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2020

CIO VIEWS

INCREASED RISK REQUIRES A CAUTIOUS ATTITUDE

THIS MONTH'S TOPIC

THE 2020 US PRESIDENTIAL ELECTION: ANOTHER CLOSE RACE?

Research & Macro Strategy

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

CIO VIEWS

Increased risk requires a cautious attitude

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

After weeks of relative stability, the threat of a trade war has returned, shaking investor confidence and awakening markets from complacency. However, while there is still a significant optimism in the market that a deal can be struck, we believe that the risk of disappointment leading to another wave of volatility remains significant.

What we have seen recently is that **the politics continue to dominate financial markets,** but mainly at the news flow level: political risk is currently perceived as a short-term nuisance, but **its impact could have much longer and more significant implications should it interfere with the economic cycle.** Even our central macro scenario – i.e., a continuation of moderate global growth, with the growth differential between Emerging and Developed Markets widening in the second part of 2019 and low inflation thanks to accommodative central banks – could be challenged in case of a material escalation of the trade war. In fact, retaliation by China could mean the extension of tariffs to all remaining Chinese exports to the US. This could have a direct impact on GDP (reduced exports) as well as indirect impacts related to business and consumer confidence, with rising inflationary pressures and input costs affecting corporate earnings.

However, we do not think a deal is just around the corner. The risks of a tough and prolonged battle remain and will not fade away in the near future, as they are the reflection of the battle of power between old and new empires in the geopolitical landscape. We are also conscious of the unforeseeable side of protectionism (reduced global trade, potential inflation pressures, etc.), and we don't see it as being priced into risk assets. **We expect the tug of war between softer and harsher tones to continue, resulting in further market volatility.**

It is also too early for the Fed to cut: markets went probably too far in pricing in a move and we don't buy this view at the moment. We think that the movement of downward revision to inflation expectations is now completed and could possibly reverse. This would mean that though the inflationary risk is marginal, volatility should show in inflation data and inflation expectations which should open up a less linear and benign phase in the bond space, especially in the US.

Market focus will soon shift to growth data (trade, earnings) and in some segments - almost priced for perfection - there is little room for disappointment at current risk premia: an other challenge for the US.

On balance, regarding these considerations, we believe **it is not yet time to go completely risk off**, but that it is time to implement strategies to protect portfolios in case of a deterioration of the situation and to take some profit, where investors have achieved target returns, as the risk / return profile looks now asymmetric (higher risks / lower returns expectation).

Financial conditions are quite easy across the board, with dividend yields appealing compared with bond yields, especially in Europe. The recent market movement has brought global equity markets back closer to fair value, erasing the excess of optimism of Q1. Even if the outlook for earnings is not particularly rosy, with earnings converging across regions in a typical late cycle feature, we don't see any risk of an earnings recession and see potential for bottom-up approaches throughout the year. However, we believe that **the global sweet spot is entering a more fragile phase during which absolute risk should be scaled back** whilst relative value opportunities could be exploited in favour of some segments in Europe and Emerging Markets.

This is clearly a tactical view for the remainder of the year, as in 2020 the risks of further deceleration will resurface, but in a low yield world playing tactical opportunities is crucial to adding some oomph to an otherwise lacklustre returns picture.

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Overall risk sentiment

Risk off | Risk on

Cautious in the short term. Further volatility will give room to selectively increase risk exposure areas with attractive valuations.

Changes vs previous month

- More cautious and selective in US credit
- More defensive in EM assets

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

MACRO

Downside risks, but global economy is resilient

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

The outlook is somewhat more uncertain than last year due to the rise of protectionism, but we must not sink into an excess of pessimism. The global economy is resilient:

- The most **advanced economies** remain **supported by domestic demand**. The first quarter growth data are clear proof of this: they were better than expected in the United States, the Eurozone and Japan, with respectively 3.2%, 1.6% and 2.1% growth (at annual rates).
- **Emerging economies will continue to grow**. Their external markets are weakening, but they are not threatened like last year by either the rise in US interest rates or the dollar appreciation.

That said, the climate of uncertainty is not conducive. The global manufacturing sector is at half mast. The countries most heavily involved in global trade are taking the biggest hit. Against this backdrop, the world economy is slowing this year. We expect about half a point less global growth YoY in 2019, with growth of 3.3%.

In the absence of inflation and given the downside risks, central banks are implicitly committed to maintaining accommodative monetary conditions. So far we have maintained a status quo for our fed funds rate estimate in 2019/2020, in line with our own GDP growth and inflation expectations. We have **increased the probability of the downside risk scenario** (from 20% to 25%) and recognise that risks have become asymmetric (in line with markets' expectations).

> "In absence of inflation and given the downside risks, Central Banks will keep accommodative policies."

Some Fed's member already argue that a simple disappointment on inflation / inflation expectations could justify a cut in the fed funds rate regardless of GDP growth (i.e. even if growth remains close to potential, with no risk of recession). The implicit idea is that the neutral rate (r*) may be a little weaker and that the Fed has gone too far in terms of rate hike last year. James Bullard (President of the Fed of St Louis) – while recognising that the normalisation has been successful and that the "stopping point" is appropriate – recently argued that a cut might also be appropriate if inflation disappoints. **We have maintained also a status quo for the ECB.** The ECB would not hesitate to mobilise the available tools if the need arises. All of this will help keep interest rates low for governments and corporates, and thus contain the debt burden. For their part, **governments will not remain inactive if GDP growth slows further**. There is less and less opposition to the mobilisation of counter-cyclical fiscal policies in a structurally weak interest rate environment. As the center of gravity of the global economy will continue to shift from West to East, we should not focus our analysis only on short-term. The world of tomorrow will benefit from multiple sources of growth. Global value chains are re-regionalising or even re-nationalising, which means that going forward we should benefit from **economic cycles** that are **less dependent** on each other at the global level.

The Strategist's view

US / China trade disputes shake markets

Since Trump's first tweet threatening to add tariffs on Chinese goods from 10% to 25% on the 5th of May, markets moved into full risk-off mood: equities sold off, core rates rallied, high yielding/ high beta currencies took a hit. Core rates have benefitted from their safe haven status and went lower: US 10Y touched 2.40%, and the German Bund is back to negative territory (both yields are back to the lows of March end). The US curve steepened (2Y10Y) as markets are back to increasing the odds of getting a cut on rates from Fed by 2019 end (the probability has moved from 50% as of post 1st of May FOMC to 75% as of 14th of May). In the G10 currency space, the USD was impacted negatively as, due to its current high-yielding currency status, it suffered the unwind of FX carry trades, to the benefit of reserve currencies like JPY, CHF and EUR. Further escalations of US/China disputes could exacerbate the aforementioned moves, in particular on the USD front as current positioning (both on the speculative and real money side) is rather elevated on the long side.

In EM, volatility has been quite high after the latest news on trade talks. Further escalation would affect not only China but also markets more linked to the global cycle and, among them, some relevant Asian markets such as Korea and Taiwan. Our key call is for China not to devaluate RMB to face higher tariffs and eventually not to overshoot the 7.0 level. Other EM FX are undervalued but, in case of escalation and RMB devaluation, they will be strongly impacted, in particular the Asian FX like the Korean Won and Taiwan Dollar. EM FX volatility has been quite high YTD, mainly for the high carry currencies that usually react strongly in a risk-off environment. In our view, **EM FX volatility will remain high** also because of some idiosyncratic stories like Turkey and Argentina that are politically related.

