ECOWEEK

No. 19-25, 21 June 2019

Central banks: synchronised swimming against the tide

■ ECB President Mario Draghi, speaking at Sintra, has raised expectations of renewed policy easing ■ The message from the FOMC meeting is that rate cuts are coming ■ This policy synchronisation reflects shared issues (inflation too low versus target) and shared concerns, the major being rising uncertainty ■ Should this continue, the effectiveness of monetary accomodation will suffer.

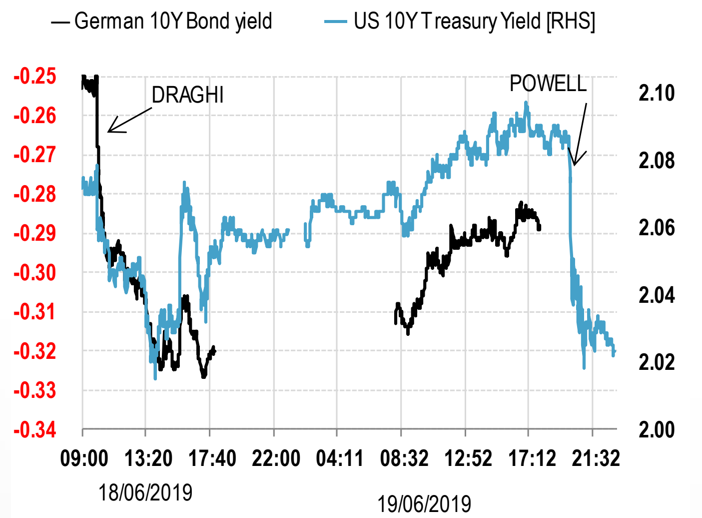
One single striking statement is like a one-off event, two may be the start of a tradition. At the ECB's annual gathering in Sintra (Portugal), Mario Draghi created a surprise in 2017 by stating that as *"the economy continues to recover, a constant policy stance will become more accommodative, and the central bank can accompany the recovery by adjusting the parameters of its policy instruments – not in order to tighten the policy stance, but to keep it broadly unchanged."*[i]

His speech this week was again headline-grabbing by evoking in not to be mistaken words the likelihood of more policy easing. *"The risk outlook remains tilted to the downside, and indicators for the coming quarters point to lingering softness… In the absence of improvement, such that the sustained return of inflation to our aim is threatened, additional stimulus will be required."*[ii] The policy implications will be discussed in the Governing Council in the coming weeks, which suggests that more accommodation can come sooner rather than later. In terms of toolkit, he mentioned forward guidance can be adjusted in terms of bias and conditionality. This means that the ECB could state that rates will stay at the current level or lower until a date which stretches further into the future. Additional interest rate cuts are possible with "*mitigating measures to contain any side effects remain part of our tools*" (this hints at a tiering of the deposit rate)[iii].

The most important sentence of the speech was that "*the Treaty requires that our actions are both necessary and proportionate to fulfil our mandate and achieve our objective, which implies that the limits we establish on our tools are specific to the contingencies we face*." To put it differently, the limits of the asset purchase programme will be adapted in line with the urgency of the situation. As shown in the charts, Bund yields dropped and pulled along US treasury yields, European equity prices increased, the euro weakened and the 5 year in 5 year inflation swap increased as well, which means slightly higher inflation expectations and/or inflation risk premium. This comes as a relief given its significant decline in recent weeks.

One interpretation why the ECB President went much further than during his press conference two weeks earlier is that the tone at the Fed's meeting the following day was expected to shift. A more dovish message from the ECB could pre-empt an appreciation of the euro if the Fed would hint at policy easing[iv].

