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Amundi ASSET MANAGEMENT

Weekly Market Review

The latest news from financial markets

for the exclusive attention of professionals

Edition of September 20, 2021 By Amundi Research

The week at a glance

- **Market:** Spreads closed broadly tighter the week with European high yield segment outperforming other areas
- **United States:** Momentum in core inflation starts decelerating in August (- 4% YoY vs 4.3% in July)
- **Eurozone:** Euro area industrial production rose in July by 7.7% (YoY)

KEY FIGURE

$72

per barrel price reached by WTI ($75 Brent)

Focus

Low bond yields and liquidity

Concerns about global growth (with the increase in Covid-19 cases and the slowdown in China) explain the recent sharp drop in long rates. Nevertheless, technical factors (liquidity, flow and positioning) have also played an important role. Since February, the US Treasury Department has used a huge amount of its cash on deposit with the Fed in the Treasury General Account (TGA) to finance the deficit. The cash balance went from $1,568 billion in mid-February to $258 billion in August! When the US Treasury uses the cash on deposit with the Fed to finance its deficit, it transfers its cash to the banking system: this has resulted in a renewed surge in global liquidity and has led to a broad based reach for yield which supported all asset classes. We expect the impact of liquidity on the bond market to diminish in the coming months with the Fed's tapering and the end of the Treasury Department's cash drawdown. As a result, yields are expected to rise - driven by the correction of a valuation overshoot, above-trend growth and additional fiscal plans in the United States.

KEY DATES

20th September	22nd September	26th September	29th September
People's Bank of China Loan Prime Rate	US Fed monetary policy meeting	German federal elections	Japan LDP presidential election

Source: Amundi Research.

Our weekly analysis

China housing deleveraging

Evergrande - one of China's biggest property developers - is on the verge of default. While authorities may feel pressure to intervene to prevent systemic financial risk, Evergrande remains the world's most heavily indebted developer and it ticks a lot - if not all - of the boxes for the authorities to shift to a new discipline regarding financial risk.

Liquidity pressures will remain high in the sector as this round of tightening is vastly different from the 2011 and 2014 cycles. Beijing has now cracked down on almost all stakeholders in the sector. Local governments are being asked to limit their land auction premiums while banks have to follow a tiered system to cap their lending to developers as well as in mortgages.

For developers, the Three Red Lines were implemented a year ago:

1. Liability/asset ratios (excluding pre-sale deposits) should remain below 70%.

2. Net gearing on the total equity ratio should remain below 100%.

3. Net cash to short-term debt ratio should be higher than 1x.

Companies that violate all three lines cannot increase their total debt from first half of 2019 levels and those that exceed two of the three lines cannot increase their total debt more than 5% per year. While a fifth of the top 100 developers had stepped over at least two lines by first half of 2021, all are required to meet the deleveraging goal by mid-2023.

Deleveraging the housing sector and stabilising housing prices suit China's long-term political agenda. To pursue Common Prosperity, the government is promoting a sustainable and healthy housing market for the greater good. Hong Kong and South Korea are constant reminders to Beijing of how elevated housing inflation could quickly erode political bases.

That said, a sharp correction is as undesirable as strong housing inflation. With third quarter data showing the sector cooling from all fronts, officials have already softened their tone, stressing the stability side more. Although the deleveraging goal will stay, a pause in tightening is likely to slow the burn.

Indice	Performance			
Equity markets	17/09/2021	1 W	1 M	YTD
S&P 500	4474	0.3%	0.6%	19.1%
Eurostoxx 50	4176	0.1%	-0.5%	17.5%
CAC 40	6638	-0.4%	-2.7%	19.6%
Dax 30	15645	0.2%	-1.7%	14.0%
Nikkei 225	30500	0.4%	11.2%	11.1%
SMI	12039	-0.2%	-3.5%	12.5%
SPI	15596	0.0%	-2.4%	17.0%
MSCI Emerging Markets (close -1D)	1277	-2.5%	1.7%	-1.2%
Commodities - Volatility	17/09/2021	1 W	1 M	YTD
Crude Oil (Brent, $/barrel)	75	3.5%	9.3%	45.7%
Gold ($/ounce)	1754	-1.9%	-1.8%	-7.6%
VIX	19	-2.1	0.9	-3.9
FX markets	17/09/2021	1 W	1 M	YTD
EUR/USD	1.18	-0.3%	0.6%	-3.6%
USD/JPY	110	0.1%	0.4%	6.6%
EUR/GBP	0.85	0.0%	0.2%	-4.5%
EUR/CHF	1.09	0.8%	2.0%	1.1%
USD/CHF	0.93	1.1%	1.5%	4.9%

