ECOWEEK

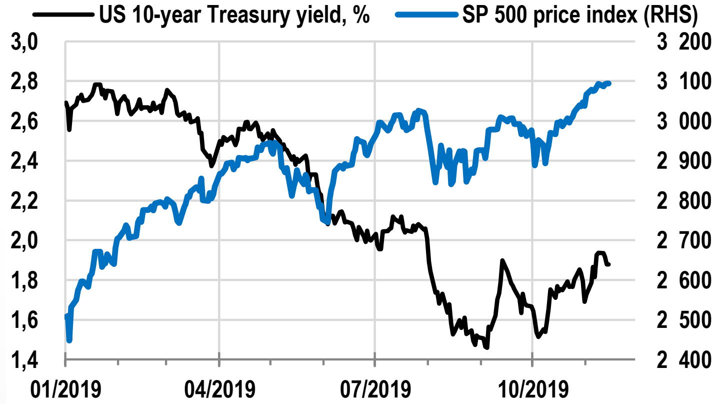
No. 19-42, 15 November 2019

What drives the recent rise in bond yields and equity markets?

■ In recent weeks, equity markets performed well. Focussing on the US, it is hard to argue that this reflects an improvement in the earnings outlook or a perspective of more rate cuts than hitherto expected. This would imply that a decline in the required risk premium was the key driver ■ US treasury yields also increased significantly, which probably reflects to a large degree an increase in the term premium ■ The decline in the equity risk premium and the increase in the bond term premium were driven by a common factor, namely a reduction in economic tail risk on the back of progress in the trade negotiations between the US and China and a stabilisation of certain survey data.
■ The reduced likelihood of very negative economic developments, which has boosted equity markets, has also reduced the attraction of bonds as a hedge against equity risk. As a consequence, bond yields have moved up in sync with equity markets.

US equity markets performed particularly well in recent weeks (chart 1) and the same holds for European equities. This could reflect an improvement in expected earnings growth, a downward reassessment of the interest rate outlook or a decline in the risk premium demanded by investors. Focussing on the US, the first explanation probably doesn't play a significant role considering that, in recent months, net revisions to the earnings outlook have become increasingly negative (chart 2). Moreover, analysts expect a slight decline in earnings per share next year (chart 3). With respect to the interest rate outlook, the recent message from the FOMC, which was reiterated by Fed Chair Powell when speaking before the Joint Economic Committee of the US Congress this week, is that it will require a material change in the outlook for there to be any change in the federal funds rate.

US 10-YEAR INTEREST RATE vs SP 500



Source: Datastream, BNP Paribas

This did not stop treasury yields from moving higher as of late, as shown in chart 1. Calculations by the Federal Reserve Board provide a decomposition of treasury yields into a risk-neutral yield (which reflects expectations of the future path of short-term treasury yields) and a term premium (which is a reward for investors in long-maturity bonds that the future path of short-term rates could turn out to be different from what was expected). As shown in chart 4, the increase in treasury yields is almost exclusively due to a pick-up in the term premium, which has become less negative[1]. In Europe, Bund yields have tracked, to a large degree, the movements of treasury yields (chart 5) and, given the state-dependent forward guidance of the ECB, one can assume that this also reflects an increase in the term premium.

…/…

[1] In chart 4, the fitted yield represents the estimated treasury yield, based on a statistical model. The differences with the observed yield are small. The model is used to decompose the bond yield in a risk neutral yield and a term premium.

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

The bank for a changing world

This implies that the very high correlation between equity and bond markets in recent weeks (chart 1) reflects a decline in the equity risk premium and an increase in the bond term premium. The former is, quite likely, related to news on the Sino-US trade negotiations and the stabilisation of economic survey data: both would imply that the likelihood of very negative developments in the economy has declined. This in turn reduces the attraction of government bonds as a tail risk hedge for investors who predominantly invest in equities: when tail risk is deemed to be declining, the demand for insurance will drop, hence the demand for government bonds declines. This in turn pushes up bond yields which, for unchanged expectations about monetary policy, causes an increase in the term premium.

