



Summary

United States

A bird in the hand is worth two in the bush
Promise made, promise kept: the Fed took a second step towards the normalization of monetary policy with a 25pb rate hike. In a time of uncertainties, the Fed chose to reassure, not to surprise.

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Netherlands

Government faces disgruntled voters

Despite the economic recovery, the ruling coalition is in for a drubbing at the general election in March 2017. Arduous negotiations are likely to form the next government.

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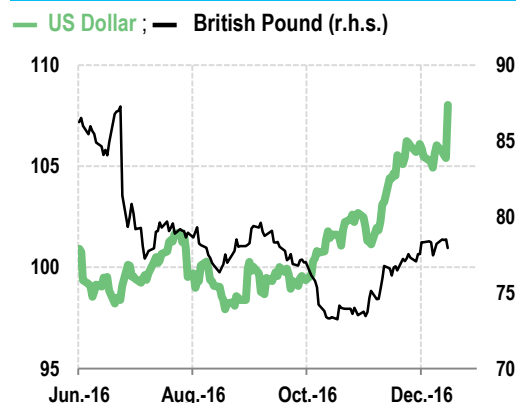


Smooth operations

■ The Fed raises rates, with caution ■ The Bank of England goes for the status quo, with caution ■ Next moves will be taken... with caution

Last week, asked about what central banks could do in the face of political uncertainties, Mario Draghi declared *"what [they] can do is to keep a steady hand, namely to continue with the monetary accommodation that is necessary to achieve their objective"*. This week, both the Bank of England and the Fed just did that, in their respective ways. For the Fed, this meant a hike, limited enough to leave rates below the estimated neutral level (see *"US: A bird in the hand is worth two in the bush"*). For the Bank of England, this meant the *status quo*. While the Fed had to publish an updated set of economic projections, it chose to just amend them. The Bank of England did not have to make a choice about how to factor uncertainty in forecast as its Inflation Report will not be released before early February. Still, it appears that the rebound in the pound could end up helping the Bank providing additional support were it be needed. Indeed, it currently foresees that its 2% inflation target will be overshoot marginally and for a limited period of time. In a way, we are back in uncharted waters, as communication is back on being the very first tool of central banks. The Bank of England, should it be willing to ease policy, would have to do so without adding additional downward pressures on the pound. As for the Fed, it has to appear confident about the economy, while limiting the enthusiasm of financial markets for undetailed fiscal push that FOMC members appear to question the opportunity. Maestros are in need...

EFFECTIVE EXCHANGE RATES



Source: Bank of England

THE WEEK ON THE MARKETS

Week 9-12 16 > 15-12-16

▲ CAC 40	4 764	► 4 819	+1.2 %
▲ S&P 500	2 260	► 2 262	+0.1 %
▲ Volatility (VIX)	11.8	► 12.8	+1.0 %
▲ Euribor 3M (%)	-0.32	► -0.32	+0.0 bp
▲ Libor \$ 3M (%)	0.96	► 0.97	+1.4 bp
▼ OAT 10y (%)	0.81	► 0.80	-1.0 bp
▼ Bund 10y (%)	0.26	► 0.26	-0.5 bp
▲ US Tr. 10y (%)	2.47	► 2.58	+11.4 bp
▼ Euro vs dollar	1.05	► 1.04	-1.2 %
▼ Gold (ounce, \$)	1 163	► 1 127	-3.1 %
▼ Oil (Brent, \$)	54.2	► 53.5	-1.3 %

Source: Thomson Reuters



United States

A bird in the hand is worth two in the bush

- **Promise made, promise kept: the Fed took a second step towards the normalisation of monetary policy with a 25bp rate hike.**
- **Interest rate projections suggest that there will be three key rate increases in 2017, although Janet Yellen reminded us that rates are not on a pre-set path.**
- **Economic projections were virtually identical with September's set, even though the past three months have seen some major changes. As if it is not hard enough to try to estimate the effects of a fiscal policy whose profile is very fuzzy at best, the markets have also reacted strongly.**
- **The Fed preferred to be reassuring, by taking predictable actions and delivering unsurprising messages, and qualified the rate increase as a "vote of confidence" in the economy.**

Even if less predictable than last year, this week Fed's decision was highly predictable. As expected, the Fed raised its key rates by 25 basis points (bp). As Janet Yellen explained, the decision was justified by the US economy, which has made "considerable progress" towards meeting the Fed's two objectives: maximum employment and price stability. In addition to the Fed's concrete monetary policy action, attention was focused on the new economic forecasts of the various FOMC members. Here, stability was the key word. There were only marginal revisions to the growth (up), inflation (up for headline, flat for core) and unemployment (down) forecasts. These revisions should be seen as a reflection of recently published economic data, rather than a new diagnosis. Specifically, they are clear of any effects from a possible fiscal stimulus.

