

ECOWEEK

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Eurozone: Strengthening resilience

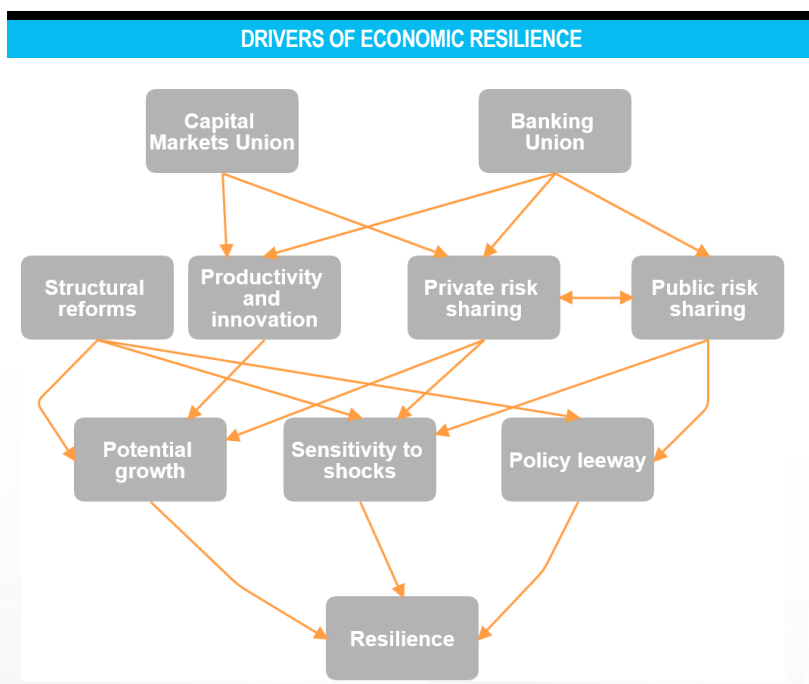
■ Support seems to be growing for the proposal of France and Germany for a eurozone budget ■ This would contribute to a much needed enhancement of economic resilience, that is the ability to cope with shocks ■ Resilience can also be strengthened through private and public risk sharing and policies seeking to boost potential growth ■ Boosting resilience is all the more important considering that risks to global growth seem to be tilted to the downside

Media reported this week that the proposal of France and Germany for a eurozone budget is gaining support from a number of other countries, thereby paving the way for stepping up the efforts in that direction. Although it looks like the journey to come to something significant will be long, the effort needs to be welcomed because, if successful, it would contribute to a much needed enhancement of the resilience of the eurozone economy. According to the OECD, resilience is “the ability of households, communities and nations to absorb and recover from shocks, whilst positively adapting and transforming their structures and means for living in the face of long-term stresses, change and uncertainty.” At the current juncture, there are many potential sources of stress: protectionist fears, concern about rising US interest rates, the build-up of leverage in certain domains, (geo)political uncertainty, etc.

Resilience can be enhanced in different ways. One is by taking countercyclical measures, like cutting interest rates when the economy enters into a recession. This means that resilience is proportional to the available policy leeway. However, in many advanced economies, and in the eurozone in particular, room for manoeuvre is limited due to high levels of public sector debt and low central bank rates. In the eurozone the challenge is even bigger due to the absence of a shared fiscal policy and the risk that shocks which hit weaker countries particularly hard would create real and/or financial contagion.

Resilience can also be enhanced through policies which boost potential output: faster growth on a sustained basis reduces the likelihood that a given headwind slows down the economy to its ‘stall speed’.

.../...



Source : BNP Paribas

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Economic scenario

ECONOMIC RESEARCH DEPARTMENT



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This concept refers to a discrete deterioration in economic performance because growth has dropped below some threshold value¹: confidence declines and triggers a self-reinforcing negative dynamic.

