ECOWEEK

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When environmental, trade and social policies meet

■The recent "economists' statement on carbon dividends" offers important policy prescriptions for the US to address global warming ■It explicitly refers to the need for a border carbon adjustment system so as to maintain competitiveness versus countries that would not have introduced a carbon tax ■The authors recommend that the carbon tax proceeds be equally distributed to US citizens ■It could be envisaged to use these proceeds in a way which takes into account the distributional aspects of environmental taxes whilst promoting energy efficiency investments

On 17 January The Wall Street Journal published the "Economists' statement on carbon dividends"[1]. It managed to grab the attention if only because of the impressive list of co-signatories[2]. They consider that a carbon tax is the most cost-effective instrument to reduce carbon emissions to a sufficient degree and pace, that it should replace less efficient regulations and that it should be increased every year until the emission reduction goals are met.

This gradualist approach should give households and companies time to adjust their behaviour and finance the necessary investments (heating, means of transportation, manufacturing processes). It implies that the cumulative increase in the carbon tax would depend on the price sensitivity of the demand for carbon intensive goods and services. The higher this sensitivity, the lower the required increase in the carbon tax.

Ideally such an approach should be adopted globally but experience has shown the difficulty of coming to a broad-based agreement and stick to it[3]. It implies that single-country measures would weaken the competitiveness of its companies and create an incentive for other countries not to do anything.

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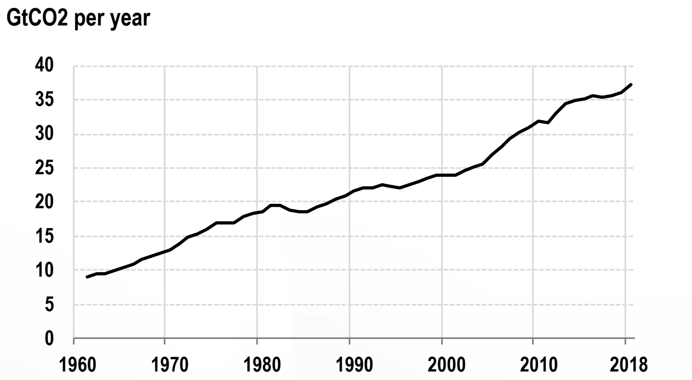
CLIMATE: CO2 EMISSIONS CONTINUE TO GROW



Source: Global Carbon Project

[1] https://www.clcouncil.org/economists-statement/
[2] The signatories include 4 former chairs of the Federal Reserve, 27 Nobel laureate economists, 15 chairs of the Council of Economic Advisers and 2 former Secretaries of the US Department of Treasury.
[3] In June 2016, the decision of Donald Trump to pull the US out of the COP21 agreement reached in Paris is just one illustration amongst many of the difficulties to come to a coordinated global approach.

ECONOMIC RESEARCH DEPARTMENT

To address this coordination problem, the signatories call for the establishment of a border carbon adjustment system in which exports to countries which do not apply a carbon tax would receive a rebate whereas imports from these countries would be taxed when entering the country[4,5]. There is a concern however that other countries would consider a carbon tax on imports as a protectionist measure which has little to do with climate change, triggering retaliation measures.

The signatories also argue that it should be revenue neutral in order to avoid debates over the size of government and for this reason *"all the revenue should be returned directly to U.S. citizens through equal lump-sum rebates"*, the so-called carbon dividend. Considering that, quite likely, the carbon footprint of wealthier households is bigger than that of households at the lower end of the income distribution, an equal lump-sum rebate would imply that the latter would see an increase of their disposable income considering that the lump-sum rebate would be higher than the carbon taxes. This could create an incentive or at least facilitate energy efficiency investments on their behalf.

It can be argued however that the revenue neutrality is a matter of judgment. The government could consider it has an important role to play in fostering energy efficiency so it could use (part of) the carbon tax revenues to finance its own green investments (e.g. increase the energy efficiency of public buildings and schools). Alternatively they could be used to address the income distribution aspects of green taxation by e.g. subsidising energy efficiency investments of financially constrained households.

