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#10
October 2022

CROSS ASSET
Investment Strategy

CIO VIEWS

Bond yields now more appealing

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Relaxed financial markets look at Lula's comeback

Confidence must be earned

Amundi ASSET MANAGEMENT

Marketing material for the exclusive attention of professional clients, investment services providers and any other professional of the financial industry

#10 - October 2022

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Geopolitical risks, inflation and hawkish central banks translate into a cautious stance on risk assets such as credit, in which, a deceleration in growth (and its impact on earnings) could create concerns over cash flows and liquidity, especially for the lower rated companies. Hence, we prefer US IG and are defensive on HY. On the other hand, USTs are attractive at current levels, but investors should stay active and also explore select opportunities in euro area curves. In equities, we favour US over Europe and selectively like quality, value names that can sustain earnings and reward shareholders even in a downturn.

Amundi Institute

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The first electoral round was won by former President Lula. However, the incumbent, Bolsonaro, performed better than expected. Their economic agendas differ on a number of issues, while risks are more asymmetric under each candidate. Either could benefit from a robust macroeconomic scenario.

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TLTRO repayments and redemptions will drive incoming ECB passive QT over the next few quarters. So far, banks have repaid a small amount of liquidity, while the ECB's recent decision on remuneration of excess reserves has helped keep current excess liquidity abundant, aiming at a smooth transmission of its monetary policy.

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The flattening of the US yield curve will depend on the persistence of core inflation and on the impact of monetary tightening on growth. The more resilient the US economy proves to interest-rate hikes, the more aggressively the Fed will have to tighten monetary policy, thereby increasing the risk of recession. We have gone from 'bad news is good news' to 'good news is bad news'.

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CIO VIEWS

Bond yields now more appealing

Vincent MORTIER,
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Matteo GERMANO,
Deputy Group Chief Investment Office

Geopolitical risks have returned to investors' radar screens with President Putin's escalation of the war in Ukraine. At the same time, inflation remains in the spotlight: the latest US reading was concerning, causing yields to rise while equity markets tumbled. Looking ahead, we confirm the outlook of slowing US inflation (headline peak looks to be behind us), but well above the Fed's targets in the near term and we think central banks, including the Fed and the ECB, will remain hawkish. **Politics is also under the spotlight with US mid-term elections, a new government in Italy, and elections in Brazil.**

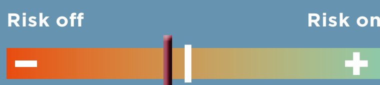
On the other hand, **the economic outlook could deteriorate.** The US faces an extended period of sub-par growth and the outlook for the Eurozone appears gloomier, compounded by the ongoing energy crisis. While there are discussions around a coordinated EU solution in the form of potential taxes, price caps, etc., markets have yet to see concrete details regarding a full-fledged response. Initiatives at the single country level still prevail, such as Germany's announced €200bn package to tackle the energy crisis and the fiscal package announced by UK PM Truss. The plunge in UK assets post the announcement of the 'mini' budget, on 23 September, triggered a restoration of BOE quantitative easing at a time when the CB is raising rates, indicating the challenging equilibrium in the policy mix and the risk of liquidity strain. Volatility in markets is here to stay. The key themes to watch include the following:

- The narrative driving core yields up at the moment is that **hawkish CBs are pushing rates up.** Attractive valuations for the UST 10Y, the amount of global pressure (supply and demand side) on economic growth, and geopolitical tensions mean that **government bonds should provide a source of protection.** Investors should keep an active view which takes into account tactical moves around 'higher for longer' rates. In Europe, a hawkish ECB has been forced to deal with supply chain shocks and factors beyond its control. This could put upward pressure on short-term yields for select Euro Area curves.
- **On credit, particularly high-quality segments, such as US IG, the picture is positive while in the HY space we keep a cautious stance.** In IG credit, debt growth and leverage look to be under control and margins are strong, despite upward pressures on costs. However, cash reserves and liquidity are areas that could emerge as concerns going forward, particularly as the earnings backdrop deteriorates. This is the case more for lower-rated issuers and those in HY, which would most likely consume their reserves when cash flows slow and it becomes more difficult to raise debt.
- **In equities, we believe investors should remain cautious, and highly selective, looking for quality.** Earnings estimates for the US and Europe do not fully reflect the deteriorating economic backdrop and we believe we are on a downward revision path. Hence, we remain very careful on the earnings front. That is why our focus is on the quality, value sides and names that reward shareholders through dividends, etc. Regionally, the US should perform better than Europe while we are now neutral on China and watchful on the evolution of the zero-Covid policy and regarding the housing sector.
- **Emerging markets** growth momentum has improved slightly, but there is a need to be selective as inflation is uncomfortably high. The broad decline in inflation has not started yet except in Brazil, where election-related volatility could hurt the real. As a result, CBs (Chile, etc.) have maintained their tightening stances. **HC debt** offers opportunities in terms of carry and valuations. In particular, we like commodity exporters (Brazil, Mexico) in Latin America, but are cautious on EM FX. Here, investors should watch for the impact of a recessionary scenario with regard to commodity prices and exports. **EM equities** present a mixed environment, with earnings expectations robust and valuations selectively attractive. Chinese authorities continue to pursue a zero tolerance Covid policy and that is shaping the outlook for near-term weakness but it is one of the few countries where policy is turning accommodative.

The environment ahead is likely to be characterised by how much pain CBs are willing to inflict on economies to bring inflation under control, particularly at a time when drivers of inflation in the US and Europe are different. However, what is clear is that they will put the brakes on economies, which could affect more vulnerable names in credit and equities. We think this is a time to include bonds and high-quality credit in portfolios, but maintain a diversified approach regarding real assets (commodities, gold). **Thus, the overarching theme is to look for returns in areas that can offer protection in an economic downturn and at the same time provide inflation-adjusted returns.**

Overall risk sentiment

Risk off | Risk on



Stay cautious on risk assets as slowing economic growth, hawkish CBs would impact demand, corporate earnings and market volatility.

Changes vs. previous month

- Select opportunities in euro area curves amid ECB tightening.
- Positive on US duration in multi-asset.
- Tactically neutral on Chinese equities.
- Cautious in Credit HY with hedges.

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

AMUNDI INSTITUTE

Inflation evolution: *desirable* then (before Covid), a *headache* now

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The Covid backdrop: Covid-19 inflicted a huge blow on the global economy: output contracted by an unprecedented 3%, but initially inflation declined markedly as the demand contraction outweighed supply constraints and as commodity prices dropped. But after the recovery took hold, improving demand, resurgent commodity prices, unresolved and long-lasting supply-chain disruptions, and labour shortages, all blended together, prompting a dramatic comeback of inflation amid still easy monetary, fiscal and macro-prudential policies. The unprecedented global policy response, which was timely and effective in cutting downside risks to growth and demand, failed to prevent imbalances stemming from constrained supply chains once economies reopened.

From goods to services: First, it was consumer goods inflation that rose, owing to demand-supply imbalances. Demand recovered strongly, supported by generous fiscal and monetary stimulus. Courtesy of mobility and consumption constraints, demand shifted dramatically towards goods, where supply-chain issues were more acute, causing the prices of goods to rise sharply. Supply chain disruptions persisted over time, until the recent easing. **However, the surge in inflation was not just driven by goods:** after remaining below pre-crisis levels during the unfolding of the pandemic in 2020, oil and commodity prices moved higher when the global recovery gained traction in 2021. As a result, food inflation kicked in, affecting many EM, given the sizeable share of food in their consumption baskets. In the next stage, services inflation materialised as recovery progressed, pushing up core inflation, which was stickier and broad-based, spurring concerns of second-round effects, especially in areas where labour markets were tighter.

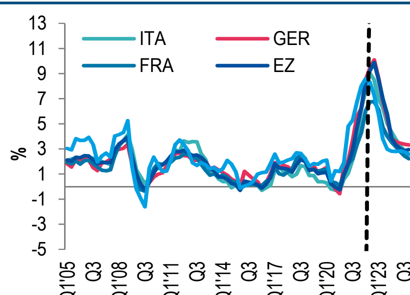
Diverging reasons for US and European inflation: In the US, labour market imbalances remain key to the inflation outlook. A shift to a lower participation rate of the labor force is complicating the calibration of policy withdrawal (from loose to tight monetary policy). The increase in wages, initially concentrated in low-skilled jobs, is now spreading across the economy; inflation remains broad-based in services and in core, and risks are becoming entrenched. Policy priorities are now to rapidly slow wage growth and rebalance labour markets. In the Eurozone, inflation was initially driven by the goods side, owing to supply constraints rather than strong demand, given the region's slower recovery vs the US. Now, however, the key driver of inflation is energy prices. **We think EZ inflation is mostly an imported and supply-related phenomenon,** and thus the ECB faces a tough task: reducing demand will not necessarily slow inflation in the short term, whereas tighter financial conditions may weigh on supply even more.

EM not far behind: 'Hi-flation' took hold pretty much across the board in EM, with the exception of China and ASEAN until recently at least, and, to a lesser degree. In both regions, inflation remained under control. This was partly due to a late and gradual reopening post Covid-19 which slowed any demand pressure and due to somewhat more effective subsidies in place. In contrast, in the CEEMEA areas and LatAm, inflation more or less moved higher earlier, driven by external and global shocks, magnified by pronounced FX depreciation and by very robust domestic demand and tight labour markets (CEE). On top of that, some EM have been impacted by idiosyncratic factors (war in Russia, unorthodox policies in Turkey, Argentina political crisis and run on the peso) overlapping with the aforementioned underlying drivers (demand/supply imbalances, etc). **EM CBs responded in a timely manner.** In LatAm, core goods inflation is moderating, thanks to aggressive CBs (eg, BCB). Still, in Brazil, services inflation is rising, providing headwinds regarding other inflation dynamics. And thanks to the BCB's policies (plus tax and fuel price cuts), inflation had already started to shift downwards months ago but at the expense of growth.

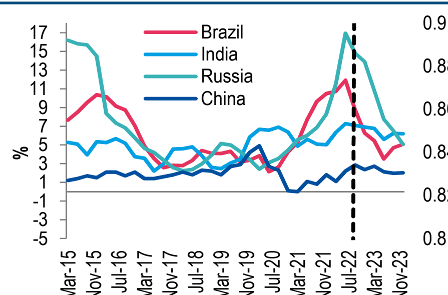
To conclude, we believe inflation is the primary concern for policymakers globally now, even as inflation trends and drivers vary across regions. While it appears that inflation peak has passed its peak in select countries, such as the US, it will still remain above CB targets in the near term. Hence, investors should aim for real returns, despite the current growth deceleration.

Inflation drivers in the US and Europe are slightly different, with supply chain disruptions causing more pain in Europe. This makes the task of the ECB more difficult

DM inflation



EM inflation



Source: Amundi Institute, on 30 September 2022. BCB = Banco Central do Brasil. Charts show headline inflation, year-on-year growth (at quarterly frequency). LHS = forecasts start from Q3 2022, RHS = forecasts start from 30 September

MULTI-ASSET

Stay cautious in a deteriorating economic scenario

Francesco SANDRINI,
Head of Multi-Asset Strategies

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

In a still cautious view on risk assets, we prefer high grade credit to equities but keep a close eye on default outlooks and financial conditions

Market volatility has remained above average as growth concerns seeped into valuations, particularly in Europe, the region more affected by recession fears and high inflation, aggravated by the energy crisis. Here, fiscal support measures from national governments and a collective EU response could be game-changers. However, current valuations only partially reflect the deteriorating global scenario. In fact we have yet to see earnings adjustments and thus expect volatility to continue. **As a result, we stay slightly constructive on duration, but look for quality credit.** In equities, our relative preference is for the US, though the outlook has weakened. On the other hand, there is a need to maintain equity hedges and a diversified stance which includes commodities and FX.

