



Summary

France

The state of the recovery

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Spain

In search of a coalition

Spain held new elections on 26 June. The Popular Party managed to bolster its position as Spain's leading party, but the political landscape is still fragmented.

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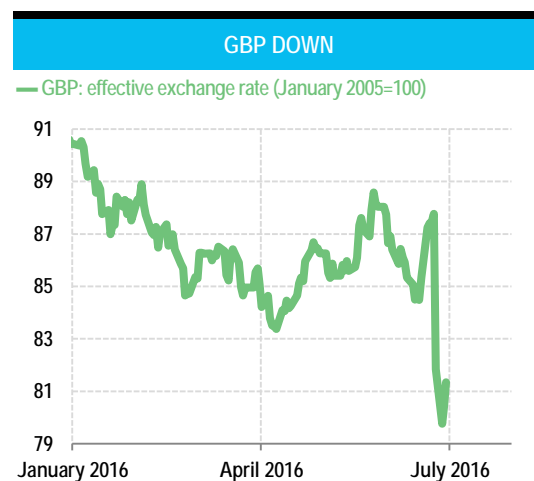
Also in :



The week after

■ The British pound depreciated by about 7% ■ Government bond yields are down in the UK, the US and the eurozone

It has been a week since Europe woke up with the news the United Kingdom had decided to leave the European Union. Estimating the consequences, beyond the direct effects of developments on financial markets, is everything but simple. The collapse of the pound will drive inflation up in the UK, to which the Bank of England will not respond in tightening, as pressures on prices will prove both temporary and recessionary; as investment and hiring plans freeze, the risks that the UK experiences a recession are non-negligible. In the eurozone, government bond yields went down, spreads did not widen while the euro depreciated against the dollar: monetary and financial conditions eased, which will help soften the likely brake on exports to the UK. The US dollar got more expensive but interest rates fell rather markedly; on the other hand, trade with the UK is too limited for the US to suffer from a British slowdown. In short, what matters is what we do not know: what will be the relation between the UK and the EU a few years from now? Negotiations will not start before a new Prime Minister is in charge, and the pro-Brexit camp does not look like having a plan. What is at stake is however quite clear: the UK will have to preserve its unity and its access to the single market.



Source: Bank of England

THE WEEK ON THE MARKETS

Week 24-6 16 > 30-6-16

➤ CAC 40	4 107	➤ 4 237	+3.2 %
➤ S&P 500	2 037	➤ 2 099	+3.0 %
➤ Volatility (VIX)	25.8	➤ 15.6	-10.1 %
➤ Euribor 3M (%)	-0.28	➤ -0.29	-0.5 bp
➤ Libor \$ 3M (%)	0.62	➤ 0.65	+2.3 bp
➤ OAT 10y (%)	0.37	➤ 0.20	-17.2 bp
➤ Bund 10y (%)	-0.06	➤ -0.13	-7.1 bp
➤ US Tr. 10y (%)	1.58	➤ 1.49	-8.7 bp
➤ Euro vs dollar	1.11	➤ 1.11	-0.1 %
➤ Gold (ounce, \$)	1 314	➤ 1 321	+0.5 %
➤ Oil (Brent, \$)	48.8	➤ 49.6	+1.8 %

Source: Thomson Reuters



France

The state of the recovery

- The Brexit vote is a game-changer. Before it, the prevailing economic situation in France was one of a slightly stronger-based recovery. Brexit is likely to slow the pace of this recovery, albeit without calling it into question.
- Although pre-Brexit growth was still fairly weak, it was gaining in strength and the ingredients of a self-sustained recovery were finally falling into place.
- Recent signs of a slowdown reflected in the latest series of economic indicators are neither surprising nor alarming.
- They take into account the expected payback in Q2 growth (+0.2% q/q according to our estimates) after the strong Q1 (+0.6% q/q).

