Institute

#01
January 2023

CROSS ASSET
Investment Strategy

CIO VIEWS

Relief rally unlikely to continue

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- China: back to pragmatism
- A strained German economy can be good news for Europe

Confidence must be earned
Amundi
ASSET MANAGEMENT

#01 - January 2023

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CIO VIEWS

Relief rally unlikely to continue

Vincent MORTIER,
Group Chief Investment Officer

Matteo GERMANO,
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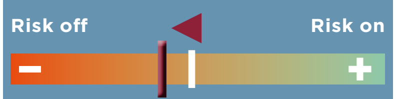
The bear market rally materialised, but strong US November job market data cooled the markets' dovish narrative, creating a mixed picture for US inflation, given that the service components remain sticky. The Fed, for its part, slowed the pace of rate hikes, but reiterated that its job is far from over. We believe central banks, including the ECB, will be walking a policy tightrope, as risks of mistakes are high.

On the other hand, we see increasing geopolitical risks in Europe and the US. In EM, the acceleration of reopening in China should result in a rebound sooner than expected, at a time when Europe will still be in recession and the US in a marked slowdown. This highlights a key feature of the 2023 outlook: the strong regional asynchrony in the economic cycles which could result in opportunities for investors.

For markets, this economic backdrop calls for a confirmation of a correction regime at the end of 2022 and in H1 2023, with inflation slowing, but still above normal levels. The correction phase will be driven by the profit recession, which will materialise in particular in H1. Investors should not add risk, but after the recent upside, return to a more cautious stance in equities and be prudent overall.

- From a cross-asset perspective, we are very active in identifying opportunities presented by market discrepancies and asynchronies in monetary policies that will soon materialise as a response to slowing growth and weaker inflation. Now, after the rebound played out as expected, we turned cautious on equities, with a neutral stance in the US and still cautious positioning in Europe. We also trimmed our positive view in credit after participating in the rally, though we remain slightly constructive. We also believe investors should seek protection throught hedges, US Treasuries and gold.
- US equities have been driven by downward movements in core yields recently, rather than any significant improvement in corporate fundamentals. We see downside risks, an asymmetric payoff, and are becoming cautious in the near term, given that current valuations do not reflect earnings risks in case of a recession. We are therefore moving neutral in the US market. In Europe, which is more exposed to a stagflationary shock, the uncertainty surrounding the Ukraine war continues. The lack of a common policy response and inflation pressures led us to further increase our defensive view on Europe. In relative terms, we keep our preference for the US over Europe.
- In government bonds, markets continue to look at inflation and the Fed's reaction, but we believe that attention will soon turn to growth and recession fears. For the time being, the direction for rates is still up. The Fed has clarified that it now expects the terminal rate to be higher than what was expected in September. How long central bank keeps rates restrictive becomes more important. Slowing economic growth and hints regarding the change in the size of rate hikes call for an active duration stance.
- Credit markets enjoyed the bear market rally, despite the transition towards a higher funding cost environment that could potentially be more painful, particularly for low-rated, excessively leveraged HY issuers. Corporate fundamentals remain strong, but cash holdings have been declining. Companies' ability to generate cash flows and withstand refinancing pressures could be affected if the economic backdrop deteriorates. This may be aggravated if commercial banks tighten their lending standards, causing liquidity to dry up for corporates when they need to refinance. Overall, in credit, we see relatively better opportunities in US IG over Europe, and we remain cautious in high yield.
- The USD is a key variable to watch in particular to detect opportunities in emerging markets. We believe that the headwinds that have penalised EM bonds in 2022 will gradually fade in 2023, when country-specific drivers will come back into focus. We stay positive on HC debt, and believe that some LC debt is selectively becoming attractive. In general, reopening plans in China will likely be another positive catalyst for EM in 2023. The recent decision by the Chinese government to lift some Covid restrictions supports an earlier rebound for the economy.

Overall risk sentiment



Moving towards year end we are becoming more cautious in equities.

Changes vs. previous month

- Cross asset: move cautious on equities and less positive on US credit, strengthen hedges.
- Equities: more defensive on DM, slight upgrade in China.
- Neutral China govies.
- Overall risk sentiment is a qualitative view towards risk.

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

AMUNDI INSTITUTE

King dollar losing some of its shine

Monica DEFEND,
Head of Amundi Institute

Federico CESARINI
Head of DM FX, Cross Asset Research Strategist

Higher real rates in the US and Fed's tightening stance have been the mainstays for the dollar in 2022. Any change to that in 2023 may lead the dollar losing its strength

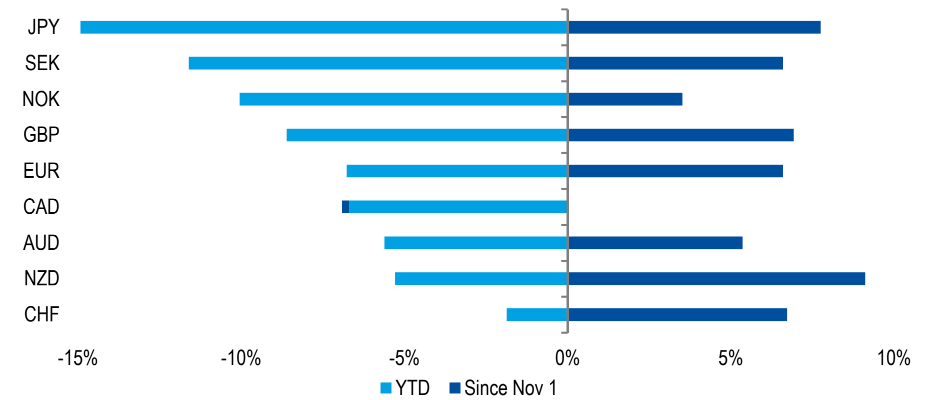
The USD cycle is being stretched. We expect to see a bumpy road, but position for a stronger depreciation in 2023.

The dollar was on the stage in 2022, registering one of the strongest rallies on record. Risk-free assets fell, uncertainty turned into volatility, and all G10 FX suffered, with no exception. Yet, positive downside surprises on US inflation, with the Fed acknowledging the possibility of lower rate hikes, worked as a cold reality check recently. The USD correction has been huge and the question now is whether the downtrend can be sustained in 2023. **To begin with, the USD traded at premium with respect to fundamentals throughout 2022 due to the three main reasons listed below. While none of these conditions has vanished completely, recent developments suggest we may have passed the maximum stress levels, indicating lower tailwinds for the USD in 2023.**

1. **Fed and its monetary policy to tame inflation** – The Fed was the key support for the USD in 2022 as the US economy ran with no growth advantage throughout the year. Unlike 2021, when US growth strongly outperformed DM peers, the USD exceptionalism has been a function of two things in 2022: i) the rising real rates advantage and ii) the rising diversification properties. The Fed remains the key factor to watch regarding both elements at this stage. We think it is too early to believe that the Fed may shift into an easing bias (the clear-cut trigger to short the USD across the board, as it erodes its carry advantage). But any further positive surprise on inflation may rapidly turn the focus towards the Fed's next steps (potential change in Fed stance), given the current inversion of the US yield curve. A bull-steepening environment usually translates into a weaker USD from a historical perspective.
2. **European energy crisis and the geopolitical risks** – The surge in energy prices was the main element causing higher production costs in EZ in 2022. Our Purchasing Power Parity framework has justified, for sometime, a EUR/USD move below parity this year[1]. Since September, though, gas prices have collapsed and the October PPI dropped significantly in response to that[2]. We are still not out of the woods (EZ still has a competitive disadvantage at the current price for energy and risks over next winter remain), but the bar for massive USD upside is getting higher from this perspective.
3. **China reopening, global growth and the USD impact** – China's zero-covid policy has certainly been a drag for global growth in 2022 and it is hard to believe the inertia can change significantly in the short term. The dollar remains a counter-cyclical asset, which usually tends to strengthen when growth slows and central banks do not provide reflationary impulses. Yet, a broader Chinese reopening as a base case for H2 2023 would be positive for the global economy. And when the cycle bottoms, the USD usually pays the toll.

Investment implications: Positive surprises on US inflation triggered a violent reflationary reaction across DM FX. We expect the road ahead to be bumpy as the USD remains a high-yielding, countercyclical asset. However, the poor risk-reward now suggests navigating with limited USD risk in this latest phase. Thus, we maintain our view that the JPY and CHF are the safest currencies to lower the USD stance. Going forward, we expect a more pronounced depreciation moving to H2 2023.