High conviction ideas

We stay cautious on equities amid geopolitical tensions and a tightening trajectory for central banks (rising cost of capital). But we play regional divergences, favouring the US over the EZ, given the downside risks from gas rationing and higher prices in the region. We think this view is supported by the more quality, growth features of the US and the value, cyclical nature of European markets. In China, although we see near-term headwinds, we believe desynchronisation of the country's economic cycle from global markets could be beneficial. Hence, we keep the relative preference for China over India. **We maintain a slightly positive stance on duration through USTs** and are neutral on core Europe. The former's valuations are attractive after recent movements and as curve inversion persists. In the UK, we now take a direct stance on 5Y nominal swaps following the sharp increase in yields. We are monitoring how the BoE's support for bonds to maintain stability in the markets affects its tightening trajectory and the country's growth. Secondly, given the ECB's hawkish stance, we see curve flattening opportunities in Italy. Recession risks could negatively affect the 2Y curve more than the 10Y, further supporting this view. Separately, we maintain our slight constructive stance on BTPs vs Bun, supported by the availability of the ECB's transmission protection instrument, and our view that the new government should not deviate too much from the fiscal and reform path. However, we are monitoring developments. **While we acknowledge pressures in risk assets in general, we believe US credit IG should fare better amid** strong corporate fundamentals (high interest coverage ratios, stabilising leverage, strong balance sheets) and robust profit margins despite rising costs. On the other hand, in European credit, we are monitoring the effects of rising borrowing costs and how that could affect the balance sheets of low-rated issuers. **In HY, we stay cautious as we believe that this is the area most exposed to risks of excessive tightening.**

In FX, we are no longer positive on the BRL vs PLN and HUF following the recent appreciation. The Brazilian elections, and the requirement for a second round, might see an increase BRL volatility. In addition, Eastern European currencies seemed to have reached quite stretched valuation levels incorporating a lot of negative news flow so that a rebound now looks plausible. On the other hand, the improving fiscal situation of Indonesia and the hiking cycle of the central bank are positive for the IDR/CNH. Elsewhere, in DM, we think the rates differential between the Fed and other CBs and the approaching global economic slowdown are key supporting factors for the USD (vs CAD, EUR). We remain slightly cautious on the EUR/ JPY as a medium-term strategy and constructive on the CHF/EUR as a safe-haven play.

Risks and hedging

Economic risks may trickle down to earnings and asset prices, leading us to believe that investors should maintain sufficient hedges on the equity side, and on the HY market. We also think there are opportunities in the derivatives market to profit from our negative view on the EUR/USD.

Amundi Cross Asset Convictions

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

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

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, QT = quantitative tightening.

FIXED INCOME

Agile on bonds, mindful of refinancing risk in credit

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Head of Fixed Income

Yerlan SYZDYKOV,
Global Head of Emerging Markets

Kenneth J. TAUBES,
CIO of US Investment Management

A steep hiking cycle is leading the markets to price in a higher Fed terminal funds rate, which could affect cost of capital, particularly for low-rated companies

High inflation is creating synchronised hawkish momentum across DM, leading to markets pricing in higher policy rates than previously was the case. We believe the Fed and the ECB will stick to higher policy rates for a longer timeframe, unless inflation falls substantially or there is a fragmentation in the Eurozone (not our central case). As a result, the cost of lending to companies may increase. **We may also see a situation where banks do not lend to corporates and primary markets also are shut. This could be particularly the case for low-rated corporates and should be kept in mind.** Thus, while staying cautious on risk assets and liquidity risks, we prefer high-rated debt in an overall flexible approach. We also see select opportunities in EM hard currency debt.

Global and European fixed income

We acknowledge the opposite pressures on yields from hawkish CBs and weak economic growth which lead us to maintain an active/tactical approach. We are slightly cautious on duration, mainly through the US and core Europe. But we are positive on China and neutral on the UK amid the recent sharp movements. Our vigilant approach across curves allowed us to assess that euro peripheral spreads have stabilised and we are monitoring fragmentation and political risks. We are slightly constructive on inflation breakevens in the US and EZ. In credit, companies are emerging from the pandemic with stronger balance sheets and accumulated cash. However, rising costs and slowing consumption, uncertainty related to the Ukraine conflict, and a hawkish ECB could cause volatility. The last factor could affect financing costs for HY and lower-rated debt. Thus, we keep an eye on defaults and potential restructuring, and watch for signs of balance sheet deterioration. Further, we prefer IG and quality debt in banking, autos, energy.

US fixed income

The inflation story continues to gain momentum as markets become more concerned that the Fed may maintain rates higher for longer. Unsurprisingly, yields have risen since the beginning of August as the inflation and hawkish Fed narrative gained momentum. **As a result, even though we maintain a tactical and close to neutral view on duration, we now have a positive bias regarding these higher yields.** The upward move in nominal yields is also reflected in real yields, leading us to monitor TIPS for attractive entry points. We notice IG spreads are marginally wide vs their long-term averages. This means we could see some repricing of liquidity risks, particularly in lower quality. So, we are cautious overall but not pessimistic, and prefer high quality. In addition, companies that depend on private credit markets for liquidity/reserves could face pressures as borrowing costs rise. In securitised credit, we are actively managing our positions in agency MBS because of valuations.

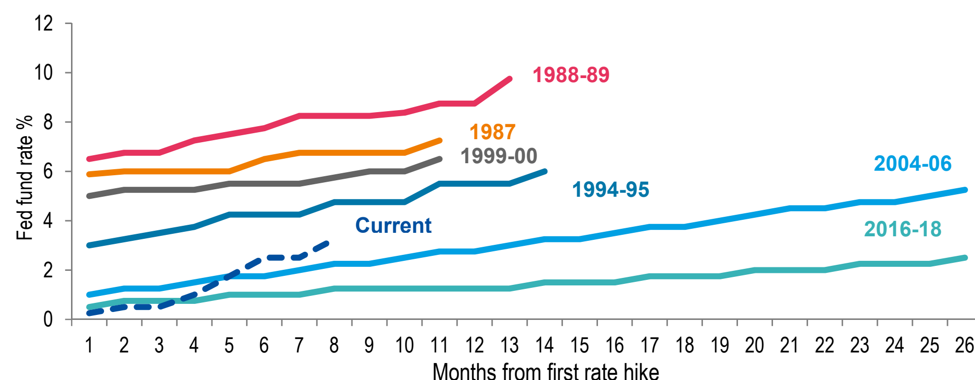
EM bonds

We are modestly defensive on duration, but believe sentiment is turning positive for EM bonds. The backdrop is more favourable for HC vs LC, but selectivity remains important amid idiosyncratic stories. We are mindful of distressed levels across regions. Our preference is for countries where the tightening cycle is close to the peak, coupled with compelling carry (Brazil). We stay cautious on EM FX.

FX

We are constructive on the USD and cautious on the GBP (new fiscal policies), EUR and CNH. However, discussions about an EU-wide response to the energy crisis could provide some support to the EUR and we remain flexible. In EM, we are positive on the MXN, CLP but cautious on the TWD.

After 1984, the current hiking cycle seems to be the steepest



Source: Amundi Institute, Bloomberg as of 30 September 2022.

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

EQUITY

Follow earnings resilience

Kasper ELMGREEN,
Head of Equities

Yerlan SYZDYKOV,
Global Head of Emerging Markets

Kenneth J. TAUBES,
CIO of US Investment Management

Overall assessment

While we are witnessing a weakening of economic data, forward earnings indicators seem too high. Until now, we have seen disruptions in supply chains, shortages, and energy supply affecting the operations of companies, but going forward, we are likely to witness consumer demand-induced surprises which could pull down markets' earnings expectations. However, not all companies will be affected equally. The ones with strong pricing power and stable balance sheets should be better able to withstand the slowdown. **As a result, we stay selective and avoid businesses with excessive debt on their balance sheets in light of the increasing cost of capital and a slowing economy.** Overall, we keep our preference for the US, but stay vigilant regarding the evolving economic backdrop.

European equities

Amid expectations of earnings downgrades, we maintain balanced and barbell-type approaches, with positive views on defensive consumer staples and quality cyclicals. The key is to understand 'what is currently implied' given where valuations are. Selectivity is key. For instance, even against a backdrop of deteriorating macro fundamentals, we like select retail banks, as implied valuation expectations are extremely low. Across sectors, we have a preference for strong balance sheets, resilience of business models, and pricing power. Importantly, the current crisis is a time to renew the emphasis on ESG. Conversely, we are cautious on technology.

US equities

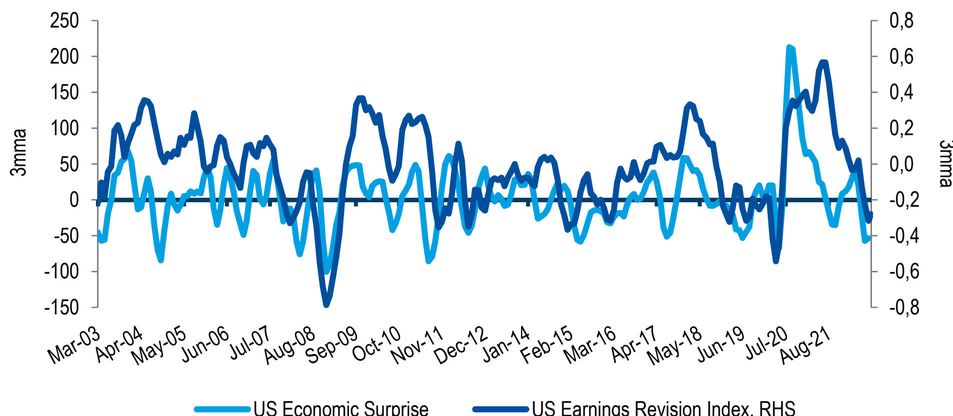
Markets expect earnings to grow in 2022 and 2023, and inflation may actually protect nominal profits to some extent. But we think markets are generally late in discounting recession-related earnings downgrades. **As a result, companies could use the upcoming reporting season to lower market earnings expectations for next year.** This, in turn, could impact prices, particularly for the more vulnerable, un-profitable and expensive businesses. Thus, we are prioritising valuations and earnings resilience, and favour companies that can deliver dividends, despite the upcoming economic slowdown. On the other hand, we stay clear of names with excessive leverage and very high cyclicality combined with high valuations. Having said that, we are also observing that valuations in select quality cyclicals and quality growth segments have corrected substantially, making them attractive from a long-term perspective. At a sector level, we like financials such as banks and insurers. US banks are demonstrating high returns on equity and credit concerns are still limited, but we remain selective. Finally, we think investors should consider a quality and value bias in their portfolios.

EM equities

Geopolitical risks and uncertainty remain elevated, leading us to keep a cautious stance short term. However, the DM-EM growth differential and selectively attractive EM valuations are positive. We like Brazil and UAE while we are tactically neutral on China and are cautious on Turkish banks. At a sector level, we search for value names in discretionary segments (especially in China, given the expected rebound in domestic demand), and favour energy over materials.

