



Summary

Germany

Inflation back in negative territory

In February, consumer prices were down by 0.2% from a year earlier. However, increased labour costs and prices of imported manufactured goods have kept inflation excluding energy close to 1.2%.

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France

Unemployment declines: the first in a series?

In Q4 2015, France's unemployment rate declined slightly, by 0.1 points to 10.3%. This decline could possibly mark the beginning of the inversion in the unemployment curve.

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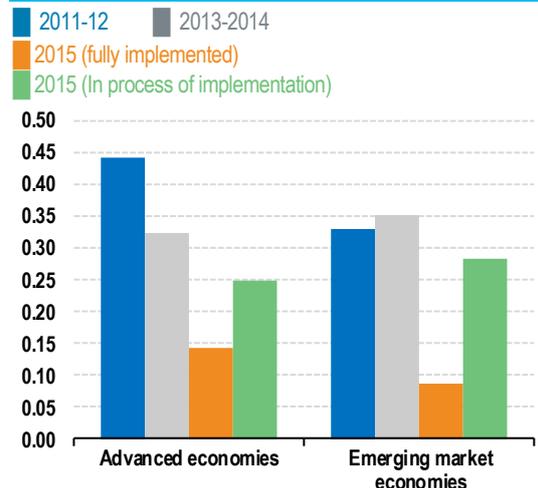


Structural policy: necessary yet difficult

■ Synergy with monetary and fiscal policies ■ Positive impact on potential growth ■ A slower pace of reforms lately

The world economy is cooling so the heat is on about what should be done. The closing statement of the G20 meeting in Shanghai has brought soothing words ("recent market volatility does not reflect the underlying fundamentals", which is a fair point) and a number of welcome commitments. There is a list of 'don'ts': no to competitive devaluation and to protectionism, no to an exclusive use of monetary policy to produce balanced growth. The list of 'do's' is, as expected, longer: using a three-pronged approach of monetary, fiscal and structural policy; clear communication to reduce policy uncertainty and to minimize negative spillovers; a commitment to enhance the reform agenda. This last point echoes recommendations made by the IMF, the OECD as well as Mario Draghi who, since he became president of the ECB, has used every press conference which follows a governing council meeting, to hit the nail of the need for structural reform. The importance of the effort is clear: reforms will boost potential GDP growth in the longer run and can even have a positive impact on confidence and spending in the short run, especially if accompanied by an appropriate fiscal policy and an expansionary monetary policy. The mountain to climb though is steep and despite the unanimously shared ambition, the OECD's recently released Going for Growth report reminds us that the pace of reform has slowed.

SHARE OF IMPLEMENTED "GOING FOR GROWTH" RECOMMENDATIONS



Sources: OECD, BNP Paribas

THE WEEK ON THE MARKETS

Week 29-2 16 > 3-3-16

↗ CAC 40	4 315	▶ 4 416	+2.4 %
↗ S&P 500	1 948	▶ 1 993	+2.3 %
↘ Volatility (VIX)	19.8	▶ 16.7	-3.1 %
↘ Euribor 3M (%)	-0.20	▶ -0.21	-1.1 bp
↘ Libor \$ 3M (%)	0.64	▶ 0.63	-0.0 bp
↗ OAT 10y (%)	0.51	▶ 0.55	+3.9 bp
↗ Bund 10y (%)	0.15	▶ 0.17	+2.8 bp
↗ US Tr. 10y (%)	1.76	▶ 1.83	+6.6 bp
↗ Euro vs dollar	1.09	▶ 1.09	+0.1 %
↗ Gold (ounce, \$)	1 216	▶ 1 256	+3.4 %
↗ Oil (Brent, \$)	36.3	▶ 37.2	+2.3 %

Source: Thomson Reuters



Germany

Inflation back in negative territory

- In February, inflation slipped into negative territory (-0.2%), because of falling energy prices.
- However, due to rising labour costs and the depreciation of the euro, inflation excluding the energy component has remained close to 1.2%.
- Inflation will remain in negative territory for most of 2016, while core inflation stays close its current level.

