

ECOWEEK

No. 17-44, 1 December 2017

QE, Dr. Pangloss, Dr. Jekyll, Mr Hyde

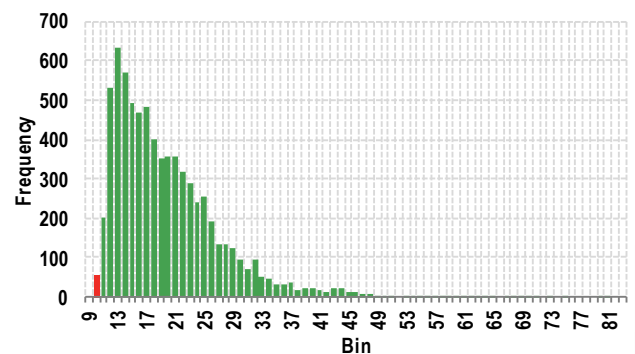
- The ECB's Financial Stability Review expresses concern about increased risk-taking behaviour in financial markets
- Such behaviour increases the sensitivity of markets to unexpected developments in the economy
- Accommodative monetary policy is a balancing act when growth is robust, inflation low and asset valuations rich

With robust growth, low inflation and rich valuations, running an accommodative monetary policy has become a balancing act. What better illustration is there than recent communication by the ECB? In a speech in Frankfurt on 17 November Mario Draghi gave a good description of how QE influences investor behaviour: *"By accumulating a portfolio of long-duration assets, the central bank can compress term premia by extracting duration risk from private investors. Via this "duration extraction" effect, the central bank frees up risk bearing capacity in markets, spurs a rebalancing of private portfolios toward the remaining securities, and thus lowers term premia and yields across a range of financial assets."* He added *"as market conditions have normalised and the economic outlook has improved, risk perceptions have declined and the capacity to absorb risk in private portfolios has risen."* To put it differently, the improved economic outlook boosts investor risk appetite. Are investors living in a Panglossian world? Not sure when one reads this: *"continued risk premia compression and signs of increased risk-taking behaviour in financial markets are sources of concern as they may sow the seeds for large asset price corrections in the future."* The quote is from the ECB's Financial Stability Review (FSR) released earlier this week. Financial market participants will be relieved that the FSR comment didn't appear in the Governing Council meeting account because it would have been interpreted as very hawkish. Yet they may also be puzzled about the contrasting messages. To be fair, the FSR is far more concerned about Wall Street than about eurozone markets. Yet, the quote reflects a worry that at some point, justifiable optimism about the state of the world economy morphs into a view that risk has virtually disappeared from the equation. In this respect, the extremely low level of the VIX index, including from a historical perspective, deserves monitoring. More than ever monetary policy is a balancing act. After all, one wants to avoid that Mister Market turns from a Dr. Jekyll into a Mr. Hyde.

FREQUENCY DISTRIBUTION OF THE VIX INDEX

Daily basis since 2 January 1990

■ Current Bin



Source: Chicago Board Options Exchange

William De Vijlder

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Economic scenario
(New update)

ECONOMIC RESEARCH
DEPARTMENT

Eco
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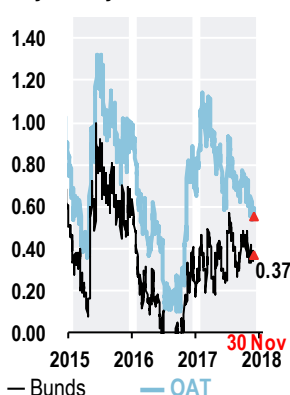
Markets overview

The essentials

Week 24-11-17 > 30-11-17

➤ CAC 40	5 390	➤ 5 373	-0.3 %
➤ S&P 500	2 602	➤ 2 648	+1.7 %
➤ Volatility (VIX)	9.7	➤ 11.3	+1.6 pb
➤ Euribor 3M (%)	-0.33	➤ -0.33	+0.0 bp
➤ Libor \$ 3M (%)	1.47	➤ 1.49	+2.0 bp
➤ OAT 10y (%)	0.57	➤ 0.55	-1.9 bp
➤ Bund 10y (%)	0.37	➤ 0.37	-0.2 bp
➤ US Tr. 10y (%)	2.34	➤ 2.42	+7.5 bp
➤ Euro vs dollar	1.19	➤ 1.19	-0.1 %
➤ Gold (ounce, \$)	1 289	➤ 1 279	-0.8 %
➤ Oil (Brent, \$)	63.6	➤ 63.8	+0.4 %

