

Financial markets

The CAC 40 at its highest since 2008

Monetary policies continue to diverge on either side of the Atlantic. On the one side, the US Federal Reserve raised its rates once again in March 2017 and is likely to increase them two more times in 2017, comforted by a core inflation rate that is close to its 2% target and the low level of unemployment. On the other side, core inflation remains moderate in the Eurozone and the ECB is pursuing its accommodating monetary policy, having decided to extend its purchase programme through to December 2017.

The credit market continues to improve in the Eurozone, although lending is increasing much less quickly than the monetary base. Situations continue to vary between the European countries: outstanding corporate loans are progressing in France, Germany and, for the first time since 2009, in Spain, while they are still decreasing in Italy. For loans to households, amounts outstanding are significantly more dynamic in France than among its partners, despite interest loans being at equivalent levels. Since the results of the presidential election, French sovereign yields have fallen, narrowing the gap with German yields to its 2015 level, while the CAC 40 has soared to its highest since 2008.

In the wake of the election of Donald Trump and the rise in the Fed's base rates, the euro fell against the dollar at the end of 2016, but has

risen again since, returning to its level of summer 2015. For the forecast, the euro exchange rates have been set to \$1.12, £0.87 and 124 yen.

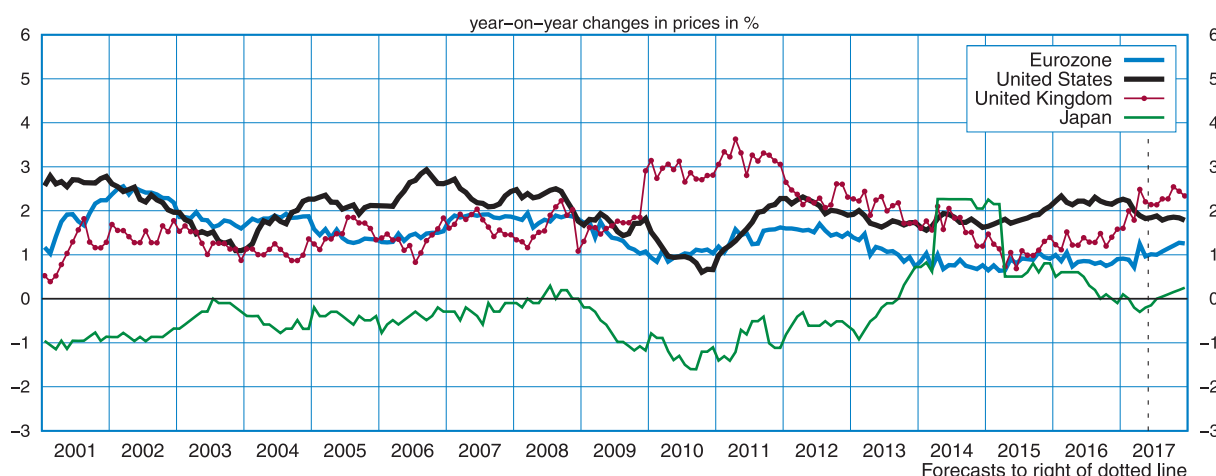
The Federal Reserve raised its base rate again in March and is set for two further hikes in 2017

In March 2017, the American central bank (Fed) raised its base rates again by one-quarter of a point, from 0.75% to 1%, after the rise in December 2016. The Fed's objectives have been achieved: the unemployment rate is levelling out at a low level (4.3%) and core inflation has remained close to the 2% threshold since January 2016 (Graph 1). As a result, the Fed should continue to normalise its monetary policy through two more base rate hikes before the end of 2017.

The ECB maintains its accommodating monetary policy

The European Central Bank (ECB), meanwhile, announced in December 2016 that it is to extend its accommodating policy through to December 2017. It is pursuing its sovereign security purchases, although reducing their volume from €80 billion to €60 billion a month since April 2017. In the Eurozone, core inflation remains moderate, well below the 2% mark. Base rates therefore remain at a historically low level: the deposit facility rate has been at -0.40% since March 2016.

1 - Inflation in the world



Sources: Eurostat, BLS, JSB, ONS

After the French presidential election, the French-German spread has returned to its 2015 level

Sovereign yields of the advanced countries rose in the wake of the election of Donald Trump and the Fed base rate hike. At the beginning of June, the French 10-year yield stood at around 0.6%, after reaching a low of 0.2% in July 2016 and exceeding the 1.0% mark in Q1 2017. The spread between the French and German rates increased to as much as 74 basis points in mid-April 2017, but has narrowed again since the first round of the French presidential election, returning to its 2015 level (Graph 2). The Italian-German spread remains high (at around 180 basis points), notably when compared to the Spanish-German spread, due to the difficulties of the Italian banking system, political uncertainties in the country and considerable outflows of private capital from Italy (Focus). Yield spreads within the Eurozone remain much smaller than between 2011 and 2013, however.

