Economic Weekly: Views from Paris

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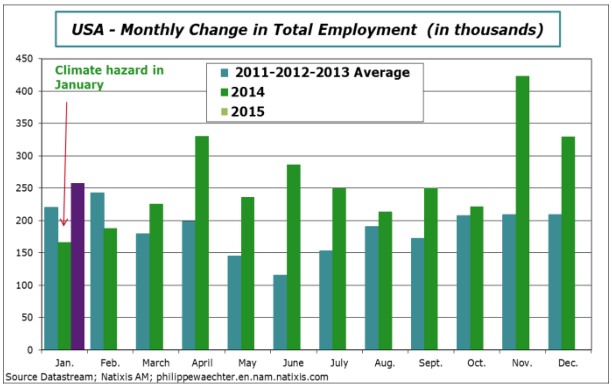
Key element of the week starting February 2

US employment has increased a lot during the last three months. The number of jobs creation was strong in January (+257 000) and the upward revisions in November and December were significant. This can be seen on the graph below.

The report was full of details that show a real improvement in the labor market. The first is the change in regime since last April. It continues in January 2015 and reflects stronger numbers since April. The second point is the strong inflow on the labor market from people that were out of the market. This means that the labor market attractiveness has dramatically changed. This is a positive signal.

On another point of view the employment rate for people between 25 and 55 years of age is improving rapidly. These people have had a succession of negative shocks. Employment has dropped rapidly in this tranche of age. Step by step they are coming back on the market. The "25-55" employment rate is now at 77.2%. It is still 2.8% below the business cycle peak in January 2008. That's a situation I was expecting in order to have a real perception that the situation is converging to a more normal trajectory. The fact that people are back to the labor market is the main reason to explain the marginal increase of the unemployment rate. With this in mind, this is a good signal.

But the trajectory is still far from its long term equilibrium and that's why there are no pressures on wages yet. The average wage rate grows at the reduced pace of 2.2%.



Other Important Issues

- The situation in Greece is still fragile. Last week trips to visit European governments have not been a real success. They still have to convince that a switch between the current situation which expired on February the 28th and a new contract will be profitable for everyone. Alexis Tsipras speech late on Sunday the 8th is still close to Syriza program. On Wednesday the 11th for the Eurogroup and the 12th with the heads of government, Varoufakis then Tsipras will have to find support. A failure would drive to increasing the probability of a Euro Area collapse.
- The ECB has changed the refinancing conditions for Greek banks. Government bonds and bonds with the government guarantee will not be eligible anymore. The ELA instrument will be available but be more expensive than the usual procedure.
- PMI indices were almost stable in January for the manufacturing sector in developed countries. Nevertheless, the US ISM dropped for the manufacturing sector; probably the impact of a low oil price.
- Composite indices in the USA and the Euro Area were stable for the first and improving for the second.
- In these surveys, emerging countries are still weak. China is below 50 and Russia in recession
- Strong improvement in retail sales for the Euro Area in the fourth quarter (strongest since Q4 2006).
- For the whole year the US inflation rate was just 1.3% for the headline and 1.4% for the core measure. Far from the 2% target for the preferred Fed's target.
- Due to poor growth prospects and to low expectations on commodity prices, the Reserve Bank of Australia has reduced its interest rate by 25 bp to 2.25%
- Industrial production was up in Germany for the 4th quarter (2.5% after -1% in Q3) - + 1.3% in 2014
- Very large surplus for the Chinese external trade: USD 60bn-Drop in import (commodities) is the main explanation. But export dynamics was poor also (-3.3% on a year)

What will happen this coming week?

- The main issue will be the two meetings on Greece (11 and 12)
- GDP growth number for the Euro Area in the 4th quarter will be available on Friday
- Retail sales in the USA (Thursday) and the inflation report in UK (Thursday)
- Industrial production indices in Europe (France, UK, Italy, Euro Area)
- Employment numbers for the 4th quarter on France (Friday)

Weekly Column

What did we learn last week?

The first point to mention is the Greek situation. On February 11, the new government will have to present its new plan to the Eurogroup members (Finances ministers of the Euro Area).
Yanis Varoufakis will need talent to convince ministers that a switch to new rules on the financing of the Greek economy is superior to the current commitment. He will propose a new contract that will link Greece to its Euro partners. The first target for these new rules is to stop the austerity mechanism. The deal is to improve first growth conditions and then to repay the debt.
Last week meeting with European governments have not been a success especially in Germany where Wolfgang Schauble said that they were not able to find a way to how to disagree on their disagreements.

