

# ECOWEEK

No. 18-28, 13 July 2018

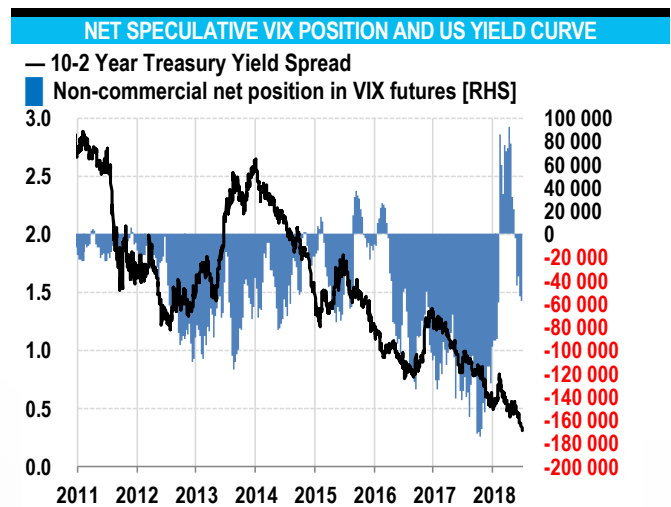
## Conflicting perspectives raise eyebrows

■ Speculative positioning in VIX futures shows investors expect volatility to remain low, which implies an absence of growth or inflation shocks ■ The flattening of the US yield curve shows investors expect slower growth ■ These conflicting views may reflect differences in investment horizon but in the end, only one of the two can get it right, which is a source of concern

Beauty is in the eye of the beholder. The expression also applies when gauging the economic environment based on market indicators. The net speculative position in VIX<sup>1</sup> futures gives reason for confidence: after having turned positive briefly in February when the US inflation surprises caused some turmoil, the net position has moved back into negative territory: investors count on inflation, growth and monetary policy, which are obvious potential causes of volatility jumps, to evolve in line with expectations. The flattening of the yield curve tells a different story: despite the monetary policy tightening cycle, the difference between 10 year and 2 year treasury yields continues to shrink and fuels recession fears considering that previous recessions have been preceded by yield curve inversions. The flattening shows that investors consider that the current level of short term rates cannot be maintained forever because eventually growth will slow. It also shows that households, anticipating an economic slowdown, want to protect their income by locking in current long term yields, believing that when the slowdown will have become headline news, yields will already have dropped considerably.

Why would the same information cause two market indicators to provide conflicting signals? One explanation is a difference in horizon. This tends to be short in a short VIX strategy: every single day without a jump in implied volatility means money is being made when the curve is in contango (the price of the short term VIX future is below the long term VIX future). In a yield curve flattening strategy the bond investor prefers long-dated paper so as not to miss the start of the cyclical bond rally, even if this means having a volatile performance in the short run. Both investors can be right but not all the time. When the balance tilts in favour of the bond investors' view on the economy things can get tricky causing a jump in volatility and portfolio adjustments (stop losses) by those who had been short VIX until then. It means that from an economic perspective, the conflicting views are a source of concern because they make a jump in volatility with spillovers across markets more likely. This in turn could weigh on sentiment and confidence in the real economy.

<sup>1</sup> The Cboe Volatility Index® (VIX® Index) measures the market's expectation of future volatility of the S&P 500 index over a constant 30-day period. It is based on prices of put and call options of different strike prices on this index. It has led to the creation tradable VIX futures and options (source: [www.cboe.com](http://www.cboe.com)).



William De Vijlder

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**Eco**  
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ECONOMIC RESEARCH DEPARTMENT



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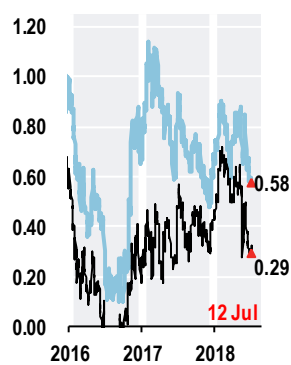
## Markets overview

### The essentials

Week 6-7 18 > 12-7-18

↗ CAC 40	5 376	▶ 5 406	+0.6 %
↗ S&P 500	2 760	▶ 2 798	+1.4 %
↘ Volatility (VIX)	13.4	▶ 12.6	-0.8 pb
↗ Euribor 3M (%)	-0.32	▶ -0.32	+0.0 bp
↗ Libor \$ 3M (%)	2.33	▶ 2.34	+0.6 bp
↘ OAT 10y (%)	0.58	▶ 0.58	+0.0 bp
↗ Bund 10y (%)	0.29	▶ 0.29	+0.2 bp
↗ US Tr. 10y (%)	2.82	▶ 2.85	+2.9 bp
↘ Euro vs dollar	1.18	▶ 1.17	-0.6 %
↘ Gold (ounce, \$)	1 255	▶ 1 247	-0.6 %
↘ Oil (Brent, \$)	77.1	▶ 73.4	-4.8 %

