



## Summary

### Germany

**Favourable business climate despite uncertainties**

The IFO climate index has been on a rising trend, supported by strong activity. But entrepreneurs are reluctant to invest given skill shortages and political uncertainty.

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### China

**PBOC is acting to reduce financial risks**

Recent growth acceleration has enabled China's central bank to start to tighten its monetary policy, but downside risks to short-term economic prospects remain high and the authorities' determination to contain financial risks could be tested rapidly in case of another slowdown in economic activity.

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## France: A (temporary) slowdown

■ Growth was limited to 0.3% in the first quarter ■ Consumer spending is sluggish ■ Investment is strong

The French economy grew by 0.3% q/q in the first quarter of 2017 according to INSEE's first estimate. This figure was slightly below what more upbeat confidence surveys were suggesting.

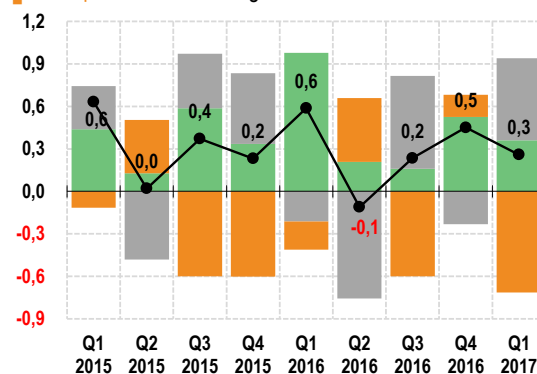
The weak areas (consumer spending was virtually stagnant and there was a marked fall in exports) were, however, explained by one-off factors (the weather, fluctuations in Airbus deliveries).

And they should not overshadow the strong points, notably the sharp rise in business and household investment.

Besides, this moderate growth figure does not call into question the strength of the ongoing French recovery, which is becoming job-richer, if we are to believe INSEE's new labour market climate indicator which is at its highest since 2011.

### FRANCE, MODERATE GROWTH

Contribution to growth, q/q, percentage points  
■ final domestic demand ■ change in business inventories  
■ net exports — real GDP growth



Source: INSEE

### THE WEEK ON THE MARKETS

Week 21-4 17 > 27-4-17

➤ CAC 40	5 059	➤ 5 272	+4.2 %
➤ S&P 500	2 349	➤ 2 389	+1.7 %
➤ Volatility (VIX)	14.6	➤ 10.4	-4.3 %
➤ Euribor 3M (%)	-0.33	➤ -0.33	+0.2 bp
➤ Libor \$ 3M (%)	1.16	➤ 1.17	+1.6 bp
➤ OAT 10y (%)	0.88	➤ 0.76	-12.5 bp
➤ Bund 10y (%)	0.25	➤ 0.30	+5.0 bp
➤ US Tr. 10y (%)	2.24	➤ 2.30	+6.1 bp
➤ Euro vs dollar	1.07	➤ 1.09	+1.7 %
➤ Gold (ounce, \$)	1 286	➤ 1 265	-1.6 %
➤ Oil (Brent, \$)	51.9	➤ 50.7	-2.4 %

Source: Thomson Reuters



## Germany

### Favourable business climate despite uncertainties

- The IFO climate index has been on a rising trend, supported by strong activity.
- The main drivers are the pick-up in global trade, euro weakness, and low interest rates.
- The lack of skilled workers is increasingly weighing on business investment.
- Entrepreneurs may also be reluctant to invest given the political uncertainty.

