September 2020

TREASURY LETTER

Confidence must be earned

Amundi ASSET MANAGEMENT

Focusing on institutional and corporate investor needs for liquidity solutions

Pascal BLANQUÉ
Group Chief Investment Officer

A Note of Caution for the Back-to-School Season

The appetite for risk assets has remained strong over the summer as we witnessed the confirmation of existing themes and the emergence of new ones. While the decoupling between the real economy and financial markets has proved persistent, another confirmed trend is that the virus cycle is not over. In this respect, the back-to-school test will be key. A sharp reacceleration of the virus cycle would hit the financial markets, leading to mounting expectations of additional support measures, and this would again drive markets. A W-shaped recovery would be the most likely scenario in this case.

On geopolitics, US-China confrontation has taken a new twist recently in the tech sphere. President Trump has to resist the temptation to break the trade deal, as this would be disruptive for the fragile recovery and markets, but he is likely to keep pressure high ahead of the elections. The Presidential race is still very uncertain and a Democratic sweep would be a market mover, possibly leading to higher volatility in the corporate sector.

It is a time to stay prudent, but not risk-off. All the elements that supported the risk asset rally are slowing –additional fiscal expansion is unlikely to be comparable to the first one, the same is true for monetary policy and the early signs of a recovery could be challenged.

At the portfolio level, the following key points should be kept in mind:

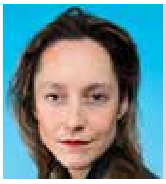
- Elevated risk level highlight the need to hold well-diversified portfolios, with quality assets and adequate levels of cash buffers.
- Focus selectively on credit, EM bonds and Euro peripheral bonds for that extra yield but do not go too low in credit quality spectrum.
- Valuations in certain market segments, such as the US tech sector, are extreme and therefore focus on business fundamentals is key. Investors should prepare for a rotation in favour of cyclical and high-quality value names. Equities are still more attractive than bonds, but the direction of interest rates is a key element to watch. Higher rates at the margin could challenge current valuations.

Overall, the scenario is uncertain, with asymmetric risks. Markets are becoming similar to their February conditions (high valuations and complacency) and the level of debt in the system has ballooned. Any disappointment around additional stimuli and a near-term vaccine is a reason for caution, and all the more so with tight valuations.

CONTENTS

THE STRATEGIST VIEWPOINT

CENTRAL BANKS MAINTAIN MONETARY SUPPORT FOR THE ECONOMY



Valentine AINOUZ, CFA
Strategy and Economic Research

The global economy rebounded quickly during the summer from the coronavirus pandemic. Economic data surprised on the upside, especially in the US. However, the risk of permanent layoffs and business bankruptcies needs to be monitored in the coming months, with the reduction of government support. Economic activity is unlikely to return to pre-Covid levels until 2022.

In this phase of recovery, massive supply of credit to governments and companies played a key role. The coronavirus crisis was characterised by counter-cyclical credit conditions, thanks to unprecedented strong coordination between governments and monetary policy makers. To tackle the health crisis, almost all governments implemented large-scale fiscal stimulus and support measures, including corporate loan guarantees. At the same time, major central banks increased their purchases of sovereign debt to levels never seen before, played a backstop role in the corporate credit market and provided cheap liquidity to banks (in the case of the ECB). **We observed:**

- **On the sovereign debt market, a big wave of new issuance.** The crisis has pushed government deficits to historically high levels. However, huge supply did not push up yields, as central bank purchases absorbed most of additional government issuance. In recent months, sovereign long-term yields fell sharply and peripheral spreads in the Eurozone tightened.
- **On the corporate bond market, a record level of issuance.** The corporate debt market was boosted by the support of central banks. Credit spreads have narrowed even though they have not yet fully returned to their pre-crisis levels on average. Indeed, companies took advantage of historically low yields and strong investors' appetite to boost their balance sheets and increase their cash holdings. This liquidity cushion has largely contributed to limiting the number of defaults.

Once the corona crisis phase is over, central banks' actions will no longer be part of an emergency plan but will aim to support economic recovery.

