Confidence must be earned

Amundi ASSET MANAGEMENT

CROSS ASSET

INVESTMENT STRATEGY

CIO VIEWS

A SWEET SPOT, BUT KEEP A SHARP EYE ON THE MACRO SIDE

THIS MONTH'S TOPIC

EUROZONE: A MERE DIP OR A SUSTAINED SLOWDOWN?

Research & Macro Strategy

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

CIO VIEWS

A sweet spot, but keep a sharp eye on the macro side

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

Risky assets have been in a very strong uptrend since the beginning of the year. The key question now is, where **do we go from here**? There are two main driving forces to focus on in the current context.

Force 1 is the dovish turn of the main Central Banks (CBs) – the game changer this year. The Fed hiking cycle seems to be over for the moment, with the probability of further hikes now very remote. The ECB has gone the extra mile of dovishness by confirming that the "*lower for longer*" narrative is going to persist, announcing a new TLTRO, and also introducing the possibility of further accommodative measures.

Force 2 is the slowdown in global growth and the very limited inflation pressures, both of which form the rationale behind the dovish stance of the CBs. Macro data have been weak in the EU, and pockets of weakness are visible in the US as well. Going forward, we expect the EU economy to bottom out, and potentially improve in the second part of the year (barring the probability of a confidence shock), and we anticipate a slight deceleration in the US, **while we see a very limited probability of a recession**.

In the first quarter of the year, the looser monetary policies (Force 1) have clearly dominated. The biggest beneficiaries have been risky assets, as goldilocks trades have come back into vogue.

In a short-term view, chasing the market does not appear to be a smart move. Most of the valuation gap we highlighted at the start of the year has now been absorbed. Moreover, the pendulum of the prevailing driving force for the market could swing back somewhat from low interest rates (good news) to weak growth (bad news). Also, **the move from the prevailing "bad news is good news" environment to the "bad news is bad news" mode is the major risk investors are facing right now**, which is clearly important at a time when the peak in earnings is behind us and trade disputes are prevalent. In fact, it is still uncertain how far the bad news could go. A small taste of this uncertainty came two weeks ago when the ECB revised down its growth and inflation forecasts, and financial stocks suffered despite the new TLTRO announcement. But as long as the sweet spot is intact (ie, a consensus of CBs on the accommodative side and no further deterioration in the growth outlook), there will be some support for risky assets, even if the valuation gaps are less attractive.

We continue to see some opportunities in risky assets, but at the same time **we suggest moderation in the deployment of risk budgets** in view of the price action already seen. As we see limited directional upside ahead, we prefer to avoid areas where the risk profile looks asymmetrical in the short term (with more risk of correction than further upside). This is the case for equities, where we have become more cautious, with a preference for EM (where we are still constructive) vs DM (more cautious). A new entry point (especially for European equities) could emerge when the negative trend in earnings revisions bottoms out, and we believe this will happen, if we are right in seeing no further deceleration and some improvement in H2. In this "wait and see" phase, corporate markets (in particular in Europe) remain attractive. **Going forward, it will be important to watch the macro side**: the sweet spot could end if there is an increasingly deteriorating macro – and this is not our call. However, it will be a close call, and it will be crucial to identify any signal or factor that could jeopardise the persistence of the sweet spot, with an eye on risks that could worsen the scenario, such as a hard landing in China, a chaotic Brexit with negative consequences for European growth, and/or further escalation in trade tensions harming global trade.

On a medium-term view*, beyond the cyclical moves and beyond any sweet spot, structural forces (demographics, low structural inflation) will continue to keep interest rates down. Facing lower expected returns, investors have no option but to be able to identify and exploit value where it lies or where it is restored. This implies being systematic and quick – and this is one of the key lessons learned this year, given the speed of the market moves this year to date.*

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Overall risk sentiment

Risk off

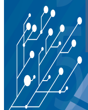
Risk on

Overall more cautious, due to the extended equity rally, in a still fragile macro backdrop.

Changes vs previous month

- More cautious on DM equities
- More constructive on EU credit
- More cautious on US duration

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



MACRO

US and Eurozone: what to expect through the year?

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

Over the past 15 months, the Eurozone economy as a whole has slowed very sharply (+1.1% yoy in Q4 2018), while the US economy has accelerated (+3.1% yoy in Q4 2018), driven by tax cuts. However, **we believe these trends could be reversed to some extent in the next 12 months.**

In the **United States**, the **first signs of a slowdown** are emerging in Q1, while though the **Eurozone** is still weakened by external trade and political uncertainty (Brexit, trade tensions), **it seems that the worst is behind us**. True, the Eurozone composite Purchasing Managers' Index (PMI) fell by 0.6 pts to 51.3 in March (the small February rebound did not last), the manufacturing PMI fell to 47.6 (its lowest level since April 2013) and new export orders posted their lowest level since mid-2012 (with sharp declines in Germany and France). However, the situation in services is reassuring: the PMI for services has changed little (52.7 vs 52.8 in February). This tends to confirm our views that the manufacturing sector and world trade will continue to weigh on growth in Q1, **but domestic demand remains resilient.**

We expect global trade growth to stabilise and to re-accelerate somewhat in H2 (stabilisation of the global trade to global GDP ratio).

Against this backdrop, **Eurozone growth should gradually recover by the end of the year**, mainly driven by household consumption, albeit not with the same strength as at the end of 2017.

But it would be striking to see this development, at the very moment when US domestic demand is slowing down.

The FOMC just lowered its growth forecast to 2.1% for 2019 and 1.9% for 2020 (-0.2% and -0.1 % respectively vs December), in line with our expectations.

In addition, the Fed's monetary policy will stay accommodative. The last FOMC highlighted the favourable labour market situation, but also the recent slowdown in household consumption and business investment.

> "The new ECB measure could support the corporate bond market, and there is more to come in case of a further deterioration of economic conditions."

Fed Chair Powell said that the FOMC will wait before changing the monetary policy stance, particularly given the domestic and external risks to economic activity. **In this context, the Fed is no longer forecasting any rate hikes in 2019** (vs two hikes expected previously) and this accommodative stance would continue in coming years.

DM= Developed Markets, EM = Emerging Markets, CB= Central Bank, ECB= European Central Bank, Fed= Federal Reserve. TLTRO= targeted longer-term refinancing operations.

The Strategist view

Central Banks abandoning normalisation

The ECB turned to an easier policy, surprising bond markets. The ECB surprised both on the timing of new measures and the likely persistence of the new easing stance:

1) Immediate decision on TLTRO - 3 and rates forward guidance (no interest rate hike in 2019), sooner than expected by the market (April-June).

2) Magnitude of downward revisions to GDP/Inflation outlook, larger than expected by consensus.

3) Balance of risks that remains tilted to the downside, indicating that further measures may come.

TLTRO features look more in line with the consensus. It also looks adequate to provide, especially peripheral banks, with the needed flexibility in managing refunding "congestion" coming from maturing previous TLTROs and bonds over the next four years. Technical conditions have improved for corporate bonds, as lower supply pressure is likely to come from financials in the coming quarters, while the search for yield is likely to strengthen, mainly supporting BBB corporates, peripheral financials, and to some extent, high yield too. The shift to the year end of the forward guidance is going to work as a gravity force on govies' yields in the short term. At the same time, the "*lower for longer* scenario" (lower rates for longer time) may force the ECB to reconsider normalising the negative depo rate as the next step, in order to reduce the unwanted side effect on bank profitability and to make the policy transmission more effective. In this case, a bear flattening of core govies' curves would look likelier, but for the moment the ECB doesn't look eager to move in that direction. The decision to index the TLTRO - 3 on the refinancing rate rather than on the deposit rate seems to leave open the door to such a normalisation by purpose.

MULTI-ASSET

Are we living in a perfect world?

MATTEO GERMANO, Head of Multi-Asset

Since the beginning of 2019, almost all asset classes are in positive territory, and volatility remains low. Are we living in a perfect world? Not really. Complacency is evident in certain areas of the market, where the rally has extended too far and too fast, going beyond what fundamentals justify. In March, we have become **more cautious on risk assets in the short term,** as risks seem more asymmetric. A significant amount of good news seems to be priced into markets. With most of the valuation gap closed, we would need some improvement in the macro scenario to see further upside from current levels. On the macro side, we continue to expect an economic slowdown and more downside risks, but very low risks of a recession. CBs will remain accommodative, but the risk that the Fed changes its communication policy too quickly is something that is worth monitoring. Any shift or signal of a less dovish Fed could provide a trigger for a market correction.