In the 23 June referendum, the UK voted to leave the European Union, opening the door to a long period of uncertainty. There can be little doubt that the Brexit vote will have negative economic consequences: the only real question is how big will be the impact. We will examine this question in the next issue of Ecoweek. For the moment, the latest series of economic indicators released in June provides a good occasion to review the pre-Brexit state of the French economy, the strength of the ongoing recovery and the forces at play, in order to evaluate its solidity and capacity to resist this most unusual of shocks.

We will begin by looking at an instructive exercise presented by the INSEE in its Economic Note of June 2016, in which it estimates the impact of various external and internal shocks on French growth in 2015 and 2016 (see table). In 2015, the positive and negative effects cancel each other out, leaving growth at what the INSEE esteems to be France's long-term trend, i.e. 1.2%. In 2016, the net impact was estimated at a positive 0.3 points, thanks to the fading effect of internal headwinds. The INSEE is forecasting growth of 1.6%.

This scenario is based on rejuvenated household consumption and corporate investment, bolstered respectively by the rebound in household purchasing power (fuelled in part by low inflation¹) and corporate profit margins (thanks to measures to reduce labour costs as well as low commodity prices). The detailed results of the Q1 2016 national accounts highlight this improvement: purchasing power increased by nearly 2% over the year, while profit margins rose again, to 32.1%, their highest level since Q4 2008. The upturn in the job market and construction sector also consolidates the growth foundations, which now seem to be more on a self-sustained basis. In 2016, exports are the only growth engine showing signs of slowing, hampered by sluggish world growth and a less favourable currency effect.

¹ Headline inflation has hovered around 0% year-on-year (± 0.3 points) since early 2015. In June 2016, it climbed slightly above zero again to +0.2% according to preliminary INSEE estimates. Core inflation has been fluctuating around 0.7% since mid-2015.

Impact of internal & external shocks on French growth

	2015	2016 (forecasts)
Impact on growth	0.0	0.3
Impact of external factors	0.5	0.4
Fall in commodity prices	0.3	0.4
Accommodative ECB monetary policy	0.4	0.2
Interest rates decline	0.2	0.2
Euro depreciation	0.2	0.0
External demand	-0.1	-0.2
Southern Europe recovery	0.1	0.0
Emerging slowdown	-0.2	-0.2
Impact of internal factors	-0.5	-0.1
Past tax hikes	-0.7	-0.4
Reduction in the labour cost (CICE & PRS)	0.4	0.3
Spending savings measures	-0.1	0.0
Household investment contraction	-0.1	0.0

Note regarding figures in the table: the estimated impacts only take into account the different shocks observed until the end of 2015. The subsequent shocks are excluded, including for 2016, except the changes in foreign demand, spending savings efforts and household investment. The impact of commodity prices fluctuations early 2016 are, in particular, not integrated: the 0.4-point impulse in 2016 only depends on the observed fall until the end of 2015.

Table

Source: INSEE

The broad outlines of our own 2016 scenario are identical. Completed before the 23 June referendum, our growth forecast (1.4%) was not as high as the INSEE's forecast, because of a less buoyant corporate investment (reflecting the delayed impact of higher risk aversion earlier in the year and the less loose nature of monetary and financial conditions), a less positive contribution of inventory changes and a slightly more negative contribution of net exports. We also foresaw a smaller decline in the unemployment rate. It remains to be seen whether the Brexit vote will have a meaningful impact on 2016 average annual growth. 2017 is a different story and we are going to revise down our growth scenario. However, the key facts already identified (such as the household consumption slowdown because of the expected uptick in inflation and the embedded negative fiscal impulse in order to cut back the fiscal deficit below the 3% threshold) will still hold true.

Although growth may have become more robust, we nonetheless expect a payback in Q2. Some of the positive effects supporting growth earlier in the year (lower pump prices, over-amortization mechanism) will indeed partly fade. The economic and survey data available so far reveal traces of a slowdown, albeit not a severe one. Our "nowcasting" model points to growth of 0.3% q/q based on hard data and 0.1% based on soft ones: our baseline forecast is situated between the two at 0.2% q/q.