Potential growth very much depends on the capacity of an economy to innovate and to generate faster growth in productivity. In a recent speech², Mario Draghi emphasized that *“deep financial markets play a critical role in facilitating diffusion, by providing the risk capital for firms to commercialise new technologies”* adding that *“completing banking union and capital markets union are the critical measures to improve this.”*

A third way to enhance resilience is to reduce the sensitivity to shocks. This is reminiscent of the often used metaphor of ‘fixing the roof while the sun is shining’ by conducting structural reforms. The way activity is financed plays an important role as well. It has been argued many times that establishing a Capital Markets Union will foster risk sharing through more internationally diversified investment portfolios. This implies that the impact of a negative shock in a given country on equity or corporate bond prices will be spread internationally. Along the same lines, completing the Banking Union, by stimulating cross-border banking and hence broader international diversification, will boost private sector based risk sharing. Importantly, Mario Draghi argues that completing the Banking Union and the Capital Markets Union will reduce the need for public risk sharing, which is based on pooling of financial resources. These can be used to create a backstop in the context of bank resolution: *“With common public risk-sharing through a backstop for the resolution fund, the incentives at the national level to limit capital and liquidity flows would disappear. That would in turn lead to greater banking integration and private risk-sharing at the euro area level.”* So the implication is that progress in terms of public risk sharing would foster private risk sharing which in turn would reduce the calls on public risk sharing to enhance the resilience of the eurozone. In case of large shocks, public risk sharing would still have an important role to play by financing countercyclical measures whilst being mindful of the necessity to avoid moral hazard. For this reason, the IMF, which has formulated concrete proposals, insists that a central fiscal stabilisation capacity can also be used to improve compliance with fiscal rules in the eurozone: *“our proposed fund seeks to encourage saving by member states with limited fiscal space—to encourage them to build*

*buffers—by requiring regular contributions from all euro area countries while at the same time making transfers conditional on compliance with the fiscal rules.”*³ This is an important point: the promise of financial support in case of economic shocks would be a strong motivation to respect on an ex-ante basis the shared fiscal rules. To look at it from another perspective, it will be all the easier to explain to voters the decision of a government to be compliant with these rules, if in return the country will benefit from support when times are tough. In the IMF proposal, these transfers would be triggered automatically when unemployment would reach certain thresholds.

To conclude, increasing resilience, i.e. the capacity of the eurozone and its members to cope with shocks, may at first glance seem particularly challenging considering the limited policy leeway. Upon closer inspection however, it turns out that a multi-pronged approach would reduce the need to rely on the traditional instruments of monetary and fiscal policy. Adopting such an approach is clearly ambitious and challenging but, in view of the narrow room for manoeuvre on the traditional countercyclical policy levers, is also necessary, all the more so in an environment where risks to growth seem to be tilted to the downside.

William De Vijlder

¹ BIS, *Do economies stall ? The international evidence*, working paper n° 407, 2013

² Economic and Monetary Union: past and present, Speech by Mario Draghi at the Europa-Konferenz at Hertie School of Governance organised by the Jacques Delors Institute, Berlin, 19 September 2018

³ A Financial Union for the Euro Area, Poul M. Thomsen, Director, European Department, International Monetary Fund. Speech delivered at the Conference of the Belgian Financial Forum (BFF) in cooperation with SUERF, Brussels, September 14, 2018



