

# ECOWEEK

N° 17-35 // 29 September 2017

## US treasuries disregard the dots for 2018

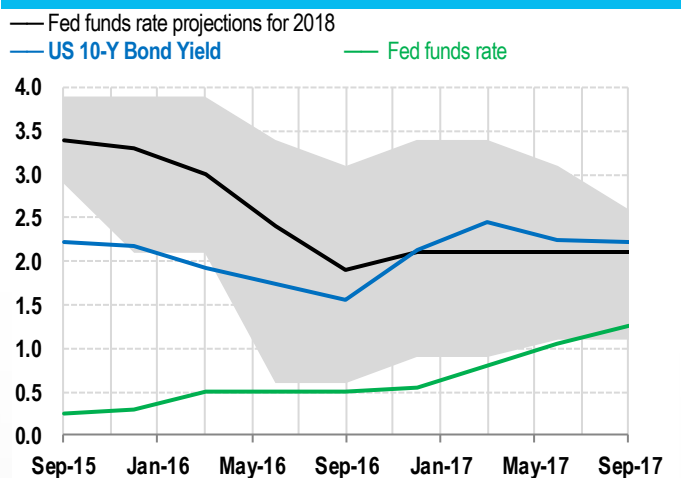
- The median projection of FOMC members for the federal funds rate at the end 2018 has been remarkably stable in recent quarters
- US 10-year treasury yields, both spot and one year forward, are only slightly higher than this median projection
- Different explanations are available with diverging implications for markets and the economy

In her speech last Tuesday on “Inflation, uncertainty and monetary policy”, Janet Yellen did not lack clarity in emphasising that the FOMC should be “wary of moving too gradually”. The statement is reminiscent of the projections (“dots”) of the FOMC members released last week when 12 out of 16 considered a rate hike in December appropriate. Such a move has thus become very likely. With 2018 getting nearer, one would expect markets to focus increasingly on the ‘dots’ for next year. The median projection for the federal funds rate at the end 2018 has been remarkably stable in recent quarters at 2.1%. Moreover, disagreement amongst the members has declined. At 2.32% the US 10-year treasury yield is only slightly higher than this median projection and the fluctuation range over the past year has actually been quite narrow. So it seems that although 2018 is getting closer, the 2018 dots have not been able to push up bond yields. Until November 2016, yields were even below the 2018 dots. This doesn’t come as a surprise: when the central bank tells you that its policy is data-dependent, projections for the distant future are heavily discounted because it’s the near term that matters. Today, 2018 is rapidly becoming “near term” yet the difference between the projected fed funds rate (2.1%) and the current 10-year yield is tiny. The same applies for the 10-year yield one year forward (2.52%).

Different interpretations are possible. One, the market thinks that the doves in the FOMC will gain the upper hand. This would imply that the dots become largely irrelevant as a communication tool. Two, the market expects a big downward revision in the 2018 dots. This would suppose a sudden deterioration in the macro environment and nothing is pointing in that direction. Three, investors believe that the Fed funds rate will converge (to a considerable degree) towards the 2018 dots in the course of next year but are happy with a low yield pick-up. Such a flat curve would imply an expectation that by then the cyclical peak in Fed funds will have been reached. Four, the market is in a myopic mode and takes its cue from the actions of the FOMC. If the latter is following the dots, yields would have to move up. Whichever interpretation one goes for, it is a matter of attention.

William De Vijlder

### FED FUNDS RATE PROJECTIONS (MEDIAN AND RANGE) AND INTEREST RATES



Source : Federal Reserve, BNP Paribas

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ECONOMIC RESEARCH DEPARTMENT

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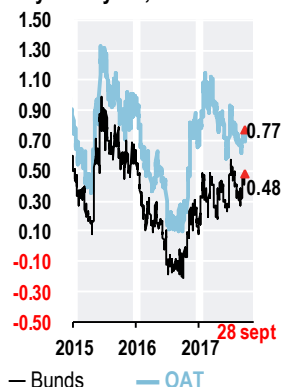
## Markets overview