Most G10 FX rose against the USD lately



Source: Amundi Institute as of 14 December 2022. G10 FX spot performance vs the USD.

[1] *Purchasing power parity model takes into account CPI, PPI and CPI/PPI differentials.*

[2] *Eurostat PPI Eurozone Industry Ex Construction dropped 2.9% month on month in October.*

MULTI-ASSET

Take some profit and cautious start to 2023

Francesco SANDRINI,
Head of Multi-Asset Strategies

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

Based on a dynamic investing approach, we downgraded risk assets owing to concerns that the current rally may not be sustained

Inflation/growth trends, and their effects on monetary tightening, have been the most important market drivers. While domestic demand has been stronger than expected, especially in Europe recently, concerns over economic growth deceleration in the US and Europe persist. **This, coupled with risks of profit recession, means investors should turn cautious on equities and credit, and enhance hedges.** On the other hand, yield curves in select DM present opportunities amid an evolving monetary policy narrative, which also allowed us to adjust our views on the USD. Overall, investors should consider keeping a diversified stance that seeks to protect them from inflation and a potential economic downturn.

High conviction ideas

After the recent rally, we are downgrading our US and European equity stances. Europe is a more cyclical region and hence will be more affected (than the US) by a global growth slowdown and the energy crisis, leading us to continue to **favour the US over Europe.** Furthermore, we maintain our preference for small over large caps, given the extreme discount of the former over the latter. **In EM, we keep our neutral stance on China** for now as we assess the new reopening policies and their impact on economic activity.

On duration, we stay constructive on USTs amid decelerating inflation and continued risks to economic growth. At the same time, we see opportunities at yield curve levels – for example, in Canada. The slowing rise path in inflation data and the easing of global supply chain bottlenecks could potentially affect monetary policies.

In Europe, we keep our slightly positive view **on 10Y BTP-Bund spreads.** This view is supported by Italian yields' positive correlation with core European yields (moving downwards), attractive valuations and positioning, and negative net issuance of Italian debt.

In credit, after the spread tightening, we downgraded our view on US IG and are no longer positive. While inflation is slowing, it remains above the Fed target, implying that the CB may maintain a longer tightening cycle, affecting financial conditions. In Europe, we maintain a preference for IG vs HY as the latter is more vulnerable to a potential deterioration of the economic environment and default outlook.

In FX, we adjusted our views and are no longer positive on the USD/EUR owing to signs of a less aggressive monetary tightening (although not dovish) approach from the Fed. We maintain the constructive stance on USD/GBP. The cyclicality of the pound, weaker UK growth and low real rates in the UK (vs the US) are headwinds. The CAD, another cyclical FX, could be under pressure owing to a decelerating growth environment, leading us to keep our positive view on the NOK/CAD. We also maintain our positive view on safe-haven currencies – in particular, the CHF/GBP and the JPY/EUR. Changing USD dynamics are also affecting our views on EM FX. On the BRL/ZAR, we are no longer negative on the ZAR but believe investors should consider maintaining exposure to the Brazilian currency as Brazil remains a positive long-term story.

Risks and hedging

Slowing growth and high inflation require efficient diversification and hedging, leading us to keep our positive view on gold and marginally constructive stance on oil. Investors should also maintain safeguards on equities and strengthen their hedges in US HY.

Amundi Cross Asset Convictions

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

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

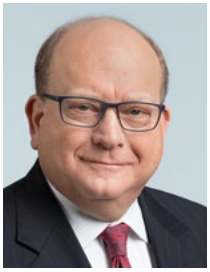
FX = foreign exchange, IG = investment grade, HY = high yield, CBs = central banks, BTP = Italian government bonds.

FIXED INCOME

Active in duration and watchful on liquidity risk

Amaury D'ORSAY,
Head of Fixed Income

Yerlan SYZDYKOV,
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

While inflation remains elevated, we are seeing signs of it peaking in the US and somewhat in Europe. This, coupled with the Fed and ECB's comments on interest rates, is driving core yields and risk assets. However, the risks of losing credibility and of loosening financial conditions, when central banks are trying to tame inflation, are high. **Hence, they are likely to maintain a tightening trajectory, even if they slow rate hikes in the face of a weaker economic outlook.** On the other hand, declining cash balances on corporate balance sheets, banks tightening their lending standards, and risks of defaults for highly leveraged businesses mean refinancing could be a problem. **As a result, in an overall cautious stance, we remain selective, and see bottom-up opportunities in US IG and HC bonds in EM.**

Global and European fixed income

As central banks' policy narratives continue to evolve, we stay active on duration and remain slightly cautious mainly through the US, Europe, the UK and Japan. We are also exploring opportunities across different yield curves and are slightly reducing our curve flattening views in Europe. On peripheral debt, our close-to-neutral stance remains in place. Although we acknowledge the positive sentiment as CBs show their willingness to reduce the magnitude of future rate hikes, we remain skeptical about rising risk in credit. We maintain our slightly positive stance, with a preference for IG and Euro subordinated financial debt. But we avoid highly leveraged names because corporate cash balances are deteriorating and earnings concerns persist. In particular, we remain cautious in HY.

US fixed income

We are witnessing mixed signals, with resilient employment and consumer balance sheets but weak money supply and inverted yield curves. Core services inflation remains sticky, which is likely to keep the Fed on the tightening path. In this environment, we remain active on duration, with a bias towards neutrality. We have a similar active approach on TIPS, which look to be reasonably valued. In credit, we remain highly selective, with a preference for financials over industrials and with a strong focus on liquidity. We also generally favour higher-quality segments. In securitised markets, given the interest rate volatility, investors should be flexible, particularly in agency MBS. While consumer fundamentals currently remain strong, they may feel the pressure as excess savings erode.

EM bonds

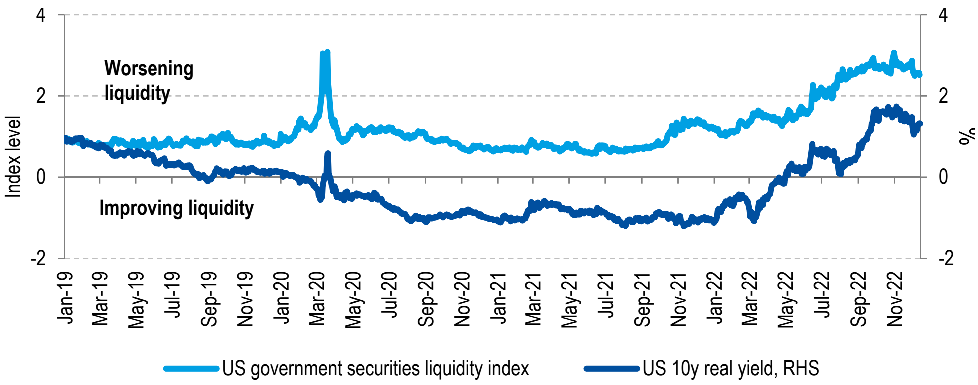
We see opportunities in 2023, thanks to some stability in core US rates. Spreads currently offer a compelling entry point for HC, and in LC, valuations are attractive. We are evaluating how a potential USD weakening and China reopening could affect Chinese bonds. In LatAm, while we like Brazil, we are monitoring policy evolution.

FX

We are positive on the USD but the peaking inflation narrative leads us to marginally lower our conviction. In EM, we raised our conviction on the BRL/USD. LatAm FX offers attractive carry and should benefit from any changes in the USD trend. We are positive on the MXN but defensive on the TWD and HUF.

The job for the Fed is not done yet as core services inflation is still sticky, keeping us vigilant on the impact of higher rates on market liquidity and credit spreads

Be watchful of deteriorating liquidity conditions



Source: Amundi Institute, Bloomberg. Data as of 13 December 2022.

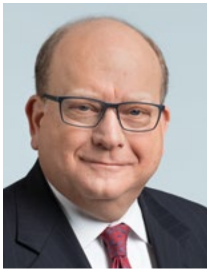
GFI = global fixed income, GEMs/EM FX = global emerging markets foreign exchange, HY = high yield, IG = investment grade, EUR = euro, UST = US Treasuries, RMBS = residential mortgage-backed securities, ABS = asset-backed securities, HC = hard currency, LC = local currency, MBS = mortgage-backed securities,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

EQUITY

Don't chase the rally, stay balanced

Kasper ELMGREEN,
Head of Equities

Yerlan SYZDYKOV,
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

Overall assessment

The rebound in equities appears to be a relief rally, led by indications on Fed policy and optimism around China reopening. But we may see this resilience breached due to headwinds on margins and a slowdown in demand (affecting revenues). On the former, we believe costs will rise from structural and cyclical perspectives, and at the same time margins should fall as consumers trade down to withstand the effects of still-high inflation. **Thus, we see significant divergences in valuations and earnings prospects that calls for a selective approach.** In addition, we like value, quality and dividends stocks which should be complemented by strong bottom-up analysis.

