Research

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February
2021

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Investment Strategy

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Amundi ASSET MANAGEMENT

#02 - February 2021

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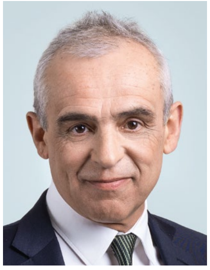


Pascal BLANQUÉ,
Group Chief Investment Officer

Vincent MORTIER,
Deputy Group Chief Investment Officer

Choppy markets in a moment of truth for rates

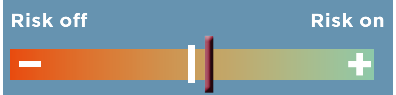
Markets closed 2020 on strong footing and the recent Democratic sweep in the US makes a greater fiscal push more likely, leading us to lift our 2021 GDP growth forecast for the US to 5.2-5.7%, 1% above previous estimates. This marks a great divergence between the US and the rest of DM, where we have been lowering our forecasts.

Markets are suddenly questioning the *no inflation forever* narrative, especially in the US, amid an accelerating economy. UST yields have been rising and the US curve steepening further at a very fast rate in just a few days. Market inflation expectations have also risen to two-year highs. While bond markets have been adjusting to this acceleration in the possible return of inflation narrative, equities have remained resilient. The adjustment has instead been felt in some areas of excess, such as cryptocurrency. President Biden's proposed Covid-19 relief package, of $1.9tn, is further supporting this trend, which has also been felt on the currency side. The USD has paused in its weakening trend since the beginning of the year, after strong moves in 2020. For investors, the reinforced reflation narrative calls for some adjustments:

- **Move towards a more cautious stance on duration**. CBs will remain dovish, but markets are starting to price in a possible reduction in asset purchases. For the first time, discussions about potential tapering by the Fed have been making the news. This debate was kick-started by the acceleration in economic growth and the progress regarding Covid-19 vaccine programmes. But many members of the Fed consider such discussions to be premature. Chairman Powell recently reiterated the importance of not exiting too early and being careful in terms of communication on this front. A more cautious stance on duration is also recommended in the EM space, where bonds still offer valuable opportunities in the hunt for yield, though duration must be carefully managed.
- **Include forms of inflation protection with liquid and illiquid assets** in a year when a resurgence of inflation in the US will likely be one of the key themes. The prospects of a larger-than-expected fiscal boost, an acceleration in economic growth, an unleashing of pent-up demand, supply chain relocations and energy price rebounds are all elements that could further drive inflation expectations higher and lead to relative market adjustments. Inflation-linked bonds will become increasingly appealing (inflation breakeven and TIPS) as well as some real assets.
- **From a cross-asset perspective, equities continue to be favoured over bonds**. However, investors should seek opportunities in areas supported by reflation, starting with value and more cyclical markets, such as Japan and EM, where commodity trends are also supportive. When it comes to any adjustment of expectations on rates, we see little space for strong directional moves of indices, but for leadership rotation within the indices to continue, with value stocks and interest rate and energy-sensitive stocks recovering vs high/hyper growth stocks. This rotation could see a temporary slowdown in Q1 with the activity deceleration and stricter lockdowns, especially in Europe, but the recovery trend in the medium term looks to be intact, as is the value rotation theme.
- **It's important to be watchful on equities as absolute valuations are far from appealing**. In particular, should 10Y yields rise further, equity market performance will be challenged. A 1.3% level for the UST 10Y would, in our view, test the market. However, we don't believe we will reach this level any time soon, and instead see the most likely scenario as one of a sideways market movement cleaning up some of the excesses that the year-end rally brought. Overall, this calls for some hedging on equity exposure to mitigate downside risks.

So far, the monetary factor narrative of low rates, low growth, and low inflation has been dominant, but a different narrative, of a faster real growth catch-up, is gaining ground. Obviously the monetary narrative remains dominant and seems firmly grounded, but even a small change would cause big noises in both bonds and, at some point, in equities. To avoid being trapped in a lose-lose game, it is important to be highly selective in the equity space by looking at attractive names able to benefit from the cyclical recovery but also prompt longer-term earnings growth. In bonds, investors should stay active in duration management and play relative value trades (at curve and regional levels). In an era during which traditional asset diversification may be challenged by rising inflation expectations, **investors should remain agile and flexible in their allocation, and consider less correlated investment strategies to enhance diversification and make portfolios more resilient to a possible regime shift**.

Overall risk sentiment



Amid high inflation expectations, high valuations and economic recovery hopes, explore relative value across asset classes

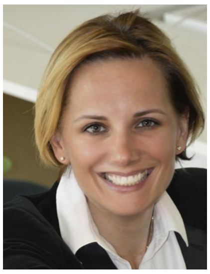
Changes vs. previous month

- Adjustments in equities, with downgrade in DM and upgrade in EM equities and FX
- Cautious on US duration, from a multi-asset view
- Positive on inflation in the US

Overall risk sentiment is a qualitative view of the overall risk assessment of the most recent global investment committee.

MACRO

Looking beyond the recent surge in yields



Monica DEFEND,
Global Head of Research

The US yield curve may steepen mildly but the Fed's resolve to maintain easy financial conditions and support a recovery indicate that the central bank would prevent any sharp upward movements in yields

- As long as the 10Y UST reflects reflationary expectations, it could move higher. However, the **relative valuations case for Treasuries with respect to risk assets, coupled with the debt-servicing cost** (given the growing debt pile), sets a cap on the extent to which yields could rise.
- Based on our current macro financial forecasts, our 2021 target for the 10Y UST is 1.30%.

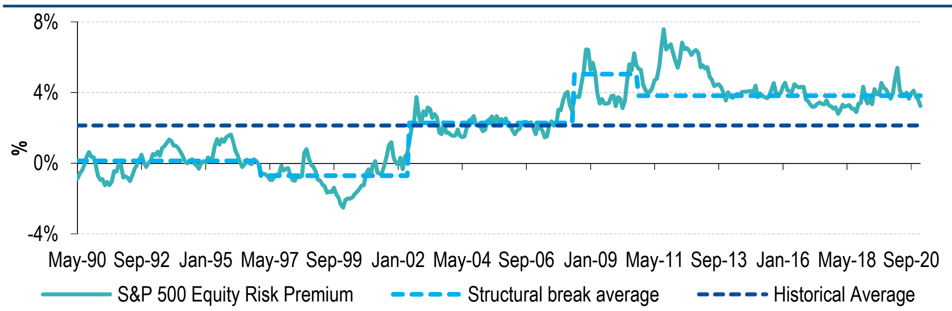
The Fed is committed to maintaining accommodative financial conditions, but in January, this commitment was tested as markets began pricing in a larger US fiscal stimulus. As we enter 2021, markets remain highly policy-driven and therefore vulnerable to any policy reversals. **This explains our vigilant stance on risk assets and also underscores the 'market-mover' role of 10Y Treasuries**. In addition, the steepening of the US yield curve in January shows that the Fed controls the short end, where rates are close to zero. On the other hand, the rise in US 30Y breakeven above 2% explains the recent increase in nominal yields: the repricing of long-term inflation breakeven and of the inflation premium warrant some fine-tuning of the 'cyclical trades' position.

Looking ahead, in 2021, we forecast the rise in long-term nominal yields to be driven by real rates as growth rebounds in H2. However, according to our projections, the Fed still has a long way to go to achieve its inflation target. Therefore, the Fed's significant accommodations would remain, with an aim to amplify fiscal boosters and the 'vaccine-effect' (on economic normalisation) to eventually help the CB get closer to its year-end inflation target. Notwithstanding the bold Asset purchase Programme (APP), 10Y yields continue to drift higher, even though the curve-steepening remains far off previous cyclical highs. Given this context, we believe there is space for only temporary overshoots. Medium term, the Fed would temper yields volatility on the long end and would maintain easy conditions so as to not undermine the recovery. Having said that, we expect tapering in 2022, when productivity gains and real growth should prove sustainable. But, the Fed will be careful and gradual so market dynamics and financial stability are not negatively affected.

Is 1.30% a tipping point? It is difficult to say, given that unpredictable behaviour and investor psychology play key roles. We therefore anchor this expectation to our findings on the relative attraction of equities vs bonds. The protracted unconventional monetary policy has changed the relative valuation pivots. Based on more than 13 years of historical evidence, we observe a structural break in the average of the S&P500 equity risk premium (ERP), lifting the average from 2% to 4% (see chart). Separately, if we plot historical ERPs at different levels of 10Y UST yields, we notice that the current yield pertains to fourth quintile of historical distribution of ERPs. This analysis also confirms the importance of interest rate movements with regard to relative attraction of equities vs bonds. Therefore, the move of the 10Y yield above 1% has significantly reduced the valuation gap.

The 2008 GFC introduced a different monetary policy framework, with CBs largely expanding their balance sheets. The persistent recourse to asset purchases turned this 'unconventionality' into 'conventionality,' with market participants buying-in this approach. Consequently, we believe, the relative valuation framework must be reconsidered and investors should accordingly adjust the discount rate of future cash flows. **To conclude, in our base scenario, we set a cap on the US curve steepening:** in the short term, higher yields might hurt the appetite for risk assets, whose volatility might hamper a recovery. Long term, deeply leveraged public and private sectors are vulnerable to shifts in interest rates.

Impact of unconventional monetary policy on equity risk premium



Source: Amundi Cross Asset Research, as on 25 January 2021. Structural break average is calculated after taking into account the Fed's unconventional monetary policy. Chart shows historical Equity Risk Premium of S&P 500 = Earnings yield-10Y UST yield.

MULTI-ASSET

Carefully stabilise portfolios with a ‘risk-on’ tilt

Matteo GERMANO,
Head of Multi-Asset

A reduction in headwinds in the form of a US stimulus, a Euro-China deal and Brexit enable us to keep our sectoral tilt towards cyclicality with some adjustments, coupled with strong hedging

We believe a pro-risk stance will persist, driven by expectations of a cyclical improvement in the economy, supported by the vaccine rollout and stimulus measures. However, **we recommend that investors be active so as to not lose sight of the big picture, as we believe it is extremely crucial to monitor the US yield curve**. If the speed and quantum of the pick-up in yield is not as benign as we expect, we could see a material tightening in financial conditions that would negatively affect risk assets. Having said that, we must not forget the role of the Fed with respect to more QE or even yield curve control. **Overall, investors should be selective, carefully fine-tuning portfolios**, exploring efficient hedges and staying vigilant with respect to lockdowns.

High conviction ideas

Earnings revisions and cyclical improvements in the global economy support our overall constructive stance on equities. In DM, while we remain neutral on the US, we downgraded Europe and the UK to neutral due to a change in our stance on UK domestic stocks amid valuation concerns, recent lockdowns, and their potential impact on the country’s economic growth. However, **we remain optimistic on Japan and Australia** as both markets should benefit from a rebound in the global economy, and, investors should stay active. These countries would also benefit from a V-shaped recovery in China, on which we upgraded our constructive view, leading to an improvement in our positive stance on EM overall. The current environment also allows investors to readjust portfolios: Hong Kong-listed shares provide an opportunity to gain exposure to China’s consumer discretionary sector, particularly because these stocks have lagged behind some of the mainland names. **On duration, we are now cautious on the US**. A Democratic Senate will allow President Biden to push for a higher fiscal stimulus and a rise in the deficit, causing curve-steepening and short-term increases in yields. Even from a relative standpoint vs core Europe, USTs don’t look attractive, given the lower potential for additional stimulus and inflation in Europe. However, President Biden’s measures would be supportive of US inflation – hence, our optimistic view remains. We stay positive **on Euro peripherals** and believe investors could find relative value in the 30Y BTP-Bund segment in light of the ECB’s massive bond-buying programme, but there is a strong need to monitor recent developments. **Demand for carry** continues to support credit, but investors should be flexible to adjust EUR and US HY exposure, according to changing conditions, without altering their overall stance. We prefer EUR over US in IG and HY, but now believe improving commodity prices may remove some headwinds in US HY. **The search for income** allows us to keep our **optimistic view on EM debt**, even though we believe the room for further spread compression is limited. Importantly, investors should partially hedge US rates exposure, which could negatively affect returns from EM debt, due to growth/inflation dynamics in the US. On EM FX, we slightly upgraded our positive stance, through the Brazilian real and Mexican peso, which offer good carry and should benefit from US growth. On DM FX, however, we maintain our view – positive the CAD/USD and NOK/EUR as commodity FX should benefit from a global recovery scenario.

Risks and hedging

Resurgence and mutations of the virus, US-China and US-EU relationships, and policy mistakes could alter the reflation view. All this, collectively, presents an opportunity to review portfolio protection and, where possible, remove inefficient hedges that don’t offer a robust cost/benefit profile. However, we believe that the case to protect equity exposure through gold, and derivatives and credit exposure is well in place.

Amundi Cross Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities						■		
Credit						■		
Duration	↘				■			
Oil					■			
Gold						■		

Source: Amundi. The table represents a cross-asset assessment on a 3- to 6-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.

UST = US Treasury, DM = Developed markets, EM/GEM = Emerging markets, FX = Foreign exchange, FI = Fixed income, IG = Investment grade, HY = High yield, CBs = central banks, BTP = Italian government bonds, EMBI = EM Bonds Index.

FIXED INCOME

Inflation dichotomy between the US and Europe

Éric BRARD,
Head of Fixed Income

Yerlan SYZDYKOV,
Global Head of Emerging Markets

Kenneth J. TAUBES,
CIO of US Investment Management

Investors should note that credit markets are expensive, but selection, research and relative value should allow them to generate decent returns without compromising on quality

Democrats' thin majority in the US Congress has increased prospects for an expansionary budget, which could potentially cause a higher deficit and debt, putting upward pressure on rates and yields. However, this is where we believe the Fed should step in to limit the steepening through its massive asset purchase programmes in order to not hamper economic growth. Hence, it is imperative today to be **very active across the fixed income universe, in rates, credit and EM debt, to generate sustainable real returns**.

