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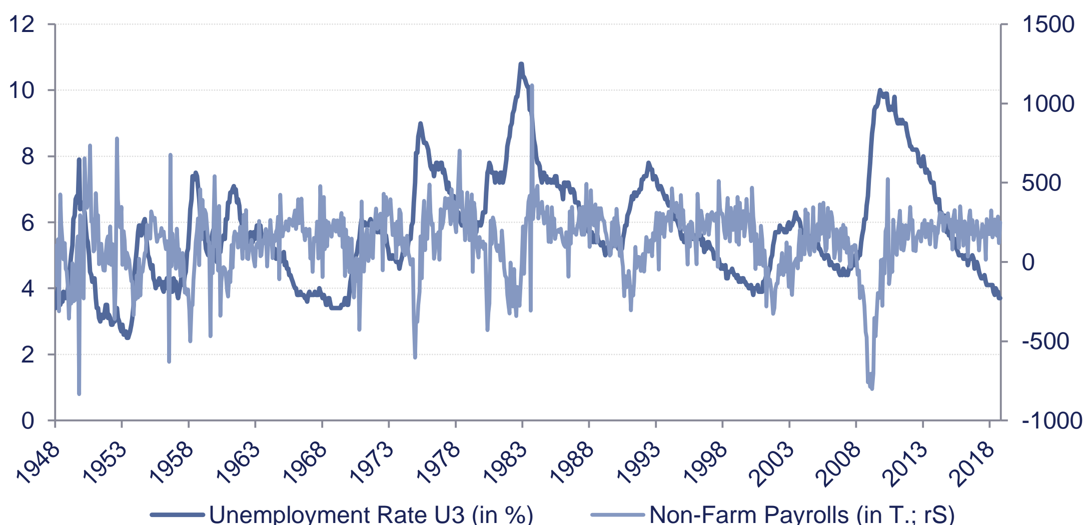
Special
Full employment makes for pressure on the Fed to take action

Analysts: Tobias Bassse // Bernd Krampen

At full employment

The economic situation in the United States remains in good shape, with preliminary data indicating year-on-year GDP growth of 3.5 percent in Q3. This was down on the strong Q2 figure of 4.2 percent in terms of real activity, but the slight slowdown to be seen of late is not a problem. On the contrary – the US economy simply cannot sustainably grow as strongly as it did Q2. Now as before, consumption remains a reliable mainstay of the US economy. The positive employment situation is likely helpful in this context. Moreover, the latest business surveys are unambiguously signalling a continuation of the growth trend. The US labour market is undoubtedly playing a role in this context as well; the feedback from the surveyed companies is increasingly indicating concerns as to a skills shortage, which can be expected to dampen the upturn in economic activity in the USA. The employment situation indeed remains highly positive, with preliminary figures indicating that October saw the US economy create 250,000 new jobs. The unemployment rate as per U3 definition stands at just 3.7 percent at the current time, against which background the USA can now be said to be at full employment. The upward trend in wages is accordingly picking up pace by degrees.

Chart: Unemployment rate and employment creation (nonfarm payrolls) in the USA



Source: Bloomberg, NORD/LB Fixed Income & Macro Research

The Fed remains under pressure to take action

Against this background the US central bank remains under a certain pressure to take action, primarily due to the buoyant employment situation. Thus, a further hike of the Fed funds target rate by 25bp is to be reckoned with in December, with the likelihood of two more upward rate adjustments in the course of 2019. In particular the pleasing situation on the US labour market provides justified grounds to expect further rate hikes by the central bank in Washington. With wage costs rising, an increasingly close eye needs to be kept on the inflation trend. Account must also be taken of the planned raising of tariffs on

imports from China from 10 to 25 percent since this will undoubtedly make for added upward price pressure in the USA. On the other hand, the economy will likely shift down a gear in the wake of a very strong 2018, which should somewhat dampen the risk of inflation. Deburdening base effects and the observed oil price decline could initially lead to declining inflation rates in the coming two to three months – which could provide reason to expect a wait-and-see approach on the part of the Fed in Q1/2019.

Implications for the financial markets

The US bond market is currently very largely pricing in the Federal Reserve's further measures. Indeed, many market participants are increasingly seeing the "risk" of a further three upward rate adjustments in 2019. This also (still) corresponds to the US central bankers' scenario in their projections. The Fed's monetary policy is thus still giving impetus to the US dollar for the time being – a rate-hike breather could weigh somewhat on the greenback. The interest rate environment in the land of unlimited opportunity is currently providing reason not to expect any stronger price rises on the stock market in the USA. With yields above the 3.00-percent mark, 10Y US Treasuries are without doubt an attractive option for investors.

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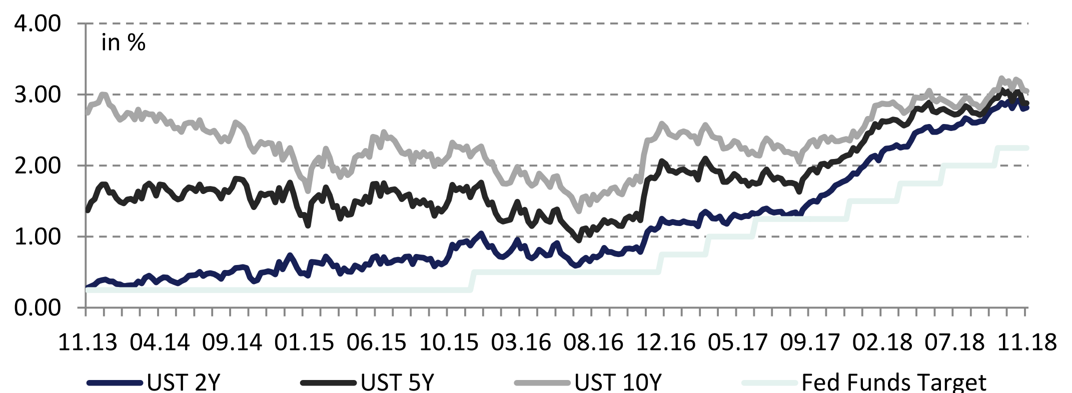
USA
Fed to remain under pressure to take action for the time being

Analysts: Tobias Basse // Bernd Krampen

Waiting for somewhat weaker growth figures

Following a truly buoyant showing in Q2 with highly positive growth figures showing impressive year-on-year GDP growth of 4.2 percent, Q3 showed certain signs of deceleration as expected. That said, the current data nevertheless indicate a pleasing state of affairs, with preliminary figures pointing to real year-on-year GDP growth of 3.5 percent at the beginning of the second half-year. The growth figures in the land of unlimited opportunity were thus weaker – but by no means weak! The preliminary data on the GDP trend in the USA are, of course, still very susceptible to revision, against which background extreme caution is called for when analyzing details of the figures. The investment activity among the companies could probably have been more positive, but it already appears that private consumption will undoubtedly have significantly bolstered demand in North America (and thus, of course, economic growth as well) in Q3 too. This means that the US consumer certainly remains a mainstay of the upswing in North America, with the latest figures on the trend in retail sales also pointing in this direction. According to preliminary figures, the headline rate for this time series showed an increase in sales in the US stores of a highly impressive 0.8 percent mom in October as month under review. Though clouding the picture somewhat, the revisions to the past data on US retail sales are unlikely to have any real impact on the interpretation of the figures, given the pronounced strength of late. Nevertheless, we expect US growth to slow a bit from Q4 onwards.

