

# ECOWEEK

N° 17-33 // 15 September 2017

## Pictures at an exhibition. On reducing the Fed's balance sheet

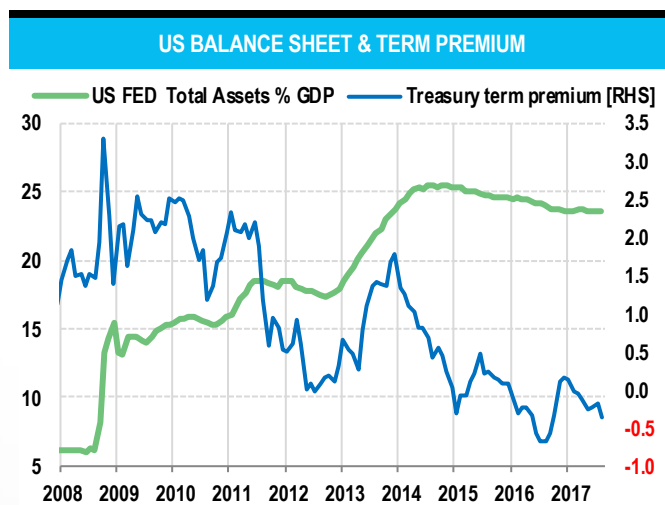
■ The Fed will probably announce the start of the reduction of its balance sheet at its meeting next week ■ Although not without risks, markets are relaxed about it ■ Fed forward guidance and rate decisions are more important than the balance sheet

In the minds of many market participants, they have received the following invite: "Your presence is requested at the vernissage in Washington DC on 20 September 2017". Based on a recent survey of investors by the Federal Reserve of New York, 57% expect an announcement of the start of the balance sheet reduction at the FOMC meeting next week. Janet Yellen described the gradual scaling back of the Federal Reserve's balance sheet with the now famous metaphor of watching paint dry, i.e. uneventful. This begs the question of whether in reality the piece of art will look like some modern monochrome painting or a Jackson Pollock. Perhaps we should go for the description given by Andrew Filardo of the BIS at a recent conference: it will be like performance art with the audience influencing the outcome.

For the time being at least, the audience, that is the markets, seem relaxed at this stage. The term premium, that is the risk premium for holding long-dated paper rather than short-term treasury bills, has been on a solid downtrend. In the above mentioned Fed survey, the median expected cumulative impact on 10 year treasury yields was +25 basis points over the coming two years. Simulations by the Federal Reserve of Kansas City point towards a similar, small increase, though the authors insist it could be as low as zero and as high as 75 basis points.

Reducing the size of the balance sheet means the "artificial" buyer of old days (during QE) now becomes an artificial seller. Everything else being the same, this would require lower prices and higher yields to balance the bond market. Reality is far more complex with many moving parts: fluctuations in risk appetite, international capital flows, bank credit, intended savings and investments. Eventually, the FOMC is still holding the key: via forward guidance and rate decisions it can influence the entire curve, thereby avoiding that an increase in the term premium would end up harming the economy. Looking at the balance sheet may very well be as exciting as watching paint dry but the real fun will be watching the Fed, as always.

William De Vijlder



Source : Federal Reserve Bank of New York, BNP Paribas

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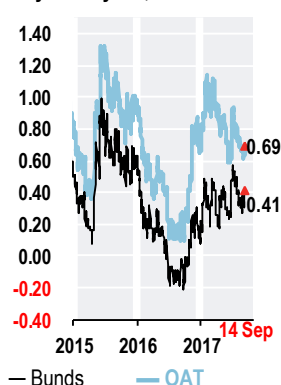
## Markets overview

### The essentials

Week 8-9 17 > 14-9-17

➤ CAC 40	5 113	➤ 5 225	+2.2 %
➤ S&P 500	2 461	➤ 2 496	+1.4 %
➤ Volatility (VIX)	12.1	➤ 10.4	-1.7 %
➤ Euribor 3M (%)	-0.33	➤ -0.33	+0.2 bp
➤ Libor \$ 3M (%)	1.31	➤ 1.32	+1.0 bp
➤ OAT 10y (%)	0.62	➤ 0.69	+7.0 bp
➤ Bund 10y (%)	0.32	➤ 0.41	+9.6 bp
➤ US Tr. 10y (%)	2.05	➤ 2.19	+13.3 bp
➤ Euro vs dollar	1.20	➤ 1.19	-1.2 %
➤ Gold (ounce, \$)	1 346	➤ 1 325	-1.5 %
➤ Oil (Brent, \$)	54.2	➤ 55.9	+3.2 %

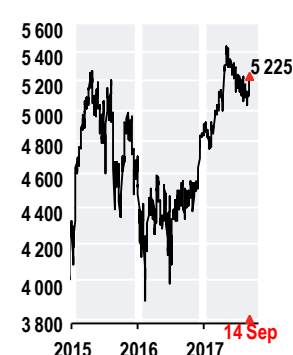
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