In 2015, German consumer prices (harmonised concept, HICP) were only 0.1% higher from a year earlier. The decline in inflation has continued in early 2016. In February, inflation slipped again into negative territory (-0.2%). This has once more evoked the risk of the economy drifting to deflation, or at least a Japan-style period of stagnation and lost decade.

For the moment, the term deflation is arguably an overstatement. For an economy to be in deflation, an essential condition is that prices of a significant number of goods are declining on a lasting basis. This condition is certainly not fulfilled in the case of Germany, as the fall in the overall price index is mainly energy-related. As energy prices fell by 7%, inflation excluding the energy component was 1.1% in 2015. Even though this is below the ECB inflation objective – below but close to 2% - it is still well above zero. Moreover, the German economy is not stagnant, as was the case in Japan during the lost decade.

The main driver behind inflation has been labour costs. In 2015, contract wages rose by 2.3%, which was slower than in 2014 (2.9%). However, on average, wages rose by 2.8%, which was even slightly higher than in 2014. The wage drift, the difference by which the actual wage increase exceeds the rise in collectively agreed wages, amounted to 0.5 percentage point, which may be attributed to the introduction of the national minimum wage in 2015. For the 2016 wage round, the trade unions have asked for a 5% increase, which is slightly below last year's demand.

The rise in labour costs is a key factor for price developments in labour intensive sectors with less room for productivity gains. For example, in the "hotels & restaurants" sector the rate of inflation rose to 2.6% in 2015. As this sector has many workers at the minimum wage level, this acceleration is largely related to the introduction of the minimum wage. Indeed, in January 2016, the annual price change eased to 2.3% compared with 2.5% in December 2015.

Another reason is the rise in import prices excluding energy by 1.7% in 2015, compared with a 0.7% decline in the preceding year. This rise is largely due to the depreciation of the euro, almost 10% in effective terms in 2015. This has particularly pushed up prices for manufactured goods imported from outside the Eurozone. In 2015, import prices for machinery and transport equipment (SITC 7) – comprising both intra and extra euro area trade - rose by 2.5%, whereas they declined modestly by 0.6% in 2014. Moreover, the

An energy-induced fall in inflation

%, y/y

— HICP — Ex. energy - - - Producer prices for durable consumer goods



Chart

Sources: Destatis, Eurostat

depreciation of the euro mitigated the fall in prices for raw materials. Import prices of raw materials excluding energy (SITC 2) declined by 3.3%.

As a result of higher costs for labour and imports of (semi-) manufactured goods, producer prices for durable consumer goods, such as motor vehicles, rose by 1.8% in 2015.

Finally, house prices, which are not part of the consumer price index, have been rapidly increasing supported by very favourable financial conditions and disposable income growth. Between end 2010 and Q3 2015, house prices rose by more than 20%. By contrast, rents increased on average only by 1.3% per annum over this period. Given the underlying factors such as the development of constructions costs and demographics, houses prices may be currently on the high side. In the coming two years, the arrival of refugees might give an extra boost to rent and house prices, estimated at 0.5% - 1% by the Bundesbank.

We expect headline inflation to remain in negative territory for most of 2016. This is largely due to energy prices remaining at very low levels. The Brent price is projected to be at USD 37 bbl on average compared with USD 53.61 in 2015. Nevertheless, excluding energy prices, inflation is likely to remain close to 1.2%.

France

Unemployment declines: the first in a series?

- In Q4 2015, France's unemployment rate declined slightly, by 0.1 points to 10.3%. For the year, it was down 0.2 points.
- We can attribute this decline to the slight upturn in growth in 2015 and to diverse measures to promote a job-rich growth.
- The decline is likely to continue, although it will probably remain small in scope.

In Q4 2015, the unemployment rate declined slightly based on the INSEE job survey, down 0.1 points to 10.3% in France (10% in metropolitan France). This favourable albeit mild trend is bolstered by the downward revision of France's Q3 unemployment rate, by 0.2 points to 10.4%. For the year, the unemployment rate declined 0.2 points. Does this decline mark the beginning of the inversion in the unemployment curve? Although there is no certainty, it is nonetheless possible.

