Research

#01
January
2022

CROSS ASSET
Investment Strategy

CIO VIEWS

Omicron uncertainty; inflation certainty

THIS MONTH'S TOPIC

Central banks: a successful hawkish turn

Confidence must be earned
Amundi
ASSET MANAGEMENT

#01 - January 2022

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Renewed concerns over Covid-19, policy actions and weakness in China caused some volatility in markets but we remain risk neutral and focus more on alpha generation and less on market directionality, particularly in credit. We also think central banks will remain broadly accommodative, despite accelerating their taper plans to control inflation. Investors should explore value, quality stocks but identifying companies with pricing power will be key as companies look to pass-on higher input costs to consumers. In addition, real assets exposure could provide inflation protection to investors able to withstand the liquidity risk.

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2021 Covid surging in 1H and inflation swelling in 2H have contributed to the political pendulum swinging hard left in LatAm. More structurally, the commodity super cycle unwind mid last decade and the political discontent likely set the entire shift in motion. Against the general trend, some elections cycles moved in the other direction as well.

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CIO VIEWS

Omicron uncertainty; inflation certainty

Pascal BLANQUÉ,
Group Chief Investment Officer

Vincent MORTIER,
Deputy Group Chief Investment Officer

The resurgence of the virus cycle, central banks' reactions to high inflation figures, and Evergrande's unavoidable default have led to some volatility in the market, but these issues have not caused any major disruption. In the battle between growth and inflation narratives, the mantra that bad news is good news for markets continues to prevail. **At this point, it is definitely too early to make a judgement on the Omicron variant and its impacts**. Investors should be aware that the virus cycle will be in focus once again. The new variant may affect the fragile parts of the supply chain, further adding to inflationary pressures. Importantly, there is a psychological element in the inflation situation currently offering a self-fulfilling narrative. This is definitely a risk to take note of moving into 2022.

Nonetheless, the level of concern is not in the red zone yet, but the Fed's tone turned more hawkish, with Chair Powell speeding-up the tapering process. Despite the Fed's shift to reducing accommodation, policy will remain easy in 2022, with the Fed Funds rate well below the "neutral" rate, a level where monetary policy neither stimulates nor restrains economic growth. In fact, the reaction of equities is an illustration of the market's belief that the Fed will master inflation while not hurting economic growth, and that this episode will only be temporary. However, we think the situation will not be so straight-forward.

Amid tight labour markets (wage pressures) and strong consumer demand, we could potentially see demand-side pressures on inflation. So, the Fed is walking on thin ice: on the one hand, inflation is barely sustainable from a political standpoint; on the other, excessive tightening of financial conditions, causing market turbulence, would be equally unsustainable. The Fed will do something, but will likely remain behind the curve with tapering and rate hikes in 2022 and it will likely keep rates at very low levels.

The third item on the news front is China: the Evergrande and Kaisa groups have officially defaulted. So far, we see no signs of contagion. China's government had also been active in recent weeks in supporting the real estate sector and taking a major role in the Evergrande's restructuring. The policy stance looks much more constructive in 2022 vs 2021 and we believe that will be an important element. Against this backdrop, we see some key considerations for investors:

- **Rising uncertainty and the risk of policy mistakes point towards a neutral stance for risk assets**. Equities will continue to be favoured based on a *TINA (there is no alternative)* argument as long as real rates remain deeply depressed and inflation expectations are well anchored. The recent *buy the dip* move signals that market sentiment is still upbeat, despite high valuations and falling real earnings yields. Hence, once again, investors should selectively favour sectors and businesses that can better navigate an inflationary environment and should prever value given the wide valuation gap vs growth.
- **In fixed income,** after the Fed's move, while 2Y Treasury yields fully priced in the FOMC's projected pace of rate hikes, intermediate- and longer-term yields did not. We see risk of a bearish steepening of the yield curve. This reinforces our negative view on duration. In credit, the recent spread widening, especially in the quality part of the market (IG), may offer some room to add exposure, but very cautiously and in the short duration part. A scenario of decent growth, easy fiscal policies, behind-the-curve CBs, and continued global demand for yield remains supportive for credit, and in particular for the segments that can withstand inflationary pressure and don't suffer from extreme leverage.
- **In EM**, investors should look for opportunities to play the asynchrony in policy responses. EM is a divided world between countries and CBs that are taking inflation seriously and those that are not. We have seen a largely credible response from EM CBs to higher inflationary pressures (Brazil, Mexico, Russia, South Africa). The divergence in monetary policy with the Fed will have important implications for 2022, benefitting the debt of EM countries that have already acted in a credible way to cool inflation risks: eg, Brazil and Russia. On the equity side, China may be the positive surprise next year.
- **Finally, we reaffirm the need to selectively add real assets exposure** for investors able to withstand the liquidity risk, as these assets may offer potential for inflation protection and higher real income.

Regarding 2022, we are entering the third year of the pandemic: it has already moved to an endemic phase in financial markets, as they have been getting used to digesting any news quite quickly amid huge doses of accommodation from central banks. **It will be a year of change and a reality check regarding what this new endemic phase will mean once CBs start to readjust their efforts, inflation proves stickier than anticipated, and long-term expectations start to be challenged.**

Overall risk sentiment

Risk off ◀ Risk on

Within the neutral paradigm for risk assets, we start the year on a vigilant note, mildly reducing credit sensitivity in fixed income approaches.

Changes vs. previous month

- Moderation of credit exposure through a bottom-up lens.
- Reduced breakevens, still marginally positive.
- Reduced Chinese govies.
- Exploring equity ideas in value.

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

CROSS ASSET RESEARCH ANALYSIS

PPI to CPI pass-through: top-down, bottom-up views

Monica DEFEND,
Global Head of Research

Amid pressures on margins from rising input costs, companies' pricing power will be a key aspect for us to monitor, and it will also guide our investment decisions in 2022

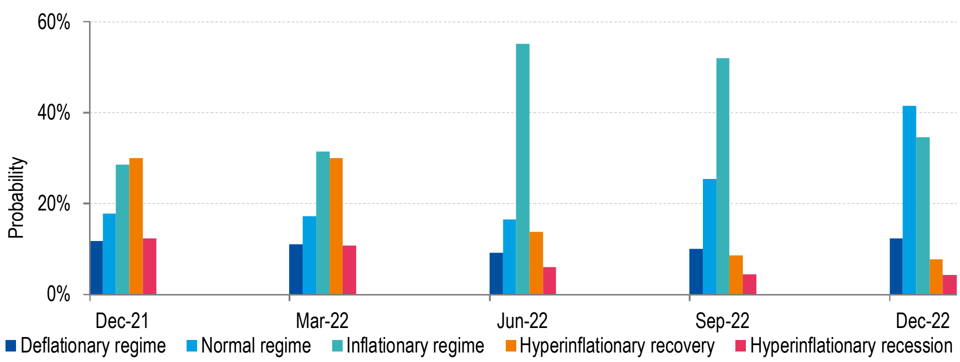
The regime shifts along growth and inflation and the sequencing of monetary policies are two key factors included in our 2022 Investment Outlook – Investing in the great transformation. **Here, we elaborate on the pass- through of PPI to CPI, the effect on corporate margins, and the significance of pricing power as an investment criterion.**

While market participants and CBs have now moved past the 'temporary/structural' inflation illusion, we are extending our 'inflationary regime' call to Q3 2022 on a combination of factors: higher trajectories for 1) the employment cost index, 2) unit labour costs (ULC), 3) import prices, and 4) PPI. These are the pivots that will frame our inflationary regime's taxonomy and the associated investment consequences. The PPI-CPI differential deserves specific attention in 2022, as it will affect margins. The gap between input costs along industrial value chains and the real pricing power per sector and/or per company will likely be on display in 2022.

From a top-down perspective, the pass-through from PPI to CPI was not evident in the figures reported over the recent earnings season, if only marginally. Typically, the 'pass-through' comes with lower revenues, USD appreciation, lower rates, tighter margins, and, therefore, lower expectations on profits and earnings formation. If in the past, the pass-through effect from PPI to CPI had been mitigated by productivity increases related to technological progress, globalisation and offshoring, trade weighted (TW) USD depreciation[1], this is unlikely to be the case in 2022. CBs' asynchrony will lead to a stronger USD while we expect single-digit EPS growth[2], assuming financial conditions remain benign amid contained TW USD appreciation[3] and negative real rates. Looking at the bottom line, we see some pressures from mildly higher ULC and higher PPI. The Omicron variant will not only procrastinate opening of supply chain bottlenecks, it may also obstruct structural decisions (ie, reshoring), given the still uncertain outlook. Top-line deceleration, lower margins, and less supportive liquidity conditions are all risks to the downside, challenging our 'benign neglect of inflation' scenario in H1 2022[4]. Moreover, relative to international peers, the US is showing greater flexibility in passing higher input costs on to consumers. In particular, if we use CPI/PPI ratios productivity's proxies (using the Balassa-Samuelson framework), we can explain part of the USD's strength seen in 2021.

From a bottom-up perspective, we believe, there is a time lag between market participants — who adapt fast and believe production adjusts almost immediately to new input prices — accepting inflation and the actual adjustments to the real industrial value chain. The latter takes longer to adjust and possibly integrate the new dynamics. After 15 years of deflationary forces, CEO/CFOs now have to adapt to this environment of bargaining and renegotiating price increases for 2022 in their budget processes (change of mind-set). So far, our anecdotal evidence shows that re-shoring and short-term adjustments of supply chains (eg, relocating sneaker production from Vietnam, Indonesia) is elusive. At a sector level, we noticed that in Europe, consumer, materials and industrial (especially transportation) saw minimal pass-through. Retailers (food and non-food) are at risk of a margin squeeze. On the other hand, consumer, luxury media, packaging and some parts of tech are showing strong pricing power. Pharma is a different ballgame: given mostly regulated prices, the sector has little pricing power but is not yet facing higher input prices. **To conclude**, the inflationary regime will dominate most of 2022. The pass-through of PPI to CPI will likely dampen earnings formation, and thus pricing power will be key. We see tangible downside for risk assets in H1 2022, justifying why we enter the year having reduced the equity exposure to neutral.

Inflationary regime forecasted for a large part of 2022



Source: Amundi Research, 20 December 2021. PPI - Producer Price Index, a measure of inflation at company level. CPI - Consumer Price Inflation, a measure of inflation faced by end-consumers. [1]Including in the basket, a larger exposure to EM currencies than DXY; [2] We forecast operating EPS for S&P500 growth at 7%, 12M forward earnings; [3] 3% appreciation over the next 6M; [4] When we recommend staying cautious.

MULTI-ASSET

Look for entry points in quality credit and equities

Matteo GERMANO,
Head of Multi-Asset

Given our overall neutral stance, we prefer rotating risk (as opposed to increasing it) to benefit from recent market movement — for example, in IG credit

Global expansion continues in the midst of growth challenges posed by the new variant, a hawkish Fed, and inflation pressures, confirming our stagflation views. This, coupled with some tactical weakening of equity momentum, prevents us from taking an aggressive risk-on stance. However, CBs remaining behind the curve does not warrant any structural de-risking either. Thus, investors should rotate out of areas that could be affected by weak risk sentiment and look for tactical as well long-term opportunities presented by market dislocations (eg, in credit). **This should be done with an overall risk-neutral mindset and based on an active and well-diversified approach.** Investors must maintain sufficient hedges to protect equity/credit exposure.

High conviction ideas

On DM and EM equities, although we stick to our neutral stance, we maintain a buy-the-dip view, without increasing our risks level. We are also debating about and investigating what should be a good entry point for investors to selectively take advantage of the recent correction in some markets, such as Japan, that have lagged the recovery and are attractively valued. In the US, with an aim to minimise asymmetrical risks, we think derivatives may offer efficient ways to gain from any upward movement in US equities. Elsewhere, we are mindful of near-term weakness in China and some other EM that could be affected by the Fed's policy turning more hawkish. Instead, we focus on areas that offer robust long-term opportunities.

In fixed income, we maintain a short duration stance in the US and Europe, but remain flexible. We are now cautious specifically on 5Y German government bonds. The recent fall in yields due to concerns about the Omicron variant was an overreaction and was particularly extreme for the core European yield curve. Thus, the 5Y and the more front-ended curves were hit the most by this sudden repricing of yields because these segments had earlier priced in a more rapid normalisation of monetary policy by central banks. **Second, while we think long-term fundamentals for Italian economic growth are strong,** there are some near-term uncertainties relating to possible effects of the new virus variant. As a result, we have become slightly more cautious on BTPs. Instead, investors should look for tactical opportunities in EUR IG credit with an aim to keep the overall risk budget constant. ECB support and favourable technicals (limited supply in H1 2022) continue to support credit (IG, HY) which remains a source of income, but we are selective. In addition, the recent market de-risking in EUR IG is not justified. **Third, we are less constructive on Chinese government debt** due to downside risks related to local FX, primarily vs the dollar, and turmoil in the country's credit markets. However, we maintain that Chinese debt offers diversification benefits for global portfolios in the long term. On EM bonds, we remain neutral. In FX, the evolving global economic environment continues to support a relative value approach. While we are monitoring events such as evolution of the Covid situation in the UK, we keep our slightly positive view on the GBP vs CHF as the franc remains the most overvalued currency in the G10 universe. Our conviction is not strong due to the UK's deteriorating economic backdrop, perennial shortages, and Brexit-related issues. These factors, coupled with high energy prices and inflation, allow us to keep our defensive view on the GBP vs the EUR and the USD.