Another projection also attracted attention: the Federal funds target rate. In September, the median projection suggested two rate increases (of 25bp each) in 2017, but the "central" scenario is now for three. Once again, this must be kept in perspective. During the press conference, Janet Yellen attributed this trend to the revised forecasts of just a "some" members. Instead of a change of perspective by the core FOMC, it should be seen as minor changes by a few members. Details show that the previously highly dovish members, the ones that were projecting a Fed fund target range of 0.50%-0.75% in end-2018 moved their projection up, factoring in the December 2016 hike and another 25 bp one next year. This moved the median forecast accordingly, a bit artificially, higher. And here again, these projections are still basically the same, while they are just that: projections. Janet Yellen reminded us once more that the rate policy was not on a pre-set course, which is unquestionable as shown by the recent past: in December 2015, that projection was for four rate hikes in 2016, which ended up with only one...

Based on what Janet Yellen said, the stability of the forecasts seems due to uncertainty more than to certainty. According to this reading, FOMC members would not attach a greater probability to their forecasts, much to the contrary. Given the uncertainty shrouding

fiscal policy trends, they would have preferred to freeze their projections while awaiting more precise details.

The world has undeniably changed since the publication of September's forecasts. Oil prices picked up after oil producing countries (both within the OPEC and beyond) agreed to reduce output, and Donald Trump's election triggered a general re-pricing movement in the financial markets. The dollar appreciated again (and further with the Fed's recent announcements). Treasury yields have risen, and with them all long-term interest rates.

It is easy to draw a parallel with the "taper tantrum" of spring 2013, even though the two episodes are not completely identical: specifically while then equities and corporate bonds were hit, they are currently benefiting from the movement, with a bullish equity market and narrower corporate spreads. Still, the increase in long-term interest rates is impressive: since the day after Election Day, the 10-year Treasury yield is up almost 70 basis points, the yield on BAA-rated corporate bonds by around 40 bp, the 30-year mortgage interest rate by close to 80 bp and the nominal effective exchange rate by more than 3.5%.

These factors are clearly headwinds for households: the rebound in energy prices will strain purchasing power, while higher mortgage rates will undoubtedly curb the housing market. Yet promises of fiscal support could also boost disposable income. It goes without saying that the effects of campaign promises are impossible to estimate, at least not until they have been translated into concrete draft proposals. To complicate matters further, the effects will not be the same for different income brackets. The ones hit hardest by headwinds (oil prices) will also benefit the least from supports (tax cuts, higher returns on savings), while they tend to be the ones with the highest propensity to consume.

In this context, the Fed preferred to strike a reassuring tone. Asked about the impact the rate increase risks having on households, Janet Yellen said the decision was a clear signal of the Fed's optimism, and should be viewed as a "vote of confidence" in the economy. In this case, being reassuring meant being predictable. No one was expecting the *status quo*, so the Fed went ahead with a rate increase. At the press conference, it was pointed out that this was the second time the Fed had waited until a monetary tightening move was fully priced in before announcing it. Although Janet Yellen said that this kind of market consensus was by no means a necessary condition, she congratulated the Fed on its capacity to deliver a clear message. And the message was heard. The Fed does not intend to let the economy overheat, and the unemployment rate is only expected to fall briefly (and marginally) below the equilibrium rate. Janet Yellen does not think this is a good time to overheat the economy. From there, it is easy to jump to the conclusion that the time is no longer ripe for fiscal stimulus, which she did. She added that the challenge for the United States is to raise the economy's potential growth rate, indicating that education and training were certainly the best tools for achieving this.