BOND YIELDS INTRADAY



Source: Bloomberg, BNP Paribas

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Eco WEEK

ECONOMIC RESEARCH DEPARTMENT

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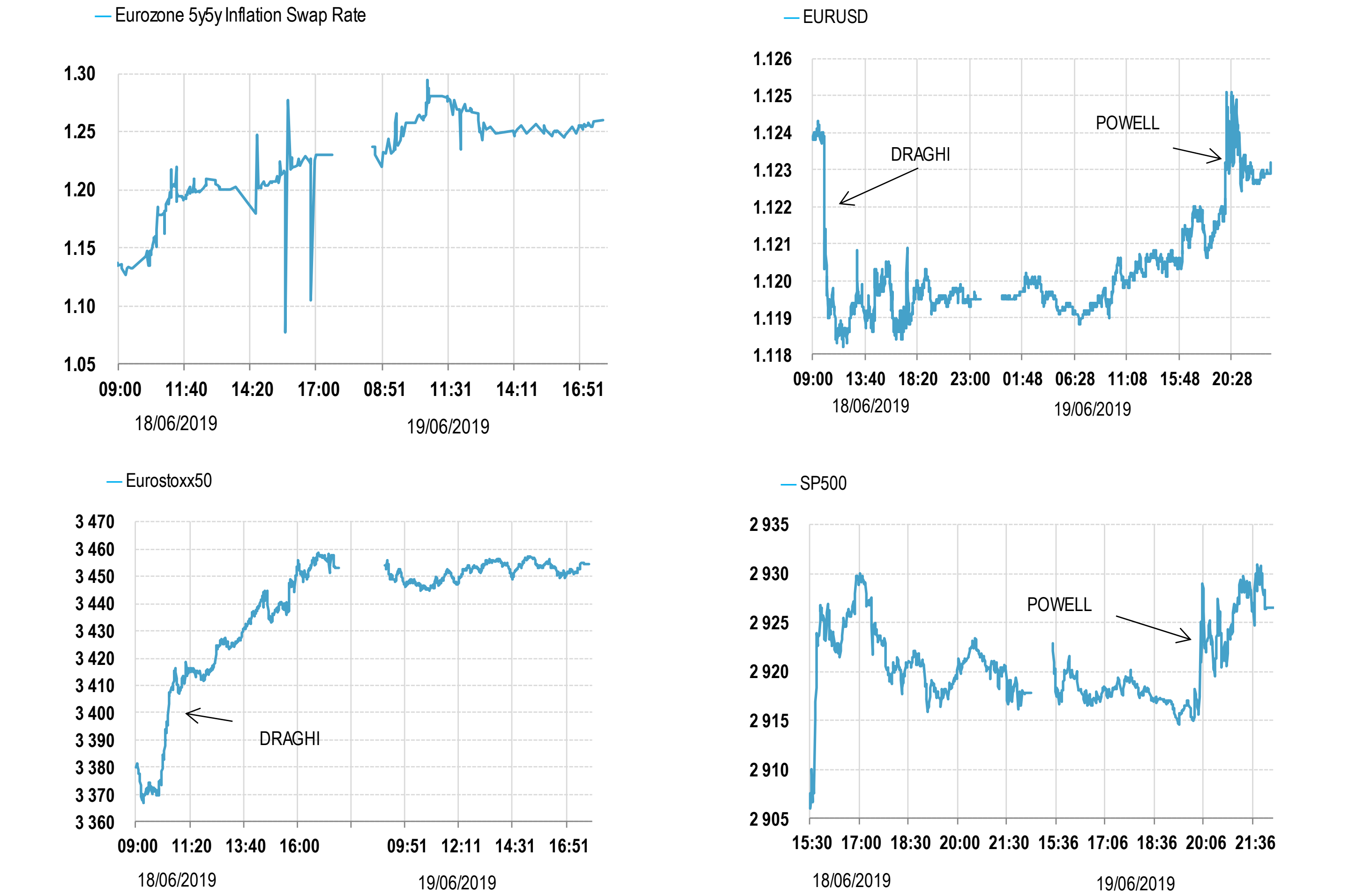
The bank for a changing world

Whether that reading is right is not clear but there is no doubt that currency markets are very sensitive to the relative monetary policy stance. After all, following the FOMC meeting outcome and Chairman Powell's press conference, the EUR/USD exchange rate even spiked above the level seen before Mario Draghi's speech. The rationale underpinning the Fed's change in tone[v] reflects increased downside risk based on cross-currents, weaker business sentiment as well as a softening investment picture. Moreover, the move of inflation to target is slowing and concern about a more sustained inflation shortfall is increasing. The issues are very much similar to those confronting the eurozone. The synchronised nature of the messages of more monetary accommodation should be welcomed: what's good for the eurozone should be good for the US and vice versa. Yet, there is an impression of swimming against a powerful tide of uncertainty. It is perhaps for this reason that the reaction of the S&P500 to Powell's comments was very much subdued.

