

ECOWEEK

N° 17-38// 20 October 2017

ECB QE: Frankfurter forward guidance

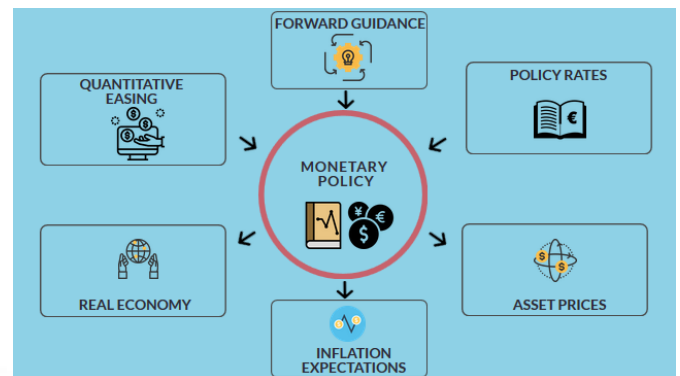
■ Next week, the ECB is expected to extend QE into 2018 but to scale back monthly purchases ■ The direction of the change may be clear but the extent isn't ■ The objective of QE has evolved. It is now a key instrument in providing guidance on the future evolution of policy rates

Next week's Governing Council meeting hasn't been so important for quite a while. Firstly because of Mario Draghi's promise back in September that the bulk of the decisions with respect to QE would be taken in October. Secondly, economic growth is robust and leading indicators of inflation like input prices or supplier delivery times suggest some upward pressure is building. Hawks could use this as an argument to advocate a big reduction in monthly purchases and only a limited extension. Finally, the somewhat softer euro following slightly more hawkish comments from the Fed gives the ECB more leeway.

Two things seem clear: there will be an extension, but the monthly volume will go down. On the extension, media have reported it could be as long as 9 months, but with a halving of the monthly volume to EUR 30 bn. Markets cheered and bond yields declined, much to the relief of the ECB one suspects.

It then seems that the devil will be in the (important) details: will there be a tilt towards more corporate and less government bond purchases? This would make sense given the focus of investors when the ECB will run out of sovereign paper to buy in countries like Germany and could fuel expectations that the extension is not the last one. Could a significantly lower monthly volume create an impression that this is the last extension or, on the contrary, that it enables to continue for longer?

At first glance, one could argue that a small monthly volume is not that different from doing nothing so why continuing? The answer is nuanced. QE works via a portfolio rebalancing channel (pushing investors out of government bonds into riskier assets including outside the eurozone) and a signaling channel. At this stage, the former channel hardly plays a role any longer, even more so if the monthly purchases were to be scaled back significantly. The latter channel however is all the more important so as to avoid that markets would price in a rate hike too early. QE has thus become a means to reinforce ECB forward guidance: *"rates are to remain at present levels for an extended period of time, and well past the horizon of the net asset purchases"*. The literature on forward guidance differentiates between Delphic and Odyssean guidance. Under the former there is no commitment for a certain course of action. The guidance is about expected macroeconomic developments and what this would entail for monetary policy. Under the latter, the central bank commits to a particular course of action. To this taxonomy we can now add "Frankfurter guidance": using QE as a way of conveying that rates will be kept unchanged thereby avoiding the obligation to exactly define what "well past" means.



William De Vijlder

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Eco
WEEK

ECONOMIC RESEARCH DEPARTMENT



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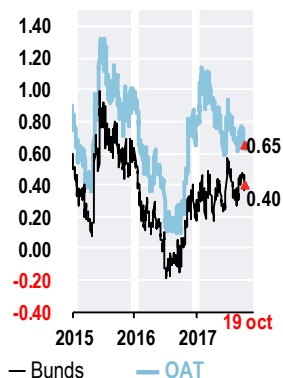
Markets overview

The essentials

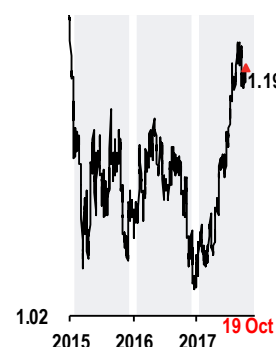
Week 13-10-17 > 19-10-17

| | | | |
|--------------------|-------|---------|---------|
| ➤ CAC 40 | 5 352 | ➤ 5 368 | +0.3 % |
| ➤ S&P 500 | 2 553 | ➤ 2 562 | +0.3 % |
| ➤ Volatility (VIX) | 9.6 | ➤ 10.1 | +0.4 % |
| ➤ Euribor 3M (%) | -0.33 | ➤ -0.33 | +0.0 bp |
| ➤ Libor \$ 3M (%) | 1.35 | ➤ 1.36 | +0.9 bp |
| ➤ OAT 10y (%) | 0.67 | ➤ 0.65 | -1.3 bp |
| ➤ Bund 10y (%) | 0.40 | ➤ 0.40 | -0.4 bp |
| ➤ US Tr. 10y (%) | 2.28 | ➤ 2.32 | +4.2 bp |
| ➤ Euro vs dollar | 1.18 | ➤ 1.19 | +0.2 % |
| ➤ Gold (ounce, \$) | 1 300 | ➤ 1 288 | -0.9 % |
| ➤ Oil (Brent, \$) | 57.2 | ➤ 57.6 | +0.8 % |

