

# ECOWEEK

No. 18-09, 2 March 2018

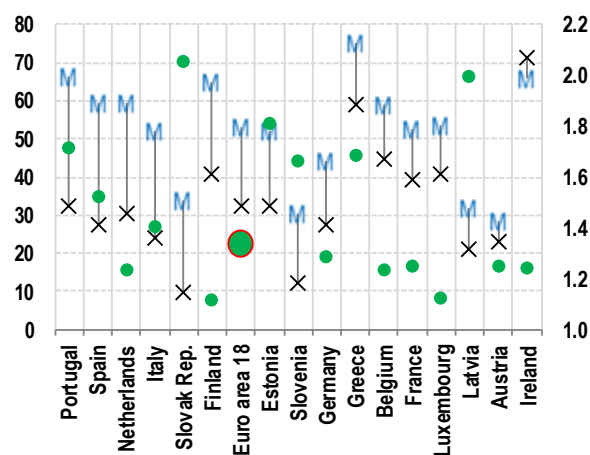
## A strong euro: inflation impact matters more than growth

■ The euro is undervalued versus the dollar on a purchasing power parity (PPP) basis ■ This raises the prospect of an appreciation of the euro ■ In gauging the consequences one should focus on inflation rather than on the growth impact

Purchasing power parities (PPPs) show the ratio of the price in national currencies of the same good or service in different countries. The concept was made popular by The Economist's BigMac index based on the price of hamburgers. The OECD uses a large basket of goods and services for its calculations. They show that the euro is currently 10% undervalued against the dollar (fair value corresponds to 1.34). As shown on the chart, Finland and Luxembourg have a PPP which is significantly below the eurozone PPP versus the dollar but also below the current EURUSD exchange rate: based on the relative price structure, these countries are already expensive versus the US. Belgium, Ireland, France, Austria and Germany have a PPP which is below the eurozone PPP yet above the current exchange rate. For them the euro is still somewhat cheap versus the dollar. Countries like Portugal, Estonia, Latvia, the Slovak Republic could afford a significantly stronger euro. Admittedly this calculation provides only a rough approximation of price competitiveness of various countries (and it does not take into account non-price competitiveness factors) but it raises the question whether, based on their PPP, some countries would be hurt more than others in case of a stronger euro. A relevant factor is the role of the dollar in the international trade of a country. In this respect it is appropriate to look at the use of the dollar as an invoicing currency rather than focusing on the bilateral trade with the US. For all countries except Ireland, the dollar has a significantly bigger role as an invoicing currency in imports than in exports. This is, at least partly, explained by commodities, which are typically traded in dollar. For Portugal, Spain, the Netherlands or Italy the difference is huge. This invoicing mismatch needs to be taken into account when assessing the impact of a stronger euro versus the dollar. Under the assumption that sales prices don't change, a stronger euro would weigh on exports invoiced in euros (volume effect) and reduce the revenues in euros from exports invoiced in dollars (translation effect). However, it also lowers the import bill expressed in euros to a very considerable degree. This would imply that a stronger euro is not so much an issue from a growth impact perspective. One caveat is the role of second round effects: reduced profitability of exporting companies can have an impact on the economy. The general conclusion however is that in gauging the impact of a stronger euro, one should focus more on inflation than on growth.

### PPP VERSUS USD AND USE OF USD AS AN INVOICING CURRENCY

M : Imports X : Exports ● PPP [RHS]



Sources: OECD, Eurostat, BNP Paribas

William De Vijlder

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ECONOMIC RESEARCH DEPARTMENT

**Eco**  
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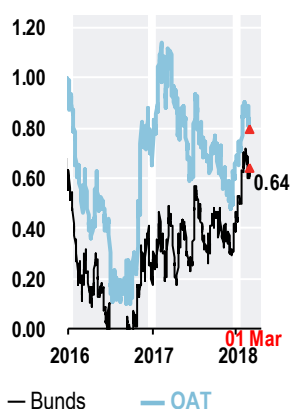
## Markets overview

