May / June 2019

TREASURY LETTER

Focusing on institutional and corporate investor needs for liquidity solutions

Confidence must be earned

Amundi ASSET MANAGEMENT

Patrick SIMEON
Head of Money Market Management
Amundi AM

2019, year of transition, what transition?

In 2018, everyone expected 2019 to be a year of change in the ECB's unconventional policy, leading to a normalization of its official rates.

We have once again the confirmation that those who were hoping for a rate increase will be disappointed this year. Mr Draghi confirmed during the ECB meeting held on 6 June in Vilnius that the forward guidance have been changed from "through the end of 2019" to "through the first half of 2020".

While everyone's attention was focused on this press conference, information published at the end of May went almost unnoticed. Yet, it will allow market participants to implement an orderly transition to the new risk-free rate, the €STR, next October. The €STR will be published from the 2nd of October 2019 and will coexist with the recalibrated Eonia, whose level will mechanically derive from the €STR plus a fixed spread that the ECB has just determined at 8.5 basis points.

This smooth transition should give time to participants to prepare for the announced termination of the Eonia by the end of 2021, due to the impossibility for this benchmark to comply with the Benchmark Regulation (BMR) constraints.

However it remains to be determined what implications this October transition has for computer systems, performances calculations or legal contracts relating to overnight indexed transactions. **Wake up, the clock is ticking.**

CONTENTS

CENTRAL BANKS LIQUIDITY WATCH

Central Banks Key interest rates	
ECB	
Main Refinancing rate	0.00%
Deposit rate	-0.40%
Marginal Lending rate	0.25%
Next ECB decision	25 July 2019

ECB Meeting 6 June 2019: ECB pushed back again the Key rate hike

Monetary Policy decisions:

ECB key rates unchanged: Refi, marginal lending facility and deposit facility rates will remain unchanged at 0.00%, 0.25% and -0.40% respectively.
The forward guidance has been changed from "through the end of 2019" to **"through the first half of 2020"**. Mario Draghi confirmed during the press conference that members of the Council raised the possibility of rate cuts, others restarting the APP. **The ECB will not increase - or cut - rates before at least mid-2020.**

Non-conventional Monetary Policy Stimulus:

The ECB will continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time to maintain favourable liquidity conditions.

Modalities of the TLTRO-III: A new series of quarterly refinancing operations will be launched starting in September 2019, each with a maturity of two years. The rate in each operation will be set at a level of 10 bp above the average rate applied in Refi operations over life of respective TLTRO (i.e. 10 basis point).

> ***The risks surrounding the euro area growth outlook are still tilted to the downside, on account of the persistence of uncertainties related to geopolitical factors, the threat of protectionism and vulnerabilities in emerging markets***

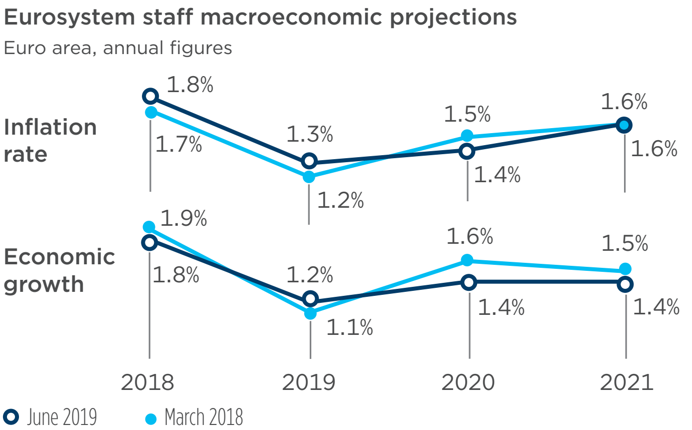
> ***The Governing Council stands ready to act and use – as I've said many times – all the instruments that are in the toolbox***

For bank exceeding a certain lending benchmark, the rate applied will be as low as average Deposit rate +10 bp (i.e. -30 bp). For comparison, under TLTRO-II the rate could be as low as the Deposit rate (i.e.-40bp).