Global and European fixed income

On duration, we remain cautious overall, with a negative stance in core Europe and a neutral/slightly long position in US as a safeguard. In addition, we are proactively managing our stance on rates and yield curve (direction, speed, quantum), particularly the US 5Y and 10Y and the 5Y, 15Y and 30Y Euro curves. We are positive on peripherals primarily through Italy BTPs, due to higher spread tightening potential vs peers in light of ECB support, but are mindful of the fluid political situation. On the other hand, higher inflation expectations have led us to upgrade our view on US breakevens, 10Y and 30Y even though inflation in Europe remains subdued.

Credit remains the engine of returns in this low-yield world. We recommend investors focus on spread compression instead of increasing their overall market risk (beta), particularly in HY vs IG, BBB- vs A-rated, and subordinated vs senior debt. Secondly, we believe a deterioration in the quality of issuers in Europe has been mitigated by government and ECB measures. In addition, a recovery in companies' financial metrics will show strong divergences, with a strong case for selection.

US fixed income

Ongoing vaccine programmes underpin a gradual economic recovery, which doesn't bode well for USTs. On the one hand, inflation expectations are rising; on the other, real rates are negative and the yield curve is steepening, putting price pressure on USTs. **As a result, we remain cautious on Treasuries, preferring TIPS**, which act as a diversifier and should benefit from rising inflation. However, investors should watch out for higher taxes and regulation under the new administration. We believe the US consumer remains strong and highly liquid and could unleash pent-up demand for services. We like agency-backed mortgages and subordinated and esoteric ABS. **Search for yield remains a key story in credit – more so in HY –** but investors should be selective to safeguard against default risks and defend excess income in HY. While we are positive overall on credit, we are cautious on long duration IG, as spreads have already compressed to post-GFC levels.

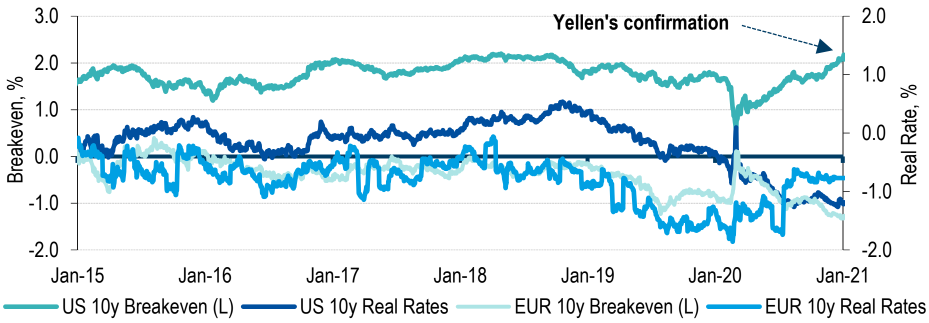
EM bonds

While the Biden administration's stance towards China has yet to be assessed, we stay positive on HC debt, with a skew towards HY, as it is in a better position to cushion the widening effect of UST yields, whereas this presents a risk to IG. We are constructive on FX, and in LC, prefer high yielders. Importantly, Asia's growth continues to outperform, with China and India in the lead. We now favour oil exporters amid recent OPEC discussions and Saudi Arabia's production cut.

FX

In light of an improving environment for cyclical assets, we are cautious USD/JPY and USD/CNY, and positive on the NOK vs the EUR and CHF

Market's inflation expectations in US have been rising



Source: Amundi, Bloomberg as on 19 January 2021

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, CRE = Commercial real estate, CEE = Central and Eastern Europe, JBGs = Japanese government bonds, EZ = Eurozone. BoP = Balance of Payments.

EQUITY

Relative value game to continue: Value vs Growth

Kasper ELMGREEN,
Head of Equities

Yerlan SYZDYKOV,
Global Head of Emerging Markets

Kenneth J. TAUBES,
CIO of US Investment Management

We believe this is the year of recovery but the timing of normalisation is not clear. Investors should look for non-disrupted business models, leaving the lowest parts (in terms of quality) untouched

Overall assessment

The resurgence of coronavirus infections and subsequent lockdowns in Europe present near- term headwinds, but vaccine rollouts, progress on the stimulus front, and pent-up consumer demand offer some solace. For investors, the interesting debates are the movement of rates/inflation and effect of these on the pro-cyclical and pro-value tilt. Although the last two are structural stories, not all components in these are attractive. As a result, investors must be very **selective and agile and should focus on balance sheet strength**.

European equities

While we maintain a bias towards normalisation, we realise that consensus is moving towards a pro-cyclical/pro-value tilt and alarm bells are ringing in some parts of the market. Hence, we remain extremely valuation-conscious, bottom-up, and aim to find cyclical value compartments offering attractive risk/reward profiles**. We stay positive on materials and have raised our constructive view on financials,** primarily through high-quality insurers and exchange operators. We are optimistic on **infrastructure**, which we believe is a by-product of all the fiscal stimulus measures. Having said that, we are mindful of the need to remain defensive due to the uncertainty over the virus. We are now more constructive towards defensive areas, such as healthcare. On the other hand, we also seek to identify areas where there are worrying signs and no one knows when the music may stop. We are cautious on discretionary and technology (valuation concerns). Finally, we believe ESG is the single most important trend in asset management and the crisis has only made this more relevant. We are likely to see an acceleration in investor demand, company adoption, and asset manager integration.

US equities

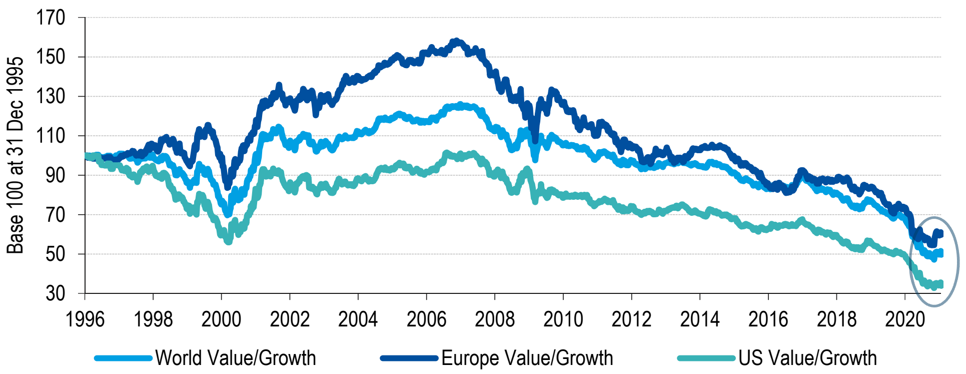
We expect supportive economic policies from the Biden administration, but believe investors should be cautious with respect to potentially higher taxes and higher interest rates. **We continue to believe that a sustained rotation out of Growth/high momentum stocks into Value is likely in light of strong earnings improvements in 2021** and the vaccine rollouts. As a result, we are cautious on the former group and are more balanced. This is because we realise there are some downside risks, ie, lower economic growth, policy mistakes, spread of the virus. On a positive note, we like quality Value/cyclicals and reasonable Growth stocks but think investors should be mindful of sectors/companies in which margins could be affected by higher input prices. In addition, the crisis is presenting stock selection opportunities as companies with strong business models are available at reasonable prices and companies without the ability to withstand the slow recovery have been left impaired. We prefer industrials, given they are not challenged by the current low-rate environment, and also like financials as having withstood the worst part of the crisis, they should benefit from potentially higher rates.

EM equities

We are optimistic on equities, particularly on Value/cyclicals over Growth and remain positive on discretionary, industrials, and IT and internet. In the last segment, **we strongly prefer regions with attractive valuations, ie, Korea over China**.

We also like India, Russia and Greece, but remain very selective and continue to differentiate on the basis of valuation and business model strength. On the other end, we are cautious on healthcare, staples and Chinese financials (although we like insurers).

Value vs growth performance

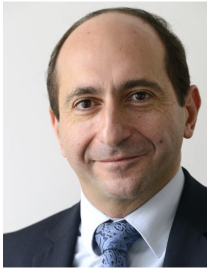


Source: Amundi, Bloomberg as on 19 January 2021

THEMATIC
GLOBAL VIEWS

Taper or not taper: a key issue for markets

The Fed is committed to maintaining very accommodative monetary conditions and unchanged interest rates until the economy has returned to full employment and inflation has stabilised above its 2.0% target. But the Fed has so far been vague on what determines the pace of its asset purchases. It is clear that these will have to decline long before it raises its key rates. But when and on what basis? Tapering has its risks but also its benefits. The challenge for the Fed will be to steer a gradual steepening as history shows that steepening episodes can be quite abrupt and generate volatility on markets.



Didier BOROWSKI,
Head of Global Views

Pierre BLANCHET,
Head of Investment Intelligence

The Fed never committed itself to keeping long-term bond yields stable

The recent upward movement in US long-term interest rates is mainly linked to the rise in inflation expectations and not to the rise in real rates. In a scenario where US GDP growth is expected to accelerate (5.2 to 5.7% in our central scenario in 2021, followed by +2.6 to 3.2% in 2022), real rates could adjust, as well. In this context, the Federal Reserve's strategy will become a key parameter to watch, with implications on portfolio construction.

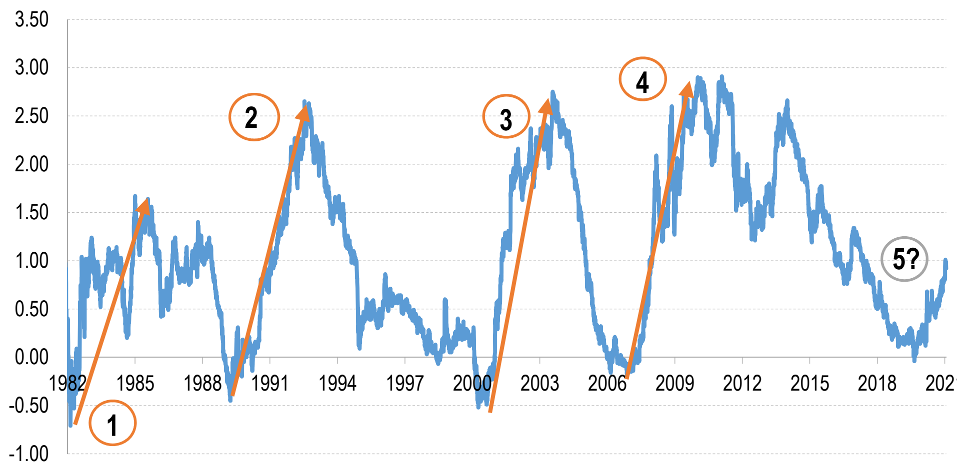
Since its strategic review, the Fed's reaction function has changed. By targeting 2% inflation on average over a cycle, the Fed aims to anchor short-term interest rates at their current level. The FOMC has also committed not to tighten monetary conditions until the economy has returned to full employment (defined on the basis of multiple criteria, such as minority, woman or age group employment), and inflation prints are above target. Since June 2020, the Fed has bought $120bn of eligible assets each month ($80bn in Treasuries and $40bn in MBS). Its balance sheet is therefore growing at a rate of nearly $1500bn per year (7.5% of GDP). This balance sheet expansion is necessary to maintain very accommodative monetary and credit conditions via low long-term bond yields in the recovery phase.

Taper tantrum 2.0

As the US economy emerges from the crisis, and if inflationary pressures materialise sooner than expected on the back of fiscal stimulus and pent-up demand, the Fed may want to revisit its policy. After all, the Fed never pre-committed to keeping the pace of its asset purchases unchanged. And it is clear that the asset purchase program must be reduced well before the Fed increases its policy rates. As a result, the expected level of asset purchases will ultimately define the path for long-term Treasury yields this year. Hence, the fear of a "taper tantrum 2.0" in reference to the one that occurred in April 2013 (the 10-year yield had then risen by 120bp in four months on the back of Ben Bernanke's announcement).

It is clear that it is not in the Fed's interest to destabilise the US bond market and the US financial system with it. The main argument is that there is still too much leverage in the economy for that (federal government, corporations, and households). A soaring debt burden would not be "sustainable" and could jeopardise the recovery. However, it is equally clear that the Fed might consider it is time to reduce the degree of monetary accommodation if nominal GDP growth accelerates and the pandemic ends. The Fed never committed itself to keeping long-term bond yields stable. Several arguments may play in favour of "early" tapering: (i) avoid a decline in real rates in a recovery phase; (ii) restore a role for markets in anchoring inflation expectations; (iii)

1/ **US Treasury 10Y - 2Y yield steepening phases**

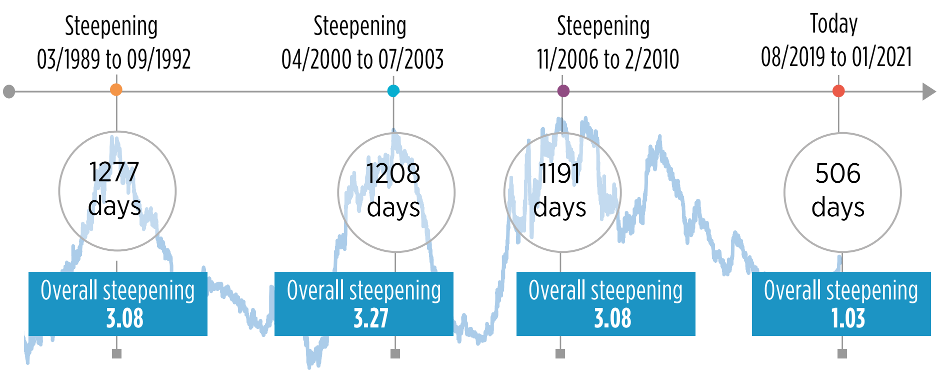


Source: Federal Reserve Bank of St Louis, Amundi Research - Data as of January 25, 2021

THEMATIC GLOBAL VIEWS

The UST yield curve (10y-2y) has steepened by 300bp over 3 years on average

Steepening phases since 1989



2019-? Potential	Days*	Overall steepening
Average	1225	3.14
Remaining	719	2.11

* Calculation including market closed days

Source: Refinitiv, Amundi Research

smooth out the rise in bond yields; and (iv) restore some policy space, should the situation deteriorate again. Some FOMC members have begun to discuss this option for 2021. The Fed needs to clarify its strategy sooner than later, since this 'taper tantrum' thematic is likely to gain ground as the GDP returns to its pre-crisis level.

