Confidence must be earned

Amundi ASSET MANAGEMENT

CROSS ASSET

INVESTMENT STRATEGY

CIO VIEWS

STAY AGILE AMID HIGH UNCERTAINTY

THIS MONTH'S TOPIC

CENTRAL BANKS HAVE CONFIRMED THE SHIFT TO A MUCH MORE ACCOMMODATIVE STANCE

Research & Macro Strategy

CIO VIEWS

Stay agile amid high uncertainty

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

Over the past few weeks markets have fluctuated between positive news around geopolitics (US-China trade talks, Italy and receding risks of no-deal Brexit) and not so good news around economic data (German recession, US manufacturing and Chinese slowdown). This led to a rebound in equities and a rise in core bond yields. A new wait and see phase has likely started during which markets will reassess recession fears and the pressures of trade dynamics on corporate balance sheets. Last year the key drivers of markets were inflation expectations and interest rates. Now, **the main factors causing market movements are expectations of recession and policy actions (monetary and fiscal)**. **On both, we believe the markets expect too much.** In our central scenario we do not think an economic recession will occur in next 12 months as domestic consumption remains strong (although manufacturing is weak). However, **corporate earnings may still be impacted,** which is a fragile environment for equities.

In addition, in our view, **markets are too optimistic with regards to their expectations of policy measures.** The ECB seems to have exceeded investor expectations by implementing easing measures. However, it is clear, that monetary policy has to go along with fiscal measures (the former alone is not sufficient to counteract low growth and low inflation). Regarding fiscal boost, we expect some fine tuning but not a substantial change in EU fiscal rules. **When expectations on policy actions are high, the risk for investors to be disappointed is also high,** causing volatility in most markets. Having said that, there are other **two alternative scenarios** that could play out in the future. The more negative one is that the **slowdown is more pronounced than expected** due to the ongoing trade war. This could affect capital expenditures or may even cause employee dismissals, particularly in the US where labour laws are flexible (however, in the short-term, businesses are reluctant to reduce staff as its expensive to replace workers), thereby affecting 'robust' consumption. Fear of recessionary risks could also lead to a recession, which could be directly negative for risk assets. There is also a third possibility – **central banks implement aggressive policies and fiscal measures are used as well**. This would further support risky assets. On the basis of these scenarios and the fact that we consider the first and the second the most likely ones at the moment (fragilities, with high valuations in many areas of the market and risks of disappointment), we believe that investors should **remain cautious and agile**.

We outline our four convictions – (1) **Interest rates will stay low leading to a continued hunt for yield** among investors, given that economic growth is likely to remain subdued. (2) **Trade and politics will remain in focus** with less globalisation ahead. Therefore, **the importance of domestic consumption** and related services in individual countries across the emerging and the developed world would increase. (3) **In equities, focus on fundamentals** and earnings will be back. (4) **Liquidity remains crucial** for investors as they should be aware of the trade-off between risk, return and liquidity that must be taken into account. **In conclusion**, our main message for investors is to try to preserve capital in this highly uncertain scenario and be agile in looking for opportunities amid volatility. Going forward, investors will have to assess the evolving probabilities of the different scenarios. Today, our base case of the markets expecting too much on the policy mix is the most likely. There are excessive fears of a recession and also the marginal effectiveness of monetary measures is diminishing. In addition, we believe there are political and economic limitations which would prevent a fiscal U-turn in Europe/Germany.

Beyond the short term, the current debate will lead to pro-growth policy combination with a "whatever it takes" approach. This means that **we will see more efforts to bridge the gap between the fiscal and the monetary space**. Some sort of 'politicisation' of monetary policies and 'monetization' of the budgetary approach may emerge with different frameworks depending on countries and institutions. This could shape the market environment in light of a recession or in light of pre-emptive moves to avoid a recession. Investors will have to assess the short-term impact (yields declining even lower across asset classes) from the shift in expectations that may ultimately follow (including inflation).

Overall risk sentiment

Defensive risk allocation. Markets are expecting very supportive central bank policy. In case of disappointment volatility will rise.

Changes vs previous month

- Tactically reduced the short stance on equity, focus on quality and valuations
- In US bonds more positive on Credit IG
- In Euro credit more positive in financial

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

MACRO

Focus on corporate fundamentals, more than GDP

DIDIER BOROWSKI, Head of Macroeconomic Research
MONICA DEFEND, Head of Strategy, Deputy Head of Research

Growth looks likely to remain weak near term amid softer global manufacturing activity and this has been reflected in downward revisions to corporate activity as the reporting season recently highlighted. On a positive note the consumer side remains resilient.

Against this backdrop the **four most debated topics** within our Research team in order to assess future economic and market directions have been:

Trade war: Notwithstanding some steps forward on trade agreements between US and China, ahead of their September talks, the trade outlook remains challenging and represents the key risk factor.

Central banks: Markets continue to pressure Central Banks to deliver more and more liquidity to suppress financial volatility and set very high expectations on the fiscal side to structurally support the economic cycle. The ECB delivered a meaningful package of aggressive easing measures to support the inflation outlook, while the Fed will pencil its rate strategy on a meeting-by-meeting basis. As (geo) politics, not economic prints, dominates markets movement, this seems to us a reasonable approach.

Financial conditions: Central banks activity will ultimately affect FX, shaping financial conditions. This is a key factor to monitor as it drives corporate earnings cycles. Interest rates and currencies (so called "translation effect" for international sales) impact corporate profits. Currently, financial conditions are a primary source of risk for a profit recession (according to our analysis we attach a 30% probability to this risk event). The deterioration of global trade (due to tariff war) is reflected in the manufacturing and in wholesale sectors.

Given that wholesale and manufacturing sectors account for 2/3 of total sales, we might be approaching a turning point. If uncertainty persists it will further chill business investment (the global capex cycle has already halted) eventually hampering job creation and/or preservation. At that stage, the spill over to consumers would be fast. On a positive note, domestic retail sales bode well because they are primarily driven by domestic consumers and are resilient to external shocks.

> "At a time of scarce visibility on growth quality, focusing on GDP data might be misleading. Weak GDP numbers do not exclude profit recessions."

Chinese growth: The Chinese data just released confirm our views of a decelerating GDP growth on the range floor at 6% YOY in H2 2019 and below 6% YoY in 2020 (at 5.8% YoY). The picture is not as dark as it might appear at a first glance: housing sector, retail sales ex-auto, infrastructure investments have been resilient in their weakness, if not moderately growing (supported by the special bonds issuances). We do expect the authorities will ramp up in their stimulus to accommodate the deceleration mentioned above. More stimulus has to come in the form of monetary policy easing, front- loading of local government special bonds, support for the auto sector (relaxing or removing purchase restrictions) and budget fund. More concessions to the US, on the trade front, should help to alleviate the short term pain coming from the external side, trying to avoid, for example, the introduction of the new tariffs or the increase of the existing tariffs rate (set to take effect on 15 October and December respectively). This latest objective is challenging; however, next trade talks could bring some temporary relief.

The Strategist's view

Politics and Currencies in the spotlight

1) **Politics dominates investment backdrop in the UK and Italy:** GBPUSD broke the post-Brexit referendum level after UK Parliament prorogation news, reaching 1.2033, but was supported by the MPs move to pass a bill that would force Johnson to ask the EU to delay Brexit, in case of a no-deal. UK 10Y yield also touched all-time lows of 0.40%. However, there is still high uncertainty surrounding the outcome of Brexit (even after the extension). Therefore, yields and the GBP will remain under pressure. Elsewhere, BTP-Bund spread fell sharply below 150bps as the Italian government found a new majority in which Eurosceptic forces have been sidelined. This political development, the 'state contingent' forward guidance by the ECB on the duration of the QE, along with the ongoing search for yield support our positive view on the Italian debt.
2) **Volatile forex markets:** Although the USTW$ retraced in September so far, progress on trade talks and China's fiscal spending and reserve requirement ratio cut should prevent further deterioration of risk sentiment. The EURUSD broke the 1.10 level in August as global growth struggled to rebound. So far, lower rates differential with the US in the past months, cheap valuation and low positioning have struggled to push the currency higher. Without a stabilization on trade and global economic indicators, optimism towards the currency should remain muted.

MPs= Members of Parliament. USTW= Trade-weighted US dollar, a measure of the value of the US dollar relative to other world currencies.