In EM, we keep our constructive view on the RUB/EUR as the currency is resilient in light of attractive valuations, low external vulnerability, and the hawkish stance of the Russian CB, although we remain vigilant regarding geopolitical tensions with Europe and the US. In Asia, we maintain our constructive view on the CNH/EUR, given China's growing importance in Asian trade and its increasing role in the global economy.

Risks and hedging

A higher inflation regime and policy mistakes remain high probability risks. We recommend that investors maintain hedges on DM equities and on US HY to protect from any tail risks.

Amundi Cross Asset Convictions

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

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

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

FIXED INCOME

Fed, inflation conundrum and Omicron clouds

Amaury D'ORSAY,
Head of Fixed Income

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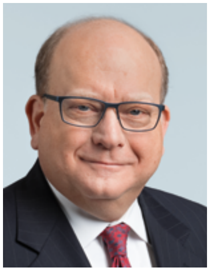
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

Entering 2022, even though we are seeing a more hawkish Fed, the broader policy stance is likely to stay benign

The evolution of the virus cycle, a deceleration in economic growth, and inflation (demand side or cost-push) will determine CB responses. The last factor has been key for the Fed, together with political pressures and the 'fiscal dominance' narrative, as it accelerated its taper plans and raised expectations for rate hikes in 2022. Despite that, we believe the Fed views inflation as transitory — even though it removed the reference — because long-term rate expectations haven't changed. So, the Fed's actions will remain within the 'benign neglect' narrative of inflation. **For investors, this means they should look for income in credit but without increasing portfolio beta,** particularly in areas where spreads have widened. Focus should be on alpha generation through a bottom-up approach and valuation bias in EM and peripheral bonds.

Global and European fixed income

We maintain a cautious but flexible stance on duration in the US, and core and semi-core Europe, but remain constructive on peripheral debt in the medium term through Italy (watchful of near-term uncertainties). On breakevens, we are monitoring valuations in the US (less constructive now) and in Europe, where we are no longer positive. **Elsewhere, we look for carry in credit through a mildly constructive view, even though** we believe investors should rely more on idiosyncratic exposure to medium-term maturities, centred on convictions such as subordinate debt (in IG and HY) and in financial, industrial and cyclical sectors. In HY, there are opportunities to selectively play the compression theme, but liquidity should be monitored (better liquidity in January). However, we avoid long-duration securities and names likely to engage in re-leveraging/LBOs. We also stay clear of consumer, transportation and chemicals sectors. Overall, we look for winners in an environment of rising core rates, wages and raw material prices.

US fixed income

We believe the risks that the economy will materially slow down are low because we see a lot of stimulus and momentum. But inflation and Covid risks persist amid tight labour markets, supply chain bottlenecks, and strong consumer demand. This, coupled with political pressures on the Fed and an acknowledgement that inflation is not transitory, encouraged the CB to accelerate its taper. We expect to see a mild increase in core rates, allowing us to stay defensive on duration. On TIPS, however, we maintain only a minimal exposure. **Instead, we look for alpha generation in corporate credit when valuations and fundamentals at the issuer level are attractive, but liquidity is key.** We also believe derivatives offer selective opportunities in managing IG and HY exposure. In addition, strong income growth and high savings rates should continue to support housing markets, which underpins our positive view on securitized investments.

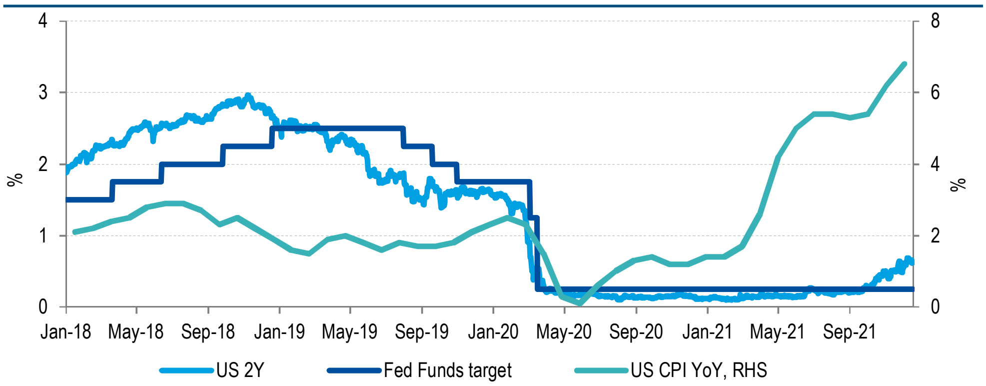
EM bonds

EM bonds remain an area of interest where relative valuations are selectively attractive. However, there are some challenges to EM debt and FX from higher rates in the US, the situation in China (corporate restructuring), and its potential to spill over to global markets. We maintain our bias towards HY vs IG, with preference for HC, while we are especially selective in LC. But, we are cautious on Brazil and Turkey (idiosyncratic risks).

FX

We remain positive on the USD, but downgraded the GBP despite the recent rate hike by the BoE, given uncertainty around the Covid situation and potential setbacks from Brexit. In EM, the PBoC indicated its desire to pause RMB appreciation. Elsewhere, we are constructive on the IDR, INR and RUB but are monitoring geopolitical tensions.

Disconnect between inflation rates, despite Fed's hawkish tone



Source: Amundi, Bloomberg, as of 17 December 2021. CPI data is monthly.

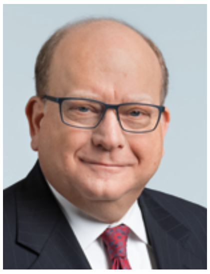
GFI = global fixed income, GEMs/EM FX = global emerging markets foreign exchange, HY = high yield, IG = investment grade, EUR = euro, UST = US Treasuries, RMBS = residential mortgage-backed securities, ABS = asset-backed securities, HC = hard currency, LC = local currency, CRE = commercial real estate, CEE = Central and Eastern Europe, JBGs = Japanese government bonds, EZ = Eurozone, BoP = balance of payments.

EQUITY

Playing the great divide

Kasper ELMGREEN,
Head of Equities

Yerlan SYZDYKOV,
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

Overall assessment

We believe that moving into the new year, the demand backdrop remains robust — strong employment, wage growth, accumulated savings — and is supported by positive fiscal impulses in Europe (green deal) and the US. On the other hand, the Covid situation continues to evolve as the Omicron variant has led to some profit-taking in segments where valuations are excessive. Given that market concentration is also high, a small part of the market is increasingly responsible for huge gains. Thus, selectivity is key to identifying winners at a time when valuation dispersion is high. But in doing this, we acknowledge that the pass through of rising input costs to consumers cannot happen for perpetuity. So, we look for demonstrated pricing power through market positioning, intellectual property, etc, and stay balanced.

European equities

We stay balanced in markets offering opportunities for selective stock-picking in value and defensive segments, such as health care. At the other end, cyclicals (industrials exposed to construction super cycle) and financials (banks) remain our focus. We also like economic reopening-related names that are trading at attractive valuations and offer high dividend yields. However, we are cautious on long duration stocks, tech (slightly less defensive), and discretionary, but are watchful for opportunities presented by market dislocations. Our overall stance is biased towards normalisation, but we continuously assess the impact of inflation and the evolving Covid situation on corporate margins beyond the short term. In doing this, we put special emphasis on balance sheet strength, the potential for improvement in financially significant ESG metrics, and the potential for investing in companies before the ESG premium sets in.

US equities

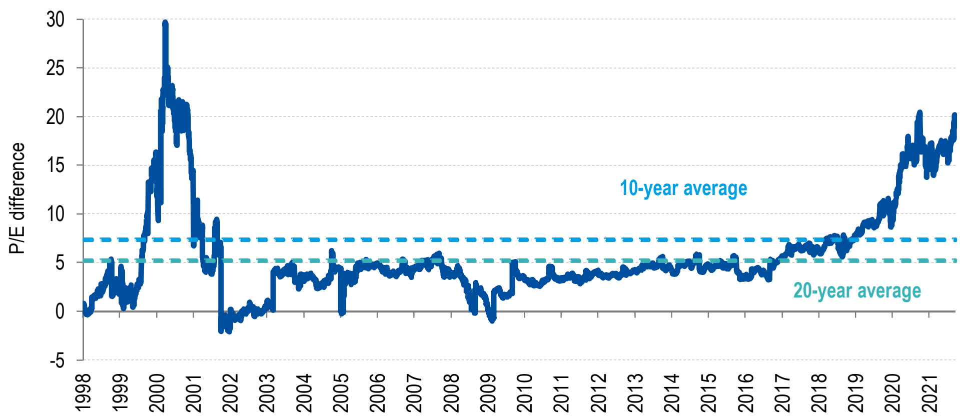
The Fed is accelerating its QE reduction but euphoric sentiment prevails in some market segments, such as tech, where the sector's relative performance vs the broader S&P index has reached the tech-bubble peak. This is one of the key risks (concentration risk) as performances of some selective large-caps are overshadowing the markets. On the other hand, while companies are delivering record margins, we are focused more on the sustainability of these margins which depends on pricing power. Once supply bottlenecks are removed, companies with limited pricing power could see margin erosion. We remain selective, believing that value should be preferred, as relative valuations vs growth are extreme. In addition, investors should tilt portfolios to areas less exposed to inflation risk, which markets are ignoring. Thus, we prioritise stock-picking over market direction and focus on company-specific drivers. At a sector level, we like high-quality, cyclical value stocks, but are cautious on high-momentum/growth names and long-duration stocks. We are also defensive on traditional risk-off sectors (staples, utilities) as potentially higher real rates could affect sentiment.

EM equities

Attractive relative valuations in the heterogeneous EM world present opportunities from a bottom-up perspective. While China's short-term outlook is blurred by uncertainty regarding the extent of the slowdown, the government's stance going into 2022 looks more supportive vs 2021. Our most preferred markets are Russia (structural demand for energy and commodities), India (benefitting a lot from China slowdown, but getting expensive), and Hungary. At a sector level, we favour consumer discretionary and energy, and maintain our preference for value over growth.

Markets mask the great divides: value vs tech growth; big size concentration and overvaluation vs the rest; companies with pricing power vs the rest. This is fertile ground for bottom-up selection

Growth minus value is at extreme levels



Source: Amundi, Bloomberg, as on 17 December 2021. 12 month forward price/earnings ratio of MSCI World Growth

THEMATIC GLOBAL VIEWS

Pierre BLANCHET,
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Didier BOROWSKI,
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You asked, we answer

Our Global Views team attempts to answer some of the questions often asked by our clients.

What are the key political events in the EU in 2022?

A number of scheduled country-level elections will carry moderate uncertainty. However, while they could bring new faces, they are unlikely to result in abrupt changes from the current generally pro-European and market-friendly stance of large EU countries' governments..

Key developments on this front have already happened in 2021, first and foremost through:

1. **The formation of the cabinet of Mario Draghi (an ex-ECB chief)** in February in Italy, seen as instrumental in retaining the trust of both the markets and Northern European countries that Italy will make good use of the European NGEU Recovery Fund and deliver the expected reforms.
2. **The German general election, in September,** which yielded a tripartite government (Social Democrats + Greens + the pro free-market FDP) seen, at the very margin, as more conducive to further European integration than the previous (Merkel) government.

H1 2022 will also see notable political events in Italy and France.

The Italian presidential election (through parliamentary votes) scheduled for January may cause some noise, yet probably no radical change. It is unclear at this stage whether a majority can be reached through a pre-agreement among political parties, to smoothly approve a successor to current President Sergio Mattarella. While Draghi himself could probably secure the necessary votes to become the next president (indeed, he recently hinted that he would accept the position), his change of role from prime minister would require the formation of a new government, with the risk that it could be weak and possibly lead to snap general elections before the scheduled June 2023 ballot. However, most Italian political forces will probably favour continuity in a period that is critical for the recovery and for the way the country is viewed in Europe, with the most probable scenarios being: 1/ Draghi becomes president while agreeing with most parties on a successor prime minister to continue to steer the country in the same direction. 2/ parties finally agree on a new president (or the re-election of Mattarella, should he drop his current rejection of another term of office), leaving Draghi in his current role. Both these scenarios would be regarded as positive from a market/ European policies perspective.