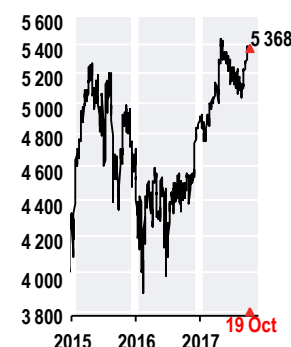
10 y bond yield, OAT vs Bund



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 | -0.18 at 02/01 | -0.18 at 17/10 |
| \$ FED | 1.25 at 15/06 | 0.75 at 02/01 |
| Libor 3M | 1.36 at 18/10 | 1.00 at 02/01 |
| Libor 12M | 1.83 at 18/10 | 1.68 at 06/01 |
| £ BoE | 0.25 at 02/01 | 0.25 at 02/01 |
| Libor 3M | 0.38 at 17/10 | 0.28 at 01/09 |
| Libor 12M | 0.75 at 09/01 | 0.59 at 06/09 |

At 19-10-17

| Yield (%) | highest' 17 | lowest' 17 |
|--------------|----------------|----------------|
| € AVG 5-7y | 0.39 at 17/03 | 0.18 at 21/06 |
| Bund 2y | -0.77 at 27/06 | -0.96 at 24/02 |
| Bund 10y | 0.40 at 06/07 | 0.18 at 18/04 |
| OAT 10y | 0.65 at 06/02 | 0.59 at 14/06 |
| Corp. BBB | 1.21 at 01/02 | 1.19 at 17/10 |
| \$ Treas. 2y | 1.56 at 18/10 | 1.14 at 24/02 |
| Treas. 10y | 2.32 at 13/03 | 2.05 at 08/09 |
| Corp. BBB | 3.48 at 14/03 | 3.38 at 05/09 |
| £ Treas. 2y | 0.36 at 27/09 | 0.01 at 28/02 |
| Treas. 10y | 1.31 at 26/01 | 0.87 at 14/06 |

At 19-10-17

10y bond yield & spreads

| | | |
|-------|-------------|--------|
| 5.40% | Greece | 500 pb |
| 2.32% | Portugal | 191 pb |
| 1.97% | Italy | 156 pb |
| 1.64% | Spain | 123 pb |
| 0.67% | Belgium | 26 pb |
| 0.65% | France | 25 pb |
| 0.63% | Ireland | 22 pb |
| 0.58% | Austria | 17 pb |
| 0.56% | Finland | 15 pb |
| 0.50% | Netherlands | 10 pb |
| 0.40% | Germany | |

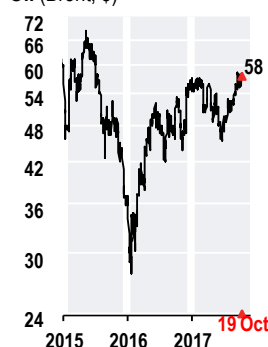
Commodities

| Spot price in dollars | lowest' 17 | 2017(€) |
|-----------------------|----------------|---------|
| Oil, Brent | 58 at 26/06 | -9.6% |
| Gold (ounce) | 1 288 at 03/01 | -0.9% |
| Metals, LMEX | 3 271 at 03/01 | +9.4% |
| Copper (ton) | 6 934 at 08/05 | +11.7% |
| CRB Foods | 345 at 24/04 | -9.4% |
| wheat (ton) | 154 at 02/10 | -6.1% |
| Corn (ton) | 124 at 18/09 | -17.1% |

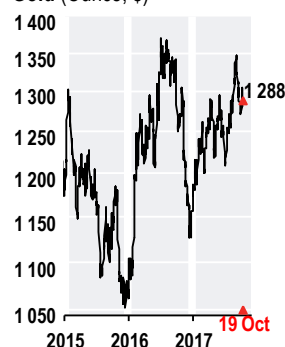
At 19-10-17

Variations

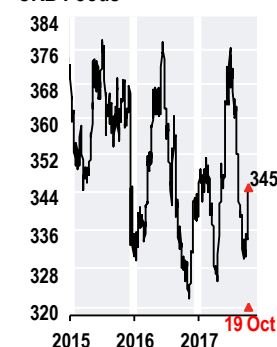
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

