Institute

#02
February
2023

CROSS ASSET
Investment Strategy

CIO VIEWS
Play market rotations, with a focus on China

AMUNDI INSTITUTE
Why and what if inflation falls faster than expected?

Confidence must be earned
Amundi
ASSET MANAGEMENT

#02 - February 2023

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CIO VIEWS

Play market rotations, with a focus on China

Vincent MORTIER,
Group Chief Investment Officer

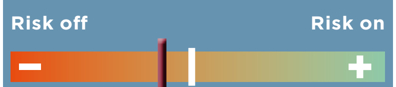
Matteo GERMANO,
Deputy Group Chief Investment Office

Markets are shifting focus away from inflation towards growth, with a slightly less disruptive economic picture for Europe and a more optimistic view on China. This is creating strong rotations: outperformances for China and EM were the most visible trends, followed by the big reversal in the dollar's strength. Intra-market rotations also materialised, with cyclical stocks favoured over defensive names in Europe while in the US, expectations of a less aggressive Fed supported tech stocks. Going forward, four themes should be crucial: (1) inflation/growth balance; (2) central bank (CB) actions; (3) dollar weakening; and (4) the corporate earnings trajectory. Any negative growth and earnings surprise could drive markets lower while there are no short-term triggers for upside at current valuation levels. This calls for a defensive allocation, but investors should play rotations as follows:

- **Maintain a cautious risk stance, but recalibrate regional preferences.** We are now more constructive on Chinese equities than on developed markets (DM), regarding which we are cautious and more in line with market capitalisation (reducing negative stance on Europe equity). From a cross-asset perspective, we are slightly positive on duration as we believe government bonds are maintaining their portfolio protection advantages. We are becoming more cautious in high yield credit while we also keep a focus on diversification through commodities such as oil and gold.
- In FI, active duration management is key. Inflation and policy rate expectations are manifesting the fastest in bond yields, which have seen a downward move, supporting our slight positive view on US duration and a marginally cautious stance in core Europe. While near-term concerns on growth should be constructive, we do not recommend taking this for granted because inflation is still high. CBs are determined to address inflation, particularly the sticky services inflation, and this warrants an active stance. On the other hand, the BoJ is likely to exit its negative rates policy following an upward revision to its 2023 inflation forecasts, making us now cautious on Japanese government bonds.
- In the "bonds are back" mantra, play credit with a selective approach. The effect of monetary tightening on corporate credit has been limited so far because of limited refinancing needs and the high use of internal cash. While the latter has supported spreads so far, it has also caused a deterioration in liquidity compared with a year ago, especially for CCC-rated issuers. Looking ahead, the effect of rising rates and low economic growth will be felt more by low-rated HY issuers. As a result, we continue to prefer IG over HY. From a regional perspective, European IG spreads are cheaper vs historical levels, whereas this is not true for US IG.
- For DM equities, investors should focus more on earnings resilience at the single-company level. The revisions on the macroeconomic front and the currency dynamics call for a more cautious stance in the US and Japan while improvements in the European economic outlook support a less negative view on the region. However, the positive scenario factored in by markets could easily turn sour due to geopolitical risks or more-hawkish-than-expected CBs. It's also worth noting that often the beginning of the year does not prove a good indication of returns for the rest of the year. The current earnings season should present a clearer picture for H1.
- Opportunities in EM, beginning with China. China continued its fast-track economic reopening and is supporting its housing market, leading us to stay constructive as we have also upgraded our growth outlook for the country. This could have a positive trickle-down effect on countries with strong trade ties to China. On EM debt, the USD trend, the EM-DM economic growth differential, and valuations are among the key drivers of sentiment.

Overall, we are entering a riskier phase as markets reassess the earnings outlook which could cause some areas of the market to correct while some opportunities to add risk could emerge in the next few weeks. Importantly, we could see an earnings recession even in a 'soft landing' economic scenario. **Hence, agility is key at this stage, but with a cautious tilt for now.**

Overall risk sentiment



A subdued earnings and economic backdrop calls for a cautious, well-diversified approach.

Changes vs. previous month

- Cross-asset: more cautious overall in DM equities and EU HY credit; positive oil.
- Equities: downgrade US, Japan; positive China.
- FI: cautious EU core govies; slight positive EM debt.

Overall risk sentiment is a qualitative view towards risk assets (credit, equity, commodities) expressed by the various investment platforms and shared at the global investment committee. Our stance may be adjusted to reflect any change in the market and economic backdrop.

AMUNDI INSTITUTE

What if the ECB turns more hawkish than expected?

Monica DEFEND
Head of Amundi Institute

Annalisa USARDI, CFA
Senior Economist, Amundi Institute

The inflation outlook for the Eurozone in 2023 is more linked to the dynamics in energy and supply chain bottlenecks, than monetary policy

Current economic assessment

Recently, we slightly upgraded our economic outlook for the Eurozone (EZ), taking stock of the data portraying better-than-expected activity in the winter so far. Recent developments in the gas market and storage levels helped remove the tail risk of energy rationing. Lower energy prices, effective national fiscal support, and news of a faster-than-expected reopening in China also improved sentiment. Looking ahead, even if the winter economic downturn is likely to prove more shallow than feared, we think headwinds for the EZ economy persist. In particular, tighter monetary conditions would be passed on to the real economy and keep economic growth subdued throughout 2023.

Simulation of a hawkish ECB: if the ECB hikes policy rates to 4% and beyond

While headline inflation gave signs of moderation in the EZ and globally, underlying inflation remains sticky and on an upward trend, showing that the supply shocks that hit the economy earlier have not yet been fully eliminated. This supports a hawkish approach by the ECB, in our opinion, with some upside risks at this stage. Wary of this, we simulated the implications of higher interest rates and the ECB's tighter policy for longer on inflation and economic growth.

Key assumption is that both growth and inflation prove more resilient than expected

For the ECB to stick to a deposit rate of 4% or higher, we assumed economic conditions in H1 2023 would point towards more resilience, in both growth and inflation, than is expected in the baseline scenario for Q4 2022 and Q1 2023 (where we assume only a mild contraction). At the same time, we assume that labour compensation continues to strengthen during H1, not only due to negotiated wages but also due to a pickup in wage growth in new open positions. This may be the result of a persistently tight labour market, which could raise concerns of second-round effects and inflation persistence among policy makers.

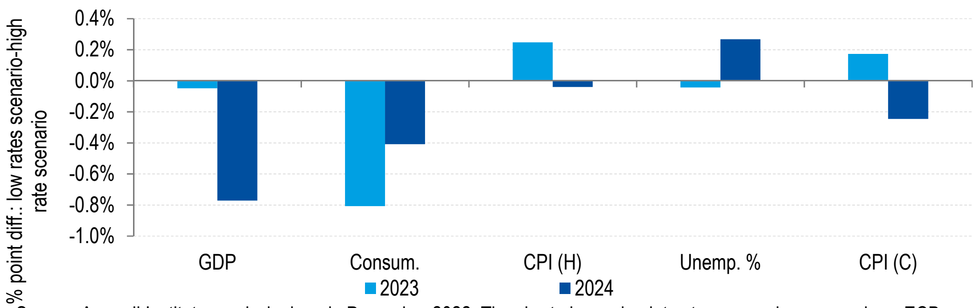
Sticky core inflation is leading the ECB to tighten policy aggressively and thus markets react. Dispersion of the cost of borrowing for non-financial corporates across Eurozone countries widens significantly and fragmentation risks mount. As a caveat, the scenario on commodities, oil, gas, global growth and government spending remains unchanged vs the baseline.

Implications for the economy

In this context, our simulations point to prolonged weakness from H2 2023, when we anticipate a severe contraction, followed by uncertain developments entering 2024. Overall, this translates to much weaker growth, especially in 2024. We believe this will be a result of a combination of the effects of monetary policy tightening, withdrawal of fiscal support, and persistent cost of living stress, given that underlying inflation, while moderating from the current highs, remains rather sticky notwithstanding the downturn. Briefly, such a development would resemble what could be interpreted as a "policy mistake": although tighter policy negatively affects GDP, employment, income and investments, it doesn't lead to significant progress in controlling inflation (as targeted by the ECB) over the forecast horizon.

From another angle, it equates to acknowledgement that much of the progress on the inflation front this year would not depend prominently on monetary policy, given that the nature of the shocks (supply side, i.e., bottlenecks, energy) that generated the inflation surge in the first place still have to be fully absorbed and passed through. However, we are monitoring key triggers and risks: wage growth dynamics and moves towards wage indexation; stickiness and breadth of core inflation; supply-side bottlenecks easing; cost of energy and food.

