ECOWEEK

No. 19-37, 11 October 2019

Japan: moving to yield curve slope control?

■ The Japanese government bond yield curve has been flattening in recent months, with very long maturities coming dangerously close to 0%. This is creating concerns amongst institutional investors with long-dated liabilities (insurance companies, pension funds) ■ Bank of Japan Governor Kuroda has argued that an excessive decline in super-long-term interest rates could negatively impact economic activity This has raised expectations that the central bank could shift to a policy of controlling the slope as well as the level of the yield curve. ■ This could influence bond yields abroad. In the eurozone it would intensify the debate about the impact of ECB policy on pension funds and insurers.

Fixed income investors are starved for yield. Reluctantly, they take more risk but, considering that everybody is adopting the same approach, this doesn't stop yields from dropping below zero. This week, Greece has been able to issue 3 month treasury bills at a negative rate of 2 basis points. Back in August, Germany sold EUR 824 million of a new 30 year bond with an average yield of -0.11%[1]. The phenomenon of declining bond yields is global because of the synchronised global slowdown but also because of international capital flows which create huge correlation amongst bond markets. Japanese institutional investors are actively contributing to this development by buying long-dated paper abroad on a currency-hedged basis. They are doing this because in Japan yields have been moving down as well.

As shown in the chart, the Japanese government bond (JGB) curve has been flattening in recent months, with very long maturities coming dangerously close to 0%. This is creating concerns amongst institutional investors with long-dated liabilities (insurance companies, pension funds). In a recent speech, Bank of Japan (BoJ) Governor Kuroda[2] has shown that he is very much aware of the issue: *"an excessive decline in super-long-term interest rates could lower the rates of return such as on insurance and pension products, and this may exert a negative impact on economic activity through a deterioration in people's sentiment."*

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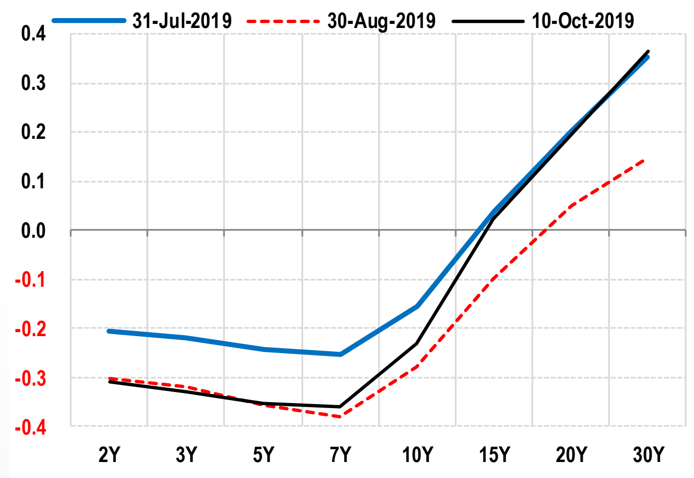
JAPANESE GOVERNMENT BONDS: YIELD CURVE



Source: Datastream, BNP Paribas

[1] *Germany sells new 30-year bond with negative yield, a first*, Reuters, 21 August 2019
[2] *Japan's Economy and Monetary Policy*. Speech at a Meeting with Business Leaders in Osaka, Haruhiko Kuroda, Governor of the Bank of Japan, 24 September 2019

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

The bank for a changing world

These comments make the BoJ meeting at the end of this month more important than usual. It could lead to a policy of ‘yield curve slope control’, whereby the central bank not only seeks to maintain a grip on the level of interest rates across the curve (yield curve control) but also on the difference between e.g. the 40 year yield and yields for maturities of 10 year or less (control of the slope of the yield curve). To this end, JGB purchases could be concentrated at the shorter end of the spectrum, leaving room for yields on very long maturities to rise, or at least not to decline. Whether that would actually happen remains to be seen and is even doubtful: yield hungry investors might be keen to seize the buying opportunity as soon as long-dated yields become slightly more attractive.

