Weekly Market Review

The latest news from financial markets

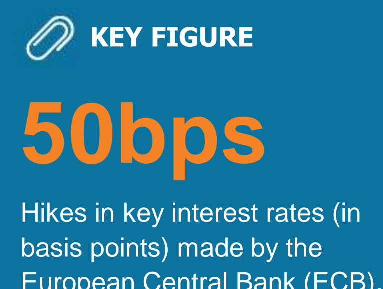
for the exclusive attention of professionals

Edition of July 25, 2022 By Amundi Institute

The week at a glance

- **Markets:** Credit markets bounce back strongly after the sharp widening of spreads recorded in June.
- **United States:** Existing home sales declined 5.4% month-on-month (m-o-m) to 5.12 million units, the weakest selling pace since mid-2020.
- **Eurozone:** Eurozone consumer confidence in July fell to -27.0 from a revised -23.8 in June.

KEY FIGURE



50bps

Hikes in key interest rates (in basis points) made by the European Central Bank (ECB).

Focus

Gas cut-off fears and gas rationing implications for Europe.

The much-feared Nord Stream 1 gas cut-off did not materialise, and Russia gas supplies to Europe resumed after stopping for 10 days for maintenance. Yet, while some fears of immediate supply shortage have been dispelled, risks of some level of energy rationing in the months to come remain material. Currently, the priority is to proceed with gas storage, with the goal of 80% by November to build up a supply buffer for winter, when heating demand peaks. EU gas storage is currently estimated around 62% full, while gas flows keep coming at a reduced intensity. Thus, downside scenarios ranging from some self-imposed pre-emptive gas rationing to gas supply cut-off-induced rationing are still possible. In both cases, a recession will be difficult to avoid for the Eurozone, potentially starting as early as in the third quarter of 2022 in the most severe outcome. Under a worst-case scenario, we estimate that Eurozone GDP growth may be severely impaired, reaching only slightly above 1% in 2022 (versus baseline 2.4%) and around -2% in 2023 (versus baseline 1.3%).

KEY DATES

26 July	28 July	29 July
U.S. Federal Reserve's monetary policy meeting (FOMC meeting)	U.S. second quarter GDP	Eurozone second quarter GDP

Source: Amundi Institute.

Document for the exclusive attention of professional clients, investment services providers and any other professional of the financial industry.

Our weekly analysis

The ECB hiked its key interest rates by 50bps, bringing the deposit rate from -0.5% to zero; the refinancing rate and the marginal lending facility were also raised by 50bps each to 0.5% and 0.75% respectively. The decision to make a big interest rate hike was justified by, on the one hand, inflation risk, and on the other hand, the new ECB purchase program, the Transmission Protection Instrument (TPI). The latter aimed at protecting the bonds of highly indebted countries from the possible negative consequences of interest rate hikes.

That said, the destination remains the same, as Christine Lagarde clearly stated that the ECB was accelerating its exit from negative interest rates but not changing the end point. The TPI was unanimously supported and is an unlimited tool: two significant positives. However, activation triggers remain vague and market participants could test the ECB's resolve.

The tone of the meeting was overall hawkish, as the ECB clearly prioritize inflation. The central bank also dropped its short-term forward guidance and is now fully in a data-dependent mode.

Purchases under the TPI are not restricted ex ante, i.e. not be subjected to issuer limit: an important condition for the tool being seen as credible by the markets. President Lagarde stressed that the ECB is capable to go big with purchases under the TPI.

The central bank approved the new anti-fragmentation tool (TPI) unanimously. The new tool "can be activated to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area. The scale of TPI purchases will depend on the severity of the risks facing policy transmission.

The activation is subject to quite a long list of macro eligibility criteria: compliance with EU fiscal framework, absence of severe macroeconomic imbalances, fiscal sustainability and sound and sustainable macroeconomic policies. Most are borrowing from other European institutions (Commission, Council, European Stability Mechanism, Recovery and Resilience Facility) but the four criteria will be indicative and the ECB will determine in its own discretion, not being hostage to anyone. All countries are currently eligible. The lack of clarity on the conditions under which TPI will be activated suggests that market participants could test the ECB's resolve. It is worth noting that the TPI will not address the sovereign risk stemming from the political risk, i.e. the election of a government that pursues policies that are inconsistent with the eligibility criteria.