The French electoral cycle (presidential elections on April 10 and 24, and legislative elections on June 12 and 19) is also unlikely to lead to any radical change. By far the two most likely outcomes are a re-election of Emmanuel Macron or his defeat by mainstream right-winger Valérie Pécresse, with, in both cases, the legislative election yielding a centre-right or moderate-right majority or coalition. While the details of Macron's and Pécresse's policies may have different effects on the French economy over the long term, both will be seen (just slightly more in the case of Macron) as strongly committed to the European project. Some moderate market stress is possible during the election process, as far-right parties are strong in polls and one of them could possibly make it to the second round of the presidential ballot, whereas left-wing parties are very weak and divided. However, it is very unlikely that either of the far-right parties could win the second turn. Moreover, the far right has removed Frexit from its agenda, meaning that the risk it carries from a market perspective is less than in 2017.

Another event to watch will be the snap general election in Portugal, on January 30. This election was called after the budget proposed by the Socialist minority government was rejected by Parliament in October, which has made it more difficult, among other things, to use the NGEU funds. The latest polls show Prime Minister António Costa's Socialist Party in first position, although short of a majority, and a strong showing by the far right (until recently, not a major political force in the country). However, given the country's strong track record in terms of implementing EU-recommended reforms (that were not reversed despite the Socialist party's parliamentary alliance with the far-left), and the generally pro-European stance of most parties, this election is unlikely to generate a lot of market stress.

In the non-Euro EU, the Hungarian general election (with the date to be confirmed in April or May) may bring significant change, as Prime Minister Viktor Orbán, whose policies have often conflicted with those of the EU majority, is currently meeting a strong challenge in polls from the pro-European United Opposition, led by moderate right-winger Péter Márki-Zay.

Will the European Capital Market Union (CMU) make progress in 2022?

In 1H 2021, capital markets increased the supply of financing to companies. EU ESG debt markets grew rapidly. However, the equity gap remains and securitisation markets have declined. Capital markets remain too fragmented in Europe. The good news is that the CMU is moving forward. On 25 November, the European Commission announced a package of measures to improve

THEMATIC GLOBAL VIEWS

the ability of companies to raise capital across the EU. In practice, these measures will ensure that investors have better access to company/trading data, encourage long-term investment, facilitate the cross-border sale of funds, improve the connection between EU companies and investors, improve companies' access to funding, and broaden investment opportunities for investors. **A deepening of the CMU is therefore in sight for 2022.** In line with the September 2020 Action Plan, the Commission announced that it will follow up in 2022 with more CMU actions, including an initiative on corporate insolvency.

This is a sweet spot for the EU: the combination of a new political/institutional environment, the implementation of the NGEU, the revision of fiscal rules (see our text in October Cross Asset), and the deepening of the CMU will allow for greater flexibility in the policy mix, facilitate real convergence, and deepen financial integration. This should foster resilience of the Eurozone and improve the allocation of savings.

The political situation in Europe this year is unique. For the first time since the birth of the euro, the leaders of the three largest Eurozone countries are very familiar with European institutional issues (CMU, BU, and fiscal rules). With France taking over the rotating presidency of the European Union in the first half of the year, Macron has a unique window of opportunity to further push the European agenda.

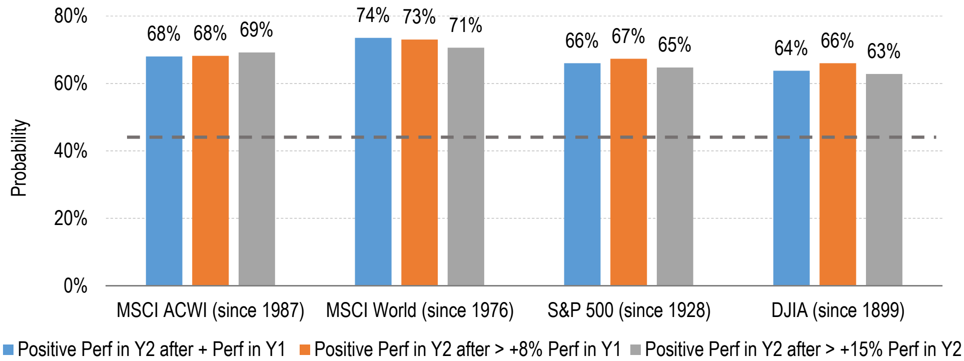
If he succeeds, the NGEU would have a better chance of turning into a permanent instrument in the coming years and facilitate the green and digital transformation. Moreover, it is good for foreign-investor sentiment and should thus contribute to attracting capital flows to Europe.

Are the equity markets more likely to fall in 2022 after their strong performances of 2021?

2021 brought strong performances of equity indices, and many investors are concerned about markets levels and the risk of a sharp correction in 2022. However, is it true that when equity markets have had a good year, they fall during the following year? The short answer is no. If you look at yearly returns of major equity indices (MSCI World, MSCI AC World, S&P 500 or Dow Jones Industrials) since they have been published, the probability of a second year of positive performance is close to 70% on average, with a very narrow dispersion of those probabilities among indices. Adding the condition that year 1 performance was above 8% brings the probability slightly down to around 66%, and it is greater than 60% for all indices when the previous year return was above 15%[1]. Therefore, the fear that equity markets are more likely to go down when they have had a good year is statistically unfounded. Actually, there is a much higher chance that the positive momentum will continue. That is the *power of momentum.* It does not mean that equities will with certainty finish 2022 in positive territory, but merely that 2021's strong performance is not *per se* a reason to be bearish. There are many other reasons why equity markets could go down in 2022, including the Covid risk, valuations and central banks hawkishness. Amundi is neutral on the asset class at the start of the year. But if equities do fall, it won't be only because they went up last year...

[1] *For example: Since 1987, the MSCI World index has 'turned positive' 34 years (out of 46). In 25 years, it turned positive after turning positive the previous year. So, the probability of turning positive after a positive year for this specific historical sample is 73.5% (25/34). The index had a >+8% performance in 26 years (out of 46). In 19 years, it turned positive after having a >+8% performance the previous year. So, the probability of turning positive after a year with this performance for this specific historical sample is 73% (19/26)*

1/ Probability of a positive performance in Year 2 after a positive performance in Year 1



Source: Amundi Research - Data as of 15 December 2021

Why are real interest rates so negative and why is that an issue?

Real interest rates are usually defined as the difference between interest rates (for instance, yields on 10-year bonds) and annualised inflation. This relationship, known as the Fisher equation, shows the purchasing power of this year's bond coupon. In theory, the bond market

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is discounting actual and future growth and inflation. Therefore, real interest rates reflect growth prospects and time preferences.

At the time of this writing, the US real rate for 10 year Treasuries was -5.4% and -5.3% for the real rate on 10-year German Bunds. These numbers suggest that growth would be negative over the course of the next 10 years. They could also highlight that investors do not believe inflation is sustainable. Using inflation forwards[2], we can adjust for that, and in the case of US 10 year Treasuries, we find -1% and -2.2% for Bunds. The Cleveland Fed publishes a UST 10y real interest series using a more complex model that includes inflation data, inflation swaps, and survey-based measures of inflation expectation (which estimates the rate of inflation over the next 30 years). It has found that today real interest rates are negative. In recent history, this has only happened after the Global Financial Crisis and during the Fed QE infinity (QE3's nickname because of its open-ended nature) and the Eurozone crisis. Longer market history shows that real interest rates were also negative around the two oil shocks, i.e., when inflation was rising very sharply, and in the early 1950s, while the Fed was controlling interest rates. Today's real interest rates levels are similar to the 1970s oil shock.

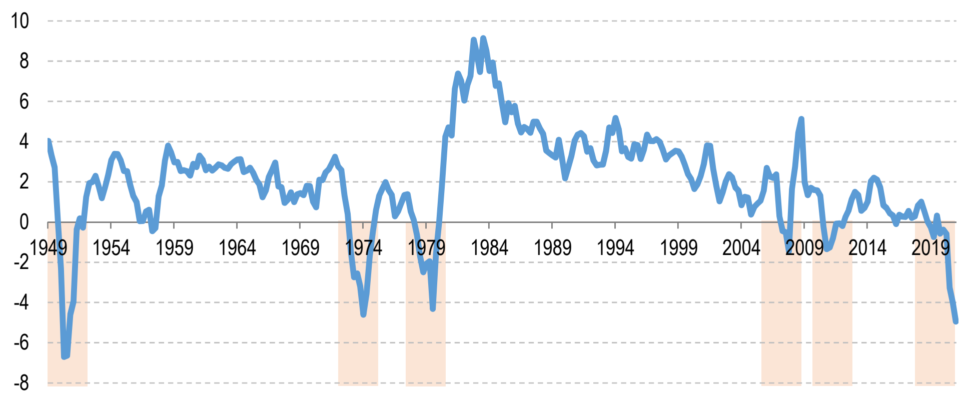
There could be two main reasons why real interest rates are negative: either because inflation is rising a lot faster than market expectations or because the central bank (the Fed in our example) is capping interest rates or at least containing interest rates adjustment via QE, or a combination of both. Investor flows into government bonds for safety or regulatory reasons are dragging down interest rates, too. It is worth noting that phases of negative real rates only last a few years and tend to rise sharply into positive territory afterwards.

Negative real interest rates hurt pension savings and push savers to invest into inflation-proof assets; they lower the cost of funding and support risky asset valuations, and long-duration assets such as high-growth stocks could create more systemic risks, such as asset price bubbles (in real estate or crypto) and eventually undermine the financial systems.

Real interest rates tend to revert back to zero in a sharp move as we have seen in 1975; 1980, 2008 and to a lesser extend in 2012. Given today's low levels, it will certainly increase the bond market volatility and could cause a temporary selloff in risky assets.

[2] *Market price of 5y5y inflation forwards in USD and EUR*

2/ US real interest rates since 1949 - (US 10y Treasury yield constant maturity minus CPI inflation)



Source: Refinitiv Datastream, Amundi Research, December 2021

What if Joe Biden's 'Build Back Better' fails to pass Congress?

Despite long negotiations, Joe Biden's flagship "Build Back Better" (BBB) policy is still short of a majority in Senate. Conservative Democrat Senator Joe Manchin is opposing the bill, which includes new social and climate change-related investments, and stopped the legislative process. Though it is not clear under which form the package will eventually come back, it is unlikely to stay in its current form and size ($1.75t). Therefore, the most likely scenario is a reduced package of $1.2 to $1.5t.

In our projections, we assumed only legislation that has already passed, i.e., the so called Bipartisan Infrastructure Plan, projecting 3.7% and 2.1% growth for 2022-2023, whilst projections for a BBB plan fully implemented would raise growth to 4.5% in 2022 and 2.6% in 2023.

A short-term impact is that several pandemic-related support packages, such as Child Tax Credit, will disappear at the end of 2022. Under current legislation, eligible families receive a payment of up to $300 per month for each child under the age of six. The end of the Child Tax Credit would mean a sharp reduction of fiscal transfers to low and middle-income households with a negative impact on consumption and core inflation. This might therefore ease the Fed's inflation expectations.

Finalised on 21 December 2021

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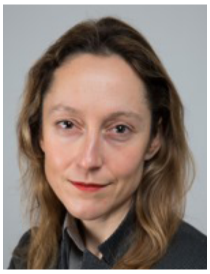

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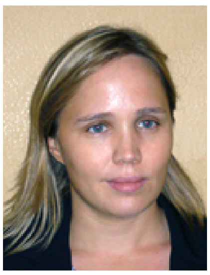

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Central banks: a successful hawkish turn

The three major central banks issued restrictive signals last week. The banks have succeeded in changing the course of their monetary policies without harming the markets.

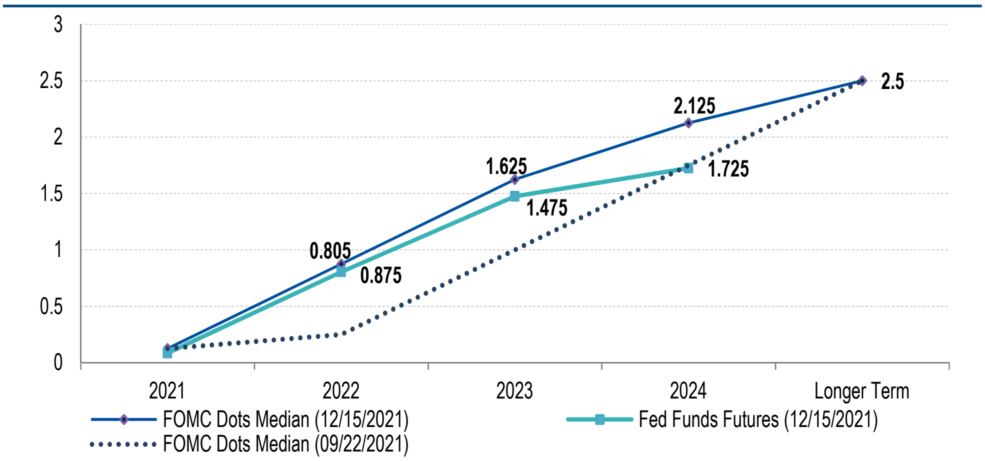
The Fed is accelerating the normalisation of its monetary policy on the back of inflationary pressures and a strong improvement in the US labour market

After well-orchestrated communication in recent weeks, the Fed has hardly surprised investors by adopting a much less accommodating, much more "hawkish" tone. The Fed is accelerating the normalisation of its monetary policy on the back of high inflationary pressure and a favourable economic environment. The Fed sold and the market bought the story that a short, rapid rate hike cycle will be enough to stem these inflationary pressures.

