MACRO HIGHLIGHTS

WEEK OF 20 NOVEMBER 2017

KEY TAKEAWAYS OF THE WEEK

Economist insights: Tax cuts come a step closer in the US, slight economic slowdown in China (p.1)

- The US House of Representatives has approved a bill on tax cuts, but their financing, although planned in the 2018 budget, remains uncertain. This could result in a widening of the deficit
- Economic activity in China faced a slight slowdown in October. The measures relating to stricter management of the country's financial imbalances should be ramped up over the coming months
- The marked disinflation and the accommodative monetary policy maintained for the past few months in Brazil are behind the progress in private consumption

UK focus: No end to the deadlock in sight (p.4)

- The economic slowdown that we forecast for 2017 has been confirmed and should continue in 2018, due to the persistent uncertainty surrounding the conditions for leaving the European Union (EU)
- For 2019, there are two possible scenarios according to our analysis: a smooth transition for the UK's exit from the EU or a definitive withdrawal without any agreement being reached
- We expect no improvement in the economic outlook with either of these scenarios: the first, which is our central scenario, would see a further slowdown in activity, while the second would trigger a recession

ECONOMIST INSIGHTS

TAX CUTS COME A STEP CLOSER IN THE US, SLIGHT ECONOMIC SLOWDOWN IN CHINA

In the US, talks concerning the new tax measures are being stepped up. The House of Representatives approved the tax cuts bill on 16 November with a majority of 227 votes in favour and 205 against. The vote in the Senate could take longer since the Republican majority is weaker – 52 senators out of 100 are Republican – and some Republicans have already voiced their opposition to the first proposal, which suggests that various amendments could be made. The main criticism concerning the new tax measures is of course the drop in revenues that they will trigger. **Illustrating this, the proposals outlined by the House of Representatives and the Senate indicate that revenues could fall by USD 1,500 billion over approximately 10 years.** While this amount is in line with the 2018 budget approved by the two Houses at the end of September, it is important to note that this budget is not legally binding. This means that the drop in revenues and the spending cuts still need to be ratified by specific laws. The USD 1,500 billion drop in revenues over 10 years and the USD 5,100 billion reduction in spending over the same period submitted in the budget is just a proposal.

While the tax cuts have a chance of being adopted, particularly because the famous "reconciliation instructions" included in the budget stipulate that a simple majority of 51 votes in the Senate is enough for the law to be passed, the probability of the spending cuts being approved is lower. For the spending, 12 subcommittees grouped together per sector are in charge of appropriations. These appropriations are laws that need to be approved with a majority of at least 60 votes in the Senate. The Democrat senators are unlikely to approve the spending cuts. **In conclusion, if the tax cuts are adopted** – which is essential for the Republicans, who want to keep their majority in the mid-term legislative elections in November 2018 – **but the spending cuts are not, the deficit is likely to grow. The Republicans are counting on a positive economic impact to boost revenues and offset the tax cuts on the one hand, while on the other hand limiting the period covered by the new tax measures for individuals.** However, according to our forecasts, while growth could be strengthened in the very short term, this is not the case for the long term. The tax cuts are thus expected to result in a growing deficit.

The next milestones are as follows:

- Senate's vote on its proposed "tax cuts and jobs act" within the next few weeks
- Reconciliation between the bills from the Senate and the House of Representatives
- Signature by D. Trump

While the government has said that it wants to complete this process before the end of the year, we expect the measures to be ratified at the start of 2018.