William De Vijlder

INTRADAY MARKET EVOLUTION (PARIS TIME)



Source: Bloomberg, BNP Paribas

[i] ECB, *Accompanying the economic recovery*, Introductory speech by Mario Draghi at the ECB Forum on Central Banking, Sintra, 27 June 2017
[ii] ECB, *Twenty Years of the ECB's monetary policy*, Speech by Mario Draghi, President of the ECB, ECB Forum on Central Banking, Sintra, 18 June 2019
[iii] Under a tiered system, different rates would apply for excess reserves deposited by banks with the central bank. Part of the reserves could even be exempted.
[iv] Although the euro is not a policy objective, it is a key component of financial and monetary conditions. After all, Mario Draghi did say at Sintra that "*the euro area is a relatively open economy… this means that the impact of negative rates on inflation and financing conditions via the exchange rate is more powerful [than in the US]*." In a slowing eurozone economy, a significantly stronger currency would be most unhelpful.
[v] This change is reflected in the downward adjustment of the federal funds rate projection (the "dots") for next year (from 2.6% to 2.1%), which now points towards policy easing, as well as comments from the Chairman during his press conference that many FOMC members consider the case for more accommodative policy has strengthened and that "8 members wrote down rate cuts".

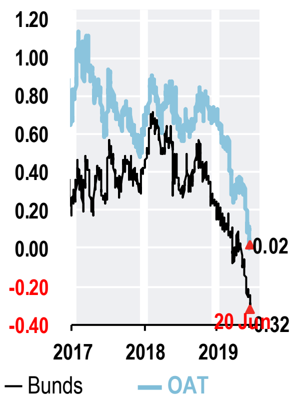
Markets overview

The essentials

Week 14-6 19 > 20-6-19

↗ **CAC 40**	5 368	▶	**5 536**	**+3.1**	%
↗ **S&P 500**	2 887	▶	**2 954**	**+2.3**	%
↘ Volatility (VIX)	15.3	▶	14.8	-0.5	pb
↘ **Euribor 3M (%)**	-0.32	▶	**-0.34**	**-2.0**	bp
↘ Libor $ 3M (%)	2.40	▶	2.39	-1.6	bp
↘ OAT 10y (%)	0.10	▶	0.02	-7.6	bp
↘ Bund 10y (%)	-0.26	▶	-0.32	-6.3	bp
↘ US Tr. 10y (%)	2.09	▶	2.00	-9.3	bp
↗ **Euro vs dollar**	1.12	▶	**1.13**	**+0.6**	%
↗ Gold (ounce, $)	1 350	▶	1 385	+2.6	%
↗ **Oil (Brent, $)**	62.2	▶	**64.3**	**+3.2**	%

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	**-0.37**	-0.25	at 07/06	-0.38	at 19/06
Euribor 3M	**-0.34**	-0.31	at 24/01	-0.34	at 20/06
Euribor 12M	**-0.21**	-0.11	at 06/02	-0.21	at 20/06
$ FED	**2.50**	2.50	at 01/01	2.50	at 01/01
Libor 3M	**2.39**	2.81	at 01/01	2.39	at 19/06
Libor 12M	**2.30**	3.04	at 21/01	2.25	at 14/06
£ BoE	**0.75**	0.75	at 01/01	0.75	at 01/01
Libor 3M	**0.78**	0.93	at 29/01	0.78	at 18/06
Libor 12M	**0.99**	1.19	at 11/01	0.97	at 10/06

At 20-6-19

Yield (%)		highest' 19		lowest' 19	
€ AVG 5-7y	**0.09**	0.68	at 09/01	0.09	at 20/06
Bund 2y	**-0.76**	-0.53	at 05/03	-0.76	at 18/06
Bund 10y	**-0.32**	0.25	at 01/01	-0.32	at 18/06
OAT 10y	**0.02**	0.73	at 08/01	0.00	at 18/06
Corp. BBB	**1.05**	2.15	at 08/01	1.05	at 20/06
$ Treas. 2y	**1.73**	2.62	at 18/01	1.73	at 20/06
Treas. 10y	**2.00**	2.78	at 18/01	2.00	at 20/06
Corp. BBB	**3.58**	4.65	at 01/01	3.58	at 20/06
£ Treas. 2y	**0.57**	0.83	at 27/02	0.52	at 07/06
Treas. 10y	**0.81**	1.35	at 18/01	0.80	at 18/06