First of all, we can note that the unemployment rate averaged 10.3% in 2015, which is stable relative to both 2014 and 2013. This stability is somewhat surprising as it occurred even though growth was sluggish over the period (+0.7% on an annual average): the unemployment trend therefore looks more favourable than what growth would seem to justify (see chart 2). In fact, we find it more surprising that unemployment did not increase further rather than that it failed to decline. One explanation lies in the much slower growth of the labour force (+0.2% on an annual average between 2013 and 2015, compared to +0.7% over the previous decade). Thanks to that, employment did not need to progress much for the unemployment rate to level off. Yet as mild as it was (annual average of +0.2%), the upturn in employment was nonetheless notable for a period of such sluggish growth. In 2013 and 2014, employment was buoyed by the increase in non-payroll employment and in public sectors, which offset the decline in non-farm private payroll employment. In 2015, however, non-farm payrolls managed to also increase though very slightly (+0.1% on an annual average and +0.3% year-on-year in Q4 2015).

This late upturn can be attributed to the slight improvement in growth in 2015 (+1.4% year-on-year at the end of 2015, compared to 0% at year-end 2014), as well as to social welfare measures to counter unemployment (via government-subsidised jobs) and job support measures taken since 2013 (Job Security Law, Competitiveness and Responsibility Pacts, "All Out for Jobs" plan, and the Macron law). Although all these measures did not suffice to curb unemployment, they at least seem to have had the merit of halting its increase.

On this basis, unemployment might well begin to decline for real in 2016, buoyed by somewhat stronger growth and the new emergency jobs plan unveiled in mid-January. The new plan calls for new facilities to promote apprenticeships, a new hiring premium for small and medium-sized companies, and, above all, a vast training programme for the unemployed. Two other reforms are also being prepared that could be game-changers on the unemployment front,

Unemployment rate levels off

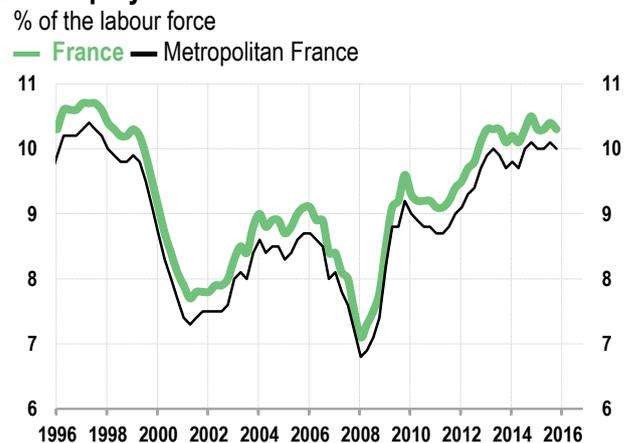


Chart 1

Source: INSEE

Growth and the unemployment rate

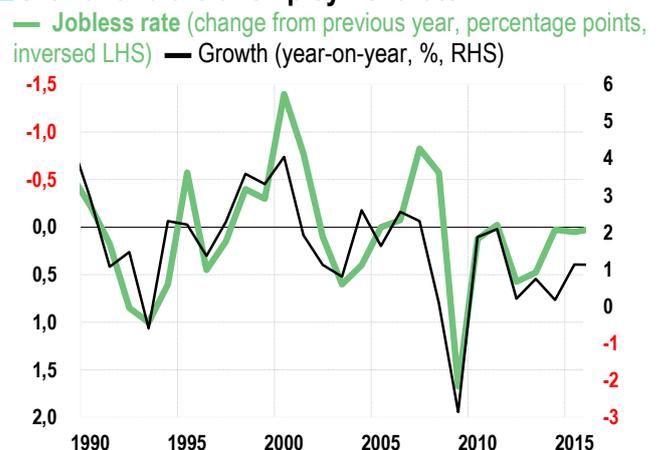


Chart 2

Source: INSEE

not right now because a lot remains to be negotiated but in the longer run: renegotiation of the unemployment insurance agreement and labour law reform. As to the renegotiation of the rules governing jobless benefits, what is at stake is not only to reduce the deficit of the unemployment insurance regime, but also to help reduce unemployment by improving the return to work. As to the labour law reform, one of the challenges is to encourage hiring under regular open-ended job contracts (*CDI*) by granting companies greater flexibility in managing working hours and staff size.