MULTI-ASSET

Still cautious, but with some tactical equity upgrade

MATTEO GERMANO, Head of Multi-Asset

Given our scenario of a late cycle environment with extra-dovish central banks and trade risks, we adopt **a defensive and agile stance** in terms of risk allocation. Our pre-summer view of favouring US duration to **de-risk the portfolio** has been nicely rewarded by the markets. We stay cautious on equities, **although with a tactical upgrade**, and constructive on credit, mainly on Euro IG. Strong directional calls may carry excessive risk and we believe it is more appropriate to focus on relative value opportunities.

High conviction ideas

We stick to **two main convictions** against an economic backdrop that remains weak (but still with no global recession in sight) and dovish central banks. Firstly, we are maintaining **a generally cautious risk allocation** across the board, as valuations are not cheap and areas of uncertainty persist. Secondly, **we think investors should be agile when they see opportunities in the market** and readjust their exposure. On the first, we maintain a selective and cautious view on equities, given pressures on earnings growth, even without a recession. Investors should also continue to consider hedging strategies. However, we have been agile **in tactically reviewing and upgrading our view on equities (US in particular)** in anticipation of a possible rebound. One way investors could preserve a flexible equity risk allocation is by implementing option strategies. In **credit**, we favour Euro IG over US IG, as US credit looks too leveraged and pricey compared to fundamentals. In fixed income, we remain positive on US 5y vs German 5y, as we think there is limited room for German yields to fall further given 5y Eonia is already pricing in further rate cuts. We became more positive on US Treasuries, when rates recently returned to back above 1.80% on the 10y. On Italian BTPs we moved our preference from the 10-year to the 30-year, as most of the positive newsflow stemming from the formation of the new government is already priced into the former. However, as this view increases the duration risk, we believe investors should consider to partially hedge the increased exposure. **In EM bonds**, we believe attractive carry, low US rates, subdued inflation, dovish Fed and EM Central Banks are all supportive of spread exposure (but hedging the duration risk). We keep our positive **stance on EMB HC**, but we think that Euro-based investors should consider partially hedging the USD exposure given the recent strong rally of the currency. **In currencies,** we maintain a preference for an FX basket of higher-carry EM currencies vs South African Rand and the South Korean Won, and in DM we still like the Norwegian Krone vs EUR (based on a strong outlook for Norwegian economy).

> “In this phase of slowdown and uncertainty, it is important to remain agile. Investors should consider recalibrating their equity stance to a less underweight position.”

Risks and hedging

While geopolitical events (US-China, Brexit) are hard to forecast, we must assess them in order to manage risks and seek opportunities. We suggest investors remain agile and risk aware as we are in a less-directional market phase. Liquidity risk may also resurface should central banks disappoint. To deal with these risks, investors should run well-diversified portfolios. Secondly, investors should actively hedge risks (using Gold, Yen and US Treasuries) to avoid forced selling during periods of turmoil. Thirdly, “stress-testing” portfolios allows investors to assess the potential effects of adverse market movements. Lastly, cash or highly-liquid government bonds (US duration) may act as liquidity buffers in case of heightened volatility.

USD = US Dollar, EMB = EM Bonds, HC= Hard Currency.

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

Selectivity and liquidity remain in focus

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

Over recent weeks the likelihood of a heightened trade war, no-deal Brexit and a return of Italian political crisis has receded. Against this more supportive risk backdrop, central banks are taking central stage. While, the ECB delivered a comprehensive monetary easing package including rate cuts of 10 bps and an asset purchase programme, and tiering system for banks, markets continue to expect massive monetary easing by central banks that may be unrealistic. All in all, **this calls for a flexible approach** to duration management and a still positive view on credit, with selection and liquidity management in focus.

DM bonds

In **global fixed income**, we maintain our neutral view on duration but investors should continue to seek opportunities at curve levels, as well as at the country allocation level, with a long US/short Germany stance for instance. **Among sovereigns**, we remain positive on the main peripheral European countries (Spain and Italy where we believe investors should consider some profit taking), supported by monetary easing by the ECB and a new coalition in Italy willing to find agreement with the EU commission on the 2020 budget. Regarding **inflation**, the Euro breakeven rate has picked up following the recent easing by ECB and we see possibility of an additional pick-up. On inflation, we keep a positive view on US break even. In **credit**, we favour EUR IG credit, where we have become more positive **in the financial sector, in particular in subordinated debt financial and senior financials** (Europe). Euro credit investors can also seek opportunities in the primary market. The recent ECB move plays in favour of IG credit. **From a US investor perspective**, the 10y Treasury yield declined inside of 1.50%, driven by risk-off sentiment and a global thirst for yield, and then rebounded, but we still see room for further rebound. Expectations for aggressive Fed cuts are too high in our view. So, we think investors should remain active in tactically adjusting the duration exposure when the market expectations get extreme. We expect the treasury curve to steepen, given the dramatic run in long term UST yields. On **US credit, we prefer higher quality carry and lower risk assets.** We favour **securitised credit** over corporate credit on expectations of strength in consumer and services sectors. In this regard, asset-backed securities (ABS), commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS) and seasoned agency MBS pools look attractive. US IG corporate

> “With supportive central banks, IG credit continue to offer opportunities, but selection and liquidity management all more important.”

market remains strong. Massive recent corporate bond issuances, both HY and IG, were met with even greater global demand, signalling that the appeal for US assets is still high.

EM bonds

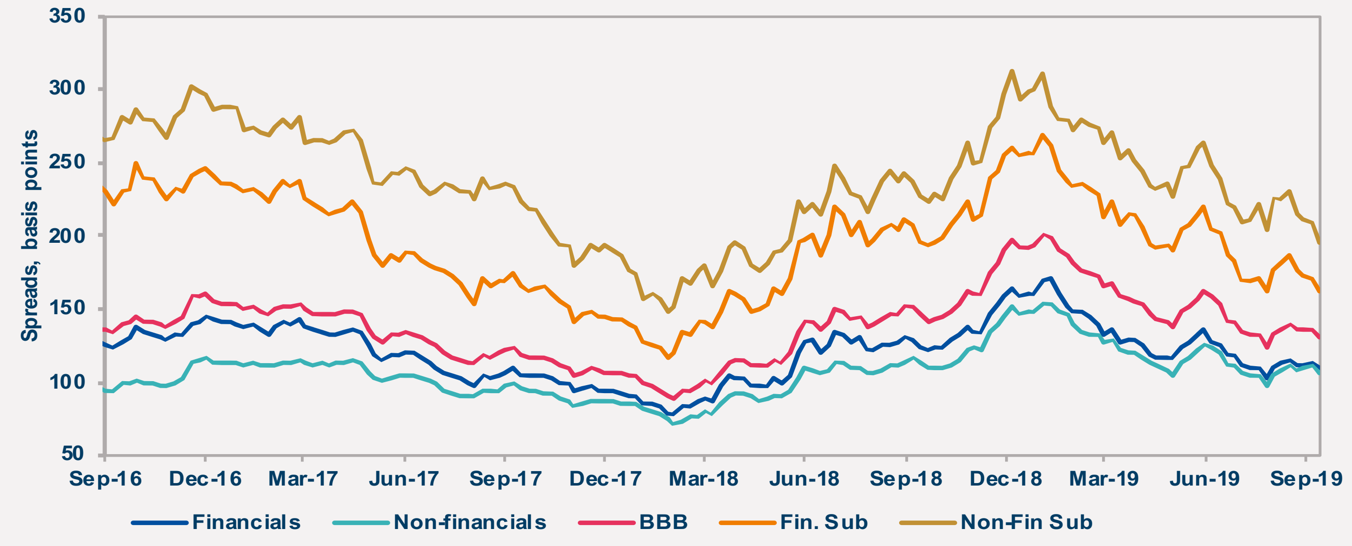
We think investors should become **more cautious** by lowering duration and increasing the cash levels to address potential lower liquidity. Our top convictions remain Brazil, Egypt, Indonesia, Serbia and Ukraine (due to improving outlook and interesting yields), but we are cautious on China (growth slowdown). In credit, we have been seeking selective opportunities in IG and also HY.

FX

We remain positive on **USD and JPY**, given that the former provides deep liquidity, safety and good yield, whereas the latter is the main risk-off protective currency. We are negative towards the British Pound (Brexit). The outlook for the Chinese Renminbi and South Korean Won is also weak, in light of the global slowdown and trade frictions.

The breakeven inflation rate is the difference between the yield of a nominal bond and an inflation linked bond, with the same maturity.

Euro credit spreads



Source: Bloomberg and Amundi Research, as of 13 September 2019.