European equities

In a barbell style approach, we are more balanced, with positive views on quality cyclical sectors such as industrials and financials (more constructive). **However, we are active in adjusting our views amid market movements.** For instance, we are taking profit in some industrial names, given their strong performances. On the other hand, we also explore idiosyncratic names that have been penalised excessively by the markets. At the other end of the spectrum, we are **constructive on attractively valued defensive names in consumer staples, but we increased our cautious stance on discretionary. I**mportantly, as Europe grapples with an energy crisis, we think progress on ESG investing should continue. In fact, this is the time to identify names that display potentially improving ESG standards and in the process could reward investors. Overall, we continue to prioritise balance sheet strength.

US equities

Companies may face a margins squeeze as employment remains robust, wages are rising, and dollar headwinds persist. If disinflation on goods continues, this could aggravate those pressures. Thus, markets' aggregate earnings expectations for 2023 are not bearish enough. It is a time for stock-pickers who can sift through expensive names by going down the market cap spectrum, carefully assessing earnings potential and evaluating the resilience of business models. This valuation dispersion should also support the **continuation of outperformance of value over growth.** At a sector level, we are becoming more balanced when it comes to consumer discretionary, particularly on services and retail businesses. This is because although select consumer surveys are still coming in strong, we are seeing consumers trading down to cheaper goods to withstand pressure on incomes. In contrast, **we like banks with stable returns on equity and select names in health care.**

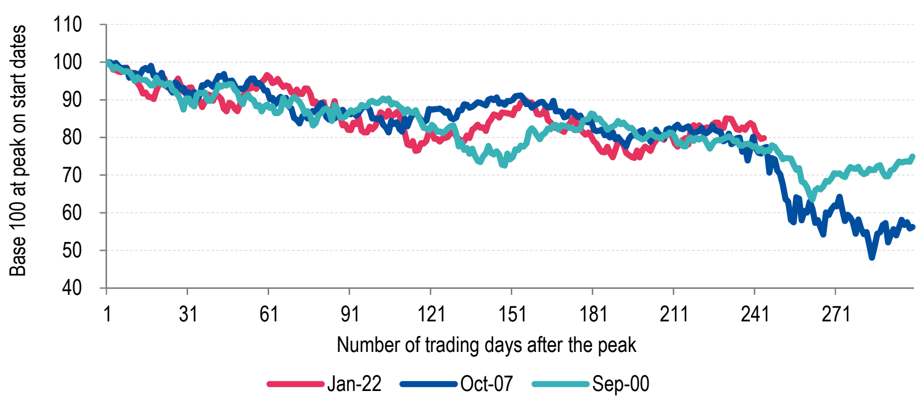
EM equities

A faster-than-expected retreat of China from its zero Covid policies could be a turning point for EM equities. This is supported by attractive valuations and limited drag from the dollar. Having said that, we are very selective and maintain a flexible stance, which allowed us **to upgrade our stance in China equity,** while we are monitoring political developments in Brazil.

At a sector level, we prefer energy over materials, and favour real estate and consumer discretionary, especially in China amid the Covid policy-induced rebound.

Markets' earnings expectations appear too optimistic and will have to come down, indicating adjustments from current levels

S&P 500 trend after peaks: Jan 2022, Oct 2007, Sep 2000



Source: Amundi Institute, Bloomberg. Data as of 20 December 2022. Starting point of 100 shows the peak for the index on January 2022, October 2007 and September 2000.

THIS MONTH'S TOPIC

China: back to pragmatism

Claire HUANG
Senior EM Macro Strategist, Amundi Institute

2022 ended in an abrupt fast-track reopening. In one month, China dropped most of its Covid-related restrictions, vowed to support the housing market more, and set pro-growth policies. We expect the Chinese economy to be separated from the global slowdown in 2023, accelerating from a low base.

Fast-track reopening

The refined zero-Covid policy (with 20 measures) introduced on 12 November was initially envisioned by the leadership as an effective tool to balance growth and the Covid outbreak. However, with the highly infectious Omicron variants, the virus quickly spread and cases continued to rise across the country despite these measures. Meanwhile, localities were confused on how to implement new policies. Most of them opted to tighten the restrictions, in order to flatten the infection curve. Economic activity stayed depressed, and social unrest increased amid poorly-executed Covid policies. After the refined zero-Covid policy proved to be ineffective in containing the outbreak, China chose to embark on a fast-track reopening instead of reverting to hard-core lockdowns. Since late November, the country has removed testing requirements for most travel, allowed home quarantines for positive cases, and introduced the second booster for the senior population.

The faster and earlier reopening caught the Chinese public as well as the market by surprise, given that the medical system is far from being prepared. In this regard, the initial stage of reopening will be chaotic, accompanied by a surge in hospitalisations and depressed mobility. Medicine shortages are already in place. However, going forward, we do not expect Chinese government to backtrack. China has passed the point of no return. Its priority now is to reserve its scarce medical resources for those most in need, and to accelerate booster injections for the elderly. Soon governments will have to let go of most restrictions. Officials announced to drop quarantine rules for overseas visitors on 8 January, right before the Chinese New Year holidays (22 January), much earlier than we expected month ago.

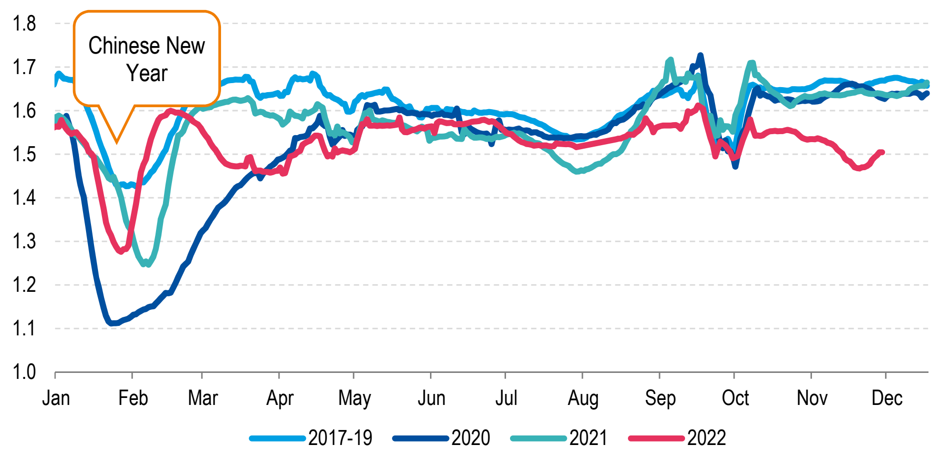
A full reopening now looks likely by end-Q1. There will be a sequencing of peak infections in different regions. For instance, Beijing is on a first-in, first-out basis. Nevertheless, most cities in China will see the peak of the first wave by mid-January and the end of first wave by March. We expect most restrictions to be removed after the Chinese New Year holidays (in late January). Returning to work is expected to start in February, and full production is likely in March.

A full reopening now looks likely by end-Q1

Winter recession, followed by strong rebound in spring

The reality is bleak at the moment. Economic growth plunged again in November, due to the additional tightening that local governments put in place right after the Party Congress. Consumption and the services sector bore the most pain. Mobility data (Chart 1) started to recover in late November, but the improvement has slowed and is likely to pause into the surge of infections. Lessons from other Asian economies suggest the whole reopening process takes two to three months before activities recover meaningfully. Also considering the quiet activity around Chinese New Year holiday period, we expect weak growth throughout February 2023. Meaningful recovery will follow in March and in Q2 2023.

1/ **Mobility of Chinese households**



Source: Amundi Institute, Wind. Data is as of 20 December 2022.