- **The Fed has undertaken a historic shift in its mandate: its priority is now maximum employment.** Fed Chair Jerome Powell said in his Jackson Hole speech that the central bank is adopting a "flexible form of average inflation targeting", i.e., targeting inflation that "averages 2 percent over time". This means that the Fed will wait until a tight job market has begun pushing inflation higher before thinking about raising rates. The message is clear: rates will remain low for at least the next three years to support economic activity. The Fed also adopted a forward guidance describing the inflation and employment conditions that would need to be met before considering rate increases. The Fed also intends to continue its bond purchase program at its current pace ($80bn in Treasuries and $40bn in Mortgage Backed Securities). What to expect next? A transition to a traditional asset purchase program buying more longer-maturity securities
- **The ECB adopted a "wait and see" mode at its last meeting despite recent disappointing inflation data and the appreciation of the euro.** The ECB increased in June the envelope for the pandemic emergency purchase programme (PEPP) by €600bn to a total of €1,350bn and extended the programme to at least the end of June 2021. As of the end of August, the ECB had already bought €500bn. Otherwise, the ECB's new economic projections suggest that the monetary stance of its policy will have to remain extremely accommodative. Core inflation is expected to increase only by 1.1% in 2022. We expect the ECB to extend its asset purchase programs (via the APP or the PEPP) to maintain financial stability and ensure a smooth transmission of monetary policy.

Governments that initially put in place support measures to help companies maintaining their operating capacity and to prevent households from losing too much income, will, in a second phase, implement stimulus measures. Most of the 2021 deficit estimates for developed economies are likely to be revised upward in the coming months. We expect central banks to continue to absorb a large number of governments' extra issuance and to play a backstop role on corporate credit markets.

CENTRAL BANKS LIQUIDITY WATCH

ECB Press Conference 10 Sep. 2020: No change in monetary policy and negligible revisions to Sep. ECB staff projections

ECB interest rates unchanged – The Refi, marginal lending facility and deposit facility rates remain unchanged at 0.00%, 0.25% and -0.50% respectively.

Unconventional policy

- PEPP: With a total envelope of €1,350 billion, the purchases will continue in a flexible manner, across asset classes and among jurisdictions, until at least the end of June 2021, and in any case, until the ECB judges that the coronavirus crisis phase is over. The maturing principal payments from securities purchased will be reinvested until at least the end of 2022.
- APP: The purchases will continue at a monthly pace of €20bn, together with the purchases under the additional €120bn temporary envelope until the end of the year.
- TLTRO: The Governing Council will also continue to provide ample liquidity through its refinancing operations.

Economic Analysis

- Strong rebound in activity although well below the pre-Covid levels. September ECB staff projections foresee GDP at -8% in 2020 (revised up versus June) and are unchanged for 2021 and 2022. Staff projections for inflation are unchanged for 2020 and revised up for 2021 (versus June).

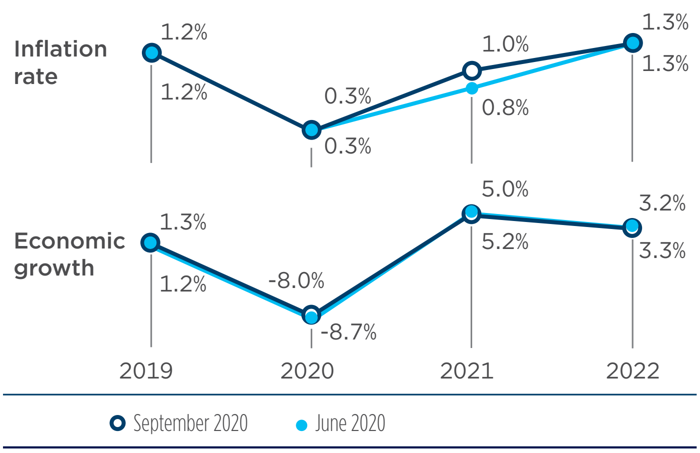
Conclusion: ECB adopted a “wait and see” stance after having deployed ample measures to support economic recovery and to preserve favourable financing conditions since COVID crisis. With persistently low inflation, asset purchase programs are here to stay.

“The balance of risks to remain on the downside. This assessment largely reflects the still uncertain economic and financial implications of the pandemic.”

Christine Lagarde

ECB staff macro-economic projections

Euro area, annual figures



Source: Amundi, ECB.