Main takes from Fed's meeting:

1. **Strong shift in inflation narrative.** The Fed is committed to fighting inflation, which has been described as "high" and no longer as "transient". Any reference to transitory factors of inflation was removed. Instead, the FOMC underlined that pandemic-related supply and demand imbalances and the reopening of the economy have continued to contribute to elevated levels of inflation. The median core inflation forecasts was sharply revised on the upside to +4.4% (+0.7bp) in 2021 and to 2.7% (+0.4bp) in 2022, due to higher realised inflation and continued supply chain disruption.
2. **The Fed is accelerating the normalisation of its monetary policy.** The Fed announced the acceleration of tapering in light of elevated inflation pressures and strengthening labour market. The pace of tapering will be doubled to $30bn per month in January. As a result, the Fed will end net asset purchases at the end of March, which should allow a first rate hike in the second quarter. Moreover, FOMC members are now considering three hikes in 2022, three hikes in 2023 and two hikes in 2024. This represents a major shift from the previous forecast in September, where the committee was split evenly between one increase in 2022 and no increase in 2022.
3. **The Fed strongly emphasised the strong macro backdrop and the rapid recovery of the labour market.** Jerome Powell was optimistic about economic growth in the US: "Economic activity is set to develop at a sustained pace this year, reflecting progress in vaccinations and the reopening of the economy" and "Global demand remains very strong". He continued to stress that the Omicron variant is a risk to the recovery. 2022 GDP growth was revised up to 4.0% from 3.8%. Powell cited the falling unemployment rate as evidence that the job market is rapidly approaching maximum employment. The projected unemployment rate improved down to 3.5% in 2022 from 3.8% previously. Powell also downgraded the importance of rising labour force participation as a pre-condition for rate hikes.
4. **The Fed expects that a rapid and limited hiking cycle will ensure that inflation is transitory**
   - The Fed continues to believe that the upward trend in prices will weaken next year, as global supply chains are restored. It is unanimous in thinking that in 2023 it will be barely above 2%. Median core inflation is projected to be back to 2.3% in 2023 (range: 2%-2.5%).
   - At the same time, the rate hiking cycle is expected to remain gradual and limited. The

1/ Implied Fed funds target rate



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

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Strong Fed shift on the inflation narrative: High inflationary pressure figures are now considered to be a drag to achieving full employment

median forecast for rates in 2024 increased only from 1.8% to just over 2.1%. The longer run dots have stayed the same. In the coming quarters, monetary policy will be highly accommodative, with negative real Fed Funds rates. The Fed is signalling a policy move close to neutral only by 2024.

Market reactions and our views:

- Fed: we expect two hikes in 2022. This could be revised upwards if positive US macroeconomic dynamics are confirmed. The strength of US demand in the second half of 2022 will be decisive (on the labour market, fiscal policy and investment cycle).
- In the short term, we expect strong data on the US labour market and US inflation to remain high. The recovery in the US labour market is so far impressive and broad based. Consequently:
  - We are short duration. 5Y yields are usually the most responsive when the employment gap closes.
  - We expect a massive upside for short-term real rates.

The ECB wants to massively reduce its purchases while maintaining a backstop strategy

The outcome of December meeting was more hawkish than expected, but ECB policy will remain much more dovish than those of the Fed and BoE, with QE to persist and no rates normalisation in sight next year. The ECB will end its emergency measures linked to the pandemic, while leaving itself some room for manoeuvre if the situation were to deteriorate again in the Eurozone.

The European Central Bank wants to end its pandemic-linked emergency measures

The ECB wants to massively reduce its purchases while maintaining a backstop strategy. A "large majority" on the Governing Council finally agreed upon 2022 for the quantitative easing outlook, combining more than EUR 500bn in additional net purchases. These decisions represent a very significant reduction in net asset purchases: they will be progressively reduced from EUR 90bn per month in 2021 to EUR 20bn in October 2022. At the same time, the ECB adopted a backstop strategy while maintaining the open character of the asset purchase program and introducing potential flexibility on reinvestment of the PEPP by asset class and by jurisdiction. This is to avoid financial fragmentation as long as economic fragmentation prevails in the Eurozone. The credibility of the ECB will be crucial in this approach.

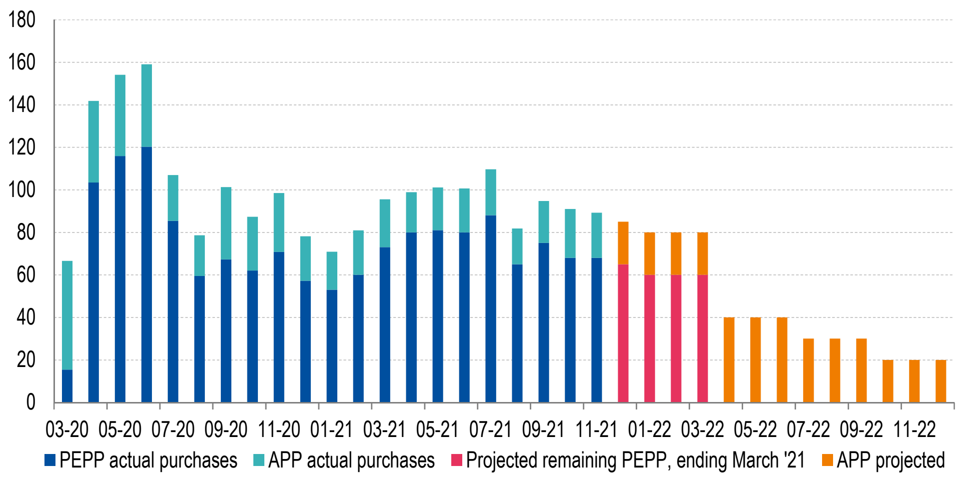
Overall, the policy stance is still supportive for spread products (periphery and credit) in the short term but more volatility should be expected. The ECB announcements reinforce our short duration and curve steepening views going into 1Q-2022. However, we should be vigilant in the face of the growing divergence of views and interests within the ECB's Executive Board. This could bring some volatility in 2022.

Main takes from ECB meeting

1. **Stable outlook for rates: the ECB's inflation projection is below target in the medium term.** As we were expecting, the revision to the set of forecasts kept showing mid-term inflation below target, despite having been raised to 1.8% in both 2023 and 2024. Therefore, the unchanged forward guidance looks still consistent with an accommodative stance through QE in 2022 and a stable rate outlook.
2. **The ECB announced plans to reduce its purchases significantly.** Most of the increased debate and divisions inside the ECB focused on QE, namely on a wide range of combinations as to the form ECB QE could take in the transition away from the PEPP. This included the combination of size with other important factors like whether or not introducing a new programme instead of simply increasing the APP path, whether open-ended or an envelope, and finally on

The divergence is widening between the Fed's and ECB's monetary cycles

2/ **ECB QE: historical and expected 2022 path, in EUR bn**



Source: Bloomberg, Amundi Research - Data as of 16 December 2021

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QE firepower announced by the ECB looks calibrated to cover sovereign debt net issuance projected in 2022

the indicated time frame/horizon (especially in the case of an envelope). In the reported chart, we show 2022 QE path implied by the ECB announcement, vs dynamics of current and previous years. As PEPP will be run in Q1 *"at a lower pace than in the previous quarter"* before being discontinued, we assumed a monthly path close to EUR 60bn between January and March next year. Then, as announced, despite being increased in Q2 to EUR 40bn per month, and in Q3 to EUR 30bn per month, APP path will be back to current EUR 20bn in Q4 next year. According to this scenario, overall yearly QE firepower appears to be slightly higher than EUR 500bn, rather than close to the EUR 600bn we expected. In terms of quarterly breakdown, the reduction in the path is quite evident: from an estimated EUR 240bn in Q1 (the remaining PEPP + the EUR 20bn APP monthly path), down to EUR 120bn in Q2 (with APP at EUR 40bn), to EUR 90bn in Q3 (with APP at EUR 30bn), and finally at EUR 60bn in Q4. QE will therefore be concentrated mainly in H1, matching higher sovereign debt supply seasonality vs the lower primary market activity usually recorded in the second part of the year.

3. **…. To move to a backstop approach : QE flexibility.** Despite not introducing a new programme for pandemic recovery, the ECB remains ready to resume PEPP, but only "if necessary, to counter negative shocks related to the pandemic". Then the ECB decided to address QE flexibility/optionality mainly through PEPP reinvestments. As they have been prolonged by one year (at least to end 2024), reinvestments actually represent an important backstop in order to retain its PEPP purchase flexibility in terms of asset classes and jurisdictions. This represents an additional buffer the ECB may use to support periphery debt in the event of undesired volatility and is also aimed to support Greek debt till a potential rating upgrade triggers the APP eligibility of its bonds. As we know, the ECB does not publish a forward schedule of PEPP reinvestments as it does for PSPP. However, as PEPP reinvestments are becoming an important policy tool, the ECB should provide more guidance to investors, in the same way as it does with the APP.
4. **The end of the special conditions applicable under TLTRO III in June 2022 was confirmed.** Still, the ECB will *"monitor bank funding conditions"*, in our view in order to avoid unwanted cliff effects: as with its purchase program, the GC will likely aim at a smooth transition away from its emergency regime, through decisions at coming meetings. Interestingly, the last TLTRO auction of the year preceding the ECB meeting saw a slightly negative addition of liquidity at -EUR 8 bn for the first time since the pandemic crisis, as some EUR 60 bn was repaid/rolled off vs a gross EUR 52bn take-up by almost 160 banks. We see this auction result overall supportive of overall financial stability, whilst having a limited impact on bank revenues as no new net liquidity was added to the system.

Our conclusions and markets' implications for EUR rates and spreads:

We should be vigilant in the face of the growing divergence of views and interests within the ECB's Executive Board. This could bring some volatility late in 2022. In the short term:

- ECB announcements reinforce our short duration and curve steepening views going into 1Q-2022. Despite the taper and improved macro picture, however, we still expect the ECB QE to absorb most of net issuance to contain the upward yield move vs other developed areas. The potential tilt of reinvestments into non-core bonds may be an additional factors supporting the expected curve move.
- The positive view on periphery debt remains confirmed, supported by technicals (lower net debt issuance still expected in 2022 to be mostly absorbed by ECB new purchases, stable policy rates in sight) and by the potential tilt of PEPP reinvestments into the asset class, together with improved fundamentals, positive rating agencies news flow, and attractive relative value.
- APP will continue to provide support in the euro credit market.

Among the G4 CBs, BoE was ultimately the first to end QE and start hiking rates

After surprising on the dovish side in November, the BoE again surprised markets and our latest expectations at its December meeting, this time on the hawkish side, with an unexpected hike of 15bp, taking the base rate to 25bp. The almost unanimous 8-1 vote, showing that the decision was largely consensual inside the MPC, looks a surprise, too, given some recent statements also delivered from hawkish members pointing to a likely stand-by on the back of the pandemic trend. At the same time, it is worth noting that, despite the lift-off delivered, the BoE seems to have chosen a halfway move with a 15bps increase (rather than 25bps).

Main takes from BoE meeting

- Going into the meeting, a first rate hike appeared fully consistent with latest macro data, as the latter showed an even greater than expected improvement in labour market trends in both October and November, in the presence of still high inflation prints in both months. At the same time, increased concerns over the Omicron variant and the UK's increasing its threat level were causes of concerns. Here again, commentary drove expectations,

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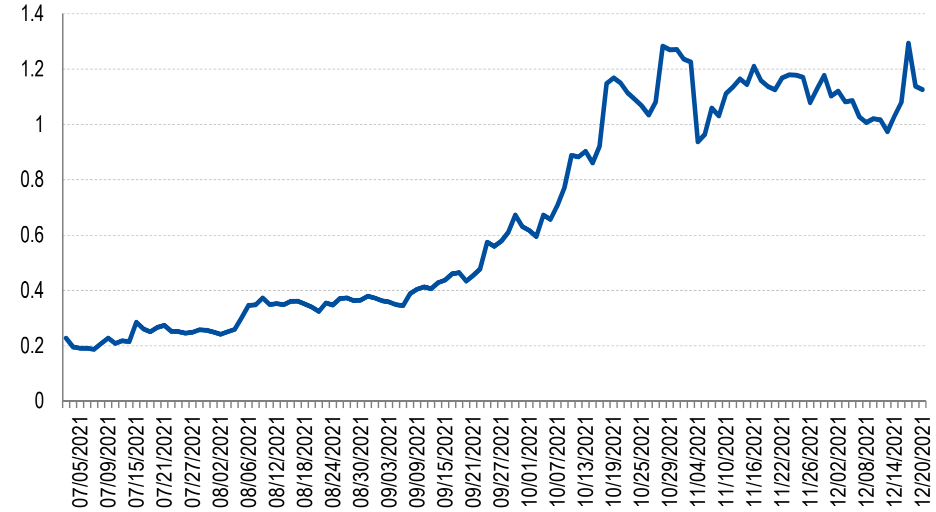
3/ **1-yr forward BoE implied rate**



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

We maintain the view that the market is still pricing in a too aggressive path for the BoE's monetary policy next year

where some members, also among hawks, pointed to caution to get more visibility on the impact of the Omicron variant and therefore reasons for remaining on hold in December and postponing the first move to February next year. After the meeting, Governor Bailey cited inflation concerns and a need to act as the main reason for the hike now, despite mounting uncertainties on the virus front. The rationale underlined by the governor appears consistent with additional risks posed by pandemic trends not only to growth but also to higher inflation potential, through negative impacts coming from eventual additional restrictions or disruptions due to a worsened pandemic trend.

