ECOWEEK

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US: the signal and the noise

■ Asset prices can play a useful role when assessing the economic outlook ■ The big drop in treasury yields during August has raised concern although a nowcast points to satisfactory third quarter growth in the US. This would mean that increased uncertainty about the trade dispute has caused a flight to safe havens and a decline in long term interest rates ■ Swings in the communication about the trade dispute cause swings in investor uncertainty and hence in risk premiums. This reduces the signal quality of asset prices, which may end up weighing on the real economy

In theory, asset prices are an important input when analysing the economic outlook: 1) they can influence spending (e.g. when bond yields decline) 2) they reflect investor expectations 3) they are available on a timely basis. The temptation to give more weight to asset prices grows when the visibility about the true state of the economy is limited (i.e. when traditional data provide conflicting messages) or when things are moving quickly. Against this background, the considerable decline in bond yields in August has been a source concern. Firstly, because it caused an inversion of the US treasury curve, which in the past has been followed - with varying delays- by a recession. Secondly, it could also be interpreted as reflecting a significant downward adjustment of growth expectations by bond market investors. This interpretation is however not borne out by the data published in August. As shown in the chart, the nowcast[1] for real US GDP growth for the third quarter has fluctuated in a narrow range and, more recently, has been moving higher, reaching a respectable 2.3%.

What could explain the huge drop in treasury yields? A possible reason is that, irrespective of the data released so far this quarter, investors have become more pessimistic about the outlook for the subsequent quarters. Such an adjustment of expectations could happen because of a bad news shock, such as an increase in uncertainty or a hawkish comment by a central bank official.

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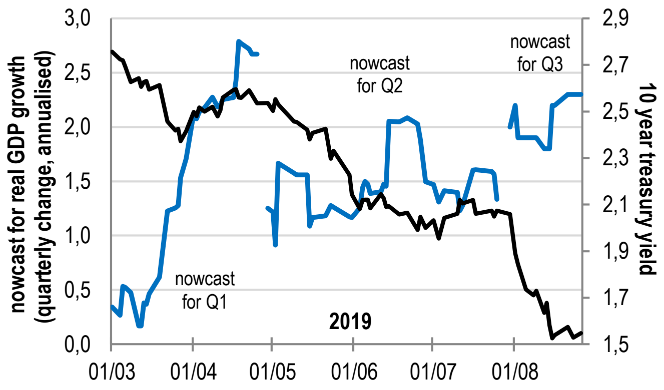
NOWCAST FOR US REAL GDP GROWTH AND 10 YEAR TREASURY YIELD



Source: Federal Reserve Bank of Atlanta, Datastream, BNP Paribas

[1] A general description of nowcast is "*the prediction of the present, the very near future and the very recent past. The term is a contraction for now and forecasting and has been used for a long-time in meteorology and recently also in economics.*" (source: Now-casting and the real-time data flow, Marta Bańbura, Domenico Giannone, Michele Modugno and Lucrezia Reichlin, ECB working paper 1564, July 2013). The nowcast of the Federal Reserve Bank of Atlanta is a model-based estimate of current quarter real GDP growth based on data released for this quarter. No subjective adjustments are made.

ECONOMIC RESEARCH DEPARTMENT

The latter factor is not applicable, quite on the contrary: the Federal Reserve has eased policy and has hinted that more rate cuts could come, so this leaves us with uncertainty as a possible explanation. Given the announcements made by President Trump about further tariff increases targeting China, and the Chinese retaliation more recently, assessing the economic outlook has, quite understandably, become more difficult. This has fuelled the demand for safe assets and caused a decline in bond yields, driving the term premium[2] of US treasuries further and further into negative territory. The phenomenon was global and has seen 10 year Bund yields reaching -70 basis points. This dynamic has probably been reinforced by the decline and increased volatility of equity markets, pushing asset allocators to buy government bonds or increase duration, hoping that declining bond yields and hence bond price appreciation would compensate for a decline in equity markets. Another factor is that investors with long-dated liabilities such as insurance companies or pension funds are forced to increase their bond exposure when yields decline, considering that this decline increases the net present value of their liabilities.[3]

Past tariff increases and the uncertainty about the outcome of the trade dispute between the US and China, make the interpretation of economic data more complex: to which extent do they e.g. explain the slowdown in exports or company investments? In addition, interpreting the development of asset prices becomes more difficult as price changes are dominated by important, uncertainty-driven swings in risk premiums, depending on the statements which are made. When the signal becomes less clear and the statistical noise increases, greater caution may very well prevail and hence weigh on the economy.

