5-16

➤ CAC 40	4 354	➤ 4 513	+3.6 %
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➤ Volatility (VIX)	15.2	➤ 13.4	-1.8 %
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➤ Libor \$ 3M (%)	0.66	➤ 0.67	+0.5 bp
➤ OAT 10y (%)	0.51	➤ 0.48	-2.7 bp
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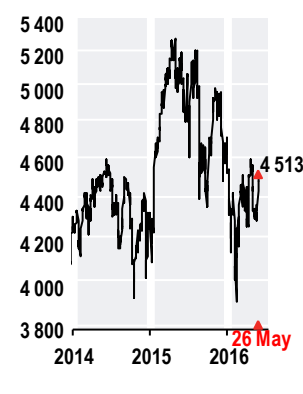
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

Interest Rates		highest' 16		lowest' 16	
€ ECB	0.00	0.05	at 01/01	0.00	at 16/03
Eonia	-0.36	-0.13	at 01/01	-0.36	at 26/05
Euribor 3M	-0.26	-0.13	at 01/01	-0.26	at 10/05
Euribor 12M	-0.01	0.06	at 01/01	-0.03	at 04/03
\$ FED	0.50	0.50	at 01/01	0.50	at 01/01
Libor 3M	0.67	0.67	at 25/05	0.61	at 04/01
Libor 12M	1.32	1.32	at 25/05	1.12	at 12/02
£ BoE	0.50	0.50	at 01/01	0.50	at 01/01
Libor 3M	0.59	0.59	at 15/02	0.58	at 08/03
Libor 12M	1.01	1.07	at 01/01	0.98	at 12/02

At 26-5-16

Yield (%)		highest' 16		lowest' 16	
€ AVG 5-7y	0.15	0.49	at 12/01	0.15	at 26/05
Bund 2y	-0.51	-0.34	at 01/01	-0.56	at 03/03
Bund 10y	0.14	0.63	at 01/01	0.09	at 07/04
OAT 10y	0.48	0.98	at 01/01	0.36	at 05/04
Corp. BBB	1.74	2.50	at 20/01	1.69	at 06/05
\$ Treas. 2y	0.86	1.06	at 01/01	0.64	at 11/02
Treas. 10y	1.82	2.27	at 01/01	1.64	at 11/02
Corp. BBB	3.70	4.50	at 12/02	3.61	at 11/05
£ Treas. 2y	0.45	0.65	at 01/01	0.28	at 08/02
Treas. 10y	1.42	1.96	at 01/01	1.28	at 11/02

At 26-5-16

10y bond yield & spreads

7.19%	Greece	704 pb
3.02%	Portugal	287 pb
1.51%	Spain	136 pb
1.46%	Italy	131 pb
0.52%	Belgium	37 pb
0.52%	Ireland	37 pb
0.48%	France	34 pb
0.42%	Finland	27 pb
0.36%	Netherlands	21 pb
0.33%	Austria	18 pb
0.14%	Germany	

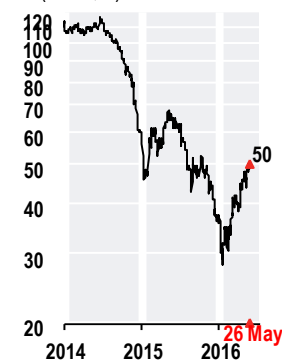
Commodities

Spot price in dollars		lowest' 16		2016(€)	
Oil, Brent	50	28	at 20/01	+35.8%	
Gold (ounce)	1 223	1 062	at 01/01	+11.8%	
Metals, LMEX	2 211	2 049	at 12/01	-2.5%	
Copper (ton)	4 682	4 328	at 15/01	-3.4%	
CRB Foods	362	329	at 11/01	+4.8%	
wheat (ton)	176	146	at 04/01	+10.5%	
Corn (ton)	154	134	at 31/03	+8.2%	

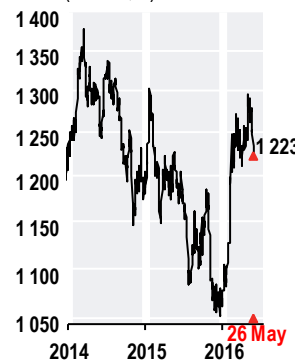
At 26-5-16

Variations

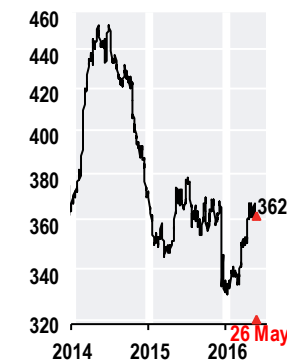
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

1€ =		highest' 16		lowest' 16		2016	
USD	1.12	1.15	at 03/05	1.07	at 05/01	+3.0%	
GBP	0.76	0.81	at 08/04	0.73	at 05/01	+3.4%	
CHF	1.11	1.11	at 04/02	1.08	at 29/02	+1.8%	
JPY	122.67	131.84	at 01/02	121.84	at 06/05	-6.1%	
AUD	1.55	1.60	at 11/02	1.45	at 20/04	+3.8%	
CNY	7.34	7.47	at 04/05	6.99	at 05/01	+4.0%	
BRL	4.01	4.53	at 16/02	3.94	at 14/04	-6.7%	
RUB	73.54	91.22	at 11/02	73.05	at 28/04	-7.3%	
INR	75.10	77.50	at 11/02	71.42	at 05/01	+4.5%	