William De Vijlder

REVISIONS OF EPS FOR US COMPANIES

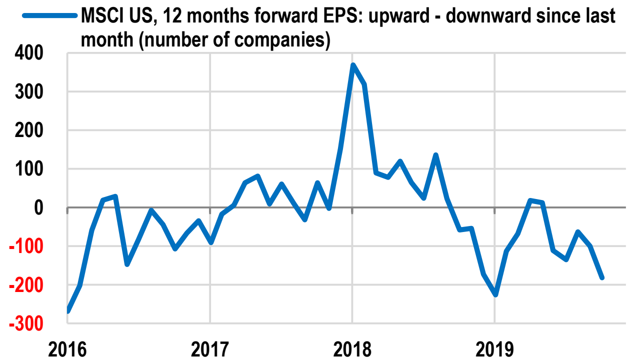


Chart 2 Source: IBES, Datastream, BNP Paribas

EXPECTED EARNINGS PER SHARE GROWTH OF US COMPANIES

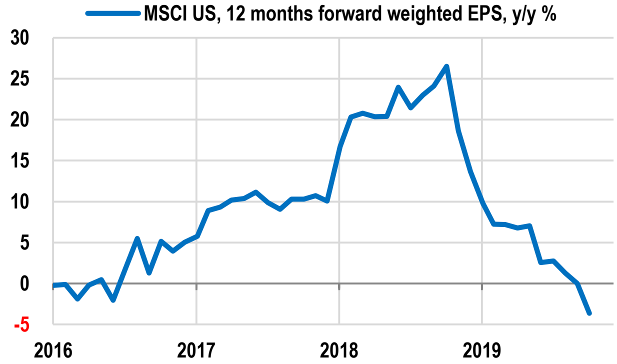


Chart 3 Source: IBES, Datastream, BNP Paribas

DECOMPOSITION OF US 10-YEAR TREASURY YIELD

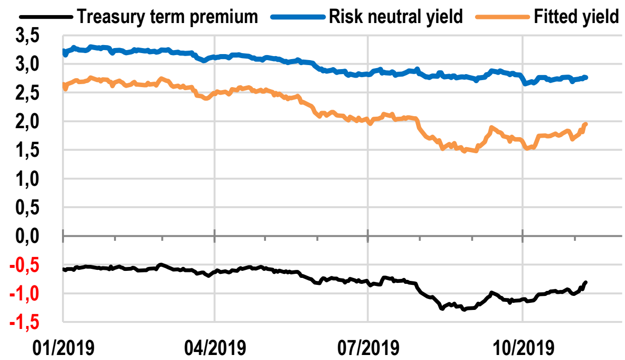


Chart 4 Source: Bloomberg, BNP Paribas

10-YEAR INTEREST RATE: US VS GERMANY

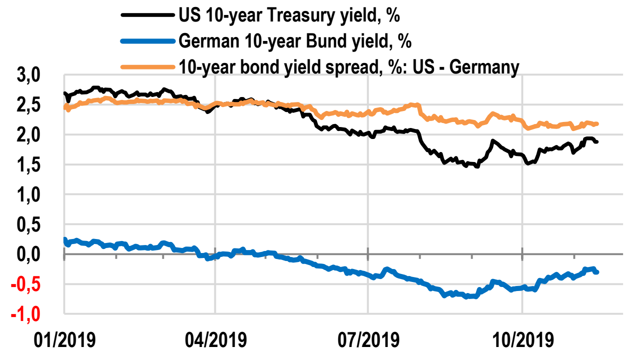


Chart 5 Source: Bloomberg, BNP Paribas

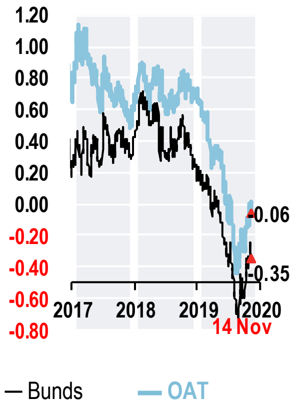
Markets overview

The essentials

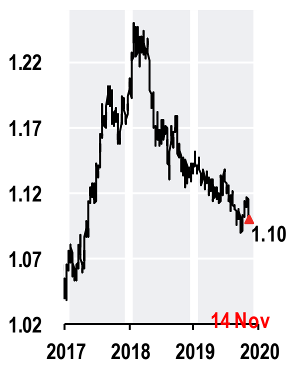
Week 8-11 19 > 14-11-19

↗ **CAC 40**	5 890	▶	**5 901**	**+0.2**	%
↗ **S&P 500**	3 093	▶	**3 097**	**+0.1**	%
↗ Volatility (VIX)	12.1	▶	13.1	+1.0	pb
↘ **Euribor 3M** (%)	-0.40	▶	**-0.40**	**-0.4**	bp
↗ Libor $ 3M (%)	1.90	▶	1.91	+0.9	bp
↘ OAT 10y (%)	-0.01	▶	-0.06	-4.7	bp
↘ Bund 10y (%)	-0.26	▶	-0.35	-8.2	bp
↘ US Tr. 10y (%)	1.94	▶	1.82	-11.4	bp
↘ **Euro vs dollar**	1.10	▶	**1.10**	**-0.2**	%
↗ Gold (ounce, $)	1 467	▶	1 471	+0.3	%
↘ **Oil (Brent, $)**	62.6	▶	**62.6**	**-0.1**	%

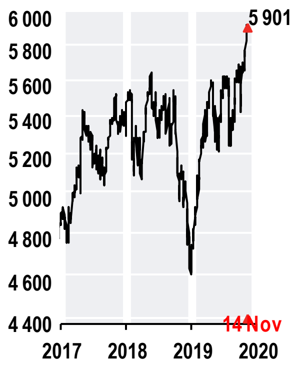
10 y bond yield, OAT vs Bund