We are not yet at the point where markets start getting attractive again, and hence, our focus remains on selection and earnings resilience beyond the near term

Economic environment would lead earnings revisions



Source: Amundi Institute, Bloomberg, as of 28 September 2022. Eco. surprise index = positive reading means data releases have been stronger than expected, whereas a negative number means data released has been worse than expected. 3 month moving averages shown above

THEMATIC GLOBAL VIEWS

Didier BOROWSKI,
Head of Macro Policy Research, Amundi Institute

The IRA would allow the United States to meet its goal of reducing GHG emissions by 50% from 2005 to 2030

United States: a green industrial policy in the making

The US Congress's August approval of the Inflation Reduction Act (IRA) came as a surprise to most observers. With the mid-term elections just months away and no majority in Congress, no one expected new legislation to be passed. Yet, the Democrats and Republicans managed to reach a compromise. We discuss below the measures announced to promote the environmental transition, which is the centrepiece of the act. Europe has much to gain from looking more closely at the modalities of the new US green industrial policy.

The IRA includes in particular $369bn in spending over a ten-year period in favour of decarbonisation, renewable energies and energy security. This is more than four times the amount that the 2009 American Recovery and Reinvestment Act devoted to investments in renewable energies and green technologies, making it **the largest federal legislative package in US history in this area.**

The IRA aims to accelerate the transition towards renewable energies. In extending several tax credits for decarbonated electricity generation and the purchase of new electric vehicles until 2031, the legislation aims to stimulate investments. **The IRA thus marks a shift in US industrial policy and in Democratic Party doctrine.**

Paradoxically and despite the law's name (the Inflation Reduction Act), **it is unlikely to slow down inflation on the horizon of our forecasts.** Whatever impact there is on prices, it will be minimal and will take several years to play out, with a lower fiscal deficit, an increase in raw materials supplies via investment in production and other critical infrastructures, and a reduction in drug prices (our focus here is the measures in favour of the energy transition). Additional downward pressure is expected on oil and gas prices by reducing consumption. Princeton University's REPEAT project estimates that crude oil prices will be lowered by about 5% and US natural gas prices by some 10-20% in the medium term (2030-35).

Environmental provisions are the law's centrepiece

The provisions include subsidies, tax credits, environmental justice measures, and investments in essential energy infrastructures.

The goal is to reduce the US's greenhouse gas (GHG) emissions. **This is clearly the first comprehensive plan proposed by the federal government to fight climate change.**

In addition to decarbonised electricity generation, the IRA also aims to reduce GHG emissions through energy efficiency. According to certain studies (e.g., by Energy Innovation), **the IRA will reduce GHG emissions** by 820-1200 mn metric tonnes (MMT) of CO_2 equivalent (CO_2e) – or **by about 40% compared to 2005 levels – by 2030.** This would allow the United States to meet its goal of reducing GHG emissions by 50% from 2005 to 2030. **The main GHG reductions will be achieved in the electricity sector** through massive investments in renewable energies and the electric grid.

In reducing the cost of clean energies and other climate solutions, the IRA will allow states, cities, and companies to raise more easily their climate ambitions.

According to Princeton energy and climate experts (REPEAT project)[1], the IRA will reduce the United States' annual energy spending by at least 4% in 2030, or an annual savings of almost $50bn for households, companies, and industry. This will result in hundreds of dollars of annual savings for US households.

Federal tax credits, rebates, and investments will lower the cost of electric vehicles, will enhance energy efficiency in buildings, and will fund investments by industry. The IRA could thus boost growth in wind and solar capacity.

The IRA should generate almost $3,500bn in cumulative investments in new US energy supply infrastructures over the next decade (2023-32). This includes more than $20bn in annual investments in transport, CO_2 sequestering and fossil fuel energy generation with carbon capture by 2030. The annual investment in hydrogen production is expected to triple by 2030 (to $3bn annually) amounting to more than $50bn by 2035. Investments in wind and photovoltaic solar energy are expected to double, reaching $321bn in 2030.

The IRA will lead to major additional energy system investments by households and companies, including the purchase of electric vehicles and devices, and more efficient and more electric-focused heating systems and industrial processes. It also provides for tens of billions of dollars in subsidies, tax credits and loans to expand clean energies and their use. **All this will stimulate additional investments and jobs. This will also boost innovation and maturing of important new clean technologies**, the building out of clean energy supply chains, improved public health, and environmental justice.

[1] *https://www.princeton.edu/news/2022/08/25/princeton-energy-and-climate-experts-weigh-impactinflation- reduction-act*

THEMATIC GLOBAL VIEWS

The new technologies will get a boost from subsidies that are expected to have an impact similar to tax credits on production and investment tax credits that helped expand wind and solar energy industries and lower costs during the past decade (by 70% to 90% since 2009).

Lastly, the IRA will support the development of US manufacturing of components and assemblies for solar and wind energy, batteries, and electric vehicles, among other things. **The IRA provides for subsidies, loans, and tax incentives that will lead to hundreds of billions of dollars in cumulative investments by 2030.**

Overall, according to estimates, up to 1.3mn new jobs could be created by the measures, in particular in construction and services, and they could add 0.6-0.8% to GDP by 2030. Some $51-74bn could be saved annually by preventing climate-related damage (which would raise total savings to a range of $329-535bn when including all other measures passed in the legislation).

Carbon tax shelved: the price of compromise between Republicans and Democrats

The strategy adopted by the US authorities contrasts with the approach taken by Europeans, which has focused on the carbon tax

The compromise between Republicans and Democrats was made possible only by the shelving of the carbon tax idea, which had so far been a key proposal to accelerate the climate transition. It is true that the carbon tax is opposed by the vast majority of Americans. Only 28% of them are in favour, whereas more than half of them are in favour of subsidies or in favour of low-carbon technologies and investments in green infrastructures.

The strategy adopted by the US authorities contrasts with the approach taken by Europeans, which has focused on the carbon tax and the carbon market. In a way, the tax credit (the main financial tool of the IRA) has supplanted the carbon tax.

In placing the priority on developing the decarbonised technologies sector, the Biden administration is implementing a true green industrial policy. The measures aim to transform supply-side conditions, and that marks a shift in Democratic Party doctrine. Most experts believe that the measures taken will not be sufficient to achieve carbon neutrality by 2050. However, it will certainly allow the United States to regain some leadership in this area. And the fact that a bipartisan agreement was reached by Congress a few months before mid-term elections raises the likelihood that new measures will be passed in the coming years, regardless of the political leanings of the next administration.

This is very good news for the planet, but this pragmatic approach should also grab the attention of other countries, starting from **Europe,** where extensive investments also must be undertaken. The carbon market route could be usefully supplemented by **proactive fiscal measures at the European level.** Europeans will also have to show imagination in achieving their goals. **The current energy crisis could and should be the catalyst for joint and coordinated action in this area. It is a matter of competitiveness and strategic autonomy for Europe.**

Finalised on 4 October 2022

THIS MONTH'S TOPIC

Relaxed financial markets look at Lula's comeback

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The first electoral round was won by former President Lula. However, the incumbent, Bolsonaro, performed better than expected. Their economic agendas differ on a number of issues, while risks are more asymmetric under each candidate. Either could benefit from a robust macroeconomic scenario.

The first round of Presidential election took place on 2 October. As expected by great majority of polls, the Workers' Party's candidate and former president Luiz Inacio Lula da Silva led after the first round and came close to winning the election outright, as predicted by several polls. However, traditional pollsters were wrong when it came to the result of incumbent president Jair Bolsonaro, who outperformed and narrowed the gap to Lula to a mere 5 percentage points (pp) (48% to 43%), while the spread projected by polls was almost double on average. Third-wave candidates, and Ciro Gomes in particular, disappointed. Turnout proved to be in line with the 2018 election and the rate of absenteeism was 21%.

The Congressional election took place on the same day. All seats in the lower house, one-third of the Senate seats, and 27 state governorships and state legislators were up for re-election. The Congressional election delivered a strong showing for right-leaning parties and the President's Liberal Party (PL). In fact, Bolsonarismo did even better than the President himself.

1/ Electoral results

1st round results	Votes (mn)	Percent	Other
Lula (L)	57.3 mil	48.4%	L-B=6.2mn or 5.2%
Bolsonaro (B)	51.1m	43.2%	
Tebet (T)	4.9m	4.2%	T+G=8.5mn
Gomes (G)	3.6m	3.0%	
Blank (Bl)	2.0m	1.6%	Bl+Nu=5.5m
Null (Nu)	3.5m	2.8%	
Abstained	32.8m	21.0%	
Total votes=123.7mn	Valid=118.3mn	50% of valid=59.2m	L needs 1.9mn, B 8.1mn

Source: Amundi Institute as of 4 October 2022

Based on the Brazil's recent history, **Lula has an edge heading into the second round,** as he won the first round. Over the past six presidential elections, first-round winners have also won the second round. The former president is comfortably ahead in the polls, even though those polls must be taken with a pinch of salt at this time, and is much closer to the hypothetical finish line of 59.2mn votes than Bolsonaro (see table).

We are constructive about the first round results for a variety of reasons. Firstly, Lula's mandate for leftist policies decreased with the closer-than-expected first-round results, while his views will have to moderate further if he wants to attract centrist voters. Secondly, the centrist/centre-right Congress -- an important arbiter in today's Brazilian political system – will be a further constraint on Lula's potentially populist ideas. Finally, while having to come back from behind, Bolsonaro has the momentum and some tailwind from the three largest states, keeping the pressure on Lula's centrist message. On the other hand, the tighter the race is, the bumpier the potential transition of power could become. The second round will take place on 30 October.

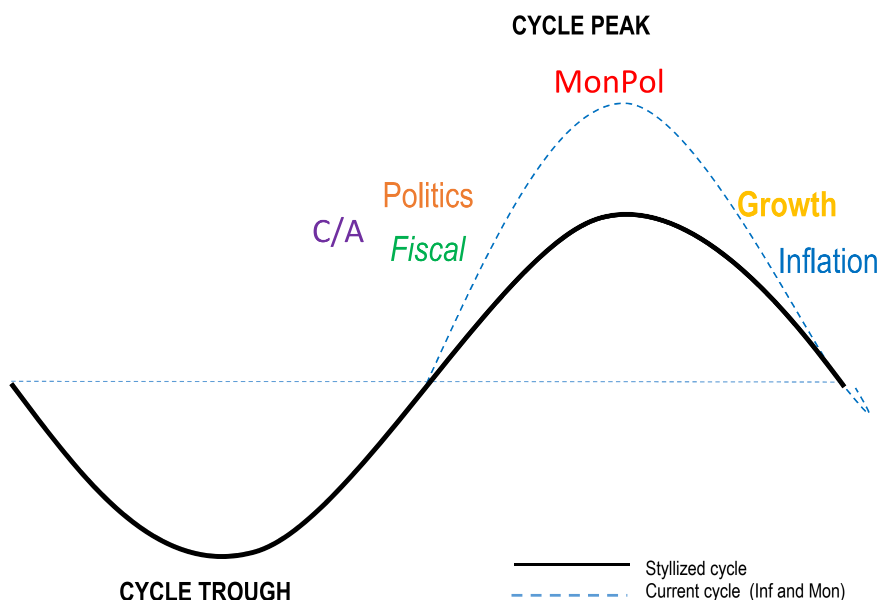
The first round was won by Lula; however Bolsonaro performed better than expected

Strong economic background

Whichever candidate wins in late October will be met by a strong cyclical outlook but weaker structural trends. Brazil's growth appears to be peaking after a robust performance so far this year, driven by the reopening of the services sector, elevated terms of trade (ToT), strong credit and employment cycles, and a large fiscal stimulus, worth some 1.5% of GDP. Economic activity is not expected to falter, even though it will be affected by tight monetary policy and softer credit cycles, due to Brazilian households' being highly leveraged. We expect a soft landing thanks to a strong agricultural sector output, moderating inflation, and still decent labour market dynamics that have benefited from the 2017 labour market reform. Fiscal momentum is unlikely to turn negative under either administration. We project annual real GDP to expand by around 3% this year and by more than 1% in 2023, with a large part accounted for by carryover. 2023 growth will depend much on the state of global economy and on the future administration's action.

