

ECOWEEK

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Australia: recession, a distant memory

■ Australia has seen 27 years without a recession and IMF and OECD forecasts show ongoing growth in coming years
■ Population growth, productivity growth, commodity exports to China and other fast growing Asian economies have played an important role together with policy aimed at enhancing economic flexibility ■ The floating exchange rate has been an important countercyclical and hence stabilising factor ■ The housing boom has become a source of concern from a financial stability perspective with recent prudential measures allowing for a “positive correction”.

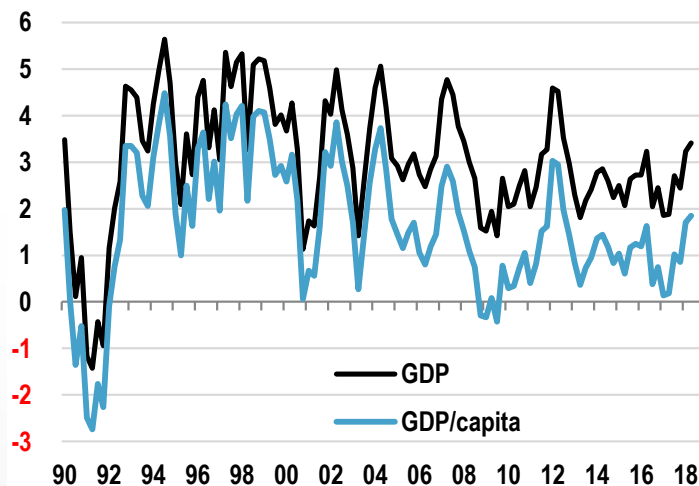
Visiting Australia is quite an experience. Coming from Europe, there is the sheer number of hours spent in a plane. Upon my arrival last week, it turned out I had just missed a major sand storm and soon after leaving there were torrential rains. Weather conditions may at times be spectacular, so is the economic performance. This is a country that is in its 108th quarter of uninterrupted growth implying that for the past 27 years it has been without a recession. GDP growth is forecast to continue to exceed 3%. With a median age of the workforce of 38 years, many people haven't experienced a recession for their entire working career. The picture in the eurozone or the US is quite different. What is behind this success story which is all the more impressive considering that over this period we have seen the Asian debt crisis, the bursting of the TMT bubble (technology, media, telecommunications), several recessions in Japan –a major trading partner– and global financial crisis of 2008. Was it a question of luck or good policy?

In 2010, the deputy governor of the Reserve Bank of Australia gave a speech on “Twenty years of economic growth”, providing an overview of the growth drivers¹. Many of the explanations remain relevant. Population growth has been a factor, both on the demand side and the supply side, by supporting a faster pace of potential GDP growth. Another factor is the exposure to China and its huge demand for commodities (iron and coal). More recently, China has become a particularly important client of the services sector: tourism and education.

.../...

¹ Twenty Years of Economic Growth, Speech given by Ric Battellino, Deputy Governor, Reserve Bank of Australia Bulletin, September Quarter 2010

AUSTRALIA: REAL GDP GROWTH (% , y/y)



Source : Australian Bureau of Statistics, Thomson Reuters, BNP Paribas

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The flexibility of the Australian economy has been a key factor in the sustained growth performance and top of the list is the flexibility of the exchange rate. The decision in 1983 to float the Australian dollar is generally considered as the single most important policy decision taken in recent decades. In a commodity rich economy where swings in volumes and commodity prices can have a big impact, the floating exchange rate acts as a countercyclical factor: booming commodity exports will trigger a currency appreciation which helps in avoiding an overheating of the economy.

Various other reforms are credited with having boosted productivity growth in the 90s: competition and industry policy, measures to increase labour market flexibility, financial system reforms and central bank independence. As a consequence, government finances improved significantly, including a reduction in the debt/GDP ratio, which in turn increased fiscal policy leeway to support growth if needed, like in 2008. According to the IMF, Commonwealth government net debt represents 20.6% of GDP in 2018 with a fiscal surplus expected in the coming year, underpinning AAA/Aaa ratings. Inflation targeting was introduced in 1993 and monetary policy has succeeded in keeping inflation in the target range of 2-3% most of the time, albeit currently below this range reflecting minimal growth in real wages. Compulsory contributions to individual pension accounts reduces the demographic drag on growth of an ageing population while the nation's sovereign wealth fund is managed to help fund public servants' pensions.