EQUITY

Seek opportunities in high quality / value names

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

Overall assessment

Global economic growth could slow down but a recession is unlikely, in our view, given strong domestic consumption (services) in the US, Europe and the emerging world, and dovish global central banks. While the S&P 500 fell in August, now the markets are back to pre-summer highs. Going forward earnings expectations will decide whether markets break upwards or fall from here. However, earnings continue to be revised down and **selectivity remains key to identifying companies with sustainable balance sheets**.

DM equities

In Europe, corporate fundamentals remain solid, although forward earnings visibility has deteriorated. Valuations seem fair and attractive in some areas and we believe heightened volatility and market dislocations (growth/value, cyclical/defensive) could provide investment opportunities. At a sector level, **quality/value names are displaying mispricing** in industrials and consumer discretionary. We are positive but selective on health care and telecoms as they provide some reasonable safety to an equity portfolio. However, we are negative on sectors such as utilities and consumer staples, which are typically seen as bond proxies, due to high valuations. We see certain opportunities in the **domestic sector in the UK**, that should be evaluated on a case-by-case basis.

In the US, the consumer remains robust, although the recent spike in oil prices is concerning. Companies may also be affected by oil prices, but it remains to be seen whether this increase is sustained (despite concerns, the supply could be restored and US production has also grown dramatically).

From a style perspective, we are **cautious on growth due to high valuations,** particularly in the med-tech, software and consumer discretionary sectors.

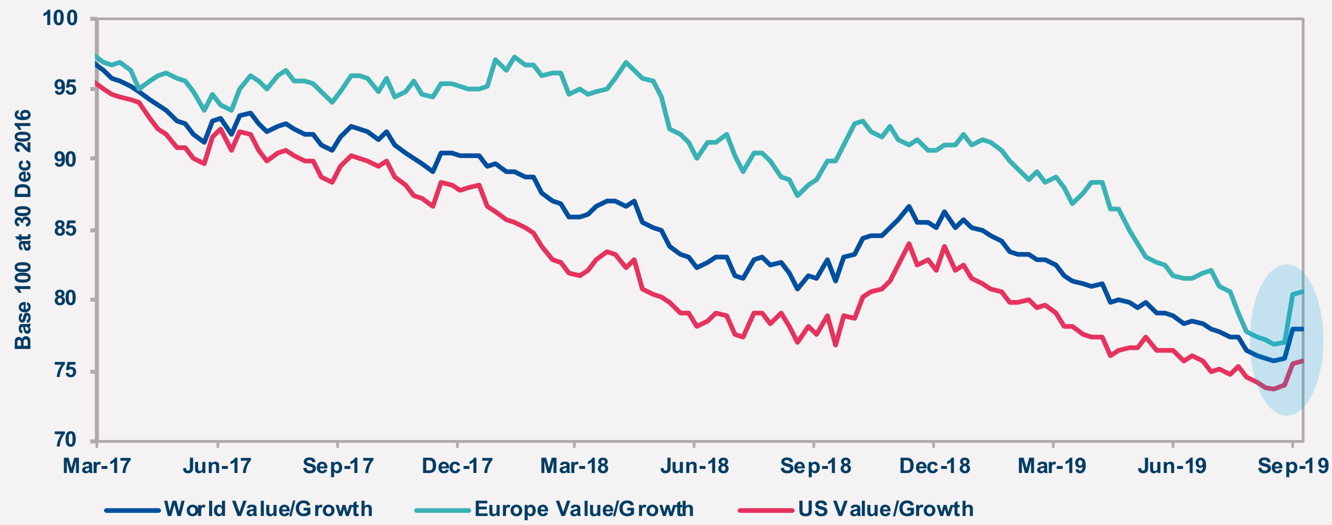
We are becoming **more positive but remain selective on high-quality stocks in the cyclical sectors** as valuations are attractive. The **outperformance of the defensive vs cyclical may be coming to an end** in our view, and perhaps risk on cyclicals are now on the upside. We believe the bond-proxies have high valuations and we remain negative towards them. However, we continue to like good quality opportunities in the real estate sector. In the special value situations space, we are positive on **names that offer a mix of value and growth**, and where we believe there are improving fundamentals that could lead to a valuation re-rating. At an overall sector level, we are **constructive on financials, consumer discretionary and real estate.** However, we are negative towards industrials, utilities and information technology.

> “With lower visibility on corporate earnings it is important to focus on quality names in cyclical sectors at attractive valuations.”

EM equities

While we are still **constructive on EM equity in the medium term, we prefer to be overall more cautious in the short term**, as oil price spikes (drone attack in Saudi Arabia) and trade tensions inevitably have negatively affected the asset class through manufacturing, exports and earnings expectations. Therefore, we would favour self-help countries for the next few months (such as **Brazil, Indonesia, Russia and India**) and look less favourably on China. As far as the sector allocation, we favour the tech hardware sector in Korea and Taiwan (well positioned to benefit from any uptick in the global economic growth).

Rotation towards value at early stage



Source: Bloomberg and Amundi Research, as of 20 September 2019.

Amundi asset class views

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=	▲	Earnings concerns and escalating trade tensions could be negative for manufacturing. However, consumption remains robust. We have a neutral view on US equity at the moment and within the US equity market we are cautious on growth.
EQUITY PLATFORM	Europe	=/+		Equities valuations are relatively attractive but the market remains exposed to trade war escalation and Brexit uncertainties. However, corporate fundamentals remain solid even if earnings visibility has deteriorated, and heightened volatility and market dislocations may provide opportunities. Recent dovish measures by ECB should be supportive.
EQUITY PLATFORM	Japan	-/=		We are cautious on Japanese equities. Valuations are attractive and so are dividend yields. Corporate governance standards are also improving. However, earnings' sensitivity to global manufacturing and forex appreciation are headwinds that underpin our cautious view.
EQUITY PLATFORM	Emerging markets	-/=		Consensus earnings growth expectations are stabilizing but selectivity is important. Strong domestic demand, soft landing in China, and favourable monetary and fiscal policies should be supportive. However, trade war escalation, idiosyncratic risks, RMB depreciation and Fed policy stance vs market expectations remain key risks. Domestic growth resilience is a key theme in focus.
FIXED INCOME PLATFORM	US govies	=/+		As expected the Fed cut rates by 25 bps in its September Federal Open Market Committee meeting. Two additional cuts are expected be delivered in December and the first half of next year. This supports our bull steepening scenario. With the treasury yields readjusting as market reprice the possible Fed cuts, it is key to be active in duration management.
FIXED INCOME PLATFORM	US IG Corporate	=/+	▲	Dovish central banks are overall supportive of the credit market. We believe corporate credit remains stable and could present opportunities. The demand for US credit is high and new issues have been well absorbed by the market. However, given 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	=		Although US HY spreads are tighter than the long-term average, the spreads still exceed the cost of default. However, increase in idiosyncratic risks is apparent and we continue to focus on selection and liquidity management.
FIXED INCOME PLATFORM	European govies	-/=		Despite the recent ECB measures, markets are aggressively pricing cuts to the deposit rate in the next 12 months. This should prevent any rise in core yields. We remain constructive on the main peripheral European countries (Spain and Italy) fuelled by ECB action, a new political coalition in Italy and the ongoing search for yield.
FIXED INCOME PLATFORM	Euro IG Corporate	++		We are positive on Euro IG, particularly on the subordinated and senior debt in financials in Europe. Good corporate fundamentals, improving technicals, the appetite for yield and ECB support will continue to drive the market. However, liquidity conditions in the secondary market remain a key area to monitor.

	Amundi asset class views			
	Asset Class	View	1M change	Rationale
FIXED INCOME PLATFORM	**Euro HY Corporate**	+		ECB support is favourable for the market and we prefer high yield for carry opportunities. However, we continue to focus on selection, idiosyncratic risks and liquidity.
	EM Bonds HC	+		Uncertainties around global outlook, trade war and China growth have deteriorated sentiment and risks. Recent oil price spikes as a result of drone attack in Saudi Arabia was also negative. However, we think that this environment of low growth and low rates could still be somewhat positive for EM fixed income. In the near future markets expectations will mostly be driven by interest rates and CBs decisions rather than growth, which will be expected to be just decent.
	EM Bonds LC	=		We continue to favour rates while being cautious on currencies. Our key argument is that risks to global growth remain on the downside, pressuring EM currencies, whilst the absence of inflationary pressures will keep the door wide open for policy rate cuts from central banks.
OTHER	**Commodities**			Trade disputes' escalation and slowing economic growth remain the most relevant concerns for the curbing of commodities' demand. We believe the recent drone attack on Saudi Aramco's facilities should not have a material impact on the long-term prices. As OPEC will flexibly manage supply to stabilize oil prices even in case of shocks, we maintain a USD55-65/bbl range for the WTI. For gold, we maintain our 12M target at c. $1550/ounce due to easing financial conditions, USD weakness and an end to Fed balance-sheet reduction. For base metals, we expect a 4-5% total return in 12M.
	Currencies			EUR/USD is still driven by the global growth regime and given that our macro scenario foresees a continuation in the current moderate slowdown on DM economies, the rate is expected to remain close to current levels. However, if global demand and trade situation improve, then the currency may move higher. But for now we decrease our 12M target to 1.13 from 1.14. The JPY should remain stable as global growth prospects are still concerning and volume of global trade is expected to weaken further. USD/JPY 12M target lowered to 104. GBP/USD is likely to remain under pressure as the probability of a no-deal Brexit increased significantly.