High conviction ideas

While remaining positive on a medium-term horizon on risk assets, we believe the market could consolidate at these levels, especially in equities. Consequently, as we expect a pullback and not a significant risk-off move, **we suggest some tactical risk reduction and rotation.** In particular, we have become **more cautious on DM equities** – valuations are not as appealing as they were at the beginning of the year, even if positioning is still light and many investors did not benefit from the bull run. Our reasons for becoming more cautious on European and US equities are the extent of the rally, and earnings revisions that remain depressed and show little evidence of bottoming out soon. In Europe, some political risk remains in the background (mainly Brexit, but also the risk of tariffs targeting the EU auto sector) which could weigh on EU equities.

In the US, the equity market is exposed to deteriorating economic momentum, and to noise arising from US fiscal policy, with the debate on the US debt ceiling expected to resume in the short term.

We have also moved our stance on **Japan back to neutral**. The results of US-China trade negotiations are expected soon. Should there be no resolution, the Japanese market could under-perform due to a strengthening Yen, which usually acts as a safe-haven asset.

> “We suggest a recalibration of risk to deal with market complacency: reduce DM equity and increase credit exposure.”

We remain positive on EM equity, and in particular Chinese markets, which look fairly valued and show improving fundamentals. In EM FX, we seek relative value opportunities, favouring those currencies with low external vulnerability and attractive valuations (eg, Ruble, Indonesian rupia).

We have increased our conviction on credit markets for multiple reasons: the search for yield is expected to continue in a low interest rate environment coupled with a still-benign default rate outlook. Within DM credit, we maintain a preference for Euro IG over US IG, taking into account better fundamentals (no excess leverage) and the favourable technical support from the ECB.

On duration, we keep an **overall cautious stance,** with a preference for US Treasuries vs German Bunds (especially the five-year maturity), although at current levels, US Treasury valuations are not particularly attractive. In **currencies**, we have moved to neutral on the GBP amid the ongoing lack of clarity on Brexit.

Risks and hedging

Having reduced the overall risk stance, we think investors should trim the hedging (gold).

Amundi Cross Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities	▼			■				
Credit	▲						■	
Duration					■			
Oil					■			
Gold	▼				■			
Euro cash				■				
USD cash						■		

The table above represents cross asset assessment on a 3-6 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 (+/++/+++). This assessment is subject to change.

FIXED INCOME

Are stars aligning for fixed income investors?

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

Positive conditions seem to be aligning for fixed income investors: slowdown in global growth, little or no inflation, and CBs committed to avoid further economic deceleration. Against this backdrop, we expect interest rates to remain low, capped by CB dovish positions and stable demand for assets perceived as safe havens. We expect that the search for yield will remain in strong focus. In March, more than $9.3tn debt* in global bonds had negative yields, up more than $3.5tn from the lows recorded in October, before the CB's U-turn.

DM bonds

In US bonds, the fall of US treasury yields reflects the Fed's more accommodative tone. The FOMC has paused its policy rate normalisation process (we don't expect any interest hike this year) and is messaging patience and data dependence with respect to future policy rate moves. We expect the Fed will conclude the balance sheet normalisation by the end of the third quarter, which would be earlier than the market is expecting. Domestic inflation signals should be monitored as a key precursor to any shift in the FOMC's current policy. At current levels, we take a more cautious view on US duration, within an overall stance close to neutral. Euro fixed income received strong support from the ECB's new accommodative measures. This should benefit the peripheral bond market, favoured in the search for income. We maintain a slightly short duration view in Europe (moderately increased vs the previous month).

> "The ECB's accommodative stance may favour peripheral bonds and financial credit."

Credit

EU credit (peripheral financials in particular) is the main beneficiary of the new ECB TLTRO. We still see room for spread compression, as the search for yield will be particularly aggressive in Europe.

Our preference is for IG financials (subordinated debt). In US credit, given the recent spread tightening, we have become more cautious regarding IG corporates. We favour sectors less vulnerable to event risk, including leveraging from mergers and acquisitions transactions, share buybacks, or increased dividends. Over corporate risk, we favour

securitised credit, which offers the benefits of reasonable valuations, tightened rating agency credit standards, compared to pre-2008 structures, and a focus on the US consumer, less vulnerable to global growth than corporates.

EM bonds

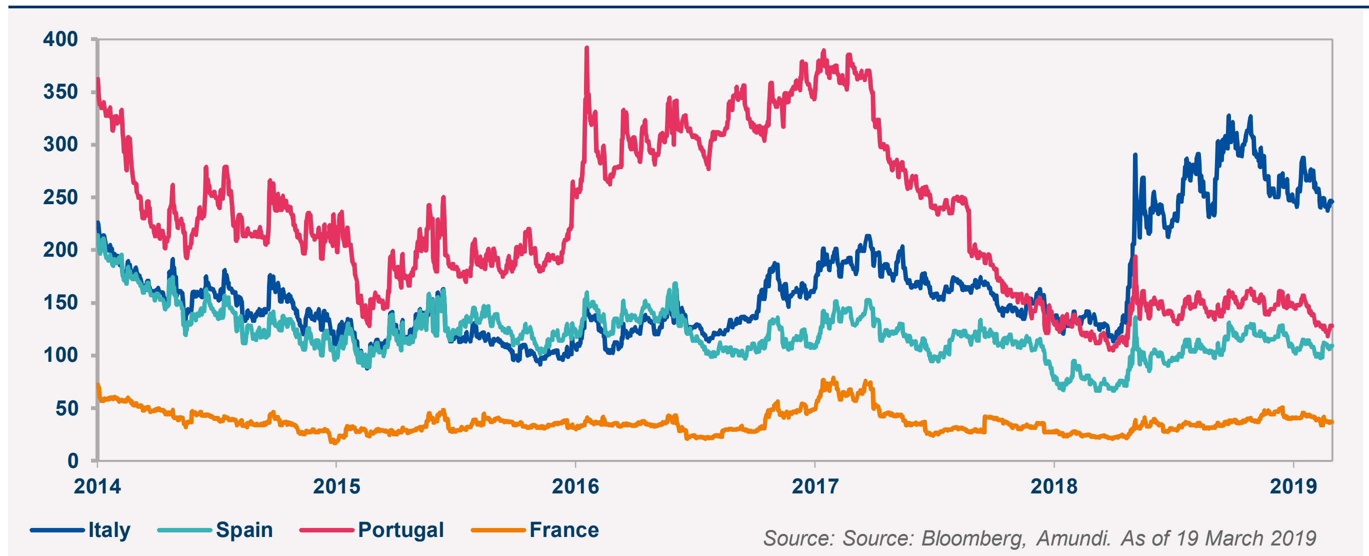
Although EM momentum has recently deteriorated, the continued dovish stance by the world's major CBs might still play in favour of EM debt markets. A trade deal between US and China looks more likely; nonetheless, we keep a watchful eye on any negative surprise. We remain constructive on EM hard currency debt (for attractive carry, while spread compression is limited), and we tend to favour those countries with cheap valuations or which are qualified for index inclusion (GCC countries). On EM bonds in local currency, we expect extra-carry returns from high-yield countries (Brazil, South Africa, and Indonesia). We remain positive on this asset class, focusing on selection as risks persist.

FX

In the short term, we don't expect the Euro to regain strength vs the USD, on a macro and ECB stance. We have a neutral view on GBP (due to Brexit), and on JPY, with a tilt towards appreciation if China-US tensions resume.

** Data refer to Bloomberg Barclays Global Aggregate Negative-Yielding Debt Index.*
FOMC: Federal Open Market Committee.

10Y Govt bond spread vs Bund



Source: Source: Bloomberg, Amundi. As of 19 March 2019

EQUITY

Beware of the aging rally

KASPER ELMGREEN, Head of Equities
YERLAN SYZDYKOV, Head of Emerging Markets
KENNETH J. TAUBES, CIO of US Investment management

Overall assessment

While the momentum of the global equity rally is quite strong, the outlook is uncertain, due to divergent forces at play: **CB's more dovish stance** is generally supportive of equities, but, on the other side, the signs of global

slowdown, **along with persistent political risks and trade tensions** are a challenge. The **global profit cycle** passed the peak, but we still expect single-digit growth in 2019. Revenues growth will be crucial. Earnings have already been significantly revised downwards and we expect some stabilisation, but a positive turn seems difficult. **Valuations are less compelling,** as many undervaluation gaps closed during this year's rebound. On the other hand, the participation in the rally has been low, and this could further support the positive momentum. Given these conflicting dynamics, we prefer to play bottom-up opportunities and maintain a cautious top-down stance, expecting a range-bound market or possibly some consolidation.

