Amundi
ASSET MANAGEMENT

Cross asset investment strategy

Research,Strategy and Analysis

WEEKLY

Letter finalised at 3pm Paris time

July 10 - 13, 2017

Highlights of the week

- **Markets :** the German 10-year rate surpassed 0.60%; the euro continues to rise against the dollar; Cash credit indices proved resilient to the sharp rise in yields in Germany, reassurance from the Fed.
- **United States :** the job market and business climate are still faring well.

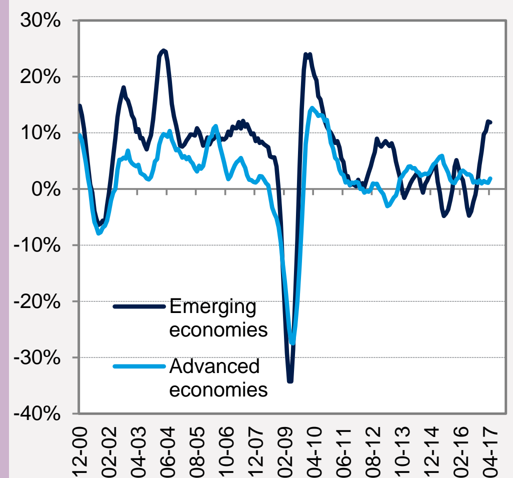
Key focus

Global trade is in much better shape than one year ago—at least for the moment

The situation has changed a lot since late 2015 and early 2016, when the first contraction in global trade volumes since the Great Recession raised many fears about the economic health of the emerging countries and, by extension, the outlook for the recoveries in the developed countries as well. Indeed, global trade has recovered steadily in recent months, with annual growth (in 6 month average terms) reaching 6.9% in April 2017, its highest level since 2011. This result is largely attributable to the 11.8% rise in imports by the emerging countries while the rate was only 1.8% for the developed countries. Naturally, part of the rebound can be explained by base effects following the trough one year earlier. It would take much more to invalidate the observation, in the last few years, of the falling "growth elasticity" of global trade: while global trade used to increase at twice the pace of global GDP growth over the previous three decades, since 2011 global trade has grown, on average, at the same pace as GDP. Furthermore, it is possible that these statistics only give a very partial view of the true behaviour of total trade flows, which increasingly consist of services that international organisations readily admit are difficult to measure, especially when such services are distributed electronically, and even more so when they are partly free and provided in exchange for information.

- **Such a rebound seemed far from assured at the end of last year, when the appetite for a return to some forms of protectionism appeared to be sharply on the rise with the Brexit vote and the election of Donald Trump.**

- **First of all, global trade has its own momentum**, which is increasingly separate from the highly visible decisions of restricting trade in particular sectors. Global value chains are increasingly integrated (even though this process is likely reaching its limit) and trade between emerging countries themselves is gaining ground. Even if the United States had withdrawn from NAFTA or if the US Congress had officially denounced China as a "currency manipulator", it is not clear whether this would have heavily impacted global figures six months down the road.



- **Nonetheless, a major factor is the fact that the escalation in protectionism has not occurred—or at least not yet.** The White House, which is increasingly on the defensive as investigations into the President's team intensify, has been unable to put forward a coherent plan. The Border Adjustment Tax endorsed by the Republicans in Congress—incidentally a well thought-out proposal—has been met with stiff resistance in the United States itself and seems to have been all but abandoned. The most visible protectionist moves have been the (not necessarily definitive) withdrawals from treaties that still needed to be finalised or ratified (TTIP and TPP). Some aspects of NAFTA are being renegotiated, though not necessarily in a protectionist direction. On this side of the Atlantic, Hard Brexit now looks slightly less likely and the results of the elections in the first half of 2017 in the Netherlands and France did not follow the trajectory set by Britain and the United States in 2016.