William De Vijlder

[2] The term premium is the risk premium which the investor receives for taking duration risk by investing in longer maturities. When it is negative, the investor pays for taking this risk.
[3] According to Aon Hewitt, a consulting company, falling bond yields over the summer have caused an increase of Dutch pension fund liabilities of 4% (source: IPE, Dutch schemes headed for right cuts after dramatic funding drop, 12 August 2019).

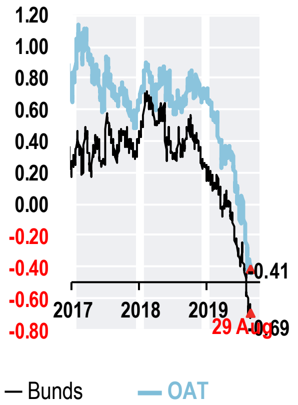
Markets overview

The essentials

Week 23-8 19 > 29-8-19

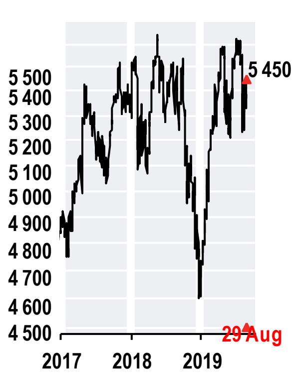
↗ **CAC 40**	5 327	▶	**5 450**	**+2.3**	%
↗ **S&P 500**	2 847	▶	**2 925**	**+2.7**	%
↘ Volatility (VIX)	19.9	▶	17.9	-2.0	pb
↘ **Euribor 3M** (%)	-0.41	▶	**-0.43**	**-1.6**	bp
↘ Libor $ 3M (%)	2.14	▶	2.12	-2.0	bp
↘ OAT 10y (%)	-0.37	▶	-0.41	-4.0	bp
↘ Bund 10y (%)	-0.67	▶	-0.69	-2.5	bp
↘ US Tr. 10y (%)	1.53	▶	1.52	-0.7	bp
↘ **Euro vs dollar**	1.11	▶	**1.11**	**-0.4**	%
↗ Gold (ounce, $)	1 534	▶	1 537	+0.2	%
↗ **Oil (Brent, $)**	59.0	▶	**60.7**	**+2.8**	%

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	**-0.43**	-0.31	at 24/01	-0.43	at 29/08
Euribor 12M	**-0.38**	-0.11	at 06/02	-0.40	at 21/08
$ FED	**2.25**	2.50	at 01/01	2.25	at 01/08
Libor 3M	**2.12**	2.81	at 01/01	2.12	at 27/08
Libor 12M	**1.95**	3.04	at 21/01	1.93	at 15/08
£ BoE	**0.75**	0.75	at 01/01	0.75	at 01/01
Libor 3M	**0.76**	0.93	at 29/01	0.76	at 13/08
Libor 12M	**0.83**	1.19	at 11/01	0.82	at 13/08

At 29-8-19

Yield (%)		highest' 19		lowest' 19	
€ AVG 5-7y	**-0.34**	0.68	at 09/01	-0.34	at 29/08
Bund 2y	**-0.90**	-0.53	at 05/03	-0.91	at 15/08
Bund 10y	**-0.69**	0.25	at 01/01	-0.72	at 28/08
OAT 10y	**-0.41**	0.73	at 08/01	-0.44	at 28/08
Corp. BBB	**0.64**	2.15	at 08/01	0.64	at 28/08
$ Treas. 2y	**1.55**	2.62	at 18/01	1.48	at 16/08
Treas. 10y	**1.52**	2.78	at 18/01	1.47	at 28/08
Corp. BBB	**3.20**	4.65	at 01/01	3.17	at 28/08
£ Treas. 2y	**0.41**	0.83	at 27/02	0.40	at 28/08
Treas. 10y	**0.36**	1.35	at 18/01	0.36	at 29/08