The most recent series of economic indicators is negative. All of the confidence surveys ticked downwards in June. The INSEE composite business climate index shed 2 points to 100. The deterioration was sharpest in the services sector (-3 points), followed by industry (-2 points) and retail trade (-1 point), while the construction sector remained flat (see chart 1). Household confidence also fell by 1 point to 97. The Markit PMI indexes declined too. According to flash estimates, the manufacturing sector was down a half point to 47.9², the services sector was down 1.7 points to 49.9, and the composite index dropped 1.5 points to 49.4.

These declines reflect in part a correction of the previous month's strength. However, looking at the strong deterioration in the balances of opinion on past activity, the INSEE surveys also show traces of the strikes, protests and other blockades of industrial sites between the end of May and early June. Prior to Brexit, this expected drop in confidence would have been considered a passing phenomenon. Due to Brexit, however, it is now more likely that the business climate will not pick up in July. It is less evident that household confidence will be affected, at least not in the very short term. Thereafter, uncertainty reigns.

The two activity indicators published recently were also negative. The number of category A job seekers (i.e. no work at all for the past month) at Pôle Emploi, France's job agency, increased slightly in May (+0.3% m/m), ending a 2-month decline. In year-on-year terms, the decline accelerated however, from -0.6% to -1%. Even more striking, the average duration of unemployment declined slightly (by 4 days to 579), the first decline since early 2009.

Household expenditure on goods also surprised on the downside in May, with a 0.7% m/m fall in real terms. Even so, the carry-over remains positive at 0.3% q/q in Q2. Consumption of manufactured goods rebounded slightly (0.2% m/m), but not enough to offset the 1% m/m decline in energy spending. This latter is to be attributed to a sharp correction in spending on heating (-6.8% m/m after two months of strong growth) offset by a notable rebound in refined products (+7.3% m/m), apparently buoyed by precautionary purchases due to fears of a petrol shortage in the second half of May. The limited increase in the consumption of manufactured goods masks a net rebound in clothing (+1.7% m/m) and food (+0.5% m/m), offset by a drop off in home furnishings (-9.2% m/m after a cumulative +14% over the three previous months).

In conclusion, the Brexit shock occurs at a time when the French recovery is finally showing timid but real signs of improvement. Brexit is bound to slow the pace of the recovery – to what extent is still hard to estimate – albeit without calling it into question.

Business confidence

— Composite index — Industry — Retailing
--- Services — Construction

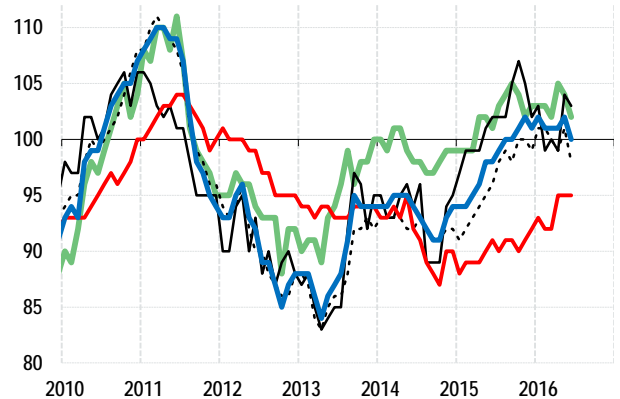


Chart 1

Source: INSEE

Household spending and confidence

— Household consumer spending on goods (y/y, %, LHS)
— Balance of opinions on the opportunity to make big-ticket purchases (% , RHS)

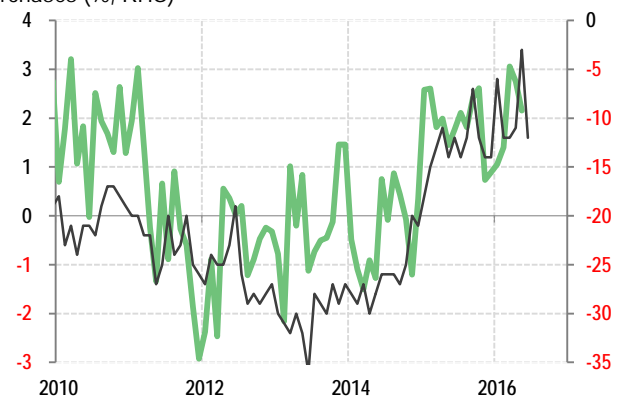


Chart 2

Source: INSEE

² This figure was revised upwards to 48.3 in the final estimate.