DM Equities

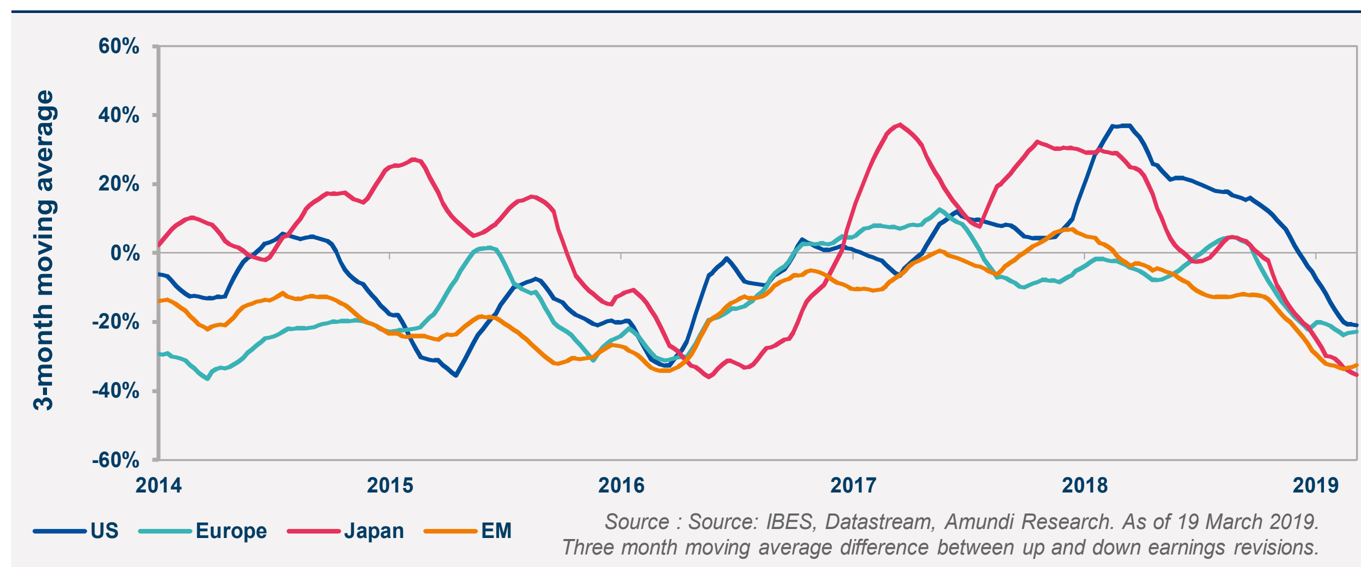
The US market is at an inflection point; a continuation of the risk-on rally would require improving, or, at least, no further deteriorating fundamentals; an earnings recession could trigger a move to a risk-off stance. **We take a cautious approach to the market**, awaiting an increase in visibility. We see attractive opportunities in financials and industrials. **European equities** have posted a strong rebound, driven by the cyclical sector where we suggest taking some profits and looking for new opportunities, for example, in healthcare names with strong balance sheets. There is limited support from the ECB for the banking sector, as the ECB will keep the deposit rate unchanged until at least 2020. Fresh positive news on the political front and stronger earnings growth are now needed to support further market upside. The **focus continues to be on stock picking**, as valuation dispersion remains high. **In Japan** valuations are still attractive even if EPS momentum is slowing. We take a neutral stance, aware of the headwinds coming from a potential stronger Yen in case of a negative surprise on the tariff negotiation side.

> "We expect a range bound market or possibly some consolidation. We prefer to play specific stories instead."

EM Equities

Our view on EM equities is positive given the supportive backdrop of growth (differential vs DM expected to widen) and valuations (which still look attractive vs DM). Potential headwinds such as a strong US dollar and deteriorating US-China trade relations have eased somewhat and might support additional growth for EM equities. In Asia, **we mainly favour China**, as valuations stand at attractive levels and a trade deal looks more likely after recent positive developments. We **also favour Russia** on the back of cheap valuations and because sanctions on Russian banks have already been partially discounted. In Latam, **we have a positive view on Brazil and Argentina**, as the outlook in both countries is promising, but we keep watch for negative developments. We suggest a cautious stance on countries with high valuations and increasing political risk.

Net earnings revision ratio (net up)

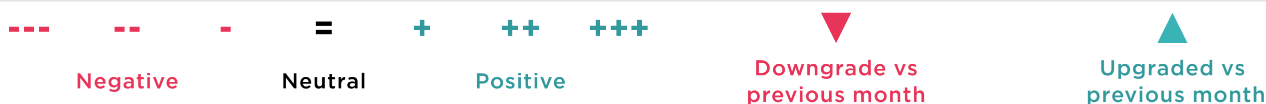


Source : Source: IBES, Datastream, Amundi Research. As of 19 March 2019. Three month moving average difference between up and down earnings revisions.

Amundi asset class views

	Asset Class	View	1M change	Rationale
EQUITIES	US	=/-	▼	We are likely to be at an inflection point for the market after the strong rally in Q1. We could see an extension of the rally in case of improving or not further deteriorating fundamentals, or a correction in case of further earnings deceleration. Due to the low visibility at this stage, we take a more cautious view on the market.
	Europe	=		Strong market rebound driven by cyclical sectors, despite risks that remain tilted to the downside in the short term, with geopolitical uncertainty still in the background (Brexit, possible new tariffs in the auto sector).
	Japan	=	▼	We have become more cautious on Japanese equities, and we believe risks have become asymmetrical. The US-China trade negotiation is expected to progress. Should it become more complicated, the Japanese market could under-perform due to the Japanese yen strengthening, which usually plays a safe-haven role.
	Emerging markets	+		EM earnings per share growth consensus expectations stabilized later in the month. Earnings revisions are bottoming out. We remain constructive on this asset class, but we could see a pause in the upside in the short term.
FIXED INCOME	US govies	=/+	▼	At current valuations, we have become more cautious on US bonds.
	US IG Corporate	=/+		Given a dovish Fed and a still-supportive macro picture, we view the near-term investment environment as supportive for credit spreads and carry, but after the sharp rebound, we see less support from valuations.
	US HY Corporate	=		With spreads having recovered from the end-of-year sell-off, we see a more carry-like return for the asset class. Some opportunities may be found in bonds that may not have fully participated in the credit rally, while we are more cautious on names that rallied and appear fully valued. Focus on sustainability of corporate debt.
	European govies	-/=		Unattractive valuations, with Bund yield close to zero after recent ECB meeting. Pockets of value can be found playing yield curve movements and Euro peripheral bonds.
	Euro IG Corporate	+		The market is well supported by the ECB's increased dovishness (TLTRO and forward guidance). Attractive asset class for carry reasons and still some possible spread tightening.
	Euro HY Corporate	+		Leverage is still low and default rates are likely to stay low in the next 12 months. In a scenario of stabilising growth in the Eurozone, the asset class could provide attractive carry opportunities.
	EM Bonds HC	=/+	▼	Dovish central banks are supportive for EM bonds, but the recent rebounds made valuations less appealing. Short-term volatility could re-open opportunities to gradually add to the asset class. Attractive carry.
	EM Bonds LC	++		We remain constructive on the asset class, due to the positive support that should come from EM FX, still undervalued. Some valuation gap has been exploited but we believe not exhausted.
OTHER	Commodities			We keep USD 55-65 range for the WTI oil. Base metals are moving in line with risky assets and other commodities.
	Currencies			The EUR/USD is expected to remain under pressure, due to ECB dovishness. The outlook for the JPY is highly dependent on risk-on / risk-off mode and equity volatility. We see the USD/JPY at 105 in Q4 2019, as we believe the risky assets rally will lose strength during the year. We have a neutral view on GBP, as the volatility is very high and the Brexit outcome highly uncertain.

LEGEND



Source: Amundi, as of 19 March 2019, views relative to a Eur-based investor. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding any fund or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. This information does not represent the actual current, past or future asset allocation or portfolio of any Amundi product.

IG = Investment grade corporate bonds, HY = High Yield Corporate; EM Bonds HC / LC =EM bonds hard currency / local currency. WTI= West Texas Intermediate.

THIS MONTH'S TOPIC

Eurozone: a mere dip or a sustained slowdown?

