Top Risks Map

Macroeconomic Research Team

The table below presents risk factors with judgmental probabilities (i.e. not market based). It also develops the possible market impacts.

Finalised on January 29, 2020	Analysis	Market impact
20% Trade war escalation	The signature of the Phase one deal is in line with our base case. Yet, the most complex issues (such as the current tariffs already in place and the Huawei case) have not been addressed and have been postponed till after the US elections. 2020 is a presidential election year and whoever the US President is next year, opposition between the two countries on strategic issues could worsen their relations. The likelihood of a comprehensive trade agreement is very low. Twists and turns could continue to deteriorate business confidence, investments and trade flows.	• Negative for equities and CNY • Positive for USD, US Treasury and gold
20% Mounting corporate vulnerabilities	Corporates have been piling up debt to levels even higher than pre-GFC. Sobering earnings are denting corporates' ability to service that debt and cover interest rates payments. At the same time, EM and frontier markets have been attracting capital flows from advanced economies, increasing their external debt. Tightening financial conditions and higher rates will hurt their ability to pay down their debt. Widespread distress and spikes in default rate will force deleveraging and a pullback on investment and employment, exacerbating the recession.	• Negative for risky assets • US IG BBB downgrade, increase in EURO and US HY B-CCC default • Positive for USD, US Treasury and gold
10% China hard landing	Chinese economic growth is slowing down, but authorities are working hard to stimulate the economy (through monetary and fiscal policies), so that it will remain on a manageable slowdown path. Recent data in November/December have shown a sort of mini cycle recovery; however, the brutal spread of the coronavirus out of Wuhan is offsetting the positive macro momentum. China's economic model is fragile, with signs of excessive credit. Non-financial corporate debt has surged since the GFC.	• Global financial instability • Negative for oil, basic materials, currencies of commodity-exporting countries, EM bonds • Positive for US Treasury /Bund and gold
10% US elections	At this stage, there are no trivial consequences from the US presidential election outcome. While the investor community focuses on the polls, it is critical to have a look at the policy actions that will follow from the person elected president (welfare and financial regulation, in particular). The risk scenario escalates from impeachment proceedings, more extreme foreign policy measures that might lead the situation to implode in Ukraine, Iran and Syria, the possibility of tax rates applied to corporate earnings under a new administration therefore faltering confidence and sinking economy.	• Increase in volatility • US markets disruption • Positive for gold
10% Escalating military tensions with global spillover	China/US, China/HK, Brexit, Iran/ ME, Libya – geopolitics is having a prominent influence on markets. The January strikes in Iraq raised concerns about military escalation with an impact on oil prices and global dynamics. The markets continue to price in that a major escalation is unlikely, with minimal corrections in safe havens (gold, treasury, oil, USD, and the yen) and risky assets (DM equities) after gain/losses. We expect no further escalation from US or Iraq; we expect oil price spikes to stay short-lived (unless oil supply disruption from Iraq takes place).	•Positive for oil prices and safe haven assets (FX and gold •Negative for risky assets
10% Credit illiquidity & risk misallocation	In a low rate environment, the search for yield has pulled institutional investors towards credit risk accumulation in their portfolios. Liquidity buffers have been decreasing to achieve nominal targets. The critical juncture of a maturing credit cycle and a shift in markets' structures amid regulatory changes, in the event of a sharp sell-off, might prove a tangible obstacle to investors selling their positions.	•Positive for cash, govies (US, Euro) and gold • Negative for EM bonds, global equity, HY, oil and basic materials
10% Drying USD liquidity	US dollar funding liquidity and a shrinking USD liquidity base could amplify the impact of a tightening in funding conditions and create spillover to countries that receive cross-border USD loans.	• Global financial instability • Positive for gold and US Treasury • Negative for risk assets (EM in particular)

MACROECONOMIC CONTEXT

Our convictions and our scenarios

Macroeconomic Research Team

This section provides a reminder of our central scenario and alternative scenarios.