At 29-8-19

10y bond yield & spreads

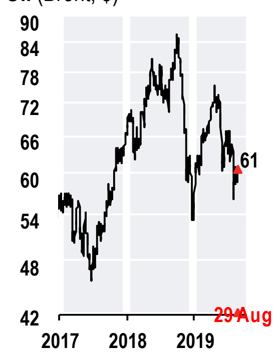
2.19%	Greece	288 pb
0.99%	Italy	168 pb
0.13%	Portugal	82 pb
0.12%	Spain	80 pb
-0.34%	Ireland	35 pb
-0.35%	Belgium	34 pb
-0.41%	France	27 pb
-0.43%	Austria	25 pb
-0.49%	Finland	19 pb
-0.55%	Netherland	14 pb
-0.69%	Germany	

Commodities

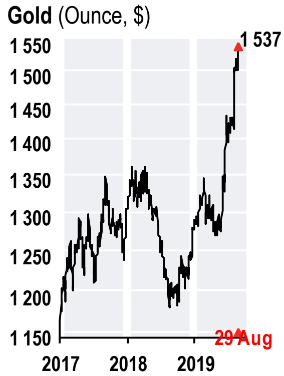
Spot price in dollars		lowest' 19			2019(€)
Oil, Brent	**60.7**	53.1	at	01/01	**+18.0%**
Gold (ounce)	**1 537**	1 268	at	02/05	**+23.9%**
Metals, LMEX	**2 735**	2 718	at	07/08	**+0.9%**
Copper (ton)	**5 710**	5 613	at	23/08	**-0.8%**
CRB Foods	**320**	320	at	29/08	**+2.0%**
wheat (ton)	**173**	167	at	10/05	**-9.2%**
Corn (ton)	**140**	128	at	24/04	**+6.3%**

At 29-8-19 *Variations*

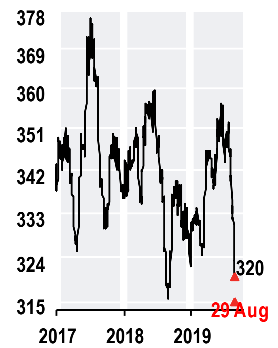
Oil (Brent, $)



Gold (Ounce, $)



CRB Foods



Exchange Rates

1€ =		highest' 19			lowest' 19			2019
USD	**1.11**	1.15	at	10/01	1.11	at	01/08	-3.2%
GBP	**0.91**	0.93	at	12/08	0.85	at	14/03	+1.0%
CHF	**1.09**	1.14	at	23/04	1.08	at	15/08	-3.3%
JPY	**117.80**	127.43	at	01/03	117.30	at	28/08	-6.1%
AUD	**1.64**	1.66	at	07/08	1.57	at	18/04	+1.3%
CNY	**7.91**	7.96	at	27/08	7.51	at	25/04	+0.8%
BRL	**4.61**	4.63	at	27/08	4.18	at	31/01	+4.1%
RUB	**73.80**	79.30	at	01/01	70.26	at	24/07	-6.9%
INR	**79.43**	82.00	at	04/02	76.37	at	01/08	-0.5%

