Confidence must be earned

Amundi ASSET MANAGEMENT

CROSS ASSET

INVESTMENT STRATEGY

CIO VIEWS

BACK TO SCHOOL. BACK TO NORMAL?

THIS MONTH'S TOPIC

TRADE WAR ESCALATION AND IMPACT ON WORLD TRADE AND ECONOMIC GROWTH

Research & Macro Strategy

CIO VIEWS

Back to school. Back to normal?

PASCAL BLANQUÉ, Group Chief Investment Officer
VINCENT MORTIER, Deputy Group Chief Investment Officer

Financial markets have been rattled in the past weeks over escalating trade war between the US and China as both imposed tariffs and counter-tariffs on imports. Idiosyncratic risks stories in countries such as Argentina resurfaced, the UK's parliament was suspended over Brexit chaos and Italy witnessed a political crisis of its own, although a government seems in sight now. Investors' search for safety pushed core bond yields to unprecedented low levels, with yield on the 30-year German bunds turning negative for the first time ever. The US yield curve inverted for the first time since 2007, with yields on 2y note rising above those on the 10y bond.

There are three main factors, in our view, behind this summer malaise.

First, markets do not like policy uncertainty and ambiguity, and both have increased. Geopolitical risk spillovers on the economic outlook are evident. Recession worries are overdone in the US (we don't expect a recession in the next 12 months) and we should not overestimate the role of the yield curve inversion as a harbinger of recession, in the era of unconventional monetary policies. **Secondly, the risk of escalation of trade war turning into a currency war is looming as both the US and China fight for global hegemony.** The yuan weakening above the 7.0 mark, the first time since the 2008 crisis, has been seen by the US administration as an attempt by the Chinese to manipulate currencies. However, we don't share the view that China will manipulate the currency proactively. Authorities are only seeking to stabilise the exchange rate to offset the negative impact of tariffs on the competitiveness of Chinese exports. **Third, political pressures on Central Banks are mounting.** The Fed has delivered a rate cut and ended quantitative tightening. But the manner in which Trump has been pressurizing Jerome Powell to reduce rates is a challenge for Fed's independence, more so in light of the 2020 Presidential elections.

What are the investment implications of these elements?

Fall in core bond yields is a reflection of a complex scenario. The narrative seems to be changing from "bad news for the economy is good news for risk assets", supported by ultra-dovish central banks to "bad news may start becoming bad news", with markets pricing economic downturn. As a result, markets and even politicians expect central banks to intervene more aggressively, but markets may have gone too far in pricing policy actions as global growth could be stronger than expected.

In the short term, expectations of aggressive monetary easing could limit equity market downside in this highly uncertain environment. Central Banks may help to extend the cycle, but the power of these new measures will be lower than in the past, if not accompanied by consistent fiscal support. It is potentially good news that Germany could stimulate the economy to avoid recession. But we are at a very early stage, the amount is limited and not coordinated at the EU level. **Equity valuations will be supported by low bond yields.** The fact that earnings revisions have already been massive, we could see a stabilization in the coming weeks. Should the equity markets weaken further this could provide some tactical opportunity to add exposure, but at this stage with fading effects of Central Banks' policies, earnings outlook will be the main drivers of the markets, and risks are to the downside.

Search for yield will continue, benefitting primarily quality IG bonds and EM debt. However, with the ultra-low level of bond yields, high duration reached by the main bond indices, and scarce liquidity, investors should be ready to face higher volatility. An active and diversified approach that puts all the fixed income levels to work (duration, currencies, curve, credit), can help to add value in the yield desert and avoid the less stretched situation. Liquidity assessment is also becoming crucial as in case of disappointment on central banks actions, less liquid areas can be more at risk.

Overall, heightened volatility will take investors back to the drawing board, emphasising the importance of basics yet again. To protect portfolios, investors could mitigate risk by adopting adequate hedging strategies (gold, options, and currency) and also consider retaining a positive view on US duration as a hedge on market and liquidity risks.

Overall risk sentiment

Defensive risk allocation, markets are pricing very supportive central bank policy, in case of disappointment volatility will rise.

Changes vs previous month

- Some profit taking on US duration
- More cautious on EM assets
- Increased focus on liquidity management

Overall risk sentiment is a qualitative view of the overall risk assessment of the most recent global investment committee.

MACRO

Accommodative policy amid downside growth risks

DIDIER BOROWSKI, Head of Macroeconomic Research
MONICA DEFEND, Head of Strategy, Deputy Head of Research
PHILIPPE ITHURBIDE, Global Head of Research

The summer months have been eventful. On the (geo)-political level, the sources of tension have multiplied globally. On the economic front, the growth momentum has weakened further, confirming the downward trend observed worldwide since April, with the deepening of the manufacturing recession.

Based on these conditions, we have revised down our global growth forecasts from 3.3% to 3.2% in 2019 and from 3.4% to 3.3% in 2020. In fact, part of the risk scenario has materialised, particularly with regard to trade tensions. Recent statements (from the US and China administrations) offer a ray of hope but the damage is done in terms of uncertainty – capex will stay under pressure, notably in countries most exposed to global trade. Consequently, we now expect an additional deceleration of growth, leading to subpar growth in advanced economies (AEs) in 2020, with a cycle trough either in H2 2019 or H1 2020. **EMs are clearly not immune. But unlike Advanced Economies, EM growth should reaccelerate somewhat next year.**

> "We expect the global policy mix to cushion the 'uncertainty shock'."

Risks remain clearly skewed to the downside, the risk of a recession has increased in the US. But we maintain our view that a global recession is not on the horizon.

In the **US and in Europe**, the job markets are supportive and the consumer is resilient. Moreover, we continue to observe a decoupling between the services and manufacturing sectors. But this is simply not enough in the short run to offset the pressure coming from trade and uncertainty. In **Germany**, even if we now foresee a technical recession (with slightly negative GDP growth in Q2-Q3 2019), it should be a mild and short-lived one.

In a low inflationary environment, the level of monetary accommodation is set to increase further. This is fully priced in by markets regarding interest rates.

On the one hand, the deterioration of the macro outlook justifies the global monetary accommodation that we are expecting but, on the other hand, we continue to think that **markets expect too much from CBs** (in particular from the Fed and the ECB, with regards to interest rates).

Looking ahead, the deterioration of the growth outlook paves the way for more fiscal easing (note that many EM countries have already moved in this direction). Fiscal policies should gradually turn more accommodative in AEs (starting with Germany).

At the end of the day, **we expect the global policy mix to cushion the "uncertainty shock".** However in the current environment, we believe that fiscal policies are more likely to be reactive (i.e. become more expansionist if the outlook deteriorates further) than proactive (i.e. turn more accommodative pre-emptively).

From a more fundamental point of view, the fact that the average interest rate paid on debt has fallen below nominal GDP growth in several AEs, provides an additional argument to governments to act (as, in these conditions, a primary surplus is no longer needed to stabilise the debt/GDP ratio).

While we believe it is premature to price in the positive impact on growth, **we expect that the anticipation of a global policy-mix turning more accommodative should help to anchor global growth expectations for 2020/2021.**

The Strategist's view

Key takeaways from recent volatility

1) **US and German yield curves flattened and we have revised downward our forecasts on bond yields:** We keep our view of bull steepening in the US. The gap between our expectations (50 bps) and markets' expectations (100 bps) of Fed's move to cut interest rates has widened. As per our calculations, the 12M forward yield on 10-year UST should be approximately 1.6%/1.8%, whereas that on the 2-year UST should be at 1.3%/1.5%. Meanwhile, the German yield curve has moved in-line with our scenario and future curve flattening would come more from the short end. We see the forward yield 10-year Bund at -0.7%/-0.5%.
2) **Favourable environment for Italian BTPs:** While the sudden opening of the political crisis came as a surprise initially, spreads moved back closer to starting levels eventually owing to investors' search for yield and even lower after, with the prospects of the new government formation. There are three key factors that will continue to support BTPs, particularly in the 5-10 year segment. First, technical factors point to a favourable environment. We expect net issuance to be negative for BTPs in the coming months, which will support demand. Secondly, attractive relative valuations. Italy now constitutes about half of the overall yield available in EUR IG fixed income space. Finally, expectations of reopening of QE by the ECB would be supportive.
3) **Mixed Q2 earnings season in the US and Europe:** In the US, the Q2 revenues and earnings of S&P 500 companies rose 4.7% and 2.9%, respectively, at a better-than-expected pace. However, the guidance for Q2 earnings was conservative due to the lack of visibility in early-July, resulting in a reduction of full year 2019 EPS growth forecasts at that time. In Europe, the Q2 earnings season for Stoxx 600 companies has been lower-than-expected. This has resulted in a reduction in earnings estimates for full year 2019, as of early July.