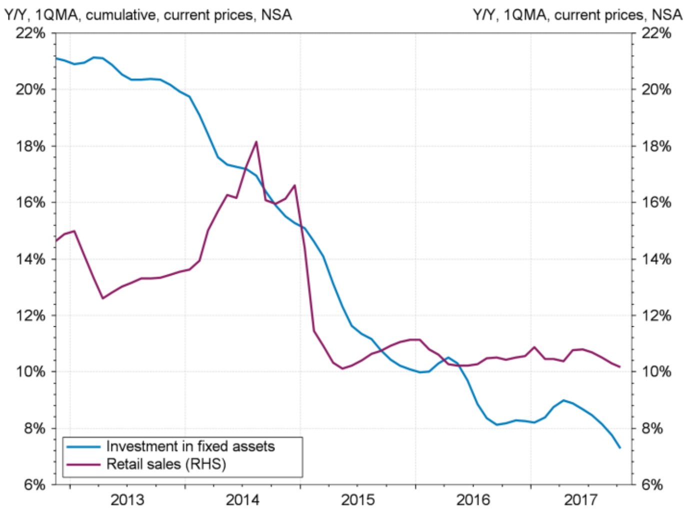
In China, October's statistics show a slight slowdown in the main economic indicators. Annual retail sales growth came to 10.0% in October, compared with 10.3% in September. Growth in retail sales is continuing to outpace investment in fixed assets, illustrating the Chinese economy's gradual rebalancing around more private consumption (see left-hand chart, p.3). Investment in fixed assets increased by 7.3% during the first 10 months of the year, compared with 7.5% in September. Infrastructure investment is continuing to see a high rate of growth, close to 16% according to our estimates, while manufacturing investment is still being penalised by the reduction in excess capacities and the application of stricter environmental standards for industry. Real estate investment levels are also falling, reflecting the moderation of property prices. Overall, the moderation of investment in fixed assets looks set to continue over the coming quarters. With this in mind, after encouraging them since 2014 to support economic growth, the Ministry of Finance has announced the introduction of tighter conditions for approving public-private partnership projects, looking to ensure effective control over local government borrowing. **This announcement is in line with the stricter management of China's financial imbalances**. While aggregate credit growth remained unchanged at 13% in October, the Financial Stability and Development Committee has reconfirmed its plans to reduce debt, as presented during the Communist Party Congress, while strengthening coordination between financial supervisory authorities. Expectations for stricter regulations have pushed bond yields up to high levels (see right-hand chart).

In Brazil, retail sales are continuing to progress, up from 3.6% in September to 6.4%. This upturn reflects the significant drop in inflation over the past few months, supporting real wages, as well as the improvement in household credit conditions and the recent moderation of unemployment to reach 12.4%.

Lisa Turk, Economist, United States
l.turk@edr.com

François Léonet, Economist, Emerging Markets
f.leonet@edr.com

Resilience of private consumption in China



Source: Thomson Reuters Datastream / NBS, Edmond de Rothschild Economic Research

Expectations for stricter financial conditions

Source: Thomson Reuters Datastream / Edmond de Rothschild Economic Research

UK FOCUS

NO END TO THE DEADLOCK IN SIGHT

Sophie Casanova, Economist, Central Banks, s.casanova@edr.com

The economic slowdown that we forecast for the UK in 2017 has been fully confirmed. It also should continue in 2018, faced with the persistent uncertainty surrounding the country's exit from the European Union (EU).

While the slow rate of progress with negotiations between the UK and the EU does not provide any clear indication of the conditions for the UK's exit in 2019, our analysis shows that there are two possible main scenarios.

The first, which we have retained as the central scenario for our 2019 forecasts, will see a transition period during which, while waiting for new trade agreements to be drawn up, the UK would temporarily maintain its trade relations with the EU. **The second scenario is for the UK's definitive exit in March 2019 without managing to reach an agreement with the EU.**

The economic and financial consequences for these two scenarios are very different. In the first case, the economic slowdown would continue, the pound would continue to gradually depreciate and bond yields would increase slightly, despite the moderation of GDP growth. In the second case, the British economy would slip into a recession, the pound would fall and bond yields would rise very sharply.

The moderation of the economic activity that we forecast for 2017 has been confirmed: after already dropping from 2.3% in 2015 to 1.8% in 2016, the UK's GDP growth fell from 1.8% for the first quarter of 2017 to 1.5% for the next two quarters.

This trend looks set to continue at the end of 2017 and into 2018, linked in particular to the weakening of the main contributor to GDP growth: household consumption.

It already slowed down from 2.8% in 2016 to 1.8% for the first half of 2017 and could continue to fall. Despite the very low unemployment rate (down to 4.3%, its lowest level since 1975), growth in nominal wages remains muted because weak productivity pushes downward hourly pay. **For households, their real purchasing power, already affected by previous increases in inflation, could continue to decline as we expect inflation to accelerate to 2.7% in 2017 and 3.0% in 2018. In addition, households, which have reduced their savings and increased their debt up until now to compensate for their weak levels of disposable income, could become more cautious**, while falling property prices are affecting their net wealth and the Bank of England's 25bp key rate hike from November 2017 will increase the cost of their borrowings.