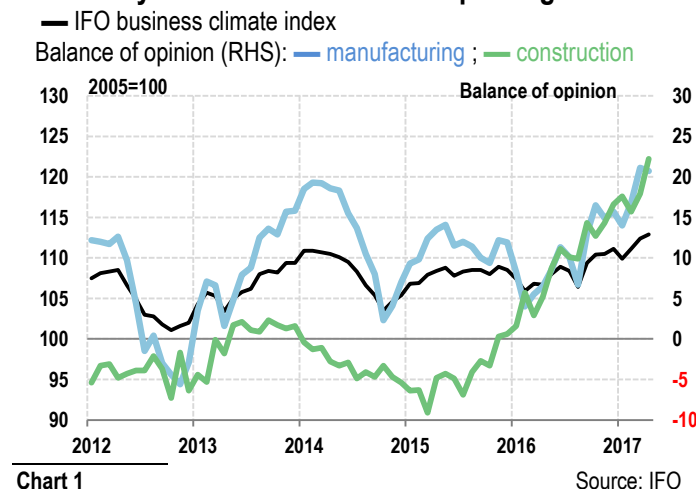
The German economy has been very dynamic in recent months. Sentiment indicators have picked up strongly and the earliest hard data confirm this picture. The IFO climate index has been on a rising trend since February. It reached 122.7, its highest value since 2011. Business leaders were in particular very satisfied with current business conditions. This component of the index has been improving since September 2016. However, the IFO panel remains rather cautious concerning the outlook. The expectations component has only marginally risen in recent months. That is not surprising given the uncertainties that the economy faces such as the unpredictable course of the new US administration, the triggering of article 50 by the UK government, and the elections in France and Germany.

In particular, the manufacturing sector recovered from the stagnation in the fourth quarter of 2016. In January-February, industrial output was on average 1.8% higher than in the preceding three months. Activity is especially driven by the strong pick-up in global demand. In January-February, the three-month rate of change of global trade surged to 2.7% compared with 1.4% in the fourth quarter of 2016 (CPB World Trade Monitor). Another factor is euro weakness, related to the ECB's very accommodative policy stance.

The ECB policy is also a major driver behind the surge in activity in the construction industry, as low interest rates and a favourable employment outlook have boosted the demand for housing. Although consumer prices have been sluggish, house prices have been rapidly rising. In 2016, in the seven major cities, real estate prices were more than 10% higher from the preceding year. The IFO business climate in the construction sector improved, thanks to a further rise in the assessment of current conditions, which reached a new record high.

The favourable situation is also reflected in labour market developments. The unemployment has been on a downward trend, falling to only 3.9% in February. But the situation is not the same in all the Länder. The labour market is especially tight in Bavaria and Baden-Württemberg, where unemployment was close to 3% in 2016. The highest unemployment was measured in the eastern part of the country, the so-called New Länder. In Sachsen-Anhalt, it even reached 7.4%.

### Germany's business climate is improving



Much of the unemployment is linked to skill-mismatches. Entrepreneurs find it increasingly difficult to recruit skilled workers. That is also the case in the New Länder, as young skilled workers are moving to the western part of the country, attracted by better salaries and career prospects. This movement is weighing on the growth prospects of the region.

Another concern for employers is the rise in labour costs, partly due to the shortage of skilled workers. In the fourth quarter, labour costs were 1.5% higher from the preceding three months and 3.1% from a year earlier. However, trade unions might be willing to moderate their demands in order to remain competitive in European markets and avoid the delocalisation of plants. Many employers also consider the rise in energy and commodity prices as a risk for their business.

In the coming months, entrepreneurs may hold off investment decisions until the uncertainty concerning the outcome of the elections in several European countries is lifted. In Germany, the general election will be held on 24 September. Chancellor Angela Merkel and the SPD leader Martin Schulz are neck-to-neck in the polls. In case of an SPD victory, some of the reforms that were implemented in recent years may be reversed.



## China

### PBOC is acting to reduce financial risks

- Economic growth has picked up slightly over the past two quarters, supported by the authorities' stimulus policy measures. In Q1 2017, the growth acceleration was fuelled by a rebound in industrial activity, lifted by stronger domestic demand and an upturn in exports.
- This cyclical strengthening has enabled the central bank (PBOC) to start to tighten monetary policy cautiously, in response to the continued rise in credit risks and liquidity risks in the financial sector.
- However, downside risks to short-term economic growth prospects remain high, and the authorities' determination to contain financial risks could be tested rapidly in case of another slowdown in economic activity.

