Monthly | Finalised at 9 January 2019

January 2019 # 01

Confidence must be earned

Amundi ASSET MANAGEMENT

CROSS ASSET

INVESTMENT STRATEGY

CIO VIEWS

FOCUS ON FUNDAMENTALS TO RIDE TURBULENT MARKETS

THIS MONTH'S TOPIC

THERE IS NO SYNCHRONISED GLOBAL ECONOMIC CYCLE

Research & Macro Strategy

CIO VIEWS

Focus on fundamentals to ride turbulent markets

PASCAL BLANQUÉ, Group Chief Investment Officer
VINCENT MORTIER, Deputy Group Chief Investment Officer

Investors are facing an unsettled environment. For 2019 we think it will be key to look at three areas:

1. From economic deceleration to where? It is time to look at where the economy is heading after the synchronised slowdown that the market has now priced in. A **global economic recession is not the central scenario**. The US economy is still enjoying solid growth and barring a major policy mistake (from the Fed or Trump), it should continue to grow nicely, although at a decelerating rate. Europe's slowdown is more pronounced, as it is bearing the brunt of multiple political issues (Brexit, Italy and more recently France). However, with some of the risks cooling or passing (easing of trade tensions, weaker oil prices, European elections in May), we see a possible stabilisation of economic conditions through the year, with growth expected to slow down but remain above potential in 2019/20. In EMs the picture is more varied, with some countries expected to decelerate (China) and the emergence of some positive stories (e.g., Indonesia). Overall, we still see a benign economic scenario, with trade disputes and geopolitical factors being the main risks to monitor.

2. Fed pausing or continuing rate rises? We do not share the view of some that the Fed will stay on hold from now on, even despite tightening financial conditions, as wage pressures have not disappeared and the Fed's credibility would be damaged if the market should perceive it as holding back as a result of recent political interference. On the other hand, we believe that the Fed will scale back its ambitions for tightening, as higher rates are already affecting corporate profits and financial conditions are tighter. The Fed's moves will also have consequences for other central banks (CBs); it will be more difficult for the ECB to raise rates if the Fed suspends its monetary tightening. We don't see any interest rate normalisation in the Eurozone in 2019/20. In EMs, some CBs that moved to a hawkish stance in 2018 could turn more neutral/dovish amid easing inflation conditions and less pressure on their currencies.

3. EMs: perfect storm or a recovery story? EMs have suffered multiple headwinds –higher US rates, the strong USD and idiosyncratic stories. The outlook could stabilise in H1 and improve later on amid a more dovish Fed. Our central scenario sees a soft landing in China as achievable, given the available policy space. Idiosyncratic factors (especially in Latam) and the global trade outlook will be crucial.

All in all we believe that global risk is still asymmetric as the process of repricing growth expectations and the related adjustments of risk premia unfolds, leading to a restoration of value across the board. Still, this restoration of value and the progressive positive alignment of planets (milder path on US rates, peak in the dollar, slower US growth) bodes well for progressive exposure to EMs. Hence, we would recommend starting the year with a cautious approach on risk assets and being ready to play any opportunities that arise from the current repricing. In EMs, we suggest entering in small steps, while in DMs, as the cycle matures, the focus could move towards more **quality assets**, avoiding overcrowded/over-indebted assets and less-liquid areas of the market. In fixed income, investors should stay neutral on US duration to help mitigate overall market volatility. In credit, **the recent spread widening could re-open opportunities but with a selective approach**, as tightening financial conditions, refunding needs and the high leverage reached by many companies make this asset class vulnerable. Long-term investors should get back to fundamentals to seek valuable assets in a more volatile world.

**EM = Emerging Markets, DM = Developed Markets. ECB=European Central Bank*

High Conviction Ideas

MULTI-ASSET

We believe investors should keep limited directional exposure to equity and credit due to weaker growth momentum, geopolitical risks and fragility in investors' confidence. We maintain a focus on portfolio diversification among regional equities. EMs are attracting our attention as an end to the Fed's tightening cycle approaches and because valuations are cheap. On the bond side, we suggest exposure to US Treasuries and cautious credit exposure, with the opportunity to increase these in 2019.

FIXED INCOME

We keep a close to neutral stance on duration in the US. We see little value in rates in core Europe. We maintain a cautious approach on credit, as fundamentals remain relatively stable but spreads could remain under pressure due to rising funding needs. We continue to prefer less indebted corporate issuers. On EM bonds, we are becoming more constructive, as the market seems more resilient despite risk assets being under pressure.

EQUITIES

In the US, earnings growth is slowing due to price pressures and economic slowdown. This is a challenge for EU equities too, while we are becoming more constructive on EMs. Globally, our bias remains towards quality companies with strong balance sheets and attractive valuations given the prevailing uncertainty. In Europe "cheap" quality is now more focused on cyclicals compared with defensives, which benefited from a rally over the last three months. We think that investors should look at single stock opportunities rather than at sectors.

MACRO

Central banks: Back to risk management policies

DIDIER BOROWSKI, Head of Macroeconomic Research
MONICA DEFEND, Head of Strategy, Deputy Head of Research
PHILIPPE ITHURBIDE, Global Head of Research

The year 2017 ended with a synchronised global recovery, with the risk of inflationary pressures likely to push central banks to normalise their monetary policy faster than expected. The possibility of a policy mistake haunted the minds of investors. This risk now seems to be behind us. First, the year 2018 ends with a risk of a synchronised global slowdown; second, core inflation has remained weaker than expected, including at the peak of the cycle in economies close to full employment. Finally, corporate financing conditions have tightened in the United States, as in Europe.

A recent study shows that an unanticipated rise in key interest rates – even a small one (25bp) – can have a significant impact on business investment, especially for young firms whose borrowing capacity depends on the value of their collateral. It is likely that this can be generalised to apply to the most indebted companies. And in the major advanced economies, it is in the US that the situation is the most worrying.

There is thus no rationale for a "monetary surprise".

In a very uncertain global environment, it is a **"risk management" approach that seems to prevail**. Inflation is not really threatening if growth slows; there is now more risk in normalising monetary policy too quickly than in keeping rates unchanged.

Fed: the slightest disappointment on growth would lead to a monetary pause.

ECB: the recent deterioration of the Eurozone economies and the absence of inflationary pressure prevent any normalisation of key interest rates. This is all the more true given the ECB is also seriously considering extending its long-term loan programme to the banking sector (TLTRO) to relieve the pressure on banks (especially Italian banks, which are suffering from rising sovereign bond yields).

BoE: monetary policy remains subject to the outcome of Brexit. The high level of uncertainty forces the status quo to prevail in the short run.

> "Repricing in risk assets has gone too far, discounting a very negative scenario."

BoJ: there is no monetary tightening in sight, contrary to what we anticipated a few months ago. The increase in the VAT rate (on 1 October 2019) is likely to increase the risks. The governor of the BoJ recently communicated the possibility of additional flexibility if necessary, by further lowering interest rates into negative territory or even buying assets.