Economic Analysis and outlook

Euro area real GDP rose by +0.4% over Q1 2019. However, the ongoing weakness in international trade in an environment of prolonged global uncertainties are weighing on the euro area manufacturing sector. At the same time, the euro zone services and construction sectors are showing resilience and the labour market is continuing to improve.
According to Eurostat's flash estimate, euro area annual HICP inflation was **1.2% in May 2019**, after 1.7% in January, reflecting lower energy and service price inflation.

June 2019 Quarterly ECB Projections



Source: ECB, Bloomberg data as of 06/06/2019
https://www.ecb.europa.eu/press/pressconf/2019/html/ecb.is190606~32b6221806.en.html

Focus of the month: EU Market Fund Reform

On 21st Jan 2019, the European MM Fund reform applies to existing money market funds.

EU MONEY MARKET FUND REFORM IN SHORT

	Public Debt CNAV	LVNAV	Short Term VNAV	Standard VNAV
ELIGIBLE INVESTMENTS	99.5% Government asset cash or reverse repo	Money market instruments, ABCP, instantly accessible deposits, reverse repo, MMFs (provided no circularity), currency and interest derivatives (for hedging purposes only)		
MIN DAILY LIQUIDITY	10%	10%	7.5%	7.5%
MIN WEEKLY LIQUIDITY	30%	30%	15%	15%
MATURITY MAX	397 days	397 days	397 days	2 years
MAX WAM	60 days	60 days	60 days	180 days
MAX WAL	120 days	120 days	120 days	12 months
CREDIT QUALITY	Based on internal credit quality assessment Credit Rating Agency ratings as inputs to internal assessment only, among others			
VALUATION	Amortised cost.	– Amortised cost for instruments < 75 days – Mark-to-market for instruments >75 days	Mark-to-market / mark-to-model only	
NAV	2 decimals	– CNAV rounded to 2 decimals – Move to 4 decimal V-NAV when MtM NAV valuation gap >20bp	VNAV rounded to 4 decimals	
LIQUIDITY FEES & GATES	– Discretionary fees / temporary gates if weekly liquidity < 30% & daily net redemptions > 10% – Mandatory fees / temporary gates if weekly liquid <10% – If suspension of redemptions exceeds 15 days over 90 consecutive days, move to V-NAV.		Non Applicable	

WHAT'S CHANGING?

VNAV (Variable NAV) FUNDS

Short term and Standard Money Market Funds keep an unchanged VNAV structure

LNAV (Low volatility NAV) FUNDS

A new classification designed to address any risk of run

- Subject to liquidity fees and redemption gates which could lead LVNAV portfolio managers to increase liquidity buckets well above 10/30% to mitigate their mandatory implementation.
- Subject to being moved into VNAV if reaching the mark-to-market gap of 20 bp which could lead LVNAV portfolio managers to limit investment maturities under 75 days.
- Impacted by the ban of the "Reverse Distribution Mechanism": According to the European Commission the RDM, the operational mechanism intended to isolate 'negative yields' is incompatible with the new regulation.

AN OPPORTUNITY TO RETHINK YOUR INVESTMENT POLICY

TIME TO SWITCH TO VNAV FUNDS

- VNAV Funds aiming capital preservation objective given the prevailing rates, offer daily liquidity with D+0 settlement and are not subject to liquidity fees nor gates.
- Credit Quality: High quality investment only based on our longstanding capacity to perform a recognized internal credit quality assessment.
- Risk Management: Being one of the world leaders in asset management sets very high standards. These standards are reflected in our unwavering search of investment security.
- Those funds abide an EU level I regulation which forbids any leverage.
- Recognized as Cash Equivalent by Accounting Authorities.

EURO SHORT TERM PRIMARY MARKET ACTIVITY

Decline of activity on the short-term primary market at the beginning of the year

Over Q1 2019, the activity on the short-term primary market in euros remained weak. The volume issued reached €13Bn, including 6.7Bn in Financial debt and 6.3Bn in Corporate debt, lower than the amount issued in 2018 over the same period (€16.7Bn). This amount can also be compared to the €21.4Bn issued over Q1 2017: these issues matured in Jan-March 2019, so only part of them were renewed.