Alongside this, the other GDP components are not likely to be able to take over. Businesses should continue to postpone their **investments** faced with the persistent uncertainty. In addition, **foreign trade** is not expected to become a growth driver because the **high content of UK exports in imports is significantly limiting the country's potential to improve its competitiveness despite sterling's continued depreciation, averaging out at $1.26 in 2018 according to our forecasts**.

We are therefore maintaining our forecast for GDP to grow 1.5% in 2017, before dropping to 1.2% in 2018.

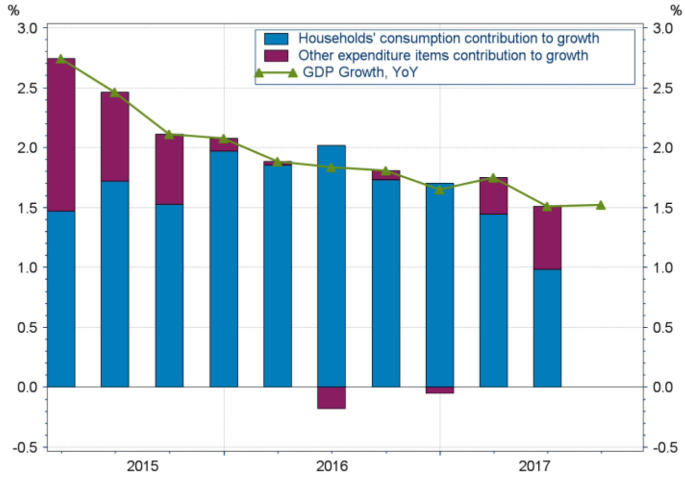
Of course, the outlook for 2019 will depend crucially on the outcome of the negotiations between the UK and Europe. While the European Commission has already clearly stated that the UK will not be entitled to the same rights and benefits as its member countries, **the slow pace of negotiations means that it is quite unlikely that a definitive agreement for new trade relations will be reached before 29 March 2019, when the UK will leave the EU**.

According to our analysis, there are thus only two possible scenarios, each with very different economic and financial consequences.

In the first scenario, the least adverse, the UK will benefit from a transition period after March 2019, during which its trade relations with the EU would temporarily be maintained while waiting for a new partnership to be defined. In this scenario, which we have retained as the central scenario for our forecasts, **growth would slow down to 1.0% in 2019**, faced with the persistent uncertainty surrounding the nature of the agreements. Combined with the UK economy's structural shortcomings, this would weaken the **pound, driving it down to an average of 1.22$**. **Inflation should remain at 3% in 2019**. This gradual approach for the UK's exit from the EU could make it possible to avoid any loss of confidence in Gilt sovereign bonds. However, the high level of inflation and sterling's depreciation could support inflation expectations and pave the way for **10-year Gilt yields to increase to an average of 2.20% for 2019** despite the slowdown in growth.

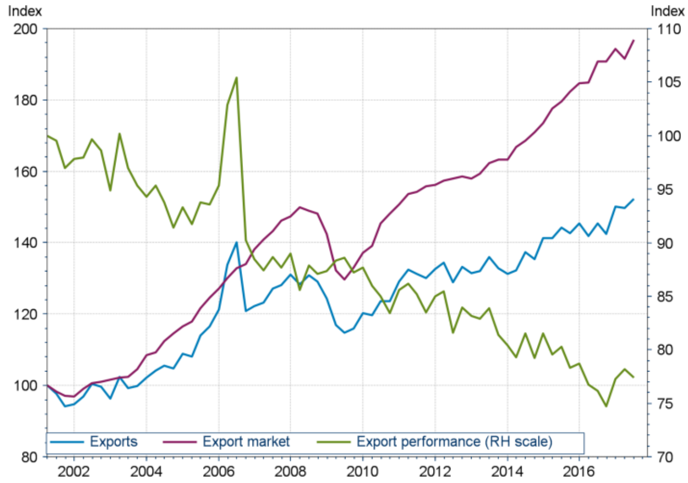
In the second scenario, the UK would definitively leave the EU in March 2019 after failing to reach an agreement with the EU. In this case, the UK would no longer have any trade agreements with the EU member states or with any of the 53 third-party countries with which the EU has agreements. The consequences for GDP growth would be immediate: domestic demand would collapse and foreign trade would fall. **According to our model, GDP could contract -1.2% in 2019**. In addition, the country's structural weaknesses are expected to increase, while capital outflows will accelerate (with foreign investors fleeing and, above all, clearing houses repatriating their operations to Europe). As a result, **the pound would drop to 1.10$ in 2019. Inflation would accelerate sharply, averaging out at 5.8%**. With the capital outflows, accelerating inflation and lack of confidence in the outlook for the UK, **sovereign yields would rise sharply, with the 10-year Gilt climbing to over 6.00% in 2019**.