Should the BoJ decide to move in that direction, this would also be important for the rest of the world. Firstly, because decisions taken in Japan can have knock-on effects abroad. When the BoJ published its October schedule for bond purchases, it caused a rise in US treasury yields because it indicated there would fewer purchases than normal at the longer end of the maturity spectrum[3]. Secondly, it will be watched carefully in Europe. With interest rates solidly in negative territory, even for long maturities, in many eurozone countries and inflation stuck well below the ECB target, the thesis that the eurozone is going down the path of Japan (Japanisation or Japanification) has been gaining popularity: *“if you want to know where the eurozone will be in a couple of years, look where Japan is today*”. From this perspective, were the BoJ to move to a policy of ‘yield curve slope control’, it would intensify the debate in the eurozone about the unintended consequences of ECB policy for pension funds and insurance companies.

William De Vijlder

[3] 10-year Treasury note yield logs biggest monthly increase since last September, MarketWatch, 30 September 2019

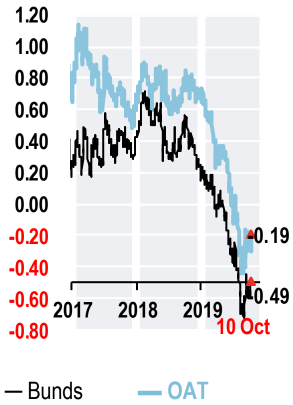
Markets overview

The essentials

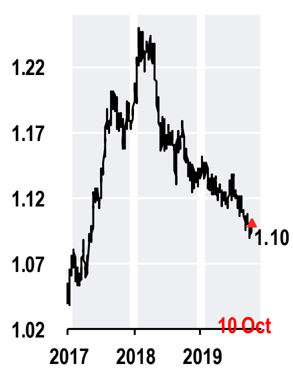
Week 4-10 19 > 10-10-19

↗ **CAC 40**	5 488	▶	**5 569**	**+1.5**	%
↘ **S&P 500**	2 952	▶	**2 938**	**-0.5**	%
↗ Volatility (VIX)	17.0	▶	17.6	+0.5	pb
↗ **Euribor 3M (%)**	-0.42	▶	**-0.42**	**+0.5**	bp
↘ Libor $ 3M (%)	2.03	▶	1.98	-4.3	bp
↗ OAT 10y (%)	-0.29	▶	-0.19	+9.5	bp
↗ Bund 10y (%)	-0.59	▶	-0.49	+9.5	bp
↗ US Tr. 10y (%)	1.51	▶	1.66	+14.2	bp
↗ **Euro vs dollar**	1.10	▶	**1.10**	**+0.3**	%
↘ Gold (ounce, $)	1 508	▶	1 492	-1.0	%
↗ **Oil (Brent, $)**	58.5	▶	**58.7**	**+0.3**	%

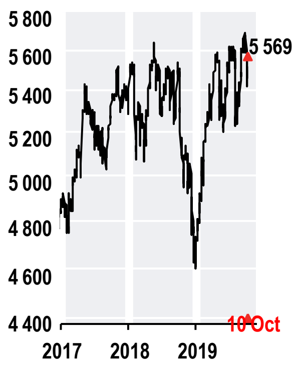
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

Interest Rates		highest' 19		lowest' 19	
€ ECB	**0.00**	0.00	at 01/01	0.00	at 01/01
Eonia	**-0.47**	-0.25	at 07/06	-0.47	at 03/10
Euribor 3M	**-0.42**	-0.31	at 24/01	-0.45	at 03/09
Euribor 12M	**-0.33**	-0.11	at 06/02	-0.40	at 21/08
$ FED	**2.00**	2.50	at 01/01	2.00	at 19/09
Libor 3M	**1.98**	2.81	at 01/01	1.98	at 09/10
Libor 12M	**1.88**	3.04	at 21/01	1.85	at 04/10
£ BoE	**0.75**	0.75	at 01/01	0.75	at 01/01
Libor 3M	**0.76**	0.93	at 29/01	0.75	at 29/08
Libor 12M	**0.87**	1.19	at 11/01	0.81	at 03/09

At 10-10-19

Yield (%)		highest' 19		lowest' 19	
€ AVG 5-7y	**-0.20**	0.68	at 09/01	-0.36	at 03/09
Bund 2y	**-0.72**	-0.53	at 05/03	-0.92	at 02/09
Bund 10y	**-0.49**	0.25	at 01/01	-0.72	at 28/08
OAT 10y	**-0.19**	0.73	at 08/01	-0.44	at 28/08
Corp. BBB	**0.88**	2.15	at 08/01	0.64	at 30/08
$ Treas. 2y	**1.53**	2.62	at 18/01	1.39	at 03/10
Treas. 10y	**1.66**	2.78	at 18/01	1.46	at 04/09
Corp. BBB	**3.28**	4.65	at 01/01	3.15	at 04/09
£ Treas. 2y	**0.42**	0.83	at 27/02	0.31	at 08/10
Treas. 10y	**0.55**	1.35	at 18/01	0.33	at 03/09