Spain

In search of a coalition

- Stuck in a political impasse since December 2015, Spain held new elections on 26 June.
- The Popular Party managed to bolster its position as Spain's leading party following the elections.
- Yet the political landscape is still fragmented, with no clear signs of a coalition taking shape.

Spain returned to the voting booths on 26 June after the main political parties failed to reach an agreement on forming a government after the December 2015 general elections. The political landscape is still fragmented after the June elections, but Spain might come up with a new government relatively soon. Indeed, it's in the best interest of the main political parties to reach an agreement because the Spanish are growing weary of it all.

The Popular Party consolidates its lead

The election did bring a few changes compared to the previous situation. The right-wing Popular Party (PP), which headed the incumbent government, managed to bolster its position as Spain's leading party by winning 33% of the vote and 137 parliamentary seats, 14 more than in December. Fed up after 6 months of political haggling, the Spanish finally shifted their support to a party which had not taken part in it. They also ended up voting for the establishment parties, which focused their electoral campaigns on fear of the unknown, i.e. the emerging parties. UK referendum results in favour of Brexit probably reinforced this message. The Socialist party PSOE probably benefited from this campaign, and managed to hold onto second place. Despite upsetting some of its left-wing supporters by attempting to form a coalition with the centre-right Ciudadanos party, the Socialists managed to defy predictions by winning 22.7% of the vote and 85 parliamentary seats (down from 90 in December). Inversely, the far-left coalition Unidos Podemos, created last May by the anti-austerity party Podemos and the communist United Left party, lost more than a million votes relative to December's elections. With 21.1% of the vote, it won 71 seats. On the right, the shift towards the PP occurred to the detriment of Ciudadanos, which obtained only 13.1% of the vote and 32 parliamentary seats, down from 13.9% and 40 seats, respectively, in December (see chart).

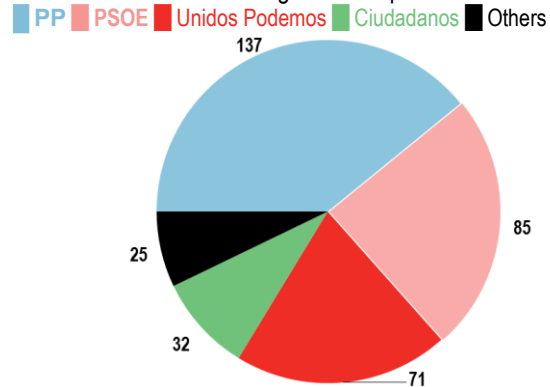
A fragmented political landscape

The PP bolstered its lead and built on its legitimacy, but the political landscape is still fragmented after the election. None of the political parties managed to obtain a majority of seats in the Congress of Deputies (176 out of 350 seats), and no coalitions are clearly taking shape despite a few concessions. There are, in particular, two possible options, but each has major obstacles.

Unidos Podemos, with its leader Pablo Iglesias, is no longer expected to insist on holding a referendum on Catalonia's

No congressional majority

Number of seats in the Congress of Deputies in June 2016



Chart

Source: Spanish Ministry of the Interior

independence as a precondition for their participation in a coalition government. Over the past six months, this condition prevented them from joining forces with PSOE and Ciudadanos. Even so, a broad coalition comprised of Unidos Podemos, Ciudadanos and PSOE seems unlikely given the divergent opinions between the left-wing coalition and Ciudadanos.