UST 10y-2y curve has 200bp further to go over the next two years

One of the many consequences of a shift of investor's expectations regarding a Fed's tapering, would be further steepness in the Treasury yield curve. Therefore, the challenge for the Fed will be to steer a gradual steepening of the Treasury curve, as history shows that steepening episodes can be quite abrupt and generate market volatility.

There have been four great episodes of steepening of the US Treasury yield curve over the past 40 years. Market participants are using several measures – from three-month bills to 30-year bonds. We think that the spread between UST 10y and 2y is most relevant for long-term comparisons, and we consider a steepening phase is starting when the curve is fully flat or inverted. Although irrelevant for the analysis, the 1980s witnessed a gradual transition from a high-inflation to a low-inflation regime, leading to high volatility in yield-curve steepness (see chart).

During the last three episodes (89-92, 00-03, 06-10), the YC (10y-2y) steepened with astonishing regularity. Indeed, the average length of steepening was 3.3 years with only a few months of difference for an average rise of 310bp in a tight range, too. Excluding periods where the yield curve was inverted does not change the outcome (275bp over around three years).

The ongoing UST steepening phase started in September 2019. It is already a year and a half old with a 100bp move so far. Should history repeat itself, we can expect the UST YC (10y-2y) to steepen by another 200bp over the next two to 2.5 years. Assuming that the Fed keeps rates at zero over the period (Amundi's scenario), this would mean bringing the UST 10-year bond yield close to 3%. Obviously, it is not because of the yield curve that long-end yields have to move, the causality is the other way round. However, it is interesting to use the yield curve as a reference point to assess the minimum level of Treasury yield over this new cycle.

Finalised on 26 January 2021

THIS MONTH'S TOPIC

2021 investment case in equities and how Japan fits into it

Eric MIJOT
Head of DM Strategy Research

Claire HUANG
EM Macro Strategist

Although the global recovery began to be priced in last year, the current pro-cyclical rotation is likely to continue. Because of the dollar's weakness, we prefer emerging markets, but Japan has other things going for it that, at the very least, can help balance out the portfolio.

2021, a pro-cyclical year for global equities

In a year of economic recovery, the risk/reward ratio is generally favourable to equities. Although some countries, particularly in Europe, are still in lockdown, the month of January is starting well with the release of the vaccines, the Brexit deal, and a Democratic victory in the US Senate conducive to a major recovery plan.

▶ Equities will benefit from a strong recovery in profits

With global growth expected to amount to more than +5% in 2021, global profits should rebound by more than +25% (Chart 1). The economic cycle has only just begun, and the growth phase will be spread out over several years. Market indicators corroborate this constructive vision. The dollar is weakening, which is contributing to the rise in inflation expectations in the United States, expectations that are themselves correlated to the cyclical/defensive ratio and to industrial raw materials prices, the latter itself being a proxy for trends in global profits.

▶ Part of the recovery in profits will be absorbed by a decline in P/Es

Equity markets anticipated an economic recovery as early as 2020 following the strong support of central banks and governments and the November announcement of the arrival of the vaccines just after the US elections. As profits fell at the same time, P/Es rose to extreme levels, sometimes to levels not seen since 2000, with a notable difference between the two periods. The 2000 PERs referred to top-of-the-cycle profits, whereas current PERs are based on bottom-of-the-cycle profits. The recovery in profits will therefore be partly consumed by a fall in P/Es. However, liquidity provided by the central banks and the low interest rate context will allow PERs to remain at sufficiently high levels to allow equity prices to rise between +5% and +10% over the year.

▶ The climax of volatility was reached in 2020 and flows should now favour equities

Historically, volatility tends to decrease as profits recover. It is also a function delayed from 18 months to two years in the evolution of monetary policy (chart 2). The high point of Fed rates having been reached in 2019, It is therefore highly likely that volatility will fall structurally in the months and years to come.

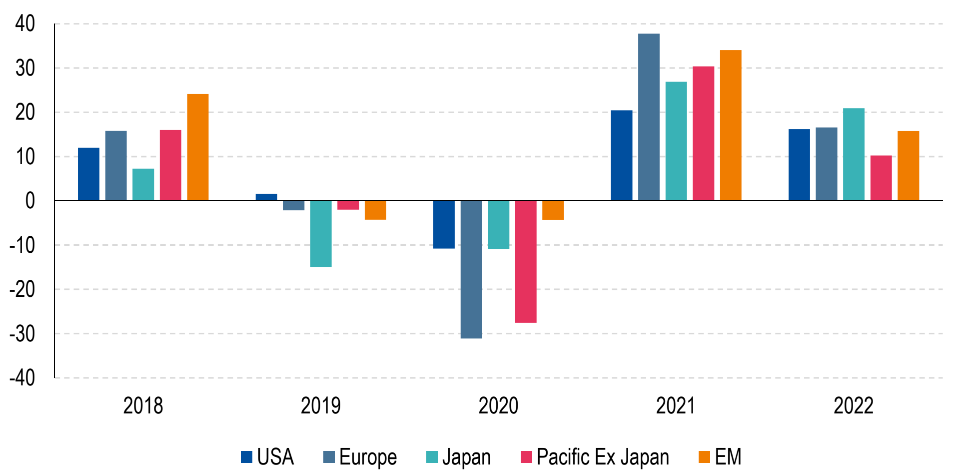
This should encourage a return of flows to equity markets, especially as high yield spreads have tightened, and alternatives for risky assets are therefore less generous.

▶ Risks are of course still present, but the risk/reward ratio is favourable

There are three kinds of risks. By far the most dangerous would be doubts cast on the vaccine's effectiveness and an uncontrolled resurgence of the virus. Beyond this black swan, a second type of risk would be a delay in the economic

Equity markets are likely to end the year higher than they began it

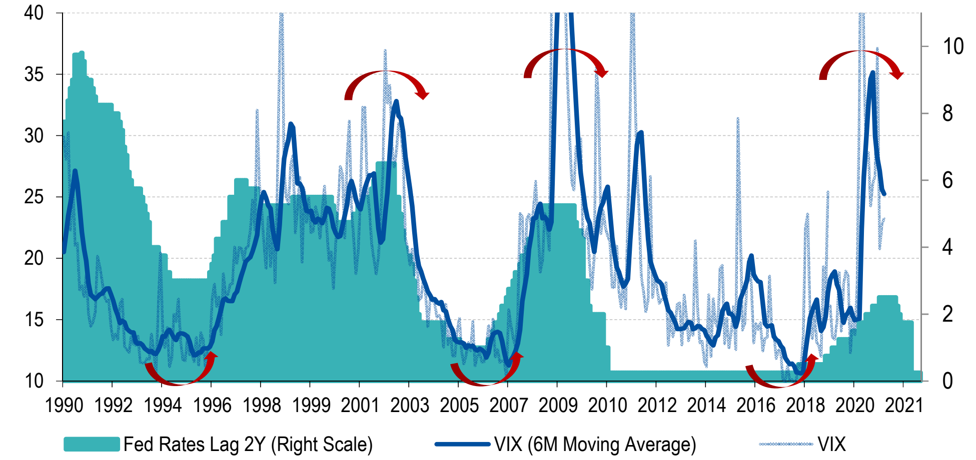
1/ **EPS Growth**



Source: Ibes, Datastream, Amundi Research - Data as of January 20, 2021

THIS MONTH'S TOPIC

2/ VIX and Fed rates



Source: Datastream, Amundi Research - Data as of January 20, 2021

recovery (caused by lockdowns, delayed vaccinations, etc.). This would rather create opportunities insofar as central banks and governments remain supportive.

Finally, the third type of risk consists, on the contrary, particularly in China and/or the United States, in the possibility that the recovery would be sufficiently underway to envisage a withdrawal of support. However, while central banks may well end up being tested by the markets in this respect, it is likely that their initial response will be rather reassuring.

The pro-cyclical rotation is likely to continue

▶ How to apply this pro-cyclical approach in an equity portfolio?

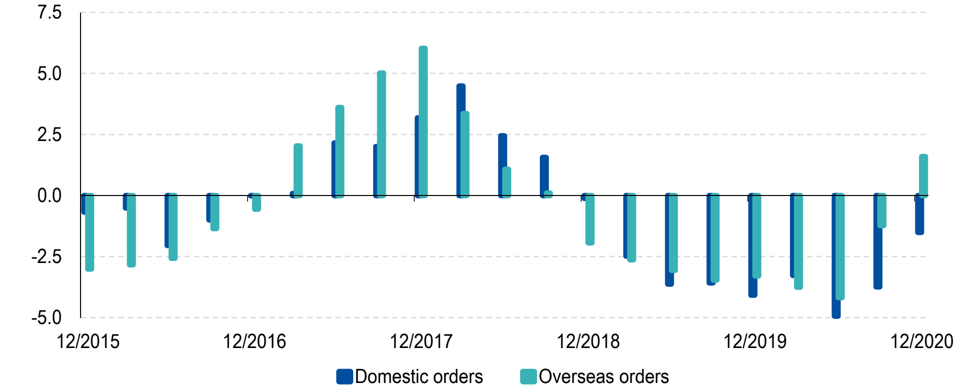
In terms of style, small caps are a great candidate. This asset class, which always outperforms at the start of the cycle, has already rebounded well, but its potential has not yet reached its limits. As for the Value style, which is lagging behind other cyclicals, it offers attractive potential for catching up. Finally, economic recoveries are usually not favourable for quality stocks, but given the low level of rates and the ongoing disruption, we believe that this style, as well as ESG equities, constitutes a valid complement to cyclical stocks to balance the risk of a portfolio, by accepting a longer-term investment horizon and as long as it is not overpaid. Geographically, this is reflected in a preference for emerging markets especially since currencies have broken out against the US dollar. However, Japan and the euro zone, also cyclical and value, should also do well at least initially.

Often atypical, the case of Japan seems interesting to us to highlight

▶ A two-track economic recovery

Despite the winter pandemic outbreak in Japan, we note that external demand gained further momentum in Q4. Overseas machine tool orders grew by 15.9% YoY in Q4 after two years of contraction, while domestic demand stumbled (Chart 3). The Japanese market appears to be shrugging off the latest deterioration in mobility data, and focusing more on the economy's global demand exposure as well as the structural push by Suga administration towards digitalisation and carbon neutrality. So, unlike the European markets, the MSCI Japan more than erased the decline triggered by the pandemic in 2020 and ended the year with records (+7% in 2020, against -4% in Europe and +19% in the

3/ Japan's machine tool orders: domestic versus overseas

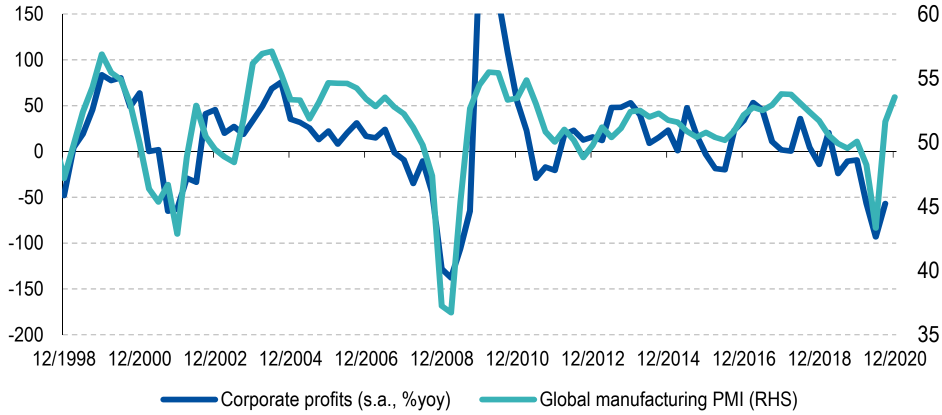


Source: Economic and Social Research Institute, CEIC, Amundi Research as of January 14, 2021

THIS MONTH'S TOPIC

As a cyclical and inexpensive market, Japan has something to offer

4/ **Japan's profit growth and global PMI**



Source: Ministry of Finance, CEIC, JPM, Amundi Research as of January 12, 2021

United States). The Nikkei index has even returned to its August 1990 level, which is still 30% off its all-time high of December 1989, but shows that structural changes underway in Japan are paying off.

An obvious candidate for a cyclical recovery

In fact, Japan's corporate profits tend to move in tandem with the global cycle, making it an ideal candidate for the cyclical recovery trade. With global PMI firming up, Japan's corporate profit growth started to recover in Q3 and is expected to strengthen further (Chart 4). Rebased to 100 in 2019, MSCI Japan's profits should rebound, according to IBES, to 137 in 2022, i.e., a little less than emerging markets (148) but more than the United States (125) and Europe (112). The sector composition of the Japanese market also makes it better positioned to ride the global cyclical recovery. The top two sectors of the market are industrials and consumer discretionary, which account for, respectively, 21% and 18% of the MSCI index, or 39%, against 22% for the world average. In total, cyclical sectors, including technology, amount to 2.3 times the weight of defensive sectors. Certainly, a little less than for emerging markets (2.9x) but more than for the United States (1.9x) and Europe (1.1x).