- Does this mean smooth sailing for global trade going forward? Not necessarily, for two reasons of a structural nature. The first is that there's no reason to believe that the many complex factors behind the rejection of globalization by large shares of the population in the developed countries will rapidly disappear. New political offers may still thrive on this find fertile ground, or Trump himself may bring the issue back onto the agenda later in his term. Indeed, at last Saturday's G20 meeting he won a concession on the role of "legitimate trade defence instruments" whose definition leaves room for interpretation. The second reason is that the purely economic factors behind the slowdown in global trade, which are still being investigated, are very probably here to stay. They include, among others, the limit reached in integrating global value chains, the smaller contribution of (trade intensive) investment in GDP growth, and reduced interest in outsourcing due to rising incomes in the emerging countries. Yet new accounting methods for international trade may emerge and cast a different light on this apparent structural deceleration.

The week at a glance

Economic indicators

Eurozone >

An increase in industrial output. Euro zone industrial production rose by 1.3% in May (vs. +1.1% forecast and after a 0.3% increase in April). It rose by 1.4% in Germany, 1.9% in France, 0.7% in Italy and 1.6% in Spain.

Figures are still solid in the euro zone. Economic growth may have been even stronger in Q2 than in Q1 (+0.6%).

United States >

The job market and business climate are still faring well. The number of job openings was 5.67m in May, which is still very high, albeit lower than in April (5.96m). The NFIB index of small business confidence continued to slip, falling to 103.6 in June from 104.5 in May after its early-year peaks but is still far higher than it was prior to Trump's election.

The US expansion cycle continues. It has been surprisingly long (eight years) and surprisingly slow, yet it is showing no true signs of running out of steam.

Monetary policy

Canada >

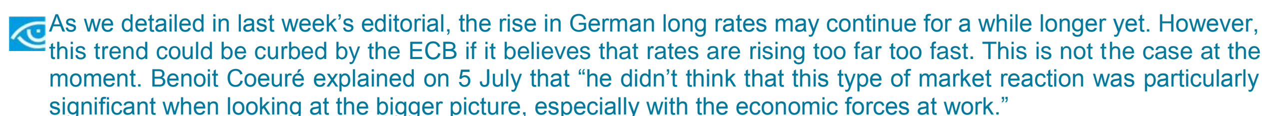
The Bank of Canada (BoC) has raised its key interest rate by 25 bp to 0.75%. The BoC's key rate had been kept at 0.50% since the summer of 2015 as the central bank adopted a cautious approach following the sharp drop in oil prices beginning in mid-2014. The BoC believes that the current weakness in underlying inflation will prove temporary and that the recent excellent growth figures will soon enable the closure of the output gap.

Members of the committee dealing with monetary policy had begun sending more aggressive signals in recent months, and the markets gradually priced in an interest rate hike. With oil prices low, the BoC will be unable to undertake a rapid tightening cycle. Furthermore, Canada's effective exchange rate has risen 5% since mid-May, which will push down inflation.

Financial markets

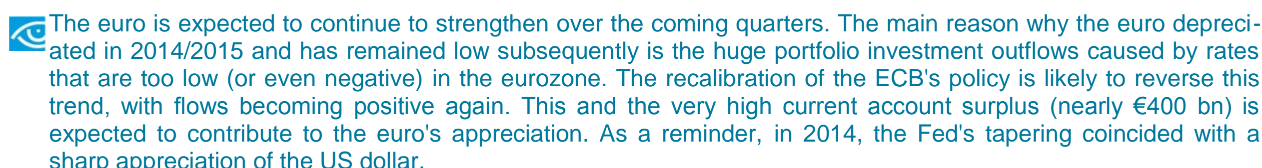
Fixed-income

The German 10-year rate surpassed 0.60% for the first time since 2015, ending the week at 0.59%. The US 10-year rate ended the week at 2.33%. Inflation breakevens in Europe recovered from their end-June low points and returned to their mid-May levels. Sovereign spreads in Europe narrowed slightly on long maturities after the widening triggered by Mario Draghi's speech on 27 June.


As we detailed in last week's editorial, the rise in German long rates may continue for a while longer yet. However, this trend could be curbed by the ECB if it believes that rates are rising too far too fast. This is not the case at the moment. Benoit Coeuré explained on 5 July that "he didn't think that this type of market reaction was particularly significant when looking at the bigger picture, especially with the economic forces at work."