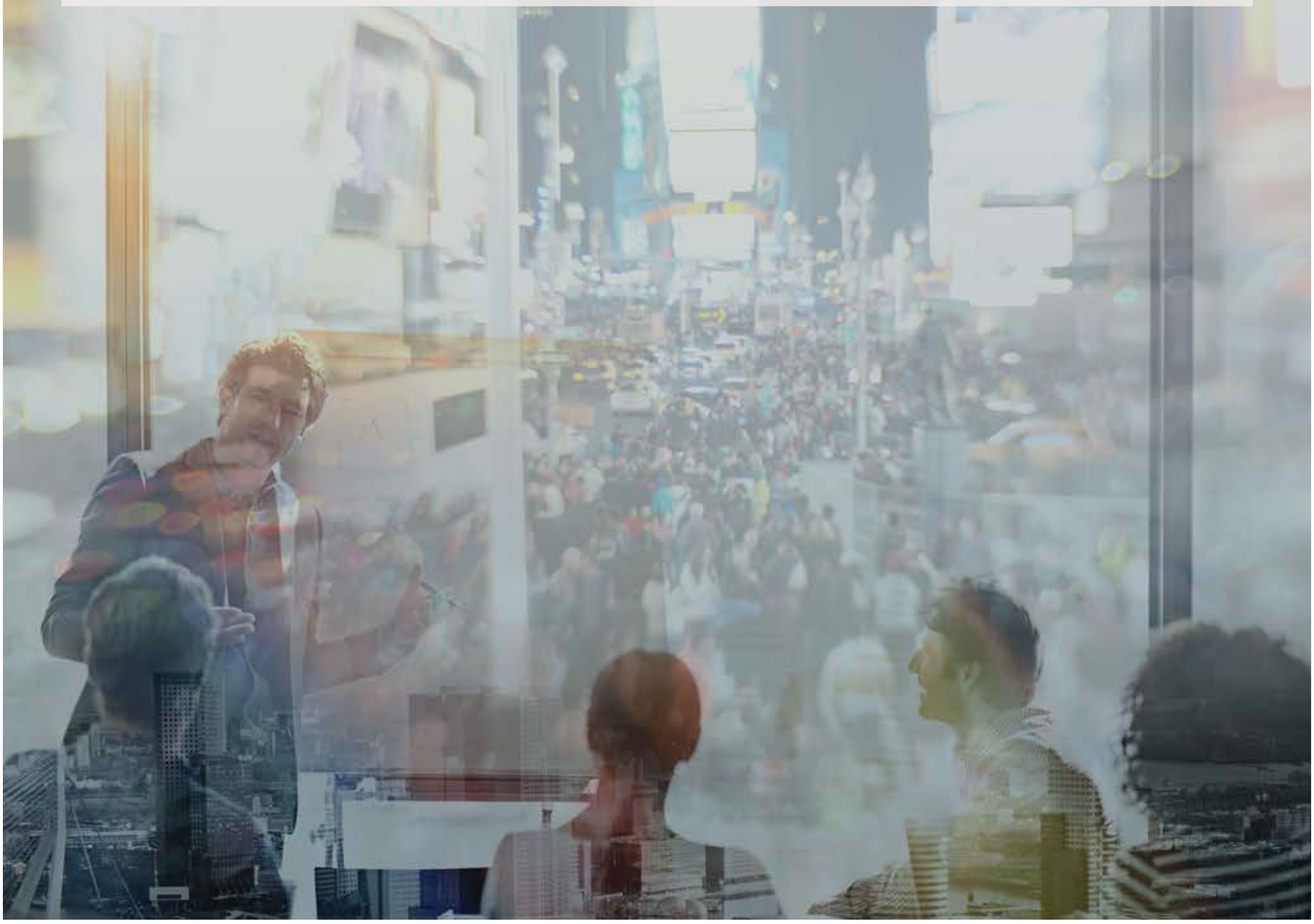
The lack of (significant) monetary tightening in large advanced economies in 2019 does not mean that liquidity will return in 2019. The Fed's balance sheet will continue to shrink, and that of the ECB has just stopped growing.

On the financial front, investors have thus lost the protection offered by central bank asset purchase programmes. On the other hand, the change in the tone of a number of central banks (including the Fed) should ease the fears of recession or continuation of the current sharp slowdown and reassure the financial markets.

The Strategist view

Short- vs long-term risk disconnection

While visibility is scarce and economic/financial conditions are fluid and uncertain, we stick to our risk assessment checklist to calibrate overall risk exposure, which remains balanced. Our risk assessment focuses on the contribution of short-term indicators (including financial conditions) and of more medium-term trackers (including risk-adjusted valuations, money velocity and total debt accumulation over growth). **Short-term indicators** highlight **investors' risk-off mode** being recently exacerbated by credit deterioration (HY in the energy sector) and spread widening. Financial conditions have tightened in Europe, while they are gradually deteriorating in the US. Taking into account the micro and macro fundamentals, **we confirm that the repricing of risk assets has gone too far in discounting almost recession levels**. While allowing for short-term relief, on a medium-term basis, **we detect a precarious equilibrium between growth generation (GDP)/monetary stimulus (money velocity) and fiscal stimulus (debt accumulation) at a time of rising real rates.** Hence, a more dovish Fed tone would be justified. The gap between **risk sentiment (negative)** and **fundamentals (still positive)** justifies the possibility of short-term risk assets relief, however **risk mitigation** will have to be considered for 2019. The first quarter will probably be the financial turning point after a phase of slower growth, higher rates and cumulating debt. However, a more dovish FED and the Q1 reporting season could act as a game changer, further prolonging the financial cycle.



MULTI-ASSET

Moving side-lines

MATTEO GERMANO, Head of Multi-Asset

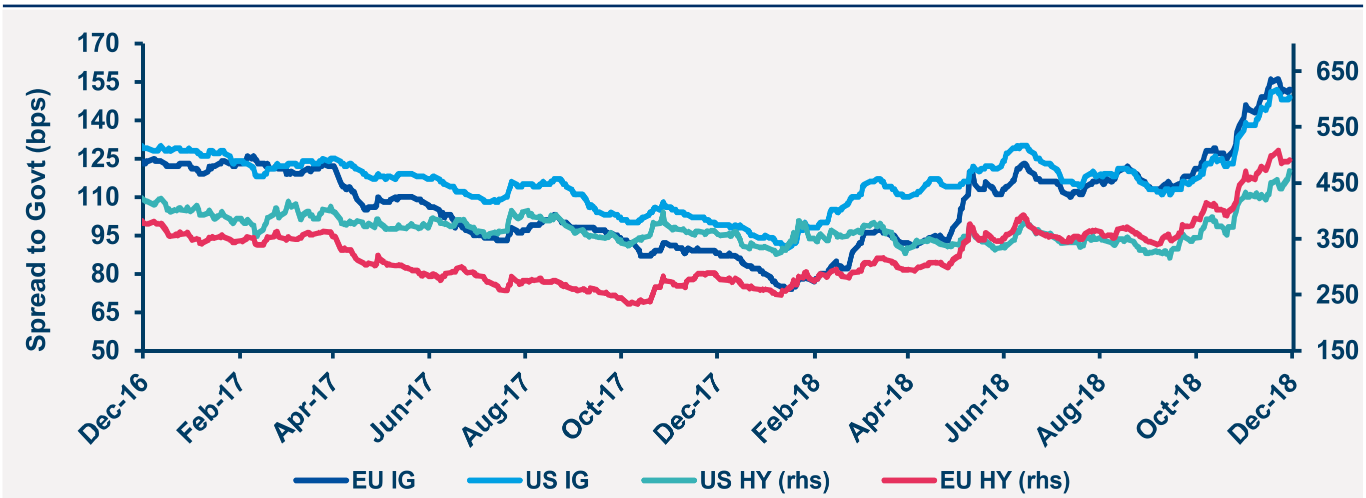
In the current phase, we see financial risks reflected in a series of factors, including lower liquidity, spread widening and negative earnings per share revisions. This will hurt sentiment first, before tightening financial conditions then eventually affecting the real economy. The combination of GDP growth generation, monetary stimulus and fiscal stimulus (debt accumulation) at a time of rising real rates provides for a fragile equilibrium, and we see the Fed carefully balancing the different risks. The Fed has now switched to a more data-dependent mode, and we expect risk assets to stay volatile, mirroring such a precarious equilibrium. On a longer-term perspective, we might turn selectively constructive, especially if the CBs turn structurally to a more dovish stance and reporting season confirms solid fundamentals.

High conviction ideas

In the short term, we maintain an **overall defensive view in terms of risk allocation**, due to a mix of factors favouring a very cautious directional approach: weaker momentum in global expansion, which we expect to stay in the near term; heightened geopolitical and idiosyncratic risks, which increases the uncertainty on the policy reaction front; and fragility in investors' confidence. We believe investors should maintain a focus on portfolio diversification, favouring relative positioning for the time being in order to mitigate overall risk exposure. In November, we became more conservative on US equity among DMs, where we have a neutral view now. This was due to a deterioration in our projections in terms of growth momentum, earnings and buyback activity. In Europe, good fundamentals, reasonable valuations and a still favourable economic environment for commodities in the last race for risky assets support maintaining a tactical view on basic materials. We also keep a preference for Eurozone value vs the overall market as a means of gaining defensive exposure, supported by valuation and technical aspects. We still favour Japanese equity, with less conviction though. The market remains cheap, with light positioning, limited exposure to geopolitical risks and resilience despite the non-exceptional earnings season. EM equities have seen a massive repricing this year, so we wonder if we are close to an entry point. Taking into account the number of

> “Elevated financial risks call for a still defensive stance in risk assets in the short term, while we are becoming more constructive in the medium term.”