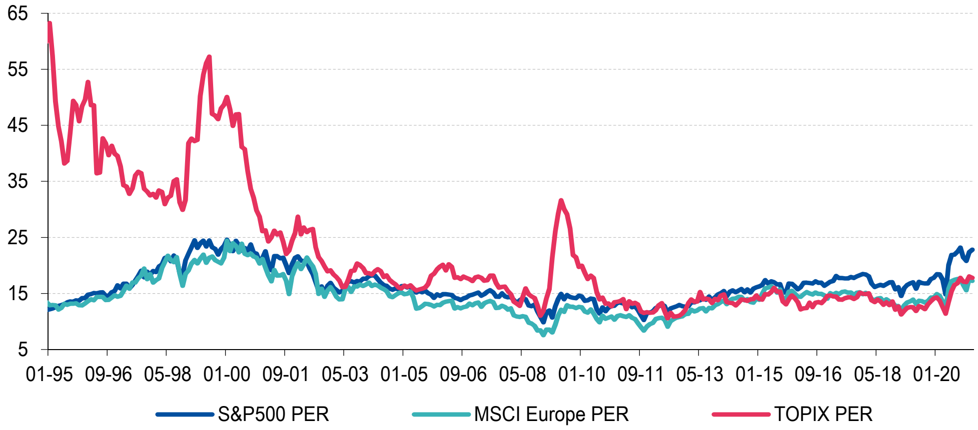
An attractive valuation

Since the 1980s bubble burst, the stratospheric PER of the Japanese market has gradually converged downwards towards the level of the PERs of other developed markets in the early 2000s (chart 5). Today, roughly equivalent to that of the euro zone (17.8x against 17.4x for the MSCI EMU), it posted a 23% discount, compared to the 12-month forward PER of the US market (23.1x). Adjusted for the cycle, the discount even reaches 35% (CAPE at 22.1x, against 33.8x for the United States). Supplemented by other valuation measures, such as Dividend Yield, Price Cash-Flow and Price to Book Value within a composite indicator, it also appears more attractive than its competitors'.

Debt under control at company level

Japanese companies started to deleverage after the bubble burst in the late 1980s. The Asian crisis of 1997, the bursting of the internet bubble, and the Great Financial Crisis have only encouraged this fundamental movement. The net debt

5/ **12 Months Forward PER**



Source: Ibes, Datastream, Amundi Research, data as of January 20, 2021

THIS MONTH'S TOPIC

of non-financial companies vs. balance sheet assets, for example, has halved over the past 20 years (from 30% to 15% according to Worldscope). This is despite the fact that distributions to shareholders have increased at the same time, notably due to buybacks, authorised since 2001 and encouraged by Prime Minister Abe, something that has also helped to improve the appeal of Japanese equities. The financial situation of Japanese companies has therefore improved considerably.

The risk? A correlation to the yen, which could act as a headwind

The link between the relative performance of the Japanese index and the MSCI World is resistant. The Japanese market underperforms when the yen appreciates against the dollar and vice versa. In a context of a downward trend in the greenback, this parameter, without being strongly negative, does not therefore work in favour of the Japanese market. In the end, however, it seems to us that the strengths of Japan in this phase of economic recovery are greater than this risk, especially since the regular purchases of ETFs by the BoJ, especially in downturns, help reduce the market volatility.

Conclusion

Although the global economic recovery was priced in as early as 2020, it should materialise in 2021. Part of the rebound in profits will be absorbed by the fall in PERs, but, provided that monetary and government policies remain accommodative, as we believe they will, equity markets are expected to end the year higher than they started. The ongoing pro-cyclical rotation should also continue. Regionally, while the weakness of the dollar makes us prefer emerging markets, Japan has other interesting arguments to surprise on the upside this year or at least to help balance a portfolio. It is indeed very cyclical, attractively valued, with a sound financial situation at the company level, and lower volatility than elsewhere.

Finalised on 20/01/2021

THEMATIC

Why we don't expect the Fed to taper its bond buying programme this year

In a world where sovereign bond yields are in the hand of central banks, the recent upward revisions of growth expectations for the US economy raised questions about the outlook for the Fed's monetary policy. Growth is expected to rebound in H2 and very accommodative monetary policy is not a free lunch. The difficulty for the Fed is estimating how sustainable this expected improvement in growth and inflation will be in H2 2021. We expect the Fed to keep a cautious approach and we believe tapering is more likely in 2022 when the core PCE index will have made significant progress towards the objective of a sustainable increase to an average of 2% or higher.

Valentine AINOUZ
Deputy Head of Developed Markets Strategy Research

Delphine GEORGES
Senior Fixed Income Strategist

"We have to make significant progress towards that goal. This does not necessarily mean that we have to get to that point" (Raphael Bostic)

Commentary from two regional Fed presidents, Robert Kaplan (Dallas) and Raphael Bostic (Atlanta), has led to market speculation that the Fed might reduce its bond purchases sooner than anticipated. In response, members of the Governing Council sought to allay any concerns that the Fed may soon taper its bond purchase programme. What is our view?

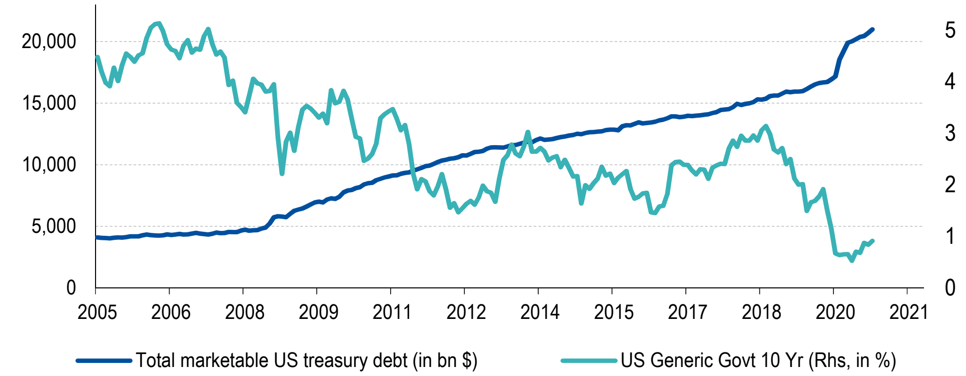
We agree that the Fed will need at some point to reduce the pace of its asset purchases

We expect the US economy to rebound strongly in H2 2021. The economy is likely to accelerate next spring, as herd immunisation will allow the reopening of the consumer services that account for most of the remaining output gap. In addition, this recovery will be supported by three other factors. (1) The new Biden administration is clearly inclined to maintain significant government support. Janet Yellen, the new Treasury secretary, voiced strong support for Joe Biden's $1.9tn relief package, arguing that "with interest at historical lows, the smartest thing we can do is act big". (2) The pandemic has resulted in record US savings rates, but mostly for households with the highest incomes. This should fuel a mid-year consumption boom and support asset valuations. (3) The Fed will maintain an accommodative monetary policy. Changes to the Fed's policy framework will likely allow the economy to operate longer at lower interest rates. Base effects will be strong: we will see inflation temporarily overshooting the 2% target as well as a rapid improvement in the labour market.

However, a very accommodative monetary policy is not a free lunch: low borrowing costs could contribute to asset bubbles, overreliance by companies and households on cheap debt and growing inequalities. The Covid-19 crisis has accelerated the already existing fragmentation of the US economy. The damage caused by this crisis is disproportionately concentrated on certain industry groups and small businesses. Indeed, large companies in specific sectors like technology and healthcare have outperformed in recent years and have not suffered from the crisis. The US is currently a two-speed economy.

- Small companies, lower quality issuers and cyclical sectors should show more balance sheet discipline. These businesses have accumulated debt due to the decline in economic activity and are now more leverage-constrained. Keeping rates low is necessary to facilitate deleveraging of these companies.
- On the other hand, companies in the tech sector could be encouraged by the central bank's new framework to take on more debt as the economic climate improves. Undeniably, despite the crisis, these sectors have seen a jump in their

1/ **US 10-year treasury yield versus Total marketable US treasury debt**



Source: Bloomberg, Amundi Research - Data as of January 2021

THEMATIC

"Now is not the time to be talking about exit. I think that is another lesson of the global financial crisis, is be careful not to exit too early" (Jerome Powell)

M&A activities and asset valuations. At some stage, the Fed may start to worry about financial conditions being too accommodative for this segment of the economy, leading to excesses.

The Federal Reserve's general view is that financial risks are manageable at the moment, notwithstanding "some issues" related to high levels of corporate debt and elevated pricing for commercial real estate.

A difficult task

The difficulty for the Fed is estimating how sustainable the expected improvement in growth and inflation will be in H2 2021. This is not an easy assessment for two reasons. First, most of the factors supporting the expected rebound in growth in the second half of 2021 will be temporary by nature. Second, the huge upcoming budget support makes the exercise even more difficult. The strategic question is whether this huge fiscal spending will help to increase the potential growth of the US economy. If it does, the US economy will be able to absorb a rise in interest rates. Otherwise, the US economy will simply need more support from the Fed to guarantee accommodative financing conditions despite high government deficit!

No room for mistakes: the US economy is highly sensitive to a rise in interest rates. The crisis has been characterised by very successful coordinated action by governments and central banks to limit the long-term damage to our economies. Central bank liquidity injections combined with government debt guarantees have kept funding conditions accommodative despite the historical contraction in GDP. However, we will emerge from this crisis with a much higher level of debt and high asset prices. As a result, a small upward move in interest rates today would have a bigger impact than in past cycles on corporate debt, the equity market and real estate markets.

The market's reaction is key! The Fed is committed to maintaining accommodative financing conditions: rates should rise for good reasons! The key question for investors is why interest rates are rising. Rising rates are positive for markets if they are expanding because of a sustainable improvement in real growth. Rising rates are negative for markets if they are expanding because of excess supply amid lower support from central banks. Clearly, the Fed would welcome higher yields without a tightening of financial conditions. This is exactly what has happened in recent weeks and it has confirmed the credibility of its monetary policy.

We expect the Fed to keep a cautious approach

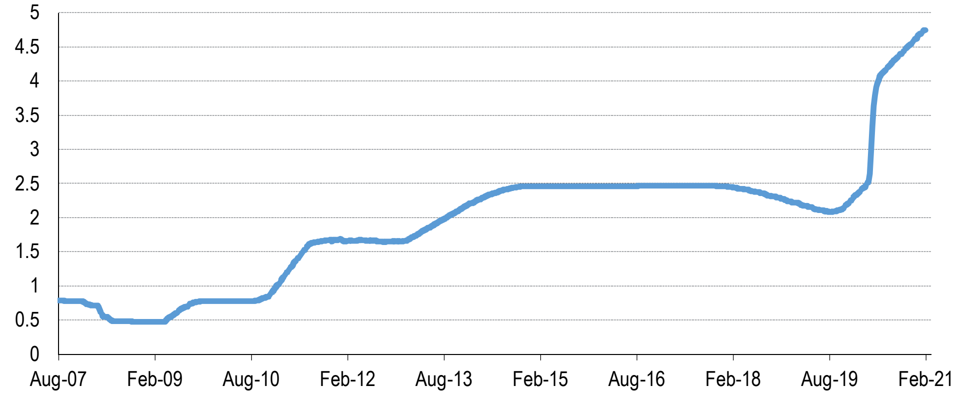
The forward guidance attached to the QE is very vague and leaves the Fed a lot of flexibility. Asset purchases should remain in place "until substantial further progress has been made toward the Committee's maximum employment and price stability goals".

No pre-emptive tightening with the new policy framework. The Fed is committed to an inflation overshoot under its new Flexible Average Inflation Targeting (FAIT) regime. The Fed's new reaction function implies that some inflation must be evident before raising rates, rather than simply forecasting it to rise. The FOMC will aim to push unemployment as low as possible, at least until inflation pressures appear. The maximum employment objective is "a broad-based and inclusive goal".

We believe tapering is more likely in 2022 when the core PCE index will have made significant progress towards the objective of a sustainable rise to 2% or higher. We do not expect the Fed to pre-emptively taper its accommodative policy. Inflation is expected to temporarily rise above 2% in Q2 2021 due to significant base effects, but the Fed will have to see sustainable progress in the underlying inflation trend before tapering, which is more likely in 2022. We do not expect supply to be a driver for rates. We expect higher rates because of an improvement in growth/inflation forecasts.

Finalised on 27 January 2021

2/ **Treasury securities held by the Federal Reserve**



Source: Bloomberg, Amundi Research, Data as of 27 January 2021

THEMATIC

Sergio BERTONCINI,
Senior Fixed Income Strategist

Supply vs demand of EMU EGB in 2021

Euro area sovereign debt issuance vs. ECB purchase dynamics look favourable in 2021. On the supply side, net issuance should decrease vs 2020, thanks to lower aggregated numbers of budget deficits, incoming support from EU funds, and for some countries, the use of increased cash accounts and higher bond redemptions. On the demand side, following December PEPP increase ECB potential purchases look more than adequate to cover for new debt and to provide as well a cushion for eventual additional funding needs.

QE potential to absorb the supply of sovereign debt looks strong in 2021

Euro area sovereign debt issuance vs. ECB purchase dynamics favourable to bond technicals in 2021

In this paper, we focus on the technical factors that are likely to dominate supply-demand dynamics for European Government Bonds (EGB) this year and which are set to continue driving Eurozone fixed income markets. As in our cross asset thematic paper published last September tilted on the remaining months of 2020, we compare the currently estimated supply of sovereign debt in 2021 with potential ECB purchases to assess the extent to which monetary policy can continue supporting the current environment of low yields, and ultimately keep the search for yields alive. Our conclusions show that the ECB's method of calibrating its QE potential in December indicates it is more than adequate to absorb the rise in sovereign debt currently projected within the Eurozone and to provide a significant cushion and backstop in the event of an increase in funding needs. To quote the ECB President's own words during the Q&A session following the December meeting: *"with the volumes that we have, with what is left under the previous PEPP, over €600 billion, plus what we have decided today, it allows us for **significant constant market presence**."*

2021 supply dynamics of EMU-10 sovereign debt

Our projections, based on draft budgets and published funding plans for 2021, point to an overall lower funding need of the EMU-10 versus the first year of the pandemic crisis, which saw fiscal deficits spiking to record levels. In 2021, the net increase in overall marketable debt (bonds and bills) should be roughly EUR 160bn lower than in 2020, with a decrease of EUR 100bn for core countries and EUR 60bn for peripheral countries.