THIS MONTH'S TOPIC

A broader policy pivot towards supporting growth

Pro-growth policies for 2023

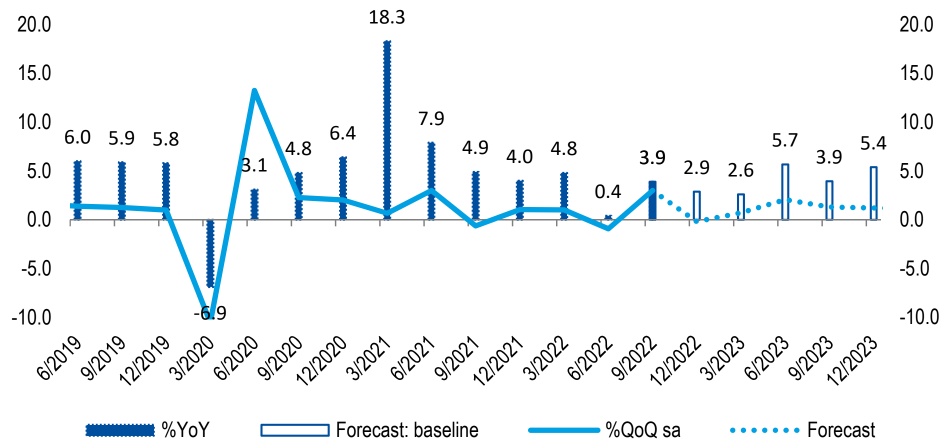
On top of reopening news, the Central Economic Work Conference (CEWC) held on 15-16 December reflects a broader policy pivot towards supporting growth. It is worth noting that leaders said it is fundamental to revive expectations and confidence. More specifically, we note a sharp turn in policies for platform companies, by recognising their role in creating jobs and supporting them to compete globally.

As for macro policy, the conference called for stepped-up spending from the fiscal pocket, while vowing to maintain an accommodative monetary policy, albeit in a more precise way by directing funding to small and micro enterprises, technology innovation, and green transition. Consumption is highlighted as a priority to expand domestic demand, including support for housing upgrading demand, electric vehicles, and elderly care services. **This means a declining role of infrastructure investment, which is no longer required as a buffer to ease downward pressures on growth.**

On the parallel track, **the tightening of housing market is officially over.** The policy stance helped stabilise the market and restore home sales, construction and land transactions from the sharp slowdown. By recognising that the housing crisis is systemic and that real estate's role in the economy is crucial, officials plan to promote project deliveries, encourage M&A, meet developer financing demand, and resolve the risks hanging over high-quality names. With housing market returning to stability and economic reopening, we expect China's growth to accelerate from a low base in 2022. The recovery trajectory will be choppy, hinging on how policymakers manage the reopening. **Evidence on hand indicates a preference for brief and sharp short-term pains and a smoother path in most of 2023.**

Finalised on 26 December 2022

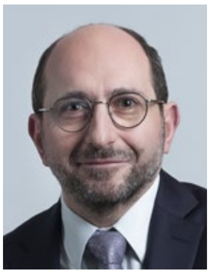
2/ **China GDP growth forecasts**



Source: Amundi Institute, CEIC. Data is as of 20 December2022.

THEMATIC

A strained German economy can be good news for Europe



Didier BOROWSKI,
Head of Macro Policy Research, Amundi Institute

The energy crisis resulting from the war in Ukraine has altered profoundly Europe's economic performance and prospects. Countries have been affected unevenly, based on how dependent they are on Russian gas and oil. German industry has been particularly hard hit. Beyond industry, the entire German economic model is now at stake. Here we provide an update on the prospects for the German economy for 2023-24. Then, we recall that the challenges to be met are Europe-wide, and that only a coordinated approach at the EU level will enable member countries to meet them. On this front, recent news is moving in the right direction.

The energy crisis in a nutshell: a complex equation for Germany

The economy was overly dependent on Russian gas, oil, and coal. Germany, like all European countries, must now review its energy mix. It is clear that Germany will never return to dependence on Russia. It needs to diversify its energy suppliers, but this will take years. In the short run, despite 100% gas storage, household consumption needs to fall by 20%. Otherwise, gas shortages during the winter would be inevitable.

Industry has already reduced its gas consumption by around 25% (compared to the 2018-21 average), including through production cuts in some industries. Gas-fired power generation has been reduced and replaced by coal-fired power plants, which have been reactivated. The remaining three nuclear power plants, which were scheduled to close in early 2023, will continue to operate until mid-April 2023.

A recession is probably inevitable in the short term, but it should be short-lived

Energy prices will continue to dominate the outlook. **Due to high inflation and a fall in household and business confidence, the outlook remains uncertain, with a risk of gas rationing during the winter, which would cause industrial production to fall further.** In the short term, the drivers of domestic demand (consumption and investment) have been weakened. High energy prices are weighing on industry, construction, and investment. Meanwhile, inflation is reducing real incomes and savings and thus consumption, despite a high savings surplus. Real wages are falling despite increases in negotiated wages and a strong labour market (labour shortages have intensified although Germany has taken in one million refugees from Ukraine, equal to 1.2% of the German population).

On the external front, the situation is not much better. Losses in competitiveness and weakening global growth are weighing on exports, while imports have risen with the energy bill. The current account surplus has been halved from 7.5% of GDP in 2021 to about 3.5% of GDP in 2022, and is expected to fall further in 2023. As a result, net trade -- which has contributed negatively to growth since the beginning of the year -- will continue to weigh in 2023. A recession seems inevitable in the short term despite the resilience observed in 2022[1].

Due to high inflation and a fall in household and business confidence, the outlook remains uncertain, with a risk of gas rationing during the winter, which would cause industrial production to fall further

The recession should however be contained, thanks to an expansionist fiscal policy

There are three energy support packages, estimated at €95bn (2.6% of GDP) in direct expenditure and an energy support fund of €200bn (5.5% of GDP) to cushion the impact of rising energy costs on businesses and households, including a 'brake' on gas prices. The VAT rate on gas was cut from 19% to 7% in October. That said, it is worth mentioning that debt metrics have deteriorated little thanks to the additional tax revenues generated by inflation and a higher nominal GDP. The budget deficit is estimated to be around 3% of GDP in 2022 and only slightly higher in 2023, while the debt-to-GDP ratio is expected to fall below 69% of GDP.

In the medium term, ambitious climate and policy objectives should support growth

The government plans to invest around €200bn by 2026, with tax incentives to attract private investment, and to increase military spending by €100bn over the next few years. Growth support will be limited by capacity constraints in the construction sector, and very long and complex planning and approval procedures will slow down the disbursement of funds.

Note that these debt-financed investments, as well as the energy support fund, will be included in shadow budgets, whose expenditure is excluded from the national debt brake, which is expected to be reinstated from 2023.

[1] *Our GDP growth forecasts: 1.8% in 2022, -0.7% in 2023, and 0.9% in 2024. Our inflation forecasts: 9.0% in 2022, 7.6% in 2023, and 2.9% in 2024. Forecasts are as of 28 December 2022.*

THEMATIC

A modest recovery is in sight in 2023-24

First, inflation will slow down, but remain high in 2023, due to pass-through of energy and producer prices to consumers, euro depreciation, and increasing wage pressures. Second, investment should eventually rebound, driven by high corporate savings, investment needs related to the reshoring of value chains, necessary development of renewable energies, and increased public investment. In addition, by end-2023, a ceasefire in Ukraine would help restore confidence for investors, businesses, and households. That said, **the energy crisis will not end with the cessation of hostilities in Ukraine. We believe that gas prices will increase again in 2023, driven by high demand and low supply.** Against this backdrop, the future of industry and the sustainability of the German economic model are at stake.

The energy crisis will not end with the cessation of hostilities in Ukraine. We believe that gas prices will increase again in 2023, driven by high demand and low supply

Germany must rethink its model

Germany's potential growth has been weakened considerably, estimated at only 0.5% on average over 2023-24. Some companies are considering relocating to areas where energy is cheaper. A survey conducted by the BDI revealed that almost one in four SMEs (the *Mittelstand*) was considering moving production outside of Germany.

The US administration's Inflation Reduction Act (IRA), which would provide $370bn in subsidies for green technologies, is a threat. Under the IRA, subsidies for the purchase of electric vehicles would be limited to those made with parts from North America and assembled in that country, a scheme that would accelerate the deindustrialisation of Germany and undermine European industry.

With a shortage of skilled jobs, less buoyant globalisation (Germany is overly dependent on China), and structurally higher energy prices, Germany needs to rethink its economic model. As the European economies are intertwined, Germany cannot go it alone.

At European level, the common interest should ultimately prevail, despite tensions.