LEGEND

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	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi, as of 19 September 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

Central banks have confirmed the shift to a much more accommodative stance

VALENTINE AINOUZ, CFA, Fixed Income & Credit Strategy
SERGIO BERTONCINI, Head of Rates & FX Research

Finalised on 27/09/2019

The essential

In their September meetings, both the ECB and Fed confirmed their easing mode. The ECB delivered a full monetary policy package (pre-announced in previous months), combining conventional and unconventional tools, together with the introduction of new measures aimed at reducing the side-effects of negative rates. The FOMC delivered its second rate cut and kept the easing bias while refraining from giving clues on forward guidance, on the back of the still supportive domestic economic picture and the mixed views emerging from the dots. For the first time, therefore, the Fed hinted at resuming the organic growth of its balance sheet: the objective will be to consistently calibrate reserves to the new level of rates, in order to keep optimal abundant liquidity levels, so as not to provide a further stimulus to the economy. In this piece, we focus on these very latest developments and on the monetary policy outlook.

Bond markets sent out very negative signals for the global economic picture in August. We saw an across-the-board and significant drop in real yields across the world. German bond yields hit record lows across the curve. Among disturbing signs, we would underline the inversion of the US yield curve. Falling bond yields reflect investors' scepticism about global growth. Indeed, inflation expectations are very low, and investors expect central banks will be more accommodative in the coming months. Is the cycle finally reaching its end? No, we do not think so. However, we are in a new regime, where we expect slower global growth momentum, low inflation and highly accommodative monetary policy. Central banks' latest meetings have confirmed this shift to a more accommodative stance. Let's review the latest decisions, messages and guidance, starting with the Fed.

1. The FOMC delivered a second rate cut but moved to a "meeting-by-meeting" approach

As widely expected, at its September meeting the FOMC delivered a second 25 bp rate cut, following its first move announced in July. The Fed also lowered its IOER rate (interest paid on excess reserves), in order to anchor the Fed Funds rate within the target range, apparently a task recently becoming more challenging for the central bank.

The Fed's decision on rates was discounted by a broad consensus and fully priced into Fed funds futures; the move therefore failed to constitute a real market mover. Understandably, market players were more focused on forward guidance and its rationale. From that respect, however, the markets collected quite a few hints from Powell, as he refrained from giving indications on next moves on rates and from mentioning the mid-cycle adjustment case, he referred to as the rationale for the first cut in July FOMC.

We assume that Powell's "reticence" in giving clues about forward guidance comes from a sort of genuine uncertainty about the depth of the easing cycle and is probably due to two major reasons, which, by the way look, intertwined. The first one has to do with fundamentals, namely the still positive tone of US economy; the second one has to do with growing divisions among FOMC members about current and future decisions on rates. The second driver is probably dependent to some extent on the first.

Getting more into details of the two mentioned drivers, the still good performance by US economy, driven by solid contributions from consumption and the labour market, despite the weaker trend in investments and trade balance, clearly makes the case for further easing less compelling in the short-term. Chair Powell highlighted that weaknesses are at global levels (notably in Europe and China) while "the U.S. economy has continued to perform well".

The Fed's new economic forecasts are also only little changed from the previous ones published in June, both in the short and the longer terms. Somewhat surprisingly, growth projections were slightly revised on the upside, up by 0.1% in 2019 (2.2%), confirmed for 2020 (2.0%), and again revised up for 2021 (1.9%). The unemployment rate is now expected to stabilise at 3.7% in 2019 and 2020, before moving to 3.8%, and 3.9% in 2021 and 2022. Finally, core PCE inflation forecasts were unchanged, at 1.8% in 2019, 1.9% in 2020, and 2.0% in 2021. This encouraging picture for a mature phase of the cycle hardly supports very dovish forward guidance based on domestic factors.

On the weaker **consensus within the central bank**, we see two points that are worth mentioning:

1. At the last FOMC meeting, members voted 7-3 to cut, with two dissenters preferring to leave rates unchanged and one arguing for a more aggressive 50 bp cut. Therefore, evidence shows that the number of dissenters, albeit for different reasons, has increased with respect to previous meetings (in July there were only two of them);
2. End-2019 dots suggest that the picture is even more mixed among members' views for the rest of the year: five believe rates have already fallen too far, five are fine with keeping rates stable, and seven would call for an additional rate cut.

In light of this picture, Powell underlined that the Fed will act in a flexible way, taking a "meeting-by-meeting", data-dependent approach that is also dependent on developments of geopolitical drivers of global confidence. At this stage, a step-by-step approach looks like the most viable one for the US central bank, as the Fed looks in a quite different position vs the ECB, which just delivered a package and forward guidance.

Overall, on rates the statement kept the easing bias through the usual message that the door remains open to further moves in case of need: "If the economy does turn down, a more extensive sequence of rate cuts is appropriate. It's not what we expect, but we would follow that if it became appropriate. In other words, we will continue to monitor these developments closely, and act as appropriate to ensure the expansion remains on track." This message kept market expectations alive for further moves, now close to two more 25bp cuts in the next 12 months, mostly discounted to be delivered sooner than later, namely in the next six months.

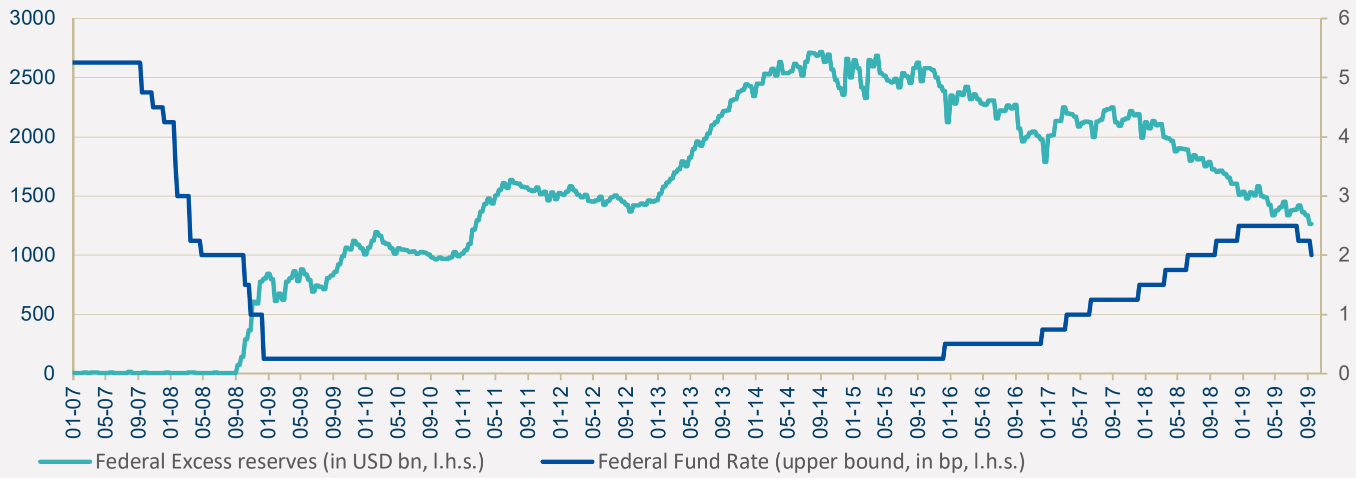
The Fed will soon reassess the return to a balance sheet organic growth, targeting higher levels of liquidity

While the rate cut had been fully discounted and no major news came along with the forward guidance, the less consensual message from the FOMC was probably the one on its balance sheet. Powell hinted at a possible return to an expansion of the Fed balance sheet, resuming organic growth after the recent decision to anticipate the end of QT in July, instead of September. Following Powell's remarks, other Fed members, such as vice-chairman Clarida, shared this view, subscribing to the opportunity to reassess the size of the balance sheet.