Consumption, the main contributor to GDP growth, is expected to continue weakening



Source: Thomson Reuters Datastream / OECD / Edmond de Rothschild Economic Research

Despite sterling's depreciation and the strengthening of global demand, UK exports have made little progress



Source: Thomson Reuters Datastream / OECD / Edmond de Rothschild Economic Research

APPENDIX 1 – LATEST CHANGES ON FINANCIAL MARKETS

PERFORMANCE IN LOCAL CURRENCY	LAST PRICE	WEEKLY CHANGE	MONTHLY CHANGE	YEAR-TO-DATE CHANGE	1-YEAR CHANGE
Equities *(total return)*					
World (MSCI)	497	-0.1%	0.5%	20.4%	23.7%
United States (S&P 500)	2'579	-0.1%	1.0%	17.3%	20.3%
Eurozone (Euro Stoxx)	386	-1.1%	-1.0%	13.4%	22.2%
Germany (DAX)	12'966	-1.0%	0.0%	13.2%	21.6%
France (CAC 40)	5'318	-1.1%	-0.8%	12.4%	21.0%
Spain (IBEX 35)	10'016	-0.8%	-1.7%	10.3%	18.8%
Italy (FTSE MIB)	22'074	-2.1%	-1.1%	17.9%	37.4%
Portugal (PSI 20)	5'266	-0.8%	-3.5%	16.4%	23.4%
United Kingdom (FTSE 100)	7'361	-0.5%	-1.4%	7.3%	13.0%
Switzerland (SMI)	9'244	0.5%	-0.9%	15.4%	19.1%
Japan (Nikkei)	22'262	-1.3%	5.0%	19.2%	27.7%
Emerging Markets (MSCI)	1'136	0.7%	1.0%	34.7%	37.6%
Sovereign Bonds, 10Y *(change in basis point)*					
United States	2.34%	-6.6	-4.5	-10.4	-1.5
Eurozone	0.36%	-5.9	-9.5	15.3	8.6
Germany	0.36%	-5.9	-9.5	15.3	8.6
France	0.70%	-8.1	-16.4	1.5	-6.0
Spain	1.54%	1.3	-11.6	16.0	-5.0
Italy	1.82%	-1.0	-22.1	0.6	-27.4
Portugal	1.95%	-2.2	-33.8	-179.4	-188.7
United Kingdom	1.31%	-1.6	-1.9	7.7	-14.1
Switzerland	-0.16%	-4.9	-9.8	6.9	-1.8
Japan	0.03%	-1.2	-3.7	-0.8	0.1
Emerging Markets (5-10 ans)	4.72%	-7.5	13.4	-24.0	-41.8
Corporate Bonds *(change in basis point)*					
United States (IG Corp.)	3.27%	0.1	9.8	-6.8	-6.9
Eurozone (IG Corp.)	0.57%	-0.5	-3.5	-12.1	-21.7
Emerging Markets (IG Corp.)	3.84%	-2.6	11.6	-15.5	-34.3
High-Yield Bonds *(change in basis point)*					
United States (HY Corp.)	6.16%	-1.8	25.6	-38.9	-76.4
Eurozone (HY Corp.)	2.71%	4.8	-5.0	-100.1	-125.4
Emerging Markets (HY Corp.)	6.03%	-9.0	16.6	-99.1	-119.2
Convertible Bonds *(price change)*					
United States (Convert. Barclays)	52	0.4%	1.4%	16.7%	18.6%
Eurozone (Convert. Exane)	7'703	-0.8%	-0.1%	3.2%	6.0%
Commodities					
Commodities (TR)	422	-0.2%	2.4%	0.4%	2.1%
Gold	1'292	1.0%	0.9%	10.8%	5.4%
Crude Oil (Brent)	62	-1.8%	7.1%	12.5%	38.0%
Currencies					
Dollar Index	93.6	-0.9%	-0.1%	-8.4%	-7.5%
EURUSD	1.18	1.1%	0.1%	12.1%	10.9%
GBPUSD	1.33	1.2%	0.6%	7.5%	6.2%
USDCHF	1.01	-0.7%	0.5%	-2.9%	-2.0%
USDJPY	112.1	-1.3%	-1.3%	-4.2%	1.2%