### The essentials

Week 23-2 18 > 1-3-18

➤ CAC 40	5 317	➤ 5 263	-1.0 %
➤ S&P 500	2 747	➤ 2 678	-2.5 %
➤ Volatility (VIX)	16.5	➤ 22.5	+6.0 pb
➤ Euribor 3M (%)	-0.33	➤ -0.33	+0.1 bp
➤ Libor \$ 3M (%)	1.96	➤ 2.02	+6.1 bp
➤ OAT 10y (%)	0.81	➤ 0.80	-1.8 bp
➤ Bund 10y (%)	0.60	➤ 0.64	+4.1 bp
➤ US Tr. 10y (%)	2.87	➤ 2.80	-7.0 bp
➤ Euro vs dollar	1.23	➤ 1.22	-1.0 %
➤ Gold (ounce, \$)	1 328	➤ 1 305	-1.7 %
➤ Oil (Brent, \$)	67.0	➤ 63.8	-4.8 %

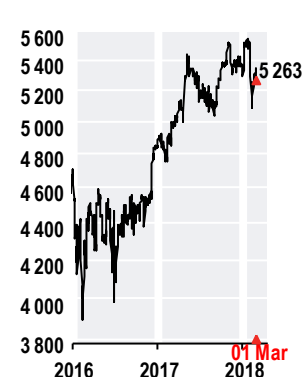
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



### Money & Bond Markets

Interest Rates	highest' 18	lowest' 18
€ ECB	0.00 at 01/01	0.00 at 01/01
Eonia	-0.36 at 01/01	-0.37 at 02/01
Euribor 3M	-0.33 at 25/01	-0.33 at 01/01
Euribor 12M	-0.19 at 01/01	-0.19 at 19/02
\$ FED	1.50 at 01/01	1.50 at 01/01
Libor 3M	2.02 at 28/02	1.69 at 01/01
Libor 12M	2.50 at 28/02	2.11 at 01/01
£ BoE	0.50 at 01/01	0.50 at 01/01
Libor 3M	0.58 at 28/02	0.52 at 04/01
Libor 12M	0.91 at 26/02	0.76 at 03/01

At 1-3-18

Yield (%)	highest' 18	lowest' 18
€ AVG 5-7y	0.66 at 15/02	0.43 at 01/01
Bund 2y	-0.63 at 02/02	-0.66 at 01/01
Bund 10y	0.64 at 15/02	0.42 at 01/01
OAT 10y	0.91 at 08/02	0.65 at 08/01
Corp. BBB	1.34 at 14/02	1.17 at 08/01
\$ Treas. 2y	2.26 at 27/02	1.89 at 01/01
Treas. 10y	2.94 at 21/02	2.41 at 01/01
Corp. BBB	4.04 at 21/02	3.59 at 01/01
£ Treas. 2y	0.72 at 27/02	0.40 at 01/01
Treas. 10y	1.67 at 15/02	1.23 at 01/01

At 1-3-18

10y bond yield & spreads

4.97%	Greece	433 pb
2.03%	Italy	138 pb
1.78%	Portugal	113 pb
1.51%	Spain	86 pb
0.93%	Belgium	29 pb
0.86%	Austria	22 pb
0.80%	France	15 pb
0.78%	Ireland	14 pb
0.76%	Finland	12 pb
0.69%	Netherlands	4 pb
0.64%	Germany	

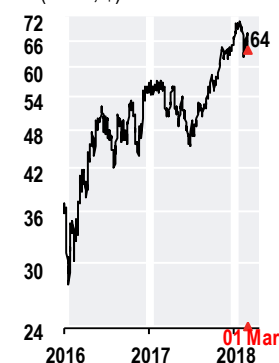
### Commodities

Spot price in dollars	lowest' 18	2018(€)
Oil, Brent	62.2 at 13/02	-5.6%
Gold (ounce)	1 303 at 01/01	-1.3%
Metals, LMEX	3 271 at 09/02	-4.0%
Copper (ton)	6 712 at 09/02	-5.8%
CRB Foods	336 at 01/01	+2.1%
wheat (ton)	155 at 16/01	+16.6%
Corn (ton)	126 at 08/01	+9.6%

