ECOWEEK

No. 19-47, 20 December 2019

2019: a difficult year, ending on a hopeful note

■ 2019 has been dominated by uncertainty, in particular about trade tensions and hard Brexit risk, as well as mounting concern about the slowdown of the global economy. This has led to additional policy easing by the ECB whereas the Federal Reserve has reversed course by cutting the federal funds rate on several occasions ■ This has further reduced the remaining policy leeway of central banks, a subject that will be analysed in the context of the strategic reviews by the Fed and the ECB. It has also led to increased calls for fiscal stimulus ■ Equity markets have delivered surprisingly strong returns with investors preferring to look at the role of lower interest rates, rather than at the weakening of the profits outlook ■ The year ended on a hopeful note with the improvement of certain business surveys.

How should one characterise 2019? Stressful, frustrating, difficult, reassuring, amazing, interesting, hopeful? Probably all of the above. Man-made uncertainty (mounting trade tensions, Brexit discussions with a fluctuating likelihood of a no-deal departure from the EU) caused stress ("when will this end?") and frustration (because of its impact on growth). But there was also endogenous uncertainty, which is inherent to the development of the business cycle (with corporate investment slowing down after having grown significantly) or a structural rebalancing of an economy, like is the case in China.

The reaction from the major central banks was reassuring. The ECB stepped up its accommodation, whereas the Federal Reserve reversed course by cutting rates on three occasions. It has demonstrated that inflation-targeting central banks are risk averse: they can't afford a big slowdown, otherwise it would jeopardise the odds of reaching their objective. Financial markets have understood this monetary put option all too well and the performance of equities has been genuinely amazing. Against a background of slowing global growth, a dimmed profits outlook and pervasive uncertainty, they have climbed the proverbial wall of worries. With interest rates stuck at a very low level, it implies, going forward, a high degree of sensitivity to the growth outlook.

Another reassuring development has been the acknowledgment that monetary policy has virtually reached the end of the road. It is reassuring because it forces a re-think of how to fight economic downturns. Mario Draghi made a rallying cry on the occasion of the September meeting of the ECB Governing Council for fiscal policy to step in so as to boost growth and enhance the effectiveness of monetary policy in reaching its target.

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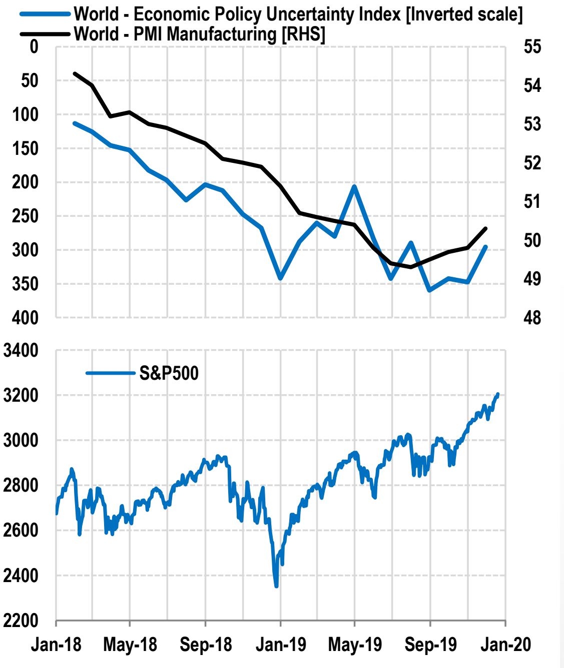
UNCERTAINTY, MANUFACTURING PMI AND STOCK MARKET



Source: Datastream, Markit, EPU, BNP Paribas

ECONOMIC RESEARCH DEPARTMENT

The Federal Reserve's strategic review of the objectives, tools and communication of its monetary policy has to be seen in the same light. The results are eagerly awaited in the first semester of next year and will fuel speculation about the outcome of a similar exercise at the ECB, where, quoting Christine Lagarde, "no stone will be left unturned". This review will take place against a background of increased concern about the unintended consequences of a prolonged period of negative interest rates. In this respect, the Swedish central bank took the interesting decision this week of hiking its policy rate and bringing it back to zero, despite a slowing economy, on the grounds that negative interest rates may end up having net negative effects.