All this does not mean that the country is not facing challenges. One is population growth, essentially driven by immigration, which requires the economy to create enough and the right type of jobs so as to avoid an increase in unemployment (currently around 5%; annual working age population growth has fluctuated between 1.5% and 1.7% in recent years) and maintain positive per capita GDP growth. As shown in the chart, per capita growth has obviously been slower than GDP growth and on this measure there was a very shallow recession in 2008 Q4 and 2009 Q1.

Another one is the exposure to China although according to the IMF Australia's diversified economy helps to cushion the impact of negative growth shocks coming from China. Moreover the *"trade linkages of the rest of Asia with Australia are similar in size to those between Australia and China"*².

² Australia's linkages with China : prospects and ramifications of China's economic transition, Philippe Karam and Dirk Muir, IMF working paper 18/119, 2018

In addition, there is, due to a variety of reasons, a lack of growth in real wages and the Reserve Bank of Australia considers this is an issue for sustaining prosperity³. The housing market has increasingly become an area of attention after years of significant price increases fueled by the build-up of mortgage debt. Measures to cool down the market have been contributed to a recent decline in house prices, deemed a positive correction rather than anything more concerning, albeit with price levels still challenging affordability.

William De Vijlder

³ To quote Philip Lowe, governor of the Reserve Bank of Australia: "some pick-up in wages growth would be a welcome development. It would help deliver a rate of inflation consistent with the target, it would help with the debt situation and it would add to our sense of shared prosperity." ("Productivity, Wages and Prosperity", speech by Philip Lowe, 13 June 2018)



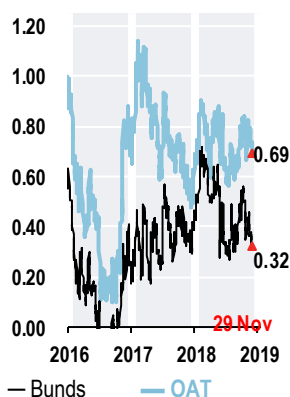
Markets overview

The essentials

Week 23-11 18 > 29-11-18

↗ CAC 40	4 947	↗ 5 006	+1.2 %
↗ S&P 500	2 633	↗ 2 738	+4.0 %
↘ Volatility (VIX)	21.5	↘ 18.8	-2.7 pb
↗ Euribor 3M (%)	-0.32	↗ -0.32	+0.0 bp
↗ Libor \$ 3M (%)	2.69	↗ 2.71	+1.5 bp
↘ OAT 10y (%)	0.72	↘ 0.69	-2.5 bp
↘ Bund 10y (%)	0.34	↘ 0.32	-1.6 bp
↘ US Tr. 10y (%)	3.06	↘ 3.04	-2.4 bp
↗ Euro vs dollar	1.13	↗ 1.14	+0.4 %
↗ Gold (ounce, \$)	1 223	↗ 1 227	+0.3 %
↗ Oil (Brent, \$)	58.9	↗ 59.6	+1.2 %

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 26/11	-0.19 at 19/02
\$ FED	2.25 at 27/09	1.50 at 01/01
Libor 3M	2.71 at 26/11	1.69 at 01/01
Libor 12M	3.13 at 09/11	2.11 at 01/01
£ BoE	0.75 at 02/08	0.50 at 01/01
Libor 3M	0.89 at 22/11	0.52 at 04/01
Libor 12M	1.14 at 14/11	0.76 at 03/01