MULTI-ASSET

A cautious approach to navigating volatility

MATTEO GERMANO, Head of Multi-Asset

Given concerns of sluggish global growth and heightened volatility in light of the US-China trade dispute, **we remain cautious** with respect to our views on risk assets. Our move last month to go long on duration and stay defensive on equities was well rewarded by the markets. Markets are already pricing-in a 100 bps of rate cuts by the Fed and 30 bps from the ECB in the next 12 months. We believe it is time for investors **to have a mild risk exposure with preference for European IG credit,** but be mindful of the opportunities that this volatile environment might present.

High conviction ideas

Developed market central banks, including the ECB and the Fed, seem to indicate their willingness to support economic growth by adopting a more dovish stance. In the short term, this is good news for DM equities, but we remain selective. In addition, on the back of an accommodative macro-economic environment, we are starting to reconsider out negative view on the **Schatz,** given that a high possibility of rate cuts doesn't support it. **On duration, we remain positive on the US** as a diversifier of the risk exposure, owing to slowing global growth and inflation, and the recent escalation of the trade war. As a result, we maintain our preference for the 10y UST and for the UST 5y vs German 5y. **In credit markets,** we expect the hunt for yield to intensify in Europe on the back of a fall into negative yields for most Euro government debt. **We continue to favour Italian BTPs and EUR IG vs HY** (more Equity like) that should benefit from technical factors such as inflows, TLTRO, and likely ECB QE2 and rate cut. We stay cautious on US Credit as it is too leveraged with respect to its fundamentals. In EM equity, we keep a neutral view due to unattractive aggregate valuations, deteriorating macro-economic momentum and negative earnings revisions.

> "In a highly uncertain environment, we think investors should have a cautious risk exposure and search for yield in Euro credit IG and EM bond with an increased focus on liquidity management."

We maintain our **preference for Korea** as it is giving signals of bottoming-out and also for China.

On the **EMB side,** we remain positive on hard currency, mostly for carry reasons, but are cautious on local currency debt which is subjected to high volatility due to the FX exposure. In general, financial environment **seems supportive for EM Debt** (attractive carry, low US rates, dovish Fed and dovish EM Central Banks, and subdued inflation), but concerns on global trade and growth are headwinds, especially for local currency debt. In currencies, we maintain a relative value approach, with a preference for a **FX basket** of higher carry EM currencies vs South African Rand and the South Korean Won, which should depreciate more on re-escalating US-China trade tensions.

Risks and hedging

Geopolitical tensions and global growth worries continue to dominate financial markets. Subdued economic data from Germany and China raised concerns over a recession. Uncertainty in Europe increased with Brexit and Italy as key hot spots.

As a result, it is important to note that fundamentals remain at risk at company level, given that profit margins could decline in case of weakening global growth and trade war escalation. Liquidity risk may also resurface should central banks disappoint the market expectations.

In this environment, investors **may mitigate risk by adopting an adequate hedging** strategy in form of gold. This would safeguard investors in case of an escalation in the currency war between the US and China. Investors may also **consider to retain a positive view on US duration as a liquid hedge,** but look to marginally reduce it after an impressive rates rally.

USD = US Dollar, JPY = Japanese Yen, Schatz = 2Y German Treasury Bond

Amundi Cross Asset Convictions								
	1 month change	---	--	-	0	+	++	+++
Equities			■					
Credit	↘						■	
Duration						■		
Oil					■			
Gold	↗					■		
Euro cash				■				
USD cash						■		

The table represents cross asset assessment on a 3-6 month horizon, based on views expressed at the most recent global investment committee. The outlook, changes in outlook and opinions on the asset class assessment reflect the expected direction (+/-) and the strength of the conviction (+/++/+++). This assessment is subject to change.

FIXED INCOME

Extreme expectations may drive volatility

ERIC BRARD, Head of Fixed Income
YERLAN SYZDYKOV, Head of Emerging Markets
KENNETH J. TAUBES, CIO of US Investment Management

Two issues compound the situation for fixed income markets, **the US-China trade war** and concerns over global economic growth, and **expectations of aggressive rate cuts** by central banks (CBs). After the rate cut by the Fed in July, the market is now pricing-in additional cuts in 2019 and some additional ones in 2020 (100 bps overall). In Europe, an accommodative stance should remain for a prolonged period. However, there is a possibility that **markets are expecting too much** and we may see more volatility in case of disappointments. We are also increasingly selective in **credit**, where **liquidity risk** assessment is at the forefront.

DM bonds

From a **global fixed income perspective,** we have an overall neutral duration stance and believe some tactical adjustment in EUR & US duration could benefit investors, given the recent dovish ECB statement. We maintain our positive view on US duration, while reducing the short duration stance in Europe.

With respect to **EU sovereigns,** we keep a constructive view on the main peripheral countries but are now more cautious on Italy BTPs as the 10y spread vs Bund has tightened significantly. We also continue to seek opportunities from yield curve movements both in Europe and in the US.

From a US investor perspective, we have become more cautious on duration amid the strong rally.

> “In case of disappointment of markets expectations on policy actions volatility will be back. Time to be cautious on credit selection and manage liquidity risk.”

Credit

In the US, given narrower credit spreads and lingering macro uncertainties tied to global trade policy, business sentiment and the Federal Reserve’s policy reaction function, we are moderately constructive.

Compared to IG credit (where we are cautious on the BBB space) we prefer securitized credit sectors such as asset-backed securities (ABS), commercial mortgage-backed securities (MBS) and residential mortgage-backed securities that can benefit from a still strong consumer sector. We also see selective opportunities in **US high yield** on the BB and B space that provide better liquidity profiles. In **European credit**, we are still constructive but selective, preferring short-term maturities with high spreads. Overall, we have become more cautious on financials, especially Italian and UK banks.

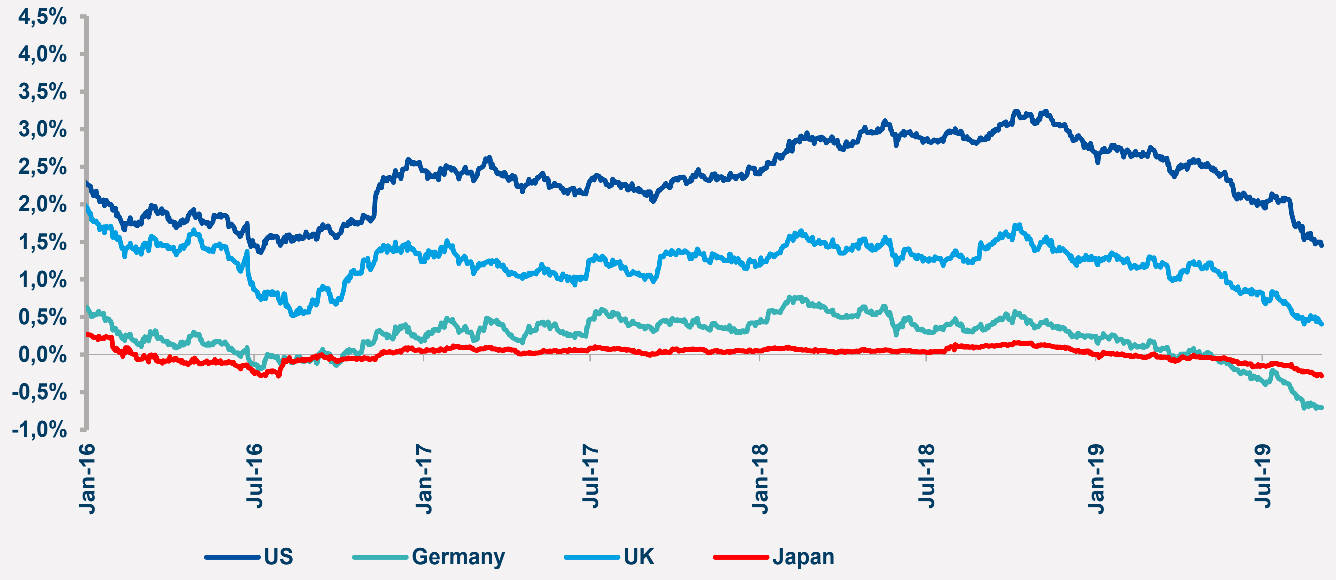
EM bonds

We are navigating a complicated market environment amid a global growth slowdown, anchored inflation expectations and elevated trade tensions. In this environment, central bank easing – in an effort to mitigate trade war risks and stimulate growth and inflation – could be supportive of EM fixed income. We believe EM bonds still offer potentially interesting return prospects and remain attractive for investors hunting for yield. But we have become more defensive with a more positive duration stance. We have a preference for Brazil, Indonesia, Serbia, and Ukraine and continue to favour selectively the hard currency space.

FX

We remain positive on the USD and JPY as a hedge. We have become more negative towards the GBP due to a fluid political situation and the increased risk of a no-deal Brexit. We are also cautious on the commodity-bloc and on EM Asian currencies threatened by the escalation in the trade war.