Chart: Interest rate development in the USA



Source: Bloomberg, NORD/LB Fixed Income & Macro Research

FOMC to remain under pressure to take action for the time being

In our view, the recently reported data on the state of the US economy are continuing to trigger appreciable pressure on the central bank in Washington to take action. Above all the employment situation remains buoyant – a factor likely to be of great importance for the future monetary policy in the United States in view of the Fed's objectives. Furthermore, there are signals that the positive situation on the US labour market is slowly having consequences in terms of wage demands as well. Accordingly, the FOMC will likely plan a further hike of the Fed funds target rate in December, so the upper limit of the key US interest rate can already be expected to rise to 2.50 percent in the very near future. In the

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course of 2019, we then expect – also due to somewhat weaker economic growth figures – the Fed's reorientation of its monetary policy to be of a less brisk nature. In our view, the capital market rates in the USA are pricing in two to three further interest rate adjustments in 2019. On the bond market, however, the scenario of "just 2 interest rate adjustments in the coming year" appears to be finding a growing number of supporters. We consider this market assessment to be highly realistic. Against this background the yield on 10Y US Treasuries is not moving more sustainably away from the psychologically important 3.00-percent mark at the moment.

Rome's budgets have weighed on the euro

Italy's future budgetary policy will likely remain of relevance in the FX segment. Rome's plans have undoubtedly weighed on the euro of late. However, the currency market is now apparently beginning to increasingly doubt that the Fed really does intend to undertake three rate hikes in 2019. This is evidently of help for the euro.

Fundamental forecasts, USA

	2017	2018	2019
GDP	2.2	2.9	2.5
Private consumption	2.5	2.5	2.2
Govt. consumption	-0.1	1.5	1.5
Fixed investment	4.0	6.0	3.0
Exports	3.0	1.5	1.5
Imports	4.6	2.0	0.5
Inflation	2.1	2.5	2.3
Unemployment rate [1]	4.4	3.8	3.6
Budget balance [2]	-3.6	-4.6	-4.6
Current acc. balance [2]	-2.3	-2.5	-2.6

Change vs previous year as percentage; [1] as percentage of the labour force; [2] as percentage of GDP

Source: Feri, NORD/LB Fixed Income & Macro Research

Quarterly forecasts, USA

	IV/17	I/18	II/18	III/18	IV/18
GDP qoq ann.	2.2	4.2	3.5	3.5	2.5
GDP yoy	2.6	2.9	3.0	3.0	3.1
Inflation yoy	2.2	2.7	2.6	2.6	2.2

Change as percentage

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Interest and exchange rates, USA

	22.11.	3M	6M	12M
Fed funds target rate	2.25	2.50	2.50	2.75
3M rate	2.69	2.65	2.80	3.00
10Y Treasuries	3.06	3.15	3.25	3.45
Spread 10Y Bund	269	265	255	245
EUR in USD	1.14	1.15	1.17	1.20

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

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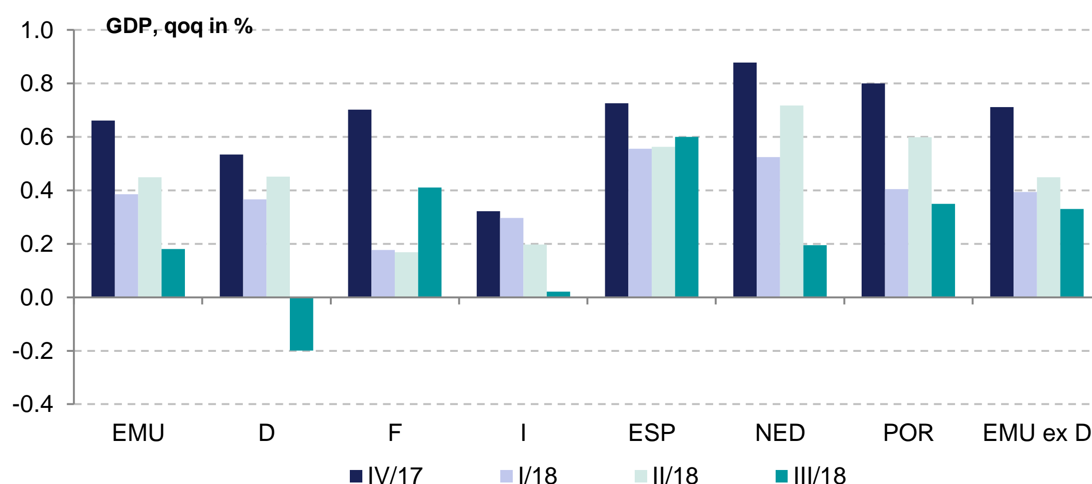
Euroland
ECB faces challenges in the face of deteriorating sentiment

Analyst: Christian Lips

Q3 delivers disappointing GDP growth

The economic data for Q3 were disappointing (see chart), with seasonally and calendar-adjusted real GDP growth in the common currency area of just 0.2 percent qoq. Italy's economic output stagnated and the Germany economy recorded the first downturn in real GDP since early 2015. While the uncertainty about the economic and fiscal course of the Northern League/Five Star Movement coalition as well as the significantly increased risk premiums on Italian debt securities will likely weigh on sentiment in the coming quarters, the situation where the German economy is concerned is expected to improve already in the current Q4 against the background of catch-up effects in automobile production.

Chart: GDP growth in selected eurozone member states



Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Italy sticks to budget plans – EU Commission to initiate deficit procedure

Italy's populist government is sticking to its budget plans and thus missed its last chance for the time being to take a step towards conciliation with Brussels. The EU Commission now intends to initiate a deficit procedure, which could also ultimately result in a penalty payment for excessive debt. From an economic standpoint, however, it seems in principle relatively devoid of sense to impose an additional penalty on a member state for excessive indebtedness – Italy's conflictual course of action thus reveals the basic problem of the EU's budget rules. The Commission will likely avoid a further escalation in order not to provide the Italian government with populist arguments in the run-up to the European elections by intensifying the conflict with Brussels.