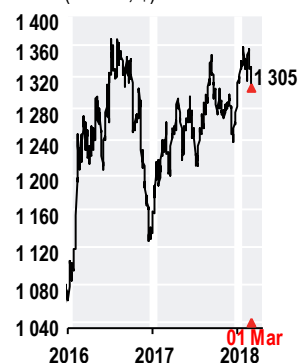
At 1-3-18

Variations

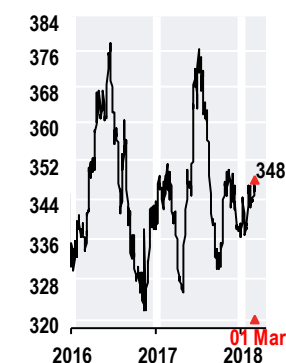
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



### Exchange Rates

1€ =	highest' 18	lowest' 18	2018
USD	1.25 at 25/01	1.19 at 09/01	+1.4%
GBP	0.89 at 04/01	0.87 at 24/01	-0.0%
CHF	1.18 at 15/01	1.15 at 27/02	-1.3%
JPY	137.29 at 02/02	130.14 at 28/02	-3.6%
AUD	1.58 at 15/02	1.53 at 09/01	+2.4%
CNY	7.92 at 25/01	7.70 at 07/02	-1.2%
BRL	4.08 at 13/02	3.87 at 08/01	-0.4%
RUB	71.44 at 09/02	68.06 at 09/01	+0.3%
INR	80.09 at 22/02	75.92 at 08/01	+3.6%

At 1-3-18

Variations

### Equity indices

Index	highest' 18	lowest' 18	2018	2018(€)
CAC 40	5 542 at 22/01	5 079 at 09/02	-0.9%	-0.9%
S&P500	2 873 at 26/01	2 581 at 08/02	+0.2%	-1.3%
DAX	13 560 at 23/01	12 107 at 09/02	-5.6%	-5.6%
Nikkei	24 124 at 23/01	21 154 at 14/02	-4.6%	-1.0%
China*	101 at 26/01	88 at 09/02	+5.6%	+4.0%
India*	642 at 29/01	583 at 22/02	-2.0%	-5.5%
Brazil*	2 393 at 26/01	2 023 at 01/01	+11.3%	+11.8%
Russia*	707 at 26/02	604 at 01/01	+11.2%	+10.6%

