



# “2014: Another Year of Economic and Market Uncertainty”

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Marketing communication

Karel De Bie, Market Strategist

CIB Capital Markets  
Research & Marketing FI Sales Brussels

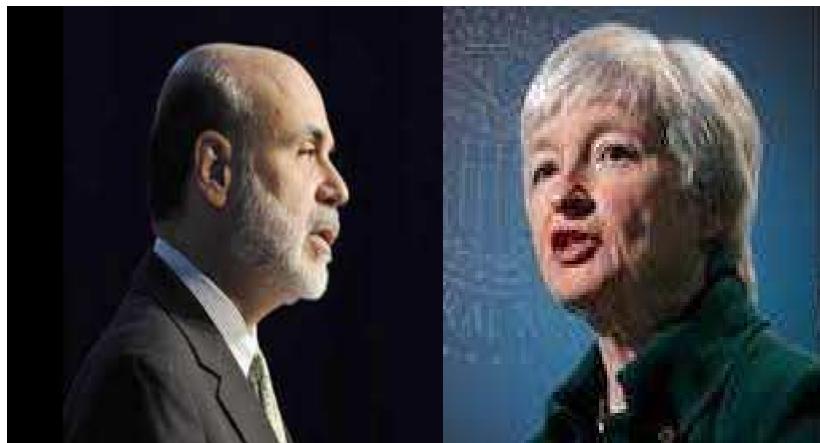


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# May you live in interesting times

