Amundi
ASSET MANAGEMENT

Cross asset investment strategy

Research,Strategy and Analysis

WEEKLY

Letter finalised at 3pm Paris time **March 13 - 17, 2017**

Highlights of the week

- **Markets :** US yields down; the dollar weakened sharply. Recovery on the US credit markets; the Fed reassures the markets.
- **Eurozone :** employment rose by 0.3% in Q4 2016 in the euro zone as a whole.
- **United States :** disappointing January retail sales.

Key focus

The Fed will believe it when it sees it (fiscal stimulus)

For the third time in this cycle, the Fed has raised its target range for key interest rates to 0.75% - 1%. However, the (lack of) change in its economic and fed fund projections has drawn most of the attention. Fed fund projections (or the "dot plot" as they are known) are almost unchanged since December: FOMC members are expecting three rate increases in 2017 and three more in 2018 (using median projections). Meanwhile, their growth projections have stuck quite close to 2% for 2017, 2018, and 2019.

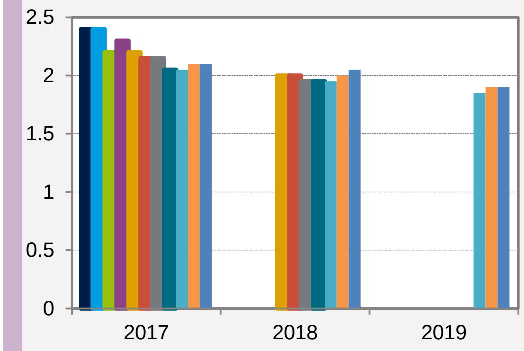
The markets' reaction was unlike that to a "traditional" fed funds increase:

- The equity markets reacted very positively to the fed funds increase.
- The credit markets also reacted very positively. Performance was especially notable for the lowest-rated issuers in the High Yield segment.
- US long-term rates were down. The 10-year rate lost 7bp over the week to close at 2.50%.
- The dollar has depreciated against virtually all currencies.

In reality, the markets do not seem to be setting the same expectations since Trump's election: risky assets seem to be awaiting a resurgence, while the Treasury certificate market remains much more conservative.

In recent months, the trend in the equity and credit markets are making the assumption of better economic prospects thanks to the measures that will be taken by the new US administration. Likewise, both consumer and business confidence indicators have shot up to high levels.

FOMC members' GDP growth projections



■ 17 Sep. 2014 ■ 17 Dec. 2014 ■ 18 Mar. 2015
■ 17 Jun. 2015 ■ 17 Sep. 2015 ■ 16 Dec. 2015
■ 16 Mar. 2016 ■ 15 Jun. 2016 ■ 21 Sep. 2016
■ 14 Dec. 2016 ■ 15 Mar. 2017

Source: Fed, Amundi Research

In parallel, the US economy still enjoys extremely accommodative financing conditions. FOMC members themselves are staying very conservative, apparently denying themselves any assumptions of fiscal stimulus in their economic scenario unless these are more clearly announced, which is why they have not adjusted fed funds projections upward. They are banking on just 2% growth in 2018, compared with almost 2.5% for the consensus. In a hollow, Janet Yellen told the press conference that the cycle of raising fed funds would accelerate only in the event of significant measures of fiscal stimulus.

Otherwise, these expectations are at odds with the real data. The latest figures point more toward a slowdown in US growth in the first quarter. The Atlanta Fed is forecasting growth of only 1.2% for Q1. That said, one should not give too much importance to an isolated figure.

As long as there is no further clarification on US fiscal policy - and this may take several months - markets will remain in a bogus situation, with very accommodating financing conditions (real rates close to zero as Fed refuses to accelerate), expectations of growth acceleration despite real data rather mixed.

The week at a glance

Other events

Netherlands >

Dutch elections: Eurosceptic vote weaker than expected. On Wednesday, 17 March the Netherlands opened the series of major European elections for 2017. The PVV Eurosceptic party fared worse than forecast by most of the recent polls (20 out of 150 MPs vs. an average of about 22 suggested by polls in March, and as many as 36 in polls taken in December). VVD, the liberal party of the incumbent prime minister Mark Rutte, lost eight seats but still fared better than expected and should be able to form a coalition government with other pro-European main-stream parties.

These elections were closely followed by international investors, mainly as a bellwether of the Eurosceptic vote in Europe. The Dutch situation itself was unlikely to change radically given that, even in the event of a better-than-expected score, the PVV would probably not have participated in a coalition government. However, the fact that PVV came in below forecasts showed that polls do not systematically underestimate protest votes, although they certainly did in 2016 on the Brexit referendum and the US presidential election. This eased fears somewhat of a National Front victory in France's presidential election in May, but uncertainty there will remain a major theme in the coming weeks.