### Industrial production growth has accelerated

Economic growth accelerated slightly in Q4 2016 and again in Q1 2017. Real GDP rose by 6.9% year-on-year (y-o-y), compared to 6.8% in the previous quarter and 6.7% for full-year 2016. Of the three main sectors of activity, services continued to report the strongest growth (7.7% y-o-y in Q1 2017, vs. 7.8% in 2016), but the industry was the only sector to report an acceleration (6.4% y-o-y in Q1 2017, vs. 6.1% in 2016), buoyed by brighter export prospects and stronger domestic demand.

After two years of contraction, Chinese exports rose by 4% in Q1 2017 compared to Q1 2016 (in US dollars), in a world environment marked by an upturn in demand, prices and trade volumes. This recovery is likely to consolidate in the very short term, and the yuan's recent depreciation (-6% in real effective terms in 2016) is also likely to help. Yet downside risks are still high, notably due to the persisting uncertainty shrouding world trade growth prospects and the possible rise in trade tensions with the United States.

Domestic demand has been the main factor supporting Chinese economic growth over the past year, and again in Q1 2017. Stimulus policy measures have helped turn around three sectors in particular: i) public infrastructure: investment growth rebounded in H1 2016 and again in early 2017, notably in water conservation and environmental projects; ii) real estate: the market has gradually picked up since year-end 2015 (sales and prices have rebounded in a growing number of cities, then triggering an upturn in investment), in response to monetary policy loosening and to the easing of the government's "property policy" (i.e. the prudential rules applied to real estate transactions and loans); and iii) automobile sales, which rose more than 10% in 2016, stimulated by fiscal incentives. Automobile sales have dropped off since early 2017 after the tax rate on small car purchases increased. Retail sales are currently supported by the need for durable goods that is accompanying the rebound in real estate transactions; however, the continued

### Investment growth recovery

Nominal Fixed-Asset Investment, year-to-date, year-on-year, % :

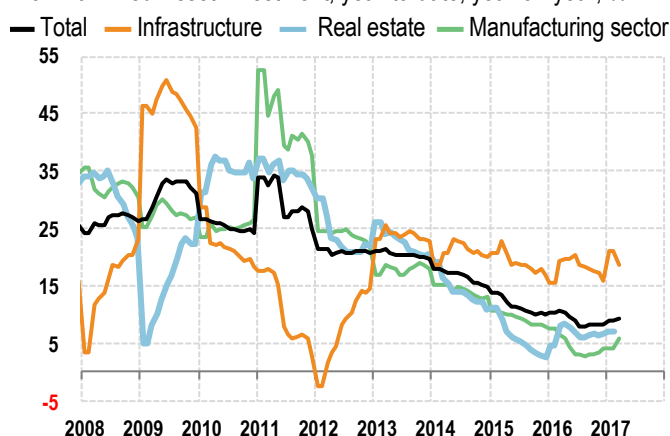


Chart 1

Source: NBS

slowdown in household revenue growth remains an important constraint on the expansion of private consumption.

The rebound in activity in the sectors directly targeted by the stimulus policy measures had only very limited spill over effects on the rest of the economy. Yet, investment in the manufacturing sector has also picked up since last fall, buoyed by the upturn in producer price inflation (which swung back into positive territory in September and reached 7.6% y-o-y in March 2017) and the growth rebound in profits of industrial enterprises (+9% in 2016, and +32% y-o-y in the first two months of 2017). The recovery in private investment growth in early 2017 also seems to have been fuelled by the development of infrastructure projects financed through public-private partnerships.

### Monetary policy is turning less growth-supportive

Infrastructure investment will remain a key growth engine in the quarters ahead. The expansionist fiscal policy could also take the form of new tax measures in favour of companies and households, if private demand were to slump again. In contrast, monetary policy has recently become less accommodative, and is likely to remain very cautious in the short term. The "property policy" has also become more restrictive in recent months (and still differentiated from one city to another), as home purchase restrictions and rules applied to mortgage loans have begun to be tightened in more than 30 cities where house prices have increased excessively fast.