Netherlands

Government faces disgruntled voters

- The currently ruling coalition played a role in the economic turnaround but is languishing in the polls.
- Issues such as EU policy and the environment are likely to influence voters, in addition to usual concerns about the economy and the labour market.
- The far right PVV may win the most seats in the election. As the other parties will be reluctant to work with them, the formation of a new coalition government could be difficult.

Dutch voters go to the polls on 15 March 2017 to elect the 150 members of the Second Chamber of Parliament, the lower house. The political landscape is fragmented and it is expected that at least ten different parliamentary groups will be represented in the next assembly. The electoral system uses proportional representation across one nationwide constituency, meaning that the number of seats allocated to each party is in line with the number of votes received.

The current government is a coalition between the Liberal Party (VVD) headed by Prime Minister Mark Rutte and the Labour Party (PvdA), which won 41 and 38 seats respectively in the 2012 general election (Chart 1). The major opposition parties are far-right Freedom Party (PVV, 15 seats), the far-left Socialist Party (SP, 15 seats), the Christian Democrats (CDA, 13 seats) and the social liberals (D66, 12 seats).

Election campaign issues

Europe

No change in European policies should be expected. Most parties would like to see a strict application of both the “no bail-out” clause and the Stability and Growth Pact for all eurozone countries. The VVD programme is most explicit on this point: it only wants to give temporary support to countries in difficulty if they agree to structural reforms. If member states are unwilling to reform, they should be forced to leave the euro, say the VVD. The party is also firmly against the issuing of eurobonds. The Green-Left party (GL) is the only party calling for more solidarity between eurozone countries.

Environment

The environment might be a critical element in coalition negotiations, especially if the support of GL is needed. With the exception of the PVV, all parties support the Paris Climate Agreement. Other common elements in party manifestos are the greening of the tax base, the improvement of the EU emissions trading system, the closing of all coal-fired power stations and more investment in renewable energy and energy efficiency. On nuclear energy, GL and PvdA would like to see the closure of the only remaining nuclear power station in the Netherlands in Borssele. D66 agrees that nuclear energy cannot be a long-term solution, but does not call for the immediate closure of the plant. Only the VVD would like to keep

The polls suggest a defeat for the coalition

Seats: ■ General election 2012 ■ Latest poll (11 December)

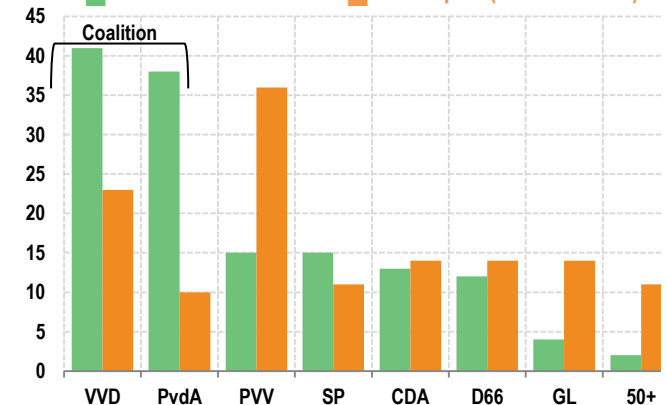


Chart 1

Sources: Kiesraad, Peil.nl

nuclear energy as an option, on condition that it can be produced safely.

Labour market and retirement

Policies concerning the labour market and retirement will probably be the most difficult for a coalition to agree. All parties are concerned about the dichotomy of the Dutch labour market, with well-protected employees on permanent contracts on one side and workers on short-term contracts on the other side; but they differ in their solutions. VVD, CDA and D66 would like to see further easing of employment protection legislation, which is among the strictest in the OECD. In addition, VVD and D66 want to ease rules for freelance workers (ZZP-ers). In contrast, PvdA, GL and SP would like to see higher unemployment insurance contributions by employers for fixed-contract workers. These parties plus CDA would like to limit the growth of ZZP-ers by requiring more protection for them.

In the low interest-rate environment, the liabilities of Dutch occupational pension schemes have substantially increased, which has led to a decline in their funding ratios. The schemes have responded by raising contributions, suspending indexation, and in many cases reducing benefits. Pension reform is high on the agenda. VVD and D66 would like to see a more flexible and individualised pension system. PvdA, SP and GL would like to see a higher discount rate for liabilities, as the current rate is exceptionally low.