Source: Bloomberg, Amundi Research – 09/17/2021 – 15:00 pm

Indice	Performance			
Credit markets	17/09/2021	1 W	1 M	YTD
Itraxx Main	+44 bp	--	-2 bp	-3 bp
Itraxx Crossover	+225 bp	-2 bp	-10 bp	-16 bp
Itraxx Financials Senior	+50 bp	-1 bp	-3 bp	-8 bp
Fixed Income markets	17/09/2021	1 W	1 M	YTD
ESTER OIS	98.90	-1 bp	-5 bp	-40 bp
EONIA	-0.48	-	-	+2 bp
Euribor 3M	-0.55	--	-	--
Libor USD 3M	0.12	-	-1 bp	-12 bp
2Y yield (Germany)	-0.70	+1 bp	+4 bp	-
10Y yield (Germany)	-0.28	+5 bp	+19 bp	+29 bp
2Y yield (US)	0.22	+1 bp	+1 bp	+10 bp
10Y yield (US)	1.35	+1 bp	+9 bp	+44 bp
Eurozone Sovereigns 10Y spreads vs Germany	17/09/2021	1 W	1 M	YTD
France	+33 bp	-	-2 bp	+10 bp
Austria	+22 bp	--	-2 bp	+7 bp
Netherlands	+12 bp	--	-2 bp	+3 bp
Finland	+22 bp	--	-4 bp	+6 bp
Belgium	+31 bp	--	-3 bp	+12 bp
Ireland	+38 bp	+1 bp	-1 bp	+11 bp
Portugal	+55 bp	-1 bp	-4 bp	-5 bp
Spain	+64 bp	-2 bp	-6 bp	+3 bp
Italy	+101 bp	-3 bp	-4 bp	-11 bp

Asset class

	MARKET	AMUNDI ANALYSIS
Equity	**Still very little volatility on the equity markets**. The Tokyo stock market nevertheless confirmed its rebound (driven by the announcement two weeks ago that Prime Minister Suga would be stepping down for the next election), while the Hang Seng and the MSCI China suffered from the Chinese government's new regulatory framework announcements, this time on casinos.	Equity markets have been driven by a strong recovery in profits since the beginning of the year. This growth will normalize next year at around +8% according to the Institutional Brokers Estimate System (IBES) compared with +47% now expected in 2021 for the MSCI World. This leads to a preference for stock-picking and quality over directional calls.
Fixed Income	**The yields on 10-year government bonds declined at the beginning of the week in a risk-off environment due to concerns related to China Evergrande's financial troubles**. Bond yields subsequently rebounded with reassuring macroeconomic data: the August retail sales report came in above consensus, the Empire State manufacturing survey rose sharply in September, reversing most of the large decline in August and alleviating fears regarding the impact of the Delta variant on the US economy. Germany's 10-year yield advanced by 5 base points to -0.28%.	We expect that at next week's FOMC meeting, Powell will confirm that a reduction in asset purchases is appropriate this year as long as the economy stays on track. Powell should retain some flexibility as to the exact timing of the official announcement (November or December). The meeting is also expected to provide important information on the Fed's policy normalization plans over the next few years with the summary of economic projections which will tell us the FOMC's perspective on the appropriate monetary policy until 2024.
Credit	**Spreads closed broadly tighter the week with the European high yield segment outperforming other areas, both in credit default swap and cash bonds**. Compression in sovereign periphery spreads and positive risk sentiment supported the performance of subordinated financial bonds more and EUR-denominated high beta instruments and US spreads generally compressed less.	Technical indicators remain the main tailwind of European corporate bonds' relative performance vs core government bonds, although absolute valuations were more stretched. September is likely to be another month of limited net supply in Europe because of high volumes of redemptions, while steady ECB purchases and positive investment flows will support the demand side. US credit markets will also keep being supported by strong investment inflows into investment grade.
Foreign Exchange	**The USD increased its value slightly vs the EUR during the week**. Among G10 currencies, the Norwegian krone was the best vs USD, while the Swiss franc was one the worst. Emerging currencies were quite mixed. The South African rand and Thai baht depreciated vs the greenback, while the Russian rouble and Chilean peso appreciated.	In our view, The sequencing of slowing global growth and the Fed's beginning a modest policy normalisation in the months to come are likely to continue to support the USD. A few cyclical currencies may have overreacted ahead of Jackson Hole and may offer some juice from current levels. Emerging currencies appear still cheap on average. There is some more upside for the Russian rouble and Indonesia rupiah but volatility is expected to remain high.
Commodities	**Commodities were flat this week. WTI and Brent moved up to $72 and $75 respectively**. Gold retraced to $1760, while base metals fell by -0.6%.	Although decelerating, economic growth remains buoyant for commodities so far. Supply bottlenecks and inventory shortages will last for a while, supporting base metals prices, while financial conditions are still the key variable for the gold price.