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# The world economy

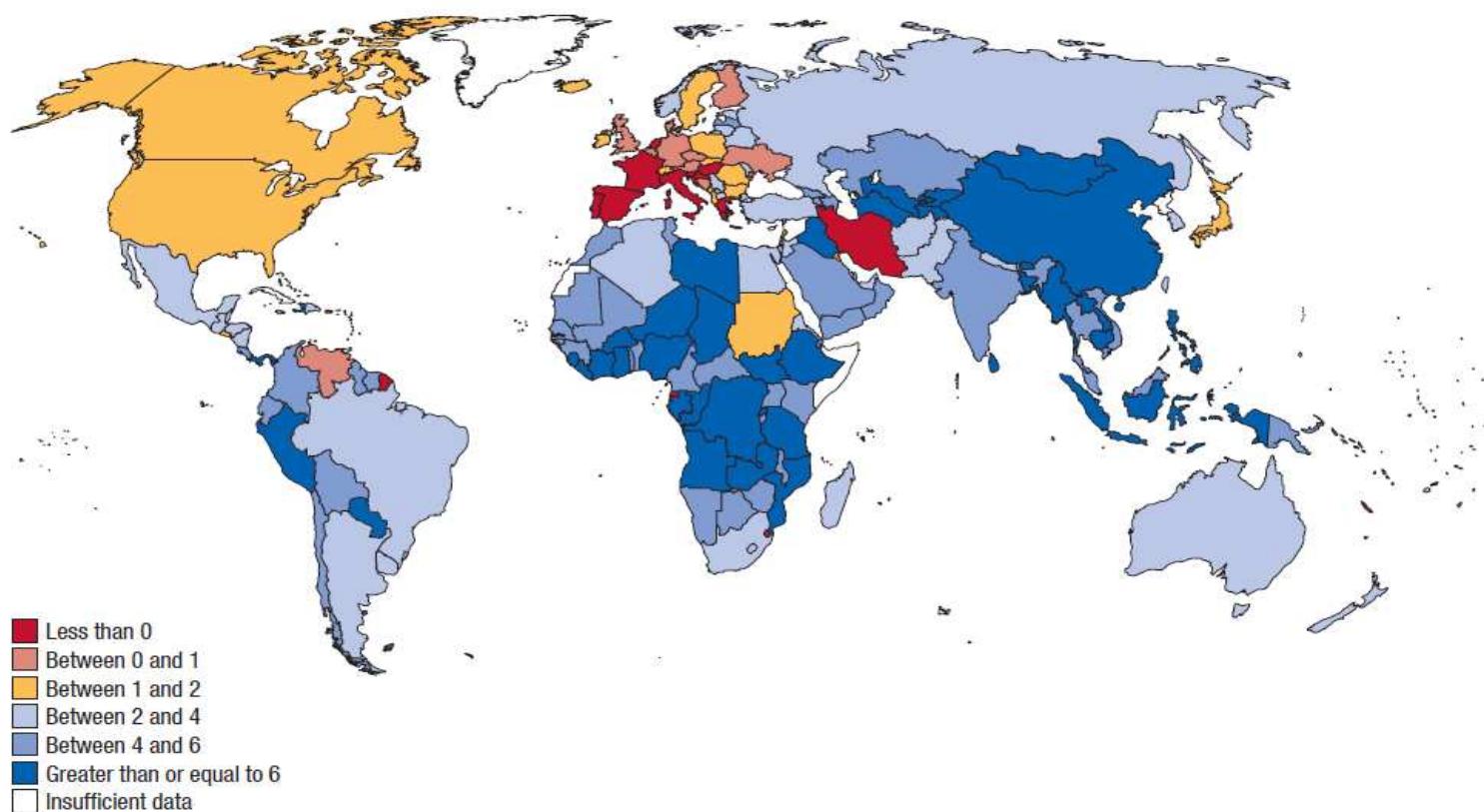


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# And the positive surprise is: Europe...

## Figure 2.1. World: 2013 GDP Growth Forecasts (Percent)





# Quo vadis ECB?

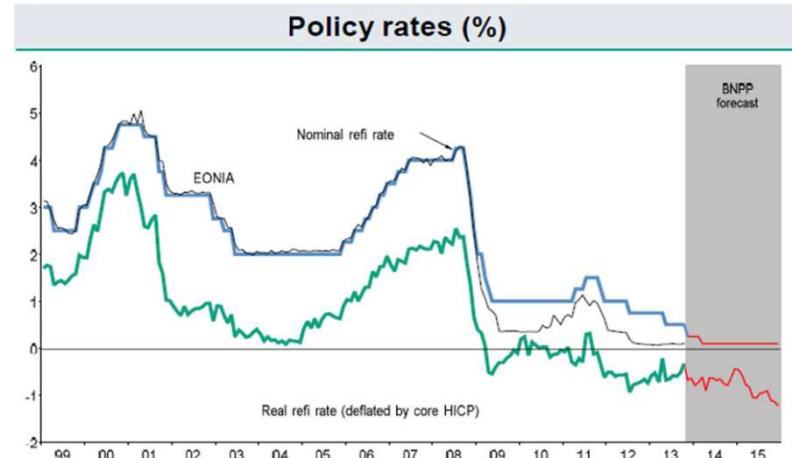


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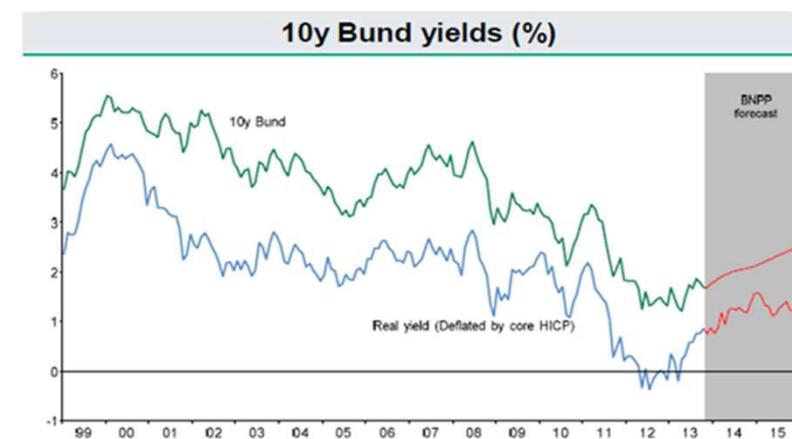
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# ECB: On hold?

- The ECB has remained unusually cautious on the economic outlook, despite the improvement in data, primarily because inflation is low and expected to stay that way
- Subdued growth in wages, domestic demand and credit indicates that risks to price stability lie to the downside.
- In the light of this, the door will remain open to further monetary policy easing, probably in the form of a further refi rate cut and/or additional liquidity provision, if some of the above risks materialize, tightening monetary and financial conditions.
- **It is clear that the ECB is closely monitoring EURUSD. 1.4 seems to be the pain level.**



Source: Reuters EcoWin Pro, BNP Paribas Market Economics and Interest Rate Strategy



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# Where should long-term interest rates be?