Challenging environment for the ECB

The central bankers in Frankfurt will have to adjust their macroeconomic projections in December; in particular GDP growth rates of 2.0 and 1.8 percent for this year and 2019 respectively are unrealistic, given the weakness in Q3 and the recent cooling of sentiment. Moreover, there are still veritable risks for overall economic development in the form of

Brexit, Trump and Italy. At the same time, with inflation having been above the European Central Bank's target rate in summer and the autumn, the ECB is likely to expect slightly higher inflation. In our view, the central bank would be well advised to nevertheless stick to its in any case very long-term and cautious policy of normalization. The ECB should not get nervous in the face of somewhat weaker growth figures nor a temporary increase in inflation, especially as the policy involves a gradual normalization in the use of the monetary policy instruments and not yet a tightening of the monetary conditions. It can therefore be safely assumed that the net asset purchases will be terminated by year-end 2018. In the first half of 2019, the ECB's forward guidance on the interest rate trend, particularly with regard to the expected speed of adjustment, will then likely be put in concrete terms. However, an initial slight raising of the negative deposit rate is not to be expected until September 2019 at the earliest. A very cautious start to the key-rate adjustments is also currently being priced in on the markets. On the basis of the EONIA forwards, the expectations are that the key interest rate will accordingly rise by just ten basis points over the year and the negative deposit rate will be done away with by year-end 2020. As of mid-2019, premature terminations of old TLTRO operations could lead to a sharp reduction in excess liquidity. The ECB is talking about reacting to that eventuality with further TLTROs.

Fundamental forecasts, Euroland

	2017	2018	2019
GDP	2.5	1.9	1.5
Private consumption	1.7	1.4	1.5
Govt. consumption	1.2	1.0	1.5
Fixed investment	2.8	3.2	2.5
Net exports [1]	0.8	0.2	0.0
Inflation	1.5	1.8	1.9
Unemployment rate [2]	9.1	8.2	7.6
Budget balance [3]	-1.0	-0.6	-0.7
Current acc. balance [3]	3.2	3.0	2.7

Change vs previous year as percentage; [1] as contribution to GDP growth; [2] as percentage of the labour force; [3] as percentage of GDP

Source: Feri, NORD/LB Fixed Income & Macro Research

Quarterly forecasts, Euroland

	IV/17	I/18	II/18	III/18	IV/18
GDP sa qoq	0.4	0.4	0.2	0.4	0.4
GDP sa yoy	2.4	2.2	1.7	1.4	1.4
Inflation yoy	1.3	1.7	2.1	2.2	2.1

Change as percentage

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Interest rates, Euroland

	22.11.	3M	6M	12M
Repo rate ECB	0.00	0.00	0.00	0.00
3M rate	-0.32	-0.31	-0.28	-0.15
10Y Bund	0.37	0.50	0.70	1.00

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

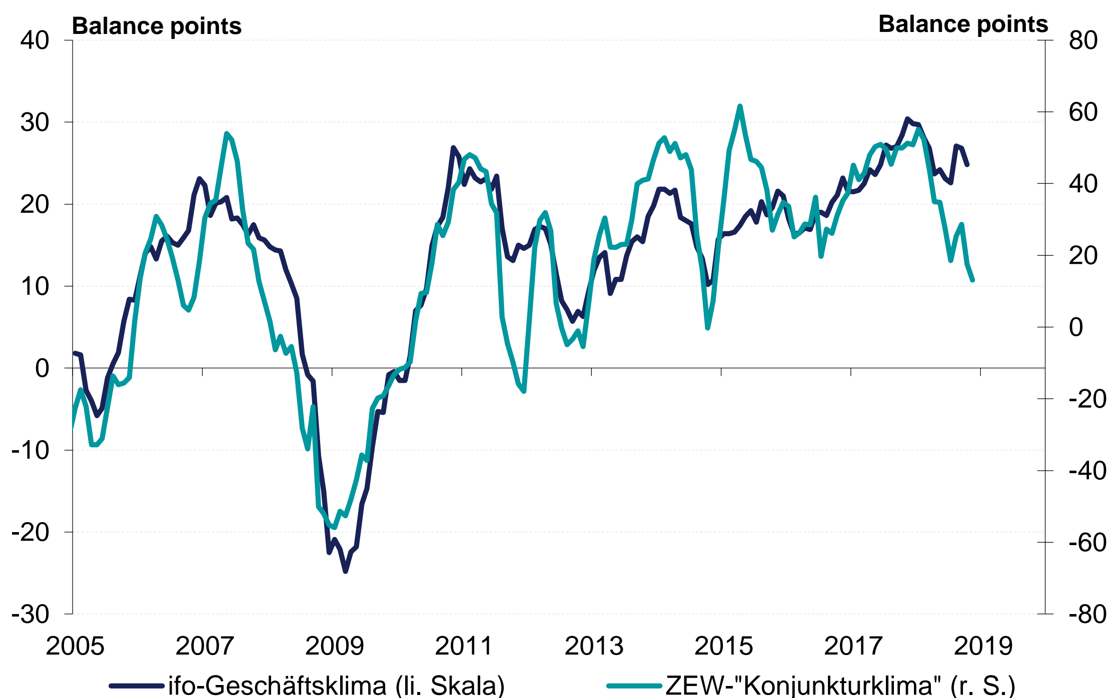
Germany
Waning economic tailwind

Analyst: Christian Lips

First GDP downturn since early 2015

Q3 saw the German economy register quarter-on-quarter contraction for the first time since early 2015, with real GDP down by a seasonally adjusted figure of 0.2 percent. This equates to an expansion rate of just 1.1 percent as against the same period last year. In the summer, foreign trade in particular had a negative impact, seeing as exports fell sharply by 0.9 percent qoq as opposed to imports (+1.3 percent qoq). Public consumption generated slightly positive stimuli, and investment in equipment and on buildings too grew by just short of 1 percent qoq in both cases; given the many uncertainties, this came as a slight surprise on the upside. In contrast, private consumption proved unusually weak, actually declining by 0.3 percent as against the previous quarter. While the positive trend in employment continued, real wages increased merely moderately in view of higher inflation. Standing at 2.3 percent yoy in September, the rate of inflation actually climbed even further in October to a year-on-year figure of 2.5 percent. This was primarily due to sharply rising energy prices. The price surge is – at least temporarily – having a dampening impact on real disposable income. Real consumption has accordingly slowed of late, especially due to consumer reticence in the private car segment.

Chart: Growing concern among financial market experts



Source: Bloomberg, NORD/LB Fixed Income & Macro Research

GDP temporarily hit by backlog in vehicle production

It should however be said that the poor GDP figures are due in part to special factors. In particular the problems with the certification of vehicle models in line with the WLTP exhaust emissions test standard have led, at least temporarily, to a marked throttling of production and sales in the automotive sector. The production figures available for October from the industry association VDA indicate a sluggishly emerging catch-up effect. Since some manufacturers expect the certification backlog to be completely cleared by year-end, the brake on production is likely to gradually ease, for which reason catch-up effects will likely take effect in the current quarter and help put the German economy back on track for growth. Besides the problems in the automotive industry, however, capacity bottlenecks and an uncertain global environment are having an increasingly dampening effect on the economy. Above all, the Brexit issue and – to put it mildly – the unorthodox policies of Donald Trump and the populist government in Italy are weighing on sentiment. The PMIs fell further in November and are approaching the 50-points mark and thus the expansion threshold. In addition, the financial market experts are significantly more pessimistic in the latest ZEW surveys than the business leaders regularly surveyed by the ifo Institute (see chart on p. 7). This difference might well to a large extent be explained by recent market developments, but a close look will nevertheless have to be taken at the next data from the leading indicators. The economic tailwind of last year is nowhere to be felt, at least for the moment. While there is still no reason for alarmism, growth rates above potential are no longer to be reckoned with in 2018 and 2019.