One area of particular debate in the Eurosystem will be the role of the central bank in the context of the climate change challenge. ECB President Lagarde said during her confirmation hearing, that she was ready to make aggressive strides toward environmental objectives. In the ECB's governing council, opinions are divided as many fear that the ECB might enter a political minefield. Concerns about the environment have increased in 2019, as CO2 emissions are still rising and the earth is still on a high emission path. The increased frequency of natural disasters (heatwaves and flooding in Europe, wild fires in the Brazil Amazon region, California and Australia) may be a warning of the things to come. Environmental considerations are increasingly taken into account in policy decisions. Recently, the EU has taken some major initiatives such as the adoption of a taxonomy for sustainable activities (which is essential for formulating climate policy to avoid green washing) and the announcement by the European Commission of the Green Deal to make the EU carbon neutral by 2050. These initiatives were most welcome considering the important setbacks in 2019. The COP25 was a failure as countries could not agree on rules for an international carbon market and President Trump confirmed that the United States will formally pull out of the Paris agreement on 4 November 2020, one day after the upcoming US presidential election. It makes next year's COP26 from 9-19 November in Glasgow crucially important. This reminds us that many developments of 2019 will influence the turn of events in 2020. Central bank policy rates are stuck at a (very) low level, uncertainty may have declined a bit but trade tensions and hard Brexit concerns haven't disappeared. However, recent survey data provided some hope that in 2020 growth could actually surprise to the upside. It is what we wish to all of our readers.

William De Vijlder

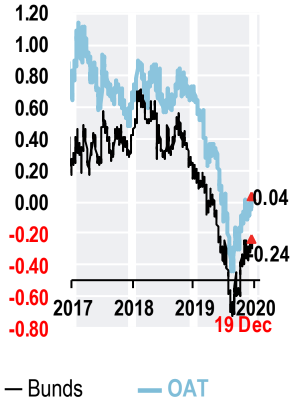
Markets overview

The essentials

Week 13-12 19 > 19-12-19

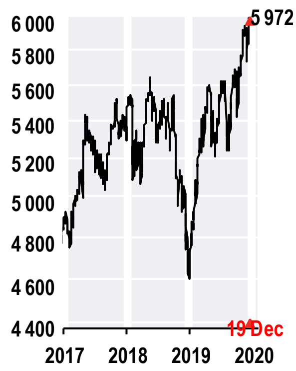
↗	**CAC 40**	5 919	▸	**5 972**	**+0.9**	%
↗	**S&P 500**	3 169	▸	**3 205**	**+1.2**	%
↘	Volatility (VIX)	12.6	▸	12.5	-0.1	pb
↗	**Euribor 3M (%)**	-0.40	▸	**-0.40**	**+0.2**	bp
↗	Libor $ 3M (%)	1.90	▸	1.91	+0.8	bp
↗	OAT 10y (%)	-0.03	▸	0.04	+6.2	bp
↗	Bund 10y (%)	-0.30	▸	-0.24	+6.0	bp
↗	US Tr. 10y (%)	1.82	▸	1.91	+8.7	bp
↘	**Euro vs dollar**	1.11	▸	**1.11**	**-0.2**	%
↗	Gold (ounce, $)	1 472	▸	1 477	+0.3	%
↗	**Oil (Brent, $)**	65.0	▸	**66.7**	**+2.7**	%