CENTRAL SCENARIO (55% PROBABILITY): Resilient domestic demand and services despite policy uncertainty

- **Slower global growth:** the economic weakness seen worldwide during the summer continued into the fall with very few exceptions. Industrial data and business surveys continued to show that the global manufacturing sector is not out of the woods yet, although the Phase One deal between US and China may provide some relief. Domestic demand remains more resilient, due primarily to household consumption, which continues to be buoyed by very low inflation and, in certain economies, by strong labour markets. Still, services have proved more resilient than manufacturing.
- **Global trade expected to bottom out in H1 2020:** global trade has plummeted over the past 18 months, driven down by protectionist rhetoric. The damage so far to world trade momentum and the real economy will not be easily or quickly reversed, although the US and China have reached the much-awaited Phase-One deal. We expect global trade to recover very slowly in 2020. Indeed, global trade is expected to remain under pressure in the short run and to grow at a slower pace than global GDP next year. The impacts on economies differ from one region to another. European exports are being hit hard. The US is advancing steadily on the path of import substitution (imports of industrial supplies and materials fell from 27% of total imports in 2007 to 18% in 2019). EMs are trying to transform the challenges posed by trade tensions into opportunities. The clamp down on economic activity in China is expected to negatively impact world trade dynamics in the short term. In addition, we must not underestimate the role of the resilience of domestic demand as global trade patterns and production chain become more integrated at regional level.
- **United States:** a gradual return to potential, with slightly greater downside risks. The US economy, boosted by very accommodative fiscal policy in 2018, began decelerating in H2 2018 and continued to do so in the following quarters. After peaking at 3.2% YoY in Q2 2018, GDP growth gradually slowed to around 2%, with a deceleration in domestic demand driven by fixed investment deceleration against a resilient personal consumption expenditure pattern. We expect this gradual deceleration to continue as protracted weakness in global trade and manufacturing, somewhat eased by the phase one deal, may a have longer-lasting impact on the economy, on the investment side. On the consumption side, signs of decelerating total labour income growth may somewhat restrain personal consumption, which anyhow we expect to be the main driver of growth. In our scenario, corporate and consumer confidence, after suffering in 2019, should stabilise and recover somewhat. Inflation is expected to gradually move higher, while still remaining in a benign framework. In this environment, monetary policy remains supportive, and we are still pencilling in a rate cut this year. Overall, we still believe the balance of risks remains tilted towards the downside. Although a truce on the trade front has been reached, geopolitical tensions will persist and political uncertainty may be added to the framework as the presidential elections approach. Although we do not expect a recession, doubts on the extension of the current cycle could intensify over the next few quarters (with less support from fiscal policy, and domestic demand decelerating).
- **Eurozone**: the Eurozone economy remains under pressure, as uncertainty continues to characterize the global economy, although sentiment has improved recently on the US-China trade front. The Eurozone has seen a deterioration in external demand, and the manufacturing sector has been hit severely, raising the question of whether spillovers into services and other important economic sectors are materializing. However, as domestic growth drivers have remained broadly resilient, expectations on economic fundamentals have progressively turned towards a more constructive outlook and economic surprises have turned positive. In this context, we expect Eurozone growth to stabilize in 2020-2021, converging to potential, as the manufacturing crisis gradually is resolved and global trade stabilizes, albeit to a lower norm. Domestic demand should remain supported by overall health labour market, with aggregate low unemployment and moderate wage growth. These are supportive for household consumption, which is expected to be the main driver of growth. Investments should benefit from a stable economic environment, and upside risks may materialize around the new EU Commission's Green New Deal. Signals of expansionary fiscal policies remain limited to country-level implementation but have not yet taken shape as a coordinated effort. A further push remains theoretically possible, in particular should the economy worsen and struggle to rebound.

As inflation is supported in its very gradual upside move by growth stabilizing, in this context we are not expecting any new easing by the ECB.