THIS MONTH'S TOPIC

2/ Brazil macroeconomic cycles are mostly in comfortable spots



Source: Amundi Institute as of 4 October 2022

On the inflation front, Brazil is leading the global inflation cycle. Headline inflation peaked in April at 12.1% YoY and will be less than half by year-end, due to federal and state tax cuts and energy price declines. Core inflation has also peaked, thanks to core goods disinflation, while services inflation has yet to start moving lower. While dropping to around the upper end of the inflation target range is relatively easy – also thanks to favourable base effects – moving to the middle of range (3.25%) will take more time, effort, and even luck. We expect inflation to hit these levels only in 2024.

Monetary and fiscal policy outlook

BCB is the first EM central bank to be done with rate hikes

On the monetary policy front, the Central Bank of Brazil (BCB) is the first EM central bank to be done with rate hikes. While the US Federal Reserve (Fed) has been front-loading hikes trying to deflate the economy and the labour market, the BCB looks done now after a hiking cycle that lasted one and a half years and resulted in the policy rate being raised by nearly 12pp (to 13.75%). The tightening cycle ended in September via the first split decision (7-2) since 2016, while the statement was hawkish. In fact, the BCB made it sound like a pause, by stating that it would *"not hesitate to resume the tightening cycle"* if necessary and otherwise employ a wait-and-see strategy *"for sufficiently long."* Given the softening growth outlook, moderating inflation, and the passively tightening real monetary policy stance (via slowing inflation), we see the BCB kicking off the easing cycle already in Q1 2023, with ex-ante real rates around 8-9%, while the Fed is likely to be still hiking rates by then.

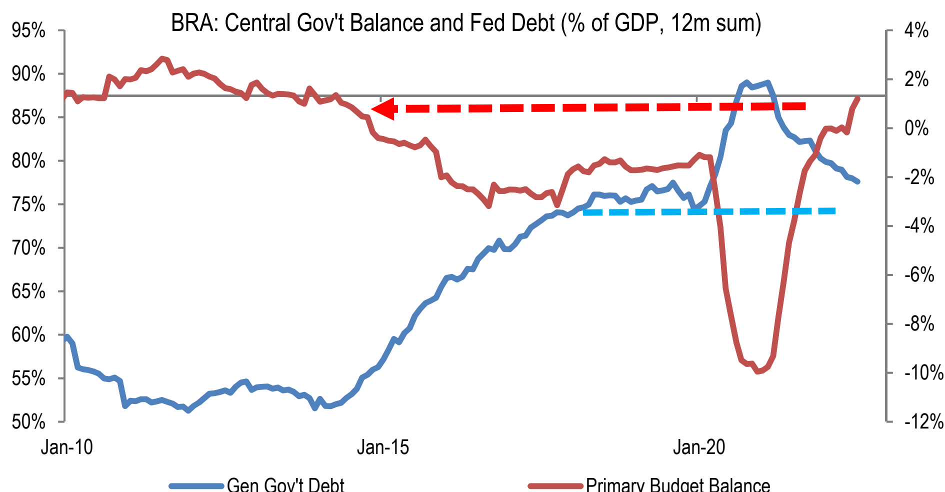
We see mild twin deficits building up. Brazil's primary budget is running in surplus for the first time in several years despite large pre-election fiscal stimulus and tax cuts, thanks to robust GDP growth, strong ToT, and high inflation (the structural primary deficit is around zero). At the same time, the current account deficit is more than fully covered by FDI inflows. In addition, the public debt-to-GDP ratio has improved much from the Covid-19 crisis peak of around 90%, falling back to around pre-Covid-19 levels (77%).

To sum up, the starting fiscal point looks benign in relative terms for any incoming administration.

However, the cyclical outperformance won't last forever with structural deterioration – though not a radical one – eventually taking over, regardless of who takes office on 1 January. This is because both presidential candidates are advocating changes to the country's ultimate fiscal anchor, the spending cap, which fixes government spending in real terms, driving it lower as a share of GDP. Lula would want to eliminate it altogether, while Bolsonaro would make it a function of nominal GDP growth. This would allow both candidates to keep Auxilio Brasil transfer payments at the temporarily boosted level of BRL 600 per month, worth over BRL 50bn, or 0.5% of GDP in extra expenditure. This is likely to be prioritised and handled via a waiver. Lula would also spend more on public capex, increase minimum and public servant wages. A big chunk of money would also need to go towards paying off *'precatorios'* and reimbursing states for tax cuts introduced recently. All in all, spending as a share of GDP is likely to head higher to over 19.0% of GDP from the budgeted 17.6% in 2023. At the same time, the primary surplus is likely to drop from the forecasted 0.6% of GDP back into deficit. Such spending trajectory would worsen the debt-to-GDP ratio, unless offset by corresponding increase in revenues, and raise it to mid-80s percentages over the coming years, especially if Lula wins.

THIS MONTH'S TOPIC

3/ **Robust fiscal starting point: debt is almost back to pre-Covid-19 levels, with a primary budget surplus**



Source: Amundi Institute, CEIC. Data is as of 4 October 2022.

Bolsonaro's and Lula's agenda do not differ much, but the latter could carry more fiscal risks

Election and financial markets

On the financial markets, there is little concern about the election result and the impact of fiscal accounts. However, Lula has potentially less orthodox ideas to implement, in line with his preference for state intervention. These include unwinding the 2017 labour market reform that introduced new outsourcing regulations and more flexible hiring scheme for temporary workers, even if Lula has refrained from talking about this idea recently. Another idea is increased activity by the Brazilian Development Bank (BNDES), which misallocated capital and deemed monetary policy far less effective via the subsidised lending rate in the past, even though BNDES recapitalisation would certainly be much lower now and fiscal guarantees used more widely instead. Lula's overall stance on state-owned enterprises (SOEs) could also weaken their governance and the lack of appetite for privatisation is evident. On the spending side, there is the already mentioned spending cap elimination to allow increased outlays on a number of initiatives and dislike for the current Petrobras' fuel pricing policy.

While Bolsonaro would also adjust the spending cap higher, his administration is unlikely to unwind any of the passed initiatives, continuing instead its drive to reform, privatise, and offer concessions of public-sector activities. Both Lula and Bolsonaro would try to pass tax and administrative reforms, much to the markets' appreciation. Lula's tax proposal would certainly be more progressive, while also emphasising closing loopholes and cutting subsidies. Both would also want to harmonise state and federal VAT taxes. On the administrative reform front, overall payroll costs could be reduced via changes in hiring regulations of new entrants.

Overall, Bolsonaro's and Lula's agendas and their bottom lines do not differ much, but the latter's presidency would seem to carry more fiscal risks if all his ideas were to materialise and add up and if offsetting proposals got watered down.

Finalised on 5 October 2022

THIS MONTH'S TOPIC

Investment implications

The first-round result was positive, with a much narrower gap between Lula and Bolsonaro than markets anticipated. Bolsonaro's allies in the Senate and in state elections did much better than expected and increased the number of Congress seats.

While the central scenario remains a victory for Lula on 30 October, most likely he will have to move further to the centre, and some of his more extreme policies might be more difficult to pass in Congress. **As such, we are constructive on Brazilian assets, especially in the FX and local-currency bonds.**

Once the election risk is behind us, we believe that **Brazil fixed income** should perform well, due to a variety of factors, including:

- Relatively high carry on BRL and rates;
- Positive real rates, which is not the case for most other EMs;
- Brazil is probably the only EM country where we are seeing a peak in rates and in inflation;
- Inflation is expected to be in single digits in 2022 and converge to the CB target by 2023-24;
- CB has stopped hiking rates; and
- GDP growth has been unexpectedly robust in 2022 thus far.

Overall, **prospects are brighter for BRL and rates,** even though the market is pricing in around 300bp of rate cuts by end-2023. BRL has been one of the best performing EM FXs this year, but with a high carry – currently at 13.75% – it is still worth investing in. It could appreciate further, towards 5 against the USD, or even lower.

In **hard-currency bonds,** Brazil CDS around 300bp is probably at fair value. We see some opportunities in corporates.

On equities, we expect the **Brazilian equity market** to rise under any final election outcome, due to various factors. Firstly, we believe the fiscal situation – a key element of Brazil's financial stability – to be neither good nor catastrophic under either outcome. If Lula wins, he will probably not get enough support in Congress to pass all the social spending he wants to. Secondly, Brazil's CB began its tightening cycle one year before the Fed's and should be among the very first countries around the world to ease its monetary policy. This should help growth to resume. Valuations are also extremely cheap. Brazil is insulated from geopolitical turmoil, is self-sufficient energy-wise, and should benefit in the long run from its agro-power status.

However, Brazilian equities will probably rise more if Bolsonaro wins, as state-owned enterprises and banks would fare better. This is testified by Lula's statements. For instance, Lula's announced that he wants fuels produced by Petrobras to be sold at 'cost plus', instead of at international prices. At the sector level, we favour consumer discretionaries and corporates levered to declining long-term interest rates, such as infrastructure and real estate.

Finalised on 3 October 2022

THEMATIC

TLTRO in the context of ECB policy normalisation

Sergio BERTONCINI
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Most TLTRO redemption volumes are concentrated in June 2023

TLTRO repayments and redemptions will drive incoming ECB passive QT over the next few quarters. So far, banks have repaid a small amount of liquidity, while the ECB's recent decision on remuneration of excess reserves has helped keep current excess liquidity abundant, aiming at a smooth transmission of its monetary policy.

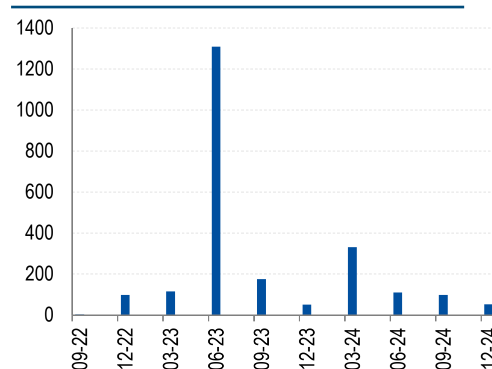
The role of TLTRO for Eurozone excess liquidity and scheduled redemptions

TLTRO borrowing played an important role in lifting the ECB balance sheet following the outbreak of the pandemic crisis, accounting for roughly 40% of the overall increase since February 2020, with QE, mainly through PEPP, making up the rest. Consistent with these trends, Eurozone excess liquidity increased by €2.8tn, corresponding to roughly 70% of the overall balance sheet expansion.

Before the pandemic, TLTROs outstanding amounted to some €600bn, mainly related to funding needs. Out of the following €1.6tn increase, roughly 25-30% was probably due to increased funding needs linked to lending activity, purchases of government bonds, and replacement of existing unsecured borrowing with TLTRO liquidity, while the remaining part appeared to be related to opportunistic borrowing. In this respect, the very attractive conditions attached to the new operations have helped mitigate the cost of negative rates in an environment of rising excess reserves.