### Money & Bond Markets

Interest Rates	highest' 17	lowest' 17
€ ECB	0.00 at 02/01	0.00 at 02/01
Eonia	-0.36 at 02/06	-0.37 at 05/06
Euribor 3M	-0.33 at 02/01	-0.33 at 10/04
Euribor 12M	-0.17 at 02/01	-0.17 at 14/09
\$ FED	1.25 at 15/06	0.75 at 02/01
Libor 3M	1.32 at 13/09	1.00 at 02/01
Libor 12M	1.71 at 15/03	1.68 at 06/01
£ BoE	0.25 at 02/01	0.25 at 02/01
Libor 3M	0.30 at 05/01	0.28 at 01/09
Libor 12M	0.63 at 09/01	0.59 at 06/09

At 14-9-17

Yield (%)	highest' 17	lowest' 17
€ AVG 5-7y	0.37 at 17/03	0.18 at 21/06
Bund 2y	-0.76 at 27/06	-0.96 at 24/02
Bund 10y	0.41 at 06/07	0.09 at 02/01
OAT 10y	0.69 at 06/02	0.59 at 14/06
Corp. BBB	1.30 at 01/02	1.24 at 07/09
\$ Treas. 2y	1.37 at 03/07	1.14 at 24/02
Treas. 10y	2.19 at 13/03	2.05 at 08/09
Corp. BBB	3.47 at 14/03	3.38 at 05/09
£ Treas. 2y	0.32 at 29/06	0.01 at 28/02
Treas. 10y	1.27 at 26/01	0.87 at 14/06

At 14-9-17

10y bond yield & spreads

5.28%	Greece	488 pb
2.81%	Portugal	241 pb
2.05%	Italy	165 pb
1.61%	Spain	121 pb
0.73%	Ireland	33 pb
0.70%	Belgium	29 pb
0.69%	France	29 pb
0.59%	Austria	19 pb
0.53%	Netherlands	13 pb
0.41%	Germany	1 pb
0.40%	Finland	

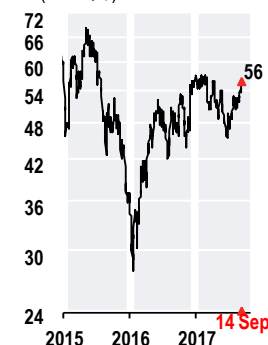
### Commodities

Spot price in dollars	lowest' 17	2017(€)
Oil, Brent	56 at 26/06	-12.4%
Gold (ounce)	1 325 at 03/01	+1.7%
Metals, LME	3 108 at 03/01	+3.8%
Copper (ton)	6 456 at 08/05	+3.8%
CRB Foods	332 at 24/04	-12.9%
wheat (ton)	160 at 24/04	-2.7%
Corn (ton)	123 at 30/08	-17.5%

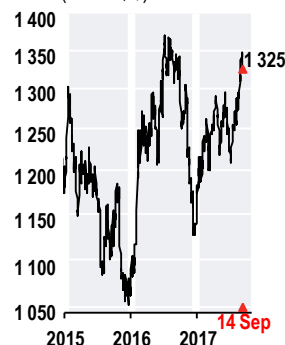
At 14-9-17

Variations

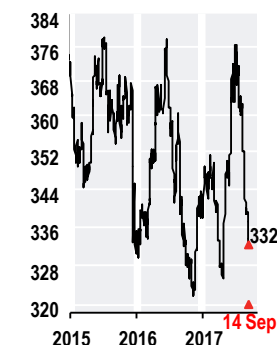
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



### Exchange Rates

1€ =	highest' 17	lowest' 17	2017
USD	1.19 at 29/08	1.04 at 03/01	+12.6%
GBP	0.89 at 29/08	0.84 at 19/04	+4.2%
CHF	1.15 at 03/08	1.06 at 08/02	+7.1%
JPY	131.38 at 13/09	115.57 at 17/04	+6.8%
AUD	1.49 at 01/06	1.37 at 23/02	+2.2%
CNY	7.78 at 03/08	7.22 at 03/01	+6.2%
BRL	3.72 at 29/08	3.24 at 15/02	+8.3%
RUB	68.24 at 02/08	59.66 at 17/04	+6.0%
INR	76.09 at 29/08	68.18 at 07/04	+6.3%