We assume that this opening to a rapid turn to the upside after the end of the normalization process is very likely in response to the recent spikes in repo rates and persistent tensions on the money market, potentially signalling that excess reserves should be higher than the current levels. In Q1 the Fed had already pre-announced an earlier end to QT from year end to September (see March Cross Asset on this topic). As we know, one of the outcomes of the July FOMC meeting was to end QT even sooner than previously planned, starting two months earlier. And since early August the Fed has indeed turned to reinvest in full the redemptions arising from its QE portfolio. This move stabilized excess reserves to the current level, close to USD 1.3tn.

In the first months of the year Fed members were indicating a range between USD 1.0tn and USD 1.3tn for excess reserves as a level assumed to be consistent with keeping policy rates within the targeted range without unwanted volatility in short-term rates. Following the earlier QT end, volumes of excess reserves finally "landed" at the top of this range but it seems that this level of liquidity is not effective in avoiding tensions in money markets. We guess that this mainly has to do with the monetary policy turn on rates through the two cuts delivered at the last FOMC meetings. Balance sheet management is therefore likely going to be back in play, albeit this time with different aims with respect to the past. The objective will be to calibrate reserves consistently to the new level of rates, in order to keep accordingly abundant liquidity optimal levels, not to provide further stimulus to the economy.

1/ Excess reserves stabilized at around 1.3 tn while federal fund rates have been cut twice



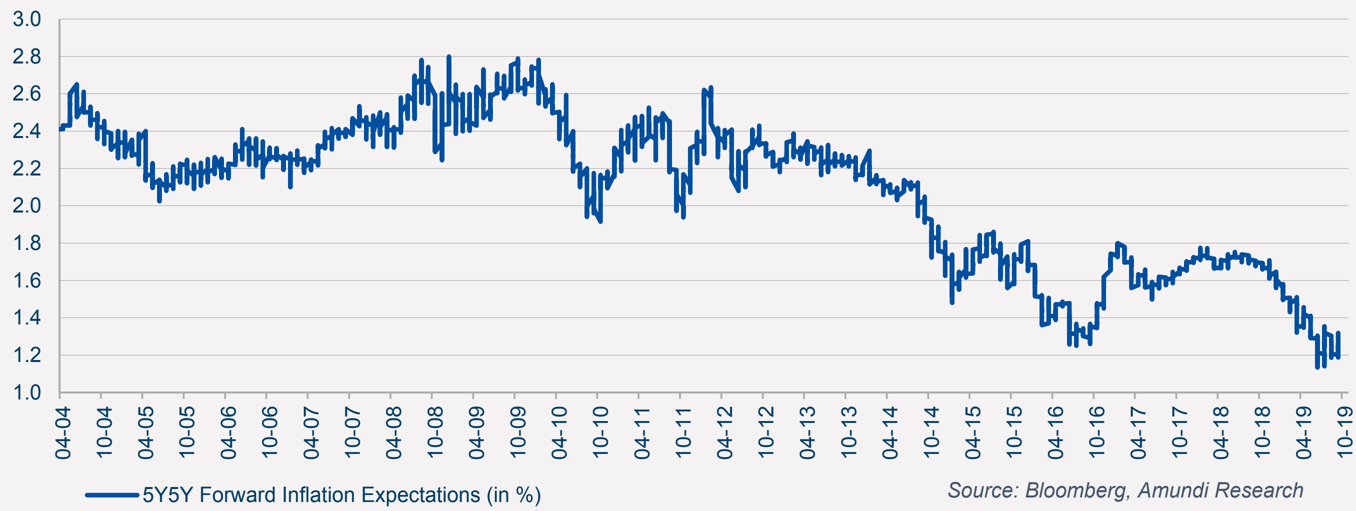
Source: Bloomberg, Amundi Research

2. The ECB delivered a full package.

In the context of a more "prolonged sag" than expected in the Eurozone, the ECB delivered a full package of measures, including (1) a cut in the deposit rate facility of 10bp to -0.5%, (2) the introduction of a two-tier system to preserve bank profitability, and (3) the reopening of the QE programme. Four important takeaways:

- **Draghi acknowledged that the Eurozone economy faced a more "prolonged sag" than was expected even a few months ago**. Draghi sees low but rising recession risks. Moreover, inflation remains a major concern for him. Draghi clarified that inflation expectations have been re-anchored at low levels, but, importantly, not de-anchored.

2/ Inflation expectations in the eurozone remain on low levels

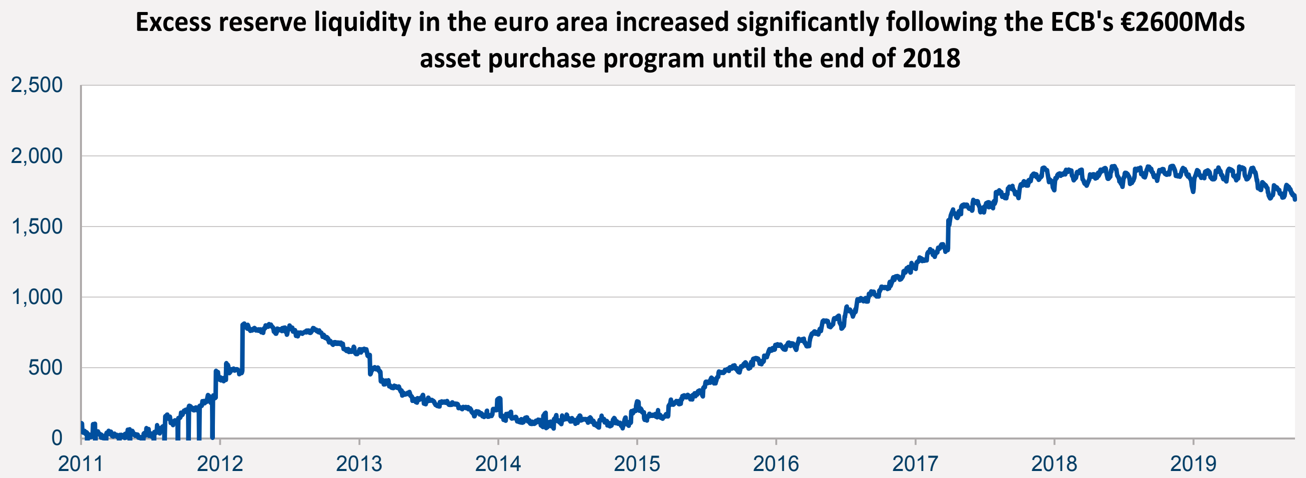


Source: Bloomberg, Amundi Research

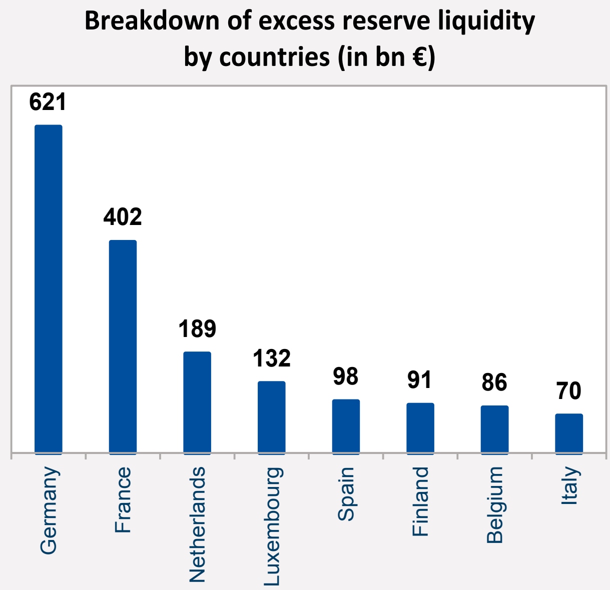
- **After promising to do "whatever it takes", Draghi has committed to do it as long as necessary.** Forward guidance is now linked to the underlying inflation rate. The size of the QE programme came at the lower end of expectations at €20bn per month. Nevertheless, does it really matter? The most important fact is that ECB support is here to stay. Net asset purchases will only end "shortly before we [the ECB] start raising the key ECB interest rates". In addition, "the ECB intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when we start raising the key ECB interest rates".
- As the negative rate environment will remain in place for a long time, the ECB is increasingly focusing on the harmful side effects of its policy.

A consequence of asset purchase programs has been the rise in excess reserve liquidity held on the ECB balance sheet by banks in core countries. Liquidity levels are now close to €1800bn and incur a significant cost for banks in core countries. The cost is particularly high for German banks (24% of profits in 2017).