Source : Bloomberg

APPENDIX 2 - LEADING ECONOMIC INDICATORS

Main Economic Indicators - Released (13 - 17 November) and to be released (20 - 24 November)

Date	Indicator	Period	Consensus	Actual	Prior	Revised
US						
14/11	**PPI, YoY**	**Oct.**	**-**	**2.8%**	**2.6%**	**-**
14/11	**Core PPI, Yoy**	**Oct.**	**-**	**2.4%**	**2.2%**	**-**
15/11	**CPI, YoY**	**Oct.**	**2.0%**	**2.0%**	**2.2%**	**-**
15/11	**Core CPI, YoY**	**Oct.**	**1.7%**	**1.8%**	**1.7%**	**-**
15/11	**Retail Sales, MoM**	**Oct.**	**0.0%**	**0.2%**	**1.6%**	**1.9%**
16/11	**Industrial Production, MoM**	**Oct.**	**0.5%**	**0.9%**	**0.3%**	**0.4%**
16/11	**Manufacturing Production, MoM**	**Oct.**	**0.6%**	**1.3%**	**0.1%**	**0.4%**
17/11	**Housing Starts, month**	**Oct.**	**1190k**	**1290k**	**1127k**	**1135k**
17/11	**Building Permits, month**	**Oct.**	**1250k**	**1297k**	**1215k**	**1225k**
21/11	*Existing Home Sales, month*	*Oct.*	*5.41m*	-	*5.39m*	-
22/11	*Durable Goods Orders, MoM*	*Oct. P*	*0.3%*	-	*2.0%*	-
22/11	*FOMC Meeting Minutes*		-	-	-	-
Euro zone						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
14/11	**GDP, QoQ**	**Q3 P**	**-**	**0.6%**	**0.6%**	**-**
14/11	**GDP, YoY**	**Q3 P**	**-**	**2.5%**	**2.5%**	**-**
16/11	**HICP, YoY**	**Oct. F**	**1.4%**	**1.4%**	**1.4%**	**-**
16/11	**Core HICP, YoY**	**Oct. F**	**0.9%**	**0.9%**	**0.9%**	**-**
23/11	*Manufacturing PMI, month*	*Nov. P*	*58.2*	-	*58.5*	-
23/11	*Services PMI, month*	*Nov. P*	*55.2*	-	*55.0*	-
23/11	*Composite PMI, month*	*Nov. P*	*55.9*	-	*56.0*	-
Germany						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
14/11	**GDP, QoQ**	**Q3 P**	**-**	**0.8%**	**0.6%**	**-**
14/11	**GDP, YoY**	**Q3 P**	**-**	**2.8%**	**2.1%**	**2.3%**
14/11	**HICP, YoY**	**Oct. F**	**-**	**1.5%**	**1.5%**	**-**
14/11	**ZEW Survey Current Situation, month**	**Nov.**	**-**	**88.8**	**87.0**	**-**
14/11	**ZEW Survey Expectations, month**	**Nov.**	**-**	**18.7**	**17.6**	**-**
23/11	*GDP, QoQ*	*Q3 F*	**0.8%**	**-**	*0.8%*	-
23/11	*GDP, YoY*	*Q3 F*	**2.8%**	**-**	*2.8%*	-
23/11	*Manufacturing PMI, month*	*Nov. P*	**60.3**	**-**	*60.6*	-
23/11	*Services PMI, month*	*Nov. P*	**55.0**	**-**	*54.7*	-
23/11	*Composite PMI, month*	*Nov. P*	**56.7**	**-**	*56.6*	-
24/11	*IFO Business Climate, month*	*Nov.*	**116.5**	**-**	*116.7*	-
France						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
15/11	**HICP, YoY**	**Oct. F**	**1.2%**	**1.2%**	**1.2%**	**-**
23/11	*INSEE Business Confidence, month*	*Nov.*	*109.0*	-	*109.0*	-
23/11	*Manufacturing PMI, month*	*Nov. P*	*55.9*	-	*56.1*	-
23/11	*Services PMI, month*	*Nov. P*	*57.0*	-	*57.3*	-
23/11	*Composite PMI, month*	*Nov. P*	*57.2*	-	*57.4*	-
Switzerland						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
21/11	*Trade Balance*	*Oct.*	-	-	*2.92b*	-
21/11	*Exports Real MoM*	*Oct.*	-	-	*-0.9%*	-
21/11	*Imports Real MoM*	*Oct.*	-	-	*-3.2%*	-
24/11	*Industry & Construction Output WDA YoY*	*Q3*	-	-	*3.4%*	-
24/11	*Industrial Output WDA YoY*	*Q3*	-	-	*2.9%*	-
UK						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
14/11	**CPI, YoY**	**Oct.**	**3.1%**	**3.0%**	**3.0%**	**-**
14/11	**Core CPI, YoY**	**Oct.**	**2.8%**	**2.7%**	**2.7%**	**-**
15/11	**ILO Unemployment Rate, month**	**Sept.**	**4.3%**	**4.3%**	**4.3%**	**-**
16/11	**Retail Sales Inc. Auto Fuel, MoM**	**Oct.**	**0.2%**	**0.3%**	**-0.8%**	**-0.7%**
Japan						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
15/11	**GDP, QoQ**	**Q3 P**	**0.4%**	**0.3%**	**0.6%**	**-**
15/11	**GDP, YoY**	**Q3 P**	**-**	**1.7%**	**1.4%**	**-**
China						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
14/11	**Retail Sales, YoY**	**Oct.**	**10.4%**	**10.0%**	**10.3%**	**-**
14/11	**Fixed Assets Ex Rural, YTD YoY**	**Oct.**	**7.3%**	**7.3%**	**7.5%**	**-**
14/11	**Industrial Production, YoY**	**Oct.**	**6.3%**	**6.2%**	**6.6%**	**-**