Clearly, these alternative approaches are less easy to explain than a lump-sum rebate for every household. The recommendations of the Economists' statement have the merit of replacing often complex existing regulations. In addition they show a direction which would allow to make considerable progress in terms of carbon emission reduction, at the initiative of a single country, thereby avoiding losing considerable time in addressing the international coordination problem, and with the added advantage of being able to take into account the distributional aspects as well.

William De Vijlder

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4 Climate Leadership Council, *The conservative case for carbon dividends,* February 2017. The wording is reminiscent of the "destination-based border-adjusted cash flow tax" as proposed by Republican members of the House of Representatives in the US in 2017, which would have acted as the combination of an export subsidy and an import tariff.

5 This is also discussed in a forthcoming article "Getting to a low carbon economy" of Raymond Van der Putten in Conjoncture (BNP Paribas) on January 2019.

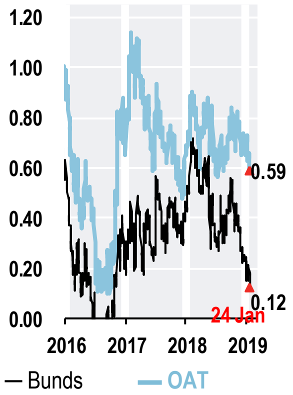
Markets overview

The essentials

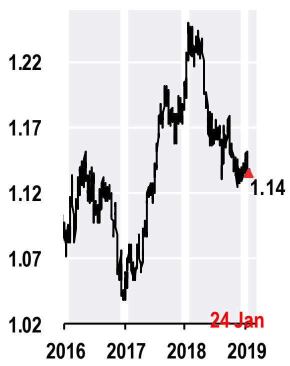
Week 18-1 19 > 24-1-19

↘ **CAC 40**	4 876	▸	**4 872**	**-0.1**	**%**
↘ **S&P 500**	2 671	▸	**2 642**	**-1.1**	**%**
↗ Volatility (VIX)	17.8	▸	18.9	+1.1	pb
↗ **Euribor 3M (%)**	-0.31	▸	**-0.31**	**+0.2**	**bp**
↗ Libor $ 3M (%)	2.76	▸	2.77	+1.0	bp
↘ OAT 10y (%)	0.66	▸	0.59	-6.8	bp
↘ Bund 10y (%)	0.21	▸	0.12	-9.0	bp
↘ US Tr. 10y (%)	2.78	▸	2.71	-7.0	bp
↘ **Euro vs dollar**	1.14	▸	**1.14**	**-0.1**	**%**
↘ Gold (ounce, $)	1 284	▸	1 283	-0.1	%
↘ **Oil (Brent, $)**	62.7	▸	**61.0**	**-2.6**	**%**

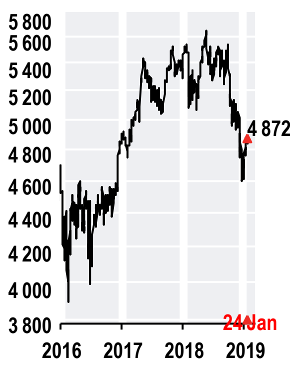
10 y **bond yield, OAT vs Bund**



Euro-dollar



CAC 40



Money & Bond Markets

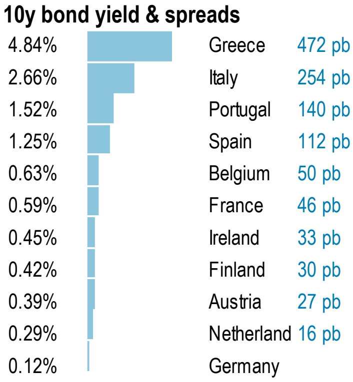
Interest Rates		highest' 19		lowest' 19	
€ ECB	**0.00**	0.00	at 01/01	0.00	at 01/01
Eonia	**-0.37**	-0.36	at 01/01	-0.37	at 18/01
Euribor 3M	**-0.31**	-0.31	at 24/01	-0.31	at 02/01
Euribor 12M	**-0.12**	-0.12	at 21/01	-0.12	at 02/01
$ FED	**2.50**	2.50	at 01/01	2.50	at 01/01
Libor 3M	**2.77**	2.81	at 01/01	2.76	at 18/01
Libor 12M	**3.04**	3.04	at 21/01	2.96	at 04/01
£ BoE	**0.75**	0.75	at 01/01	0.75	at 01/01
Libor 3M	**0.92**	0.93	at 15/01	0.90	at 07/01
Libor 12M	**1.17**	1.19	at 11/01	1.16	at 22/01