3/ Holding such excess liquidity is costly for commercial banks



Source: Bloomberg, Amundi Research



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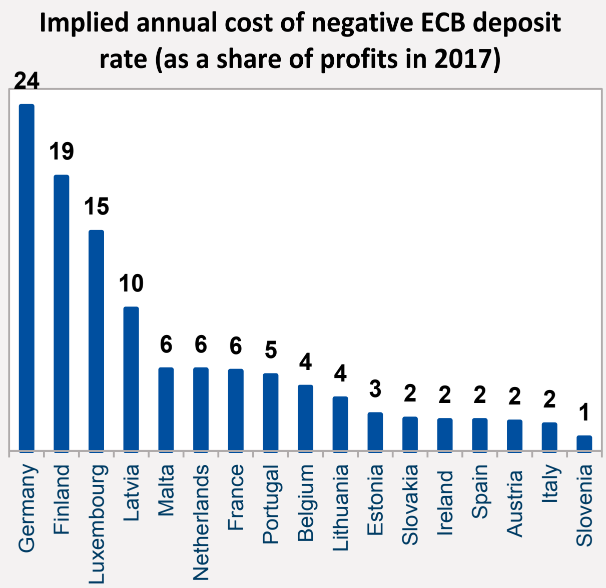
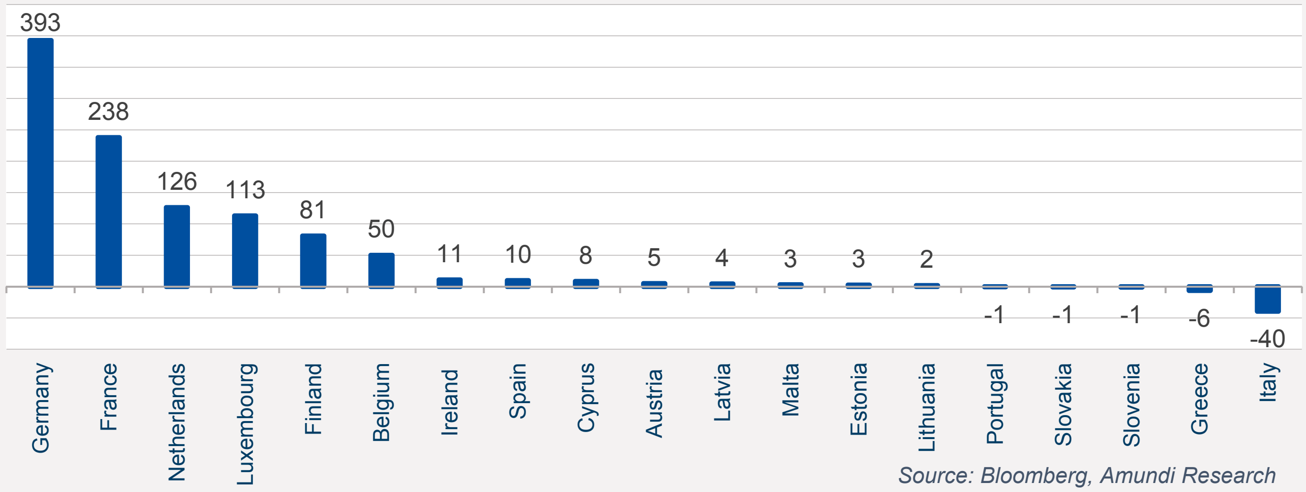


Source: Bloomberg, Amundi Research

In order to preserve banks' profitability, the ECB introduced a two-tier system for the remuneration of liquidity reserves. A part of banks' holdings of excess liquidity will now be exempt from the negative deposit rate (six times the minimum reserve requirements). Overall, €1000bn of excess reserve liquidity will be taxed at -0.5%, and €800bn will be tax-exempt. These new measures will allow a 30% reduction in the cost of holding excess reserves. It is worth noting that tiering and Targeted Longer-Term Refinancing Operations (TLTROS) are very favourable for peripheral banks. The total exemption is higher/very close to the current amount of excess reserves for Italy, Spain, Portugal and Greece. Italian banks thus have the capacity to deposit an additional €40bn, according to our calculations, in excess reserves at the ECB at no cost

- **The ECB's immediate QE resumption generated opposition from core Europe**. "Such a far-reaching package was not necessary," said Jens Weidmann, head of the Bundesbank. The central bank of the Netherlands even published a communiqué on its website after the meeting to publicly oppose what had been announced. Benoit Coeuré was against the move. Sabine Lautenschläger's resignation from the ECB board also highlighted the widening split within the ECB.

4/ **The tiering system should provide expemtion for about €800bn**



Source: Bloomberg, Amundi Research

At a very fundamental level, the question now is for how long accommodative monetary policy can support growth. Central bankers have been the only game in town for the last decade. Accommodative monetary policy has done a great job for financial stability but failed to bring inflation back to 2%. Moreover, years of accommodative monetary policy have resulted in a huge increase in debt and have not prevented a decline in potential growth across developed economies. We believe that monetary policy is near its limits, and fiscal policy is essential for truly creating a new growth story.

Risk factors

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Macroeconomic Research Team

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

Finalised on 30/09/2019

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 (to 31 January 2020) on October 19 if no deal has 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). Moreover, the Supreme Court ruled that Johnson's decision to suspend Parliament until Oct 14 was unlawful, which allowed MPs to reconvene. 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 elections or (less likely) a second referendum now seems the most likely scenario. Current polls indicate that Tories may win an outright majority in snap elections, but the political dynamics could change very rapidly depending on what happens by 31 October. An alliance with the Brexit Party would be disliked by many moderate Tory voters. On the other hand, opposition parties would 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 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? Not by a long shot! In the event that the outcome is unfavourable for the UK, we would see a weaker 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%) and it is posed to be weak in Q3, as well. In particular, risks of a technical recession in Germany are not negligible. Manufacturing surveys keep signalling weakness in the sector and the extent of the weakness poses risks of contagion to other sectors of the economy, which so far have remained resilient. 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), US tariffs on the European auto sector (a decision could come in November), and Brexit. At the political level, some degree of uncertainty persists (including the stability of Italy's new government and the likelihood of a no-deal Brexit). On the upside, deployment of fiscal plans (at national and/or EU levels) may help stabilise the Eurozone economy's domestic demand against external uncertainties. Yet, appetite for a coordinated effort still seems modest. In this context, a significant pickup in growth in 2020 is unlikely, and risks remain prominent and significantly tilted to the downside.

Market impact | A major slowdown would clearly be bad news for European assets and the euro. But, in that case, the policy mix would become even more accommodative in both monetary and fiscal terms, and this should help anchor growth expectations. We would therefore 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 | US recession

Analysis | The US economy is gradually slowing. Recent revised data show that the peak of growth had already been reached in Q2 2018 and that, since then, the US economy has been gradually decelerating towards the trend. Incoming data have begun to support the view that domestic demand is also gradually decelerating, due to weakening investments and capex and a labour market shifting into lower gear. Looking forward, we therefore expect muted growth in investments and moderating US consumer spending (as total labour income is decelerating somewhat and confidence in the future is worsening). Persistent uncertainty on the trade front, with risks of 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, 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 deceleration could become more pronounced, and economic signals align to point to slower domestic demand. In this context, the Federal Reserve will keep attempting to facilitate a macroeconomic soft landing by contrasting the forces that could drag down US growth and we expect protracted dovishness, with the possible return to balance sheet expansion, in order to keep rates in the targeted range, through a higher level of liquidity in the system. The markets are pricing in two and half cuts over the next 12 months.

Risk # 4 | 15% probability | US & China: negotiations resume

Analysis | As far as we know, the most complex issues (intellectual property rights, technology transfers, tariffs already in place, and the Huawei case) are still on the table, and the Sino-US confrontation returned to the forefront early in September, with tariffs from both sides increasing. On a more positive note, talks have resumed at a lower-level delegation and are expected to continue in early October at a higher level. The two sides have approached the ongoing talks with a more constructive tone, with China's making some exceptions to its tariffs regime (including sensitive sectors for the US) and the US's postponing the increase of current tariffs rate from 25% to 30% to 15 of October, showing some goodwill during the Chinese Golden Week and the ongoing talks. Keep in mind that the US is entering a pre-election period, and opposition to China goes far beyond the Republicans. Regardless of whoever is elected US President 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 comprehensive agreement is very low.

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 # 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 (notably the attack on a major Saudi oil facility) and aggressive statements by both sides have only worsened the situation.

