Confidence must be earned

Amundi ASSET MANAGEMENT

# Weekly Market Review

**The latest news from financial markets**

for the exclusive attention of professionals

**Edition of August 2, 2021**

By research Amundi

## **The week** at a glance

- **Markets**: US equities reached new record high,s as long bond yields stabilised
- **United States**: Q2 GDP growth was 6.5% below consensus expectations
- **Eurozone**: Q2 GDP growth was 2% QoQ and 13.7% annualised

**KEY FIGURE**

**+11.8%**

is the growth rate of US consumption in Q2 annualised

**Focus**

At its July meeting, the FOMC has sent the first signal that QE tapering is approaching by acknowledging for the first time that "the economy has made progress" on tapering goals. The FOMC will continue to assess this progress in coming meetings as well as provide advance notice before making any changes to the purchases. The timing of the tapering will clearly depend on the labor market as J. Powell noted that “we have some ground to cover on the labor market side” and he said that he wants to see strong job numbers. The outlook on the job market was rather constructive and J. Powell downplayed the rising growth scare around the delta variant. Inflation is still viewed as transitory. The bottleneck effects have been larger than anticipated. The FOMC has no confidence in the timing and the size of these effects in the near term, but is confident that inflation will move back down in the medium term. We maintain the view that the FOMC will give more details on the timeline of the tapering at Jackson Hole or in September, before a formal announcement in December. The tapering of asset purchases should start at the beginning of 2022 at a pace of $10bn per month.

**KEY DATES**

**August 2**
Eurozone PMI and US ISM manufacturing

**August 5**
Bank of England policy rate decision

**August 6**
US employment data

*Source: Amundi Research.*

# Our weekly analysis

### China: changes are underway

The recent regulatory changes have highlighted a layer of risks that could impact our investment framework beyond traditional policy drivers such as credit and interest rates.

The grand goal of President Xi's political agenda is to address inequality and promote common prosperity, as he said in an internal speech in Jan 2021:

"Realising common prosperity is more than an economic goal. It is a major political issue that bears on our Party's governance foundation. […] We cannot permit the wealth gap to become an unbridgeable gulf."

The crackdown on housing speculation, off-campus tutoring, and monopolistic practices fit the agenda. The source of market panic goes beyond that: so what's next?

For both housing and education, warnings come years in advance, followed by increased tightening. However, unlike housing, which is always under the spotlight, the stance on education is easily forgotten. In September 2018, President Xi addressed the National Education Conference, mentioning "some off-campus training organisations offer examination-oriented courses, which goes against good practice in education and the healthy growth of students. […] An industry calling for conscience should not become profit-driven."

As for healthcare, the regulations are more granular and delicate. A push to reduce drug prices is already underway. In May this year, the Politburo released guidelines for the reform of healthcare service prices. The principle is to ensure that overall healthcare service costs are affordable and transparent. While making basic healthcare accessible to everyone, this doesn't prohibit differentiated services.

Concerns around consumption are overblown. The government's goal is to expand the middle class, and it has had a laissez-faire attitude around this sector, albeit with increased protections for consumer privacy and prevention of differentiated prices for common household goods, in line with the anti-monopolistic move in the e-commerce space. Meanwhile, consumption upgrade is still considered a desirable goal.

| Equity markets | 30/07/2021 | 1 W | 1 M | YTD |
|---|---|---|---|---|
| S&P 500 | 4419 | 0.2% | 2.8% | 17.7% |
| Eurostoxx 50 | 4102 | -0.2% | 0.9% | 15.5% |
| CAC 40 | 6636 | 1.0% | 2.0% | 19.5% |
| Dax 30 | 15553 | -0.7% | 0.1% | 13.4% |
| Nikkei 225 | 27284 | -1.0% | -5.2% | -0.6% |
| SMI | 12129 | 0.0% | 1.6% | 13.3% |
| SPI | 15588 | -0.1% | 1.6% | 17.0% |
| MSCI Emerging Markets (close -1D) | 1295 | -1.2% | -5.8% | 0.3% |
| **Commodities - Volatility** | **30/07/2021** | **1 W** | **1 M** | **YTD** |
| Crude Oil (Brent, $/barrel) | 76 | 2.8% | 1.4% | 47.0% |
| Gold ($/ounce) | 1825 | 1.2% | 3.1% | -3.9% |
| VIX | 19 | 1.8 | 3.2 | -3.8 |
| **FX markets** | **30/07/2021** | **1 W** | **1 M** | **YTD** |
| EUR/USD | 1.19 | 0.9% | 0.2% | -2.8% |
| USD/JPY | 110 | -0.8% | -1.3% | 6.3% |
| EUR/GBP | 0.85 | -0.4% | -0.6% | -4.7% |
| EUR/CHF | 1.08 | -0.5% | -1.9% | -0.4% |
| USD/CHF | 0.91 | -1.4% | -2.0% | 2.4% |