The meeting with the Eurogroup will be more complicated after Alexis Tsipras' speech in Athens on Sunday 8th. He said he wanted to keep the Syriza program on minimum wage (up), on a property tax (abolished) and on the minimum income for taxation (minimum income to pays tax will be increased). The government wants to exit from austerity and to give hope to the Greek people. The issue is to be able to withdraw from constraints that have been put in place by the troika.

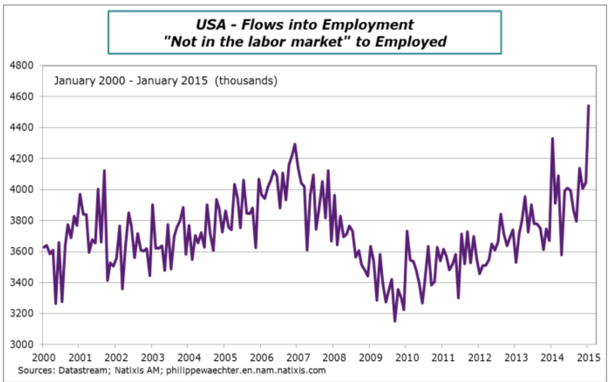
On Wednesday 4, the ECB has changed the refinancing conditions for Greek banks. Government bonds and guaranteed assets by the Hellenic government are no longer eligible for refinancing operations. Greek banks will have to go through an emergency procedure that is managed by the Greek central bank. Banks will be able to refinance but at a higher cost. The ECB keeps the management of this procedure as it can be withdrawn by the Council of Governors with a majority of 2/3.

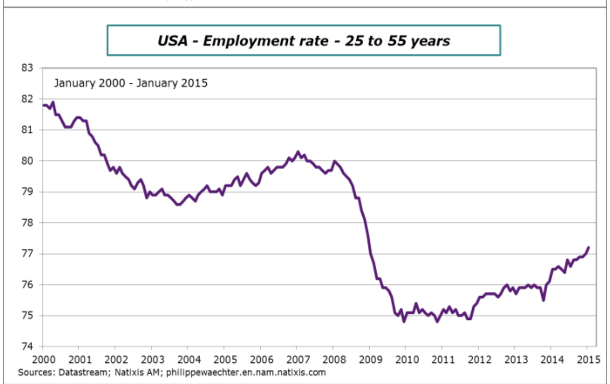
The absence of an agreement at the 2 meetings this week could put supplementary pressures on banks as the financing support from the troika would end. In that case, banks wouldn't be able to refinance even with the ELA procedure. If it was the case, Greece would have to find other sources of financing or to create its own currency. In every case, it would be a source of fragility for the euro construction.

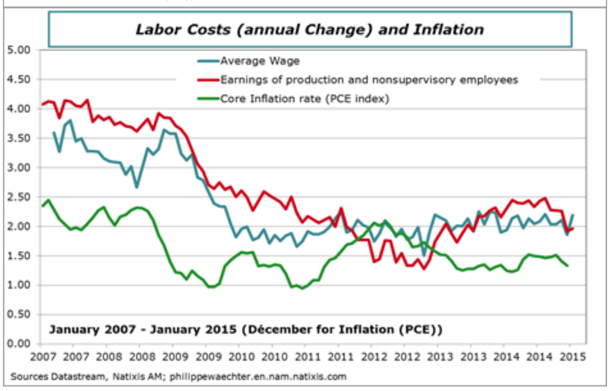
That's the main reason for an agreement. We can summarize the situation in few sentences:

- The adjustment has been large for Greek people. GDP dropped by 25%, the unemployment rate is above 25% but now the current account and the primary budget balance (budget ex payment for the interest on public debt) are in surplus.
- The troika is financing Greece. This financing is conditioned to the convergence to some specific targets
- What the Greek government says is that converging to these targets would weaken growth prospects. That's the main reason to switch to another contract with the troika. They want to repay the debt only when economic activity will recover. The troika and most euro governments want to maintain the current contract.
- This is the divergence that has to be explained. That's the reason of this week meetings. The constraint on the discussion is that Greece doesn't want to exit from the euro area and euro members do not want to take the risk of a Grexit. A Grexit could weaken the whole construction of the euro zone and no one really wants to take this kind of risks
- That's why we expect an agreement