### The essentials

Week 22-9-17 > 28-9-17

➤ CAC 40	5 281	➤ 5 294	+0.2 %
➤ S&P 500	2 502	➤ 2 510	+0.3 %
➤ Volatility (VIX)	9.6	➤ 9.6	-0.0 %
➤ Euribor 3M (%)	-0.33	➤ -0.33	+0.0 bp
➤ Libor \$ 3M (%)	1.33	➤ 1.34	+0.6 bp
➤ OAT 10y (%)	0.74	➤ 0.77	+3.6 bp
➤ Bund 10y (%)	0.45	➤ 0.48	+2.9 bp
➤ US Tr. 10y (%)	2.26	➤ 2.31	+4.5 bp
➤ Euro vs dollar	1.20	➤ 1.18	-1.5 %
➤ Gold (ounce, \$)	1 296	➤ 1 285	-0.8 %
➤ Oil (Brent, \$)	56.8	➤ 57.9	+1.8 %

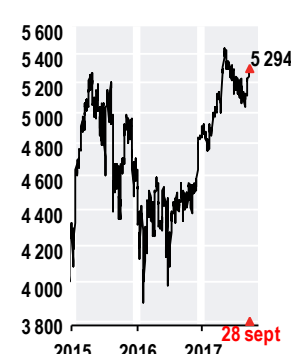
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



### Money & Bond Markets

Interest Rates	highest' 17	lowest' 17
€ ECB	0.00	0.00 at 02/01
Eonia	-0.36	-0.33 at 02/06
Euribor 3M	-0.33	-0.32 at 02/01
Euribor 12M	-0.17	-0.08 at 02/01
\$ FED	1.25	1.25 at 15/06
Libor 3M	1.34	1.34 at 28/09
Libor 12M	1.79	1.83 at 15/03
£ BoE	0.25	0.25 at 02/01
Libor 3M	0.33	0.37 at 05/01
Libor 12M	0.73	0.78 at 09/01

At 28-9-17

Yield (%)	highest' 17	lowest' 17
€ AVG 5-7y	0.43	0.68 at 17/03
Bund 2y	-0.75	-0.60 at 27/06
Bund 10y	0.48	0.57 at 06/07
OAT 10y	0.77	1.14 at 06/02
Corp. BBB	1.32	1.65 at 01/02
\$ Treas. 2y	1.44	1.47 at 27/09
Treas. 10y	2.31	2.61 at 13/03
Corp. BBB	3.49	3.90 at 14/03
£ Treas. 2y	0.40	0.42 at 27/09
Treas. 10y	1.42	1.51 at 26/01

At 28-9-17

10y bond yield & spreads

5.51%	Greece	505 pb
2.41%	Portugal	195 pb
2.13%	Italy	167 pb
1.63%	Spain	117 pb
0.77%	France	31 pb
0.77%	Ireland	31 pb
0.76%	Belgium	31 pb
0.66%	Austria	20 pb
0.61%	Netherlands	15 pb
0.48%	Germany	2 pb
0.45%	Finland	

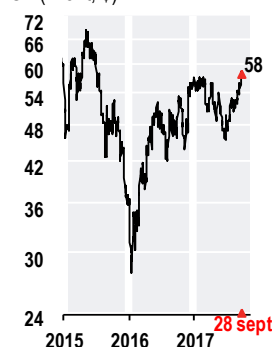
### Commodities

Spot price in dollars	lowest' 17	2017(€)
Oil, Brent	58	46 at 26/06
Gold (ounce)	1 285	1 156 at 03/01
Metals, LMEX	3 140	2 639 at 03/01
Copper (ton)	6 474	5 462 at 08/05
CRB Foods	331	325 at 24/04
wheat (ton)	160	146 at 24/04
Corn (ton)	125	120 at 18/09

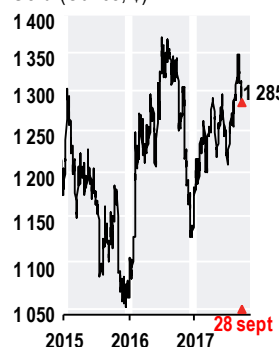
At 28-9-17

Variations

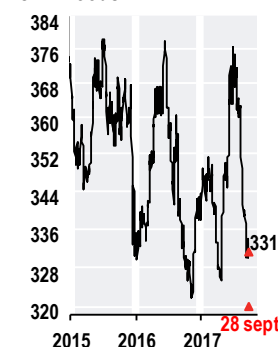
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