10 y bond yield, OAT vs Bund



Euro-dollar

CAC 40



Money & Bond Markets

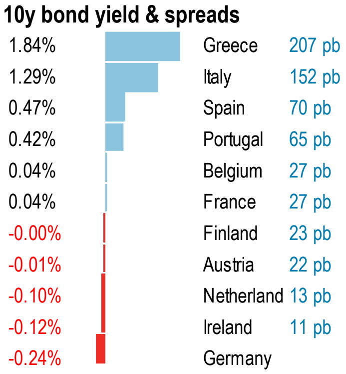
Interest Rates		highest' 19		lowest' 19	
€ ECB	**0.00**	0.00	at 01/01	0.00	at 01/01
Eonia	####	####	at 19/12	-0.47	at 03/10
Euribor 3M	**-0.40**	-0.31	at 24/01	-0.45	at 03/09
Euribor 12M	**-0.26**	-0.11	at 06/02	-0.40	at 21/08
$ FED	**1.75**	2.50	at 01/01	1.75	at 31/10
Libor 3M	**1.91**	2.81	at 01/01	1.89	at 05/12
Libor 12M	**1.97**	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 19-12-19

Yield (%)		highest' 19		lowest' 19	
€ AVG 5-7y	**0.06**	0.68	at 09/01	-0.36	at 03/09
Bund 2y	**-0.62**	-0.53	at 05/03	-0.92	at 02/09
Bund 10y	**-0.24**	0.25	at 01/01	-0.72	at 28/08
OAT 10y	**0.04**	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	**1.62**	2.62	at 18/01	1.39	at 03/10
Treas. 10y	**1.91**	2.78	at 18/01	1.46	at 04/09
Corp. BBB	**3.21**	4.65	at 01/01	3.15	at 04/09
£ Treas. 2y	**0.54**	0.83	at 27/02	0.31	at 08/10
Treas. 10y	**0.81**	1.35	at 18/01	0.33	at 03/09

At 19-12-19

10y bond yield & spreads

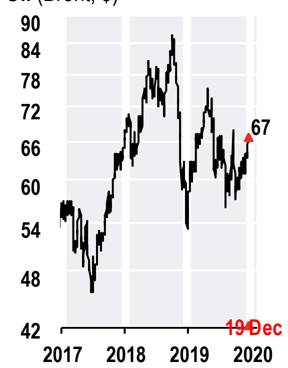


Commodities

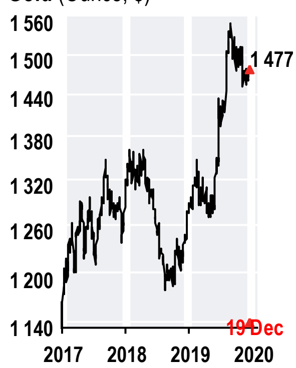
Spot price in dollars		lowest' 19			2019(€)
Oil, Brent	**66.7**	53.1	at	01/01	**+29.2%**
Gold (ounce)	**1 477**	1 268	at	02/05	**+18.5%**
Metals, LMEX	**2 860**	2 718	at	07/08	**+5.0%**
Copper (ton)	**6 191**	5 585	at	03/09	**+7.0%**
CRB Foods	**333**	312	at	11/09	**+5.7%**
wheat (ton)	**224**	166	at	30/08	**+16.8%**
Corn (ton)	**149**	128	at	24/04	**+12.3%**

At 19-12-19 *Variations*

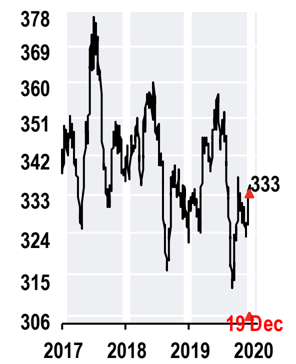
Oil (Brent, $)



Gold (Ounce, $)



CRB Foods



Exchange Rates

1€ =		highest' 19			lowest' 19			2019
USD	**1.11**	1.15	at	10/01	1.09	at	30/09	**-2.8%**
GBP	**0.85**	0.93	at	12/08	0.83	at	13/12	-4.9%
CHF	**1.09**	1.14	at	23/04	1.08	at	04/09	-3.5%
JPY	**121.51**	127.43	at	01/03	116.08	at	03/09	-3.1%
AUD	**1.62**	1.66	at	07/08	1.57	at	18/04	-0.5%
CNY	**7.79**	7.96	at	27/08	7.51	at	25/04	-0.7%
BRL	**4.52**	4.70	at	26/11	4.18	at	31/01	+2.0%
RUB	**69.35**	79.30	at	01/01	69.35	at	19/12	-12.5%
INR	**78.95**	82.00	at	04/02	76.37	at	01/08	-1.1%