The second key issue this week was the improvement on the US labor market. Figures for January were strong (+257 000 new jobs) but the upward revisions in November and December were impressive: the three month change at annual rate (+2.78%) was the strongest since January 2000.
The most interesting part of the report is the fact that the labor







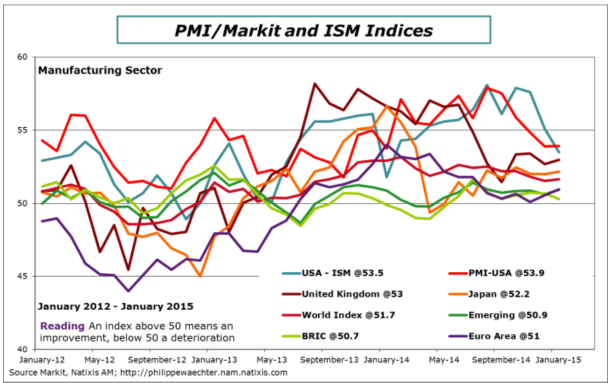
market is now converging toward a more "normal" behavior. A lot of people that was pushed out of the labor market are now coming back. They feel that the market is better shaped and that they will, now, be able to find a job. This type of behavior is always an important one as the labor market attractiveness is improving at a mid-term horizon. The other important issue is the higher employment rate for people in the range of 25 to 55 years in age. This is consistent also with a higher participation rate of this tranche of age. The employment rate is still low at 77.2%, 2.8% below the January 2008 peak.
This explains the higher unemployment rate in a situation of strong jobs creation. **As the labor market is still on its adjustment path after a persistent shock, it is not surprising that the annual change in wages remains low**. Pressures are still limited. It will come later and mustn't be for the Fed a trigger for a lift-off in its interest rates.

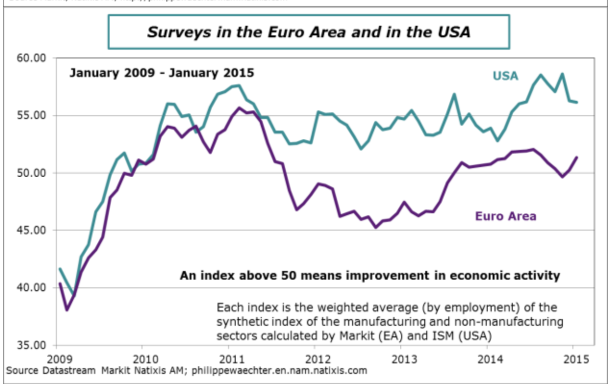
Short term prospects are almost stable if we follow the PMI/Markit surveys. The world index is still showing growth in the manufacturing sector but without acceleration. It can be consistent with a modest growth for the industrial production. It is not a advanced signal for a rapid improvement in world trade. The US Markit index is almost stable as are UK and Japanese indices. The Euro Area index is inching up but remains weak. The BRIC index is still close to but above 50. The Brazilian index is improving (above 50) for the second month in a row but the Chinese index is still below the 50 threshold (2nd month and it is also the case now for the official index). **The Russian index is falling rapidly. Russia will be in recession this year.**
2 remarks:
- **The ISM index for the USA is decelerating** rapidly as it can be seen on the graph. It is linked with new orders and probably the short term impact of a low oil price on investment.
- **The Swiss index dropped well below the 50 threshold**. It was way above 50 before the Swiss National Bank decision to withdraw the ceiling between the Swiss franc and the euro. The risk of recession is high.

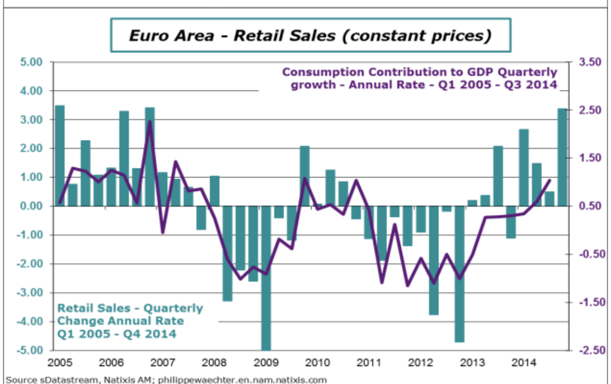
Composites indices in the US and in the Euro zone are still following divergent paths. We notice that the Euro Area index is improving.