- The macro rationale behind moving sooner rather than later appeared also consistent with the mix of the latest BoE revisions to its economic projections. Here are some details in terms of key macro updates vs the November Financial Stability Report:
  - projections were revised down for 2021 Q4 GDP growth to 0.6% from 1% at the time of the November Report, leaving GDP around 1.5% below its pre-Covid level (of Q4 2019); disruptions in supply chains and shortages of labour kept impacting on growth, but
  - the unemployment rate is now expected to fall more rapidly, to around 4% in 2021 Q4, better than the 4.5% projection in the November report, while
  - twelve-month CPI inflation rose from 3.1% in September to 5.1% in November while BoE expects inflation to remain around 5% through most of the winter, and to peak at around 6% in April 2022.

Our conclusions on the expected path of monetary policy and view on UK Gilt curve.

On projected rate normalisation, we maintain the view that the market is still pricing in a too hawkish path for the MPC next year, with more than three additional hikes, each by 25bps, still priced in by end 2022. In our

QE vs expected sovereign net supply in 2022

Although lower than expected, QE firepower announced by the ECB looks calibrated to cover sovereign debt net issuance projected in 2022. This is more the case on the back of the very recent issuance guidelines published by Germany and other countries. In light of declining gross funding needs and according to the 2022 issuance plan released on 16 December, Germany is now expected to combine in 2022 net issuance of bonds close to EUR 53bn (down from EUR 93bn this year) and a negative net issuance of Bills of EUR 25bn (vs an increase by EUR 41bn in 2021). This would mean for Germany quite a fall with respect to 2021 figures, overall (bonds +bills) by more than EUR 100bn. In light of these and other recent releases, we have therefore lowered our previous estimates for EMU-10 countries' debt net issuance to EUR 350/360bn, including Bills. On the demand side, we estimate ECB QE to reach EUR 510bn next year, out of which EUR 390bn may be allocated to sovereign debt. This would mean estimated flows of EUR 60bn available for corporates, roughly EUR 10bn for covered bonds, and finally more than EUR 50bn for supranationals (included EU issuance). The reported chart shows that, despite failing to make net issuance negative as in 2021 and 2020, the ECB role is going to remain remarkable in absorbing new sovereign debt.

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view, the BoE would rather take rates to 75bp, and then pause in the rate hiking cycle. This would be consistent with the need to keep flexibility in managing Quantitative Tightening planned to start when base rate have reached 1%. Although inflationary pressures suggest the BoE should raise rates again in February, it might consider instead a wait-and-see approach, monitoring closely how the economy develops coming out of another Covid-wave, in order to deliver the second hike. In our view, while the front end of UK Gilt curve is probably pricing in too much of a rate normalisation, the long end is still looking rich vs inflation expectations and relative to other curve segments. Therefore, we see potential for a steeper Gilt curve in 2022, accounting for long end current valuations, not only relative to the 2-yr but also to the 5-yr maturities.

Finalised on 22 December 2021

THEMATIC

LatAm's political pendulum takes a hard swing to the left in 2021

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2021 Covid surging in 1H and inflation swelling in 2H have contributed to the political pendulum swinging hard left in LatAm. More structurally, the commodity super cycle unwind mid last decade and the political discontent likely set the entire shift in motion. Against the general trend, some elections cycles moved in the other direction as well.

2021 was an intense and dramatic year for the LatAm region with Covid surging in 1H, inflation swelling in 2H and the political pendulum swinging hard left for chunks of the year. While the former two likely contributed to the latter's leftward shift cyclically, the longer in duration structural decline caused by the commodity super cycle unwind mid last decade likely set the entire shift in motion. The strong public discontent with the status quo resulted in Peru's anti-establishment vote in favour of its first ever (hard) left president while Chile's demand for change loaded the constitutional assembly with the left leaning independents and the highest office in the country going to a Leftist too. In Brazil and Colombia, which are yet to hold elections in this cycle of elections, left aligned presidential candidates (Lula and Petro) are clearly leading in the polls.

But while the general political trend throughout the region has been surprising to the left, there have been some course inflections and corrections in the other direction as well. In Mexico's mid-term elections held in June, AMLO's ruling coalition lost the qualified majority (and power to amend the constitution) while Castillo's first cabinet saw a reshuffle in a more moderate direction after a very erratic couple of months. In Brazil, Lula is flirting with an idea of adding a centrist name to his presidential ticket which could suggest a more pragmatic policy direction if elected. But the biggest turn to the right took place in Argentina where the opposition won decisively the October mid-term elections and the ruling coalition lost the Senate majority for the first time since 1983.

We discuss LatAm's 2021 political events in more detail and take a sneak preview of the ones awaiting us in the new year below.

Peru: Takes a hard left turn first and a step in a more moderate direction a few months later. Will the trend continue?

Peru took a hard left turn first and a step in a more moderate direction a few months later

In June 2021, Pedro Castillo, a rural leftist teacher defeated right wing Keiko Fujimori in an extremely polarised and tight presidential elections. Contested results made the transition anything but smooth while government appointments were far from market friendly in most cases. That in turn led to a turbulent couple of months and a cabinet reshuffle eventually. But while President Humala's u-turn four months into his term in 2011 set a far more market friendly course for country, Castillo's cabinet reshuffle four months after winning the *ballottage* was far from a complete course correction. It did however mark a turn in the 'right' and more moderate direction.

Most importantly, President Castillo replaced the controversial Premier Bellido who used nationalisation threats freely with a moderate-left leaning lawmaker Vazquez formerly a House Speaker under President Sagasti in 2020/21. All in all, the cabinet is now relatively better aligned with the Finance Minster's Francke position after a pivot away from the most radical ideas represented by the Peru Libre party leader Mr. Cerron – the latter came out strongly against the move and in no longer supporting the government.

But as evidenced by some recent events – e.g. an announcement by the government four mines would be shut down as their extensions would not be granted over environmental concerns - low visibility on policy actions by the current administration is likely to continue. We suspect we might see yet another impeachment in Peru – there have been 5 presidents over the past 4 years – before policy takes another and clearer moderating move. In the meantime, we take comfort from seeing Mr. Velarde reappointed as BCRP governor that ensures monetary policy continuity.

Chile: Big-state on the way with the Constitutional Assembly and presidency in the hands of the left leaning independents and a leftist

In yet another anti-establishment vote in LatAm, the ruling and right aligned coalition, traditionally a recipient of around 40-45% votes, won only about 20% of the seats in the Constitutional Convention election held in May of 2021 called after nearly 80% of voters sided in favour of redrafting the Constitution several months earlier – the constitutional process in turn was initiated after the country was rocked by mass protests against high levels of inequality and corruption. The fifth acquired was well below expectations and 1/3 required to block any radical proposals that might make it into the new Constitution. Instead, it is the left wing delegates and independents in control the constitutional agenda that will

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likely push for a much larger State and broader social rights.

The left will also control the highest seat in the country with Gabriel Boric, former protest leader, winning the December ballotage by 11pp over the conservative and hard right candidate Kast. The wide margin of victory on a fairly high participation rate points to a strong mandate to pursue an ambitious overhaul of the country's economic and social model including its healthcare, pension, housing, education, pension system etc. That in turn would require a big structural boost to revenues.

It is worth noting two mitigating factors before outright extrapolating the size and the interventionist nature of the state in line with the presidential election outcome. One is composition of the Parliament. In the October congressional elections the right surprised on the upside ending up with half of the Senate seats and maintaining the veto power over Constitutional/key matters while the Lower House is split between right and left. The other is Boric's moderating stance taken during the runoff campaign. The president elect acknowledged the change would be gradual and the permanent expenses would need to be covered by permanent revenues in order to stabilise the debt dynamics in the medium term. Needless to say, the country is heading in the direction of the state taking on a bigger role and social safety net broadening in scope while the only question remains to what extent.

Colombia: Social discontent on display in the streets and in Petro's lead

Social discontent on display in the Columbian streets and in Petro's lead

As in many places across the region, social discontent with the *status quo* rose high and in case of Colombia spilled over into the streets in 2Q'21. Hell broke loose when the administration proposed a way too ambitious, prudent and poorly timed tax reform with protests and strikes paralysing parts of the country for a good few weeks. The fiscal reform was eventually withdrawn but social demands only grew and the fiscal story also deteriorated when fiscal consolidation was delayed until 2023. As a consequence of all, Colombia's credit rating was downgraded to junk with painful consequences on asset prices.

But the worse might be behind it now with the economy rebounding strongly and about pre-Covid levels now, the labour market dynamics surprising on the upside and inflation showing the least malign inflationary trends in the region. Most importantly however, a far more pragmatic fiscal reform received a broad political support and while not resolving the issues structurally, it tackled the cyclical objectives to an acceptable degree.

When it comes to next year's presidential elections, Petro (communist, former M-19 rebel member, current senator) leads in the polls by a double digit margin. We do however take some conform from knowing the economy will have another six months before elections take place and an extreme position by Petro will in theory unite the electorate to vote against his radical ideas in the second round of the elections as already seen a few years ago.

Mexico: First one to defy the regional trends

While the Latam region was voting or polling left, elections in Mexico took a slightly different turn

While the Latam region was voting or polling left, elections in Mexico took a slightly different turn, at least at the federal level. In June midterm elections, the Morena coalition lost the super majority it won three years earlier and AMLO's Morena Party lost the simple majority. The ruling coalition will thus control the budget (and fund projects close to the president's heart e.g. refinery, train line etc) and the legislative agenda in 2H of AMLO's term but it won't have the votes to amend the constitution and implement AMLO's state centric vision of the energy sector or another unorthodox and often less friendly market idea.

The latter constrain is already on display. AMLO's proposal to overhaul the electricity sector would allocate majority of the market to the state-owned power utility. In the process, and due to a smaller participation of a typically more efficient private sector, electricity would likely get more expensive, its provision less reliable and its generation dirtier. That's a clearly suboptimal outcome domestically but also potentially in violation of the new NAFTA trade agreement.

But while losing quite a few seats at the federal level, Morena coalition did well in state elections and in fact strengthened its local presence (except for in Mexico City). The ruling coalition won 12 governorships which together with 5 already in Morena's hands gives it an important majority (there are 32 states in Mexico).

All in all, we see the election outcome in Mexico as a glass half empty outcome for the Morena coalition. It will constrain AMLO going forward in pushing its, often less market friendly, agenda. It won't however stop him from making inroads in other areas of policy or exerting influence over country's institutions. AMLO's recent Banxico appointment decision is a clear case in point. A late governor replacement with a far less experienced and trained name is a risky proposition especially at a time when the Fed is losing its patience with 'transitory' nature of inflation and the domestic hi-flation cycle might need far more action and preference over growth considerations. Fortunately, the Central Bank might be seeing things similarly having raised interest rates by a bigger 50bps at its latest policy meeting in December.

THEMATIC

Brazil: Polling Left but is Lula skewing center left?

The presidential elections in Brazil scheduled for late 2022 give the authorities more time to get the economy on a firmer footing and inflation down from politically sensitive double digits. That in order to avoid a potentially leftward shift under Lula's stewardship who is polling strongly and is visibly ahead of Bolsonaro in both first and second round simulation. But while a favourable timing of the elections avoided an apparent turn to the left seen in the rest of the region, the current administration has taken a number of questionable actions of populist nature in the recent past.

The less prudent and orthodox policy mix had been driven by both economic and political considerations. Global pandemic of hi-flation has hit Brazil particularly hard hammering disposable income visibly and Bolsonaro's popularity in the process. The administration's response to alleviate the intensifying social demands was to increase handouts of the flagship welfare program fitting the bill under the Spending Cap, the ultimate fiscal anchor, via a creating accounting trick only.

Elections wise, while we don't see a third party candidate, such as former minister Moro currently polling in low single digits, reaching the ballotage stage, we are encouraged by recent signals former president Lula is considering adding a centrist name (Ackmin, four time governor of Sao Paolo, former presidential candidate) to his presidential ticket. That would suggest a more pragmatic policy mix by the Lula administration than his party's political orientation and a less noisy presidency by the 'unity ticket' than the current one despite a highly polarised environment. A glass half full outcome, we think.