At 10-10-19

10y bond yield & spreads

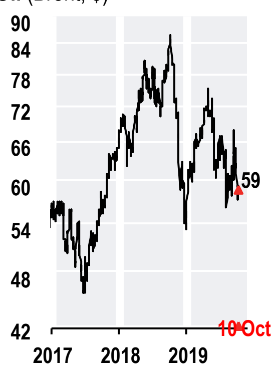
1.75%	Greece	224 pb
0.96%	Italy	144 pb
0.23%	Spain	71 pb
0.19%	Portugal	68 pb
-0.16%	Belgium	33 pb
-0.17%	Ireland	32 pb
-0.19%	France	30 pb
-0.21%	Finland	27 pb
-0.22%	Austria	26 pb
-0.35%	Netherland	14 pb
-0.49%	Germany	

Commodities

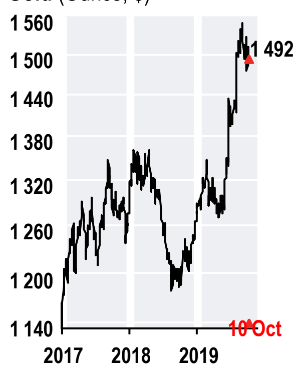
Spot price in dollars		lowest' 19			2019(€)
Oil, Brent	**58.7**	53.1	at	01/01	**+14.6%**
Gold (ounce)	**1 492**	1 268	at	02/05	**+20.9%**
Metals, LMEX	**2 769**	2 718	at	07/08	**+2.6%**
Copper (ton)	**5 750**	5 585	at	03/09	**+0.3%**
CRB Foods	**327**	312	at	11/09	**+4.7%**
wheat (ton)	**176**	166	at	30/08	**-7.4%**
Corn (ton)	**145**	128	at	24/04	**+10.4%**

At 10-10-19 *Variations*

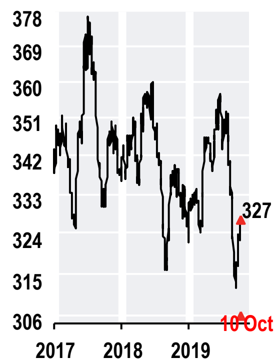
Oil (Brent, $)



Gold (Ounce, $)



CRB Foods



Exchange Rates

1€ =		highest' 19		lowest' 19		2019
USD	**1.10**	1.15	at 10/01	1.09	at 30/09	**-3.7%**
GBP	**0.90**	0.93	at 12/08	0.85	at 14/03	-0.1%
CHF	**1.10**	1.14	at 23/04	1.08	at 04/09	-2.7%
JPY	**118.89**	127.43	at 01/03	116.08	at 03/09	-5.2%
AUD	**1.63**	1.66	at 07/08	1.57	at 18/04	+0.4%
CNY	**7.85**	7.96	at 27/08	7.51	at 25/04	-0.0%
BRL	**4.52**	4.63	at 27/08	4.18	at 31/01	+2.0%
RUB	**71.10**	79.30	at 01/01	70.22	at 24/09	-10.3%
INR	**78.27**	82.00	at 04/02	76.37	at 01/08	-1.9%

At 10-10-19 *Variations*

Equity indices

	Index	highest' 19			lowest' 19			2019	2019(€)
CAC 40	**5 569**	5 691	at	20/09	4 611	at	03/01	+17.7%	**+17.7%**
S&P500	**2 938**	3 026	at	26/07	2 448	at	03/01	+17.2%	**+21.7%**
DAX	**12 164**	12 630	at	04/07	10 417	at	03/01	+15.2%	**+15.2%**
Nikkei	**21 552**	22 308	at	25/04	19 562	at	04/01	+7.7%	**+13.6%**
China*	**74**	86	at	09/04	68	at	03/01	+6.0%	**+9.7%**
India*	**551**	612	at	03/06	526	at	22/08	+0.6%	**+2.5%**
Brazil*	**2 074**	2 354	at	10/07	1 862	at	17/05	+12.9%	**+10.7%**
Russia*	**699**	747	at	04/07	572	at	01/01	+14.8%	**+26.8%**