PERRIER TRISTAN, Macroeconomic Research

Finalised on 27/03/2019

The essential

After a long series of disappointments in 2018, Eurozone economic figures have remained very mixed so far in 2019. However, the situation should improve over the coming quarters, thanks to a combination of robust household income, heavy fiscal support, and global trade that is a little weaker than it has been in recent months. Even if there is a slight improvement, there will be no return to the growth figures of 2017, and it won't happen if serious risks, such as a no-deal Brexit and the imposition of US trade tariffs on European auto imports, come into play. Moreover, the domestic political situation will remain volatile in some EU member-states.

Hopes were high a little more than a year ago, after a tremendous 2017, but the Eurozone economy has delivered disappointment after disappointment since the start of 2018. In last year's four quarters, GDP expanded by just 1.1% (including just 0.3% in the second half), down from 2.7% in the four previous quarters. Italy slipped back into a slight recession in the second half, and Germany almost did so. Q1 2019 data has been mixed, indicating prolonged difficulties in the manufacturing sector yet a brighter situation regarding services and consumption.

The economy has been undermined by several factors

- **Each of the Eurozone's three largest economies has faced their own particular challenges**. The **German** auto industry was hit hard by a change in emission testing standards just as Q3 gave way to Q4 (the GDP growth impact was about 0.5% for all of 2018). **Italy** was hit by serious political uncertainty when an "anti-system" governing coalition came to power in spring. And, after already a number of strikes at the beginning of the year, **France**'s household consumption was brought to a halt in Q4 by the "yellow vest" movement (for a total impact estimated at 0.1% of GDP).
- **But the main hit to the Eurozone was from the slowdown in global trade**, due in part to various direct factors (disruption of the value chain and the Chinese economy) and indirect ones (uncertainty shock) from protectionist measures. This slowdown hit European manufacturers hard even though the measures taken against Europe were very moderate (limited to customs duties on steel and aluminium, with the US having suspended its threats against the auto industry in summer 2018). Moreover, exports to two important markets, Turkey and the UK, were affected by events specific to those two countries; the euro's strength in early 2018 also probably took a toll; and exceptionally strong exports in 2017 were followed by a negative payback the following year. All in all, the contribution of exports to Eurozone GDP growth fell from 3.1pp in the four quarters of 2017 to 0.75pp in the four quarters of 2018, which also revealed a clear split between, on the one hand, Italy and Germany, which are heavily exposed to global manufacturing cycles, and, on the other hand, France and Spain, which are less affected by these external developments, as their manufacturing sectors are smaller.
- **Lastly, oil prices were far higher than one year previously, and this also had a negative impact.** Despite a sharp late-year drop, Brent averaged 25% more in euro terms in 2018 than in 2017.

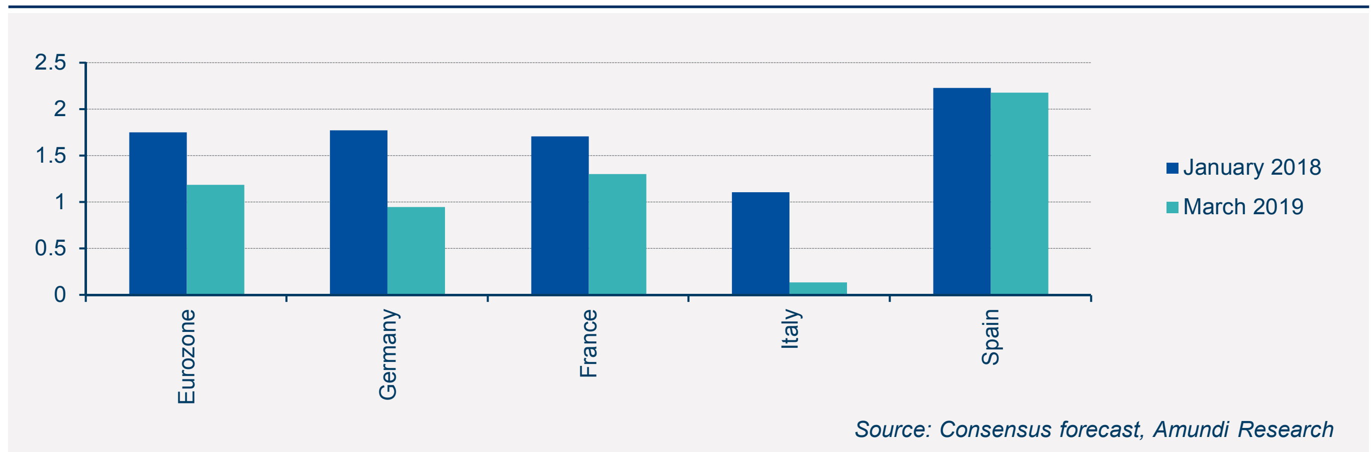
Now that some of these shocks are behind us, several factors are pointing to a moderate re-acceleration in growth in the coming quarters, as long as certain serious risk factors do not come into play.

First of all, some of the factors that were highly negative in 2018 are temporary and likely to fade. While the **German auto industry** faces very serious challenges in the medium and long terms , production should return to normal (if by "normal" we mean overcoming the specific impact of the 2018 changes in standards) by the start of

Q2. Similarly, the easing of the Q1 social unrest in France (although it would be premature to say that the crisis is completely over) should mean a rebound in consumer spending.

Moreover, household income in recent quarters has been on a steep upward trajectory, with the impact in real terms likely to be amplified in 2019 by the receding in inflation. Even as bad news was piling up on GDP and other economic indicators, the unemployment rate kept declining (to 7.8% in January 2019 from 8.6% 12 months earlier); employment remained strong, albeit slightly less so (1.3% in the four quarters of 2018 vs. 1.7% in the four quarters of 2017); and, most importantly, wages rose by about another 2% last year. All of these figures should mean an increase in real household consumption far above last year's 1.2%, while year-on-year inflation recedes rapidly under the the base effects of energy prices (even when assuming a slight increase in oil prices this year).

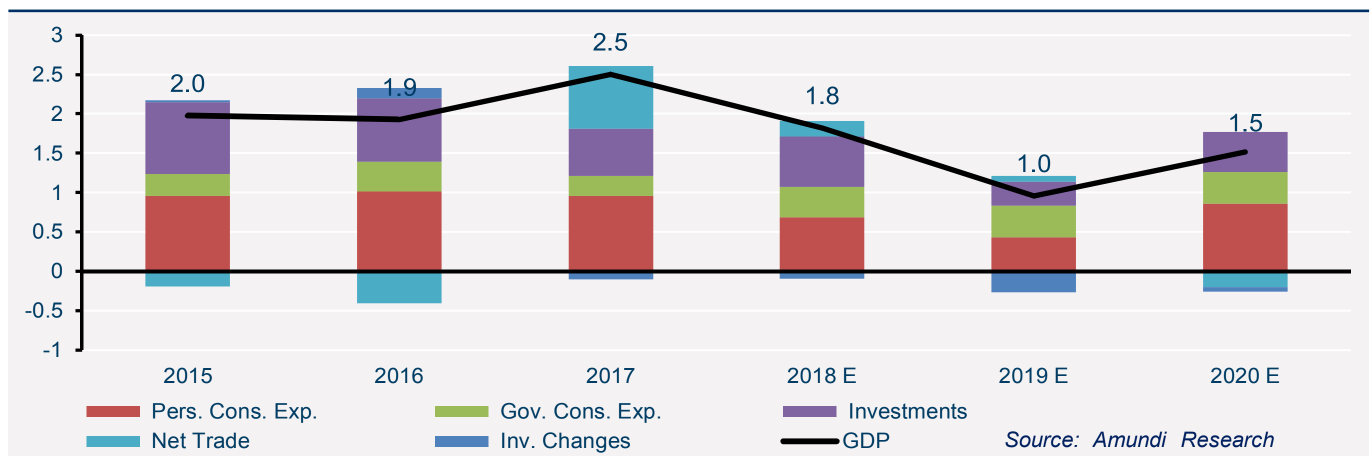
1/ **2019 GDP growth forecast: change in consensus forecast between Jan 2018 and March 2019**



In addition to solid household income, fiscal stimulus is expected to have a significant impact on growth this year

- It is true that fiscal support is likely to remain modest in **Italy**, where ambitions had to be revised downward after negotiations with the European Union and where what can be gained in growth through wider public deficits is likely to be cancelled out in part by the market's concerns and downgraded market financing terms.
- The situation, however, is different in **France**, where household tax cuts in effect since the end of 2018 (particularly in payroll taxes) will come with other measures announced in December in an attempt to calm down social unrest (a total stimulus of about 0.5% of GDP, most of which is targeted at lower-income households with a high propensity to consume).
- After an unvoluntary fiscal tightening in 2018 (caused by the long search for a viable governmental coalition, and, hence, by delays in implementing some public policies), **Germany** is likely to see some positive compensation in 2019 that, when adding new targeted spending in pensions, family policy and investment, is estimated at about 0.7% of GDP.
- Lastly, **Spain**'s failure to obtain parliamentary approval of its 2019 budget, which had included several tax hikes, is generating, *de facto*, a slight stimulus in the country.