Government finances

With the exception of PVV, GL and SP, all parties would like to balance the budget over the cycle, and the current fiscal framework, whereby the coalition partners agree on spending limits at the start of the new government term, is widely accepted. In general, the main parties want to simplify the tax system and lower the tax rate on savings, increase environmental levies and use the proceeds to ease the tax burden on labour.



The VVD campaigns for lower corporate taxes. Some parties (D66, PvdA and GL) would like to limit how much tax can be deducted from interest payments by companies, to make the tax system more neutral with respect to the financial structure of the company. These proposals may be included in a future coalition agreement. Proposals for a uniform European corporate tax as well as for a limit on mortgage interest relief are unlikely to make it into a coalition agreement.

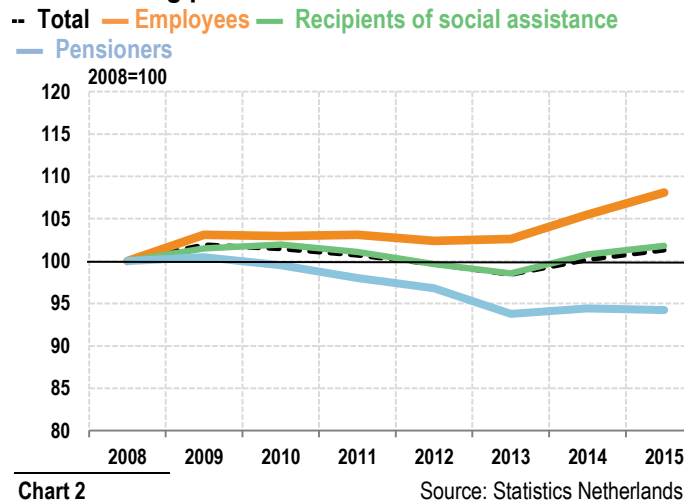
The imbroglio of forming a new coalition government

The current Rutte government adopted policies which contributed to the economic turnaround. When it came to power in November 2012, the Dutch economy was in dire straits following the financial crisis. In Q4 2012, GDP was close to 3% below its 2008 peak. The government accelerated budgetary consolidation programmes and introduced structural reforms in the labour market, such as raising the mandatory retirement age to 67, which allowed for a fall in occupational pension contributions. The latest quarterly data show GDP in Q3 2016 was 6.7% above the level in Q4 2012 and unemployment had declined by 0.4 percentage points.

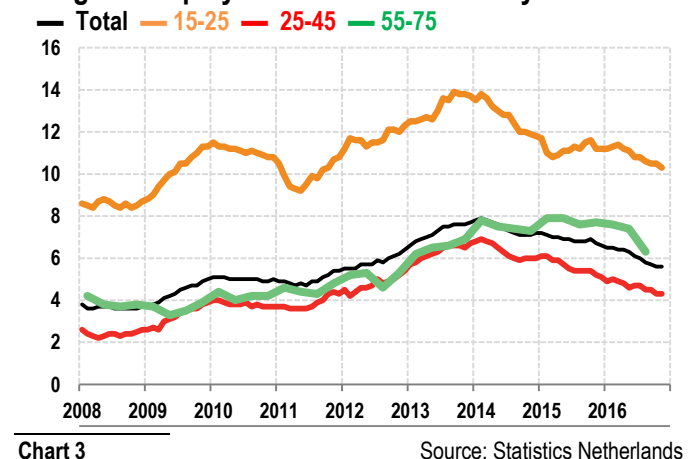
Nevertheless, discontent among Dutch voters has grown substantially, as large sectors of society feel they have been disadvantaged. In terms of purchasing power, pensioners were worse off because of cuts in pension benefits (Chart 2). This group was also much affected by the reductions in health spending. Employees fared best because of a fall in pension contributions. However, in return they had to accept an increase of the retirement age to 67. In addition, job insecurity has increased, in particular for older workers. Unemployment among them has remained high, despite a general improvement in labour market conditions (Chart 3). Opinion polls suggest that the Dutch coalition government is in for a drubbing at the general election in March 2017. As the former Luxembourg Prime Minister Jean-Claude Juncker once famously remarked, 'We all know what we should do, but we don't know how to get elected after we've done it'.