APPENDIX 3 - OUR GROWTH AND INFLATION FORECASTS

GDP GROWTH IN VOLUME (%)	2014	2015	2016	2017f	Consensus	2018f	Consensus
United States	2.4	2.6	1.6	2.1	2.2	2.5	2.3
Japan	0.4	1.1	1.0	1.3	1.2	0.8	1.0
Eurozone	1.2	1.9	1.7	1.7	1.7	1.8	1.6
Germany	1.6	1.5	1.8	1.6	1.6	1.8	1.6
France	0.7	1.2	1.1	1.4	1.4	1.7	1.5
Italy	0.2	0.7	1.0	0.9	0.9	0.8	0.9
Spain	1.4	3.2	3.2	2.7	2.7	2.6	2.3
Portugal	0.9	1.6	1.4	1.6	1.6	1.4	1.5
Luxembourg	5.6	4.0	4.2	4.5	3.4	4.3	3.3
Europe ex-Eurozone							
United Kingdom	3.1	2.2	1.8	1.5	1.7	1.2	1.3
Switzerland	2.0	0.8	1.3	1.4	1.5	1.6	1.7
Israel	3.2	2.6	4.0	3.4	3.3	3.3	3.2
Emerging countries	4.9	4.0	4.1	4.6	-	4.7	-
China	7.3	6.9	6.7	6.6	6.6	6.4	6.4
Brazil	0.1	-3.8	-3.6	0.3	0.6	1.9	2.3
India	7.0	7.5	7.6	7.1	7.2	7.8	7.7

CONSUMER PRICE INDEX (%)	2014	2015	2016	2017f	Consensus	2018f	Consensus
United States	1.6	0.1	1.3	2.3	2.4	2.5	2.3
Japan	2.7	0.8	-0.1	0.5	0.6	0.9	0.9
Eurozone (HCPI)	0.4	0.0	0.2	1.6	1.6	1.6	1.5
Germany	0.8	0.1	0.4	1.8	1.8	1.9	1.7
France	0.6	0.1	0.3	1.3	1.3	1.4	1.3
Italy	0.2	0.1	0.0	1.4	1.4	1.3	1.3
Spain	-0.2	-0.6	-0.3	2.1	2.1	1.7	1.5
Portugal	-0.2	0.5	0.6	1.2	1.3	1.2	1.4
Luxembourg	0.7	0.1	0.0	2.4	2.0	2.2	1.7
Europe ex-Eurozone							
United Kingdom	1.5	0.0	0.6	3.1	2.6	3.0	2.6
Switzerland	0.0	-1.1	-0.4	0.4	0.4	0.6	0.6
Israel	0.5	-0.6	-0.5	0.8	0.7	1.4	1.3
Emerging countries	4.4	4.7	4.0	3.7	-	3.9	-
China	2.0	1.4	2.0	1.8	2.1	2.2	2.2
Brazil	6.3	9.0	8.8	4.4	4.2	4.7	4.5
India	6.7	4.9	5.0	3.8	3.9	5.0	4.8