Economic indicators

Eurozone >

Employment rose by 0.3% in Q4 2016 in the euro zone as a whole, after a 0.2% gain in Q3. The year-on-year increase is 1.1%. By country, the Q4 increase was 0.1% in Germany, 0.2% in France, 0.3% in Italy, and 0.4% in Spain. Industrial output rose by 0.9% in January in the euro zone, after a 1.2% decline in December. By country, the January change was 3.3% in Germany, -0.3% in France, -2.3% in Italy, and +0.3% in Spain.

The recovery continues to spread to the job market, albeit without accelerating. Monthly industrial output figures are highly volatile. The January rebound was essentially due to catching up from the December decline.

United States >

Disappointing January retail sales. Retail sales rose by 0.1% in February, but after a steeper increase in January than previously announced (+0.6% instead of +0.4%). The control group retail sales (i.e., a perimeter similar to that used for calculating household consumption in GDP) also rose by 0.1%, less than the +0.2% expected (the January figure was also revised upward). February housing starts were higher than expected (1.29m vs. 1.26m) and the NAHB confidence index was surprisingly strong in March (at 71, vs. a forecast of no change at 65). In contrast, building permits were lower than expected in February (1.21m vs. 1.26m).

Retail sales figures are not very good news for Q1 GDP growth, which could turn out rather low. Keep in mind, however, that business climate indicators are good and that the job market remains very strong. The weak figures could be a passing phenomenon, but that will depend mostly on the fiscal policy decisions that will actually be made by the White House and Congress.

Japan >

Caution on consumer expenditure. The Japan Trade Union Federation, the largest alliance of labour unions, disclosed the initial results spring wage negotiations for this year. Although an aggregate print on wage increase for this year is yet to be compiled, settlements by major companies suggest that the scope of year-on-year pay rises will be lower than last year. In the case of the Toyota Group, for example, management and labour unions agreed to raise monthly salaries by JPY 1,300 after increases of JPY 1,500 in 2016 and JPY 3,000 in 2015. Negotiations at small and mid-sized companies, which employ 65% of the national workforce, are far more severe. The Federation will release live score for the next few months.

Despite Prime Minister Abe's firm determination to bolster wage increases, aspirations of companies to provide continuous wage increase seem to be receding after three years, reflecting growing uncertainties in politics and international trade and investment. Looking back, labour unions won substantial pay raises in the last three years (+2.08% in 2014, +2.07% in 2015 and +2.00% in 2016), when many companies once again achieved record earnings. However, irresistibly weak pricing power and subsequent slowing expansion in operating margin prevent them from generous treatment.

In terms of the increase in the portion which effectively boosts national employees' compensation (the so-called "base-up"), the degree of gain whittled to +0.44% last year, after +0.69% in 2015. Due to reluctance by major companies, the "base-up" is likely to fall short of +0.4% this year. From the viewpoint of real wage increases, at least 1.5% base-up will be required in order to maintain the same magnitude of increase in real earnings. This looks unconceivable.

China > **China's Fixed Asset Investment surprised big to the upside in February 2017.** (1) **China's Fixed asset investment** ytd yoy growth came in much better than expected at 8.9% in January/February (vs. a consensus of 8.3% and a prior figure of 8.1%). (2) **China's Industrial output** ytd yoy growth came in slightly stronger than expected at 6.3% in January/February (vs. a consensus of 6.2% and a prior figure of 6.0%); (3) **China's Retail Sales** ytd yoy growth surprised big to the downside in January/February, falling below 10% for the first time, at 9.5% (vs. a consensus of 10.6% and a prior figure of 10.4%).

Among February's real economic activity data, there are several highlights: 1. January/February's Property FAI grew at +8.9% yoy (vs. +11.1% in December), which is the big surprise on the market as it remains at high levels.Also, FAI in highways remained strong in January/February at 21.6% yoy (vs. +1.8% in December), and railway FAI picked up to 12.1% yoy in January/February (vs. -23.4% in December 2016). 2. The improvements in industrial output in January/February are associated with cement production, which recovered to -0.4% yoy (vs. -1.2% yoy in December), crude steel production, which picked up to +5.8% yoy (vs. +3.2% yoy in December), finished steel production, which improved to +4.1% yoy (vs. -0.2% yoy in December), and power generation, which remained around +6.3% yoy (vs. 6.9% yoy in December). We think that the stabilisation of the Chinese economy is sustainable in 2017 and even into 2018.

India > **India's wholesale prices index (WPI), was higher than expected at 6.55% yoy in February** (vs. a consensus of 6.10%, and a prior figure of 5.25%). **India's February CPI was in line with expectations at 3.65% yoy** (vs. a consensus of 3.60%, and a prior figure of 3.17%).