Fundamental forecasts, Germany

	2017	2018	2019
GDP	2.2	1.5	1.5
Private consumption	1.8	1.1	1.6
Govt. consumption	1.6	0.9	1.7
Fixed investment	2.9	3.1	2.4
Exports	4.6	2.2	2.5
Imports	4.8	3.7	3.7
Net exports [1]	0.3	-0.5	-0.4
Inflation [2]	1.7	1.9	2.0
Unemployment rate [3]	5.7	5.2	4.9
Budget balance [4]	1.0	1.6	1.1
Current acc. balance [4]	8.0	7.6	7.2

Change vs previous year as percentage; [1] as contribution to GDP growth; [2] HICP; [3] as percentage of the civil labour force (Federal Employment Office definition); [4] as percentage of GDP

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Quarterly forecasts, Germany

	IV/17	I/18	II/18	III/18	IV/18
GDP sa qoq	0.4	0.5	-0.2	0.6	0.4
GDP nsa yoy	1.4	2.3	1.1	1.1	1.3
Inflation yoy	1.4	1.9	2.1	2.3	2.4

Change as percentage

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

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Switzerland
Franc in the pincer grip of geopolitics

Analyst: Bernd Krampen

Swiss economy in ongoingly buoyant shape

Despite the growing international problems, the Swiss economy remains in buoyant shape. October as month under review saw the Alpine country deliver sound economic data. Particularly worthy of note in this context was the resurgence in exports, which, having been in decline in September, now registered month-on-month growth of 6.3 percent. Unemployment remained very low, with a seasonally adjusted figure of just 2.5 percent. In contrast, the PMI shows a more mixed picture, having declined by 2.3 percent last month but, at 57.4 points, nevertheless giving a far better showing than those of Switzerland's European neighbours. Moreover, 25 November is a date to note in two respects, on the one hand because of the decision on Brexit being taken on that day in Brussels and, on the other, on account of the "self-determination initiative" being voted on almost simultaneously in Switzerland. This initiative is aimed at ensuring that the national constitution takes precedence over international agreements. A result in its favour could have direct implications for the negotiations on Switzerland's further cooperation with the EU.

Geopolitical conflicts determine the Swiss franc

The appreciation pressure on the Swiss franc has grown again of late. This development is by no means likely to chime with what the SNB's central bankers would like to see. The reason for this upward movement has always been the same in recent weeks and months. The uncertainty in Europe is growing anew with this coming Sunday and the Brexit summit of heads of state and government in Brussels in view. In addition there are further sources of conflict, such as the trade dispute between the USA and China which remains unresolved even after the Apec meeting. All of this is contributing to the geopolitical situation becoming increasingly diffuse and driving investors increasingly to safe havens such as the Swiss national currency. The SNB is thus likely to go on being frequently forced to augment its currency reserves even further in the future in order to stem the franc's appreciation, as was the case recently when the central bank raised these by around 14 billion francs to a volume of CHF 753.3 billion.

Fundamental forecasts*, Switzerland

	2017	2018	2019
GDP	1.6	3.0	1.7
Inflation (CPI)	0.5	1.0	1.0
Unemployment rate [1]	3.2	2.7	2.4
Budget balance [2]	1.1	0.4	0.5
Current acc. balance [2]	9.8	11.0	10.5

Interest and exchange rates, Switzerland

	22.11.	3M	6M	12M
LIBOR target rate	-0.75	-0.75	-0.75	-0.75
3M rate	-0.75	-0.75	-0.75	-0.75
10Y	-0.09	0.00	0.10	0.30
Spread 10Y Bund	-46	-50	-60	-70
EUR in CHF	1.13	1.14	1.15	1.17

*Change vs previous year as percentage; [1] as percentage of the labour force; [2] as percentage of GDP

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

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Japan
Weak Q3 as expected

Analyst: Dr. Stefan Grosse

Weak Q3 as expected

After what was an excellent Q2, Q3 saw the Japanese economy register a negative growth rate for the second time this year, with a quarter-on-quarter drop of 0.3 percent according to the initial estimate; it ought not to be forgotten, however, that these initial estimates are as a rule quite susceptible to revision. Special factors had a negative effect, however. Japan suffered from various natural disasters: heat waves, floods, typhoons and earthquakes – events that impacted private consumption and exports and disrupted production and logistics chains. Even real investment could have contracted as a result, likewise registering a negative quarter-on-quarter growth rate. However, the "home-grown" special factors are likely not the only explanation for the slowdown, with the global economy, the trade war disputes and, in particular, the slowdown in growth in China also having left their mark. The "Red October" on the stock markets is likely having a negative impact on sentiment at the present time. Against this background we are not likely to see 2018 end all too dynamically in terms of the economy – though on a conciliatory note, with growth back in the positive zone in the wake of catch-up effects. Currently, the country is also likely to breathe a sigh of relief that the US president has put the topic of tariffs on cars on ice for the time being. At any rate, the outcome of the negotiations between Tokyo and Washington remains to be seen. It goes without saying that a lot will also depend on Trump's – limited – patience.

Mixed data situation

Apart from the stock markets, the leading indicators are not yet painting an overwhelmingly positive picture. The significant growth in car sales and the exceptionally strong imports with year-on-year expansion of almost 20 percent in each case for October point to a revival in domestic consumption. That said, net exports are also shrinking significantly as a result, since exports recovered but not to the same extent as imports. The export statistics are also indicating possible difficulties in the People's Republic of China, where demand for machinery, among other things, appears to be lagging far behind the other major trading partners USA and Europe. The upward trend in the current situation component of the Eco Watchers Index too points to a slight upturn in the domestic economy.

Fundamental forecasts*, Japan

	2017	2018	2019
GDP	1.7	0.8	0.8
Inflation	0.5	1.1	1.8
Unemployment rate [1]	2.8	2.4	2.8
Budget balance [2]	-3.5	-3.7	-3.9
Current acc. balance [2]	4.0	3.8	3.7

* Change vs previous year as percentage

Interest and exchange rates, Japan

	22.11.	3M	6M	12M
Key rate	-0.10	-0.10	-0.10	0.00
3M rate	-0.11	-0.10	-0.06	0.00
10Y	0.09	0.11	0.12	0.14
Spread 10Y Bund	-28	-39	-58	-86
EUR in JPY	129	130	131	134
USD in JPY	113	113	112	112

[1] as percentage of the labour force; [2] as percentage of GDP

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

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China
Loss of momentum

Analyst: Dr. Stefan Grosse

Loss of momentum

There are ongoing signs that Asia's most important economy is losing momentum. While the country's foreign trade statistics continued to report extraordinary growth in both imports and exports, this is likely due in part to a front-loading effect. A closer look at the details, for instance the Japanese foreign trade statistics, reveals not only a slowdown in pace but also a lack of demand for capital goods (machinery). The two PMIs are just about able to remain above the critical 50-points mark in the production sector, with significant downturns in the services sector. The declining momentum in retail sales and producer prices also fit into the picture. Though the PBOC is ensuring liquidity in the financial system through its lowering of the minimum reserve rates, among other measures, further cuts in interest and reserve rates are conceivable. However, this alone is not likely to suffice as stimulus. In this respect it is clear that the endeavours towards reducing debt are currently on hold, as the quarterly meeting of the Politburo on 31 October confirmed virtually conclusively: a corresponding passage was missing. Infrastructure measures will not be long in coming. The mountains of debt are thus growing further.