2/ **EMU GDP Contributions, annual average, %**

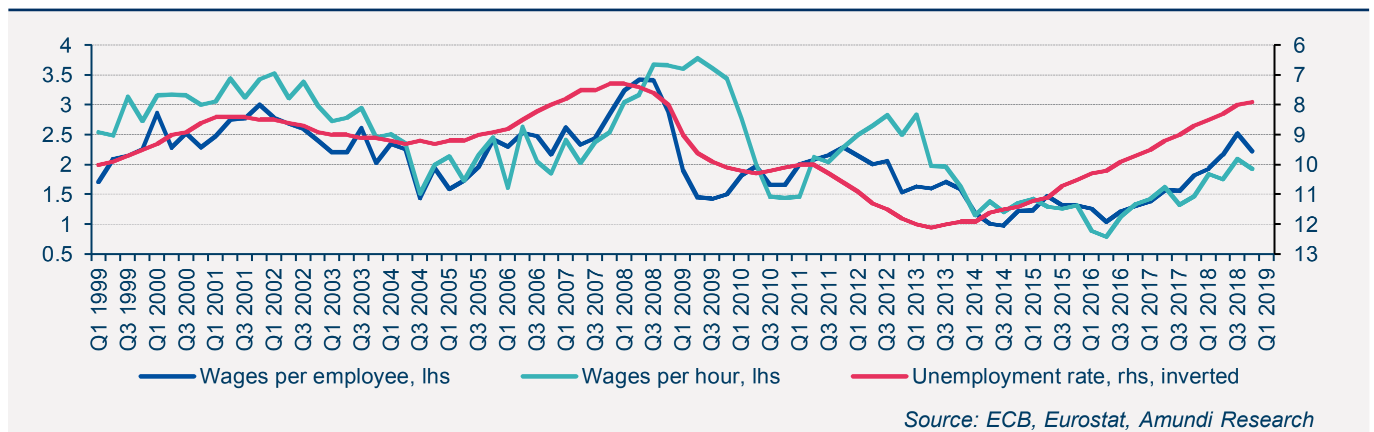


All in all, fiscal support (as measured by the widening in the primary structural deficit) is likely to amount to about 0.5% of GDP for the Eurozone as a whole. As fiscal support is in the form of various measures taken in 2018 in response to each major country's specific challenges, it will not be as effective as a coordinated stimulus plan. Even so, if we assume a conservative multiplier of a little less than 50%, it should result in an additional 0.2pp of GDP in 2019. However, the effect is likely to fade in 2020, as maintaining such a heavy fiscal boost is not possible under current projections in all countries.

Regarding export momentum, to which the Eurozone is far more exposed than the United States (27% of its GDP vs. 13%, goods and services combined), a slowdown as great as the one in 2018 is unlikely. Our baseline scenario does assume a slowdown in the two major economies and export markets of China and the US, but their growth is still likely to remain much stronger than in the Eurozone. Most importantly, we believe that tensions are more likely to ease than to worsen (at least on the strictly trade front) between these two countries, and that there will therefore be fewer disruptions and uncertainties in global value chains. Lastly, and unlike the previous year, the very poor 2018 figures could give way to a positive payback, notably via restocking.

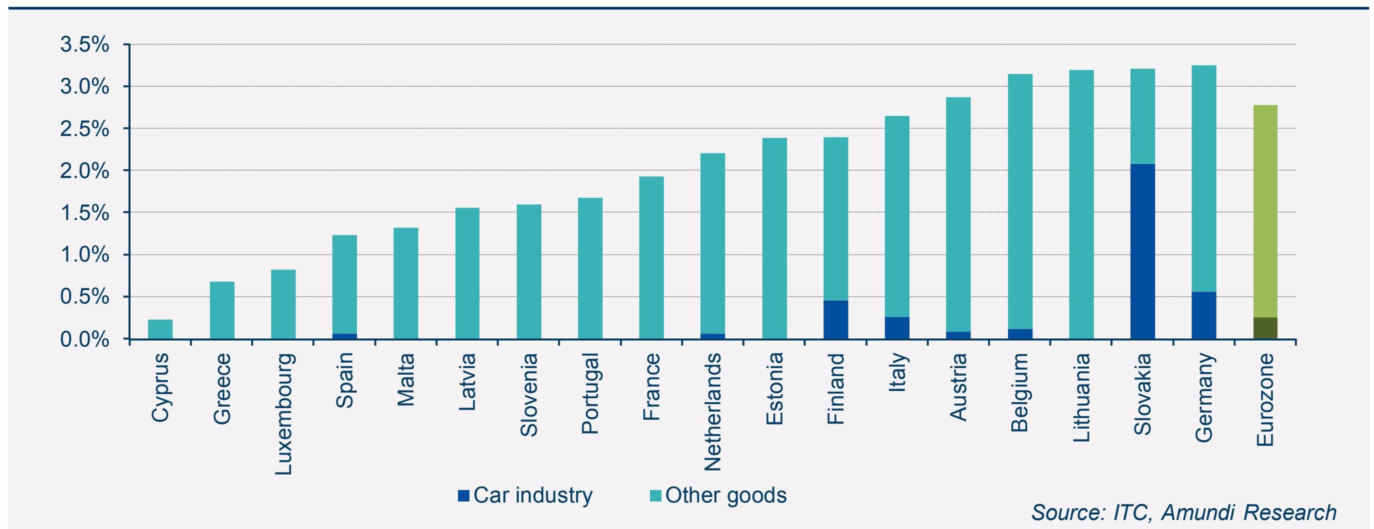
However, this baseline scenario does not reflect a number of risk factors, which, if they come to pass, could make economic agents more cautious and thus easily cancel out the expected benefits from both gains in household purchasing power and a stabilisation in foreign demand.

3/ Eurozone employment and wages



- **The first clear risk factor is Brexit**: at this writing, while the positive economic scenarios of a soft Brexit or a long extension in the deadline are still possible, **the risk of a hard Brexit** in the coming weeks **cannot be completely ruled out** (we assign it a probability of about 20%). The macroeconomic consequences of such an event would depend closely on possible 11th-hour mitigation measures (in addition to those already explicitly planned). However, such consequences would very probably lead us to at least slightly lower our Eurozone growth forecasts (albeit far less than for the UK).
- **A second risk factor is the persistent threat of customs duties on the European auto industry.** Following the investigation conducted in February under Section 232 of the Trade Expansion Act of 1962, the US president must make a decision by mid-May. We don't expect the customs duties to go through, as that would trigger a tit-for-tat that would backfire on the US economy just as signs of economic slowdown are already perceptible there and as the Republican administration will soon begin campaigning for the 2020 elections. What is possible, however, is that this threat will continue hanging over the economy for several quarters, for example, via a **theoretical activation along with a renewable grace period**, in order to use them as a means of pressuring the EU into broader trade negotiations (one of the EU's challenges will be reaching a common ground, given that exposure to auto exports to the US varies greatly from one member-state to another). Thus, the real medium-term danger of customs duties would be that they would continue to undermine confidence in European manufacturing. If, however, contrary to our expectations, the duties are put through, we would have reason to lower our forecasts for Germany and countries intertwined in the value chains of German automakers.
- **Lastly, best to be alert to a possible resurgence in domestic political risks.**
  - Opinion polls suggest that the **European elections** – the major mid-year event – are unlikely to see a landslide victory by "anti-system" parties (although things could be made more complicated if the UK ends up taking part). The two "traditional" groups – the Christian Democrats and the Social Democrats – are likely to lose the majority they have held in the European Parliament since it was founded in 1979, but they should be able to form another majority (albeit with some additional negotiations and foot-dragging), with other, pro-institutional forces, such as the Greens or the Liberals.

4/ **Exports of goods to the US, % of GDP**



Source: ITC, Amundi Research

- However, the **political situation is still volatile in Italy**. Yes, early elections could bring good news for the economy and the markets, as they could lead to the emergence of a new governing coalition uniting the Northern League and the traditional right. But even if this happens (or if the current coalition stays in place), it would not necessarily head off a new confrontation with EU institutions when the 2020 budget is negotiated (scheduled for late this year). Moreover, Italy is still exposed to risks of sovereign debt downgrades.
- Lastly, while other countries holding general elections in 2019 (including Finland, Spain, Belgium, Portugal and Greece) do not appear to pose systemic risks to the Eurozone, social unrest that began in November 2018 in **France** has still not been put down fully. The movement reminds us that the government's very solid parliamentary majority is not enough to shield France from risks of instability.