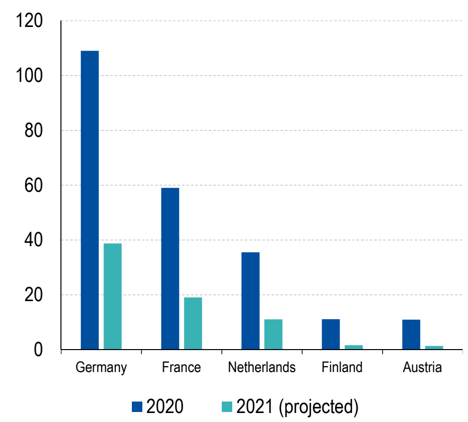
The following three main drivers of lower net supply of marketable public debt are expected this year:

1. a decrease in aggregated numbers of budget deficits, despite countries showing different fiscal trends vs. 2020,
2. support from EU funds, through EC SURE and the EU recovery fund,
3. for some countries, the use of increased cash accounts, alternative sources of financing and higher bond redemptions.

Funding mix to change mainly in core countries

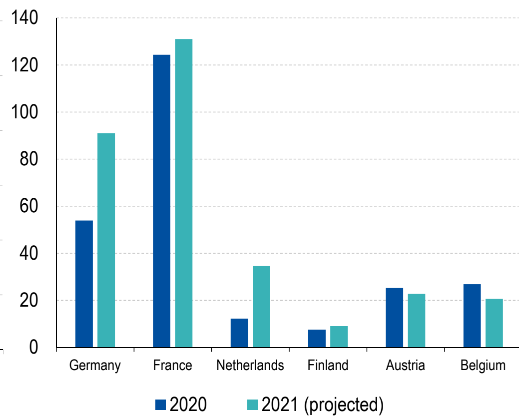
In terms of the split between medium- and long-term instruments and monetary market instruments, the projected net issuance of EMU-10 **bonds** is likely to remain close to 2020 volumes at EUR 530bn vs. EUR 515bn in 2020, while a sharp fall is expected net issuance of **bills** to less than EUR 80bn from a record of nearly EUR 250bn in 2020. As we pointed out also in our September analysis, the extraordinary funding needs caused by the Covid crisis were matched in 2020 by different

1/ **Core countries: net issuance of Bills, in EUR bn**



Source: Bloomberg, Amundi Research. Data as of January 15, 2021. Belgium not included, as numbers close to flat in both years

2/ **Core countries: net issuance of Bonds, in EUR bn**



Source: Bloomberg, Amundi Research. Data as of January 15, 2021

THEMATIC

Periphery countries are among those supported by the full combination of major factors that will drive lower net supply in 2021

funding mixes in core countries and periphery countries. As in the aftermath of the GFC and the sovereign crisis, core countries turned to sizeable issuance of bills and short-dated government bonds, while periphery countries continued to favour mid and longer dated bonds, in order to keep average debt maturity high and reduce refunding risk in subsequent years. 2020 ended with net debt issuance split almost 50-50 between bonds and bills for core countries, and 90% bonds for periphery countries. The funding mix in core countries is likely to show a bigger change this year as 2021 is expected to see a return to a more usual mix of 80-20 for bonds & bills, while in periphery countries bonds could reach 95%/97% after 90% last year. Net bond issuance is likely to be higher in Q121 due to front-loading and low redemptions, but then it should subside in the following quarters. Core countries are likely to see an increase in net EGB issuance mainly on the back of the change in the expected funding mix between bonds and bills, with a significant fall in the net issuance of bills (from EUR 225bn to EUR 72bn).

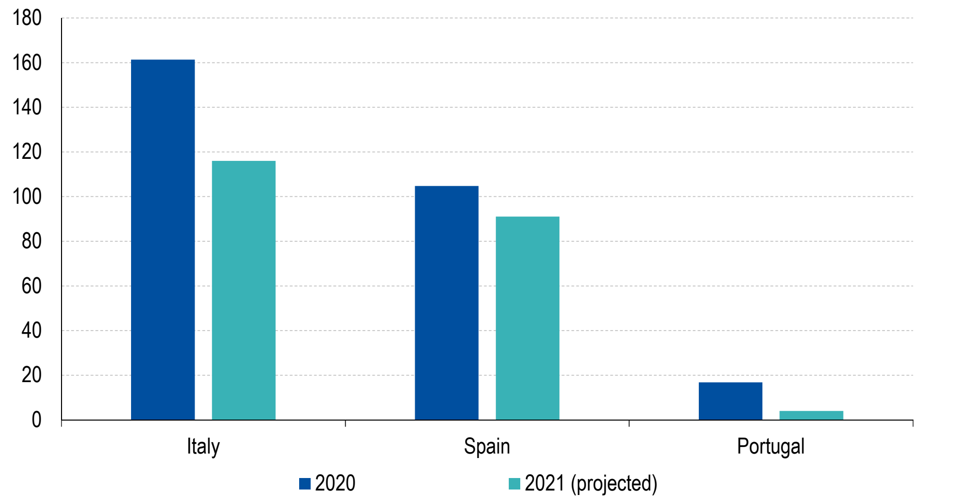
Debt market dynamics of periphery countries supported by lower deficits, higher redemptions, EU funds

Periphery countries are among those supported by the full combination of the three major factors outlined above that will drive lower net supply in 2021. Along with the fact that deficits are expected to be lower, the EU funds likely to be available in 2021 should reduce the level of recourse to the markets by periphery countries. Italy, Spain and Portugal should together receive a volume of resources close to a combined 60% of the SURE & Recovery Funds estimated to be available before year-end. At the same time and contrary to core countries, which will have less support from bond redemptions this year (lower than in 2020), maturing debt appears higher for each of the three periphery countries, by a combined volume of EUR 35bn, which will therefore help to reduce net supply. Concerning bills, expected changes are residual, with Spain likely to make some use of them after successfully increasing the average maturity of its debt relative to other countries in 2020. Bills should remain a potential cushion allowing flexible management of potentially higher fiscal needs. Finally, Portugal plans to use a high proportion of its cash account, which will be stronger thanks to last year's funding, to cover this year's needs.

What about potential ECB purchases?

Together with supply dynamics, we also estimated the potential firepower of ECB QE in relation to the net issuance of sovereign debt projected for 2021. Many different scenarios may be built on the distribution of QE flows over the next 15 months, bearing in mind also that the total amount available may not be entirely used. It could also be argued that 2021 will see more flows on a relative basis than Q1 2022, as economic recovery should gain ground and fiscal support from NGEU should gradually kick in, opening to a sort of QE front running. In our projections we refrained from this kind of scenario and favoured a more neutral view of QE deployment over time, assuming a steady monthly use of firepower, with a proportion of QE allocated to public debt similar to 2020 and assuming capital key rules will be followed on a country basis. The results show a strong QE capacity to absorb the supply of sovereign debt, thanks to the combination of decreased funding needs and the recent increase in QE potential on the back of the December package. The results also show that net EGB issuance is likely to be negative after the ECB potential QE for all countries:

3/ **Periphery countries: net issuance of Bonds & Bills, in EUR bn**

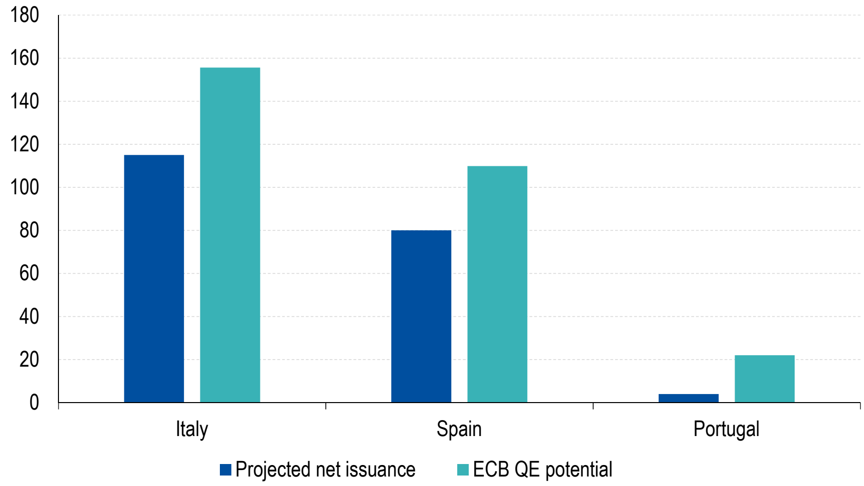


Source: Bloomberg, Amundi Research - Data as of January 15, 2021

THEMATIC

The ECB's firepower provides a substantial cushion for an increase in funding requirements

4/ **Periphery countries: projected bond net issuance vs estimated ECB QE potential, in EUR bn**



Source: Bloomberg, Amundi Research - Data as of January 15, 2021

the picture for periphery countries is shown in the last chart reported.

In conclusion, the numbers confirm that EGB technicals will continue to be strongly supported by monetary policy in 2021. Risks to sovereign debt supply are mostly to the upside, as governments remain committed to providing fiscal support and plans are subject to revision as restrictions to economic activity persist. At the same time, we expect some eventual variations to be absorbed in bill stocks as was the case last year, while the ECB's firepower provides a substantial cushion for an increase in funding requirements.

Finalised on 25/01/2021

THEMATIC

New money and maybe new powers too: Central Bank Digital Currencies are coming

Tristan PERRIER,
Global Views Analyst

While it is still too early to see a full launch in a large country, the CBDC (Central Bank Digital Currency) theme is likely to grow in importance in 2021. Over the recent period, central banks have accelerated their studies and tests in this domain. As an instrument for helping economies adapt to digitalisation, CBDCs are also intended to bolster a state's monetary sovereignty in the face of new challenges. However, their implementation raises complex issues, including those concerning their coexistence and interaction with bank deposits. While not yet viewed as serving a primary role as a new instrument of monetary policy, CBDC could nevertheless offer new possibilities in this area.

Recent announcements have put a spotlight on the CBDC development programmes of major central banks, although stages of advancement vary significantly.

It is very unlikely we will see a major country introduce a fully functional retail CBDC this year[1]. That said, central banks, including some of the larger ones, seem to be speeding up their preparatory work. China's PBoC, for instance, has conducted new tests in several large cities in recent weeks (others may be rolled out shortly in Beijing and Shanghai) while the ECB recently concluded a vast survey to decide whether it will launch a concrete project in the second half of the year (full deployment could happen in 2024 or 2025). While the US Federal Reserve's communication on the subject remains more cautious[2] (which does not mean it is not looking closely at the mater), certain central banks of smaller countries (Sweden notably, that is already testing its e-krona) are at a more advanced stage[3].

The motivations for CBDC projects vary quite a lot across countries

The goal in creating retail CBDCs is to give the public access to a digital currency that retains a certain number of the characteristics of physical currency.

Like physical currency and unlike bank deposits, retail CBDCs will constitute a direct liability for the central bank, eliminating in principle any credit risk for the holder. Depending on the selected architecture (direct or indirect account of the end-holder with the central bank, and/or a digital token that can be used online or offline, etc.), such currencies could offer (albeit not completely) similar advantages of portability and confidentiality to notes and coins. However, their immunity to different undesirable events would differ (e.g. CBDC and physical currency would not be vulnerable to the same types of criminal activity or disaster).

Among other roles in supporting the digitalisation of the economy, CBDCs would pursue sovereignty objectives.

CBDC projects are part of a general public policy effort around the adaptation to digitalisation and the creation of ecosystems conducive to financial innovation. By reducing the use of physical currency (although to differing degrees depending on the country) and intensifying online exchange in several domains, the Covid crisis has added to the incentives already existing in this area. The relative weight of different motivations to develop CBDCs varies a lot across countries: for instance, in a number of emerging economies, they are seen as a way to improve the financial inclusion of people who cannot easily access the financial system. However, among their various aspects, CBDCs are also perceived as a means for states to preserve (or strengthen) their monetary sovereignty in the face of new challenges. More than with highly volatile cryptocurrencies such as Bitcoin, public authorities seem to be concerned with the development of private retail "stablecoins" (centralised or decentralised digital assets that are pegged to a traditional currency[4]), as well as with the prospect that foreign CBDC could become easily accessible to their own citizens[5]. In normal times, and even more so during times of crisis, competition between such alternative

[1] *To date, only the Bahamas has already launched a functional retail CBDC, in October 2020.*

[2] *On 14 Jan 2021, J. Powell mentioned that the Federal Reserve felt no "need or urge to be first" and that it would be years, rather than months, before it had a CBDC ready. Among the justifications he provided for this patient approach was the first mover advantage given by the US dollar reserve currency status.*

[3] *In total, a Bank or International Settlements report in January 2021 indicated that 86% of the more than 60 Central Banks it surveyed (covering all of the world's major economic powers) were exploring the topic of CDBCs with central banks representing a fifth of the world's population (presumably meaning at least China) "likely to issue a general purpose CDBC in the next three years".*

[4] *Facebook, in particular, is set to launch its digital currency, Diem, in 2021.*

[5] *Christine Lagarde explicitly mentioned this risk in a communication in l'ENA hors les murs on 30 Nov 2020.*

THEMATIC

CBDCs have, among other, sovereignty objectives

New monetary policy possibilities could in theory be vast

currencies could have the effect of eroding the status of a traditional currency, and even lead to destabilising capital movements (both domestic and international)[6]. The extent and nature of this sovereignty aspect is, however, very different depending on the power of the country concerned and the international status of their currency: serving as a defensive instrument for some, the CBDC could, on the other hand, be used as a means of external influence for others.

