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**Amundi**

ASSET MANAGEMENT

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# Why Catalonia crisis should not trigger a market risk-off

INVESTMENT TALKS



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## **What is your reading of recent evolution of Catalonia crisis? Do you see a Catalonia secession a true possibility going forward and what could be the implications?**

**TP:** We continue to firmly believe that Catalan independence will not happen. There are multiple reasons to believe this. In the first place the Spanish central government and most Spanish political parties remain categorically opposed. The second reason is that the Catalan pro-independence government does not have the practical means to impose the secession. In addition to these, pro-independence supporters in Catalonia fall short of an outright majority of the population and finally there is little scope for the Catalan pro-independence camp to gather any significant external support (EMU countries and institutions stand firmly behind the Spanish government). Moreover, the recent announcements by a number of large companies that they would or could leave Catalonia has also shown that independence would probably cause a major economic shock. However, if we were wrong and Catalonia became independent, the implications for the rest of Western Europe would be massive (as it would have created a precedent for other pro-secession movements in countries like Belgium, the UK and even Italy and France).

## **What do you envisage for Spain going forward? What are the key things to watch in the next few weeks?**

**TP:** The standoff between the regional and national governments will continue in the coming days. A key point will be how the regional government answers the central government's request for a clarification on whether independence has been formally declared or not. Then, depending on the answer (which could be, again, ambiguous) the Spanish government will have to decide whether to trigger article 155 of the Constitution (direct administration of Catalonia), although this could also be done partly or gradually to avoid giving a counter-productive impression of brutality in public opinion. It will also be important to watch to what extent other Spanish mainstream political parties support the central government's actions, and, perhaps first and foremost, whether new cracks appear within the Catalan pro-independence camp. As the crisis lasts and the perception of potential economic damage increases, the pressure will rise to defuse the crisis through negotiations. In our view, this will ultimately happen, with the Catalan camp making most of the concessions (i.e. full independence will be off the table).

## **Due to recent events and evolutions, do you see the risk of resurgence of anti-Euro force in other regions of the Eurozone?**

**TP:** Most of the Catalan pro-independence movement is not anti-Euro. On the contrary they intend to join the Eurozone or rather, if it were possible, simply stay in it as a new member state. However, should the Spanish central government (that has no majority in Parliament) make major mistakes in its handling of the crisis and lose the passive support of other parties, early elections in Spain itself could become necessary. Depending on the exact circumstances, this situation could lead to a new push of anti-establishment parties, notably Podemos, in the country. More generally, despite the results of the Dutch and French elections in the first semester, protest forces (of various political inspirations depending on the country) are here to stay in the Eurozone. It would be foolish to conclude that they will naturally disappear, or become decisively weaker, with the economic recovery. Just look at the English-speaking countries: D. Trump was elected and Brexiters won even though economic recoveries were robust and unemployment rates at record lows.

## **Do you think that the Catalonia crisis will trigger a risk off sentiment in the market?**

**FS:** The last few weeks saw a rising level of nervousness from investors on the mid-term perspectives of the Catalonia crisis resulting in the sell-off of Spanish assets. This trend has been visible both in the equities IBEX and fixed income markets. For example flows on the Spanish equity market moved in the opposite direction to the European average and spreads of Bonos versus Bunds have temporarily widened above the average of peripherals, although this move is already reversing. Having said that, we believe that this tactical move out of Spanish assets due to the current uncertainty will not trigger a general risk-off sentiment, as the overall picture continues to benefit risk assets and we believe that the crisis in Catalonia will remain a regional issue.

***Our preference for equity markets in Europe, due to the benign economic and business environment, remains unchanged despite the current crisis in Catalonia.***

### **From a Multi-Asset perspective how do you think investors should approach the current market environment?**

**FS:** The positive economic backdrop and the good corporate earnings growth outlook continue to support in our view, a positive stance on risk assets, at least for the next few months, before we move towards a late cycle phase. Our view that equity markets are stronger in Europe due to the supporting economic and business environment underpinning the case for a European renaissance, remains unchanged despite the current crisis in Catalonia. We also maintain a positive view on Emerging Markets (EM), where selection remains crucial in our view. We believe investors should look closely at Korea, Russia and China within EM equity markets. On bonds, we believe that valuations are getting stretched across credit markets, and while opportunities are still available, a selective approach is increasingly important to avoid areas vulnerable to stretched valuations and overcrowding. On duration, we believe investors should keep a short duration stance, while seeking opportunities across curves and maturities as well as on inflation-linked securities. Despite this moderately optimistic risk-on stance, given persistently elevated geopolitical risks (including the Catalonia crisis) we also believe that hedging against tail risks will be key, as we expect possible spikes in volatility from the currently suppressed levels.

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