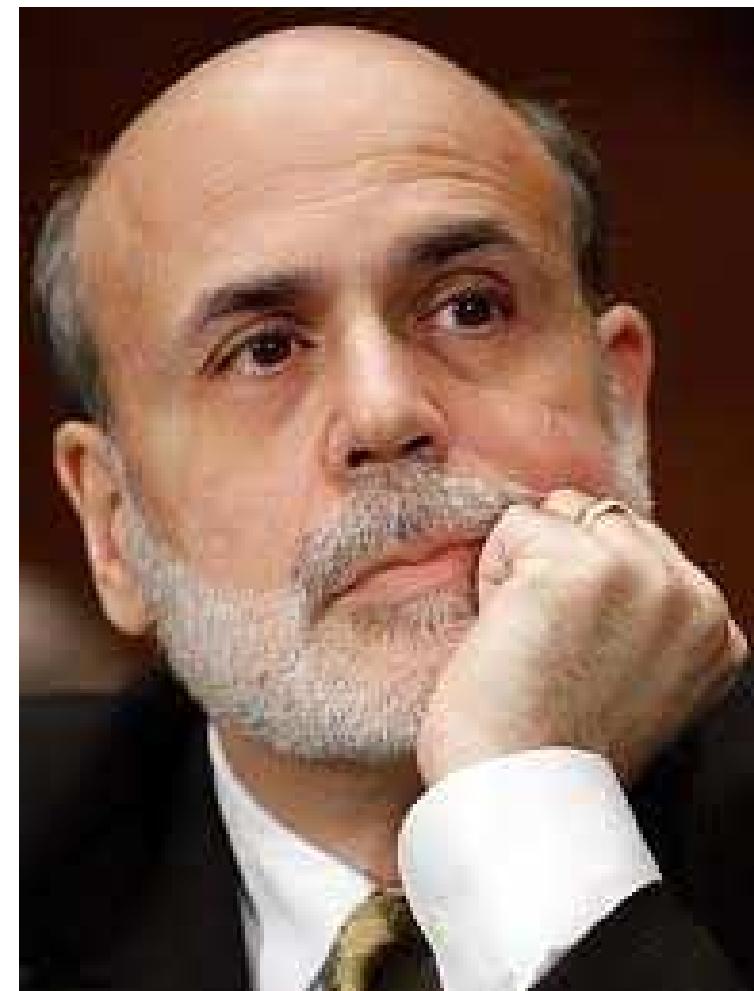
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# What would the impact of an exit scenario be?

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- ❑ The golden rule tells us that nominal GDP growth should equal nominal interest rates.
- ❑ Since 1960 in the US nominal GDP growth has been 6,79%, meanwhile the 10 year yield has averaged 6,59%. (in Europe the figures are Nominal GDP growth 7,72% and the 10y yield 7,75%).
- ❑ This worked well until 2008.
- ❑ Academic studies reveal on average that QE reduced the US 10y by 50 basis points. (5 bp per USD 100 billion).
- ❑ The US will probably normalize first.
- ❑ However, all « big » bond markets are correlated between 85% and 100%.
- ❑ So if US yields head higher, Europe is bound to follow.
- ❑ The best example is the 1994 case. The Fed unexpectedly hiked rates while Germany was cutting. US long yields went up and took the German ones with it.



# History of long term interest rates

## The long history of long (10-year US treasuries) yields



Source: Global Financial Database, Goldman Sachs Global ECS Research. Special thanks to Jose Ursua.



# Another football field please...

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- On August 11, 1987 Alan Greenspan succeeded Paul Volcker at the helm of the Fed.
- Immediately after the crash, Greenspan stated that the Fed 'affirmed today its readiness to serve as a source of liquidity to support the economic and financial system'.
- From then on, that was the mantra of the Fed.