The different reactions in terms of fiscal policies have created confusion and dissension between the major Eurozone countries, and in particular between France and Germany. Moreover, the reform of the Stability and Growth Pact (under review until spring/summer 2023) may still be a source of tension between EU member states. Fiscal and budgetary governance has indeed always been the most sensitive point in European construction. However, we believe that **common interests will eventually prevail in 2023-24.** This is shown, for example, by some recent agreements:

- On defence: on 18 November, France, Germany, and Spain reached an agreement on starting the next phase of development of a new fighter jet (FCAS). This is Europe's largest defence project with an estimated cost of more than €100bn. This project was originally meant to unify Europeans after Brexit, but it had been a source of tension between France and Germany since then, although the French and German government broadly agreed to the project.

- On energy: on 25 November, France and Germany signed an agreement to support each other in securing their energy supply. Concrete measures are foreseen, including French support to Germany through gas deliveries, while Germany will support France in securing its electricity supply.

In addition, European countries agreed on 19 December to cap the price of natural gas at €180/MWh, ending months of political wrangling over whether to intervene in an energy crisis. The cap was intended as a deterrent rather than a tool to be actively used. It is indeed primarily intended to prevent extreme peaks. Germany and other countries had expressed concern that capping prices in Europe would make the region less attractive to sellers from around the world, at a time when the EU is looking for alternatives to Russian supplies. This agreement could unlock further emergency measures to limit market volatility and even pave the way for joint gas purchases, which had been put on hold, due to disagreement over price caps.

To conclude, whether it is on the plan to overhaul the energy mix, on the attitude to adopt towards China, on the construction of strategic independence, or on the measures to be put in place to deal with the fallout of the US Inflation Reduction Act, Europeans have more common interests than points of divergence. In the end, **as with all past crises in Europe, the energy crisis could help the European institutions to move forward, not to mention the fact that it is likely to accelerate the energy transition in the years to come.**

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Finalised on 19 December 2022

CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We maintain the probabilities of our scenarios unchanged. Some of the risk factors we identify may occur in our central scenario, which is probably not yet fully priced-in by markets. Risks remain skewed to the downside in the short term, but it would take a combination of several risk factors to trigger the downside scenario at the 12-18 month horizon. At this horizon, we believe that the downside is counterbalanced by an upside scenario, that of a rapid decline in inflation due to an easing of gas prices, a ceasefire in Ukraine, 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.**.
- **Recession in China.**
- **Global economic downturn** with, in a second stage, renewed deflationary pressures.
- **Global financial crisis/debt crisis with several EM defaults.**
- **Governments can no longer implement countercyclical fiscal policies.** Recession paves the way for 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 Ukraine war.** We expect a ceasefire at some point in 2023; in the meantime, the situation may deteriorate further.
- **Energy crisis here to stay.** Gas prices expected to rise in the restocking phase, with no credible cap in the EU.
- **Covid-19** is an endemic disease.
- **Inflation fails** to return to CB target by 2024.
- **Deep global economic slowdown in 2023:** recession in Europe and rising recession risks in the United States and China. Modest expansion and sub-par growth expected in 2024.
- Global **nominal GDP to trend higher,** mitigating the impact on earnings.
- **CB divergences:** Fed and ECB to continue policy normalisation, but reduce the size of hikes; the ECB cannot do as much as the Fed and may have to activate TPI; PBoC on an easing bias.
- **The policy mix is inconsistent across the EU:** accommodative fiscal policies, but uncoordinated and not well targeted. Conversely, the fiscal impulse was negative in the United States in 2022, but is expected to be more neutral 2023-24.
- **Climate change** disrupts the commodity cycle and adds to stagflationary trends.

Market implications

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

UPSIDE SCENARIO 15%

Inflation falls back quickly, ending the stagflationary episode

Analysis

- **Ceasefire in Ukraine paving the way for peace talks.**
- **Russia partially resumes gas exports to Europe,** commodity market normalises.
- **Covid-19** recedes.
- **Inflation falls back quickly,** supply bottlenecks ease.
- **Global recession fears** dissipate and inflation gradually returns to more normal levels, easing pressure on CB.
- **Lower uncertainty,** extra savings and renewed purchasing power can fuel consumption and investment in DM.
- **Fiscal discipline** gradually restored. In Europe, a new plan (common debt) is put in place to address the changing energy mix.
- **Climate change** policies and energy transitions become first priority.

Market implications

— US Treasury curve to bear steepen.
— Favour risky assets with cyclical and value exposure.
— USD depreciation.
— 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 see risks on all fronts, but with a little less intensity at the beginning of the year. As such, we lowered the probabilities from 30 to 25%. Economic fundamentals are deteriorating globally, which is reflected in the central scenario, but is not yet fully priced in the equity market. The course of the Ukraine war and its potential implications can tip the scenario in either direction: risks are tilted to the downside in the short term, but the probability of ceasefire by year-end remains significant. We consider Covid-19-related risks as part of the economic risks. Risks are clustered to ease the detection of hedging strategies, but they are related.

ECONOMIC RISK 25%

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

— **The *weaponisation* of gas supply** by Russians could cause a **severe energy crisis in Europe,** leading to a **deep recession** (confidence shock).

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

— Central banks continue to raise interest rates, giving priority to the fight against inflation, without worrying about the recession risks. **Global profit recession** triggered by the global slowdown, coupled with persistent input-cost pressures.

— **Recession in China: the new Covid-19 wave of covid is not contained.**

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

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

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

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

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

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

FINANCIAL RISK 25%

— **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.

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

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

(GEO)POLITICAL RISK 25%

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

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

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

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

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

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

- **Credit and equity, EMBI.**

CROSS ASSET DISPATCH: detecting markets turning points

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

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. Recession risks remain prominent for mid-2023 in the United States, while for Europe we confirm our expectations of a cost-of-living- and inflation-driven recession during the upcoming winter season.
- Inflation has peaked in the United States. We expect a progressive deceleration in both headline and core indices, although signs of greater-than-normal persistence remain. In the Eurozone, inflation may be close to peaking, but is expected to remain near double digits and at stressful levels for some months to come.
- The prolonged stress on the geopolitical front and the tug-of-war between fiscal and monetary policy make the final economic outcome uncertain, exacerbating data volatility.

FUNDAMENTALS & VALUATION

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

NEUTRAL + ASSET ALLOCATION

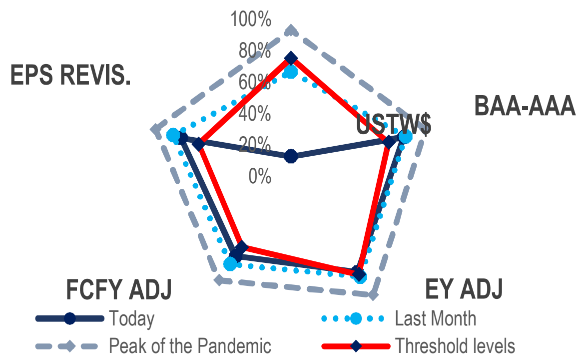
TECHNICALS

- Technicals remain highly volatile in the current market set-up and moved into negative territory in December 2022. Our trend-following indicators do not see value in being long risky assets, as most trends turned fragmented in December.

SENTIMENT

- Lower US inflationary pressures pushed back interest-rate volatility, and financial conditions eased in response to that. Risk sentiment metrics remain fragile. Financial conditions are tight, but eased substantially. The sharp dollar sell-off has been feeding into our CAST model, which now sees a much lower risk-off probability than in November.

Cross Asset Sentinels Thresholds (CAST) – The sell-off in the USD is the strong supportive factor in November. CAST defensiveness is moderating lower.



Source: Amundi Institute. Data as of 16 December 2022.

The CAST risk perception failed to show a structural increase in Q1 but has turned less favourable since Q2. EPS revisions remain negative and the credit risk premium remains high and above alert, yet the move in the USD is calling for a less defensive stance. CAST OFF probability is off its highs and entering a neutral zone.

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

AMUNDI INSTITUTE CLIPS

1 Global growth outlook

- The 2023 global GDP forecast was cut to 2.2% from 2.5% YoY. Core inflation should prove sticky across DMs, while EMs have gradually been winning their fight against inflation.
- G3 CBs may be done with jumbo rate hikes, while about 40% of EM CBs have wrapped up their tightening cycle.
- The US soft landing has been confirmed, with very weak growth foreseen in H2 2023 and non-negligible risks of recession. US headline inflation will decelerate markedly in H1. Among core inflation components, core goods will be deflationary, while core services will be the main driver of sticky above-target inflation.
- The Eurozone economy should contract mildly in Q4 2022-Q1 2023. It is too early to call a peak in inflation. Over the next few months, we foresee significant moderation in headline inflation and more gradual moderation in core inflation.
- EM growth has been slowing, despite a possible early reopening in China. As of October, inflation had peaked in some 60% of the emerging universe.