At this date, 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 support 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 statements 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 new government is now facing its first difficult task, setting the challenging 2020 budget, with the stated goal of avoiding a VAT rate hike and keeping public finances in check while avoiding fiscal consolidation. Its goal, actually, would be to even include a few limited fiscal expansionary measures (e.g., higher financial support and protection to workers, lower labour and incomes taxes, less administration, and a new wave of investment plans). All this would clearly be very difficult to achieve. 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 has pledged to comply with EU rules for the 2020 budget, potentially relying on the greater flexibility that may be granted by the European Commission.

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 back 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. In order to see further yield compression, the markets are likely waiting for the publication of the 2020 budget. While a small premium for political risks is likely to remain priced in, given the latent fragility of the coalition, there is still room for yields to decline, especially in the longer end of the curve.

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

Analysis | The European Parliament is more fragmented, although European Elections introduced a slightly "pro-institution" surprise (in reaction to fears of a euro-sceptic wave). European governments and institutions are facing a harder time than usual negotiating appointments to the EU's top jobs (European Commission, Council, Parliament and Central Bank), and this could mirror future complexity in negotiations aimed at further integration. However, this should not be able to trigger any major crisis at the European level. Yet, 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 (in Germany and Spain). While this is manageable in good times, it may become problematic should a worsening of the economic situation (or other emergencies) require a strong political hand. Moreover, other changes are only complicating 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 for outside investors of understanding European institutions means that European assets may continue to carry a specific political risk premium.

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 by 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 the 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 per 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 sooner than later.

Market impact | In the risk case, spreads and equity markets would once again be significantly impacted. This is particularly true as the 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 (although it has mildly increased lately). 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

DIDIER BOROWSKI, Head of Macroeconomic Research
Macroeconomic Research Team

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:** the economic weakness seen worldwide during the summer has continued into the fall with very few exceptions. Industrial surveys and data continue to show that the global manufacturing sector is in recession. However, domestic demand remains more resilient, due primarily to household consumption, which continues to be buoyed by very low inflation and in certain economies by a vibrant labour market. Still, services have proved more resilient than manufacturing.

- **Global trade remains under heavy pressure:** global trade has plummeted over the last 18 months. Protectionist rhetoric and measures have increased again recently, with the US imposing new tariffs on 1 September and China retaliating immediately. The level of uncertainty on a trade deal is still higher, although talks have resumed. Approaching the new round of negotiations, both sides have shown a more constructive attitude, with China's announcing some exceptions lasting one year on some items under tariffs since 2018 (sensitive sectors included) and Washington's postponing the tariffs rate increase to 15 October from 1 October. An interim deal looks like more likely. Having said that, 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 must not underestimate the resilience of the domestic demand. While global trade has indeed made a strong contribution to global growth over the last few decades, this is less and 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:** a 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 worsened recently, raising concerns of a sharper deceleration in domestic demand. At this stage, while probabilities of recession have risen, we don't think a recession is likely in 2019 or 2020. And yet, signals are starting to appear that the labour market is decelerating and perhaps turning, with a slower pace of growth in payrolls and new hiring intentions, supporting the view that domestic demand will keep decelerating as we go into 2020. Even so, 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, and 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. With this in mind, the Federal Reserve should stick to its dovish stance, signalling reasonable pragmatism and cautiousness in using its "policy ammunition": however, recent trends in trade disputes and risks to financial conditions (mostly driven by the strong USD) make an additional rate cut likely before the end of 2019.

- **Eurozone:** the Eurozone economy expanded by 1.2% YoY (0.2% QoQ), denoting softening momentum as manufacturing weakness persisted and uncertainty remained high on the trade and political fronts, as a result of the continued risks of escalation with new tariffs, weak data on global trade, and political developments (e.g., Italy and the 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, and signs point to persistent weakness in Q3. No sharp reacceleration is in sight for now and risks of technical recession are still looming. Other economies remain broadly resilient, like Spain, France, and Portugal, albeit with moderating growth and other, more minor economies are keeping their fundamentals overall on track. The unemployment rate remains on a downward path but has stopped declining in a few member-states (e.g. Germany and the Netherlands), yet remains below its long-term average and at historically low levels. 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, with still open the possibility of a very disruptive no-deal Brexit. Some signs that member-states with fiscal room may be willing to engage in some fiscal expansion now appear more supported by news (e.g. Germany and the Netherlands), although a more coordinated fiscal effort at the EU level seems still far from reaching a consensus at this stage. At its September meeting the ECB delivered a comprehensive package, managing not to disappointing markets expectations. On the one hand, the 10bps deposit rate cut and EUR 20bn per month of QE were lower than the markets' expectations. On the other hand, the improvement in TLTRO III conditions and the length of the QE passing from "date"- to "state"- contingent (meaning dependent on inflation projections) were the dovish surprises. Another 10bps depo rate cut in the next 12 months is possible, although in a context that offers very limited room for further cuts and with the need to compensate additional negative effects to the banking system. The next meeting is on 24 October.

- **United Kingdom:** Another extension of the Brexit deadline now seems the most likely scenario. Indeed, Parliament has tied the hands of PM Boris Johnson by 1/ passing a motion instructing him to request an extension from the EU by 19 October (if no deal has been ratified); and 2/ refusing his request for a snap election before 31 October. Snap elections are probable (although not certain) after the extension. Their outcome would be very uncertain. Should the Tories win a clean mandate, the probability of a no-deal Brexit would increase although: 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 to be negotiated with the WTO). On the other hand, should the Tories fail to obtain a majority, many possibilities would open up, such as a new referendum, new negotiations 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:** August's string of data (released in September) has confirmed and, in a way, has accentuated the perception of the economic slowdown seen in July. At this point, we confirm our view of a GDP decelerating at the range floor at 6% YoY in H2 2019 and below 6% YoY in 2020 (at 5.8% YoY). Chinese authorities have signalled their determination to maintain growth above 6%. However, the latest data haven't shown a uniformly dark picture. Housing, retail sales ex-auto, and infrastructure investments have been resilient in their weakness if not moderately growing as in the case below (supported by the special bonds issues). We expect the authorities will ramp up their stimulus to accommodate the deceleration mentioned above. More stimulus has to come in the form of monetary policy easing (RRR and LPR), front-loading of local government special bonds, support for the auto sector (relaxing or removing purchase restrictions) and the budget fund. More concessions to the US on the trade front should help to alleviate the short-term pain from the external side.

- **Inflation:** underlying inflation remains low in the advanced economies (despite a recent advance in the US). 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 the 2018 acceleration in GDP growth was not accompanied by higher inflation. In the Eurozone, against a backdrop of slowing growth, we believe that companies have virtually no pricing power (with 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. Under an adverse, recessionary scenario (not our central scenario), upside pressure on wages would not last long, anyway.

- **Oil prices:** While the attack on major Saudi oil installations on September 14 generated a very sharp spike in oil prices, most of the effect was short-lived, as reports indicated that the country could rapidly restore most of the lost supply. Beyond this short term volatility, fears of a global slowdown and increased US production continue to exert downward pressure on prices (indeed, oil faltered in August on downward revisions in demand, while there was a surprise jump in OPEC production). On the other hand, continued OPEC+ coordination (following the July agreements to reduce production) will continue to manage supply. Therefore, all things considered, we reiterate our target of $60-70/barrel (Brent) and $55-65 (WTI).

- **Central banks' incremental dovishness in September and more to come:** As expected, the Federal Reserve lowered its target range for the Federal Funds rate by 25 basis points to 1.75%-2.00% at its September meeting. The policy decision was in response to slowing global growth, lingering uncertainty about trade policy, and muted inflation pressures. Going forward, we see more easing coming but we do expect fewer rate cuts (50bps) than the market. In a much-awaited meeting, the ECB announced an easing package, including a 10bps deposit rate cut, an open-ended QE program, a two-tiered reserve system, and improved TLTRO terms. As per the Fed, we expect a lower ECB deposit rate. On the EM side, we had the same incremental dovishness: Central banks cut their policy rates by 325bps (Turkey), 50bps (Brazil), and by 25bps (Russia and Indonesia), to name a few.

DOWNSIDE RISK SCENARIO (30%): full-blown 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 into consumption:

- **Growth falls further, profit recession** / the global recession comes back to the forefront
- **Central banks:** even more accommodative monetary policies than what are 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. pre-emptive) in that case, while it would likely come somewhat later with trade tensions alone..

