

ECOWEEK

No. 19-29, 19 July 2019

Eurozone: pockets of inflation in a low inflation world

■ Despite an increase in June, core inflation in the eurozone remains stubbornly low ■ The dispersion is significant between countries and between the expenditure components of the price index. Inflation is low for clothing and footwear, furnishings and household equipment, transport and communications. It is higher for housing-related items, restaurants and hotels, miscellaneous goods and services and recreation and culture ■ Non-energy industrial goods price inflation is very low. Should this continue, it would imply that the acceleration of inflation which is the ECB is pursuing by renewed policy easing, has to come from services. However, research shows that it takes more time for services prices to respond to monetary policy and economic activity. Monetary accommodation is here to stay.

In June, the annual inflation rate for the eurozone was 1.3%. Core inflation –which excludes energy, alcohol, food and tobacco- rose to 1.1%, from 0.8% in May. Since the start of the year, it has been fluctuating between 0.8% and 1.3%. Both inflation measures remain well below the objective of the ECB, which is to have, over the medium term, a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) below but close to 2%.

Yet, the average hides considerable dispersion, which has a large impact on national real interest rates. As shown in chart 1, five countries have inflation of 2% or more but five countries, among which France and Italy, are below 1.0%. In Germany, despite massive bottlenecks, core inflation is only 1.5%. The dispersion is also considerable when looking at the expenditure items per country. The highlighted cells in chart 2 show inflation higher than 1.5%. In most countries, inflation is low for clothing and footwear, furnishings and household equipmentⁱ, transport and communications. The picture on education is mixed, but it only represents 1% of HICP. Housing-relatedⁱⁱ items, restaurants and hotels, miscellaneous goods and servicesⁱⁱⁱ and, to a lesser extent, recreation and culture, have inflation of 1.5% or more, sometimes significantly so. Inflation well above average for restaurants, hotels, recreation and culture doesn't come as a surprise at this point of the business cycle: a low unemployment rate, low interest rates and good growth in compensation support consumer spending, which creates room for companies to raise prices. Housing-related inflation is explained by higher energy bills and bottlenecks in the construction sector.

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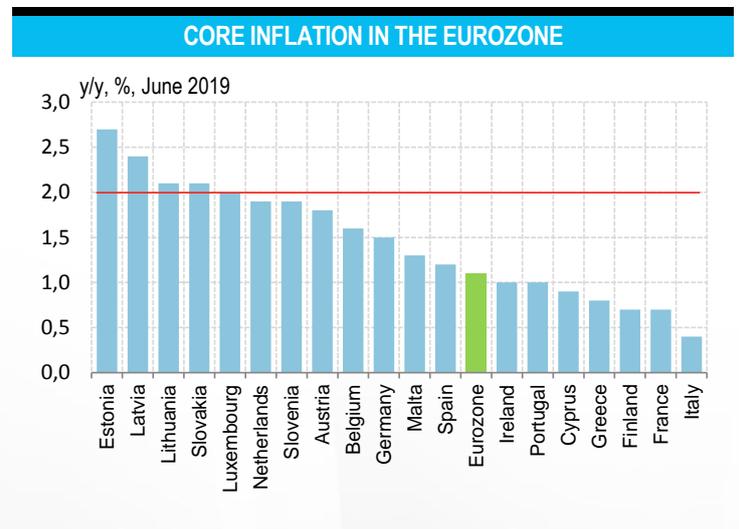


Chart 1

Source: Eurostat

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Economic scenario

ECONOMIC RESEARCH DEPARTMENT



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Another measure of dispersion is the difference between services and goods prices (chart 3). Whereas services price inflation ranges between 1.4% and 3.4%, goods price inflation is very low at 0.3%. There is virtually no inflation for a long list of items (bicycles, clothing and footwear, watches, household textiles, medical products, furnishings, refrigerators, freezers, toys, etc.) and inflation is even negative for a broad range of items (mobile telephone equipment, personal computers, cameras, household appliances, lighting equipment, etc.). This reminds us of the usual explanations for the structural decline of inflation: globalisation and increased competition via internet, which facilitates price comparisons.