DM= Developed Markets, EM = Emerging Markets, CB= Central Bank, ECB= European Central Bank, Fed= Federal Reserve.

MULTI-ASSET

Low visibility on market direction=cautious approach

MATTEO GERMANO, Head of Multi-Asset

In a late financial environment, we are maintaining an **overall cautious stance on risk assets, with a preference for credit vs equities.** Those elements that, a couple of months ago, suggested some risk reduction in our positioning, are still present (Brexit, growth concerns in China and escalating trade disputes). We believe current equity levels are discounting very high expectations regarding a deal between US and China. Therefore markets remain vulnerable to a tactical pull back, given the ebb and flow of negotiations. Weaker momentum in the global expansion and world trade are expected to continue into the summer. Risks are skewed to the downside as a combination of geopolitical and idiosyncratic hazards increases the uncertainty on the policy reaction front and may further dampen growth.

High conviction ideas

We remain cautious on DM equities: while the easy financial conditions and the light positioning of institutional investors in Europe represent a good support for the market, many factors suggest a defensive stance. Since the beginning of the year, the undervaluations gaps have mostly closed, and global equities are priced at fair value now, profit cycle has passed the peak – although we still expect single digit growth in 2019. Moving on to economics, the global situation remains fragile and exposed to further negative surprises. We express this caution through a defensive stance regarding Europe and the US market. **We have moved to neutral view on EM equities,** where we prefer a country specific / relative value approach, in light of the lack of visibility on market direction. In EM, we prefer more cyclical markets – Korea for example which could benefit from a mild rebound in the cycle in the second part of the year, and exhibits interesting valuations compared to the rest of the EM.

We continue to like China, particularly the domestic sector, which should benefit from the recent fiscal and monetary stimulus. Investors could also play EM divergences in the currency space, preferring for example currencies with positive carry (ie a basket of Indonesian Rupia, Brazil Real and Russian Rouble), vs shorting high beta currencies (South African Rand). This offers a way to keep volatility low while exploiting relative value opportunities.

> “We remain defensive, as the elements that previously called for de-risking in our approach are still present.”

In **fixed income**, we recommend continuing to **exploit carry from credit**, where we still prefer Euro IG over US IG, given the better fundamentals. We also find a better risk/reward profile in IG vs HY securities. While we have revised down our rate projections, we believe **investors should keep low duration risk.** We don’t expect core European bond yields to fall below current levels, especially in short-term maturities, as the ECB is not expected to cut rates further unless the Eurozone economy deteriorates sharply, which is not our base case scenario. Accordingly, we find more value in 5Y US Treasuries vs 5Y German Bunds. We are defensive on UK 10Y real rates, based on a weaker outlook regarding UK growth, combined with nominal rates being vulnerable to sharp sell-off.

Risks and hedging

The main risks to monitor emanate from the political arena, especially the tensions over trade disputes (US-China, US - Eurozone). The lack of visibility on Brexit, and the imminent European elections are also in focus. Investors should keep hedging strategies in place (to protect equity and high yield bond exposure) and a preference for the Yen vs USD, which should outperform in case of a further escalation in geopolitical risk.

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Amundi ASSET MANAGEMENT

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

Pricing for safety is, and will likely remain, high

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

The scenario of moderate growth and dovish central banks remains supportive for fixed income, and in particular for bonds which provide investors with an income - ie corporates and EM bonds. However, as these markets are no longer cheap, it is important to “optimise” the carry opportunities across the board (EM debt hard currency, EU investment grade, US corporates less exposed to trade disputes). We expect US Treasuries to continue to protect portfolios in case of an escalation of trade tensions and other geopolitical risks (resurfacing frictions around the Iran nuclear deal could impact the oil outlook). The price for safety is high, with the 10 Y US treasury yield below 2.3% (10 Y Bund yield in negative territory), but it will likely remain so, as there is strong demand for safe assets and scarce supply. As we expect the US dollar to stay around current levels in the short term, non US-investors could consider gaining exposure to this source of protection and liquidity without a full currency hedging.

> **“We believe it is appropriate to adopt a “careful carry” approach, moving up in quality.”**

DM bonds

Current market conditions don’t justify in our view aggressive duration stances. US treasuries may benefit from uncertainty, due to their “safe haven” status, but the market is quite expensive and it is difficult to see rates going far below the current levels: a 25bps cut for next year is already priced in; we do not expect a cut this year. Inflation expectations are low now and we could see a mild repricing in inflation expectations (due to oil, input prices and wages rising) which could cause a return of volatility to fixed income. In relative terms, we see more value in US Treasuries vs German Bunds. We remain positive on EU peripherals bonds, keeping a flexible approach as the political situation appears quite fragile.

Credit

Considering the current economic conditions, carry represents the primary source of return for fixed income investors; investors should maintain a preference for European credit, due to good fundamentals, even if the room for spread tightening is limited considering the strong performance of the asset class since the start of the year. We believe it is appropriate to adopt a “careful carry” position, that involves selectively reducing spread

duration and moving up in quality. We see also selective opportunities in the high yield market, especially after the repricing which followed the recent tariff disputes, as the outlook for default rates remains benign.

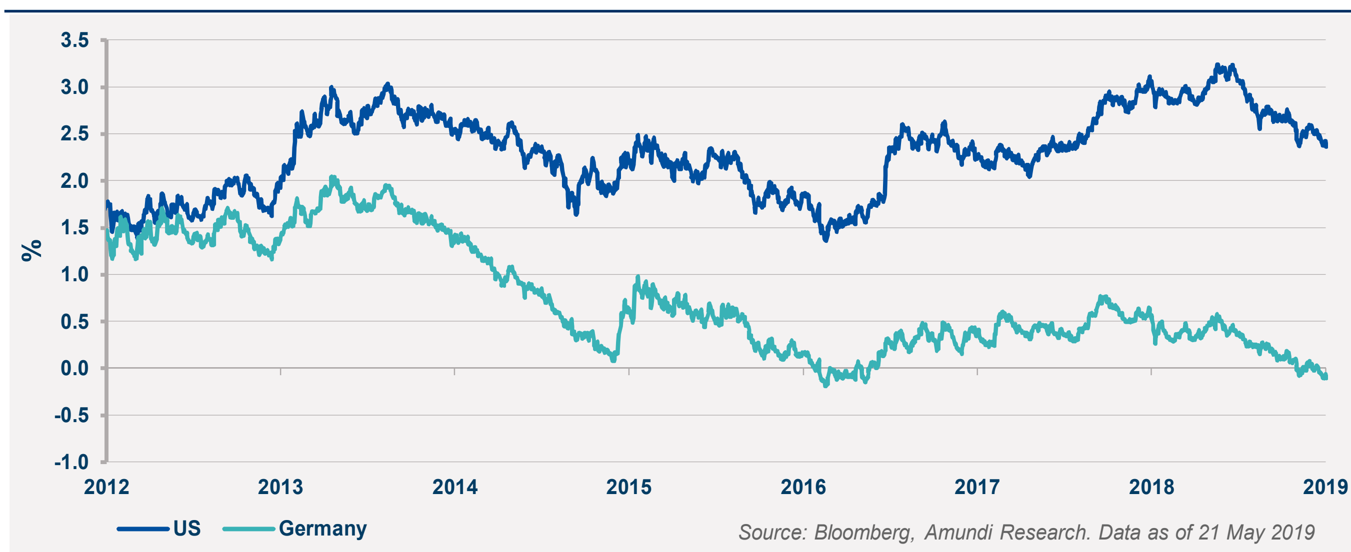
EM bonds

Increased trade and political risk still suggest a cautious stance on the EM debt sphere. The EM macro story is still intact and we keep our positive view on the asset class over the medium-long term. The recent volatility, while suggesting us the need for a more defensive and selective approach for the time being, likewise may create attractive entry points in countries and sectors. We thus look for tactical opportunities in hard currency debt, which continues to be an appealing source of carry and may continue to perform well at this stage. We also view exporting countries favourably: they could potentially benefit from a global shift in the supply chain; conversely, we keep a defensive stance on currencies more exposed to China growth.