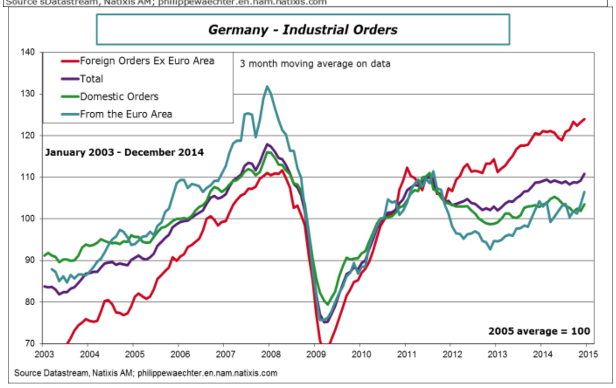
In the Euro Area, retail sales have had a stronger momentum during the fourth quarter of 2014. The quarterly change (volume) at annual rate was the highest since the fourth quarter of 2006. Lower energy prices and a marginal improvement on the labor market (the unemployment rate was down in December) have been a trigger for a change. It implies that GDP growth numbers for the fourth quarter, published next Friday, could be better oriented than expected.
In Germany, industrial orders have followed a stronger trajectory in December. The momentum is higher in the Euro Area and there is a reversal in domestic orders. German companies may perceive stronger prospects that are consistent with IFO and ZEW surveys.

During the coming week, the most important issue will be the Eurogroup meeting (11) and the heads of government meeting (12) on the Greek situation
Next Friday, GDP growth numbers for the fourth quarter and for 2014 will be published for the Euro Area, Germany, France, Italy..
The report on retail sales will be on air next Thursday in the US. The same day, the report on Inflation will be published by the Bank of England. On Friday INSEE will present employment figure for the last quarter of 2014. During the week, figures on industrial production will be available in Europe.









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EQUITY MARKETS FEBRUARY 6, 2015	Level		On a year (close)		Change in local currency			Change in Euro		
	12/31/14	01/06/15	Min	Max	1 Y	YTD	1w	1 y	YTD	1 w
CAC 40	4272.75	4691.03	3918.62	4703.30	10.95	9.79	1.88			
DAX	9805.55	10846.39	8571.95	10911.32	16.60	10.61	1.42			
EuroStoxx	3146.43	3398.16	2874.65	3415.53	11.84	8.00	1.39			
FTSE	6566.09	6853.44	6182.72	6878.49	4.29	4.38	1.54	16.58	9.00	2.66
SNP 500	2058.90	2055.47	1797.02	2090.57	14.38	-0.17	3.03	37.31	6.48	2.48
Nasdaq	4736.05	4744.40	3999.73	4806.91	14.99	0.18	2.36	38.04	6.85	1.80
Nikkei 225	17450.77	17648.50	13910.16	17935.64	22.03	1.13	-0.15	25.81	8.66	-1.98
MSCI Emerging	956.31	978.57	909.98	1100.98	4.40	2.33	1.77	25.33	9.14	1.22
MSCI World USD	1709.67	1720.55	1592.60	1764.12	6.75	0.64	2.56	28.15	7.34	2.01

INTEREST RATES – FEBRUARY 6, 2015	Interest Rates – February 6, 2015							Interest Rates December 31, 2014			
	Level				Weekly Change						
	Central Bank	3 month*	2 Year	10 Year	3 month	2 Year	10 Year	Central Bank	3 month	2 Year	10 Year
USA	0 - 0.25	0.256	0.65	1.95	0.00	0.18	0.27	0 - 0.25	0.26	0.67	2.17
Zone Euro	0.05	0.053	-0.183	0.331	0.00	-0.01	0.06	0.05	0.08	-0.07	0.54
UK	0.5	0.53	0.586	1.539	0.00	0.18	0.18	0.5	0.53	0.51	1.76
Japan	0.1	0.173	0.043	0.342	0.00	0.03	0.06	0.1	0.18	-0.03	0.33

SPREADS	3 month* (02/06/15)	2 year (02/06/15)	10 year (02/06/15)	3 month (12/31/14)	2 year (12/31/14)	10 year (12/31/14)
USA – Euro Area	0.20 (0.20) §	0. 83 (0.64) §	1.62 (1.41) §	-0.04	0.19	1.1
UK – Euro Area	0.48 (0.48) §	0.77 (0.58) §	1.21 (1.09) §	0.24	0.37	1.09