The charts also illustrate the challenges faced by the ECB. Food including alcohol and tobacco has a weight of 19% in HICP, energy 10%, so monetary policy tries to influence the remaining 71%. The weight of non-energy industrial goods is 26.4%, but for structural reasons goods price inflation remains stubbornly low. Moreover, a slowing economy and persistently high uncertainty restrain the eagerness of companies to raise prices. This implies, for inflation to move closer to the ECB's target on a lasting basis, services inflation needs to accelerate further from an already satisfactory level. Against this background, Benoît Coeuré's comment in a recent speech^{iv} that "prices in the services sector change much less frequently than in other sectors and are less sensitive to exchange rates" which implies that "it takes longer for inflation to respond to changes in monetary policy and economic activity than it did a few decades ago" reminds us that patience will be necessary. Monetary accommodation is here to stay.

EUROZONE INFLATION: GOODS VERSUS SERVICES

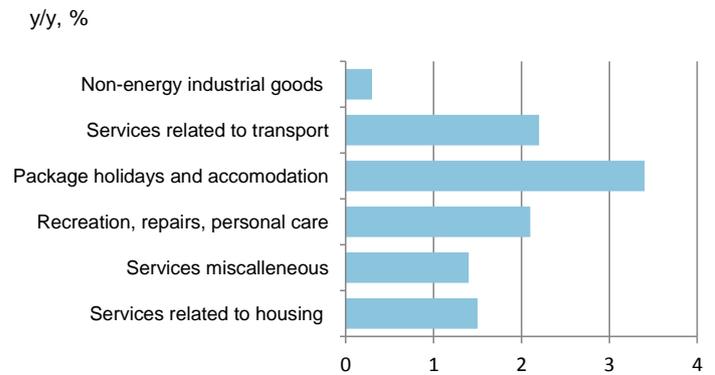


Chart 3

Source: Eurostat

William De Vijlder

ⁱ This concerns items such as household furniture, lighting equipment, carpets, repair of furniture, household textiles, household appliances, cleaning and maintenance products, domestic services, etc.
ⁱⁱ Items consist of actual rentals for housing, maintenance and repair of the dwelling, services of plumbers, electricians, painters, carpenters, cost of water, electricity and gas supply, etc.
ⁱⁱⁱ This covers personal care, jewellery, social protection, insurance, charges by banks and post offices, legal services and accountancy, etc.
^{iv} The rise of services and the transmission of monetary policy, Speech by Benoît Coeuré, Member of the Executive Board of the ECB, at the 21st Geneva Conference on the World Economy, 16 May 2019

INFLATION DISPERSION: SERVICES AND GOODS PRICES

June 2019	HICP	Core inflation	Clothing and footwear	Housing, water, electricity, gas and other fuels	Furnishings, household equipment and routine household maintenance	Health	Transport	Communications	Recreation and culture	Education	Restaurants and hotels	Miscellaneous goods and services
Germany	1,5	1,5	2,2	2,2	0,6	1,1	2,1	-1,2	1	-3,6	3	2,3
Austria	1,6	1,8	-0,4	3,1	1,4	1,5	0,6	-2,5	1,5	2,4	3	2
Belgium	1,3	1,6	0,4	0,5	0,6	1,1	1	0,1	2,1	1,3	3,2	2,1
Cyprus	0,3	0,9	-4,2	5,3	0,1	0	0,1	-2,8	2	1,9	0,2	1,2
Spain	0,6	1,2	1,7	-1,4	0,6	0,7	0	0,1	-0,5	1	2,4	1,7
Estonia	2,6	2,7	0,8	2,9	1,7	2,2	-0,5	-2,7	6,2	4,4	5,7	2,5
Finland	1,1	0,7	-1,6	3,3	1	0,8	0,2	0,2	-1	1,2	2,1	1,4
France	1,4	0,7	-0,8	2,5	0,2	-0,8	0,8	-2,5	0,6	2,4	1,6	1
Greece	0,2	0,8	-0,1	-0,1	-1,9	0,7	0,4	3,7	-0,7	-0,8	1,4	-0,9
Ireland	1,1	1	-1	4,5	-3,5	0,4	1,1	-6,6	0,3	1,7	3,2	-0,4
Italy	0,8	0,4	0,2	3,2	-0,1	0,6	0,8	-9,4	-0,3	0	1,5	1,6
Latvia	3,1	2,4	1,4	4,2	2,6	2	0,8	2	3	2,7	4,6	1,7
Lithuania	2,4	2,1	-1,1	3,2	1,9	4,6	0,4	-2,8	2,3	1,9	4,5	2,7
Luxembourg	1,5	2	1,3	2	1	1,4	-0,4	0,9	1,2	9,1	3,1	2,5
Malta	1,8	1,3	1,4	2,1	0,1	1,5	0,8	1,6	1,1	-4,6	2,1	2,5
Netherlands	2,7	1,9	-0,7	5,9	0,2	2,6	2,5	-4,9	2,3	-3,2	5,5	1,5
Portugal	0,7	1	-3,8	0,6	0,3	1	0,9	-3,8	-0,6	1,4	3,4	1,6
Slovakia	2,7	2,1	1	5,1	1,3	2,1	-2,3	3	1,6	1,4	4	3
Slovenia	1,9	1,9	1,1	5,5	1,2	2,7	-1	-1,4	1,6	3,1	3,9	1,7
Eurozone	1,3	1,1	0,4	2,3	0,4	0,7	1,1	-2,6	0,7	-0,6	2,4	1,6