PBOC (People's Bank Of China) has numerous objectives (it must guarantee price stability, support economic growth and the job market, promote financial reforms, etc.). Two main goals were given priority for 2016 and 2017: supporting economic growth and financial stability. The first priority led the monetary authorities to pursue an expansionist policy through Q3 2016, in response to the rapid



slowdown in industrial growth. The second priority justifies recent monetary policy tightening actions. As a matter of fact, credit risks, risks of liquidity tensions in the financial sector and risks of asset market bubbles are elevated and have only increased further over the past year. With the recent improvement in real GDP growth rates and industrial performance and the upturn in producer price inflation, the authorities have been able to rank their priorities somewhat differently.

PBOC has announced a “prudent and neutral” monetary policy for 2017, and set a target for growth in total social financing (+12%) that is slightly lower than the 2016 target (+12.8%). In fact, the authorities have already taken actions to tighten monetary conditions.

The central bank uses a series of liquidity management instruments, such as reserve requirement ratios but, most importantly, it has also resorted increasingly to open-market operations and to “liquidity facilities”, which enable to provide liquidity to certain well-targeted institutions. Interest rates on these liquidity facilities and repo rates have in fact become the main determinants of interbank market rates. Repo rates have been increased gradually since Q4 2016 and the rates on the liquidity facilities have been increased since early 2017.

PBOC still has recourse to its “benchmark interest rates on loans and deposits”. Although there are no longer any interest rate controls since October 2015, commercial banks continue to monitor these benchmark rates to determine the rates they offer customers. These benchmark interest rates, which were cut six consecutive times between year-end 2014 and year-end 2015, have been held steady ever since.

These actions illustrate the cautious approach of the monetary authorities. They want to avoid raising too much the cost of borrowing for households and corporates in order not to weigh on activity or aggravate debt servicing charges, but at the same time, they tighten monetary rates in order to discourage the use of interbank financing. Interbank financing has indeed increased steadily in the recent past and is largely used by small banks and non-bank financial institutions (shadow banking). The problem is that excessive reliance on interbank financing aggravates the risks of financial instability, by increasing the volatility of the creditors' sources of financing, balance-sheet transformation risks and contagion risks in case of a liquidity squeeze on certain institutions. These risks only add to the already high level of credit risks resulting from the debt excess of the Chinese economy (debt of the non-financial sector reached an estimated 213% of GDP at the end of Q1 2017), from the lack of supervision and weak governance of financial institutions.

New macro-prudential measures were introduced in recent months to address this later point, aimed at strengthening risk management by both the authorities and the financial institutions.

### Repo rates trending up (%)

--- Benchmark rate on 1-year loans — 7-day repo rate  
■ Non-financial sector debt, year-on-year (r.h.s.)

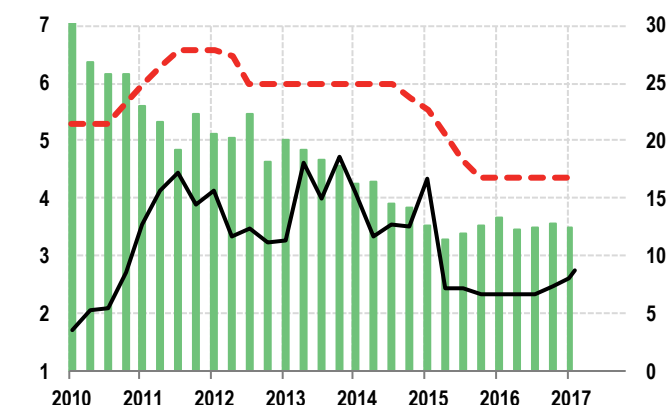


Chart 2

Sources: PBOC, BNPParibas

Prudent monetary policy tightening, a more restrictive property policy in cities with overheating housing markets, and a tighter regulatory framework for the financial sector are positive steps, which might not enable to reverse, but at least could help stabilize the dynamic of worsening credit risks registered in the last decade. However, to achieve this would mean maintaining a “cautious policy tightening” stance. Yet this policy could be rapidly called into question if economic growth were to slow down excessively, due to the very impact of the recent tightening of monetary conditions, for example. Stable economic growth will indeed remain Beijing's top priority, at least until the 19th Congress of the Communist Party in fall 2017.