### Exchange Rates

1€ =	highest' 17	lowest' 17	2017
USD	1.18	1.20 at 29/08	1.04 at 03/01
GBP	0.88	0.93 at 29/08	0.84 at 19/04
CHF	1.14	1.16 at 21/09	1.06 at 08/02
JPY	132.84	134.04 at 21/09	115.57 at 17/04
AUD	1.50	1.52 at 01/06	1.37 at 23/02
CNY	7.86	7.99 at 03/08	7.22 at 03/01
BRL	3.75	3.81 at 29/08	3.24 at 15/02
RUB	68.29	71.97 at 02/08	59.66 at 17/04
INR	77.23	77.55 at 22/09	68.18 at 07/04

At 28-9-17

Variations

### Equity indices

Index	highest' 17	lowest' 17	2017	2017(€)
CAC 40	5 294	5 432 at 05/05	4 749 at 31/01	+8.9%
S&P500	2 510	2 510 at 28/09	2 239 at 02/01	+12.1%
DAX	12 705	12 889 at 19/06	11 510 at 06/02	+10.7%
Nikkei	20 363	20 398 at 25/09	18 336 at 14/04	+6.5%
China*	82	85 at 20/09	59 at 02/01	+40.1%
India*	544	580 at 18/09	445 at 03/01	+17.6%
Brazil*	2 047	2 155 at 20/09	1 639 at 21/06	+19.8%
Russia*	581	622 at 03/01	497 at 22/06	-7.6%

At 28-9-17

Variations

\* MSCI index



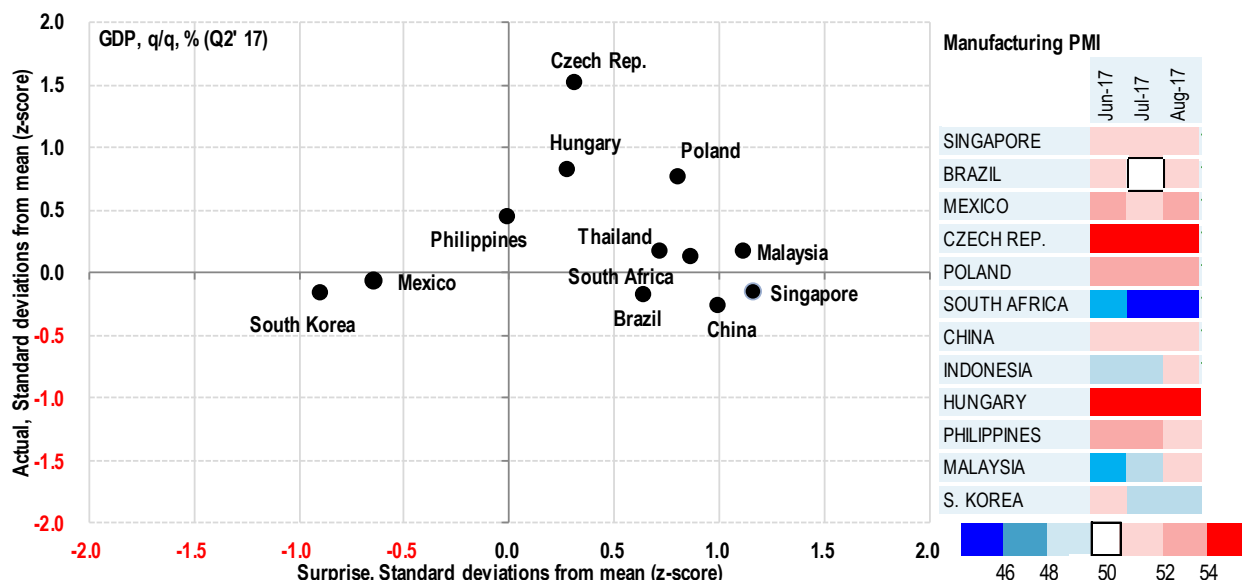
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## Pulse

## Emerging countries: Eastern Europe ahead of the pack

In terms of growth momentum, Central European economies substantially outperform the other emerging economies. Even in terms of growth level, they are doing better than Asian economies which are comparable in terms of size and economic structure. The drivers are mainly endogenous with a booming labour market, accelerating real wages and a stronger contribution of domestic credit.



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 (for China since 2011).

Sources: Bloomberg, Markit, BNP Paribas calculations

## Indicators preview

As usual at the beginning of a new month, a very heavy calendar. The Tankan report in Japan, the ISM in the US and the PMIs in many countries will allow to finetune the assessment of what's happening in Q3. Highlights of the week are the US labour market data (important for gauging what the Fed will do in December) and the ECB meeting account.