The PVV -- cashing on fears about the inflow of refugees, insecurity and costs related to financial support for southern European countries -- currently leads in the polls and is predicted to win more than 30 seats. On the left, the Green-Left party has been making a strong comeback since the last election and could win up to 15 seats (four previously) thanks to the popularity of its youthful leader Jesse Klaver. The party is a refuge for disappointed Labour Party voters who do not share the anti-EU stance of the SP. Support for the elderly party 50Plus has also risen, perhaps to 10 seats (from two), out of concern about the income of the elderly and cuts in the care sector.

Purchasing power since the crisis



High unemployment rate for the elderly



A new coalition government will be difficult to form. Most parties are unwilling to cooperate with the PVV because of its uncompromising stance on certain issues, such as Islam and migration. A centre-right coalition around VVD, CDA and D66 might only muster just over 50 seats. It could still succeed with the tacit support from GL and some one-issue parties such as 50Plus. Whatever the outcome, it seems likely that a protracted period of negotiation to form a new government is likely.



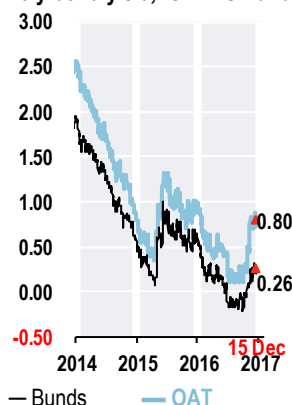
Markets overview

The essentials

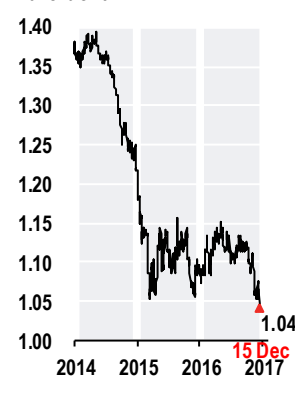
Week 9-12 16 > 15-12-16

➔ CAC 40	4 764	➔ 4 819	+1.2 %
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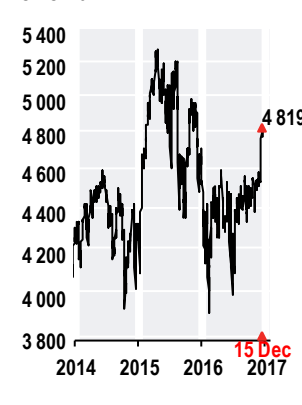
10 y bond yield, OAT vs Bund



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	-0.32	-0.13	at 01/01	-0.32	at 08/12
Euribor 12M	-0.08	0.06	at 01/01	-0.08	at 14/12
\$ FED	0.75	0.75	at 15/12	0.50	at 01/01
Libor 3M	0.97	0.97	at 14/12	0.61	at 04/01
Libor 12M	1.65	1.65	at 12/12	1.12	at 12/02
£ BoE	0.25	0.50	at 01/01	0.25	at 04/08
Libor 3M	0.38	0.59	at 15/02	0.38	at 08/09
Libor 12M	0.79	1.07	at 01/01	0.72	at 10/08

At 15-12-16

Yield (%)		highest' 16		lowest' 16	
€ AVG 5-7y	0.27	0.63	at 12/12	-0.14	at 27/09
Bund 2y	-0.78	-0.34	at 01/01	-0.79	at 28/11
Bund 10y	0.26	0.63	at 01/01	-0.22	at 28/09
OAT 10y	0.80	0.98	at 01/01	0.10	at 27/09
Corp. BBB	1.62	2.50	at 20/01	1.14	at 07/09
\$ Treas. 2y	1.27	1.27	at 15/12	0.56	at 05/07
Treas. 10y	2.58	2.58	at 15/12	1.36	at 08/07
Corp. BBB	3.95	4.50	at 12/02	3.24	at 18/08
£ Treas. 2y	0.14	0.65	at 01/01	0.07	at 29/09
Treas. 10y	1.49	1.96	at 01/01	0.61	at 12/08

At 15-12-16

10y bond yield & spreads

7.36%	Greece	710 pb
3.78%	Portugal	352 pb
1.87%	Italy	160 pb
1.43%	Spain	117 pb
0.89%	Ireland	63 pb
0.80%	France	54 pb
0.67%	Belgium	41 pb
0.64%	Austria	37 pb
0.52%	Netherlands	25 pb
0.51%	Finland	25 pb
0.26%	Germany	

