Research

#11
November 2021

CROSS ASSET
Investment Strategy

CIO VIEWS

Markets in quicksand: inflationary risks persist

THIS MONTH'S TOPIC

Q3 2021: From a recovery phase to an inflationary late cycle

Confidence must be earned

Amundi ASSET MANAGEMENT

#11 - November 2021

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CIO VIEWS

Markets in quicksand: inflationary risks persist

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Like it or not, the alignment of the planets regarding inflation will last for a while. October saw the recognition of a more permanent than expected inflation, with the IMF officially stating that we are entering a phase of inflationary risk and CBs partially admitting that inflation is proving stickier than anticipated. **In our view, this adds an extra dimension to the idea that markets are moving in quicksand and the permanent inflation narrative is getting a boost.** The mismatch between supply and demand is widening, with shortages all over the world and full economic reopenings in the main markets fuelling demand. Supply bottlenecks are intensifying and the astonishing rise in energy and food prices is further driving inflation dynamics in a vicious circle. The additional factor that could trigger further inflation rises is the wage component. Persistent rises in prices will, in our view, push workers to ask for wage increases.

Given the known risks regarding the I (inflation) part of the equation, the market's focus will return to the G (growth) side. Are we heading towards a deceleration around potential or below, therefore feeding *stagflation* fears? On growth, all economic areas (US, Europe, China) face some challenges.

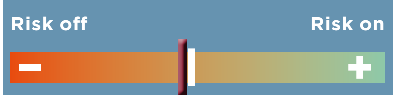
Our base case is for a controlled deceleration entering 2022, while further fiscal support to address the different open issues should kick in next year and help reinvigorate growth throughout 2022. Longer term, the energy transition is the key priority that might once again fuel an additional global fiscal push. COP26 will be a key milestone to watch to assess the future path of policy actions. Market reactions will depend on CBs and there is no room for mistakes on their side. We think any action by CBs will be incredibly gradual because there is little that CBs can do to address supply-side inflationary forces.

This scenario confirms our current stance:

- **Real rates are the key variable to watch**. In this phase of growth reassessment, we expect nominal rates to drift marginally higher but stay capped, while real rates trend lower. This phase will still favour equities over bonds. Later in the sequence there will likely be a catch-up, with nominal rates trending higher and real rates staying flat (at some point in 2022). This phase may trigger volatility in both equities and bonds and will require investors to add additional sources of diversification. The third sequence is about real and nominal rates both trending up. This could be a more challenging development, but we do not think this is around the corner.
- **Overall duration stance remains short, but we do not expect much of a rise in rates for now.** Credit remains favoured as fundamentals have been improving, but at current spread levels selection is vital to prepare for the next sequence, when liquidity risks will rise. China local government bonds remain in demand in the hunt for yield and more generally, so do EM bonds with a short-maturity bias.
- **Stay neutral on equity and search for possible entry points at better levels,** but be aware of risks and keep hedges amid phases of higher volatility, should growth deteriorate further and/or central bank communications be weak. In equity, each business case should be tested against rising inflation and rising rates. Value remains a good hunting ground for companies that can show real inflation-proof business models. This reporting season should be one of the toughest in terms of visibility. Expectations are already discounting headwinds, so the earnings season should not be a bad one, but uncertainty is very high and some of the energy pressure is not yet priced in and therefore it will be important to assess its impact in terms of forward guidance. The growth part of the market remains more vulnerable to rising rates. While at the moment the rise is capped, the next sequence will be more challenging and investors should prepare to embrace a very cautious stance in areas where valuations are excessive.
- **In EM,** which may now join the reopening narrative thanks to an improvement in the virus cycle, discrimination is increasingly relevant. Countries that can benefit from rising energy prices, such as Russia/Indonesia, are favoured, while those most exposed to the China slowdown look weakest.

Overall, the backdrop for investors is becoming more uncertain and riskier, with little upside potential in the short term. Markets are stuck in the middle. Rising inflation fears push long-term yields higher, but only to a certain extent because when growth is under threat, CBs are reluctant to tighten policy significantly. Equities is the place to remain given the low yields from bonds, but in an already stretched valuation environment in absolute terms, any rise in inflation and long-term yields should result in a reassessment of each business case.

Overall risk sentiment



Neutral stance on risk assets, with increased vigilance on real rates and higher emphasis on selection, in light of persistent inflation and asymmetric risks.

Changes vs. previous month

- Adjustment to core Euro duration (still cautious), higher selectivity in credit.
- Tactical changes to FX, more cautious on GBP.
- Valuation-conscious on TIPS.

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

CB = central bank, HC = hard currency, FI = fixed income, EM = emerging market, DM = developed markets, YTD = year to date, HY = high yield.

CROSS ASSET RESEARCH ANALYSIS

Energy shortage: Europe, China the most affected

Monica DEFEND,
Global Head of Research

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Head of Cross Asset Research

Current supply pressures could affect economic growth through a pass-through to inflation, but a shift to a long-term high price for oil seems unlikely for the time being

- The current energy crisis is related to short-term pressures,[1] imbalances over the green transition.
- Europe and China are being hit harder than other areas as they are the largest natural gas importers.
- A global power crunch is not likely in 2022, but energy sector turmoil will affect inflation and weigh on growth and profit margins.

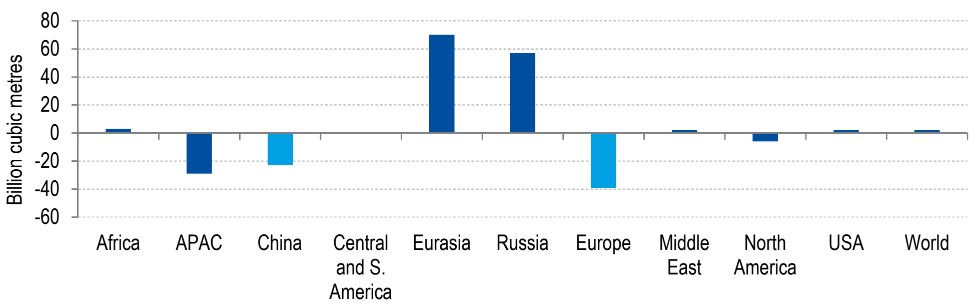
Since the beginning of the summer, we have seen significant repricing in various energy and related commodities. While there are many interconnected factors at play (recovery seasonal bottlenecks), the catalyst was strong global electricity demand. According to the IEA, after falling by about 1% in 2020 due to Covid, global demand is expected to increase by close to 5% in 2021 and slightly less in 2022, almost double the 10-year annual average (2.7%). All this occurred at a time when the green transition and the global fight against climate change intensified, limiting coal emissions, mainly in the EU and China.

Europe and Asia are in an uncomfortable position in terms of gas production as they have historically been the largest net importers and the deficit to fill in the coming years will be huge. Natural gas demand pressures materialised in Europe as the increased requirements were barely matched by supply from the two largest suppliers (Russia, Norway). In China, aggravated by a very hot and dry summer, energy demand has been remarkable. Typically, about 65% of electricity consumption is powered by coal, and 17% is powered by hydro. However, the supply of power from both sources has been limited – for coal, domestic production has struggled due to regulatory reforms and emission limitation goals; for hydro the dry summer limited its contribution. As a result, demand for natural gas in China has been very strong. Increasing concerns over supply shortages in green commodities and the potential power crunch underpinned several commodities, from copper to aluminum and gas to oil.

The rush in Europe and Asia to store gas is unprecedented and the two regions are struggling the most to restore gas and oil inventories amid the approaching winter. The skyrocketing price of natural gas has spilled over to oil markets, lifting oil prices as many countries were forced to find substitutes for coal and gas. Oil moved above $80 due to potential undersupply concerns, despite a decelerating growth environment, as oil suppliers[2] seem reluctant to boost production in the next weeks for different and opposite reasons. US production lagged global oil demand due to a temporary pause in drilling amid hurricanes and subdued shale oil production. At current prices and without the market being flooded with US supply, OPEC is piling up revenues in an attempt to correct sovereign fiscal balances. In the meantime, the energy sector, mainly in Europe, will remain under pressure given that we are entering the winter with historically low gas inventories and Russia and Norway will not be able to boost their flows to the EU in the near term; if anything, Russian flows to Europe are already higher than pre-Covid levels. **Our central case is not for a power crunch in winter but the turmoil and higher prices will hit European growth** through high inflation, household consumption, a corporate profits squeeze and decreasing productivity.

WTI crude should remain at about $80 for a while, and it is premature to call for a structural shift to the $80-100 range. This is because US oil production should progressively recover in H122. Second, OPEC+ members are likely to match any unexpected demand spikes. Should the power grip exacerbate further and prices move out of control, the group is likely to respond. Third, despite the fact that the switch from coal to gas and oil will support these markets in the long run, the economic cyclical contribution to demand should diminish in 2022 as growth decelerates toward trend levels. **Thus, we expect to see oil below $80, in line with the EIA official outlook, by the end of 2022.**

Natural gas: deficit/surplus (2020 to 2021)



Source: IEA = International Energy Agency; APAC includes China, Eurasia includes Russia, North America includes US numbers. Chart shows increase/decrease in production minus increase in demand from 2020 to 2021

EIA = US Energy Information Administration.[1] Winter, pick-up in demand, 2 OPEC+ and US

MULTI-ASSET

Stay neutral, amid higher risks and strong earnings

Matteo GERMANO,
Head of Multi-Asset

We are neutral on risk assets and well-diversified overall, keeping a balanced stance on equities, favouring value names and avoiding those with limited pricing power

Economic growth continues to be robust, but there are risks emerging in the form of production capacity constraints, which, coupled with the base effects from lockdowns and the recent CPI data, are fuelling the inflation narrative moving into H1 2022. They are also putting pressure on CBs to act, with the high likelihood of a Fed tapering announcement at its November meeting being a signal of this. On the other hand, risk sentiment is still constructive and pro-cyclical amid the evolution of the pandemic. Financial conditions are accommodative despite some upward movement in core yields and the weakness in China. Thus, investors should **remain neutral on risk assets, with a patient, active approach and wait for better opportunities, keeping hedges in place.**

High conviction ideas

Equity valuations now depend on low rates, allowing us to stay in a 'buy-the-dip' mode, which could offer attractive levels that are in sync with fundamentals. Thus, while remaining close to neutral on DM and EM, we focus on the earnings season to understand forward guidance and see which companies have pricing power. Currently, the market's earnings growth expectations are disconnected from economic data surprises. This is important when considering margin pressures emanating from higher input costs, tight labour markets and bottlenecks. We are also balancing the positive factors with the not-so-positive ones (stagflation, tapering, higher real rates and weakness in China).

Our defensive stance on 10Y USTs is maintained, but managed tactically, because the fundamentals indicate higher yield levels in the face of high debt and inflation. The UST supply will remain high in spite of a better fiscal deficit situation in 2022, further supporting our stance. Although we believe there is scope for yields to increase further and the curve to steepen despite the recent surge, we are monitoring movements carefully.

We keep our view for a UK curve steepening, even though the rationale for this has changed from reflation to stagflation. We remain constructive also on BTP vs. Bund, amid attractive carry, potential economic surprises from Italian growth and the impetus from the Next Gen EU funds.

Chinese govt bonds are a strong diversifier for global portfolios when yields in DM are expected to rise. Unlike US yields, Chinese yields should remain stable over the next six months amid PBoC support. However, we remain neutral on EMBI more broadly.

The search for income in European IG and HY continues, in light of better fundamentals, positive technicals and CBs' policies of keeping short rates anchored. Interestingly, given the downward trend in default rates, improving distress ratios and benign financial conditions, we believe subordinated debt and high yield are attractive credit segments to be in.

FX offers attractive relative value plays. For instance, stabilising global growth and the Fed's policy normalisation have been positive for the USD, providing investors an opportunity to benefit from the rising USD/JPY. We are no longer negative on the EUR vs. NOK as the latter could suffer from increased volatility. We maintain our view on the FX carry trade GBP/CHF, and our cautious stance on GBP/EUR. With respect to the greenback, the GBP could be under pressure from the UK's geopolitical isolation vs. the US and the EU, as well as the ongoing energy crisis. Thus, we are now defensive on GBP/USD. In EM we now believe the IDR could be affected by potential risk-off sentiment stemming from the Chinese slowdown. However, we keep our positive stance on the KRW and the CNH vs. the EUR and on RUB/EUR.

Risks and hedging

Rising cost pressures from inflation could potentially affect margins and P/E ratios, making this a high-impact risk on our radar and potentially affecting prices. As a result, we recommend investors maintain protection to safeguard equity exposure.