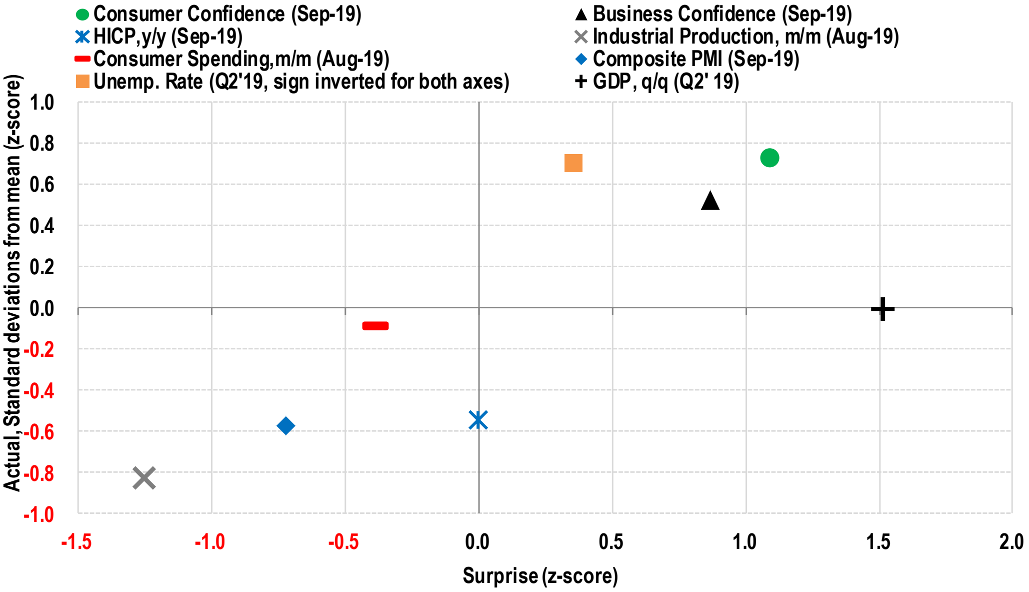
At 10-10-19 *Variations*

* MSCI index

Pulse

France: Q3 growth prospects look decent, nothing more

Our Pulse indicators are less dispersed than at first glance. In the north-east quadrant, sending a positive signal, we find in particular the INSEE confidence surveys for September whereas in the south-west quadrant, sending a negative signal, we have August hard data. Which signal prevails ? The question has no easy answer. The good performance of the INSEE surveys is as encourageing as is concerning the disappointing trend of production and household consumption expenditure on goods. Our *Nowcast* model reconciles the two sets of data. Be it based on the soft data or on the hard ones, Q3 growth is estimated at a similar small 0.2% q/q. This matches our official forecast while the INSEE and the Bank of France have just confirmed their own at 0.3%.



Note: z-score is a score which indicates how many standard deviations an observation is from the mean: z=(x-μ)/σ where x: observation, μ: mean, σ: standard deviation. On the X-axis, x corresponds at the last known surprise for each indictor 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 (for China since 2011).

Indicators preview

Next week will see the publication of many data on China: trade balance, inflation, GDP, retail sales. In the US we have the publication of regional business surveys (Empire State, Philadelphia) as well as several indicators on the housing sector (NAHB index, building permits and housing starts). The Federal Reserve will publish its Beige Book. The retail sales numbers and the Conference Board's index of leading indicators will also be eagerly awaited.

Date	Country/Region	Event	Period	Survey	Prior
10/14/2019	Eurozone	Industrial Production MoM	Aug	--	-0.4%
10/14/2019	Switzerland	Trade Balance	Sep	3.5e+10	3.484e+10
10/15/2019	Switzerland	PPI YoY	Sep	-1.2%	-0.8%
10/15/2019	France	CPI EU Harmonized YoY	Sep	--	1.1%
10/15/2019	United States	Empire Manufacturing	Oct	2.3	2.0
10/16/2019	Eurozone	EU27 New Car Registrations	Sep	--	-8.4%
10/16/2019	Eurozone	CPI YoY	Sep	--	1.0%
10/16/2019	United States	Retail Sales Advance MoM	Sep	0.3%	0.4%
10/16/2019	United States	NAHB Housing Market Index	Oct	68	68
10/16/2019	United States	U.S. Federal Reserve Releases Beige Book			
10/17/2019	United Kingdom	Retail Sales Ex Auto Fuel YoY	Sep	--	2.2%
10/17/2019	United States	Building Permits MoM	Sep	-5.4%	7.7%
10/17/2019	United States	Housing Starts MoM	Sep	-3.2%	12.3%
10/17/2019	United States	Philadelphia Fed Business Outlook	Oct	9.1	12.0
10/17/2019	United States	Industrial Production MoM	Sep	-0.1%	0.6%
10/17/2019	Japan	Tokyo Dept Store Sales YoY	Sep	--	4.7%
10/18/2019	Switzerland	Retail Sales YoY	Sep	7.8%	7.5%
10/18/2019	Switzerland	GDP YoY	3Q	6.2%	6.3%
10/18/2019	United States	Leading Index	Sep	0.1%	0.0%