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	**-0.45**	-0.25	at 07/06	-0.47	at 03/10
Euribor 3M	**-0.40**	-0.31	at 24/01	-0.45	at 03/09
Euribor 12M	**-0.27**	-0.11	at 06/02	-0.40	at 21/08
$ FED	**1.75**	2.50	at 01/01	1.75	at 31/10
Libor 3M	**1.91**	2.81	at 01/01	1.89	at 01/11
Libor 12M	**1.99**	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	**0.79**	0.93	at 29/01	0.75	at 29/08
Libor 12M	**0.96**	1.19	at 11/01	0.81	at 03/09

At 14-11-19

Yield (%)		highest' 19		lowest' 19	
€ AVG 5-7y	**0.01**	0.68	at 09/01	-0.36	at 03/09
Bund 2y	**-0.64**	-0.53	at 05/03	-0.92	at 02/09
Bund 10y	**-0.35**	0.25	at 01/01	-0.72	at 28/08
OAT 10y	**-0.06**	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	**1.59**	2.62	at 18/01	1.39	at 03/10
Treas. 10y	**1.82**	2.78	at 18/01	1.46	at 04/09
Corp. BBB	**3.27**	4.65	at 01/01	3.15	at 04/09
£ Treas. 2y	**0.52**	0.83	at 27/02	0.31	at 08/10
Treas. 10y	**0.71**	1.35	at 18/01	0.33	at 03/09

At 14-11-19

10y bond yield & spreads

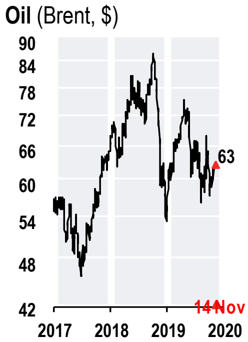
2.04%	Greece	238 pb
1.34%	Italy	168 pb
0.46%	Spain	80 pb
0.39%	Portugal	73 pb
-0.03%	Belgium	31 pb
-0.06%	France	28 pb
-0.09%	Finland	25 pb
-0.11%	Austria	23 pb
-0.11%	Ireland	23 pb
-0.20%	Netherland	14 pb
-0.35%	Germany	