- **United Kingdom:** The Conservative Party's victory in the 12 December elections made it possible to ratify the Withdrawal Agreement negotiated with the EU in October, which opened the door to a smooth Brexit on 31 January. A transition period will allow the UK to retain most of its access to the European Single Market until the end of 2020. During the transition period, the future permanent framework will be negotiated on UK-EU trade relations, including a free-trade agreement and provisions on services. Even so, the deadline is very tight, as the UK has served notice that it doesn't wish to extend the transition period. Uncertainty on negotiators' ability to reach an agreement could stoke fears of a trade shock at the end of 2020 (with a sudden denial of UK access to the EU market). We nonetheless expect pragmatism to carry the day and that, regardless of how tough positions are when negotiations open, an agreement will be reached allowing free trade to continue for at least the majority of goods.
- **Oil prices:** Oil prices spiked after Iraq's strikes and in the immediate aftermath of military events/retaliations could move even higher on a temporary basis as the possibility of further actions cannot be ruled out. Yet, unless a full-blown military escalation takes place, with a disruption in Iraq oil production, a sustainable shift to significantly higher oil prices is unlikely, as the elasticity of oil prices to temporary supply shock is lower than in the past, as other producers can absorb the shock. In particular, US oil production is more flexible than in the past and has proven very resilient, making oil less vulnerable than in the past to supply disruption concerns.
- **Central banks:** back to a "wait and see" attitude in AEs.
  - **Fed:** The soft outlook for inflation is maintaining a dovish stance for the future. The Fed is sticking to its easing bias, despite moving to a more data-dependent approach. In line with market expectations, our central scenario is for another rate cut in 2020, in order to maintain accommodative financial conditions and to keep US growth on track.
  - **ECB:** In a context of stabilising growth and inflation gradually moving in the right direction, and in the year of the ECB strategic review, we are not expecting any major policy change, unless the macroeconomic picture materially changes. QE2 has just started and no major new measures are expected to be delivered in the short term. **Unless a material deterioration in the macro picture occurs, we expect the ECB to keep its rates on hold for the next 12 months, as the bar looks quite high for another cut, given the very limited room left by risks of additional negative effects to the banking system.**
  - **BoJ:** The BoJ may still consider additional easing in 2020 if geopolitical risks increase again and JPY strengthens materially. We expect one, 10bps rate cut in the next 12 months on two conditions. First, a cut in the short-term interest rate target must be accompanied by realignment of the three-tiered structure in the BoJ's current account deposit in order to mitigate adverse effects on financial institutions. Second, the BoJ will obviously keep the longer-end of the curve from declining, in order to secure the slope of the curve.
  - **BoE:** The BoE still seems keen to flag that monetary policy could respond in either direction to changes in the economic outlook in order to ensure a sustainable return of inflation to the 2% target. Provided that incoming data continue to support *the case of MPC's projections,* we still believe the likeliest attitude will be to keep rates on hold over the next 12 months.

DOWNSIDE RISK SCENARIO (30%): full-blown contagion into domestic demand

- Trade war escalates and materialises into a deeper contraction of global trade, a manufacturing slump (with a spillover into services) and a currency war. Recession due to globalisation unwinding.
- Exacerbation of idiosyncratic risks (Middle East, Hong Kong, US elections), Chinese hard landing with the policy mix's inability to support a gradual slowdown, with regional and global implication on growth and macro stability.

UPSIDE RISK SCENARIO (15%): modest reacceleration of global growth in 2020

- Fiscal policy support stronger than anticipated both in Europe (Germany and the Netherlands) and possibly the US, too; unexpected coordinated fiscal push at the Eurozone level; this would pose key upside risks of a better policy mix and powerful support to a monetary-policy stance.
- Europe: significant progress on the financial architecture (capital market union, banking union, and flexible fiscal rules) could create a better framework for investments to thrive, stabilise expectations, and improve the monetary-policy transmission mechanism.
- True de-escalation between China and the US, with a meaningful trade agreement.