According to our forecasts, the decline in the unemployment rate will nonetheless remain small in scope (-0.1 point) in the absence of stronger growth and also because of our expectation of stronger labour productivity gains. Productivity looks indeed bound to improve after being squeezed for several years. This is also a lever to strengthen competitiveness and potential growth, which in turn should fuel job creation.



Markets overview

The essentials

Week 29-2 16 > 3-3-16

Table with 4 columns: Index, Value, Change, % Change. Includes CAC 40, S&P 500, Volatility (VIX), Euribor 3M, Libor \$ 3M, OAT 10y, Bund 10y, US Tr. 10y, Euro vs dollar, Gold, Oil.

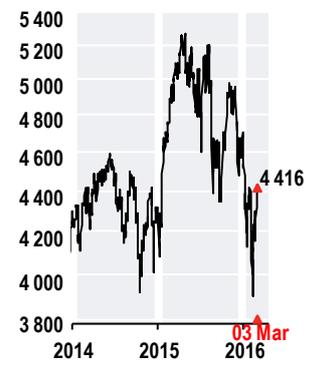
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

Table of Interest Rates for ECB, FED, and BoE across various maturities (3M, 6M, 12M).

At 3-3-16

Table of Yield (%) for various bonds (AVG 5-7y, Bund 2y, 10y, OAT 10y, Corp. BBB, Treas. 2y, 10y, £ Treas. 2y, 10y).

At 3-3-16

10y bond yield & spreads

Table showing 10-year bond yields and spreads for various countries (Greece, Portugal, Spain, Italy, Belgium, Ireland, France, Austria, Finland, Netherland, Germany).

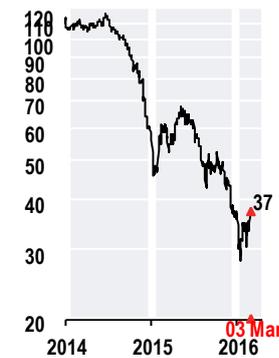
Commodities

Table of Spot price in dollars for Oil, Gold, Metals, Copper, CRB Foods, wheat, and Corn.

At 3-3-16

Variations

Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

Table of Exchange Rates for various currencies (USD, GBP, CHF, JPY, AUD, CNY, BRL, RUB, INR) against the Euro.

At 3-3-16

Variations

Equity indices

Table of Equity Indices (CAC 40, S&P500, DAX, Nikkei, China, India, Brazil, Russia) with values and variations.