Investment consequences

- The economic backdrop and profit cycle will remain fragile into 2023.
- Amid the correction, cross-asset positioning will remain defensive: UW global equity, OW government bonds, inflation-linked bonds, IG, and gold.

2 Fed outlook

- The Fed is likely to reduce the size of rate hikes, but this does not mean a dovish pivot is likely in the short term.
- The Fed will stay committed to fighting inflation, while past tightening takes a toll on labour market.
- We have cut our 12-month target on 10-year US Treasury yields to 3.5-3.7% from 3.9-4.1%; we expect the US yield curve to bull-steepen in H2 2023.

Investment consequences

- Tactical UW on US duration before moving to neutral stance.
- The Treasury-Bund spread should narrow.

3 Prospects for quantitative tightening in 2023

- The Fed is likely to continue its QT programme in its current form, with monthly caps at $60bn and $35bn on Treasury and MBS run-offs, respectively; the Fed's balance sheet should shrink by some $1tn in 2023.
- Regarding the ECB, QT is likely to be limited to APP securities and to begin in mid-2023. We expect a jump in net supply net of ECB flows.

Investment consequences

- Duration UW on euro rates.
- Peripheral spreads could be under pressure.

4 Recent easing in financial conditions is not justified

- We disagree with the dovish market interpretation of Chair Powell's speech.
- Lending conditions have already been tightening in multiple segments of the US economy; US banks have been tightening lending standards on industrial loans at a pace consistent with a recessive environment.

Investment consequences

- DM bond valuations have become stretched after the rally.
- Markets may have misplaced their hope of a forthcoming Fed dovish pivot.

5 The dollar bull cycle is getting stretched

- The current environment is shifting and a few dollar supports have been fading, as US inflation has been decelerating and the Fed has opened the door to a less aggressive pace of rate hikes.
- The focus could shift sharply from the risk premium over the Fed – which was a strong dollar driver in 2022 – to a dollar premium over fundamentals, as a downside risk.

Investment consequences

- Deeper dollar depreciation in 2023: Six-month EUR/USD target raised to 1.00 from 0.92; 12-month target raised to 1.10 from 1.04.
- We are currently keeping limited dollar exposure (favoured shorts: EUR, GBP and CAD).
- Short USD against JPY and CHF.

AMUNDI ASSET CLASS VIEWS

Platform	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=	▼	Markets seem to be pricing in a soft landing scenario, but we think there are risks to profits amid deteriorating economic momentum. A profit recession will not be enough for the Fed to change its stance, which remains key for an upgrade of our views. We maintain our bottom-up selective view, focussing on value, quality and dividend stocks.
EQUITY PLATFORM	US value	+		We like value names with resilient business models and the ability to maintain earnings growth and market share. We think combining value investing with quality characteristics is a less volatile way to hedge against economic risks.
EQUITY PLATFORM	US growth	-		Mega cap growth and the unprofitable growth sector are likely to be affected by higher policy rates, as they rely on cash flows way into the future for their valuations. However, we are following the segments where valuations have corrected.
EQUITY PLATFORM	Europe	-		High energy inflation in 2023 may mean prolonged stress on consumption patterns and subsequently on corporate earnings. This, coupled with the recent rally and continuing geopolitical tensions, makes us cautious. We stay vigilant towards earnings and explore businesses with attributes such as strong balance sheets and product differentiation.
EQUITY PLATFORM	Japan	=/+	▲	Japan, which is an export-oriented economy, is also a way to play the reopening in China that should be supportive for the country's markets. However, slowing global growth momentum and a strong yen are factors to watch out for.
EQUITY PLATFORM	China	=/+	▲	Recent indications of a move away from zero Covid policies and news of vaccinations for the elderly point to a gradual economic re-opening which should improve mobility and unleash pent-up demand. We believe the path will not be linear and remain selective in light of geopolitical risks and pressures on exports.
EQUITY PLATFORM	Emerging markets-ex China	=		Selection across the EM world is crucial in light of country-specific drivers such as domestic demand, monetary policies and fiscal prudence. We are positive on Brazil (but watchful of President Lula's economic policies) and cautious on the Philippines and Malaysia (expensive valuations). From a sector perspective, we like energy over materials.
FIXED INCOME PLATFORM	US govies	=/+		We think the Fed lowering the size of rate hikes doesn't necessarily mean a dovish pivot. Instead, it shows that the central bank will take into account the cumulative effects of tightening done so far before taking further action. Hence, we stay vigilant and maintain an active stance on duration. At the same time, we think economic deceleration and slowing inflation rate are positive for USTs. We are also constructive on real rates.
FIXED INCOME PLATFORM	US IG corporate	=/+		IG provides attractive carry, valuations are attractive, and corporate balance sheets healthy, allowing us to be slightly constructive. However, we are selective due to declining cash balances for companies and recession concerns.
FIXED INCOME PLATFORM	US HY corporate	-		HY fundamentals, such as leverage and interest coverage, remain strong but the liquidity position is deteriorating. The segment could be affected in an environment of high funding costs and lower economic growth. Thus, we stay cautious, particularly in lower-rated segments (CCC-rated).
FIXED INCOME PLATFORM	European govies	=		We stay neutral in an overall active stance on core Europe duration as we assess the ECB's monetary policy and views on inflation and economic growth. The ECB will continue to keep rates in restrictive territory. We remain cautious on peripheral bonds.
FIXED INCOME PLATFORM	Euro IG corporate	=		While the markets expect the ECB to slow its hiking process, we see persistent risks to IG spreads from weak growth, high inflation and geopolitical tensions (energy crisis). Thus, we keep a close eye on refinancing needs of companies.
FIXED INCOME PLATFORM	Euro HY corporate	-		EU HY may face higher volatility in light of potential liquidity and default risks, which are contained for now. As interest rates stay high and consumption is subdued, a rising cost of capital and a weak earnings outlook could be negatives.
FIXED INCOME PLATFORM	China govies	=	▼	While the decoupling of China from the US provides diversification benefits to global investors, the gradual change in the zero Covid stance should boost mobility and economic activity. We are neutral and evaluating the PBoC's policy stance.
FIXED INCOME PLATFORM	EM bonds HC	=/+		Stabilising US rates should be supportive, along with attractive carry and valuations. Spreads offer good entry points but we are selective in light of the evolving growth dynamics across the EM world, including in Brazil and China.
FIXED INCOME PLATFORM	EM bonds LC	=		While LC debt valuations are becoming attractive on a selective basis, we are cautious overall on Asia and on EM FX in general. However, a changing trajectory of USD strength and Covid policies in China could be positive for carry trade opportunities in future for certain FX such as MXN, IDR and INR. For now, we stay neutral and vigilant on liquidity trends.
OTHER	Commodities			While concerns on growth may cap oil prices in the near term, supply constraints could return in the driver's seat in the medium term. Economic reopening in China sets a floor for base metals prices, but a sustainable rebound would require broader support. CBs' potential pivots and a weaker dollar would provide fresh tailwinds for gold (6M target: $1,900/oz).
OTHER	Currencies			Fed policy tightening has been the main driver of dollar strength in 2022, but with signs of a potential change to that (within the overall tightening framework), we are getting slightly less constructive on the greenback.

LEGEND

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Negative			Neutral	Positive			Downgrade vs previous month	Upgraded vs previous month

Source: Amundi, as of 20 December 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 28/12/2022

Annual averages (%)	Real GDP growth %			Inflation (CPI, YoY, %)		
	2022	2023	2024	2022	2023	2024
World	3.4	2.2	2.8	8.2	6.2	4.0
Developed countries	2.6	0.4	0.9	7.5	5.1	2.5
US	2.0	0.9	0.6	8.1	4.3	2.3
Japan	1.3	0.5	1.2	2.4	0.5	0.4
UK	4.4	-0.9	0.8	9.2	8.2	3.9
Eurozone	3.3	-0.5	0.8	8.5	7.3	3.2
Germany	1.8	-0.7	0.9	9.0	7.6	2.9
France	2.5	-0.1	0.9	6.0	5.4	2.9
Italy	3.8	-0.4	1.0	8.8	8.3	2.8
Spain	4.5	0.3	1.3	8.4	4.0	3.3

Source: Amundi Institute.