Impact of a hawkish ECB on the economy



Source: Amundi Institute, analysis done in December 2022. The chart above simulates two scenarios – one where ECB rates (deposit facility) are close to 3-3.25% and another where interest rates are close to 4% – and their effects on economic parameters such as GDP, consumption, CPI headline, unemployment rate and CPI core.

MULTI-ASSET

Benefit from divergences, but stay defensive

Francesco SANDRINI,
Head of Multi-Asset Strategies

John O'TOOLE,
Head of Multi-Asset Investment Solutions

Our concerns around a profit recession in the US in H1 lead us to be cautious and strengthen our diversification

We confirm our economic deceleration scenario but acknowledge the evolving backdrops around global earnings, inflation and monetary policy. **However, we notice the divergences made possible by the evolving Covid policies and strengths of individual regions such as China.** On the markets front, sentiment has improved of late, but this was mainly the result of the dollar weakening and a change in the pace of interest rate hikes by central banks. There is no indication of improving fundamentals at a global level yet. **As a result, we stay cautious on risk assets and recommend investors consider benefitting from market rotations.** This is also a time to enhance portfolio diversification through commodities such as oil.

High conviction ideas

We turned more cautious on DM equities overall mainly through the US and Japan. In the former, the earnings season should lead to lower guidance on margins and profits. We also adjusted our views on Europe to become less defensive, owing to our preference for maintaining a more consistent regional stance in line with our risk views. We are assessing how European earnings and valuations evolve vs the US. For the time being, we favour the US over the EZ due to higher risk of stagflationary shocks, and in US, we prefer small over large caps. In EM, we upgraded China due to the country abandoning its zero Covid policy and expectations around investor flows.

We keep a slightly constructive stance on duration through 10Y USTs. They should benefit from the Fed's slowdown in the pace of rate hikes, lower inflation, and a weak economic outlook. Valuations also look attractive. Elsewhere, we are now defensive on Japanese government bonds. We think the BoJ is likely to relinquish its yield curve control (pushing yields higher) in H1 to control high inflation. In Canada, our view on 2-10Y swap curve steepening is maintained. The curve is one of the most inverted in this maturity segment and has the strongest bull steepening potential. Closer to home in Europe, we stay positive on 10Y BTP-Bund spreads, which have been resilient. Foreign investor flows are now less of a driver of Italian BTP markets than they were in the past.

Risks in credit markets persist and we expect economic growth to slow. We think valuations in US IG are close to fair value and we are neutral for now. In Europe, the HY outlook has deteriorated and we are now more cautious than before. The rally has gone too far and prices are not in line with our earnings and economic growth expectations.

In FX, we maintain our cautious stance on EUR/JPY as the yen should benefit from its safe- haven status and the BoJ's policy stance. We are also defensive on the GBP vs the USD and CHF. The UK's weak relative economic growth is a headwind for the cyclical pound. In addition, the NOK should continue to do well vs the CAD (cyclical FX). In EM, the BRL/USD is likely to benefit from positive domestic macro developments, China's re-opening, and a less aggressive Fed, but we are monitoring the evolution of domestic politics.

Risks and hedging

Investors should consider a more diversified stance through oil, which should benefit from structural imbalances and is also a safeguard against risks from a potential geopolitical crisis involving Iran (vs US, Saudi Arabia, Israel). Similarly, gold offers diversification and protection in times of stress arising from a deeper-than expected-recession. Further, we think financial hedges in the equity and HY credit spaces must be maintained in order to protect against a potential weakening of fundamentals in Q1.

Amundi Cross Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities*	↘			□				
Credit & EM bonds**	↘				■			
Duration						■		
Oil***	↗					■		
Gold						■		

Source: Amundi. The table represents a cross-asset assessment on a three- to six-month horizon based on views expressed at the most recent global investment committee. The outlook, changes in outlook and opinions on the asset class assessment reflect the expected direction (+/-) and the strength of the conviction (+/++/+++). This assessment is subject to change and includes the effects of hedging components.

FX = foreign exchange, IG = investment grade, HY = high yield, CBs = central banks, BTP = Italian government bonds.

*We became more cautious on equities overall, with a stance on the lower side of the single minus.

**While we are neutral on credit and EM bonds overall, we moved to a more cautious position in Euro HY.

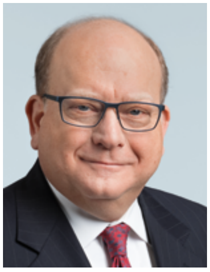
***We added further regarding oil vs last month, but the overall stance remains at +.

FIXED INCOME

Credit in focus, but quality at the forefront

Amaury D'ORSAY,
Head of Fixed Income

Yerlan SYZDYKOV,
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

In the "bonds are back" market theme, play IG credit while staying cautious in HY

Central banks are concerned about inflation, along with the risk of losing their credibility. As a result, they are hesitant to move to a dovish pivot yet. Markets, on the other hand, are worried about the impact of higher rates on end-consumption, which in turn could affect corporate profitability and cash flows. **While companies spruced up their balance sheets after the Covid-19 crisis, they now face a host of challenges: higher funding costs, energy prices, and in some cases higher labour costs (US).** We think the investment grade space is well positioned, as fundamentals have improved in recent years, while high yield is at risk, as the default outlook could deteriorate in the near future. Thus, with an overall vigilant approach, we stay selective, maintaining a preference for IG over HY. There are also select opportunities in EM debt amid a weakening dollar.

Global and European fixed income

We keep our marginally cautious stance on duration (core Europe and Japan, neutral US) but are vigilant regarding inflation, monetary policy, and yield movement dynamics to adjust this. On peripheral debt, while our stance is close to neutral, we are assessing yield curves across different regions to identify any discrepancies. **The level of economic activity across the developed world has surprised to the upside, and that is positive for corporate credit.** However, questions remain as to what extent the situation will improve, leading us to monitor credit quality and defaults. Hence, we are selective and keep a slightly constructive stance and a preference for IG over HY. We also believe valuations in EU IG are attractive, but follow a rigorous selection process based on idiosyncratic risks. In particular, we like subordinated financials and government-guaranteed debt.

US fixed income

US core inflation has been stickier than headline, and wage growth is also above the levels consistent with the Fed's target for long-term inflation. **Hence, policy actions and a 'pause,' if any, will be determined by the evolution of labour markets and services inflation.** This leads us to actively manage our duration stance, with a positive bias currently. Although agency mortgages offer attractive long-term value vs government bonds, we are monitoring how shifting valuations and QT impact returns. For now, we remain careful, as spreads are tied to interest rate volatility. In corporate credit, we are very selective and believe investors should limit their spread duration. Specifically, we favour IG over HY and financials over industrials. Having said that, liquidity remains an important factor for us, but issuer fundamentals are robust, at least for now.

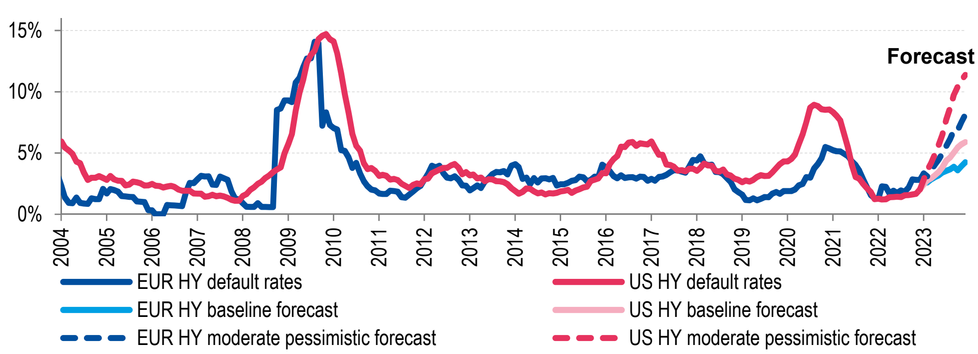
EM bonds

While we remain marginally defensive on duration, we keep a **cautiously optimistic outlook.** EM offers attractive carry after last year's surge in global yields. HC bonds offer compelling entry points. In particular, we like Brazil and South Africa (commodity exporters). **LC bonds and FX should benefit from a potential peak in the USD,** as we explore upside potential in select CEE countries.