FX

We have our positive view on the USD in the short term and cautious stance on the EUR due to downside risks on growth.

10Y Government Yields



Source: Bloomberg, Amundi Research. Data as of 21 May 2019

EQUITY

Deep dive in search for value

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

Overall assessment

The intensification of the trade disputes between the US and China halted the equity bull run. However the correction was limited, the US and the European markets partly recovered from the post-tariffs lows, supported by financial conditions which continue to remain loose, dovish CBs, generally easier fiscal policies and relief from the low expectations on Q1 reporting season. Supporting factors for the market are still in place, but a cautious and selective approach is preferable due to the wide spectrum of geopolitical risks and the less appealing risk/return profile compared to the beginning of the year.

DM equities

US equity valuations remain attractive relative to fixed income. There are opportunities in quality and growth, but these are very stock- or vertical (i.e., within a sector)-specific. We see value in companies linked to infrastructure/cloud/data centre spending (these stocks sit in three sectors), selective financials such as insurance brokers, and auto & home insurance. In addition to valuations, many of these services stocks have lower foreign input costs that might be subject to tariffs and are also less exposed to potential trade retaliation given they have less non-US sales exposure than goods companies. Services stocks have faster sales and earnings growth, more stable gross margins, and stronger balance sheets. We are now cautious on capital goods, tech hardware, and semiconductors, industries which had been among our preferences in the past few years. Bond proxies, such as consumer staples and utilities, plus staple-like companies with no structural threats in many other sectors, are expensive on a relative-value basis.

European equities could offer interesting entry points after the EU elections, should the economic outlook improve in H2 and domestic demand remain resilient, as we expect. The current features of the market (increasing valuations dispersion, lower sectoral correlation) fit a stock picking approach. We continue to see selective opportunities in the cyclical part of the market (but with less conviction than one month ago), while the defensive part is expensive. Industrial and energy are the high conviction ideas, while on banks we believe a cyclical rebound has to be confirmed to see a convincing repricing opportunity. In the defensive space, health care sector is our favourite choice.

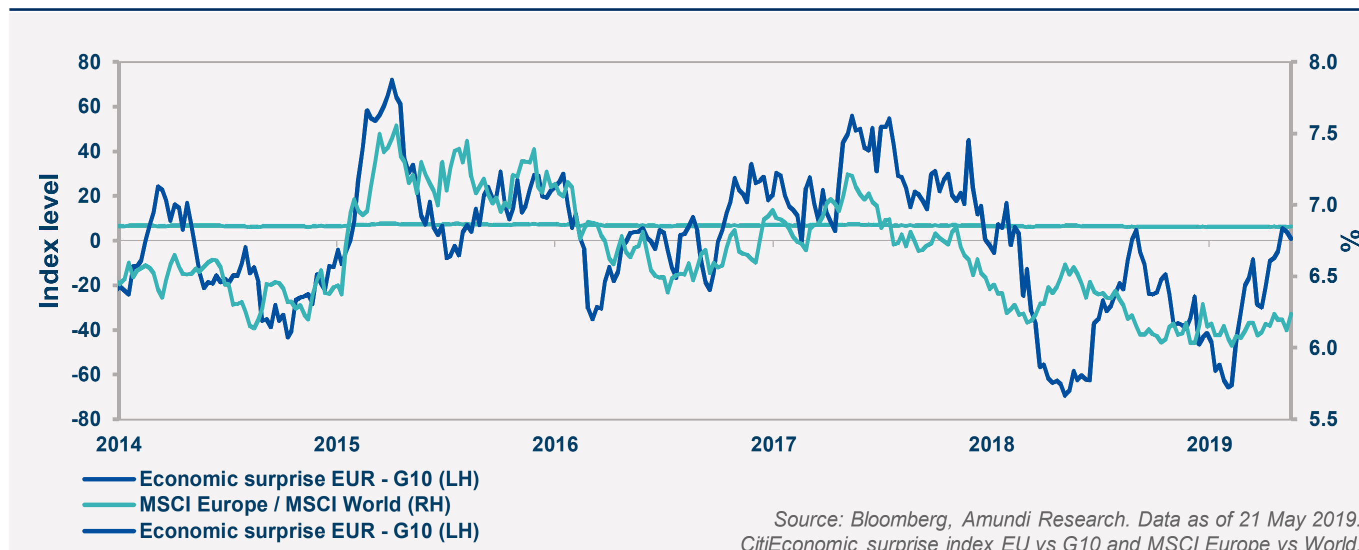
> "We see a more favourable stock -picking market ahead, due to rising valuation dispersion and decreasing sectorial correlation."

Japanese equities show compelling valuations but a possible strengthening of the yen backed by increased uncertainty represents an headwind for the equity market.

EM equities

We see a mixed picture for EM equities: relative performance will now largely depend on the development of US-China trade story. A satisfactory deal would be beneficial for EM stocks, as it is not fully priced in at the moment. Given ongoing uncertainty, downside risk are still lurking in the background, suggesting near-term defensive positioning. Global investors are underweight EM, providing a potential technical support to the asset class. Dividend theme is attractive as the dividend per share growth is accelerating in main countries. We maintain our preference for China given the supportive measures related to credit growth rebound and tax cuts. Also some domestic demand growth stories in Asia, more insulated in case of a trade escalation, are attractive as defensive plays.

Economic surprise index and EU equity relative performace



Source: Bloomberg, Amundi Research. Data as of 21 May 2019. CitiEconomic surprise index EU vs G10 and MSCI Europe vs World.