Commodities

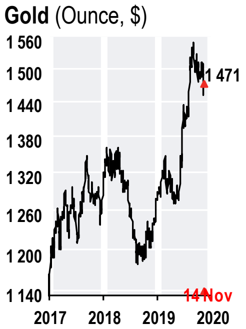
Spot price in dollars		lowest' 19			2019(€)
Oil, Brent	**62.6**	53.1	at	01/01	**+22.4%**
Gold (ounce)	**1 471**	1 268	at	02/05	**+19.3%**
Metals, LMEX	**2 767**	2 718	at	07/08	**+2.6%**
Copper (ton)	**5 788**	5 585	at	03/09	**+1.1%**
CRB Foods	**330**	312	at	11/09	**+5.7%**
wheat (ton)	**201**	166	at	30/08	**+6.0%**
Corn (ton)	**144**	128	at	24/04	**+10.2%**

At 14-11-19 *Variations*

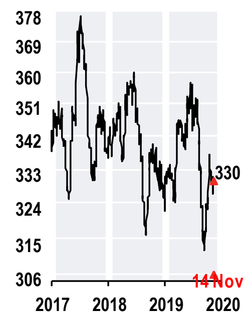
Oil (Brent, $)



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	**-3.8%**
GBP	**0.86**	0.93	at	12/08	0.85	at	14/03	-4.7%
CHF	**1.09**	1.14	at	23/04	1.08	at	04/09	-3.5%
JPY	**119.45**	127.43	at	01/03	116.08	at	03/09	-4.8%
AUD	**1.62**	1.66	at	07/08	1.57	at	18/04	+0.0%
CNY	**7.72**	7.96	at	27/08	7.51	at	25/04	-1.6%
BRL	**4.61**	4.63	at	27/08	4.18	at	31/01	+4.0%
RUB	**70.48**	79.30	at	01/01	70.22	at	24/09	-11.1%
INR	**79.17**	82.00	at	04/02	76.37	at	01/08	-0.8%

At 14-11-19 *Variations*

Equity indices

	Index	highest' 19			lowest' 19			2019	2019(€)
CAC 40	**5 901**	5 920	at	12/11	4 611	at	03/01	+24.7%	**+24.7%**
S&P500	**3 097**	3 097	at	14/11	2 448	at	03/01	+23.5%	**+28.4%**
DAX	**13 180**	13 289	at	07/11	10 417	at	03/01	+24.8%	**+24.8%**
Nikkei	**23 142**	23 520	at	12/11	19 562	at	04/01	+15.6%	**+21.4%**
China*	**78**	86	at	09/04	68	at	03/01	+10.3%	**+14.5%**
India*	**571**	612	at	03/06	526	at	22/08	+5.6%	**+6.4%**
Brazil*	**2 122**	2 354	at	10/07	1 862	at	17/05	+18.0%	**+13.4%**
Russia*	**760**	793	at	07/11	572	at	01/01	+24.1%	**+38.1%**