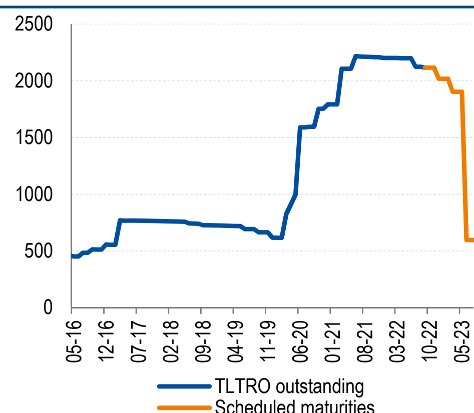
TLTRO repayments and redemptions will drive incoming ECB passive QT over the next few quarters. The maturity schedule shown in the chart below sees the largest **volumes in June 2023. Before this, early TLTRO repayments will be a key driver of Eurozone excess liquidity.** The right-hand chart below shows the resulting trend in the outstanding TLTRO amount without any meaningful prepayment compared to the scheduled timeline. The first date when banks decided whether to partly repay their liquidity was June 2022. After this date, the option for early repayment is on a quarterly basis. In June, banks repaid a very small amount of liquidity, around €75bn, as the rapid change in the ECB monetary policy stance and the ongoing rate normalisation increased the incentive to keep outstanding volumes stable. The trend in expected repayments changed significantly also in the ECB's surveys of Eurozone banks. In this respect, rising uncertainty surrounding the economic outlook and the higher fragmentation risk led some financial intermediaries to refrain initially from early repayments and to postpone their payback. Then the July front-loaded ECB rate hike and the acceleration in the expected rate hiking cycle reduced even more the banks' willingness to go through with early repayments.

1/TLTRO III: amount by maturity date, in € bn



Source: Bloomberg, Amundi Institute.
Data as of 30 September 2022.

2/ECB TLTRO : outstanding volume scenario with no prepayments, in € bn



Source: Bloomberg, Amundi Institute.
Data as of 30 September 2022.

Abundant excess liquidity in an environment of front-loaded rate hikes

Unlike previous hiking cycles, the current one not only appears aggressive in terms of front-loaded rate rises but is also taking place within a context of abundant liquidity surplus and a swift raise of rates into positive territory from a multi-year negative environment. As such, after having kept the deposit rate negative for eight years, the ECB finally brought it back to zero in July and then raised it into full positive territory by increasing policy rates by 75bp in September.

THEMATIC

The recent ECB decision on remuneration of excess liquidity likely aims at reducing risks to monetary policy transmission in the front-end segment

In terms of monetary policy implementation, the return of the deposit rate into positive territory has important potential implications on the transmission of monetary policy, depending on how the ECB will manage the remuneration of banks excess reserves first, and then of other deposits at the Eurosystem level, such as government deposits. Not only bank excess liquidity increased considerably through TLTRO, but also government deposits, which have more than doubled compared to pre-pandemic levels and were above €500bn recently. In the current context of collateral scarcity and huge excess liquidity being redeposited at the ECB, the reduction in reserve remuneration could have important implications on front-end bonds and repo rates. The demand for yield could indeed lead banks – and governments, as well – to invest at least part of their large amounts of extra cash in money-market instruments, fuelling richening pressures in a context of policy rates normalisation, likely impacting short-term asset swap spreads (ASW) that had already moved higher in previous months.

Latest ECB decision on remuneration of excess reserves addressing current environment

At its September meeting – at which it at last raised its deposit rate broadly into positive territory at 75bp – the ECB decided to suspend its two-tier system remuneration system by reducing the multiplier to zero but did not change the remuneration of excess banking reserves. This is important in light of the guidance on future hikes to be expected over the next few meetings and implies that the entire amount of the excess reserves held both at the ECB deposit facility and in CB current accounts will be remunerated at the deposit rate. The statement was as follows: ***"Following the raising of the deposit facility rate to above zero, the two-tier system for the remuneration of excess reserves is no longer necessary. The Governing Council therefore decided today to suspend the two-tier system by setting the multiplier to zero."*** At the same meeting, the ECB reiterated previous messages on refinancing operations, namely that: ***"The Governing Council will continue to monitor bank funding conditions and ensure that the maturing of operations under the third series of targeted longer-term refinancing operations (TLTRO III) does not hamper the smooth transmission of its monetary policy."*** Following these statements, and as hinted to at President's Lagarde press conference, a review is likely to be conducted soon, including on TLTRO terms and conditions. The decision to suspend tiering appears to reduce the probability of some form of reverse-tiering to lower the remuneration of excess reserves at this stage. Removing some of the uncertainty on the short-term horizon, this decision helped limit the repayment of TLTRO borrowing at end-September, ultimately supporting the current liquidity environment. In our view, this decision may aim at reducing risks to monetary policy transmission in the front-end segment, providing some relief to the repo market, which had richened with a sharp widening of short-term ASWs. As such, the ECB's latest decision looks consistent with the upcoming Q4 seasonality for liquidity in the current context of collateral scarcity.

Finalised on 3 October 2022

THEMATIC

Too early for a Fed pivot

The flattening of the US yield curve will depend on the persistence of core inflation and on the impact of monetary tightening on growth. The more resilient the US economy proves to interest-rate hikes, the more aggressively the Fed will have to tighten monetary policy, thereby increasing the risk of recession. We have gone from ‘bad news is good news’ to ‘good news is bad news’.

Valentine AINOUZ,
Deputy Head of Developed Markets Research, Amundi Institute

Delphine GEORGES,
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For the Fed it is still all about inflation. The Fed remains much more concerned about the risk of inflation expectations becoming unanchored than about downside risks to growth. The Fed is determined to act to bring inflation back to target:

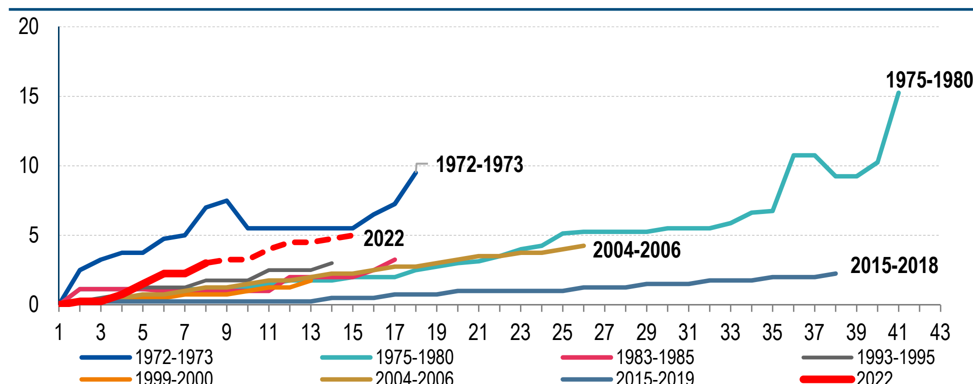
- **The committee sees resilient underlying growth and persistent inflationary pressures.** According to the Fed, “this is a strong, robust economy.” Despite the growth slowdown, the labour market has proved tight, with the unemployment rate near a 50-year low, job vacancies close to historic highs, and wage growth elevated. Inflation is running hot. At their September meeting, FOMC members revised up their median core inflation forecast for 2022 and 2023 by 0.2pp to 4.5% and by 0.4pp to 3.1%, respectively. They left their 2024 forecast unchanged at 2.3%.
- **The committee sees a higher terminal rate and a longer hiking cycle** and warned that “restoring price stability will likely require maintaining a restrictive policy stance for some time.” As such, no rate cuts are foreseen before 2024. The median dot now shows a Fed Funds target mid-point at 4.375% at end-2022 and 4.625% at end-2023. Almost a third of the committee members see a peak target range of 4.75-5.0% in 2023 as appropriate.
- **The Fed wants to continue its restrictive monetary policy.** Restrictive territory means positive real rates across the curve, which seems consistent with the Fed’s new willingness to push Fed Funds rates above 4.5% in 2023. “Restrictive means that you will have a positive real Fed Funds rate adjusted for short-term inflation expectations which could be 1 percent or so… it would be significantly positive”.
- **Jerome Powell is willing to risk a recession in order to bring inflation back down to 2.0%.** Indeed, “the chances of a soft landing are likely to diminish to the extent that policy needs to be more restrictive or restrictive for longer”. The true policy mistake would be to fail to restore price stability, Powell said, but reducing inflation will require “a sustained period of below-trend growth” as well as weaker labour markets, which will cause “some pain” for households and firms. A soft landing scenario implies a rebalancing of supply and demand on the labour market, which does not require an excessive slowdown in economic growth. The soft landing scenario would mean inflation expectations remaining anchored, and a greater supply of labour. “It’s plausible that job openings could come down significantly, and they need to, without as much of an increase in unemployment as has happened in earlier historical episodes”.

The market expects the Fed to stop hiking rates at 4.5% in early 2023. However, we see upward pressure on this terminal rate assumption, as US core inflation has accelerated further, boosted by a very strong labour market. The US economy is also supported by (1) the recent decline in oil prices, (2) past fiscal policy responses to Covid-19, (3) the past decade of historical low rates, and (4) stricter requirements for granting mortgages after the Lehman crisis.

- **The US labour market is extremely tight.** The impact of rate hikes on the unemployment rate will be mitigated by the labour shortage. The labour market is clearly out of balance, with demand for workers substantially exceeding the supply of available workers. The gap between available jobs and workers stands at 5.2mn workers, down from a peak of 5.9mn,

We expect the Fed to take further aggressive steps to cool down inflation. “We will keep at it until we are confident the job is done.”

1/ **This is the fastest rate hiking cycle since the early 1980s (Change in Federal Funds Rate since hiking began in %)**



Source: Bloomberg, Amundi Institute. Data as of 30 September 2022.

THEMATIC

A soft landing scenario implies a rebalancing of supply and demand on the labour market, which does not require an excessive slowdown in economic growth

We are moving from "bad news is good news" to "good news is bad news"

but still close to the most overheated level in post-war history. Indeed, early retirement and the aging of the population have shrunk the workforce, while the share of population over 55 has increased. Moreover, people in their early twenties are 3% less likely to be in the workforce now than they were when the pandemic began. Employment levels remain well below pre-Covid-19 levels in the leisure & hospitality, healthcare, and government sectors.

- **The US housing downturn is nothing like the one in 2008.** The housing market has cooled in recent months, as US mortgage rates have climbed to 6.7%, their highest level in 15 years. The housing affordability index has dropped to its lowest rate since 1989. New home sales and prices have begun to decline. However, the impact of the doubling of mortgage rates will be partly offset by:
  - **Low inventories.** The United States has been underbuilding housing over the past decade. The lack of new and available residences has been amplified by delays caused by the Covid-19 crisis. The inventory of newly finished homes is 40% below pre-pandemic levels.
  - **Solid US household balance sheets and accumulated savings.**
  - **High credit quality.** Over the past decade, mortgages have been granted only to households with high credit scores.
- **A decade of low interest rates helped lower the average cost and increase the duration of corporate debt.** The recent rate hike will take some time to negatively impact the average cost of corporate debt. We need to monitor access to the financial bond market.

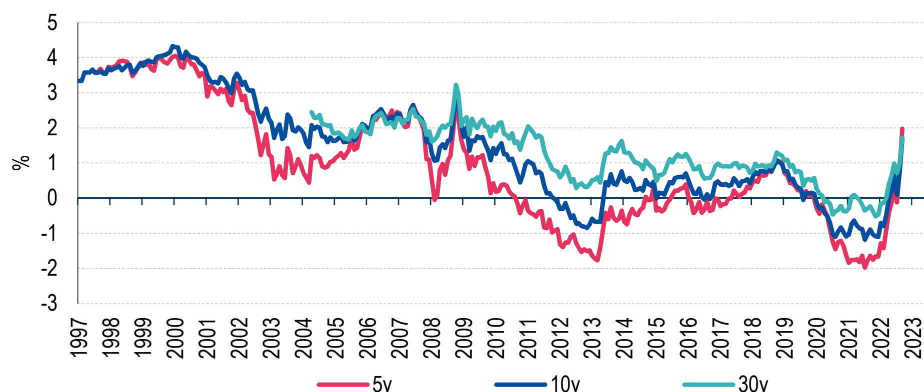
The flattening of the US yield curve will depend on the persistence of underlying inflation and on the coming impact of monetary tightening on growth. We have moved from 'bad news is good news' to 'good news is bad news'. The Fed is committed to hiking aggressively amidst sustained inflationary pressures and resilient growth. Its firm rhetoric "to keep at it until the job is done" and its willingness to accept recession risks argue for flatter curves. The two-ten yield curve at -40bp has now reached its peak inversion of the last three cycles.