Amundi asset class views

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	-/=		Q1 earnings season has been positive, with revenue and earnings increasing. While the top line was sustained, the bottom line was less buoyant, and marked a clear deceleration vs 2018. We remain cautious on the market after the strong YTD rally, with sector/stock selection being the main strategy to approach the market, in which there are very expensive stocks (ie, in bond proxies) as well as more appealing situations (eg, in the service sector).
EQUITY PLATFORM	Europe	=		Q1 reporting season has been solid. Green shoots could come from easier fiscal policy and stabilization/ improvement of growth in H2. Geopolitical factor could ease somewhat, with the EU election behind us. Valuations are attractive. Potential market entry points could materialize in the coming weeks in the market.
EQUITY PLATFORM	Japan	-/=		The earnings per share momentum is weak, although valuations are attractive. Increased volatility due to geopolitical factors, could lead to a stronger Yen, which could potentially be a drag for the market. Opportunities could be found at the stock picking level, but we are cautious on the overall market.
EQUITY PLATFORM	Emerging markets	=/+	▼	EM equity valuations are less compelling than few weeks ago. The 1Q19 reporting season showed marginal signals of bottoming out in Asia. We still think that China and domestic stories in Asia are attractive. Dividend is an attractive theme to play, as dividend per share growth increased strongly and is expected to further improve.
FIXED INCOME PLATFORM	US govies	=		We believe that the market has overestimated the probability of a rate cut by the Fed. The market could be vulnerable in case of readjustment of inflation expectations. A cautious duration position is warranted given current 10Y Treasury yields
FIXED INCOME PLATFORM	US IG Corporate	=		The current environment should be supportive for spread assets. We note, however, that recent market performance has reduced the prospects for returns relative to risk in many credit sensitive asset classes and reduced the scope for material near-term spread tightening.
FIXED INCOME PLATFORM	US HY Corporate	=		Our outlook for the asset class is broadly unchanged. We see valuable carry, but limited space for spread compression at the current level. The still sound economic picture is benign for the default outlook. Default rates are expected to remain very low in 2019.
FIXED INCOME PLATFORM	European govies	-/=		At the current Bund yield levels, we see little value in core govies. For fixed income investors, opportunities could be found playing yield curve flattening and Euro peripheral bonds.
FIXED INCOME PLATFORM	Euro IG Corporate	+		Valuations have become less compelling after the aggressive spread tightening but the asset class is still attractive for carry reasons and fundamentals remain solid. Central Banks actions could support financials. Subordinated debt is an area of interest too.
FIXED INCOME PLATFORM	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 selective carry opportunities.
FIXED INCOME PLATFORM	EM Bonds HC	=/+		Our view is still constructive on HC debt in the medium term, due to a benign economic outlook for EM, dovish Central Banks and loose financial conditions. In the short terms, spreads are quite tight and some volatility could return in the market in light of the increased tensions between China and the US.
FIXED INCOME PLATFORM	EM Bonds LC	=	▼	We have a neutral view on the asset class, as currency volatility has increased and geopolitical risks are elevated.
OTHER	Commodities			For WTI, we keep the 55-65 range (USD/Barrel) despite the recent strong rebound driven mainly by OPEC cut and economic stabilization. However geopolitical tensions in middle East, Iran sanctions and Venezuela political situation will likely inflate volatility and upward pressure in the short term and will exacerbate supply disruption concerns. Base metals are vulnerable to China and global economic slowdown. All in all, the picture remains still supportive for delivering decent returns as the inventories cycle remain reasonably supportive.
OTHER	Currencies			EUR/USD: the single currency is still trading in a tight range as signs of Chinese and Eurozone's activity bottoming out are offset by concerns on the political front. We expect the EUR/USD to trade around 1.17 at the end of 2019, while remaining supported in the short term. We expect USD/JPY at 107 on a 12M horizon. For the next 12 months we expect also a mild upside for EM FX (on average +1.5%, with differences from country to country). To be selective remains key.

LEGEND

Source: Amundi, as of 21 May 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

The 2020 US Presidential Election: Another Close Race?

PARESH UPADHYAYA, Director of Currency Strategy, US, Portfolio Manager

Finalised on 13/5/2019

- **President Donald Trump's performance on the US economy gives him a significant advantage over his Democratic rivals heading into the 2020 election.**
- **However, Trump has consistently polled poorly with voters on character issues including leadership, temperament and management skills. The potential fallout from the Mueller report and ongoing House investigations remain wildcards.**
- **The 2020 election could be another close call, possibly a 50-50 tossup at this stage in the election cycle.**
- **We see four potential election scenarios that could have significantly different implications for the US economy and investors.**

The 2016 Presidential election produced one of the biggest upsets in US Presidential history. It was also one of only five elections since 1788 where the winning candidate lost the popular vote, but won the Electoral College. It was just another reflection of a deeply polarized electorate. Because of the lack of a popular mandate and very high unfavorable ratings, Trump never enjoyed a honeymoon. His net approval rating has never been positive. He has consistently had high negative approval ratings for most policy issues, while his rating is deeply unfavorable for attributes such as honesty and trustworthiness.

While Trump's road to reelection remains challenging, his prospects for another term are not as bleak as might appear, based on an analysis of recent polling data and the patterns of previous elections. The market is starting to anticipate a Democratic victory, as evidenced by the recent decline in healthcare stocks over concerns about potential democratic reforms. However, it's far too early to decide on the winner.

The US Presidential elections are 18 months away. However, in this era where politics and geopolitics are having a bigger impact on financial markets, we believe it is a perfect time to preview the Presidential race.

This paper examines four hypothetical election scenarios, likely key policy initiatives associated with each one, and potential economic and market implications. The wildcard that could alter the election dynamics at any time remains the fallout from the Mueller Report and other ongoing House and State investigations.

Uphill Odds for Trump

An analysis of the political fundamentals indicates an uphill road to reelection for Trump.

- His approval rating has averaged 42% during his tenure, while his disapproval rating was 53% as of June 16, resulting in a net approval rating of -11%. Trump is the only President who has not experienced a positive net approval rating by this point during his first term.
- In a NBC/WSJ Poll conducted February 24-27, Trump lagged an unnamed candidate by 7%. He lagged front-runner Joe Biden by 8% in a Morning Consult/Politico poll (4/19-21), and lagged Bernie Sanders by 3% in an Emerson Poll (4/11-14).
- Market expectations tracked by political betting website, Predictit, gave Democrats a 57% probability of winning the election, while Trump's reelection probability was 43%, as of April 17. The trend has been stable for the last three months. Similar to the 2016 polls, this political betting website was also off the mark.

Many voters are not impressed with Trump personally. He has significant net unfavorable ratings in leadership attributes, such as temperament, trustworthiness and management skills by margins of -41%, -25% and -18%, respectively, according to a CNN poll (Mar.14-17, 2019). Overall, his unfavorable ratings outnumber his favorable ratings by a 2.1 margin.

He trailed in multiple areas, including education, healthcare, social security and the environment, according to a recent Politico/morning Consult poll (Apr.5-7, 2019). Despite Trump's landmark achievement, the Tax Cuts and Jobs Act of 2017, he has a net disapproval rating on his handling of taxes from the Pew Poll (Mar.20-25, 2019). Recent polls suggest the Democrats have been successful at labeling the tax cuts as benefitting the wealthy.

However, Trump Has a Path

Despite Trump's poor standing on key fundamentals, he has a path to reelection. Historically, a negative net approval rating has not necessarily been a deterrent to reelection. President Ronald Reagan was reelected with a net approval rating of -9%, not far from Trump's current level of -11%. Conversely, a positive net approval rating has not necessarily translated to victory. President George H. Bush had a strongly positive net approval rating of +70%, but lost the election decisively to Bill Clinton. Trump's trailing position at this early stage does not mean a loss on election day. Clinton won reelection despite trailing an unnamed GOP candidate at this point in the election cycle.

In a Quinnipiac Poll (Mar.21-25, 2019), Trump enjoyed a net favorable rating for personal fundamentals. He scored +46% and +5%, respectively for the statements, "stands up for beliefs" and "tough to handle a crisis". In my opinion, these two factors may be important enough to offset some of the other "softer" factors where Trump rates poorly.