At 3-3-16

Variations

* Indices MCSI





Economic forecasts

En %	GDP Growth			Inflation			Curr. account / GDP			Fiscal balances / GDP		
	2015	2016 e	2017 e	2015	2016 e	2017 e	2015	2016 e	2017 e	2015	2016 e	2017 e
Advanced	1.8	1.5	1.5	0.3	0.6	1.7						
United States	2.4	1.9	1.5	0.1	1.1	2.2	-2.6	-2.8	-2.9	-2.5	-3.2	-3.3
Japan	0.4	0.3	0.2	0.8	0.1	1.8	3.3	3.6	3.3	-4.6	-3.7	-3.2
United Kingdom	2.2	1.7	2.0	0.1	0.4	1.9	-4.5	-4.8	-3.8	-4.1	-3.0	-2.2
Euro Area	1.5	1.3	1.4	-0.2	1.0	1.0	3.0	2.6	2.5	-2.2	-2.0	-1.7
Germany	1.4	1.3	1.5	0.1	-0.0	1.5	8.1	7.7	7.6	0.7	0.3	0.3
France	1.1	1.2	1.3	0.1	0.1	1.1	0.0	0.0	-0.7	-3.7	-3.5	-3.2
Italy	0.6	1.0	0.9	-0.1	0.8	0.8	2.1	1.8	1.9	-2.7	-2.8	-2.3
Spain	3.2	2.6	2.1	-0.6	-1.0	1.0	0.9	0.6	0.5	-4.8	-3.8	-2.7
Netherlands	1.9	1.8	1.6	0.2	0.3	1.1	9.6	8.7	8.5	-2.1	-2.0	-1.8
Belgium	1.4	1.3	1.6	0.6	0.5	1.6	0.8	1.4	1.7	-2.7	-2.7	-2.5
Portugal	1.5	1.5	1.5	0.5	0.3	1.2	1.0	1.2	1.4	-4.1	-3.0	-2.5
Emerging	4.1	4.1	4.6	6.0	6.4	5.4						
China	6.9	6.4	6.1	1.4	1.5	1.7	2.8	3.1	2.2	-2.4	-3.1	-3.3
India	7.3	7.9	8.1	4.9	5.8	5.2	-1.3	-0.6	-0.6	-4.1	-3.9	-3.5
Brazil	-3.8	-4.0	0.0	9.0	9.1	7.4	-3.4	-1.0	-1.1	-10.3	-10.6	-10.3
Russia	-3.7	-1.8	0.6	15.6	9.1	7.2	5.4	2.8	7.4	-3.9	-4.8	-4.7
World	3.1	3.0	3.3	3.6	3.9	3.8						

Source : BNP Paribas Group Economic Research / GlobalMarkets (e: Estimates & forecasts)

Financial forecasts

Interest rates		2015				2016				2015	2016e	2017e
		Q1	Q2	Q3	Q4	Q1e	Q2e	Q3e	Q4e			
US	Fed Funds	0.25	0.25	0.25	0.5	1	1.25	1.5	1.00-1.25	0.01	1.00-1.25	2.00-2.25
	3-month Libor \$	0.27	0.28	0.33	0.61	1.23	1.48	1.73	1.38	0.61	1.38	2.25
	10-year T-notes	1.93	2.35	2.03	2.27	2.40	2.75	2.90	2.75	2.27	2.75	2.75
EMU	Refinancing rate	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
	3-month Euribor	0.02	-0.01	-0.04	-0.13	-0.40	-0.50	-0.60	-0.60	-0.13	-0.60	-0.60
	10-year Bund	0.18	0.77	0.59	0.63	-0.40	-0.50	-0.60	-0.60	0.63	-0.60	-0.20
	10-year OAT	0.42	1.20	0.90	0.98	0.65	0.60	0.30	0.10	0.98	0.10	0.10
	10-year BTP	1.29	2.31	1.73	1.60	1.50	1.45	1.25	0.95	1.60	0.95	0.80
UK	Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00
	3-month Libor £	0.57	0.58	0.58	0.59	0.75	0.75	0.75	0.75	0.59	0.75	1.25
	10-year Gilt	1.58	2.03	1.77	1.96	1.40	1.40	1.47	1.50	1.96	1.50	1.80
Japan	Overnight call rate	0.02	0.01	0.01	0.04	-0.10	-0.30	-0.30	-0.30	0.04	-0.30	-0.50
	3-month JPY Libor	0.17	0.17	0.17	0.17	0.10	0.00	-0.05	-0.10	0.17	-0.10	-0.25
	10-year JGB	0.40	0.44	0.35	0.25	0.00	-0.10	-0.10	-0.10	0.25	-0.10	-0.25

Exchange rates		2015				2016				2015	2016e	2017e
		Q1	Q2	Q3	Q4	Q1e	Q2e	Q3e	Q4e			
USD	EUR / USD	1.07	1.11	1.12	1.09	1.14	1.16	1.15	1.14	1.09	1.14	1.05
	USD / JPY	120	122	120	120	110	108	110	115	120	115	124
EUR	EUR / GBP	0.72	0.71	0.74	0.74	0.77	0.77	0.74	0.72	0.74	0.72	0.68
	EUR / CHF	1.04	1.04	1.09	1.09	1.12	1.14	1.14	1.16	1.09	1.16	0.01
	EUR/JPY	129	136	134	131	125	125	127	131	131	131	130