Chart 2

Source: Eurostat



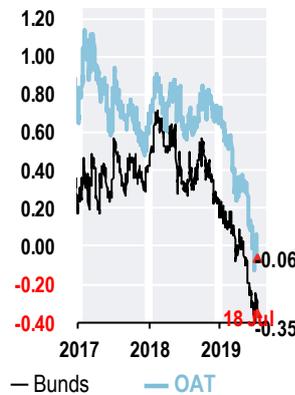
Markets overview

The essentials

Week 12-7 19 > 18-7-19

➤ CAC 40	5 573	▶ 5 551	-0.4 %
➤ S&P 500	3 014	▶ 2 995	-0.6 %
↗ Volatility (VIX)	12.4	▶ 13.5	+1.1 pb
➤ Euribor 3M (%)	-0.36	▶ -0.37	-0.7 bp
➤ Libor \$ 3M (%)	2.32	▶ 2.30	-2.0 bp
➤ OAT 10y (%)	0.06	▶ -0.06	-12.1 bp
➤ Bund 10y (%)	-0.25	▶ -0.35	-10.7 bp
➤ US Tr. 10y (%)	2.11	▶ 2.04	-6.7 bp
➤ Euro vs dollar	1.13	▶ 1.12	-0.3 %
↗ Gold (ounce, \$)	1 408	▶ 1 426	+1.2 %
➤ Oil (Brent, \$)	66.8	▶ 61.8	-7.5 %

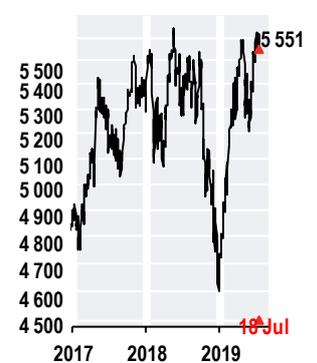
10 y bond yield, OAT vs Bund



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 07/06	-0.38 at 19/06
Euribor 3M	-0.37 at 24/01	-0.37 at 18/07
Euribor 12M	-0.30 at 06/02	-0.30 at 18/07
\$ FED	2.50 at 01/01	2.50 at 01/01
Libor 3M	2.30 at 01/01	2.29 at 03/07
Libor 12M	2.22 at 21/01	2.15 at 25/06
£ BoE	0.75 at 01/01	0.75 at 01/01
Libor 3M	0.77 at 29/01	0.76 at 03/07
Libor 12M	0.88 at 11/01	0.87 at 04/07

At 18-7-19

Yield (%)	highest' 19	lowest' 19
€ AVG 5-7y	-0.03 at 09/01	-0.05 at 05/07
Bund 2y	-0.75 at 05/03	-0.76 at 18/06
Bund 10y	-0.35 at 01/01	-0.40 at 04/07
OAT 10y	-0.06 at 08/01	-0.13 at 04/07
Corp. BBB	0.90 at 08/01	0.90 at 18/07
\$ Treas. 2y	1.77 at 18/01	1.73 at 20/06
Treas. 10y	2.04 at 18/01	1.95 at 03/07
Corp. BBB	3.55 at 01/01	3.48 at 03/07
£ Treas. 2y	0.52 at 27/02	0.49 at 03/07
Treas. 10y	0.76 at 18/01	0.67 at 04/07

At 18-7-19

10y bond yield & spreads

2.92%	Greece	327 pb
1.56%	Italy	190 pb
0.48%	Portugal	83 pb
0.36%	Spain	71 pb
0.01%	Belgium	36 pb
-0.06%	France	29 pb
-0.10%	Austria	25 pb
-0.17%	Ireland	18 pb
-0.18%	Finland	17 pb
-0.19%	Netherland	16 pb
-0.35%	Germany	