10Y government bond yields free fall



Source: Bloomberg, and Amundi, Data as of 29 August 2019

EQUITY

Be selective and not too optimistic on earnings

KASPER ELMGREEN, Head of Equities
YERLAN SYZDYKOV, Head of Emerging Markets
KENNETH J. TAUBES, CIO of US Investment management

Overall assessment

Equities reacted to the summer volatility as we witnessed a **reversal of globalization** in the form of increased protectionism and trade-wars. As a result prices now more closely reflect weaker fundamentals. Low bond yields make equity relatively attractive. However, the outlook is more uncertain, as earnings expectations are still high for 2020 and we could expect further downward revision. From an economic standpoint, there are **expectations of stabilization at low levels of growth.**

DM equities

In **Europe**, the reporting season has been largely in line with expectations but forward Q3 and Q4 estimates have declined. We **believe 2020 earnings estimates are too optimistic** and would be revised downwards. Portfolio balance remains important for investors, given the uncertain macro-economic environment. We continue to find opportunities among cyclicals such as industrials and energy. In particular, we prefer companies with high quality business models and strong balance sheets. While the value sectors are historically cheap, we are mindful of highly indebted companies and those that are particularly exposed to disruption in areas such as retail, media, and autos unless we are adequately compensated for the additional risks. **Defensive sectors such as consumer staples have high valuations** now. We also see limited opportunities in IT, materials and utilities. Encouragingly, health care and telecommunication present opportunities.

In EU, the banking sector appears structurally challenged, given falling rates. While there are no clear triggers, we believe the valuation of this sector is cheap and a significant tactical opportunity to buy European banks should arise. In an overall neutral view on financials, we prefer banks over insurers. In the UK, no deal Brexit risk has increased. This would have implications on the domestic economy and broader European countries.

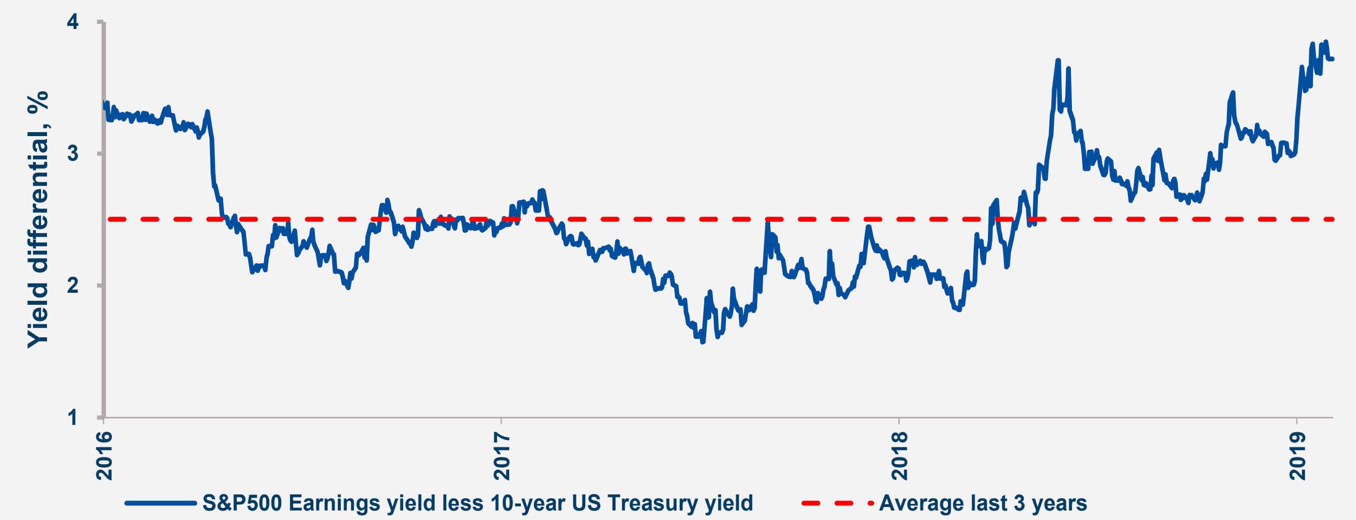
> "Low yields make equity risk premia more attractive, but given the uncertainty on earnings growth it is key to focus on quality and valuations."

In the US, among US cyclicals, we expected a volatile earnings season for Q2 and that is essentially what happened, albeit it was not as bad as originally feared. Therefore, we are now **cautious towards the more cyclical sectors**, as this is where we have seen the most pain points from quarterly results and management outlooks. From a style perspective, although we still prefer growth, **we now believe valuations are extremely stretched in med-tech, software and consumer space**. Bond proxies and other low volume stocks still appear very expensive, with the exception of real estate which is the preferred bond proxy. Overall **in the US, we prefer sectors such as consumer discretionary, health care, financials. We are negative towards industrials, utilities and consumer staples.**

EM equities

EM equity reacted negatively to the deterioration in US-China trade relations and the primary vote outcome in Argentina (and the following downgrade by rating agencies). Geopolitical risks and uncertainty remain elevated, leading to an increase in investor risk aversion and market volatility, and we expect this to be only partly offset by central banks' easing stance. In this environment, despite attractive valuations, **we prefer to be overall more cautious in the short term**. Relatively, we favour countries less exposed to external vulnerabilities and with good valuations (such as Brazil, Russia, India).

Equity more appealing given lower bond yields



Source: Bloomberg and Amundi, data as of 21 August 2019

	Amundi asset class views			
	Asset Class	**View**	**1M change**	**Rationale**
EQUITY PLATFORM	**US**	-/=		In the US the earnings season has been somewhat better than market expectations, but the trade war effects are starting to materialize, resulting in a more uncertain earnings outlook, despite a still resilient economic backdrop. The market is not cheap overall. We are cautious on cyclicals and prefer growth in less stretched areas.
EQUITY PLATFORM	**Europe**	=/+		European Equities valuations are relatively attractive but the market remains very exposed to trade war escalation, Brexit and the Italian political crisis. On the positive side, the ECB intervention could support the market.
EQUITY PLATFORM	**Japan**	-/=		We remain cautious on Japanese equities. Valuation looks attractive and domestic recovery surprised to the upside, but this is only half of the story as the earnings momentum has been hammered by the forex appreciation and the deceleration of global trade which justifies our cautious view.
EQUITY PLATFORM	**Emerging markets**	-/=	▼	Strong domestic demand in emerging countries, soft landing in China, and supportive monetary and fiscal policies should support equities. However, we believe, EMs are now facing some headwinds which must be monitored in the form of trade war escalation, idiosyncratic risks, RMB depreciation and Fed policy stance vs market expectations.
FIXED INCOME PLATFORM	**US govies**	=/+		We maintain our preference for duration exposure in the US, on more ammunitions available to the Fed on monetary policy. But the long-end has probably gone too far in August, and therefore a tactical profit taking may be attractive at current levels.
FIXED INCOME PLATFORM	**US IG Corporate**	-/=		Accommodative central banks are overall supportive for the credit market. However, given narrower credit spreads and lingering macro uncertainties, we prefer to keep a cautious attitude on credit risk, favouring high quality carry and increasing the focus on liquidity assessment.
FIXED INCOME PLATFORM	**US HY Corporate**	=		US high yield spreads are tighter than the long-term average, but we believe spreads still meaningfully exceed the cost of defaults. The default outlook remains benign, and the Fed's apparent accommodative stance should help keep the recession risk low. However, we are mindful of the idiosyncratic risks and focus on selection and liquidity management.
FIXED INCOME PLATFORM	**European govies**	-/=		The new dovish ECB stance will prevent any rise in core yields. The market is expensive and it will remain quite expensive as the search for safety will continue to be at the forefront of investors' minds. We keep a constructive view on the main peripheral European countries but are now more cautious on Italy BTPs as the 10y spread with the Bund tightened significantly in July.
FIXED INCOME PLATFORM	**Euro IG Corporate**	++		Good corporate fundamentals, improving technicals, the appetite for yield and ECB support (expected to re-open the corporate sector purchasing programme in September), will be, in our view, the key drivers of the market. We maintain a positive view on the asset class, although we are cautious on financials (Italian and UK banks) and mindful of low liquidity.

Amundi asset class views

	Asset Class	View	1M change	Rationale
FIXED INCOME PLATFORM	**Euro HY Corporate**	+		The high yield segment is attractive for carry opportunities. The default outlook is still positive, as is ECB support. Focus on selection, idiosyncratic risks and liquidity management.
FIXED INCOME PLATFORM	**EM Bonds HC**	+		Sentiment has slightly deteriorated as a consequence of trade disputes escalation. However, the market is resilient thanks to CBs support and the ongoing search for yield. Contagion from Argentina issues is limited. Some pullback could be an opportunity to add to the asset class, with a medium-term perspective.
FIXED INCOME PLATFORM	**EM Bonds LC**	=	▼	We see value in local EM rates and EM credit, but we expect increased pressures on EM currencies from a challenging global growth backdrop and geopolitical risks.
OTHER	**Commodities**			Trade war escalation and slowing economic growth are headwinds for commodities' demand. While financial conditions should remain reasonably supportive, USD appreciation might be a trigger for the asset class performance. We maintain a $55-65/b range for the WTI due to OPEC's flexibility and willingness to stabilise prices. For gold, we lift our 12M target to around $1550/ounce due to easing financial conditions, hunt for safe havens and end of Fed balance-sheet reduction. For base metals, we expect a 4-5% total return in 12M, as the inventory cycle remains reasonably supportive.
OTHER	**Currencies**			EUR/USD is expected to remain range-bound, on the back of the rebalancing of rate cuts and repricing expectations from the Fed and the ECB. EUR movement will also be impacted by persisting weak macro numbers and rising uncertainties about Brexit. 12M target maintained at around 1.14. JPY will likely consolidate in the short-term, following recent strong appreciation vs USD. USD/JPY 12M target kept at 105. GBP/USD is likely to remain under pressure as the probabilities of no-deal increased.