*Source: Bloomberg, Amundi Research – 30/07/2021 – 15:00 pm*

| Credit markets | 30/07/2021 | 1 W | 1 M | YTD |
|---|---|---|---|---|
| Itraxx Main | +46 bp | - | -- | -1 bp |
| Itraxx Crossover | +235 bp | +3 bp | +3 bp | -6 bp |
| Itraxx Financials Senior | +54 bp | - | -1 bp | -5 bp |
| **Fixed Income markets** | **30/07/2021** | **1 W** | **1 M** | **YTD** |
| ESTER OIS | 98.98 | -1 bp | -5 bp | -32 bp |
| EONIA | -0.48 | - | +1 bp | +2 bp |
| Euribor 3M | -0.54 | - | -- | - |
| Libor USD 3M | 0.13 | -- | -2 bp | -11 bp |
| 2Y yield (Germany) | -0.75 | -3 bp | -9 bp | -5 bp |
| 10Y yield (Germany) | -0.45 | -3 bp | -24 bp | +12 bp |
| 2Y yield (US) | 0.19 | -1 bp | -6 bp | +7 bp |
| 10Y yield (US) | 1.24 | -3 bp | -23 bp | +33 bp |
| **Eurozone Sovereigns 10Y spreads vs Germany** | **30/07/2021** | **1 W** | **1 M** | **YTD** |
| France | +35 bp | +2 bp | +2 bp | +12 bp |
| Austria | +25 bp | +2 bp | +4 bp | +9 bp |
| Netherlands | +13 bp | - | +2 bp | +5 bp |
| Finland | +26 bp | +1 bp | +12 bp | +10 bp |
| Belgium | +34 bp | +3 bp | +3 bp | +15 bp |
| Ireland | +40 bp | +2 bp | +3 bp | +13 bp |
| Portugal | +63 bp | +2 bp | +3 bp | +3 bp |
| Spain | +72 bp | +3 bp | +10 bp | +11 bp |
| Italy | +108 bp | +4 bp | +5 bp | -4 bp |

## Asset class

| | MARKET | AMUNDI ANALYSIS |
|---|---|---|
| **Equity** | **The S&P 500 reached another record high this week**. The second-quarter reporting season has been stronger than expected, providing a support for stocks as they climb back into record-high territory. Emerging markets performance has been slightly negative, mainly driven by the strong correction in China. | Earnings are expected to remain robust. A breather is probably due going into the summer, but relative valuation will prevent a consolidation changing into a bear market. In Europe, the end of lockdown is favoring the start of cyclical recovery. In addition, Pacific markets (including Japan) should benefit from their cyclical behavior. Value laggards and Emerging markets are the place to be. Final remarks from Politburo in China this weekend will be crucial. |
| **Fixed Income** | **German 10Y yields fell by 3bp over the week to -0.44% after the dovish ECB meeting of last week which was consistent with ECB hiking rates even later than anticipated**. 10Y US yields declined by 5 bp to 1.24% the decline was due to the sell-off on Chinese tech stocks at the beginning of the week. | The FOMC has sent the first signal that QE tapering is approaching by acknowledging for the first time that "the economy has made progress" on tapering goals. We maintain the view that the FOMC will give more details on the timeline of the tapering at Jackson Hole or in September, before a formal announcement in December. The tapering of asset purchases should start at the beginning of 2022 at a pace of $10bn per month. Nevertheless, J. Powell seemed quite constructive on the labour market and there is a risk that the tapering starts before the end of the year. |
| **Credit** | **Credit spreads hardly changed during this week.** The interventions of the ECB and the Fed had no impact on this resilient asset class as bankers maintained the status quo. In terms of HY credit, BBs outperformed CCCs by 16bp in total return, making it the 6th consecutive week of their outperformance. | During the summer period, technical factors will remain favorable for the credit market. Indeed, during this period, we will record fewer issues, less returns, less liquidity. Nonetheless, liquidity conditions have already started to weaken in July - a bit early compared to the typical summer slowdown. All of these will contribute tightening or stabilizing spreads until the end of August, while assuming that asset prices will continue to view the delta variant as a short-term risk with limited impact over the medium term. |
| **Foreign Exchange** | **While the Fed acknowledged further progress in the economic recovery this week, disappointing Q2 growth figures offset earlier expectations of tapering-off.** As a result, the USD lost ground vs the entire G10 and EMFX spectrum. SEK, GBP, CHF, and NOK were the best performers in the G10. BRL, ZAR, TRY, HUF, and CZK were the session winners in the EMFX universe, while only PEN and HKD crossed over into marginally negative territory compared to last week. | The narrative of USD exceptionalism is losing traction somewhat, following the disappointing Q2 GDP growth and the huge drop in LT US interest rates registered since end-Q1 2021. However, US growth is still expected to outperform the rest of the world, and inflationary pressures, although temporary, could push the FED to normalise its policy stance. Most of the USD upside has been consumed since the June FOMC meeting. |
| **Commodities** | **Commodities moved up this week despite concerns over growth.** Oil was stronger, with the WTI and the Brent reaching USD 73.6/b and USD 75/b respectively. Gold, base metals, and agriculture are all up 1.50% over last week. | Despite new concerns over growth due to the new Covid-19 variants, the economic picture and central bank monetary policies remain supportive of commodities. Gold will be driven by FED decisions and rate movements (nominal and real), and should remain supported in the absence of earlier and stronger policy normalisation. Oil is expected to linger at around $70 in the near term, and supply will dominate price swings in the months to come. Base metals should move higher, in line with the economic recovery and a potential shortage of certain commodities. |