Credit spreads



Source: Amundi, Bloomberg. Data as of 20 December 2018.

challenges and vulnerabilities, we think that the policy stimulus in China will be able to support the economy, so we will gradually start approaching the market with a more directional view for the Chinese domestic sector (best represented in the HSCEI*). **On the bond side**, we have recently become more constructive on duration in the US. We also maintain a preference for US Treasuries vs German Bunds (5y bonds) and we believe investors should favour an increase in their exposure to US rates (nominal and real) if better entry levels materialise. On **credit**, we see tactical opportunities opening up in 2019 on the back of spread widening, but we keep a defensive stance in the short term as the slowing economies and deteriorating fundamentals could spur more spread widening, amid a seasonal fall in market liquidity.

Risks and hedging

Geopolitical risks and downside risks to growth are the focus. We suggest effective portfolio diversification and liquidity buffers to exploit the better entry points that will materialise in 2019. Investors should keep structural hedges to mitigate financial risks and to smooth the risk assets sell- off, with a preference for assets perceived as safe haven: gold, JPY vs USD and AUD, or options to cover widening spreads in the HY sector.

FIXED INCOME

Cautiously seeking opportunities in credit

ERIC BRARD, Head of Fixed Income
YERLAN SYZDYKOV, Head of Emerging Markets
KENNETH J. TAUBES, CIO of US Investment Management

Overall assessment

After the sharp rise in real yields generated by Fed policy normalisation, in the last two months, US Treasuries have rallied amid political concern and economic deceleration. In a rapid move the market switched from discounting 3/4 hikes to discounting less than one interest rate hike for 2019. In this bumpy path for interest rates, corporate and EM bonds suffered strong outflows. Credit spreads have significantly repriced, discounting, in our view, a probability of recession and not just a deceleration. EMs have recently shown some resilience, possibly an early signal of investors' confidence coming back. The key question for fixed income investors, is how far the Fed can go on hiking rates, amid already tightening financial conditions. We believe we are getting close to the point at which the Fed is turning more neutral, and this would help relax some pressure on the USD and ease liquidity conditions. If our central scenario is confirmed, the Fed is likely to pause next year and there are signs of an easing in trade tensions, so we see the recent cheapening of DM credit and EM debt as an opportunity to rebuild exposure on more attractive valuations – but very gradually and on a selective basis.

> "Some entry points are expected in EM bond, main beneficiaries of a more dovish FED in 2019."

DM bonds

The cyclical deceleration of the economies, combined with market uncertainties, tends to exert a downward pressure on the yield curves. We prefer US rates among DMs. In Europe, we keep a neutral stance on peripherals. In Italy, while progress has materialised, we prefer to stay prudent, maintaining a wait-and-see stance, as we expect some risk premium to remain. We see opportunities in break-even inflation, as growth is above potential and the output is quickly closing. On corporate bonds, during the second half of the year spreads priced in the higher rates and the higher corporate leverage, creating attractive entry points on selected issuers. In Europe, new issuance could give opportunities to re-enter the market. However, Euro credit will remain volatile, as political uncertainty is high and European growth is decelerating, with risks tilted to the downside (internal and external risks, considering Europe is quite exposed to the Chinese slowdown). In the US, credit offers moderate value as fundamentals remain relatively stable, but extended credit poses some risks. We suggest to favor more liquid issues in IG and specific segments of the HY market (single-B ratings offer more opportunities of selection).

EM bonds

Sentiment has recently shifted more positive for EMs on the back of a Fed that is less hawkish than expected and a China-US trade easing. The technical backdrop is supportive for both local and external EM debt, but our preference is for hard currency at the moment, as we are confident that the asset class may deliver positive returns over the medium term (the yield on EM external debt is higher than the yield on EM local debt for the first time since 2009) while protecting investors against currency risk. We look more favourably to countries with less political risk (the political agenda is very crowded for EM in 2019), those that are less exposed to trade disputes and also those with higher carry.

FX

The upward pressure on the US Dollar should begin to wane next year. In Europe, we prefer Nordic currencies (SEK, NOK) to the Euro as these are more sheltered from Euro area political stress. The sterling could still suffer from volatility as the tail risk from the political crisis is still open.

EM bond and Fed policy

Source: Amundi, Bloomberg. Data as of 20 December 2018.

EQUITY

Becoming more constructive in Emerging Markets

ALEXANDRE DRABOWICZ, Deputy Head of Equity
YERLAN SYZDYKOV, Head of Emerging Markets
KENNETH J. TAUBES, CIO of US Investment management

Overall assessment

After the sell-off in October and the modest rebound in November, markets turned negative again at the beginning of December, as fears on future growth prospects dominated market sentiment. The US is now adding to the list of countries in the correction area, though a further downside without a recession is highly unlikely. A relief rally ahead is possible, with a possible trigger being a more dovish Fed. A Fed pause should also support Emerging Markets, which are already in bear territory. Hence, we are becoming more constructive on EM equity, though we do not think it is time yet to aggressively increase risk allocations as the overall economic and geopolitical outlook remains uncertain. Overall, we remain focused on quality at a reasonable price.

Europe: politics vs valuations

In Europe, additional uncertainty coming from recent yellow vest protests in France is adding to an already weak sentiment due to Brexit and Italy's budget issues. Bottom-up analysts' consensus for earnings seem elevated and revisions are likely to converge lower. European equities are discounting a bigger slowdown in growth, but certainly not a recession. Against this backdrop, we stick to the view that a strong focus on the quality of companies and the sustainability of earnings growth is key, as cost rises add pressure on European earnings. The turnaround in favour of defensives against cyclicals has been brutal – it is difficult to chase this move as valuations in defensives are trading at high levels in relative terms. We continue to see good opportunities at single stock level, but avoid big sector views. Sentiment is almost at an all-time low and the technical unwinding of positions could continue despite valuations in Europe becoming attractive.

US: time to lower the cyclical tilt

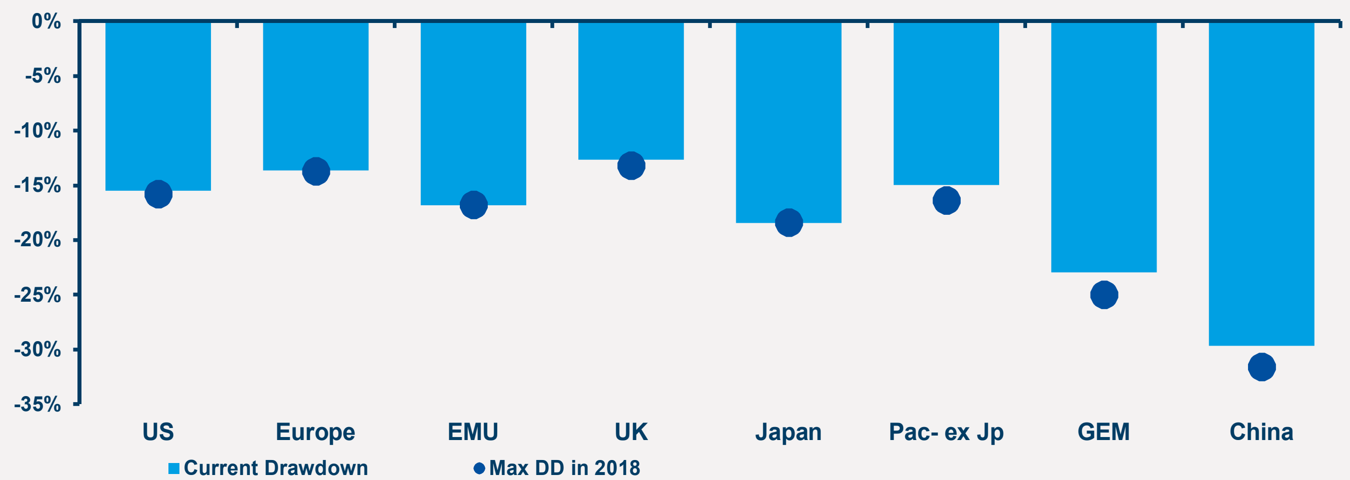
With increasing signs of economic and earnings growth deceleration, the big question is whether the cycle is over or flattening. In our view, for industries such as capital goods, banks or semiconductors, the market is waiting to see them execute successfully through a slowdown to then reward them with the positive re-rating that many of them deserve for improved, more stable business models vs prior cycles. With this observation, we have become more cautious on cyclicals, where we maintain a focus on the highest conviction cyclical stocks, those with the most valuation support that are best able to successfully navigate a slowdown. In addition, after the correction in tech, we are leaning towards increasing bias to tech and quality that can withstand late cycle pressures, while, as mentioned already, lowering our cyclical bias.