Active primary market on longer maturities

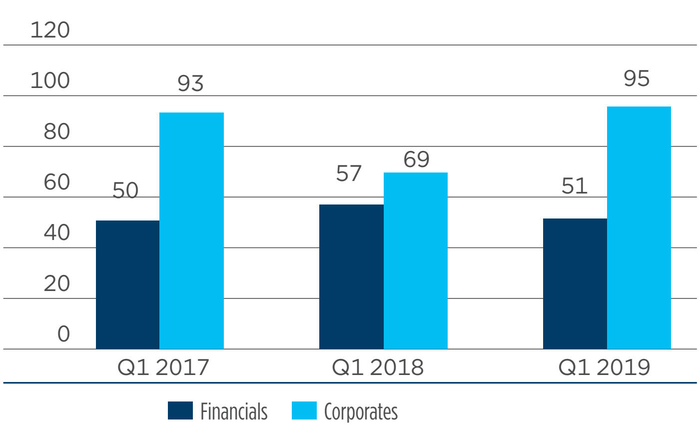
Over Q1 2019, the volume of issuances was higher than in previous years with €147Bn issued for both Financials and Corporate. The observed figures therefore illustrate a shift from shorter issues to longer maturities.

This trend can be explained by various factors:

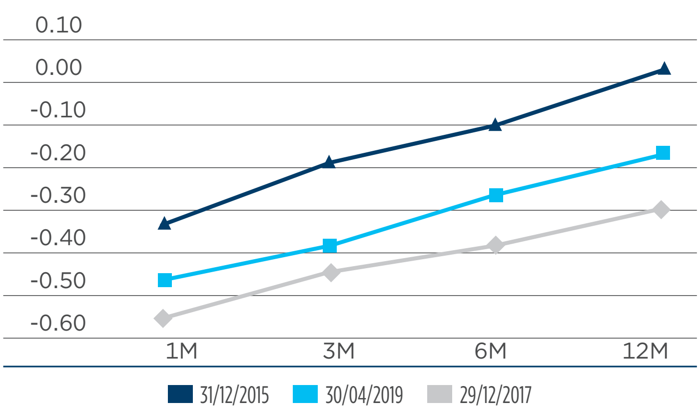
- The long-lasting environment of ultra-low rates: Investors are then keen to take advantage of low interest rates to issue on long maturities.
- The new series of TLTRO announced at the March 7th ECB meeting, and widely anticipated by the market, offers an interesting funding alternative for banks with maturities of less than 2 years.
- The regulatory context (Basel III) that encourages banks to finance themselves in the longer term.

In this context, the yields of Banks remain below the ECB deposit rate (-40 bp) below 3-Month maturities.