At 24-1-19

Yield (%)		highest' 19		lowest' 19	
€ AVG 5-7y	**0.50**	0.68	at 09/01	0.50	at 24/01
Bund 2y	**-0.59**	-0.57	at 08/01	-0.62	at 03/01
Bund 10y	**0.12**	0.25	at 01/01	0.12	at 24/01
OAT 10y	**0.59**	0.73	at 08/01	0.59	at 24/01
Corp. BBB	**1.95**	2.15	at 08/01	1.95	at 24/01
$ Treas. 2y	**2.56**	2.62	at 18/01	2.39	at 03/01
Treas. 10y	**2.71**	2.78	at 18/01	2.55	at 03/01
Corp. BBB	**4.47**	4.65	at 01/01	4.47	at 24/01
£ Treas. 2y	**0.76**	0.82	at 14/01	0.68	at 03/01
Treas. 10y	**1.27**	1.35	at 18/01	1.18	at 03/01

At 24-1-19

10y bond yield & spreads

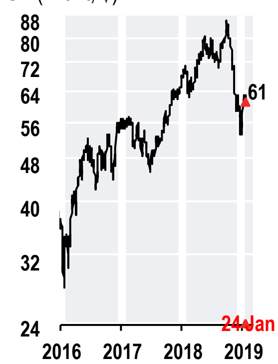


Commodities

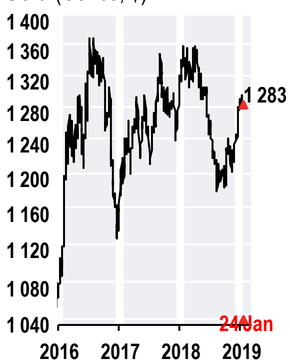
Spot price in dollars		lowest' 19			2019(€)
Oil, Brent	**61.0**	53.1	at	01/01	**+15.7%**
Gold (ounce)	**1 283**	1 281	at	21/01	**+0.8%**
Metals, LMEX	**2 865**	2 730	at	03/01	**+3.0%**
Copper (ton)	**5 894**	5 714	at	03/01	**-0.2%**
CRB Foods	**332**	324	at	01/01	**+3.2%**
wheat (ton)	**203**	197	at	01/01	**+3.7%**
Corn (ton)	**138**	136	at	01/01	**+1.9%**

At 24-1-19 *Variations*

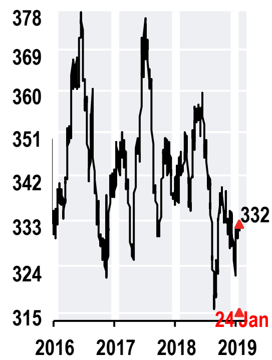
Oil (Brent, $)



Gold (Ounce, $)



CRB Foods



Exchange Rates

1€ =		highest' 19			lowest' 19			2019
USD	**1.14**	1.15	at	10/01	1.14	at	24/01	**-0.7%**
GBP	**0.87**	0.90	at	03/01	0.87	at	24/01	-3.0%
CHF	**1.13**	1.13	at	21/01	1.12	at	02/01	+0.2%
JPY	**124.42**	125.42	at	01/01	122.54	at	03/01	-0.8%
AUD	**1.60**	1.63	at	03/01	1.58	at	18/01	-1.6%
CNY	**7.71**	7.87	at	09/01	7.69	at	18/01	-1.7%
BRL	**4.27**	4.43	at	01/01	4.24	at	09/01	-3.7%
RUB	**74.65**	79.30	at	01/01	74.65	at	24/01	-5.9%
INR	**80.80**	81.21	at	14/01	79.57	at	04/01	+1.2%