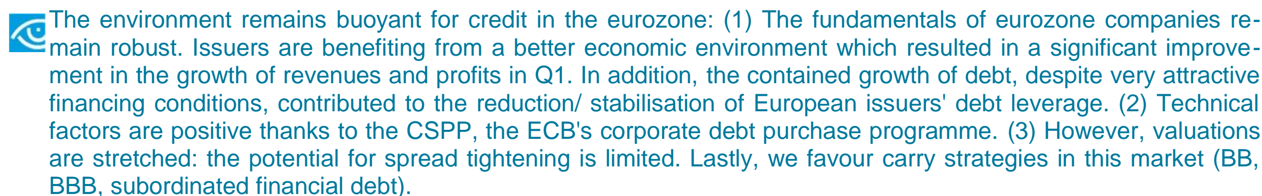
Foreign exchange

The euro continues to rise against the dollar, with the spread narrowing between US and German rates. The EUR/USD exchange rate is now close to 1.15, which is its highest level since early 2015.


The euro is expected to continue to strengthen over the coming quarters. The main reason why the euro depreciated in 2014/2015 and has remained low subsequently is the huge portfolio investment outflows caused by rates that are too low (or even negative) in the eurozone. The recalibration of the ECB's policy is likely to reverse this trend, with flows becoming positive again. This and the very high current account surplus (nearly €400 bn) is expected to contribute to the euro's appreciation. As a reminder, in 2014, the Fed's tapering coincided with a sharp appreciation of the US dollar.

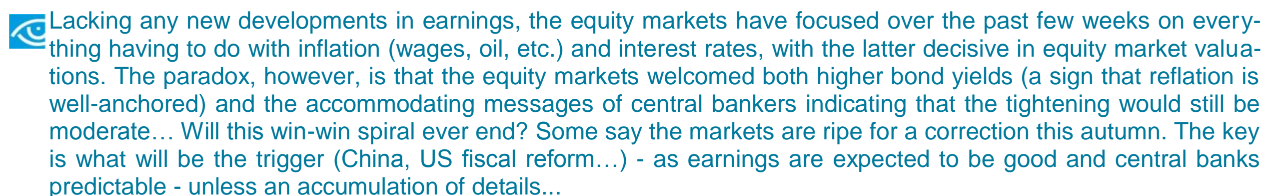
Credit

Cash credit indices proved resilient to the sharp rise in yields in Germany. Credit indices performed in the euro and dollar markets.


The environment remains buoyant for credit in the eurozone: (1) The fundamentals of eurozone companies remain robust. Issuers are benefiting from a better economic environment which resulted in a significant improvement in the growth of revenues and profits in Q1. In addition, the contained growth of debt, despite very attractive financing conditions, contributed to the reduction/ stabilisation of European issuers' debt leverage. (2) Technical factors are positive thanks to the CSPP, the ECB's corporate debt purchase programme. (3) However, valuations are stretched: the potential for spread tightening is limited. Lastly, we favour carry strategies in this market (BB, BBB, subordinated financial debt).

Equity

Reassurance from the Fed: Janet Yellen's remarks during her Congressional hearing clearly reassured the equity markets. After missing a step early in the week, the markets rallied in unison, with the exception of Japan, driven by the Fed chairman's cautious tone (see above). In the US, the Dow Jones rose by 0.6% to a new high. The NASDAQ, which is more sensitive to interest rates, turned in even stronger gains (+1.1%). European markets, which are more volatile than the US market, amplified the rally with average gains of +1.5%. Emerging markets (+2.2%) were the main beneficiaries of the Fed's conciliatory tone. Japan, on the other hand, gave up 0.5% on Wednesday, hit by the strengthening in the yen.