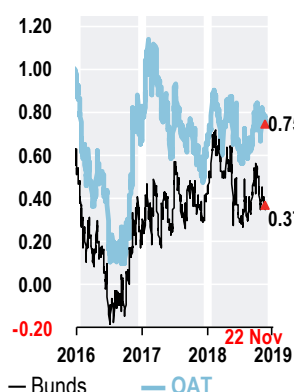
Markets overview

The essentials

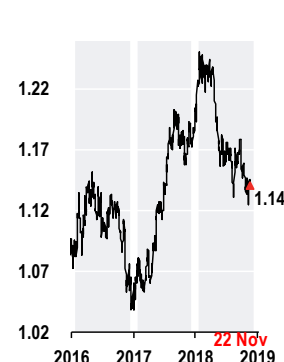
Week 16-11-18 > 22-11-18

➤ CAC 40	5 025	➤ 4 938	-1.7 %
➤ S&P 500	2 736	➤ 2 650	-3.2 %
➤ Volatility (VIX)	18.1	➤ 20.8	+2.7 pb
➤ Euribor 3M (%)	-0.32	➤ -0.32	+0.0 bp
➤ Libor \$ 3M (%)	2.64	➤ 2.68	+3.2 bp
➤ OAT 10y (%)	0.76	➤ 0.75	-1.6 bp
➤ Bund 10y (%)	0.37	➤ 0.37	-0.3 bp
➤ US Tr. 10y (%)	3.08	➤ 3.07	-1.3 bp
➤ Euro vs dollar	1.14	➤ 1.14	+0.1 %
➤ Gold (ounce, \$)	1 221	➤ 1 228	+0.6 %
➤ Oil (Brent, \$)	67.2	➤ 62.9	-6.4 %

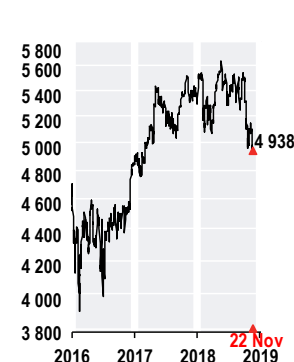
10 y bond yield, OAT vs Bund



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 31/10	-0.37 at 18/05
Euribor 3M	-0.32 at 08/11	-0.33 at 01/01
Euribor 12M	-0.15 at 24/10	-0.19 at 19/02
\$ FED	2.25 at 27/09	1.50 at 01/01
Libor 3M	2.68 at 21/11	1.69 at 01/01
Libor 12M	3.11 at 09/11	2.11 at 01/01
£ BoE	0.75 at 02/08	0.50 at 01/01
Libor 3M	0.89 at 20/11	0.52 at 04/01
Libor 12M	1.14 at 14/11	0.76 at 03/01

At 22-11-18

Yield (%)	highest' 18	lowest' 18
€ AVG 5-7y	0.82 at 19/10	0.41 at 18/04
Bund 2y	-0.61 at 25/09	-0.79 at 29/05
Bund 10y	0.37 at 15/02	0.27 at 19/07
OAT 10y	0.75 at 08/02	0.57 at 13/07
Corp. BBB	2.02 at 21/11	1.17 at 08/01
\$ Treas. 2y	2.82 at 08/11	1.89 at 01/01
Treas. 10y	3.07 at 08/11	2.41 at 01/01
Corp. BBB	4.74 at 20/11	3.59 at 01/01
£ Treas. 2y	0.75 at 05/10	0.40 at 01/01
Treas. 10y	1.42 at 10/10	1.23 at 01/01

At 22-11-18

10y bond yield & spreads

5.12%	Greece	475 pb
3.45%	Italy	308 pb
1.95%	Portugal	157 pb
1.65%	Spain	128 pb
0.82%	Belgium	45 pb
0.75%	France	37 pb
0.70%	Ireland	32 pb
0.67%	Finland	29 pb
0.62%	Austria	25 pb
0.52%	Netherlands	14 pb
0.37%	Germany	

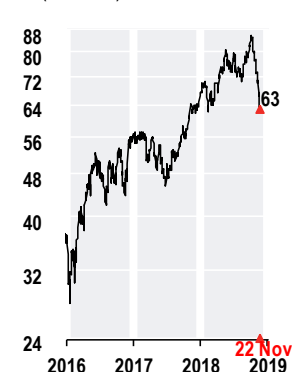
Commodities

Spot price in dollars	lowest' 18	2018(€)
Oil, Brent	62.9 at 13/02	-0.7%
Gold (ounce)	1 228 at 17/08	-0.8%
Metals, LMEX	2 924 at 15/08	-10.0%
Copper (ton)	6 286 at 15/08	-8.2%
CRB Foods	331 at 30/08	+3.6%
wheat (ton)	192 at 16/01	+27.2%
Corn (ton)	130 at 18/09	+7.9%