At 26-5-16

Variations

Equity indices

Index		highest' 16		lowest' 16		2016		2016(€)
CAC 40	4 513	4 637	at 01/01	3 897	at 11/02	-2.7%		-2.7%
S&P500	2 090	2 102	at 20/04	1 829	at 11/02	+2.3%		-0.7%
DAX	10 273	10 743	at 01/01	8 753	at 11/02	-4.4%		-4.4%
Nikkei	16 772	19 034	at 01/01	14 953	at 12/02	-11.9%		-6.1%
China*	54	59	at 01/01	48	at 12/02	-8.2%		-11.0%
India*	452	460	at 01/01	393	at 11/02	-0.1%		-4.4%
Brazil*	1 285	1 454	at 29/04	860	at 21/01	+12.3%		+20.4%
Russia*	483	509	at 28/04	331	at 20/01	+9.7%		+15.9%

At 26-5-16

Variations

* Indices MCSI



Economic forecasts

%	GDP Growth			Inflation			Curr. Account / GDP			Fiscal balances / GDP		
	2015	2016 e	2017 e	2015	2016 e	2017 e	2015	2016 e	2017 e	2015	2016 e	2017 e
Advanced	1.9	1.5	1.5	0.3	0.7	1.6						
United States	2.4	1.6	1.5	0.1	1.2	2.1	-2.7	-2.8	-2.9	-2.5	-3.1	-3.1
Japan	0.6	0.2	0.2	0.8	0.0	0.7	3.3	3.6	3.3	-4.6	-4.3	-4.2
United Kingdom	2.3	1.7	2.1	0.1	0.6	1.8	-5.2	-5.0	-4.0	-3.9	-3.2	-2.2
Euro Area	1.5	1.5	1.3	0.0	0.0	1.3	3.2	2.9	2.7	-2.1	-2.0	-1.8
Germany	1.4	1.5	1.3	0.1	0.2	1.6	8.6	8.4	7.8	0.7	0.2	0.2
France	1.2	1.4	1.3	0.1	0.2	1.1	-0.2	-0.1	-0.7	-3.5	-3.3	-3.0
Italy	0.6	1.0	0.7	0.1	-0.2	0.9	2.2	1.9	1.8	-2.6	-2.7	-2.5
Spain	3.2	2.8	2.0	-0.6	-0.7	1.3	1.4	1.2	1.1	-5.1	-4.0	-3.1
Netherlands	2.0	1.8	1.6	0.2	0.4	0.9	9.4	9.5	9.2	-1.8	-1.8	-1.6
Belgium	1.4	1.2	1.5	0.6	1.5	1.4	0.8	1.6	1.9	-2.6	-2.6	-2.4
Emerging	4.1	4.1	4.9	6.1	6.4	5.5						
China	6.9	6.6	6.3	1.4	1.9	2.2	3.1	3.2	2.4	-2.4	-3.0	-3.2
India	7.3	7.8	8.4	4.9	5.6	5.0	-1.3	-0.9	-1.3	-4.1	-3.9	-3.5
Brazil	-3.8	-4.0	2.0	9.0	8.6	5.0	-3.3	-1.1	-1.6	-10.3	-8.7	-7.0
Russia	-3.7	-0.5	2.0	15.6	7.4	6.4	5.3	3.5	3.6	-3.7	-4.5	-3.8
World	3.1	3.0	3.4	3.6	4.0	3.8						

Source : BNP Paribas Group Economic Research / GlobalMarkets (e: estimates & forecasts)

Financial forecasts

Interest rates		2015				2016						
End of period, %		Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e	2015	2016e	2017e
\$	Fed Funds	0.25	0.25	0.25	0.50	0.50	0.25-0.50	0.25-0.50	0.25-0.50	0.50	0.25-0.50	0.25-0.50
	Libor 3m \$	0.27	0.28	0.33	0.61	0.63	0.66	0.65	0.70	0.61	0.70	1.05
	T-Notes 10y	1.93	2.35	2.03	2.27	1.79	1.84	1.55	1.60	2.27	1.60	1.75
€	ECB "Refi"	0.05	0.05	0.05	0.05	0.00	0.00	0.00	0.00	0.05	0.00	0.00
	Euribor 3m	0.02	-0.01	-0.04	-0.13	-0.24	-0.26	-0.30	-0.30	-0.13	-0.30	-0.30
	Bund 10y	0.18	0.77	0.59	0.63	0.16	0.17	0.00	-0.20	0.63	-0.20	-0.20
£	OAT 10y	0.42	1.20	0.90	0.98	0.41	0.51	0.30	0.10	0.98	0.10	0.10
	BTP 10y	1.29	2.31	1.73	1.60	1.23	1.49	1.10	0.80	1.60	0.80	0.80
	BoE Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00
¥	Gilts 10y	1.58	2.03	1.77	1.96	1.42	1.46	1.35	1.50	1.96	1.50	1.80
	BoJ Overnight	0.02	0.01	0.01	0.04	-0.00	-0.30	-0.30	-0.30	0.04	-0.30	-0.50
	JGB 10y	0.40	0.44	0.35	0.25	-0.04	-0.12	-0.20	-0.20	0.25	-0.20	-0.30
Exchange rates		2015				2016						
End of period		Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e	2015	2016e	2017e
\$	EUR / USD	1.07	1.11	1.12	1.09	1.14	1.16	1.15	1.14	1.09	1.14	1.05
	USD / JPY	120	122	120	120	112	108	108	110	120	110	124
€	EUR / GBP	0.72	0.71	0.74	0.74	0.79	0.77	0.74	0.72	0.74	0.72	0.68
	EUR / CHF	1.04	1.04	1.09	1.09	1.09	1.14	1.14	1.16	1.09	1.16	1.20
	EUR / JPY	129	136	134	131	128	125	124	125	131	125	130

Source : BNP Paribas Group Economic Research / GlobalMarkets (e: estimates & forecasts)



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