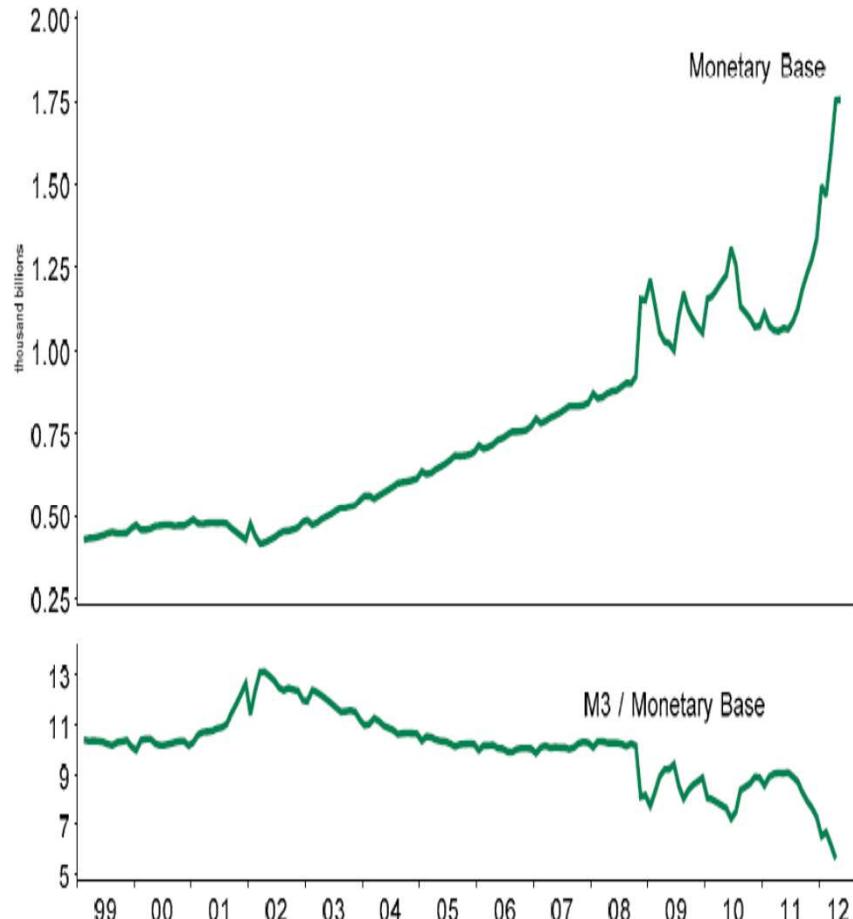


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## Eurozone: Money multiplier

- The monetary base (M0 plus bank reserves) has surged...
- ... but the money multiplier continues to trend down.



Source: Reuters EcoWin Pro



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# EUR/USD



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# EUR/USD

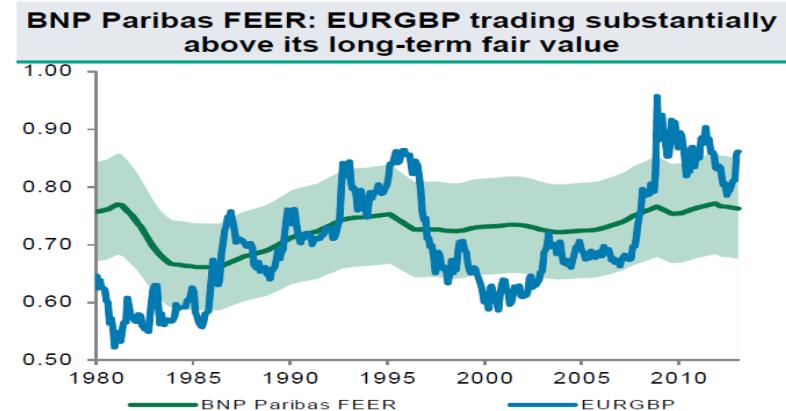
## Central Banks to determine direction EUR/USD

- ❑ There are three main drivers for EURUSD movement, namely monetary policy, trade flows, and investment flows.
- ❑ Typically the USD trends lower during periods of (American) QE. However, comments about tapering (reducing and eventually stopping QE) is expected to put downward pressure on EURUSD.
- ❑ The trade flows are still also (firmly) in favour of a stronger EURUSD, as the Eurozone is running a trade surplus with the United States.
- ❑ These two positive drivers are typically slowed down by the investment flows which are usually in favour of the US (as Europe is investing more in the US than the other way around).
- ❑ During times of tension the « safe haven » flows dominate all others and typically lead to a lower EURUSD.
- ❑ THE LOW EUROPEAN INFLATION FIGURE WAS REALLY A GAME CHANGER.