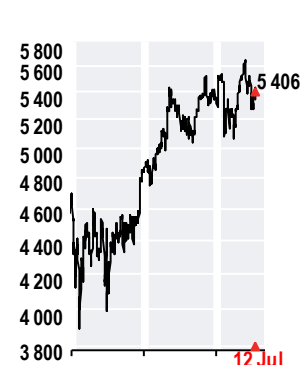
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



— Bunds — OAT

### 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 18/05
Euribor 3M	-0.32 at 29/05	-0.33 at 01/01
Euribor 12M	-0.18 at 11/07	-0.19 at 19/02
\$ FED	2.00 at 14/06	1.50 at 01/01
Libor 3M	2.34 at 04/05	1.69 at 01/01
Libor 12M	2.78 at 05/07	2.11 at 01/01
£ BoE	0.50 at 01/01	0.50 at 01/01
Libor 3M	0.72 at 19/04	0.52 at 04/01
Libor 12M	1.00 at 17/04	0.76 at 03/01

At 12-7-18

Yield (%)	highest' 18	lowest' 18
€ AVG 5-7y	0.67 at 08/06	0.41 at 18/04
Bund 2y	-0.64 at 07/03	-0.79 at 29/05
Bund 10y	0.29 at 15/02	0.28 at 29/05
OAT 10y	0.58 at 08/02	0.58 at 06/07
Corp. BBB	1.57 at 11/06	1.17 at 08/01
\$ Treas. 2y	2.60 at 12/07	1.89 at 01/01
Treas. 10y	2.85 at 17/05	2.41 at 01/01
Corp. BBB	4.34 at 17/05	3.59 at 01/01
£ Treas. 2y	0.66 at 21/03	0.40 at 01/01
Treas. 10y	1.33 at 15/02	1.23 at 01/01

At 12-7-18

10y bond yield & spreads

4.41%	Greece	411 pb
2.64%	Italy	234 pb
1.75%	Portugal	145 pb
1.29%	Spain	100 pb
0.66%	Belgium	36 pb
0.58%	France	28 pb
0.54%	Austria	24 pb
0.53%	Ireland	24 pb
0.46%	Netherlands	16 pb
0.45%	Finland	15 pb
0.29%	Germany	

### Commodities

Spot price in dollars	lowest' 18	2018(€)
Oil, Brent	73.4 at 13/02	+13.2%
Gold (ounce)	1 247 at 02/07	-1.7%
Metals, LMEX	3 067 at 06/07	-7.8%
Copper (ton)	6 210 at 11/07	-11.4%
CRB Foods	346 at 04/04	+5.7%
wheat (ton)	184 at 16/01	+18.9%
Corn (ton)	124 at 11/07	+0.2%

At 12-7-18

Variations

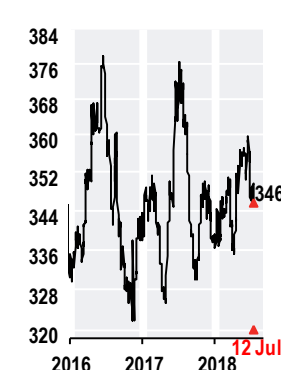
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



### Exchange Rates

€ =	highest' 18	lowest' 18	2018
USD	1.17 at 25/01	1.16 at 29/05	-2.7%
GBP	0.89 at 02/03	0.86 at 17/04	-0.5%
CHF	1.17 at 19/04	1.15 at 31/05	-0.2%
JPY	137.29 at 02/02	125.87 at 29/05	-2.9%
AUD	1.58 at 26/03	1.53 at 09/01	+2.8%
CNY	7.92 at 25/01	7.42 at 29/05	-0.4%
BRL	4.62 at 06/07	3.87 at 08/01	+13.2%
RUB	72.64 at 11/04	68.06 at 09/01	+5.1%
INR	80.09 at 25/04	75.92 at 08/01	+4.5%

At 12-7-18

Variations

### Equity indices

Index	highest' 18	lowest' 18	2018	2018(€)
CAC 40	5 640 at 22/05	5 066 at 26/03	+1.8%	+1.8%
S&P500	2 873 at 26/01	2 581 at 08/02	+4.7%	+7.6%
DAX	13 560 at 23/01	11 787 at 26/03	-3.3%	-3.3%
Nikkei	24 124 at 23/01	20 618 at 23/03	-2.5%	+0.4%
China*	101 at 26/01	84 at 05/07	-3.4%	-1.1%
India*	642 at 29/01	547 at 23/05	+1.2%	-3.2%
Brazil*	2 393 at 26/01	1 603 at 27/06	-1.6%	-13.1%
Russia*	707 at 26/02	571 at 16/04	+10.5%	+6.2%

