Amundi
ASSET MANAGEMENT

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Research,Strategy and Analysis

WEEKLY

Letter finalised at 3pm Paris time

May 15 - 19, 2017

Highlights of the week

- **Markets :** Developed rates down in the wake of new political scandals in the US and Brazil. Deep dive by the Brazilian real Profit-taking finally took place on the credit markets. Equity : Political risk changes
- **Brazil :** The Supreme Court has authorized a corruption probe into the president Temer.
- **United States :** Mixed numbers on the construction sector, but a rebound in manufacturing.
- **Eurozone :** In the wake of the election of Emmanuel Macron, Germany and France want to step up their cooperation. Q1 economic growth: weak in Italy, moderate in the Netherlands, strong in Portugal.

Key focus

The markets bounce from one presidential news item to the next

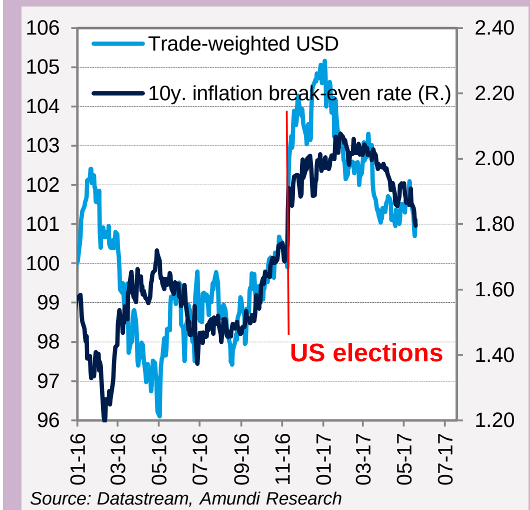
While the European markets moved to the rhythm of the French presidential elections over the first part of the year, the political news about the US and Brazilian presidents has had major repercussions on the markets this week.

US newspapers revealed that FBI Director James Comey, dismissed by President Donald Trump on 9 May, would have written in a memo that Trump had asked him to drop his inquiry into the ties between Michael Flynn, who was briefly National Security Advisor, and Russia. Deputy Attorney General Rod Rosenstein has announced the appointment of a special prosecutor, the highly-respected Robert Mueller, who was FBI Director for 12 years, to supervise the inquiry into ties between Trump's campaign team and Russia. **This extremely rare procedure is a very hard blow to the US president and has turned up the volume on talk of a possible impeachment.**

This has caused the primary safe havens to appreciate dramatically. **The yen, Swiss franc, and gold have all appreciated. The equity markets have lost ground, and the US 10Y gave up 9 bp over the week, going from 2.33 to 2.24%.**

What about Trumponomics? One of Donald Trump's ambitions was to bring economic growth back up above 3% over the long term, via an ambitious infrastructure investment plan and broad-based tax reform. The first point met with resistance from a large number of Congressional Republicans, who hold to a certain fiscal orthodoxy; and the second was already becoming complicated before the appointment of a special prosecutor, and will probably move even slower after the latest developments. The protectionist platform of the presidential campaign has been greatly diluted. However, we should note that many deregulation measures have been adopted. **Ultimately, many hopes of rapid "reflation" have been disappointed: the dollar (measured by the Fed's basket of currencies) and inflation expectations are back where they were during the US presidential election.**

United States : USD & market inflation expectations



Source: Datastream, Amundi Research

The USD effective exchange rate is measured here with a base of 100 at January 1st 2016.

Another president has been under the spotlight this week, the Brazil president Michel Temer. A Brazilian newspaper article reported that tapes involving the president Michel Temer were presented to the prosecutors as part of plea bargain agreement of JBS, the largest meat processing company in the world. In the tapes, president Michel Temer is alleged to have talked about cash payments to the former president of the Chamber of Deputies of Brazil, Eduardo Cunha, who is currently in jail. The money would be a way to keep Mr Cunha “silent” and not implicate the government in the scandals of corruption.

