

ECOWEEK

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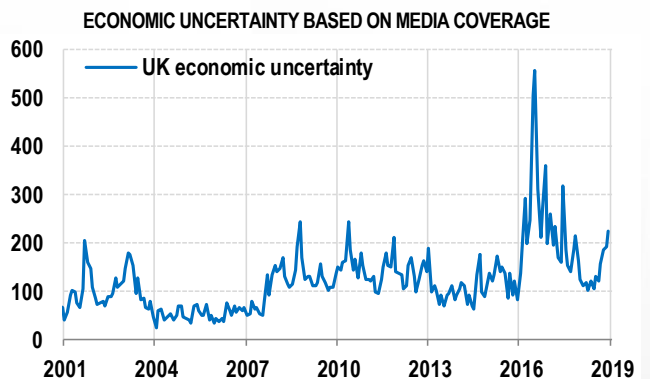
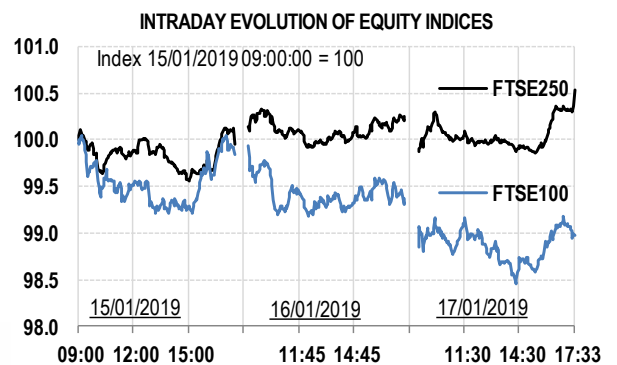
United Kingdom: Brexit, the cost of uncertainty

■ Market reaction suggests that the parliamentary vote, with a wide majority, against the Brexit deal which had been negotiated with Europe, has reduced the likelihood of a no-deal Brexit ■ Whether this feeling of relief lasts will depend on how the discussions on possible outcomes evolve ■ The economic headwind which comes with this prolonged uncertainty, for the UK but also for the companies in the EU which trade with the UK, will not go away soon

Judging by the equity market reaction the day after the debate in parliament on Brexit, during which prime minister Theresa May suffered a historically large defeat, it seems investors are of the view that the likelihood of ending up where one does not want to be, that is a no-deal hard (i.e. without a transition period) Brexit, has receded. This reading is based on the underperformance of the more internationally oriented FTSE100 versus the more domestically focused FTSE250 index. It suggests that markets are a bit less concerned about the hit to the economy in case of a no-deal departure from the EU. The Bank of England has estimated that the negative impact of a hard Brexit on the level of real GDP in 2023 could range between 4.75% and 7.75%. These estimates are surrounded by uncertainty but it seems safe to assume that the impact would be considerable. It would also be front-loaded: confidence would drop in view of the jump in uncertainty of how business would cope with the disruption in supply chains, household purchasing power would suffer from the increase in inflation due to the introduction of import tariffs and the weakening of sterling.

A no-deal Brexit can be considered as a tail risk and market reaction suggests that tail risk fears have abated. Whether this is more than just temporary relief will depend on how the discussions in the UK and between the UK and the EU evolve. The huge majority against the deal which had been negotiated implies that profound changes are needed to get parliamentary support keeping in mind that the European partners need to agree as well. At the risk of oversimplifying, it's like trying to square a circle: taking enough distance from the EU so as to be able to negotiate its own trade agreements whilst avoiding a hard border between Ireland and Northern Ireland. Given the challenge, delaying the Brexit date of 29 March seems quite likely now. Giving the negotiators more time provides hope that the tail risk can be avoided but it does imply that the economic headwind which comes with this prolonged uncertainty, for the UK but also for the companies in the EU which trade with the UK, will not go away soon. The observation that, all in all, the UK economy has held up well since the referendum should not make us forget that uncertainty since then did imply an opportunity cost and will continue to do so.