Euro Primary Market All Maturities (IG private issuers) in EUR Billion

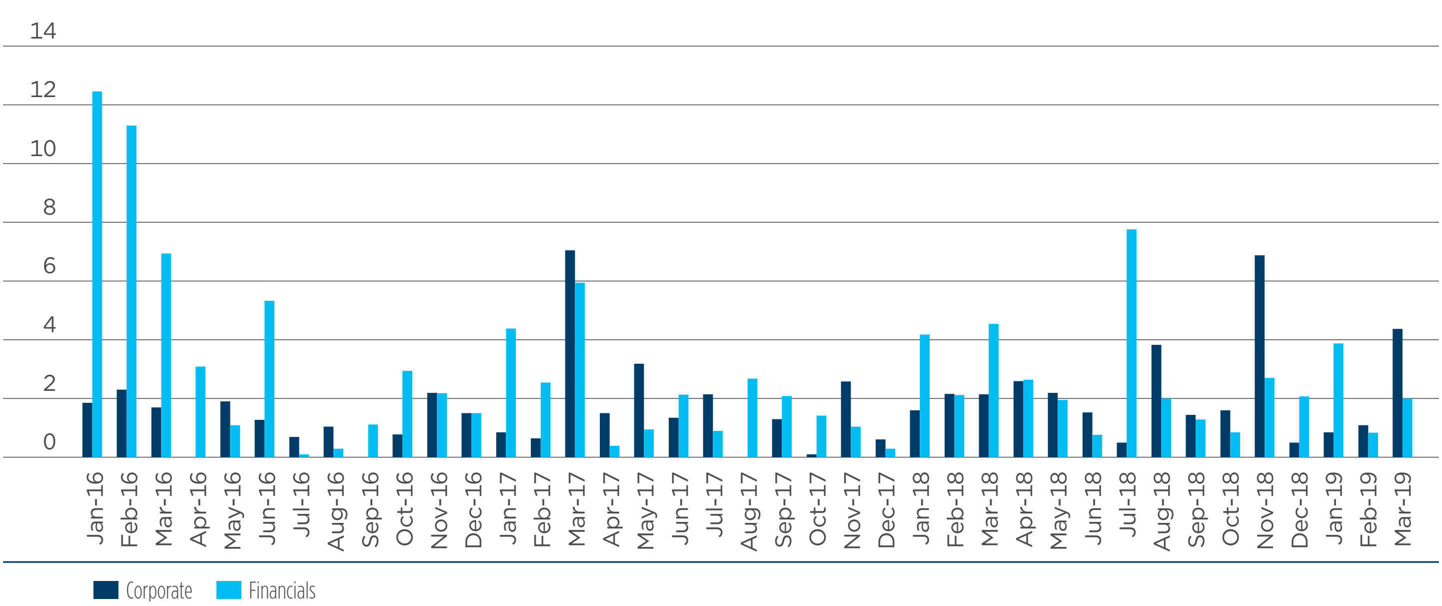


Yield (%) of Financial issuances (NEU CP)



Source: Amundi Trading Desk as of 30/04/2019.
Illustration with French Banks rated A1/P1

Euro Short Term Primary market (<2 years, >€100 million, IG private issuers, unsecured issuance) in EUR Billion



Source: Amundi Investment Management, Bloomberg. Data as 31/03/2019. IG issuers, below 2 years except govies and quasi-govies.

MARKET SNAPSHOT AND KEY INDICATORS

MONEY MARKET

	SPOT	LOW	1M RANGE	HIGH
EURO	bp			
EONIA*	**-35.9**	-37.2		-35.6
OIS 1 M*	**-36.6**	-36.7		-36.4
OIS 3 M*	**-36.8**	-36.8		-36.4
OIS 6 M*	**-38.0**	-38.0		-36.5
OIS 12 M*	**-40.1**	-40.1		-36.7
EURIBOR 3M	**-32.2**	-32.2		-30.8

	SPOT	LOW	1M RANGE	HIGH
US	bp			
FedFunds*	**240**	238		245
OIS 1 M	**237**	237		240
OIS 3 M	**233**	233		240
OIS 6 M	**223**	223		238
OIS 12 M	**201**	201		233
ICE LIBOR USD 3M	**2.50**	2.50		2.58

	SPOT	LOW	1M RANGE	HIGH
GBP	bp			
SONIA*	**70.8**	70.7		71.1
OIS 1 M*	**70.9**	70.9		71.3
OIS 3 M*	**70.8**	70.8		71.5
OIS 6 M*	**70.4**	70.1		74.1
OIS 12 M*	**69.0**	69.0		78.7
LIBOR 3M	**79.6**	79.4		81.9

FOREX MAJORS

	SPOT	LOW	1M RANGE	HIGH
EUR/USD	**1.1169**	1.1129		1.1233
EUR/GBP	**0.8841**	0.8502		0.8841
EUR/JPY	**120.9600**	120.9600		124.7600
GBP/USD	**1.2629**	1.2608		1.3173
USD/JPY	**108.2900**	108.2900		111.5100

GOV RELATED BONDS

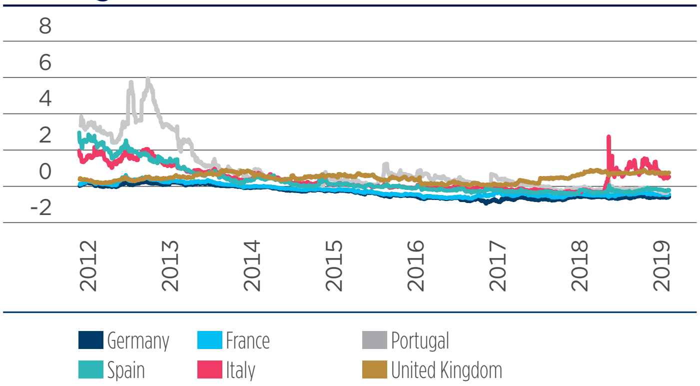
	SPOT	LOW	1M RANGE	HIGH
Bunds	%			
2 Y	**-0.66**	-0.66		-0.58
5 Y	**-0.58**	-0.58		-0.41
10 Y	**-0.20**	-0.20		0.03
30 Y	**0.43**	0.43		0.68
UK Govt. Bonds	%			
2 Y	**0.60**	0.60		0.80
5 Y	**0.64**	0.64		0.95
10 Y	**0.89**	0.89		1.22
30 Y	**1.47**	1.47		1.74