In light of the above, the Eurozone's economic outlook as Q1 2019 draws to a close is, in our view, more positive on the whole than suggested in recent months' very poor figures. The most likely scenario is a rebound based mainly on household consumption, which itself will be supported by improved resilient job market and fiscal stimulus, and on less negative (while not positive) trends in foreign demand. However, the rebound is likely to remain modest. We forecast GDP growth of 1.2% between Q4 2018 and Q4 2019 and 1.6% during the four quarters of 2020. A return to 2017-like numbers would require a very strong surge in exports – unlikely under current global conditions. Most important, the rebound is exposed to many risks (beginning with Brexit, US protectionism and domestic political uncertainties) on which visibility could be limited over the next few months. What's more, under a negative scenario, few major instruments of stabilisation seem to be immediately available – the ECB's rates are already zero or negative; and a coordinated fiscal response would be hard to organise.

Risk factors

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

Risk # 1 — 20% probability — Renewed escalation in trade tensions between the US and China

Analysis | The US announced it would delay the tariff increase on $200bn worth of China's products, which was scheduled for 1st March. This seems to have reflected meaningful progress made in several rounds of US/China trade talks into 2019. Such talks seem to have put more focus on core topics, including structural issues and enforcement, as well as technical details. If additional progress could be achieved, there could be potentially another Trump/Xi meeting, and the probability for US/China to reach some kind of deal to avoid tariff increase and to prevent further escalation would be appreciably higher than in late 2018. This seems to be helping reduce some downside risks in the near term, and to have helped market sentiment recover somewhat. That said, uncertainty remains relatively high, and it could take much longer to ultimately solve the problems, as many complicated issues are involved. We cannot yet rule out a severe confrontation between the US and China.

Market impact | Tariffs have started to hit trade, and uncertainty has been weighing 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 into 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 emissions testing regime), growth momentum in Q4 2018 and Q1 2019 is slower than what we had anticipated a few months ago. The central scenario remains that the economy will slowly bottom out, with GDP growth back to potential by the end of the year, but risks are clearly tilted to the downside, in particular in the short run. The combination of elevated uncertainty (Brexit, trade tensions) and external negative factors (notably the expected slowdown in the US) could cause growth to fall further. Lower oil prices are a supportive factor. However, a reversal of this trend would be another drag on 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 — 20% probability — No-deal Brexit

Analysis | We see 3 scenarios (S1, S2 and S3).

S1 (40%). Short extension decided by 12 April and deal approved by 22 May. Reaching the new deadline of 12 April without a deal, the UK asks for an extension of Article 50 to 22 May (i.e. the UK does not participate in the EU elections in May). The option of a long extension will automatically become impossible and may force both parties to reach an agreement to avoid a no-deal exit. MPs could consider new options (e.g. Norway + customs union) that may require changes to the political declaration while remaining compatible with the Withdrawal Agreement and acceptable by the EU.

S2 (40%). Long extension (at least to end-2019) decided by 12 April. In case the deal is still not approved (with PM Theresa May probably leaving) as the new deadline of 12 April approaches, the UK could ask for a longer extension to seek new elections or a second referendum. UK would take part in the EU Parliamentary election in May (23-26).

S3 (20%). No deal. The UK exits the EU without (or with only a very limited) transition regime. Many sub-scenarios are possible: an outright "default" to a WTO regime is a risk, but mitigation measures ("managed no-deal" and "deals under no-deal"), may be agreed. Negative impact on EU GDP growth with differences across countries (Ireland would be the worst hit, followed by countries well integrated in international supply chains). Extreme uncertainty concerning the Irish border issue.

Market impact | S1: Markets pressure may persist until the deadline. **S2**: Uncertainty approaching the new deadline (12 April), followed by market relief if a long extension is secured. **S3**: Not fully priced-in by the market, negative for EU equities and GBP.
We must prepare for dense newsflow in the coming days. 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 approved, sterling would continue to appreciate and business investment would probably benefit from a drop in uncertainty.

Risk # 4 | 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 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. The relationships with the EC have improved at least for the time being but may resurface when the budget law is presented After contracting for two consecutive quarters in 2018 H2, weak coincident indicators for Q1 still point to a risk of another negative quarter. With slow growth ahead (we expect GDP growth at 0.1% in 2019), tensions related to debt sustainability concerns may likely arise.

Market impact | There is no systemic risk in our opinion. On the one hand, rising Italian bond yields have tightened local financial conditions, and that is weighing on GDP growth in Italy. But on the other hand, the absence of an EDP has provided 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 contagion to other peripheral markets. In addition, the ECB has announced new TLTROs to alleviate difficulties in the banking system. All of this should contain the contagion risk on peripheral sovereign spreads and corporate credit spreads.

Risk # 5 | 15% probability | US recession

Analysis | The US economy was stronger than expected in Q4 (+2.9% YoY), boosted in particular by business investment while personal consumption expenditures remained resilient. Incoming data related to Q1 this year, although more mixed, tend to confirm our outlook pointing to a gradual convergence towards potential growth. US growth will slow, in particular regarding investment after the remarkable performance seen in 2018, while consumption should remain resilient, given the strength of the job market and a benign inflation outlook. The fact that the Fed's normalisation is almost done ("wait and see" attitude, stabilisation of the balance sheet expected by the end of the year) will maintain very accommodative monetary conditions, which should sustain domestic demand. Against this backdrop the probability of recession remains low for the foreseeable future.

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 are likely to become increasingly mixed as the cycle extends. The probability of a recession remains low. But as the cycle matures, the best choice for investors is to limit exposure to credit. . On the equity side, selection of themes, sectors and single names will be increasingly relevant.

Risk # 6 | 10% probability | Contagion in the "emerging world"

Analysis | Emerging markets asset classes started 2019 buoyantly, thanks to (1) the Fed's U-turn in communication ("wait and see" attitude on interest rates revising the dots, stabilisation of its balance sheet by Q3 2019); (2) a more negative newsflow concentrated in DM (Europe in particular); and (3) a less likely escalation in the trade war between the US and China if not a more likely proper deal between the two. Having said that, the contagion risk in the EM world remains well alive whether through real economy spillovers (overall weaker global growth will reflect in weaker global trade) or through financial markets spillovers. The Federal Reserve stance shift has been quite earlier and stronger than anticipated in our 2019 outlook and the risk of a monetary policy mistake by the main central banks has increased. Indeed, today we do see the risk of contagion through financial market higher than through the chain trade. The recent case of the Turkish lira's steep depreciation in a day reminds us that, notwithstanding the significant outperformance of EM assets on the year to date, their vulnerability to external shocks remains quite high. Moreover, although consensual from many sources, the USD hasn't started to depreciate yet.

Market impact | Spreads and equity markets would once again be highly hurt; it is all the truer that emerging currencies would be again under pressure with capital outflows. However, the emerging world is far from being a homogeneous block, and markets would deteriorate more in the most vulnerable countries, whether due to poor external positions or fragile fiscal and political conditions. Some caution on emerging markets is still required at present.

Risk # 7 | 10% 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 monetary and fiscal policies) so that the economy will remain resilient. Recent data tend to indicate that the policy mix has a noticeable positive impact on the economy. That being said, the country's economic model is fragile: the excess of credit is visible, and 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 the trend in Chinese private debt closely, especially if the economy slows. Meanwhile, the de-escalation in trade tensions should give China policymakers time to adjust their policy implementations and to better manage short-term risks. In the event of a 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 bursting 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. Although an agreement was reached, this topic could flare up again, due to more fiscal slippage in 2019. In France, where the situation had been stable since the 2017 presidential election, sudden and violent social movements caught the government off-guard in late 2018 and could complicate the continuation of its supply-side reform agenda. Although less immediately worrying, the political outlook is also uncertain in Germany (where the stability of the government coalition could be questioned) 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 remains a tailwind for anti-system political forces. The May 2019 European election will be 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 may 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): slowdown in 2019 but more decoupling looking ahead

- **Growth has slowed worldwide:** 2018 had begun based on the theme of a synchronised global recovery. But this did not last. Since spring 2018, the protectionist measures taken by Donald Trump have changed the game. Emerging economies, some of which are heavily indebted in dollars, were weakened last year by the broad-based appreciation of the USD. Moreover, economic activity has weakened markedly in the Eurozone since Q4 2018. Hence, 2019 has begun with a global synchronised slowdown with risks remaining tilted to the downside.

