THEMATIC

Back to school, back to politics?

DIDIER BOROWSKI
Head of Global Views

PIERRE BLANCHET
Head of Investment Intelligence

The macro-economic backdrop has improved, albeit at a slower pace more recently. The European response to the crisis has further strengthened investor sentiment. However, the political picture has changed over the summer in the US and deteriorated in emerging markets.

As Back to School season kicks off, we see little change on the economic front…

A recovery is underway, but it is not a "V-shaped" rebound. The epidemic is clearly not under control yet and a "W-shaped" scenario can no longer be ruled out. Conversely, progress in vaccine research and better medical treatments of the disease provide a glimmer of hope.

On financial markets, real interest rates have declined further into negative territory (in the US in particular) on the back of higher inflation expectations and sizeable Central Bank (CB) bond purchases. Low real interest rates have been (and still are) **one of the main supportive factors for risk assets.** We expect this to continue.

ECB and Fed activism is here to stay. In the absence of inflationary threat, nominal rates are under control. If inflation rises a bit, CBs will not abandon their QEs. In the Eurozone (EZ), there is some evidence that the negative interest rate policy has fuelled loan growth with limited side effects. In other words, positive effects have dominated so far. In the US, the new strategy revealed by Chair Powell at Jackson Hole (average inflation targeting over the cycle) means that a "low for longer" rate policy has been formally adopted by the Fed. A similar approach is likely to be adopted by the ECB at some point. This means that government bond yields will continue to decouple from their fundamentals for an extended period. **Thanks to this unprecedented long-lasting central bank support, governments are continuing to support their economies without worrying** about debt overdose or rising bond yields. It's therefore more of the same on the macro front.

Little change on the economic front… but the political landscape has dramatically evolved

… the political landscape has dramatically evolved since June.

The July EU summit brought cohesion to European policy response, but risks have resurfaced. The **EU Recovery fund is a strong positive signal** for markets and a sizable fiscal push. However, **a few things could still go wrong**: disagreement over supply-side reforms, lack of eligible investment projects and red tape delays. In addition, **the Brexit cliff theme is set to rise again from September on.** We expect Free Trade agreements (FTAs) for most goods, but only sector-by-sector agreements on services by the end of the year. And yet, no-deal risk is high with negative spillovers on business activities. Meanwhile, geopolitical tensions have arisen at the European border. After Ukraine, Belarus may further weaken an already fragile relationship with Russia. **Turkey has become Europe's Achilles heel.** In addition to the already deteriorated macro-financial situation, tensions with Greece have emerged over the summer (dispute over drilling rights).

The US election will take centre stage over the next few months, although both the Democratic and Republican conventions have promoted more "measured" positions than initially feared. On the Democratic side, **Biden has confirmed a centrist stance.** In particular, regulation/dismantling of big techs (one of the most disruptive topics for the markets) should not be on the agenda. A Democratic senate looks less likely, which would prevent a "Biden" administration from raising taxes significantly (the number one fear for the US equity market). The Republican platform remains vague at this point. But its general tone is no surprise (less taxes, more deregulation, more reshoring of US companies located in China, deglobalisation, less interventionism, less immigration). And with the polls showing the President Trump campaign regaining momentum, we believe the uncertainty on the outcome of the election has reduced its embedded risk. After all, if the incumbent candidate had less and less chances to win, he might have become even more unpredictable with a negative impact on markets.

Instability risk within and among EM countries

The health and economic crisis, combined with the political situation in the United States (Trump moving away from multilateralism + incoming election), is potentially conducive to geopolitical stress and national instability within EMs. Authoritarian leaders are threatened by domestic discontent, and may try to "act" before the US elections to consolidate power or advance geopolitical objectives.

At this point, we do not see a natural candidate for a "systemic" crisis, but we must closely monitor the situation in many regions/countries: Libya, Greece/Turkey, Lebanon, Belarus, protests in Eastern Russia, India & China frontier dispute. For Turkey already on a very thin ice with domestic imbalances flashing warning lights, the dispute with Greece carry additional risks.

Finalised on 01/09/2020

Amundi Research Center

Find out more about Amundi publications research-center.amundi.com

Emerging Private Equity Money Markets Find Monetary Policies Foreign Top-down Bottom-up Exchange Corporate Equities Sovereign Bonds Forecasts High Yield Fixed Income Real Estate ESG Quant Investment Strategies Asset Allocation

Document issued by Amundi, "société par actions simplifiée"- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com

Photo credit: ©MDelporte - iStock/Getty Images Plus - Yulia Naumenko

Chief editor

BLANQUÉ Pascal, *Group Chief Investment Officer*

Editor

DEFEND Monica, *Global Head of Research*

Deputy-Editors

BLANCHET Pierre, *Head of Investment Intelligence*
BOROWSKI Didier, *Head of Global Views*

With Global Research contributers

AINOUZ Valentine, *Deputy Head of Developed Markets Strategy Research, CFA*
BELLAICHE Mickael, *Fixed Income Strategist*
BERARDI Alessia, *Head of Emerging Markets Macro and Strategy Research*
BERTONCINI Sergio, *Head of FI and FX Research*
BLANCHET Pierre, *Head of Investment Intelligence*
BOROWSKI Didier, *Head of Global Views*
HUANG Claire, *EM Macrostrategist*
CESARINI Federico, *Cross Asset Strategist*
DELBO' Debora, *Global EM Senior Strategist*
GEORGES Delphine, *Fixed Income Strategist*
HERVE Karine, *EM Senior Economist*
LEONARDI Michele, *Cross Asset Analyst*
PERRIER Tristan, *Global Views Analyst*
PORTELLI Lorenzo, *Head of Cross Asset Research*
USARDI Annalisa, *Senior Economist, CFA*
VARTANESYAN Sosi, *EM Senior Economist*
WANE Ibra, *Senior Equity Strategist*

With the Amundi Insights Unit contribution

BERTINO Claudia, *Head of Amundi Investment Insights Unit*
FIOROT Laura, *Deputy Head of Amundi Investment Insights Unit*
DHINGRA Ujjwal, *Amundi Investment Insights Unit*
LICCARDO Giovanni, *Amundi Investment Insights Unit*
PANELLI Francesca, *Amundi Investment Insights Unit*

Conception & production

BERGER Pia, *Research and Macro Strategy*
PONCET Benoit, *Research and Macro Strategy*