FX

We are now **neutral on the USD** on concerns of a potential reversal in capital flows, but on JPY and NOK, we stay constructive. A weaker USD could promote a positive environment for select LatAm FX, where we are positive on MXN and BRL. In Asia, we like IDR and THB, but are defensive on the TWD, PHP and certain Eastern European FX.

US and European HY default outlook



Source: Amundi Institute, Moody's. Data as of 25 January 2023. Forecasts start from January 2023.

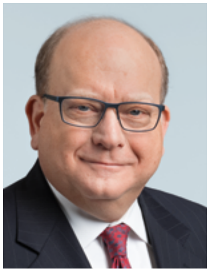
GFI = global fixed income, GEMs/EM FX = global emerging markets foreign exchange, HY = high yield, IG = investment grade, EUR = euro, UST = US Treasuries, RMBS = residential mortgage-backed securities, ABS = asset-backed securities, HC = hard currency, LC = local currency, MBS = mortgage-backed securities, CRE = commercial real estate, QT = quantitative tightening. CEE = Central and Eastern Europe

EQUITY

Excessive optimism priced in after the rally

Kasper ELMGREEN,
Head of Equities

Yerlan SYZDYKOV,
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

Overall assessment

The double whammy of declining household purchasing power and slowing economic activity is creating pressures on earnings and margins. The downward trend is likely to continue for some time, but is already priced into many companies' valuations. This has led to volatility and return dispersion, making it a stock picker's market. **Thus, our focus remains on valuations and on identifying companies with the ability to defend earnings and those with low debt.** These are more likely to withstand higher borrowing costs and avoid any need to raise equity. Overall, we stay vigilant on corporate margins, with a preference for value, quality, high-dividend names.

European equities

We keep a balanced approach, combining a preference for high quality and value stocks. In particular, we like cyclicals (industrials), but are not tempted to upgrade after the recent rally. However, the problem of underinvestment in energy supply persists, leading us to explore the sector. In financials, interest margins and earnings should be boosted by higher rates. We prefer retail banks given their robust balance sheets and valuations. At the other end, select defensive names look cheap. **We focus not only on a company's quality of earnings, but also evaluate how our portfolios can maintain a diversified exposure to end-consumer markets.** In staples, we prefer businesses whose pricing power ensures that rising input costs can be passed on to customers without affecting sales. Many of these businesses' balance sheets provide a shield in times of rising rates. Conversely, we are cautious on utilities, tech.

US equities

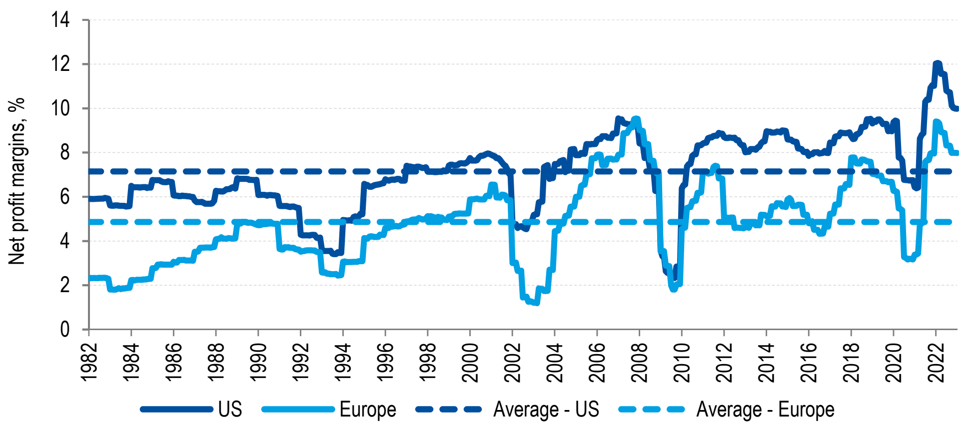
Current earnings guidance does not fully reflect the upcoming economic slowdown, even as we see huge valuation anomalies in the market. This, along with the likely negative effects of the rising USD last year on Q1 and Q2 corporate earnings, and with profit margins at record levels, leads us to be **very selective and cautious on mega-cap names.** On the other hand, we are debating about the timing and which sectors would do well (beyond energy and banks) after the environment eventually improves. Being either too early or too late could hamper returns. As a result, we remain active and are moving only gradually by exploring businesses that could deliver earnings growth in a slowdown. We like banks, but credit risk remains a key parameter for us. From a style perspective, we **like quality and value, but note that cyclical names are becoming less attractive after recent rallies. We avoid unprofitable growth and distressed value,** and believe the staples, utilities and real estate sectors are not attractive.

EM equities

The asset class is supported by an earlier-than-expected China reopening, plus attractive valuations and earnings expectations. However, we are selective in light of geopolitical tensions (Ukraine war, China/Taiwan) and the subdued growth outlook in certain cases. We are becoming **constructive on China,** playing the Covid policy-induced rebound, and maintain our constructive view on Brazil. At a sector level, we are positive on consumer discretionary and real estate. We also prefer energy over materials, but remain cautious on healthcare and tech semiconductor names.

Notwithstanding the weak earnings growth estimates, we could still be surprised on the downside. Hence, we are cautious and look for sustainable margins

Margins have fallen, but are still above their long-term averages



Source: Amundi Institute, DataStream as of January 2023. DataStream indices above representing US and European markets.

THIS MONTH'S TOPIC

Mahmood PRADHAN,
Head of Global Macroeconomics, Amundi Institute

Annalisa USARDI, CFA
Senior Economist, Amundi Institute

Why and what if inflation falls faster than expected?

High inflation has not triggered a wage-price spiral in the advanced economies. Monetary tightening has contained inflation expectations and a continued firm stance will bring down inflation, possibly faster than expected.

There is now broad consensus that headline measures of inflation have peaked and are on the way down, both in the United States and in Europe. However, core inflation remains elevated for central banks to take sufficient comfort, and especially in Europe, where it is still rising. Our central case sees the Fed and the ECB continuing to tighten until the second half of 2023 and maintaining a restrictive policy stance. With fiscal support also expected to wane gradually, could this lead to lower inflation pressures in the second half of 2023 and a faster decline in inflation? We consider some of the factors that could exert downward pressures on inflation relative to our central scenario.

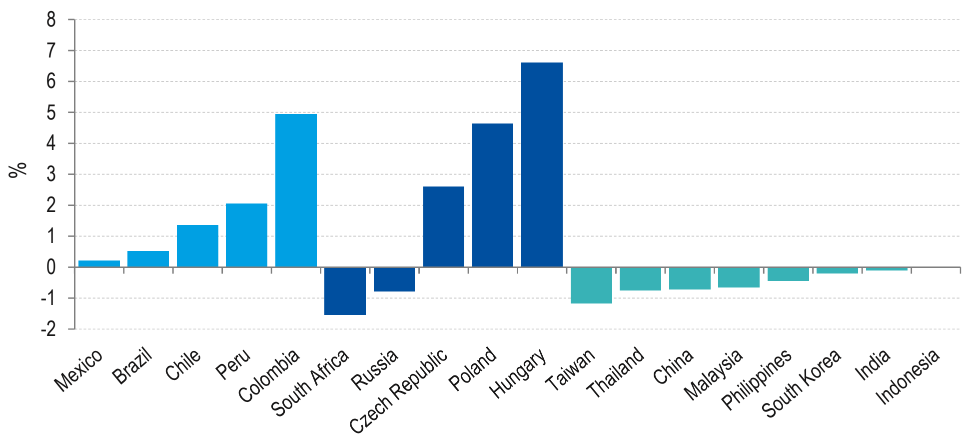
In the United States, our central scenario of headline inflation at 4.3% is marginally more positive than official forecasts (the Fed's median Dot Plot) because of our expectation of a more subdued growth outlook for 2023 and 2024, with a relatively high 40% probability of a recession in the second half of 2023. Among the major components, goods prices are deflating at a faster pace than we had expected, while services inflation and the shelter components will decline only gradually, keeping core inflation stubbornly high for a while longer. That said, both headline and core measures have turned decisively.

In Europe, we expect lower energy prices to continue to exert significant down pressure on headline inflation, but core inflation to remain elevated and decline very gradually, to a little under 4% at the end of this year. This reflects our expectation that the overall wage bill (employment compensation), which is still moderate, will continue to increase by about 3.5% this year and next. As a result, monetary policy makers will remain cautious on any near-term pause until core inflation is firmly on a downward trend.

Inflation in emerging markets has also peaked, though from very elevated levels, and with wide differences across countries. On balance, China's reopening should reduce EM inflation as supply chains continue to normalise, notwithstanding some offset from higher commodity prices.