- **Global trade:** Surprisingly, global trade has weakened markedly over the past 18 months; it started 2018 at around 5% yoy but fell sharply in Q4 (+1.4% yoy). Protectionist rhetoric has pushed uncertainty to an all-time high, dragging down investment. Global trade rebounded in January but will remain particularly weak in Q1. Having said that, the de-escalation on trade between China and the US bodes well and should lead to a stabilisation in trade. At the end of the day, we continue to expect global trade growth to stabilise at around the level of global GDP growth (i.e. we would expect global trade to return to around 3% yoy by the end of 2019).

- **United States:** The US economy has been driven by a 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 expect GDP growth at 2.4% on average in 2019 and 1.8% in 2020 (yoy growth, would thus slow from 3.1% yoy in Q4 18 to 2.1% in Q4 19). This situation will have a negative impact on corporate profits, especially if some inflationary pressures materialise by then, which is still possible, given the fact that the economy is operating at close to full employment. We do believe that a recession is highly unlikely in 2019 (household consumption should continue to benefit from higher disposable income). However, doubts about the extension of this cycle are likely to rise in the coming quarters (less support from fiscal policy, business investment expected to slow, more mixed signals from sentiment and hard data). And we must keep in mind that sub-par growth may trigger a profits recession.

- **Eurozone**: We have cut our 2019 GDP growth forecasts to 1.0% and left our 2020 forecast unchanged at 1.5%; The data for Q1 has been mixed, with some figures improving, but also some persistent weakness in manufacturing. Although they began recovering well after the US, Eurozone economies began to slow in 2018, much more sharply than other economies. Several transitory factors have contributed to the slowdown in EZ growth. Germany was close to falling into recession in Q4, due to an abrupt slowdown in world trade, disruptions in the auto sector caused by new pollution tests, and weakness in the manufacturing sector. The late-2018 shock to the EZ manufacturing sector has been clearly underestimated. In France, the yellow vest movement has weighed on economic activity. And the Italian economy has suffered from tighter credit conditions. In addition, political uncertainties (Brexit, Italian budget) have muddied the waters. However, we are sticking to the view that domestic demand (in particular consumption) will remain supported by the strong labour market, strong income growth, the level of monetary policy accommodation, and a significant fiscal stimulus (especially in Germany and France). Subsequently, we believe that growth will gradually reaccelerate in H2. In the short term, the May 2019 European elections, Brexit, and the threat of US tariffs on European autos will likely maintain uncertainty at a high level. While we believe that mainstream parties will dominate the European Parliament, the level of political fragmentation will increase. As a result, it will take time to form the new Commission, and we do not expect any significant progress in strengthening the EU and the Eurozone before 2020.

- **United Kingdom:** The political situation in the UK is highly unstable. Many options are still possible regarding Brexit. Everything will ultimately depend on the scenario (see section risk factors and our "investment talk" published on the subject). We continue to believe that the probability of a deal is well above the probability of a no-deal. And with a deal, we would expect a rebound in domestic demand in H2 2019.

- **China:** Chinese economic growth seems to have has stabilised in Q1 2019, thanks to a very expansionist policy mix, to the point that we cannot rule out a (short-lived) reacceleration of growth. That being said, the country's economic model remains fragile: the excess of credit is visible, and non-financial corporate debt has surged since the GFC. The de-escalation between the US and China on trade tensions should give China valuable time to adjust its policy implementations and better manage short-term risks. Keep in mind, however, that trade tensions (on intellectual property, high technology) between the US and China are here to stay.

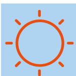
- **Inflation:** Core inflation remains low at this stage of the cycle in advanced economies. The slowdown in inflation in recent years is primarily structural in nature, as it is tied to supply-side factors, while the cyclical component of inflation has weakened (with a flattening of the Phillips curve). Core inflation is likely to pick up only slightly in advanced economies. An "inflationary surprise" remains possible with the pick-up in wages (in the United States and the Eurozone) but would not last long, given the slowdown in global growth and the lack of pricing power (i.e., corporate margins more at risk than final sale prices). In emerging economies, inflation has recently slowed more than expected, but this was mainly due to the decline in energy and food prices. At the end of the day, with low inflation and subdued growth, most central banks have turned more dovish.
- **Oil prices:** Oil prices have decreased sharply: from $86/bbl. (Brent) in early October to $66 in late March. The main trigger at the very beginning of the decline was the large number of waivers 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 in early December, together with fears of a more pronounced economic slowdown are keeping oil prices around this level.
- **Central banks on the dovish side:** The risk management approach prevails. The Fed is in a "wait and see" mode; we expect no rate hike in 2019. The ECB ended its monthly asset purchases in late December and will continue to replace maturing securities. For the ECB, we expect a status quo (regarding interest rates) in 2019 or 2020. The ECB has no room for manoeuvre to normalise its monetary policy, given the economic slowdown and the absence of inflation. The ECB announced new TLTROs in March (to come in September, with the technicalities probably announced in June) and surprised with its dovish stance: 1) Immediate decisions on TLTRO3 and rates forward guidance; 2) downward revisions to GDP growth/inflation outlook larger than expected by the consensus; and 3) balance of risk still tilted to the downside, meaning that the ECB may ease further if growth slows further. A two-tiered system is being seriously considered for the deposit rate, to alleviate the burden on banks that have very large excess reserves (Germany).

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

- Risk of further protectionist measures from the US, followed by retaliation from the rest of the world.
- Repeated uncertainty shocks (global trade, Brexit, European elections) weigh heavily on global demand.

Consequences:

- All things being equal, a trade war would drag down global trade and trigger a synchronised and sustained 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 fears in the US.
- Under a worst-case scenario, CBs could once again resort to unconventional tools, such as expanding their balance sheets (particularly true for the ECB).



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 reaccelerates in the Eurozone after a dip. Growth picks up again in China on the back of a stimulative policy mix.
- Central banks 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

Slowing down: patience and data dependency

- Economic growth is decelerating gradually amidst mixed data, with a shift in drivers of domestic demand away from (decelerating) investments and towards still-supported personal consumption. The fiscal boost supportive to 2018 growth will fade.
- US consumers remain broadly upbeat. Still-dynamic labour demand and wage growth, coupled with contained inflationary pressure, support resiliency in personal consumption, which is expected to be the main driver of domestic demand.
- Business confidence has moderated appreciably among small and larger businesses, while uncertainty on the growth and demand outlook seems to be driving moderation in capex intentions and investments.
- Moderate domestic and external inflationary pressures are keeping both core and headline CPI in check, within a benign inflation outlook. Lower energy prices will likely put a ceiling on the increase in annual headline inflation.
- In this context, at its March meeting the Federal Reserve signalled no further rate hikes this year, announced the end of QT, and revised economic projections significantly downward on growth and inflation.

Risk factors

- Concerns over global growth and external and domestic demand may hold back new capex plans more than expected
- Tariffs risks may negatively impact economic performance, both directly (prices and orders) and indirectly (confidence)
- Geopolitical risks linked to a more hawkish shift by the US administration

Eurozone

A gradual improvement expected despite considerable risks

- After a highly disappointing 2018, figures have so far been mixed in 2019. However, while most of the difficulties involve export-intensive (manufacturing) sectors, the job market is holding up well and is likely to support consumption and services. We expect a gradual improvement, especially beginning in the second half of the year.
- Brexit and the threat of US trade tariffs on the auto sector are significant risks. There are still some considerable political uncertainties, particularly the upcoming European elections and the situation in Italy.

Risk factors

- Stronger political protest movements
- An appreciation in the euro
- External risks (trade war, slowdown in the US and China)

United Kingdom

Major uncertainty as Brexit approaches

- Brexit is undermining confidence and investment. The United Kingdom has won an additional extension from the European Union (until at least 12 April), but there is still lots of uncertainty over whether the UK Parliament can reach a majority to approve any option in the coming weeks. Many scenarios are possible, including a long postponement. While the default option, no-deal Brexit, is not the most likely outcome, the possibility of it cannot be ruled out.
- Despite political uncertainties, the job market remains strong, and wages are increasing in real terms, driven by the receding in inflation.

