ECOWEEK

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Elevated uncertainty slows growth despite lower rates

■Business surveys in the US paint a diverging picture: manufacturing is worsening significantly but services have picked up nicely. Taking a broader perspective, evidence is building of a slowing economy ■Less dynamic growth can be observed in engines of growth of the world economy: China and India, although reasons differ ■In Europe, Germany is probably already in a technical recession whereas France is resilient ■Central banks are back in easing mode but the effectiveness will be hampered by elevated uncertainty, despite the announcement of a new round of trade negotiations between the US and China

The global manufacturing slowdown has finally reached the US. The latest Institute for Supply Management's report for this sector provides sobering reading. The overall index dropped 2.1 percentage points to 49.1 with the new orders component as well as the employment index registering even bigger declines.

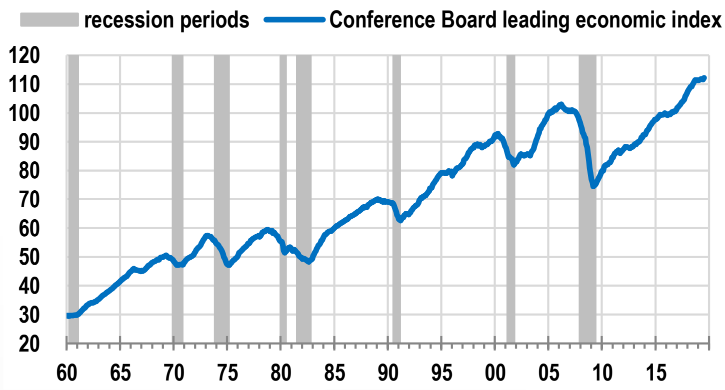
More telling are the comments from survey respondents. In the chemical products sector business is still strong but "*there is an undercurrent of fear and alarm regarding the trade wars and a potential recession*." Somebody from the machinery sector stated that "*business is starting to show signs of a broad slowdown*." One manufacturer commented that "*we continue to plan for a hard Brexit and a long trade war between the U.S. and China*."

Other sectors were however more positive, something which is echoed in the Federal Reserve's Beige Book[1]: "*the economy expanded at a modest pace through the end of August. Although concerns regarding tariffs and trade policy uncertainty continued, the majority of businesses remained optimistic about the near-term outlook.*" Those who want to argue that the glass is still half full can refer to the non-manufacturing ISM index, which in August jumped 2.7 percentage points to a healthy 56.4%. Yet, when taking a broader perspective, it is clear there is more at work than tariff-related shocks and uncertainty which are hitting the manufacturing sector: the underlying trend is one of slowing growth. Analyst forecasts of corporate profits have been scaled back, which doesn't bode well for company investments. Growth in residential construction has been negative in recent quarters on the back of a declining trend in affordability and it is unlikely this will change in the near term. For household spending, a lot will depend on how the labour market is doing. For the moment, it remains rather strong although job creations in August came in below expectations.

.../...

[1] The Beige Book is a publication of the Federal Reserve System. It provides a description of current economic conditions and prospects across the 12 Federal Reserve Districts. Anecdotal information gathered by each Federal Reserve Bank is a key input for this report.

THE CONFERENCE BOARD LEADING ECONOMIC INDEX



Source: Conference Board, NBER, BNP Paribas

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Eco WEEK

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

The bank for a changing world

Looking beyond the US, evidence of slower growth continues is mounting. In China, the slowdown is accelerating as the country is confronted with an uncomfortable combination of a trade conflict with the US, a need to rebalance the economy away from being export and investment-led to becoming consumer led, increasingly cautious households and a policy mix which needs to find a balance between need for stimulus and keeping an eye on stability goals. This implies that monetary policy easing will be gradual and prudent whereas currency depreciation should remain moderate. Fiscal policy on the other hand is supportive for growth. India is also seeing a significant weakening of growth: households adopt a more cautious stance on the back of rising unemployment, declining confidence and a deceleration in non-bank credit.

