Confidence must be earned

Amundi ASSET MANAGEMENT

Weekly Market Review

The latest news from financial markets

Edition of July 11, 2022

By Amundi Institute

The week at a glance

- **Markets:** Commodities fell by 0.7% on recession fears.
- **United States:** The Institute for Supply Management (ISM) services index for June came in above expectations at 55.3.
- **Eurozone:** Germany had a monthly trade deficit in goods in May for the first time since 1991.

KEY FIGURE

1.01

EURUSD exchange rate briefly touched Friday morning

Focus

The magnitude is up for debate but it seems clear the economy is heading for a slowdown. In contrast, corporate earnings continue to be upgraded. Over the past month, 2022 growth forecasts, for earnings per share, moved marginally up in the U.S. (to 9.6% from 9.5%) and in Europe (to 14.3% from 14.0%), while jumping in Japan by 1.3%, to 5.8%. Only Emerging Markets had no visible upgrades, but no downgrades either. In part, this is expected, as earnings are nominal and hence inflation provides a boost. In line with that, commodity sectors were largely responsible for earlier upgrades. However, more recently, despite commodities turning, earnings continue to move higher, as upgrades broaden out to other sectors. On the one hand, this suggests pricing power and profit margins at historical highs across regions add to that view. On the other hand, margins tend to revert to the mean, especially in cyclical sectors. And the trend implies consumers are using the buffer of excess savings. So, the longer that pricing power persists, the lower the likelihood that it will continue. The picture suggests the risk that earnings will need to be adjusted lower later this year and this adjustment could happen at a fast pace, potentially creating a turbulent period for equity markets.

KEY DATES

13 July	U.S. Inflation
15 July	China second quarter GDP and June data

Source: Amundi Institute.

Our weekly analysis

Downside risks to euro/U.S. dollar parity are justified

Slowing global growth and lower risk appetite are proving to be strong supports for the U.S. dollar, which is trending higher across most G10 currencies in 2022. Parity with the euro is fast approaching and we continue to see the move as consistent with the cyclical shock that is coming.

In fact, when the global economy slows towards recession, investors' demand for safe assets surges and the U.S. dollar strengthens to the point where the U.S. Federal Reserve (Fed) blinks and turns dovish. In other words, the Fed is the only trigger to induce an inversion of the U.S. dollar trend whilst the global economy is entering a recession.

In August 2020, in the middle of the Covid crisis, the "average inflation targeting regime" announced in Jackson Hole was in fact, the key catalyst for shorting the U.S. dollar. We see it as unlikely in the short term (but expect that to play out ahead in the forecasting horizon) and continue to see a negative asymmetry for EURUSD in the second half-year 2022.

Given the risks to the global backdrop (a slowdown in growth and the risk of higher inflation), we see the U.S. dollar premium over its fair valuation as not entirely incorporating such a cyclical shock.

Standard PPP (purchasing power parity) frameworks - which use Consumer Price Index (CPI) differentials to obtain equilibrium exchange rates - appear to be underestimating the nature of the ongoing inflation spike, highlighting the limits to the potential rebound. Adjusting for productivity (we proxy with CPI/PPI differentials), the EURUSD is much more expensive than we may think.

We see EURUSD flirting with parity at the end of the year but see risks of undershooting towards U.S. dollar 0.94 in the shorter run.

Indice	Performance			
Equity markets	07/08/22	1 W	1 M	YTD
S&P 500	3906	2,1%	-5,1%	-18,1%
Eurostoxx 50	3502	1,6%	-7,6%	-18,5%
CAC 40	6029	1,6%	-6,5%	-15,7%
Dax 30	12995	1,4%	-10,0%	-18,2%
Nikkei 225	26517	2,2%	-6,1%	-7,9%
SMI	11006	2,2%	-4,0%	-14,5%
SPI	14197	2,3%	-3,5%	-13,7%
MSCI Emerging Markets (close -1D)	994	0,2%	-7,4%	-19,3%
Commodities - Volatility	07/08/22	1 W	1 M	YTD
Crude Oil (Brent, $/barrel)	106	-5,1%	-14,2%	36,3%
Gold ($/ounce)	1745	-3,6%	-5,8%	-4,6%
VIX	25	-1,7	1,0	7,8
FX markets	07/08/22	1 W	1 M	YTD
EUR/USD	1,02	-2,2%	-5,0%	-10,4%
USD/JPY	136	0,6%	1,3%	18,2%
EUR/GBP	0,85	-1,8%	-1,1%	0,5%
EUR/CHF	0,99	-0,7%	-5,2%	-4,2%
USD/CHF	0,98	1,5%	-0,3%	7,0%