LEGEND

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Negative			Neutral	Positive			Downgrade vs previous month	Upgraded vs previous month

Source: Amundi, as of 26 August 2019, views relative to a EUR-based investor. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding any fund or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. This information does not represent the actual current, past or future asset allocation or portfolio of any Amundi product.

IG = Investment grade corporate bonds, HY = High Yield Corporate; EM Bonds HC / LC = EM bonds hard currency / local currency. WTI= West Texas Intermediate.

THIS MONTH'S TOPIC

Trade war escalation and impact on world trade and economic growth

ALESSIA BERARDI, Deputy Head of Macroeconomic Research

Finalised on 10/9/2019

The essential

Trade tensions re-escalated during the summer. Starting on 1 September, the US Administration introduced new tariffs and China retaliated simultaneously. More tariffs are likely from the US side, including an increase in tariffs already in place from 25% to 30% and new tariffs on the last tranche of imported goods from China. Concerning extra-tariffs measures, in August the temporary licences granted to US companies to operate with Huawei were extended upon their expiration but, so far, with no additional structural guidance.

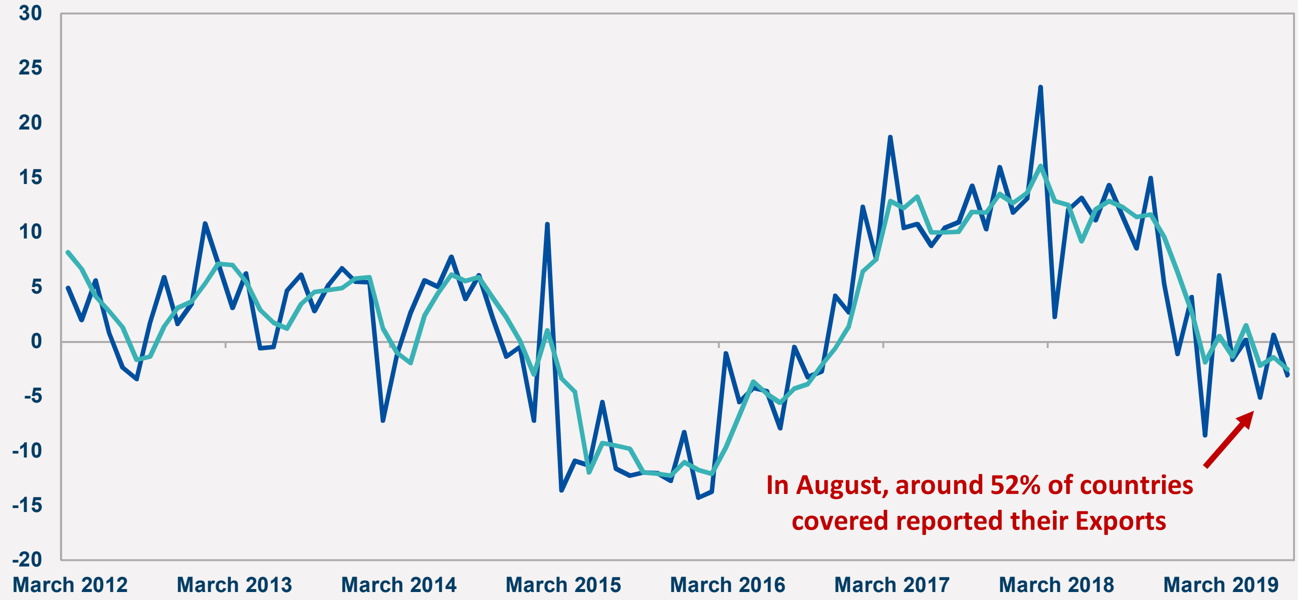
On a more positive note, a new round of high-level talks in Washington has been confirmed by early October. As a consequence of the latest developments, we have again revised our global trade forecasts downward for the second half of 2019 and 2020 with a clearly negative impact on global economic performance, in particular in those economies that are most open and most integrated with China. Overall, central banks worldwide have increased their dovishness incrementally to offset the shock to trade and poorer domestic economic conditions. On top of that, more fiscal stimulus should come.

Trade tensions re-escalated this summer. Starting on 1 September, the US Administration introduced new tariffs, by 15% on a first tranche (around $125bn) of the remaining imports from China. China simultaneously retaliated with 5%-10% tariffs on goods on their target list, specifying only the number of items, 1717, but not their value. On top of that, public hearings began in the US (ending by 20 September) to increase the 25% rate of tariffs already in place to 30%; this further increase should be effective at the beginning of October. Finally, the US Administration is expected to impose tariffs on the last tranche of imported goods from China by mid-December. Concerning extra-tariffs measures, the temporary licences conceded to the US corporate to operate with Huawei were extended in August upon expiration but, so far, with no additional structural guidance on how to operate with such an important counterpart. All of this leaves the world with more tariffs in place and greater uncertainty with regard to a trade deal between the US and China; just recently a new round of high-level talks in Washington was confirmed by Vice Premier Liu He and US Trade Representative Robert Lighthizer.

Why are the above events that important? As a consequence of the latest developments, we have again revised our global trade growth forecasts downward for the second half of 2019 and for 2020, with a clearly negative impact on global economic performance and a particular hit to those economies that are most open and most integrated with China.

Among developed markets, Europe is suffering more than the US, and countries like Germany and Italy (manufacturing exporters) are in bigger trouble than other European Union members. Because of their growth model, emerging markets are still closely dependent on external demand, and EM earnings are still generally dependent on EM Exports. Asian economic momentum is by far the weakest in a long time. Latin America, particularly those countries whose performances are more closely linked to the commodities cycle, have been quickly catching up on a cyclical downward path (Peru and Chile).

1/ EM Exports (Aggregate % YoY and % YoY 3MAV)



Source: CEIC, Amundi Research - As of 9th September 2019

On top of the hit from trade tensions, it's worth adding that several idiosyncratic risks arose (when they were not actually blowing up), in both developed economies (Italy and UK) and emerging markets (Argentina). Some of them have managed something of a solution (with a new government in Italy under a different coalition) and a Brexit reprieve. On the other hand, the Argentinian crisis is much deeper and after the surprising elections outcome, it is now rated as a default.

We have lowered our 2019-20 growth forecasts significantly in most emerging markets. Among the most relevant, the BRICS, this involves China and India in particular. China is at the heart of the trade dispute, and the measures implemented are without any doubt dragging down growth. The external shock is going hand in hand with domestic policy restrictions (with, first and foremost, more regulation and deleveraging) that are still in place, although the economy is under external threat. The industrial, consumer and property sectors are all sharing the domestic and external policy-driven pain. We expect Chinese GDP growth to land on the range floor of 6% in the second half of 2019, while succeeding in keeping the annual growth average barely above 6%. However, we expect that the new growth target range for 2020 will fall slightly below 6% and therefore we expect China to grow by around 5.8% next year. The Chinese policy mix remains on a stimulating stance, though so far in a very limited way and far away from the massive stimulus implemented in recent years. On the monetary policy side, rates cuts are limited and closely targeted (more RRR to come soon) and credit growth bounced back slightly last October and has increased only slightly since then. The recently announced LPR (Loan Prime Rate) reform is again moving in the direction of a marginal easing, in effect favouring the big banks and the safest customers (big corporations) without promoting more credit access for the riskiest customers (small businesses). In late August, it was clarified that LPR should be a floor for mortgage rates, keeping them from falling too much and confirming the unwillingness to stimulate the economy through the property market.

In India, poor economic conditions are broadly based, too. As India is a relatively insulated economy, exports have suffered on average less than in other Asian economies but domestic structural issues (in the rural and banking sectors) are weighing on investments and household consumptions. The GDP growth forecast for fiscal year 2020 (ending March 2020) was recently lowered to 5.7% YoY from 6.1% YoY and increased slightly for FY 2021 to 6.7% YoY from 6.5% YoY. Likewise, the policy mix has turned partially more supportive mainly on the monetary policy side: the RBI has cut its policy rate by 110 bps so far thisyear and we expect more easing to come. In August, the RBI has announced the transfer of an extraordinary dividend to the government to support fiscal expenditure without compromising the fiscal consolidation path reiterated last July (FD at 3.3% out of GDP for FY20) in the revised budget law. In the first four months of the current Fiscal Year, the Fiscal Deficit is already at 78% of thetargeted, due to the revenues shortfall due to the weak economic growth. If India will not compromise its fiscal targets while trying simultaneously to implement more structural reforms, it's difficult to see the economic growth on a path of a more sustainable recovery.