BREXIT: POLICY UNCERTAINTY AND MARKET REACTION



Source: Bloomberg, www.policyuncertainty.com, BNP Paribas

William De Vijlder

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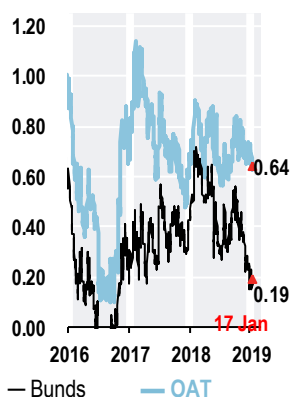
Markets overview

The essentials

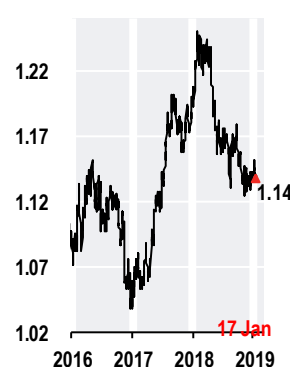
Week 11-1 19 > 17-1-19

➔ CAC 40	4 781	▶ 4 794	+0.3 %
➔ S&P 500	2 596	▶ 2 636	+1.5 %
↘ Volatility (VIX)	18.2	▶ 18.1	-0.1 pb
➔ Euribor 3M (%)	-0.31	▶ -0.31	+0.0 bp
↘ Libor \$ 3M (%)	2.79	▶ 2.78	-0.7 bp
↘ OAT 10y (%)	0.66	▶ 0.64	-1.4 bp
➔ Bund 10y (%)	0.18	▶ 0.19	+0.9 bp
➔ US Tr. 10y (%)	2.70	▶ 2.75	+4.8 bp
↘ Euro vs dollar	1.15	▶ 1.14	-0.9 %
➔ Gold (ounce, \$)	1 290	▶ 1 292	+0.1 %
➔ Oil (Brent, \$)	60.7	▶ 60.9	+0.3 %

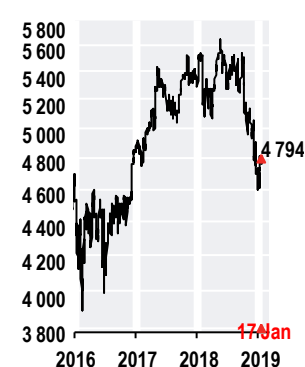
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

Interest Rates	highest' 19	lowest' 19
€ ECB	0.00 at 01/01	0.00 at 01/01
Eonia	-0.37 at 01/01	-0.37 at 16/01
Euribor 3M	-0.31 at 08/01	-0.31 at 02/01
Euribor 12M	-0.12 at 01/01	-0.12 at 02/01
\$ FED	2.50 at 01/01	2.50 at 01/01
Libor 3M	2.78 at 01/01	2.77 at 15/01
Libor 12M	3.03 at 09/01	2.96 at 04/01
£ BoE	0.75 at 01/01	0.75 at 01/01
Libor 3M	0.92 at 15/01	0.90 at 07/01
Libor 12M	1.18 at 11/01	1.17 at 02/01

At 17-1-19

Yield (%)	highest' 19	lowest' 19
€ AVG 5-7y	0.53 at 09/01	0.53 at 17/01
Bund 2y	-0.59 at 08/01	-0.62 at 03/01
Bund 10y	0.19 at 01/01	0.15 at 03/01
OAT 10y	0.64 at 08/01	0.63 at 15/01
Corp. BBB	2.03 at 08/01	2.02 at 16/01
\$ Treas. 2y	2.57 at 08/01	2.39 at 03/01
Treas. 10y	2.75 at 17/01	2.55 at 03/01
Corp. BBB	4.57 at 01/01	4.57 at 03/01
£ Treas. 2y	0.81 at 14/01	0.68 at 03/01
Treas. 10y	1.33 at 17/01	1.18 at 03/01

At 17-1-19

10y bond yield & spreads

4.85%	Greece	465 pb
2.78%	Italy	258 pb
1.62%	Portugal	142 pb
1.37%	Spain	118 pb
0.70%	Belgium	51 pb
0.64%	France	45 pb
0.53%	Ireland	33 pb
0.50%	Finland	30 pb
0.46%	Austria	26 pb
0.35%	Netherland	15 pb
0.19%	Germany	