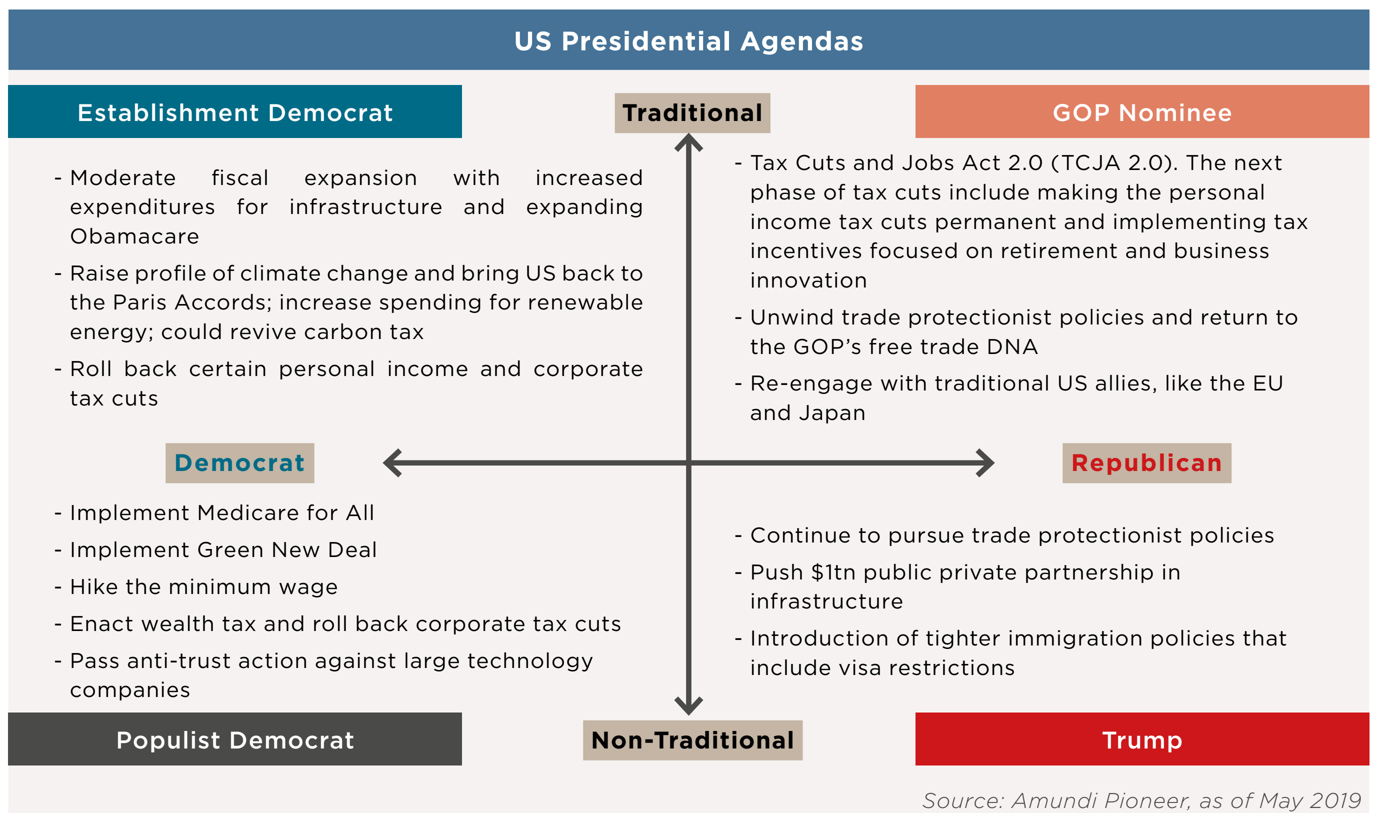
Trump's Advantage: The Economy

In economic fundamentals, Trump has been polling ahead of Democrats in Congress on the most critical issues likely to influence the outcome of the election, including his handling of the economy, jobs and national security. In these areas, Trump was ahead by +12%, +10% and +5%, respectively, according to a Politico/Morning Consult poll as of Apr.5-7, 2019. Of all the fundamentals that are important factors in the election, economic fundamentals will be the most critical to monitor. If the economy continues to expand and the unemployment rate remains low, then Trump's reelection prospects improve.

US Presidential Elections: Four Scenarios

We can see four potential scenarios in the 2020 US Presidential Elections.

Potential Scenarios	Odds	Description
Trump Reelected	**45%**	The economy remains robust and Trump's style of politics boosts the unfavorable ratings of his Democratic opponent – the classic "lesser of two evils" scenario (a repeat of the 2016 election).
GOP Nominee Elected	**5%**	In this unlikely, but not entirely implausible scenario,scandal envelops Trump, either forcing him to resign, to be forced out of office or abandon a run for reelection, the GOP is forced to find a replacement nominee.
Establishment Democrat Wins	**35%**	The US economy slows dramatically, Trump's approval rating falls into the mid-30s, and broad-based disapproval of Trump's politics & style feeds the narrative for change.
Populist Democrat Wins	**15%**	The economy slumps into recession, increasing voter fatigue about ongoing scandals plague Trump. Widespread disenchantment about income inequality feeds the narrative for a seismic shift for change.



Source: Amundi Pioneer, as of May 2019

Potential Economic Implications

	Trump	GOP Nominee	Establishment Democrat	Populist Democrat
Growth	Above Trend Growth	Trend Growth	Near Trend Growth	Below Trend Growth
CPI	Rising	Upward Pressure	Downward Pressure	Stagflation
Monetary Policy	Tightening	Upper end of Neutral	Neutral	U-Shaped Cycle

Source: Amundi Pioneer, as of May 2019

- **Trump Reelected:** Under a reelected Trump, we believe there is greater likelihood of easier fiscal policy via lower taxes and an increase in infrastructure expenditures which, in combination, should propel US economic activity further above trend. Partly offsetting this boost to growth will be the administration's continued protectionist policies, rising interest rates and a strong US dollar. Robust economic activity would put upward pressure on inflation and wages, potentially prompting the Fed to resume its tightening cycle.

- **GOP Nominee:** Moderate fiscal stimulus, lower and permanent taxes and a reduction in trade tensions could support trend economic growth. The tightening labor market could add to moderate wage pressures. The Fed may need to fine tune monetary policy, especially if wages rise.

- **Establishment Democrat:** In this scenario, softer growth has led to reelection of Democratic candidate. In this case, modest fiscal stimulus, a weaker US dollar and removal of tariffs could help boost GDP growth. The soft growth could keep inflation in check, while drug price controls could pull prices lower. The Fed would likely maintain a neutral monetary policy.

- **Populist Democrat:** Under this scenario, a US recession results in the election of a populist Democrat. A populist Democratic administration is more likely than not to maintain many of Trump's protectionist tendencies. A populist agenda could lead to much easier fiscal policy aimed at stimulating the economy. The recession would dampen inflation, but a likely weaker US dollar, along with implementation of a carbon tax and tariffs, raise stagflation concerns. Finally, the Fed might initially lower rates in response to the recession, but rising inflationary pressures could force the Fed to hike.