# GBP weakness: an opportunity to buy?

- GBP is one of the « cheapest » G10 currencies from a valuation perspective, suggesting substantial scope for appreciation, especially as UK yields begin to rise in response to the country's better growth prospects.
- In the very near term, the Bank of England remains accommodative via its forward guidance policy, has put a cap on inflation expectations and, hence, a floor under sterling.
- Next year, the UK economy should grow by 2.4%, faster than the eurozone (1.1%) and faster than the US 2.2%
- BNP Paribas expects the UK economy to outperform the eurozone for the next four years.



GBP Forecast		
Forecast	2013*	2014*
GBPUSD	1.57	1.58
EURGBP	0.84	0.78
GDP (% y/y)	1.5	2.6
CPI (% y/y)	2.7	2.6
Current account (% of GDP)	-3.4	-2.8
Gross Gov debt (% of GDP)	91.2	93.0
Policy rate (%)	0.50	0.50
3m OIS rate at year-end (%)	0.42	0.53
10y yield (%)	3.00	3.40

Source: Bloomberg, BNP Paribas

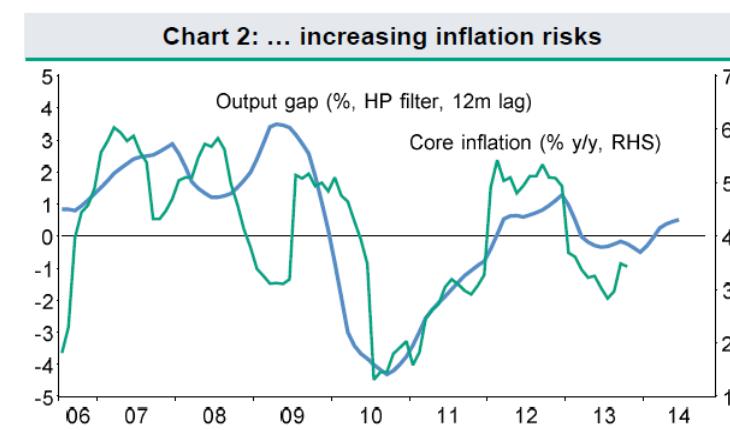


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# HUF: gradually stronger?

- ❑ The Hungarian economy continues to recover, with domestic demand becoming an increasingly important driver of growth.
- ❑ Exports are benefitting from the eurozone recovery.
- ❑ Nevertheless, we think the Hungary's CPI inflation rate is likely to remain very low over the coming 12 months (partly due to VAT cuts).
- ❑ This means monetary easing is set to continue and the main policy rate could well fall to 3% in coming months.
- ❑ We see a substantial risk of inflation bouncing back sharply and topping the Central Bank's 3% target once the impact of the administered measures fades, possibly as soon as late 2014.
- ❑ The main reason for this is Hungary's very small output gap.





# What about commodities?



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# The end of the supercycle?



- Over the long-run, commodities typically go back to their marginal cost of production.
- The bottlenecks are being worked off.
- There is quite a bit of supply coming to market in the oil space: Shale oil, Iraq, Brazil, Antarctica (not yet).
- Up until now OPEC has been able to keep the market in balance.
- For how long will this last?
- **Will lower energy have a downward impact on the metals complex as well?**





# Equities: a new structural bull?



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# Are we in a new secular bull market?