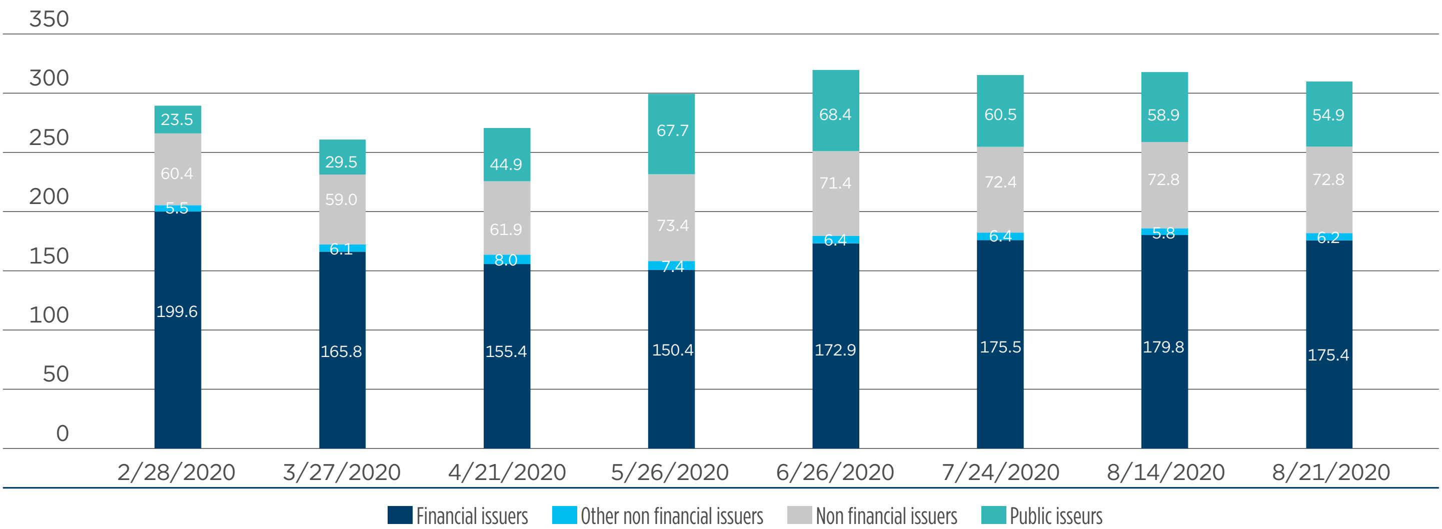
EURO SHORT TERM PRIMARY MARKET ACTIVITY

NEUCP MARKET

Evolution of the outstanding amount between February and August 2020 :

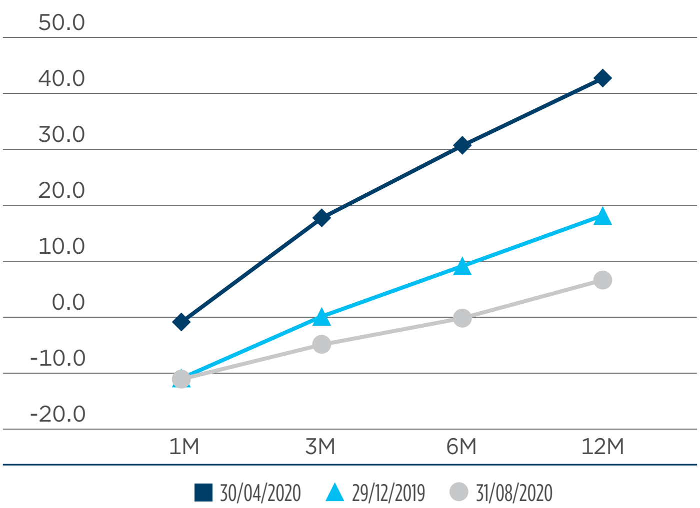
- The total issuance of NeuCPs - French negotiable debt securities – reached € 309Bn at the end of August (see graph below)
- Overall outstandings increased by 20 billion euros, mainly due to public issuers.
- The volume of bank issues fell by 24 billion euros.
- Corporate issuers' volume increased by 12.4 billion euros.

French market Evolution of NeuCP outstanding (in billion euros)



Source: Amundi, Banque de France. Data as of 30 June 2020.