The latter might be willing to lend its support to the PP without demanding that Mariano Rajoy resign from his post as prime minister. Even so, to obtain a sufficient number of parliamentary seats, this coalition would still need the support of the PSOE and its leader Pedro Sanchez. It seems highly unlikely that Mr. Sanchez would agree to participate in a government lead by the PP, or to lend his support to a coalition comprised of the PP and Ciudadanos, given the differences in opinion between the two parties and the corruption scandals implicating the PP. In this case, PSOE would also risk alienating part of its left-wing supporters hostile to austerity measures, which would strengthen Podemos.

The parties have as much time as they need to reach an agreement. King Felipe VI does not have an official deadline by which the political leaders must form a new government. Nonetheless, all of the parties are determined to help Spain pull out of this political impasse. Without explicitly supporting a broad right-wing coalition, PSOE could abstain from a second-round vote in the Congress of Deputies¹. This coalition would then be in a position to form a minority government.

¹ An absolute majority is necessary on the first round. In case of a simple majority, only the votes actually cast are taken into account.



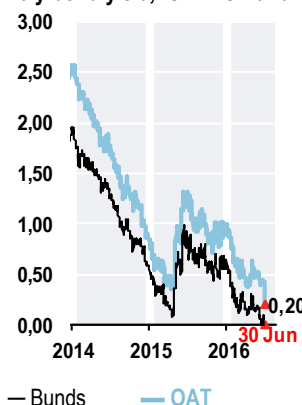
Markets overview

The essentials

Week 24-6 16 > 30-6-16

➤ CAC 40	4 107	➤ 4 237	+3.2 %
➤ S&P 500	2 037	➤ 2 099	+3.0 %
➤ Volatility (VIX)	25.8	➤ 15.6	-10.1 %
➤ Euribor 3M (%)	-0.28	➤ -0.29	-0.5 bp
➤ Libor \$ 3M (%)	0.62	➤ 0.65	+2.3 bp
➤ OAT 10y (%)	0.37	➤ 0.20	-17.2 bp
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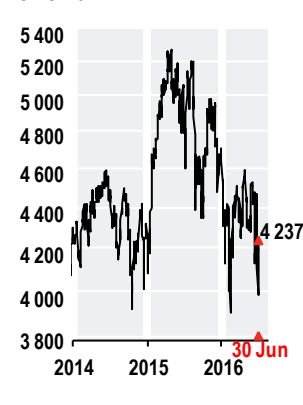
10 y bond yield, OAT vs Bund



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	-0.29	-0.13 at 01/01	-0.36	at 26/05	
Euribor 3M	-0.29	-0.13 at 01/01	-0.29	at 30/06	
Euribor 12M	-0.05	0.06 at 01/01	-0.05	at 29/06	
\$ FED	0.50	0.50 at 01/01	0.50	at 01/01	
Libor 3M	0.65	0.69 at 31/05	0.61	at 04/01	
Libor 12M	1.22	1.34 at 31/05	1.12	at 12/02	
£ BoE	0.50	0.50 at 01/01	0.50	at 01/01	
Libor 3M	0.56	0.59 at 15/02	0.55	at 27/06	
Libor 12M	0.91	1.07 at 01/01	0.90	at 27/06	

At 30-6-16

Yield (%)		highest' 16		lowest' 16	
€ AVG 5-7y	0.03	0.49 at 12/01	0.01	at 29/06	
Bund 2y	-0.64	-0.34 at 01/01	-0.65	at 28/06	
Bund 10y	-0.13	0.63 at 01/01	-0.13	at 29/06	
OAT 10y	0.20	0.98 at 01/01	0.20	at 30/06	
Corp. BBB	1.59	2.50 at 20/01	1.59	at 30/06	
\$ Treas. 2y	0.58	1.06 at 01/01	0.58	at 30/06	
Treas. 10y	1.49	2.27 at 01/01	1.46	at 27/06	
Corp. BBB	3.42	4.50 at 12/02	3.42	at 29/06	
£ Treas. 2y	0.14	0.65 at 01/01	0.14	at 30/06	
Treas. 10y	1.02	1.96 at 01/01	1.02	at 30/06	