> "Quality remains at the forefront in Europe and the US. EMs are reaching a floor, as a more dovish Fed could be supportive for a recovery next year."

Emerging markets: improving outlook

The market is starting to price in a gentle deceleration in US growth and less hikes from the Fed – likely to lead to a weak US dollar – therefore making the environment more constructive for EM equities. We expect EMs to deliver a decent improvement in both earnings and valuations, with the valuation picture becoming increasingly attractive regardless of the different scenarios. Within EM equities, we tactically prefer China (we favour the technology and energy sectors) as most of the concerns on trade tensions seem already priced in and the Chinese policy stimulus could be enough to prevent a further slowdown in growth. Russia is attractive, in our view, thanks to the historical cheapness of equities, but it is vital to monitor the impact of sanctions. For the time being, we prefer to stay out of countries with high political risk (namely, Turkey and Argentina).

Drawdowns across the board



Source: Bloomberg. As of 31 December 2018. MSCI Indexes total return in local currency. Drawdown: The peak-to-trough decline during a specific record period of an investment, fund or commodity, usually quoted as the percentage between the peak and the trough.

Asset allocation: multi-class outlook

	1 month change	---	--	-	0	+	++	+++
Equities vs govies	→				■			
Equities vs credit	↗					■		
Credit vs govies	↗				■			
Duration	↗				■			
Oil	↘				■			
Gold	→					■		
Euro cash	→			■				
USD cash	→				■			

The table above represents cross asset assessment of 3 to 6 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 (+/++/+++).

Relative outlook and convictions by major asset class

	Asset Class	1 month change on view	Underweight	Neutral	Overweight
GOVIES	US	↗			●
	US linkers	↗			●
	Euro core	→	●		
	Euro peripherals	→		●	
	UK	→	●		
	Japan	→	●		
CREDIT	US IG	→		●	
	Euro IG	↗		●	
	US HY	→	●		
	Euro HY	→			●
	GEM debt hard cur.	→		●	
	GEM debt loc. cur.	→		●	
EQUITIES	US	↘		●	
	Eurozone	→		●	
	UK	→		●	
	Japan	↘			●
	Pac. ex Jap.	→		●	
	Global EM	↗			●

Currency and real assets

FOREX	EUR vs USD	↗
	EUR vs GBP	→
	EUR vs JPY	→
	USD vs JPY	→
REAL ASSETS	Real estate	→
	Global Infrastructure	→
	Private Debt	→

LEGEND

↘	Downgrade
→	Unchanged
↗	Upgrade
● (red)	Underweight
● (black)	Neutral
● (green)	Overweight

Source: Amundi, as of 20 December 2018. The 3-6 month return outlook refers to research views based on expected returns by asset class. 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.**

THIS MONTH'S TOPIC

There is no synchronised global economic cycle

DIDIER BOROWSKI, Head of Macroeconomic Research

Finalised on 04/01/2019

The essential

A key theme at the start of 2019 is a synchronised global economic slowdown. This is the clear message given by the recent PMI surveys. Global growth seems to be on the wane, while global risks continue to add to the climate of uncertainty. In the developed economies, all eyes are on the US cycle and the fall in its ISM indexes. Meanwhile, in the emerging world, the focus is naturally on China, whose economy continues to show signs of losing steam at the start of this year.

However, appearances can be deceptive. In particular, this is because the signs of a slowdown chiefly relate to manufacturing (which is inherently more exposed to global trade), a sector that will tend to shrink over time. Also, we should remember that 2018 started with an apparently synchronised global expansion – but that did not last long! It now seems that the global cycle peaked at the end of 2017, so we should not rush to judgement on 2019 just yet. Different economies have slowed or are slowing for a variety of reasons. And some of factors that have weighed on the last few months have disappeared (oil has slumped by some 30% since early October). The US and China have struck a trade truce that is in the interests of both parties to uphold, given the worsening outlook. **In this environment, the apparent synchronisation of the global cycle may prove short lived.** While the United States and China are gradually slowing down, the rest of the world may still experience "autonomous cycles". This is made more likely as monetary policies are set to become more dovish: either more accommodative (China), or less restrictive (United States).

Let's take a look at the main trends affecting the key regions.

In the United States, the 5-point fall on the manufacturing ISM (at its lowest level in December since November 2016) suggests that the slowdown will be more severe than expected – especially as credit spreads have tightened considerably over the past weeks. The government shutdown and the stock market correction have further fuelled uncertainty. Meanwhile, the stimulus effect of the tax cuts and spending increases will begin to fade soon. As such, business investment is likely to show a more marked slowdown than expected (slowdown in global demand, downward revision in earnings projections, less visibility).

However, none of these factors should push the US economy into recession. The strength of the labour market should continue to support household consumption. Furthermore, US economic growth looks set to return to potential (around 1.7-1.8%) before long. The overall picture is of a significant economic slowdown that will naturally be accompanied by a marked fall in earnings, albeit after an exceptionally good year boosted by tax cuts. It is this latter point that is concerning the equity markets, which have probably begun to take higher levels of growth (GDP and corporate earnings) for granted.

As a result, the Fed is likely to make a pause sooner than expected, as the risks are becoming asymmetric. There will still be time to get monetary normalisation back on track later if the signs of a slowdown do not materialise, while at the same time inflation begins to accelerate.

In Europe, despite the recovery starting later than in the United States, the economies began to slow down in 2018, and there were still signs of a downturn at the turn of the year. The output gap has closed in most countries. **Several factors contributed to the decline in growth in 2018:** the rise in oil prices (until October), the slowdown in global trade and lower growth in the emerging economies. **Moreover, political uncertainty on a number of fronts has made the European outlook more gloomy** (Brexit, Italian budget, "yellow vest" protests).

- The Italian government – under pressure from the markets – revised down its deficit target for 2019 to stave off the EU's excessive deficit procedure (to 2.0%), illustrating the governing coalition's pragmatism.

- In France, the "yellow vest" crisis is still impacting the country's economy (Q1 growth figures are expected to take a hit) and political situation (the reforms will probably be postponed). That said, the measures announced by the government will increase consumers' purchasing power, which should boost consumption a little later in the year.
- In Germany, Angela Merkel's decision not to stand for re-election of the CDU following the results of the regional elections has effectively shut down discussions on further eurozone integration. However, it is worth noting that Annegret Kramp-Karrenbauer, who will succeed her as CDU leader, takes the same line on many issues as Mrs Merkel.

We will nonetheless have to wait for the European elections in May, and then a new parliament, a new German Chancellor and the new heads of key European institutions (Commission, ECB) for any significant progress to be made in strengthening the Eurozone – so nothing will happen before the autumn. In the meantime, political tensions are inevitable between now and the elections in May.

The United Kingdom's fate continues to be tied to the outcome of Brexit. In our central scenario, we assume that Theresa May's withdrawal plan is approved by the UK Parliament. This would enable the UK to benefit from a long transition period (from March 2019 to December 2020) with its trade rules unchanged while it continues its negotiations with the EU. However, we cannot rule out an "accident" of history that would lead to a hard Brexit (see section on risks and the investment talk released on this issue on 9 January).

In Japan, the economy weakened towards the end of the year. However, the Japanese economy is largely insulated from the effects of the US-China trade war, as exports to the US and China only account for around 3% of Japan's GDP. On the plus side, it is encouraging to note that Japanese firms are planning to increase their investment spending at a level unseen since 2007, despite the threats currently weighing on global trade. The labour market is at its tightest since 1974 and pay is rising at its fastest rate for 20 years. The VAT rise scheduled for October 2019 (from 8% to 10%) should boost consumption before weighing on household spending, once the increase is in place.