Nevertheless, we see room for further inversion:

- The two-year yield will remain under upward pressure until we have more visibility on the terminal rate which could continue to drift higher until the economy reaches these three challenging outcomes: 1) much slower growth, 2) labour market showing better supply-demand balance, and 3) clear evidence that inflation is moving back to 2%. In light of the resilience of the US economy, the persistence of inflation and the Fed's willingness to go into highly restrictive territory, our base case is now for a Fed Funds terminal rate at 5%, above current market expectations of 4.5%. Nevertheless, we see further upside risks to this level.
- On the other hand, the Fed is engineering the fastest tightening cycle in history, financing conditions are tightening sharply, and the growth outlook is weaker for 2023, which will at some point put downward pressure on long-term yields.

Finalised on 6 October 2022

2/ US real yields surge (in %)



Source: Bloomberg, Amundi Institute. Data as of 30 September 2022.

CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We maintain the content and probabilities of our scenarios. Note that some of the risk factors we identify may occur in our central scenario, which is probably not yet fully priced-in by markets. It would take a combination of risk factors for the downside scenario to materialise. The downside is counterbalanced by an upside scenario, that of a rapid decline in inflation due to an easing of gas prices and/or to the combined tightening of global monetary policies, the impact of which can be underestimated.

DOWNSIDE SCENARIO 15%

Deep global slump

Analysis

- Worsening/expanding **war in Ukraine**
- Energy crisis and **deep recession in Europe**
- **Covid-19 resurgence**
- **De-anchoring of inflation expectations,** disorderly adjustments by CBs
- **Recession in China**
- **Global economic downturn** with, in a second stage, renewed deflationary pressures
- **Global financial crisis/debt crisis with several EM defaults**
- **Governments fail to implement countercyclical fiscal policies.** Decisive action on financial repression
- **Climate transition measures postponed**

Market implications

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

CENTRAL SCENARIO 70%

A stagflationary episode, with rising divergences

Analysis

- **Stalemate in the war in Ukraine**
- **Confidence shock in EU,** due to high energy prices
- **Covid-19** is an endemic disease
- **Inflation fails** to return to CB targets by 2024
- Global **nominal GDP growth to trend higher,** mitigating the impact on earnings
- **Growth divergences:** recession in the EZ/ UK, sluggish rebound in China, sub-par growth expected in the US (well below potential in 2023)
- **CBs divergences:** Fed to continue its tightening cycle but adopting a dovish stance (end of Q4); BoE on a soft hiking cycle; ECB to raise rates, and activate the TPI; PBoC in easing bias
- **Divergent fiscal policies:** mild expansion in the EU; restrictive in the US in 2022-23
- **Climate change** disrupts the commodity cycle and adds to stagflationary trends

Market implications

- Lower risk-adjusted real returns expected.
- Contained steepening of US Treasuries yield curve as well as EZ and EM
- Inflation hedge via gold, linkers, equities, real assets and commodities
- EM: short-term caution, long-term real income and growth story intact

UPSIDE SCENARIO 15%

Inflation falls back quickly, ending the stagflationary episode

Analysis

- **Ukraine war** ends and **sanctions** are withdrawn gradually.
- **Russia maintains gas supplies,** commodity market normalises
- **Covid-19** recedes
- **Inflation falls back quickly,** supply bottlenecks ease
- **Recession fears dissipate** and inflation remains under control which eases the pressure on CBs
- **Lower uncertainty,** extra savings and renewed purchasing power can fuel consumption and investment in DM without erosion of corporate margins
- **Fiscal discipline** gradually restored
- **Climate change** policies and energy transitions become first priority

Market implications

- US Treasuries curves bear steepen
- Favour risky assets with cyclical and value exposure
- Favour linkers and equities as an inflation hedge

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

TOP RISKS

Monthly update

We keep the same probabilities for the three families of risks. We see risks growing on all fronts, closely linked to each other. Economic fundamentals are deteriorating globally (which is reflected in the central scenario). The course of the war in Ukraine and its potential implications can tip the scenario in either direction. We consider Covid-related risks (including lockdowns in China) as part of the economic risks.
Risks are clustered to ease the detection of hedging strategies, but they are obviously related.

ECONOMIC RISK 30%

- **Global recession** driven by an oil/gas shock, a tightening of monetary conditions, and a loss of purchasing power.
- **The *weaponisation* of gas supply** by Russians could cause a s**evere energy crisis in Europe,** leading to a **deep recession** (confidence shock).
- **Economic crisis in Eastern Europe** following a collapse of the Russian economy, elevated energy prices, uncontrolled inflation, and a migrant crisis.
- **Disordered adjustments by CB,** which underestimate supply-driven inflation and lose control.
- **Global profit recession t**riggered by the global slowdown, coupled with persistent input-cost pressures (margin compression).
- **Recession in China.** Zero Covid-19 policy combined with a housing crisis spiraling out of control.
- **End of the great coincidence:** with the persistence of stagflationary pressure, CB and governments' objectives are no longer fully aligned: the room for countercyclical fiscal policies is reduced.
- **Pandemic:**
  - Risk of a more dangerous and vaccine-resistant variant.
  - New lockdowns or mobility restrictions.
- **Climate change-related natural events** hurt growth visibility and social balance.

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

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

FINANCIAL RISK 30%

- **Sovereign debt crisis:**
  - An extended war in Ukraine would hurt DM vulnerable public finances with public debt ratios already at historic highs.
  - De-anchoring inflation expectations could lead to harsher monetary tightening and to a bond market dislocation.
  - Most countries are vulnerable to rating downgrades and rising interest rates.
  - Weak EM could face a balance-of-payment crisis and increased default risks.
- **Corporate solvency risk increases,** amid deteriorating fundamentals, rising uncertainty, and corporate margins under pressure (high input cost, double orders lead to profit warnings).
- **Widespread greenwashing and ESG investment bubble undermine the energy transition funding.**
- **USD overshooting** leads to unstable currency markets.
- **Currency wars:** currency appreciation is a way for CB to fight inflationary pressures.

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

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

(GEO)POLITICAL RISK 30%

- **Ukraine war:**
  - Prolonged military struggle leading to high-intensity conflict and potentially to a Western military confrontation.
  - The Russians are losing ground militarily, which increases the risk of Russia using tactical nuclear weapons.
  - High risk of accident at the nuclear facilities in Ukraine.
  - [That said, it is also possible that in the coming months the situation will calm down, paving the way for a resolution/ceasefire].
- **EU political fragmentation** or populist vote bring disagreement on how to manage the relationship with Russia.
- **The United States takes a hard line with China** in order to block any attempt to occupy Taiwan. Risk of accidental confrontations in the South China Sea or the Taiwan Strait.
- **EM political instability driven** by higher food and energy prices, leading to a wave of social unrest.
- Iran or Korea nuclear programmes renewed concerns and sanctions.
- **On a global scale, increasing risks of setting back the energy transition once again. Global warming** leads to increased risk of conflicts, driven by water shortages and migration movements.
- **Cyber-attack or data compromise,** disrupting IT systems in security, energy, and health services.

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

- **Credit and equity, EMBI.**

CROSS ASSET DISPATCH: detecting markets turning points

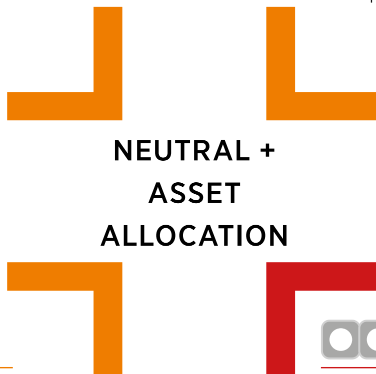
The turning point has occurred | Approaching the turning point | Not reached yet too early to call it

ECONOMIC BACKDROP

- Economic momentum is slowing amid persistently high inflationary pressures and weakening domestic demand. While we still expect a soft landing for the US economy, recession risks remain for mid-2023, as a policy mistake remains a key risk. On the European front, we expect a cost-of-living and inflation-driven recession during winter, which we now expect to be deeper than previously expected and followed by a shallow recovery.
- Direction of revisions on the inflation and growth outlook diverge amid stagflationary momentum.
- The prolonged stress on the geopolitical front and the tug of war between fiscal and monetary policy makes the final economic outcome uncertain, exacerbating data volatility.

FUNDAMENTALS & VALUATION

- Current wild sell-off cleaned up the overvaluation built up after the summer rally. Still difficult to see entry levels in the near term.
- Stock multiples looks more in line with the current inflationary environment and tight monetary policy, but are not discounting recession yet, as EPS expectations remain optimistic.
- Fundamentals are worsening compared to September, as stagflation should sound an alert for corporate profitability.



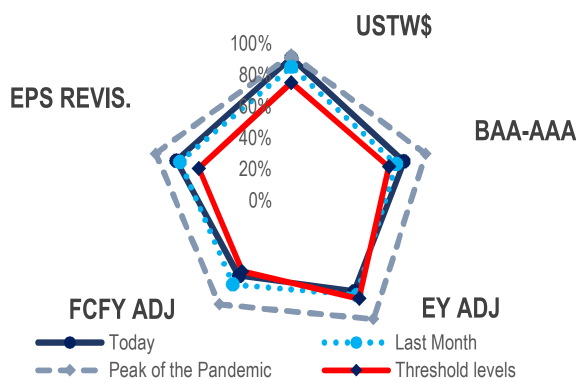
TECHNICALS

- Technicals highlight a fragile picture across the multi-asset universe. Asset trends are highly fragmented, failing to open for continued breaths in the market. Equities, government bonds, and credit remain unattractive from a trend-following perspective, yet contrarian metrics prevent aggressive de-risking and, from time to time, are triggers for sharp short-squeezes.

SENTIMENT

- Risk sentiment deteriorated strongly in September, with all our three models in deep risk-off. Financial conditions tightened everywhere following the worse-than-expected September US CPI, while the USD and risk-concentration metrics keep fuelling into higher risk-off probability in our CAST and MoMo models, respectively. All in all, the risk-sentiment pillar keeps suggesting that a defensive asset allocation may be required in the short-term.

Cross Asset Sentinels Thresholds (CAST) still supportive



Source: Amundi Institute. Data as of 30 September 2022.

The CAST risk perception failed to show a structural increase in Q1, but has turned less favourable since Q2. EPS revisions have turned negative in response to recession fears and the USD calls loudly for risk-off. Credit risk premium remains high and above alert, calling for a defensive stance across risky assets.

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

GLOBAL RESEARCH CLIPS

1 US inflation proved strong, but has probably peaked; Fed to stay hawkish

- US August CPI data surprised on the upside. It may have peaked, and we expect US headline inflation to slow from its 9% high to the 7.5-7.0% range in Q4 2022, but momentum will stay strong in the near term.
- Should the next couple of readings show stronger resilience of core inflation than we expect, then the Fed may adopt an even tighter approach to avoid an inflation resurgence later on, thus increasing the risk of overtightening.
- Against such a backdrop, the Fed will keep its hawkish stance to cool down inflation. We expect it to keep hiking rates aggressively, with a terminal Fed Funds rate seen at 5.0% in March 2023.
- We have raised our US two-year Treasury yield forecast to 4.3-4.5% over a 12-month horizon and our 10-year yield forecast to 3.9-4.1%.