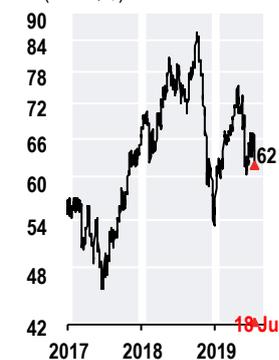
Commodities

Spot price in dollars	lowest' 19	2019(€)
Oil, Brent	61.8 at 01/01	+18.6%
Gold (ounce)	1 268 at 02/05	+13.4%
Metals, LME	2 730 at 03/01	+4.2%
Copper (ton)	5 971 at 03/01	+2.3%
CRB Foods	347 at 07/03	+9.2%
wheat (ton)	181 at 10/05	-6.3%
Corn (ton)	169 at 24/04	+26.6%

At 18-7-19

Variations

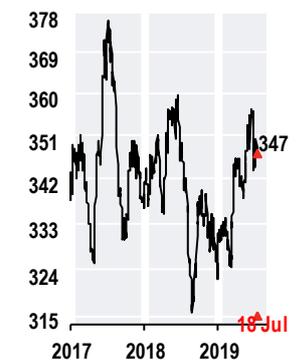
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

€ =	highest' 19	lowest' 19	2019
USD	1.15 at 10/01	1.11 at 30/05	-1.9%
GBP	0.90 at 03/01	0.85 at 14/03	+0.1%
CHF	1.11 at 23/04	1.11 at 24/06	-1.7%
JPY	127.43 at 01/03	120.97 at 18/07	-3.5%
AUD	1.64 at 17/06	1.57 at 18/04	-1.9%
CNY	7.87 at 09/01	7.51 at 25/04	-1.7%
BRL	4.59 at 20/05	4.18 at 31/01	-5.1%
RUB	79.30 at 01/01	70.49 at 16/07	-10.8%
INR	82.00 at 04/02	76.78 at 05/07	-3.1%

At 18-7-19

Variations

Equity indices

Index	highest' 19	lowest' 19	2019	2019(€)
CAC 40	5 621 at 04/07	4 611 at 03/01	+17.3%	+17.3%
S&P500	3 014 at 15/07	2 448 at 03/01	+19.5%	+21.7%
DAX	12 630 at 04/07	10 417 at 03/01	+15.8%	+15.8%
Nikkei	22 308 at 25/04	19 562 at 04/01	+5.2%	+9.0%
China*	86 at 09/04	68 at 03/01	+10.8%	+13.0%
India*	612 at 03/06	530 at 19/02	+4.1%	+7.4%
Brazil*	2 354 at 10/07	1 862 at 17/05	+16.8%	+23.1%
Russia*	711 at 04/07	572 at 01/01	+14.6%	+26.7%

At 18-7-19

Variations

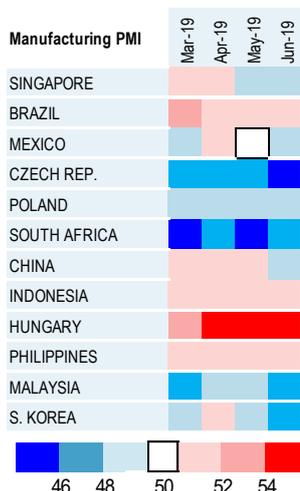
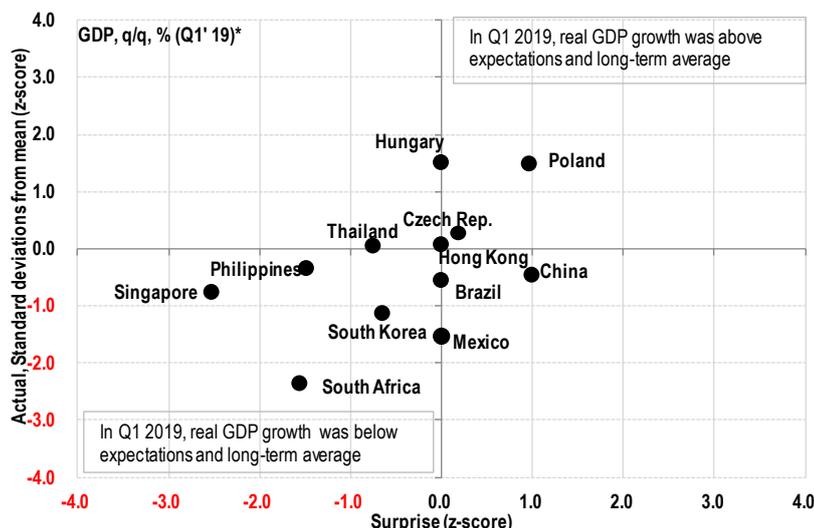
* MSCI index