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

We are raising the probability of the upside risk scenario (and lowering the probability of the central to 60%)

- Actually, we have substantially revised down our central scenario, by embedding part of the downside risk scenario into 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 a 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 29/09/2019

United States

US growth gradually decelerates amid trade war concerns and geopolitical uncertainty

- The drivers of domestic demand keep slowing, with investment spending hit worse than private consumption. Business climate surveys are showing a weak spot in manufacturing and services.
- Consumer confidence signals are mixed, but, on average, suggest that confidence is worsening in the future. Some signals point to a moderating pace of labour income with softening growth in payrolls and weaker new-hiring intentions, and wages and salary growth moderating. On the investment front, spending plans are tending to decline. Inflation is low (1.7% overall, 2.4% for core inflation) but remains close to the Federal Reserve's target.
- The Fed delivered a second 25 bps cut at its September FOMC. It remains open to act again in case of need. The Fed signalled reasonable pragmatism and cautiousness in using its "policy ammunition", but recent trends in trade disputes and risks to financial conditions (mostly driven by a strong USD) make an additional rate cut likely by the end of 2019

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 and tariffs could pose an upside risk to oil prices and to our inflation outlook

Eurozone

Weaker industrial activity is adversely affecting the economy

- The majority of business climate indicators saw a further deterioration in September. The situation is particularly bad in industry (especially in Germany), due to both specific difficulties (automotive sector) and external causes (trade war and risk of a no-deal Brexit).
- While, for the moment, the spreading of industrial difficulties to the service sector and the labour market remains limited, it is an increasing risk.

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 contraction in Q2 (+0.5%, largely due to precautionary spending), the data showed an improvement at the beginning of Q2. The labour market is strong and wages rise significantly. Political uncertainty, however, continues to weigh on investment.
- Uncertainty about Brexit is extremely high. PM Boris Johnson continues to state that Brexit will happen on 31 October, even without a withdrawal agreement. However, Parliament has passed a motion instructing him to request an extension of the Brexit deadline from the EU, should there be no deal approved by 19 October.

Risk factors

- A no-deal Brexit

Macroeconomic picture by area

Finalised on 29/09/2019

Japan

External threats gradually impair the corporate sector

- Corporate revenues have become anaemic and profits have plunged markedly, although exports show signs of stabilization. Private machinery orders lack strength, reflecting companies' reluctance to boost capacity and/or renew plant and equipment amid growing uncertainties surrounding global trade.
- So far resiliency in the service sector is keeping capital spending afloat as the MOF's corporate survey shows a massive 8.3% increase in capex plans this year. However, business morale of non-manufacturers fell to a 3-year low, though much better than the case of manufacturers, which hit a 6-1/2-year low. Job vacancy dropped for the third month in a row, mirroring slower domestic economic growth.
- In light of the above, consumption could be another source of pain for the economy. Real household spending is being affected by weaker earnings and fears of a consumption tax hike.

Risk factors

- **Economic package will not sufficiently alleviate the pain of consumption tax hike, as expected**
- **Companies will accelerate suspension or cancellation of capital investment as the global economy weakens farther**

China

- Approaching the new round of negotiations, China has announced some exceptions for some items placed under tariffs in 2018. These exceptions will last one year and will involve some sensitive sectors for the US (like agriculture). Moreover, China has announced and started larger purchases of farm goods from the US.
- Chinese macroeconomic data continue to decelerate on a broad basis, including in manufacturing, consumer goods and fixed capital investments.
- The policy mix continues to support the economy in a limited way, through both the monetary and fiscal levers. The LPR fell by another 5bps on 20 August.
- In a recent speech, the PBoC Governor, Yi Gang, said that, unlike other central banks, the PBoC will not slash its policy rates or introduce any quantitative easing. The PBoC wants to pursue an orthodox monetary policy.

Risk factors

- **A likely interim deal between China and the US after the October talks**
- **China's economy is decelerating more than expected.**
- **Policy mix still mildly supportive**

Asia (ex JP & CH)

- Economic conditions in the region keep worsening, driven by a further decline in external demand and soft domestic demand. The outlook for exports is poor, due to a re-escalation in trade tensions. The new round of negotiations between China and the US could offer some relief if an interim deal is achieved.
- The region's inflation figures have remained very benign. Inflation in August picked up mildly, except in South Korea (0% YoY from 0.6% YoY) and the Philippines (1.7% YoY from 2.4% YoY).
- In September, Bank of Indonesia resumed its easing with a 25bp rate cut, while the Bank of Thailand remained on hold. We expect more easing in the area.
- In September, the Indian government surprisingly cut the corporate income tax rate from its current level from 35% to 25% for companies already operating, and to 17% for companies set up after 1 of November 2019 in an attempt to revive domestic investments and attract foreign investments.

Risk factors

- **Still weak macro momentum in the region. A trade deal is crucial.**
- **Inflation still very benign, with a mild pick up in August.**
- **Central banks in the region still accommodative.**
- **India lowered the corporate tax rate for existing and new companies significantly.**

Macroeconomic picture by area

Finalised on 29/09/2019

Latam

- The growth outlook has worsened significantly in all countries. However, macro momentum has improved very slightly in Chile and Brazil. Mexico is in recession, while Brazil's growth outlook looks more resilient.
- On the inflation front, the overall environment remains benign. Mexican inflation has converged nicely towards the central value of the target, with its latest figure at 3.2% YoY, down from 3.8% YoY. Argentina inflation is still above 50%, stable around 54% YoY in August, and will not converge soon.
- The central bank of Brazil cut its policy rate again by 50bps and left the door open to a further significant easing.
- Pension reform deliberations have been postponed to mid-October, while the economy minister is trying to form a consensus on fiscal reform, starting with the introduction of a new VAT system at the federal level. The $5.4bn tranche of disbursement by the IMF to Argentina has been postponed until there is more clarity on the new government's intentions

Risk factors

- **Economic conditions continued to weaken; Mexico is in a recession.**
- **Inflation is benign overall. Argentine inflation in August remained above 50%.**
- **BCB once cut again the Selic rate by 50bps.**
- **The $5.4bn tranche of disbursement by the IMF to Argentina has been postponed.**

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 August by 25bps. We expect another 25bp cut in the next few months, given decelerating inflation.

Risk factors

- **Drop in oil prices, stepped-up US sanctions and further geopolitical tensions**

South Africa: exit from recession, but no miracle

- Recently released Q2 GDP showed more resilience than the market was expecting mainly thanks to post strike recovery in mining. We confirm our 2019 GDP forecast of 0.8% YoY with downside risks.
- Given deteriorating fiscal dynamics, creeping inflation and Rand weakness the SARB is likely to remain on hold.

Risk factors

- **Increased risk aversion, risk of sovereign rating downgrades, rising social demands in the run-up to elections and the risk of fiscal slippage**

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, and +1.5 for 2020.
- The Central Bank of Turkey cut its policy rates significantly in September, by 325bps to 16.5%. We expect some more easing to come in support of very weak economic conditions.

Risk factors

- **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
(27 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	2.4	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

	27/09/2019	Amundi + 6m.	Consensus Q1 2020	Amundi + 12m.	Consensus Q3 2020
US	2.00	1.50	1.75	1.50	1.75
Eurozone	-0.50	-0.60	-0.60	-0.60	-0.60
Japan	-0.1	-0.2	-0.1	-0.2	-0.1
UK	0.75	0.75	0.70	0.50	0.75

Long rate outlook

2Y. Bond yield

	27/09/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1,65	1.20/1.40	1,56	1.30/1.50	1,51
Germany	-0,756	-0.90/-0.70	-0,81	-0.90/-0.70	-0,85
Japan	-0,313	-0.30/-0.20	-0,35	-0.30/-0.20	-0,38
UK	0,405	0.20/0.40	0,30	0.20/0.40	0,27

10Y. Bond yield

	27/09/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1.69	1.40/1.60	1.74	1.60/1.80	1.78
Germany	-0.59	-0.50/-0.70	-0.55	-0.50/-0.70	-0.51
Japan	-0.24	-0.20/0.00	-0.18	-0.20/0.00	0.14
UK	0.48	0.50/0.70	0.54	0.50/0.70	0.58

Currency outlook

	26/09/2019	Amundi + 6m.	Consensus Q1 2020	Amundi + 12m.	Consensus Q3 2020
EUR/USD	1.09	1.10	1.12	1.13	1.14
USD/JPY	108	105	105	104	105
EUR/GBP	0.89	0.89	0.90	0.89	0.89
EUR/CHF	1.09	1.08	1.10	1.12	1.11
EUR/NOK	9.92	9.70	9.80	9.42	9.68
EUR/SEK	10.67	10.60	10.65	10.36	10.59
USD/CAD	1.33	1.31	1.32	1.28	1.30
AUD/USD	0.67	0.69	0.68	0.72	0.70
NZD/USD	0.63	0.64	0.64	0.67	0.66
USD/CNY	7.13	7.25	7.20	7.15	7.20

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