At 14-9-17

Variations

### Equity indices

Index	highest' 17	lowest' 17	2017	2017(€)
CAC 40	5 225 at 05/05	4 749 at 31/01	+7.5%	+7.5%
S&P500	2 496 at 13/09	2 239 at 02/01	+11.5%	-1.0%
DAX	12 540 at 19/06	11 510 at 06/02	+9.2%	+9.2%
Nikkei	19 807 at 20/06	18 336 at 14/04	+3.6%	-3.0%
China*	83 at 13/09	59 at 02/01	+42.4%	+25.8%
India*	577 at 04/08	445 at 03/01	+22.0%	+14.8%
Brazil*	2 114 at 11/09	1 639 at 21/06	+21.7%	+12.3%
Russia*	576 at 03/01	497 at 22/06	-8.9%	-15.0%

At 14-9-17

Variations

\* MSCI index



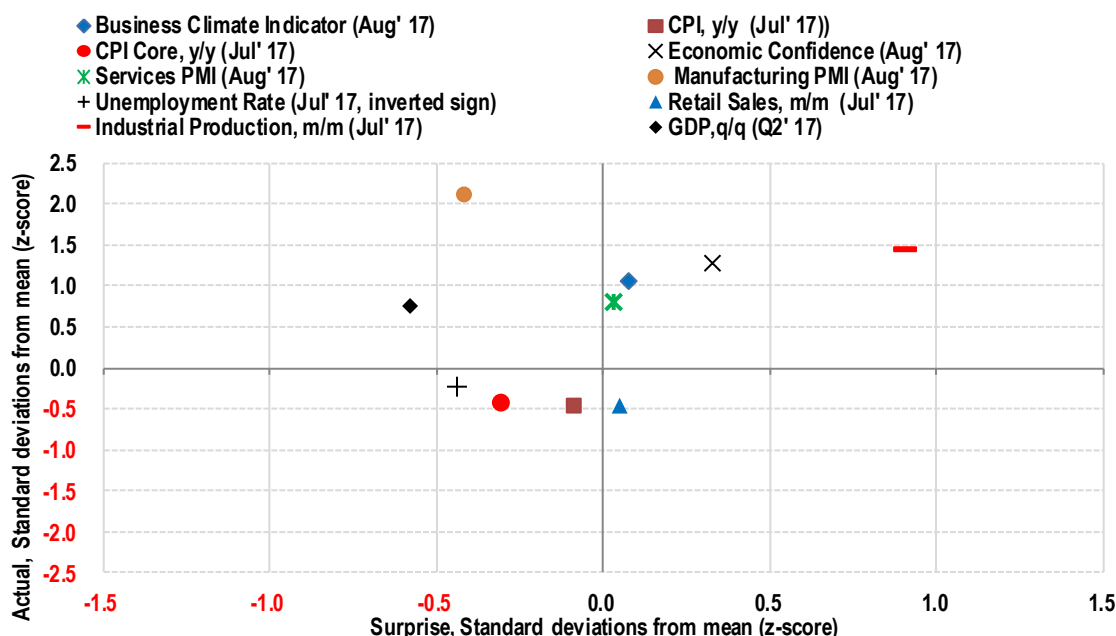
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## Pulse

## Eurozone: A genuine recovery

Recent economic indicators published in the Eurozone confirm the solidity of the recovery: most of them are in the upper part of the chart. In terms of surprises, deviations are less important, a sign that investors took stock of the strength of the Eurozone economy.



Note: z-score is a score which indicates how many standard deviations an observation is from the mean:  $z = (x - \mu) / \sigma$  where  $x$ : observation,  $\mu$ : mean,  $\sigma$ : standard deviation. On the X-axis,  $x$  corresponds at the last known surprise for each indicator represented on the graph,  $\mu$  and  $\sigma$  corresponds respectively to the mean and the standard deviation of the last 24 value for monthly data and the last 8 quarters for quarterly data. On the Y-axis,  $x$  corresponds at the last known value of indicator,  $\mu$  and  $\sigma$  corresponds respectively to the mean and the standard deviation for this indicator since 2000.

Sources: Bloomberg, Markit, BNP Paribas calculations

## Indicators preview

A busy week with the FOMC meeting, housing market data in the US, eurozone inflation and confidence and on Friday the September PMIs for several countries.

Date	Country	Event	Period	Survey	Prior
09/18/17	Eurozone	CPI MoM	Aug	--	-0.5%
09/18/17	United States	NAHB Housing Market Index	Sep	67	68
09/19/17	Germany	ZEW Survey Current Situation	Sep	--	86.7
09/19/17	United States	Housing Starts MoM	Aug	2.2%	-4.8%
09/19/17	United States	Building Permits MoM	Aug	-1.6%	-4.1%
09/20/17	United States	FOMC Rate Decision (Upper Bound)	Sept	1.25%	1.25%
09/21/17	Eurozone	Consumer Confidence	Sept	--	-1.5
09/21/17	Japan	BOJ Monetary Policy Statement			
09/22/17	France	GDP QoQ	2Q	--	0.5%
09/22/17	France	Markit France Manufacturing PMI	Sept	--	55.8
09/22/17	France	Markit France Services PMI	Sept	--	54.9
09/22/17	France	Markit France Composite PMI	Sept	--	55.2
09/22/17	Germany	Markit/BME Germany Manufacturing PMI	Sept	--	59.3
09/22/17	Germany	Markit Germany Services PMI	Sept	--	53.5
09/22/17	Germany	Markit/BME Germany Composite PMI	Sept	--	55.8
09/22/17	Eurozone	Markit Eurozone Manufacturing PMI	Sept	--	57.4
09/22/17	Eurozone	Markit Eurozone Services PMI	Sept	--	54.7
09/22/17	Eurozone	Markit Eurozone Composite PMI	Sept	--	55.7