Amundi Cross Asset Convictions

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

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

CGB = Chinese government bonds, EM = emerging markets, PBoC = People's Bank of China, FX = foreign exchange, IG = investment grade, HY = high yield, CBs = central banks, BTP = Italian government bonds, EMBI = EM Bonds Index

FIXED INCOME

Inflation-adjusted returns through credit selection

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Global Head of Emerging Markets

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CIO of US Investment Management

We will witness more discrimination in credit, as sound businesses become more expensive and low-quality names cheapen further. Thus, the need for selection and idiosyncratic stories will be high

High borrowing, aggravated by the fiscal response to the Covid crisis, combined with economic reopenings, supply shortages and demographics, is pushing inflation up. While financial repression (government borrowing below market rates) works when inflation is under control, this could now be a problem for asset values. Even some CBs that kept rates low are realising that inflation is not transitory. We think the Fed and the ECB are likely to taper but will refrain from extreme actions, although we might see asynchronous policies. Overall, liquidity will remain high. Investors should resist a positive stance on duration despite the recent upward yield movements and should stay active. **In credit, subordinated debt and EM bonds offer decent real returns but investors should be mindful of leverage and increase their scrutiny of investment cases amid the tight valuations.**

Global and European fixed income

We remain cautious but active on duration in the US, core and semi-core Europe and the UK, but positive on Chinese govt bonds. We now see steepening potential in Canada vs. flattening in Australia. On peripheral debt, our positive view is maintained (marginal adjustment) as Italy offers a good risk/reward trade-off. In credit, fundamental metrics continue to improve, albeit at a slower pace, and we see no increase in distress or defaults, while carry remains decent. Investors should increase selection to identify companies that can pass on price increases to consumers. However, we are cautious on long-term debt (duration risk) and focus on shorter maturities. We are constructive on lower-rated names but balance this with the potential for extra yield to play the compression card, and on subordinated financials in HY and IG. **Carbon intensity and ESG performances are key factors to watch.** The energy crisis reaffirms our view that investments in low-carbon-intensive technologies must accelerate for us to reach Net Zero by 2050.

US fixed income

We believe inflation is a global, long-term phenomenon, driven by lower participation rates in the US, declining birth rates in China and worker shortages. In this environment, markets are currently in a wait-and-watch mode, but core yields should eventually move higher. We remain sceptical but flexible on USTs amid the high debt as we track the path of nominal and real rates. In contrast, **we are constructive on TIPS, but are watchful of valuations and their limited upside potential.** Credit fundamentals are supportive and we recommend investors be highly selective to limit portfolio beta and exposure to long duration IG. Given that spreads have already compressed this year, we focus on idiosyncratic risks. **Securitised credit – RMBS and consumer credit – is relatively attractive** given consumer earnings are strong. Overall, we remain vigilant on housing and see value in selective non-residential mortgages.

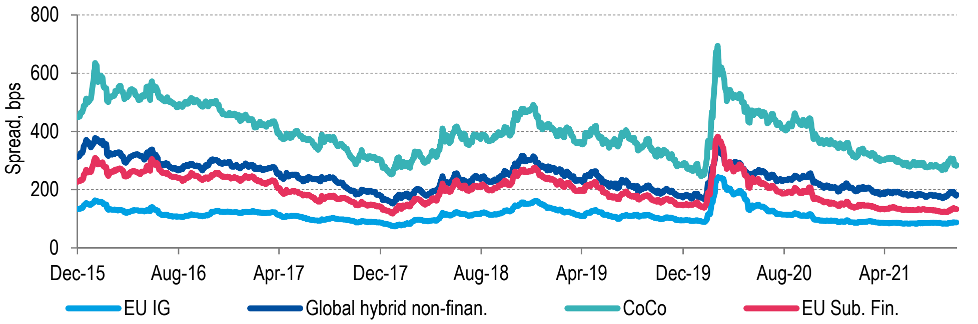
EM bonds

While the growth differential between EM and the US is moving in favour of the former, supply-side bottlenecks and high energy prices persist. Thus, investors should look at countries where CBs are acting to control inflation (LatAm and Russia) and avoid those where CBs are not. The third category is China, which is facing near-term weakness but where selective long-term opportunities remain. For LC bonds our conviction is for countries such as Russia. In HC, we maintain our preference for HY vs. IG, as well as for EM corporates.

FX

We maintain our near-term constructive view on the dollar amid the currency's safe-haven status but are watchful given that it is a consensual view. On EM FX, we are selectively positive (RUB, INR, MXN) but think the Fed's change in tone could dampen the mood. We remain vigilant, particularly on the CNY.

Spreads remain tight, but selective opportunities exist



Source: Amundi, Bloomberg, as of 20 October 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

Energy crisis is testing the markets

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Global Head of Emerging Markets

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CIO of US Investment Management

Overall assessment

The key issue for markets currently is inflation and whether companies will be able to withstand the pressures on their margins. This is relevant in light of the spike in energy prices that is affecting companies as well as households (politically sensitive issue). We believe the current situation in Europe will accelerate the energy transition in the long term. On the other hand, valuations in some areas seem expensive, leading us to question the sustainability of these in the face of high inflation and rates increases. From an investor perspective, **we believe the range of outcomes is wide, and thus investors should maintain a thorough selection process that prioritises fundamentals (earnings quality and growth), and look to play rotations favouring value, quality stocks.**

European equities

We maintain a balanced stance, with a tilt towards normalisation and reopening, and implement this view through a barbell approach of quality cyclical stocks in industrials and financials (value). Here, the economic reopening is not fully discounted by the market and thus valuations are selectively attractive. On the other hand, the picture in the consumer and energy sectors looks mixed. In the latter, we have become more cautious in our view because of the strong run lately and are looking for answers beyond the earnings season, especially in terms of the impact of green investing on the broader green energy landscape. We think there is a need to invest in the energy sector with an ESG improver approach that could have a meaningful impact and push clean energy investments. At the other end of the barbell, we hold attractive defensive names in healthcare and telcos. Overall, we look for opportunities offering strong risk/reward profiles, and hence avoid expensive growth names.

US equities

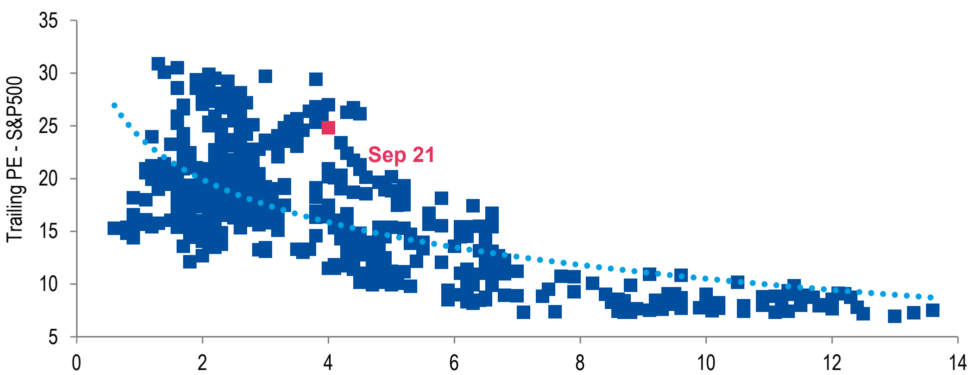
Inflation, even if it peaks in the coming quarters, is likely to affect equity valuations, underscoring the need for investors to protect their portfolios from rising prices. In addition to base effects and energy prices, a key aspect pushing inflation up is worker wage growth, which has been developing for quite some time now (demographics, deglobalisation, China). We believe value stocks provide an opportunity to inflation-proof portfolios but these require strong selection. **Energy and financials present some interesting value.** As investors, while we are aggressive in phasing out coal and oil from energy generation, our capital should be tilted towards companies that will support this transition, in the process benefitting from the move. This, we think, is the only solution to take us to Net Zero emissions by 2050. Furthermore, we look at financials, particularly banks, that are active in rewarding shareholders through buybacks and dividends. On the other hand, we are reducing cyclicality in global sectors affected by higher logistics and input price risks. We avoid expensive growth and distressed value stocks, but focus on relative value.

EM equities

Attractive relative valuations and the receding effects of Covid are important factors supporting EM equities. However, there are some risks on the horizon, such as the near-term weakness in China and idiosyncratic stories, especially in some LatAm countries. Our main convictions are Russia (energy and commodities exporter) and India (domestic consumption, will benefit from the China situation), whereas in sectors we favour consumer discretionary and communication services, maintaining our preference to increase value/cyclicals over growth.

Markets will reward companies that can increase prices and preserve margins vs. those that are unable to pass on rising costs to consumers, thereby affecting stock prices

High inflation may challenge high valuations



Source: Amundi, Bloomberg, as of 20 October 2021. P/E ratio for S&P 500 Index

THEMATIC GLOBAL VIEWS

Didier BOROWSKI,
Head of Global Views

Pierre BLANCHET,
Head of Investment Intelligence

Monetary policy is only one angle of the financial repression triangle

The triangle of financial repression

The idea that we are entering a phase of financial repression regularly returns to the fore as real interest rates are negative and nominal interest rates are very low. As the Federal Reserve begins to normalise its policy with tapering and as US Treasury yields are rising, investors might believe this is only a temporary phenomenon. In fact, we believe we entered a regime of financial repression soon after the Global Financial Crisis 15 years ago, the intensity of which could increase in the context of the Covid-19 and climate crises. Indeed, financial repression is not only a function of monetary policy but also includes regulation and government decisions, forming a triangle with a moving barycentre. It appears to be a reasonable policy to ensure a smooth energy transition.

Financial repression is usually described as institutional constraints on interest rates designed to reduce the government's cost of funding and eventually shrink public debt. The "repression" comes from the fact that these measures distort the bond market, where sovereign bond interest rates are lower than free interest rates, and channel funds to governments. Low funding costs for fiscal policies mean lower returns for savers and investors.

The triangle of financial repression

Measures leading to financial repression are usually seen as mainly linked to central bank's policies (QE, low or negative policy rates) because it is the most visible part. **Financial repression can actually be defined as a triangle, which includes monetary policy, financial regulation and government actions.** Regulation plays an important role as it ensures a tied investor base (usually institutions), which is obliged to buy and hold government debt. Changes in prudential policies for banks and insurance companies, for instance, incentivise them to increase their holdings of sovereign securities, despite poor or negative returns. Capital and reserve requirements, liquidity and leverage ratios are among the regulatory constraints that take part in financial repression. The third angle is government direct control of financial flows, where it caps interest rates or dictates financial returns or make investment compulsory. Direct lending to the state from the banking sector and capital mobility constraints are other examples seen in the past.

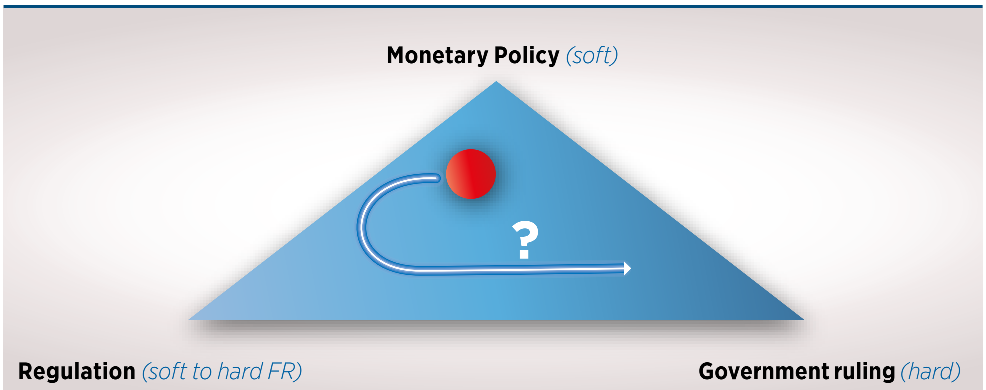
The intensity and effectiveness of each angle are different, and so is its strength. *Monetary policy* can be considered as soft and *regulation* as soft to hard, while *government* ruling is, by definition, hard. Moreover, financial repression is not an iterative mechanism. Each angle can be "on" or "off", with different intensity and strength at different periods. Today in advanced economies, monetary policies and regulations are "on", while government ruling is mostly "off". **Each of the three angles holds its own rationality and is perceived as a good or at least reasonable choice by the consensus in the current circumstances** (for instance, QE is seen as positive). The dynamics of financial repression are generated by crises. Hence, the fact that one or several angles of the triangle are switched "on" or heightened following episodes of financial or economic distress. Financial repression shouldn't therefore be defined as a level, but as a barycentre, of the triangle.