As fiscal support should wane, this could lead to lower inflation pressures in the second half of 2023 and to a faster decline in inflation

1/ **Q4 2023 Change in inflation expectations relative to upper bands of CB targets**



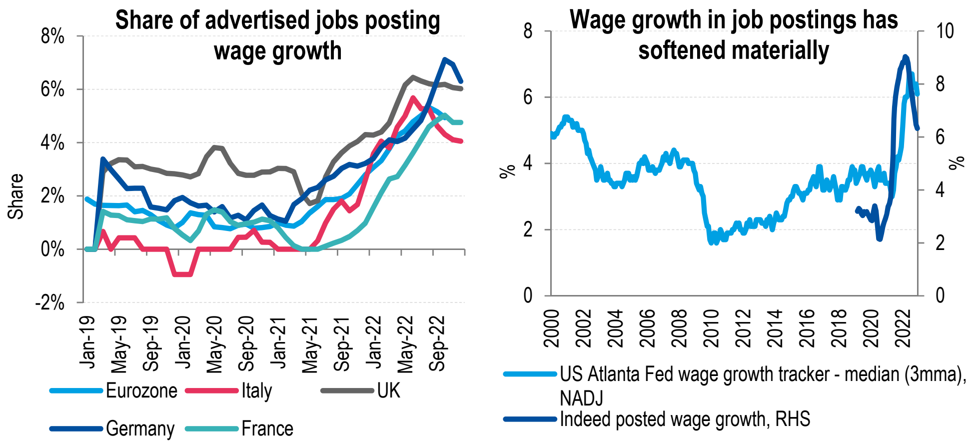
Source: Amundi Institute, CEIC, Bloomberg. Data is as of 24 January 2023.

Why inflation could fall faster?

1. **Lower risk this time of a wage-price spiral.** In many previous episodes of rising inflation, wage growth did not accelerate when real wages were falling and inflation expectations remained anchored because of monetary tightening. A recent IMF study confirms this for 22 similar periods of rising inflation in advanced economies. The current episode of high inflation, which does not emanate from labour markets, shows similar characteristics, both in Europe and in the United States – real wages falling despite positive nominal wage increases, but with monetary policy expected to remain tight. In the United States, where labour market pressures have been more intense, average earnings are already moderating and there is evidence that employers are offering lower wage increases on advertised job offerings (compared to median wage growth on existing jobs).

THIS MONTH'S TOPIC

2/ Wage growth: Eurozone vs. United States



Source: Amundi Institute, Datastream. Data is as of 25 January 2023.

2. **Financial conditions will get tighter.** Despite substantial monetary tightening thus far, financial conditions have eased recently as markets have been cheered by the resilience of growth. However, the typical lags associated with monetary policy will eventually play out, and borrowing costs for firms and households have already tightened substantially. Add to this, little prospect of any sustained fiscal support for demand, overall macro policy will not add to inflation pressures. Even in Europe, many governments will find it difficult to maintain current levels of support for energy bills.
3. **China reopening will ease inflation pressures.** Economic activity in China gradually normalising will relieve supply chains and reduce inflation pressures globally. On balance, this effect will outweigh higher domestic demand in China, which will largely affect consumption, as compared to significantly higher overall demand for commodities (with the exception for some industrial commodities). Any significant rise in domestic inflation in China could also bring forth some policy tightening.
4. **Still weak growth outlook.** Growth in the United States and in Europe is projected to remain very subdued (well below potential) for this year and next, with a material probability of a recession in the United States and Europe. With very little policy space to respond, a period of protracted weakness should weigh on inflation.

A scenario of headline and core inflation falling proportionately would be a strong positive for most asset classes

What if inflation falls faster than expected?

With respect to asset prices, the most favourable scenario would be a proportionate fall in both headline and core measures due to wage moderation, sustained lower energy prices, and the lagged effects of monetary policy tightening already in the pipeline. This would be a strong positive for most asset classes -- essentially a 'good' soft landing. By contrast, if core inflation remains sticky (while headline continues to fall), central banks will be in a bind. They will continue to worry about prospective wage inflation and inflation expectations. Central banks being less patient will increase the risks of a harder landing, which will depress equity markets and lead to a bear flattening in rates markets.

However, a faster fall in inflation could be a mixed blessing. If inflation falls because of a sharper than expected decline in growth, the risks of a deeper recession and protracted weakness will be significant, especially as this time there is little room for a policy response. Beyond fixed income, most asset classes will be under sustained pressure.

Finalised on 2 February 2023

CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We revise the probabilities of our alternative scenarios. Some of the risk factors we identify may occur in our central scenario, which is probably not yet fully priced in, especially by equity markets. **We think risks remain skewed to the downside in the short term, but at the same time, we believe that it would take an unlikely combination of several risk factors to trigger the downside scenario at the 12-18 month horizon.** At this horizon, we believe that the upside scenario of rapidly falling inflation is now more likely to materialise. Indeed several factors of different nature can push prices down: easing gas prices, combined tightening of global monetary policies (which has a delayed impact), and normalisation of global value chains thanks to China's re-opening.

DOWNSIDE SCENARIO 10%

Recession in DM

Analysis

- Worsening/expanding **war in Ukraine.**
- Worsening energy crisis and **deep recession in Europe, coupled with a US recession.**
- **Covid-19 resurgence.**
- **De-anchoring of inflation expectations.**
- **Governments can no longer implement countercyclical fiscal policies.**
- **Climate transition measures postponed.**

Market implications

- Favour cash, USD and US Treasuries.
- Play minimum-volatility strategies.
- Gold.

CENTRAL SCENARIO 70%

Stagflationary episode, with rising divergences and persistence

Analysis

- **Stalemate in the Ukraine war.** We expect a ceasefire at some point in late 2023; in the meantime, the situation is likely to deteriorate further.
- **Energy crisis is here to stay.** Gas prices expected to rise in the restocking phase.
- **Covid-19** is an endemic disease.
- **Sticky core inflation due to unit labour costs.** Inflation fails to return to CB target by 2024.
- **Global economic slowdown in 2023,** but with growing divergences: anaemic growth in Europe, rising recession risks in the United States, rebound in China with the reopening. Sub-par growth expected in 2024 in most DM.
- Global **nominal GDP to trend higher,** mitigating the impact on earnings.
- **CB divergences:** Fed and ECB to stop hiking rates by mid-2023; PBoC on an easing bias.
- **In Europe, fiscal policies** have not been well coordinated and targeted, but Europeans are making progress on consultation to respond to the US IRA. The US fiscal impulse is expected to be neutral for 2023-24.
- **Climate change** adds to stagflationary trends.
- **Climate risk** hampers growth

Market implications

- Lower risk-adjusted real returns expected.
- Contained steepening of yield curve, govies regain their function of hedging against a deeper recession.
- Inflation hedge via gold, linkers, equities, real assets, and commodities.
- EM: short-term caution, long-term real income, and growth story intact.

UPSIDE SCENARIO 20%

Inflation falls back

Analysis

- **Ceasefire in Ukraine in sight.**
- **Russia resumes partially gas exports to Europe,** commodity market normalises.
- **Inflation and core inflation fall back quickly.**
- **Recession fears** dissipate and inflation returns to more normal levels, easing pressure on CB.
- **No V-shaped recovery,** but reduced uncertainty and increased confidence may yet fuel domestic demand in DM.
- **Climate change** policies and energy transitions top priority.

Market implications

- US Treasury curve to bear steepen.
- Favour risky assets with cyclical and value exposure.
- USD depreciation.
- Selective increase in the exposure to EM debt in LC.

Geopolitics *Covid-19 related topics* *Recovery plans or financial conditions* *Economic or financial regime*
Growth and inflation expectations *Solvency of private and public issuers* *Social or climate related topics*
Monetary and fiscal policy

TOP RISKS

Monthly update

We see risks on all fronts, but with a little less intensity at the beginning of the year. As such, we lowered the probabilities of the economic and financial risks from 25% to 20%. Economic fundamentals have deteriorated globally, which is reflected in the central scenario, but is not yet fully priced in the equity market. The course of the Ukraine war and its potential implications can tip the scenario in either direction: risks are tilted to the downside in the short term, but the probability of ceasefire by year-end remains significant. We consider Covid-19-related risks as part of the economic risks. Risks are clustered to ease the detection of hedging strategies, but they are related.

ECONOMIC RISK 20%

— **Global recession** driven by an oil/gas shock, tightening monetary conditions, and a loss of purchasing power.