The Supreme Court has authorized a corruption probe into Michel Temer: many asked him to resign and some evoked a possible impeachment procedure” (keep in mind that Michel Temer became president in August 2016 after Dilma Rousseff had been impeached and the next presidential elections are expected to be held in October 2018). This opens a new era of political uncertainty in Brazil. The reaction of financial markets has been violent as the Bovespa index fell 8.8% (Thursday) and as the Brazilian real (BRL) fell 7.5% vs the USD. Volatility should remain high for some time.

While the election of Emmanuel Macron had contributed to dissipate somehow the political risk in Europe, the news this week show that the political developments will continue to be one of the main determinants of financial markets in the coming months.

The week at a glance

> Other events

Brazil >

The Supreme Court has authorized a corruption probe into the president Temer. In Brazil, the triggering of a new chapter in the ongoing political crisis on Thursday set the political risk of the country in new heights. The called "Operation Car Wash", an investigation into the corruption scandal which has implicated important political figures including former president Lula (who is currently being investigated) has now reached the current president of the country, Michel Temer. A Brazilian newspaper article reported that tapes involving the president Michel Temer were presented to the prosecutors as part of plea bargain agreement of JBS, the largest meat processing company in the world. While the Brazilian government has formally refused the allegation, the damage is already done as the opposition has already started asking Mr Temer to resign his position and talking about a new impeachment procedure.

This adds high uncertainty to the already fragile political scenario in Brazil – it would be the second impeachment in one year and the prospects for the next year election is even more unclear as the corruption scandal involves all the political parties and the main known politicians. Moreover, this also clearly threatens the delicate macroeconomic perspective of the country as important reforms planned by the government, such as the "pension reform" should remain blocked as consequence of this scandal. Markets responded promptly to the bad news: in particular, the Brazilian Real, which depreciated by 7.5% against the USD. As important political factors exert high influence in the currency movements, the current outlook shows that a great volatility for the BRL should be expected from now on.

Greece >

The Greek Parliament approved the measures requested by its creditors, including new cuts in pensions and tax hikes. This vote, on May 18, should clear the way to the disbursement of the tranche of assistance that Greece needs to meet its payment deadlines this summer (a decision that could be confirmed on 22 May). It is also one step further towards rescheduling the debt owed to other European governments, a condition for the IMF to provide its own assistance.

The spectre of a new Greek crisis has receded, but the country's economic and financial outlook (with its GDP shrinking again slightly in Q1 after a steep drop in Q4) remains very uncertain. In particular, the fiscal objectives that the Europeans wish to impose on Greece (i.e., a primary surplus of 3.5% of GDP for five years) look unrealistic to many observers (the only countries that can generally achieve such ratios are those with a very special economic structure, such as major commodities exporters).

Eurozone >

In the wake of the election of Emmanuel Macron, Germany and France want to step up their cooperation. Leaders of both countries have mentioned several issues to be addressed, while the French president has sought to reassure the German chancellor that he does not seek to create Eurobonds and mutualize past debts. However, he did make the case for building joint Eurozone financing capacities for investment purposes (remember that Macron's presidential campaign platform included the establishment of a minister of finances for the Eurozone, under the control of a dedicated Parliament with an autonomous budget and borrowing capacity). The German chancellor, meanwhile, said it might be possible to amend European treaties "if that makes sense".

Relations between the new French president (whose general economic programme has been welcomed in Germany) and the German chancellor have got off to a good start, which is good news for the Eurozone. The possibility cannot be ruled out that Germany will agree (albeit very cautiously) to some of the directions suggested by the French president. However, for this to happen, France must meet its own commitments on reducing its fiscal deficit and enacting structural reforms to its economy, which are prerequisites to establishing confidence with Germany.

> Economic indicators

Eurozone >

Q1 economic growth: weak in Italy, moderate in the Netherlands, strong in Portugal. Italian GDP rose by +0.2% in Q1, a figure in line with expectations (and similar to Q4). In the Netherlands, growth was +0.4% in Q1 (vs. +0.5% expected and after +0.6% in Q4). In Portugal, the positive surprise was strong, with GDP gaining 1% (vs. +0.7% expected, and after an increase adjusted upward of +0.7% in Q4).