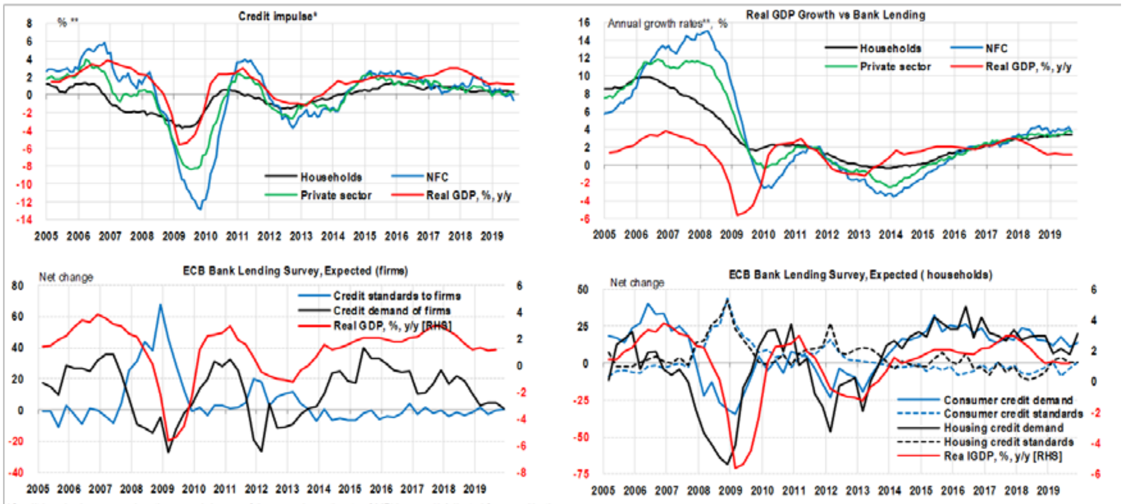
At 14-11-19 *Variations*

* MSCI index

Pulse

Eurozone: sharp decline in credit impulse for non-financial corporations

The credit impulse has declined in September, moderately for households and much more noticeably for non-financial corporations (NFC). For the latter, the credit impulse has hit its lowest level since the beginning of the asset purchases programme by the ECB at the start of 2015. These movements contrast with the stability of GDP growth in the third quarter in the Eurozone (with a year-on-year rate of 1.2%, like in the second quarter). They almost exclusively involve loans with a maturity of less than one year, which is mainly related to destocking behaviour. For the fourth quarter of 2019, banks interrogated by the ECB anticipate a continued moderation of demand by NFCs and an intensification of demand for housing loans by households.



*Credit impulse is measured as the annual change of the annual growth rate of MFI loans **Adjusted for securitizations

Source: ECB, ECB survey on the distribution of credit, BLS, BNP Paribas calculations

Indicators preview

Several surveys will be published next week offering a picture of the economic situation in November: PMIs in several countries, business confidence in France, household sentiment and regional surveys in the US, consumer confidence in the eurozone. These numbers will be scrutinised to assess whether the tentative signs of stabilisation in October have been confirmed in November. In addition, in the US we will have several releases concerning the housing market. The FOMC minutes will also be eagerly awaited.

Date	Country/Region	Event	Period	Survey	Prior
11/18/2019	United States	NAHB Housing Market Index	Nov	72	71
11/19/2019	United Kingdom	CBI Trends Total Orders	Nov	--	-37
11/19/2019	United States	Building Permits MoM	Oct	-0.1%	-2.7%
11/19/2019	United States	Housing Starts MoM	Oct	4.3%	-9.4%
11/20/2019	United States	FOMC Meeting Minutes	Oct-30	--	--
11/21/2019	Japan	Machine Tool Orders YoY	Oct	--	-37.4%
11/21/2019	France	Business Confidence	Nov	--	105
11/21/2019	Eurozone	OECD Economic Outlook			
11/21/2019	United States	Philadelphia Fed Business Outlook	Nov	6.7	5.6
11/21/2019	United States	Leading Index	Oct	-0.1%	-0.1%
11/21/2019	Eurozone	Consumer Confidence	Nov	--	-7.6
11/21/2019	United States	Existing Home Sales MoM	Oct	2.1%	-2.2%
11/22/2019	Japan	Natl CPI Ex Fresh Food, Energy YoY	Oct	--	0.5%
11/22/2019	Japan	Jibun Bank Japan PMI Mfg	Nov	--	48.4
11/22/2019	Japan	Jibun Bank Japan PMI Composite	Nov	--	49.1
11/22/2019	Germany	GDP SA QoQ	3Q	--	--
11/22/2019	France	Markit France Manufacturing PMI	Nov	--	50.7
11/22/2019	France	Markit France Services PMI	Nov	--	52.9
11/22/2019	Eurozone	Markit Eurozone Manufacturing PMI	Nov	--	45.9
11/22/2019	Eurozone	Markit Eurozone Services PMI	Nov	--	52.2
11/22/2019	Eurozone	Markit Eurozone Composite PMI	Nov	--	50.6
11/22/2019	United States	University of Michigan Sentiment	Nov	--	95.7
11/22/2019	United States	Kansas City Fed Manf. Activity	Nov	--	-3

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 but recent progress might imply this effect would wane.
- We expect one more Fed Funds target rate cut 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 the international environment and elevated uncertainty. The recent stabilization of business surveys provides some hope but needs to be confirmed.
- 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 very accommodative monetary policy 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. 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 again in December in reaction to a slowing economy, moderate inflation and high 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, although these will also be influenced by yield movements in the US.
- No policy rate change expected in Japan.
- 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)

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