Investment consequences

- Stay cautious on equities.
- Underweight US 10-year inflation-linked bonds and Eurozone nominal bonds.
- Neutral on US breakevens.
- Favour IG over HY credit.

2 Eurozone to enter a recession in late 2022 amid a hawkish ECB

- Our baseline scenario for natural gas prices poses downside risks to the contraction expected in Q3 2022-Q1 2023 and to the recovery foreseen beginning in Q2 2023, making it shallower. We have cut our 2023 real GDP growth forecast to -0.5%.
- The impact of measures put in place by national governments to offset the energy crisis will be limited by tight monetary policy. Fiscal support is unlikely to offset the shock fully.
- With no regulation changes, Eurozone inflation should pick up during the fall-winter season, with the peak still to be reached.
- Consequently, the ECB has turned very hawkish. We expect further rate hikes, with the terminal deposit rate at 2.75% by May 2023 amid discussions of quantitative tightening.
- Sovereign core bond yields should rise further. We have raised our two-year Bund yield target to 1.8-2.0% over a 12-month horizon and our 10-year yield target to 2.3-2.5%.

Investment consequences

- Stay cautious on Eurozone assets; on equities and credit, we prefer the United States to the Eurozone.
- We are cautious on sovereign core bonds.
- On the forex market, we believe the USD could appreciate further against the EUR, possibly to 0.94 in the short term.

3 Italy election outcome is mildly positive for markets

- The centre-right coalition won with some 44% of votes. It will have enough seats to form a stable government but not enough to vote for constitutional amendments, which require a two-thirds majority.
- Italy's new prime minister should be Brothers of Italy's leader Giorgia Meloni. Mario Draghi's caretaker government will address some of the work on the budget law.
- The new government may make adjustments to public finance figures and try to negotiate a revision to the NRRP. It is likely to stick to EU fiscal targets and avoid clashes with EU institutions on economic policy.
- The recent widening in spreads looks to be driven by external factors, such as the strong repricing of ECB terminal rates and the rise in core yields. Technicals have improved and could help offset the hawkish ECB stance.
- On equities, we expect some short-term relief. To see a structural rally, we need more clarity on government appointments, on the approval of the 2023 budget law, and on possible changes to the NGEU plan.

Investment consequences

- Stay cautious on Italian debt, as volatility may stay high.
- In Italian equities, focus on companies that have visibility on future growth, along with some protection from strong inflation, and keep a balanced exposure to sectors.

4 FX market: risk of technical short squeeze rally and high volatility

- The USD is a long position that both speculative and institutional investors have held since mid-2021.
- USD longs are widespread, while EUR, GBP, and JPY are at their lowest levels in two to five years, yet we are still far from historic lows.
- Despite the stretched positioning on G4 FX, we should not factor in yet a shift in the strategic view.

Investment consequences

- Exploit any rebound of short-positioning currencies to add to USD long positions, especially against EUR, GBP, CAD, SEK, and NZD.
- JPY is the only currency that we would not short and where we see upside risks by end-2022.
- CNY could depreciate further, as moderating China export growth, negative interest rate differentials against the United States, and Taiwan tensions could outweigh positive factors, including expected positive growth differentials and stabilising portfolio flows.

AMUNDI ASSET CLASS VIEWS

Platform	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=/+		The main themes remain how far the Fed is willing hike rates and how earnings would be affected by slowing growth. We think strong consumer demand, tight labour markets, and improving consumer surveys indicate support for corporate earnings. We stay selective and look for businesses that reward shareholders through dividends, share buybacks, etc.
	US value	+		The upcoming growth deceleration underscores the need to complement value with less-cyclical names that display quality characteristics and sustainable margins. On the other hand, investors should avoid segments where valuations do not justify the earnings potential, such as those in expensive growth sectors.
	US growth	-		In an environment of rising rates and the effects on cost of capital, stocks whose valuations depend more on cash flows way into the future would be more affected. In addition, current valuations in some segments are not justified by fundamentals. Thus, we stay cautious but are observing areas such as quality growth where prices look reasonable.
	Europe	--		Recession uncertainty and geopolitics lead us to stay cautious on Europe amid a rising cost of living. Given that Europe is a cyclical market, a global downturn is negative for European earnings. However, when the slowdown ends, the region should be among the first ones to benefit. We remain focused on long term-earnings resilience and balance sheet strength.
	Japan	=		We are neutral on Japan in light of slowing global growth (and thus potential impacts on exports) and relatively attractive valuations of the Japanese markets.
	China	=	▼	While monetary and fiscal policies are accommodative, problems in the housing sector and the sporadic Covid lockdowns are affecting household incomes and spending. Long-term drivers in the form of balanced, high-quality growth are in place.
	Emerging markets-ex China	=		The EM investment space is affected by a combination of domestic, idiosyncratic stories, coupled with global headwinds and geopolitical tensions. Thus, on the one hand, we like commodity exporters, such as UAE, Brazil, but on the other, we are cautious on countries such as Thailand, Taiwan and Tukey. We keep a selective stance overall.
FIXED INCOME PLATFORM	US govies	=		The Fed downgraded its economic growth outlook recently but reiterated its intent to tame inflation by hiking rates. This, coupled with attractive yield levels, leads us to believe bonds can offer protection. We stay neutral on duration, with a positive bias and an agile stance. Given the recent surge in real yields, we are also monitoring TIPS for entry points,
	US IG corporate	=/+		Robust corporate and consumer balance sheets, attractive carry and valuations encourage us to prefer US IG over other weaker credit. But we identify selective names that can withstand the risks of a 'hard landing' and show earnings resilience.
	US HY corporate	-	▼	The default picture looks contained for now but we are watchful of spreads, given the Fed's willingness to raise rates to tame inflation that could eventually affect the liquidity situation for companies with weak cash flow generation. Thus, we stay cautious and aim to balance yield with liquidity and fundamentals.
	European govies	=		Despite the ECB's commitment to bringing prices under control, economic pressures in Europe may limit how far the bank can go with its rate hikes. We stay neutral on core Europe for now while maintaining a flexible view and looking for opportunities across geographies and curves. On peripheral debt, we are mindful of fragmentation and political risks.
	Euro IG corporate	=		Recent spread widening seems to be an indication of a hawkish ECB, coupled with high inflation and growth concerns, although corporate fundamentals remain robust. We avoid over-leveraged areas and are instead looking for quality assets in an overall neutral approach in European credit.
	Euro HY corporate	-	▼	We notice a mild deterioration in financial conditions which could eventually lead to higher financing costs, especially for lower-rated issuers. Thus, we are monitoring liquidity, the cash flow situation & default outlook in an overall cautious stance.
	China govies	=/+		China is one of the few countries where policy is turning accommodative. This, coupled with the diversification benefit of Chinese debt for global investors, and a potential relaxation of lockdown policy in future, allow us to stay slightly positive.
	EM bonds HC	=/+		Tightening policy rates in DM are putting pressures on EM debt, but the region shows huge divergences. We see value in HY over IG, as the former may provide a cushion from Fed rate hikes. We like commodity exporters in Latin America (Mexico, Brazil) and in the MENA region (Bahrain), but are very active in adjusting this stance.
	EM bonds LC	=		While the situation is improving, it still calls for a slightly cautious/neutral stance. We are selective, with a preference for high carry countries (South African, Brazil). EM FX will remain under pressure short term owing to a strengthening USD.
OTHER	Commodities			Decelerating global growth and its resulting impact on demand, including in China, is not supportive for cyclical commodities and oil. We downgraded our 3M target for WTI to $90/bbl, but long-term supply-side issues remain. Rising real rates due to a hawkish Fed increase the opportunity cost of holding gold, putting pressures on its prices in the near term.
	Currencies			Sticky US core inflation means it is still early for the Fed to tilt towards a dovish pivot and for the USD to be dethroned. We expect the dollar to touch new highs within the next six months.

LEGEND

--- -- - Negative | = Neutral | + ++ +++ Positive | ▼ Downgrade vs previous month | ▲ Upgraded vs previous month

Source: Amundi, as of 3 October 2022, 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 30/09/2022

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2021	2022	2023	2021	2022	2023
World	6.2	3.2	2.5	3.9	8.0	5.3
Developed countries	5.2	2.3	0.5	3.2	7.2	4.3
US	5.8	1.6	0.9	4.7	8.0	3.8
Japan	1.7	1.6	0.5	-0.2	1.9	0.3
UK	7.4	3.4	-0.5	2.6	9.1	7.6
Eurozone	5.2	2.9	-0.5	2.6	8.4	6.3
Germany	2.6	1.5	-0.7	3.2	8.6	6.1
France	6.8	2.5	0.0	2.1	6.0	4.6
Italy	6.6	3.2	-0.5	1.9	7.9	5.6
Spain	5.1	4.5	0.3	3.1	9.5	5.3

Source: Amundi Institute

- **United States: Growth.** We are still calling a soft landing in the US, with an extended period of sub-par growth for 2023 and 2024. We expect the US economy to grow by 0.9% in 2023 (1.1% Q4/Q4) and 1.3% in 2024 (1.3% Q4/Q4). **Inflation.** Headline inflation has peaked in the US and is now set to slow progressively as the economy runs below potential. Core inflation will peak slightly later, between Q3 and Q4 22, and then gradually decline, although remaining above target. The Fed will stick to its tightening cycle until current and leading inflation indicators point clearly in the desired direction.
- **Eurozone: Growth.** We now see a somewhat deeper recession in autumn-winter 22-23, followed by a shallower recovery than before. We expect the Eurozone economy to contract by -0.5% in 2023 and to slowly recover to 1.3% in 2024. **Inflation.** We confirm our call for inflation to peak little below 10% in Q4 22 and to decelerate towards 4% by Q4 23. The outlook remains highly uncertain as highlighted by recent geopolitical events related to gas supply and gas prices. The ECB remains is in a tough position, needing to calibrate policy tightening in a stagflationary context.
- **United Kingdom: Growth.** We still see a mild recession for the UK. We expect the economy to contract to around -0.5% in 2023 and then to recover, growing by 1.3% in 2024. **Inflation.** We have lowered our peak inflation projections for 2022 and 2023, but raised our core inflation forecast for 2024, as we expect the new budget to produce more persistent inflationary pressures in the medium term. The recently announced fiscal package will stimulate demand in a supply-constrained economy, putting a floor on growth but also supporting inflationary pressures, likely forcing the BoE to bolder actions.
- **Japan:** the government relaxed inbound travel further in September. Mainland Chinese – who accounted for 30% of visitors to Japan before the pandemic – will still be missing. Nevertheless, the reopening of the borders, along with resumed domestic travel subsidies and an ultra-weak yen, will lend support to services consumption in the coming months. Household inflation expectations remain at a historic high. We expect core inflation to climb further, and overshoot the BoJ's 2% target in Q4 2022-Q1 2023. The BoJ is likely to downplay this overshoot and repeat that it is not sustainable.

