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Amundi ASSET MANAGEMENT

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INVESTMENT TALKS

ECB: dovish tone and calm markets - but flexibility needed with volatility ahead

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"The ECB is still assessing the nature of the recent deterioration of the economic surveys; it seems likely that it will wait until July to clarify its monetary strategy."

KEY INSIGHTS:

- ***ECB tone:*** *The overall stance is still broadly accommodative and aims to confirm the consensus view. It is reasonable to expect a gradual tapering of the Asset Purchase Programme (APP) in Q4 and the first rate hike in mid-2019. However, the ECB still questions the reading of the recent deterioration seen in the surveys: it seems likely that it could wait until July to clarify its monetary strategy.*
- ***Economy and risks:*** *As expected, President Draghi did not talk-down the economy but, instead, took the opportunity to stress that real GDP growth outlook, despite signs of moderation in Q1, is still solid and broader based in terms of engines of growth. While the risks to growth are still considered balanced, the "global risks" - in particular the rise in protectionist tensions - have become prominent.*
- ***Investment strategy****: Carry is still the 'name of the game' to generate value in Euro fixed income (as the recent slowdown in growth does not call for a faster change in current monetary policy) at least until the next meeting. High flexibility applied to portfolio management is a must, in our view, to benefit from the expected volatility that will arise when ECB delivers a clearer message on what will come next. On global credit, different phases in the cycle call for actively playing sector divergences in Europe and the US. In Europe, we are cautious on industrials and prefer financials, while in the US is the opposite: we prefer industrials, energy and TMT, but we are less keen on financials.*

What are your main takeaways from the ECB policy meeting?

D. Borowski: As expected, the ECB has not changed its monetary policy. President Draghi's press conference was, as usual, eagerly awaited, particularly in view of the recent deterioration of business and confidence surveys. Mario Draghi was reassuring about the ongoing recovery. This deterioration is explained by temporary factors (weather conditions, strikes, protectionist risk, etc.) and also reflects, to some extent, a kind of normalisation after a year of strong growth (2.4% in 2017, the highest growth since 2007). Core inflation remains subdued, but the economic outlook is supportive and the ECB continues to expect a gradual rise in inflation. That said, the ECB remains cautious. While the risks to growth are still considered balanced, the "global risks" - in particular the rise in protectionist tensions – have become prominent. Consequently, the tone is slightly more accommodative than at the last monetary policy committee. But this "*caution is tempered by unchanged confidence that inflation will converge in the medium term towards its target of 2%*". To achieve this result, the ECB must maintain a high degree of monetary accommodation. On this point the ECB communication is unchanged.

Do you see the recent softening of macro momentum affecting the ECB policy going forward?

D.Borowski: ECB policy willdepend on the nature of recent developments. If the ECB's diagnosis is correct, it is reasonable to expect a gradual tapering of the Asset Purchase Programme (APP) in Q4 and a first rate hike in mid-2019. Today, this is the consensus view. That said, Mario Draghi revealed that the monetary policy outlook was not discussed at this committee. This is unusual and inevitably raised a question. In fact, the ECB still questions the reading of the recent deterioration seen in the surveys. Is it linked to temporary or permanent factors? Is it due to supply constraints or to a slowdown in demand? Should potential growth be revised higher?
In other words, the ECB makes a diagnosis but has still no clear-cut answers to these questions, and thus needs some time to confirm its diagnosis. Against this backdrop, it seems likely that the ECB will wait until July to clarify its monetary strategy.

On the one hand, the ECB's communication was calibrated to reinforce the consensus view. But on the other hand, it was probably also calibrated to open the door to an extension of the APP if needed (i.e. if the slowdown is more than a soft patch).

What is your outlook for the Euro in light of recent economic development?

S. DiSilvio. EUR/USD still has room for appreciation. The Eurozone's macro backdrop remains one of growth above potential, with the ECB on the path of continuing to reduce monetary policy accommodation, albeit at a very gradual pace. Currency valuation is favourable as Amundi's fair value for EUR/USD stands at 1.28, level that we also target over a 12 months horizon. Triggers for a shift higher of the currency (from the current 1.20-1.25 to 1.25-1.30 range) are very much reliant on Eurozone's macro data. The recent softening on PMI indicators and industrial production has raised some concerns that the economic activity might be showing early signs of a slowdown. We think this is not the case and we tend to see such a softening on macro data as temporary. Next core CPI readings will be key in assessing market's expectations on the next moves of the European Central Bank, and on the Euro.

Do you see a re-acceleration of asynchronies among major DM Central Banks or are all still on track in the "normalization" path?

E. Brard/L. Crosnier: We do not see the global growth pickup becoming asynchronous, and therefore we are seeing only limited tactical opportunities from changing perceptions of monetary policy stances. As the IMF recently re-confirmed, global expansion remains on track and is being driven by all regions. Central banks in all the major countries are, therefore, from their different starting points, set on the path to normalization. From time to time, one or other may appear to slow or accelerate, but the underlying dynamic remains of steady removal of accommodation.

"Value for European fixed income investors will primarily come from credit, peripheral countries holdings rather than from duration".

From a European investment perspective, where is it possible to generate value for investors?

E.Brard/MA. Allier: April ECB meeting did not bring any new element, but only confirmed the mantra of President Draghi: confidence, patience, persistence and prudence are the key words of ECB communication. Preliminary conclusion calls for no reason to change our previous views on European fixed income markets. Carry is still the 'name of the game' (as the recent slowdown in growth does not call for a faster change in current monetary policy) at least until the next meeting in June. Value will therefore be drawn from credit exposure, peripheral countries holdings rather than from duration. However, high flexibility applied to portfolio management is a must, in our view, so as to benefit from the expected volatility that will undoubtedly arise when ECB delivers a clearer message on what will come next.

"On global credit, different phases in the cycle call for actively playing sector divergences in Europe and US."

On global credit what are the opportunities and risks now in the market?

E. Brard/L. Crosnier: For most market participants, ECB President Draghi's press conference was a non-event. Our views remain unchanged: We believe we should observe more re-leveraging in Europe as we expect companies to make the most of the historically low interest rates before the ECB begins to normalize and raise rates. As a direct consequence, we remain cautious on corporates and industrials segments (also considering that the corporate sector purchasing programme will come to an end), mostly long dated and hybrids, but favour financials.

In the US, our stance is the opposite, we prefer industrials as we expect deleveraging. We are also positive on energy and TMT but less keen on financials (especially versus our stance in European financials). And, differently to Europe, in the US we would favour the back end of the curve. The Sterling market, particularly the long end, appears attractive but not compensating enough given the lower liquidity. Finally, selected opportunities may be found in EM corporates.

Important Information

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