— **Severe energy crisis in Europe,** leading to a **deep recession** (confidence shock).

— **Economic crisis in Eastern Europe** following a collapse of the Russian economy, elevated energy prices, uncontrolled inflation, and migrant crisis.

— **Central banks continue to raise interest rates**, giving priority to the fight against inflation.

— **Global profit recession** triggered by the global slowdown, coupled with persistent input-cost pressures.

— **End of the great coincidence:** with stagflationary pressure, CB and governments' goals are no longer fully aligned: the room for countercyclical fiscal policies is reduced.

— **Europe: inconsistency in the policy mix (accommodative fiscal stance coupled with restrictive monetary policy)**

— **Pandemic:**
- Risk of a more dangerous and vaccine-resistant variant.
- New lockdowns or mobility restrictions.

— **Climate change-related natural events** hurt growth visibility and social balance.

+ **Cash, linkers, JPY, Gold, USD, Quality vs. Growth, Defensive vs. Cyclicals.**

- **Risky assets, AUD CAD and NZD, EM local CCY.**

FINANCIAL RISK 20%

— **US debt ceiling**
- Republicans and Democrats fail to reach a compromise: the risk of a US default causes severe financial turbulence and possibly a serious financial crisis

— **Sovereign debt crisis:**
- An extended war in Ukraine would hurt DM vulnerable public finances with public debt ratios already at historic highs.
- De-anchoring inflation expectations could lead to harsher monetary tightening and to a bond market dislocation.
- Most countries are vulnerable to rating downgrades and rising interest rates.
- Weak EM could face a balance-of-payment crisis and increased default risks.

— **Corporate solvency risk increases,** amid deteriorating fundamentals, rising uncertainty, and corporate margins under pressure (high input cost, double orders lead to profit warnings).

— **Widespread greenwashing and ESG investment bubble undermine the energy transition funding.**

+ **CHF, JPY, Gold, CDS, optionality, Min Vol.**

- **Oil, risky assets, frontier markets and EMs.**

(GEO)POLITICAL RISK 25%

— **Ukraine war:**
- **Risks are titled to the downside.** There is a **60% likelihood** of a negative development of the war, including a **25% likelihood of direct confrontation with the West.** This risk grows the more Russia faces military defeats.
- Despite our expectation for the conflict to worsen in the meantime, **our base case is an end to hostilities 2023** (most likely H2) at **35%** likelihood.

— Following mid-term election, **the United States will focus on domestic political battles, which will heighten tensions with China,** as Republicans and Democrats compete for hawkishness, **contributing to growing the 'Taiwan' risk in 2023.**

— **EM political instability is driven** by higher food and energy prices, leading to a wave of social unrest.

— Iran or Korea **nuclear programmes** renewed concerns and sanctions.

— **Cyber-attack or data compromise,** disrupting IT systems in security, energy, and health services is elevated, as Russia seeks to undermine Western support to Ukraine.

+ **DM Govies, Cash, Gold, USD, Volatility, Defensive, Oil.**

- **Credit and equity, EMBI.**

CROSS ASSET DISPATCH: detecting markets turning points

Monthly update: The traffic light on technicals has turned from red to green and from red to orange on sentiment.

The turning point has occurred | Approaching the turning point | Not reached yet too early to call it

ECONOMIC BACKDROP

- Economic momentum is slowing globally amid persistently high inflationary pressures. Recession risks remain significant for H2 2023 in the United States, while for Europe the outlook has improved somewhat, although we keep expecting sluggish/contracting GDP growth in winter and below-potential growth in H2.
- Headline inflation is likely to have peaked in the United States and Eurozone. However, this is not yet clear for core inflation, particularly in Europe. Overall, we expect underlying inflation in both the US and Europe to show a higher degree of stickiness than headline, which has started to correct visibly lower, as base effects contribute to dragging down energy inflation. This underlying stickiness will be an important driver of monetary policy choices.
- The prolonged stress on the geopolitical front and the tug-of-war between fiscal support and monetary policy tightening make the final economic outcome uncertain, exacerbating data volatility.

FUNDAMENTALS & VALUATION

- Stocks look less expensive after their recent pullback, but we do not see any strong catalysts for entry points in the next few weeks.
- Stock multiples look more aligned with the current inflationary environment and tight monetary policy, but are not pricing in fully the expected profit recession. In relative terms, considering high rates, fundamentals do not favour risky assets.
- Fundamentals deteriorated further; a profit recession is the central case for H1 2023, as well.

NEUTRAL + ASSET ALLOCATION

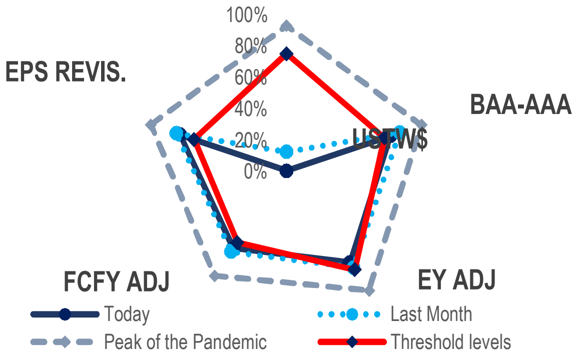
TECHNICALS

- Technicals remain mixed in January 2023. Most assets rallied strongly in early 2023, with very few exceptions. Trend-following metrics keep showing positive asymmetry for all assets, with a preference for duration products (credit and government bonds) over equity. On the other hand, most contrarian metrics show market complacency. RSIs are back to the upper bounds of their range (signalling that markets are becoming overbought across the spectrum) and positioning reinforces the message (there was no capitulation in positioning in 2022 and equity was added to the first month of 2022).

SENTIMENT

- The three consecutive downside surprises on inflation have induced a sharp reset in rates volatility since Q4 2022, resulting in easier financial conditions and improving risk sentiment metrics. Sentiment has improved strongly since last year and the dollar has been one of the main drivers lately (our CAST OFF probability fell sharply in response to that, although EPS revisions and credit risk premium remain above alert). On the other hand, financial conditions eased but are staying historically tight. Market risk concentration is growing and suggests being cautious in chasing the market (most assets rebound in tandem, while systemic risk is rising). That leaves our sentiment pillar in neutral-positive zone in January 2023.

Cross Asset Sentinels Thresholds (CAST) – The sell-off in the USD has been the strong supportive factor since November 2022, in turn translating into low CAST OFF probability. The message is confirmed in January 2023.



Source: Amundi Institute. Data as of 24 January 2023.

CAST risk perception improved strongly since November 2022, as the sell-off in the USTWD has more the offset the negative contribution coming from the other sentinels. EPS revision and credit risk-premium have been improving since Q4 2022, but remain above alert.

Methodology: We consider five input variables, called 'sentinels': US trade-weighted dollar, Moody's Baa-Aaa spread, EPS revisions, adjusted earnings yield risk, and adjusted cash flow yield risk. These sentinels are used to reposition our tactical asset allocation. Once sound thresholds are detected, the five variables are aggregated as an indicator that anticipates any market stress conditions, with a certain level of conviction. The pentagon visualises the five sentinels, where the red line represents the alert threshold. The greater the distance above the red line, the greater the risk perception, and eventually the need to move closer to a defensive asset allocation.

AMUNDI INSTITUTE CLIPS

1 What if inflation drops much faster than expected?

- We foresee different outcomes, depending on the cause of such a drop.
- A drop of 2% faster than our current projection for 2023 – both in the United States and in the Eurozone – could result in a risky-asset-friendlier scenario if core inflation falls at the same pace and if such a positive surprise on price pressures is not the result of lower-than-expected growth.

Investment consequences

- Cross asset positioning remains defensive, with UW on equities and OW on HY.
- We have downgraded government bonds, but they remain in OW territory.
- IG moved to neutral.

2 What if the ECB terminal rate is 4%?

- A higher ECB terminal rate will entail higher costs on the growth front with few benefits on the inflation side.
- If inflation proves stronger than expected in the first half of 2023, the ECB will be more hawkish than currently expected and may push rates up to 4%.
- This should cause a prolonged contraction in the second half of the year and, overall, much weaker growth in 2024, due to monetary tightening and the cost-of-living issue, while core inflation should remain sticky overall.

Investment consequences

- EUR should prove stronger than expected against USD.

3 QT and supply fallout on euro government rates

- This year net euro issuance is set to rise sharply: net EMU-10 issuance should jump to €420bn, EU issuance to €150bn, and core and semi-core issuance to €300bn from €226bn.
- This means that a total of €720bn will have to be absorbed by markets this year, with supply coming from both core and semi-core countries, while peripheral supply is expected to fall from €140bn to €120bn overall.