At 29-8-19 *Variations*

Equity indices

	Index	highest' 19			lowest' 19			2019	2019(€)
CAC 40	**5 450**	5 621	at	04/07	4 611	at	03/01	+15.2%	**+15.2%**
S&P500	**2 925**	3 026	at	26/07	2 448	at	03/01	+16.7%	**+20.5%**
DAX	**11 839**	12 630	at	04/07	10 417	at	03/01	+12.1%	**+12.1%**
Nikkei	**20 461**	22 308	at	25/04	19 562	at	04/01	+2.2%	**+8.8%**
China*	**74**	86	at	09/04	68	at	03/01	+5.2%	**+8.3%**
India*	**538**	612	at	03/06	526	at	22/08	-0.7%	**-0.3%**
Brazil*	**2 019**	2 354	at	10/07	1 862	at	17/05	+11.7%	**+7.3%**
Russia*	**676**	747	at	04/07	572	at	01/01	+14.3%	**+22.1%**

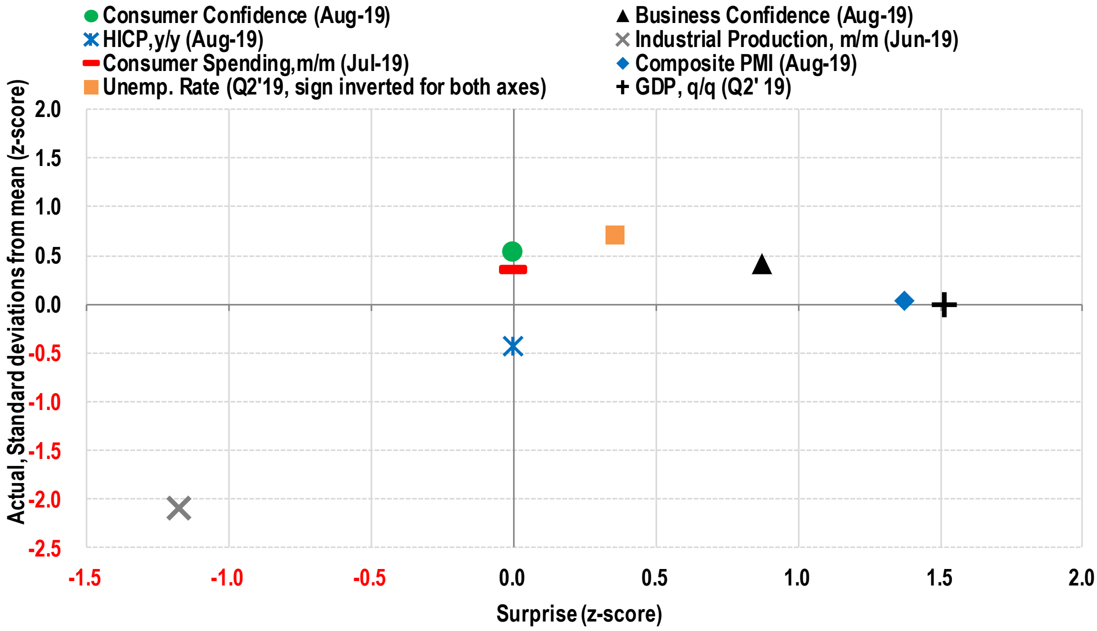
At 29-8-19 *Variations*

* MSCI index

Pulse

France: reassuring data amidst increased risks

Our pulse indicators continue to send a positive signal: stability of the INSEE business and consumer confidence surveys in August, even a slight improvement in the composite PMI; a more important than expected fall in Q2 unemployment rate (-0.2 points, at 8.5%); a small but solid rebound in July consumer spending on goods (+0.4% m/m); a slight upward revision of the second estimate of Q2 GDP growth (+0.1 point, at 0.3% q/q), thus running at the same rate as in Q1. These signs of good performance of the French economy are noteworthy while uncertainties and worrying signals have been building up on the external front. In this context, even if the latest economic news is reassuring, risks on Q3 French growth remain on the downside.



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

Indicators preview

As always, the start of the month is very rich in terms of data releases. We will have the manufacturing, services and composite PMIs for a large number of countries, as well as the ISM indices in the US. In the eurozone, a new estimate for second quarter growth will be published. The Beige Book of the Federal Reserve will provide a detailed picture of the US economy, but the highlight of the week are of course the labour market data. Given its declining trend in recent months, the length of the workweek (average weekly hours) should get some attention as well.