In China, the increased threat of protectionism has weakened the economy and heightened the risk of a hard landing. The fall below 50 in December's manufacturing PMI and the slowdown in industrial output is fuelling concerns. Although the Chinese authorities radically changed the direction of their economic policy in the summer by implementing counter-cyclical measures to stabilise its currency, this has yet to have much effect. China will use all the levers at its disposal to avoid a hard landing. Also, it is worth remembering that it has more leeway in these matters than the United States. As such, we continue to expect a managed slowdown of the Chinese economy. Lastly, the agreement reached between presidents Trump and Xi at the G20 on 1 December should alleviate tensions between the two countries in the coming months.

In the other emerging economies, the deterioration in domestic conditions – mainly stemming from the risks posed by US protectionism – will continue to weigh on the business and investment climate (particularly in North Asia and Mexico). However, other countries will continue to cover their infrastructure needs (Indonesia and the Philippines, for example). Consumption should remain strong in the countries that are close to full employment. A number of emerging economies are still weak (Argentina, South Africa), while Turkey's recession deepened at the start of the year, in line with projections. **Nonetheless, we should mention that two of the factors that destabilised the emerging economies in 2018** (the rise in US long rates and dollar appreciation) **are no longer an issue**: long-term rates have come down and the dollar has stopped rising, which will ease the pressure on the countries with the most dollar-denominated debt. In addition, it should be borne in mind that the nominal growth potential for emerging economies is on average much higher than for the developed economies, which in theory ought to enable them to service their debt more easily.

At the global level, the presence of multiple – and, in particular, political – sources of risk tends to increase overall uncertainty, which could weigh more heavily on investment decisions. **Tensions over US-China trade, the Middle East and political upheavals in Europe are not going to be resolved any time soon**, and nor are the other major problems (high debt, weak growth, climate risk, inequalities impacting Western democracies). The foundations on which growth is currently based are therefore fragile, and would be particularly vulnerable to a sudden hike in interest rates (increase in risk premiums).

This fragility is especially worrying given that the central banks and governments of many countries now have scarcely any room for manoeuvre: there are not many countries that would be able to implement a counter-cyclical policy to respond to a shock, and they are becoming increasingly rare.

- In particular, **the US procyclical fiscal policy leaves little room for manoeuvre** in the event of a downturn, especially as Congress is now divided (the democrats have gained control of the House, while the republicans have increased their majority in the Senate).

- **In Europe, there is not much room for manoeuvre in either fiscal or monetary policy.** Although the ECB has not really started to normalise its monetary policy, growth is already slowing. We expect no rate hike from the ECB in 2019..

Trade tensions are high and global trade is sluggish, but this does not mean that global growth will plummet. The disruption of value chains caused by the trade war is changing the landscape of the international trade in goods, to China's benefit. Trade in services is expanding, economies remain closely intertwined and Donald Trump is isolated on the international stage. It is particularly important to note that the interests of populist/nationalist regimes are not necessarily converging: many of them are reliant on the rest of the world for their development (Eastern Europe, Turkey and Brazil, among others). Lastly, the share of consumption tends to increase in emerging countries as they develop.

As such, economies are more likely to experience more autonomous economic cycles in the future, as these will be more dependent on their domestic demand. And this is all the more likely if political risks are present on most continents, as there is indeed no reason for them to materialise simultaneously. In a world with an increasingly unstable political environment, we should expect economic cycles to decouple more often.

In short, given the uncertain outlook for both the United States and China, **risks remain tilted to the downside**. **Even though it is clear that we cannot rule out a long-lasting and synchronised global slowdown, we strongly believe that emerging and advanced economies are likely to decouple again by the end of the year.**

Risk factors

DIDIER BOROWSKI, Head of Macroeconomic Research
PHILIPPE ITHURBIDE, Global Head of Research

The table below presents risk factors with judgmental probabilities (i.e. not market based). It also develops the possible market impacts.

Risk # 1 | 40% probability | Renewed escalation in trade tensions between the US and China

Analysis | US and China ceased fire after a temporary deal reached by President Trump and President Xi during G20 meetings at Argentina. The planned increase of tariff rates in January 2019 paused and the risk of an additional tranche of tariffs on the rest of US imports from China ($267bn) seems to have been also delayed, while negotiations resumed, with signs of China to deliver some of commitments before 90 days of deadline. This should at least help to reduce some downside risks in the near term, with direct impacts on trade to be less concerned, and market sentiment to recover slightly from being very downbeat. That said, this deal is still temporary, and it could take much longer to ultimately solve the problems, as many complicated topics are involved. we cannot rule out a severe confrontation between the US and China.

Market impact | Trade tensions have begun to weigh on business climate (especially in the manufacturing sector) and on the Chinese economy. Subsequently some private-investment projects have probably been postponed. Even in the absence of a large-scale trade war, global trade, which has started to slow, may thus slow down further. A chain reaction would cause a fall in global trade of goods while exacerbating local inflationary pressures in the short run (mainly in the US), putting central banks in a corner. This would cause a general rise in risk aversion (fear of a global downturn). At the end of the day, a more severe confrontation would only make losers.

Risk # 2 | 20% probability | Major European slowdown

Analysis | Eurozone GDP growth slowed down to only 0.2% QoQ in Q3, after 0.4% in Q1 and Q2 and 0.7% in Q3 and Q4 2017. While Q3 weakness was largely the result of temporary negative factors (a sharp drop in German car production due to a new emission testing regime), the growth momentum in Q4 is slower than what we anticipated a few months ago. The central scenario remains a continuation of the recovery at a slightly above-potential pace, but risks are tilted to the downside, in particular in the short run. Indeed, the combination of continuing internal political stress and external negative factors (notably a slowdown in the US and/or Chinese momentum) could cause growth to fall further. Lower oil prices are currently a supportive factor into 2019. However, a reversal of this trend would be another drag for the European economy.

Market impact | As the ECB would be left with few tools to face a slowdown, and as a coordinated fiscal stimulus would be very difficult to decide due to the complex European institutional and political environment, a major slowdown would clearly be negative for European assets and the euro.

Risk # 3 | 15% probability | Political instability in Italy with renewed stress on sovereign spreads in the Eurozone

Analysis | The government coalition in Italy (between M5S and the League) maintained very tense relations with the EU until recently. The government revised down its deficit target, with a smaller budget deterioration in 2019 (2.04% vs. 2.4%). It is not a structural adjustment, but thanks to this revision, the European Commission (EC) has decided not to launch an Excessive Deficit Procedure at this stage. The relationships with the EC have improved at least for the time being.. Incoming data on contracting economic growth in Q3 and weak coincident and leading indicators for Q4 increased the risks of another dip. With slow growth ahead (we expect GDP growth at 0.5% in 2019), tensions with the EC will inevitably resurface later in 2019.

Market impact | There is no systemic risk in our opinion. On the one hand, the rise in Italian bond yields has tightened local financial conditions and that weighs on GDP growth in Italy. But on the other hand, the absence of an EDP gave some short-term relief. Yet, the long-term outlook has not changed much. We perceive risks as remaining domestic. Keep in mind that the ECB has anti-contagion tools that it could mobilise to avoid a contagion to other peripheral markets. All of this should contain the contagion risk on peripheral sovereign spreads and on corporate credit spreads.

Risk # **4** | **15%** probability

No-deal Brexit

Analysis | The news-flow concerning Brexit has been quite intense since the UK government was able to secure an agreement with the EU on 25 November 2018. The most notable developments have been since early December: The "Grieve" amendment, giving MPs more influence regarding the Brexit process if a Brexit deal is voted down ; The decision of the UK government to postpone the ratification of the deal by the UK Parliament as it was bound to fail by a very large margin (a new attempt has been scheduled for 15 January 2019); The confirmation by the European Court of Justice (ECJ) that the UK can unilaterally revoke Article 50; The failure of a no-confidence vote held among Tory MPs against PM May. Since mid-December, various announcements regarding contingency planning measures in case of no-deal Brexit. In our view, these events (despite the last item) have slightly reduced the probability that the UK will exit the EU as soon as March 2019, either with or without a deal (although the exit with a deal remains the most likely scenario), and have increased the probability that the UK will remain in the EU beyond March 2019, with prolonged uncertainty regarding how (and, possibly, even whether) Brexit will happen. At the end of the day, we see a 60% chance that the Brexit deadline arrives with a deal agreed. We attribute a 15% probability to a no-deal scenario. The probability of prolonged uncertainty is assumed at 25%.