Source: Bloomberg, Amundi Institute – 07/08/2022 – 15:00 pm

Indice	Performance			
Credit markets	07/08/22	1 W	1 M	YTD
Itraxx Main	+116 bp	-4 bp	+26 bp	+68 bp
Itraxx Crossover	+575 bp	-13 bp	+123 bp	+333 bp
Itraxx Financials Senior	+128 bp	-4 bp	+28 bp	+73 bp
Fixed Income markets	07/08/22	1 W	1 M	YTD
ESTER OIS	98,44	-1 bp	-5 bp	-30 bp
EONIA	-0,51	-	-	-
Euribor 3M	-0,09	+9 bp	+22 bp	+49 bp
Libor USD 3M	2,43	+13 bp	+74 bp	+222 bp
2Y yield (Germany)	0,53	+1 bp	-17 bp	+115 bp
10Y yield (Germany)	1,34	+11 bp	-2 bp	+152 bp
2Y yield (US)	3,11	+27 bp	+33 bp	+237 bp
10Y yield (US)	3,08	+20 bp	+6 bp	+157 bp
Eurozone Sovereigns 10Y spreads vs Germany	07/08/22	1 W	1 M	YTD
France	+53 bp	-3 bp	+1 bp	+16 bp
Austria	+56 bp	-2 bp	+3 bp	+29 bp
Netherlands	+34 bp	-2 bp	+4 bp	+19 bp
Finland	+54 bp	-3 bp	+8 bp	+27 bp
Belgium	+63 bp	-3 bp	+2 bp	+27 bp
Ireland	+58 bp	-3 bp	-1 bp	+15 bp
Portugal	+107 bp	+3 bp	-9 bp	+42 bp
Spain	+107 bp	+2 bp	-6 bp	+33 bp
Italy	+192 bp	+6 bp	-10 bp	+57 bp