Investment consequences

- Short positioning on euro duration.
- Cautious stance on peripheral spreads.

4 Budget trends across the Eurozone

- The rise in borrowing rates is not an immediate threat to public debt sustainability.
- Eurozone government debts are staying on a sound path in the near term, thanks to the still favourable interest rate-GDP growth differential.
- However, in the long term, a return to fiscal discipline is needed to ensure debt sustainability. In this respect, 2024-25 budgets will be key.

Investment consequences

- Stay short on euro duration.
- Cautious stance on peripheral spreads.

5 Earnings season early takeaways

- First US results have been positive so far, beating expectations by some 5%.
- S&P 500 EPS for Q4 2022 is forecasted to be the first negative quarter since Q3 2020, with a -1.6% drop, resulting in end-2022 earnings at +4.5%; materials and communications services should be the worst sectors.
- Stoxx 600 Q4 EPS is expected at +14.5%; FY2022 at +19.9%.
- Overall, 2023 is setting the lowest bar ever for S&P 500 EPS growth expectations (+3.2%); in Europe, expectations are close to zero (0.6%).

Investment consequences

- US equities downgraded to UW from neutral against rest of the world, mostly on the growth-value argument.

6 Outlook for primary credit markets

- We foresee limited fallout on primary credit markets from rate hikes, as low refinancing needs and heavy use of cash holdings have mitigated the fallout of monetary tightening thus far.
- However, higher funding costs and slowing growth should start hitting low-rated high-yield issuers the most in 2023.

Investment consequences

- Long credit: we keep our preference for Europe over the United States and for IG over HY.

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	-/=	▼	Growth deceleration in the near future and its subsequent impact on earnings and margins, which are already very high, makes us very vigilant. In this environment, we are very selective, focusing on value, dividends and quality stocks because valuations, in general, are inconsistent with the earnings outlook.
EQUITY PLATFORM	US value	+		We continue to see a valuation dispersion between value and growth and this is likely to support the former's performance. However, we prefer combining value with quality amid slowing economic growth.
EQUITY PLATFORM	US growth	--	▼	Expensive growth and mega cap names demonstrate different valuations vs the rest of the market, and continue to be segments we are avoiding. Higher policy rates and slowing inflation mean higher real rates, which are negative for valuations of longer duration growth stocks.
EQUITY PLATFORM	Europe	-/=	▲	Energy and cost of living crises are shaping the outlook for European equities, as they directly affect end-consumption and, by extension, corporate earnings. While we are seeing some decline in gas prices and attractive valuations from an historical perspective, we are still cautious, owing to concerns about earnings, and prefer strong balance sheets.
EQUITY PLATFORM	Japan	-/=	▼	We think the Bank of Japan is likely to exit its negative rates policy, putting upward pressure on the yen, which in turn could weigh on Japanese exports. However, China reopening should be positive and we prefer to stay balanced.
EQUITY PLATFORM	China	+	▲	Continuation of economic reopening is likely to boost economic activity, along with an easier policy environment for e-commerce companies. We remain slightly constructive and selective (given the geopolitical risks with respect to relations with the US and Taiwan), looking for long-term stories with the potential for sustainable returns.
EQUITY PLATFORM	Emerging markets-ex China	=		EM should be supported by better valuations and earnings prospects, particularly for countries with strong finances. But given some geopolitical risks, we believe the scope for selection is high. Given this background, we are constructive on Brazil, but vigilant regarding President Lula's policies. We continue to favour value over growth.
FIXED INCOME PLATFORM	US govies	=/+		The Fed remains concerned over rising prices and doesn't want the market to interpret the reduction in rate hikes as a lack of commitment to fight inflation, which remains high but is decelerating. At the same time, economic growth outlook is subdued. Hence, we keep an active stance on duration. TIPS look reasonably valued, especially in intermediate range.
FIXED INCOME PLATFORM	US IG corporate	=/+		We see attractive carry and strong balance sheets in the sector, but cannot rule out the possibility of a policy mistake that could affect cause a deeper slowdown, which may eventually affect spreads. Thus, we stay very selective, and prefer financials over non financials sectors and idiosyncratic stories in general.
FIXED INCOME PLATFORM	US HY corporate	-		We remain vigilant on liquidity and the default outlook, which are expected to increase this year vs last year. This, coupled with higher funding and labour costs looking ahead, and sluggish growth, keeps us cautious on HY.
FIXED INCOME PLATFORM	European govies	-/=	▼	The ECB is committed to a steady rate hiking path, as controlling inflation remains its top priority, leading it to maintain rates in restrictive territory (along with upcoming quantitative tightening). Hence, we stay slightly cautious, but manage the stance actively as we assess the region's economic growth trajectory.
FIXED INCOME PLATFORM	Euro IG corporate	=		Valuations are attractive in EU IG, but geopolitical tensions and the energy crisis present key risks. We are monitoring how companies handle the economic slowdown, their refinancing needs, and the evolution of liquidity risks.
FIXED INCOME PLATFORM	Euro HY corporate	-		We expect to see volatility in spreads, owing to concerns regarding default rates and cash flows, and a potential deterioration in operational metrics in the face of higher funding costs. Thus, we stay defensive.
FIXED INCOME PLATFORM	China govies	=		Chinese debt offers strong diversification benefits to global investors, but we continue to monitor the mildly accommodative policy stance of the People's Bank of China amid the economic reopening.
FIXED INCOME PLATFORM	EM bonds HC	=/+		Higher global yields have increased the appeal of carry in EM debt, where the outlook is mildly constructive and HC valuations are attractive. We remain selective in countries such as Brazil and are monitoring country-specific economic and political risks after the recent violent protests.
FIXED INCOME PLATFORM	EM bonds LC	=		We are close to neutral on EM FX, but believe the asset class could see positive support from a weakening dollar and a less aggressive Fed. On local rates, we see potential for a better environment this year (vs last year), but at the moment, we stay selective and look for opportunities in Central and Eastern European countries such as Romania.
OTHER	Commodities			We see upside to gold prices as the Fed slows its rate hikes and markets shift their focus from rising policy rates to declining economic growth. We revised our 12m target from $1,900/oz to $2,000/oz. Oil prices should be supported by production discipline of OPEC+ and their limited spare capacity, along with demand from China. On base metals, positive news from China reopening is already priced in and we could see a modest pullback in the near term but long-term prospects remain.
OTHER	Currencies			A potential slowing in rate hikes by the Fed (main support for the dollar), slightly resilient economic growth outside the US, and weaker-than-expected domestic economic activity all make us less positive on the USD.

LEGEND

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	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi, as of 30 January 2023, views relative to a EUR-based investor. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding any fund or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. This information does not represent the actual current, past or future asset allocation or portfolio of any Amundi product.
IG = investment grade corporate bonds, HY = high yield corporate, EM bonds HC/LC = EM bonds hard currency/local currency, WTI = West Texas Intermediate, QE = quantitative easing.

DEVELOPED COUNTRIES

Macroeconomic outlook

Data as of 03/02/2023

Annual averages (%)	Real GDP growth %			Inflation (CPI, YoY, %)		
	2022	2023	2024	2022	2023	2024
World	**3.4**	**2.4**	**2.8**	**8.2**	**5.8**	**4.2**
Developed countries	**2.7**	**0.6**	**0.9**	**7.4**	**4.5**	**2.6**
US	**2.1**	**1.0**	**0.6**	**8.0**	**3.7**	**2.4**
Japan	**1.3**	**0.5**	**1.2**	**2.5**	**1.0**	**0.6**
UK	**4.1**	**-0.5**	**1.0**	**9.2**	**7.8**	**3.8**
Eurozone	**3.5**	**0.2**	**1.0**	**8.4**	**6.2**	**3.2**
Germany	1.9	0.0	0.9	8.7	7.3	3.0
France	2.6	0.3	1.0	5.9	5.4	2.9
Italy	3.9	0.3	0.9	8.7	6.9	2.3
Spain	5.5	0.8	1.1	8.3	3.6	3.3

Source: Amundi Institute.