Macroeconomic picture by area

Macroeconomic Research Team

Finalised on 30/01/2020

United States

US growth slows, Uncertainty switches from trade to politics

- Domestic demand keeps slowing, with investment spending hit worse than private consumption. Business climate surveys show resilient services and still suffering manufacturing, but recently signs of a tentative bottoming-out are appearing.
- Seasonal factors and base effects lifted December retail sales, but overall consumption should continue to moderate gradually. Consumer confidence is compatible with decent consumption growth in the near future but softening signs for aggregate income growth coming in tell us consumption should moderate going forward. On the investment front, spending plans have significantly moderated, although there have been few signs of tentative bottoming.
- Inflation remains benign, although in the near term some upside movement is materialising (2.3% core and headline inflation); yet core PCE (1.6% YoY) remains close to, but below, the Federal Reserve's target.
- The Fed considers its policy stance appropriate and well calibrated to support moderate growth and resilience on the labour market. Yet, as we expect some disappointment to come on growth, we are pencilling in another cut in 2020.

Risk factors

- The Phase One deal may help sentiment in the short run, yet we think past trade actions have materially impacted the economy and will gradually be more visible
- Political uncertainty to rise around the Democratic candidate's program
- Geopolitical developments could pose an upside risk to oil prices if they generate a persistent supply shock, impacting our inflation outlook

Eurozone

Bottoming out

- Q3 GDP growth (+0.2% QoQ, 1.2% YoY) was slightly better than expected; economic activity was supported by personal consumption, while fixed investments moderated after a very strong performance in Q2.
- The Q4 bank lending survey confirms the relative strength of the consumer sector, with strong net demand from households across the board; though, while conditions and standards remain broadly unchanged, lending demand from corporates remains weak in aggregate,
- Preliminary Euro Area composite PMI in January remained steady, resulting from an improvement in manufacturing and a softening in services, which warrants monitoring.
- While remaining subdued, the year ended with an upside note on inflation, as both core and headline moved to 1.3% YoY.
- With this backdrop, we expect the ECB to remain on hold this year, as long as the economies develop according to a gradual recovery/stabilisation scenario while financial conditions remain accommodative.

Risk factors

- The signature of the Phase One deal should provide support to sentiment, but data on global trade flows are still having a hard time finding a bottom. The external sector may still be a drag
- Domestic political tensions may still resurface during the year
- Lack of strategic plans/ reforms implementation and design, due to political fragmentation
- While the hard Brexit risk have been removed, the risks of Brexit "cliffs" persists

United Kingdom

Growth is being driven by public expenditure but slowed by the uncertainty as to what will happen after 2020

- Brexit went smoothly on 31 January 2020. The latest economic signals are mixed.

Risk factors

- A trade shock at the end of 2020 if a free-trade agreement cannot be signed with the EU by then

Macroeconomic picture by area

Finalised on 30/01/2020

United Kingdom

- The increased public expenditure planned by the Conservative government should provide a boost to growth.
- Uncertainty surrounding the future trade framework with the EU (after the transition period expires at the end of 2020) will nonetheless continue to impede investment.

Risk factors

Japan

Virus concerns to hamper a reacceleration from the Q4/19 trough

- Consumer spending has finally started showing signs of recovery from the VAT hike-induced weakness, once households had realized fiscal compensation to disperse cashless settlements and to assist child-raising. Exports stopped falling, as demand for electronic devices from China gained momentum.
- The Diet approved the FY19 supplementary budget, which contains a part of the recent sizable economic package. Meanwhile, base money growth has accelerated, as the BOJ has suspended its tapering of JGB buying since December.
- However, inbound tourism into Japan is bearing the brunt of the outbreak of the coronavirus, now that one-third of foreign visitors come from Greater China, which normally celebrates the Lunar New Year holidays. Disruption of supply chains could exacerbate problems in the auto industry, which is already struggling with poor sales.

Risk factors

- The depth, duration and dispersion of the outbreak of the coronavirus
- The Japanese yen soars by attracting risk-averse money
- Consumer demand fails to recover on an anaemic spring wage negotiation

China

- Most of the economic data monitored rebounded in December (stable property sector and infrastructure Investments). GDP figures for Q4 2019 released as expected at 6.0% YoY. Notwithstanding the rebound, the sudden spreading of the coronavirus out of Wuhan is posing serious downside risk to growth in China.
- Headline inflation remained stable at 4.5% YoY in December and food prices shifted slightly.
- The policy mix once again proved only marginally supportive: 50bps RRR cut at the beginning of the year, and LPR on hold in January at 4.15%.
- Even so, it's rational to expect that the virus impact will fade away getting out from the winter season, the incremental lock-down/travel ban and their duration will determine how much Chinese growth and, to a far greater extent than in 2003, global growth, slows.