In the eurozone, German data continue to deteriorate, with a still considerable difference between the manufacturing sector and services, which had been resilient until quite recently. The latest Ifo report also showed a deterioration in services. The Bundesbank also reported that the problems faced by the manufacturing sector were starting to spread to the broader economy. Growth in France however continues to be resilient. In Italy the formation of a new government, has been met with relief because new elections have been avoided. The positive market reaction should provide some support for an economy which is growing at a very slow pace. Finally, in the UK, Brexit uncertainty remains huge acts more and more as a lid on the economy.

Over the summer months, the demand for safe assets has been boosted by the combination of slowing global growth, the prospect of generalised central bank easing and further increases in uncertainty. Risk hedging strategies have acted as an accelerator, causing a big drop in treasury yields in August which was disproportionate given the data released during the month. This had global repercussions and in the eurozone, 10 year Bund yields even dropped below -70 basis points at some point. The German government even issued a 30 year bond with a negative yield. Unsurprisingly, investor enthusiasm was lukewarm. The moves in treasury yields have caused a further inversion of the US yield curve, which has increased talk about a looming recession. This assessment is however not confirmed by data from the real economy such as the labour market or the Conference Board's index of leading indicators which do not yet display the typical pre-recession dynamics.

Nevertheless, the attitude of central banks is 'better safe than sorry' so more easing is to come, in the US, the eurozone but also in emerging markets, which benefit from the leeway created by the Federal Reserve rate cuts. The effectiveness however to a large degree hinges upon the decline in uncertainty. The announcement that US and Chinese delegations will meet to re-start the trade negotiations has boosted sentiment but, given that we have been there before, this begs the question for how long.

William De Vijlder

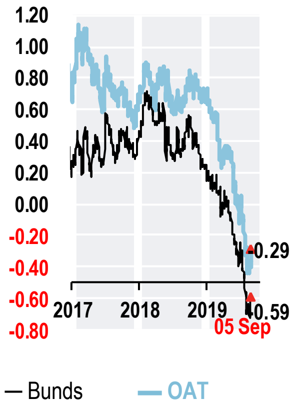
Markets overview

The essentials

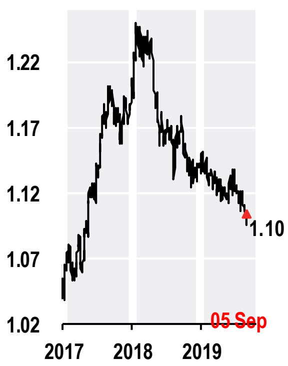
Week 30-8 19 > 5-9-19

↗	**CAC 40**	5 480	▸	**5 593**	**+2.1**	%
↗	**S&P 500**	2 926	▸	**2 976**	**+1.7**	%
↘	Volatility (VIX)	19.0	▸	16.3	-2.7	pb
↘	**Euribor 3M (%)**	-0.43	▸	**-0.44**	**-0.8**	bp
↘	Libor $ 3M (%)	2.14	▸	2.11	-2.5	bp
↗	OAT 10y (%)	-0.42	▸	-0.29	+13.4	bp
↗	Bund 10y (%)	-0.71	▸	-0.59	+11.7	bp
↗	US Tr. 10y (%)	1.51	▸	1.57	+5.4	bp
↗	**Euro vs dollar**	1.10	▸	**1.10**	**+0.3**	%
↘	Gold (ounce, $)	1 529	▸	1 519	-0.7	%
↗	**Oil (Brent, $)**	60.5	▸	**62.1**	**+2.7**	%