The development of a CBDC implies taking into account its possible consequence for banking systems.

Economic agents holding domestic CBDC alongside bank deposits (which are also dematerialised but are liabilities of private sector financial institutions) raises the issue of the respective roles and interactions of these two asset categories. Central banks will, in fact, have to define the future terms of competition (a ceiling on holding of CBDC by a single person or entity is sometimes mentioned) and plan for or prevent the changes that their coexistence could bring on banks' cost of financing, risk profile, and the mechanisms by which they normally create currency. They will also have to determine the extent of the role of intermediary played by banks in giving the public access to CBDC (since central banks thus far have not been equipped to interact directly with individuals, it is generally envisaged that commercial banks would be given this role). These are complex issues that, in addition to the technical and operational aspects, warrant a cautious pace of progress by the authorities.

Although not developed for this purpose at present, CBDC could serve as a new instrument of monetary policy.

At present, no major central bank seems to view CBDC as serving a primary role as a new monetary policy instrument (beyond the strengthening of the legitimacy and use of the official national currency). Nevertheless, many observers (including the central banks themselves) are reflecting on such a possibility and its major implications. An initial aspect is that a CBDC could lower the "effective lower bound" of monetary policy if, for example, they carried negative interest rates or, by contrast, increase it to zero if they constituted zero-rate assets which are less costly to hold (in terms of storage and security) than physical currency. A second aspect is that a CBDC could, in theory, become a "programmable currency" whose possibilities of use (time-limited, restricted to certain expenditure, etc.) could be managed dynamically by the authorities. Other possibilities, such as new interactions between monetary policy and fiscal policy, are also envisageable. Visibility in this domain is as limited as the theoretical possibilities are vast.

CBDC could therefore have many consequences, some of which would be complex and difficult to figure out; considerable work and additional testing is therefore vital before they are introduced. However, with the gradual reduction in the use of physical money and the rapid development of digital rivals for traditional currencies, it is very likely that we will see CBDC introduced within a few years. This could impact on many sectors of domestic economic and financial life, as well as international financial equilibria.

Finalised on 27/01/2021

[6] *Public authorities' concern over the excessive power of large private payment systems players may also be an incentive for some Central Banks to develop CBDCs.*

CENTRAL & ALTERNATIVE SCENARIOS

Monthly update

This month, we maintain the probabilities and narrative of our central and alternative scenarios. We confirm our constructive medium-term view on the "financial recovery regime", with more caution in the short-term on financial markets, given the virus-dependent news flow.

DOWNSIDE SCENARIO 15%

Secular stagnation

Analysis

- Genetic evolution of the virus drives the pandemic out of control and leads to another negative growth shock, extending the length of the crisis
- Policy mistakes and execution risks of fiscal plans undermine the recovery
- Pause or rollback of accommodative monetary policies, due to internal (asset bubble) or external (FX) constraints
- Protracted economic downturn, due to uncertainty and lack of visibility, affecting business and consumer confidence
- Economic crisis evolves into a financial crisis
- Protectionism and de-globalisation accelerate, negatively affecting trade and global value chains

Market implications

- Favour cash and US Treasuries
- Favour gold, CHF and the yen
- Play minimum volatility strategies

CENTRAL SCENARIO 75%

Multi-year and multi-speed recovery

Analysis

- Multi-year process to get the world economy back on track, with a bumpy road to recovery
- Relapses in economic growth, due to virus outbreaks and lockdown measures until 4Q21
- Massive vaccine rollouts in 1H21 though uneven across regions
- Strong political commitment to mobilise fiscal policies in AEs, but timely execution is a risk
- Accommodative monetary policies continue, in order to cope with deflationary risks and rising public debt
- Positive momentum in corporate earnings and diminishing solvency risks
- Ratio of global trade to global GDP slips further but lower geopolitical tensions after the US elections
- The Covid crisis to exacerbate income and wealth inequalities (risk of increased social tensions)

Market implications

- Contained steepening of US Treasuries yield curve
- Progressive rotation from Credit HY into equities
- Equity thematics are cyclical sectors and are more domestically driven
- Maintain income pockets with EM bond, and credit IG
- Favour gold on pervasive uncertainty, deflation and recession fears

UPSIDE SCENARIO 10%

V-shaped recovery

Analysis

- Health crisis resolved by the end of 1H21, thanks to mass vaccination and efficient lockdown measures
- Sustained "vaccine- enabled" recovery
- Productivity boosts on new digital and green developments
- Faster normalisation of economic activities
- With lower uncertainty, policy boosters feed through to the real economy and financial markets, closing the gap between manufacturing and service sectors
- Sustainable growth and diminishing need for further (fiscal) policy support

Market implications

- US Treasuries curves bear steepening on fast rising growth and inflation expectations
- Favour risky assets with cyclical exposure but can undermine growth stocks
- Favour linkers and gold as an inflation hedge

TOP RISKS

Monthly update

Risks are clustered to ease the detection of hedging strategies, but they are obviously linked. We maintain the overall narrative and change the probabilities of risks in light of the recent developments.

ECONOMIC RISK 20%

- **Covid-19 vaccine rollout issues**
  - Unexpected logistic or side effects issues of the vaccine could have a very negative impact on investors and business sentiment, which has improved significantly since November 2020
  - One or several virus variants that would make existing vaccine ineffective would undermine the expectations of an end soon to the pandemic
- **A protracted recovery with multiple relapses** might hit business and consumer confidence, looping in sectors that have not yet been directly hit by the pandemic, such as financials
- **Underestimated hysteresis effects in the labour market**, with rising unemployment and uneven impact, could undermine the recovery and generate social tensions
- **A rebirth of inflation and a second "taper tantrum"**
  - The risk is very low in the short run, but upward inflation pressures could build up over time, as the epidemic fades away
  - QE programmes may become problematic when inflation enters the equation
  - Inflation dynamics and central banks reaction function could be sources of uncertainty, in particular in EM, where inflation is close to CBs target
  - Federal Reserve early exit or miscommunication could lead to a second taper tantrum similar to 2013

+ **Cash, linkers, JPY, Gold, USD, Defensives vs. Cyclicals**

- **Oil, risky assets, AUD CAD or NZD, EM local CCY exporters**

FINANCIAL RISK 15%

- **Corporate solvency risk**
  - Prior to the Covid-19 crisis, corporate leverage reached levels above pre-GFC highs
  - The magnitude of the recession has increased solvency risks, regardless of central banks' actions and government guarantee schemes
- **USD significant weakness** could push the Fed to stop its APP and negatively impact the UST market, bring deflation into the EZ and Japan, and undermine the EM recovery
- **Sovereign debt crisis**
  - With public debt as a share of GDP reaching historically high levels in peacetime, most countries are vulnerable to rating downgrades and rising interest rates, in the event of policy errors
  - Emerging market fragilities (single commodity exporters tourism) could also face a balance of payments crisis and increase default risks

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

- **Oil, risky assets, frontier markets and EM**

(GEO)POLITICAL RISK 10%

- **US/China cold war**
  - Post US elections the hawkish tone from Democrats maintains uncertainties regarding the relationship with China
  - The delisting of Chinese companies might trigger similar retaliation
  - Possible accidental confrontations in the South China Sea or the Taiwan Strait
- **Instability within, and among, EM countries** on the back of chaotic virus crisis management
- **Brexit 2.0**
  - 2020 ended with an exit deal but implementation of it might prove to be a lot more disruptive than anticipated, leading to supply disruptions
  - In the context of a third national lockdown, the domestic political consensus around the Prime Minister might fade as the exit brings an immediate loss of income in several sectors
  - Scotland may ask for another independence referendum

+ **DM Govies, cash, gold, linkers, USD, volatility, quality**

- **Oil, risky assets, EMBI**

CROSS ASSET DISPATCH: Detecting markets turning points

How to the read turning point assessment

Not reached yet too early to call it | Approaching to the turnaround | Turnaround happened

ECONOMIC BACKDROP

- The extension of the Covid-19 restrictions across the Euro area keeps weighting on economic activity. Accordingly, both Q4 2020 and Q1 2021 are expected to print a GDP contraction albeit significantly softer than Q2 2020. In the US, after a deceleration in Q4 2020, economic activity is expected to gain momentum, supported by the new fiscal stimulus.
- Soft and hard data confirm these trends, highlighting however remaining divergences across sectors, as manufacturing activities which are less disrupted by the latest restrictions holds up better than services.

FUNDAMENTALS & VALUATION

- Risky assets are trading at high levels, discounting solid growth expectations.
- Equities' absolute P/Es are still above their historical average, though they are expected to revert going forward as profits rebound.
- The equity risk premium and P/E adjusted for CB liquidity injections are still in favour of equities in relative value terms.

DEFENSIVE ASSET ALLOCATION

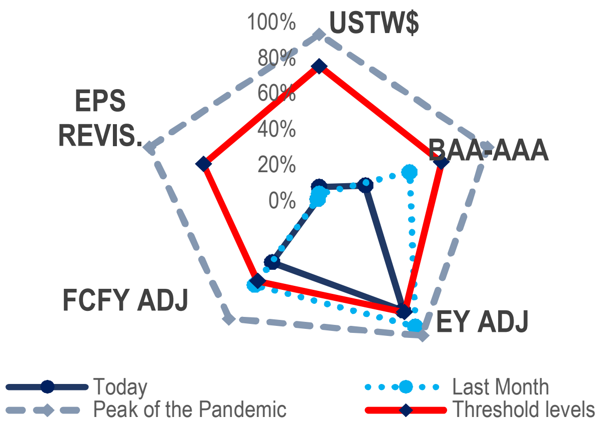
TECHNICALS

- 2021 starts with risk on tone following Georgia elections and fiscal stimulus expectations.
- Signals of overbought risky markets materialised in the latest 2 weeks, mainly RSI indicators and some vulnerability in the reflationary trades in the near term is likely.

SENTIMENT

- With CBs reassuring the market about their support for the global recovery, financial conditions eased further in December, thus leading our risk-sentiment barometer to remain in support of risky assets for the beginning of 2021.
- The USD downward trend and improved perceptions about credit conditions (Moody's Baa-Aaa spread tightened further in December and is currently 10 bps below our alert level) are the key supports for our CAST indicator, which shows a limited probability of a sell-off (CAST OFF probability < 10%).
- Additional supports come from our flow-based risk indicator, suggesting that investor's appetite remains high at cross asset levels (equities and commodities are the segments with a higher risk stance).

Cross Asset Sentinels Thresholds (CAST) still supportive



Source: Amundi Research, Data as of 15 January 2021

CAST flags extremely low risk perception.

Sentinels remain in pro-risk territory due to a general improvement in all its components (except ERP adjusted for credit risk).

<u>Methodology</u> We consider five inputs which we call "Sentinels": USTW$, Moody's Baa-Aaa, EPS revisions, Earning Yield risk adjusted and Cash Flow yield risk adjusted. 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 the market's stress conditions, with a certain level of conviction. The pentagon visualizes the five sentinels where the red line represents the alert threshold. The greater the distance above the red line, the higher the risk perception, and eventually the need to move closer to a defensive asset allocation.

GLOBAL RESEARCH CLIPS

1 We see a tipping point for UST 10Y yield @ 1.30%

- Notwithstanding the bold Fed purchase program, the UST 10Y yield reached 1.16% (before falling back to 1.0%over the past days). The rise in nominal yields has been driven by break-evens, and the US 30Y breakeven is now above 2%.
- Yield curves in the US have steepened but remain far from previous cyclical highs.
- As long as 10Ys reflects reflationary expectations, it could move even higher but will eventually set a cap for equity valuations.
- Our 2021 target is 1.30% on 10Ys. Medium-term, we expect the Fed to temper yield volatility on the long end to keep financial conditions easy.
- Based on historical evidence, we calculate the empirical distribution of the equity risk premium on the 10Ys, and we believe the tipping point relative to equity valuation is 1.30%.

2 The end of USD exceptionalism

- Despite its sell-off in H220, the USD remains slightly expensive.
- Most of the plunge can be attributable to the end of USD exceptionalism, as both expected growth and the real rate premium vs the rest of G10 FX have collapsed.
- Global conditions and the Fed's "average inflation targeting regime" suggest the USD will remain under pressure, at least in the first half of 2021.
- With a Democratic clean sweep, US growth expectations climbed, and a partial re-rating into US interest-rate expectations has already materialised. We see it as source of short-term volatility but not enough to trigger a new USD bull run.
- A strong rerating in US rates is, in our opinion, the only potential game changer.

3 US growth impacted by fiscal stimulus while Europe is revised down

- Our US GDP growth baseline was 3.7% average 2021 growth with no fiscal stimulus.
- The $900 billion package is adding +1.8% to our average growth forecast, which is now ranging from 5.2% to 5.7%.
- In Europe, we are revising downward our 2021 growth range for the Eurozone (now 3 to 3.5%) as well as for the UK (now 3 to 3.5%).

4 EM growth assessment

- Growth forecast revisions during Q4 2020 have seen a shift in the growth premium towards EMs in 2021 in comparison with previous expectations. Mobility data, broadly decelerating, have been confirming these expectations.
- EM mobility data have declined overall, but less so in Asia with the last period corresponding to the Christmas break.
- China high-frequency data are confirming our view of a sequential slowdown but stronger than originally expected. Our central scenario assumes Chinese GDP to grow by 8.4 to 9% this year.
- We expect EM GDP to grow from 5.7 to 6.5 % in 2021 and 3.9 to 4.9% in 2022.