At 29-11-18

Yield (%)	highest' 18	lowest' 18
€ AVG 5-7y	0.73 at 19/10	0.41 at 18/04
Bund 2y	-0.63 at 25/09	-0.79 at 29/05
Bund 10y	0.32 at 15/02	0.27 at 19/07
OAT 10y	0.69 at 08/02	0.57 at 13/07
Corp. BBB	2.00 at 21/11	1.17 at 08/01
\$ Treas. 2y	2.83 at 08/11	1.89 at 01/01
Treas. 10y	3.04 at 08/11	2.41 at 01/01
Corp. BBB	4.77 at 29/11	3.59 at 01/01
£ Treas. 2y	0.74 at 05/10	0.40 at 01/01
Treas. 10y	1.36 at 10/10	1.23 at 01/01

At 29-11-18

10y bond yield & spreads

4.92%	Greece	460 pb
3.20%	Italy	287 pb
1.83%	Portugal	151 pb
1.51%	Spain	119 pb
0.77%	Belgium	44 pb
0.69%	France	37 pb
0.61%	Finland	28 pb
0.60%	Ireland	28 pb
0.57%	Austria	24 pb
0.46%	Netherlands	13 pb
0.32%	Germany	

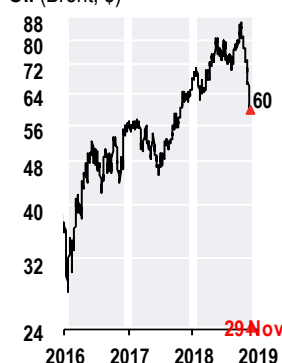
Commodities

Spot price in dollars	lowest' 18	2018(€)
Oil, Brent	58.9 at 23/11	-5.6%
Gold (ounce)	1 179 at 17/08	-0.7%
Metals, LMEX	2 820 at 15/08	-11.2%
Copper (ton)	5 759 at 15/08	-8.6%
CRB Foods	316 at 30/08	+3.8%
wheat (ton)	155 at 16/01	+27.4%
Corn (ton)	115 at 18/09	+9.7%

At 29-11-18

Variations

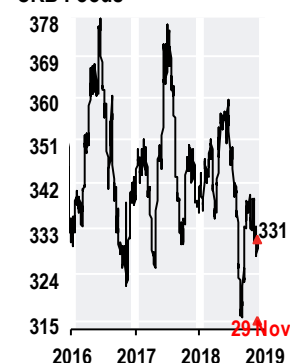
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

€ =	highest' 18	lowest' 18	2018
USD	1.25 at 25/01	1.13 at 12/11	-5.2%
GBP	0.91 at 28/08	0.86 at 17/04	+0.4%
CHF	1.20 at 19/04	1.12 at 07/09	-3.1%
JPY	137.29 at 02/02	124.96 at 15/08	-4.6%
AUD	1.63 at 11/09	1.53 at 09/01	+1.4%
CNY	8.10 at 25/09	7.42 at 29/05	+1.1%
BRL	4.88 at 14/09	3.87 at 08/01	+10.0%
RUB	81.62 at 10/09	68.06 at 09/01	+8.9%
INR	79.52 at 11/10	75.92 at 08/01	+3.7%

At 29-11-18

Variations

Equity indices

Index	highest' 18	lowest' 18	2018	2018(€)
CAC 40	5 640 at 22/05	4 925 at 20/11	-5.8%	-5.8%
S&P500	2 931 at 20/09	2 581 at 08/02	+2.4%	+8.0%
DAX	13 560 at 23/01	11 066 at 20/11	-12.5%	-12.5%
Nikkei	24 271 at 02/10	20 618 at 23/03	-2.2%	+2.5%
China*	101 at 26/01	68 at 30/10	-16.0%	-11.6%
India*	642 at 29/01	487 at 26/10	-0.6%	-4.2%
Brazil*	2 393 at 26/01	1 561 at 11/09	+15.4%	+4.9%
Russia*	707 at 26/02	551 at 23/08	+12.6%	+5.3%