Market impact | In any case, the road to the deal ratification will probably be difficult and may thus a source of temporary stress. In the event that the outcome is ultimately unfavourable for the UK, we would see a weakening of the GBP and below-trend GDP growth. But should a deal be voted, the Sterling would re-appreciate and business investment would probably benefit from a drop in uncertainty.

Risk # **5** | **15%** probability

Continuation of the contagion in the "emerging world"

Analysis | Emerging markets have been suffering since the start of the year, impacted by (1) the Fed's rate hikes and strong USD; (2) by the trade war rhetoric; (3) by the tightening in domestic monetary conditions (many EM central banks have risen their key rates); (4) by the deterioration of the outlook in several countries at the same time (Argentina, China, Turkey and South Africa). In fact, even though the systemic risk is lower than in the past (given the lesser vulnerability of emerging countries), most EM assets dropped in 2018. The fact that the Fed is close to the end of its tightening cycle and that the USD has peaked is good news for EM markets in 2019. However an escalation in the trade war between the US and China would undoubtedly push to a larger contagion (because value chains are very integrated).

Market impact | Credit spreads and equity markets would be highly hurt; it all the more true that emerging currencies would remain under pressure with more capital outflows. However, the emerging world is not a homogeneous block, and the market will deteriorate more in the most vulnerable countries, whether due to poor external positions whether due fragile fiscal and political conditions. Some caution about emerging markets is still required at present but the risk probability has reduced. Indeed, we believe EM markets have already priced in most bad news, and at some point, they should become attractive again.

Risk # **6** | **15%** probability

US Recession

Analysis | Recent surveys indicate that the US economy started to slow in Q4. We think that US growth will continue to slow looking ahead, in particular regarding investment. Given the shutdown, there is no compromise to expect between Democrats and Republican on infrastructure in the short term. All eyes are on the Federal Reserve which is likely to make a pause earlier than expected.

Market impact | Markets are likely to become more circumspect with regard to 2020 growth expectations as the deceleration could become more pronounced and economic signals increasingly mixed as the cycle extends. The best choice for investors is to limit exposure to credit, diversify the portfolio smartly and to take a flexible duration management (close to neutrality at this stage). On the equity side, selection of themes, sectors and single names will be increasingly relevant.

Risk # **7** | **15%** probability

A Chinese "hard landing"/ a bursting of the credit bubble

Analysis | Chinese economic growth is slowing down but the authorities are working hard to stimulate the economy (through FX management, monetary and fiscal policies) so that the economy is expected to remain resilient. That being said, the country's economic model is fragile: the excess of credit is visible, non-financial corporate debt has surged since the GFC. The good news is that the NFC debt to GDP ratio had started to drop since late 2017. We will continue to monitor closely the trend in Chinese private debt, especially if the economy slows. Meanwhile, a cease of fire with US on trade tensions could gain valuable time for China to adjust their policy implementations and to better manage short-term risks. In the case of hard landing or the bursting of the credit bubble, the Chinese authorities would be unable to avoid a stronger depreciation of the Yuan.

Market impact | A hard landing linked to a burst of the credit bubble would have a very negative impact and its cascading effects would be particularly disastrous: vulnerability of banking systems (in China and elsewhere), vulnerability of the global financial system, vulnerability linked to China's public and private debt, negative impact on regional and global trade, and thus on commodities and emerging countries, impacts on the currencies of commodity-exporting countries, advanced countries and emerging countries, etc..

Risk # **8** | **10%** probability | **Major political crisis in Europe**

Analysis | European politics is becoming less predictable due to the rise of various non-mainstream political forces in several countries. In September, the non-mainstream Italian government coalition announced a 2019 budget in breach of European rules, thus opening an episode of tensions with the rest of the Eurozone. In France, where the situation had been stable since the 2017 presidential election, sudden and violent social movements caught the government off guard at the end of 2018 and appeared to seriously threaten at least the continuation of its supply-side reform agenda. Although less immediately worrying, the political outlook is also uncertain in Germany (due to the leadership change at the head of Merkel's CDU party and uncertainty regarding the future of the government coalition) and in Spain (due to the lack of a proper majority in Parliament and the recent rise of a far-right party). More generally, the combination of strong anti-immigrant feelings and frustration towards European institutions seem to give a strong impetus to anti-system political forces, with the May 2019 European election seen as a major gauge of their progress.

Market impact | Given the still positive economic backdrop, we do not believe that these events will trigger a new round of systemic crisis in Europe. Non-mainstream political forces that are in a position to rule countries (such as in Italy) have shown that they want to blame European political institutions and try to modify them, but not exit the Eurozone. However, this problematic political news flow will continue to generate market stress in 2019 while the difficulty to understand European institutions for outside investors means that European assets will continue to carry a specific political risk premium. Italian government spread vs. Bund could continue to be volatile.

MACROECONOMIC CONTEXT

Our convictions and our scenarios

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This section provides a reminder of our central scenario and alternative scenarios.

Central scenario (75% probability): global growth slows gradually but surely

- **Growth is slowing worldwide:** 2018 had begun based on the theme of a synchronised global recovery. But, this did not last. Since the spring, the protectionist measures taken by Donald Trump have changed the game. Emerging economies, some of which are heavily indebted in dollars, have been weakened due to the broad-based appreciation of the US currency. The depreciation of their currencies has generated local inflation and led their central banks to tighten monetary policies, which has weighed on economies already negatively affected by massive capital outflows. The Eurozone has also begun to slow down. Hence 2019 starts with a global synchronised slowdown with downside risks. However, a new factor that arrived lately in the picture has been the oil price drop that should support the European economies and the EM oil Importers such as India and Turkey.

- **World trade:** Global trade keeps weakening; it started 2018 at around 5% YoY and in October it has grown by 3.6% YoY. Protectionist rhetoric has pushed down business confidence, particularly in Europe. That said, uncertainty is tending to drag down investment and disrupt value chains that have developed in lock-step with the expansion in global trade over the past 15 years. However, the truce between China and the US (after the G20 meeting in Argentina) has resulted in a more positive than expected short-term scenario, where the further increase in US tariffs towards China from 10% to 25% at the 1st of January 2019 has been postponed by 90 days (1st of March 2019).

- **United States:** The economy has been driven by very accommodative fiscal policy but its impact should progressively erode this year. We expect growth to decelerate to its potential by early 2020, meaning in practice that the US economy will lose 1pp of growth by the end of the year. Indeed, we have revised down our GDP growth forecast from 2.7% to 2.4% in 2019 and from 2.0% to 1.8% in 2020 (yoy growth, would thus slow from 3.1% in Q4 18 to 2.1% in Q4 19). This situation will have a negative impact on corporate profits, especially if inflationary pressures materialise by then, which is possible, given the fact that the economy is operating at close to full employment. We do confirm our expectation that a recession is highly unlikely in 2019, but the cycle-end story will probably return to the fore at some point by next summer, as the fiscal multiplier impact fades and as the effects of monetary policy tightening show up.

- **Eurozone:** Last month, we revised our growth forecasts slightly downward. Despite a recovery that has started well after that in the US, national economies have begun to slow in 2018. The output gap has closed in most countries, and Italy is the only one in the Eurozone (excluding Greece) where GDP has not recovered to pre-crisis levels. Several factors have contributed to the slowdown in growth in 2018: the slowdown in world trade and until October a high oil price have been the most relevant. In addition, political uncertainties have muddied the waters (Brexit, Italian budget). The possibility of a coalition change in Germany following the defeat of the two major government coalition parties (CDU and SPD) in local elections marks the end of the Merkel era. The loss of the chancellor's leadership may hinder initiatives to strengthen the integration of the Eurozone that were under consideration. It will probably be necessary to wait for European elections in May 2019 and a new parliament, a new European Commission, a new Chancellor in Germany, and clarification regarding leadership of the institutions of the EU (Commission, ECB) to make significant progress in strengthening the the EU and the Eurozone. In Italy, incoming data on contracting economic growth in Q3 and weak coincident and leading indicators for Q4 increased the risks of another dip that prompted the Government to tone down rhetoric

- **United Kingdom:** The political situation in the UK is very unstable, with a parliamentary vote that is expected on 15 January. Everything will ultimately depend on the scenario (see section risk factors and our "investment talk" published on the subject on 9 January).