Asset Class

	MARKET	AMUNDI ANALYSIS
Equity	The upward trend of global equity markets continued this week despite fears on inflation and recession persisting. The MSCI World Index edged up nearly 1.5% this week. MSCI World Growth outperformed Value over the week. In the U.S., stock markets were up, supported by hints from the U.S. Fed that interest rate hikes could be tempered if growth suffered. Overseas, the European stock market underperformed the U.S.. Soaring energy prices this week stoked inflation concerns and affected most European markets. The Euro Stoxx 50 ended the week slightly up. On emerging markets, Covid woes and geopolitical tension outweighed economic stimulus.	European gas prices surged this week as Norwegian offshore oil and gas workers went on strike. Since European inflation is already high, mostly due to energy prices, an energy shock triggered by this king of catalyst, may heighten concerns of recession for the region. The quarterly earnings season has just started but not many companies reported so far. Earnings results for the second quarter will be key for global equity markets this month. They will also provide insight on the both economic and monetary policy path for comings quarters.
Fixed Income	U.S. growth is clearly slowing and bond markets have been repositioning for the possibility of a strong slowdown in U.S. growth as the Federal Reserve delivers successive rate hikes to tame elevated inflation and consumer confidence is at a record low. But at the end of the week two of the Fed's most hawkish policy makers backed raising interest rates rapidly, by another 75 basis point in July and 50bp in September while playing down recession fears. In addition, job data published on Friday was stronger than expected. As a result 10y yield is up 18bp over the week and German 10y yields are up 10bp.	Recent market developments may understate inflation risks. Market inflation expectations have fallen sharply: the 5-year average inflation expected by the market has fallen from 3.7% in April to 2.7% today. The market expects a return in line with the Fed's 2% target over the next 2 years. This sharp drop in market inflation expectations is due to (1) a sharp slowdown in U.S. growth (2) a downward revision of long term inflation expectations from the University of Michigan (3) to improvement in supply chain issues (freight rates are plunging, inventory is overstocked at major distributors).
Credit	Following weeks of broad and sizeable widening, spreads finally tended to stabilise in recent days, especially among investment grade bonds, despite high volatility not only in the fixed-income space but also among risky assets, on persistent recessionary fears. European high yield underperformed its U.S. counterparts, while credit default swaps finally tended to regain some ground after hitting new highs.	Valuations driven to levels implying almost recessionary levels in European credit markets are still failing to trigger a recovery, as technicals remain challenged by persistent outflows and by the end of European Central Bank (ECB) corporate sector purchase program (CSPP) support, while the macro picture keeps showing weaker prints in soft data. U.S. corporate bonds offer less attractive valuations vs Europe in relative terms but also a more resilient fundamental picture and lower risks on the macro front.
Foreign Exchange	U.S. dollar appreciated vs all other G10 currencies, with the only exception of Australian dollar. The euro continues to slide toward dollar parity, due also to the Federal Reserve's hawkish stance while the prospect of an economic slowdown raises some doubts on the European Central Bank's ability to tighten monetary policy sufficiently to fight inflation. In addition, all emerging market currencies depreciated vs U.S. dollar.	We are close to the short-term target we had in mind for U.S. dollar vs euro. The euro could recover in the second half of the year. We are still cautious on emerging market currencies, in particular in Eastern Europe. We are more bullish on commodity exporters far from the conflicts, like the South African rand and Malaysian ringgit.
Commodities	Commodities fell by 0.7% on recession fears. West Texas Intermediate (WTI) and Brent moved down to $102 and $105, respectively. Agriculture declined by 0.7%; gold fell to $1741; and base metals moved down by 0.5%.	We maintain our positive view on commodities despite fears of a global recession and a liquidity drain from the Fed. Supply shortages are still evident in some specific base metals, due to geopolitical tensions and world electrification. Central banks and nominal (real) rates remain the key movers for the gold price, as we have seen in the latest months. Oil will be driven by Organization of Petroleum Exporting Countries (OPEC) decisions and potential shortages after a concrete oil ban in Europe.

Economic Indicators

	MARKET	AMUNDI ANALYSIS
United States	The Institute for Supply Management (ISM) services index for June came in above expectations at 55.3 (versus 54.0 expected), decreasing less than expected.	The composition of the report was mixed, with the business activity component increasing, but the new orders and employment components declining and falling into contractionary territory.
Eurozone	German trade figures showed the country had a monthly trade deficit in goods in May for the first time since 1991.	The cause of such an extraordinary event in Germany's recent history was higher import costs, as a result of recent commodity shocks, alongside disruptions to trade from factors including sanctions on Russia, which left the monthly deficit at €1.0bn.
Japan	Total cash earnings growth eased to 1% year-on-year in May from 1.3% year-on-year in April, in line with expectations. The slowdown in wage growth was driven by an increased share of non-regular workers and a suspension of manufacturing and construction activities, as total hours worked moderated in May.	Real wages slid further in May, as inflation picked up. Inflation expectations have continued to rise as well, while the realised core inflation rate stayed subdued at below 1%. Amidst rising costs and a weaker currency, we expect core inflation to rise the rest of the year but not to break above the 2% target.
Emerging Market	While the central banks of Romania (NBR) and Hungary (NBH) have increased their monetary tightening. NBR increased its key rate +100bps to 4.75%, instead of 75bps previously. NBH, for its 1-week deposit rate increased +200bps to 9.75%, against 50bps previously. National Bank of Poland (NBP) only increased its key rate by 50bps at 6.5% versus 75bps before. In any case, these rate hikes are taking place in a context of high inflation and still bullish expectations.	For the NBR, the objective is also to limit the rate gap with its neighbours and for the NBH it is to try to contain the fall in its currency value. For the NBP, concerns about growth weighed in the decision to reduce the pace of the tightening. Rate hikes are expected to continue in the coming months, but the question is how fast as the domestic and especially global growth outlook is darkening.