At 29-11-18

Variations

* MSCI index



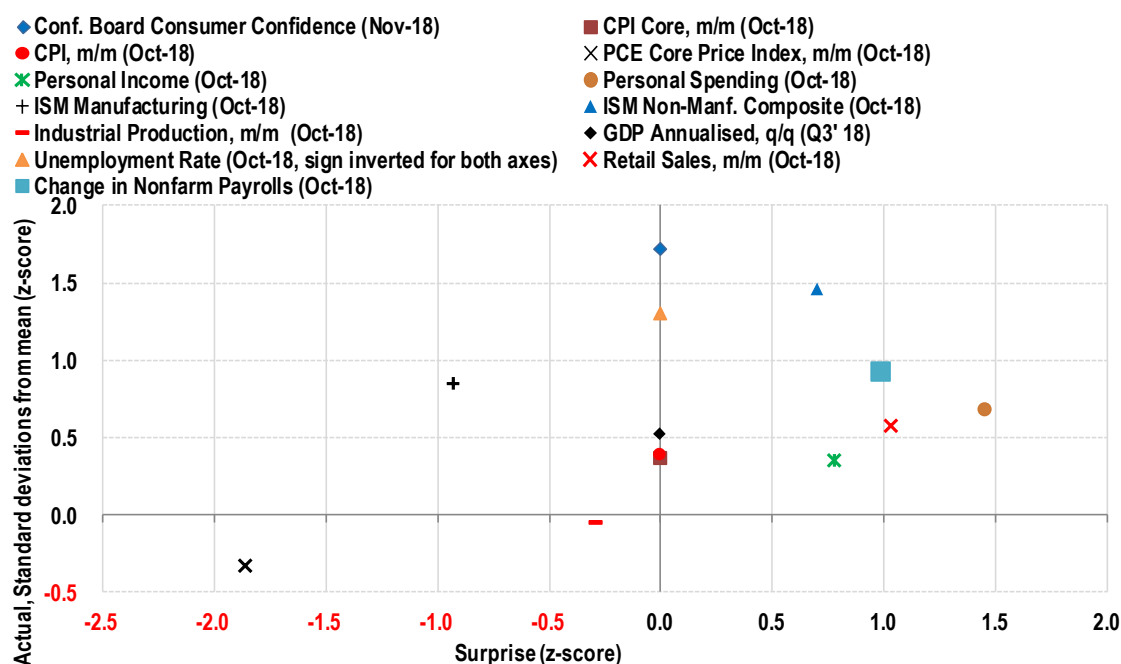
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United States: strong growth to slow down

Most indicators remain above their long term average and several, of which the all-important non-farm payrolls, have surprised to the upside. Ongoing strong growth is reflected in the Atlanta Fed nowcast for the current quarter (an annualised 2.6% versus the previous quarter). Growth is expected to slow in the coming quarters, whilst remaining above potential, under the influence of several factors: the diminishing impact of the fiscal boost, slower world growth, the strong dollar which weighs on price competitiveness of exports, the effect of Fed rate hikes, a softening of the housing market, slower corporate earnings growth, increased uncertainty (trade with China), financial market volatility.



Source: Bloomberg, Markit, BNP Paribas

Indicators preview

It's the start of a new month, which implies a packed schedule of important data releases. The PMIs (manufacturing, services and composite) in several countries, both ISM indicators in the US, the University of Michigan sentiment index and, most importantly, the labour market data in the US. Also worth noting, the Fed beige book on the economic situation across the US.

Date	Country	Event	Period	Prior
12/03/2018	France	Markit France Manufacturing PMI	Nov	--
12/03/2018	Eurozone	Markit Eurozone Manufacturing PMI	Nov	--
12/03/2018	United States	ISM Manufacturing	Nov	57.7
01/05/2018	France	Markit France Composite PMI	Nov	--
12/05/2018	Eurozone	Markit Eurozone Services PMI	Nov	--
12/05/2018	Eurozone	Markit Eurozone Composite PMI	Nov	--
12/05/2018	Eurozone	Retail Sales MoM	Oct	--
12/05/2018	United States	ISM Non-Manufacturing Index	Nov	60.3
12/05/2018	United States	U.S. Federal Reserve Releases Beige Book		
12/06/2018	United States	Durable Goods Orders	Oct	--
12/07/2018	Eurozone	GDP SA QoQ	3Q	--
12/07/2018	United States	Change in Nonfarm Payrolls	Nov	250000
12/07/2018	United States	Unemployment Rate	Nov	3.7%
12/07/2018	United States	U. of Mich. Sentiment	Dec	--
12/07/18-12/12/18	United Kingdom	CBI Trends Total Orders	Dec	--

Source: Markit, 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, weaker international trade as well as tighter monetary and financial conditions promise a slowdown.
- Inflation has passed its peak, as oil prices are now falling.
- The monetary tightening is coming closer to its end. We forecast the Fed funds target rate to reach 3% in Q2 2019, the stalling.