Date	Country	Event	Period	Survey	Prior
10/02/17	Japan	Tankan Large Mfg Index	3Q	18	17
10/02/17	France	Markit France Manufacturing PMI	Sep	56.0	56.0
10/02/17	Germany	Markit/BME Germany Manufacturing PMI	Sep	60.6	60.6
10/02/17	Eurozone	Markit Eurozone Manufacturing PMI	Sep	58.2	58.2
10/02/17	United States	ISM Manufacturing	Sep	57.5	58.8
10/04/17	France	Markit France Services PMI	Sep	57.1	57.1
10/04/17	France	Markit France Composite PMI	Sep	57.2	57.2
10/04/17	Germany	Markit Germany Services PMI	Sep	55.6	55.6
10/04/17	Germany	Markit/BME Germany Composite PMI	Sep	57.8	57.8
10/04/17	Eurozone	Markit Eurozone Services PMI	Sep	55.6	55.6
10/04/17	Eurozone	Markit Eurozone Composite PMI	Sep	56.7	56.7
10/04/17	United States	ISM Non-Manf. Composite	Sep	55.1	55.3
10/05/17	Eurozone	ECB account of the monetary policy meeting			
10/05/17	United States	Cap Goods Ship Nondef Ex Air	Aug	--	0.7%
10/06/17	United States	Change in Nonfarm Payrolls	Sep	75000	156000
10/06/17	United States	Underemployment Rate	Sep	--	8.6%



## 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% by year-end, 2.00% 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>2.0</b>	<b>2.1</b>	<b>0.8</b>	<b>1.7</b>	<b>1.6</b>
United-States	1.5	2.1	2.7	1.7	2.1	1.8
Japan	1.0	1.4	1.1	-0.1	0.4	0.6
United-Kingdom	1.8	1.6	1.0	0.6	2.7	2.7
<b>Euro Area</b>	<b>1.8</b>	<b>2.2</b>	<b>1.9</b>	<b>0.2</b>	<b>1.5</b>	<b>1.4</b>
Germany	1.9	2.2	2.0	0.4	1.7	1.6
France	1.1	1.7	1.7	0.3	1.1	0.9
Italy	1.0	1.4	1.0	-0.1	1.4	1.1
<b>Emerging</b>						
China	6.7	6.6	6.4	2.0	1.6	2.3
India	7.5	7.3	7.8	4.9	4.9	5.2
Brazil	-3.6	1.0	3.0	8.8	3.5	3.8
Russia	-0.6	1.2	2.0	7.1	4.2	4.3

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

### INTEREST RATES & FX RATES

Interest rates, %		2017	2018					
End of period		Q4e	Q1e	Q2e	Q3e	Q4e	2017e	2018e
<b>US</b>	Fed Funds	1.25	1.50	1.75	2.00	2.00	1.25	2.00
	Libor 3m \$	1.50	1.55	1.70	1.80	1.85	1.50	1.85
	T-Notes 10y	2.25	2.35	2.50	2.65	2.75	2.25	2.75
<b>Ezone</b>	ECB Refi Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Euribor 3m	-0.32	-0.32	-0.32	-0.32	-0.05	-0.32	-0.05
	Bund 10y	0.70	0.80	1.00	1.10	1.25	0.70	1.25
	OAT 10y	1.15	1.25	1.45	1.60	1.65	1.15	1.65
<b>UK</b>	Base rate	0.25	0.25	0.25	0.25	0.50	0.25	0.50
	Gilts 10y	1.20	1.35	1.50	1.75	1.95	1.20	1.95
<b>Japan</b>	BoJ Rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
	JGB 10y	0.04	0.08	0.08	0.08	0.05	0.04	0.05

Exchange Rates		2017	2018					
End of period		Q4e	Q1e	Q2e	Q3e	Q4e	2017e	2018e
<b>USD</b>	EUR / USD	1.17	1.15	1.16	1.19	1.23	1.17	1.23
	USD / JPY	112	115	115	111	109	112	109
	GBP / USD	1.29	1.25	1.29	1.34	1.40	1.29	1.40
	USD / CHF	0.98	1.01	1.01	0.99	0.97	0.98	0.97
<b>EUR</b>	EUR / GBP	0.91	0.92	0.90	0.89	0.88	0.91	0.88
	EUR / CHF	1.15	1.16	1.17	1.18	1.19	1.15	1.19
	EUR / JPY	131	132	133	132	134	131	134

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



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