## Markets overview

## The essentials

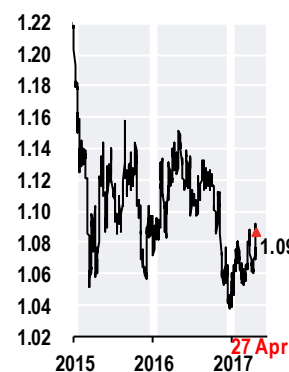
Week 21-4-17 &gt; 27-4-17

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➤ Volatility (VIX)	14.6	➤ 10.4	-4.3 %
➤ Euribor 3M (%)	-0.33	➤ -0.33	+0.2 bp
➤ Libor \$ 3M (%)	1.16	➤ 1.17	+1.6 bp
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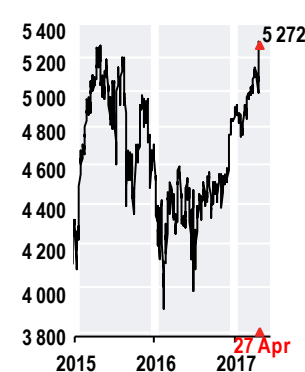
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



## Money &amp; Bond Markets

Interest Rates		highest' 17		lowest' 17	
€ ECB	0.00	0.00 at 02/01	0.00	at 02/01	
Eonia	-0.36	-0.35 at 04/01	-0.36	at 26/04	
Euribor 3M	-0.33	-0.32 at 02/01	-0.33	at 10/04	
Euribor 12M	-0.12	-0.08 at 02/01	-0.12	at 20/04	
\$ FED	1.00	1.00 at 16/03	0.75	at 02/01	
Libor 3M	1.17	1.17 at 26/04	1.00	at 02/01	
Libor 12M	1.78	1.83 at 15/03	1.68	at 06/01	
£ BoE	0.25	0.25 at 02/01	0.25	at 02/01	
Libor 3M	0.32	0.37 at 05/01	0.32	at 26/04	
Libor 12M	0.68	0.78 at 09/01	0.68	at 26/04	

At 27-4-17

Yield (%)		highest' 17		lowest' 17	
€ AVG 5-7y	0.47	0.68 at 17/03	0.23	at 02/01	
Bund 2y	-0.77	-0.66 at 25/01	-0.96	at 24/02	
Bund 10y	0.30	0.49 at 10/03	0.09	at 02/01	
OAT 10y	0.76	1.14 at 06/02	0.67	at 02/01	
Corp. BBB	1.40	1.65 at 01/02	1.39	at 18/04	
\$ Treas. 2y	1.25	1.38 at 14/03	1.14	at 24/02	
Treas. 10y	2.30	2.61 at 13/03	2.18	at 18/04	
Corp. BBB	3.62	3.90 at 14/03	3.56	at 18/04	
£ Treas. 2y	0.02	0.22 at 06/01	0.01	at 28/02	
Treas. 10y	1.00	1.51 at 26/01	0.97	at 18/04	

At 27-4-17

10y bond yield &amp; spreads

6.44%	Greece	613 pb
3.48%	Portugal	317 pb
2.26%	Italy	195 pb
1.62%	Spain	132 pb
0.83%	Ireland	52 pb
0.77%	Belgium	47 pb
0.76%	France	45 pb
0.54%	Netherlands	23 pb
0.49%	Austria	18 pb
0.40%	Finland	10 pb
0.30%	Germany	

## Commodities

Spot price in dollars		lowest' 17		2017(€)	
Oil, Brent	51	50 at 22/03	-13.3%		
Gold (ounce)	1 265	1 156 at 03/01	+6.1%		
Metals, LMEX	2 788	2 639 at 03/01	+1.8%		
Copper (ton)	5 669	5 487 at 03/01	-0.4%		
CRB Foods	328	325 at 24/04	-5.9%		
wheat (ton)	155	146 at 24/04	+2.9%		
Corn (ton)	135	130 at 23/03	-1.5%		