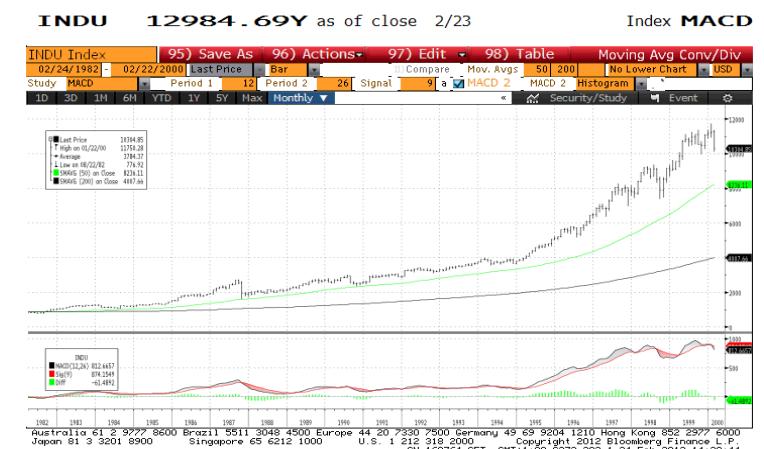
- ❑ The Dax and the SPX are at all time highs.
- ❑ Other markets are a long way off.
- ❑ Duration (only 13 years) and valuation level are a bit too short and too high to mark a decade low.
- ❑ Nevertheless, when the market talks, we tend to listen...



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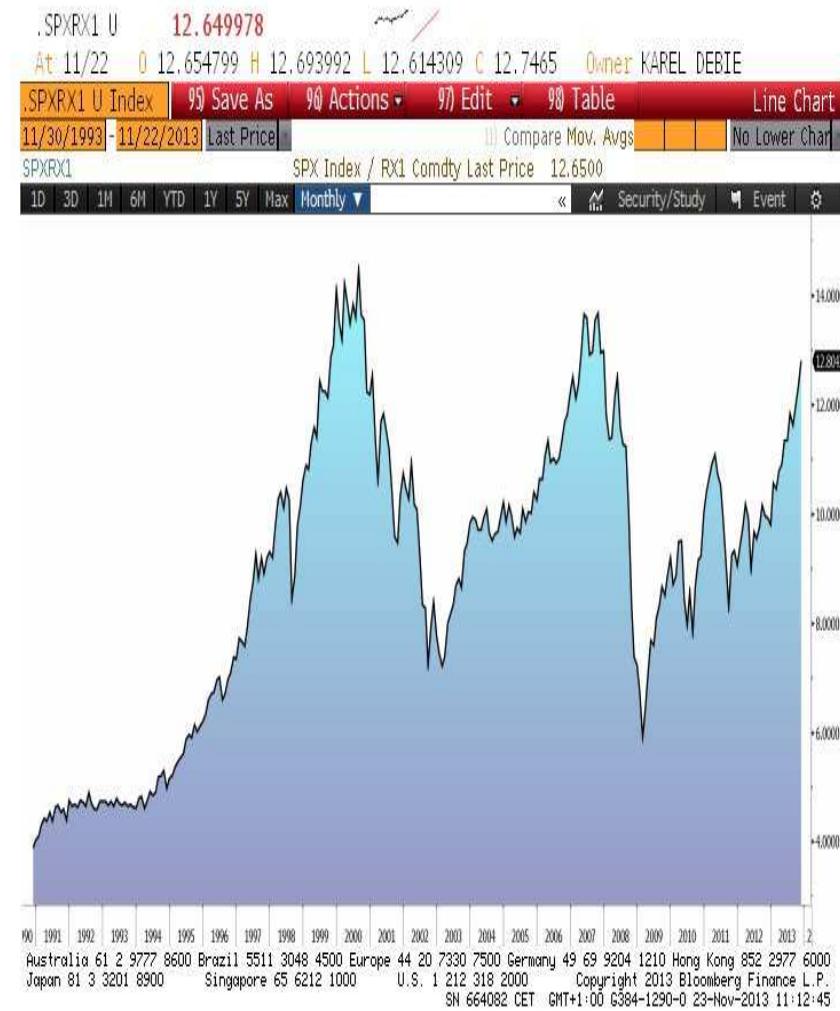
# Moving in cycles



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# Great rotation coming up?