- **China:** Chinese economic growth is slowing down but the authorities are working hard to stimulate the economy (through FX management, monetary and fiscal policies) so that the economy is expected to remain resilient. That being said, the country's economic model is fragile: the excess of credit is visible, non-financial corporate debt has surged since the GFC. The good news is that the NFC debt to GDP ratio had started to drop since late 2017. Meanwhile, a cease of fire with US on trade tensions should gain valuable time for China to adjust their policy implementations and to better manage short-term risks. In the case of hard landing or the bursting of the credit bubble, the Chinese authorities would be unable to avoid a stronger depreciation of the Yuan.

- **Inflation:** Core inflation remains low at this stage of the cycle in advanced economies, and should recover gradually. That said, the slowdown in inflation in recent years is primarily structural in nature, as it is tied to supply-side factors, while the cyclical component of inflation has weakened (with a flattening of the Phillips curve). Core inflation is likely to pick up only slightly in advanced economies. An "inflationary surprise" remains possible with the pick-up in wages (United States, Eurozone) but would not last long (due to a lack of pricing power) and would drag down corporate margins more than final sale prices, all the more so if global growth slackens. Things are different in emerging economies, where inflationary pressures are greater in many countries, in reaction to which many central banks have raised their key rates.

- **Oil prices:** Oil prices have decreased sharply: from $86/b (Brent) as of 4 October to $60 in early January. The main trigger at the very beginning of the decline have been the large amount of waivers conceded by the US administration to different countries with regard to the sanctions imposed to Iran oil exports. A moderate OPEC and Non-OPEC production cut decided at the beginning of December together with fear of a more pronounced economic slowdown are keeping oil prices at low levels.

- **Main central banks to turn more accommodative:** The Fed should stop soon its hike rates, earlier than expected (we only expect one rate hike this year). The ECB has ended its monthly asset purchases at the end of December, as announced. But will continue to replace maturing securities (between €160 and 200 bn in 2019) without clarifying its reinvestment policy in order to retain some flexibility. I The ECB has no room for manoeuvre to normalise its monetary policy, given the economic slowdown and the absence of inflation.

Downside risk scenario (20% probability): a marked trade-war-driven economic slowdown, a geopolitical crisis or a sudden repricing of risk premiums

- The risk of further protectionist measures from the US (even after the 90 days agreed during last G20 meeting), followed by retaliation from the rest of the world, remains high. China and the EU are particularly exposed to this risk.
- Uncertainty regarding rising trade tensions (primarily between the US and China) against a backdrop of geopolitical risks, crises in several large emerging economies (e.g., Turkey, Argentina), political risk in Brazil, a slowdown in China, and political tensions in Europe (a deterioration in the budget situation in Italy, Brexit) is encouraging companies to remain cautious.

Consequences:

- All things being equal, a trade war would drag down global trade and trigger a synchronised and durable slowdown in growth and, in the short term, inflation. That said, a global trade war would quickly become deflationary by creating a shock to global demand.
- An abrupt repricing of risk on fixed income markets, with an across-the-board rise in government or credit spreads, for both advanced and emerging economies, and a decline in market liquidity.
- Recession fear in the US.
- In the worst - albeit highly unlikely - case would once again resort to unconventional tools, such as expanding their balance sheets.

Upside risk scenario (5% probability): a pick-up in global growth in 2019

Donald Trump makes an about turn, reducing barriers to trade and engaging in bilateral negotiations with China. Domestically, the theme of increasing infrastructure spending could return to centre stage and extend the cycle in the United States.

- Acceleration driven by business investment and a rebound in global growth.
- Pro-cyclical US fiscal policy generating a greater-than-expected acceleration in domestic growth. Growth is reaccelerating in the Eurozone after a dip. Growth picks up again in China on the back of a stimulative policy mix.
- Central banks would react late, initially maintaining accommodative monetary conditions.

Consequences:

- An acceleration in global growth would boost inflation expectations, forcing central banks to consider normalising their monetary policies more rapidly.
- An increase in real key rates, particularly in the US.

Macroeconomic picture by area

United States

Risk factors

Mixed signals may increase

- Economic growth remains above potential, still consistent with a gradual slowdown. As the cycle extends, the likelihood of having mixed signals from data increases.
- We see domestic demand remaining the key driver of growth, with a change in composition favouring a prominence of consumption over investments.
- Business confidence remains strong, although data show a moderation in capex intentions and a deceleration in non-residential and residential investments.
- The labour market remains strong with a pick-up in wage growth and labour costs more consistent with this phase of the cycle.
- The inflation outlook remains benign, with modest domestic inflationary pressures as CPI and Core CPI converged to 2.2%
- The Fed met on 19 December, delivering a much-expected hike (rates now at 2.25% to 2.5%); the statement sounded more cautious on the outlook. The dot plot now implies two hikes for 2019.
- The December G20 meeting reopened trade negotiations between China and the US, suspending any escalations for 90 days.

Risk factors:

- **Fed tightening impacting interest rate-sensitive segments (housing, consumer credit)**
- **Abrupt, protracted and severe tightening of financial conditions**
- **Tariffs and retaliation negatively impacting economic performance, both directly (prices) and indirectly (confidence)**
- **Geopolitical risks linked to a more hawkish shift by the US Administration**

Eurozone

The recovery continues in spite of disappointing figures and rising political risks

- Growth fell far short of expectations in 2018. Temporary negative factors, such as the German auto sector, were one reason, but not the only one. Rising oil prices (until October), trade tensions, and political risks also played a part. The recovery will continue but at a weaker pace than what had been expected (with the 2019 growth forecast lowered once again from 1.6% to 1.5%).
- An agreement was reached on the Italian budget, but France experienced very serious social unrest in Q4, and political risks will remain very high in 2019.

Risk factors:

- **Stronger political protest movements**
- **Euro appreciates**
- **External risks (especially of a trade war)**

United Kingdom

Lots of uncertainty in the run-up to Brexit

- Despite the lack of visibility on Brexit procedures, the labour market is still strong and real wages have moved back into positive territory. Falling oil prices will help inflation pull back.
- Even so, Brexit is weighing on confidence and investment. The UK Parliament's ratification of the deal negotiated with the EU in November is very uncertain, and many scenarios are possible, although we believe that a "no deal Brexit" is ultimately unlikely.

Risk factors:

- **"No Deal Brexit"**
- **The current account deficit remains very high**

Japan

Generous fiscal policy should limit downside risk in economic growth

- Catch-up activities after natural disasters, coupled with mild weather should boost economic growth for now. A sharp decline in inventories will stimulate production while the recovery in foreign visitors will benefit regional economies.
- The BOJ *Tankan* revealed that corporate morale was resilient despite an avalanche of uncertainties outside Japan. Capital spending plan for this year marked the fastest pace of expansion.
- Following FY18 supplementary budgets for disaster relief and infrastructure reinforcement, the government released measures to avoid any economic setback after the VAT hike scheduled for October 2019. This stimulus, combined with higher income and pre-announced economic policies, is likely to offset most of the adverse impact of the higher tax.

Risk factors:

- **The US administration set to take a tough line on trade talks with Japan, starting January**

China

Risk factors

- The economy continued to slow, while policymakers signalled that they would be more proactive into New Year, following annual the Economic Work Conference.
- For now, US/China trade tensions look like less of a concern, as the two sides have resumed talks, while China has taken several actions, presumably as agreed at the G20 meeting, including imports of US soybean, temporary reduction of US auto tariffs and strengthening intellectual property protection.
- Nonetheless, exports look to be weakening, although perhaps not as much as previously feared.
- Meanwhile, previous deleveraging efforts continued to weigh on domestic demand, particularly in the auto sector in recent months.
- There are signs of policy supports passing through into the economy, but they still in the early stage.
- Looking ahead, we are waiting for more policy measures and more visible effects. At least, the RMB looks to have stabilised in recent weeks.