Economic indicators

	MARKET	AMUNDI ANALYSIS
United States	**Momentum in inflation began decelerating, while signs of high persistence remain in a "mixed-bag" report**. Consumer Price Index headline 5.3% YoY (July 5.4%) was in line with the consensus, while the core figure of 4.0% (4.3% in July) was below it. Monthly momentum has begun decelerating (headline slowed from 0.5% MoM to 0.3% MoM and core from 0.3% MoM to 0.1% MoM).	Data are in line with our expectations of decreasing momentum in inflation. However, a system of price indicators points to significant persistence of inflationary pressures. Producer Price Index rolled over but is still high, supply chain disruptions and bottlenecks remain significant, the labour market is healing fast and wage growth should pick up in a more diffuse/broader way going into next year, supporting the cyclical components of inflation further, as pandemic-induced base effects fade. We expect inflation to remain above 3% till the middle of next year.
Eurozone	**According to the latest release by Eurostat, Eurozone industrial production rose by 1.5%** MoM in July while industrial production grew by 7.7% compared to July 2020.	Eurozone industrial production expanded at a significantly stronger rate than expected, underlain by a broad expansion across the main product categories. Non-durable goods rose accordingly by 3.5%, followed by a 2.7% rise in capital goods and a 0.6% increase in durable consumer goods. The strong rise in Eurozone industrial production confirmed the resilience of the manufacturing sector, which continues to benefit from sound and solid demand, despite very severe supply chain disruptions and input shortages, which continue to weigh on output volumes.
Japan	**Japan's LDP presidential election campaign officially began on September 17 with four candidates: Kono, Kishida, Noda and Takaichi.** The latest polls show Kono remains the most popular candidate. As Ishiba has decided not to run and will reportedly support Kono, his popularity among grassroots LDP members will boost Kono's support further.	Kono is a market-friendly candidate, focusing on raising Japan's growth potential, and will continue the digital and green transformation. He is also pragmatic, supporting the use of nuclear power during the transition. He is likely to support Bank of Japan's 2% inflation target and maintain the consumption tax rate at 10%. He will maintain close ties with Europe and the US.
Emerging Market	**In India, headline inflation printed at 5.3% YoY, down from 5.6% YoY in July, remaining within the Reserve Bank of India's (RBI) target 2%-6%.** Food prices (mainly for vegetables) were the main driver of inflation deceleration, contributing 1.7%, vs 2.0% the previous month. In contrast, wholesale prices kept increasing, to 11.4% YoY from 11.2% in July on the back of cost pressures.	As in most countries in the region, Indian inflation is not ramping up. Food price dynamics follow a domestic cycle different from global food prices. While inflation is stubbornly higher than the RBI's 4% pivot target, the current and next inflation trend still allows RBI to keep its dovish stance. Normalisation will start with a return to the symmetric corridor, increasing the Reverse Repo Rate later, most likely in early 2022.