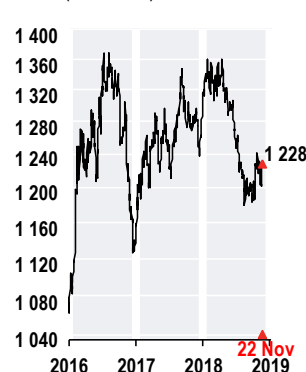
At 22-11-18

Variations

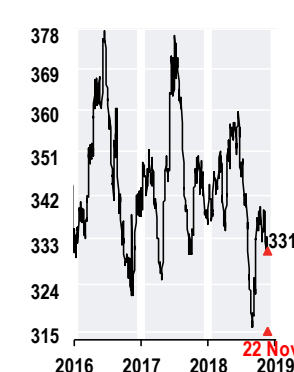
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

€ =	highest' 18	lowest' 18	2018
USD	1.14 at 25/01	1.13 at 12/11	-5.0%
GBP	0.89 at 28/08	0.86 at 17/04	-0.2%
CHF	1.13 at 19/04	1.12 at 07/09	-3.0%
JPY	128.87 at 02/02	124.96 at 15/08	-4.7%
AUD	1.57 at 11/09	1.53 at 09/01	+2.5%
CNY	7.91 at 25/09	7.42 at 29/05	+1.2%
BRL	4.35 at 14/09	3.87 at 08/01	+9.2%
RUB	74.79 at 10/09	68.06 at 09/01	+8.2%
INR	80.92 at 11/10	75.92 at 08/01	+5.6%

At 22-11-18

Variations

Equity indices

Index	highest' 18	lowest' 18	2018	2018(€)
CAC 40	5 640 at 22/05	4 925 at 20/11	-7.0%	-7.0%
S&P500	2 931 at 20/09	2 581 at 08/02	-0.9%	+4.3%
DAX	13 560 at 23/01	11 066 at 20/11	-13.8%	-13.8%
Nikkei	24 271 at 02/10	20 618 at 23/03	-4.9%	-0.2%
China*	101 at 26/01	68 at 30/10	-17.5%	-13.4%
India*	642 at 29/01	487 at 26/10	-3.1%	-8.2%
Brazil*	2 393 at 26/01	1 561 at 11/09	+12.6%	+3.1%
Russia*	707 at 26/02	551 at 23/08	+12.0%	+5.3%

At 22-11-18

Variations

* MSCI index



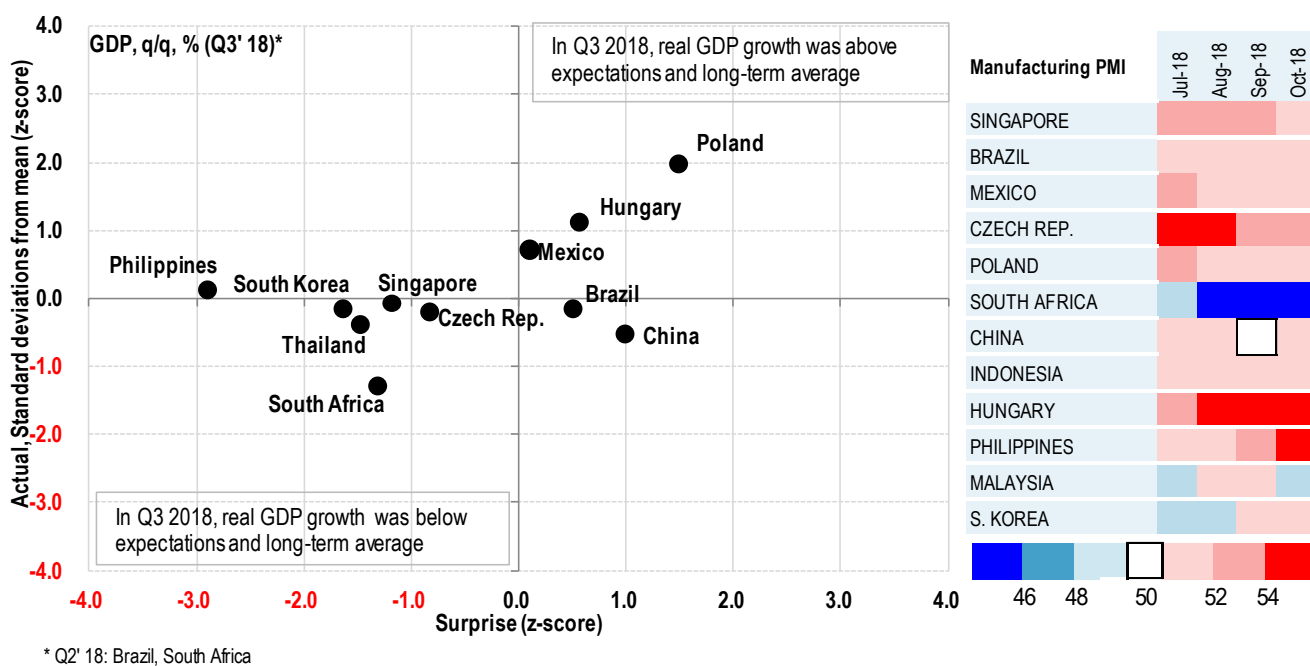
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Pulse