"Financial repression": the wrong word for the right concept

Financial repression has been widely used post-WWII in Europe and the US to manage public debt and reduce it relative to GDP[1]. In the 1980s, reforms removed restrictions on financial markets and the banking sector. **The concept of financial repression was coined in**

[1] *The Liquidation of Government Debt, Carmen Reinhart and Belen Sbrancia, IMF Working Paper 2015*

1/ **Financial repression position as the barycenter of triangle**



THEMATIC GLOBAL VIEWS

Monetary policy and regulation should be enough to channel investments towards decarbonisation of the economy

the 1970s[2] as the opposite of liberalisation and therefore has a negative connotation, since everyone aspires to freedom. The word "repression" illustrates the merits of the liberal doctrine and the positive outcomes expected from deregulation. The main argument was (and still is) that restrictions on the financial sector discourage savings and investments, limit financial intermediaries' capabilities and fail to efficiently channel capital. Over the long run, financial repression would lead to a suboptimal allocation of capital and reduce growth potential.

The Global Financial Crisis brought back the idea of regulation, supervision and control, since self-regulation by financial markets was a clear failure. With the Eurozone crisis came the need to keep interest rates low, in order to maintain public debt sustainability and avoid a fragmentation of the monetary zone. Financial repression restarted a decade ago after 30 years of liberalisation, which saw major crises and unprecedented income inequalities.

Covid-19 and climate change are bringing new imperatives in the context of historically high global public and private debt, deglobalisation and unsustainable wealth disparity. The concept is therefore back on the agenda[3]. The need to fund the energy transition and rebuild some form of industrial autonomy in the main regions has become paramount, but requires a lot of capital and long lead investments. **We believe "repression" will not recede** but actually intensify, with the regulatory angle strengthening and probably government ruling switching on, as the need to channel capital to achieve decarbonisation will be critical. This "repression" is likely to be seen as a positive and not a negative to achieve the higher purpose of net zero versus return on savings. We should therefore assume that interest rates will remain low relative to nominal growth for a long time.

Channel funding for the energy transition

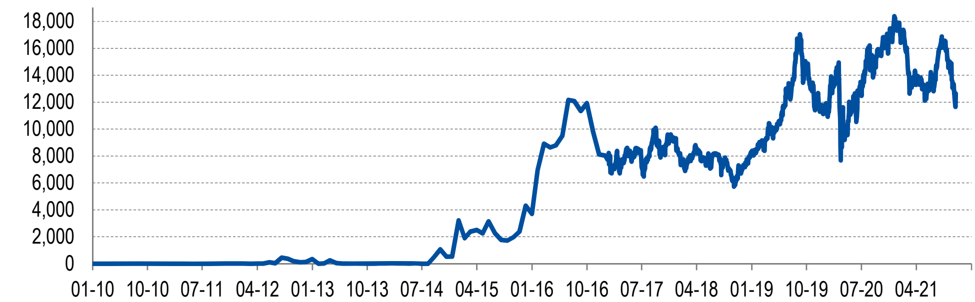
Financial repression is more effective when combined with inflation, which itself could be the consequence of excessive money creation, expansionary fiscal policy or excess leverage in the private sector, wage-increase spirals or supply shortages. Any of these, combined with the twin angles of monetary policy and regulation, should be enough to ensure an efficient transition to decarbonisation. However, the harder version of financial repression involving governments can't be excluded. It would require some market turbulence, though, and maybe another crisis to be justified and implemented.

Finalised on 18 October 2021

[2] *Shaw, Edward S. Financial Deepening in Economic Development. Oxford University Press, 1973. McKinnon, Ronald I. Money and Capital in Economic Development. Brookings Institution, 1973*

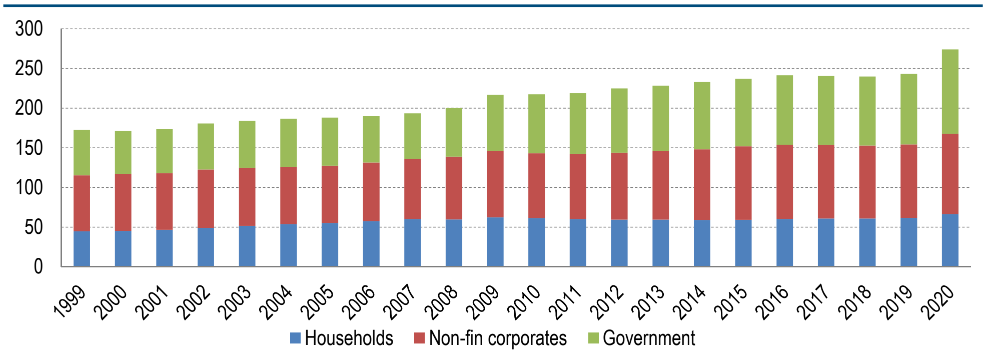
[3] *Financial Repression is Knocking at the Door, Again. Jafarov, Maino, Pani. IMF Working Paper 2019*

2/ **Negative Yielding Debt (USD bn)**



Source: Bloomberg, Amundi Research, Data as October 2021
Bloomberg Global Agg Negative Yielding Debt Market Value (USD bn)

3/ **Global Debt (% of GDP)**



Source: Amundi Research, Data as of October 2021

THIS MONTH'S TOPIC

Q3 2021: From a recovery phase to an inflationary late cycle

- **A second derivative stagflationary environment of decelerating growth amid sustained inflationary pressures. The fiscal lever continues to play a pivotal role.**
- **This translates into moderate equity exposure with a tilt towards value and quality sectors. Interest rates on IG is preferred to govies, with linkers offering a hedge.**

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Head of Cross Asset Research

Silvia DI SILVIO,
Cross Asset Research Macro Strategist

Annalisa USARDI,
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Lower growth, higher inflation and moderate risk exposure is expected for 2022 as a central scenario

1. A second derivative stagflationary environment of decelerating growth amid sustained inflationary pressures

The Global Growth outlook in recent months has deteriorated in several factors, culminating in the downgrade of expected growth in China and the US, among others.

In China, despite the relaxation of social distancing rules, a confluence of factors continues to weigh on economic recovery, including the housing slowdown and the NDRC's energy use control, posting a negative string of data, with exports being the only exception. Policy tightening with the housing slowdown, self-imposed restraints (zero-tolerance Covid-19 policies, de-carbonisation production cuts, and electricity rationing) and the global chip shortage all contributed to a weaker economic performance in Q3. For the second time in less than two months, we have downgraded our growth forecasts; we no longer expect growth to recover to trend in Q4 2021, and we have revised down our growth forecasts for 2021 and 2022.

On the US front, for the second time we have revised down our projections for US economic momentum in H2 2021, based on softer domestic demand and consumption. The increase in Delta cases and expiring of some measures supporting household income, amid higher-than-expected inflation, have generated a sharper-than-expected deceleration in domestic demand and GDP in Q3, trimming growth prospects for H2 2021, although we see signs of improving activity for Q4. **The growth premium between** DM and EM is expected to return more in favour of DM for the time being, with China spillovers weighing first on EMs with high trade and commodity exposure to China, as well as limited policy room. **The growth premium is expected to rebalance more in favour of DMs, mainly due to positive economic momentum for next year in several countries materialising on the back of new fiscal support (the US infrastructure plan and the NGEU in the Eurozone) and the prosecution of the massive vaccination campaign, which should somewhat reduce the propensity of governments to implement severe activity restrictions in case of new Covid waves.** Growth will remain multispeed, uneven and heterogeneous at global and regional levels and, crucially, will be dependent on getting the withdrawal speed of policy support right.

POLICY MIX - The fiscal lever continues to play a pivotal role in supporting the recovery, especially among advanced economies, in a context where monetary policy, while remaining broadly supportive, will have to begin a gradual normalisation process. This is particularly true in the US, where a full-sized "Build Back Better" plan would provide a significant upside risk to our growth projections, which currently encompass only what is so far included in the bipartisan deal; this also holds true for the Eurozone, where the role of NGEU-financed projects is one of the main drivers of the sustained and above-trend pace of growth we project for next years. Indeed, implementation risk is considered, but the spillovers of higher investments and structural reforms remain broadly positive, especially in supporting higher potential growth. Among **emerging markets, the policy mix looks more heterogeneous.** Broadly speaking, the EM Policy mix is relatively tighter. Monetary policy is normalising faster than anticipated on high inflation even though real rates are slowly getting to more neutral levels. In September, we increased the final policy rates for some economies (Andean and CEE mainly) or anticipated the start of hiking (Colombia). Recent Fed comments have moved slightly to a relatively more hawkish stance, although the market reaction remains gradual and benign for EMs.

INFLATION - The annual inflation outlook has been revised higher for DMs, on a combination of higher commodity and energy prices, cost pressures and, in a few countries, stronger domestic demand prospects. Much of the expected rise and overshoot of headline inflation this year has extended longer than expected. In particular, supply-side issues, compounded with higher energy and input costs (delays in logistics and increased shipment costs, to name few bottlenecks), have created a mix favourable to higher inflation persistence. Some of these factors will start to ease in mid- 2022 (e.g., supply bottlenecks) while others will tend to persist, leaving the terminal inflation rate at the end of our horizon significantly higher than prior to the crisis, in particular in the US. In this respect, we are monitoring the increase in consumer and market inflation expectations and their implications for second-round effects and wage settings. Yet, as of now, the stabilisation of core inflation above the central banks' target appears to be more a US-

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specific case. In the Eurozone, it is still unclear how the withdrawal of furlough schemes and labour support measure will play out in terms of labour market slack and wage growth.

Among EMs, in August headline inflation has generally remained high relative to the central banks' desired levels. Cost pressure continued in September. Still, Asia is keeping the most benign picture, due to more sluggish growth dynamics. In Latam, we still see the pandemic- and the global-recovery-related drivers of high inflation as mostly transitory. While strong one-offs, two-speed services and core goods inflation dynamics make high inflation clearly more robust and stickier, but the (lack of the) Phillips curve pressures will be a stabilising force, once economies reopen and normalise.

Inflationary late cycle the most likely phase with potential downside risks

Medium-term investment outlook

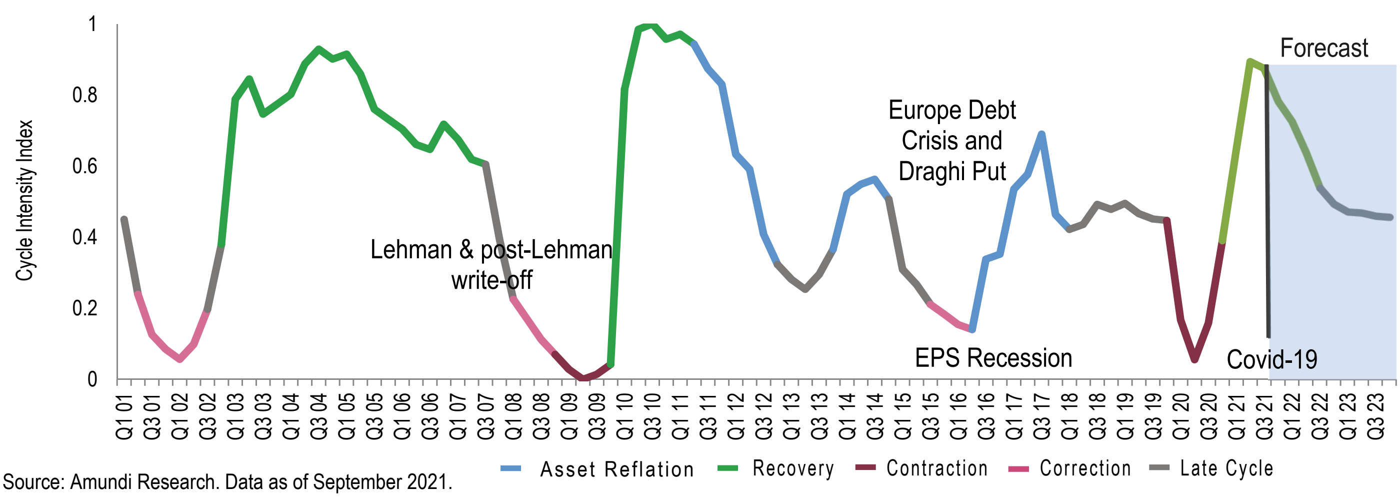
On a 12 months horizon, the current macro-financial backdrop calls for a continuation of the ongoing *recovery* phase through H1 2022. Starting from Q3 2022, the *late-cycle* regime will become likelier and develop into the predominant one from Q4 2022 and for the remainder of our forecasting horizon, in 2023.