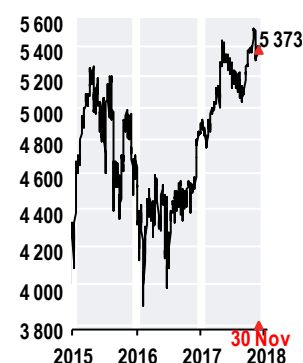
10 y bond yield, OAT vs Bund



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	-0.24 at 30/11	-0.37 at 05/06
Euribor 3M	-0.33 at 02/01	-0.33 at 10/04
Euribor 12M	-0.19 at 02/01	-0.19 at 15/11
\$ FED	1.25 at 15/06	0.75 at 02/01
Libor 3M	1.49 at 30/11	1.00 at 02/01
Libor 12M	1.95 at 30/11	1.68 at 06/01
£ BoE	0.50 at 02/11	0.25 at 02/01
Libor 3M	0.52 at 13/11	0.28 at 01/09
Libor 12M	0.79 at 02/11	0.59 at 06/09

At 30-11-17

Yield (%)	highest' 17	lowest' 17
€ AVG 5-7y	0.68 at 17/03	0.18 at 21/06
Bund 2y	-0.72 at 27/06	-0.96 at 24/02
Bund 10y	0.37 at 06/07	0.18 at 18/04
OAT 10y	0.55 at 06/02	0.53 at 21/11
Corp. BBB	1.17 at 01/02	1.06 at 07/11
\$ Treas. 2y	1.79 at 30/11	1.14 at 24/02
Treas. 10y	2.42 at 13/03	2.05 at 08/09
Corp. BBB	3.62 at 14/03	3.38 at 05/09
£ Treas. 2y	0.47 at 29/11	0.01 at 28/02
Treas. 10y	1.36 at 26/01	0.87 at 14/06

At 30-11-17

10y bond yield & spreads

5.27%	Greece	489 pb
1.88%	Portugal	150 pb
1.70%	Italy	132 pb
1.45%	Spain	108 pb
0.58%	Ireland	21 pb
0.57%	Belgium	20 pb
0.55%	France	18 pb
0.53%	Finland	15 pb
0.52%	Austria	15 pb
0.46%	Netherlands	9 pb
0.37%	Germany	

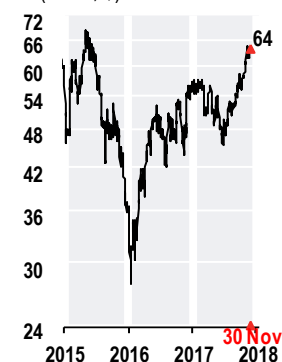
Commodities

Spot price in dollars	lowest' 17	2017(€)
Oil, Brent	63.8 at 26/06	-0.5%
Gold (ounce)	1 279 at 03/01	-2.2%
Metals, LMEX	3 176 at 03/01	+5.6%
Copper (ton)	6 735 at 08/05	+7.9%
CRB Foods	345 at 24/04	-9.9%
wheat (ton)	158 at 02/10	-4.4%
Corn (ton)	124 at 18/09	-17.6%

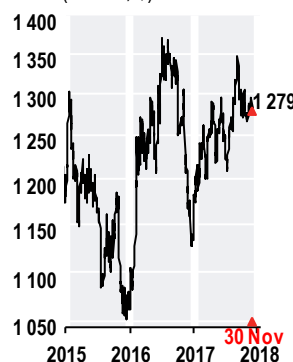
At 30-11-17

Variations

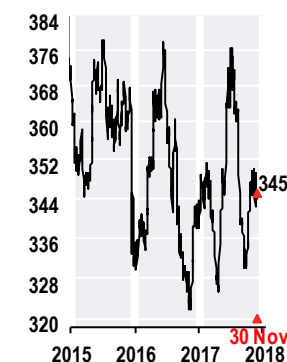
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