Moving towards less systemic countries, Argentina is where the growth revision has been the most significant: from -1% YoY to -2.3% YoY in 2019 and from 2.5% YoY to 0% YoY in 2020. The unexpected preliminary (PASO) elections on 11 August precipitated the country tothe verge of default. The election outcome and apossible halt ofthe fiscal austerity implemented under the IMF plan triggered a downgrade of Argintina by the main rating agencies and bonds that are already pricing indefault. The president in charge is now dealing with measures aimed to boost his chances for the next elections in October and to stop the peso bleeding, with obvious repercussions on an inflation rate already above 50% YoY. Partial capital controls have recently been introduced and the next (mid September) IMF disbursement and plan continuity are uncertain.

Overall, thanks to an incrementally dovish Federal Reserve and ECB, EM monetary policy stance has become more accommodative, too. In August around 15 central banks, of those under review cut their policy rates, some of them surprisingly like the Bank of Thailand and the Central Bank of Peru. More easing is expected to come, in particular if the main global central banks will confirm market expectations in September. This further dovishness will help to alleviate the economic weakness only if properly passed into the real economy. Otherwise more fiscal stimulus where affordable and more pro-business reforms and policies to promote more inward economic development should do better.

Risk factors

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The table below presents risk factors with judgmental probabilities (i.e. not market based). It also develops the possible market impacts.

Finalised on 10/9/2019

Risk # **1**	**30%** probability	**No-deal Brexit**

Analysis | Events accelerated in the first week of September. After taking control of its own agenda, Parliament passed a motion instructing the PM to request from the EU an extension of the Brexit deadline (until 31 January 2020) on October 19 if a deal has not been agreed by then with the EU or if the Commons has not given its assent to a no-deal Brexit. After excluding 21 Tory MPs who had voted for the above motions (thereby losing his parliamentary majority), Boris Johnson proposed snap elections for 15 October. However, his bid failed as opposition parties either voted against or abstained (a 2/3 majority is required). As of September 6, it appears that Labour will agree to snap elections, but to be held only after 31 October (i.e. after the aforementioned Article 50 extension becomes effective). Even though there remains a small risk that Johnson could find a constitutional backdoor to force elections before 31 October, an extension followed by snap election (in November or December?) now seems the most likely scenario. Current polls indicate that Tories could win an outright majority, but the political dynamics could change very rapidly (i.e., after the exclusion of Tory MPs, or during the Party conferences to be held later in September, or during the campaign and as the extension becomes effective). An alliance with the Brexit Party would be unsavoury to many moderate Tory voters. On the other hand, opposition parties will find it difficult to campaign on any common platform, barring a second referendum, which is a divisive issue among Labour voters. Moreover, Jeremy Corbyn is a difficult figure to rally around for moderate voters. The result of snap elections at the end of the year is therefore very uncertain and the risk of no-deal in 2020 remains real.

Market impact | The risk of a no-deal on 31 October has receded, but uncertainty remains on the 2020 horizon. In the face of uncertainty, the risk premium on UK assets must be sufficient – with a weak currency and lower prices for risky assets – to attract foreign investors. Is this enough today? Nothing is less sure! In the event that the outcome is unfavourable for the UK, we would see a weakening of the GBP and below-trend GDP growth. But should a deal be approved or Article 50 be revoked, we would see the opposite. The situation remains very binary and thus not very conducive to strong portfolio recommendations.

Risk # **2**	**20%** probability	**Major European slowdown**

Analysis | After Q1 GDP growth figures (+0.4% QoQ for the entire Eurozone), which came as a relief but were partly due to positive temporary factors (strong precautionary imports from the UK and mild weather which supported construction), growth slowed in Q2 (+0.2%), with even slightly negative growth in Germany (-0.1%). Moreover, manufacturing surveys (PMIs) have dropped further since then on the back of higher uncertainty (increased trade tensions). Should they remain depressed for long, more contagion to the rest of the economy could occur. A number of risks could worsen the situation, notably a further escalation in US-China tensions (to which European manufacturing is heavily exposed through global value chains) or US tariffs on the European auto sector (a decision could come in November). However, on the political level, the situation has improved since the start of the summer. First, in Italy where the new coalition is more in favour of Europe. Then, in the UK, where it seems highly likely that the Brexit will be delayed from 31 Oct to 31 Jan 2020. In addition, in most Eurozone economies the job market remains a key supportive factor for household consumption. And, as a result, services - which are more sensitive to domestic demand than to global trade - have remained resilient.

Market impact | A major slowdown would clearly be negative for European assets and the euro. But in that case, the policy mix would become even more accommodative both in monetary and fiscal terms, and this should contribute to anchor growth expectations. Therefore we would expect any negative market impact (related to a stronger slowdown than expected) to be short lived, as investors would want to price in the positive impact on the economy of the policy mix.

Risk # 3 | 20% probability | Re-escalation in trade tensions between the US and China

Analysis | As expected, the truce achieved at the latest G20 meeting was short-lived. As we know, the most complex issues (intellectual property rights, technology transfers, tariffs already in place, and the Huawei case) were not addressed at the G20. Indeed, the Sino-US confrontation returned to the forefront quite quickly. The issues mentioned are still on the table and moreover, tariffs from both sides have increased. On a very marginal positive side, talks are expected to resume officially by the beginning of October. Keep in mind that the US is entering a pre-election period, and opposition to China goes far beyond the Republicans. Whoever the US President is next year, opposition between the two countries on strategic issues could worsen their relations in the coming years. It is therefore important not to misunderstand the context. Protectionist rhetoric will not disappear from the radar screens. The likelihood of a global trade agreement is very low. Tariff uncertainty is long-lasting, which is clearly not good news for investment and trade.

Market impact | Along with the tit-for-tat, the most relevant implication on the markets soon after the recent events has been the CNY depreciations above the psychological threshold of 7 against the USD. The trade-weighted dollar is now historically high and EM currencies had a short period of instability in the aftermath of the CNY depreciation. That instability should accentuate in the event that the CNY depreciates much further.

Risk # 4 | 20% probability | US recession

Analysis | The US economy is gradually slowing. Recent data revision show that the peak of growth had been already reached in Q2 2018 and that, since then, the US economy has been gradually decelerating towards the trend. Incoming data remain more mixed and are providing signs of a somewhat more pronounced deceleration in investments and capex and decelerating labour market. Looking forward, we thus expect muted growth in investments but still resilient US consumer spending (although total labour income is decelerating somewhat). Renewed tensions on the trade front with China with the step-up in tariffs and persistent geopolitical issues represent key risks to our outlook, which is tilted to the downside. According to the most recent updates as of mid-August, we are seeing signs of an increased probability of recession from both the macro and financial data we monitor, over a 12-month horizon. From the current low probability of having a recession in the short term (below 5%), the likelihood increases over time to above 20%.

Market impact | The markets are likely to become more circumspect with regard to 2020 growth expectations as the deceleration could become more pronounced, and economic signals are likely to become increasingly mixed as the cycle extends. In this context, the Federal Reserve could be framed as "pre-emptive", i.e. an attempt to engineer a macroeconomic soft landing by contrasting the forces that could drag down US growth. Markets are currently expecting a 1.30% of cut over the next two years, suggesting there is a full cycle priced in, even in presence of better macro conditions than in 2007/2008.

Risk # 5 | 15% probability | Major geopolitical crisis in the Middle-East

Analysis | While there are always geopolitical risks centred in the Middle-East, US-Iranian tensions have increased in recent months after Donald Trump: 1/ cancelled the waivers that enabled some countries to import Iranian oil; and 2/ decided on new sanctions on Iran. Recent security incidents (attacks on tankers in the Persian Gulf, the shooting down of a US drone by Iran, and the seizure of an Iranian tanker in Gibraltar) and aggressive declarations by both sides have only worsened the situation.

At this state, it is unclear whether the departure of John Bolton, Donald Trump's very hawkish national security advisor, will lead to any softening of the US stance. Indeed, Trump already appeared a lot more pragmatic than him. On the Iranian side, the risk of a military confrontation with the US is made larger by internal divisions, and the possibility that the IRGC could conduct operations without the full approval of the country's leaders.

Market impact | Oil prices would be the main item to watch, while a US-Iran open confrontation could be detrimental to most risky asset classes and cause a surge in safe-haven flows to the USD. However, at this point, we expect no sustained upside shock to oil prices, given the high level of US shale gas production and declarations by Saudi Arabia and the UAE that they can make up for the shortfall in Iranian exports.