- **United States:** the US economy is showing signs of deceleration, with restrictive monetary policy starting to weigh on activity and progressively dragging growth below potential. We foresee increased recession risks in H2 2023, when we project stagnant growth and very weak composition of domestic demand, implying heightened recession risks. While inflation seems to have peaked, stickiness in underlying inflation may remain a key feature in the months to come, with core inflation declining slowly and remaining above target.
- **Eurozone:** we expect Eurozone GDP to contract in Q4 2022-Q1 2023 under the drag of the cost-of-living crisis, followed by a modest recovery over the spring-summer period, as decelerating inflation should start providing some relief to consumers, although still significantly above the ECB target. Tighter monetary policy will represent an headwind too. 2023 average dynamics will be weaker than previously expected, feeding into below-potential growth in 2023-24. Risks related to the energy component remain prominent for both the inflation and growth outlook.
- **United Kingdom:** with upwardly revised inflation projections, in double-digit territory for a few months and above target for several quarters, we foresee a cost-of-living-induced recession playing out in the United Kingdom this winter, extending for a few quarters and further exacerbated by tight financial conditions. Also the recovery projected for 2024 will see the economy performing below potential. Risks are tilted to the downside, as the energy component remain a prominent downside risk for both the inflation and growth outlook.
- **Japan:** we maintain our below-consensus growth forecast of 0.5% for 2023, believing the uneven recovery should continue. Services sector led the improvement of December PMI, thanks to reopening. However, the manufacturing index stayed below 50 and is likely to resume its downtrend on weaker DM demand in early 2023. The catch-up effect from reopening can off-set only partially the slowdown of global demand. GDP is likely to contract in H1 2023 on softer exports. Meanwhile, we expect national core core inflation to climb further over the coming months and stay above the BoJ's 2% target until mid-2023.

Key interest rate outlook

	28-12 2022	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
US	4.50	5.25	5.00	5.25	4.50
Eurozone	2.00	3.25	3.30	3.25	3.50
Japan	-0.10	0.00	0.08	0.00	0.30
UK	3.50	4.50	4.70	4.50	4.70

Source: Amundi Institute.

Monetary policy agenda

Central banks	Next meeting
Bank of Japan MPM	**18 January**
ECB Governing Council	**25 January**
Federal Reserve FOMC	**1 February**
Bank of England MPC	**2 February**

Source: Amundi Institute.

- **Fed:** the latest FOMC meeting slowed the pace of rate hikes from 75bp to 50bp, taking the Fed Funds target to 4.25-4.50%, while the projected Federal Funds rate was revised higher, to a median of 5.125% from 4.625% in September for end-2023. New economic projections saw a deteriorating outlook, with sharply lower GDP forecasts and higher unemployment rate and core PCE projections. Overall, the dots plot and Chair Jerome Powell's press conference were hawkish, with Powell maintaining full commitment to fight inflation. This supports our expectations of 5.25% expected terminal rate.
- **ECB:** at its December meeting, the ECB hiked rates by 50bp to 2.0% (deposit rate). The Bank delivered a very hawkish statement. Inflation remains the main concern and top priority. The ECB foresees sticky inflation, with Eurozone inflation driven mostly by energy prices. Fiscal policy also plays a key role, while supporting demand. In the short term, we see pressure on core sovereign bond rates and on peripheral spreads. We revised our terminal deposit rate in the current hiking cycle to 3.0% from 2.5%, with risks tilted to a possible further upgrade.
- **BoJ:** at its December meeting, the BoJ surprisingly widened its YCC target band from +/-0.25% to +/-0.5% for ten-year JGBs, earlier than expected. This is de facto tightening, when yields tend to move upward. Political willingness to normalise monetary policy has increased. It is reported that the 2013 Joint Statement – by the government and the BOJ -- will be revised The final goal is unclear at the moment, but exiting from Negative Interest Rate Policy (NIRP) is likely. Before that, the BoJ has to abolish its YCC yield-target completely, or in a quicker move, scrap NIRP and YCC together in one go.
- **BoE:** at its latest meeting, the BoE hiked rates by 50bp. As in previous meetings, the vote was split, but this time with a higher gap between the dissenting opinions, as two members opted for no rate hike, while one opted for a 75bp move. The meeting failed to produce any meaningful surprise on rates guidance, essentially unchanged, on the expected economic outlook in light of latest fiscal announcements, and on QT. Following the latest rate hike, we confirmed our expected rate path and the expected terminal rate, which is likely to peak at 4.5% in our baseline scenario.

EMERGING COUNTRIES

Macroeconomic outlook

Data as of 28/12/2022

Annual averages (%)	Real GDP growth %			Inflation (CPI, YoY, %)		
	2022	2023	2024	2022	2023	2024
World	3.4	2.2	2.8	8.2	6.2	4.0
Emerging countries	3.9	3.4	4.1	8.8	6.9	5.0
China	3.0	4.4	4.9	2.0	2.2	2.1
Brazil	3.1	0.5	1.7	9.3	4.5	4.2
Mexico	3.2	1.5	0.9	7.9	5.6	4.5
Russia	-3.3	-1.5	2.0	13.8	7.5	4.5
India	7.0	5.4	6.0	6.7	5.4	5.9
Indonesia	5.2	4.5	4.8	4.2	4.4	4.1
South Africa	2.4	1.2	1.5	6.9	5.9	4.9
Turkey	4.9	3.1	4.3	72.5	55.2	29.8

Source: Amundi Institute.

- **China:** officials announced to drop quarantine rules for overseas visitors on 8 January, right before the Chinese New Year holidays (22 January), much earlier than we expected month ago. A full reopening now looks likely by end-Q1. The reality is bleak at the moment. Economic growth plunged again in November. Bearing in mind the faster reopening, we expect production to resume in February and a meaningful recovery to follow in March and Q2. The rebound of consumer demand will drive up core inflation, but PPI and energy disinflation will contain overall inflation at around 2%.
- **Asia:** central banks in South Asia continued their monetary policy tightening, although in some cases at a slower pace compared to their most recent decisions (e.g., Philippines and Indonesia). Asia is lagging behind in terms of monetary policy normalisation because inflation picked up later and less sharply than in other EM regions, such as Latam or Eastern Europe. Although none of these central banks has announced any pause in its monetary policy conduct, we expect that the end of the monetary policy action is almost mature with a few rates hikes still in the pipeline across the region.
- **CEE3:** except for Romania where it stabilised in QoQ terms and accelerated in YoY terms, Q3 real GDP figures showed that economies continued to decelerate sharply, both in QoQ and YoY terms. Double-digit inflation is here to stay for long and will prevent central banks from cutting anytime soon. Elevated inflation, tight monetary policy, (partial) removal of supports on energy and gas prices as well as fiscal consolidation in some countries will add further tailwinds to growth in the coming months. We expect Czech Republic and Hungary to enter recession as early as Q4 this year.
- **South Africa:** even though Q3 real GDP figures were higher than in Q2, the country had a tough month, with strong volatility on bonds and FX markets. President Ramaphosa was embroiled in a corruption scandal known as “Farm gate”. After the parliament voted against impeachment, South African assets regained ground. Ramphosa has been reelected as ANC leader, but he is not off the hook yet, as there are other ongoing investigations in the matter by the SARB, the public protector, and the South African police services. All eyes will be focused on 2023 to see if the reform agenda is progressing.

Key interest rate outlook

	20-12 2022	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
China	3.65	3.65	3.65	3.65	3.65
India	6.25	6.50	6.45	6.50	6.30
Brazil	13.75	13.50	13.55	11.50	11.60
Russia	7.50	7.50	7.15	7.50	7.00

Source: Amundi Institute.

Monetary policy agenda

Central banks	Next communication
PBoC	**20 January**
BCB Brazil	**1 February**
RBI	**8 February**
CBR	**10 February**

Source: Amundi Institute.