Spread of Financial issuances (bp) French banks (Rated A1/P1)



Source: Amundi, Banque de France. Data as of 30 June 2020.

Market impact:
The excess liquidity in the euro system leads banks to lower their short-term borrowing rates.

- For the first time, the 3M Euribor rate is lower than the 3 M Eonia swap rate.
- The credit spreads on bank are narrowing, reaching record low (see graph on left)

MARKET SNAPSHOT AND KEY INDICATORS

MONEY MARKET

	SPOT	LOW	1Y RANGE	HIGH
EURO	bp			
EONIA*	**-47.1**	-47.2		-35.2
OIS 1 M*	**-47.0**	-57.0		-35.7
OIS 3 M*	**-47.5**	-60.0		-40.0
OIS 6 M*	**-48.9**	-62.7		-44.3
OIS 12 M*	**-51.8**	-67.1		-44.6
EURIBOR 3M	**-50.1**	-50.1		-16.1

	SPOT	LOW	1Y RANGE	HIGH
US	bp			
FedFunds*	**9**	4		242
OIS 1 M	**9**	4		234
OIS 3 M	**8**	4		217
OIS 6 M	**7**	4		203
OIS 12 M	**5**	1		187
ICE LIBOR USD 3M	**0.23**	0.23		2.34

	SPOT	LOW	1Y RANGE	HIGH
GBP	bp			
SONIA*	**5.5**	5.5		71.3
OIS 1 M*	**5.3**	5.3		71.1
OIS 3 M*	**4.6**	4.6		71.4
OIS 6 M*	**1.4**	1.4		69.9
OIS 12 M*	**-3.6**	-3.6		67.2
LIBOR 3M	**5.9**	5.9		81.5

FOREX MAJORS

	SPOT	LOW	1Y RANGE	HIGH
EUR/USD	**1.18**	1.07		1.19
EUR/GBP	**0.93**	0.83		0.94
EUR/JPY	**125.69**	114.54		126.41
GBP/USD	**1.28**	1.15		1.34
USD/JPY	**106.12**	102.36		112.10

GOV RELATED BONDS

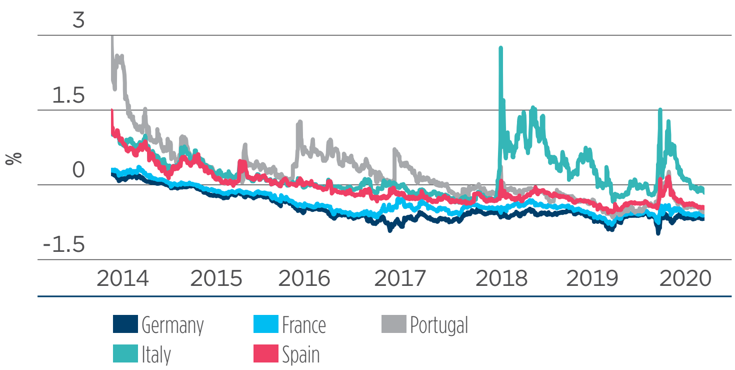
	SPOT	LOW	1Y RANGE	HIGH
Bunds	**%**			
2 Y	**-0.70**	-1.00		-0.58
5 Y	**-0.69**	-0.99		-0.41
10 Y	**-0.49**	-0.86		-0.16
30 Y	**-0.05**	-0.49		0.39
UK Govt. Bonds	**%**			
2 Y	**-0.11**	-0.13		0.63
5 Y	**-0.12**	-0.13		0.65
10 Y	**0.18**	0.08		0.87
30 Y	**0.75**	0.51		1.44

	SPOT	LOW	1Y RANGE	HIGH
US Govt. Bonds	**%**			
2 Y	**0.13**	0.11		1.91
5 Y	**0.27**	0.19		1.89
10 Y	**0.68**	0.51		2.14
30 Y	**1.43**	1.00		2.66
Japanese Govt. Bonds	**%**			
2 Y	**-0.13**	-0.34		-0.09
5 Y	**-0.11**	-0.38		-0.05
10 Y	**0.02**	-0.29		0.08
30 Y	**0.59**	0.11		0.65