## Economic scenario

### UNITED STATES

- GDP growth keeps on a decent 2% pace and picked-up a bit in Q2. However the fiscal outlook remains uncertain. A fiscal stimulus still is possible, but it would not be implemented before end-2017. Potential effects are thus uncertain.
- The labour market is as buoyant as ever. Still, the support to households' disposable income is not as strong as it looks as wage inflation remains limited.
- With inflation relatively muted at this stage of the cycle, the Fed is in no rush to increase rates. We forecast the Fed Funds target rates to come at 1.25/1.50% by year-end, 2/2.5% by mid-2018.

### CHINA

- After a period of stabilisation and slight recovery since Q2 2016, economic growth is expected to slow down moderately in the coming quarters.
- Exports should continue to rebound and infrastructure projects will continue to drive investment. However, downside risks are high due to the reduction in excess production capacity in the industry and given risks of a downturn in the property market and financial instability.
- The authorities will maintain an expansionist fiscal policy while the central bank should continue to tighten monetary conditions cautiously, especially to foster a deleveraging of financial institutions.

### EUROZONE

- The recovery is getting stronger and broader: the dispersion of economic performances among member states is receding.
- Despite the cyclical recovery, core inflation still shows no sign of a convincing upward trend. For the recovery to enter its inflationary phase the economy has to improve further, until the point at which wages will tend to increase.

The level of slack remains uncertain though. Broader measures of labor underutilization reach 18%, double the level of the current unemployment rate. The ECB is expected to remain cautious.

### FRANCE

- A clear growth acceleration is underway. Higher rates of growth should resume. Households' consumption is supported by the jobs recovery but restrained by the upturn in inflation. Investment and exports dynamics are favourable. Risks lie slightly on the upside.
  - We expect the output gap to slowly narrow and the unemployment rate to progressively decline, containing the rise in inflation.
- Fiscal policy should continue to combine growth supportive measures and consolidation ones. The fiscal deficit should not be a lot more reduced but it should remain below the 3% threshold.

### SUMMARY

%	GDP Growth			Inflation		
	2016	2017 e	2018 e	2016	2017 e	2018 e
<b>Advanced</b>	<b>1,6</b>	<b>2,1</b>	<b>1,9</b>	<b>0,8</b>	<b>1,6</b>	<b>1,7</b>
United-States	1,6	2,3	2,6	1,3	1,9	2,3
Japan	1,0	1,7	1,0	-0,1	0,4	0,6
United-Kingdom	1,8	1,5	1,0	0,6	2,8	2,8
<b>Euro Area</b>	<b>1,7</b>	<b>2,1</b>	<b>1,6</b>	<b>0,2</b>	<b>1,5</b>	<b>1,1</b>
Germany	1,8	1,8	2,0	0,4	1,9	1,7
France	1,1	1,6	1,6	0,3	1,4	1,0
Italy	1,0	1,3	0,9	-0,1	1,3	0,8
<b>Emerging</b>	<b>4,1</b>	<b>4,6</b>	<b>4,9</b>	<b>4,4</b>	<b>3,1</b>	<b>3,4</b>
China	6,7	6,6	6,4	2,0	1,8	2,3
India	7,5	7,3	7,8	4,9	4,9	5,2
Brazil	-3,5	1,0	3,0	8,8	3,6	3,8
Russia	-0,6	1,2	2,0	7,1	4,2	4,3

### FX RATES

Exchange Rates		2018					
End of period	Q4e	Q1e	Q2e	Q3e	Q4e	2017e	2018e
USD EUR / USD	1,13	1,15	1,17	1,19	1,20	1,13	1,20
USD / JPY	118	120	118	116	114	118	114
GBP / USD	1,26	1,29	1,31	1,37	1,41	1,26	1,41
USD / CHF	0,99	0,97	0,96	0,94	0,96	0,99	0,96
EUR EUR / GBP	0,90	0,89	0,89	0,87	0,85	0,90	0,85
EUR / CHF	1,12	1,12	1,12	1,12	1,15	1,12	1,15
EUR / JPY	133	138	138	138	137	133	137

### INTEREST RATES

Forecasts currently under revision.



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