Until the first half of 2022 the recovery phase will still be supported by:

- the **strong** (albeit decelerating) **pace of economic growth** expected for the current year and the first half of next one, also boosted in some areas (US and EU) by very supportive fiscal policy;
- **inflation** remaining **above trend** (due to both supply and demand dynamics);
- global EPS cycle to deliver solid growth, thanks to the still elevated level of economic activity;
- extremely accommodative financial conditions.

Starting from the second half of 2022 and into 2023, the cycle is expected to lose traction and transition into the so-called *late cycle*. Growth approaching trend levels, inflation decelerating from 2021-early 2022 peaks, monetary policy turning less accommodative in some DMs (namely the US and UK) and EM countries and the resulting tightening in financial conditions from the current record easy levels, will all contribute to the economic regime shift, with inevitable consequences on financial assets.

1/ **Advanced Investment Phazer Regimes occurrences since 2001**



Source: Amundi Research. Data as of September 2021.

2. Investment consequences: late cycle less benign for risky assets, due to inflation scare

The late cycle has historically been a phase where risky assets have delivered positive returns. This time it should be less supportive, due to higher inflation than normal, Fed tapering, and absolute and relative value considerations. For the first time since 2007, margins are vulnerable to rising production costs, due to supply disruption and bottlenecks. The top line is likely to remain solid enough for preventing profit recessions, but downside risks are not negligible and visibility is quite low. As a consequence, a conservative asset allocation has been confirmed in the near term and the tilt in favour of asset classes, positively impacted by rising prices, should be favoured in equities, FI and FX. US inflation linkers are the natural candidates in govies despite looking a bit stretched after the recent rally; IG (mainly in Europe) should guarantee positive carry at reasonable risk. Decelerating growth and margin-squeeze concerns are driving focus more on the sustainability of quality business models in the value segment rather than specific regional equities exposure. Despite decelerating growth towards trend levels, inflation scares will lift rates higher, in line with long-term inflation expectations putting some pressure on central banks.

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US inflation

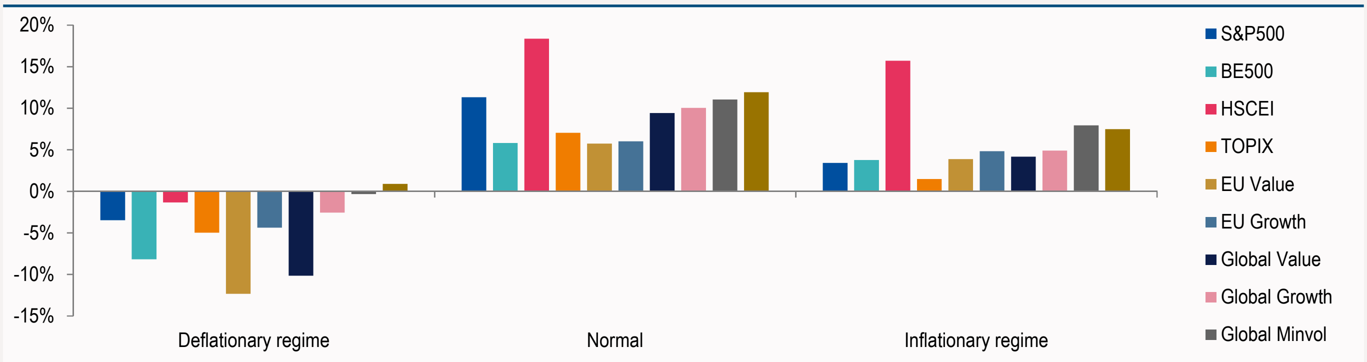
Looking at the next 12-18 months, **a dynamic mix of factors will continue to drive inflation in the US as price pressures broaden out to stickier and more persistent components,** with implications for pipeline cost pressure and PPI, for headline and core inflation pass-through and ultimately for inflation expectations and labour costs.

- Over the course of next year several base effects that held inflation depressed in 2020 and, conversely, supported inflation in 2021, will drop in a year-over-year comparison, generating a noticeable transition in mid-2022 to lower levels of headline inflation. **These levels will, anyhow, be significantly higher than pre-crisis ones, due to higher levels of core inflation.**
- **More "structural" forces will take the lead in defining the core inflation trend: wage dynamics,** which we expect to pick-up as the labour market tightens further, **and rental growth,** which we expect to grind higher till early 2022 at least.
- **We also have to acknowledge that, although somewhat decelerating, demand, in particular for core goods, remains strong and above its pre-crisis trend, keeping prices supported as supply remains constrained;** while we assume bottlenecks will begin to be resolved in 2022, thus reducing pipeline pressures, core goods prices will remain supported above their usual trends also during the first half of next year.
- **On the near-term (upside) risks, we also have to mention the possible pickup in travel-related pricing of some core services** (which we assume will take place in the holiday season, given the decline in Delta cases and the expected resumption in travel).

We gauge a measure of what inflation regime can be expected over the forecast horizon leveraging on *Amundi's Inflation Phazer*. The expected pattern of the US price indices included in the tool implies that CPI, PPI and Core PCE will register a YoY level in line (or even above in PPI's case) with the *Inflation* regime band (3-6%) at the end of 2021. Consequently, the Inflation Phazer assigns the highest probability to such a regime for the current year. In 2022 and 2023, as all three of the aforementioned indicators are expected to decelerate and stabilise within the *Normal* regime range (2-3%), the Phazer is accordingly giving the highest probability to such a regime for both years. Looking at the overall distribution of probabilities, a relevant aspect is also represented by the evolution of the two *hyperinflationary* regimes. Their aggregated probability indeed spikes from 10% (the average level at which hyperinflation risks are very low) up to a range of 30-35% in the second half of 2021. It is interesting to notice an analogous juncture in 2008, when the *inflation* regime was paired with a similar risk of *hyperinflation*.

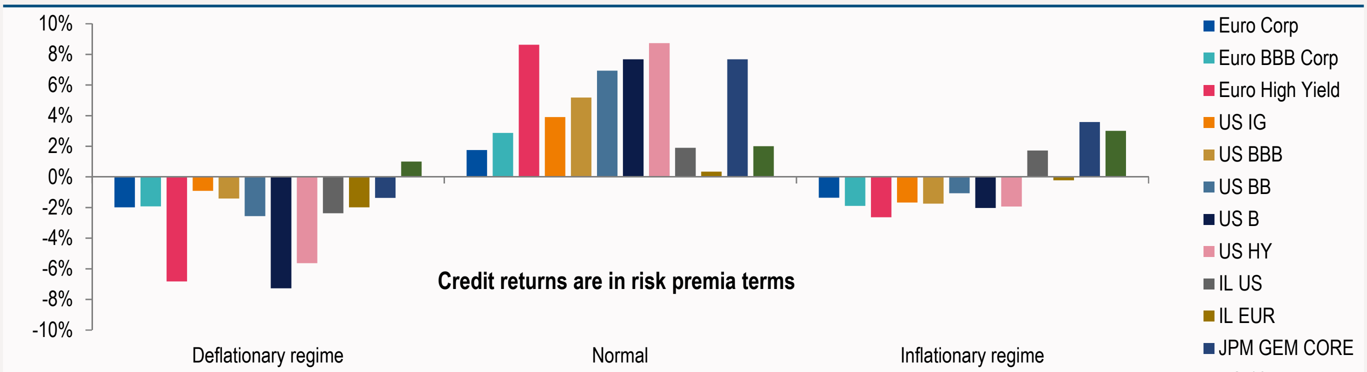
In terms of investment consequences, concerns on global deceleration's meeting rising inflation expectations translates in a progressive recalibration in the risk budgeting of our portfolios towards a reduction of the overall equity exposure, while maintaining a tilt towards value and quality sectors. Moreover, under the "*Inflation*" regime, monetary policy is expected to undertake a normalisation path. Such a context is less supportive than the "Normal" one for risky assets. As interest rates rise, equity is preferred to credit, with inflation-linked bonds offering a hedge.

2/ Equity performance (Total return)



Source: Amundi Research, Data as of September 2021

3/ Credit and inflation linked performance (Total return)



Source: Amundi Research, Data as of September 2021

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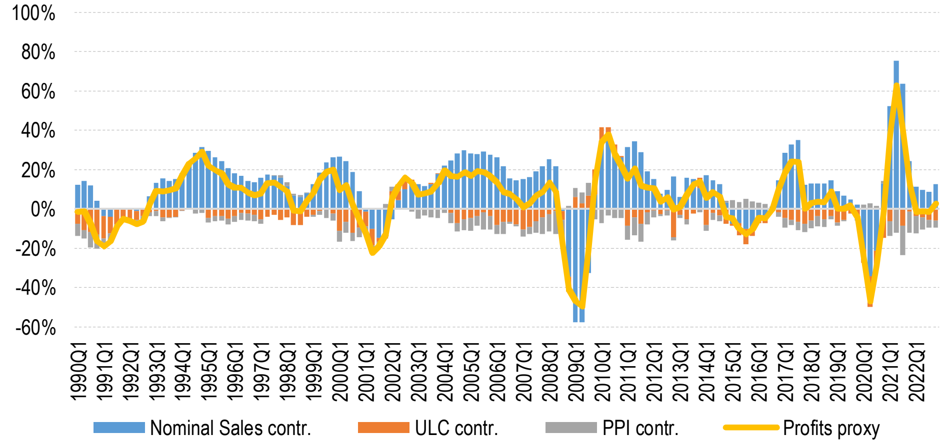
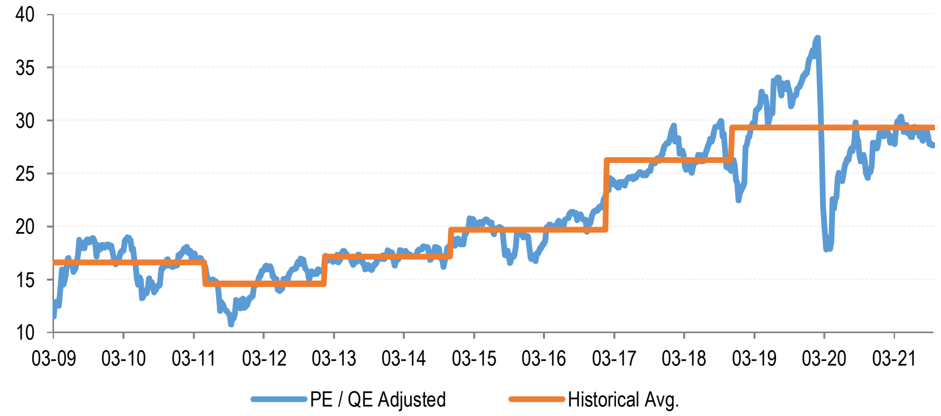
4/ Profits margins are vulnerable to rising production costs and supply disruptions this time
Top & Bottom Line: YoY Contributions



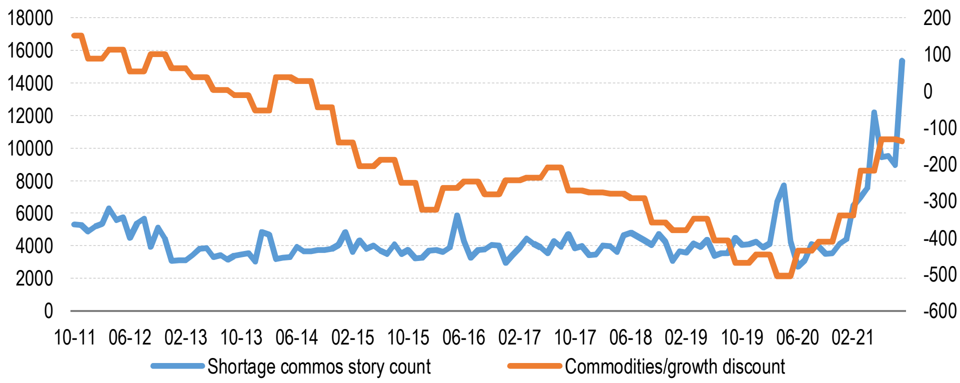
Source: Bloomberg, Amundi Research calculation. Data as of October 19, 2021.
Methodological note: Profit proxy is calculated as Top line (Nominal Sales YoY Contribution) –Bottom Line (Unit Labour cost YoY and PPI YoY contributions)

5/ Unlikely to see higher multiples from current levels going forward, even liquidity-adjusted multiples
S&P 500 PE Adjusted for Fed balance sheet expansion



Source: Bloomberg, Amundi Research calculation. Data as of October 19, 2021.
Methodological note: S&P500 PE is the time weighted average of current and next year PE. These PEs are then adjusted (ratio) for a liquidity multiplier: FED Total Asset Balance Sheet (rebased to 1 at the beginning of QE in March 2009). The historical average is dynamic and considers historical breaks to reflect monetary and economic regimes changes.