Data as of 17 September 2020. *Data as of last tradable end of day

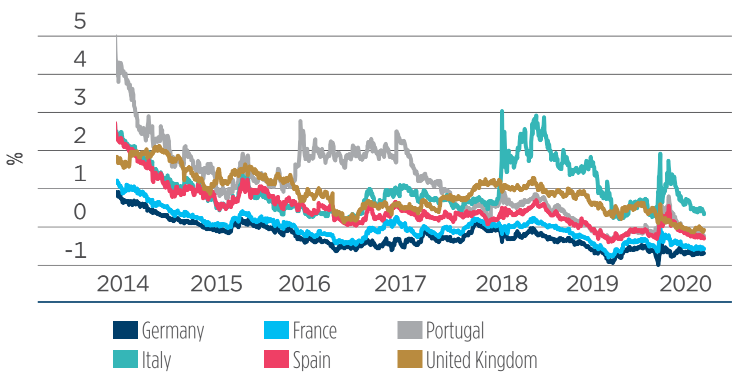
Spot

Sovereign 2 Years



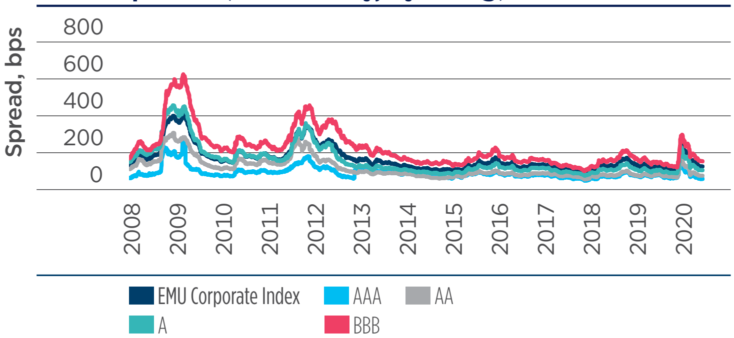
Source: Amundi, Bloomberg (16/09/2020)

Sovereign 5 Years



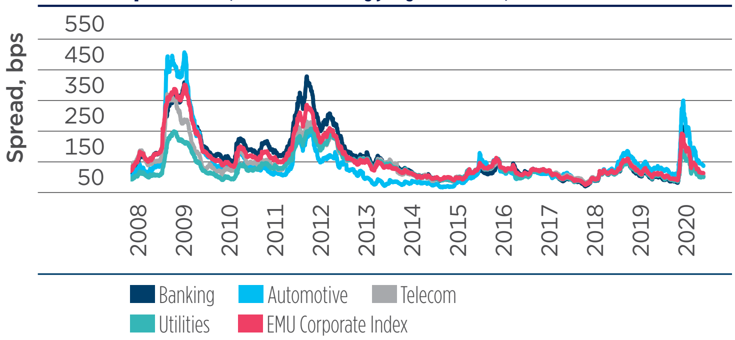
Source: Amundi, Bloomberg (16/09/2020)

Credit spreads (vs Germany, by rating)



Source: Amundi, BofA (16/09/2020)

Credit spreads (vs Germany, by sector)



Source: Amundi, BofA (16/09/2020)

MACROECONOMIC PICTURE BY AREA

DEVELOPED COUNTRIES

UNITED STATES

A resurgence of Covid-19 outbreak in several states in July and August led to increased caution in reopening the economy and slowing recovery momentum, even as labour market remains distressed. The US economy is expected to continue along a gradual and progressive recovery path, underpinned by easy monetary policy and a delayed new round of fiscal support. We expect quarterly growth to be supported by recovering domestic and external demand, although uncertainty from November elections may delay new investments. Inflation, which has been more volatile due to lockdown-induced distortions, will gradually return towards target, with temporary mild overshooting in mid-2021 due to energy base effects

EUROZONE

Economic activity recovered fast in the early stages of Q3, although new Covid-19 hotspots in several countries during July and August prompted a deceleration in high-frequency indicators of activity. As schemes to avoid massive layoffs are still in place, the unemployment rate did not surge to all-time highs, but it did increase nonetheless. Uncertainty linked to risks of new outbreaks may keep economic activity from returning to pre-crisis levels for several quarters, while we expect a gradual pickup in both domestic and external demand, supported by extraordinary easy monetary policy and counter-cyclical fiscal policies. Inflation will remain subdued in the near term, yet base effects and correction of lockdown-induced distortions will move inflation higher into 2021, but still below target.