5 The big disconnect between real economies and financial markets continues

- Market participants are looking with only marginal interest at fundamentals, having full confidence in central banks' keeping the "pedal to the metal" to preserve loose financial conditions.
- We are not in this camp. We think the reporting season is a relevant sanity check moment. Maybe Q1 reporting season will be more insightful than the current Q4 but we think that fundamentals have to come back in the radar.
- We expect a growth rebound in H2, but as long-term investors, we must look at its sustainability over time. The equity markets are racing ahead on the expectation of massive public spending and rapid rollout of vaccines, we are more comfortable with a relative value position than embracing outright risk-on.

Covid-19 update: virus mutations and vaccines efficacy

by David Brecht *Fixed Income Analyst, CFA*

Several recent studies are showing that the three worrisome coronavirus variants (UK, South Africa, Brazil), have the same mutation in the spike protein, and it appears they evolved this mutation separately. The studies have been small and many use pseudo-viruses instead of live coronaviruses, but they show the current approved vaccines will work effectively against the UK variant. However, it does appear that existing vaccines and convalescent blood serum do not provide as much of an antibody response to the South African and Brazilian variants. The mRNA vaccines (Pfizer and Moderna) promoted a very strong antibody response in trials (higher than seen in patients who had actually recovered from Covid infections). Therefore, these vaccines should still have some level of efficacy with the new variants. Moreover, these trials do not factor in other parts of the human immune system that also play a role in fighting infection (e.g. T-cells). Finally, these vaccines will be updated over time to account for mutations; Moderna is talking about the next version of its vaccine, which could be ready two months after being designed. **As time of writing, we therefore believe it is reasonable to assume that mass vaccinations will curb the pandemic.**

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=		2021 is likely to be a strong year for earnings growth, driven by the health of US consumer which has a lot of savings and pent-up demand. However, excessive valuations, potential tax rises, and higher interest rates, coupled with inefficiencies in logistics and higher input costs, require high selectivity. While maintaining the view of rotation towards quality, value and cyclical stocks, investors should move away from companies that will be unable to withstand these pressures.
EQUITY PLATFORM	Europe	=	▼	We are close to neutral in equities, given that a recovery regime should be supportive, but are mindful of segments where valuations are excessive and discounts have closed in. We suggest a barbell position, with exposure to cyclical, value, segments that can benefit from a recovery, and at the same time, explore defensive names. Above all, investors should continue to focus on non-disrupted business models with strong balance sheets and potential for sustainable growth.
EQUITY PLATFORM	Japan	+		Japan is a cheap, cyclical market with growing return on equity and an improving shareholder focus which is not yet appreciated by the market. Overall, it is an attractive long-term opportunity tied to a recovery in large global markets such as China.
EQUITY PLATFORM	Emerging markets	++	▲	We are optimistic on EM, particularly EM Asia. We believe the rebalancing of North Asia towards internal dynamics and demand could act as a good diversifier for portfolios. In addition, the past experience of Chinese authorities in better handling the virus situation should help them deal with new lockdowns. Overall, differentiation is key in EM, and we remain positive on cyclical growth and quality components, but are valuation conscious.
FIXED INCOME PLATFORM	US govies	=		With a global fixed income perspective, investors should remain close to neutral on USTs given their role as a safeguard if economic growth disappoints, but we continue to monitor the direction of rates and inflation. We are more positive on TIPS. From a US fixed income perspective, we are cautious on USTs in light of curve steepening and inflation expectations amid the massive fiscal stimulus (high-debt) plans of the Biden administration.
FIXED INCOME PLATFORM	US IG Corporate	=		We are neutral/slightly positive overall on IG as Fed actions should support the markets. However, we are cautious on long-duration IG as spreads in general have compressed to close to post-GFC levels. Strong consumer earnings and savings present opportunities in the consumer and residential mortgage markets, particularly in agency mortgages.
FIXED INCOME PLATFORM	US HY Corporate	=		We believe it is important to defend the additional income offered by high yield credit through security and sector selection. This is all the more important in light of rising yields and inflation expectations. Overall, quality should be a priority, given the risks related to defaults in a low-growth environment.
FIXED INCOME PLATFORM	European govies	-/=		We are defensive on core Euro bonds as we believe yields are unlikely to fall further, even though the ECB will be continuing its support programme. On peripherals, we stay positive, primarily through Italy, but are closely monitoring the political developments in the country.
FIXED INCOME PLATFORM	Euro IG Corporate	=/+		CBs' accommodative policies have decoupled markets from the real economy, but appetite for EUR IG remains strong, as reflected in primary markets. The asset class continues to offer positive carry at a time when interest rates are low/negative; thus, investors' search for yield, particularly in the BBB-rated segment, would continue to support IG. However, liquidity and quality should remain a key focus.
FIXED INCOME PLATFORM	Euro HY Corporate	=		Technicals and fundamentals are supportive of spread compression in HY, but this will not happen across the board. Therefore, we believe investors should be very selective, given the continuing lockdowns and expectations of an uneven recovery and their collective effects on default rates.
FIXED INCOME PLATFORM	EM Bonds HC	=/+		We maintain our bias towards HC, with a skew towards HY, as we believe IG valuations are now fair. HY is in a better position to cushion the widening effect of UST yields whereas the latter presents a risk to the IG universe. Overall, the US-China relationship under the new Biden administration is still to be assessed.
FIXED INCOME PLATFORM	EM Bonds LC	+		We stay positive and believe the current environment will still be supportive of EM FX. However, we do not expect to see a much weaker USD. We maintain a preference for high yielders over low yielders in the LC space.
OTHER	Commodities			Oil prices were driven up by the reinforcing convictions on global recovery and ongoing rotation. We revised up our target for 2021 to the $45-55/bbl range for WTI, due to expectations of lower production growth after Saudi Arabia's announced cut. We also reiterate our constructive view on gold, despite the recent correction, as we believe the metal should benefit from a prolonged dovish stance of central banks in the long run.
OTHER	Currencies			The USD sold off in 2H20 as both expected growth and real rates premium vs the rest of G10 FX collapsed. Results of the Georgia Senate run-offs gave Dems a clean sweep, providing a boost to US growth and interest rate expectations. However, we consider this to be a source of short-term volatility (especially for low yielders) rather than a clear catalyst for a new USD bull run. Average-inflation-targeting means the Fed should prevent sharp spikes in rates, thereby suggesting fiscal expansion should not come with monetary tightening in 2021. We see a gradual and limited dollar depreciation, which still trades 3% above its average fair valuation. Commodity-related currencies remain the relative winners.

LEGEND

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	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi 20 January 2021, 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 29/01/2021

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2020	2021	2022	2020	2021	2022
	range					
World	**-3.9/-3.3**	**5.0/5.7**	**3.4/4.2**	**2.6**	**2.7**	**3.0**
Developed countries	**-5.5/-5.2**	**4.0/4.5**	**2.7/3.2**	**0.7**	**1.4**	**1.7**
US	**-3.7/-3.3**	**5.2/5.7**	**2.6/3.2**	**1.2**	**2.2**	**2.3**
Japan	**-5.6/-5.0**	**2.7/3.3**	**1.7/2.3**	**0.0**	**0.1**	**0.2**
UK	**-11.1/-10.5**	**3.0/3.5**	**3.2/3.7**	**0.9**	**1.7**	**1.9**
Eurozone	**-7.0/-6.8**	**3.0/3.5**	**3.1/3.6**	**0.3**	**0.8**	**1.5**
Germany	-5.1/-4.9	2.7/3.2	2.6/3.2	0.4	1.3	1.6
France	-8.5/-8.3	4.4/5.0	3.1/3.5	0.5	0.9	1.6
Italy	-8.9/-8.7	3.2/3.6	2.8/3.3	-0.2	0.5	1.5
Spain	-11.1/-10.9	3.9/4.4	4.0/4.6	-0.3	0.6	1.5

Source: Amundi Research

- **United States:** After a deceleration in Q4 on foot of a fresh rise in Covid-19 cases, we expect the potential weakness in 2021 to be offset by the fiscal support approved in December, particularly during H1. Based on stronger fiscal support than previously expected, we have revised up our growth outlook. We have also raised our inflation forecast but expected it to remain within target, with a temporary mid-year overshoot due to base effects. New rounds of fiscal stimulus, not currently included, would represent an upside risk to our 2021 outlook.
- **Eurozone:** Based on the extended lockdowns implemented in Q4 and Q1, both Q420 and Q121 will likely see a fresh contraction in GDP (albeit much more limited than in Q2) as high frequency activity indicators currently imply. The extended lockdowns and very gradual roll-out of the vaccination campaign weigh on our forecast for H1; we expect much stronger growth from H2, based on a mix of improved sentiment, released pent-up demand, lift-off of major mobility restrictions and support from NGEU. Inflation should remain subdued in the near term before moving gradually higher in 2021, although it should remain significantly below target.
- **Japan:** Amid a worsening of the pandemic outbreak, the government declared a state of emergency in major regions. Business sentiment and consumer activity have retreated since November, prompting us to downgrade our growth forecasts for Q4 2020 and Q1 2021. Given the deep negative output gap, inflation will remain close to zero. However, we do not expect the economy to fall into outright contraction again due to resilient external demand. Overseas machine tool orders rebounded strongly by 15.9% yoy in Q4, the first positive data since end-2018.
- **United Kingdom:** Based on tougher and more extended lockdowns implemented during Q4 and stretching well into Q1, we expect the UK economy to contract both in Q4 and Q1. The roll-out of the vaccination campaign will help to lift sentiment, but we do not expect the economy to regain momentum until H2. The pressure on the labour market is severe, with a high degree of slack, despite the job support schemes. Fiscal and monetary policies remain supportive, while additional measures cannot be ruled out should the economic situation deteriorate further and to offset the Brexit impact.

Key interest rate outlook

	26-01 2021	Amundi + 6m.	Consensus Q2 2021	Amundi + 12m.	Consensus Q4 2021
US	**0.13**	**0/0.25**	**0.11**	**0/0.25**	**0.11**
Eurozone	**-0.50**	**-0.50**	**-0.52**	**-0.50**	**-0.56**
Japan	**-0.02**	**-0.1**	**-0.07**	**-0.1**	**-0.02**
UK	**0.10**	**0.00**	**0.03**	**0.00**	**0.01**

Source: Amundi Research

- **Fed:** The Fed introduced forward guidance on the asset purchases program: it will continue at the monthly pace of $120bn "until substantial further progress has been made toward maximum employment and price stability goals". A strong economic rebound in H2 2021 set the stage for a discussion on potential tapering of bond buying by the end of the year. Chair Powell sought to allay any concerns that the Fed might soon taper its bond purchases. We believe a tapering is more likely in 2022, when core PCE will have made significant progress towards the objective of a sustainable rise to or above 2%.
- **ECB:** Following the December package, the ECB's January meeting saw monetary policy unchanged. The ECB stressed that its main objective is to preserve favourable financing conditions, confirming that the PEPP envelope for bond purchases may not be used in full, but at the same time that it can "equally" be extended. The symmetry of flexibility in managing QE remains fully in place, as a crucial means to reach the above target. Although the ECB baseline economic scenario remains broadly on track, risks remain tilted to the downside.
- **BoJ:** Policy was kept unchanged as expected in January meeting. Interestingly, the central bank revised up its growth outlook for FY2021 and FY2022, by 0.3ppt and 0.2ppt to 3.9% and 1.8%, respectively, amid the worsening of the pandemic outbreak. We read this as a vote of confidence in the global recovery, where Japan is well positioned. Meanwhile, the focus is on the monetary policy assessment due in March. Governor Kuroda said a suppression of side effects, such as excessive decline in the super-long rates (>10yr) while stabilizing the remaining yield curve, is desired.
- **BoE:** As widely expected, the Bank of England kept its monetary stimulus unchanged in December, pending eagerly awaited developments on Brexit negotiations and on the back of the package already delivered in the previous meeting. The Brexit deal reduces the need for immediate action in terms of additional measures. However, the Bank of England is likely to stick to its dovish stance in 2021, keeping QE alive and adapting its size to eventual additional fiscal needs, which may result necessary to contrast downside risks posed by recent restriction to economic activity.

Monetary policy agenda

Central banks	Next meeting
Federal Reserve FOMC	**March 17**
ECB Governing Council	**March 11**
Bank of Japan MPM	**March 19**
Bank of England MPC	**February 4**

Source: Amundi Research

EMERGING COUNTRIES

Macroeconomic outlook

Data as of 29/01/2021

Annual averages (%)	Real GDP growth % 2020	2021	2022	Inflation (CPI, yoy, %) 2020	2021	2022
	range					
World	-3.9/-3.3	5.0/5.7	3.4/4.2	2.6	2.7	3.0
Emerging countries	-2.7/-2.0	5.7/6.5	3.9/4.9	3.9	3.7	3.8
Brazil	-4.3/-4.0	3.0/4.0	1.1/3.1	3.2	5.4	3.8
Mexico	-8.8/-8.5	4.0/5.0	1.8/3.8	3.4	2.9	3.3
Russia	-4.0/-3.5	2.5/3.5	2.0/3.5	3.4	3.9	3.8
India	-7.8/-6.8	7.8/9.0	4.2/5.6	6.6	5.6	6.2
Indonesia	-2.8/-2.2	3.0/3.8	4.2/5.2	2.0	2.6	3.3
China	2.3	8.4/9.0	5.1/5.7	2.5	1.6	2.0
South Africa	-7.8/-6.8	2.6/3.6	1.6/2.6	3.0	3.7	4.3
Turkey	0.5/1.5	2.4/3.4	3.7/4.7	12.3	13.7	11.1

Source: Amundi Research

- **China:** GDP growth firmed to 6.5% yoy in Q4 from 4.9% yoy in Q3, ending the year on a high note. The recovery, however, is uneven. While exports and industrial production consistently surprised on the upside, consumption recovery was less impressive. Income growth was slow, despite the tightening of the labour market. Still, we expect consumers to lead the overall recovery in 2021, given ongoing restoration of household balance sheets and narrowing excess savings. We revised up our 2021 growth forecasts on persistent strength in exports, vaccine supply and carry-over from 2020.
- **Malaysia:** On 11th January, on the back of a recent virus outbreak, Malaysia re-introduced the Movement Control Order (MCO), to be lifted in February if the pandemic is brought back under control. Accordingly, a new fiscal package has been announced, though much smaller than in the previous phase. The new fiscal support will come more from intra-budget re-allocation than new money. BNM remained on hold in January and we will reiterate our easing call (-25bps) at the next MP meeting in March. Inflation is still negative and not expected to move to an upward trend until March 2021.
- **Brazil:** The uneven v-shaped recovery is clearly moderating under the triple headwinds of fiscal tightening, Covid-related deterioration and less monetary support - the BCB blinked and unwound the forward guidance just last week but it is likely to hike by less than the markets expect. Policy is being held back by politics but as of now the 2021 budget (guidelines) are spending cap-compliant. The speakership elections are holding things back, along with fiscal, tax, administrative and other reforms. The country has begun vaccinating but the short-term outlook is not looking great.
- **Mexico:** The economy continued to perform strongly in Q4 driven by external demand but far less domestic pull, with a credit-less recovery and a slow return of formal jobs a clear sign of the fragility of the domestic economy, and a testament to the lack of policy support. Covid-related restrictions were tightened recently leading to less mobility but the resilient and fiscally supported US economy will be a big, albeit lonely, tailwind this year. Inflation looks set to moderate after the Q2 base effects related to Banxico cutting rates a further 50-75bp and after approval of a benign version, if any, of the FX-bill.