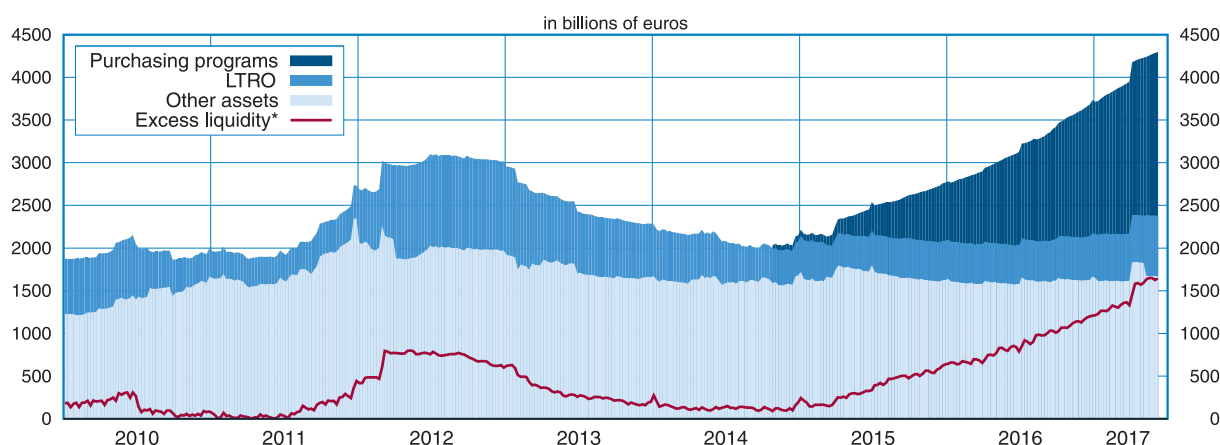
Lending to households is more dynamic in France than in the rest of the Eurozone

Outstanding loans to non-financial corporations in the Eurozone have been increasing since January 2016, continuing the improvement that started in early 2014. Year on year, outstanding loans increased by 1.6% in April 2017. This upturn in lending remains modest, however, in relation to the sharp growth in the monetary base carried out by the ECB. The surplus liquidities that the banks leave in reserve with the ECB therefore continue to swell (Graph 3). Outstanding corporate loans are dynamic in France (+5.2% year on year) and in Germany (+4.3%). In Spain, they are progressing for the first time since 2009. Outstanding corporate loans continue to fall in Italy, however. Interest rates on new loans have converged between the main Eurozone countries (at around 1.5%), except in Spain where they remain higher (2.1%).

2 - Spreads against the Bund



3 - ECB balance sheet and excess liquidity



*Excess liquidity: the banks' deposits with the Central Bank in excess of the minimum reserves.
Source: European Central Bank, INSEE calculations

International developments

Regarding lending to households, France stands out from its main European partners by its much greater dynamism: year-on-year growth in amounts outstanding reached 5.5% in April 2017, against 2.6% for the Eurozone as a whole (*Graph 4*). Yet rates on new loans to households are comparable in the Eurozone.

The cycle of easing in the credit market would appear to be drawing to a close in Europe in the wake of the upturn in sovereign yields, according to the latest credit surveys conducted by the ECB among private banks.

Stock market indices rising on the whole since the beginning of the year

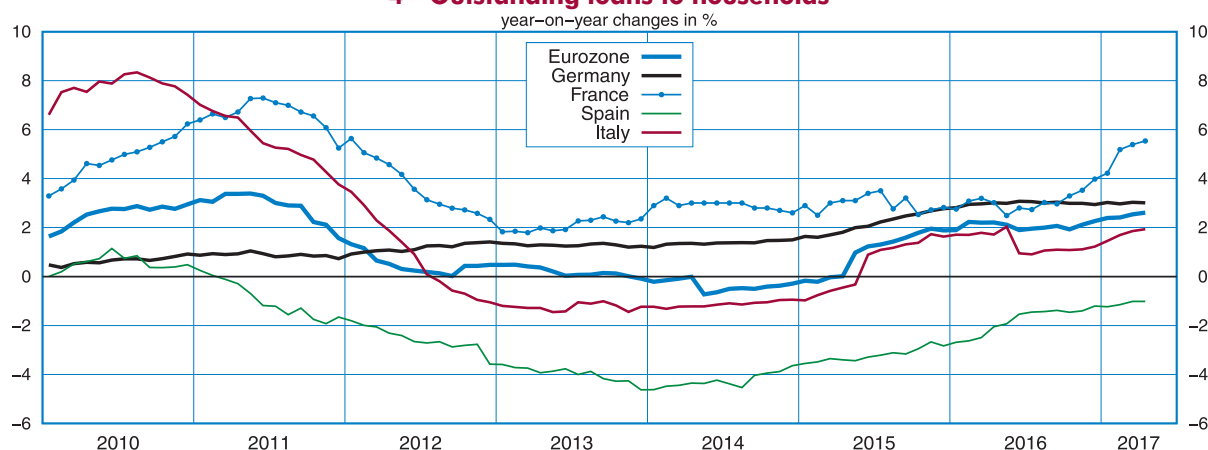
Stock market indices have been rising on the whole since the beginning of the year (*Graph 5*): the CAC 40 in particular surged upwards after the first round of the French presidential election, to stand at its highest since 2008 in early May 2017.