- **United States:** the US economy has been showing signs of deceleration, as the fiscal and monetary policy drag weigh on activity, although at different intensity. Although some upside surprise may come from a stronger-than-expected Q4, we keep seeing significant growth deceleration unfolding, driven by weakening domestic demand and global growth. Growth will remain significantly below potential on average in 2023-24, with particular weakness in H2 2023, implying heightened recession risks. Inflation seems to have peaked and have moved to a lower monthly regime, yet we expect stickiness in underlying inflation, with the core index declining more slowly than the headline one.
- **Eurozone:** we upgraded our Eurozone growth outlook. While we still expect weakness and activity contraction over winter, we expect it to be less profound than previously feared. Notwithstanding the modest upward revision, headwinds for the Eurozone economy remain significant. Over the spring-summer period we expect some growth recovery, even if modest at this stage, helped by decelerating inflation and improved sentiment. Tighter monetary policy will represent a clear headwind, keeping growth below potential in 2023-24. Risks related to the energy crisis seem to have receded, but remain prominent for both the inflation and growth outlook.
- **United Kingdom:** with persistent inflation projections -- seen above target for several quarters -- we foresee a cost-of-living-induced recession playing out in the United Kingdom during early 2023, extending for a few quarters. Fiscal and monetary policy will weigh on growth too. Although we improved slightly our outlook, we see all headwinds as still present for the UK economy. With some modest recovery to follow, we see the economy running below potential also in 2024. As for the Eurozone, energy crisis risks remain prominent for both the inflation and growth outlook.
- **Japan:** the first signals for 2023 growth performance are mixed and for now we keep our below-consensus growth forecast of 0.5% for 2023, with an uneven recovery taking shape. The strong external-oriented manufacturing sector will be, on one side, hit strongly by weakening global demand, as shown by business surveys. On the other side, China's reopening has been favouring Japan as one of the most important targets of Chinese travelling abroad. In the meantime, December national CPI data confirmed the gloomy picture painted by Tokyo CPI (4.0% YoY, strongest growth in around 40 years), making though the BoJ job tougher.

Key interest rate outlook

	06-02 2023	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
US	**4.75**	**5.25**	**4.90**	**4.75**	**4.50**
Eurozone	**2.50**	**3.50**	**3.30**	**3.50**	**3.30**
Japan	**-0.10**	**0.00**	**0.12**	**0.00**	**0.20**
UK	**4.00**	**4.50**	**4.20**	**4.25**	**4.00**

Source: Amundi Institute.

- **Fed:** inflation has been declining over the past several months against a backdrop of moderate growth, but with inflation still high and indications of continued supply-demand imbalances, monetary policy still has work to do to bring inflation back to 2%. We expect the Fed to raise the Fed Funds rate to 5.25% in March before pausing for a few months. Fed officials have emphasised that the focus should shift from 'how fast' towards 'how far' rates need to rise and how long those levels need to be maintained. Our scenario now includes a contraction in economic activity in Q3 and a rapid decline in inflation. Now, we anticipate the first rate cut in December, while previously we were expecting it in January.
- **ECB:** at its February meeting, the ECB hiked rates by 50bp and pointed out their intention to deliver another 50bp raise in March. Both the statement and the press conference were hawkish, despite the ECB no longer sees upside risks in its inflation forecasts. Our baseline expectation is for the ECB to hike by 50bp at its March meeting and follow up with 25bp hikes in May and June. This means a terminal rate of 3.50% before summer, above market expectations, currently at 3.25%. The persistence of core inflation will pressure the ECB, with core CPI close to 4.5% in the third quarter according to our scenario.
- **BoJ:** after the surprise move in December, the BoJ held its policy unchanged at the January meeting. Expecting tepid recovery in 2023 and frontloaded inflation pressures in H1, we believe the goal of policy normalisation is to exit Negative Interest Rate Policy (NIRP) without additional rate hikes. We expect the BoJ to terminate YCC in March and NIRP in June. Risks to our forecasts are skewed towards a delayed ending of NIRP.
- **BoE:** the BoE delivered a 50bp hike at its February meeting, with the Bank Rate now at 4.0%. The split vote over the decision was expected, as seven out of nine policymakers backed the 50bp move, while two members preferred no rate hike. On rates guidance, the MPC signalled a likely reduction of the hiking pace to 25bp at the upcoming meeting. When referring to future moves, the minutes dropped the reference to "forcefully" (understood as meaning 50bp rate hike increments). We confirm our expectation for the terminal rate of this hiking cycle, which is likely to slow to 25bp moves from March, with a peak still at 4.5% in our baseline scenario.

Monetary policy agenda

Central banks	Next meeting
Bank of Japan MPM	**10 March**
ECB Governing Council	**16 March**
Federal Reserve FOMC	**22 March**
Bank of England MPC	**23 March**

Source: Amundi Institute.

EMERGING COUNTRIES

Macroeconomic outlook

Data as of 03/02/2023

Annual averages (%)	Real GDP growth %			Inflation (CPI, YoY, %)		
	2022	2023	2024	2022	2023	2024
World	3.4	2.4	2.8	8.2	5.8	4.2
Emerging countries	3.9	3.6	4.0	8.7	6.7	5.4
China	3.0	5.1	4.7	2.0	2.1	2.2
Brazil	2.9	0.7	1.7	9.3	4.9	5.0
Mexico	3.1	0.8	0.8	7.9	5.7	4.5
Russia	-3.3	-1.5	2.0	13.8	7.5	4.5
India	7.0	5.3	6.0	6.7	5.3	5.6
Indonesia	5.2	4.7	4.8	4.2	4.3	4.0
South Africa	2.4	0.2	0.6	6.9	5.7	4.5
Turkey	4.9	3.1	4.3	72.0	51.1	39.0

Source: Amundi Institute.

- **China:** on the back of stronger-than-expected Q4 2022 GDP, more resilient monthly data (retail sales), and a rebound in high-frequency indicators on rising mobility, we upgraded our 2023 GDP forecast from 4.4% YoY to 5.1%. The rebound happened earlier than expected and earlier than the Chinese New Year holidays. On the other hand, the housing sector performed poorly again in December, paving the way for some weak stabilisation in 2023. Again, the property sector will barely offer support to the economic growth this year.
- **South Africa:** inflation is likely to return to the upper end of the central bank's target range by the end of the first half of the year, but risks remain on the upside. After a rather resilient year in 2022, the growth outlook is weak. Household consumption is likely to continue to shrink, and the increasing frequency of electricity outages is likely to undermine growth even more. The SARB has therefore slowed the pace of its rate hikes, with an increase of just 25 bps at its latest meeting, no doubt for the last time. If conditions are right, it could begin a loosening cycle early in the second half of the year.
- **Mexico:** as in the rest of the Latin American region, economic has been slowing after a robust 2022. External demand has been softening in line with the cooling US economy, while Mexico's tight labour market has kept domestic demand more resilient. Headline inflation peaked in Q3 2022. Banxico is in the fine tuning stage of its hiking cycle, pivoting to a slower tightening pace mindful of more sticky core inflation and the Fed action. Politically, the country is an oasis of peace compared to the rest of the region and a big potential beneficiary of near-shoring trends.
- **Brazil:** the economy has slowed visibly after robust growth over the first three quarters of 2022, as reopening has run its course and tight monetary policy started to bite the credit cycle more forcefully. We see GDP expanding by less than 1.0% this year compared to 3.0% in 2022. Inflation more than halved by December 2022 after peaking in April at 12.1%, which allowed the BCB to wrap up its hiking cycle in August already at 13.75%. President Lula's less prudent than expected fiscal policy may complicate the central bank's disinflationary battle, delaying BCB's easing cycle (to Q4), while posing questions around the country's debt trajectory.

Key interest rate outlook

	07-02 2023	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
China	3.65	3.65	3.65	3.65	3.65
India	6.25	6.50	6.5	6.50	6.4
Brazil	13.75	13.75	13.65	12.75	11.9
Russia	7.50	7.50	7.30	7.50	7.10

Source: Amundi Institute.

Monetary policy agenda

Central banks	Next communication
RBI	**8 February**
CBR	**10 February**
PBoC	**20 February**
BCB Brazil	**22 March**

Source: Amundi Institute.