Renminbi under pressure – waiting for G20 summit

The economic data and the trade war are making for ongoing depreciation pressure on the Chinese currency. US President Trump's tweet that he was confident of reaching a deal with China made the markets quite upbeat in early November. This didn't last for long, however. The US dollar is currently trading close to the CNY 6.95 mark again. Alone the melting of the reserves to USD 3,053.10 bn as of 31 October and the correspondingly shrinking share of US Treasuries held by the People's Republic send out a clear signal. It is now particularly important to keep an eye on developments at the G20 summit in Argentina in late November, where there will be talks between Xi and Trump. A lack of signs of any relaxation of tensions would likely make for even greater pressure on the renminbi. The turbulent APEC summit is no good indication of an amicable outcome. That said, we are prepared to be surprised on the upside, in which case the USD/CNY 7 mark would likely be overstepped towards year-end.

Fundamental forecasts*, China

	2017	2018	2019
GDP	6.9	6.5	6.4
Inflation	1.6	2.2	2.7
Unemployment rate [1]	4.2	4.3	4.3
Budget balance [2]	-3.6	-3.6	-3.7
Current acc. balance [2]	1.3	1.5	1.7

* Change vs previous year as percentage

Interest and exchange rates, China

	22.11.	3M	6M	12M
Deposit rate	1.50	1.50	1.50	1.50
3M SHIBOR	3.06	2.30	2.20	3.15
10Y	3.40	3.50	3.61	3.89
Spread 10Y Bund	303	300	291	289
EUR in CNY	7.91	8.14	8.52	8.76
USD in CNY	6.93	7.08	7.28	7.30

[1] as percentage of the labour force; [2] as percentage of GDP

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

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Britain
Deal and chaos

Analyst: Dr. Stefan Grosse

The deal

The draft Brexit deal is all of 585 pages long. In essence, it involves the transition period and the shaping of the British-European future without, however, going into the trade issues. The UK is to contribute in full to the EU budget at least until 2020 and for pension payments, for example, until 2064. Should the transitional period be extended, the payment obligation is to be accordingly extended. The rights of EU citizens are to remain unchanged, as are those of Britons in mainland Europe. A hard Northern Ireland border is avoided. The lack of a trade agreement at the end of the transitional period would mean the UK remains in the customs union (backstop). The draft deal provides for labour, environmental and tax standards to be left in place and also serve as guidelines for the future shaping of the cooperation in order, for example, to prevent fiscal competition. All in all reasonable conditions which, rationally speaking, are acceptable and give the British more time to regulate the details on trade in goods in particular. EU chief negotiator Barnier was open to the possibility of a further extension of the transition phase to 2022, a precondition admittedly being that all 27 EU member states consent thereto. They will likely give the green light at the EU summit on 25.11., though Spain and France still have sensitivities on the issue.

… and the chaos

The trouble began early for prime minister May: while she succeeded in convincing her Cabinet, several ministers and secretaries of state submitted their resignations. The most prominent of these were Dominic Raab – now the second Brexit minister to quit the position in four months – and work and pensions minister Esther McVey. Her own party is threatening her with a vote of no confidence. If she manages to overcome this hurdle, which is quite likely, the next one awaits her in the House of Commons at the beginning of December. There, the situation will be far more complicated. The problem lies in the manifold individual interests. The Brexiteers take issue with the backstop and the payment obligations. Labour prefers a new election, the Remainers want a new referendum to prevent Brexit. The differing ideas about the future of the UK in the EU cut across the parties. Behind the scenes, the battle to unseat and replace the prime Minister is raging. One gets the impression that the aim is to let her fail so her position becomes vacant, no matter what that would mean for the country. Game of Thrones thus goes on air earlier than April 2019.

Fundamental forecasts*, Britain

	2017	2018	2019
GDP	1.7	1.2	1.0
Inflation (CPI)	2.7	2.5	2.1
Unemployment rate [1]	4.4	4.1	4.7
Budget balance [2]	-1.8	-1.4	-2.2
Current acc. balance [2]	-3.7	-3.7	-3.7

* Change vs previous year as percentage

Interest and exchange rates, Britain

	22.11.	3M	6M	12M
Repo rate	0.75	0.75	0.75	1.00
3M	0.89	0.90	0.90	1.10
10Y	1.43	1.60	1.70	1.80
Spread 10Y Bund	106	110	100	80
EUR in GBP	0.89	0.87	0.87	0.87
GBP in USD	1.29	1.32	1.34	1.38

[1] as percentage of the labour force as per ILO concept; [2] as percentage of GDP

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

NORD/LB

Canada
Renewed rate hike firmly in view – oil price weighs on CAD

Analysts: Tobias Basse // Bernd Krampen

Further rate hike likely to be on the agenda again soon

The Bank of Canada undertook its last rate hike as recently as 24 October, and the next upward adjustment is already to be reckoned with. The central bankers could bide their time again in early December, but we are likely to see the key rate raised to a level of 2.00 percent in January at the latest. This was indicated in the quite "hawkish" comments from Ottawa of late, with BoC president Stephen Poloz remarking that higher interest rates are a fundamental necessity in a healthy economy. A renewed rate adjustment by the end of the first quarter should therefore be reckoned with. A further reason for expecting a further hike lies in the diminished uncertainty in the wake of the successful NAFTA negotiations, with the result in the form of a new free trade area pact under the name of 'USMCA' having averted a trade dispute involving new customs duties. We had in any case expected a last-minute compromise, so there was no need for us to adjust our growth forecasts for Canada. Solely the tightening of the BoC's monetary policy is now being speeded up.

Sound economy and diminished concerns about the financial system

A further reason for expecting this lies in the quite sound economic data from the land of the maple leaf of late. Business sentiment remains at a healthy level and the unemployment rate has fallen slightly to 5.8 percent. Solely the construction data were not so pleasing. That said, this could indicate a basically striven-for slow soft landing of the real estate market. This generally brighter environment with slightly rising interest rates is basically a factor in favour of the Canadian currency, in addition to which we also expect the Federal Reserve to shift down a gear as well within the framework of normalizing its monetary policy in 2019. However, the fact that the loonie nevertheless got no tailwind in the past few days was once again due to the developments on the crude oil markets: the collapse of the oil price by 25 percent since early October to its lowest level since late last year is weighing on the commodity currency. We expect a slight countermovement on the oil front, in the wake of which the Canadian dollar too can be expected to strengthen somewhat.