Risk factors

- Improving macro momentum in China is offset by negative news related to the spread of the coronavirus
- Still high inflation with a deflecting food contribution
- The policy mix is still mildly supportive

Asia (ex JP & CH)

- Economic conditions in the region improved on the back of constructive export flows out of countries such as South Korea, Taiwan and China that are heavily exposed to the semiconductor sector.
- The region's inflation figures remained very benign, although they generally increased in December. Noteworthy December figures once again came from India and China, with a high contribution from food basket components, at 7.4% YoY and 4.5% YoY, respectively.
- In January, the Malaysia Central Bank (BNM) unexpectedly reduced its reference policy rate by 25bps to 2.75%, on concerns about economic growth and the external risks to it.
- The spread of the coronavirus out of China is expected to negatively impact neighbouring countries, in particular ones receiving important touristic inflows, such as Thailand and Vietnam.

Risk factors

- Improved macro momentum on the back of semiconductor exports
- Inflation still very benign, with high levels in China and India
- BNM cut its policy rate by 25bps
- The spread of the coronavirus will impact neighbouring countries, such as Thailand and Vietnam

Macroeconomic picture by area

Finalised on 30/01/2020

Latam

- Macro momentum in the region remained stable and mildly positive. Brazil macro momentum has, in a way, stabilized but remains on the positive side, followed by Colombia. Mexico GDP decelerated in Q4 less than expected, at -0.3% YoY vs -0.5% YoY forecast.
- Inflation spiked in Brazil in December to 4.3% YoY from 3.3% YoY in November. The main driver was the food component, contributing by 1.3% YoY out of 4.3%. After two months of readings below 50% YoY, inflation in Argentina rose again in December to 50.6% YoY.
- Central banks in the region remained on hold, while the BCB Governor opened the door to further mild easing ahead.
- Talks between the Argentina government and the IMF began to deal with debt restructuring to avoid a default. A detailed timeline is expected to be released by February. On the 29th of January, the US president signed the USMCA, the trade deal replacing NAFTA.

Risk factors

- **Economic momentum overall mildly positive**
- **Inflation is overall benign. Brazilian CPI spiked on high food prices**
- **CBs in the region on hold.**
- **USMCA signed and Argentina has begun talks with the IMF**

EMEA (Europe Middle East & Africa)

Russia: Real GDP growth is expected to slow to 1.2% in 2019. However, it is expected to accelerate in 2020 and over the medium term on the back of a significant infrastructure spending programme from 2019 to 2024 and a lower-interest-rate environment.

- Despite the threat of potential US sanctions down the road, the macroeconomic scenario remains supportive. Russia is one of the few emerging market sovereigns with "twin surpluses" in 2019, while accumulating assets in its National Wealth Fund.
- The CBR cut its policy rate again in December by 25bps, to 6.25%. We expect two 25bp cuts over the next twelve months, given decelerating inflation.

South Africa: unexpectedly, the SARB cut its rate

- Despite a challenging environment regarding capital outflows and exchange rate pressures due to fiscal concerns and low growth outlook, the SARB cut its rate by 25 bp to + 6.25% in the first committee of the year. The decision of the SARB has been motivated by a downward revision of its growth and inflation forecasts as well as inflation expectations for 2020.We don't expect much more easing in the coming months due to current increasing risk aversion.

Turkey: December inflation's rebound did not change the monetary policy stance

- Despite a rebound in inflation in December, the Turkish central bank (CBRT) lowered again its rate in January by 75 bp to + 11.25% in line with the consensus. The CBRT favoured support for growth, indicating that the inflation trajectory was in line with its forecasts at 8.2% yoy by the end of 2020. The press release only contains minor changes foreshadowing further rate cuts.