* 3 month interbank rate, § previous week

FOREX – GOLD – OIL MARKET – FEBRUARY 6, 2015		Level		Change		
		12/31/2014	02/06/15	1 week	YTD	1 year
Euro – Dollar (var. + higher euro)		1.210	1.134	0.53	-6.25	-16.70
Euro – Yen (var. + higher euro)		145.079	135.022	1.86	-6.93	-3.00
Euro – Sterling (var. + higher euro)		0.779	0.747	-0.51	-4.06	-10.12
Dollar – Yen (var. + higher dollar)		120.550	117.500	-0.63	-2.53	15.15
Dollar – Sterling (var. + higher sterling)		1.559	1.527	1.65	-2.09	-6.88
Dollar – Yuan (var. + higher dollar)		6.206	6.244	-0.10	0.61	2.98
Oil Price (Brent)	Dollar	55.84	56.68	17.99	1.50	-47.61
	Euro	46.15	49.96	17.35	8.27	-37.11
Gold Price (Ounce)	Dollar	1186.33	1233.61	-3.11	3.99	-2.32
	Euro	980.39	1087.37	-3.63	10.91	17.26

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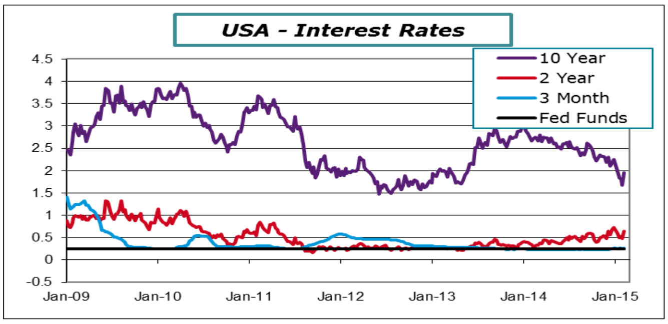
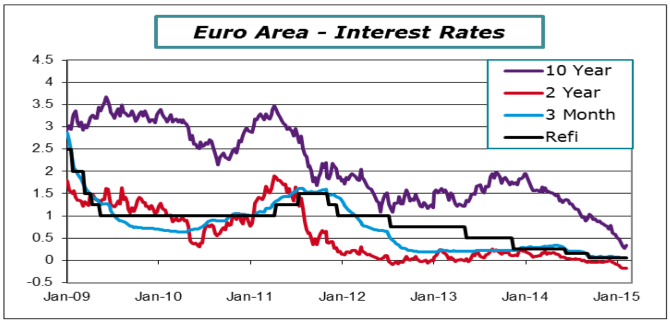
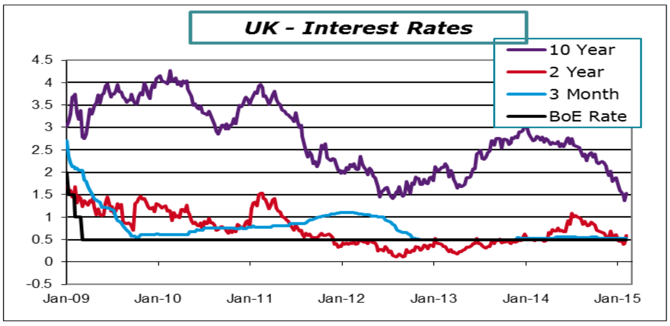
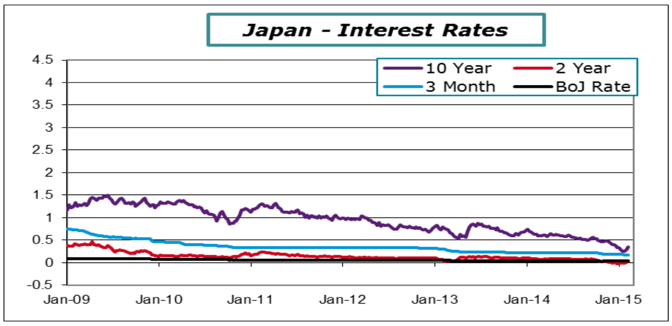
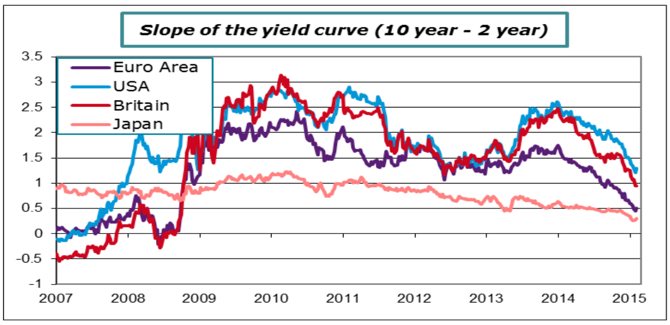
Financial Markets – February 6, 2015