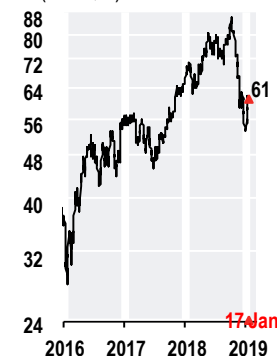
Commodities

Spot price in dollars	lowest' 19	2019(€)
Oil, Brent	53.1 at 01/01	+15.2%
Gold (ounce)	1 281 at 01/01	+1.3%
Metals, LME	2 730 at 03/01	+1.9%
Copper (ton)	5 714 at 03/01	+0.7%
CRB Foods	324 at 01/01	+3.0%
wheat (ton)	197 at 01/01	+2.7%
Corn (ton)	136 at 01/01	+2.8%

At 17-1-19

Variations

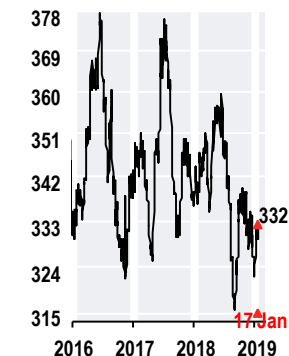
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

€ =	highest' 19	lowest' 19	2019
USD	1.15 at 10/01	1.14 at 02/01	-0.5%
GBP	0.90 at 03/01	0.88 at 17/01	-1.8%
CHF	1.13 at 17/01	1.12 at 02/01	+0.4%
JPY	124.06 at 01/01	122.54 at 03/01	-1.1%
AUD	1.59 at 03/01	1.59 at 16/01	-2.1%
CNY	7.71 at 09/01	7.70 at 16/01	-1.8%
BRL	4.28 at 01/01	4.24 at 09/01	-3.3%
RUB	75.77 at 01/01	75.72 at 16/01	-4.5%
INR	80.80 at 14/01	79.57 at 04/01	+1.2%

At 17-1-19

Variations

Equity indices

Index	highest' 19	lowest' 19	2019	2019(€)
CAC 40	4 814 at 09/01	4 611 at 03/01	+1.3%	+1.3%
S&P500	2 636 at 17/01	2 448 at 03/01	+5.2%	+5.6%
DAX	10 919 at 16/01	10 417 at 03/01	+3.4%	+3.4%
Nikkei	20 402 at 15/01	19 562 at 04/01	+1.9%	+3.1%
China*	74 at 16/01	68 at 03/01	+5.4%	+5.8%
India*	551 at 01/01	543 at 14/01	+0.5%	-0.8%
Brazil*	2 171 at 10/01	1 944 at 01/01	+8.4%	+12.2%
Russia*	616 at 17/01	570 at 01/01	+4.0%	+8.5%