€ =	highest' 17	lowest' 17	2017
USD	1.19 at 29/08	1.04 at 03/01	+13.0%
GBP	0.88 at 29/08	0.84 at 19/04	+3.2%
CHF	1.17 at 30/11	1.06 at 08/02	+9.2%
JPY	133.43 at 25/10	115.57 at 17/04	+8.5%
AUD	1.57 at 30/11	1.37 at 23/02	+7.8%
CNY	7.88 at 03/08	7.22 at 03/01	+7.5%
BRL	3.90 at 15/11	3.24 at 15/02	+13.5%
RUB	69.65 at 02/08	59.66 at 17/04	+8.2%
INR	76.88 at 22/09	68.18 at 07/04	+7.4%

At 30-11-17

Variations

Equity indices

Index	highest' 17	lowest' 17	2017	2017(€)
CAC 40	5 373 at 03/11	4 749 at 31/01	+10.5%	+10.5%
S&P500	2 648 at 30/11	2 239 at 02/01	+18.3%	+4.6%
DAX	13 024 at 03/11	11 510 at 06/02	+13.4%	+13.4%
Nikkei	22 725 at 07/11	18 336 at 14/04	+18.9%	+9.6%
China*	87 at 22/11	59 at 02/01	+49.1%	+31.2%
India*	583 at 06/11	445 at 03/01	+23.9%	+15.4%
Brazil*	1 947 at 05/10	1 639 at 21/06	+17.0%	+3.0%
Russia*	592 at 03/01	497 at 22/06	-5.2%	-13.1%

At 30-11-17

Variations

* MSCI index



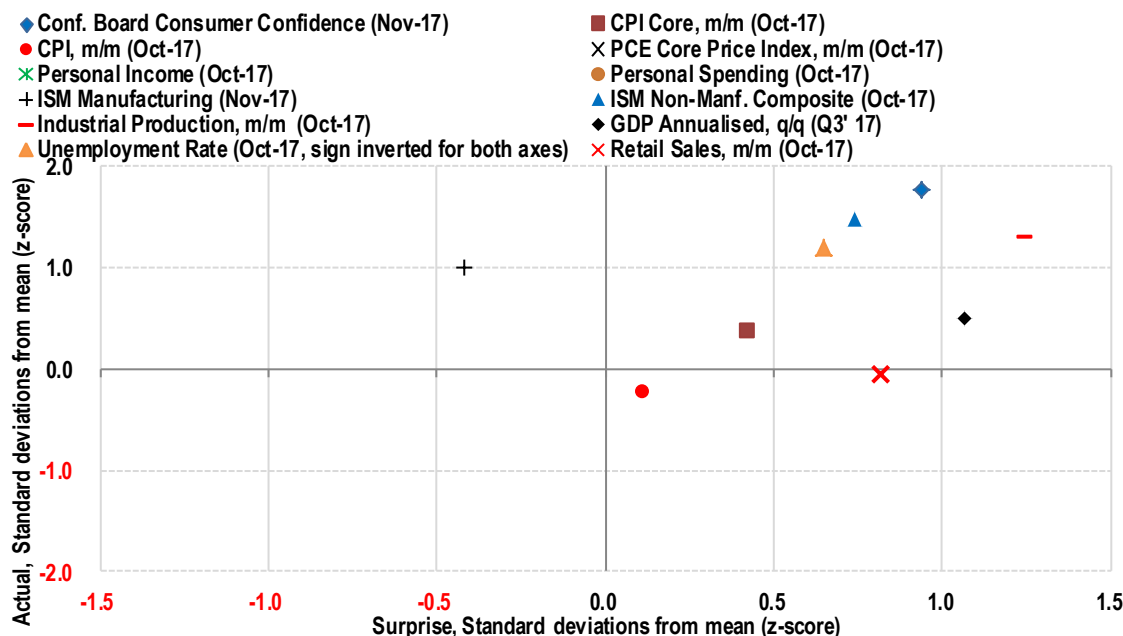
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Pulse

United States: In a sweet spot

The US economy is in a sweet spot with most of the recent data having surprised positively whilst being above the long-term average.



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, Markit, BNP Paribas calculations

Indicators preview

A busy week ahead of us with the services sector and composite PMIs in several countries, the US non-manufacturing ISM and on Friday the US labour market data.