## Economic indicators

| | MARKET | AMUNDI ANALYSIS |
|---|---|---|
| United States | **Q2 GDP growth was up 6.5% Q/Q AR, a disappointing result.** However, a more detailed look at the release shows final sales to private domestic purchasers up 9.9%, indicating impressive strength in private domestic demand. In fact, both consumption (up 11.8% AR) and business investments (up 8%), were especially strong. | The significant "miss" was due to a larger-than-expected slow-down in residential investment (-9.8%), government spending (-1.5%) and inventories and trade, weakening growth by -1.1% and -0.4% respectively. But overall, growth composition was strong, and the slow-downs in inventories and trade should reverse in the coming quarters as capacity constraints begin to disappear. |
| Eurozone | **Euro area GDP rose by 2.0% Q/Q (13.7% Y/Y) during the second quarter, according to the preliminary release by Eurostat**. On a country basis, GDP expanded by 2.7% Q/Q (17.3% Y/Y) in Italy, 2.8% Q/Q (19.8% Y/Y) in Spain, 1.5% Q/Q (9.6% Y/Y) in Germany and 0.9% Q/Q (18.7% Y/Y). | Eurozone GDP expanded at a solid rate in Q2, benefiting from the easing of Covid-19 restrictions and progressive reopening, in line with both high frequency and soft data projections. The main positive surprises came from the Eurozone's southern economies, with Spain, Italy, and Portugal showing significantly stronger than expected growth. Looking ahead, Euro area economies are expected to grow at a sustained rate over the third quarter, inspired by solid optimism about the ongoing recovery and the progressive return to normalcy despite remaining uncertainties around the evolution of the pandemic. |
| Japan | **Nominal retail sales rose 3.1% MoM (seasonally adjusted) in June, reversing part of the decline during the previous two months.** In real terms, retail sales were low in Q2, down 2.8% from the previous quarter. This weakness was broadly based across all segments, with the exception of foods & beverages. | The increase in infections in Japan and still-slow pace of vaccinations suggest that improvements in domestic consumption will be limited in July. The weak retail sales were in stark contrast to industrial production, which expanded for the fourth straight quarter. Solid external demand will continue to support the economic recovery. |
| Emerging Market | **National Bank of Hungary (NBH) raised its policy rate by 30bp to 1.2%, 20bp higher than consensus expectations.**<br><br>Czech Q2 real GDP flash estimation released at 7.8% yoy much higher than in Q1 (-2.4%) but much lower than expected by consensus (9.2%). | The NBH justified its decision by the need "to ensure price stability, prevent second-round inflationary effects and anchor inflation expectations". As inflation is to stay elevated, NBH will likely continue its normalization process and additional hike should come as soon as next August meeting.<br><br>This high number reflects base effects from the depressed level of last year, rather than any inherent strength. The flash report contains no details regarding the composition of growth. |