| 1€ = | highest' 17 | lowest' 17 | 2017 |
|------|-----------------|-----------------|--------|
| USD | 1.19 at 29/08 | 1.04 at 03/01 | +12.4% |
| GBP | 0.93 at 29/08 | 0.84 at 19/04 | +5.2% |
| CHF | 1.16 at 21/09 | 1.06 at 08/02 | +7.7% |
| JPY | 133.36 at 21/09 | 115.57 at 17/04 | +8.4% |
| AUD | 1.52 at 11/10 | 1.37 at 23/02 | +3.2% |
| CNY | 7.99 at 03/08 | 7.22 at 03/01 | +7.2% |
| BRL | 3.76 at 29/08 | 3.24 at 15/02 | +9.4% |
| RUB | 67.95 at 02/08 | 59.66 at 17/04 | +5.5% |
| INR | 77.18 at 22/09 | 68.18 at 07/04 | +7.8% |

At 19-10-17

Variations

Equity indices

| Index | highest' 17 | lowest' 17 | 2017 | 2017(€) |
|---------|-----------------|-----------------|--------|---------|
| CAC 40 | 5 432 at 05/05 | 4 749 at 31/01 | +10.4% | +10.4% |
| S&P500 | 2 562 at 19/10 | 2 239 at 02/01 | +14.4% | +1.8% |
| DAX | 13 043 at 18/10 | 11 510 at 06/02 | +13.1% | +13.1% |
| Nikkei | 21 449 at 19/10 | 18 336 at 14/04 | +12.2% | +3.5% |
| China* | 85 at 16/10 | 59 at 02/01 | +45.6% | +28.9% |
| India* | 572 at 18/09 | 445 at 03/01 | +22.9% | +14.0% |
| Brazil* | 2 132 at 05/10 | 1 639 at 21/06 | +24.1% | +13.5% |
| Russia* | 622 at 03/01 | 497 at 22/06 | -7.5% | -13.4% |

At 19-10-17

Variations

* MSCI index



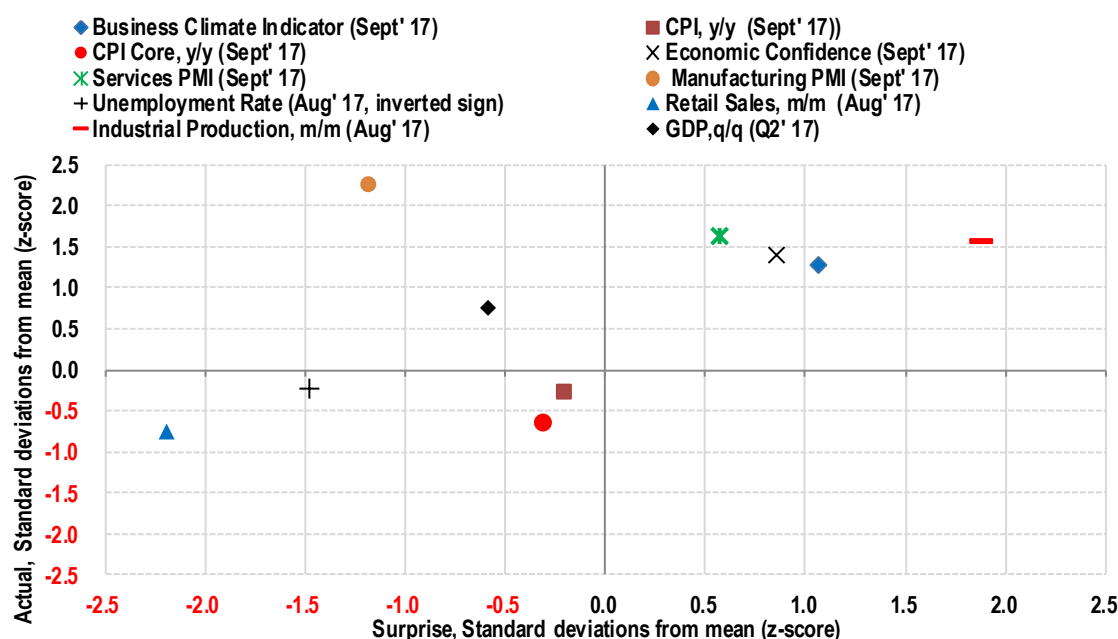
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Pulse

Eurozone: Robust growth to continue

Most economic indicators continue to show an improving situation in the euro area. Generally speaking the recovery is solid. Measures of underlying inflation are eventually showing some signs of improvement even though they remain at subdued levels. Against this backdrop, the ECB, which is about to recalibrate its monetary support (see the editorial) will probably continue to adopt a cautious stance conveying the idea that monetary policy will remain durably accommodative.



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, μ : mean, σ : standard deviation. On the X-axis, x corresponds at the last known surprise for each indicator represented on the graph, μ and σ 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, μ and σ corresponds respectively to the mean and the standard deviation for this indicator since 2000.