Source: Bloomberg, BNP Paribas

Economic scenario

UNITED STATES

- Growth is slowing and this trend is expected to continue under the influence of corporate investment (slower profits growth, uncertainty) and housing (declining trend of affordability). Consumer spending should be more resilient. The trade dispute with China acts as an additional drag. Inflation is expected to decline, due to softer growth and weaker oil prices.
- We expect two more Fed Funds target rate cuts of 25bp this year and two additional cuts in 2020.

CHINA

- Economic growth continues to slow and our GDP forecasts have been revised down since June. Industrial activity and exports have been hard hit by US tariff hikes. Domestic demand has also decelerated.
- The central bank is easing liquidity and credit conditions, though the reduction in financial-instability risks should remain a priority and banks seem to remain prudent. Fiscal policy is expansionary through increased infrastructure spending and a rising number of household/corporate tax cuts.
- In the short term, exports and private domestic investment should continue to decelerate. Tax measures should have some success in supporting consumer spending.

EUROZONE

- The economic slowdown is continuing in the eurozone, especially in Germany, due to notably international environment uncertainties and a slowdown of the Chinese economy. Activity in the manufacturing sector continues to decline but services still show resilience.
- Inflation is now expected to decrease while core CPI is hardly moving. The activity slowdown also implies that the pick-up in core inflation should be slower than expected until recently.
- Faced with an outlook of subdued inflation, the Governing Council has eased policy at its meeting on 12 September. This very accommodative environment will be maintained as long as inflation hasn't converged sufficiently, in a convincing and lasting way, towards the ECB's objective.

FRANCE

- Growth is slowing although the economy shows resilience. 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, we expect the Fed to cut its official rate in October and December in reaction to a slowing economy, moderate inflation and heightened uncertainty. 2020 should see two more cuts. Treasury yields are to decline further in the coming months. Eventually, in the course of 2020 they should move up again in anticipation of a pick-up in growth.
- In the eurozone, the ECB's state-dependent forward guidance and the sluggishness of the inflation process imply that the very accommodative environment will remain in place for a long time. This will exert downward pressure on bond yields.
- No policy rate change expected in Japan.
- With the Fed in easing mode and given the very accommodative ECB policy, we expect little change in EUR/USD even though euro's fair value is quite higher than current pricing. The yen should strengthen on the back of stable BoJ policy and high market volatility.

	GDP Growth			Inflation		
%	2018	2019 e	2020 e	2018	2019 e	2020 e
Advanced	**2.2**	**1.6**	**1.0**	**2.1**	**1.4**	**1.3**
United-States	2.9	2.2	1.5	2.4	1.8	1.8
Japan	0.8	1.2	0.2	1.0	0.6	0.3
United-Kingdom	1.4	1.1	0.6	2.5	1.9	1.8
Euro Area	**1.9**	**1.1**	**0.7**	**1.8**	**1.1**	**0.8**
Germany	1.4	0.4	0.2	1.9	1.4	1.0
France	1.7	1.2	1.0	2.1	1.2	1.0
Italy	0.7	0.1	0.0	1.2	0.6	0.5
Spain	2.6	2.2	1.6	1.7	0.8	0.7
Emerging	**4.4**	**3.8**	**4.2**	**4.7**	**4.8**	**4.5**
China	6.6	5.9	5.6	2.1	2.4	2.8
India*	6.8	6.5	6.3	2.9	3.0	3.3
Brazil	1.1	0.5	2.0	3.7	3.7	3.5
Russia	2.3	1.2	2.0	2.9	4.8	3.8