At 12-7-18

Variations

\* MSCI index



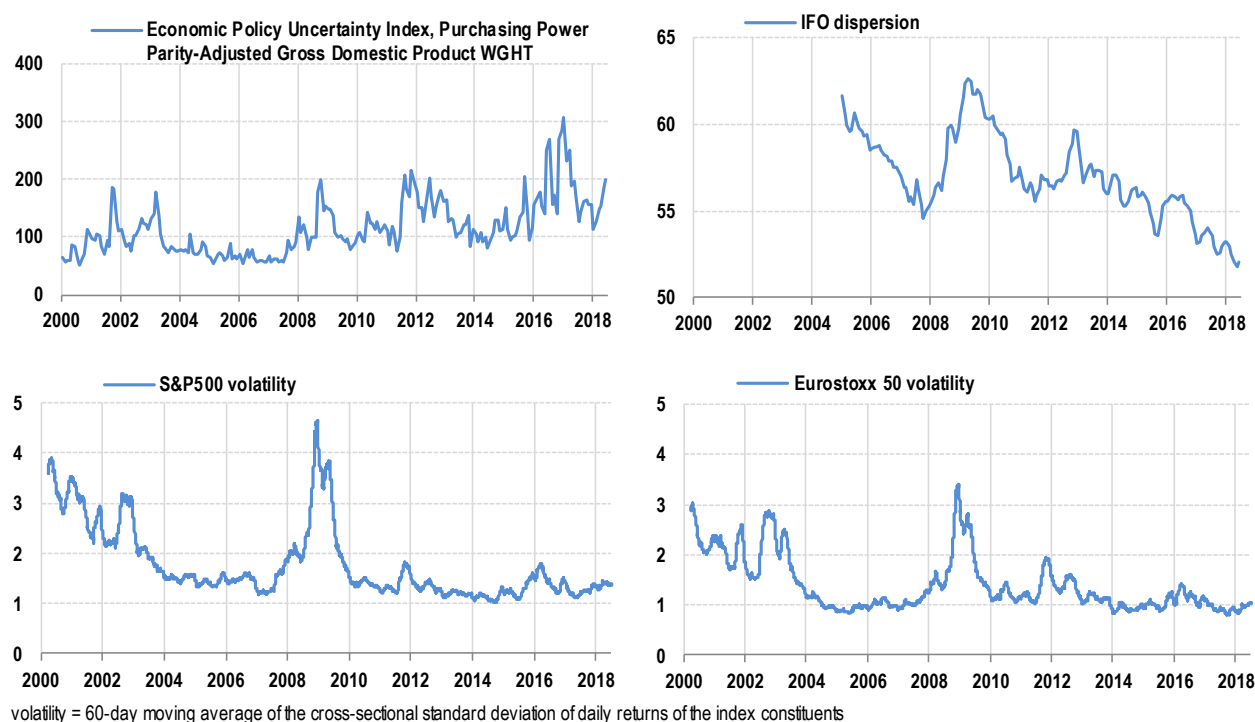
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## Pulse

## Uncertainty: Thus far increase has been limited

Uncertainty has a considerable influence on decisions by households and companies. Because it is not directly observable, proxies are used. Starting top left and moving clockwise, the first chart shows an index of economic policy uncertainty based on media coverage. Based on this indicator uncertainty has increased considerably. The second chart shows the dispersion of the assessment of the economic outlook made by German companies. Its low level suggests that uncertainty hasn't really increased yet. The two remaining charts show the dispersion of individual stock returns in the US and the eurozone. This dispersion increases when uncertainty picks up. The increase thus far has been very limited. The overall conclusion is that although uncertainty is much talked about in media, other indicators suggest the increase has remained limited.



Source: Economic Policy Uncertainty, Bloomberg, IFO, BNP Paribas

## Indicators preview

A rather light week ahead of us in terms of data. Important to mention are the inflation numbers in the eurozone and the UK, where it will influence expectations ahead of the August meeting of the Bank of England. In the US the Beige Book will be scrutinised for evidence of an impact of trade war concerns on business. The Empire State Manufacturing index of the Fed of New York and the Philadelphia Fed business outlook for July are important for the same reason.