Argentina: A clear rejection of the status quo and Left's policy mix

The November parliamentary elections brought a multiple defeat for the ruling Argentina's Coalition

We will see over the coming weeks and months whether actions follow election results, but the political set up has seen a dramatic make over in Argentina in late 2021. The November parliamentary elections brought a multiple defeat for the ruling coalition. The FdT lost the national vote by around 10pp, the city of Buenos Aires (BA) by a whooping 20pp and even the province of BA, Kircherist stronghold. In addition, while the ambitious goal of the ruling coalition was to win the Lower House majority, the FdT in fact lost a couple of seats in it. More crucially however, the Peronists lost the senate majority for the first time since 1983. The election results were in line with the primaries held a couple of months earlier despite a costly fiscal response and heavy handed macro interventions that included transfers to household, price and capital/FX controls and even export bans. But rising poverty rate and >50%Y inflation seem to have been too big of a factor for the majority of the voters who voted decisively in demand for change.

The defeated administration is looking at an equally weak economic expansion beyond the cyclical, post pandemic rebound and structurally unbalanced economy, with little buffers at its disposal. There are also the pending IMF repayments – the March instalment will be already heavy – and quite frankly very little resources to meet these obligations (over $40 billion in total) over time. The existing status quo will be difficult to sustain economically, and by extension costly politically, until the next election scheduled for late 2023.

The difficult starting point and worrisome outlook are a clear incentives for the administration to strike a deal with the IMF, necessary though not sufficient condition, and start getting the economic house in some sort of order. It is also in government's advantage to get an agreement done sooner rather than later as long the conditionality is light. In line with that thesis, post-election speeches by President Fernandez and Finance minister Guzman seemed to be preparing the political ground for a roll out of a multi-year adjustment program aligned with a broad understanding reached with the IMF. Importantly, the vice president Kirchner while distancing herself from a potential agreement, spoke of legal, political and historical responsibility of the entire Congress to consider its approval. This bodes well for a deal with the IMF which might be struck fairly quickly in order to avoid any substantial repayments. The economic adjustment will require however far more time, sacrifice, and perseverance, we suspect.

Finalised on 22 December 2021

CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We are making no change to the narrative and the probabilities of the scenarios. The central scenario assumes that Covid will become endemic with multiple, albeit manageable waves, that fiscal levers will remain significant and tied to monetary policy, and that growth will come back to potential in 2023. We assume the Omicron variant will temporarily impact the recovery in Europe.

DOWNSIDE SCENARIO 15%

Renewed slump toward stagflation

Analysis

- Several risks precipitate an **economic downturn**, whose depth depends on the nature and intensity of the shock.
- **Upward price pressures fade**, as global demand falls and labour markets deteriorate.
- **Renewed monetary and fiscal accommodation,** possibly a further step in financial repression.
- Inflation to resurface later, forcing **CBs to deviate** from their guidance and lose credibility.
- **Possible triggers** include China's hard landing, a Covid-19 resurgence, financial shocks, de-anchoring inflation expectations, climate-change-related natural disasters and policy mistakes.

Market implications

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

CENTRAL SCENARIO 70%

Bumpy road, regional divergences

Analysis

- **Covid-19** becomes an endemic disease, with random contagion waves.
- After catching up in 2021-22, **growth** converges to trend in 2023. Soft patch in H1 2022 due to China's slowdown, negative impact of Omicron and accelerating inflation.
- Persistent **inflation** pressures due to supply-side bottlenecks and to rising wage pressures.
- **Monetary policy asynchrony:** Fed in fast tapering mode and hiking twice this year; BoE in a soft hiking cycle, ECB recalibrating QE; and PBoC on an easing bias. Rates to stay low for longer.
- **Fiscal policy:** withdrawal of some support, but public funding will be needed for the energy transition.
- **Climate change** bites into growth and inflation by disrupting the commodity cycle and adding to stagflationary trends.

Market implications

- Lower risk-adjusted expected returns due to high valuations and decelerating growth
- Contained steepening of US Treasuries yield curve as well as EZ and EM
- Inflation hedge via gold, linkers and equities
- EM: Short-term caution, long-term income and growth story intact

UPSIDE SCENARIO 15%

Inclusive and sustainable growth

Analysis

- **Pandemic recedes** more quickly than anticipated despite variants.
- Extra savings and wage rises fuel **consumption** with no erosion of corporate margins.
- **Productivity gains** thanks to tech changes and structural reforms.
- **Inclusive growth** and effective fight against inequality.
- **Inflation** remains under control.
- **Higher interest rates** due to stronger investment and less savings.
- **Central Banks** policy normalisation is well received by financial markets.
- **Debt is sustainable** thanks to strong growth and a gradual shift towards fiscal discipline.
- **Possible triggers** include good policies (e.g., structural reforms, effective vaccine campaigns, and inclusive de-centralised finance).

Market implications

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

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

TOP RISKS

Monthly update

We make no change to the top risks to our 2022 central scenario this month since the Omicron wave was already part of Pandemic 2.0

We consider Covid-19-related risks to be part of the economic risks. Risks are clustered to ease the detection of hedging strategies, but they are obviously linked.

ECONOMIC RISK 20%

— **Pandemic 2.0**
  - Despite mass vaccinations, a new Covid wave kicks off in the Northern Atmosphere.
  - Variants with limited vaccine efficacy undermine the economic recovery (new lockdowns or mobility restrictions).

— **Supply chain disruptions** carry on, and input cost pressures lead to corporate earnings recession.

— **China property market collapses,** leading to lower growth prospects.

— **Oil & Gas shock** driven by surging demand and capex cuts fuels high inflation.

— **Monetary policy mistake**
  - As inflation expectations rise, the Fed and large DM central banks tighten financing conditions too early, hurting the recovery while inflation eventually falls back
  - Central banks' miscommunication leads to greater uncertainty.

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

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

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

FINANCIAL RISK 20%

— **De-anchoring inflation expectations** lead to a bond market dislocation and harsher monetary tightening.

— **Corporate solvency risk increases,** despite improving fundamentals once central bank liquidity and government supports are withdrawn.

— **Sovereign debt crisis**
  - With public debt as a share of GDP reaching historically high levels in peacetime, most countries are vulnerable to rating downgrades and rising interest rates.
  - Emerging market weaknesses could also face a balance- of-payments crisis and increased default risks.

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

— **USD instability** and gradual loss of its reserve currency status lead to unstable currency markets.

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

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

(GEO)POLITICAL RISK 20%

— **US & Europe vs. China & Russia**
  - Loss of US influence post Afghanistan withdrawal and mistrust from Nato allies
  - The US takes a hard line with China and Russia
  - The EU could follow the US, despite their economic interests
  - Accidental confrontations in the South China Sea or the Taiwan Strait
  - Military action at the Ukraine border

— **European populist vote,** in France or in Italy on the back of the Covid crisis and rising energy prices. Increased EU fragmentation

— **EM political instability driven by:**
  - Chaotic virus crisis management
  - Higher food and energy prices, leading to a wave of unrest similar to the Arab Spring

— **US & China lose credibility** on the energy transition and undermine the Paris agreement.

— **Global warming** leads to an increased risk of conflicts, driven by water shortages and migratory movements.

— **Cyber-attack or data compromise,** disrupting IT systems in security, energy and health services

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

- **Oil, credit & 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

- After the strong expansion of the third quarter, the deteriorating pandemic situation is leading to a more pronounced deceleration of economic activity.
- Lower Q4 growth rate is also confirmed by slowing high frequency data and soft indicators. The service sector remains the most exposed as the latest December flash PMIs confirmed.
- However, manufacturing activity continues to expand at a solid rate despite severe supply chain disruptions and strong inflationary pressures.
- Economic surprises have stabilised supported by soft data surprises. Conversely, hard data surprises remain stable and negative.
- Despite improving, our CESI index remains negative in Germany and Spain while continuing to trend higher for Italy and France and stay positive in the US supported by soft data surprises

FUNDAMENTALS & VALUATION

- Multiples and EPS expectations are too complacent considering the economic deceleration and the Fed tapering impact, even if we consider that interest rates will stay low in the near future.
- Liquidity has been the strongest driver of risky assets. This support should fade somehow now that inflation pressures push central banks to start normalising their policies.

NEUTRAL + ASSET ALLOCATION

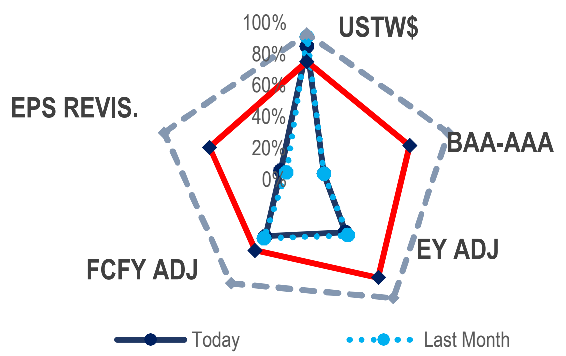
TECHNICALS

- Technicals keep showing a mixed environment with a lack of clear-cut directionalities.
- The medium-term trend in risky assets remains solid, yet short-term momentum signals are less supportive.
- Rising uncertainty generated by the Omicron variant.
- Contrarian metrics cleaned out during the recent market correction. Most risky assets are not overbought anymore. Yet considering stretched valuation both in stocks and credit, we believe the signal is not enough to initiate long positions if taken in isolation.
- Buy the deep narrative seems to be working. However, the deteriorating backdrop coupled with more active central banks suggest higher volatility.

SENTIMENT

- The new variant is adding concerns on growth, whilst inflation is getting more and more persistent, forcing CBs to consider a normalisation in both asset purchases and policy rates.
- We confirm the lack of evidence of structural de-risking in our risk metrics toolkit, yet something different from the past is emerging.
- Financial conditions started to signal a modest tightening at global level, with EM financial conditions taking the lead.
- We are still far from a "risk-off" environment, yet institutional investors have trimmed their risk exposure in most of the dimensions (equities, FX and bonds).

Cross Asset Sentinels Thresholds (CAST) still supportive



Source: Amundi Research, Data as of 14 December 2021

The CAST risk perception has failed to show a structural increase. The deterioration in EPS revisions remains limited and credit risk premiums (we proxy using Moodys' Baa-Aaa spread) remain low and a function of still-loose financial conditions. Yet the USD is the dimension calling loudly for risk-off, and its spill-over into the residual dimensions needs to be closely monitored.

<u>**Methodology:**</u> We consider five inputs, which we call "sentinels": USTW$, Moody's Baa-Aaa, 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 the market's 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 higher the risk perception, and eventually the need to move closer to a defensive asset allocation.

GLOBAL RESEARCH CLIPS

1 US inflation revised higher, extending the current regime into 2022 and postponing the convergence to lower levels in 2023

- 2022E CPI @ 4.4% (versus 3.8%, quarterly avg.), on a higher base (Q4) and confirmed persistence
- Amundi's CPI forecast is slightly above consensus which stood at 4.2% 2022E. We therefore expect an extension of the current inflationary regime into 2022 and convergence to a "normal" inflation regime (as per Inflation Phazer labelling) to start overtaking in Q4 2022 and prevailing in 2023
- Worst case scenario: Covid-19 spillovers continue impairing supply (higher costs) and demand (progressive erosion), pushing central banks into a corner

Investment consequences:

- The inflationary regime is now the central case for 2022, implying: 1) central banks are more under pressure on monetary policy adjustments; 2) there is upward potential on nominal (and real) yields; and 3) there is less support for valuations in risky assets, which markets are not factoring in yet despite the recent pullback

2 Changing our Fed rate hike forecasts for 2022: we are adding one rate hike in June (25bps), confirming the other one in Q3/Q4.