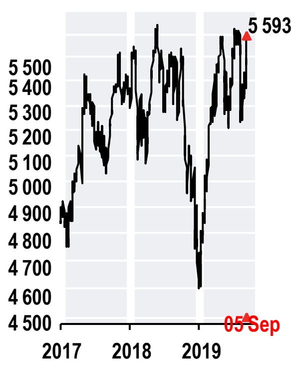
10 y **bond yield, OAT vs Bund**



Euro-dollar



CAC 40



Money & Bond Markets

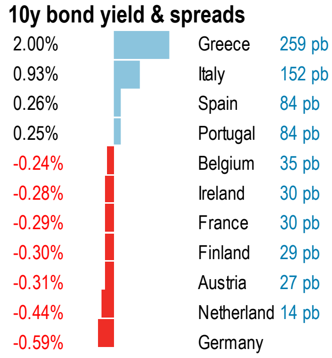
Interest Rates		highest' 19		lowest' 19	
€ ECB	**0.00**	0.00	at 01/01	0.00	at 01/01
Eonia	**-0.36**	-0.25	at 07/06	-0.38	at 19/06
Euribor 3M	**-0.44**	-0.31	at 24/01	-0.45	at 03/09
Euribor 12M	**-0.37**	-0.11	at 06/02	-0.40	at 21/08
$ FED	**2.25**	2.50	at 01/01	2.25	at 01/08
Libor 3M	**2.11**	2.81	at 01/01	2.11	at 04/09
Libor 12M	**1.90**	3.04	at 21/01	1.90	at 04/09
£ BoE	**0.75**	0.75	at 01/01	0.75	at 01/01
Libor 3M	**0.76**	0.93	at 29/01	0.75	at 29/08
Libor 12M	**0.83**	1.19	at 11/01	0.81	at 03/09

At 5-9-19

Yield (%)		highest' 19		lowest' 19	
€ AVG 5-7y	**-0.31**	0.68	at 09/01	-0.36	at 03/09
Bund 2y	**-0.87**	-0.53	at 05/03	-0.92	at 02/09
Bund 10y	**-0.59**	0.25	at 01/01	-0.72	at 28/08
OAT 10y	**-0.29**	0.73	at 08/01	-0.44	at 28/08
Corp. BBB	**0.72**	2.15	at 08/01	0.64	at 30/08
$ Treas. 2y	**1.54**	2.62	at 18/01	1.44	at 04/09
Treas. 10y	**1.57**	2.78	at 18/01	1.46	at 04/09
Corp. BBB	**3.23**	4.65	at 01/01	3.15	at 04/09
£ Treas. 2y	**0.44**	0.83	at 27/02	0.32	at 03/09
Treas. 10y	**0.53**	1.35	at 18/01	0.33	at 03/09

At 5-9-19

10y bond yield & spreads

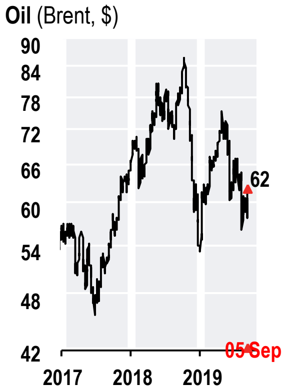


Commodities

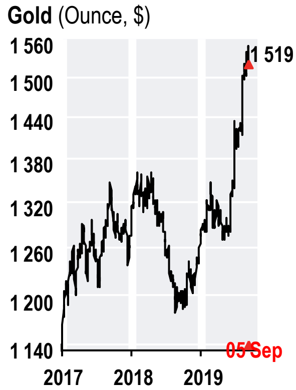
Spot price in dollars		lowest' 19			2019(€)
Oil, Brent	**62.1**	53.1	at	01/01	**+21.0%**
Gold (ounce)	**1 519**	1 268	at	02/05	**+22.7%**
Metals, LMEX	**2 828**	2 718	at	07/08	**+4.5%**
Copper (ton)	**5 825**	5 585	at	03/09	**+1.4%**
CRB Foods	**316**	316	at	05/09	**+0.8%**
wheat (ton)	**173**	166	at	30/08	**-8.8%**
Corn (ton)	**136**	128	at	24/04	**+3.5%**

At 5-9-19 *Variations*

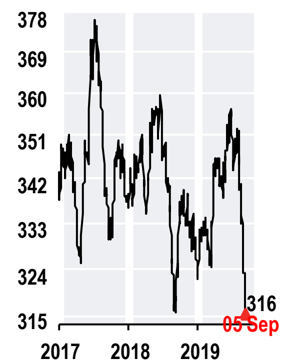
Oil (Brent, $)