	SPOT	LOW	1M RANGE	HIGH
US Govt. Bonds	%			
2 Y	**1.92**	1.92		2.34
5 Y	**1.91**	1.91		2.35
10 Y	**2.12**	2.12		2.54
30 Y	**2.57**	2.57		2.93
Japanese Govt. Bonds	%			
2 Y	**-0.17**	-0.17		-0.15
5 Y	**-0.19**	-0.19		-0.16
10 Y	**-0.09**	-0.09		-0.04
30 Y	**0.46**	0.46		0.57

Data as of 31/05/2019.(Lookback: 1 year (365 days))*Data as of last tradable end of day

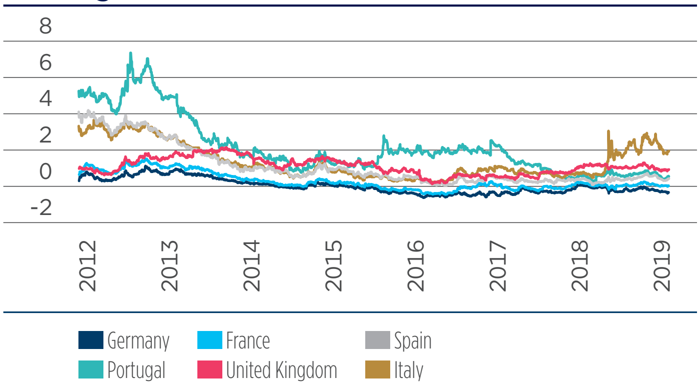
Spot

Sovereign 2 Years



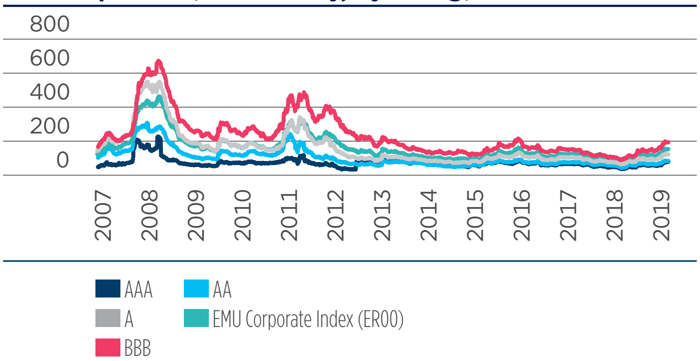
Source: Amundi, Merrill Lynch (30/05/2019)

Sovereign 5 Years



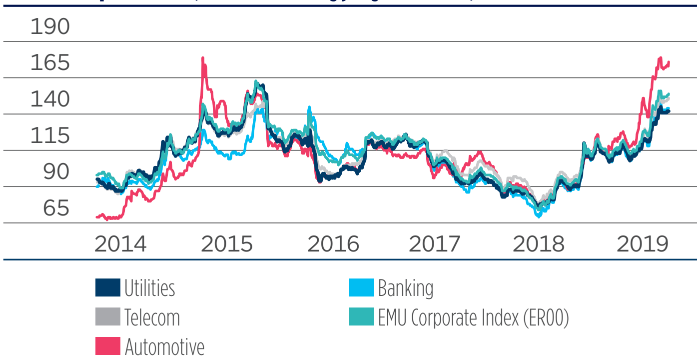
Source: Amundi, Merrill Lynch (30/05/2019)

Credit spreads (vs Germany, by rating)



Source: Amundi, Merrill Lynch (30/05/2019)

Credit spreads (vs Germany, by sector)



Source: Amundi, Merrill Lynch (30/05/2019)

MACROECONOMIC PICTURE BY AREA

Americas

UNITED STATES

Normalisation progresses

- As the fiscal boost fades, key drivers of domestic demand are slowing progressively and getting closer to long-term trends gradually, as monetary policy and financial conditions smooth and accompany this normalisation.
- US consumers remain upbeat in general. Still-dynamic labour demand and wage growth, coupled with contained inflationary pressures, support resiliency in personal consumption, which is expected to be the main driver of domestic demand.
- Business confidence has moderated appreciably compared to last year among small and larger businesses, and this reflects a moderation in capex intentions and investments, which anyhow remain in line with our outlook.
- Moderate domestic and external inflationary pressures are keeping both core and headline CPI in check and somewhat subdued, composing a benign inflation outlook. The Federal Reserve is not expected to deliver further rate hikes this year, will end QT, and will remain alert o any changes in financial conditions, economic outlook and inflation dynamics.