Risk factors

- **Drop in oil prices, stepped-up US sanctions and further geopolitical tensions**
- **Increased risk aversion, risk of sovereign rating downgrades, rising social demands, and continued fiscal slippage in the absence of reforms**
- **Excessive easing by the central bank, a loose fiscal stance, escalation of geopolitical tensions, and a slowdown in Eurozone activity**

Macro and Market forecasts

Macroeconomic forecasts
(4 February 2020)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020	2021	2019	2020	2021
US	**2.3**	**1.9**	**1.8**	**1.8**	**2.2**	**2.1**
Japan	**1.2**	**0.7**	**0.8**	**0.7**	**0.7**	**0.6**
Eurozone	**1.2**	**1.0**	**1.2**	**1.2**	**1.2**	**1.5**
Germany	0.6	0.7	1.1	1.5	1.5	1.5
France	1.2	1.1	1.3	1.3	1.3	1.5
Italy	0.2	0.2	0.4	0.7	0.8	1.2
Spain	2.0	1.5	1.5	0.7	1.2	1.2
UK	**1.3**	**1.1**	**1.4**	**1.8**	**2.2**	**2.1**
Brazil	1.1	1.7	1.8	3.7	4.6	4.6
Mexico	-0.1	0.8	1.2	3.6	3.4	3.4
Russia	1.3	1.7	2.5	4.7	3.2	4.0
India	5.1	5.1	5.6	3.7	5.9	4.2
Indonesia	5.0	5.0	5.1	3.0	3.1	3.8
China	6.2	5.6	5.7	2.9	3.4	1.7
South Africa	0.3	0.8	1.0	4.6	4.1	4.9
Turkey	0.2	1.8	2.2	15.6	11.3	9.8
Developed countries	**1.7**	**1.4**	**1.5**	**1.5**	**1.7**	**1.7**
Emerging countries	**4.1**	**4.1**	**4.4**	**4.0**	**4.4**	**3.4**
World	**3.1**	**3.0**	**3.3**	**3.0**	**3.3**	**2.8**

Source: Amundi Research

Key interest rate outlook

	29/01/2020	Amundi + 6m.	Consensus Q2 2020	Amundi + 12m.	Consensus Q4 2020
US	1.75	1.50	1.60	1.50	1.55
Eurozone	-0.50	-0.50	-0.50	-0.50	-0.50
Japan	-0.1	-0.2	-0.11	-0.2	-0.06
UK	0.75	0.75	0.81	0.75	0.95

Long rate outlook

2Y. Bond yield

	29/01/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1.57	1.30/1.50	1.60	1.30/1.50	1.63
Germany	-0.586	-0.70/-0.50	-0.58	-0.70/-0.50	-0.57
Japan	-0.136	-0.30/-0.20	-0.13	-0.30/-0.20	-0.14
UK	0.474	0.40/0.60	0.39	0.40/0.60	0.44

10Y. Bond yield

	29/01/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1.84	1.70/1.90	1.90	1.50/1.70	1.96
Germany	-0.17	-0.20/0.00	-0.13	-0.40/-0.20	-0.08
Japan	0.00	-0.10/0.10	0.03	-0.10/0.10	0.06
UK	0.74	0.80/1.00	0.81	0.80/1.00	0.87

Currency outlook

	30/01/2020	Amundi + 6m.	Consensus Q2 2020	Amundi + 12m.	Consensus Q4 2020
EUR/USD	1.10	1.13	1.13	1.14	1.16
USD/JPY	109	107	108	105	107
EUR/GBP	0.84	0.86	0.85	0.86	0.85
EUR/CHF	1.07	1.12	1.11	1.10	1.12
EUR/NOK	10.13	9.79	9.83	9.91	9.70
EUR/SEK	10.63	10.50	10.50	10.44	10.40
USD/CAD	1.32	1.30	1.31	1.27	1.30
AUD/USD	0.67	0.69	0.69	0.69	0.70
NZD/USD	0.65	0.65	0.66	0.67	0.67
USD/CNY	6.91	7.05	7.00	7.10	6.93

Research & Macro Strategy

February 2020 #02

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