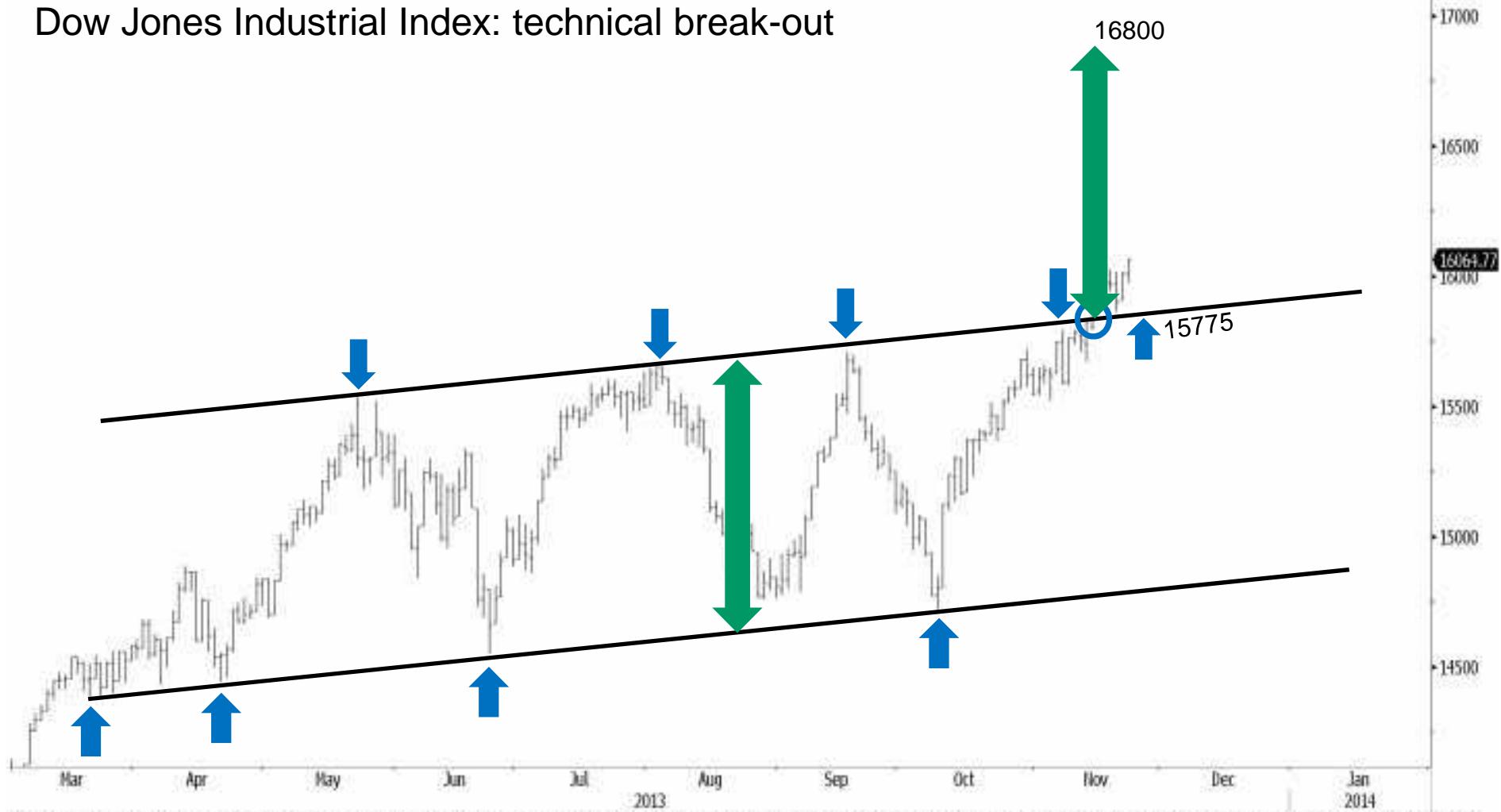


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Dow Jones Industrial Index: technical break-out



Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000  
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2013 Bloomberg Finance L.P.  
 SN 664082 CET GMT+1:00 G384-1290-0 23-Nov-2013 12:36:27



# Gold: in a downtrend?



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# Gold: trending down

- ❑ As global tensions have receded, gold has lost some of its lustre.
- ❑ Will the world become inflationary or deflationary?
- ❑ Goldminers and especially the juniors have been taken out and shot.
- ❑ Is this justified?





# Conclusion



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# Conclusion

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- ❑ The world economy seems to be on the mend, driven by the more mature markets.
- ❑ Inflation in the short and medium term is not a problem.
- ❑ Central Banks will continue to be very accommodative.
- ❑ Still, long-term interest rates seem to have set a major low.
- ❑ The most likely scenario remains one in which risky assets remain well supported and most of the trends remain in place.



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