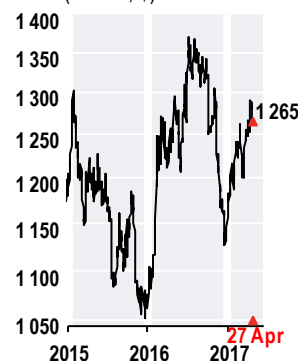
At 27-4-17

Variations

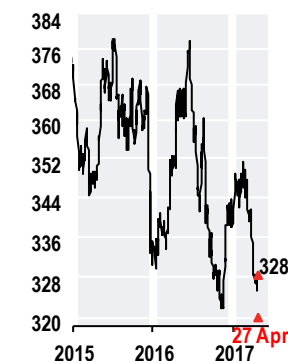
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



## Exchange Rates

1€ =		highest' 17		lowest' 17		2017	
USD	1.09	1.09 at 25/04	1.04	at 03/01	+3.0%		
GBP	0.84	0.88 at 16/01	0.84	at 19/04	-1.3%		
CHF	1.08	1.09 at 25/04	1.06	at 08/02	+0.8%		
JPY	120.82	123.21 at 06/01	115.57	at 17/04	-1.8%		
AUD	1.46	1.46 at 27/04	1.37	at 23/02	+0.1%		
CNY	7.49	7.52 at 25/04	7.22	at 03/01	+2.2%		
BRL	3.45	3.46 at 26/04	3.24	at 15/02	+0.5%		
RUB	62.20	64.95 at 31/01	59.66	at 17/04	-3.4%		
INR	69.70	73.32 at 31/01	68.18	at 07/04	-2.6%		

At 27-4-17

Variations

## Equity indices

Index		highest' 17		lowest' 17		2017		2017(€)
CAC 40	5 272	5 288 at 26/04	4 749	at 31/01	+8.4%		+8.4%	
S&P500	2 389	2 396 at 01/03	2 239	at 02/01	+6.7%		+3.6%	
DAX	12 444	12 473 at 26/04	11 510	at 06/02	+8.4%		+8.4%	
Nikkei	19 252	19 634 at 13/03	18 336	at 14/04	+0.7%		+2.6%	
China*	68	68 at 25/04	59	at 02/01	+16.7%		+12.9%	
India*	534	535 at 26/04	445	at 03/01	+12.9%		+16.0%	
Brazil*	1 821	2 001 at 22/02	1 654	at 02/01	+6.3%		+5.7%	
Russia*	567	622 at 03/01	537	at 09/03	-10.8%		-8.7%	