- **PBoC (China):** the PBoC left policy rates unchanged in December. As the reopening path is confirmed, we do not expect any further rate cuts. The central bank has no urgency to hike rates either. Inflation will be contained at below 3% throughout 2023. The likely increase in effective rates on improved growth outlook will lead to moderate tightening of financial conditions. Signals from the annual economic conference suggests the PBoC will step back from broad easing. Targeted monetary easing will continue, via structural lending tools and special financial programmes.
- **RBI (India):** as expected, the RBI continued its hiking cycle in December, even though at a slower pace. The repo rate was raised by 35bp to 6.25%. RBI governor stated that further calibrated monetary policy action is warranted to keep inflation expectations anchored, break core inflation persistence, and contain second-round effects. We expect the RBI to hike again in February by 25bp to 6.5%, as real policy rates are already mildly positive or close to neutral, in line with what the RBI targeted at the beginning of its hiking cycle in May.
- **BCB (Brazil):** the BCB stayed on hold in December and did not kick off any easing cycle, with the Selic rate unchanged at 13.75%. Despite the risk around the inflation outlook looks balanced, the Copom emphasised the uncertainty related to the fiscal policy framework: on the upside, through additional fiscal stimulus to support aggregate demand and increase inflation expectations; on the downside, through the expected -- though uncertain -- reversal of tax cuts. Clearly next monetary policy action will depend on the future fiscal framework.
- **CBR (Russia):** at its December meeting, the CBR left its policy rate unchanged at 7.5%, sounding increasingly less dovish. While keeping its inflation forecasts unchanged, the CBR emphasised that pro-inflationary factors dominate over disinflationary ones, such as labour market tightness, elevated inflation expectations, weaker rouble, and potentially looser fiscal policy. Inflation continued to decline to 12.0% YoY in November, down from 12.6% in October. Given this increasingly cautious tone and inflationary pressures, we no longer expect any rate cut over the next six months and a potential hiking cycle in late 2023.

MACRO AND MARKET FORECASTS

Macroeconomic forecasts

28 December 2022

Annual averages (%)	Real GDP growth %			Inflation (CPI, YoY, %)		
	2022	2023	2024	2022	2023	2024
US	2.0	0.9	0.6	8.1	4.3	2.3
Japan	1.3	0.5	1.2	2.4	0.5	0.4
Eurozone	3.3	-0.5	0.8	8.5	7.3	3.2
Germany	1.8	-0.7	0.9	9.0	7.6	2.9
France	2.5	-0.1	0.9	6.0	5.4	2.9
Italy	3.8	-0.4	1.0	8.8	8.3	2.8
Spain	4.5	0.3	1.3	8.4	4.0	3.3
UK	4.4	-0.9	0.8	9.2	8.2	3.9
China	3.0	4.4	4.9	2.0	2.2	2.1
Brazil	3.1	0.5	1.7	9.3	4.5	4.2
Mexico	3.2	1.5	0.9	7.9	5.6	4.5
Russia	-3.3	-1.5	2.0	13.8	7.5	4.5
India	7.0	5.4	6.0	6.7	5.4	5.9
Indonesia	5.2	4.5	4.8	4.2	4.4	4.1
South Africa	2.4	1.2	1.5	6.9	5.9	4.9
Turkey	4.9	3.1	4.3	72.5	55.2	29.8
Developed countries	2.6	0.4	0.9	7.5	5.1	2.5
Emerging countries	3.9	3.4	4.1	8.8	6.9	5.0
World	3.4	2.2	2.8	8.2	6.2	4.0

Key interest rate outlook

Developed countries

	28 Dec 2022	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
US	4.50	5.25	5.00	5.25	4.50
Eurozone	2.00	3.25	3.30	3.25	3.50
Japan	-0.10	0.00	0.08	0.00	0.30
UK	3.50	4.50	4.70	4.50	4.70

Emerging countries

	20 Dec 2022	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
China	3.65	3.65	3.65	3.65	3.65
India	6.25	6.50	6.45	6.50	6.30
Brazil	13.75	13.50	13.55	11.50	11.60
Russia	7.50	7.50	7.15	7.50	7.00

Long-term rates outlook

Two-year bond yields

	28 Dec 2022	Amundi +6M	Forward +6M	Amundi +12M	Forward +12M
US	4.34	4.0/4.20	4.09	3.40/3.60	3.86
Germany	2.64	2.40/2.60	2.61	2.40/2.60	2.42
Japan	0.01	0.1/0.20	0.08	0.1/0.2	0.13
UK	3.52	3.20/3.40	3.48	3.30/3.50	3.67

Ten-year bond yields

	28 Dec 2022	Amundi +6M	Forward +6M	Amundi +12M	Forward +12M
US	3.83	3.60/3.80	3.80	3.50/3.70	3.77
Germany	2.49	2.30/2.50	2.48	2.30/2.50	2.46
Japan	0.45	0.40/0.60	0.59	0.40/0.60	0.67
UK	3.69	3.60/3.80	3.76	3.60/3.80	3.84

Currency outlook

	29 Dec 2022	Amundi Q2 2023	Consensus Q2 2023	Amundi Q4 2023	Consensus Q4 2023
EUR/USD	1.07	1.02	1.05	1.10	1.08
USD/JPY	133	132	135	123	131
EUR/GBP	0.88	0.89	0.88	0.90	0.88
EUR/CHF	0.98	0.94	0.99	1.03	1.01
EUR/NOK	10.53	10.43	10.15	9.74	9.85

	29 Dec 2022	Amundi Q2 2023	Consensus Q2 2023	Amundi Q4 2023	Consensus Q4 2023
EUR/SEK	11.16	11.02	10.80	10.31	10.50
USD/CAD	1.35	1.37	1.32	1.28	1.30
AUD/USD	0.68	0.65	0.67	0.75	0.70
NZD/USD	0.63	0.60	0.62	0.66	0.65
USD/CNY	6.96	7.10	7.00	6.80	6.85

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 PORTFOLIO STRATEGY

How do institutions segment their investment universe? (25-10-2022)
PORTELLI Lorenzo, Head of Cross Asset Research - Amundi Institute -TAZÉ-BERNARD Eric, Senior Advisor - Amundi Institute

Articulating asset allocation across different time horizons (6-09-2022)
FRANCERIES Karin, Head of OCIO advisory - PORTELLI Lorenzo, Head of Cross Asset Research - Amundi Institute - Tazé-Bernard Eric, Senior Advisor - Amundi Institute

THEMATIC PAPERS GREEN & SOCIAL

Themes in depth/ Artificial intelligence for sustainable finance: why it may help (13-10-2022)
BRIERE Marie, Head of the Investor Research Center, Amundi Institute - KEIP Matthieu, Innovation Lead, Amundi Technology - LE BERTHE Tegwen, Head of ESG Scoring & Methodology

Themes at a glance/ Artificial Intelligence and ESG: How do they fit? (13-10-2022)
BRIERE Marie, Head of the Investor Research Center, Amundi Institute - KEIP Matthieu, Innovation Lead, Amundi Technology - LE BERTHE Tegwen, Head of ESG Scoring & Methodology

COMPASS

Inflationary era demands new approach from pension plans (08-12-2022)
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Emerging Markets Charts and Views - EM investing after the great repricing (27-10-2022)
SYZDYKOV Yerlan, Global Head of Emerging Markets - DEFEND Monica, Head of Amundi Institute

INSIGHTS PAPERS

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PUBLICATIONS HIGHLIGHTS

INVESTMENT TALKS

Hawkish surprise from the ECB (19-12-2022)
AINOUZ Valentine, Head of Global Fixed Income Strategy – Amundi Institute - DAUPHINE Gilles, Deputy Head of Fixed Income

Fed: Staying the course until the job is done (16-12-2022)
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UK Fiscal Budget: main political, social and market implications (21-11-2022)
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WORKING PAPERS

The Market Effect of Acute Biodiversity Risk: the Case of Corporate Bonds (30-11-2022)
Amina CHERIEF, Takaya SEKINE, Lauren STAGNOL, Quantitative Portfolio Strategy, Amundi Institute

Net Zero Investment Portfolios - Part 1. The Comprehensive Integrated Approach (23-11-2022)
BARAHHOU Inès, BEN SLIMANE Mohamed, OULID AZOUZ Noureddine - Quant Portfolio Strategy - Amundi Institute
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Incorporating ESG Risk In Fundamental Market Risk Models (18-11-2022)
Dr. SCHWEIMAYER Gerhard, Amundi Germany - STOYANOVA Niya, LMU (University of Munich)

INVESTMENT OUTLOOK

2023 Investment Outlook - Some light for investors after the storm (21-11-2022)
MORTIER Vincent, Group Chief Investment Officer - GERMANO Matteo, Deputy Group Chief Investment Officer - DEFEND Monica, Head of Amundi Institute

ASSET CLASS VIEWS

Asset Class Return Forecasts – Q4 2022 (04-11-2022)
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ESG

ESG Thema – Special COP15 – The Paris moment for biodiversity? (22-12-2022)
CHAMPOLLION MOREL Hélène, Head of Advocacy - DE VECCHI Viola, ESG Advocacy Analyst - DUTTA Basundhara, ESG Advocacy Analyst - DAY Apolline, Institutional Marketing Analyst

Biodiversity : It's Time to Protect Our Only Home (07-12-2022)

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