Key interest rate outlook

	28-01 2021	Amundi + 6m.	Consensus Q2 2021	Amundi + 12m.	Consensus Q4 2021
China	3.85	3.85	3.85	3.85	3.85
India	4	4	3.85	4	3.9
Brazil	2.00	2.50	2.50	3.50	3.35
Russia	4.25	4.00	4.15	4.00	4.25

Source: Amundi Research

Monetary policy agenda

Central banks	Next communication
PBoC	February 20
RBI	February 5
BCB Brazil	March 17
CBR	February 12

Source: Amundi Research

- **PBoC (China):** The bank has performed a delicate balancing act in the market by injecting just enough liquidity to accommodate the seasonal increase in demand ahead of the Lunar New Year, and recycling swiftly when liquidity becomes excessive. In light of the increased number of Covid cases, the latest policy meetings reiterated that necessary supports for SMEs and consumers would continue, but through the removal of unreasonable fees, continuous credit lines, and improvements to the business environment. There is a degree of reluctance to mobilise monetary policy tools when growth holds strong.
- **RBI (India):** In early December, the RBI decided to keep its policy repo rate unchanged at 4.0%, together with an accommodative stance for as long as necessary to support the economy. Headline inflation data released for December shows a decline, as expected, to 4.6% YoY from 6.9% YoY, well within the RBI target, thanks to a favourable base effect and a sharp decline in food prices. Moving into 2021, we expect headline inflation to be higher overall, closer to the upper end of the target range (between 5.5%-6.0%), and, accordingly, we see no further room for easing by the RBI.
- **BCB (Brazil):** The BCB has blinked and unwound its forward guidance. It is now leading the global monetary policy peloton out of an ultra-accommodative approach. The BCB will not hike just yet though as Q1 activity is likely to soften on foot of the withdrawal of fiscal support and Covid-related headwinds. Neither will it hike by much as the economy was weak even before the pandemic and inflation is far from out of control (core/services inflation is benign). We are forecasting 125bps of hikes this year, kicking off mid-year, far less than the markets are pricing in.
- **CBR (Russia):** The Central Bank of Russia left its policy rate unchanged at 4.25% at its December 18th meeting, on a less dovish note. The CBR expects inflation to be within a range of 4.6-4.9% at the end of 2020, higher than previously forecast, part of the reason being the pass-through from the ruble's earlier depreciation. Inflation in December reached 4.9% yoy, but it should decline in 2021. With stronger short-term inflationary factors and expectations of a faster global economic recovery, disinflationary risks for 2021 have been reduced. As a result, the CBR will be assessing whether there may be a need for an additional key rate reduction. Taking into account the various factors, we expect a 25bp cut in H1-2021.

MACRO AND MARKET FORECASTS

Macroeconomic forecasts
(29 January 2021)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2020	2021 range	2022	2020	2021	2022
US	-3.7/-3.3	5.2/5.7	2.6/3.2	1.2	2.2	2.3
Japan	-5.6/-5.0	2.7/3.3	1.7/2.3	0.0	0.1	0.2
Eurozone	-7.0/-6.8	3.0/3.5	3.1/3.6	0.3	0.8	1.5
Germany	-5.1/-4.9	2.7/3.2	2.6/3.2	0.4	1.3	1.6
France	-8.5/-8.3	4.4/5.0	3.1/3.5	0.5	0.9	1.6
Italy	-8.9/-8.7	3.2/3.6	2.8/3.3	-0.2	0.5	1.5
Spain	-11.1/-10.9	3.9/4.4	4.0/4.6	-0.3	0.6	1.5
UK	-11.1/-10.5	3.0/3.5	3.2/3.7	0.9	1.7	1.9
Brazil	-4.3/-4.0	3.0/4.0	1.1/3.1	3.2	5.4	3.8
Mexico	-8.8/-8.5	4.0/5.0	1.8/3.8	3.4	2.9	3.3
Russia	-4.0/-3.5	2.5/3.5	2.0/3.5	3.4	3.9	3.8
India	-7.8/-6.8	7.8/9.0	4.2/5.6	6.6	5.6	6.2
Indonesia	-2.8/-2.2	3.0/3.8	4.2/5.2	2.0	2.6	3.3
China	2.3	8.4/9.0	5.1/5.7	2.5	1.6	2.0
South Africa	-7.8/-6.8	2.6/3.6	1.6/2.6	3.0	3.7	4.3
Turkey	0.5/1.5	2.4/3.4	3.7/4.7	12.3	13.7	11.1
Developed countries	**-5.5/-5.2**	**4.0/4.5**	**2.7/3.2**	**0.7**	**1.4**	**1.7**
Emerging countries	**-2.7/-2.0**	**5.7/6.5**	**3.9/4.9**	**3.9**	**3.7**	**3.8**
World	**-3.9/-3.3**	**5.0/5.7**	**3.4/4.2**	**2.6**	**2.7**	**3.0**

Key interest rate outlook

Developed countries

	26/01/2021	Amundi + 6m.	Consensus Q2 2021	Amundi + 12m.	Consensus Q4 2021
US	0.13	0/0.25	0.11	0/0.25	0.11
Eurozone	-0.50	-0.50	-0.52	-0.50	-0.56
Japan	-0.02	-0.1	-0.07	-0.1	-0.02
UK	0.10	0.00	0.03	0.00	0.01

Emerging countries

	28/01/2021	Amundi + 6m.	Consensus Q2 2021	Amundi + 12m.	Consensus Q4 2021
China	3.85	3.85	3.85	3.85	3.85
India	4	4	3.85	4	3.9
Brazil	2.00	2.50	2.50	3.50	3.35
Russia	4.25	4.00	4.15	4.00	4.25

Long rate outlook

2Y. Bond yield

	26/01/2021	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	0.12	0.25/0.5	0.17	0.25/0.5	0.22
Germany	-0.722	-0.70/-0.50	-0.79	-0.70/-0.50	-0.83
Japan	-0.124	-0.30/-0.20	-0.14	-0.30/-0.20	-0.13
UK	-0.133	0/0.25	-0.14	0/0.25	-0.08

10Y. Bond yield

	26/01/2021	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1.04	1.1/1.2	1.15	1.2/1.3	1.26
Germany	-0.54	-0.60/-0.40	-0.52	-0.50/-0.30	-0.49
Japan	0.04	-0.10/0.10	0.08	0/0.2	0.12
UK	0.28	0.20/0.4	0.37	0.3/0.5	0.44

Currency outlook

	26/01/2021	Amundi Q2 2021	Consensus Q2 2021	Amundi Q4 2021	Consensus Q4 2021
EUR/USD	1.22	1.23	1.25	1.25	1.22
USD/JPY	104	103	103	103	106
EUR/GBP	0.89	0.89	0.90	0.90	0.90
EUR/CHF	1.08	1.09	1.11	1.10	1.11
EUR/NOK	10.39	10.25	10.13	10.02	9.93

	26/01/2021	Amundi Q2 2021	Consensus Q2 2021	Amundi Q4 2021	Consensus Q4 2021
EUR/SEK	10.09	10.00	9.92	9.99	9.81
USD/CAD	1.27	1.27	1.23	1.26	1.24
AUD/USD	0.77	0.77	0.79	0.78	0.79
NZD/USD	0.72	0.72	0.72	0.73	0.70
USD/CNY	6.47	6.45	6.30	6.40	6.40

Source: Amundi Research

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**

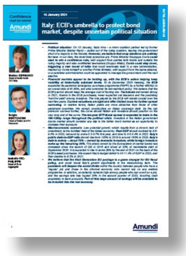
  The probabilities of risks are the outcome of an internal survey. Risks to monitor are clustered in three categories: Economic, Financial and (Geo)politics. While the three categories are interconnected, they have specific epicentres related to their three drivers. The weights (percentages) are the composition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

PUBLICATIONS HIGHLIGHTS

MARKET OUTLOOK

2021 investment outlook - market rotations in an uneven recovery (23-11-2020)
BLANQUÉ Pascal, Group Chief Investment Officer - MORTIER Vincent, Deputy Group Chief Investment Officer with the contribution of Research Team, Investment Platforms Leadership Teams, Investment Platforms Leadership Teams

INVESTMENT TALKS



Italy: ECB's umbrella to protect bond market, despite uncertain political situation (15-01-2021)
GERMANO Matteo, Head of Multi Asset CIO Italy - BERTONCINI Sergio, Senior Fixed Income Strategist - VIC-PHILIPPE Isabelle, Head of Euro Aggregate

Biden and Democrats take control despite Trump protesters (08-01-2021)
TODD Christine , Head of US Fixed Income - UPADHYAYA Paresh , Director of Currency Strategy, US Portfolio Manager, US

A thin and last-minute Brexit deal should give temporary relief to UK assets (06-01-2021)
ELMGREEN Kasper, Head of Equities - GERMANO Matteo, Head of Multi-Asset - PERRIER Tristan, Global Views Analyst

THEMATIC PAPERS

Asset Class Return Forecasts – Q4 2020 (30 10 2020)
DEFEND Monica, Global Head of Research, GISIMUNDO Viviana, Deputy Head of Institutional Advisory, KIM MOON Jung Hun, Quantitative Analyst –Institutional Advisory, PORTELLI Lorenzo, Head of Cross Asset Research

INSIGHTS PAPERS

European insurers: the case for going global in the credit allocation (13-01-2021)
DAUPHINE Gilles, Head of Euro Fixed Income - MUNERA Romain, Senior Portfolio Manager Fixed Income for Insurance - SINKOVA, CFA Natalia, Senior Portfolio Manager Fixed Income for Insurance

Sustainability-linked bonds: nascent opportunities for ESG investing (11-12-2020)
CREHALET Erwan, ESG analyst, Climate Change - DE FAY Alban, Head of Fixed Income SRI processes and Credit Portfolio Manager

Responsible investing expands further with green convertible bonds (11-12-2020)
CREHALET Erwan, ESG analyst, Climate Change - DE FAY Alban, Head of Fixed Income SRI processes and Credit Portfolio Manager - KUNG Julia, Portfolio Manager, Global Convertible Bonds

Social bonds: financing the recovery and long-term inclusive growth (18-11-2020)
LAUGEL Elodie, Chief Responsible Investment Officer - VIC-PHILIPPE Isabelle, Head of Euro Aggregate

WORKING PAPERS

The market measure of carbon risk and its impact on the minimum variance portfolio (26-01-2021)
RONCALLI Théo, Master BIBS - RONCALLI Thierry, Head of Quantitative Research - LE GUENEDAL Theo - LEPETIT Fréderic - SEKINE Takaya - Quantitative Research

Responsible Investing and Stock Allocation (13-01-2021)
Marie BRIÈRE, Head of the Investor Research Center - Stefano RAMELLI, University of Zurich

Liquidity Stress Testing in Asset Management (05-01-2021)
RONCALLI Thierry, Head of Quantitative Research - KARRAY-MEZIOU Fatma, Risk Management - PAN François, Risk Management - REGNAULT Margaux, Quantitative Research

Facts and Fantasies about the Green Bond Premium (08-12-2020)
BEN SLIMANE Mohamed, Quantitative Research - DA FONSECA Dany, Credit Portfolio Management - MAHTANI Vivek, Alpha Fixed-income Solution

PUBLICATIONS HIGHLIGHTS

DISCUSSION PAPERS

Creating resilient pension portfolios post Covid-19 (18-11-2020)
Prof. Amin Rajan

Factor Investing and ESG in the Corporate Bond Market Before and During the COVID-19 Crisis (18-11-2020)
BEN SLIMANE Mohamed – SEKINE Takaya, Quantitative Research – DUMAS Jean-Marie, Alpha FI Solutions

Europe, US and China tomorrow-Will it be possible to avoid geopolitical and economic traps (16-11-2020)
ITHURBIDE Philippe, Senior Economic Advisor

THE DAY AFTER

The day after #13 -
How will Central Banks impact the equity markets in the post-Covid world? (15-12-2020)
MIJOT Eric, Head of Developed Markets Strategy Research

The day after #12
Changing shares of labour and capital incomes: what implications for investors? (21-10-2020)
BARBERIS Jean-Jacques, Head of Institutional and Corporate Clients Coverage - BLANCHET Pierre, Head of Investment Intelligence - POUGET-ABADIE Théophile, Business Solutions and Innovation

The day after #11
Post-crisis narratives that will drive financial markets (23-09-2020)
BLANQUE Pascal, Group Chief Investment Officer

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