Date	Country	Event	Period	Survey	Prior
12/04/17	United States	Cap Goods Orders Nondef Ex Air	Oct	--	-0.5%
12/05/17	France	Markit France Composite PMI	Nov	60.1	60.1
12/05/17	Germany	Markit/BME Germany Composite PMI	Nov	57.6	57.6
12/05/17	Eurozone	Markit Eurozone Composite PMI	Nov	57.5	57.5
12/05/17	Eurozone	Retail Sales MoM	Oct	-0.7%	0.7%
12/05/17	Eurozone	GDP SA QoQ	3Q	0.6%	0.6%
12/05/17	United States	ISM Non-Manf. Composite	Nov	59.0	60.1
12/07/17	Japan	Leading Index CI	Oct	106.1	106.4
12/08/17	Japan	GDP SA QoQ	3Q	0.4%	0.3%
12/08/17	France	Industrial Production MoM	Oct	-0.2%	0.6%
12/08/17	United States	Change in Manufact. Payrolls	Nov	15 000	24 000
12/08/17	United States	Underemployment Rate	Nov	--	7.9%
12/08/17	United States	University of Michigan Sentiment	Dec	98.9	98.5
12/08/17	Japan	Eco Watchers Survey Current SA	Nov	52.2	52.2

Sources: Bloomberg, BNP Paribas



Economic scenario

UNITED STATES

- GDP growth is accelerating along with the recovery in the emerging countries and reinforcing world trade. However the fiscal outlook remains uncertain. A fiscal stimulus still is possible, but it would not be implemented very rapidly. 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 1.50% by year-end, 2.00% by mid-2018.

CHINA

- Economic growth has started to moderate during the fall and this trend should continue in the coming quarters.
- Despite the slowdown, the central bank will have to continue to act to encourage the deleveraging of financial institutions and corporates and reduce financial instability risks. The authorities should maintain an expansionist fiscal policy in the short term.
- The tightening of domestic credit conditions, restructuring measures in the industry and the correction in the property market will weigh on economic activity. Meanwhile, exports and private consumption should be supporting factors.

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	2,1	2,4	1,7	1,7	1,7	1,9
United-States	2,3	2,9	1,9	2,1	2,0	2,2
Japan	1,5	1,3	0,6	0,3	0,6	0,8
United-Kingdom	1,5	1,2	1,8	2,7	2,7	2,4
Euro Area	2,3	2,4	1,8	1,5	1,6	1,7
Germany	2,6	2,8	2,1	1,7	1,7	1,8
France	1,8	2,0	1,6	1,2	1,6	1,8
Italy	1,6	1,5	1,1	1,4	1,4	1,5
Spain	3,1	2,6	2,2	2,1	1,8	1,6
Belgium	1,6	1,6	1,5	2,1	1,9	1,9
Emerging	4,5	4,8	4,9	4,0	4,2	4,2
China	6,8	6,4	6,5	1,6	2,3	2,5
India	7,0	7,6	7,8	3,4	4,5	4,9
Brazil	1,0	3,0	2,5	3,5	3,5	3,9
Russia	1,8	1,6	1,5	4,0	4,3	4,5

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
US	Fed Funds	1,50	1,75	2,00	2,25	2,25
	Libor 3m \$	1,40	1,55	1,70	1,80	1,85
	T-Notes 10y	2,35	2,60	2,75	2,75	3,00
Ezone	ECB Refi	0,00	0,00	0,00	0,00	0,00
	Euribor 3m	-0,30	-0,30	-0,30	-0,30	-0,30
	Bund 10y	0,36	0,65	0,75	1,10	1,50
	OAT 10y	0,70	0,95	1,00	1,30	1,70
UK	Base rate	0,50	0,50	0,50	0,50	0,75
	Gilts 10y	1,30	1,45	1,55	1,90	2,30
Japan	BoJ Rate	-0,10	-0,10	-0,10	-0,10	-0,10
	JGB 10y	0,03	0,08	0,08	0,08	0,08

Exchange Rates		2017	2018			
End of period		Q4e	Q1e	Q2e	Q3e	Q4e
USD	EUR / USD	1,15	1,14	1,13	1,18	1,22
	USD / JPY	115	116	117	115	112
	GBP / USD	1,28	1,25	1,26	1,33	1,39
	USD / CHF	1,01	1,03	1,04	1,01	0,98
EUR	EUR / GBP	0,90	0,91	0,90	0,89	0,88
	EUR / CHF	1,16	1,17	1,18	1,19	1,20
	EUR / JPY	132	132	132	136	137

Source : GlobalMarkets (e: Estimates & forecasts)



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