Financial Market Implications				
	Trump	GOP Nominee	Establishment Democrat	Populist Democrat
Growth	Above Trend Growth	Trend Growth	Near Trend Growth	Below Trend Growth
Equities	Positive Equities	Positive Equities	Neutral Equities	Negative Equities
Rates	Rising Rates	Stable Rates	Stable Rates	Falling Rates
USD	Strong USD	Stalbe USD	Weak USD	Weak USD

Source: Amundi Pioneer, as of May 2019

Trump reelected: The equity markets benefit from a strong economy, higher corporate earnings and lower taxes. The infrastructure and defense sectors are potential winners in this environment. Interest rates would rise due to strong growth and rising inflation, keeping the Fed on tightening cycle. The resumption of the Fed's tightening cycle would keep global interest rate differentials in favor of a strong US dollar.

GOP Nominee Wins: Healthy growth, permanent tax cuts, capital gains indexing and reduced trade tensions could support equity prices. A neutral Fed policy would likely keep interest rates consolidated in a wide range. While stable interest rate differentials mean a stable US dollar, the US dollar is more likely to be influenced by developments overseas.

Establishment Democrat Wins: In this scenario, it is assumed a Democratic president takes over in a weak economy. The stock market would likely be largely stable, but experience a cyclical rebound as growth improves. The tech, pharmaceutical and healthcare sectors could underperform due to Democratic reforms The global convergence in growth and monetary policy drive the US dollar lower.

Populist Democrat Wins: This scenario assumes the economy is in a recession. Below-trend growth and an aggressive populist Democratic agenda lead to a negative environment for equities. In particular, tech, pharmaceutical, defense and healthcare sectors underperform, while construction and resource stocks outperform. Interest rates could rally as the Fed eases policy, but if concerns about stagflation emerge the yield curve may steepen as long rates rise. The negative outlook on US asset prices and narrowing interest rate differentials could lead to depreciation in the US dollar.

Key Determinants for the 2020 Presidential Elections

- **The Economy/Jobs –** this is one of the few areas where Trump has polled consistently well so far in his first term. Arguably, it is probably the most important as well. Voters trust Trump over the Democrats in Congress on the handling of the economy by 52% versus 40%, according to the Politico/Morning Consult poll (Apr.5-7, 2019). The economy has averaged a strong 2.8% growth rate so far in Trump's first term through the first quarter of 2019. This is the strongest growth rate since Clinton's 3.3% in his first term. If the economy continues to grow above trend and the unemployment rate remains at or near 4%, voters may overlook Trump's poor approval and favorable ratings and vote to reelect.
- **Potential Fallout from Trump Investigations –** According to the NBC/WSJ poll from Mar. 23-27, 40% of Americans believe the Mueller Report has not exonerated Trump, while 29% believe it has. Impeachment did not have broad-based support, according to a Washington Post poll taken Mar.26-29, in which 41% supported, and 54% did not. There remains a lot of uncertainty over the ongoing House Democratic investigations and, probably more importantly, local state investigations that may have legal repercussions. It could take a revelation of criminal action or resounding conclusive unethical behavior to affect Trump's reelection prospects.
- **Democratic Opponent –** Trump's Democratic opponent will have a big impact on the prospects of his reelection. An establishment Democratic candidate would have a better chance of defeating Trump then a populist one, based on several polls consistently showing an establishment Democrat like Biden defeating Trump by larger margins compared with populist candidates like Sanders and Warren. There is a divide within the Democratic Party between candidates embracing left wing policies like Medicare-for-all and those calling for more moderate incremental changes to policies like healthcare. Trump has been exposing this divide by raising fears that Democrats are embracing Socialism. According to a Harris/Hill TV poll taken on Jul. 21-22, 2018, 76% of Americans would not vote for a Socialist, while 24% would. It would probably take a US recession or profound social upheaval for Americans to elect a populist Democratic candidate.

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Financial Market Implications

Financial markets are already reacting to the start of the 2020 Presidential election campaigns. The market perception of an early edge by the Democrats is leading to the pricing in of some key populist Democratic policies, most notably the Medicare-for-All proposal. This has led to a severe underperformance of the Healthcare sector, which had a year-to-date total return of -0.14% as of April 22, well below the 16.7% gain of the S&P 500 Index. Industrials have outperformed the S&P 500 year-to-date, while the Materials sector has lagged. The potential exists for materials to rally on expectations of an infrastructure program.

The Presidential election is still 21 months away, but the battle has already begun. The Democratic field has 20 candidates and counting, the largest field in recent memory, and the campaigning and fundraising is well underway.

At this time, I believe the GOP's probability of holding on to the Presidency is 50/50 – better odds than current polls and market expectations. There remains a constant tug and pull dynamic in this race that will ultimately determine the outcome and why Trump's chances remain even. The positive ratings on the economy remain the consistent pull, while voters disappointed in his personal flaws represent the tug. At this juncture, it is too early to know how close we are to the line. Our base case scenario envisions Trump running against an establishment Democrat. Under this scenario, the economy should continue to grow at or above trend. However, there could be a divergence in financial market performance, with equities and the USD performing better under a reelected Trump, while interest rates underperform.

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 | 25% probability | Uninterrupted escalation in trade tensions between the US and China

Analysis | US/China negotiations had a surprising turnaround, with tariff raised on $200bn in Chinese goods from 10% to 25%, adding new downward pressures to global trade. Uncertainty increased in near term following the US announcement to restrict Huawei's purchases from US suppliers. There is a need for caution in the near term. On the other hand, the current tariff increase still looks manageable for China. Chinese policymakers are better prepared than last year, with policy effects on the way. Looking ahead, the window for US/China to reach a deal is still open. Two sides have made concrete progress, with several major issues left to be decided by President Trump and President XI. Both sides should feel more pressures and greater pains to come. The US should be careful about raising tariffs on the rest of $300bn Chinese products, as most of them will be consumer goods, unlike previous tranches.

Market impact | Tariffs have started to hit trade again, and have uncertainty been weighing on the business climate (especially in the manufacturing sector) and on the Chinese economy. As a result, 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 therefore 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 (due to fear of a global downturn). At the end of the day, a more severe confrontation would only make losers.

Risk # 2 | 25% probability | No-deal Brexit

Analysis | The UK is in the midst of a deep political crisis. Conservatives and Labour were sanctioned by voters. Nigel Farage's Brexit party is the big winner. Consequently, Boris Johnson has the wind in his sails to succeed Theresa May. But nothing is done yet. Theresa May's resignation will be effective on 7 June. From 10 June, the procedure to find a successor will begin. Theresa May will remain in office until the end of the procedure. There is no shortage of candidates. We should be fixed by the end of July at the latest. It should be noted that staunchly pro-Bremain parties (such as the Liberal Democrats) also scored well in the election, making the political situation even more polarised and, possibly, bringing more impulse to those demanding a second referendum. It should be remembered that the 27 EU countries must be unanimous on 31 October for a further extension of the deadline, which is not a foregone conclusion. Against this backdrop, the likelihood of the UK leaving the EU without an agreement has increased and it is therefore necessary to continue to prepare for it both at national and company level. However at the end of the day, everything remains possible: no-deal Brexit, new elections, new referendum, new Article 50 extension, not to mention that it cannot be ruled out that the British Government could simply revoke Article 50. The only good news is that fewer and fewer protesting/populist parties in Europe are calling for the exit of the euro (which would require an exit from the EU). It is likely that they are being vaccinated by the British turmoil.