6/ Shortage narrative is driving commodities prices higher, notwithstanding decelerating growth
Commodities valuation vs shortage narrative



Source: Bloomberg, Amundi Research calculation. Data as of October 19, 2021.
Methodological note: Commodities/growth discount is calculated as difference of global commodities price and blended basket index (World OECD Leading ind.+ US nom gdp, rebased jun-1961). “Shortage narrative” is calculated through BLG News trend tool on “Shortage” AND “Commodities” words.

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Tapering and profits deceleration not in favour of expansion in multiples

Fed monetary policy and unconventional tools for pumping extraordinary amounts of liquidity provided formidable support to the 2021 equity rally, besides the strong rebound in profits and economy. Liquidity-adjusted valuation metrics have been in cheap territory with few exceptions so far. Although the Fed is expected to remaining dovish and monetary policy accommodative going forward, the tapering process should reduce liquidity propellant to the markets while the deceleration in EPSs should mitigate investors' complacency. As a result, multiples should barely expand in 2022, if any they should contract. For the time being profits growth should be strong enough to deliver positive returns although all risks (rates, productions costs, margins and new Covid variants) are all skewed on the downside.

Reality check on the continuation and sustainability of the commodities rally

After several years of depressed valuations and being a laggard in this bull market, global commodities are benefiting from an exceptional combination of positive factors: the ongoing recovery-driven boost in demand while the green transition and Covid issues generate short-term bottlenecks, supply disruptions and long-term pressure on commodities necessary for the green conversion. As a consequence, commodities have been one of the best performers in the latest month, and they are expected to be quite resilient going forward. Seasonal factors will exacerbate the energy shortage in Q4 21 and Q1 22, and current levels for natural gas and oil will last for a while. Commodities hence should be the favourite asset class in a balance portfolio helping to mitigate potential drawdown from shortage-induced external shocks.

Conclusion

A second derivative stagflationary environment of decelerating growth amid sustained inflationary pressures have taken the stage, marking a shift towards a more cautious asset allocation in the near term. The Global Growth outlook in recent months has deteriorated on several factors, culminating in the downgrade of expected growth in China and the US, among others. The annual inflation outlook has been revised higher for DMs, on a combination of higher commodity and energy prices, cost pressures and, in a few countries, stronger domestic demand prospects. Starting from the second half of 2022 and into 2023, the cycle is expected to lose traction and transition into the so-called late cycle.

In terms of investment consequences, concerns on the global deceleration, combined with rising inflation expectations, translates in a progressive recalibration in the risk budgeting of our portfolios towards a reduction of overall equity exposure, while maintaining a tilt towards value and quality sectors. Moreover, under the "Inflation" regime, monetary policy is expected to undertake a normalisation path. Such a context is less supportive than the "Normal" one for risky assets: as interest rates rise, equity is preferred to credit, with inflation-linked bonds offering a hedge.

Finalised on 20 October 2021

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2022 EGB supply vs ECB QE

We expect a further slowing of growth in Eurozone public debt in 2022, mirroring the 2021 trend vs. 2020 which saw a peak in net issuance, while EU bond supply is likely to remain close to the 2021 level. Lower public deficits, higher redemptions of maturing bonds, high cash reserves and NGEU funds flowing into some countries are all factors that underpin this trend. On the demand side, we expect the ECB to calibrate the level of QE accordingly, with volumes being reduced vs. the last two years, but still with the goal of absorbing the bulk of net public debt issuance; it should therefore continue to play a stronger role than other central banks in reducing impacts on rates and spreads on the domestic fixed income market.

Sergio BERTONCINI,
Senior Fixed Income Research Strategist

The level of liquidity accumulated by Euro Area Treasuries is fairly high by comparison with historical standards

EMU-10 EGB and EU issuance: only a marginal proportion of supply remaining before year-end

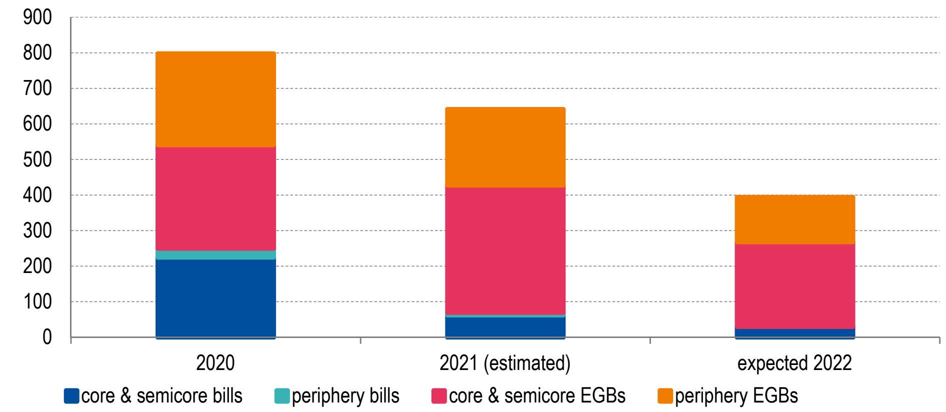
As of mid-October, EMU-10 countries have made strong progress in covering their yearly funding needs, with most of the projected gross and net bond funding already placed. The total gross issuance amount so far is higher than EUR 1trn while issuance net of redemptions stands at EUR 510bn, respectively 84% and 90% of gross and net projected volumes for all of 2021. This means we can expect quite a fall in issuance in the short-term, with only 10% still remaining. Over the next two months, we expect the ECB to maintain overall monthly purchases of approximately EUR 90bn (EUR 70bn PEPP + EUR 20bn APP). Therefore, despite a moderate decline versus the previous two quarters, QE asset purchases should more than cover the remaining sovereign supply, ultimately meaning negative net supply post QE.

Furthermore, the risks on the remaining net supply for 2021 look tilted more to the downside, as:

1. The level of liquidity accumulated by Euro Area Treasuries is fairly high by comparison with historical standards (overall close to EUR 600bn vs. pre-Covid level in the region of EUR 250bn), and
2. The improved macro picture has led some countries to a -downward revision of this year's deficits versus initial projections (in some cases on the back of both lower-than-projected expenses and higher-than-expected tax revenues). Some countries, therefore, Germany for instance, have already announced a slight downward revision to their projected Q4 funding.

There has also been strong progress in EU issuance, as only a fraction of NGEU funding remains to be covered between now and the year-end, out of the EUR 80bn announced in June. The portion of funding that remains looks even lower if we consider that the NGEU issuance volumes are in addition to EUR 50bn EU SURE bonds issued in the first part of the year, and another EUR 11bn issued under other funding programmes. The EU, therefore, has already issued around 90% of the total volume of around EUR 140bn targeted for this year.

1/ **EMU-10 debt net issuance (in € bn)**



Source: Bloomberg, Amundi Research, Data as of 22 October 2021

2022 supply: the big picture

With many of the draft budget plans for 2022 already published, we have started to assess the potential gross and net issuance of sovereign debt in 2022 and compared them with 2021 and 2020. In a nutshell, we can expect the slowing trend that started this year to continue also in 2022, mainly driven by the following factors:

1. Deficits are broadly expected to be lower, averaging roughly half of 2021 levels,

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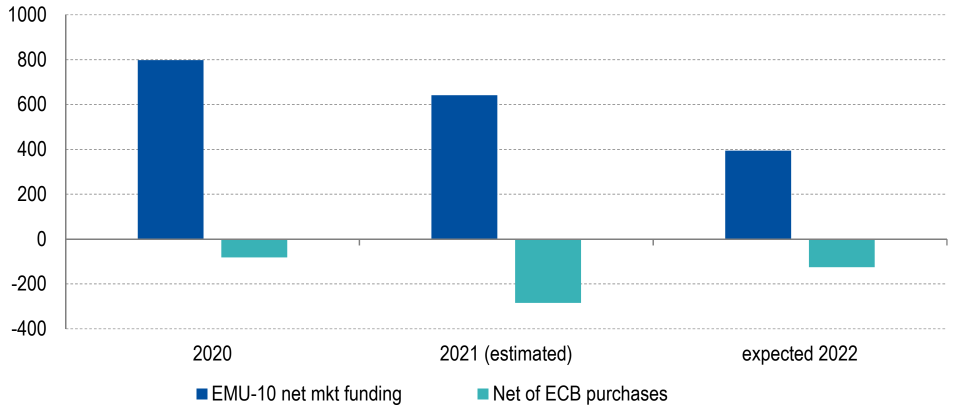
Our projections for the EMU-10 countries point to overall net EGB issuance at roughly 65% of 2021 volume

2. Redemptions of maturing debt are expected to increase versus 2021 in almost all countries (by more than EUR 80bn overall),
3. Record levels of accumulated cash are likely to support lower or negative net issuance of short-term instruments (bills), potentially lower EGB issuance too,
4. NGEU funds should play a supporting role in reducing the market funding needs of some countries.

More specifically, given the expected fall in deficits next year, we may see a switch from T-bills to bonds, i.e. negative net issuance of T-bills, feeding through to a higher component of bonds within the overall level of net funding. This should be the case especially for core countries, which strongly relied on higher net issuance of bills last year and to a lower extent this year. Eurozone Government cash reserves subsequently increased to high levels (overall close to EUR 600bn vs. a pre-Covid level in the region of EUR 250bn), boosted by treasury funding mainly through medium-long term securities, despite a lower trend in funding needs. Tax revenues which tended to surprise on the upside and expenditure failing to offset the increase in revenues also supported these trends. Netting mainly bills against high cash holdings would mean an overall negative net issuance of bills next year. However, bond issuance in 2022 may also see second-order benefits due to high cash buffers compared to projected negative short-term net debt. Another factor to be considered is the stronger potential role of NGEU funds in 2022: overall, NGEU funds of close to EUR 90bn are expected to flow into EU countries next year, ultimately contributing to greater funding flexibility. Italy looks like it will be in a better relative position as roughly 50% of the overall funds projected for next year should flow in its direction.

Our projections for the EMU-10 countries point to overall net EGB issuance at roughly 65% of 2021 volume, with net issuance expected to be lower than this year in all EMU-10 countries, although to varying degrees. Among periphery countries, net issuance looks likely to fall more significantly in the case of Italy, while among core and semi-core countries, it should fall more significantly in the case of the Netherlands, Austria, Belgium and Ireland. France should maintain a relatively high pace of MLT debt funding despite a lower deficit, while the current projections for German debt figures may be revised following the recent elections and in light of the expected formation of a new government. Contrasting with the EGB trend, we expect EU issuance to remain close to 2021 volumes in 2022 at around EUR 130-140bn, mainly to cover the expected NGEU funds that will flow into EU countries in 2022.

2/A slowdown of total QE size to EUR 650bn area would more than cover for EMU-10 net issuance in 2022, too



Source: Bloomberg, Amundi Research, Data as of 22 October 2021

What impact will the ECB's QE have on the demand side?

Both ECB Chief Economist Philip Lane and ECB President Christine Lagarde hinted that the net bond supply will influence the pace of APP

As we underlined in the September issue of the Cross Asset, the pace of QE in 2022 is likely to be a function of the outlook for inflation and net supply. Recently, both ECB Chief Economist Philip Lane and ECB President Christine Lagarde hinted that the net bond supply will influence the pace of APP. Philip Lane, in particular, was quite explicit in that regard: *"You cannot think about the volume of the APP independently of the volume of net bond supply. The relatively high fiscal deficits that we saw last year and this year will not be lasting in the coming years, but the scale of deficits may remain higher than the pre-pandemic levels."* From this perspective, at its December meeting the ECB will have more detailed information to hand on the expected supply in 2022 based on which to calibrate its purchases.