At 1-3-18

Variations

\* MSCI index



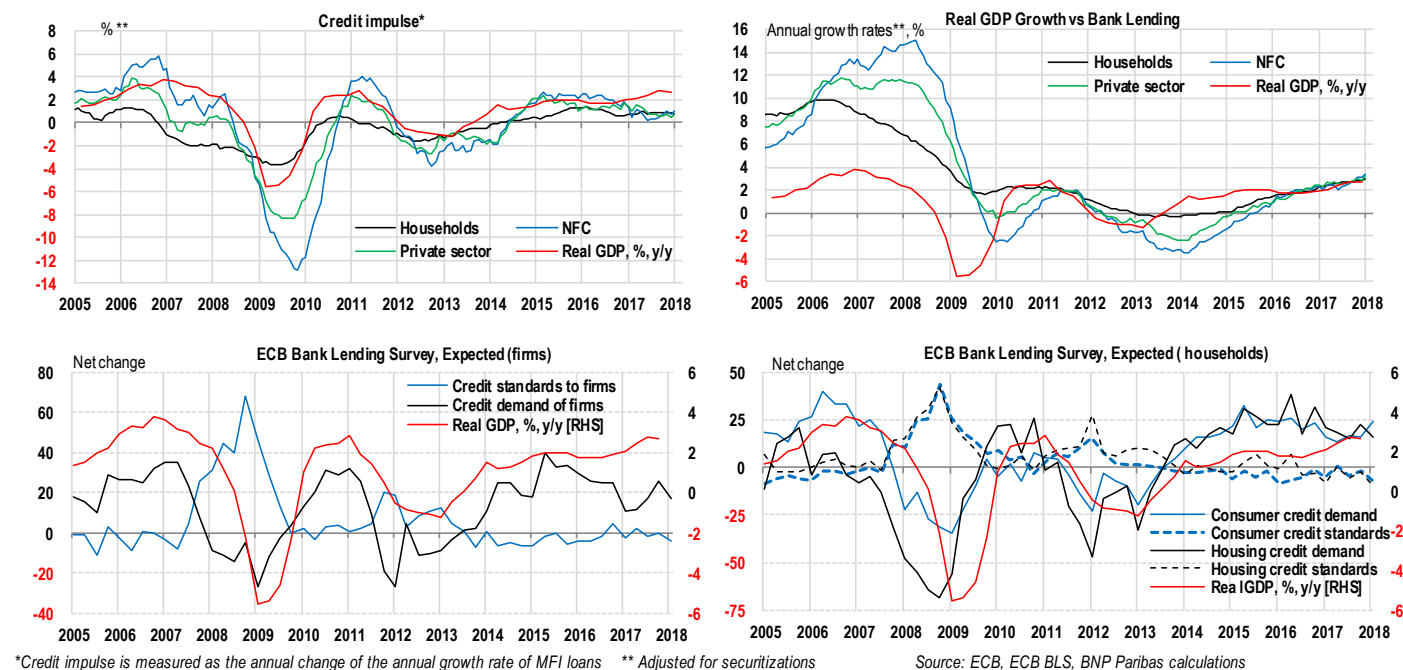
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## Pulse

## Eurozone: Credit pulse

The year-over-year growth rate of bank lending continues to accelerate (top right chart) in line with faster GDP growth. The assessment by banks of credit demand of corporates and households (housing, consumer credit) continues to be positive. In addition, the annual change of credit growth remains positive.



## Indicators preview

As usual at the start of the month, a very busy week. Markit will publish its composite PMI for various countries, in the US we have the non-manufacturing ISM and in France industrial sentiment. The second part of the week is particularly important with the ECB and BoJ meetings and the labour market data in the US where markets will focus on the change in hourly earnings.

Date	Country/Region	Event	Period	Prior
03/05/18	France	Markit France Composite PMI	Feb.	--
03/05/18	Eurozone	Markit Eurozone Composite PMI	Feb.	--
03/05/18	United States	ISM Non-Manf. Composite	Feb.	59.9
03/06/18	United States	Durable Goods Orders	Jan.	--
03/07/18	France	Trade Balance	Jan.	3.468e+09
03/07/18	Eurozone	GDP SA QoQ	4Q	0.6%
03/07/18	United States	U.S. Federal Reserve Releases Beige Book		
03/08/18	Japan	GDP SA QoQ	4Q	0.1%
03/08/18	Eurozone	ECB Main Refinancing Rate	March-08	0.000%
03/08-03/09/18	France	Bank of France Ind. Sentiment	Feb.	105
03/09/18	France	Industrial Production MoM	Jan.	0.5%
03/09/18	United States	Change in Nonfarm Payrolls	Feb.	2E+05
03/09/18	United States	Average Hourly Earnings MoM	Feb.	0.3%
03/09/18	Japan	BoJ Policy Balance Rate	March-09	-0.100%

Sources: Bloomberg, BNP Paribas



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## 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. Tax cuts would add +0.5 pp to the GDP growth this year, that would trend near 3%.
- The labour market is as buoyant as ever, showing its first signs of tension (participation rates and real wages are up).
- Fed Funds rates: 1.75% in Q1 2018, 2% by mid-2018.