Source : BNP Paribas Group Economic Research / GlobalMarkets (e: Estimates & forecasts)



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Group Economic Research

■ **William DE VIJDER** +33(0)1 55 77 47 31 william.devijlder@bnpparibas.com
Chief Economist

ADVANCED ECONOMIES AND STATISTICS

■ **Jean-Luc PROUTAT** +33.(0)1.58.16.73.32 jean-luc.proutat@bnpparibas.com
Head

■ **Alexandra ESTIOT** +33.(0)1.58.16.81.69 alexandra.estiot@bnpparibas.com
Works coordination - United States - United Kingdom - Globalisation

■ **Hélène BAUDCHON** +33.(0)1.58.16.03.63 helene.baudchon@bnpparibas.com
France (short-term outlook and forecasts) - Labour markets

■ **Frédérique CERISIER** +33.(0)1.43.16.95.52 frederique.cerisier@bnpparibas.com
Euro Area - European Institutions and governance - Public finances

■ **Thibault MERCIER** +33.(0)1.57.43.02.91 thibault.mercier@bnpparibas.com
France (structural reforms) - European central bank

■ **Caroline NEWHOUSE** +33.(0)1.43.16.95.50 caroline.newhouse@bnpparibas.com
Japan, Ireland, Scandinavia - Ageing, pensions - Consumption

■ **Catherine STEPHAN** +33.(0)1.55.77.71.89 catherine.stephan@bnpparibas.com
Spain, Portugal - World trade - Education, health, social conditions

■ **Raymond VAN DER PUTTEN** +33.(0)1.42.98.53.99 raymond.vanderputten@bnpparibas.com
Germany, Netherlands, Austria, Switzerland - Energy, climate - Long-term projections

■ **Tarik RHARRAB** +33.(0)1.43.16.95.56 tarik.rharrab@bnpparibas.com
Statistics and Modelling

BANKING ECONOMICS

■ **Laurent QUIGNON** +33.(0)1.42.98.56.54 laurent.quignon@bnpparibas.com
Head

■ **Céline CHOLET** +33.(0)1.43.16.95.54 celine.choulet@bnpparibas.com

■ **Laurent NAHMIA** +33.(0)1.42.98.44.24 laurent.nahmias@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

■ **François FAURE** +33.(0)1 42 98 79 82 francois.faure@bnpparibas.com
Head

■ **Christine PELTIER** +33.(0)1.42.98.56.27 christine.peltier@bnpparibas.com
Deputy Head - Greater China, Vietnam - Methodology

■ **Stéphane ALBY** +33.(0)1.42.98.02.04 stephane.alby@bnpparibas.com
Africa (French-speaking countries)

■ **Sylvain BELLEFONTAINE** +33.(0)1.42.98.26.77 sylvain.bellefontaine@bnpparibas.com
Turkey, Brazil, Mexico, Central America - Methodology

■ **Sara CONFALONIERI** +33.(0)1.42.98.74.26 sara.confalonieri@bnpparibas.com
Africa (English and Portuguese speaking countries)

■ **Pascal DEVAUX** +33.(0)1.43.16.95.51 pascal.devaux@bnpparibas.com
Middle East, Balkan countries - Scoring

■ **Anna DORBEC** +33.(0)1.42.98.48.45 anna.dorbec@bnpparibas.com
CIS, Central European countries

■ **Hélène DROUOT** +33.(0)1.42.98.33.00 helene.drouot@bnpparibas.com
Asia

■ **Johanna MELKA** +33.(0)1.58.16.05.84 johanna.melka@bnpparibas.com
Asia, Russia

■ **Alexandra WENTZINGER** +33.(0)1.42.98.74.26 alexandra.wentzinger@bnpparibas.com
South America, Caribbean countries

■ **Michel BERNARDINI** +33.(0)1.42.98.05.71 michel.bernardini@bnpparibas.com
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Registered Office: 16 boulevard des Italiens – 75009 PARIS
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