Key interest rate outlook

	06-10 2022	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
US	3.13	5.00	4.50	5.00	4.50
Eurozone	0.75	2.50	2.64	2.75	2.98
Japan	0.00	-0.1	0.02	-0.1	0.09
UK	2.25	4.5	5.5	4.75	5.7

Source: Amundi Institute

- **Fed:** as widely expected, the FOMC delivered in September a third consecutive 75 bps hike, bringing the Fed Funds rate to 3.25%. The incremental hawkishness came via the Summary of Economic Projections, which showed a surprisingly sharp increase in Fed funds rate projections. Indeed, the FOMC is committed to hiking aggressively amidst sustained inflationary pressures from an economy that is being supported by a very resilient and robust labour market. In light of the resilience of the US economy, persistent inflation and the Fed's willingness to go into highly restrictive territory, we now see a high probability that Fed will hike rates until a terminal policy rate in the 4.75% to 5% range.
- **ECB:** at its September meeting, the ECB decided unanimously to hike its three key interest rates by 75bp. The decision was driven by concerns about the risk of inflation expectations getting de-anchored. Given very high inflation, we expect the ECB to maintain a hawkish stance in the coming months, as the central bank is determined to front-load rate hikes and normalise policy rates rapidly. The ECB baseline scenario is for stagnation in Q4 2022/Q1 2023 rather than for a recession. We expect the ECB to keep a hawkish stance and raise rates further at its next meetings.
- **BoJ:** the BoJ left its policies and forward guidance unchanged in September, resisting pressure from aggressive tightening overseas and a sharply depreciating yen. Shortly thereafter, the MoF spent 2.8 trillion yen intervening on the FX market. The BoJ continued to buy JGBs after the FX intervention, sending a strong signal to markets that it wants to defend the YCC and its ultra-loose monetary policy stance. We don't expect any change in the foreseeable future, as the BoJ appears to be buying time, waiting for US rates to peak and reduce the policy gap for it automatically.
- **BoE:** no hawkish surprise came from the last BoE meeting, as markets had implied the significant probability of a higher 75bps hike than the 50bp delivered. At the same time, the MPC unanimously backed the launch of its QT. However, the stronger-than-expected fiscal package announced after the meeting means that the central bank will be forced to react with hikes that are stronger than previously expected, ultimately leading to a higher terminal rate. At the same time the, BoE intervened announcing temporary long-end gilt buying operations in order to stabilise the market.

Monetary policy agenda

Central banks	Next meeting
ECB Governing Council	**27 October**
Bank of Japan MPM	**28 October**
Federal Reserve FOMC	**2 November**
Bank of England MPC	**3 November**

Source: Amundi Institute

EMERGING COUNTRIES

Macroeconomic outlook

Data as of 30/09/2022

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2021	2022	2023	2021	2022	2023
World	6.2	3.2	2.5	3.9	8.0	5.3
Emerging countries	6.9	3.8	3.8	4.4	8.6	5.9
China	8.1	2.9	5.2	0.9	2.2	2.3
Brazil	4.6	3.1	1.4	8.3	9.4	4.6
Mexico	4.8	2.3	0.7	5.7	8.0	5.9
Russia	4.7	-3.3	-1.5	6.7	13.9	7.5
India	9.1	7.3	5.7	5.1	6.8	6.1
Indonesia	3.7	5.2	4.5	1.6	4.5	5.5
South Africa	5.5	1.7	1.1	4.6	6.9	5.8
Turkey	11.9	5.3	3.0	19.4	71.7	30.6

Source: Amundi Institute

- **China:** high-frequency data, including housing sales and mobility, improved towards the end of September, thanks to the partial relaxation of Covid restrictions. We expect the restrictions to remain tight in October, as local governments are doubling down on measures before the 20th Party Congress (16-22 October). But most of this extra tightening will likely be reversed in November, paving the way for a soft recovery beyond that. CPI has stayed subdued below 3%, as pork and energy prices plateaued, and the repeated disruptions in services sector from Covid controls have contained underlying inflation.
- **Indonesia:** in September, the BI hiked its rates by 50bps (vs. consensus and our expectations at 25bps). While the surprise was on the size of the hike, it's fair to highlight that the headline inflation figure for September, at 5.9% YoY from 4.7% YoY, has proven to incorporate the subsidies reduction implemented in early September. Based on these measures, we expect inflation to trend higher in Q4 2023, more around 7.0%, calling for further hiking by the BI and at the margin higher than what we were expecting before: 100bps in the pipeline with some easing possibly by the end of next year.
- **CEE4:** the inflationary effects of the energy crisis have started to affect growth and are expected to intensify. These countries will find it difficult to escape at least a technical recession. Moreover, those countries most economically and/or politically vulnerable vis-à-vis Europe and the availability of European funds (i.e., Hungary and Poland) are facing and will continue to face, major pressures on their currencies, which will penalise them further. Even though CBs have reached, or are closed to, the end of their hiking cycle, we cannot expect any rate cut soon, given the high level of inflation, uncertainties on inflation expectations, and the tightening of the main CBs, i.e., the Fed and the ECB.
- **Turkey:** while inflation is reaching peaks (nearly 85% YoY) and most central banks are tightening their monetary policies, the CBRT again lowered its rate by 100bps to 12%, causing the currency to fall again. We think that the CBRT could go even further, as it doesn't seem to be much concerned by the TRY depreciation, 20TRY/USD will likely mark a threshold to stop easing. While expectations are for a recession in the Eurozone, Turkey may grow by 3% YoY in 2023 thanks to credit growth and extra-loose fiscal policy, especially ahead of next elections.

Key interest rate outlook

	06-10 2022	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
China	3.65	3.65	3.65	3.65	3.65
India	5.90	6.15	6.20	6.15	6.15
Brazil	13.75	13	13.75	10.50	12.20
Russia	7.50	7.00	7.40	6.50	7.25

Source: Amundi Institute

- **PBoC (China):** the PBoC kept policy rates unchanged in September after the surprising cuts of the previous month. It stepped up support to the faltering housing sector, reducing the mortgage rate for the housing provident fund by 15bps for first-home buyers and allowing banks in qualified regions to reduce mortgage rate floors. With the zero-Covid policy and a slowing housing market weighing on the economy, we expect the central bank to continue with its accommodative monetary policy. Further rate cuts will depend on whether housing sales manage to stabilise.
- **RBI (India):** as expected, the RBI hiked again its policy rates by 50bp in September, to 5.9%. Since May 2022, the RBI has pursued its front-loading actions in order to keep inflation expectations under control as well as intervening to limit the INR's depreciation in reaction to deteriorating external conditions. Indeed, in Q2 2022, the current account deficit reached almost 3.0% of GDP. We expect inflation to remain above 6% until the end of Q1 2023 and then slowly moderate below the upper range band of 6.0%. RBI is expected to hike its rates by 25bps more, taking the repo rate to 6.15%.
- **BCB (Brazil):** 1st EM hiking finisher. While the Fed is still front-loading rate hikes to try to deflate the economy and the labour market, the BCB appears to be done now with its diesel hiking cycle that lasted for 1.5 years and raised rates by nearly 12pp to 13.75%. But the decision that brought about the end was far from a standard one. It was the first split decision (7-2) since 2016, while the statement was full of hawkish remarks. In fact, COPOM made it sound more like a pause by saying it would "not hesitate to resume the tightening cycle" if necessary and otherwise employ the wait-and-see strategy "for sufficiently long."
- **CBR (Russia):** the CBR cut its policy rate again by 50bp to 7.5% on 16 September. The magnitude of the cut was in line with market expectations. The main reasons for the cut were declining inflation and subdued consumer demand. CBR's message was rather balanced (less cutting bias), referring to risks from the potential direction of fiscal policy and the reaction of external markets. We expect another 50bp cut from the CBR over the next six months and possibly an additional 50bp after that, bringing the policy rate to around 6.5% over the twelve-month horizon.

Monetary policy agenda

Central banks	Next communication
PBoC	**20 October**
CBR	**28 October**
RBI	**5 December**
BCB Brazil	**7 December**

Source: Amundi Institute

Marketing material for the exclusive attention of professional clients, investment services providers and any other professional of the financial industry

MACRO AND MARKET FORECASTS

Macroeconomic forecasts

30 September 2022

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2021	2022	2023	2021	2022	2023
US	5.8	1.6	0.9	4.7	8.0	3.8
Japan	1.7	1.6	0.5	-0.2	1.9	0.3
Eurozone	5.2	2.9	-0.5	2.6	8.4	6.3
Germany	2.6	1.5	-0.7	3.2	8.6	6.1
France	6.8	2.5	0.0	2.1	6.0	4.6
Italy	6.6	3.2	-0.5	1.9	7.9	5.6
Spain	5.1	4.5	0.3	3.1	9.5	5.3
UK	7.4	3.4	-0.5	2.6	9.1	7.6
China	8.1	2.9	5.2	0.9	2.2	2.3
Brazil	4.6	3.1	1.4	8.3	9.4	4.6
Mexico	4.8	2.3	0.7	5.7	8.0	5.9
Russia	4.7	-3.3	-1.5	6.7	13.9	7.5
India	9.1	7.3	5.7	5.1	6.8	6.1
Indonesia	3.7	5.2	4.5	1.6	4.5	5.5
South Africa	5.5	1.7	1.1	4.6	6.9	5.8
Turkey	11.9	5.3	3.0	19.4	71.7	30.6
Developed countries	5.2	2.3	0.5	3.2	7.2	4.3
Emerging countries	6.9	3.8	3.8	4.4	8.6	5.9
World	6.2	3.2	2.5	3.9	8.0	5.3

Key interest rate outlook

Developed countries

	6 Oct 2022	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
US	3.13	5.00	4.50	5.00	4.50
Eurozone	0.75	2.50	2.64	2.75	2.98
Japan	0.00	-0.10	0.02	-0.1	0.09
UK	2.25	4.50	5.50	4.75	5.70

Emerging countries

	6 Oct 2022	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
China	3.65	3.65	3.65	3.65	3.65
India	5.90	6.15	6.20	6.15	6.15
Brazil	13.75	13.00	13.75	10.50	12.20
Russia	7.50	7.00	7.40	6.50	7.25

Long-term rates outlook

Two-year bond yields

	6 Oct 2022	Amundi +6M	Forward +6M	Amundi +12M	Forward +12M
US	4.19	4.50/4.70	4.23	4.30/4.50	4.20
Germany	1.78	1.8/2.00	1.85	1.80/2.00	1.73
Japan	-0.07	-0.10/0.00	-0.04	-0.10/0.00	-0.03
UK	4.13	3.9/4.10	4.34	3.9/4.10	4.50

Ten-year bond yields

	6 Oct 2022	Amundi +6M	Forward +6M	Amundi +12M	Forward +12M
US	3.80	4.00/4.20	3.80	3.90/4.10	3.80
Germany	2.08	2.30/2.50	2.11	2.30/2.50	2.12
Japan	0.25	0.10/0.30	0.33	0.10/0.30	0.41
UK	4.20	3.70/3.90	4.22	3.70/3.90	4.26

Currency outlook

	23 Sept 2022	Amundi Q1 2023	Consensus Q1 2023	Amundi Q3 2023	Consensus Q3 2023
EUR/USD	0.97	0.92	1.02	1.02	1.05
USD/JPY	143	137	134	127	130
EUR/GBP	0.89	0.90	0.86	0.89	0.87
EUR/CHF	0.95	0.91	0.97	0.97	0.99
EUR/NOK	10.30	10.38	9.85	9.94	9.70

	23 Sept 2022	Amundi Q1 2023	Consensus Q1 2023	Amundi Q3 2023	Consensus Q3 2023
EUR/SEK	10.95	11.02	10.53	10.67	10.40
USD/CAD	1.36	1.40	1.29	1.30	1.26
AUD/USD	0.65	0.62	0.70	0.69	0.72
NZD/USD	0.57	0.53	0.62	0.60	0.65
USD/CNY	7.13	7.20	6.92	6.60	6.90

Source: Amundi Institute

DISCLAIMER TO OUR FORECASTS

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

METHODOLOGY

— Scenarios

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

— Risks

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

PUBLICATIONS HIGHLIGHTS

THEMATIC PAPERS MACROECONOMICS

Themes at a glance: Only a new policy regime can stop rampant inflation, but don't count on it yet (26-08-2022)
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Asset Class Return Forecasts - Q3 2022 (08-08-2022)
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