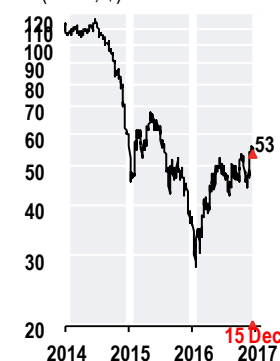
Commodities

Spot price in dollars		lowest' 16		2016(€)	
Oil, Brent	53	28	at 20/01	+56.3%	
Gold (ounce)	1 127	1 062	at 01/01	+10.6%	
Metals, LMEX	2 793	2 049	at 12/01	+32.2%	
Copper (ton)	5 724	4 328	at 15/01	+26.9%	
CRB Foods	340	322	at 09/11	+5.8%	
wheat (ton)	148	126	at 16/08	-0.2%	
Corn (ton)	133	113	at 31/08	+0.7%	

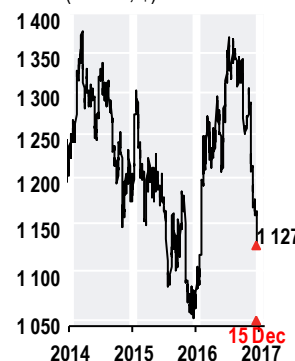
At 15-12-16

Variations

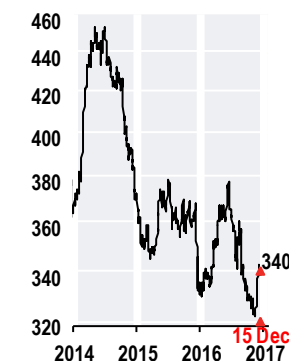
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

1€ =		highest' 16		lowest' 16		2016	
USD	1.04	1.15	at 03/05	1.04	at 15/12	-4.1%	
GBP	0.84	0.90	at 13/10	0.73	at 05/01	+13.9%	
CHF	1.07	1.11	at 04/02	1.07	at 18/11	-1.2%	
JPY	123.50	131.84	at 01/02	110.95	at 08/07	-5.5%	
AUD	1.42	1.60	at 11/02	1.41	at 09/12	-5.1%	
CNY	7.22	7.54	at 22/08	6.99	at 05/01	+2.4%	
BRL	3.53	4.53	at 16/02	3.39	at 25/10	-17.8%	
RUB	64.46	91.22	at 11/02	64.46	at 15/12	-18.8%	
INR	70.67	77.50	at 11/02	70.67	at 15/12	-1.7%	

At 15-12-16

Variations

Equity indices

Index		highest' 16		lowest' 16		2016		2016(€)
CAC 40	4 819	4 819	at 15/12	3 897	at 11/02	+3.9%		+3.9%
S&P500	2 262	2 272	at 13/12	1 829	at 11/02	+10.7%		+15.4%
DAX	11 366	11 366	at 15/12	8 753	at 11/02	+5.8%		+5.8%
Nikkei	19 274	19 274	at 15/12	14 952	at 24/06	+1.3%		+7.1%
China*	59	65	at 22/09	48	at 12/02	-1.4%		+2.7%
India*	447	504	at 08/09	393	at 11/02	-0.3%		+1.4%
Brazil*	1 563	1 882	at 31/10	860	at 21/01	+29.3%		+57.3%
Russia*	596	609	at 13/12	331	at 20/01	+29.0%		+53.6%