The strength in CPI is being driven by higher than expected food prices – food inflation within the CPI increased to 2.5% yoy (vs. 0.5% yoy in January). The strong victory for the BJP and Prime Minister Modi in the Indian elections confirms the focus is back on development, governance and growth for India. Furthermore, the impact from demonetisation has been weaker than expected, which is also putting India in a better position. We expect the RBI to hold at the current level for longer than expected in light of the continued US hiking cycle (which is preventing it from cutting), but also due to continued weaker-than-expected inflation (which is preventing it from hiking).

> Monetary policy

Turkey > **Turkey's central bank raised its late liquidity rate by 75 bp to 11.75 % in line with the consensus** and left its one-week repo and overnight lending and borrowing rates unchanged. The average cost of funding was raised from 10.8% to 11.5%.

The statement was more hawkish, as the CBRT mentioned that it will maintain a tight monetary policy until inflation, which is running at more than double the regulator's target, improves. It also indicated that it expects price increases to accelerate in the short term due to the weaker lira. In contrast with the latest committee meeting, the CBRT didn't hike its overnight lending rate that undermines the hawkish signal in our point of view. The bank's decision also comes after the U.S. Federal Reserve raised borrowing costs for the second time in three months, on Wednesday.

> Financial markets

Fixed-income

US yields down. The 10y. US yield fell heavily after the FOMC (see front page) before rising slightly. The German 10y. yield ends the week more or less where it started, at 0.44%. Note that the 2y. US yield has risen, with rumours of a possible deposit rate hike from the ECB before a potential announcement about the reduction of asset purchases.

We think that there is more room for a rise of long-term rates in Europe than in the US in 2017. This should be facilitated after the French elections.

Foreign exchange

The dollar weakened sharply. The USD lost ground against all major currencies during the week and the USD currency basket followed by the Fed lost 1%. EMEs currencies were the top highlights: the Turkish lira and South African rand, in particular, gained more than 3%. But the euro was also noteworthy, moving back to the 1.075 level, a five-week high. The Japanese yen gained 1.8% (the USDJPY reached 112.8) and the GBP (+ 1.7%) moved back to 1.23$, both two-week highs.

The soft tone adopted by the FOMC regarding the tightening cycle might have disappointed markets, which were expecting a more aggressive tone, given prospects of a promising positive outlook for the US – supported in particular by the fiscal package talks. In this regard, the Fed adopted a "wait-and-see mode" and did not revise its growth forecast (see editorial).

We also note that idiosyncratic factors may provide some important support for some currencies. During the week, Peter Navarro, Trump's top trade adviser, stated that the US is seeking an alliance with Mexico and Canada to unite in a regional manufacturing "powerhouse". This could be very good news for the MXN, which hit hard by the US elections.

Credit

The Fed's dovish tone which accompanied the very much expected rate increase, together with the stabilisation of energy prices, supported a recovery on the US credit markets, and in particular on the high yield segment. As a result, spreads tightened after the FOMC, while equity prices strengthened. On the other side of the Atlantic, the result of Dutch elections brought relief to spread products and risky assets, too, as they have shown that support for populist parties may face a ceiling. As a consequence, credit markets were supported by both factors (the Fed message and the outcome from Dutch elections).

Credit markets continue to be driven by an environment combining positive macro and micro momentum and an accommodative global monetary policy stance: relative to a month ago, the Fed took the next step in the hiking cycle a bit earlier but the important message is about the speed, which has not been increased. At the same time the QE programmes at the BoJ and ECB, which are supporting technical, are keeping the search for yield alive, especially in short maturity segments. In this respect, IG financials and HY bonds are among the fewer suppliers of yield left in the eurozone, while US IG corporates, despite tighter valuations, still offer interesting absolute yield levels.

Equity

The Fed reassures the equity markets. After a short pause last week (-0.2% from 3-10 March for the MSCI World AC), the markets took off again this week (+0.7% as of Thursday evening), setting them back on the bullish trend begun in mid-2016 (+14.5% since 30 June). The trigger this week was the Fed's decision to move ahead on raising interest rates without tightening their guidance for the months to come.

This moderate message was well-received by investors, who were afraid the Fed would be stricter. While Wall Street rebounded by 0.8% the day of the announcement, its weekly gains were more limited (+0.3%), with US equity valuations high and the market starting to question the actual vigor of the US recovery in Q1. Such moderation from the Fed, by driving the dollar down, was just the ticket for the emerging markets (+2.4%), though not Japan's (+0.0%). Meanwhile, after a rough patch early in the year, the Eurozone (+0.8%) outperformed the MSCI World AC for the third consecutive week. While the strengths of Eurozone equities (rebound in earnings, moderate valuation) were not winning many over, this will eventually change after the good performance of economic indicators, the ECB's reassuring remarks last week, and the victory of the moderate parties in the Netherlands.