At 20-6-19

10y bond yield & spreads

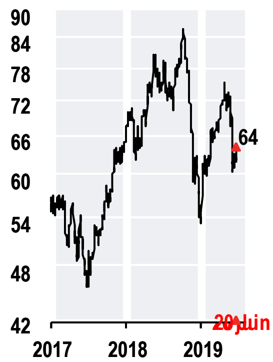
3.24%	Greece	356 pb
2.14%	Italy	246 pb
0.54%	Portugal	85 pb
0.39%	Spain	71 pb
0.08%	Belgium	40 pb
0.02%	France	33 pb
-0.04%	Austria	28 pb
-0.11%	Finland	20 pb
-0.13%	Ireland	19 pb
-0.15%	Netherland	17 pb
-0.32%	Germany	

Commodities

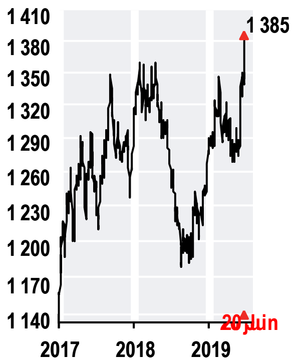
Spot price in dollars		lowest' 19			2019(€)
Oil, Brent	**64.3**	53.1	at	01/01	**+22.5%**
Gold (ounce)	**1 385**	1 268	at	02/05	**+9.4%**
Metals, LMEX	**2 800**	2 730	at	03/01	**+1.2%**
Copper (ton)	**5 961**	5 714	at	03/01	**+1.4%**
CRB Foods	**356**	324	at	07/03	**+11.0%**
wheat (ton)	**206**	167	at	10/05	**+5.8%**
Corn (ton)	**173**	128	at	24/04	**+28.5%**

At 20-6-19 *Variations*

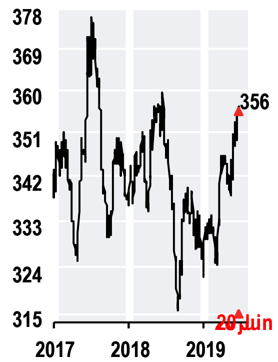
Oil (Brent, $)



Gold (Ounce, $)



CRB Foods



Exchange Rates

1€ =		highest' 19			lowest' 19			2019
USD	**1.13**	1.15	at	10/01	1.11	at	30/05	-1.2%
GBP	**0.89**	0.90	at	03/01	0.85	at	14/03	-0.9%
CHF	**1.11**	1.14	at	23/04	1.11	at	20/06	-1.6%
JPY	**121.42**	127.43	at	01/03	120.99	at	31/05	-3.2%
AUD	**1.63**	1.64	at	17/06	1.57	at	18/04	+0.5%
CNY	**7.73**	7.87	at	09/01	7.51	at	25/04	-1.4%
BRL	**4.33**	4.59	at	20/05	4.18	at	31/01	-2.2%
RUB	**71.16**	79.30	at	01/01	71.16	at	20/06	-10.3%
INR	**78.41**	82.00	at	04/02	76.84	at	03/04	-1.7%

At 20-6-19 *Variations*

Equity indices

	Index	highest' 19			lowest' 19			2019	2019(€)
CAC 40	**5 536**	5 592	at	23/04	4 611	at	03/01	+17.0%	**+17.0%**
S&P500	**2 954**	2 954	at	20/06	2 448	at	03/01	+17.8%	**+19.3%**
DAX	**12 355**	12 413	at	03/05	10 417	at	03/01	+17.0%	**+17.0%**
Nikkei	**21 463**	22 308	at	25/04	19 562	at	04/01	+7.2%	**+10.8%**
China*	**78**	86	at	09/04	68	at	03/01	+11.3%	**+12.9%**
India*	**595**	612	at	03/06	530	at	19/02	+6.2%	**+8.0%**
Brazil*	**2 201**	2 304	at	04/02	1 862	at	17/05	+12.2%	**+14.6%**
Russia*	**736**	736	at	20/06	572	at	01/01	+18.5%	**+30.3%**