CHINA

- Economic growth will decelerate in 2018-2019 due to both structural and cyclical reasons. The export outlook is significantly darkened by US tariff hikes. 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 is easing liquidity and credit conditions. At the same time, the reduction in financial instability risks via regulatory tightening should remain a top policy priority. Fiscal policy is also turning expansionary (tax cuts, increased infrastructure spending).

EUROZONE

- The slowdown is becoming increasingly evident, especially in the German economy, which encounters capacity constraint and suffers from reduced demand coming from the EMEs.
- Inflation is now expected to decelerate with falling oil price, while core CPI trend remains subdued. We do not expect the ECB to move rates before 19Q4 (see below)

FRANCE

- Growth slows down but remains above potential. Households' consumption should get a boost from the 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 2 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		
	2018 e	2019 e	2020 e	2018 e	2019 e	2020 e
Advanced	2.2	1.7	1.3	2.0	1.7	1.8
United-States	2.9	2.1	1.5	2.4	1.8	2.0
Japan	0.9	0.7	0.3	1.0	0.6	1.4
United-Kingdom	1.3	1.8	1.6	2.4	2.0	2.0
Euro Area	1.9	1.4	1.2	1.8	1.8	1.5
Germany	1.6	1.5	1.3	1.9	2.2	1.6
France	1.7	1.6	1.3	2.1	1.7	1.6
Italy	1.0	0.6	0.5	1.3	1.5	1.2
Spain	2.5	2.2	2.0	1.8	1.7	1.3
Emerging	5.9	5.9	5.7	2.8	2.7	3.1
China	6.6	6.2	6.0	2.2	1.9	2.5
India	7.4	7.6	7.8	3.8	4.0	4.1
Brazil	1.3	3.0	2.5	3.7	3.8	3.6
Russia	1.8	1.7	1.6	2.8	3.6	4.2

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	2018e	2019e	2020e
US	Fed Funds	2.50	2.75	3.00	3.00	3.00	2.50	3.00	3.00
	Labor 3m \$	2.65	2.90	3.05	3.05	3.05	2.65	3.05	2.80
	T-Notes 10y	3.20	3.30	3.40	3.45	3.50	3.20	3.50	3.25
Ezone	ECB Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.20
	Euribor 3m	-0.30	-0.30	-0.25	-0.20	-0.15	-0.30	-0.15	0.00
	Bund 10y	0.55	0.55	0.60	0.80	1.00	0.55	1.00	0.90
	OAT 10y	0.90	0.95	1.00	1.10	1.25	0.90	1.25	1.15
UK	Base rate	0.75	0.75	1.00	1.00	1.25	0.75	1.25	1.50
	Gilt 10y	1.20	1.70	1.85	2.00	2.10	1.20	2.10	2.10
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
	JGB 10y	0.14	0.15	0.15	0.15	0.14	0.14	0.14	0.08

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

Exchange Rates		2018					2019		
End of period		Q4e	Q1e	Q2e	Q3e	Q4e	2018e	2019e	2020e
USD	EUR / USD	1.14	1.15	1.17	1.21	1.25	1.14	1.25	1.34
	USD / JPY	111	110	108	105	100	111	100	90
	GBP / USD	1.27	1.32	1.36	1.41	1.47	1.27	1.47	1.58
	USD / CHF	0.99	1.01	1.00	0.98	0.96	0.99	0.96	0.93
EUR	EUR / GBP	0.90	0.87	0.86	0.86	0.85	0.90	0.85	0.85
	EUR / CHF	1.13	1.16	1.17	1.18	1.20	1.13	1.20	1.25
	EUR / JPY	127	127	126	127	125	127	125	121

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



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