APPENDIX 4 - OUR RATE AND CURRENCY FORECASTS

KEY INTEREST RATES (%)*	2014	2015	2016	2017f	Consensus	2018f	Consensus
United States	0.25	0.50	0.75	1.50	1.50	2.25	-
Japan	0.10	0.10	-0.10	-0.10	-0.10	-0.10	-
Eurozone	0.05	0.05	0.00	0.00	0.00	0.00	-
Europe ex-Eurozone							
United Kingdom	0.50	0.50	0.25	0.50	0.30	0.75	-
Switzerland	-0.25	-0.75	-0.75	-0.75	-0.75	-0.75	-
Israel	0.25	0.10	0.10	0.10	0.10	0.25	-
Emerging countries							
China	5.60	4.35	4.35	4.35	4.40	4.10	-
Brazil	11.75	14.25	13.75	8.25	7.35	7.25	-
India	8.00	6.75	6.25	6.00	6.00	6.25	-

*data at end of period

EXCHANGE RATE**	2014	2015	2016	2017f	Consensus	2018f	Consensus
Dollar							
EUR/USD	1.20	1.08	1.11	1.12	1.13	1.14	1.20
USD/JPY	120	120	109	113	112	116	111
GBP/USD	1.56	1.47	1.36	1.29	1.29	1.25	1.32
USD/CHF	0.99	1.00	0.98	0.98	0.98	0.98	0.97
USD/CNY	6.21	6.49	6.95	6.78	6.76	7.00	6.70
Euro							
EUR/JPY	144	130	120	126	126	132	133
EUR/GBP	0.77	0.73	0.81	0.87	0.87	0.91	0.91
EUR/CHF	1.20	1.09	1.09	1.10	1.11	1.12	1.16
EUR/SEK	9.44	9.17	9.47	9.56	9.54	9.40	9.10

**yearly average

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EDMOND DE ROTHSCHILD

EDMOND DE ROTHSCHILD (SUISSE) S.A.

Rue de Hesse 18 – 1204 Genève - T. +41 58 818 91 91
Rue de Morat 11 – 1700 Fribourg - T. +41 26 347 24 24
Avenue Agassiz 2 – 1003 Lausanne - T. +41 21 318 88 88
Via Ginevra 2 – 6900 Lugano - T. +41 91 913 45 00
Beethovenstrasse 9 – 8002 Zürich - T. +41 44 818 81 11

BANQUE PRIVÉE EDMOND DE ROTHSCHILD EUROPE S.A.

Luxembourg – Boulevard Emmanuel Servais, 20 – 2535 Luxembourg – T. +352 24 88 1
Belgique – Avenue Louise – Louizalaan 480/ Boite 16A – 1050 Bruxelles – T. +32 2 645 5757
Espagne – Paseo de la Castellana, 55 – 28046 – Madrid – T. +34 91 364 6600
Portugal – Rua D.Pedro V, 130 – 1250-095 Lisboa – T. +351 21 045 4660

EDMOND DE ROTHSCHILD (FRANCE)

47 Rue du Faubourg Saint-Honoré – 75008 Paris – T. +33 1 40 17 25 25
116 rue de Jemmapes – 59800 Lille – T. +33 3 62 53 75 00
27 rue Auguste Comte – 69006 Lyon – T+33 4 72 82 35 25
Hôtel de Saige 23 cours du Chapeau Rouge – 33000 Bordeaux – T+33 5 56 44 20 66
165 avenue du Prado – 13008 Marseille – T+33 4 91 29 90 80
11 rue La Fayette – 44000 Nantes – T+33 2 53 59 10 00
6 avenue de la Marseillaise – 67000 Strasbourg – T+33 3 68 33 90 00
22 rue Croix Baragnon – 31000 Toulouse – T+33 5 67 20 49 00

www.edmond-de-rothschild.com