Risk factors:

- **Uncertainty remains in US/China trade talks**
- **Policy mistakes in managing near-term risks and the structural transition**
- **Geopolitical noise regarding North Korea**

Asia (ex JP & CH)

- As might be expected from all the noise from the escalation of the trade issue between China and the US, growth in the area worsened, driven mainly by external demand. We have revised our GDP forecasts down quite broadly throughout the region.
- The region's inflation figures remained benign. Finally, inflation in the Philippines declined significantly, to 6.0% YoY from 6.7% YoY, showing a faster-than-expected converging path to the target. India's inflation surprised again on the downside at 2.3% YoY in November, on the back of negative growth in food prices.
- The BSP and BI recently paused after their aggressive hiking cycle. The BoT raised its policy rate in December following the change in its monetary policy stance.
- During the last two months a clash between the RBI and the Indian government was brought to the public's attention. In the run-up to the elections, the government would like to see the RBI become more proactive in letting public banks ease credit conditions for SMEs.

Risk factors:

- **Growth outlook revised downwards in the region**
- **Inflation still very benign. In the Philippines, it has begun to decline significantly**
- **BSP and BI recently paused in their hiking cycle**
- **The RBI signals interferences from the government**

Latam

- The recently released Q3 2018 GDP figures highlight a mixed macroeconomic picture in the area: Brazil and Peru accelerated more than expected, while Colombia, Chile and Mexico slowed down.
- On the inflation front, the overall environment remained benign. In Mexico, inflation finally confirmed the reversal trend in November with a more pronounced deceleration at 4.7% YoY. In Peru inflation kept increasing at 2.2% YoY yet remaining within the CB's target.
- The region's main central banks kept their monetary policy unchanged at their recent meetings, while Banxico raised its policy rates again by 25bps to 8.25% in December.
- On the fiscal side, the most relevant news was the publication of the Mexican budget for 2019 to assess the fiscal stance of the new administration. The figures budgeted showed a prudent approach, even in their assumptions on GDP, inflation and MXN peso dynamics.

Risk factors:

- **Brazil still on track for recovery**
- **Inflation turning more benign in Mexico**
- **Tighter monetary policy in Mexico**
- **Mexican budget showing some fiscal prudence**

EMEA (Europe Middle East & Africa)

Russia: we forecast 1.7% YoY growth for 2018 and slightly lower for 2019

- Despite the threat of potential US sanctions down the road, the macroeconomic scenario remains supportive. Russia will be among the few emerging market sovereigns with the "twin surpluses" in 2019, while accumulating assets at the National Wealth Fund.
- The Central Bank may hike again in Q1- 2019 depending on rouble weakness, inflation expectations and external risks.

Risk factors:

- **Drop in the price of oil, stepped-up US sanctions and further geopolitical tensions**

South Africa: exit of recession but no miracle

- South Africa emerged from recession in Q3 thanks to the recovery of manufacturing and services. On the expenditure side, household consumption rebounded as well as inventories while private and public investment declined. The contribution of net exports was also negative.
- In terms of policy mix, there is very little room for manoeuvre. The SARB has raised its rates and it is not excluded that it still has to do it in 2019.

Risk factors:

- **Increased risk aversion, rising social demands, lack of structural reforms**

Turkey: we expect double-digit inflation and recession in 2019

- The strong tightening of interest rates, the rebound in the Turkish lira, the fall in the price of oil and the implementation of discretionary measures on some goods, have provided some respite to inflation. However, it should not fall below 20% for several months.
- In this context, household purchasing power and corporate margins are at their lowest. We therefore expect a sharp drop in activity in the second half of 2018 and a GDP recession of 1% in 2019.

Risk factors:

- **A too rapid easing of the central bank, a cooling of budgetary policy, a slowdown in activity in the eurozone**

Macro and Market forecasts

Macroeconomic forecasts
(8 January 2019)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	**2.9**	**2.4**	**1.8**	**2.4**	**2.3**	**2.3**
Japan	**0.7**	**1.0**	**0.6**	**1.0**	**0.7**	**1.3**
Eurozone	**1.9**	**1.5**	**1.5**	**1.8**	**1.7**	**1.7**
Germany	1.7	1.6	1.7	1.9	1.7	1.6
France	1.6	1.4	1.5	2.1	1.6	1.5
Italy	0.9	0.5	0.6	1.3	1.7	1.7
Spain	2.7	2.3	1.7	1.5	1.5	2.3
UK	**1.4**	**1.5**	**1.6**	**2.3**	**2.3**	**2.3**
Brazil	**1.3**	**2.2**	**2.1**	**3.7**	**4.5**	**4.3**
Russia	**1.7**	**1.5**	**1.7**	**2.9**	**4.9**	**4.2**
India	**7.8**	**6.9**	**7.1**	**4.0**	**3.9**	**4.7**
Indonesia	**5.1**	**5.3**	**5.4**	**3.2**	**3.4**	**4.2**
China	**6.6**	**6.2**	**6.1**	**2.1**	**2.2**	**2.4**
Turkey	**2.8**	**-1.0**	**1.5**	**16.2**	**16.5**	**13.3**
Developed countries	**2.2**	**1.9**	**1.6**	**2.0**	**1.9**	**2.0**
Emerging countries	**4.9**	**4.6**	**4.8**	**4.1**	**3.9**	**3.8**
World	**3.8**	**3.5**	**3.5**	**3.2**	**3.1**	**3.1**

Source: Amundi Research

Key interest rate outlook

	08/01/2019	Amundi + 6m.	Consensus Q2 2019	Amundi + 12m.	Consensus Q4 2019
US	2.50	2.75	2.75	2.75	3.00
Eurozone	0	0	0	0	0.1
Japan	-0.1	-0.1	-0.1	-0.1	-0.1
UK	0.75	1.0	1.0	1.0	1.0

Long rate outlook

2Y. Bond yield

	08/01/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.56	2,80/2,90	2.57	2,80/2,90	2.53
Germany	-0.58	-0,50/-0,40	-0.55	-0,50/-0,40	-0.52
Japan	-0.14	-0,20/0,00	-0.13	-0,10/0,10	-0.15
UK	0.75	0,80/1,00	0.77	0,80/1,00	0.75

10Y. Bond yield

	08/01/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.72	2,90/3,10	2.73	2,90/3,00	2.74
Germany	0.23	0.35/0.55	0.30	0.35/0.55	0.36
Japan	0.00	0,15/0,25	0.04	0,10/0,20	0.07
UK	1.26	1.40/1.60	1.32	1,40/1.60	1.37

Currency outlook

	09/01/2019	Amundi + 6m.	Consensus Q2 2019	Amundi + 12m.	Consensus Q4 2019
EUR/USD	1.15	1.18	1.17	1.20	1.20
USD/JPY	108	109.0	111.0	107	108.0
EUR/GBP	0.90	0.90	0.89	0.88	0.88
EUR/CHF	1.13	1.17	1.15	1.18	1.16
EUR/NOK	9.77	9.30	9.48	9.20	9.30
EUR/SEK	10.24	10.00	10.10	9.80	9.85
USD/CAD	1.32	1.30	1.30	1.30	1.29
AUD/USD	0.72	0.73	0.73	0.70	0.74
NZD/USD	0.68	0.68	0.68	0.69	0.70
USD/CNY	6.81	6.80	6.90	6.70	6.80

Recent publications

WORKING PAPERS

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Leila BENNANI, Théo LE GUENEDAL, Frédéric LEPETIT, Takaya SEKINE — Quantitative Research — Amundi, Lai LY — Head of ESG Analysis — Amundi, Vincent MORTIER — Deputy Group Chief Investment Officer — Amundi, Thierry RONCALLI — Head of Quantitative Research — Amundi

Robust Asset Allocation for Robo-Advisors
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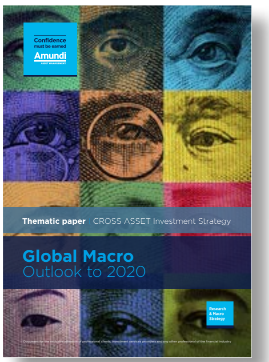

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