Fundamental forecasts*, Canada

	2017	2018	2019
GDP	3.0	2.1	2.1
Inflation	1.6	2.3	2.1
Unemployment rate [1]	6.3	5.9	5.8
Budget balance [2]	-1.0	-0.8	-0.7
Current acc. balance [2]	-2.9	-2.8	-2.4

* Change vs previous year as percentage

Interest and exchange rates, Canada

	22.11.	3M	6M	12M
O/N target rate	1.75	2.00	2.25	2.25
3M	1.70	2.10	2.30	3.40
10Y	2.37	2.50	2.70	2.90
Spread 10Y Bund	200	200	200	190
EUR in CAD	1.50	1.50	1.52	1.56
USD in CAD	1.32	1.30	1.30	1.30

[1] as percentage of the labour force; [2] as percentage of GDP

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Mexico
Interest rate hike in the wake of change of government and the peso's weakness

Analysts: Tobias Basse // Bernd Krampen

Interest rate hike in the wake of change of government
After last month's agreement on the "NAFTA 2.0" deal initially gave rise to hope that the Mexican economy would now get a little boost, this hope now seems to have partially evaporated. Confronted with this development, the Mexican central bank, Banxico, reacted by raising its key interest rate by 25 basis points. This hike to eight percent was also expected by the market in this form, though the reason given as to why the central bankers felt compelled to take this step came as a surprise. On the one hand, the statement was extremely hawkish and particularly addressed the risks of rising inflation. On the other, a certain degree of criticism about the incoming government became clear. More particularly, the central bankers made it clear that the assumption of office by Andrés Manuel López Obrador in just over a week's time is to a certain extent also making for increasing uncertainty about future economic policy. This is primarily connected with the halt on the construction of the planned airport in Mexico City. To counter this negative news, the Banxico bankers have already indicated that they will be keeping a close eye on the country's future developments and, in case of doubt, will not hesitate to take the necessary monetary measures towards achieving the 3-percent inflation rate target. With a year-on-year inflation rate of 4.9 percent at present, the country has diverged markedly from this target.

Peso remains under pressure
The concerns about the upcoming policies of president-elect Obrador have increased the pressure on the Mexican peso of late, with the country's national currency overstepping the psychologically important mark of 20 pesos per dollar and temporarily even approaching a level of 21 MXN/USD. This development is also having a close watch kept on it by the Mexican central bank and is frequently seen as a reason for further interest rate adjustments. Against this background we anticipate a further raise of the key rate before the end of this year and an additional hike next year. Whether or not these measures will be sufficient to stabilize the peso will depend largely on the new president's first weeks in office.

Fundamental forecasts*, Mexico

	2017	2018	2019
GDP	2.0	2.1	2.1
Inflation	6.0	4.9	4.0
Unemployment rate [1]	3.4	3.4	3.5
Budget balance [2]	-1.7	-2.3	-2.5
Current acc. balance [2]	-1.1	-1.7	-1.8

* Change vs previous year as percentage

Interest and exchange rates, Mexico

	22.11.	3M	6M	12M
O/N target rate	8.00	8.00	8.00	8.00
3M	8.19	8.10	7.90	7.80
10Y	9,04	8,50	8,30	8,00
Spread 10Y Bund	867	800	760	700
EUR in MXN	23.16	22.43	22.82	23.40
USD in MXN	20.31	19.50	19.50	19.50

[1] as percentage of the labour force; [2] as percentage of GDP

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

NORD/LB

Australia
Sound data, hopes set on China – AUD manages rebound

Analysts: Tobias Basse // Bernd Krampen

Sound labour market report

The Australian labour market report for October delivered a positive picture: more than 32,000 jobs were created – predominantly of a full-time nature. The unemployment rate remained ongoingly low, at 5.0 percent, appearing to indicate that the Reserve Bank of Australia's low-interest policy is having a positive economic effect. On the other hand, it should also be noted that the sentiment among Australian companies has deteriorated somewhat. The great concern as to the further economic developments in China may have played a certain role in this trend. Australia's consumers at any rate still appear to be unimpressed by this, as reflected by the upward trend in the consumer sentiment surveys in November.

China remains a highly important factor for Down Under

The news on the Chinese economy remains a focus of attention. The concerns as to the consequences of a possible trade war between Washington and Beijing without doubt constitute a burdening factor, against which background the reports of a possible willingness for talks between Washington and Beijing – presumably at the G20 meeting in Buenos Aires – made for a certain relaxing of tensions. Whether or not an agreement can be reached then or later still rests in the lap of the gods, however.

RBA to remain in wait-and-see mode for the time being

The Reserve Bank of Australia will be keeping a close eye on the uncertain economic outlook. Domestic challenges, such as the high level of household debt, also need to be taken into account, as pointed out by central banker Guy Debelle, for example, who spoke of a considerable risk in the event of a negative shock. For now, we do not expect the Australian central bank to act within the next six months – but quite likely in the second six months of 2019. In the wake of sound Australian data and the hopeful news on the trade conflict, the Australian dollar stopped its downward trend and leapt to a level above the USD 0.73 mark. A further bolstering factor lay in the fact that the perspectives for the Federal Reserve also changed somewhat, with growing speculation as to a pause in interest rate hikes in 2019. Against this background the Australian dollar is likely to give a somewhat more stable showing in the months ahead.

Fundamental forecasts*, Australia

	2017	2018	2019
GDP	2.2	3.2	2.8
Inflation	1.9	2.1	2.2
Unemployment rate [1]	5.6	5.4	5.1
Budget balance [2]	-0.5	-1.0	-0.8
Current acc. balance [2]	-2.6	-2.6	-2.8

* Change vs previous year as percentage

Interest and exchange rates, Australia

	22.11.	3M	6M	12M
Cash target rate	1.50	1.50	1.50	1.75
3M	1.94	1.95	2.05	2.20
10Y	2.68	2.70	2.80	3.00
Spread 10Y Bund	231	220	210	200
EUR in AUD	1.57	1.55	1.53	1.53
USD in AUD	0.73	0.74	0.75	0.75

[1] as percentage of the labour force; [2] as percentage of GDP

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

NORD/LB

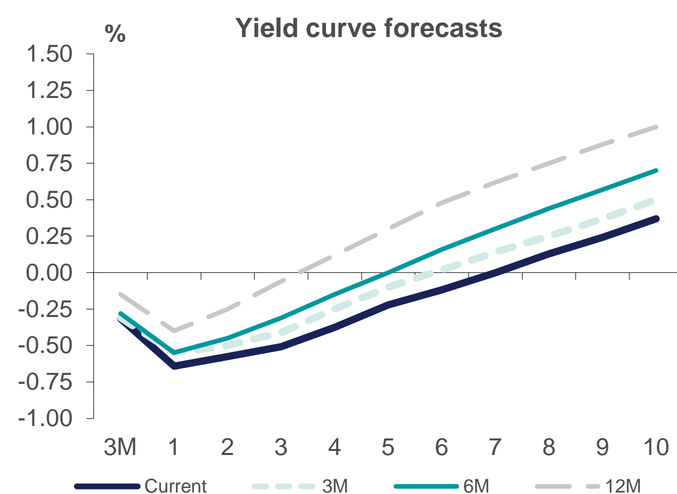
Portfolio strategies
Yield curve, Euroland

Yields and forecasts (Bunds/Swap)