At 27-4-17

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
<b>Advanced</b>	<b>1.6</b>	<b>2.0</b>	<b>2.1</b>	<b>0.8</b>	<b>2.0</b>	<b>1.9</b>						
<b>United States</b>	<b>1.6</b>	<b>2.2</b>	<b>2.7</b>	<b>1.3</b>	<b>2.4</b>	<b>2.6</b>	<b>-2.5</b>	<b>-2.4</b>	<b>-2.4</b>	<b>-3.4</b>	<b>-4.2</b>	<b>-5.0</b>
Japan	1.0	1.2	0.9	-0.1	0.7	1.0	3.8	4.2	4.6	-4.7	-4.4	-4.1
United Kingdom	1.8	1.8	1.1	0.6	2.7	2.6	-4.7	-4.1	-3.2	-3.0	-2.7	-3.1
<b>Euro Area</b>	<b>1.7</b>	<b>1.6</b>	<b>1.6</b>	<b>0.2</b>	<b>1.8</b>	<b>1.4</b>	<b>3.4</b>	<b>3.0</b>	<b>3.1</b>	<b>-1.7</b>	<b>-1.4</b>	<b>-1.2</b>
Germany	1.8	1.8	2.0	0.4	1.9	1.6	8.8	8.3	8.5	0.6	0.7	0.6
France	1.1	1.3	1.5	0.3	1.6	1.0	-0.9	-0.9	-1.1	-3.4	-3.0	-2.7
Italy	1.0	0.6	0.6	-0.1	1.6	1.0	2.1	2.2	2.1	-2.4	-2.4	-2.5
Spain	3.3	2.6	2.0	-0.3	2.2	1.5	1.8	2.1	2.1	-4.6	-3.6	-3.0
Netherlands	2.1	2.1	1.6	0.1	1.2	1.4	8.7	8.7	8.3	-0.5	0.0	0.3
Belgium	1.2	1.4	1.5	1.8	2.1	1.9	0.7	0.5	0.5	-3.0	-2.3	-2.2
<b>Emerging</b>	<b>4.2</b>	<b>4.5</b>	<b>5.0</b>	<b>4.8</b>	<b>4.6</b>	<b>4.4</b>						
China	6.7	6.5	6.4	2.0	2.7	2.5	1.9	1.6	1.4	-3.0	-3.5	-3.3
India	7.5	7.3	7.8	5.0	5.2	5.3	-1.1	-0.8	-1.7	-3.8	-3.5	-3.2
Brazil	-3.6	1.0	3.0	8.8	4.1	4.3	-1.2	-1.4	-2.1	-8.9	-9.6	-8.3
Russia	-0.2	1.8	1.4	7.1	4.9	4.5	1.9	3.4	3.2	-3.7	-2.7	-2.1
<b>World</b>	<b>3.1</b>	<b>3.4</b>	<b>3.8</b>	<b>3.1</b>	<b>3.5</b>	<b>3.3</b>						

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

## Financial forecasts

Interest rates		2016				2017				2016	2017e	2018e
End period		Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e			
<b>US</b>	Fed Funds	0.25-0.5	0.25-0.5	0.25-0.5	0.5-0.75	1	0.75-1.00	1.00-1.25	1.25-1.50	0.5-0.75	1.25-1.50	2.25-2.50
	3-month Libor \$	0.63	0.65	0.85	1.00	1.15	1.25	1.50	1.75	1.00	1.75	2.50
	10-year T-notes	1.79	1.49	1.61	2.45	2.40	3.00	3.25	3.50	2.45	3.50	4.00
<b>EMU</b>	Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25
	3-month Euribor	-0.24	-0.29	-0.30	-0.32	-0.33	-0.33	-0.30	-0.30	-0.32	-0.30	-0.05
	10-year Bund	0.16	-0.13	-0.19	0.11	0.33	0.50	0.75	1.00	0.11	1.00	1.60
	10-year OAT	0.41	0.20	0.12	0.69	0.97	0.95	1.15	1.45	0.69	1.45	2.00
	10-year BTP	1.23	1.35	1.19	1.84	2.13	2.20	2.60	3.00	1.84	3.00	3.40
<b>UK</b>	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	0.37	0.34	0.40	0.40	0.40	0.37	0.40	0.40
	10-year Gilt	1.42	1.02	0.76	1.24	1.07	1.55	1.75	1.90	1.24	1.90	2.50
<b>Japan</b>	Overnight call rate	-0.00	-0.06	-0.06	-0.06	-0.06	-0.10	-0.10	-0.10	-0.06	-0.10	-0.10
	3-month JPY Libor	0.10	0.06	0.06	0.06	0.06	0.05	0.05	0.05	0.06	0.05	0.05
	10-year JGB	-0.04	-0.23	-0.08	0.05	0.07	0.10	0.10	0.30	0.05	0.30	0.40

Exchange rates		2016				2017				2016	2017e	2018e
End period		Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e			
<b>USD</b>	EUR / USD	1.14	1.11	1.12	1.05	1.07	1.02	1.02	1.00	1.05	1.00	1.06
	USD / JPY	112	103	101	117	111	121	124	128	117	128	130
<b>EUR</b>	EUR / GBP	0.79	0.83	0.87	0.85	0.86	0.82	0.82	0.80	0.85	0.80	0.82
	EUR / CHF	1.09	1.08	1.09	1.07	1.07	1.10	1.12	1.12	1.07	1.12	1.15
	EUR/JPY	128	114	114	123	119	123	126	128	123	128	138

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



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