- **Inflation speeds up the policy tightening** via faster tapering (ending March) and therefore opening the door to rate hikes soon thereafter
- We believe the number of FFR hikes will be linked to the job market participation rate
- We expect one hike in June, followed by another one in Q3 or Q4
- The short end of the US curve is more sensitive than the long end. We have revised our 2Y target to 0.80/1% in 6M (was 0.45/0.60%) and to 1/1.20% in 12M (was 0.70/0.90%), while leaving 10Ys unchanged
- These FFR hikes are more an opportunistic signal than effective normalisation, as real interest rates will remain negative
- **Omicron is a game changer**, which was not included in the Fed's forecasts

Investment consequences:

- We reiterate our short duration call on UST 5y, as well as on the UST10y as the employment gap closes

3 Risk sentiment is still "ON" but deteriorating progressively, and is providing less support to risky assets

- Risk Sentiment is still in "ON" mode, but the last leg of the USD appreciation caused a meaningful tightening to EM financial conditions
- Emerging markets' financial conditions have recently been experiencing a broader tightening, due mainly to USD's strength
- Risk sentiment is therefore the pillar, which is deteriorating faster despite remaining risk-on
- The moderation in risk sentiment signals that the early phase of the cycle is approaching its end, and that we are approaching **a late-cycle regime**
- Credit and financial conditions are back to October 2020 levels, something consistent with the fact that lower growth is becoming an issue, but liquidity is what matters the most to investors in maintaining their long exposure to markets
- While preventing a full risk on stance, the current environment is not yet a call for closing all risks
- Moody's spread widening weighted on HY already

Investment consequences

- Decreasing growth, USD's strength, credit widening and wage increasing pose a clear risk of severe downward revisions to EPS in H1 2022, which is not yet factored in

4 EM macro momentum: Asia mildly picking up versus Latam and CEEMEA

- While EM macro momentum is still negative, for the first time in a while we see a shift across the regions, favouring Asia vs Latam and CEE/MEA
- Overall, softening domestic and mainly external demand will result in lower growth projections
- We expect China's GDP growth to stay close to, but below, 5% over the next two years. EM growth should be above 4% in 2022 and 2023, while inflation should be above 4% on average

GLOBAL RESEARCH CLIPS

5 Chinese policies have shifted more quickly to the easing side: broadly positive for Chinese assets and for global growth

- With the latest 50bp RRR cut, the PBoC policy stance has decisively shifted the focus back to growth stability and domestic demand
- As the policy stance is much more constructive in 2022 vs 2021, a rate cut now looks possible
- Politburo's policy stance for 2022 is much more constructive than last year. The leadership might have decided that supply-side reforms were over-done, shifting their focus back to growth stability and domestic demand. On housing, it is asking the sector to "better meet proper housing demand"

Investment consequences:

- RMB weaker in the ST at 6.55 (6M) and 6.4 in 12M
- Stable govies targets 2.8%-2.9% (lower yields by few basis points in case of rate cut)
- Even more constructive than anticipated on Equity (particularly on the CSI 300 Dividend)

6 The EU sweet spot

- The Capital Market Union (CMU) is moving forward as the European Commissions announced a package of measures to improve the ability of companies to raise capital across the EU
- More political cohesion in the EZ with convergence of interests Germany (Scholtz), France (Macron) and Italy (Draghi)
- More reforms to come on fiscal rules, investments spending with the NGEU and new proposals from Germany on Banking Union

Investment consequences

- Positive foreign investors sentiment towards the Euro area (peripheral bonds and equities),
- Resilience and internationalisation of the euro
- Financing the green & digital transformation

7 Eurozone 2022 GDP forecast revised down in light of the impact of Covid-19 Omicron

- Containment measures introduced and new lockdowns announced in some EA countries were not embedded in our forecasts with the November update
- We have reduced our growth forecasts by a cumulative 0.4 percentage point over 4Q21 and 1Q22
- Average growth rate expected: 2021@ 5.0%, 2022@ 3.8%, and 2023 @ 2.2%
- In light of the November inflation reading and PPI, we are also revising up our inflation projections for Q4 2021 and for the 2022 year average
- Average CPI headline annual rate expected: 2021@ 2.5%, 2022@ 2.9% , 2023@ 1.7%

Covid-19 situation update

Pierre BLANCHET, *Head of Investment Intelligence*

The Covid-19 sanitary crisis has moved to another phase, with the Omicron variant spreading quickly throughout the world. According to recent studies, Omicron cases are doubling in 1.5 to 3 days according to the WHO and are now rising in 64 out of 240 countries. Europe, which already had a growing share of global cases since September, is so far the epicentre of this new wave. Most European countries have seen a surge of cases, while the UK is facing a record high level of infections (with a daily rate above 1k per million people[1]). At the time of this writing, Omicron was spreading across the US, accounting for three quarters of new cases.

Although the Omicron variant is far more contagious than the Delta variant, existing studies confirm it is not more dangerous and that, thanks to vaccines, the hospitalisation rate is not increasing as fast. According to the WHO, preliminary evidence suggests that there may be a reduction in vaccine efficacy and effectiveness against infection and transmission associated with Omicron. However, several vaccine producers have confirmed the efficacy of their jabs against the variant.

In advanced economies, governments are urging people to take a booster jab in order to increase immunity and reduce the number of severe cases. However, scientific advisory panels have said that data are showing that boosters alone will not be enough to contain Omicron. Mobility restrictions are now being implemented across Europe where most yearend public events have been cancelled. The Netherlands has reimposed a strict nationwide lockdown. Germany and France are setting new entry rules for travellers outside the EU. A strange feeling of "déjà vu" and Covid fatigue is noticeable across Europe.

[1] *Our World in data – 21 December 2021*

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=		We remain neutral in light of tight valuations in some segments and high concentration risk. However, we are looking for names that allow us to safeguard portfolios from inflation through strong selection capabilities. In addition, we are aware that only companies with strong pricing power will be able to sustain earnings once supply bottlenecks are eliminated.
	US value	+		In light of continued economic growth, value names should deliver performance, but this will be driven more by selection and less by market direction. Interestingly, quality value areas present opportunities to inflation-proof portfolios and in the ESG space.
	US growth	-		Long duration stocks are likely to be affected more by increases in core rates as their valuations rely heavily on discounting of future cash flows. Valuations in this segment are already expensive, which is not justified by fundamentals, and any upward move in rates could be damaging.
	Europe	=		Current earnings expectations are conservative and with strong growth upside in 2022, earnings could provide a positive surprise, but the key unknown is the pandemic. Initial assessment points to a benign impact of the new variant, indicating the risks of a delayed recovery rather than a derailment. Amid high valuation dispersion, the scope for selection is high
	Japan	=		Japan, which has been a laggard in the recovery so far and is trading at attractive relative valuations, should benefit from increased external demand as supply issues are resolved, fiscal stimulus and a weaker yen.
	China	=		The country presents selective opportunities, but the short-term outlook is blurred by uncertainty over the extent of the slowdown in areas such as construction, regulations and policy for zero-tolerance of Covid. We stay watchful amid the government's desire to propagate common prosperity which should help reduce inequalities.
	Emerging markets	=		On a medium-term view, EM equities offer opportunities for investors amid an expected growth rebound in 2022 and attractive valuations. We like markets such as are Russia (structural demand for energy and commodities) and India.
FIXED INCOME PLATFORM	US govies	-		Recent hawkish overtures from the Fed reinforce our negative view on duration, indicating a mild increase in core yields and bear steepening of the yield curve. However, we believe this will be balanced by maintenance of broad easy financial conditions and investors should stay defensive and flexible. On TIPS, we are less positive now due to valuations.
	US IG corporate	=		We are cautious on long-duration IG given their potential to be affected by rising core yields. However, we look for attractive names from a valuation and fundamentals perspective as we focus more on alpha. We also look for income in agency MBS, and consumer and residential mortgages, but are more selective regarding structure and the quality of their collateral.
	US HY corporate	=		We are mindful of the liquidity situation in HY but believe strong earnings and cash flows are positives. However, we remain cautious and aim to balance yield with quality, relying more on selection.
	European govies	-/=		Our cautious approach on duration in Europe and core-Europe is maintained amid the recent move by the ECB to gradually reduce QE. We are closely monitoring Italian peripheral bonds, given the impact of ECB policy, the political situation, and the expected recovery supported by the Next Gen EU plan.
	Euro IG corporate	=/+		Amid continued recovery and hopes of improving credit fundamentals, we believe investors should look for more idiosyncratic exposure to high-quality names and in subordinated debt. But there is a need to stay vigilant, in line with the uncertainty caused by rising yields and the evolving Covid situation.
	Euro HY corporate	=		High yield offers selective opportunities from a bottom-up perspective, but we are monitoring liquidity as we enter 2022. We are also keeping any eye on how distress ratios and defaults develop in a benign environment.
	China govies	=/+		We are watchful of near-term headwinds, but believe policymakers are taking note of the slowdown and policies are turning supportive. We are neutral with a positive bias, as the PBoC remains on the dovish side, amid moderate inflation.
	EM bonds HC	=/+		Fed action presents near-term risks to EM debt, but we maintain a bias towards HY over IG amid attractive yields. We are closely monitoring the inflation narrative across the emerging world.
	EM bonds LC	=		We remain prudent overall, looking for tactical pullbacks in EM FX in 2022. On corporates, spreads appear attractive compared to alternative options. We like commodity-driven countries and sectors; we think exporters will have better traction and earnings overall supported by a strong dollar. However, we are cautious on Brazil and Turkey.
OTHER	Commodities			The overall view on commodities remains constructive despite demand concerns arising from potential for new lockdowns. Supply issues and bottlenecks could last for a while, supporting prices of base metals and natural gas. For gold, however, CB policies and real rates remain the key variables to watch. Oil will be driven by OPEC and geopolitical issues.
	Currencies			We expect the USD to stay strong and believe the low yielders lack the catalysts to balance the pressure from a hawkish Fed. We changed the 6M EUR/USD target from 1.14 to 1.10, but the 1.14 level for 12M is confirmed.

LEGEND

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	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi, as of 20 December 2021, views relative to a EUR-based investor. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding any fund or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. This information does not represent the actual current, past or future asset allocation or portfolio of any Amundi product.
IG = investment grade corporate bonds, HY = high yield corporate, EM bonds HC/LC = EM bonds hard currency/local currency, WTI = West Texas Intermediate, QE = quantitative easing.

DEVELOPED COUNTRIES

Macroeconomic outlook

Data as of 17/12/2021

Annual averages (%)	Real GDP growth %				Inflation (CPI, yoy, %)			
	2020	2021	2022	2023	2020	2021	2022	2023
World	-3.3	5.9	4.0	3.3	2.6	3.8	4.5	3.3
Developed countries	-5.1	5.0	3.5	2.0	0.8	3.0	3.2	2.0
US	-3.4	5.8	3.7	2.1	1.3	4.6	4.4	2.5
Japan	-4.9	1.7	2.0	0.9	0.3	-0.4	0.6	0.6
UK	-9.7	6.9	4.3	1.8	0.9	2.4	3.6	2.4
Eurozone	-6.5	5.0	3.8	2.2	0.3	2.5	2.9	1.7
Germany	-4.9	2.8	3.3	2.3	0.3	3.3	2.9	1.8
France	-8.0	6.8	3.9	2.0	0.5	2.1	2.6	2.0
Italy	-9.0	6.4	4.4	2.4	-0.1	2.0	2.9	1.7
Spain	-10.8	4.4	5.4	3.2	-0.3	3.0	3.2	1.6

Source: Amundi Research

- **United States:** after the sharper-than-expected deceleration in Q3 and a pickup in Q4, we expect real GDP growth to progressively decelerate in 2022 in sequential terms, stabilising above trend first and eventually converging to potential in 2023. Progressively less fiscal and monetary policy accommodation will drive this normalisation. Inflation is also expected to abate, although only gradually, while remaining above 3% until summer. As transitory drivers fade, still resilient demand, rents and wage growth will help supporting core inflation at higher than pre-crisis levels.
- **Eurozone:** we believe peak growth is now past and that the impact of Omicron and some new restrictions will translate into a deceleration of sequential growth entering into 2022, further delaying the recovery in consumer spending and in the service sector, as consumers and businesses already had to face the headwinds of higher energy prices and supply bottlenecks. Inflation is also acting as a drag on domestic demand and consumption and is not yet being compensated by higher wage growth. Once the transitory factors supporting the 2021 Q4 peak in inflation are over, from mid-2022 we expect the current gap between core and headline inflation to narrow with inflation stabilising to somewhat higher than pre-crisis levels, yet within target in 2023.
- **United Kingdom**: After the 2021 rebound, we expect growth to slow sequentially in 2022 on headwinds from inflation, tighter policy, Brexit adjustments and political risks. The Omicron variant will add further downside, as the steep surge in cases drags activity lower, as mobility and high frequency data start to show. While 2022 will likely start on a weaker footing than previously expected, we continue to expect resilience in domestic demand, with consumption supported by a strong labour market and investments underpinned by tax credits. Inflation will stage a slow decline from 2021 peaks, as commodities and bottlenecks will only progressively reduce their upside pressure on prices.
- **Japan:** December PMI, although weaker than expected, rounds off the best quarter since Q4 2018. Despite recent Omicron uncertainties, we continue to expect a rebound in private consumption in Q4 and Q1 to drive the overall economic recovery. In addition, supply constraints continued to ease, leading to a sharp jump in auto exports in November. In 2022, one-off factors (mobile phone charge reduction and rebasing) will wear off, laying the ground for consumer inflation to return to the positive territory. That said, we expect the prints to stay below 1%.