Risk # **6**	**10%** probability	**Political instability in Italy with renewed stress on BTP**

Analysis | The government crisis triggered in early August by one of the two parties forming the government coalition (the League), led to the resignation of the prime minister on 20 August. Consultations run by the Italian president avoided snap elections and found a new majority as the Five-Star Movement (5SM) and the Democratic Party (PD) finalized a new government after several rounds of negotiations. The new coalition's programme appears to be oriented to the left, with a stated focus on social and environmental issues and the broader goal to provide Italy with a new cycle of inclusive, green and more equal economic development. The new Italian government's 2020 budget law would VAT hikes while penciling-in some level of expansionary fiscal policy (e.g., higher financial support and protection to workers, lower labour and incomes taxes, less administration, and a new wave of investments plans). Despite the sharp reduction in near-term risks relating to a potential debt crisis or a long-lasting political confrontation with the European authorities, structural issues, which are a medium-term concern (public debt burden and limited fiscal space) remain unresolved. As a matter of fact, the government pledged to comply with EU rules for the 2020 budget, despite potential reliance on the greater flexibility that may be granted by the European Commission. From a political perspective, uncertainties will likely remain until the new government proves its staying power.

Market impact | Italian financial markets welcomed the avoidance of further uncertainties that would have been inevitable in the case of a snap election. As a result, BTP vs. Bund spreads tightened strongly, falling to mid-May 2018 levels. Moreover, the flattening of the Italian curve confirmed that easing political uncertainties support the attractiveness of longer Italian bonds, one of the few remaining oases in the European desert of yield.

Risk # **7**	**10%** probability	**Major political crisis in Europe**

Analysis | Aside from the Italian situation (see risk#3) there are few identifiable triggers for short-term systemic political risk in the Eurozone, in particular as the European election results were broadly in line with what opinion polls had indicated, even producing a slight "pro-institution" surprise. While the European Parliament is more fragmented, and European governments and institutions are having a harder time than usual negotiating appointments to the EU's top jobs (European Commission, Council, Parliament and Central Bank), this should not trigger a major crisis. However, it is far from clear that voters' support for "anti-system" parties has peaked and the presence of these parties in national parliaments is complicating the building of government majorities. Politics is therefore becoming less predictable, notably in large countries where it used to be stable (Germany and Spain). While this is manageable in good times, it may become problematic should a deterioration of the economic situation (or other emergencies) require a strong political hand. Moreover, other changes only complicate European political life further: "Pro-system" forces other than traditional political parties are also making progress (notably the Greens and the economic Liberals), while recent events in France have indicated the possibility of protest movements not led by political parties or trade unions. On the positive side, it should be mentioned that appetite for leaving the euro is diminishing, and is no longer on the agenda of major protest parties in France and Italy.

Market impact | Given the still positive economic backdrop, we do not believe that a new round of systemic crisis in Europe is possible. Non-mainstream political forces that are in a position to rule countries (such as in Italy) have shown that they want to blame European political institutions and try to modify them, but not exit the Eurozone. However, we cannot rule out some market stress while the difficulty to understand European institutions for outside investors means that European assets may continue to carry a specific political risk premium. Italian government spread vs. Bund should continue to be volatile.

Risk # **8** | **10%** probability | **Major slowdown in the "emerging world"**

Analysis | The recent trade war escalation has triggered a renewed wave of growth deceleration within the EM universe and not only. However, the incrementally dovishness among the main central banks (namely the Federal Reserve and the ECB) is making the global financial environment easier for the emerging markets. A more pronounced USD depreciation is the missing factor in this environment. The rosier financial picture will only worsen if there is any abrupt re-adjustment in very dovish market expectations following a more cautious monetary policy pursued by the Fed/ECB. Having said that, the amount of dovishness announced and realistically put through should prevent idiosyncratic risks from becoming systemic risks, as happened in Argentina in August. On the real economy side, spillover from the external demand shock to domestic demand (mainly via capex) has been considerable in Asia, more so than in other regions. In order to see the expected stabilisation in growth and not a major slowdown, an orderly solution to the trade dispute is needed in the next few months.

Market impact | In the risk case, spreads and equity markets would once again be significantly impacted. This is particularly true as emerging currencies would once again be under pressure due to capital outflows. However, emerging markets are far from being a homogeneous block, and the markets would worsen more in the weakest and most vulnerable countries, due to their poor external positions or fragile fiscal and political conditions.

Risk # **9** | **10%** probability | **A Chinese "hard landing"/ a bursting of the credit bubble**

Analysis | Chinese economic growth is slowing down, but the authorities are working hard to stimulate the economy (through monetary and fiscal policies), so that the economy will remain on a manageable slowdown path. Recent data indicate that the trade war is biting and a supportive policy mix is necessary. The country's economic model is fragile: signs of excessive credit are visible, and non-financial corporate debt has surged since the GFC. The good news is that the NFC debt-to-GDP ratio had started to drop since late 2017. We will continue to monitor the trend in Chinese private debt closely, especially if the economy slows. If any harder landing approaches, the Chinese authorities still have enough ammunition to offset the shocks, including more depreciation, an expansion of credit in the property market, and more expansionary fiscal and easier monetary policy.

Market impact | A hard landing triggered by a bursting of the credit bubble would have a very negative impact, and its cascading effects would be particularly disastrous, including vulnerability of banking systems (in China and elsewhere), vulnerability of the global financial system, vulnerability linked to China's public and private debt, negative impact on regional and global trade, and thus on commodities and emerging countries, impacts on the currencies of commodity-exporting countries, advanced countries and emerging countries, and so on.

MACROECONOMIC CONTEXT

Our convictions and our scenarios

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This section provides a reminder of our central scenario and alternative scenarios.

CENTRAL SCENARIO (60% probability): resilient domestic demand and services despite the uncertainty adversely affecting trade

Slower global growth: there was protracted economic weakness worldwide this summer with very few exceptions. Industrial surveys and data continue to show that the global manufacturing sector is in recession. However, domestic demand remains resilient, due primarily to household consumption, which continues to be buoyed by the labour market and low inflation. Still, services have proved more resilient than manufacturing.

Global trade is still very much under pressure: global trade has plummeted over the last 18 months. Protectionist rhetoric and measures have increased again recently: the US imposed new tariffs on 1 September, and China retaliated immediately. The level of uncertainty on a trade deal is higher, although talks should resume by early October. Investments have plunged in numerous trade-sensitive countries. Trade is expected to remain under pressure for the time being, and it will grow at a slower pace than global GDP. That said, we believe that the resilience of domestic demand is being underestimated. While global trade has indeed made a strong contribution to global growth over the last few decades, this is increasingly less so, as global growth is now being driven primarily by domestic demand. And the services sector is less and less correlated to industry, which can be attributed to the relative importance of consumption in relation to investments and trade since the 2008 crisis.

United States: gradual return to potential, with slightly higher downside risks. The US economy, boosted by very accommodative fiscal policy in 2018, began decelerating in H2 2018 and continued to do so in the following quarters. After peaking at 3.2% YoY in Q2 2018, GDP growth gradually decelerated and stood at 2.3% YoY in Q2 2019, recently revised data show. Fixed investments have been trending down markedly since the second half of 2019, while personal consumption expenditures have remained resilient overall. The protracted weakness in global trade and manufacturing, coupled with uncertainty over the implementation of tariffs, may have played a role in discouraging investments, partially offsetting the benefits of fiscal policy. Corporate and consumer confidence indeed softened recently, but barring a major shock the slowdown should remain contained. At this stage, while probabilities of recession have risen, we don't think a recession is likely in 2019 or 2020, as household consumption fundamentals remain in general supportive of a gradual slowdown and not set for a sudden stop. Yet, risks remain tilted to the downside: if trade and geopolitical tensions persist, doubts on the extension of the current cycle could intensify over the next few quarters (less support from fiscal policy, domestic demand under pressure with a contagion from manufacturing to services). Moreover, it is important to bear in mind that below-normal growth and tighter financial conditions could trigger a contraction in profits.

Eurozone: the Eurozone economy expanded by 1.2% YoY (0.2% QoQ), denoting softening momentum as the manufacturing sector continues to weaken, and uncertainty remains high on the trade and political fronts, as a result of the new tariffs recently introduced and political developments in key members or partners (e.g., Italy and UK).
The Eurozone economy's declining trend is the result of different growth patterns from one country to another. Germany and Italy weakened further in Q2, with the former crippled by the sharp decline in its manufacturing sector, bringing the country towards the edge of a technical recession. This trend was partially offset by resilience in other important economies like Spain, France, Portugal and other minor economies whose fundamentals remain overall on track.
The negative spillover from manufacturing to the domestic economy appears overall limited, as consumption on average confirmed its strength and the labour market strengthened further, albeit at a slower pace.

Risks remain tilted to the downside: uncertainties are likely to persist in the coming months as potential further escalations in the trade war are possible, Brexit remains unresolved, and Germany's willingness to engage fiscal stimulus did not seem to be considered as urgent as the new Italian government's proving its staying power. The upcoming ECB meeting will provide important lessons on the potential impact that monetary policy could have in helping the Eurozone economy withstand a challenging environment.