Lacking any new developments in earnings, the equity markets have focused over the past few weeks on everything having to do with inflation (wages, oil, etc.) and interest rates, with the latter decisive in equity market valuations. The paradox, however, is that the equity markets welcomed both higher bond yields (a sign that reflation is well-anchored) and the accommodating messages of central bankers indicating that the tightening would still be moderate… Will this win-win spiral ever end? Some say the markets are ripe for a correction this autumn. The key is what will be the trigger (China, US fiscal reform…) - as earnings are expected to be good and central banks predictable - unless an accumulation of details...

Key upcoming events

Economic indicators

China : Retail sales is expected to drop in June. **UK :** CPI should be remained stable in june.

Date	Country	Upcoming macroeconomic data	Consensus	Prior
July 17	China	Retail sales. YoY. June	10.6%	10.7%
July 18	UK	CPI. YoY. June	2.9%	2.9%
	Eurozone	CPI. YoY. June	-	1.4%
July 20	Germany	PPI. YoY. June	-	2.8%
	Eurozone	Consumer confidence. July	-	-1.3

Source: Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
July 18	ESM	Short-term, amounts not available on Thursday
July 19	Germany	Long-term, € 1 Bn
July 20	France	Long-term, amounts not available on Thursday
	Spain	Long-term, amounts not available on Thursday

Source: Bloomberg, Amundi Strategy

Key events

Date	Upcoming monetary policy committee meetings
July 20, 2017	European Central Bank (ECB)
	Bank of Japan (BoJ)
July 26, 2017	Federal Reserve (Fed)
August 3, 2017	Bank of England (BoE)

Date	Upcoming important events
24 September 2017	Germany - General Election

Source: Amundi Strategy

Market snapshot

Equity markets	13/07/2017	Over 1 week	Over 1 month	Ytd
S&P 500	2443	1,4%	0,1%	9,1%
Eurostoxx 50	3527	1,9%	-0,9%	7,2%
CAC 40	5243	1,8%	-0,3%	7,8%
Dax 30	12628	2,0%	-1,1%	10,0%
Nikkei 225	20100	0,5%	1,0%	5,2%
MSCI Emerging Markets (close -1D)	1030	2,4%	2,0%	19,4%
Commodities - Volatility	**13/07/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	48	-0,9%	-2,1%	-16,1%
Gold ($/ounce)	1221	-0,4%	-3,6%	5,9%
VIX	10	-2,3	-0,1	-3,8
FX markets	**13/07/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1,14	-0,1%	1,8%	8,5%
USD/JPY	113	0,1%	2,9%	-3,1%
EUR/GBP	0,88	0,1%	0,3%	3,3%
EUR/CHF	1,10	0,5%	1,5%	2,8%
Fixed Income markets	**13/07/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0,36	-	--	-3 bp
Euribor 3M	-0,33	--	-	-1 bp
Libor USD 3M	1,30	--	+6 bp	+31 bp
2Y yield (Germany)	-0,62	-4 bp	+8 bp	+15 bp
10Y yield (Germany)	0,59	+3 bp	+33 bp	+39 bp
2Y yield (US)	1,35	-4 bp	-1 bp	+16 bp
10Y yield (US)	2,33	-3 bp	+12 bp	-11 bp
Eurozone Sovereigns 10Y spreads vs Germany	**13/07/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+27 bp	-9 bp	-7 bp	-21 bp
Austria	+17 bp	-7 bp	-10 bp	-5 bp
Netherlands	+12 bp	-7 bp	-9 bp	-3 bp
Finland	-2 bp	-6 bp	-9 bp	-16 bp
Belgium	+27 bp	-8 bp	-5 bp	-5 bp
Ireland	+31 bp	-11 bp	-11 bp	-23 bp
Portugal	+256 bp	+6 bp	-12 bp	-99 bp
Spain	+106 bp	-5 bp	-11 bp	-11 bp
Italy	+169 bp	-1 bp	-2 bp	+8 bp
Credit markets	**13/07/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+55 bp	-1 bp	-3 bp	-17 bp
Itraxx Crossover	+244 bp	-8 bp	+8 bp	-44 bp
Itraxx Financials Senior	+51 bp	-3 bp	-11 bp	-43 bp

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

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