At their current monthly pace, PEPP purchases are expected to be close to EUR 70bn at the year-end, which would mean that roughly EUR 240bn would be available for Q1 2022, pointing to roughly EUR 480bn in overall QE firepower (together with APP of EUR 20bn at its current pace) for all of 2022. The option of the introduction of a new specific pandemic recovery programme seems to have

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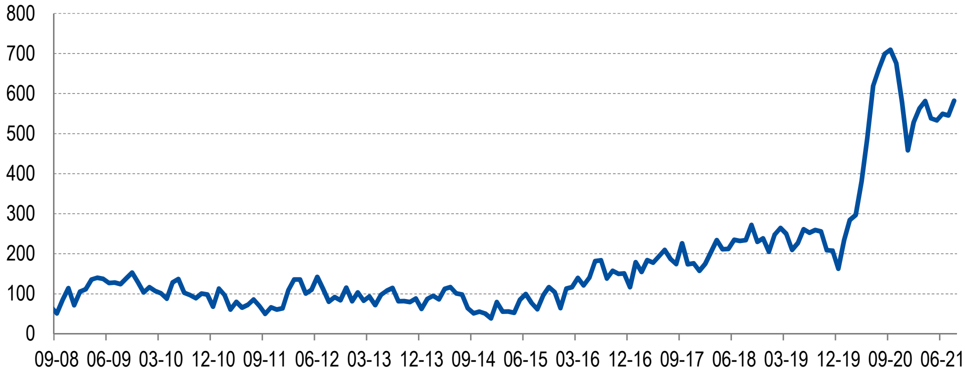
3/**Euro Area Government deposits, in EUR bn**



Source: ECB, Amundi Research, Data as of August 2021

gathered pace recently as an alternative to simply doubling the APP envelope, in order to maximise flexibility. In a recent speech, for example, ECB GC member Francois Villeroy highlighted the benefits of flexibility of policy transmission, in particular flexibility across asset classes and among jurisdictions. In any case, both options (the introduction of a new programme or doubling of the APP size) would push 2022 QE firepower within a range of EUR 600bn and EUR 700bn. This seems more than enough to cover the estimated EUR 400bn of EMU-10 sovereign debt net issuance and roughly half of the estimated EU bond issuance, while also leaving roughly EUR 65bn available for private debt QE programmes (mainly supporting corporate bonds). Therefore, assuming a slowdown of ECB purchases, in this scenario net issuance after QE flows will remain slightly negative for the EMU-10 in 2022. This would make the ECB's supportive role stronger than that of the Fed in the US fixed income market, particularly as the Fed is likely to taper and end QE by mid-year, and even stronger still than that of the BoE, which is expected to start raising rates soon and put an end to its QE. With stimulus expected to continue, and together with more anchored rates thanks to the forward guidance, we expect the technicals of both rates and spread levels to be better in the Eurozone than in other jurisdictions.

Finalised on 22 October 2021

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Can stablecoins bring major disruption to the financial system?

Tristan PERRIER,
Global Views

More directly than other types of cryptocurrencies, the rapidly growing stablecoins may soon bring new opportunities and risks to payments and finance. Regulatory authorities are preparing to respond, yet the stakes are complex and not the same in all countries.

Stablecoins have been a rising topic in 2021

Stablecoins, referred here as those of the currently largely unregulated cryptocurrencies that, through various means[1], maintain a quasi fixed parity with a conventional currency[2] (most often the USD) have been attracting growing attention for several reasons:

Rapid growth

- **While the total market capitalisation of stablecoins remains moderate, at around USD 130bn in October 2021, it is increasing at a very rapid rate**. Their overall capitalisation was only 30bn in January 2021.
- **Stablecoins only represents roughly 6% of the total cryptocurrency market cap, yet account for a much larger share in terms of transaction volume**: Most cryptocurrency trades involve a stablecoin on one side, with Tether, the largest stablecoin, being also the most traded cryptocurrency (ahead of Bitcoin).

Signs that their use may soon extend to the broader economy

- **So far, the main role of stablecoins has been to facilitate cryptocurrency trading**, allowing market participants to stabilise the value of their investment in USD terms, without having to move funds out of the cryptocurrency ecosystem.
- **However, if used for other purposes, stablecoins can offer many practical advantages over bank deposits**: they are accessible via easily set-up digital wallets, are well adapted to peer-to-peer transactions, provide quasi-instantaneous 24/7 settlement and are well suited to interact with innovative fintech applications. While some stablecoin transactions may be difficult to trace by public authorities (although they do not offer absolute anonymity), their ease of use could also make them a tool for financial inclusion of currently unbanked population groups. Stablecoins, more than other fluctuating cryptocurrencies, may thus be seen, for better or worse, as the most imminent competitors to conventional money.
- **Against this backdrop, recent partnership announcements between stablecoin issuers and major players of other sectors** (notably Paxos with Paypal, or the inclusion of stablecoins issued by Paxos and Circle in the Novi digital wallet recently launched by Facebook[3]) hint at the possibility that stablecoins soon become mainstream instruments for money transfers and purchases of services, goods, and noncrypto assets.

Stablecoins can be very practical tools for many types of transactions

Potential new risks to the financial system

- **As competitors of bank deposits, stablecoins could, in theory, have an adverse effect on banks' credit distribution capacity**, although there are many, yet complex, ways such risks could be circumvented (for instance through changes in bank regulatory ratios, an adaptation of central bank financing or various forms of cooperation between stablecoins issuers and banks).
- **Yet it is also easy to think of circumstances where, if seen as relatively safe, stablecoins could act as magnets for destabilising money runs**, be it in a purely domestic crisis (if holding money in banks were seen as unsafe) or in one with cross border implications (if the citizens of a country with a fragile currency preferred to hold easily accessible foreign, presumably USD-pegged, stablecoins).
- **Conversely, the failure of a large stablecoin could generate a financial shock:** its sudden inability, for whatever reason, to maintain its targeted parity would cause large losses to its holders (until now, such

[1] *These means are usually either 1/(most often for large stablecoins) partial or total collateralization by assets such as cash, cash equivalents, commercial papers and government securities 2/(for many, although not all, minor stablecoins) a combination of overcollateralization by various assets (including other cryptocurrencies) and algorithmic mechanisms that adjust the stablecoins' supply and attempt to guide market participants' expectations.*

[2] *Other fixed parity digital assets are sometimes referred as stablecoins even though they are not usually considered cryptocurrencies: That can be the case, notably, for bank stablecoins, that are claims on the bank issuing them and, thus, digital equivalents of conventional bank deposits.*

[3] *Facebook has also been working on its own stablecoin project, which initially attracted a lot of attention. However, after several delays, its launch date remains unclear.*

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a situation has mainly been seen as a risk for the sole cryptocurrency market, but it could directly hit the broader financial system if many non-specialist participants held stablecoins). In this respect, note that a number of small stablecoins have already failed and that Tether's large holdings of commercial papers (with undisclosed details) recently raised questions over whether it had exposure to the troubled Chinese real estate giant Evergrande (which Tether has denied).

Growing regulatory push

Public authorities have therefore well identified the regulation of stablecoins as one of the most pressing tasks within their ongoing broader cryptocurrency regulation efforts.

A large stablecoin failing to maintain its peg could cause a financial shock

- **The ECB issued a report on the topic in September 2020** (when stablecoins were much smaller than they are today), **but concerns accelerated in the US at the end of summer 2021** with both Treasury Secretary J. Yellen and Fed Chairman J. Powell calling for swift action on stablecoin regulation[4].
- **The IMF, which devoted a section of its last Global Financial Stability Report to cryptocurrencies, stressed the risk that a troubled stablecoin could conduct a fire sale of its assets,** bringing contagion to other markets (notably commercial paper).
- **Stablecoins have also been mentioned by central bankers as a major reason to develop their own digital currencies (CBDCs)**[5] (which, depending on their architectural choices, could offer some of the same advantages as stablecoins, but without credit risk).

Regulation will mitigate some of the risk, but the stakes are complex

In most cases, authorities are much more likely to regulate stablecoins than ban them as they cannot ignore the fact that, despite the risks, stablecoins offer many practical advantages and can support financial innovation, generally seen as promising in terms of income, development of new skills and jobs. Yet, how exactly they will be regulated is still unclear.

Stablecoins may be vectors of dollarisation

- **A focus will most certainly be on imposing KYC (*Know-Your-Customer*) procedures and transparency on the assets held by stablecoins issuers to maintain the pegs.** Further steps will likely involve more alignment of stablecoins and their issuers' obligations and rights with those of money market funds, banks and bank deposits.
- **However, the large dominance of USD-pegged stablecoins also means that the stakes are not exactly the same in the United States and in other countries.** From the US perspective, while stablecoins do raise domestic challenges, they may also be vectors to consolidate the global influence of the USD. Moreover, with little foreign threat to the status of the USD on their domestic territory, US authorities feel less pressure than others to quickly develop a CBDC[6]. They may then well find strong arguments in favour of letting stablecoins grow: valuable insight into people's attitude towards digital money can thus be acquired, while private sector stablecoin technology can be experimented with a view to subsequent application to a CBDC. This, however, would only apply to stablecoins that would be well regulated and cooperative with US authorities, leading some observers to hint that US authorities may currently have more a Tether problem (Tether being issued by a Hong Kong based company and subject in 2021 to fines by several US authorities for lack of transparency) than a lasting problem with all stablecoins issuers.
- **In the case of other countries, however (although to very varying extents), USD stablecoins do bring with them, among other challenges, some risk of dollarisation.** Local authorities are therefore likely to face more pressing decisions than their US counterparts. These choices can be either tight regulation, active fostering of stablecoins pegged to local currencies, acceleration of CBDC programmes or acknowledgement that at least a limited dollarisation in niche sectors need be accepted so as to reap the practical benefits of stablecoins and the innovation they bring.

All in all, given the complexity of the assessment, by public authorities, of the balance between the many threats and opportunities presented by stablecoins, it is unlikely that their current development will soon be brought to a sudden stop. The most likely outcome is that stablecoins will continue to grow and find new uses, both as an asset class and means of payment, with regulation making progress yet nonetheless struggling to keep pace with the rapid changes brought by these newcomers to the financial system.

Finalised on 27 October 2021

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[4] *At the time of writing the press was reporting that the US Treasury and other agencies would soon publish a report on stablecoins and their necessary regulation.*

[5] *Fed Governor Lael Brainard notably made this point several times this year.*

[6] *On 14 Jan 2021, J. Powell mentioned that the Federal Reserve felt no "need or urge to be first" in developing a CBDC. Among the justifications he provided for this patient approach was the first mover advantage given by the US dollar reserve currency status.*

CROSS ASSET DISPATCH: Detecting markets turning points

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

ECONOMIC BACKDROP

- After the strong expansion over the summer, economic growth rates are expected to remain solid, although moderating, as highlighted by the progressive stabilisation of high-frequency and soft data as economies head toward pre-Covid-19 levels. The consensus continues to adjust downward, while economic surprises remain negative despite some very moderate signs of a potential upward reversion.
- Economic activity in the US is expected to pick up in Q4 after the deceleration seen at the end of Q3, in line with gradual improvements in high-frequency and soft data. The CESI Index remains in negative territory, despite reverting progressively upward, supported by both hard and soft data releases. The consensus continues to trend downward, remaining, however, in positive territory.

FUNDAMENTALS & VALUATION

- Multiples and, in general, valuations will be tested by this reporting season, keeping in mind margin-squeeze concerns and forward guidance for next year. In general, most equities markets are in expensive territory and consistent with positive growth expectations. Should reporting season disappoint potential, repricing likely be the final outcome.
- CB liquidity injection remains a solid argument for the markets' high levels, although the start of tapering should erode investors' complacency.

NEUTRAL + ASSET ALLOCATION

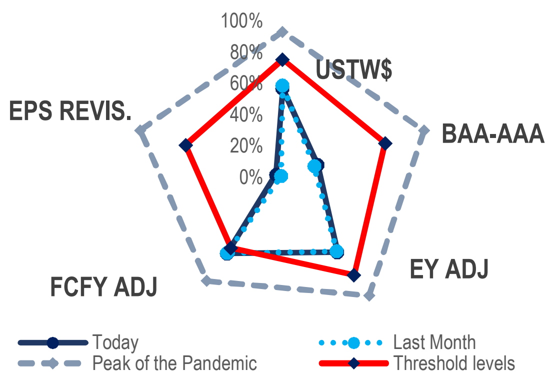
TECHNICALS

- We are still seeing the same mixed environment from last month.
- Contrarian metrics were showing that a few markets were approaching oversold levels (looking at RSIs) last month and the reading, whilst worsening, didn't change much in October. RSIs moved higher but remain pretty far from overbought levels.
- On the other hand, momentum is struggling to build up in most risky assets, and this seems to be a function of rising uncertainty and the low visibility over the next steps.
- Technicals remain mixed, with a lack of directional bias at the time of this writing.