Market impact | In the short run, uncertainty is likely to stay elevated as long as the new Prime Minister is not designated and it may even rise further if the next government adopts a confrontational approach with the EU-27. -In the face of uncertainty, the risk premium on UK assets must be sufficient - with a weak currency and lower prices for risky assets - to attract foreign investors. Is this enough today? Nothing is less sure! In the event that the outcome is unfavourable for the UK, we would see a weakening of the GBP and below-trend GDP growth. But should a deal be approved or the article 50 be revoked, we would see the opposite, The situation remains very binary and thus not very conducive to strong portfolio recommendations.

Risk # **3** | **25%** probability

Political instability in Italy with renewed stress on sovereign spreads in the Eurozone

Analysis | In early April the Italian Government released its latest economic blueprint (SGP), embedding the new economic forecasts for the 2020 budget and beyond. Projections are now more aligned with the consensus, implying weaker growth and a worsened state of public finances. Growth projections now expect the Italian economy to grow at 0.2% YoY in 2019, followed by a modest recovery to 0.6% in 2020. The deficit is expected to reach 2.4% of GDP in 2019, declining gradually to 1.5% in 2022. Yet, due to the combination of a worsening growth profile and a reduction in the primary surplus, debt is expected to increase further from 132.2% of GDP in 2018 to 132.6% in 2019. The target for 2022 is set at 128.9%. Due to the 2018 increase in the debt profile, compared with previous agreed targets, on May 29th the EU commission sent a letter notifying the breach and asking for clarification of the special factors that forced the deviation. To add further tension to the Italian economy, the EU election results have completely changed the balance of power within the governing coalition, with the League almost doubling the Five Star Movement's votes. This came with a high voter turnout. Confrontational tones within the government and with the EU on the Commission's budget rules resurfaced immediately, with increased risks of new elections. Although political incentives may not be absolutely in favour of this outcome, we cannot completely rule out the possibility of early elections, the earliest date possible being September (although this could fall very close to the start of the 2020 budget discussion, and would therefore not be the best political outcome).

Market impact | Notwithstanding the better than expected Q1 GDP, which marked an exit from the technical recession suffered by the Italian economy in H2 2018, markets remain nervous about the Italian government's new confrontational tones with regards to EU budget rules. Moreover, heightened tensions within the government coalition have increased the risk of snap elections and the uncertainty on how Italy would deal with the daunting task of addressing the 2020 budget, which should sterilise relevant VAT hikes while revamping a challenging spending review. At the moment, there is no systemic risk in our opinion. We perceive risks as remaining domestic. Keep in mind that the ECB has anti-contagion tools that it could call on to avoid a spread to other peripheral markets. In addition, the ECB has announced new TLTROs to alleviate the banking system. All of this should contain the contagion risk on peripheral sovereign spreads and on corporate credit spreads.

Risk # **4** | **20%** probability

Major European slowdown

Analysis | Q1 GDP growth figures (+0.4% QoQ for the entire Eurozone) came as a relief after high frequency indicators had signalled more weakness at the beginning of the year. For the moment, at least in core countries, economic difficulties are largely contained within the manufacturing sector. Moreover, the risk of US tariffs on the European car sector is now less imminent (D. Trump has postponed his decision by 90 days). However, there are risks that manufacturing remains under pressure, notably due the effect of renewed US-China tensions on international supply chains, while new US trade action against Europe cannot be fully ruled out. Domestic political risk is also present, first and foremost in Italy, whose 2020 budget negotiation with the new EU Commission will be difficult. Finally, the "no-deal" Brexit risk, although postponed, is rising again following the resignation of T. May. Such problematic events could occur against a backdrop where the key supporting factors of 2019, the still buoyant labour market and the significant easing of fiscal policies in large countries, gradually lose some of their strength due to cyclical and political causes.

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

US recession

Analysis | The US economy was stronger than expected in Q1 (+3.2%), although the composition of growth was somewhat volatile and sent out mixed signals, as almost half of the boost was in inventory growth and net trade. Incoming data related to Q1 this year, although more mixed, tend to confirm our outlook, pointing to a gradual convergence towards potential growth. Keep an eye, however, on the performance of the manufacturing sector, which soft data seem to describe in some difficulty.

Renewed tensions on the trade front with China, with the step up in tariffs, the still open risk of imported cars tariffs from Europe (postponed by six months), and uncertainty in the very important process of ratifying the USMCA (aka NAFTA 2.0) add uncertainty to the risks in our outlook. Yet, in our central scenario, US growth will slow, driven by slower domestic demand, which we anyhow expect to remain resilient, consumption in particular, given the strength of the job market and a benign inflation outlook. Against this backdrop, the probability of recession remains low in the foreseeable future, and we expect the Federal Reserve to remain on hold.

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. At the time of the writing, the markets have begun pricing in two and half rate cuts by the Fed by end of 2020, the first one occurring by the end of 2019. 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** | **15%** probability

Major geopolitical crisis in the Middle-East

Analysis | While there are always geopolitical risks centred in the Middle-East, US-Iran tensions have increased in recent weeks after D. Trump 1/ cancelled the waivers that enabled some countries to import Iranian oil 2/decided new sanctions on Iran. Recent security incidents (attacks on tankers in the Persian gulf) and aggressive declarations by both sides have only worsened the situation. An important factor is that Trump's team for foreign and security affairs is now considerably more hawkish than at the beginning of his mandate, with the appointment of personalities such as Mike Pompeo at the State Department and, even more so, John Bolton as National Security Advisor. However, Trump appears to be a lot more pragmatic than the latter. On the Iranian side, the risk of a military confrontation with the US is made larger by internal divisions, and the possibility that the IGRC could conduct operations without the full approval of the country's leaders.

Market impact | Oil prices would be the main item to watch, while a US-Iran open confrontation could be detrimental to most risky asset classes and cause a surge in safe-haven flows to the USD. However, at this point, we expect no durable upside shock on oil prices, given the high level of US shale gas production and declarations by Saudi Arabia and the UAE that they can make up for the shortfall in Iranian exports.

Risk # **7** | **10%** probability

Major political crisis in Europe

Analysis | The European Election results were broadly in line with what opinion polls had indicated, although with a slight "pro-institution" surprise. Key takeaways are, first, a decline in the votes for the two large political groups which are the social-democrats and the Christian-democrats or moderate right; these two parties had, since 1979, commanded a combined majority in the European Parliament, and this is now over. Second, a rise in other so-called "mainstream" forces, the pro-market liberal centre including the Party of French President Macron, and, even more notably, the Greens. Together, all these pro-institution, pro-European forces command roughly 67% of MP vs. 70% before the elections. Then the other major take-away is that far-right (or right-wing Eurosceptic) parties see their share increasing from roughly 20% to 25%, with prominent cases being France, where the far-right national front comes first before the President's party, and Italy. However, far-right parties also scored a bit short of expectations in other key countries such as Germany and the Netherlands, while far-left party have seen their share diminish from 10% to 7%. All in all, while combined radical parties, Eurosceptic parties see their total share increasing from 30% to 32%, this is not the tsunami that could really have been a shock to institutions. The two historic mainstream parties which can build a majority through a coalition either with the liberal centre, or with the Greens will find it a bit more difficult than it used to be, yet it should still be manageable. Radical parties will have a bit more power, especially through parliamentary committees, they could try to propose amendments but they should not be able to block key legislation except on topics where mainstream forces could be very divided. What is also remarkable is the rise in the participation rate at the vote. Turnouts at the European election had been historically low and falling and this time it rose from 43% to around 50%, which shows a rising interest in European affairs.