Key upcoming events

Economic indicators

United States : Manufacturing PMI is expected to accelerate in March. **Eurozone:** Consumer confidence should improve slightly in February.

Date	Country	Upcoming macroeconomic data	Consensus	Prior
March 20	Germany	PPI. YoY. February	0.4%	0.7%
March 21	UK	IPC. YoY. February	2.2%	1.9%
March 22	Japan	Trade balance. February		-1087 $ Bn
March 23	Germany	CB consumer confidence. April	10.0	10.0
	UK	Retail sales. MoM. February	0,3%	-0,2%
	Eurozone	Consumer confidence. February	-5.9	-6.2
	New-Zealand	Trade balance. February	160 M $	-285 M $
	US	New home sales. February	565 K	555 K
March 24	Eurozone	Manufacturing PMI. March	55.3	55.4
	Eurozone	Composite Markit PMI	55.8	56.0
	Eurozone	Services PMI. March	55.3	55.5
	US	Manufacturing PMI. March	54.8	54.2

Source: Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
March 20	France	Short-term, € 6.4 Bn
March 21	ESM	Short-term, € 1.5 Bn
March 22	Germany	10 years, € 3 Bn

Source: Amundi Strategy

Key events

Date	Upcoming monetary policy committee meetings
April 27, 2017	European Central Bank (ECB)
	Bank of Japan (BoJ)
May 3, 2017	Federal Reserve (Fed)
May 11, 2017	Bank of England (BoE)

Date	Upcoming important events
March 31, 2017	UK - Deadline for triggering Article 50 to leave the EU
April 23, 2017	France- First round of Presidential election
May 7, 2017	France - Second round Presidential election
June 11, 2017	France - First round of Legislative Elections
June 18, 2017	France - Second round of Legislative Elections
24 September 2017	Germany - General Election

Source: Amundi Strategy

Market snapshot

Equity markets	17/03/2017	Over 1 week	Over 1 month	Ytd
S&P 500	2382	0.4%	1.3%	6.4%
Eurostoxx 50	3447	0.9%	4.2%	4.7%
CAC 40	5022	0.6%	3.2%	3.3%
Dax 30	12087	1.0%	2.8%	5.3%
Nikkei 225	19522	-0.4%	1.5%	2.1%
MSCI Emerging Markets (close -1D)	963	4.0%	2.6%	11.7%

Commodities - Volatility	17/03/2017	Over 1 week	Over 1 month	Ytd
Crude Oil (Brent, $/barrel)	52	1.0%	-7.0%	-8.7%
Gold ($/ounce)	1231	2.2%	-0.3%	6.8%
VIX	11	-0.6	-0.4	-3.0

FX markets	17/03/2017	Over 1 week	Over 1 month	Ytd
EUR/USD	1.08	0.7%	1.3%	2.2%
USD/JPY	113	-1.7%	0.0%	-3.5%
EUR/GBP	0.87	-0.9%	1.6%	1.9%
EUR/CHF	1.07	-0.6%	0.7%	0.0%

Fixed Income markets	17/03/2017	Over 1 week	Over 1 month	Ytd
EONIA	-0.35	--	-	-3 bp
Euribor 3M	-0.33	-	-	-1 bp
Libor USD 3M	1.15	+3 bp	+10 bp	+15 bp
2Y yield (Germany)	-0.78	+5 bp	+3 bp	-1 bp
10Y yield (Germany)	0.44	-5 bp	+14 bp	+23 bp
2Y yield (US)	1.31	-4 bp	+12 bp	+12 bp
10Y yield (US)	2.50	-7 bp	+9 bp	+6 bp

Eurozone Sovereigns 10Y spreads vs Germany	17/03/2017	Over 1 week	Over 1 month	Ytd
France	+66 bp	+3 bp	-8 bp	+18 bp
Austria	+20 bp	+1 bp	-10 bp	-2 bp
Netherlands	+25 bp	-1 bp	-8 bp	+10 bp
Finland	+11 bp	-1 bp	-8 bp	-3 bp
Belgium	+49 bp	-2 bp	-5 bp	+16 bp
Ireland	+70 bp	+1 bp	-7 bp	+16 bp
Portugal	+384 bp	+26 bp	+11 bp	+28 bp
Spain	+143 bp	+3 bp	+10 bp	+26 bp
Italy	+191 bp	+2 bp	+2 bp	+30 bp

Credit markets	17/03/2017	Over 1 week	Over 1 month	Ytd
Itraxx Main	+70 bp	-2 bp	-4 bp	-2 bp
Itraxx Crossover	+276 bp	-7 bp	-22 bp	-13 bp
Itraxx Financials Senior	+85 bp	-1 bp	-7 bp	-8 bp

Source: Bloomberg, Amundi Strategy *3:00 pm Paris time*