Date	Country	Event	Period
07/16/18	United States	Empire Manufacturing	July
07/16/18	United States	Retail Sales Advance MoM	June
07/17/18	United Kingdom	ILO Unemployment Rate 3Mths	May
07/17/18	United States	Capacity Utilization	June
07/18/18	United Kingdom	CPI MoM	June
07/18/18	Eurozone	CPI MoM	June
07/18/18	United States	Housing Starts MoM	June
07/18/18	United States	Building Permits MoM	June
07/18/18	United States	U.S. Federal Reserve Releases Beige Book	June
07/19/18	United States	Philadelphia Fed Business Outlook	July
07/19/18	United Kingdom	CBI Trends Total Orders	July

Source: Bloomberg, BNP Paribas



## Economic scenario

### UNITED STATES

■ Despite slow start, economy is expected to expand at a 3% or so in 2018, thanks to tax cuts, booming profits and credit. However, the current weakening in external trade indexes put the risk on the downside.

■ Inflation is accelerating in the wake of higher oil prices and more evident tensions in the labour market.

■ The Fed will keep on normalizing monetary conditions. We forecast the Fed Funds target rate to reach 2.75% by early

### 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 continuing, although it has been weaker than expected at the start of the year. Intra-EU trade builds with domestic demand, especially corporate investment.

■ Inflation has rebounded in the wake of higher oil prices, but the core CPI trend remains subdued. Along with renewed tensions over sovereign debt spreads (Italy) this argues for the ECB to keep on buying until year end at least, and to maintain the status quo on key rates thereafter (first hike seen in Q4'19).

### FRANCE

■ Growth remains robust but gets back down to a less rapid pace than in 2017. Households' consumption is supported by the jobs recovery but restrained by the upturn in inflation. Investment and exports dynamics remain favourable. Risks are on the downside. A slight rise in core 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	2018 e	2019 e	2017	2018 e	2019 e
<b>Advanced</b>	<b>2.3</b>	<b>2.4</b>	<b>1.7</b>	<b>1.8</b>	<b>2.1</b>	<b>1.9</b>
United-States	2.3	3.0	2.0	2.1	2.5	2.1
Japan	1.7	0.8	0.6	0.5	0.9	0.8
United-Kingdom	1.8	1.4	1.3	2.7	2.8	2.2
<b>Euro Area</b>	<b>2.6</b>	<b>2.2</b>	<b>1.7</b>	<b>1.5</b>	<b>1.8</b>	<b>1.8</b>
Germany	2.5	2.1	1.9	1.7	1.9	2.0
France	2.3	2.1	1.9	1.2	2.0	1.6
Italy	1.6	1.4	1.2	1.3	1.4	1.7
Spain	3.1	2.8	2.2	2.0	1.7	1.7
Netherlands	3.3	2.3	1.7	1.3	1.7	1.8
<b>Emerging</b>	<b>5.9</b>	<b>5.9</b>	<b>5.9</b>	<b>2.4</b>	<b>2.9</b>	<b>3.2</b>
China	6.9	6.4	6.3	1.6	2.3	2.5
India	6.7	7.4	7.6	3.6	4.5	4.4
Brazil	1.0	2.0	3.5	3.4	3.0	3.3
Russia	1.5	1.8	1.7	3.7	3.0	4.0

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

### INTEREST RATES & FX RATES

Interest rates, %		2018				2017	2018e	2019e
End of period		Q1	Q2e	Q3e	Q4e			
<b>US</b>	Fed Funds	1.75	2.00	2.25	2.50	1.50	2.50	2.75
	Libor 3m \$	2.31	2.20	2.50	2.65	1.69	2.65	2.55
	T-Notes 10y	2.75	3.07	3.20	3.25	2.41	3.25	3.00
<b>Ezone</b>	ECB Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.25
	Euribor 3m	-0.33	-0.33	-0.33	-0.33	-0.33	-0.33	0.07
	Bund 10y	0.50	0.53	0.90	1.10	0.42	1.10	1.50
	OAT 10y	0.60	0.84	1.15	1.35	0.66	1.35	1.75
<b>UK</b>	Base rate	0.50	0.50	0.75	0.75	0.50	0.75	1.25
	Gilt 10y	1.39	1.50	1.60	1.75	1.23	1.75	2.10
<b>Japan</b>	BoJ Rate	-0.07	-0.10	-0.10	-0.10	-0.04	-0.10	-0.10
	JGB 10y	0.04	0.05	0.05	0.05	0.05	0.05	0.00

Exchange Rates		2018				2017	2018e	2019e
End of period		Q1	Q2e	Q3e	Q4e			
<b>USD</b>	EUR / USD	1.23	1.18	1.18	1.24	1.20	1.24	1.34
	USD / JPY	106	108	107	104	113	104	98
	GBP / USD	1.40	1.33	1.33	1.41	1.35	1.41	1.52
	USD / CHF	0.96	1.00	1.01	0.97	0.97	0.97	0.93
<b>EUR</b>	EUR / GBP	0.88	0.89	0.89	0.88	0.89	0.88	0.88
	EUR / CHF	1.18	1.18	1.19	1.20	1.17	1.20	1.25
	EUR / JPY	131	127	126	129	135	129	131

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



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