At 17-1-19

Variations

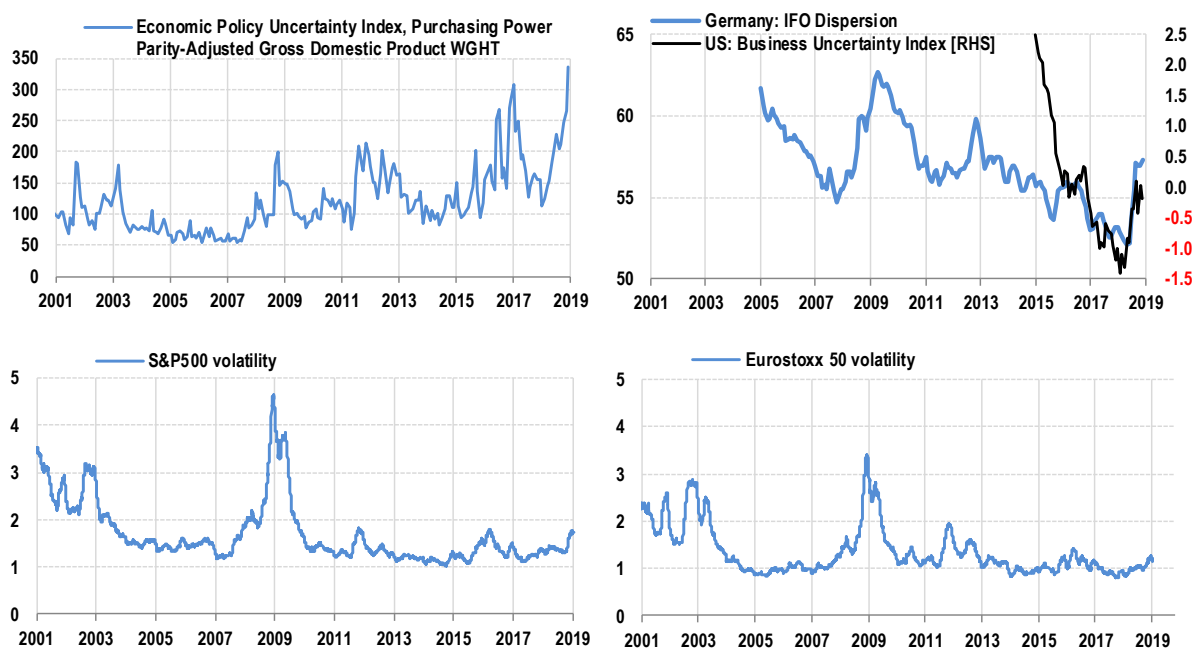
* MSCI index



Pulse

Uncertainty on the rise

The economic policy uncertainty index, which is based on media coverage of this topic, has seen a huge increase since the middle of last year, even surpassing the previous high reached at the end of 2016. Measures of business uncertainty in Germany and the US have also risen. The dispersion of individual stock returns, a third measure of uncertainty, has also increased in the US and to a lesser extent in the eurozone. The different indicators lead to the same conclusion of a rising trend in uncertainty on the back of trade war fears, Brexit concerns, slower growth. A prolonged period of high uncertainty would end up acting as a headwind to growth.



volatility = 60-day moving average of the cross-sectional standard deviation of daily returns of the index constituents

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

Indicators preview

Highlights of next week are the meetings of the Bank of Japan and the ECB. Markets will be looking for signs of a possible change in the assessment of the outlook. Also worth noting are several indicators for the month of January: Markit PMI, business confidence in France and the UK, the IFO business climate in Germany, consumer confidence in the eurozone as well as the Richmond Fed and Kansas City Fed manufacturing index. All in all, by the end of next week we will have a better picture of how key countries have started the year.

Date	Country	Event	Period	Surv(M)	Prior
01/16/19-01/22/19	United States	New Home Sales MoM	Nov	4.2%	-8.9%
01/16/19-01/25/19	United States	Trade Balance	Nov	-5.4e+10	-5.55e+10
01/17/19-01/25/19	United States	Retail Sales Control Group	Dec	0.4%	0.9%
01/19/19-01/25/19	United Kingdom	CBI Business Optimism	Jan	--	-16
01/21/19	United Kingdom	Rightmove House Prices MoM	Jan	--	-1.5%
01/22/19	United Kingdom	ILO Unemployment Rate 3Mths	Nov	--	4.1%
01/22/19	United States	Existing Home Sales MoM	Dec	-0.9%	1.9%
01/23/19	France	Business Confidence	Jan	--	102
01/23/19	United States	Richmond Fed Manufacturing Index	Jan	--	-8
01/23/19	Eurozone	Consumer Confidence	Jan	--	-6.2
01/23/19	Japan	BOJ Policy Balance Rate	Jan 23	--	-0.100%
01/24/19	France	Markit France Manufacturing PMI	Jan	--	49.7
01/24/19	France	Markit France Composite PMI	Jan	--	48.7
01/24/19	Eurozone	Markit Eurozone Manufacturing PMI	Jan	--	51.4
01/24/19	Eurozone	Markit Eurozone Composite PMI	Jan	--	51.1
01/24/19	Eurozone	ECB Main Refinancing Rate	Jan 24	--	0.000%
01/24/19	United States	Kansas City Fed Manufacturing Activity	Jan	--	3
01/25/19	Germany	IFO Business Climate	Jan	--	101.0
01/25/19	United States	Durable Goods Orders	Dec	--	--

Source: Bloomberg, BNP Paribas



Economic scenario

UNITED STATES

- Growth is expected to slow to 2.1% this year. Trade war uncertainty acts as a drag, the housing market is softening, corporate investment should slow as well as exports in reaction to the past strengthening of the dollar against a broad range of currencies
- Core inflation remains well under control and has eased a bit.
- Markets no longer price in rate hikes and the message from Fed governors has indeed become far more dovish