At 24-1-19 *Variations*

Equity indices

	Index	highest' 19			lowest' 19			2019	2019(€)
CAC 40	**4 872**	4 876	at	18/01	4 611	at	03/01	+3.0%	**+3.0%**
S&P500	**2 642**	2 671	at	18/01	2 448	at	03/01	+5.4%	**+6.1%**
DAX	**11 130**	11 206	at	18/01	10 417	at	03/01	+5.4%	**+5.4%**
Nikkei	**20 575**	20 719	at	21/01	19 562	at	04/01	+2.8%	**+3.6%**
China*	**75**	76	at	21/01	68	at	03/01	+6.5%	**+7.1%**
India*	**548**	559	at	01/01	543	at	14/01	+0.2%	**-1.0%**
Brazil*	**2 225**	2 225	at	24/01	1 944	at	01/01	+11.0%	**+15.2%**
Russia*	**633**	633	at	24/01	572	at	01/01	+5.7%	**+11.5%**

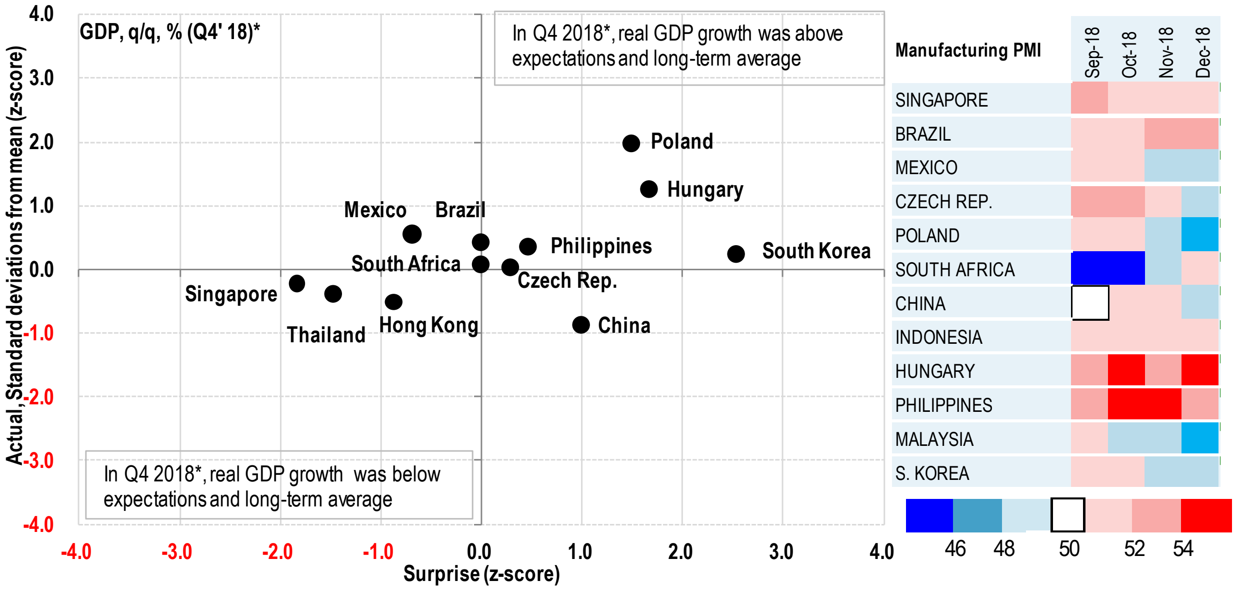
At 24-1-19 *Variations*

* MSCI index

Pulse

China: Economic growth slowdown worsened in Q4 2018

In China, real GDP growth slowed to 6.4% in Q4 2018 year-on-year from 6.5% in Q3. The slowdown in the industrial sector worsened in Q4 while growth in the services sector remains more dynamic. Regarding demand components, exports have weakened markedly in the two last months of 2018, mostly due to the impact of US tariff hikes on imports of Chinese goods. Growth in household consumption has continued to decelerate (especially in the car market). Meanwhile, investment growth has picked up slightly, mainly in the infrastructure sector, in response to stimulus policy measures. Export growth prospects remain dark in the very short term and then will depend on the possible trade deals that Beijing and Washington will be able to sign in the coming weeks. Domestic demand growth should be increasingly supported by counter-cyclical economic policies. Nonetheless, China's economic growth will continue to slow in 2019 and remain below its long-term average.