At 19-12-19 *Variations*

Equity indices

	Index	highest' 19			lowest' 19			2019	2019(€)
CAC 40	**5 972**	5 992	at	16/12	4 611	at	03/01	+26.2%	**+26.2%**
S&P500	**3 205**	3 205	at	19/12	2 448	at	03/01	+27.9%	**+31.5%**
DAX	**13 212**	13 408	at	16/12	10 417	at	03/01	+25.1%	**+25.1%**
Nikkei	**23 865**	24 066	at	17/12	19 562	at	04/01	+19.2%	**+23.1%**
China*	**84**	86	at	09/04	68	at	03/01	#N/A	**+22.7%**
India*	**598**	612	at	03/06	526	at	22/08	#N/A	**+10.2%**
Brazil*	**2 349**	2 354	at	10/07	1 862	at	17/05	#N/A	**+24.3%**
Russia*	**#N/A**	#N/A	at	#N/A	#N/A	at	#N/A	#N/A	**#N/A**

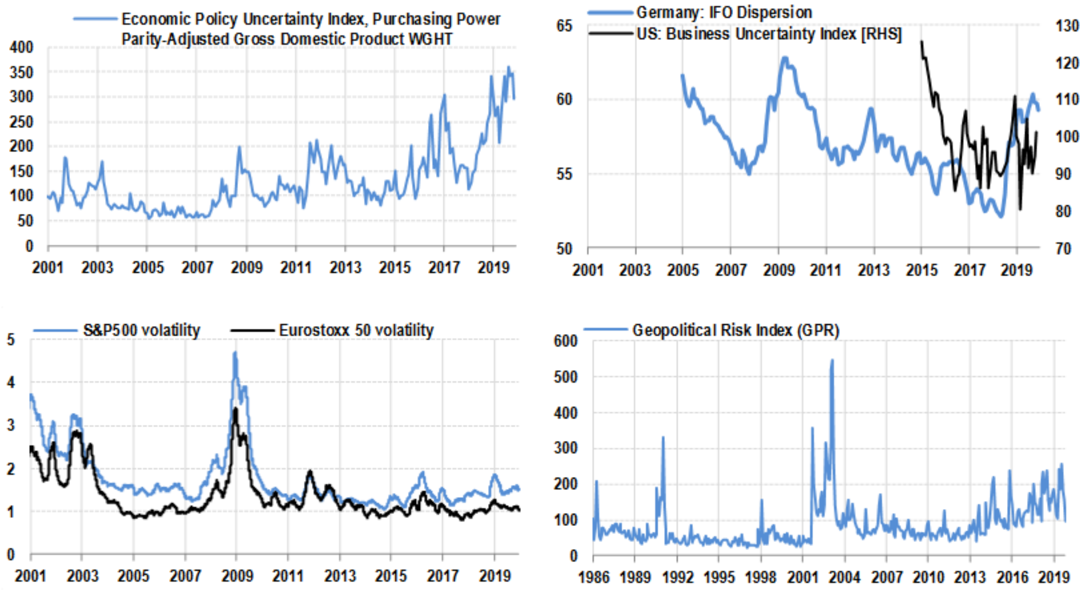
At 19-12-19 *Variations*

* MSCI index

Pulse

Uncertainty indicators have eased

We monitor uncertainty by means of different metrics and several have eased as of late. Starting top left and moving clockwise, the economic policy uncertainty index, which is based on media coverage, has declined although it remains at a high level. This is probably related to the (still to be signed) phase 1 trade agreement between the US and China and to hope that following the UK elections, there will not be a hard Brexit. Uncertainty of companies in Germany has declined as well. This is obviously a very welcome development, given the difficult situation that the manufacturing sector is in. The geopolitical risk index, again based on media coverage, has declined as well. Uncertainty based on individual share price performance is on a rising trend in the US, although the level remains low. It has been declining in the eurozone since the start of the year.



