

### 3 China Property Market: Bubble or no bubble?

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The outlook for the Chinese property market, especially for 2016 and 2017, is becoming increasingly unclear to global investors. Property inventory destocking is indeed happening, with spill-over effects from Tier-1 cities to Tier-2/3/4 cities (no bubble?), and with rising land prices, especially from Tier-1/2 cities and also with potential spill-over effects to Tier-3/4 cities (bigger bubble?). What view should we as investors take?

#### Why focus on the Chinese property market?

There is only one pillar industry in China and that is property. It is important in determining the direction of Chinese economic growth, given that the property sector is linked to over two hundred sectors, both downstream and upstream. Hence, there is one simple outcome in the event of a hard landing in Chinese property, and that is that the Chinese economy, and therefore the global economy, will experience a hard landing. How healthy the Chinese property sector is, fundamentally shapes the outlook for the Chinese economy with knock-on-effects on the global economy. The property sector's impact on the Chinese economy is real, in contrast to the equity, bond, or commodity futures markets, or FX market corrections, none of which have direct impact on the real economy.

#### What are the major debates?

- 1. Bubble?** Arguments that there is a Chinese property bubble are based on: (1) little affordability; (2) low rental; (3) lots of construction over the years, already with zombie homes, etc.
- 2. No bubble?** Arguments that there is not a bubble are generally based on: (1) officially, income has been rising faster than housing prices (of course, housing prices may be understated, and income may have risen fast among the rich, so there is an issue of inequality); and (2) the lack of leverage, in that the loan-to-value ratio is low, household debt is limited, and bank loans to the property sector are limited (direct loans, in any case).
- 3. Structural bubble?** The arguments would be: (1) most household wealth is held in deposits, which earn low rates (lower than the housing price increase), and this incentivizes people to buy property; (2) no property tax; (3) local governments are pushing up land prices; (4) lots of construction already; and (5) construction as a share of per capita GDP is rising constantly.
- 4. Property supply?** The term "supply" is really hard to quantify, especially under the pre-sales system, in which developers can fasten construction to meet pre-sales criteria or, on the contrary, slow it down and reduce "supply". The government can also reduce supply by halting all issuance of pre-sales consents. Hence the supply is rather dynamic.
- 5. Property demand?** Similarly, the market normally uses the transaction volume to quantify demand, which is rather dynamic, as well, in our view. On a more fundamental basis, actual demand synthesized by urbanization, marriage, housing upgrades, etc. can help us reach a healthier supply-demand balance. Of course, in practice, this is rather difficult to quantify, as well.
- 6. Property equilibrium?** The supply and demand balance in the housing market hinges on the amount of "excess vacancies", defined as the number of vacant housing units above and beyond the level warranted in normal circumstances. Even in normal times, when there is little imbalance between housing supply and demand, vacant homes exist because of second homes and household turnovers. Excess vacancies are an important measure of housing oversupply. However, excess vacancies are difficult to pin down, as well.

#### The essential

**How healthy the Chinese property sector is, fundamentally shapes the outlook for the Chinese and world economy.**

With significant property inventory destocking over the past year, the bubble is diminishing to a larger extent. However, Chinese land prices are also rising significantly in some cities and regions, and we believe ever rising land prices could lead to a potential property bubble.



Bubble or no bubble?



Structural bubble?



The above six arguments have long been there, and given lack of data, it is very hard to make judgments. We have to change the angles of our analysis.

For the long term, in our October 2015 Cross Asset Monthly, we made the point clearly that the new-born population is closely correlated with new housing demand years later. From the experience of Japan, a 41% reduction in the number of births from 1948 to 1961 resulted in a 29% decline in floor space of new starts from 1973 to 1983; similarly, a 40% reduction in the number of births from 1973 to 1989 resulted in a 46% decline in floor space of new starts from 1994 to 2012. As for China, the number of births fell 38% from 1987 to 2003, and the coming years will likely see a major decline in floor space of new starts. Hence the real Chinese GDP growth will decline, given that the property sector is its pillar industry.

### What are the facts?

Here, we will focus, however, on Chinese residential property and the near term (2016 and 2017) for investment relevance.