Indice	Performance			
Equity markets	07/22/22	1 W	1 M	YTD
S&P 500	3999	3.5%	6.4%	-16.1%
Eurostoxx 50	3616	4.0%	4.4%	-15.9%
CAC 40	6231	3.2%	5.3%	-12.9%
Dax 30	13329	3.6%	1.4%	-16.1%
Nikkei 225	27915	4.2%	6.8%	-3.0%
SMI	11168	1.7%	6.1%	-13.3%
SPI	14417	1.8%	6.2%	-12.3%
MSCI Emerging Markets (close -1D)	991	3.0%	-0.3%	-19.6%
Commodities - Volatility	07/22/22	1 W	1 M	YTD
Crude Oil (Brent, $/barrel)	104	2.4%	-7.3%	33.1%
Gold ($/ounce)	1725	1.0%	-6.1%	-5.7%
VIX	23	-1.3	-6.0	5.8
FX markets	07/22/22	1 W	1 M	YTD
EUR/USD	1.019	1.1%	-3.6%	-10.4%
USD/JPY	137	-1.4%	0.3%	18.7%
EUR/GBP	0.85	0.1%	-1.2%	1.1%
EUR/CHF	0.97	-1.2%	0.3%	5.8%
USD/CHF	0.98	-0.2%	-3.3%	-5.3%

Source: Bloomberg, Amundi Institute – 07/22/2022 – 15:00 pm

Indice	Performance			
Credit markets	07/22/22	1 W	1 M	YTD
Itraxx Main	+104 bp	-18 bp	-6 bp	+56 bp
Itraxx Crossover	+523 bp	-83 bp	-24 bp	+280 bp
Itraxx Financials Senior	+116 bp	-18 bp	-3 bp	+61 bp
Fixed Income markets	07/22/22	1 W	1 M	YTD
ESTER OIS	98.42	-1 bp	-5 bp	-32 bp
EONIA	-0.51	-	-	-
Euribor 3M	0.20	+13 bp	+37 bp	+77 bp
Libor USD 3M	2.76	+2 bp	+57 bp	+255 bp
2Y yield (Germany)	0.44	-3 bp	-62 bp	+106 bp
10Y yield (Germany)	1.04	-9 bp	-59 bp	+122 bp
2Y yield (US)	3.01	-11 bp	-5 bp	+228 bp
10Y yield (US)	2.80	-12 bp	-36 bp	+129 bp
Eurozone Sovereigns 10Y spreads vs Germany	07/22/22	1 W	1 M	YTD
France	+58 bp	-3 bp	+4 bp	+21 bp
Austria	+56 bp	-2 bp	-1 bp	+29 bp
Netherlands	+33 bp	-	+1 bp	+18 bp
Finland	+53 bp	--	-3 bp	+26 bp
Belgium	+62 bp	-2 bp	-1 bp	+25 bp
Ireland	+62 bp	+1 bp	-3 bp	+19 bp
Portugal	+117 bp	--	+14 bp	+53 bp
Spain	+123 bp	+8 bp	+16 bp	+49 bp
Italy	+228 bp	+14 bp	+37 bp	+93 bp