United Kingdom: Snap elections in late 2019, after another extension of the Brexit deadline, now seem the most likely scenario (although still not a certainty, as more surprises could come in September). However, the outcome of these elections (which may be considered a quasi-referendum on a no-deal Brexit), is very uncertain. Should the Tories win a clean mandate, a no-deal Brexit could become the most likely scenario, even though: 1/concessions from the EU making room for a deal cannot be completely ruled out; and 2/a no-deal could be accompanied by mitigation measures (for instance, a limited transition period or sectoral agreements). On the other hand, should the Tories fail to obtain a majority, many possibilities would open up, such as a new referendum, a new negotiation leading to a softer Brexit (e.g., 'Norway+') or even a unilateral repeal of Art. 50. However, unless Labour obtains an outright majority, forming a government coalition of "Bremainer" Parties will be difficult as they are opposed on most other issues. The risk of a hung Parliament's only prolonging the uncertainty cannot be completely ruled out.

China: On the back of disappointing economic figures and a re-escalation of trade tensions (a new wave of tariffs and retaliation), the authorities have recently stepped up in their fiscal and monetary support to the economy to cushion the shock from the slowdown in global trade. After an initial delay, talks between China and the United States will resume in early October. Simultaneously in August, the temporary licenses for the US corporate to operate with Huawei were extended without a clearer and more comprehensive guideline. The pressure on global value chains should remain, particularly in the technology sector. Tensions with regard to these strategic issues (intellectual property rights and technology transfer) are not showing any sign of progress. We cannot rule out new tensions between the United States and China in a form different from tariffs. Therefore, the Chinese authorities cannot let down their guard.

Inflation: underlying inflation remains low in the advanced economies. The slowdown in inflation in recent years has a structural component, related to supply factors, while the cyclical component of inflation has weakened (with the flattening of the Phillips curve). Underlying inflation is only expected to accelerate slightly in the advanced economies. In theory, an "inflationary surprise" remains possible with the pick-up in wages (in the Unites States and the Eurozone), but it is striking to see that inflation has slowed in the United States, whereas real GDP growth has accelerated! In the Eurozone, against a backdrop of low inflation, we believe that companies have virtually no pricing power (margins under pressure). Ultimately, in view of low inflation and the increase in downside risks, most central banks have made a U-turn in terms of communication since the beginning of the year. In an adverse, recessionary scenario (not our central scenario), upside pressure on wages would not last long anyway.

Oil price: fears of a global slowdown and the increase in US production are exerting downward pressure on oil prices, which is creating concern among Middle Eastern countries. In response, OPEC countries and 10 other countries including Russia signed a cooperation agreement in early July, which de facto creates an enlarged OPEC. All these countries (OPEC+) – which account for 50% of global production (vs. 30% for OPEC) – have renewed (for nine months) their agreement of last December aimed at reducing their cumulative supply by 1.2 million barrels/day in relation to their production in October 2018. Ultimately, we believe that supply pressures will continue to drive prices upwards, whereas fears on global demand trends should keep them under pressure (indeed, oil faltered in August on downward revisions in demand, while there was a surprise jump in OPEC production). Therefore, all things considered, we reiterate our target of $60-70/barrel (Brent).

Central banks accommodative for some time to come: the Fed is in a dovish stance. We expect further preventive cuts in its rates of 50bp in 2019 (as an "insurance policy"). Another 25bps in 2020 is coherent under our central scenario in which consumption proves resilient. We consider market expectations (125bps in cuts over a period of 12 months) to be excessive unless, naturally, downside risks were to materialise. In terms of the ECB, Mario Draghi clearly opened the door to an easing policy with regard to policy rates and/or a securities purchase (QE) programme. We do expect a couple of cuts in the deposit rate by 2019 and a decent QE program announced in September with the same kind of securities in the radar (sovereign and corporate bonds). A two-tier system is seriously being considered for deposit rates, in order to lighten the burden on banks that have substantial surplus reserves (Germany).

DOWNSIDE RISK SCENARIO (30%): full blow contagion to domestic demand

Two «families» of risks with different conclusions on monetary policies and scenarios

1. **Trade-related risks:** global trade takes longer to «normalise», additional escalation on trade war and full blown contagion to consumption:
   - **Growth falls further, profit recession** / the global recession comes back to the forefront
   - **Central Banks:** even more accommodative monetary policies than what is currently priced in by markets
   - **Fiscal policies:** would gradually take over from monetary policy to support growth
2. **Market-related risks:** sudden repricing of risk premia with a large impact on financial conditions exacerbated by low liquidity (various triggers: wars (e.g. Middle East), crisis in HK, credit event (HY) etc.)
   - **The policy mix** (fiscal & monetary) would become much more proactive (i.e. preemptive) in that case. While it would likely come somewhat lately with trade tensions alone.

UPSIDE RISK SCENARIO (10%): modest reacceleration of global growth in 2020

We increase the probability of the upside risk scenario (at the expense of the central scenario, of which the probability was lowered to 60%)

- Actually, we have substantially revised down our central scenario, by embedding part of the downside risk scenario in the central scenario. By definition, this means that it's now much easier to be "positively surprised". For instance, on the political level the most recent news flow is more positive (pro European coalition in Italy, possible trade de-escalation).
- Subsequently, going forward, we may see at the same time lower (political) risks and a more expansionist policy mix worldwide, which would pave the way for rebound in confidence and a quicker normalisation of global trade.
- A modest reacceleration of growth (slightly above potential) - vs. subpar growth in the base case – is a distinct possibility.

Macroeconomic picture by area

Macroeconomic Research Team

Finalised on 05/09/2019

United States

US growth gradually decelerates amid trade war concerns and geopolitical uncertainty

- The drivers of domestic demand are slowing, with investment spending worse affected than private consumption. Business climate surveys are showing a downturn in manufacturing and services, although small business confidence was slightly higher.
- Consumer confidence rose slightly, but is still showing expectations of a downturn. However, the labour market continues to provide good news for consumer spending – while wages are rising slightly more slowly than expected, the labour force participation rate is rising and lower inflation is boosting real earnings. On the investment front, spending plans are tending to decline, but the latest capital goods orders surpassed expectations. Inflation is low (1.8% overall, 2.2% for core inflation) but it remains close to the Federal Reserve's target.
- In foreign trade, after China announced reprisals, the US announced a further increase in customs duties on imports from China.
- The Federal Reserve has maintained its expansionary stance, emphasising the need to help the economy towards a soft landing and to offset the negative effects of trade tensions and geopolitical uncertainties.

Risk factors

- Tariffs risks may negatively impact economic performance, both directly (in prices and orders) and indirectly (in confidence). The longer the list of goods included in tariffs, the higher the impact on U.S. domestic demand
- Renewed policy uncertainty may hold back new capex plans more than expected
- Geopolitical risks (Iran, Venezuela) and tariffs, could represent an upside risk to oil prices and to our inflation outlook

Eurozone

2020 forecasts downgraded due to the gloomy outlook for world trade

- Growth was disappointing in Q2 (+0.2%) and indicators for the start of Q3 are very weak. Activity remains strong in the services sector but the manufacturing sector is struggling, especially in Germany. Newsflow over the summer (the heightening trade war between the US and China and the growing risk of a hard Brexit) dragged down confidence.
- We have lowered our GDP growth forecast for 2020 to 1.0% (from 1.2% previously).

Risk factors

- Trade war and the threat of US tariffs on the European automotive sector
- No-deal Brexit

United Kingdom

Increased risk of no-deal Brexit

- After the rebound in growth in Q1 (+0.5%, largely due to precautionary spending), the economy contracted in Q2 (-0.2%), although the labour market remains strong.
- Uncertainty about Brexit is extremely high. Boris Johnson is determined that Brexit will happen on 31 October, even without a withdrawal agreement. However, while the EU seems unwilling to make any additional concessions, the UK parliament is opposed to a no-deal Brexit.

Risk factors

- A no-deal Brexit

Macroeconomic picture by area

Finalised on 05/09/2019

Japan

Exhilaration is long gone, and the spectre of austerity haunts in coming quarters

- GDP expanded by an annualized 1.8% in Q2, following a sprint of 2.8% in the previous quarter. The escalating US-China trade spat did not hamper the economy, as consumer spending gained, driven by the unprecedented 10-day consecutive holidays on the accession of new Emperor, and capex gobbled up by construction and refurbishment.
- However, consumer morale fell to a five-year low in July. Somehow, a longer rainy season and the subsequent sudden change in temperature spoiled consumers' appetite. More importantly, elusive real income growth compounded concerns about the consumption tax hike in October, prompting savings rather than early-purchases ahead of the heavier levy.
- Monthly machinery orders started weakening, although every survey on capex plans continues to radiate unbridled optimism. More companies are expected to suspend or downsize business investment, as the US-China trade squabble lingers.