#### 1. Prices

- In Chinese Tier-1 cities (Beijing, Shanghai, Shenzhen, and Guangzhou) property prices had a huge run from the start of 2015 to June 2016, with property prices on average increasing by 167% in Shenzhen (this is beyond everyone's expectation, and mainly due to annual supply restrictions) and by 49% in Beijing, whereas Shanghai and Guangzhou were almost unchanged.
- In Tier-2 cities, i.e. provincial cities, such as Chengdu, the capital city of Sichuan province, prices rose around 45% within a space of eighteen months; in contrast, the capital city of Hainan province, Haikou, experienced a steady price correction totalling 23%.
- In Tier-3 cities, Dongguan, Guangdong province, was up around 39% over the same period. Wenzhou's prices have now stabilised after steep corrections, which is a positive signal for Eastern China stabilization after its correction.
- China has over 600 cities. Even Tier-5 cities have populations of no less than 1 million. Price movements within and between tiers are different, given the large number of cities and locations, housing scarcity, housing supply restrictions, home purchasing restriction policies (yes or no), land prices, and so on.
- It is clear that the sharp property prices rise in Beijing, Shenzhen, Chengdu, and Dongguan are not what the Chinese government wants to achieve (it wants property prices stable within a narrow range). Hence, we have seen tightening policies after the sharp property price rises in March/April.

“Shenzhen property prices up 167% within one and half years!”

“Shanghai inventory months to clear at 5.5 now!”

#### PRICE, per square meters in RMB

		4-Jan-15	19-juin-16	% change
<b>Tier 1</b>	Beijing	21,498	31,951	49%
	Shanghai	22,881	22,346	-2%
	Shenzhen	25,539	68,149	167%
	Guangzhou	15,003	16,263	8%
<b>Tier 2</b>	Hangzhou	22,188	24,187	9%
	Chengdu	7,130	10,373	45%
	Haikou	11,876	9,114	-23%
<b>Tier 3</b>	Wenzhou	14,376	14,629	2%
	Dongguan	10,176	14,126	39%

Source: Soufun, Wind, CEIC, and Amundi Research

## 2. Volume

- Months to clear inventory is one good indicator of a bubble (generally, if this is more than 20 months) and how big the bubble is (generally, if the months to clear are above 30 or 40).
- As for Tier-1 cities, Beijing's months to clear inventory was down from 32.4 months (Mar 2015, peak level), to 7.8 months (Dec 2015, trough level), indicating a clearance of 24.6 months of inventory within 9 months, which is significant reduction in inventory in that short period of time. From March 2015 to March 2016 within a year's time, Shanghai/Shenzhen cleared 17/17.9 months of inventory, which is significant as well.
- As for Tier-3 cities for example, Ningbo/Xiamen in Eastern China, cleared 39.3/33.2 months of inventory within a year's time, which is a very significant reduction.
- We also need to look at the current status of inventory months to clear. As of mid-June 2016, there were severe shortages in terms of inventory months for cities such as Shanghai (5.5 months), Hangzhou (2.4 months), and Nanjing (2.2 months).
- The direct implication from inventory clearance is that developers' cash flow is getting much stronger, hence with more cash available for further property investment.

“300 cities' land prices rose 57% in the first five months of the year!”

Inventory, months to clear, Jan 2015 to June 2016

		Peak	Peak month	Trough	Trough month	juin-16
Tier 1	Beijing	32.4	mar-15	7.8	dec-15	13.5
	Shanghai	20.2	mar-15	3.2	mar-16	5.5
	Shenzhen	22.9	mar-15	5.0	mar-16	14.2
	Guangzhou	28.4	mar-15	6.6	may-16	7.7
Tier 2	Hangzhou	15.6	mar-15	2.1	apr-16	2.4
	Nanjing	22.4	mar-15	1.9	june-16	2.2
	Fuzhou	29.9	june-15	6.7	apr-16	10.3
Tier 3	Ningbo	46.1	mar-15	6.8	apr-16	8.8
	Xiamen	37.5	mar-15	4.3	may-16	9.2

Source: Soufun, Wind, CEIC, and Amundi Research

## 3. FAI

- Strong property inventory clearance generated strong cash flow for developers, hence strong pickup in property investment. Given the mounting property inventories, which peaked around last March, property investment has been pretty sluggish, and was in negative growth for five months in a row from September last year. Property investment truly rebounded from this February (2%), March (8%), April (11%) and May (8%), after the strong inventory clearance that had been almost completed around March this year.
- What worries the market is the sustainability of property investment going into the second half of 2016 and also into 2017. For regions and cities with inventory shortages, we believe property investment will hold at mid- to high-single-digit growth at least to the end of 2016. In China as a whole, there is a large chance that overall property investment can hold at around mid-single-digit growth, which hasn't been expected by the market since the end of last year.

“Property policy has to remain overall accommodative!”