SENTIMENT

- If, on the one hand, we acknowledge that nothing has improved much when dealing with growth perception, on the other we also continue to note that most of our risk sentiment metrics are still in pretty solid shape.
- Despite the mounting wall of worries, we are sticking with a moderately constructive risk sentiment in the market. Financial conditions remain loose in most regions, whilst EPS revisions, whilst worsening, are still compensating for both the USD and the drop in economic surprises (which are clearly showing early signals of risk-gyration).
- Institutional investors continue to show a positive risk-attitude, with risk-on dynamics still apparent in equities and commodities.

Cross Asset Sentinels Thresholds (CAST) still supportive



Source: Amundi Research, Data as of 15 October 2021

CAST risk perception failed to show a structural increase. EPS revisions started moderating (reducing the gap with negative data surprises) but CBs are still keeping credit risk premia low and the USD momentum softened on the margin. All in all we are lacking evidences of structural de-risking, yet visibility on the next steps keeps deteriorating.

__Methodology__ 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 The energy crisis should be temporary

- Natural gas prices have surged, contributing to global resource inflation.
- China and Europe are seeing the largest demand/production imbalance.
- Despite the rally, natural gas prices are not out of control, and, as the world is expected to ultimately be in net surplus, natural gas flows will rebalance imports in Europe and Asia.

Investment consequences:

- Central case: no power crunch this winter in European and Chinese energy, but pressure persisting.

2 China's growth forecast downgraded and impact on EM countries

- Weaker than expected Q3 GDP, more negative than positive catalysts on a six-month horizon.
- We are downgrading our growth forecasts again, no longer expecting growth to recover to trend in Q4 2021, due to the housing slowdown and the decarbonisation production cuts.
- CPI inflationary pressures remain subdued as services consumption has been hit hard by the Covid zero-tolerance policy.

Investment consequences:

- Slowdown in China to affect Chile and Peru the most via trade and commodity exports.

3 EM short- and medium-term economic backdrop update

- Economic momentum tracked by CEMI deteriorated more than expected, driven by GEM component (specifically China).
- Inflation looks more persistent, putting pressure on monetary policy and nominal (and real) rates.
- Medium-/long-term: atypical normalisation: growth to potential and inflation at last-decade highs.

Investment consequences:

- In the short term, this is a less benign environment for valuation in risky assets, which markets have not yet priced in, despite the recent pullback.

4 G10 FX in a narrow range

- Most of our year-end targets were reached in September 2021, with cyclical currencies hitting lower levels than what we previously expected.
- Main FX themes currently:

  1) Monetary policy divergence calling for high vs low yielders.

  2) Slowing global growth suggesting carry would need to be of the highest quality (i.e., the USD).

  3) Risk-on, risk-off dynamics would likely accelerate the moves.

  4) Lack of clear-cut directionality.

Investment consequences:

- G10 FX to trade in narrow ranges, due to a lack of clear-cut directionality, with the USD benefitting vs low yielders and stabilising against most cyclical currencies.

Covid-19 situation update

Pierre BLANCHET, *Head of Investment Intelligence*

As we enter the winter season in the northern hemisphere, the rising number of Covid cases is reviving fears of a new wave. China is witnessing a resurgence of the outbreak, despite its mass vaccination campaign, albeit with a less effective vaccine. In western Europe, several countries including France and Germany are seeing an increase in weekly cases, although the level of Covid-related deaths is still limited. The UK is an outlier with three times more cases than on the Continent and eight times more casualties. But the main concern relates to Central and Eastern Europe, where the vaccination rate remains low and the infection and death rates are among the highest in the world. In Romania, Bulgaria and Moldavia, which are at the heart of this new wave, the number of daily deaths per one million inhabitants is 10 to 15 times greater than in the West. A lack of trust in authorities, inefficient public health structures and political instability explain the low vaccination rate (20-30% on average) which translates into a high death rate. Across emerging countries, the Covax programme backed by the WHO has not (yet) provided enough vaccines to limit the circulation of the virus, which means we could see the emergence of more virulent strains with far reaching consequences for advanced economies.

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=		After the Fed's taper update in late September, inflation expectations and bond yields gained strength and the reopening trade reasserted its relative performance. However, strong inflation data necessitates that investors protect their portfolios from rising prices and volatility from debt ceiling and tax hikes should also be kept in mind. While remaining overall neutral on equities, we believe investors should increase their focus on fundamentals as valuations remain high.
	US value	+		The recent rise in core yields has been accompanied by escalating inflation. We believe value (financials, energy) is a strong way to inflation-proof portfolios, particularly in the case of quality companies that possess strong pricing power. The value vs. growth discount is high but long-term returns in this realm will be driven more by stock selection.
	US growth	-		We think current valuations are inconsistent with expectations of high inflation and subsequently higher (real) rates, which could challenge excessive valuations. As we progress on this front, growth stocks that rely on low discount rates for their prices should experience volatility, thereby warranting a defensive stance.
	Europe	=		Amid a spike in energy prices, economic recovery continues in Europe but valuations are extreme in some segments and are not justified by high inflation, which pressures companies to absorb costs, thereby affecting margins. However, amid the high valuation dispersion, investors should prioritise selection and explore value and quality stocks that can withstand price pressures through strong pricing power or a dominant market position beyond the current earning season.
	Japan	=		Given that Japan is a more cyclical market, equities should remain supported by an earnings catch-up as new Covid cases recede and as the reopening continues. A weaker yen should further support this.
	Emerging markets	=		We believe the case for selection is high in EM and it should no longer be seen as 'one block.' Looking ahead, normalisation of earnings and progress on the vaccination front paint an encouraging picture for EM, but there are some idiosyncratic risks. On China, some weakness in growth and potential regulatory measures make us cautious in the near term, but the long-term outlook is positive as the country embarks on more balanced and high-quality growth. We like countries such as Russia due to its strong exports, and India owing to its potential for domestic demand.
FIXED INCOME PLATFORM	US govies	-		Core yields have been rising after comments from the September FOMC meeting amid the Fed's tapering indications. But inflation remains elevated even as supply constraints persist. We believe USTs could be under pressure, but the risks of inflation derailing a recovery mean CBs may be unwilling to implement substantial tightening. As a result, we are cautious on duration but remain flexible. TIPS offer inflation-protected returns but there are valuation concerns.
	US IG corporate	=		Credit fundamentals are constructive but we are exploring the asset class through a highly selective lens that allows us to limit our beta and exposure to long duration debt. We are also watchful of the risks from rising core yields at the moment. Securitised credit and mortgages are attractive due to high consumer earnings and savings, but we are vigilant on housing markets amid the Fed's potential tapering.
	US HY corporate	=		We are moving towards a phase where market directionality will play a decreasing role in driving returns. Although the segment offers good carry and fundamentals are benign, we are increasingly relying on selection to separate the wheat from the chaff and avoid highly leveraged areas.
	European govies	-/=		Inflation is high amid supply bottlenecks and pressures from the energy situation, which is collectively reflected in rising yields. While the ECB indicated some slowing in asset buying, we believe it will strive to maintain accommodative financial conditions. Thus, we remain defensive and agile on core and semi-core European government bonds. On periphery debt, however, we are positive due to the recovery and support from the Next Gen EU fund, but are monitoring political risks.
	Euro IG corporate	=/+		Fundamentals continue to improve, albeit at a slightly slower pace, and liquidity remains high. However, we increase the selectivity in our portfolios to look for companies that can pass on the increase in costs to consumers. We like shorter maturity debt and BBB-rated names, but avoid higher rated names that may engage in unproductive M&A or add debt.
	Euro HY corporate	=		We believe this is not a time for structural derisking but are careful of longer-dated debt and prefer playing the spread compression card. Subordinated financial debt presents a strong theme across credit with its attractive yield, but overall we maintain a balance between higher yield and quality.
	EM bonds HC	=/+		Improving current account balances and the EM growth differential vs. DM are positives. We continue to favour HC debt and maintain our bias towards HY vs. IG in countries benefitting from strong fundamentals and higher commodity prices.
	EM bonds LC	=		A strengthening dollar in the near term and potential tightening in the developed world are a natural challenge for LC, underscoring the need to be selective. We focus on countries such as Russia, where monetary tightening is almost over. In Asia, the PBoC will strive to avoid any spillover to other parts of the economy.
OTHER	Commodities			While natural gas prices have increased due to demand/supply imbalances in Europe and Asia, they are not out of control. In the long run, the world is expected to be in net surplus. OPEC should increase oil production in order to avoid a hit to global demand. However, gold could see some volatility (Fed policy normalisation) but is still a decent portfolio diversifier.
	Currencies			Monetary policy divergences and slowing global growth should be positive for the USD (high quality carry) vs. low yielding FX such as the EUR, CHF and JPY. However, relative to high yielding cyclical currencies, the USD should stabilise. Long term, high US deficits and debt are likely to weigh on the greenback.

LEGEND

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	Negative		Neutral	Positive			Downgrade vs previous month	Upgraded vs previous month

Source: Amundi, as of 26 October 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 28/10/2021

Annual averages (%)	Real GDP growth %				Inflation (CPI, yoy, %)			
	2020	2021	2022	2023	2020	2021	2022	2023
World	-3.3	5.8	3.9	3.4	2.6	3.7	3.9	3.3
Developed countries	-5.1	5.0	3.5	2.0	0.8	2.9	2.8	2.1
US	-3.4	5.7	3.3	2.1	1.3	4.4	3.7	2.8
Japan	-4.9	2.4	2.6	0.9	0.3	-0.4	0.6	0.6
UK	-9.7	6.9	4.6	2.4	0.9	2.4	3.7	2.5
Eurozone	-6.5	4.9	3.9	2.2	0.3	2.4	2.4	1.7
Germany	-4.9	2.5	3.9	2.0	0.4	3.1	2.4	1.7
France	-8.0	6.1	3.9	1.8	0.5	2.0	2.3	2.0
Italy	-9.0	6.1	4.8	1.9	-0.1	1.8	2.3	1.7
Spain	-10.8	5.2	5.9	2.8	-0.3	2.6	2.4	1.7

Source: Amundi Research

- **United States:** we expect growth to pick up in Q4, after decelerating in Q3, as Delta cases recede. High-frequency indicators point to a resumption in mobility and activity, boding well for the holiday season. Inflation is posed to increase further in Q4, driven by accelerating rents, higher energy costs, supply-side issues amid strong demand. We recently revised our inflation outlook upward while shaving a few basis points from growth. Fiscal policy remains pivotal to the outlook, representing an upside risk, should a full-scale Biden infrastructure plan be approved (currently not our base case).
- **Eurozone**: after an earlier than expected pickup in activity in Q2 across several member states, we expect the recovery to continue, yet with a decelerating growth pace, in line with the latest high-frequency and survey data. This moderation will occur alongside continued upward pricing pressures, reflecting near-term supply-side issues compounded by the energy crisis. For the moment, we do not envisage second-round effects on inflation (wage negotiations). Thus, while we are revising our inflation projections for 2021 upward, we still expect inflation to moderate progressively into next year.
- **Japan:** Fumio Kishida took office as Japan's new prime minister, setting up the prospect of a continuation in supportive monetary and fiscal policies. At home, Japan has begun to lift its state of emergency gradually since September, as the full vaccination rate climbed to over 70%, paving the way for a recovery in private consumption. But we maintain our view of soft inflationary pressures in 2021, expecting limited pass-through from surging energy prices. Inflation will increase at a faster pace in 2022, as transitory factors (mobile phone fee changes, rebasing) fade out.
- **United Kingdom:** the UK economy expanded strongly in 2Q. During 3Q, the economy likely benefitted from the further removal of restrictions, although the boost from the final stages of lockdown easing is not likely to lead to a repeat of the April and May performance. The recovery is indeed posed to lose some steam, as high-frequency data point to weakening momentum. Supply-side issues, the energy crisis and signs of wage increases have made us revise up our inflation projections for Q4 2021 and also for 2022, although we still expect inflation to moderate towards the target late next year.