Source : BNP Paribas Group Economic Research (e: Estimates & forecasts)
* Fiscal year from April 1st of year n to March 31st of year n+1

Interest rates, %		2019						
End of period		Q1	Q2	Q3	Q4e	2018	2019e	2020e
US	Fed Funds	2.50	2.50	2.00	1.50	2.50	1.50	1.00
	Libor 3m $	2.60	2.32	2.09	1.70	2.81	1.70	1.25
	T-Notes 10y	2.42	2.00	1.67	1.00	2.69	1.00	1.50
Ezone	deposit rate	-0.40	-0.40	-0.50	-0.60	-0.40	-0.60	-0.60
	Euribor 3m	-0.31	-0.35	-0.42	-0.60	-0.31	-0.60	-0.60
	Bund 10y	-0.07	-0.32	-0.57	-0.80	0.25	-0.80	-0.50
	OAT 10y	0.26	-0.01	-0.28	-0.55	0.71	-0.55	-0.30
UK	Base rate	0.75	0.75	0.75	0.75	0.75	0.75	0.75
	Gilts 10y	1.00	0.84	0.40	0.55	1.27	0.55	0.75
Japan	BoJ Rate	-0.06	-0.08	-0.06	-0.10	-0.07	-0.10	-0.10
	JGB 10y	-0.09	-0.16	-0.22	-0.40	0.00	-0.40	-0.25

Source : BNP Paribas GlobalMarkets (e: Forecasts)

Exchange Rates		2019						
End of period		Q1	Q2	Q3	Q4e	2018	2019e	2020e
USD	EUR / USD	1.12	1.14	1.09	1.11	1.14	1.11	1.14
	USD / JPY	111	108	108	102	110	102	96
	GBP / USD	1.30	1.27	1.23	1.23	1.27	1.23	1.36
	USD / CHF	1.00	0.98	1.00	0.99	0.99	0.99	1.00
EUR	EUR / GBP	0.85	0.89	0.89	0.90	0.90	0.90	0.84
	EUR / CHF	1.12	1.11	1.09	1.10	1.13	1.10	1.14
	EUR / JPY	124	123	118	113	125	113	109

Source : BNP Paribas GlobalMarkets (e: Forecasts)

GROUP ECONOMIC RESEARCH

William De Vijlder Chief Economist	+33 1 55 77 47 31	william.devijlder@bnpparibas.com
ADVANCED ECONOMIES AND STATISTICS		
Jean-Luc Proutat Head – United States, United Kingdom	+33 1 58 16 73 32	jeanluc.proutat@bnpparibas.com
Hélène Baudchon France – Labour markets	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com
Louis Boisset European Central Bank watch, Euro area global view, Japan	+33 1 57 43 02 91	louis.boisset@bnpparibas.com
Frédérique Cerisier Euro area (European gouvernance and public finances), Spain, Portugal	+33 1 43 16 95 52	frederique.cerisier@bnpparibas.com
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Raymond Van Der Putten Germany, Netherlands, Austria, Switzerland – Energy, climate – Long-term projections	+33 1 42 98 53 99	raymond.vanderputten@bnpparibas.com
Tarik Rharrab Statistics	+33 1 43 16 95 56	tarik.rharrab@bnpparibas.com
BANKING ECONOMICS		
Laurent Quignon Head	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Laure Baquero	+ 33 1 43 16 95 50	laure.baquero@bnpparibas.com
Céline Choulet	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
Thomas Humblot	+ 33 1 40 14 30 77	thomas.humblot@bnpparibas.com
EMERGING ECONOMIES AND COUNTRY RISK		
François Faure Head	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Christine Peltier Deputy Head – Greater China, Vietnam, South Africa	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Stéphane Alby Africa (French-speaking countries)	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Sylvain Bellefontaine Turkey, Ukraine, Central European countries	+33 1 42 98 26 77	sylvain.bellefontaine@bnpparibas.com
Sara Confalonieri Africa (Portuguese & English-speaking countries)	+33 1 42 98 43 86	sara.confalonieri@bnpparibas.com
Pascal Devaux Middle East, Balkan countries	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot Korea, Thailand, Philippines, Mexico, Andean countries	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
Salim Hammad Latin America	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Johanna Melka India, South Asia, Russia, Kazakhstan, CIS	+33 1 58 16 05 84	johanna.melka@bnpparibas.com
CONTACT MEDIA		
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The bank for a changing world