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, BC, BNP Paribas

Indicators preview

The next two week will see the publication of regional activity indices in the US and, more importantly, the purchasing managers indices in several countries. In the US we will also have consumer confidence data as well as the minutes of the latest FOMC meeting. Also worth noting is the publication of the ECB montly bulletin.

Date	Country	Event	Period	Survey	Prior
12/23/2019	United States	Chicago Fed Nat Activity Index	Nov	--	-0.71
12/24/2019	United States	Durable Goods Orders	Nov	1.5%	0.5%
12/24/2019	United States	Richmond Fed Manufact. Index	Dec	--	-1
12/27/2019	Japan	Jobless Rate	Nov	--	2.4%
12/27/2019	Japan	Retail Sales MoM	Nov	--	-14.4%
12/27/2019	Japan	Industrial Production MoM	Nov	--	-4.5%
12/27/2019	Eurozone	ECB Publishes Economic Bulletin			
12/27/2019	Germany	Retail Sales MoM	Nov	--	-1.9%
12/30/2019	United States	Dallas Fed Manf. Activity	Dec	--	-1.3
12/31/2019	China	Composite PMI	Dec	--	53.7
12/31/2019	United States	Conf. Board Consumer Confidence	Dec	128.0	125.5
01/02/2020	China	Caixin China PMI Mfg	Dec	51.5	51.8
01/02/2020	France	Markit France Manufacturing PMI	Dec	--	50.3
01/02/2020	Germany	Markit/BME Germany Manufacturing PMI	Dec	--	43.4
01/02/2020	Eurozone	Markit Eurozone Manufacturing PMI	Dec	--	45.9
01/02/2020	United States	Markit US Manufacturing PMI	Dec	--	52.5
01/03/2020	France	CPI EU Harmonized MoM	Dec	--	0.1%
01/03/2020	Germany	CPI EU Harmonized YoY	Dec	--	1.2%
01/03/2020	United States	ISM Manufacturing	Dec	48.6	48.1
01/03/2020	United States	FOMC Meeting Minutes	Dec 11	--	--

Source: Bloomberg, BNP Paribas

Economic scenario

%	GDP Growth 2018	2019 e	2020 e	2021 e	Inflation 2018	2019 e	2020 e	2021 e
Advanced	**2.2**	**1.7**	**1.1**	**1.6**	**2.0**	**1.5**	**1.6**	**1.4**
United-States	2.9	2.3	1.5	2.0	2.4	1.8	2.4	1.9
Japan	0.8	1.0	0.2	0.7	1.0	0.5	0.6	0.3
United-Kingdom	1.4	1.3	1.1	1.7	2.5	1.8	1.5	1.8
Euro Area	**1.9**	**1.1**	**0.8**	**1.3**	**1.8**	**1.2**	**1.0**	**1.0**
Germany	1.5	0.5	0.4	1.2	1.9	1.4	1.2	1.2
France	1.7	1.3	1.1	1.3	2.1	1.3	1.0	1.1
Italy	0.7	0.2	0.2	0.6	1.2	0.7	0.6	0.5
Spain	2.4	2.0	1.7	1.6	1.7	0.8	0.8	0.9
Emerging	**4.4**	**3.8**	**4.0**	**4.2**	**4.6**	**4.6**	**4.6**	**3.6**
China	6.6	6.1	5.7	5.8	2.1	2.8	3.5	1.5
India*	6.8	5.8	5.5	6.0	2.9	3.0	3.3	3.5
Brazil	1.1	1.0	2.0	3.0	3.7	3.7	3.4	3.7
Russia	2.3	0.9	1.5	1.5	2.9	4.7	3.8	4.0

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

* Fiscal year from April 1st of year n to March 31st of year n+1

UNITED STATES

- Despite the support coming from the Fed rate cuts in 2019, we expect growth to slow in the near term under the influence of corporate investment (slower profits growth, trade uncertainty) and housing (declining trend of affordability, despite a recent rebound). Consumer spending should be more resilient but could slow on the back of a less dynamic labour market.
- As a consequence, we expect two Fed funds target rate cuts in the first half of 2020.