The Portuguese economy's rebound is a very nice surprise (and is drawing attention, since Portugal's government has had a more leftist policy over the past few quarters than the European institutions were recommending for it). However, the Italian economy, number three in the eurozone by size, continues to disappoint. Now that France's political uncertainty has diminished, Italian risk could be the focus of the markets' attention in H2. Remember that in Q1, GDP growth was +0.5% in the eurozone, +0.6% in Germany, +0.3% in France, and +0.8% in Spain.

United States > **Mixed numbers on the construction sector, but a rebound in manufacturing.** Building permits fell unexpectedly in April (1.229 million vs. 1.270 million expected, following 1.267 million in March). Housing starts were also lower than expected (1.172 million vs. 1.260 million expected, following 1.203 million in March). However, the NAHB (developer confidence) index rose to 70 in May, though it was expected not to move from 68 in April. Another good number was industrial output, speeding up in April to +1% for the month (vs. +0.4% expected, following +0.4% in March). Capacity utilisation rose to 76.7% (versus 76.1% in March).

After somewhat disappointing numbers in Q1, the US economy should fare better in Q2. On the whole, despite the monthly volatility of some indicators, construction is still healthy and continues to support the recovery. The American expansion cycle will continue. The markets' attention has been much more focused on political news over the past few days (see editorial)

China > **China's April 2017 monetary data kept surprising on the upside while real economic activity showed slight and temporary weakness.** As for the April 2017 monetary data, new yuan loans came in better than expected at RNB 1.1trn (vs. consensus 815bn and prior 1.02trn); total social financing was better than expected, as well, at RMB 1.39trn (vs. consensus 1.15trn and prior 2.1189trn); M1 growth was much better than expected at 18.5% yoy growth (vs. consensus 17.3% and prior 18.8%), not a sharp deceleration as market expected; M2 growth remained stable at 10.5% (slightly weaker than the consensus 10.8% and prior 10.6%). As for April real economic activity data, (1) China's April Fixed asset investment YtD yoy growth came in slightly weaker than expected at 8.9% (vs. consensus 9.1% and prior 9.2%). (2) China's April Industrial Production YtD yoy growth came in slightly weaker than expected at 6.7% (vs. consensus at 6.9% and prior at 6.8%); and (3) China's April Retail Sales YtD yoy growth came in-line at 10.2% (vs. consensus 10.2% and prior at 10.0%).

Current financial deleveraging in China only implies credit tightening in financial sector, but not in the real economy, and not monetary tightening, as seen in the April monetary data. Also, among the April real economic activity data, there are several highlights: 1. April Property FAI yoy grew at +9.6% (vs. +9.4% in March), which continues to be big surprise to the market as it remains higher than expected. Also, FAI in highway remains strong in April at 24.4% yoy (vs. +27.5% in March) 2. The improvements seen in industrial production in April are cement production, which recovered to +2.4% yoy (vs. 0.3% yoy in March) and crude steel production, which picked up to +4.9% yoy (vs. +1.8% yoy in March). We continue to believe stabilization is sustainable in China into late 2018.
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India > **India's April wholesale prices yoy (WPI)** were much lower than expected at 3.85% (vs. consensus 4.55%). India's April CPI yoy came weaker than expected, as well, at 2.99% (vs. consensus at 3.30%, and prior 3.89%).

The weakness in CPI is driven by lower than expected food prices for both WPI and CPI. The April inflation reading brings it to the lower end of RBI's inflation target. We continue to expect RBI to hold at the current level for longer than expected if the US tightening cycle continues (keeping it from cutting), and if inflation remains weaker than expected (keeping it from hiking).

Russie > **Real GDP has increased by 0.5% yoy in Q1 2017 according to the flash estimate roughly in line with consensus (0.4%).** This marks a small rise compared to Q4 2016 (0.3%). The expenditure breakdown will be published mid-June.

The data released is not seasonally adjusted and regarding working days number, GDP growth could be revised upwards. At this stage, without any further information on the expenditure breakdown and considering better but still weak cyclical indicators, we maintain our 2017 growth forecast at +1% yoy below consensus (+1.2%).