Key interest rate outlook

	28-10 2021	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
US	0.13	0/0.25	0.19	0/0.25	0.49
Eurozone	-0.50	-0.50	-0.48	-0.50	-0.40
Japan	-0.04	-0.1	-0.03	-0.1	-0.02
UK	0.10	0.5	0.77	0.75	1.10

Source: Amundi Research

Monetary policy agenda

Central banks	Next meeting
Federal Reserve FOMC	**November 3**
Bank of England MPC	**November 4**
ECB Governing Council	**December 16**
Bank of Japan MPM	**December 17**

Source: Amundi Research

- **Fed:** the reduction in asset purchases should begin as early as November, with a view to ending the programme by mid-2022. The Fed is expected to cut its purchases by $15 billion per month until June. Treasury purchases should decrease by $10bn each month from the current level of $80bn per month. MBS purchases should decrease by $5bn per month from $40bn per month currently. Inflation forecasts have been revised upwards, with the core PCE now expected at 2.3% in 2022 and 2.2% in 2023. Inflation is likely to be the decisive factor in the timing of the first rate hike and the pace of subsequent hikes. If core inflation continues to surprise on the upside in 2022, the first rate hike could take place in Q4 2022.
- **ECB:** we expect the ECB to continue the PEPP at the current pace of close to €70bn per month until the year-end and to use the residual envelope in Q1, or to taper it over H1 in order to smooth out the monthly purchases. In December, the ECB will announce its stimulus strategy for 2022, and we expect it to maintain a somewhat dovish stance, with a stable outlook for rates and a steady pace of asset purchases by historical standards, calibrating its QE with a view to absorbing the bulk of net issuance, as it has done over the last two years.
- **BoJ:** as widely expected, the BoJ left its policies unchanged at its October meeting. In its new Quarterly Outlook Report, the central bank downgraded its FY2021 GDP growth forecast slightly given the delay in the anticipated consumption recovery due to Covid-19 complications. Core CPI inflation was also downgraded sharply due to the one-off base revision. As the full vaccination rate climbs to over 70%, we expect consumer demand and inflation to strengthen gradually. However, the core reading is likely to stay below the BoJ's 2% target in 2022-23, delaying policy normalisation.
- **BoE:** following a surprisingly hawkish rate forward guidance at its last meeting, the recent communication from the BoE intensified the message on the need to act soon, mainly to keep inflation expectations anchored. We now expect the MPC to raise the bank rate earlier than previously thought, and see it delivering a 15bps hike by year-end (with a close call between November and December), followed by another 25bps hike at the February meeting. A further 25bps increase could follow at the August 2022 MPC meeting, depending on future macro trends.

EMERGING COUNTRIES

Macroeconomic outlook

Data as of 28/10/2021

Annual averages (%)	Real GDP growth %				Inflation (CPI, yoy, %)			
	2020	2021	2022	2023	2020	2021	2022	2023
World	-3.3	5.8	3.9	3.4	2.6	3.7	3.9	3.3
Emerging countries	-2.0	6.4	4.3	4.3	3.9	4.2	4.7	4.1
China	2.3	7.7	4.7	4.8	2.5	0.8	2.1	1.8
Brazil	-4.1	5.1	0.7	1.5	3.2	8.2	7.5	5.3
Mexico	-8.3	6.0	2.7	2.0	3.4	5.6	4.8	3.8
Russia	-3.1	4.2	2.6	2.5	3.4	6.5	5.6	4.2
India	-7.1	8.2	6.3	6.4	6.6	5.0	5.9	5.6
Indonesia	-2.0	3.5	4.7	5.1	2.0	1.6	2.9	2.8
South Africa	-6.9	4.6	2.7	2.3	3.2	4.5	4.8	4.8
Turkey	1.6	7.8	4.4	4.0	12.3	17.7	14.9	11.3

Source: Amundi Research

- **China:** we expect China's GDP to grow 7.7% and 4.7% in 2021 and 2022 respectively, down from 8.3% and 4.9% a month ago. Despite the relaxation of social distancing rules, a confluence of factors continues to weigh on economic recovery, including the housing slowdown and the NDRC's energy use control. Services consumption and infrastructure investments are likely to bounce back, cancelling out part of the slowdown. Inflation-wise, higher PPI data are likely given the prevailing supply constraints. The CPI should remain subdued with a bumpy consumption recovery.
- **Brazil:** While the Covid situation is looking fairly solid and the economy as a whole has returned to pre-Covid levels, the cyclical macro dynamics are looking far more challenging. Economic activity is facing multiple headwinds, including high inflation, rising rates, and high levels of political and fiscal uncertainty. Inflationary pressures are not abating, with rising global energy prices and weaker FX playing a big role, landing policy rate in double digits. The administration meanwhile is responding to increasing social demands (driven by high inflation) with additional spending now outside the spending cap according to the latest proposal. The markets in turn are reacting harshly to the news, adding momentum to the vicious cycle dynamic.
- **Turkey:** in the opposite direction of most EM central banks, the CBRT has cut its Reference Rate from 18% to 16%. While a rate easing was expected by the market due to the recent changes in the Monetary Policy Committee, the increase by the CBRT was double what was estimated (-200bps vs -100bps expected). At this point in time, Turkey is experiencing the same pressure on inflation (19.6% YoY in September) that would have normally triggered a tighter monetary policy stance. The cut by 200bps was in line with our Q4 21 expectation and the door is now open for further, and likely earlier, easing (above our forecast of 100bps) in 2022.
- **CEE-3:** growth in the region is expected to remain at around 4% or higher in 2021-22. Momentum has been decelerating in H2-21 due to prolonged supply chain shortages, a delay in EU fund disbursements and virus-related uncertainties. Over the month, the hiking cycle has continued (HNB 15bp, CNB 75bp), or started (NBP: 40bp) due to inflationary pressures from both supply (e.g. energy) and demand (recovery and tight labour market). Inflation is expected to be above target until end-H1-21. We expect further hiking next year due to continued inflationary pressures and strong growth fuelled by continuing fiscal support.

Key interest rate outlook

	28-10 2021	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
China	3.85	3.85	3.85	3.85	3.85
India	4.00	4.25	4.15	4.75	4.45
Brazil	7.75	10.75	8.9	10.75	8.90
Russia	7.50	8.00	6.80	7.50	6.15

Source: Amundi Research

- **PBoC (China):** the PBoC has hinted that it will simply roll over MLF by the same amount, instead of cutting RRR ahead of the Q4 MLF maturity deadline. We are removing our call that there will be an additional 50bp RRR cut in October, and maintain our view that there will be no policy rate cut. A targeted re-lending programme for carbon neutrality projects or SME at preferential rates is more likely at this stage. Marginal changes in housing policies are also underway. The PBoC urged banks to correct their over-execution of macro-prudential policies. The delayed loan disbursement to developers and prolonged mortgage approvals are likely to ease.
- **RBI (India):** during its Monetary Policy Committee meeting in October, the RBI kept its Policy Rates on hold at 4.0%, left the asymmetric corridor with the Reverse Repo Rate at 3.35% and also maintained its dovish policy stance. The only change announced was the end of Quantitative Easing from October 21 (G-SAP), due to adequate fiscal room over the fiscal year. The normalisation process should start soon (December 21) with the Reverse Repo rate increasing to 3.75% (+40bps) followed by Policy Rates being tightened from April 2022. In 2022, inflation should fluctuate around the RBI upper range.
- **BCB (Brazil):** the BCB hiked rates by 150bps (to 7.75%) in October and pre-announced another hike of similar magnitude at the next meeting in December. In addition, the CB tightened its forward guidance stating that policy rates needed to rise "even further" into contractionary territory as a response to rising fiscal concerns - the administration announced that the spending cap, the ultimate fiscal anchor, would be breached/tweaked to create fiscal room needed to alleviate pressing social demands - and additional upside risks to inflation. We see the BCB taking SELIC into double digits in the new year and a terminal rate around 11%, highest in nearly five years.
- **CBR (Russia):** on October 22nd, the Central Bank of Russia hiked its policy rate by 75bps to 7.5% - a larger hike than expected by the market. The CBR mentioned faster growth in domestic demand than in supply capacity, leading to increasing inflationary expectations. The CBR left the door open for further hikes. Household inflation expectations reached a new five-year high in October, while business price expectations are also close to multi-year highs. The CBR expects year-end inflation to be in the 7.4-7.9% range, higher than its previous forecasts, and a decline to 4-4.5% by the end of 2022.

Monetary policy agenda

Central banks	Next communication
PBoC	November 22
RBI	December 8
BCB Brazil	December 8
CBR	December 17

Source: Amundi Research

MACRO AND MARKET FORECASTS

Macroeconomic forecasts

(28 October 2021)

Annual averages (%)	Real GDP growth %				Inflation (CPI, yoy, %)			
	2020	2021	2022	2023	2020	2021	2022	2023
US	-3.4	5.7	3.3	2.1	1.3	4.4	3.7	2.8
Japan	-4.9	2.4	2.6	0.9	0.3	-0.4	0.6	0.6
Eurozone	-6.5	4.9	3.9	2.2	0.3	2.4	2.4	1.7
Germany	-4.9	2.5	3.9	2.0	0.4	3.1	2.4	1.7
France	-8.0	6.1	3.9	1.8	0.5	2.0	2.3	2.0
Italy	-9.0	6.1	4.8	1.9	-0.1	1.8	2.3	1.7
Spain	-10.8	5.2	5.9	2.8	-0.3	2.6	2.4	1.7
UK	-9.7	6.9	4.6	2.4	0.9	2.4	3.7	2.5
China	2.3	7.7	4.7	4.8	2.5	0.8	2.1	1.8
Brazil	-4.1	5.1	0.7	1.5	3.2	8.2	7.5	5.3
Mexico	-8.3	6.0	2.7	2.0	3.4	5.6	4.8	3.8
Russia	-3.1	4.2	2.6	2.5	3.4	6.5	5.6	4.2
India	-7.1	8.2	6.3	6.4	6.6	5.0	5.9	5.6
Indonesia	-2.0	3.5	4.7	5.1	2.0	1.6	2.9	2.8
South Africa	-6.9	4.6	2.7	2.3	3.2	4.5	4.8	4.8
Turkey	1.6	7.8	4.4	4.0	12.3	17.7	14.9	11.3
Developed countries	-5.1	5.0	3.5	2.0	0.8	2.9	2.8	2.1
Emerging countries	-2.0	6.4	4.3	4.3	3.9	4.2	4.7	4.1
World	-3.3	5.8	3.9	3.4	2.6	3.7	3.9	3.3

Key interest rate outlook

Developed countries

	28/10/2021	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
US	0.13	0/0.25	0.19	0/0.25	0.49
Eurozone	-0.50	-0.50	-0.48	-0.50	-0.40
Japan	-0.04	-0.1	-0.03	-0.1	-0.02
UK	0.10	0.5	0.77	0.75	1.10

Emerging countries

	28/10/2021	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
China	3.85	3.85	3.85	3.85	3.85
India	4.00	4.25	4.15	4.75	4.45
Brazil	7.75	10.75	8.9	10.75	8.90
Russia	7.50	8.00	6.80	7.50	6.15

Long rate outlook

2Y. Bond yield

	22/10/2021	Amundi +6M	Forward +6M	Amundi +12 M	Forward +12 M
US	0.48	0.45/0.60	0.82	0.7/0.9	1.12
Germany	-0.64	-0.70/-0.50	-0.59	-0.70/-0.50	-0.55
Japan	-0.10	-0.20/-0.10	-0.12	-0.20/-0.10	-0.10
UK	0.68	0.50/0.70	0.83	0.7/0.8	0.84

10Y. Bond yield

	22/10/2021	Amundi +6M	Forward +6M	Amundi +12 M	Forward +12 M
US	1.66	1.6/1.8	1.80	1.8/2.0	1.93
Germany	-0.10	-0.3/-0.1	-0.03	-0.3/-0.1	0.03
Japan	0.10	0/0.20	0.13	0/0.20	0.18
UK	1.17	1.0/1.2	1.27	1.2/1.4	1.32

Currency outlook

	22/10/2021	Amundi Q2 2022	Consensus Q2 2022	Amundi Q4 2022	Consensus Q4 2022
EUR/USD	1.16	1.14	1.17	1.14	1.18
USD/JPY	114	113	112	116	112
EUR/GBP	0.85	0.85	0.85	0.83	0.85
EUR/CHF	1.07	1.07	1.10	1.08	1.12
EUR/NOK	9.73	9.91	9.90	9.21	9.73

	22/10/2021	Amundi Q2 2022	Consensus Q2 2022	Amundi Q4 2022	Consensus Q4 2022
EUR/SEK	9.98	10.11	10.00	9.88	9.80
USD/CAD	1.24	1.27	1.24	1.21	1.22
AUD/USD	0.75	0.73	0.75	0.77	0.76
NZD/USD	0.72	0.70	0.72	0.71	0.73
USD/CNY	6.39	6.45	6.50	6.50	6.40

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. Source: Amundi Research

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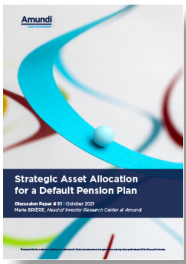

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