Poland: Growth at its highest level for a decade

Poland's GDP growth surprised to the upside in Q3 (+5.7% y/y), the strongest quarterly reading in ten years, after an already strong performance in H1 (+5% y/y). Economic growth was driven by booming private consumption and a pick-up in EU funded investment, while exports lost steam. In its Autumn forecasts, the European Commission revised upwards Poland's GDP growth expectations for 2018 to 4.8% from 4.3%.



Source: Bloomberg, Markit, BNP Paribas

Indicators preview

Next week will see the publication of several surveys for the month of November: IFO business climate (Germany), consumer confidence (France, Germany, eurozone, UK, Japan, US) and, for the eurozone, economic confidence. In the US attention will focus on third quarter GDP and the minutes of the FOMC. Also worth mentioning are the inflation data for France and Germany.

Date	Country	Event	Period	Prior
11/26/18	Germany	IFO Business Climate	Nov	102.8
11/27/18	France	Consumer Confidence	Nov	95
11/27/18	United States	Conf. Board Consumer Confidence	Nov	137.9
11/28/18	Germany	GfK Consumer Confidence	Dec	10.6
11/28/18	United States	GDP Annualized QoQ	3Q	3.5%
11/28/18	United States	New Home Sales MoM	Oct	-5.5%
11/29/18	Japan	Retail Sales MoM	Oct	-0.2%
11/29/18	France	GDP QoQ	3Q	0.4%
11/29/18	Germany	Unemployment Claims Rate SA	Nov	5.1%
11/29/18	Eurozone	Economic Confidence	Nov	109.8
11/29/18	Eurozone	Business Climate Indicator	Nov	1.01
11/29/18	Eurozone	Consumer Confidence	Nov	--
11/29/18	Germany	CPI EU Harmonized MoM	Nov	--
11/29/18	United States	Personal Income	Oct	0.2%
11/29/18	United States	Personal Spending	Oct	0.4%
11/29/18	United States	FOMC Meeting Minutes	Nov 08	--
11/30/18	United Kingdom	GfK Consumer Confidence	Nov	-10
11/30/18	Japan	Consumer Confidence Index	Nov	43.0
11/30/18	France	CPI EU Harmonized MoM	Nov	--
11/30/18	Eurozone	Unemployment Rate	Oct	8.1%

Source: Bloomberg, BNP Paribas



Economic scenario

UNITED STATES

- Economy is expected to expand at approximately 2.8% this year on the back of tax cuts, booming profits and credit. However, the slowdown of international trade implies the risk is on the downside.
- Inflation is accelerating in the wake of higher oil prices and a tight labour market.
- The Fed will keep on tightening its policy. We forecast the Fed funds target rate to reach 2.75% in Q1 2019.

CHINA

- Economic growth will decelerate in 2018-2019. The export outlook is significantly darkened by US protectionist measures. Private domestic demand should be affected by the worsening performance of the export manufacturing sector and the continued moderation in the property market.
- In order to contain the slowdown, the central bank has started to ease liquidity and credit conditions. At the same time, the reduction in financial instability risks should remain a top policy priority. Fiscal policy will also be expansionary and infrastructure spending is projected to rise.