Gold (Ounce, $)



CRB Foods



Exchange Rates

1€ =		highest' 19			lowest' 19			2019
USD	**1.10**	1.15	at	10/01	1.10	at	03/09	**-3.4%**
GBP	**0.90**	0.93	at	12/08	0.85	at	14/03	-0.2%
CHF	**1.09**	1.14	at	23/04	1.08	at	04/09	-3.3%
JPY	**118.22**	127.43	at	01/03	116.08	at	03/09	-5.7%
AUD	**1.62**	1.66	at	07/08	1.57	at	18/04	-0.2%
CNY	**7.89**	7.96	at	27/08	7.51	at	25/04	+0.5%
BRL	**4.51**	4.63	at	27/08	4.18	at	31/01	+1.9%
RUB	**72.87**	79.30	at	01/01	70.26	at	24/07	-8.1%
INR	**79.33**	82.00	at	04/02	76.37	at	01/08	-0.6%

At 5-9-19 *Variations*

Equity indices

	Index	highest' 19			lowest' 19			2019	2019(€)
CAC 40	**5 593**	5 621	at	04/07	4 611	at	03/01	+18.2%	**+18.2%**
S&P500	**2 976**	3 026	at	26/07	2 448	at	03/01	+18.7%	**+22.9%**
DAX	**12 127**	12 630	at	04/07	10 417	at	03/01	+14.8%	**+14.8%**
Nikkei	**21 086**	22 308	at	25/04	19 562	at	04/01	+5.4%	**+11.8%**
China*	**77**	86	at	09/04	68	at	03/01	+9.2%	**+12.7%**
India*	**533**	612	at	03/06	526	at	22/08	-1.6%	**-1.0%**
Brazil*	**2 096**	2 354	at	10/07	1 862	at	17/05	+13.7%	**+11.6%**
Russia*	**705**	747	at	04/07	572	at	01/01	+18.1%	**+27.6%**

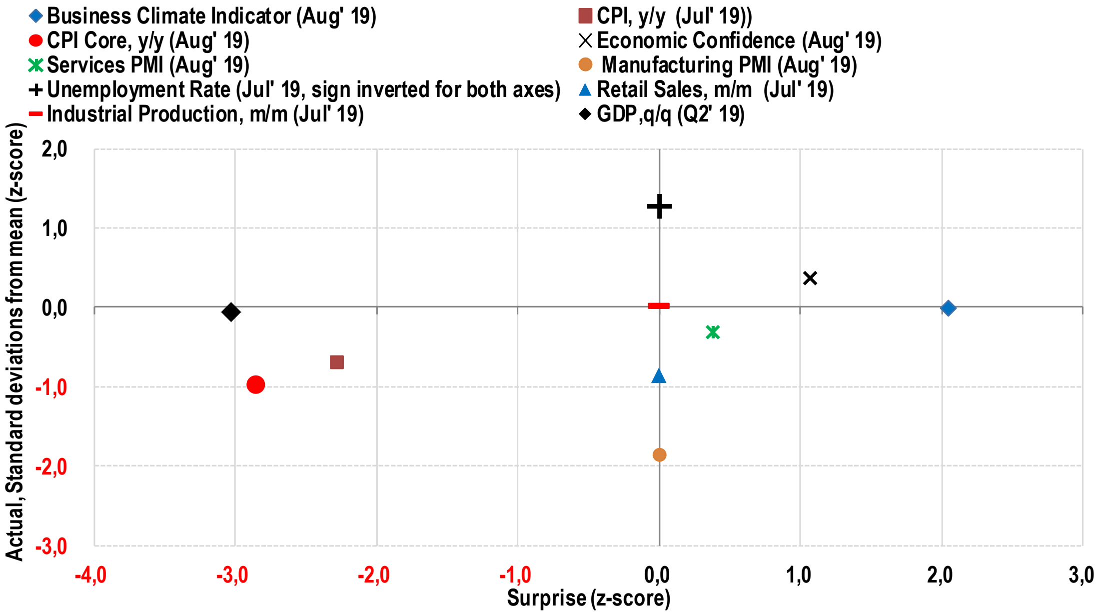
At 5-9-19 *Variations*

* MSCI index

Pulse

Eurozone: fragile economic equilibrium between manufacturing and services sectors