> Financial markets

Fixed-income

Developed rates down in the wake of new political scandals in the US and Brazil. The German and US 10-year rates rate lost 3 and 9 bps respectively, at 0.36% and 2.24%. Italian spreads are down on short maturities. Note that the 10-year spread between Portugal and Germany fell below the bar of 300 bps for the first time since the summer of 2016.

The impact of the latest political developments involving President Trump should be short-lived. We continue to think that European long rates will have a room to increase over the second part of the year, with a gradually less-accommodating message from the ECB.

Foreign exchange

"Safe havens" on the rise, deep dive by the Brazilian real (see above). The Swiss franc and the yen gained more than 2% against the dollar, in the wake of new political scandals in the US and Brazil. EUR/USD was back above 1.11 for the first time in six months. The Brazilian real fell heavily, down 7.5% against the dollar.

While it was hard to see the new Brazilian scandal coming, it should be noted that the Brazilian real was the most overvalued currency early in the week, according to our models. The real's trend should be much more volatile over the coming weeks, as it was during the period leading up to Dilma Rousseff's impeachment.

Credit

Profit-taking finally took place on the credit markets amid growing concern over political developments in the US and following the rise in equity implied volatility and weaker share prices. Despite the supportive effect from the recovery in oil prices, US HY also suffered from the renewed political risk, which did not occur in the eurozone this time. As usual, corporate bonds were more resilient than CDS to profit taking with high beta segments underperforming the most. CDS of EUR financial subordinated debt gave back part of their strong performance delivered since first round of the French Presidential elections: at 160 b.p. they moved up from the 140 b.p. lows reached after Macron's second-round victory, but they still much lower than the 200 b.p. level from where the rally started on 21 April. Crossover proved to be more stable. The cash market was less volatile than the synthetic market, as we were underlying, but US HY tended to be more impacted than their European counterparts by political concerns towards the end of the week.

We believe that the recent weaker action has partly to do with a genuine growing concern on political risk, but that it is also the effect of a plausible profit taking move, after such a strong rally delivered in recent weeks on diminished political risk in the eurozone and stronger than expected macro and micro signals. The ECB seems to be slightly reducing its corporate bond purchases, but its support remains quite effective at this stage. In April (the first month at the reduced level of EUR 60 bn, compared to the previous EUR 80 bn in monthly QE purchases) the central bank totalled a volume of corporate bond purchases close to EUR 7 bn, only slightly below the average of EUR 8 bn purchased in the previous three months. The first two weeks of May, however, saw a lower weekly average which may point to a monthly volume closer to EUR 6 bn rather than EUR 7 bn for May as a whole. Still, we believe that, to a certain extent at least, high grade corporate bonds are considered as effective substitutes for safe-haven assets by many investors. In light of the positive fundamental picture and the central banks' supportive attitude, we are maintaining a supportive view on credit markets, despite the decline in valuations.

Equity

Political risk changes sides. Recently centred on Europe and the French elections, the market's worries have shifted to the United States. After a passably rocky first 100 days in office, the latest outcry around the dismissal of the FBI's director and possible attempts to obstruct justice are increasingly weakening President Trump. While some are already calling for his impeachment, at the very least, Congressional output should be seriously slowed in the weeks to come. In other words, Trump's signature plan for the markets, his great tax reform, could suffer new delays. Consequently, risk aversion has bobbed back up to the surface. The Vix has risen by more than five points since last Friday. Likewise, Wall Street fell by 1.8% on Wednesday, its biggest loss in a single day in eight months! With this risk aversion accompanied by an easing of interest rates, the banking sector has been struggling. The ripples have also reached the European markets (-1.6% in the eurozone). On the other hand, the emerging markets, profiting from the downward slide of the dollar and interest rates, have been more resilient.

How will this turbulent phase play out? It's too soon to judge, but it was inevitable that the market would reprice US growth forecasts, which were decidedly too optimistic on 2018. In practice, whether tax reform is simply delayed or Vice-President Pence is brought in to succeed Trump should not pose any insurmountable problems for the market. In principle, the next few weeks could remain volatile. If Wall Street's correction remains limited, the eurozone and emerging equity markets stand to gain. But if it is more far-reaching, all the markets will struggle

Key upcoming events

Economic indicators

US : GDP is expected to accelerate in Q1 2017. **Eurozone** : Services and Manufacturing PMIs should stabilize in May.