Yields (in %)		NORD/LB forecast for horizons		
	current	3M	6M	12M
3M	-0.32	-0.31	-0.28	-0.15
1Y	-0.64	-0.55	-0.55	-0.40
2Y	-0.58	-0.50	-0.45	-0.25
3Y	-0.51	-0.41	-0.31	-0.06
4Y	-0.37	-0.25	-0.15	0.12
5Y	-0.22	-0.10	0.00	0.30
6Y	-0.12	0.02	0.16	0.48
7Y	0.00	0.14	0.30	0.62
8Y	0.13	0.25	0.44	0.75
9Y	0.24	0.37	0.57	0.88
10Y	0.37	0.50	0.70	1.00
2Y (Swap)	-0.14	0.00	0.05	0.20
5Y (Swap)	0.31	0.40	0.50	0.75
10Y (Swap)	0.92	1.00	1.15	1.35

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Yield curve forecasts (Bunds)



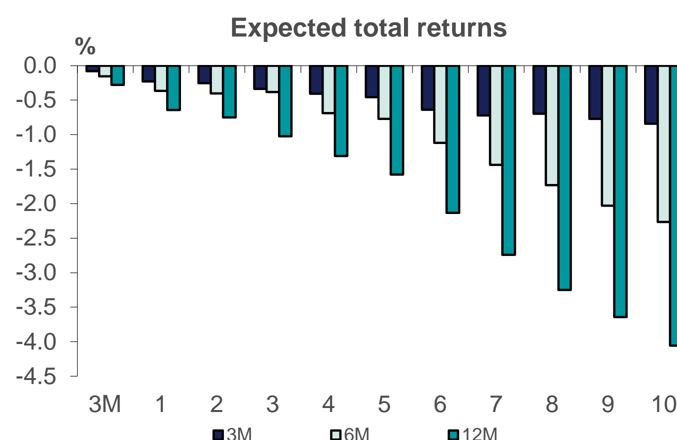
Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Forecasts and total returns

	Total returns (in %) for horizons...		
	3M	6M	12M
3M	-0.08	-0.16	-0.28
1Y	-0.23	-0.37	-0.64
2Y	-0.26	-0.40	-0.75
3Y	-0.34	-0.38	-1.02
4Y	-0.41	-0.69	-1.31
5Y	-0.46	-0.77	-1.58
6Y	-0.64	-1.12	-2.13
7Y	-0.72	-1.44	-2.74
8Y	-0.70	-1.73	-3.25
9Y	-0.77	-2.03	-3.64
10Y	-0.84	-2.26	-4.06

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Expected total returns



Source: Bloomberg, NORD/LB Fixed Income & Macro Research

A total return is the absolute profit from an investment in the time period under consideration, with account being taken of the pro-rata yields plus the price gains or losses to be anticipated on the basis of the forecast yield curve change.

NORD/LB

Portfolio strategies
International yield curve: 3-month & 12-month horizons

3-month horizon

Expected total returns (as %) in euro

	EUR	USD	GBP	JPY	CHF
1Y	-0.2	-0.2	2.0	-1.0	-0.7
2Y	-0.3	0.1	1.8	-1.0	-0.7
3Y	-0.3	0.0	1.6	-1.0	-0.9
4Y	-0.4	-0.3	1.4	-1.0	-0.9
5Y	-0.5	-0.4	1.2	-1.0	-1.0
6Y	-0.6	-0.6	0.9	-1.0	-1.1
7Y	-0.7	-0.5	0.5	-1.0	-1.2
8Y	-0.7	-0.6	0.2	-1.0	-1.3
9Y	-0.8	-0.5	0.3	-1.0	-1.2
10Y	-0.8	-0.6	0.3	-0.9	-1.1

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Expected total returns (as %) in national currencies

	USD	GBP	JPY	CHF
1Y	0.7	0.2	-0.1	-0.2
2Y	0.9	0.0	-0.1	-0.4
3Y	0.8	-0.2	-0.1	-0.4
4Y	0.6	-0.4	-0.1	-0.4
5Y	0.4	-0.5	-0.1	-0.6
6Y	0.2	-0.8	-0.1	-0.6
7Y	0.3	-1.2	-0.1	-0.7
8Y	0.3	-1.5	-0.1	-0.9
9Y	0.4	-1.5	0.0	-0.7
10Y	0.2	-1.4	0.0	-0.7

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

12-month horizon

Expected total returns (as %) in euro

	EUR	USD	GBP	JPY	CHF
1Y	-0.6	-2.4	2.6	-4.0	-3.9
2Y	-0.8	-2.4	2.2	-4.1	-3.8
3Y	-1.0	-2.6	1.7	-4.1	-3.9
4Y	-1.3	-2.8	1.3	-4.2	-4.0
5Y	-1.6	-3.1	1.2	-4.2	-4.4
6Y	-2.1	-3.5	1.0	-4.3	-4.9
7Y	-2.7	-4.0	0.7	-4.3	-5.1
8Y	-3.2	-4.1	0.4	-4.3	-5.5
9Y	-3.6	-4.4	0.3	-4.1	-5.5
10Y	-4.1	-4.4	0.3	-3.8	-5.6

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Expected total returns (as %) in national currencies

	USD	GBP	JPY	CHF
1Y	2.7	0.8	-0.2	-0.9
2Y	2.7	0.4	-0.2	-0.8
3Y	2.5	-0.1	-0.2	-1.0
4Y	2.3	-0.5	-0.3	-1.0
5Y	2.0	-0.6	-0.4	-1.4
6Y	1.5	-0.7	-0.4	-1.9
7Y	1.0	-1.1	-0.4	-2.2
8Y	0.9	-1.4	-0.4	-2.6
9Y	0.6	-1.4	-0.2	-2.6
10Y	0.6	-1.5	0.0	-2.6

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

A total return is the absolute profit from an investment in the time period under consideration, with account being taken of the pro-rata yields plus the price gains or losses to be anticipated on the basis of the forecast yield curve change.

NORD/LB

Portfolio strategies
Stock market strategy; 3- month, 6-month & 12-month horizons

Levels and performance

Index	Level as at 22.11.2018	Status		Performance since	
		Prev. month	Start of year	Prev. month	Start of year
DAX	11,138.49	11,447.51	12,917.64	-2.70%	-13.77%
MDAX	23,093.08	24,180.16	26,200.77	-4.50%	-11.86%
EuroSTOXX50	3,126.67	3,197.51	3,503.96	-2.22%	-10.77%
STOXX50	2,881.82	2,947.71	3,177.84	-2.24%	-9.32%
STOXX600	352.57	361.61	389.18	-2.50%	-9.41%
Dow Jones	24,465.64	25,115.76	24,719.22	-2.59%	-1.03%
S&P 500	2,641.89	2,711.74	2,673.61	-2.58%	-1.19%
Nikkei	21,507.54	21,920.46	22,764.94	-1.88%	-5.52%