The latest economic indicators still send a mixed signal. The months pass but nothing seems to change. While GDP growth is declining (+0.2% q/q in Q2 2019 after +0.4% in Q1), activity in manufacturing remains subdued and the Purchasing Managers Index (PMI) of this sector is well below its long-term average. Conversely, the services sector resists and the PMI is globally in line with expectations. In this environment, headline inflation remains pretty far from the 2% target, and surprised to the downside. The core component of the CPI keeps oscillating around only 1% (+0.9% in July).



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

The highlight of the week will be the ECB Governing Council meeting. More easing measures are a virtual certainty, the question is which and to which extent. In Japan, many data will be published: sentiment of analysts (EcoWatchers survey), machinery orders, capacity utilisation, etc. The Banque de France will publish its industrial sentiment indicator for the month of August. In the US, the focus will be on the retail sales numbers and University of Michigan sentiment.

Date	Region	Event	Period	Survey	Prior
09/09/2019	Japan	GDP SA QoQ	2Q	0.3%	0.4%
09/09/2019	France	Bank of France Ind. Sentiment	August	--	95
09/09/2019	United Kingdom	Monthly GDP (3M/3M)	July	--	0.3%
09/09/2019	Japan	Eco Watchers Survey Outlook SA	August	--	44.3
09/09/2019	China	Aggregate Financing CNY	August	1.7e+12	1.01e+12
09/10/2019	France	Private Sector Payrolls QoQ	2Q	--	0.3%
09/10/2019	France	Industrial Production MoM	July	--	-2.3%
09/10/2019	United Kingdom	ILO Unemployment Rate 3Mths	July	--	3.9%
09/10/2019	United States	NFIB Small Business Optimism	August	--	104.7
09/11/2019	United States	PPI Ex Food and Energy MoM	August	0.2%	-0.1%
09/12/2019	Japan	Core Machine Orders MoM	July	--	13.9%
09/12/2019	Germany	CPI EU Harmonized MoM	August	--	-0.1%
09/12/2019	France	CPI EU Harmonized MoM	August	--	0.5%
09/12/2019	Eurozone	Industrial Production SA MoM	July	--	-1.6%
09/12/2019	Eurozone	ECB Deposit Facility Rate	Sept-12	--	-0.400%
09/12/2019	United States	CPI MoM	August	0.1%	0.3%
09/13/2019	Japan	Capacity Utilization MoM	July	--	-2.6%
09/13/2019	Japan	Industrial Production MoM	July	--	1.3%
09/13/2019	Eurozone	Trade Balance SA	July	--	1.79e+10
09/13/2019	United States	Retail Sales Control Group	August	0.4%	1.0%
09/13/2019	United States	University of Michigan Sentiment	Sep.	--	89.8

Source: Bloomberg, BNP Paribas

Economic scenario

UNITED STATES

- Growth is slowing and this trend is expected to continue under the influence of corporate investment (slower profits growth, uncertainty) and housing (declining trend of affordability). Consumer spending should be more resilient. The trade dispute with China acts as an additional drag. Inflation is expected to decline, due to softer growth and weaker oil prices.
- We expect two more Fed Funds target rate cuts of 25bp this year and two additional cuts in 2020.

CHINA

- Economic growth continues to slow and our GDP forecasts have been revised down since June. 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, though the reduction in financial-instability risks should remain a priority and banks seem to remain prudent. Fiscal policy is 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 have some success in supporting consumer spending.