## 4. Mortgage loans

- Housing mortgage loans have been growing very steadily quarter by quarter, at around 6% to 7%, with an acceleration in the first quarter of 2016 to 7.2% qoq growth. The major driver has probably been the declining mortgage rate, at only 4.17% now vs. more than 5.5% previously.

- Chinese housing mortgage loans as a percentage of GDP are on a clear rising path, from 19% of GDP in the first quarter of 2015 to 23% in the first quarter of 2016.

## 5. Land sales

- "Land kings" reappear with strong property inventory destocking and robust pickups in property investment. The value of the first five months' land sales in Hangzhou rose by more than 286% from last year, and Suzhou is even at 1533% in comparison to the first five months of 2015. The 300-city average figure for China is 68%, and land prices are becoming much more expansive than before. As for Key Tier-2 cities, land sales amazingly grew by more than 163%.
- What does this phenomenon reflect? For certain cities with strong housing demand but scarce land supply, "land kings" are unavoidable consequences. This will push the residential property prices even higher.
- Local government's dependence on land revenue is still high, given long overdue property taxes.
- **We believe the overall Chinese property market bubble is due to ever-rising land prices, and when land prices are much higher than potential rates of return, that is where the bubble has to burst. Hence, close monitoring of land prices is key to judging potential risks in the Chinese property market.**
- Shanghai as a typical example where land supply is decreasing but land prices are rising significantly, and the final sold price is even 42% higher than the launched price for the first five months of 2016. This is obviously not sustainable!

### China Residential Land Sales

5M16, yoy	Land Sales	Land Volume (GFA)	Land Price	% of price sold over launched
Beijing	-45%	-65%	56%	-9%
Shanghai	17%	-54%	152%	42%
Hangzhou	286%	72%	124%	50%
Nanjing	576%	168%	152%	71%
Suzhou	1533%	106%	693%	64%
300 Cities	68%	7%	57%	35%
Tier-1 Cities	-18%	-44%	48%	15%
Key Tier-2 Cities	163%	7%	145%	23%

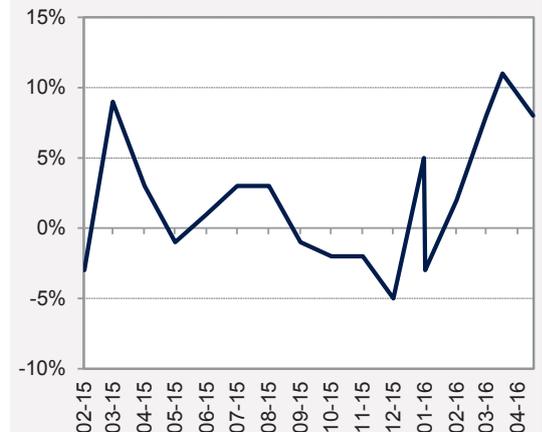
Source: Soufun, Wind, CEIC, and Amundi Research

### What is the property policy outlook?

As far as we understand, the role of the property sector as the single pillar industry in China hasn't changed. Hence, in order to achieve the GDP target (6.5-7% in 2016, and 6.5% per annum by 2020), the overall policy towards the property market will be biased on the easing side.

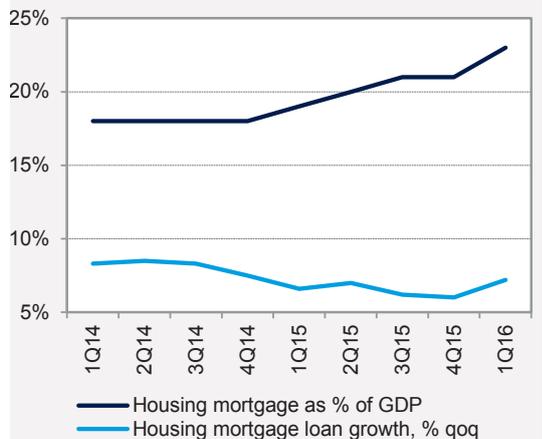
The Chinese government strives to strike a balance between stable property/land prices and relatively low inventory levels. Hence, whenever there are property/land price hikes, the Chinese government will have to come up with some tightening measures to mitigate the impact. The government pays more attention to inventory, and if mounting inventory is in sight, easing measures will certainly be announced soon thereafter. From May till mid-June we had more property easing measures than tightening measures, and even the inventory level on average is already relatively low.