Volatility of the European indices increased somewhat before the French elections, especially for the CAC, but has fallen back again since. It remains low in light of past shocks.

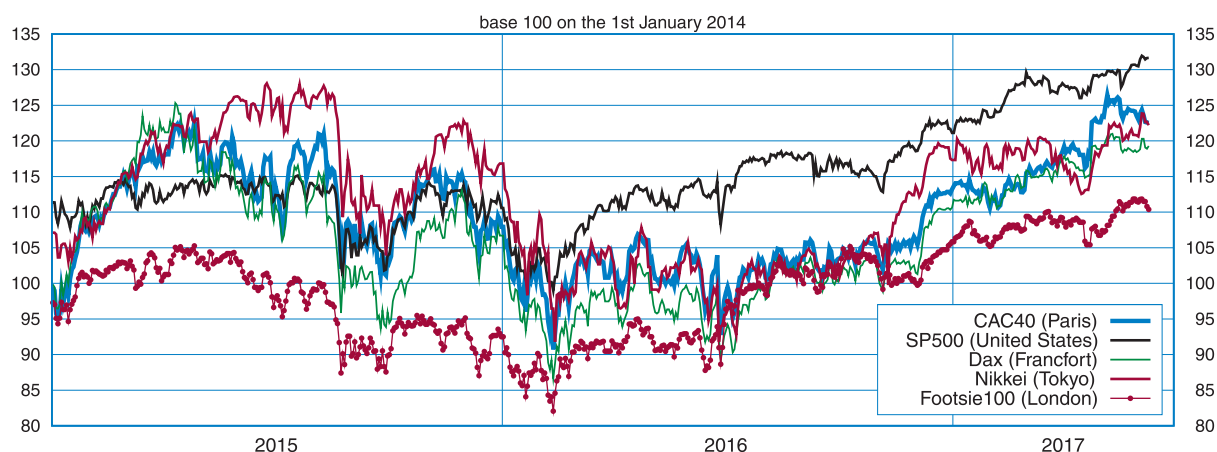
The dollar has fallen against the Euro since the beginning of 2017

The election of Donald Trump and the Fed base rate hike contributed to a marked rise in the dollar against the euro at the end of 2016. Since the beginning of 2017, it has fallen again. In May 2017, it was trading at \$1.12 to the euro, as in summer 2016. The exchange rate of sterling has levelled out at around £0.87 to the euro, after a marked fall before and after the Brexit referendum. The yen has been fluctuating since December 2016 at around 124 yen to the euro. All in all, the French effective exchange rate fell slightly at the end of 2016 and in Q1 2017, due to the inflation gap between France and its main partners, among

4 - Outstanding loans to households



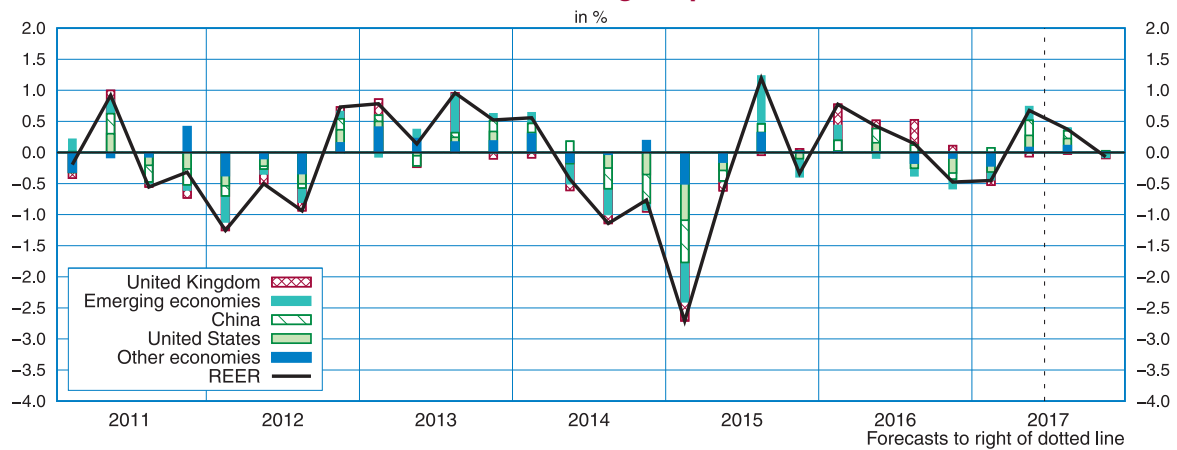
5 - Stock market indices of the advanced countries



other factors (Graph 6). By convention, the exchange rate of the euro against the various currencies has been set to its last known level in early June (\$1.12, £0.87 and 124 yen for one euro) through to the end of 2017. There is

uncertainty surrounding the euro-dollar exchange rate, however, which will depend on the pace at which US monetary policy is tightened and on the scale of the fiscal stimulus that is finally implemented. ■

6 - Quarterly change in real effective exchange rate (REER) of France and its contributing components



Source: Macrobond, INSEE calculations