* Q3' 18: Brazil, Czech Rep., Hong Kong, Hungary, Poland, Thailand, South Africa, Mexico

Indicators preview

A very busy schedule next with the much attended FOMC meeting and in particular Jerome Powell's press conference and the possible change in guidance it may bring. The US, the eurozone and France will publish GDP growth for Q4 2018 and several countries will release the January data on consumer confidence (France, US, Japan, Germany, eurozone, UK). In addition we will also have economic confidence in the eurozone, the Markit PMI and, in the US, the ISM. Most importantly, we will see the publication of the US labour market data for January. By the end of next week we will not only have a good picture of how we finished 2018 but also how we started the new year.

Date	Country/Region	Event	Period	Surv(M)	Prior
01/29/19	France	Consumer Confidence	Jan	--	87
01/29/19	United States	Conf. Board Consumer Confidence	Jan	126.3	128.1
01/30/19	Japan	Consumer Confidence Index	Jan	--	42.7
01/30/19	France	GDP QoQ	4Q	--	0.3%
01/30/19	Germany	GfK Consumer Confidence	Feb	--	10.4
01/30/19	Eurozone	Economic Confidence	Jan	--	107.3
01/30/19	Eurozone	Consumer Confidence	Jan	--	--
01/30/19	Germany	CPI EU Harmonized MoM	Jan	--	0.3%
01/30/19	United States	GDP Annualized QoQ	4Q	2.7%	3.4%
01/30/19	United States	FOMC Rate Decision (Upper Bound)	janv-30	2.50%	2.50%
01/31/19	United Kingdom	GfK Consumer Confidence	Jan	--	-14
01/31/19	France	CPI EU Harmonized MoM	Jan	--	0.1%
01/31/19	Eurozone	Unemployment Rate	Dec	--	7.9%
01/31/19	Eurozone	GDP SA QoQ	4Q	--	0.2%
02/01/2019	Japan	Jobless Rate	Dec	--	2.5%
02/01/2019	France	Markit France Manufacturing PMI	Jan	--	--
02/01/2019	Eurozone	Markit Eurozone Manufacturing PMI	Jan	--	--
02/01/2019	United States	Change in Nonfarm Payrolls	Jan	163000	312000
02/01/2019	United States	ISM Manufacturing	Jan	54.0	54.1
02/01/2019	United States	University of Michigan Sentiment	Jan	--	90.7

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	2.5	2.0	2.0
Euro Area	**1.9**	**1.4**	**1.2**	**1.7**	**1.8**	**1.5**
Germany	1.6	1.5	1.3	1.8	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	1.7	1.7	1.3
Emerging	**5.9**	**5.9**	**5.7**	**2.7**	**2.7**	**3.1**
China	6.6	6.2	6.0	2.1	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						
End of period		Q4	Q1e	Q2e	Q3e	Q4e	2018	2019e	2020e
US	Fed Funds	2.50	2.75	3.00	3.00	3.00	2.50	3.00	3.00
	Libor 3m $	2.81	2.90	3.05	3.05	3.05	2.81	3.05	2.80
	T-Notes 10y	2.69	3.30	3.40	3.45	3.50	2.69	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	-0.31	-0.30	-0.25	-0.20	-0.15	-0.31	-0.15	0.00
	Bund 10y	0.25	0.55	0.60	0.80	1.00	0.25	1.00	0.90
	OAT 10y	0.71	0.95	1.00	1.10	1.25	0.71	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	1.27	1.70	1.85	2.00	2.10	1.27	2.10	2.10
Japan	BoJ Rate	-0.07	-0.10	-0.10	-0.10	-0.10	-0.07	-0.10	-0.10
	JGB 10y	0.00	0.15	0.15	0.15	0.14	0.00	0.14	0.08

Source : BNP Paribas GlobalMarkets (e: Forecasts)

Exchange Rates			2019						
End of period		Q4	Q1e	Q2e	Q3e	Q4e	2018	2019e	2020e
USD	EUR / USD	1.14	1.15	1.17	1.21	1.25	1.14	1.25	1.34
	USD / JPY	110	110	108	105	100	110	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	125	127	126	127	125	125	125	121

Source : BNP Paribas GlobalMarkets (e: Forecasts)

GROUP ECONOMIC RESEARCH

William DE VIJLDER 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
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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 CHOULET	+33.(0)1.43.16.95.54	celine.choulet@bnpparibas.com
Thomas HUMBLOT	+33.(0)1.40.14.30.77	thomas.humblot@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 HAMMAD 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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