EUROZONE

- The economic slowdown is continuing in the eurozone, especially in Germany, due to notably international environment uncertainties and a slowdown of the Chinese economy. Activity in the manufacturing sector continues to decline but services still show resilience.
- 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.
- The message from the July meeting of the Governing Council was clear: inflation is expected to remain too low compared to the target, so more easing is necessary. Decisions in this respect should be announced at the meeting on 12 September.

FRANCE

- Growth is slowing although the economy shows 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. 2020 should see two more cuts. Treasury yields are to decline further in the coming months. Eventually, in the course of 2020 they should move up again in anticipation of a pick-up in growth.
- In the eurozone we expect that a comprehensive package of measures will be announced at the Governing Council meeting of 12 September. This will exert downward pressure on bond yields.
- No policy rate change expected in Japan.
- With the Fed and the ECB both in easing mode, we expect little change in EUR/USD even though euro's fair value is quite higher than current pricing. The yen should strengthen on the back of stable BoJ policy and high market volatility.

	GDP Growth			Inflation		
%	2018	2019 e	2020 e	2018	2019 e	2020 e
Advanced	**2.2**	**1.6**	**1.0**	**2.1**	**1.4**	**1.3**
United-States	2.9	2.2	1.5	2.4	1.8	1.8
Japan	0.8	1.2	0.2	1.0	0.6	0.3
United-Kingdom	1.4	1.1	0.6	2.5	1.9	1.8
Euro Area	**1.9**	**1.1**	**0.7**	**1.8**	**1.1**	**0.8**
Germany	1.4	0.4	0.2	1.9	1.4	1.0
France	1.7	1.2	1.0	2.1	1.2	1.0
Italy	0.7	0.1	0.0	1.2	0.6	0.5
Spain	2.6	2.2	1.6	1.7	0.8	0.7
Emerging	**4.4**	**3.8**	**4.2**	**4.7**	**4.8**	**4.5**
China	6.6	5.9	5.6	2.1	2.4	2.8
India*	6.8	6.5	6.3	2.9	3.0	3.3
Brazil	1.1	0.5	2.0	3.7	3.7	3.5
Russia	2.3	1.2	2.0	2.9	4.8	3.8

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	Q2	Q3e	Q4e	2018	2019e	2020e
US	Fed Funds	2.50	2.50	2.00	1.75	2.50	1.75	1.25
	Libor 3m $	2.60	2.32	1.90	1.70	2.81	1.70	1.25
	T-Notes 10y	2.42	2.00	1.35	1.00	2.69	1.00	1.50
Ezone	Deposit rate (%)	-0.40	-0.40	-0.50	-0.60	-0.40	-0.60	-0.60
	Bund 10y	-0.07	-0.32	-0.50	-0.80	0.25	-0.80	-0.50
	OAT 10y	0.26	-0.01	-0.20	-0.55	0.71	-0.55	-0.30
UK	Base rate	0.75	0.75	0.75	0.75	0.75	0.75	0.75
	Gilts 10y	1.00	0.84	0.75	0.55	1.27	0.55	0.75
Japan	BoJ Rate	-0.06	-0.08	-0.10	-0.10	-0.07	-0.10	-0.10
	JGB 10y	-0.09	-0.16	-0.30	-0.40	0.00	-0.40	-0.25

Source : BNP Paribas GlobalMarkets (e: Forecasts)

Exchange Rates		2019						
End of period		Q1	Q2	Q3e	Q4e	2018	2019e	2020e
USD	EUR / USD	1.12	1.14	1.10	1.11	1.14	1.11	1.14
	USD / JPY	111	108	105	102	110	102	96
	GBP / USD	1.30	1.27	1.20	1.23	1.27	1.23	1.36
	USD / CHF	1.00	0.98	0.99	0.99	0.99	0.99	1.00
EUR	EUR / GBP	0.85	0.89	0.92	0.90	0.90	0.90	0.84
	EUR / CHF	1.12	1.11	1.09	1.10	1.13	1.10	1.14
	EUR / JPY	124	123	116	113	125	113	109

Source : BNP Paribas GlobalMarkets (e: Forecasts)

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