Pulse

Singapore: economic growth slowing sharply

Based on advance indicators for Q2 2019, Singapore's GDP barely increased in y/y terms (+0.1%) and declined by 3.4% q/q sa (down from +1.1% and 3.8%, respectively, in Q1). GDP contraction is due to the weak performance of the manufacturing sector, which is hard hit by the effects of US-China trade tensions and weakening global tech cycle. The authorities have recently revised down their forecast for real GDP growth in 2019, to a "1.5%-2.5%" range from a "1.5%-3.5%" range projected earlier this year. Risks to the outlook remain tilted to the downside.



Note: z-score is a score which indicates how many standard deviations an observation is from the mean: $z = (x - \mu) / \sigma$ where x : observation, μ : mean, σ : standard deviation. On the X-axis, x corresponds to the last known surprise for each indicator 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 to 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).

* Q2' 19: China, Singapore

Indicators preview

An important week ahead of us. The highlight is the ECB meeting. Expectations about further easing have increased following the comments of Mario Draghi at the ECB conference in Sintra in June. The question now is whether the Governing Council will meet the elevated expectations. The ECB will also publish the Survey of Professional Forecasters. It will be interesting to see how inflation expectations have evolved. In terms of data we have a heavy schedule: flash PMIs in several countries, IFO business climate in Germany, French business confidence, regional indicators in the US (Richmond, Kansas City) and, importantly, second quarter US GDP growth.

Date	Country/Region	Event	Period	Survey	Prior
07/23/2019	United Kingdom	CBI Business Optimism	July	--	-13
07/23/2019	United States	Richmond Fed Manufact. Index	July	--	71.6535
07/23/2019	Eurozone	Consumer Confidence	July	--	-7.2
07/23/2019	United States	Existing Home Sales	June	5.36e+06	5.34e+06
07/23/2019	United States	Existing Home Sales MoM	June	0.4%	2.5%
07/24/2019	Japan	Jibun Bank Japan PMI Composite	July	--	50.8
07/24/2019	France	Business Confidence	July	--	106
07/24/2019	France	Markit France Composite PMI	July	--	52.7
07/24/2019	Germany	Markit/BME Germany Composite PMI	July	52.2	52.6
07/24/2019	Eurozone	Markit Eurozone Composite PMI	July	--	52.2
07/24/2019	United States	MBA Mortgage Applications	July-19	--	-1.1%
07/24/2019	United States	Markit US Composite PMI	July	--	51.5
07/24/2019	United States	New Home Sales MoM	June	7.0%	-7.8%
07/25/2019	Germany	IFO Business Climate	July	97.6	97.4
07/25/2019	France	Total Jobseekers	2Q	--	3.3919e+06
07/25/2019	Eurozone	ECB Main Refinancing Rate	July-25	0.000%	0.000%
07/25/2019	United States	Cap Goods Orders Nondef Ex Air	June	--	0.5%
07/25/2019	United States	Kansas City Fed Manf. Activity	July	--	--
07/26/2019	Eurozone	ECB Survey of Professional Forecasters			
07/26/2019	United States	GDP Annualized QoQ	2Q	1.7%	3.1%

Source: Bloomberg, BNP Paribas



Economic scenario

UNITED STATES

- Growth picked-up by early 19 but this was partly due to one-off factors (inventories). The trend in private domestic demand is more subdued. The housing market is softening, corporate investment should slow, as well as exports. Core inflation remains well under control and has eased a bit.
- Regarding the more cautious message delivered by the Fed's president. J. Powell (about trade tensions), we believe the Fed Funds target rate will be cut by 2 quarter points in Q3, coming back to 1.75-2%.