Risk Factor

- Tariffs risks may negatively impact economic performance, both directly (in prices and orders) and indirectly (in confidence)
- Renewed policy uncertainty may hold back new capex plans more than expected
- Geopolitical risks (Iran, Venezuela) could represent an upside risk to oil prices and our inflation outlook

LATAM

- Mexico and Brazil continue to experience two soft patches in terms of economic growth. However, differently from each other. Mexico is expected to decelerate in 2019 versus 2018 while Brazil is expected to slightly accelerate.
- On the inflation front, the overall environment remains benign. In March, Mexican inflation went back up to 4% from the 3.9% previously published (Banxico target range is 2%-4%). In Brazil, inflation jumped to 4.6% YoY from 3.9%.
- The region's main central banks left their monetary policy rates unchanged. We see Banxico starting the easing process if the domestic policy uncertainty reduces.
- In Brazil, the new president and his economic team decided to present a very bold pension reform plan to Congress. The first vote by the Constitution and Justice Committee in the lower house is scheduled to take place by April but will probably be further delayed.

Risk Factor

- Overall poor Q1 GDP figures released so far
- Inflation is benign overall, but higher than wanted in Mexico and Argentina
- BCRA makes the no-intervention zone more flexible
- Brazilian President Bolsonaro's popularity is sliding

Europe

EUROZONE

A gradual improvement expected despite considerable risks

- After a highly disappointing 2018, figures have so far been mixed in 2019. However, while most of the difficulties involve export-intensive (manufacturing) sectors, the job market is holding up well and is likely to support consumption and services. We expect a gradual improvement during the rest of 2019.
- The risk of a no-deal Brexit has become less imminent, but there is still the threat of US trade measures against Europe. Moreover, there are still some considerable political uncertainties, particularly the upcoming European elections and the situation in Italy.

Risk Factor

- Stronger political protest movements
- External risks (trade war, slowdown in the US and China)

UNITED KINGDOM

Major uncertainty as Brexit approaches

- Brexit is undermining confidence and investment. The United Kingdom has won an additional Brexit extension from the European Union (till 31 October), but the domestic political situation could be volatile in the coming months. The UK's participation in European elections could generate tensions, and a change of government, new elections or the holding of a new referendum are all possible scenarios.
- Despite political uncertainties, the job market remains strong, and wages are increasing in real terms, driven by the receding in inflation.

Risk Factor

- "No Deal Brexit"
- The current account deficit remains very high

Source: Amundi Research. As of June 2019.

Asia

JAPAN

Fiscal policy and private demand will eclipse tainted export landscape

- Exports in general have weakened, with exports to China (22% of total exports) plunging due to US bans on the China-made products. Meanwhile, demand from the US and Europe remains healthy.
- In contrast, domestic demand is supported by steady income growth and companies' aspirations to cope with the labour shortage. Global uncertainties appear to be dragging down corporate morale. Yet capex is likely to simply slow its ascent rather than decrease. Moreover, public investment in light of rebuilding in disaster-affected areas should mitigate contagion of the trade dispute.
- As a consequence, inventory adjustment has finally come to an end. The decline in imported oil prices will improve companies' terms of trade, while a sharp mark-down in mobile communication charges scheduled for April will encourage spending in other areas.