Risk factors

- **Supply chain disruption on the back of the US-China and Japan-Korea trade dispute**
- **Companies accelerate suspension of capital investment as global economy weakens farther**
- **A consumption tax hike in October 2019 could exacerbate the economic downturn**

China

- In a re-escalation of trade tensions, China retaliated against the US tariffs increase, with 5%-10% hike on some of the $75bn of targeted goods (1717 items, not clear at this point what their value is), starting on 1 September 2019.
- Chinese macroeconomic data are showing a certain degree of deceleration that is quite broad-based, including in the manufacturing sector, consumer goods and property. The latest export data have shown some resilience, due to the front-loading of incoming tariffs.
- The policy mix continues to support the economy in a limited way, both monetarily and fiscally. More stimulus is expected (RRR cuts and increases in the quota of local government bonds).
- In August, a move was made towards greater liberalization of interest rates, including the loan prime rate (LPR). The path to full liberalization is still far off, while China has gradually eased its monetary policy.

Risk factors

- **Still some uncertainty in the US/China relationship**
- **China's economy is decelerating more than expected**
- **Policy mix only mildly supportive**

Asia (ex JP & CH)

- Economic conditions in the region keep deteriorating, driven by a further decline in external demand and soft domestic demand. The outlook for Korean exports is dark, due to a re-escalation in trade tensions. India's growth outlook, broadly based, is weaker than expected.
- The region's inflation figures have remained very benign. Indonesian inflation picked up on food prices mainly, while Thai inflation is experiencing new minimum levels.
- In August, many central banks in the region moved towards a more accommodative monetary policy, including Indonesia, the Philippines and Thailand, which all cut their policy rates by 25bps, while India cut its by 35bps.
- Several countries are trying to stimulate their economies through fiscal leverage. The Philippines, Thailand and India recently announced different fiscal packages/measures. On the opposite side, in its 2020 budget announcement, Indonesia is pursuing its virtuous fiscal consolidation path.

Risk factors

- **Still weak macro momentum in the region. India's growth is disappointing**
- **Inflation still very benign. Food prices have been driving inflation up**
- **Central banks in the region are more accommodative**
- **Fiscal expansion has started to join monetary policy in the policy mix to support the economic cycle**

Macroeconomic picture by area

Finalised on 05/09/2019

Latam

- The growth outlook has deteriorated significantly in Mexico. It is in recession and the GDP forecast for 2019 has been more than halved, from 1.3% YoY to 0.5% YoY. Brazilian growth has weakened more moderately.
- On the inflation front, the overall environment remains benign. Mexican inflation has resumed converging towards the target, with its latest figure within the band at 3.8% YoY, down from 4% YoY. Argentina inflation is still above 50%, at 54% YoY in July and it will not converge soon.
- The main central banks have recently started to ease their monetary policies, including Brazil by 50bps, and Mexico, Peru, the Dominican Republic and Paraguay by 25bps.
- In a surprising result in the PASO elections in Argentina, the Fernandez-Fernandez Peronist couple won by a wide margin over President Macri. Both Fitch and S&P downgraded Argentina's sovereign ratings: Fitch by three notches from B to CCC, and S&P from B to B- with a negative outlook.

Risk factors

- **Economic conditions continued to weaken; Mexico is in a recession**
- **Inflation is benign overall. Argentine inflation in July disappointed on the high side**
- **Many central banks in the area adopted an easier monetary policy**
- **Argentina on its way to default**

EMEA (Europe Middle East & Africa)

Russia: Real GDP growth was 2.2% in 2018 and is expected to slow down to 1.2% in 2019. However, growth is expected to accelerate over the medium term on the back of a significant infrastructure spending programme from 2019 to 2024.

- Despite the threat of potential US sanctions down the road, the macroeconomic scenario remains supportive. Russia is one of the few emerging market sovereigns with "twin surpluses" in 2019, while accumulating assets in its National Wealth Fund.
- As expected, the CBR cut its policy rate in July by 25bps. We expect more cuts, given decelerating inflation.

South Africa: exit from recession, but no miracle

- Recently released Q2 GDP showed more resilience than the market was expecting. We confirm our 2019 GDP forecast of 0.8% YoY, a good result amid the strong deterioration that most of the EM economies are currently experiencing.
- In an environment of incremental dovishness among developed- and emerging-market central banks, we do expect the SARB to adopt a very mild accommodative stance in 2019.

Turkey: we expect double-digit inflation and a recession in 2019

- The growth report for the second quarter of the year showed only a marginal improvement in the recessionary phase that Turkey is going through. We do confirm our GDP forecasts at -1.8% over 2019.
- The Central Bank of Turkey cut its policy rates significantly at the end of July, by 425bps. We do expect more easing to come soon in support of very weak economic conditions.

Risk factors

- **Drop in oil prices, stepped-up US sanctions and further geopolitical tensions**
- **Increased risk aversion, risk of sovereign rating downgrades, rising social demands in the run-up to elections and the risk of fiscal slippage**
- **A too rapid easing of the central bank, a cooling of budgetary policy, and a slowdown in Eurozone activity.**

Macro and Market forecasts

Macroeconomic forecasts
(4 September 2019)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	**2.9**	**2.3**	**1.7**	**2.4**	**1.8**	**2.3**
Japan	**0.8**	**1.0**	**0.5**	**1.0**	**0.8**	**1.0**
Eurozone	**1.9**	**1.0**	**1.0**	**1.8**	**1.3**	**1.5**
Germany	1.5	0.6	0.7	1.7	1.5	1.7
France	1.7	1.3	1.2	2.1	1.3	1.4
Italy	0.7	0.1	0.4	1.1	0.6	1.0
Spain	2.6	2.2	1.9	1.7	0.8	1.1
UK	**1.4**	**1.2**	**1.1**	**2.5**	**1.9**	**2.0**
Brazil	1.1	0.9	1.6	3.7	4.0	4.4
Russia	2.2	1.2	1.7	2.9	4.8	4.0
India	7.4	5.7	6.5	4.0	3.3	4.2
Indonesia	5.2	5.1	5.2	3.2	3.5	3.8
China	6.6	6.2	5.8	2.1	2.4	2.5
Turkey	2.9	-1.8	1.5	16.2	15.6	12.9
Developed countries	**2.2**	**1.7**	**1.4**	**2.0**	**1.6**	**1.8**
Emerging countries	**4.9**	**4.2**	**4.4**	**4.0**	**4.0**	**3.9**
World	**3.8**	**3.2**	**3.2**	**3.2**	**3.0**	**3.1**

Source: Amundi Research

Key interest rate outlook

	02/09/2019	Amundi + 6m.	Consensus Q1 2020	Amundi + 12m.	Consensus Q3 2020
US	2.25	1.75	2.00	1.75	2.00
Eurozone	-0.40	-0.50	-0.45	-0.60	-0.40
Japan	-0.1	-0.1	-0.1	-0.1	-0.1
UK	0.75	0.75	0.75	0.50	0.75

Long rate outlook

2Y. Bond yield

	02/09/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1.53	1.20/1.40	1.39	1.30/1.50	1.31
Germany	-0.923	-0.90/-0.70	-0.97	-0.90/-0.70	-1.00
Japan	-0.296	-0.30/-0.20	-0.33	-0.30/-0.20	-0.36
UK	0.379	0.20/0.40	0.22	0.20/0.40	0.21

10Y. Bond yield

	02/09/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1.52	1.40/1.60	1.54	1.60/1.80	1.57
Germany	-0.71	-0.50/-0.70	-0.66	-0.50/-0.70	-0.62
Japan	-0.27	-0.20/0.00	-0.24	-0.20/0.00	-0.21
UK	0.45	0.50/0.70	0.46	0.50/0.70	0.51

Currency outlook

	05/09/2019	Amundi + 6m.	Consensus Q1 2020	Amundi + 12m.	Consensus Q3 2020
EUR/USD	1.10	1.10	1.13	1.13	1.14
USD/JPY	107	105	105	104	103
EUR/GBP	0.89	0.89	0.90	0.91	0.91
EUR/CHF	1.09	1.08	1.10	1.10	1.11
EUR/NOK	9.94	9.60	9.75	9.83	9.81
EUR/SEK	10.69	10.40	10.60	10.39	10.57
USD/CAD	1.32	1.31	1.31	1.29	1.32
AUD/USD	0.68	0.69	0.68	0.71	0.70
NZD/USD	0.64	0.64	0.64	0.65	0.66
USD/CNY	7.15	7.30	7.15	7.10	7.25

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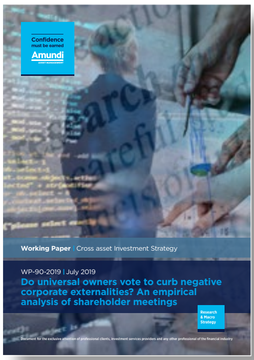

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September 2019 #09

Document issued by Amundi, “société par actions simplifiée”- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com

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