CHINA

- Economic growth continues to slow. Activity rebounded in March 2019 but weakened again afterwards. The recent flare-up in trade tensions with the US has again darkened export prospects.
- The central bank is easing liquidity and credit conditions, though the reduction in financial-instability risks via regulatory tightening should remain a priority. Fiscal policy has also turned 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 support consumer spending.

EUROZONE

- Despite a stronger than expected growth in the 1st quarter of 2019, the economic slowdown is continuing in the eurozone, especially in Germany, due to international environment uncertainties and a slowdown of exports to China. Capacity constraints also play a role and activity in the manufacturing sector continues to decline.
- 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.
- Monetary policy remains cautious and proactive, the ECB announcing the launch of another round of longer-term refinancing operations (TLTRO) for eurozone banks.

FRANCE

- Growth is slowing although the economy should show some 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 rates twice in the second semester in reaction to a slowing economy, subdued inflation and heightened uncertainty. Bond markets are already pricing in rate cuts, which is why we expect that the decline of the 10 year treasury yield will only be moderate.
- The combination of slower growth and subdued core inflation leads us to expect that ECB official rates will remain unchanged this year and next. 10 year Bund yields are expected to rise only marginally to 0.00% by the end of this year. We forecast a yield of 0.15% by the end of 2020.
- No change expected in Japan.
- We expect the euro to strengthen versus the dollar considering that the latter is expensive on valuation grounds and that the Fed will ease its policy

%	GDP Growth			Inflation		
	2018	2019 e	2020 e	2018	2019 e	2020 e
Advanced	2.2	1.8	1.3	2.0	1.6	1.6
United-States	2.9	2.7	1.8	2.4	2.1	2.0
Japan	0.8	0.6	0.2	1.0	0.6	0.5
United-Kingdom	1.4	1.3	1.4	2.5	1.9	1.9
Euro Area	1.9	1.1	1.0	1.8	1.3	1.3
Germany	1.4	0.6	1.0	1.9	1.5	1.5
France	1.7	1.3	1.2	2.1	1.4	1.5
Italy	0.7	0.3	0.2	1.3	0.9	0.9
Spain	2.6	2.2	1.9	1.7	1.0	1.2
Emerging	4.5	4.2	4.7	4.7	4.8	4.3
China	6.6	6.2	6.0	2.1	2.2	2.6
India*	7.0	7.4	7.6	3.4	3.5	4.2
Brazil	1.1	0.8	2.5	3.7	3.9	3.9
Russia	2.3	1.5	1.7	2.9	5.1	4.1

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				2018	2019e	2020e
End of period		Q1	Q2e	Q3e	Q4e			
US	Fed Funds	2.50	2.50	2.00	2.00	2.50	2.00	1.75
	Libor 3m \$	2.60	2.45	2.00	2.00	2.81	2.00	1.80
	T-Notes 10y	2.42	2.10	1.95	1.90	2.69	1.90	2.25
Ezone	ECB Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Euribor 3m	-0.31	-0.30	-0.30	-0.30	-0.31	-0.30	-0.30
	Bund 10y	-0.07	-0.05	-0.05	0.00	0.25	0.00	0.15
	OAT 10y	0.26	0.30	0.30	0.30	0.71	0.30	0.45
UK	Base rate	0.75	1.00	1.00	1.25	0.75	1.25	1.25
	Gilts 10y	1.00	1.85	2.00	2.10	1.27	2.10	2.10
Japan	BoJ Rate	-0.06	-0.10	-0.10	-0.10	-0.07	-0.10	-0.10
	JGB 10y	-0.09	-0.03	-0.02	-0.02	0.00	-0.02	-0.05

Source : BNP Paribas GlobalMarkets (e: Forecasts)

Exchange Rates		2019				2018	2019e	2020e
End of period		Q1	Q2e	Q3e	Q4e			
USD	EUR / USD	1.12	1.13	1.16	1.20	1.14	1.20	1.25
	USD / JPY	111.0	108.0	105.0	102.0	110.0	102.0	95.0
	GBP / USD	1.30	1.27	1.32	1.38	1.27	1.38	1.49
	USD / CHF	1.00	1.01	0.99	0.97	0.99	0.97	0.94
EUR	EUR / GBP	0.85	0.89	0.88	0.87	0.90	0.87	0.84
	EUR / CHF	1.12	1.14	1.15	1.16	1.13	1.16	1.18
	EUR / JPY	124.0	122.0	122.0	122.0	125.0	122.0	119.0

Source : BNP Paribas GlobalMarkets (e: Forecasts)



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