- Capital spending plan for this year is subject to reduction
- Companies may stop, downsize or postpone business investment on anaemic corporate earnings and the escalating US-China trade dispute

CHINA

- Economic activity recovered some strength after a poor performance ahead of the Chinese New Year. With policy gradually taking effect, growth seems to be near bottom. Credit growth is bottoming out, while fiscal spending has been accelerating.
- Already, local orders are recovering, as PMI data implied. The latest data also suggested that the auto and smartphone sectors, which were major drags in H2 2018, are past the worst time.
- The property sector is holding up better than expected and the slowdown ahead could be manageable, with further relaxation of Hukou and policy easing at a local level.
- Meanwhile, exports in the region have avoided another sharp slowdown for now, after a bad Q4.
- The RMB is seeing slight upward pressures, helped by a resilient growth outlook and a dovish Fed.
- US/China trade negotiations showed further positive progress, with possible results in the next few weeks.

- Uncertainty in US/China trade relationship
- Policy mistakes in managing near-term risks and the structural transition
- Geopolitical noise regarding North Korea

Source: Amundi Research. As of June 2019.

AMUNDI'S RESEARCH FORECAST

Macroeconomic forecasts (16 May 2019)

Annual average (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	2.9	2.4	2.0	2.4	2.0	2.4
Japan	0.8	0.9	0.7	1.0	0.9	1.3
Eurozone	1.8	1.0	1.5	1.8	1.2	1.5
Germany	1.4	0.8	1.5	1.7	1.5	1.5
France	1.5	1.3	1.5	2.1	1.3	1.5
Italy	0.8	0.1	0.6	1.1	1.0	1.5
Spain	2.5	2.0	1.8	1.7	1.6	1.9
UK	1.4	1.1	1.4	2.4	2.2	2.2
Brazil	1.1	1.9	2.3	3.7	4.3	4.7
Russia	2.2	1.5	1.7	2.9	4.8	4.0
India	7.4	6.0	7.0	4.0	3.4	4.6
Indonesia	5.2	5.0	5.3	3.2	3.5	4.2
China	6.6	6.2	6.1	2.1	2.2	2.5
Turkey	2.9	-1.5	1.5	16.2	15.6	12.9
Developed countries	2.2	1.7	1.7	2.0	1.6	2.0
Emerging countries	4.9	4.4	4.8	4.0	3.9	3.9
World	3.8	3.3	3.6	3.2	3.0	3.1

Key interest rate outlook

	24/05/2019	Amundi + 6m.	Consensus Q2 2019	Amundi + 12m.	Consensus Q4 2019
US	2.250	2.50	2.50	2.50	2.50
Eurozone	0.00	0.00	0.00	0.00	0.00
Japan	-0.10	-0.10	0.00	-0.10	-0.10
UK	0.75	0.75	0.75	1.00	1.00

Long rate outlook

2Y. Bond yield

	30/05/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward +12m.
US	2.16	2.20/2.40	2.05	2.20/2.40	1.99
Germany	-0.63	-0.60/-0.40	-0.67	-0.60/-0.40	-0.66
Japan	-0.15	-0.20/0.00	-0.17	-0.20/0.00	-0.18
UK	0.66	0.60/0.80	0.61	0.70/0.90	0.62

10Y. Bond yield

	30/05/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward +12m.
US	2.32	2.40/2.60	2.35	2.40/2.60	2.39
Germany	-0.12	0.05/0.20	-0.02	0.05/0.20	0.05
Japan	-0.07	0.00/0.10	-0.03	0.00/0.10	0.01
UK	0.97	1.10/1.30	1.05	1.15/1.35	1.10

Currency outlook

	30/05/2019	Amundi + 6m.	Consensus Q2 2019	Amundi + 12m.	Consensus Q4 2019
EUR/USD	1.12	1.13	1.14	1.17	1.17
USD/JPY	110	109	110	107	108
EUR/GBP	0.89	0.87	0.86	0.86	0.85
EUR/CHF	1.12	1.14	1.13	1.15	1.15
EUR/NOK	9.80	9.40	9.54	9.30	9.43
EUR/SEK	10.75	10.40	10.50	10.20	10.35
USD/CAD	1.35	1.32	1.32	1.30	1.31
AUD/USD	0.69	0.70	0.72	0.69	0.74
NZD/USD	0.65	0.66	0.67	0.66	0.68
GBP/USD	6.91	6.70	6.72	6.70	6.70

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

Lise Bardin-Berenger - Corporate Sales - GRM

Caroline Rochas - Euro Fixed-Income Product Specialist

Marion Pouget – 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. "http://www.amundi.com" www.amundi.com