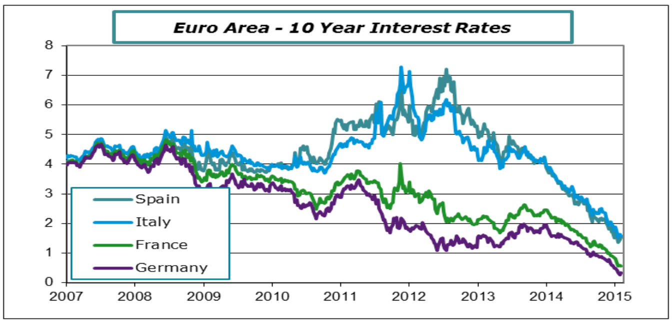


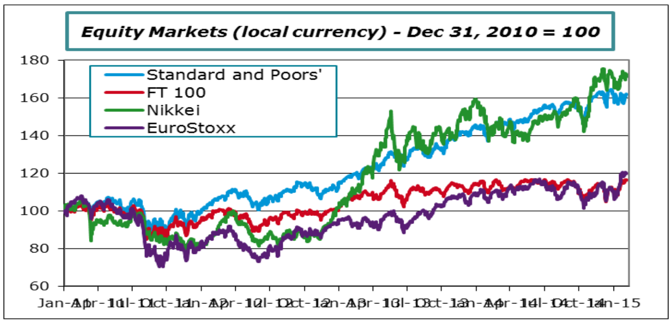


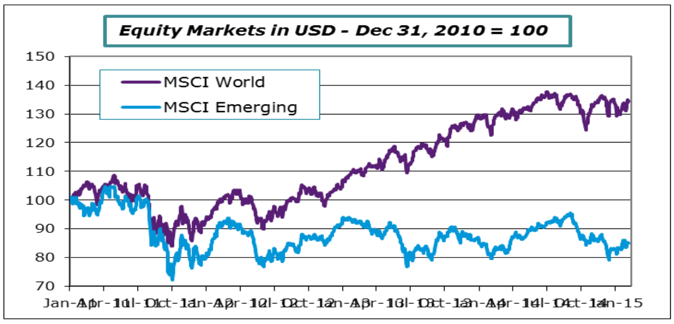


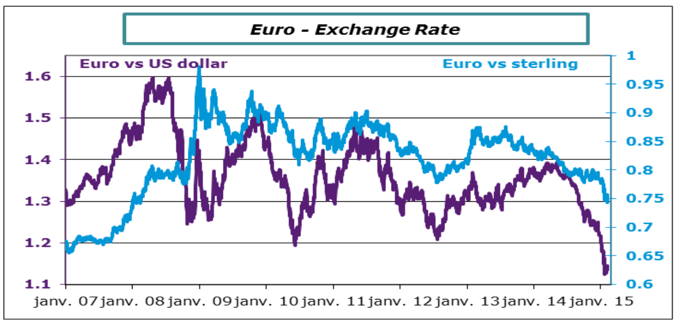


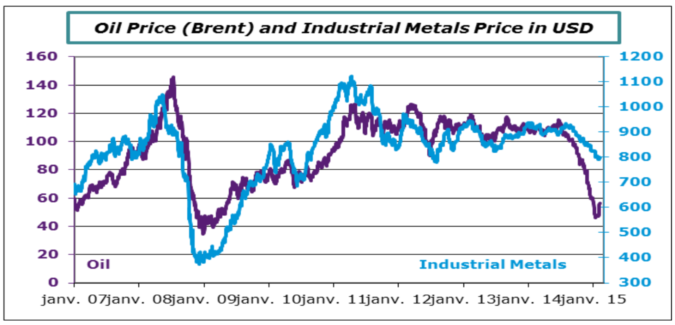












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