At 30-6-16

10y bond yield & spreads

8.29%	Greece	841 pb
3.09%	Portugal	322 pb
1.35%	Italy	148 pb
1.11%	Spain	124 pb
0.54%	Ireland	66 pb
0.24%	Belgium	36 pb
0.20%	France	32 pb
0.15%	Finland	28 pb
0.09%	Netherlands	21 pb
0.05%	Austria	17 pb
-0.13%	Germany	

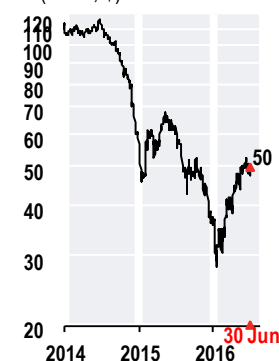
Commodities

Spot price in dollars		lowest' 16		2016(€)	
Oil, Brent	50	28 at 20/01		+35.9%	
Gold (ounce)	1 321	1 062 at 01/01		+21.6%	
Metals, LMEX	2 369	2 049 at 12/01		+5.2%	
Copper (ton)	4 840	4 328 at 15/01		+0.6%	
CRB Foods	362	329 at 11/01		+5.8%	
wheat (ton)	163	146 at 04/01		+3.0%	
Corn (ton)	136	134 at 31/03		-3.8%	

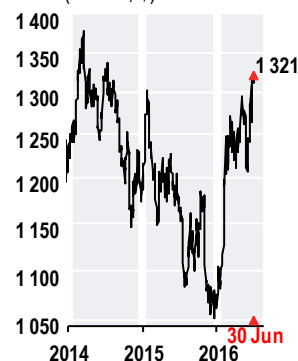
At 30-6-16

Variations

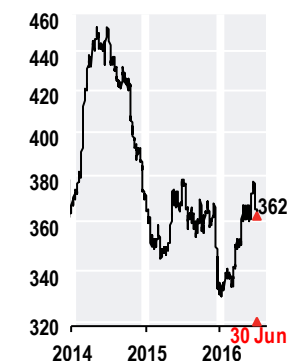
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

1€ =		highest' 16		lowest' 16		2016	
USD	1.11	1.15 at 03/05	1.07	at 05/01		+2.3%	
GBP	0.83	0.83 at 27/06	0.73	at 05/01		+12.8%	
CHF	1.08	1.11 at 04/02	1.08	at 24/06		-0.5%	
JPY	113.97	131.84 at 01/02	111.61	at 27/06		-12.8%	
AUD	1.49	1.60 at 11/02	1.45	at 20/04		-0.1%	
CNY	7.38	7.49 at 08/06	6.99	at 05/01		+4.6%	
BRL	3.56	4.53 at 16/02	3.56	at 30/06		-17.2%	
RUB	70.96	91.22 at 11/02	70.70	at 29/06		-10.6%	
INR	74.98	77.50 at 11/02	71.42	at 05/01		+4.3%	

At 30-6-16

Variations

Equity indices

Index		highest' 16		lowest' 16		2016		2016(€)
CAC 40	4 237	4 637 at 01/01	3 897	at 11/02		-8.6%		-8.6%
S&P500	2 099	2 119 at 08/06	1 829	at 11/02		+2.7%		+0.4%
DAX	9 680	10 743 at 01/01	8 753	at 11/02		-9.9%		-9.9%
Nikkei	15 576	19 034 at 01/01	14 952	at 24/06		-18.2%		-6.2%
China*	56	59 at 01/01	48	at 12/02		-6.4%		-8.5%
India*	461	466 at 08/06	393	at 11/02		+2.3%		-1.9%
Brazil*	1 495	1 495 at 30/06	860	at 21/01		+16.9%		+41.1%
Russia*	483	509 at 28/04	331	at 20/01		+7.3%		+16.8%

At 30-6-16

Variations

* Indices MCSI



These economic and financial forecasts do not incorporate the British referendum results, except exchange rates.