### CHINA

- Economic growth will decelerate in 2018. 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. Fiscal policy should remain expansionist.
- The outlook for exports and household spending is rather favourable in the short term, but the tightening of domestic credit conditions, restructuring measures in the industry and less buoyant property market will weigh on economic activity.

### 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 ECB is expected to remain cautious. Possible extension of APP after Sept. no rates hike before mid-2019.

### FRANCE

- A clear growth acceleration is underway. Households' consumption is supported by the jobs recovery but restrained by the upturn in inflation. Investment and exports dynamics are favourable.
- A slight rise in inflation is appearing but remains to be confirmed.

### INTEREST RATES AND FX RATES

- In the US, ongoing strong growth and a very low unemployment rate pave the way for several rate hikes (we expect 4 this year and 1 next). This will put upward pressure on bond yields in 2018. The ECB is expected to stop its QE programme at the end of 2018 and to hike its rates by the middle of 2019. As a consequence, bond yields should follow a rising trend, including in 2019. No change expected in Japan
- The narrowing bond yield differential between the US and the eurozone should cause a strengthening of the euro, all the more so considering it is still below its long-term fair value (around 1.34).

### SUMMARY

%	GDP Growth			Inflation		
	2017 e	2018 e	2019 e	2017 e	2018 e	2019 e
<b>Advanced</b>	<b>2.2</b>	<b>2.7</b>	<b>1.9</b>	<b>1.7</b>	<b>1.9</b>	<b>1.8</b>
United-States	2.3	3.1	2.1	2.1	2.3	2.1
Japan	1.6	1.3	0.6	0.5	0.6	0.9
United-Kingdom	1.7	1.5	1.8	2.7	2.6	2.1
<b>Euro Area</b>	<b>2.5</b>	<b>2.8</b>	<b>2.1</b>	<b>1.5</b>	<b>1.7</b>	<b>1.7</b>
Germany	2.6	3.1	2.0	1.7	1.7	1.8
France	2.0	2.4	1.9	1.2	1.8	1.8
Italy	1.6	1.8	1.3	1.4	1.4	1.5
Spain	3.1	2.9	2.2	2.1	1.5	1.6
Netherlands	3.2	2.3	1.7	1.4	1.7	1.8
<b>Emerging</b>	<b>4.5</b>	<b>4.8</b>	<b>4.9</b>			
China	6.9	6.4	6.4	1.6	2.3	2.5
India	6.6	7.5	7.8	3.6	4.4	4.6
Brazil	1.1	3.0	3.5	3.4	3.3	3.8
Russia	1.7	1.6	1.5	3.7	4.0	4.4

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

### INTEREST RATES & FX RATES

#### Interest rates, %

End of period		Q2 2018e	Q4 2018e	Q4 2019e
<b>US</b>	Fed funds	1.75-2.00	2.25-2.50	2.50-2.75
	10-year	3.10	3.25	3.00
<b>Eurozone</b>	Refi	0.00	0.00	0.25
	10-year	0.85	1.50	1.80
<b>Spreads to Germany (bp)</b>				
	France (10y)	25	20	25
	Italy (10y)	110	100	120
	Spain (10y)	75	75	90
<b>Japan</b>	IOER	-0.10	-0.10	-0.10
	10-year	0.08	0.08	0.00

#### Exchange Rates

		2018					
End of period		Q1e	Q2e	Q3e	Q4e	2018e	2019e
USD	EUR / USD	1.26	1.27	1.28	1.28	1.28	1.34
	USD / JPY	106	105	104	102	102	98
	GBP / USD	1.38	1.41	1.44	1.45	1.45	1.52
	USD / CHF	0.93	0.93	0.93	0.94	0.94	0.93
EUR	EUR / GBP	0.91	0.90	0.89	0.88	0.88	0.88
	EUR / CHF	1.17	1.18	1.19	1.20	1.20	1.25
	EUR / JPY	134	133	133	131	131	131

Source: GlobalMarkets BNP Paribas (e: estimates & forecasts)



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