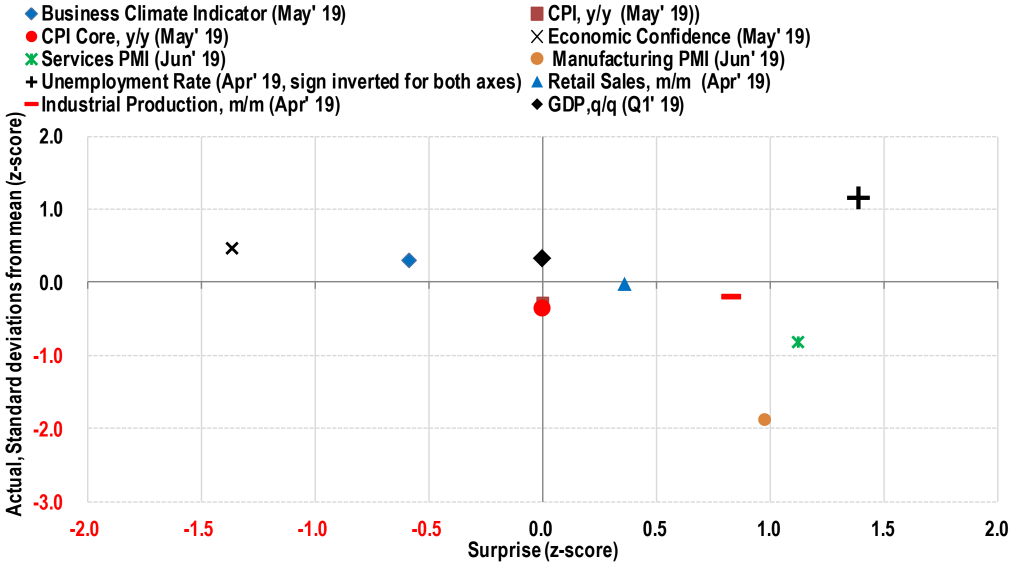
At 20-6-19 *Variations*

* MSCI index

Pulse

Eurozone: mixed signals

Despite a quite good 1st quarter 2019 in terms of economic growth (+0.4% q/q), the latest economic indicators sent mixed signals. Worries about the Purchasing Managers' Index (PMI) in the manufacturing sector remain despite its stabilization, at a low level, in June (47.8). In the services sector, the PMI seems to be unaffected by the manufacturing woes. The PMI Services is indeed still well above the 50 threshold (53.4) but below its long-term average. The economic background behind this resilience is favourable, especially regarding the good state of the labour market. The unemployment rate was better than expected and still below the historical average.



Source: Bloomberg, Markit, BNP Paribas

Indicators preview

Next week sees a heavy schedule with many data releases for the month of June: business climate in Germany, business confidence in France, consumer confidence in the US, Germany, France, the eurozone and the UK. We also have University of Michigan sentiment and the economic confidence indicator of the European Commission. Inflation data will be published in Germany and France. In Japan we have the unemployment rate and industrial production. In the US, non-defence capital goods order excluding aircraft will be monitored closely: this series, which is considered as a proxy for corporate investment, has been slowing in recent months.

Date	Country/Region	Event	Date	Survey	Prior
06/24/2019	Germany	IFO Business Climate	June	--	97.9
06/25/2019	France	Business Confidence	June	--	106
06/25/2019	United States	New Home Sales MoM	May	1.8%	-6.9%
06/25/2019	United States	Conf. Board Consumer Confidence	June	132.0	134.1
06/26/2019	Germany	GfK Consumer Confidence	July	--	10.1
06/26/2019	France	Consumer Confidence	June	--	99
06/26/2019	United States	Cap Goods Orders Nondef Ex Air	May	0.0%	-1.0%
06/27/2019	Eurozone	Economic Confidence	June	--	105.1
06/27/2019	Eurozone	Consumer Confidence	June	--	--
06/27/2019	Germany	CPI EU Harmonized MoM	June	--	0.3%
06/27/2019	United States	GDP Annualized QoQ	1Q	3.2%	3.1%
06/27/2019	Germany	Retail Sales MoM	May	--	-2.0%
06/28/2019	United Kingdom	GfK Consumer Confidence	June	--	-10
06/28/2019	Japan	Jobless Rate	May	--	2.4%
06/28/2019	Japan	Industrial Production MoM	May	--	0.6%
06/28/2019	France	CPI EU Harmonized MoM	June	--	0.1%
06/28/2019	United Kingdom	GDP QoQ	1Q	--	0.5%
06/28/2019	United States	Personal Income	May	0.3%	0.5%
06/28/2019	United States	Personal Spending	May	0.5%	0.3%
06/28/2019	United States	University of Michigan Sentiment	June	--	97.9

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						
End of period		Q1	Q2e	Q3e	Q4e	2018	2019e	2020e
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						
End of period		Q1	Q2e	Q3e	Q4e	2018	2019e	2020e
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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