JAPAN

The economy continues to bounce back from the Q2 dip, albeit at a slower pace entering August, amid a Covid-19 resurgence. Government has refrained from declaring another state of emergency, despite the fact that daily new cases far exceeded the previous peak. Having said that, the risk of recurring epidemic waves adds uncertainties to the recovery path, together with a worse-than-expected GDP performance in Q2. We are therefore downgrading our full year growth forecast. Inflation will remain soft in the rest of 2020, given a negative output gap.

UNITED KINGDOM

The UK continues to recover after the steep downturn of Q2. High frequency data confirm the ongoing rebound in summer, with consumption being particularly supportive as the country emerges from the lockdown. After rebounding in Q3, a progressive stabilisation from Q4 onwards is expected to materialise, supported by stronger domestic demand and recovering global trade. Yet, uncertainty from Brexit remains a key risk for 2021. The labour market remains under pressure, with a possible unemployment surge if furlough schemes (ending in October) are not extended. This outcome would make a new round of fiscal support more likely, together with some easing on the monetary front, later in the year.

EMERGING COUNTRIES

CHINA

Economic recovery continued in Q3, albeit at a slower pace sequentially. Momentum was uneven across sectors. The state-led stimulus boosted land sales, construction and related equipment sales, while manufacturing capex and private consumption lagged behind. Looking ahead, we expect growth to continue to normalize down in sequential terms, but the equivalent headline YoY growth will move higher. We expect headline CPI to resume its downtrend throughout the rest of the year. A meaningful pick-up in inflation is not expected until 2021.

INDONESIA

The easing of the lockdown has brought partial relief, as the pandemic continues to spread. MoF (Ministry of Finance) and Bank Indonesia (BI) have embarked on a burden-sharing scheme, with BI acting as a backstop for funding a very high deficit. In the past two months, monetary policy has been prudent with only 25 bps of easing, notwithstanding very subdued inflation (1.5% YoY), a narrow current account deficit and a huge output gap. The 2021 budget announced in mid-August, has slightly widened the fiscal deficit, which is expected to increase next year from 5.2% to 5.5% of GDP. As of today, the revenue shortage is being offset by a very timid fiscal disbursement.

TURKEY

In addition to the Covid-related economic slowdown, Turkey has been facing growing headwinds due to widening imbalances and rising geopolitical tensions. The credit-fuelled growth model has been accompanied by a widening current account deficit, capital outflows and a continued decline in international reserves, which has reached precarious levels. Given the lack of credible tightening on behalf of the central bank, the TRY has depreciated by almost 20% year to date -- among the worst performers in EMs. On August 20th, the central bank decided to hold the policy rate at 8.25% (headline CPI is running at above 10%), a decision which does not augur well for the TRY and Turkish assets.

BRAZIL

The economy is recovering robustly, except in services, thanks to the whatever it takes policy response of both monetary and fiscal nature – the latter totalled 9% of GDP – and normalising mobility thanks to better Covid dynamics. In fact, GDP is expected to shrink by about 5% and ‘only’ half of Mexico’s near double-digit contraction. The administration has some conflicting choices to make in the near future such as the spending-cap-compliant 2021 budget, which in-turn would weigh on growth and fiscal consolidation itself. There might be another option – trade a temporary breach of the cap in exchange for fiscal reform that would both support the recovery and improve the medium-term fiscal story.