At 15-12-16

Variations

* MSCI index



Economic forecasts

En %	GDP Growth			Inflation			Curr. account / GDP			Fiscal balances / GDP		
	2016 e	2017 e	2018 e	2016 e	2017 e	2018 e	2016 e	2017 e	2018 e	2016 e	2017 e	2018 e
Advanced	1.6	1.7	2.1	0.8	1.7	1.9						
United States	1.5	2.2	2.8	1.2	2.2	2.6	-2.5	-2.4	-2.4	-3.4	-4.2	-5.0
Japan	0.8	0.9	0.7	-0.1	1.1	1.0	3.8	4.0	4.4	-4.6	-4.2	-4.1
United Kingdom	2.1	1.1	1.6	0.6	2.4	2.6	-5.5	-4.6	-3.5	-3.7	-4.0	-4.1
Euro Area	1.6	1.2	1.5	0.2	1.2	1.3	3.2	2.9	2.9	-1.8	-1.6	-1.4
Germany	1.8	1.5	1.8	0.4	1.6	1.5	8.9	8.1	8.4	0.6	0.6	0.5
France	1.3	1.1	1.5	0.3	1.0	1.1	-0.9	-0.6	-0.8	-3.4	-3.1	-2.8
Italy	0.8	0.4	0.7	-0.1	0.9	1.0	2.0	2.2	2.0	-2.5	-2.6	-2.6
Spain	3.2	2.1	1.9	-0.4	1.6	1.6	1.1	1.6	1.6	-4.6	-3.8	-3.2
Netherlands	2.2	1.5	1.4	0.1	0.8	1.2	8.5	8.2	7.9	-1.1	-0.5	-0.2
Belgium	1.4	1.2	1.4	1.8	1.6	1.6	0.8	0.6	0.6	-2.9	-1.6	-1.9
Emerging	4.3	4.6	5.1	4.8	4.4	4.2						
China	6.7	6.2	6.4	2.0	2.3	2.5	2.2	1.7	1.5	-3.0	-3.3	-3.5
India	7.5	8.1	8.3	5.0	5.7	4.9	-1.1	-0.5	-1.3	-3.9	-3.5	-3.5
Brazil	-3.7	1.0	3.0	8.8	4.9	4.4	-1.2	-1.7	-2.5	-9.6	-10.4	-8.4
Russia	-0.5	1.0	2.5	7.0	4.6	4.2	2.5	2.7	3.2	-3.9	-3.0	-1.9
World	3.1	3.3	3.8	3.1	3.3	3.3						

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

Financial forecasts

Interest rates		2016				2017				2016e	2017e	2018e
End period		Q1	Q2	Q3	Q4e	Q1e	Q2e	Q3e	Q4e			
US	Fed Funds	0.25-0.5	0.25-0.5	0.25-0.5	0.50-0.75	0.50-0.75	0.50-0.75	0.75-1.00	1.00-1.25	0.50-0.75	1.00-1.25	2.00-2.25
	3-month Libor \$	0.63	0.65	0.85	0.91	0.90	0.90	0.95	1.10	0.91	1.10	2.45
	10-year T-notes	1.79	1.49	1.61	2.35	2.55	2.75	2.85	3.00	2.35	3.00	3.50
EMU	Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	3-month Euribor	-0.24	-0.29	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15
	10-year Bund	0.16	-0.13	-0.19	0.30	0.40	0.50	0.60	0.70	0.30	0.70	1.20
	10-year OAT	0.41	0.20	0.12	0.75	0.90	0.90	1.00	1.10	0.75	1.10	1.70
	10-year BTP	1.23	1.35	1.19	2.05	1.90	2.10	2.30	2.50	2.05	2.50	3.00
UK	Base rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
	3-month Libor £	0.59	0.56	0.38	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
	10-year Gilt	1.42	1.02	0.76	1.55	1.70	1.65	1.75	1.90	1.55	1.90	2.15
Japan	Overnight call rate	-0.00	-0.06	-0.06	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
	3-month JPY Libor	0.10	0.06	0.06	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
	10-year JGB	-0.04	-0.23	-0.08	0.00	0.05	0.05	0.10	0.15	0.00	0.15	0.15

Exchange rates		2016				2017				2016e	2017e	2018e
End period		Q1	Q2	Q3	Q4e	Q1e	Q2e	Q3e	Q4e			
USD	EUR / USD	1.14	1.11	1.12	1.07	1.04	1.02	1.02	1.00	1.07	1.00	1.09
	USD / JPY	112	103	101	110	115	120	125	128	110	128	135
EUR	EUR / GBP	0.79	0.83	0.87	0.86	0.84	0.82	0.82	0.80	0.86	0.80	0.76
	EUR / CHF	1.09	1.08	1.09	1.07	1.08	1.10	1.12	1.12	1.07	1.12	1.15
	EUR/JPY	128	114	114	118	120	122	128	128	118	128	147

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



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