- **PBoC (China):** the PBoC left policy rates unchanged in January. Based on the earlier-than-expected economic rebound, we do not expect any further rate cut over 2023. However, for the time being, the central bank has no urgency to hike rates either. Inflation will stay below 3% throughout 2023, staring at low levels and firming up on higher consumer demand. Having said that, signals from the annual economic conference suggest that the PBoC will step back from broad easing. A more and more targeted monetary easing will continue, via structural lending tools and special financial programmes.
- **RBI (India):** India inflation printed again below consensus in December across the board (headline at 5.7% YoY and WPI at 5.0% YoY), except for core prices that are still stubbornly little above 6.0% YoY. Food prices returned well within the RBI target, while energy prices remain high (11% YoY). Overall, the disinflationary path could allow the RBI to pause its hiking cycle in February. However, governor Shri Shaktikanta Das has reiterated its focus on core price dynamics. For the time being, we maintain our call for the final hike to occur in early February by 25bp, though with less conviction.
- **BCB (Brazil):** high for longer. The first and most aggressive hiker (starting in March 2021, 1200bp overall) and the first 'pauser' (August 2022) is most for sure not going to be the first cutter in 2023. That is because President Lula's expansionary fiscal policy undermines the BCB's contractionary monetary policy stance designed to bring inflation back to target. More so, the recent rumours on raising the inflation target will pressure inflation expectations to the upside. We see the BCB cutting rates only in Q4 and easing thereafter more gradually than previously envisaged, in line with the latest BCB forward guidance.
- **CBR (Russia):** the CBR left the policy rate unchanged for the second time at 7.5% at the December meeting. The signal from the CBR was neutral with a hawkish note. While current inflationary pressures remain subdued, pro-inflationary risks had increased due to supply-side constraints, labour market pressures, and looser fiscal policy. Inflation continued to decline to 11.9% in December from 12.0% YoY in November. We expect the CBR to remain on hold for the next six months or longer, and then start its tightening cycle depending on the geopolitics and local economic conditions.

MACRO AND MARKET FORECASTS

Macroeconomic forecasts

3 February 2023

Annual averages (%)	Real GDP growth %			Inflation (CPI, YoY, %)		
	2022	2023	2024	2022	2023	2024
US	2.1	1.0	0.6	8.0	3.7	2.4
Japan	1.3	0.5	1.2	2.5	1.0	0.6
Eurozone	3.5	0.2	1.0	8.4	6.2	3.2
Germany	1.9	0.0	0.9	8.7	7.3	3.0
France	2.6	0.3	1.0	5.9	5.4	2.9
Italy	3.9	0.3	0.9	8.7	6.9	2.3
Spain	5.5	0.8	1.1	8.3	3.6	3.3
UK	4.1	-0.5	1.0	9.2	7.8	3.8
China	3.0	5.1	4.7	2.0	2.1	2.2
Brazil	2.9	0.7	1.7	9.3	4.9	5.0
Mexico	3.1	0.8	0.8	7.9	5.7	4.5
Russia	-3.3	-1.5	2.0	13.8	7.5	4.5
India	7.0	5.3	6.0	6.7	5.3	5.6
Indonesia	5.2	4.7	4.8	4.2	4.3	4.0
South Africa	2.4	0.2	0.6	6.9	5.7	4.5
Turkey	4.9	3.1	4.3	72.0	51.1	39.0
Developed countries	2.7	0.6	0.9	7.4	4.5	2.6
Emerging countries	3.9	3.6	4.0	8.7	6.7	5.4
World	3.4	2.4	2.8	8.2	5.8	4.2

Key interest rate outlook

Developed countries

	6 February 2022	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
US	4.75	5.25	4.90	4.75	4.50
Eurozone	2.50	3.50	3.30	3.50	3.30
Japan	-0.10	0.00	0.12	0.00	0.20
UK	4.00	4.50	4.20	4.25	4.00

Emerging countries

	7 February 2022	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
China	3.65	3.65	3.65	3.65	3.65
India	6.25	6.50	6.50	6.50	6.40
Brazil	13.75	13.75	13.65	12.75	11.90
Russia	7.50	7.50	7.30	7.50	7.10

Long-term rates outlook

Two-year bond yields

	6 February 2022	Amundi +6M	Forward +6M	Amundi +12M	Forward +12M
US	4.12	3.90/4.10	3.64	3.50/3.70	3.30
Germany	2.47	2.50/2.70	2.21	2.30/2.50	1.92
Japan	0.02	0.10/0.20	0.06	0.20/0.40	0.09
UK	3.49	3.20/3.40	3.06	3.20/3.40	3.18

Ten-year bond yields

	6 February 2022	Amundi +6M	Forward +6M	Amundi +12M	Forward +12M
US	3.42	3.60/3.80	3.35	3.30/3.50	3.32
Germany	2.02	2.40/2.60	1.96	2.30/2.50	1.93
Japan	0.46	0.50/0.70	0.55	0.60/0.80	0.67
UK	3.32	3.50/3.70	3.31	3.50/3.70	3.38

Currency outlook

	2 February 2023	Amundi Q2 2023	Consensus Q2 2023	Amundi Q4 2023	Consensus Q4 2023
EUR/USD	1.09	1.05	1.08	1.15	1.11
USD/JPY	129	125	127	119	125
EUR/GBP	0.89	0.90	0.88	0.90	0.89
EUR/CHF	1.00	0.95	1.00	1.04	1.02
EUR/NOK	10.96	10.69	10.48	10.24	10.11

	2 February 2023	Amundi Q2 2023	Consensus Q2 2023	Amundi Q4 2023	Consensus Q4 2023
EUR/SEK	11.31	11.38	10.89	10.83	10.60
USD/CAD	1.33	1.35	1.32	1.28	1.29
AUD/USD	0.71	0.69	0.70	0.76	0.72
NZD/USD	0.65	0.63	0.64	0.67	0.66
USD/CNY	6.73	6.70	6.75	6.40	6.65

Source: Amundi Institute

DISCLAIMER TO OUR FORECASTS

The uncertainty around the macro forecasts is very high, and it triggers frequent reassessments any time fresh high frequency data are available. Our macroeconomic forecasts at this point include a higher qualitative component, reducing the statistical accuracy and increasing the uncertainty through wider ranges around them.

METHODOLOGY

— Scenarios

The probabilities reflect the likelihood of financial regimes (central, downside and upside scenario) which are conditioned and defined by our macro-financial forecasts.

— Risks

The probabilities of risks are the outcome of an internal survey. Risks to monitor are clustered in three categories: Economic, Financial and (Geo)politics. While the three categories are interconnected, they have specific epicentres related to their three drivers. The weights (percentages) are the composition of highest impact scenarios derived by the quarterly survey run on the investment floor.

PUBLICATIONS HIGHLIGHTS

THEMATIC PAPERS ECONOMY AND MARKETS

Bonds are back: credit markets in focus during 2023 (19-01-2023)
DEFEND Monica, Head of Amundi Institute - D'ORSAY Amaury, Head of Fixed Income - AINOUZ Valentine, Head of Global Fixed Income Strategy, BERTONCINI Sergio, Senior Fixed Income Research Strategist – Amundi Institute - DAUPHINE Gilles, Deputy Head of Fixed Income - COHEN Marina, Head of Euro HY Bond Portfolio Management - BOIRAL Hervé, Head of Euro Credit - FAWN Steven, Head of Global Credit
With the contribution of: ABAZA Nadine, Portfolio Manager – Global Corporate Bonds and PANELLI Francesca, Investment Insights and Client Division, Amundi Institute

THEMATIC PAPERS PORTFOLIO STRATEGY

Themes at a glance/ What Artifical Intelligence reveals about share price reactions? (13-01-2023)
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THEMATIC PAPERS GREEN & SOCIAL

Themes at a glance / The market effect of acute biodiversity risk: the case of Brazilian corporate bonds (19-01-2023)
Amina CHERIEF, Quant Portfolio Strategy – Amundi Institute - Takaya SEKINE, Deputy Head of Quant Portfolio Strategy - Amundi Institute - Lauren STAGNOL, Quant Portfolio Strategy - Amundi Institute

Themes in depth/ ESG in motion: a dynamic forward-looking approach to detect ESG 'improvers' (06-01-2023)
ELMGREEN Kasper, Head of Equities - DRABOWICZ Alexandre, Deputy Head of Equities -KEANE Suzanne, Senior European Equity Portfolio Manager - Equity Solutions - IACCARINO Piergaetano, Head of Equity Solutions - FIOROT Laura, Head of Investment Insights & Client Divisions - Amundi Institute - NIALL Paula, Investment Insights & Client Divisions - Amundi Institute

COMPASS

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INVESTMENT TALKS

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PUBLICATIONS HIGHLIGHTS

WORKING PAPERS

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Raphaël SEMET, Quant Portfolio Strategy, Amundi Institute

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The Market Effect of Acute Biodiversity Risk: the Case of Corporate Bonds (30-11-2022)
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ESG

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ESG Thema – Special COP15 – The Paris moment for biodiversity? (22-12-2022)
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