Date	Country	Upcoming macroeconomic data	Consensus	Prior
May 22	Japan	Trade balance. April	520.7 Bn ¥	614 Bn ¥
May 23	Germany	GDP. QoQ. Q1	0.6%	0.6%
	Germany	IFO business climate index. May	113.1	112.9
	Eurozone	Manufacturing PMI. May	56.5	56.7
	Eurozone	Services PMI. May	56.3	56.4
	US	New home sales. April	615K	621K
	US	Manufacturing PMI. May	53.4	52.8
	US	Services PMI. May		53.1
May 24	US	Existing home sales. April	5.67M	5.71M
May 25	Spain	GDP. QoQ. Q1	0.8%	0.8%
	UK	GDP. QoQ. Q1	0.3%	0.3%
	Japan	CPI. YoY. April	0.4%	0.2%
May 26	US	GDP. QoQ. Q1	0.9%	0.7%
	US	Michigan consumer confidence. May	97.5	97.7

Source: Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
May 22	France	Short-term, € 6.6 Bn
May 23	Germany	2 years, € 5 Bn
May 24	Germany	10 years, € 3 Bn
May 26	Italy	Long-term, amounts not available on Friday

Source: Bloomberg, Amundi Strategy

Key events

Date	Upcoming monetary policy committee meetings
June 8, 2017	European Central Bank (ECB)
June 14, 2017	Federal Reserve (Fed)
June 15, 2017	Bank of England (BoE)
June 16, 2017	Bank of Japan (BoJ)

Date	Upcoming important events
June 8, 2017	United Kingdom - Parliamentary Elections
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	19/05/2017	Over 1 week	Over 1 month	Ytd
S&P 500	2366	-1.1%	1.2%	5.7%
Eurostoxx 50	3577	-1.7%	4.6%	8.7%
CAC 40	5314	-1.7%	6.2%	9.3%
Dax 30	12611	-1.2%	5.0%	9.8%
Nikkei 225	19591	-1.5%	6.3%	2.5%
MSCI Emerging Markets (close -1D)	988	-1.4%	3.7%	14.6%
Commodities - Volatility	**19/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	53	4.7%	0.6%	-6.3%
Gold ($/ounce)	1254	2.1%	-2.1%	8.8%
VIX	13	2.9	-1.7	-0.8
FX markets	**19/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1.12	2.3%	4.4%	6.3%
USD/JPY	111	-1.9%	2.2%	-4.9%
EUR/GBP	0.86	1.4%	2.5%	0.7%
EUR/CHF	1.09	-0.2%	2.2%	1.9%
Fixed Income markets	**19/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0.36	--	--	-3 bp
Euribor 3M	-0.33	--	-	-1 bp
Libor USD 3M	1.18	--	+2 bp	+18 bp
2Y yield (Germany)	-0.68	--	+12 bp	+9 bp
10Y yield (Germany)	0.36	-3 bp	+16 bp	+15 bp
2Y yield (US)	1.27	-2 bp	+10 bp	+9 bp
10Y yield (US)	2.24	-9 bp	+3 bp	-20 bp
Eurozone Sovereigns 10Y spreads vs Germany	**19/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+44 bp	-1 bp	-31 bp	-4 bp
Austria	+28 bp	+2 bp	+6 bp	+6 bp
Netherlands	+21 bp	--	-4 bp	+6 bp
Finland	+6 bp	-2 bp	-7 bp	-8 bp
Belgium	+39 bp	-1 bp	-17 bp	+7 bp
Ireland	+47 bp	-1 bp	-24 bp	-8 bp
Portugal	+280 bp	-18 bp	-81 bp	-76 bp
Spain	+120 bp	-3 bp	-27 bp	+3 bp
Italy	+176 bp	-10 bp	-32 bp	+15 bp
Credit markets	**19/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+64 bp	+1 bp	-12 bp	-8 bp
Itraxx Crossover	+255 bp	-2 bp	-41 bp	-33 bp
Itraxx Financials Senior	+70 bp	+2 bp	-23 bp	-24 bp

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

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WEEKLY
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