EUROZONE

- The recovery is continuing, although it has been weaker than expected at the start of the year. Intra-EU trade grows with domestic demand, especially corporate investment.
- Inflation has rebounded in the wake of higher oil prices, but the core CPI trend remains subdued. This argues for the ECB to maintain the status quo on the refinancing rate for a long period of time.

FRANCE

- Growth slows down but remains above potential. Households' consumption should get a boost from the planned tax cuts and the jobs recovery but inflation reduces purchasing power gains. Business investment dynamics remain favourable. The global backdrop is less supportive. 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 more rate hikes. We expect 1 more this year and 1 in the first half of 2019 after which the Fed will want to see how the economy reacts. As a consequence, US treasury yields should increase, although to a limited degree: the market expects that the tightening cycle is already well advanced. The ECB has announced it intends to stop its net asset purchases at the end of 2018. A first hike of the deposit rate is expected after the summer of 2019. As a consequence, bond yields should increase. 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
Advanced	2.2	2.2	1.5	1.8	2.1	1.9
United-States	2.2	2.8	1.8	2.1	2.5	2.1
Japan	1.7	0.9	0.6	0.5	1.0	1.0
United-Kingdom	1.7	1.3	1.6	2.7	2.4	2.1
Euro Area	2.5	2.0	1.5	1.5	1.9	1.9
Germany	2.5	1.9	1.6	1.7	1.9	2.1
France	2.3	1.7	1.6	1.2	2.1	1.6
Italy	1.6	1.2	1.0	1.3	1.5	1.9
Spain	3.0	2.7	2.0	2.0	1.8	1.8
Emerging	5.9	5.8	5.8	2.4	2.9	2.9
China	6.9	6.4	6.1	1.6	2.1	1.9
India	6.7	7.4	7.6	3.6	4.8	4.6
Brazil	1.0	1.5	3.0	3.4	3.7	3.7
Russia	1.5	1.7	1.7	3.7	2.7	4.1

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

INTEREST RATES & FX RATES

Interest rates, %		2018	2019						
End of period		Q4e	Q1e	Q2e	Q3e	Q4e	2017	2018e	2019e
US	Fed Funds	2.50	2.75	2.75	2.75	2.75	1.50	2.50	2.75
	Libor 3m \$	2.36	2.80	2.85	2.65	2.55	1.69	2.36	2.55
	T-Notes 10y	3.10	3.15	3.20	3.10	3.00	2.41	3.10	3.00
Ezone	ECB Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Euribor 3m	-0.30	-0.30	-0.25	-0.20	-0.15	-0.33	-0.30	-0.15
	Bund 10y	0.75	0.85	1.00	1.10	1.20	0.42	0.75	1.20
	OAT 10y	1.00	1.10	1.25	1.35	1.45	0.66	1.00	1.45
UK	Base rate	0.75	0.75	1.00	1.00	1.25	0.50	0.75	1.25
	Gilt 10y	1.55	1.70	1.80	1.90	2.00	1.23	1.55	2.00
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.04	-0.10	-0.10
	JGB 10y	0.14	0.12	0.10	0.04	0.02	0.05	0.14	0.02

Exchange Rates		2019							
End of period		Q4e	Q1e	Q2e	Q3e	Q4e	2017	2018e	2019e
USD	EUR / USD	1.20	1.22	1.25	1.28	1.30	1.20	1.20	1.30
	USD / JPY	106	102	100	99	98	113	106	98
	GBP / USD	1.30	1.34	1.40	1.45	1.49	1.35	1.30	1.49
	USD / CHF	0.97	0.97	0.96	0.95	0.94	0.97	0.97	0.94
EUR	EUR / GBP	0.92	0.91	0.89	0.88	0.87	0.89	0.92	0.87
	EUR / CHF	1.16	1.18	1.20	1.22	1.22	1.17	1.16	1.22
	EUR / JPY	127	124	125	127	127	135	127	127

Source : GlobalMarkets (e: Estimates & forecasts)



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