Risk factors

- A no-deal Brexit
- The current account deficit remains very high

Japan

Drifting into the worst phase

- Global economic deceleration has dampened the corporate sector and finally started threatening capital spending. Shipments of capital goods and machinery orders have weakened as an increasing number of companies postpone, downsize, or cancel business investment.
- Although three quarters of corporate executives worry about the state of the Chinese economy, exports to, and machine-tool orders from, China have recently bottomed out. Exports in general remain precarious. Yet, shipments to the U.S. continue to grow while those to the EU are surprisingly resilient.
- On the domestic economy front, the government is accelerating disaster restoration projects, infrastructure investment and urban development for the 2020 Tokyo Olympic Games. A sharp mark-down in mobile phone charges scheduled in April should encourage spending on other goods and services.

Risk factors

- A lop-sided appreciation of the yen could threaten companies, leading to further downward revisions in capex plans

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China

- Overall economic activity looks to slow further in Q1, while policymakers have reaffirmed their supportive stance. The annual NPC sent a clear signal that growth is the top priority this year. The fiscal package came out larger than widely expected, with confirmation of a meaningful corporate VAT cut and heavier issuance of local government special bonds.
- While exports are suffering and the property sector is softening, drag from the auto sector is becoming smaller, and the state sector has begun stabilisation efforts, helped by policy supports. Overall credit growth seems to be bottoming out.
- US/China trade negotiations remain a key uncertainty. Recent signs have shown meaningful progress, with planned tariff increases being postponed for now.
- Stress in RMB and capital outflows have remained under control, helped by a more dovish Fed and a softer dollar, as well as improving market sentiment.

Risk factors

- **Uncertainty 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)

- The full set of GDP releases for Q4 2018 confirmed some resilience in the region, driven mainly by domestic demand. The first two months of 2019 confirmed very weak export dynamics across the region.
- The region's inflation figures remained very benign. Oil and food prices pushed inflation to levels lower than expected. In the Philippines February inflation finally went down within the BSP range, at 3.8% yoy.
- Overall, CBs in the region are in a wait-and-see mode before shifting towards a more dovish stance, thanks to a more favourable global financial environment. India cut its policy rates by 25bps.
- In Thailand, House of Representatives elections have been held. 95% of the votes have been counted, while the remaining 5% is under investigation for irregularities. Currently, no parties or alliances (as per the information available) have any majority. Final results will be announced after the 9th of May.

Risk factors

- **Exports dynamics still very weak in early 2019**
- **Inflation still very benign. In the Philippines and finally within CB target range**
- **Central banks in the region in wait-and-see mode**
- **Election outcome in Thailand is not showing any clear victory by parties or current alliances**

Latam

- Q4-18 GDP figures have confirmed better economic conditions in mid-sized and smaller countries in the region than in the largest countries. Latin America is the region with the most mixed dynamics between domestic and external demand, as exports have been less heavily negative in Argentina and Brazil.
- On the inflation front, the overall environment remained benign. Finally, in February Mexican inflation came in at a level just within Banxico's target range at 3.9% YoY, continuing to decline from the 4.4% figure of January.
- The region's main central banks left their monetary policy rates unchanged. We have changed our monetary policy outlook for Banxico to an easier one.
- In Brazil, the new president and his economic team decided to present a very bold pension reform plan to Congress. The first vote by the Constitution and Justice Committee in the lower house is scheduled to take place by April but will probably be further delayed.

Risk factors

- **Better economic conditions in smaller countries**
- **Inflation is benign overall, with Mexican inflation back within Banxico's target range**
- **We do expect Banxico to ease earlier than anticipated**
- **The very bold pension reform announced in Brazil is at risk of delay**

EMEA (Europe Middle East & Africa)

Russia: real GDP growth is expected to be around 2% in 2018 and slightly lower in 2019, but growth is expected to accelerate over the medium-term, thanks to a significant infrastructure spending programme from 2019 to 2024

- 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 "twin surpluses" in 2019, while accumulating assets in the National Wealth Fund.
- The central bank is likely to stay on hold for the time being.

Risk factors

- **Drop in oil prices, stepped-up US sanctions and further geopolitical tensions**

South Africa: exit from recession but no miracle

- South Africa Q4 2018 GDP figure released higher than expected, at 1.1% YoY. Overall, 2018 GDP growth was 0.7% YoY (yearly average), instead of the 0.5% YoY forecast. Better-than-expected GDP figures should not distract from the fact that investment performance (mainly in public SOEs) remains very poor. We expect higher growth in 2019 +1.7% YoY.
- Growth data, along with more benign inflation could dictate easier monetary policy; however, a certain degree of cautious is in order, due to the deteriorating fiscal outlook. Due to the government's support for the national electricity company, Eskom, the fiscal outlook is worse than forecast for 2019.

Risk factors

- **Increased risk aversion, risk of sovereign rating downgrading, and rising social demands in the run-up to elections**

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

- The aggressive tightening of interest rates, the rebound in the pound, the drop in oil prices and the implementation of discretionary measures on certain goods have given little respite to inflation. However, it should not fall below 20% for another several months, thus limiting the central bank's margins of manoeuvre. In this context, household purchasing power and corporate margins are at their lowest. We therefore expect a GDP recession for 2019 of at least 1%.

Risk factors

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

Macro and Market forecasts

Macroeconomic forecasts
(28 March 2019)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	**2.9**	**2.4**	**1.8**	**2.4**	**2.2**	**2.3**
Japan	**0.8**	**1.0**	**0.7**	**1.0**	**0.7**	**1.3**
Eurozone	**1.8**	**1.0**	**1.5**	**1.8**	**1.2**	**1.5**
Germany	1.4	0.8	1.5	1.7	1.5	1.5
France	1.5	1.3	1.5	2.1	1.3	1.5
Italy	0.8	0.1	0.6	1.1	1.0	1.5
Spain	2.5	2.0	1.8	1.7	1.6	1.9
UK	**1.4**	**1.1**	**1.4**	**2.3**	**2.2**	**2.2**
Brazil	1.1	2.0	2.3	3.7	3.9	4.4
Russia	1.7	1.5	1.7	2.9	5.0	4.0
India	7.3	6.4	6.9	4.0	3.6	4.7
Indonesia	5.2	5.3	5.3	3.2	3.2	4.0
China	6.6	6.2	6.1	2.1	2.0	2.4
Turkey	2.9	-1.0	1.5	16.2	15.4	12.9
Developed countries	**2.2**	**1.7**	**1.6**	**2.0**	**1.7**	**1.9**
Emerging countries	**4.9**	**4.5**	**4.7**	**4.1**	**3.7**	**3.8**
World	**3.8**	**3.4**	**3.5**	**3.2**	**2.9**	**3.0**

Source: Amundi Research

Key interest rate outlook

	29/03/2019	Amundi + 6m.	Consensus Q3 2019	Amundi + 12m.	Consensus Q1 2020
US	2.50	2.50	2.50	2.50	2.75
Eurozone	0	0	0	0	0
Japan	-0.1	-0.1	-0.1	-0.1	-0.1
UK	0.75	0.75	0.75	1.00	1.00

Long rate outlook

2Y. Bond yield

	29/03/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.25	2.40/2.60	2.18	2.20/2.40	2.12
Germany	-0.6	-0.60/-0.40	-0.61	-0.60/-0.40	-0.60
Japan	-0.18	-0.20/0.00	-0.19	-0.20/0.00	-0.19
UK	0.64	0.60/0.80	0.6	0.70/0.90	0.62

10Y. Bond yield

	29/03/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.40	2.50/2.70	2.42	2.40/2.60	2.44
Germany	-0.07	0.10/0.25	-0.02	0.10/0.25	0.03
Japan	-0.09	0.00/0.10	-0.06	0.00/0.10	-0.03
UK	0.99	1.10/1.30	1.07	1.15/1.35	1.13

Currency outlook

	29/03/2019	Amundi + 6m.	Consensus Q3 2019	Amundi + 12m.	Consensus Q1 2020
EUR/USD	1.12	1.14	1.15	1.17	1.18
USD/JPY	111	109	110	106.5	108
EUR/GBP	0.86	0.87	0.85	0.86	0.86
EUR/CHF	1.12	1.14	1.14	1.15	1.16
EUR/NOK	9.68	9.40	9.50	9.30	9.40
EUR/SEK	10.42	10.25	10.30	10.10	10.20
USD/CAD	1.33	1.31	1.31	1.30	1.31
AUD/USD	0.71	0.72	0.72	0.70	0.73
NZD/USD	0.68	0.68	0.68	0.69	0.69
USD/CNY	6.71	6.70	6.73	6.70	6.70

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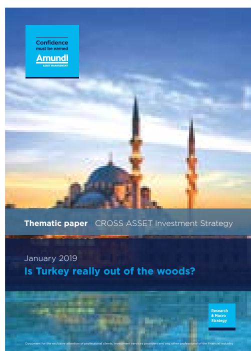

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