Economic forecasts

En %	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	1.7	1.6	0.1	1.3	2.2	-2.7	-2.8	-2.9	-2.5	-3.1	-3.1
Japan	0.5	0.2	0.2	0.5	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	1.6	1.5	1.3	0.0	0.1	1.3	3.2	2.9	2.7	-2.1	-2.0	-1.8
Germany	1.4	1.5	1.3	0.1	0.3	1.6	8.6	8.4	7.8	0.7	0.2	0.2
France	1.2	1.4	1.3	0.1	0.4	1.2	-0.2	-0.1	-0.7	-3.5	-3.3	-3.0
Italy	0.6	1.0	0.7	0.1	-0.1	0.9	2.2	1.9	1.8	-2.6	-2.7	-2.5
Spain	3.2	2.8	2.0	-0.6	-0.6	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
Portugal	1.5	1.1	1.1	0.5	0.6	1.4	0.8	0.6	0.4	-4.4	-2.9	-2.7
Emerging	4.1	4.2	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	-3.0	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				2015	2016e	2017e
End period		Q1	Q2	Q3	Q4	Q1	Q2	Q3e	Q4e			
US	Fed Funds	0.25	0.25	0.25	0.5	0.5	0.5	0.25-0.50	0.25-0.50	0.01	0.25-0.50	0.25-0.50
	3-month Libor \$	0.27	0.28	0.33	0.61	0.63	0.65	0.65	0.70	0.61	0.70	1.05
	10-year T-notes	1.93	2.35	2.03	2.27	1.79	1.49	1.55	1.60	2.27	1.60	1.75
EMU	Refinancing rate	0.05	0.05	0.05	0.05	0.00	0.00	0.00	0.00	0.05	0.00	0.00
	3-month Euribor	0.02	-0.01	-0.04	-0.13	-0.24	-0.29	-0.30	-0.30	-0.13	-0.30	-0.30
	10-year Bund	0.18	0.77	0.59	0.63	0.16	-0.13	0.00	-0.20	0.63	-0.20	-0.20
	10-year OAT	0.42	1.20	0.90	0.98	0.41	0.20	0.30	0.10	0.98	0.10	0.10
	10-year BTP	1.29	2.31	1.73	1.60	1.23	1.35	1.10	0.80	1.60	0.80	0.80
UK	Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00
	3-month Libor £	0.57	0.58	0.58	0.59	0.59	0.56	0.75	0.75	0.59	0.75	1.25
	10-year Gilt	1.58	2.03	1.77	1.96	1.42	1.02	1.35	1.50	1.96	1.50	1.80
Japan	Overnight call rate	0.02	0.01	0.01	0.04	-0.00	-0.06	-0.30	-0.30	0.04	-0.30	-0.50
	3-month JPY Libor	0.17	0.17	0.17	0.17	0.10	0.06	-0.05	-0.10	0.17	-0.10	-0.25
	10-year JGB	0.40	0.44	0.35	0.25	-0.04	-0.23	-0.20	-0.20	0.25	-0.20	-0.30

Exchange rates		2015				2016				2015	2016e	2017e
End period		Q1	Q2	Q3	Q4	Q1	Q2	Q3e	Q4e			
USD	EUR / USD	1.07	1.11	1.12	1.09	1.14	1.11	1.10	1.10	1.09	1.10	1.05
	USD / JPY	120	122	120	120	112	103	108	110	120	110	124
EUR	EUR / GBP	0.72	0.71	0.74	0.74	0.79	0.83	0.82	0.80	0.74	0.80	0.68
	EUR / CHF	1.04	1.04	1.09	1.09	1.09	1.08	1.14	1.16	1.09	1.16	0.01
	EUR/JPY	129	136	134	131	128	114	119	121	131	121	130

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



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Publisher: Jean Lemerre
Editor: William De Vijlder