CHINA

- Economic growth continues to slow. 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, but the reduction in financial-instability risks should remain a priority and banks are prudent. Fiscal policy is expansionary through increased investment in infrastructure projects and household/corporate tax cuts. Tax measures are expected to have some success in supporting consumer spending.
- Consumer price inflation has accelerated due to rising food prices (soaring pork prices), but core inflation remains subdued.

EUROZONE

- The economic slowdown is continuing in the eurozone, especially in Germany, due to the international environment and difficulties in the manufacturing sector. The recent stabilization of business surveys, albeit at a low level, 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 could be slower than expected until recently.
- The very accommodative monetary policy should 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 twice in the first half of 2020 in reaction to a slowing economy, moderate inflation and high uncertainty. This should support the medium term growth outlook, which is why, after an initial decline, we expect Treasury yields to increase gradually.
- 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. The movement of bond yields will be very much influenced by what happens to US yields, although we expect the increase in Bund yields to be smaller. Sovereign spreads in the eurozone should decline.
- We expect that the Bank of Japan will refrain from further monetary easing.
- We expect little change in EUR/USD even though euro's fair value is quite higher than current pricing.

Interest rates, %		**2019**		**2020**						
End of period		Q3	Q4e	Q1e	Q2e	Q3e	Q4e	**2018**	**2019e**	**2020e**
US	Fed Funds	2.00	1.75	1.50	1.25	1.25	1.25	2.50	1.75	1.25
	T-Notes 10y	1.67	1.75	1.60	1.80	2.10	2.00	2.69	1.75	2.00
Ezone	Deposit rate	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
	Bund 10y	-0.57	-0.35	-0.50	-0.40	-0.30	-0.30	0.25	-0.35	-0.30
	OAT 10y	-0.28	-0.05	-0.20	-0.15	-0.10	-0.10	0.71	-0.05	-0.10
UK	Base rate	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
	Gilts 10y	0.40	0.71	1.00	1.10	1.20	1.20	1.27	0.71	1.20
Japan	BoJ Rate	-0.06	-0.10	-0.10	-0.10	-0.10	-0.10	-0.07	-0.10	-0.10
	JGB 10y	-0.22	-0.05	-0.10	0.00	0.05	0.10	0.00	-0.05	0.10

Source : BNP Paribas GlobalMarkets (e: Forecasts)

Exchange Rates		**2019**		**2020**						
End of period		Q3	Q4e	Q1e	Q2e	Q3e	Q4e	**2018**	**2019e**	**2020e**
USD	EUR / USD	1.09	1.11	1.12	1.13	1.13	1.14	1.14	1.11	1.14
	USD / JPY	108	107	104	103	103	103	110	107	103
	GBP / USD	1.23	1.32	1.35	1.36	1.36	1.39	1.27	1.32	1.39
	USD / CHF	1.00	0.99	0.99	0.99	0.99	1.00	0.99	0.99	1.00
EUR	EUR / GBP	0.89	0.84	0.83	0.83	0.83	0.82	0.90	0.84	0.82
	EUR / CHF	1.09	1.10	1.11	1.12	1.12	1.14	1.13	1.10	1.14
	EUR / JPY	118	119	116	116	116	117	125	119	117

Source : BNP Paribas GlobalMarkets (e: Forecasts)

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Registered Office: 16 boulevard des Italiens – 75009 PARIS
Tel: +33 (0) 1.42.98.12.34 – Internet :
www.group.bnpparibas.com
Publisher: Jean Lemierre. Editor: William De Vijlder