Sources: Bloomberg, INSEE, Markit, BNP Paribas calculations

Indicators preview

An important week ahead of us with the ECB meeting, a lot of data on October (PMI, IFO, Michigan...) as well as Q3 growth numbers in the US and the UK.

| Date | Country | Event | Period | Survey | Prior |
|----------|----------------|--------------------------------------|--------|--------|-------|
| 10/23/17 | United Kingdom | CBI Business Optimism | Oct | -- | 5 |
| 10/23/17 | Eurozone | Consumer Confidence | Oct | -1.1 | -1.2 |
| 10/24/17 | France | Business Confidence | Oct | -- | 109 |
| 10/24/17 | France | Manufacturing Confidence | Oct | -- | 110 |
| 10/24/17 | Eurozone | ECB Bank Lending Survey | | | |
| 10/24/17 | France | Markit France Manufacturing PMI | Oct | -- | 56.1 |
| 10/24/17 | France | Markit France Composite PMI | Oct | -- | 57.1 |
| 10/24/17 | Germany | Markit/BME Germany Manufacturing PMI | Oct | 60.0 | 60.6 |
| 10/24/17 | Germany | Markit/BME Germany Composite PMI | Oct | 57.7 | 57.7 |
| 10/24/17 | Eurozone | Markit Eurozone Manufacturing PMI | Oct | 57.7 | 58.1 |
| 10/24/17 | Eurozone | Markit Eurozone Composite PMI | Oct | 56.5 | 56.7 |
| 10/25/17 | Germany | IFO Business Climate | Oct | 115.0 | 115.2 |
| 10/25/17 | United Kingdom | GDP QoQ | 3Q | 0.3% | 0.3% |
| 10/25/17 | United States | Cap Goods Orders Nondef Ex Air | Sep | 0.2% | 1.1% |
| 10/26/17 | Germany | GfK Consumer Confidence | Nov | 10.8 | 10.8 |
| 10/26/17 | Eurozone | ECB Main Refinancing Rate | Oct | 0.0% | 0.0% |
| 10/27/17 | France | Consumer Confidence | Oct | -- | 101 |
| 10/27/17 | United States | GDP Annualized QoQ | 3Q | 2.5% | 3.1% |
| 10/27/17 | United States | Core PCE QoQ | 3Q | 1.3% | 0.9% |
| 10/27/17 | United States | U. of Michigan Sentiment | Oct | 101.0 | 101.1 |



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 | | |
|------------------|------------|------------|------------|------------|------------|------------|
| | 2017 e | 2018 e | 2019 e | 2017 e | 2018 e | 2019 e |
| Advanced | 2.0 | 2.1 | 1.6 | 1.8 | 1.7 | 1.9 |
| United-States | 2.1 | 2.7 | 1.9 | 2.2 | 2.1 | 2.5 |
| Japan | 1.4 | 1.1 | 0.5 | 0.4 | 0.6 | 0.5 |
| United-Kingdom | 1.6 | 1.0 | 2.0 | 2.7 | 2.7 | 2.4 |
| Euro Area | 2.2 | 1.9 | 1.4 | 1.5 | 1.4 | 1.6 |
| Germany | 2.2 | 2.0 | 1.5 | 1.7 | 1.6 | 1.9 |
| France | 1.7 | 1.7 | 1.4 | 1.1 | 0.9 | 1.4 |
| Italy | 1.4 | 1.0 | 0.6 | 1.4 | 1.1 | 1.4 |
| Spain | 3.2 | 2.6 | 1.9 | 2.0 | 1.3 | 1.6 |
| Belgium | 1.6 | 1.6 | 1.5 | 2.1 | 1.9 | 1.9 |
| Emerging | 4.7 | 4.9 | 4.9 | 3.0 | 3.3 | 3.6 |
| China | 6.6 | 6.4 | 6.5 | 1.6 | 2.3 | 2.5 |
| India | 7.1 | 7.0 | 7.6 | 4.5 | 3.4 | 4.5 |
| Brazil | 1.0 | 3.0 | 2.5 | 3.5 | 3.8 | 4.1 |
| Russia | 1.8 | 1.8 | 1.5 | 4.5 | 4.8 | 4.8 |

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 | |
| US | 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 | |
| Ezone | ECB Ref 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 | |
| UK | Base rate | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.25 | 0.50 | |
| | Gilt 10y | 1.20 | 1.35 | 1.50 | 1.75 | 1.95 | 1.20 | 1.95 | |
| Japan | 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 | |
| USD | 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 | |
| EUR | 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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 Prepared by Economic Research – BNP PARIBAS
 Registered Office: 16 boulevard des Italiens – 75009 PARIS
 Tel: +33 (0) 1.42.98.12.34 – Internet :
www.group.bnpparibas.com
 Publisher: Jean Lemierre. Editor: William De Vijlder



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