Key interest rate outlook

	23-12 2021	Amundi +6M	Consensus +6M	Amundi +12M	Consensus +12M
US	0.13	0.25/0.5	0.44	0.5/0.75	0.8
Eurozone	-0.5	-0.5	-0.48	-0.5	-0.46
Japan	-0.04	-0.1	-0.04	-0.1	-0.06
UK	0.25	0.75	0.85	1.0	1.24

Source: Amundi Research

- **Fed:** The Fed will accelerate tapering in light of elevated inflation pressures and the strengthening labour market. The pace of tapering will be doubled to $30bn per month in January, to end in March. The new rate projections indicate three hikes in 2022, three in 2023 and two in 2024, while in September the committee was evenly split between one hike in 2022 and no hike. Any reference to transitory factors of inflation has been removed, and instead the FOMC underlined that supply and demand imbalances related to the pandemic and the reopening of the economy have continued to contribute to elevated levels of inflation.
- **ECB:** Though more hawkish than expected, the ECB confirmed its much more dovish stance than the Fed and BoE, keeping open-ended QE running for all of 2022, calibrating its size to cover for most of next year's net debt issuance, with an additional support through PEPP flexible reinvestments, prolonged to end-2024 and acting as a backstop. The stable outlook for rates has been confirmed, consistent with ECB's inflation projection below target in the long run, while no decision on TLTROs was actually taken, though the ECB will "monitor bank funding conditions".
- **BoJ:** The BoJ decided to partially extend Covid supports. It will end purchases of corporate bonds and commercial paper at the end of March, but will continue to provide interest-free loans to banks aiding pandemic-hit SMEs by another six months till the end of September. It will take six months to reduce the purchases of commercial paper to pre-Covid levels and five years for bond buying. Governor Kuroda firmly ruled out policy tightening, seeing no possibility of consumer inflation reaching or exceeding 2%. Policy rates will be kept at their rock bottom.
- **BoE:** BoE surprised the consensus again at its last meeting with an unexpected hike of 15bp, taking the base rate to 25bp. The almost unanimous 8-1 vote showed that the decision was largely consensual within the MPC, and that improving labour market and high inflation prints prevailed on uncertainties linked to pandemic newsflow in the decision. We expect the BoE to take rates to 75bp by the end of 2022, and then pause in rate hiking cycle, consistent with the need to keep flexibility in managing QT, the latter planned to start when base rate have reached 1%.

Monetary policy agenda

Central banks	Next meeting
Bank of Japan MPM	**January 17**
Federal Reserve FOMC	**January 26**
ECB Governing Council	**February 3**
Bank of England MPC	**February 3**

Source: Amundi Research

EMERGING COUNTRIES

Macroeconomic outlook

Data as of 17/12/2021

Annual averages (%)	Real GDP growth %				Inflation (CPI, yoy, %)			
	2020	2021	2022	2023	2020	2021	2022	2023
World	-3.3	5.9	4.0	3.3	2.6	3.8	4.5	3.3
Emerging countries	-2.0	6.5	4.4	4.2	3.9	4.4	5.4	4.3
China	2.3	7.7	4.7	4.8	2.5	0.9	2.1	1.8
Brazil	-3.9	4.6	0.5	1.6	3.2	8.3	8.4	3.7
Mexico	-8.2	5.8	2.7	2.2	3.4	5.7	5.5	4.1
Russia	-3.1	4.3	2.6	2.5	3.4	6.6	7.1	5.3
India	-7.1	8.4	6.9	5.5	6.6	5.2	6.0	5.8
Indonesia	-2.0	3.2	4.8	4.9	2.0	1.6	2.8	3.4
South Africa	-6.4	4.9	2.3	2.5	3.3	4.5	5.1	4.6
Turkey	1.6	10.5	3.8	4.0	12.3	18.3	27.6	15.5

Source: Amundi Research

- **China:** The Chinese economy continued to suffer from its self-imposed policy constraints at the beginning of Q4, registering a weak recovery. The broad weakness in the economy has caught policymakers' attention, and we expect an easing of the policy constraints. However, housing sector deleveraging is most likely to continue, and we don't expect another round of big credit stimulus. We maintain our view that economic growth will rebound sequentially in Q4 from its dip in Q3 and then stay slightly below trend in 2022. Inflation will remain comfortably below 3%.
- **Indonesia:** Indonesia's momentum is improving on the back of the recent reopening and continuous vaccination rollout. After being very subdued in 2021, inflation dynamics should trend higher in 2022, moving towards the upper part of the BI target. Domestic macro conditions, together with a changing global financial landscape (Fed), will trigger the first rates hike by BI by mid-2022 (or Q3 2022). Policy support is expected to remain in place, through a gradual tightening of monetary policy and the slow fiscal consolidation expected. The fiscal deficit target by 3% in 2023 should be achieved via the recently passed tax reform.
- **Turkey:** Despite surging inflation (21.3% YoY in Nov.), with a peak forecasted at more than 30% in the coming months, the central bank once again lowered its interest rates by 100bp to 14%. Although the central bank's communiqué pointed to a pause, the market reacted immediately. The lira dropped, reaching an all-time low. Several days later, following some measures announced on monetary and financial sides by Erdogan, the lira recovered some ground. In such high level of domestic and global uncertainties, it is hard to make any forecasts, but we do expect growth to remain positive in 2022, driven by an expansionist fiscal policy.
- **CEE-3:** Inflation figures once again came out higher for the month of November. No doubt, central banks will stick to their monetary tightening cycle amidst serious domestic and global inflationary pressures and in which the Fed is flagging the normalisation of its monetary policy and, hence, a possible strengthening in the dollar vs. other currencies. However, if the Omicron variant were to lead to new restrictions, the extent of rate hikes expected in 2022 could be lower than expected.

Key interest rate outlook

	20-12 2021	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
China	3.80	3.75	3.80	3.75	3.80
India	4.00	4.25	4.20	4.75	4.60
Brazil	9.25	10.75	11.25	10.75	10.95
Russia	8.50	9.00	8.35	8.00	7.65

Source: Amundi Research

Monetary policy agenda

Central banks	Next communication
PBoC	**January 20**
BCB Brazil	**February 2**
RBI	**February 9**
CBR	**February 11**

Source: Amundi Research

- **PBoC (China):** The Politburo meeting and the Central Economic Work Conference confirm China is moving into monetary easing and will step up policy supports at the turn of the year. Broad monetary easing is already underway with the 50bp RRR cut in mid-December and a 5bp Loan Prime Rate cut on 20 December. We expect another 5bp rate cut in January. On the FX side, the PBoC has increased its verbal intervention, embedded a depreciation bias in daily fixing and hiked the FX RRR by 2ppt, to discourage RMB appreciation.
- **RBI (India):** In early December, the RBI kept unanimously on hold the Policy Rate at 4% and left its accommodative stance unchanged. Contrary to our expectations, the Reverse Repo Rates remained at 3.35%, without any increase (by 40bps) to make the corridor around the Policy Rate symmetric. The RBI reiterated the need to keep the policy support ongoing even more in consideration of new risks such as the Omicron virus variant. While expected to increase in the short term, Headline Inflation outlook remains benign and not in contrast with a continuous accommodative stance.
- **BCB (Brazil):** The BCB again hiked its rates by 150bps (to 9.25%) and again pre-announced another hike of similar magnitude in February. The Committee will persist in its strategy of tightening into restrictive territory until the disinflationary process and expectations anchoring around its target have consolidated. Headline Inflation in November printed at 10.7%, the same level as in October. At the same time, the Copom acknowledged the weakening economic conditions. We see the BCB taking SELIC into double digits in the new year and a terminal rate around 11%, a nearly five-year high.
- **CBR (Russia):** On December 17th the Central Bank of Russia hiked the policy rate by 100bps to 8.5%. The main reason for the hike was the persistent supply and demand pressures, with further potential upside to inflation and inflationary expectations. Household inflation expectations reached a new five-year high in December. Inflation accelerated 8,4% YoY in November, from 7,4% in October and is expected to be 8.1% in December, well above the 4% target. The CBR left the door open for further hikes at upcoming meetings. The CBR's hawkish stance, combined with continued inflationary pressures, makes another hike at the February meeting probable.

MACRO AND MARKET FORECASTS

Macroeconomic forecasts

(17 December 2021)

Annual averages (%)	Real GDP growth %				Inflation (CPI, yoy, %)			
	2020	2021	2022	2023	2020	2021	2022	2023
US	-3.4	5.8	3.7	2.1	1.3	4.6	4.4	2.5
Japan	-4.9	1.7	2.0	0.9	0.3	-0.4	0.6	0.6
Eurozone	-6.5	5.0	3.8	2.2	0.3	2.5	2.9	1.7
Germany	-4.9	2.8	3.3	2.3	0.3	3.3	2.9	1.8
France	-8.0	6.8	3.9	2.0	0.5	2.1	2.6	2.0
Italy	-9.0	6.4	4.4	2.4	-0.1	2.0	2.9	1.7
Spain	-10.8	4.4	5.4	3.2	-0.3	3.0	3.2	1.6
UK	-9.7	6.9	4.3	1.8	0.9	2.4	3.6	2.4
China	2.3	7.7	4.7	4.8	2.5	0.9	2.1	1.8
Brazil	-3.9	4.6	0.5	1.6	3.2	8.3	8.4	3.7
Mexico	-8.2	5.8	2.7	2.2	3.4	5.7	5.5	4.1
Russia	-3.1	4.3	2.6	2.5	3.4	6.6	7.1	5.3
India	-7.1	8.4	6.9	5.5	6.6	5.2	6.0	5.8
Indonesia	-2.0	3.2	4.8	4.9	2.0	1.6	2.8	3.4
South Africa	-6.4	4.9	2.3	2.5	3.3	4.5	5.1	4.6
Turkey	1.6	10.5	3.8	4.0	12.3	18.3	27.6	15.5
Developed countries	-5.1	5.0	3.5	2.0	0.8	3.0	3.2	2.0
Emerging countries	-2.0	6.5	4.4	4.2	3.9	4.4	5.4	4.3
World	-3.3	5.9	4.0	3.3	2.6	3.8	4.5	3.3

Key interest rate outlook

Developed countries

	23/12/2021	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
US	0.13	0.25/0.5	0.44	0.5/0.75	0.8
Eurozone	-0.5	-0.5	-0.48	-0.5	-0.46
Japan	-0.04	-0.1	-0.04	-0.1	-0.06
UK	0.25	0.75	0.85	1.0	1.24

Emerging countries

	20/12/2021	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
China	3.80	3.75	3.80	3.75	3.80
India	4.00	4.25	4.20	4.75	4.60
Brazil	9.25	10.75	11.25	10.75	10.95
Russia	8.50	9.00	8.35	8.00	7.65

Long rate outlook

2Y. Bond yield

	23/12/2021	Amundi +6M	Forward +6M	Amundi +12 M	Forward +12 M
US	0.68	0.8-1.0	1.03	1/1.2	1.29
Germany	-0.68	-0.70/-0.50	-0.69	-0.70/-0.50	-0.69
Japan	-0.09	-0.20/-0.10	-0.10	-0.20/-0.10	-0.10
UK	0.67	0.50/0.7	0.85	0.7/0.8	0.87

10Y. Bond yield

	23/12/2021	Amundi +6M	Forward +6M	Amundi +12 M	Forward +12 M
US	1.48	1.6/1.8	1.59	1.8/2.0	1.69
Germany	-0.26	-0.3/-0.1	-0.19	-0.3/-0.1	-0.14
Japan	0.07	0/0.20	0.12	0/0.20	0.16
UK	0.92	1.0/1.2	1.02	1.2/1.4	1.06

Currency outlook

	16/12/2021	Amundi Q2 2022	Consensus Q2 2022	Amundi Q4 2022	Consensus Q4 2022
EUR/USD	1.13	1.10	1.13	1.14	1.16
USD/JPY	114	113	115	117	115
EUR/GBP	0.85	0.84	0.84	0.83	0.84
EUR/CHF	1.04	1.05	1.07	1.09	1.09
EUR/NOK	10.18	10.30	9.83	9.46	9.70

	16/12/2021	Amundi Q2 2022	Consensus Q2 2022	Amundi Q4 2022	Consensus Q4 2022
EUR/SEK	10.24	10.48	9.99	9.98	9.90
USD/CAD	1.28	1.31	1.24	1.23	1.23
AUD/USD	0.72	0.70	0.74	0.76	0.75
NZD/USD	0.68	0.66	0.72	0.69	0.72
USD/CNY	6.37	6.55	6.42	6.40	6.44

Source: Amundi Research

DISCLAIMER TO OUR FORECASTS

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

METHODOLOGY

— Scenarios

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

— Risks

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

PUBLICATIONS HIGHLIGHTS

INVESTMENT OUTLOOK

Investment Outlook 2022 Investing in the great transformation (17-11-2021)
BLANQUE Pascal, Group Chief Investment Officer - MORTIER Vincent, Deputy Chief Investment Officer - Research team

ASSET CLASS VIEWS

Asset Class Return Forecasts – Q4 - 2021 (09-11-2021)
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BLANQUE Pascal, Group Chief Investment Officer

Shifts & Narratives #11 - Green sentiment: what impact on stock returns and firm's behaviour? (15-10-2021)
BLANQUE Pascal, Group Chief Investment Officer - Marie BRIERE, Head of the Investor Research Center

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BLANQUE Pascal, Group Chief Investment Officer

Shifts & Narratives #9 - Adapting equity portfolios to a regime of higher inflation (01-10-2021)
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Emerging Markets Charts & Views - Why EM could be back in focus in 2022 (14-10-2021)
SYZDYKOV Yerlan, Global Head of Emerging Markets

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Graph Neural Networks for Asset Management (1-12-2021)
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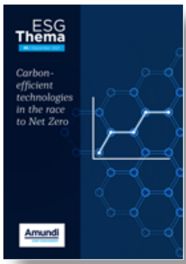

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