Asset class

	MARKET	AMUNDI ANALYSIS
Equity	**The upward trend in global equity markets continued this week** despite inflation and recession fears persisting. The MSCI World Index edged up nearly +3.7% this week. The MSCI World Growth index outperformed the Value one over the week. In the U.S., stock markets moved up, mostly driven by growth stocks. Overseas, despite gas supply concerns and negative news on the Russian-Ukrainian conflict, the European stock market edged up. The Euro Stoxx 50 returned nearly +3% over the week. Moreover, despite the resignation of Italian's prime minister Mario Draghi, the FTSE MIB index still ended the week slightly up. On emerging markets, the Chinese stock market was choppy and returns were negative this week.	The outperformance of the U.S. market was driven by growth stocks this week. Tech stocks rebounded with the Nasdaq Index ending sharply higher (+4%). The Netflix's upbeat forecast on growth subscribers helped this rally. In terms of earnings, 12% of companies have reported so far, and 78% reported above expectations. In Europe, earnings are expected to rise by 22.1% for the second quarter. Excluding the energy sector, earnings are expected to increase by +3.3%. 60% of reported results have exceeded analyst estimates in Europe as of today.
Fixed Income	**A leading indicator dropped to a 17-month low in July,** dipping beneath the level that signals contraction of the economy. Economists had expected a mild expansion. As a result, German bond yields dropped and investors trimmed bets on ECB's rate hikes. The moves come one day after policy makers surprised with a half-point hike, with investors growing increasingly concerned the ECB is raising borrowing costs just as the economy starts slowing. The spread on the 10y Italian bond yield rose to 227bps versus Germany after the resignation of Prime Minister Draghi.	At its June meeting, the ECB announced only a 25bps move for July. In fact, it has raised all interest rates by 50bps, and the deposit rate now stands at 0.0%. The fact that the ECB has decided to make a big interest rate move after all is due to inflation risks and the new ECB purchase program (TPI), that protects the bonds of highly indebted countries, such as Italy, from the possible negative consequences of interest rate hikes. We expect a 50bps rate hike at the next meeting in September, but the ECB could be constrained to pause end 2022 or 2023 if the economic situation deteriorates.
Credit	**Credit markets bounce back strongly** after the sharp widening of spreads recorded in June. At the same time, sovereign bonds sold off, pushing corporate yields higher, as higher sovereign bond yields offset the sharp tightening in spreads. Risk appetite had the upper hand for most of this week, as there were no major disappointments in the economic data.	The TPI announcement could help bolster sentiment towards investment grade credit, relative to high yield, suggesting a stronger beta decompression ahead. Moreover, beta decompression momentum has already strengthened in euro credit. Indeed, investment grade funds have recently recorded smaller outflows than high yield funds. With valuations still attractive, market attention should focus on the second quarter earnings season over the next few weeks.
Foreign Exchange	**Less hawkish comments from Federal Reserve (Fed) officials** and the ECB's hawkish surprise were valid reasons to see a U.S. dollar correction this week. All G10 currencies enjoyed a mild relief rally, with the Swedish krona, the Australian dollar, the Norwegian krone and the Canadian dollar leading the group. Within emerging markets, market trading is more complex and worries concerning higher growth resulted in cyclical weakness. Except for the Chilean peso, all Latin American currencies are down compared to last week.	Correlation with monetary policy decisions has dropped significantly in the last quarter, with hawkish central bank repricing failing to push up currencies. The hawkish surprise from the ECB (which hiked rates by 50bps yesterday, more than expected) should prove no exception on this front. When growth worries kick in, the dollar's safe haven status is the dominant market driver.
Commodities	**Commodities advanced by 4% this week,** rebounding after the recent sell-off. West Texas Intermediate and Brent rose to $99 and $103 a barrel, respectively. Agriculture fell by 2.7%. Gold moved up to $1,718 an ounce, while base metals were up by 1%.	We maintain our positive view on commodities, despite the likelihood of a recession increasing, and the liquidity drain implemented by central banks. The shortage in supply is expected to continue for some specific base metals, due to geopolitical tensions and world electrification. Central banks and nominal (real) rates remain the key movers for gold, but fears of a recession are expected to provide support again. Oil prices will be driven by the decisions of the Organization of Petroleum Exporting Countries (OPEC) and cooling demand over the next few quarters.

Economic indicators

	MARKET	AMUNDI ANALYSIS
United States	**Existing home sales declined 5.4% month-on-month** (m-o-m) to 5.12 million units, the weakest selling pace since mid-2020, as housing demand continues to slide, dampened by higher mortgage rates. Yet, house prices are still rising, with the median price increasing 1.9% m-o-m as supply remains capped.	With a tighter financial environment and weaker consumer/households outlook ahead, we expect housing to gradually exert a drag on GDP, likely subtracting already from second quarter GDP, as expected by coincident indicators. Yet, until price growth becomes decent, the linkage between consumption and housing may be less pronounced than in 2007-2009, thus leading to milder negative spillovers from housing to consumption.
Eurozone	**Eurozone consumer confidence in July fell to -27.0 from a revised -23.8 in June**, scoring below its previous minimum reached at the beginning of the Covid-19 crisis and hitting its lowest level on record.	The flash estimate confirms that Eurozone consumers are increasingly affected by the cost-of-living crisis stemming from high energy and food prices in particular, hitting real disposable incomes and forcing them to choose between discretionary and non-discretionary spending. The outlook for consumption remains grim in the months to come, amid heightened geopolitical and economic uncertainty.
Japan	**The Bank of Japan (BoJ) kept its policy stance and rates forward guidance unchanged**. It revised down its 2022 growth forecast to 2.4% from 2.9%, but upgraded its 2023 and 2024 growth forecasts to 2.0% and 1.3%, respectively, from 1.9% and 1.1%. It revised up 2022 core inflation to 1.3% from 0.9% and to 1.4% from 1.2% for 2023.	BoJ Governor Kuroda indicated he has no plan to hike rates or expand the target range of Japanese government bonds in the near term. We maintain our view that BoJ has missed the boat of tightening. Domestic inflationary pressures have increased notably, so have global recessionary risks. The expected peaking of U.S. Treasuries yield will help ease yen depreciation.
Emerging Markets	**South African inflation rose in June to 7.4% year-on-year from 6.5% in May.** The acceleration of inflation for energy and food products remains once again the main factor in this global increase. The central bank (SARB) increased its key rate by 75bps to 5.5%, citing the risks to inflation forecasts, which it revised upwards, the need to limit the rise in inflation expectations and the more pronounced tightening of other central banks.	There are many factors that should favor lower inflation: the deceleration of domestic demand, commodity prices and monetary tightening. However, other factors such as the recent depreciation of the rand could work in the opposite direction. Between now and the end of the year, inflation should therefore remain high. In such a context, the SARB should continue to increase its rates with the aim of remaining credible and not appearing to be behind the curve.

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