### 1 Residential Property Investment, yoy %



Source: Soufun, Wind, CEIC, Amundi Research

### 2 Chinese Housing Mortgage Loan



Source: Chinese Housing Mortgage Loan, Amundi Research



The role of the property sector as the single pillar industry in China hasn't changed



## Conclusion

How healthy the Chinese property sector is, fundamentally shapes the outlook for the Chinese. With significant property inventory destocking over the past year, the bubble is diminishing to a larger extent. However, Chinese land prices are also rising significantly in some cities and regions, and we believe ever-rising land prices could lead to a potential property bubble. And when land prices are much higher than potential rates of return, that is when the bubble has to burst.

### Property Easing Measures

- 6-May-16** HPF loan approval duration expected to be reduced from 15 days to 10 days: The government released a notice on improving provisions on personal loans in the housing provident fund, aiming to streamline the procedures of HPF loan applications and optimizing business procedures. According to the notice, the main supplementary application documents will be proof of identity (e.g., copies of ID card) and proof of home purchase. For second homes, an intended borrower and his/her spouse, as well as the seller can submit relevant materials to selected bank branches, which can pass on initial feedback to the applicants. For other types of homes, the applicant can also choose to submit applications through agencies. The duration of approval of applications is expected to be reduced from 15 days to 10 days as a result.
- 9-May-16** MOHURD will support the leasing market in China in six ways: Mr. Lu Kehua, Vice Minister of Housing and Urban-Rural Development, said in a meeting that the leasing market has yet to be developed and also lacks standardization and property rules and regulations. He said the ministry will support the leasing market in six ways: i) nurturing supply groups; ii) encouraging leasing consumption; iii) improving the public leasing system; iv) supporting the construction of leasing properties; v) enhancing policy support; and vi) enhancing monitoring of the leasing market.
- 10-May-16** Citizens in Nanjing are encouraged to use HPF for rent payments: the HPF Management Center of Nanjing has issued a notice stating that the application period for withdrawal of HPF for rent payments will be extended. Applications can be made from June to December each year. Previously, such applications could only be made in June and December. The monthly quota for rental payment is RMB 900 / RMB 1,800 for individuals / couples.
- 10-May-16** Henan lowers farmers' entry barrier to housing mortgage: MOHURD of Henan province and the Finance Office of the province and Agricultural Bank (601288.SS; 1288.HK) jointly announced a new plan to assist farmers in applying for mortgage loans to purchase residential units. Some features of the plan are: a lower benchmark score for housing mortgage applications; simplified proof of income; flexibility in choosing quarterly, semi-annual or annual repayments; zero penalties for early repayment; accepting payment guarantees issued under local government-controlled financing guarantees aims to improve credit quality.
- 13-May-16** Beijing to provide public rental housing to the newly employed: MOHURD of Beijing issued a notice that the ministry has allocated 490 public rental units in three projects for those who are newly employed and are aged between 18 and 35. The applicants have to be employed and not own any property units in the city. Non-local citizens are also eligible if they meet the criteria for home purchasing in Beijing.
- 16-May-16** Zibo launches pilot scheme on subsidized rentals of government-subleased units: Media reported that since the end of 2015, a new mode of subsidising public housing has arisen amid the many problems encountered in building affordable housing. In Zibo, Shandong Province, the local government rents houses of GFA not greater than 100sqm and "subleases" the units to qualified citizens at a lower rent. The difference in the rent is subsidized by the local government. Officials from the relevant housing authorities claim that the pilot scheme could improve utilization of idle houses in the city and alleviate the funding and time pressures for the construction of affordable housing.
- 19-May-16** Chengdu HPF Management Committee announced that, starting from June 6, the term of personal HPF loan will increase from 20 years to 30 years. For any family of two persons or above the single lump sum that can be borrowed will be RMB 700,000. Also, the ratio of maximum loan to HPF contribution will be lifted to 30x, and any citizen whose individual contribution is less than RMB 10,000 will not be subject to such a ratio and will be eligible for HPF loan of RMB 300,000.
- 20-May-16** The first batch of co-ownership housing to be launched in Nanjing: Nanjing Price Bureau published a notice on the price of housing units available from the conversion of affordable housing. In particular, housing units of four selected affordable housing projects will be converted into the first batch of co-owned private units in the city and sold at ASP of approximately RMB 9,952 psqm, compared with average ASP for commodity residential units of approximately RMB 19,000 psqm. Qualified buyers will be able to select houses starting from 1 July 2016.