Date	Region	Event	Period	Survey	Prior
09/02/2019	China	Caixin China PMI Mfg	August	49.8	49.9
09/02/2019	France	Markit France Manufacturing PMI	August	51.0	51.0
09/02/2019	Eurozone	Markit Eurozone Manufacturing PMI	August	47.0	47.0
09/03/2019	United States	ISM Manufacturing	August	51.5	51.2
09/04/2019	China	Caixin China PMI Composite	August	--	50.9
09/04/2019	France	Markit France Composite PMI	August	--	52.7
09/04/2019	Eurozone	Markit Eurozone Composite PMI	August	51.8	51.8
09/04/2019	Eurozone	Retail Sales MoM	July	-0.5%	1.1%
09/04/2019	United States	U.S. Federal Reserve Releases Beige Book			
09/05/2019	Germany	Factory Orders MoM	July	-1.3%	2.5%
09/05/2019	United States	Durable Goods Orders	July	--	2.1%
09/05/2019	United States	ISM Non-Manufacturing Index	August	53.6	53.7
09/06/2019	France	Trade Balance	July	--	-5.187e+09
09/06/2019	Eurozone	GDP SA QoQ	2Q	0.2%	0.2%
09/06/2019	United States	Change in Nonfarm Payrolls	August	165000	164000
09/06/2019	United States	Unemployment Rate	August	3.7%	3.7%
09/06/2019	United States	Average Weekly Hours All Employees	August	34.4	34.3

Source: Bloomberg, BNP Paribas

GROUP ECONOMIC RESEARCH

William De Vijlder Chief Economist	+33 1 55 77 47 31	william.devijlder@bnpparibas.com
ADVANCED ECONOMIES AND STATISTICS		
Jean-Luc Proutat Head – United States, United Kingdom	+33 1 58 16 73 32	jeanluc.proutat@bnpparibas.com
Hélène Baudchon France – Labour markets	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com
Louis Boisset European Central Bank watch, Euro area global view, Japan	+33 1 57 43 02 91	louis.boisset@bnpparibas.com
Frédérique Cerisier Euro area (European gouvernance and public finances), Spain, Portugal	+33 1 43 16 95 52	frederique.cerisier@bnpparibas.com
Catherine Stephan Nordic countries – World trade – Education, health, social conditions	+33 1 55 77 71 89	catherine.stephan@bnpparibas.com
Raymond Van Der Putten Germany, Netherlands, Austria, Switzerland – Energy, climate – Long-term projections	+33 1 42 98 53 99	raymond.vanderputten@bnpparibas.com
Tarik Rharrab Statistics	+33 1 43 16 95 56	tarik.rharrab@bnpparibas.com
BANKING ECONOMICS		
Laurent Quignon Head	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Laure Baquero	+ 33 1 43 16 95 50	laure.baquero@bnpparibas.com
Céline Choulet	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
Thomas Humblot	+ 33 1 40 14 30 77	thomas.humblot@bnpparibas.com
EMERGING ECONOMIES AND COUNTRY RISK		
François Faure Head	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Christine Peltier Deputy Head – Greater China, Vietnam, South Africa	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Stéphane Alby Africa (French-speaking countries)	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Sylvain Bellefontaine Turkey, Ukraine, Central European countries	+33 1 42 98 26 77	sylvain.bellefontaine@bnpparibas.com
Sara Confalonieri Africa (Portuguese & English-speaking countries)	+33 1 42 98 43 86	sara.confalonieri@bnpparibas.com
Pascal Devaux Middle East, Balkan countries	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot Korea, Thailand, Philippines, Mexico, Andean countries	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
Salim Hammad Latin America	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Johanna Melka India, South Asia, Russia, Kazakhstan, CIS	+33 1 58 16 05 84	johanna.melka@bnpparibas.com
CONTACT MEDIA		
Michel Bernardini	+33 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 :

www.group.bnpparibas.com

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