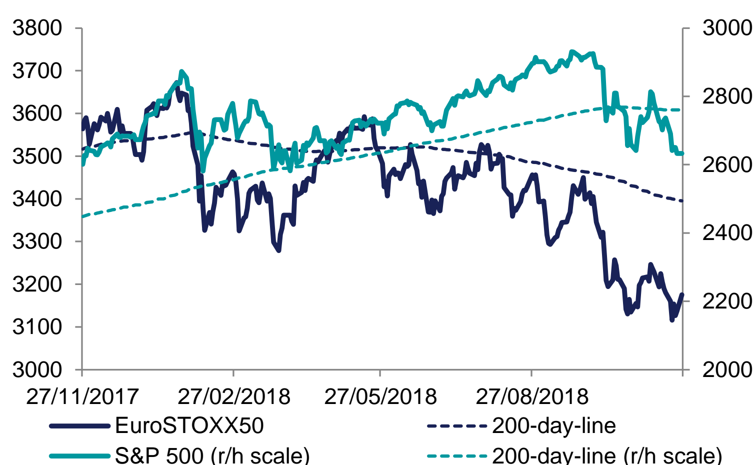
Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Index forecasts

Index	NORD/LB forecasts for horizons ...		
	3M	6M	12M
DAX	11,800	12,200	12,600
MDAX	24,800	25,800	26,600
EuroSTOXX50	3,280	3,400	3,450
STOXX50	3,025	3,150	3,175
STOXX600	370	385	390
Dow Jones	25,750	26,000	26,500
S&P 500	2,775	2,825	2,875
Nikkei	21,500	22,000	21,300

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

EuroSTOXX50 and S&P500



Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Date of going to press for data, forecasts and text was **Friday, 23 November 2018, 1:56 pm**.

The next English issue of Economic Adviser will be appearing on **17 December 2018**.

NORD/LB

Overview of forecasts

Fundamental forecasts

in %	GDP growth			Rate of inflation			Unemployment rate[1]			Budgetary balance[2]		
	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2018	2019
USA	2.2	2.9	2.5	2.1	2.5	2.3	4.4	3.8	3.6	-3.6	-4.6	-4.6
Euroland	2.5	1.9	1.5	1.5	1.8	1.9	9.1	8.2	7.6	-1.0	-0.6	-0.7
Germany	2.2	1.5	1.5	1.7	1.9	2.0	5.7	5.2	4.9	1.0	1.6	1.1
Japan	1.7	0.8	0.8	0.5	1.1	1.8	2.8	2.4	2.8	-3.5	-3.7	-3.9
Britain	1.7	1.2	1.0	2.7	2.5	2.1	4.4	4.1	4.7	-1.8	-1.4	-2.2
Switzerland	1.6	3.0	1.7	0.5	1.0	1.0	3.2	2.7	2.4	1.1	0.4	0.5
China	6.9	6.5	6.4	1.6	2.2	2.7	4.2	4.3	4.3	-3.6	-3.6	-3.7
Canada	3.0	2.1	2.1	1.6	2.3	2.1	6.3	5.9	5.8	-1.0	-0.8	-0.7
Mexico	2.0	2.1	2.1	6.0	4.9	4.0	3.4	3.4	3.5	-1.7	-2.3	-2.5
Australia	2.2	3.2	2.8	1.9	2.1	2.2	5.6	5.4	5.1	-0.5	-1.0	-0.8

Change vs previous year as percentage; [1] as percentage of the labour force (Germany: as per Federal Employment Office definition); [2] as percentage of GDP

Source: Feri, NORD/LB Fixed Income & Macro Research

Key rates

In %	22.11.18	3M	6M	12M
USD	2.25	2.50	2.50	2.75
EUR	0.00	0.00	0.00	0.00
JPY	-0.10	-0.10	-0.10	0.00
GBP	0.75	0.75	0.75	1.00
CHF	-0.75	-0.75	-0.75	-0.75
CNY	1.50	1.50	1.50	1.50
CAD	1.75	2.00	2.25	2.25
MXN	8.00	8.00	8.00	8.00
AUD	1,50	1,50	1,50	1,75

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Exchange rates

EUR in...	22.11.18	3M	6M	12M
USD	1.14	1.15	1.17	1.20
JPY	129	130	131	134
GBP	0.89	0.87	0.87	0.87
CHF	1.13	1.14	1.15	1.17
CNY	7.91	8.14	8.52	8.76
CAD	1.50	1.50	1.52	1.56
MXN	23.16	22.43	22.82	23.40
AUD	1.57	1.55	1.53	1.53

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Interest rates (government bonds)

	3M rates				Yields 2Y				Yields 5Y				Yields 10Y			
	22.11.	3M	6M	12M	22.11.	3M	6M	12M	22.11.	3M	6M	12M	22.11.	3M	6M	12M
USD	2.69	2.65	2.80	3.00	2.81	2.60	2.90	3.05	2.89	3.00	3.10	3.25	3.06	3.15	3.25	3.45
EUR	-0.32	-0.31	-0.28	-0.15	-0.58	-0.50	-0.45	-0.25	-0.22	-0.10	0.00	0.30	0.37	0.50	0.70	1.00
JPY	-0.11	-0.10	-0.06	0.00	-0.15	-0.13	-0.12	-0.08	-0.10	-0.08	-0.06	-0.01	0.09	0.11	0.12	0.14
GBP	0.89	0.90	0.90	1.10	0.77	0.85	0.85	1.20	0.99	1.15	1.20	1.40	1.43	1.60	1.70	1.80
CHF	-0.75	-0.75	-0.75	-0.75	-0.77	-0.75	-0.75	-0.65	-0.52	-0.40	-0.30	-0.10	-0.09	0.00	0.10	0.30

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

Spreads (bp)

	3M EURIBOR				2Y Bunds				5Y Bunds				10Y Bunds			
	22.11.	3M	6M	12M	22.11.	3M	6M	12M	22.11.	3M	6M	12M	22.11.	3M	6M	12M
USD	301	296	308	315	339	325	335	330	311	310	310	295	269	265	255	245
JPY	21	21	22	15	43	37	33	17	12	2	-6	-31	-28	-39	-58	-86
GBP	121	121	118	125	135	135	130	145	121	125	120	110	106	110	100	80
CHF	-43	-44	-47	-60	-20	-25	-30	-40	-30	-30	-30	-40	-46	-50	-60	-70

Source: Bloomberg, NORD/LB Fixed Income & Macro Research

NORD/LB

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Sales Sparkassen & Regional Banks	+49 511 9818-9400
Sales MM/FX	+49 511 9818-9460
Fixed Income/ Structured Products Europe	+352 452211-515
Sales Asia	+65 64 203131

Trading

Covereds/SSA	+49 511 9818-8040
Financials	+49 511 9818-9490
Governments	+49 511 9818-9660
Federal States/Regions	+49 511 9818-9550
Frequent Issuers	+49 511 9818-9640

Origination & Syndicate

Origination FI	+49 511 9818-6600
Origination Corporates	+49 511 361-2911

Treasury

Collat. Management/Repos	+49 511 9818-9200
Liquidity Management	+49 511 9818-9620 +49 511 9818-9650

Corporate Sales

Ships/Aircraft	+49 511 9818-9440
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FX/MM	+49 511 9818-4006

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