- 24-May-16** PBOC allows RMB30trn capital entering the bond market: PBOC issued a document on 20 May that eligible institutional investors including HPF, pension funds, charity funds and more wealth management products are allowed to enter the interbank market. PBOC will be following the standard criteria and procedures to issue the notice for approved of applications from those eligible investors, and such notice will be valid for three months. Industry participants commented that the arrangement by the PBOC is smoothing the application process and encouraging commitments in the bond market. Media reported that the total scale of the mentioned funds is approximately RMB30trn.
- 2-Jun-16** Hunan aims to reduce land supply in cities with high inventories: The government of Hunan Province has issued a statement on enhancing the aggregate use of land resources. Cities with high stock levels will be required to reduce the scale of land use plans and land supply. In addition, the government may suspend land supply in cities with inventory periods of three years or more. The government, however, encourages long-term leasing, the practice of renting a land site before purchasing it in the future, and other flexible land supply arrangements that can help reduce land cost for enterprises. (Hexun)
- 3-Jun-16** State Council releases new policies for rental market: On 3 June the State Council published an opinion to speed up development of the residential rental market. Measures include: permitting the conversion of commercial properties to residential housing units; 1.5% VAT to be applied to rental income from properties owned by individuals will; VAT will be exempted for individuals with rental income of less than RMB 30K per month until end-2017; 6% VAT on real estate agencies providing residential rental brokerage services; 5% VAT will be applied to rental income from properties acquired before the VAT pilot scheme was launched.
- 10-Jun-16** Dalian announces relaxing policies on destocking: On 8 June the government of Dalian issued a document detailing new policies to develop the city's real estate market. The policies, targeting at destocking for the city, include: i) to complete all shanty town redevelopment works in 2-3 years; ii) to provide talents, leaders or the like with a maximum of RMB3mn of subsidy for house purchase; iii) to provide a subsidy of RMB100 psqm for home upgrades under certain conditions; iv) to remove HPRs imposed on the four districts of the city as well as the high-tech development zone; and v) to remove restrictions regarding the maximum number of commodity residential units foreigners can buy.
- 15-Jun-16** New loosening measures in Shanxi to tackle inventory problems: The government of Shanxi Province released a document on 13 June detailing 11 measures to help destocking in the real estate sector. Key measures are: to lower the down-payment ratio for loans of first-time purchase of commodity residential housing units to 20%; to lower such ratio for home upgrade purchases to 30%; to lower deeds tax for property transactions by 1-2%; to relax conditions for workers from rural areas to transfer their hukou to the current work location; to encourage modification of unsold commodity properties for other purposes such as e-commerce business and incubators for technology enterprises.

### Property Tightening Measures

- 5-May-16** Land supply will be strictly controlled for Beijing-Tianjin Hebei development: MLR and NDRC issued a land use plan for the development of the Beijing-Tianjin-Hebei region in 2015-2020. The plan has mentioned that, for regions that need to reduce the land supply, basically there will be no new construction land supply and some of the existing construction land will be changed for environmental purpose. And some regions will be maintained a stable scale of total land use where large scale of construction is not favourable. For regions that need to increase land supply, new land supply will be controlled with the focus on social infrastructures.
- 5-May-16** Beijing MOHURD and the local government of Tongzhou District jointly issued a notice regarding tightening measures on property market: eligible homebuyers for apartment units for commercial / residential use have to fulfil one of the following criteria: i) families or individuals who are with local hukou but without owning any property units; ii) families who own one property units in the city; iii) non-local families who own no property units in the city and have contributed to the social insurance and with tax payment proofs for five consecutive years. The notice also mentioned that newly constructed commercial and office properties can only be sold to companies or organizations, and the same measures will also apply to the reselling of such properties.
- 18-May-16** The MLR of Suzhou Municipality announced that for some of the land parcels to be auctioned on or after May 23, price caps will be imposed, and the ministry has the right to void a land sale should the final price exceed the cap (circuit breaking). People with knowledge of the matter revealed that the highest priority for the ministry right now is to avoid further cases of excessive land prices and consequently to cool down developers' quest for land in the city, ahead of potential HPRs. (Guandian)
- 27-May-16** The government of Nanjing issued a notice saying that tightening measures for Nanjing will be launched, to control land and property prices. The measures include: i) capping the total land premium for auctions. If bidders raise the bidding price over the limit, the land auction will be terminated and the bidding price will become invalid. ii) Over the 45% threshold of the premium to the asking price, developers will be bidding on the area of social housing to be provided in the project. Moreover, the cost of projects will be strictly monitored by the pricing bureau; the portion of land cost that is over a 45% premium to the asking price cannot be included as part of the development cost, and hence, this will not be included in the consideration for price setting.

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