CHINA

- Economic growth is slowing 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 reduce 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 above potential growth, a very low unemployment rate and a pick-up in wage growth point towards more rate hikes. Are forecasts still point towards 2 more in the first half of 2019 after which the Fed will want to see how the economy reacts. However this scenario has become less clearcut considering dovish message from FOMC members and its president. The ECB has ended 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	1.5	1.6	1.3	2.1	1.5	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					2018e	2019e	2020e
		Q4e	Q1e	Q2e	Q3e	Q4e			
US									
Fed Funds	2.50	2.75	3.00	3.00	3.00	2.50	3.00	3.00	
Libor 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	
Gilts 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	End of period	Q4e	2019					2018e	2019e	2020e
			Q1e	Q2e	Q3e	Q4e				
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)



GROUP ECONOMIC RESEARCH

■ **William DE VIJDER**
Chief Economist

+33.(0)1 55 77 47 31

william.devijlder@bnpparibas.com

ADVANCED ECONOMIES AND STATISTICS

■ **Jean-Luc PROUTAT**
Head

+33.(0)1.58.16.73.32

jean-luc.proutat@bnpparibas.com

■ **Alexandra ESTIOT**

Works coordination - United States - United Kingdom - Globalisation

+33.(0)1.58.16.81.69

alexandra.estiot@bnpparibas.com

■ **Hélène BAUDCHON**

France (short-term outlook and forecasts) - Labour markets

+33.(0)1.58.16.03.63

helene.baudchon@bnpparibas.com

■ **Louis BOISSET**

European central bank watch, Euro area global view, Japan

+33.(0)1.57.43.02.91

louis.boisset@bnpparibas.com

■ **Frédérique CERISIER**

Euro Area (European governance and public finances), Spain, Portugal

+33.(0)1.43.16.95.52

frederique.cerisier@bnpparibas.com

■ **Catherine STEPHAN**

Nordic countries - World trade - Education, health, social conditions

+33.(0)1.55.77.71.89

catherine.stephan@bnpparibas.com

■ **Raymond VAN DER PUTTEN**

Germany, Netherlands, Austria, Switzerland - Energy, climate - Long-term projections

+33.(0)1.42.98.53.99

raymond.vanderputten@bnpparibas.com

■ **Tarik RHARRAB**

Statistics and Modelling

+33.(0)1.43.16.95.56

tarik.rharrab@bnpparibas.com

BANKING ECONOMICS

■ **Laurent QUIGNON**
Head

+33.(0)1.42.98.56.54

laurent.quignon@bnpparibas.com

■ **Laure BAQUERO**

+33.(0)1.43.16.95.50

laure.baquero@bnpparibas.com

■ **Céline CHOLET**

+33.(0)1.43.16.95.54

celine.choulet@bnpparibas.com

■ **Thomas HUMBLLOT**

+33.(0)1.40.14.30.77

thomas.humbloit@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

■ **François FAURE**
Head

+33.(0)1 42 98 79 82

francois.faure@bnpparibas.com

■ **Christine PELTIER**

Deputy Head - Greater China, Vietnam, other North Asian countries, South Africa

+33.(0)1.42.98.56.27

christine.peltier@bnpparibas.com

■ **Stéphane ALBY**

Africa (French-speaking countries)

+33.(0)1.42.98.02.04

stephane.alby@bnpparibas.com

■ **Sylvain BELLEFONTAINE**

Turkey, Ukraine, Central European countries

+33.(0)1.42.98.26.77

sylvain.bellefontaine@bnpparibas.com

■ **Sara CONFALONIERI**

Africa (Portuguese & English-speaking countries)

+33.(0)1.42.98.43.86

sara.confalonieri@bnpparibas.com

■ **Pascal DEVAUX**

Middle East, Balkan countries

+33.(0)1.43.16.95.51

pascal.devaux@bnpparibas.com

■ **Hélène DROUOT**

Korea, Thailand, Philippines, Mexico, Andean countries

+33.(0)1.42.98.33.00

helene.drouot@bnpparibas.com

■ **Salim HAMDAD**

Latin America

+33.(0)1.42.98.74.26

salim.hammad@bnpparibas.com

■ **Johanna MELKA**

India, South Asia, Russia, Kazakhstan, CIS

+33.(0)1.58.16.05.84

johanna.melka@bnpparibas.com

■ **Michel BERNARDINI**
Contact Média

+33.(0)1.42.98.05.71

michel.bernardini@bnpparibas.com



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Registered Office: 16 boulevard des Italiens – 75009 PARIS

Tel: +33 (0) 1.42.98.12.34 – Internet :

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