AMUNDI'S RESEARCH FORECAST

Macroeconomic forecasts (31 August 2020)						
Annual average (%)	Real GDP growth (YoY%)			Inflation (CPI, YoY%)		
	2019	2020	2021	2019	2020	2021
US	2.3	(5.6)-(4.2)	3.0-4.0	1.8	1.3	1.8
Japan	1.2	(5.1)-(4.5)	2.1-2.7	0.7	0.1	0.3
Eurozone	1.2	(9.4)-(7.4)	4.2-6.2	1.2	0.4	1.4
Germany	0.6	(7.6)-(5.6)	2.6-4.6	1.5	0.7	1.5
France	1.2	(11.2)-(9.2)	6.0-8.0	1.3	0.5	1.2
Italy	0.3	(11.7)-(9.7)	4.1-6.1	0.7	0.1	1.1
Spain	2.0	(12.5)-(11.5)	7.5-8.5	0.7	0.1	1.2
UK	1.4	(11.5)-(10.5)	7.0-9.0	1.8	0.8	1.5
Brazil	1.1	(5.9)-(4.9)	3.7-4.7	3.7	2.7	3.0
Russia	1.3	(4.5)-(3.9)	2.5-4.5	4.5	3.2	3.8
India	4.9	(9.5)-(8.1)	7.6-8.9	3.7	6.4	5.9
Indonesia	5.0	(3.4)-(2.4)	2.9-3.9	2.8	2.1	2.8
China	6.2	1.8-2.4	7.9-8.5	2.9	2.7	2.0
Turkey	0.9	(5.1)-(4.1)	3.3-4.3	15.5	11.3	11.0
Developed countries	1.7	(7.2)-(5.8)	3.7-5.0	1.4	0.8	1.5
Emerging countries	4.0	(3.2)-(2.4)	5.5-6.5	4.1	3.7	3.6
World	3.1	(4.8)-(3.8)	4.8-5.9	3.0	2.6	2.8

Key interest rate outlook					
	28/08/20	Amundi + 6m.	Consensus Q1 2021	Amundi + 12m.	Consensus Q3 2021
US	0.13	0-0.25	0.08	0-0.25	0.08
Eurozone	(0.50)	(0.55)	(0.51)	(0.58)	(0.55)
Japan	(0.05)	(0.2)	(0.05)	(0.2)	(0.05)
UK	0.10	0.00	0.06	0.00	0.01

Long rate outlook

2Y. Bond yield					
	28/08/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward +12m.
US	0.19	0.25/0.50	0.22	0.25/0.50	0.25
Germany	-0.673	-0.70/-0.50	-0.72	-0.70/-0.50	-0.73
Japan	-0.142	-0.30/-0.20	-0.14	-0.30/-0.20	-0.15
UK	-0.044	0/0.25	-0.04	0/0.25	-0.02

10Y. Bond yield					
	28/08/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward +12m.
US	0.71	0.70/0.90	0.81	0.80/1.00	0.89
Germany	-0.41	-0.60/-0.40	-0.39	-0.50/-0.30	-0.35
Japan	0.02	-0.10/0.10	0.07	0.00/0.20	0.11
UK	0.24	0.20/0.40	0.29	0.30/0.50	0.36

Currency outlook					
	31/08/2020	Amundi Q4 2020	Consensus Q4 2020	Amundi Q2 2021	Consensus Q2 2021
EUR/USD	1.194	1.16	1.180	1.196	1.200
USD/JPY	106	105	106	105	105
EUR/GBP	0.89	0.91	0.91	0.91	0.91
EUR/CHF	1.08	1.07	1.08	1.11	1.09
EUR/NOK	10.41	9.97	10.50	10.21	10.30
EUR/SEK	10.32	9.77	10.40	9.97	10.30
USD/CAD	1.30	1.32	1.33	1.29	1.33
AUD/USD	0.74	0.75	0.71	0.75	0.72
NZD/USD	0.67	0.66	0.65	0.67	0.67
USD/CNY	6.85	7.00	6.99	6.90	6.90

CONTRIBUTORS

Editors

Thierry Ancona – Co-Head Treasury Business line

Thierry Darmon - Co-Head of Treasury Business Line

Deputy –Editors

Patrick Siméon - Head of Money Market Funds

Patrick Carletto - Deputy Head of Money Market Funds

Nathalie Coffre - Head of Short Term Solutions

Estelle Honthaas – Portfolio Manager Short Term Solutions

Pierre Genest - Corporate sales- Business development

Caroline Rochas - Euro Fixed-Income Product Specialist

Denis Duong – Euro Fixed-Income Product Specialist

Amundi Asset Management, French „société par actions simplifiée" - SAS with a registered capital of €1,086,262,605 and approved by the French Securities Regulator (Autorité des Marchés Financiers-AMF) under number GP 04000036 as a portfolio management company - 90 boulevard Pasteur -75015 Paris- France - 437 574 452 RCS Paris. - www.amundi.com