Market impact | Given the still positive economic backdrop, we do not believe that a new round of systemic crisis in Europe is possible. 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, we cannot rule out some market stress while the difficulty to understand European institutions for outside investors means that European assets may continue to carry a specific political risk premium. Italian government spread vs. Bund should continue to be volatile.

Risk # 8 | 10% probability | Major slowdown 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 news-flow concentrated in DM (Europe in particular); and (3) a less likely escalation in the trade war between the US and China with likely a 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 and less external demand for EM economies) 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 remains non negligible. Indeed, today we do see the risk of contagion through financial market higher than through the chain trade. As long as the global financial environment remains dovish, the contagion risk coming from the usual fragile suspects like Turkey and Argentina remains limited; however, should the global environment change towards a tighter one, the contagion risk would increase.

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 # 9 | 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.

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 (70% probability): domestic demand and services to remain resilent despite rising uncertainty on trade

- **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. They are signs of stabilisation but with risks being increasingly tilted to the downside.
- **Global trade** is under pressure but its importance must not be overestimated: Global trade has fallen over the past 18 months; it started 2018 at around 5% yoy but fell sharply in Q4 2018, zigzag over the last few months and should face challenge again given recent increase of tariff for Chinese imports to US. The economic slowdown in China probably played a role in late 2018. But most importantly, the protectionist rhetoric has pushed uncertainty to an all-time high (with a peak in Jan), dragging down investment. Re-escalation on trade between China and the US doesn't bode well such as the one between the US and Mexico and, on the other hand, a trade war between the EU and the US remains a distinct possibility. At this stage, we however 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 mid-2020). And in addition, we believe that the resilience of domestic demand is underestimated. True global trade strongly contributed to global growth over the past decades, but that's less and less the case: global growth is primarily driven by domestic demand. Services are increasingly becoming decoupled from industry, which can be explained by the relative strength of consumption vs investment and trade since the global financial crisis.
- **United States:** The US economy has been driven by a very accommodative fiscal policy; its impact should progressively erode this year. True, real GDP growth was well above expectations in Q1 19 (3.1% qoq at annual rate after 2.2% in Q4 18). This was the third quarter the US economy grows at a rate above 3% in the last 5 quarters. GDP growth also picked-up on a year on year basis from 3.0% in Q4 18 to 3.2% in Q1 19. Yet, nominal GDP growth slowed from 5.2% YoY in Q4 to 5.0% in Q1. Looking at the composition of quarterly growth, domestic demand slowed notably (both household consumption - especially in durables goods - and investment in equipment decelerated). Due to very accommodative monetary and financial conditions, we however think that growth should be able to gradually decelerate to its potential in 2020, barring any major shock on financial conditions or major confidence corrections from businesses and consumers. Corporate profits will remain under pressure, especially if inflation re-accelerates, which is still possible, given that the economy is operating at close to full employment and tariffs may get at least partially passed through. We do believe that a recession is unlikely in 2019 and in 2020 (as 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, domestic demand under pressure, mixed signals from sentiment and hard data) if trade and geo-politic tensions do not ease. And we must keep in mind that sub-par growth may trigger a profit recession.
- **Eurozone:** Growth rebounded 0.4% QoQ in Q1, which came as a relief after a very weak H2 2018. Importantly, the figure for Germany, the Eurozone's economic powerhouse, was also 0.4% after two quarters of quasi-recession. Strong spending by German consumers showed that the spill-

overs of manufacturing weakness to the overall economy had remained, so far, limited. However, Eurozone data for Q2 was mixed: Manufacturing indicators have stabilised, but some of them continue to show a contraction in activity. Indicators for services continue to show an expansion, although at a moderate pace. The labour market remains generally strong, although some minor cracks are visible in Germany. In terms of risks, the Eurozone economy remains exposed to trade tensions. While there was a reprieve concerning the threat of higher US tariffs on European autos, as D. Trump postponed his decision to mid-August, European corporations can nonetheless be hit by US-China tensions through global value chains. Brexit also came back to the spotlight, after the April lull, as T. May's resignation seemed to increase again the probability of a UK exit from the EU without a deal. Finally, regarding the domestic political agenda, the European elections' result were a relief as anti-system parties, while achieving some gains, did not obtain more votes than announced by the polls. Nonetheless, the confrontation could flare up again between the anti-system ruling coalition in Italy (as the Lega Nord may feel bolstered by its gains at the European election) and European authorities over the 2020 Italian budget. In Germany, following the poor showing of the two ruling coalition party at the European election, the risks that it could break up has also slightly increased.

- **United Kingdom:** Political visibility in the UK is very limited after PM Theresa May announced she would resign as leader of the Conservative party (and therefore, subsequently, as PM). The Conservative party will elect a new leader over the Summer with a significant probability that she or he, as PM, could have a tougher approach on Brexit, increasing the risk of a no-deal exit from the EU. However, as Parliament remains strongly opposed to a no-deal, and may have the ability to prevent it, many Brexit scenarios remain possible, all the more so that a political gridlock leading to new elections cannot be ruled out.

- **China:** The surprising turnaround in US/China negotiations and tariff increases on $200bn Chinese goods are adding new downward pressures to China's economy. Uncertainty increased in near term following US announcement to restrict Huawei's purchases from US suppliers. That said, we think the window for US/China to reach a deal is still open, as concrete works have been done with several major issues left to be decided by President Trump and President XI, while both sides are set to feel more pains. The current tariff increase still looks manageable for China, as policymakers are better prepared than last year, and policy supports since H2 last year are taking effects.

- **Inflation:** Core inflation remains low 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. In theory, an "inflationary surprise" remains possible with the pick-up in wages (in the US and the Eurozone) but it is striking to see that inflation slowed in the US in Q1 19 just as real GDP growth accelerated! In the Eurozone, in a low inflation environment, we consider that corporates have almost no pricing power (i.e., corporate margins more at risk than final sale prices). At the end of the day, with low inflation and subdued growth, most central banks have turned more dovish since the start of the year.

- **Oil prices:** Oil prices have unexpectedly dropped over the past weeks due to the trade war escalation (with the Brent falling close to US$ 60 pb). Economic stabilisation remains supportive but geopolitical tensions can change dramatically the overall picture eroding demand projections in the next 12 months. OPEC and supply disruption concerns in Venezuela, Libya, Iran and recently in all middle East are here to stay. At the end of the day, oil prices will probably continue to move within a wide range, with some volatility. On the one hand, supply-side pressures will continue to push prices up while, on the other hand, fears about the evolution of aggregate demand should keep them under pressure. All in all, we are sticking to our range target of $60-70 (Brent).

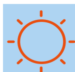
- **Most central banks on the dovish side:** The Fed is in a "wait and see" mode; we expect neither rate hike nor rate cut in 2019 except in the latest case if downside risks materialise, if financial conditions tighten, or if inflation surprises on the downside. Risks have clearly become asymmetric. For the ECB, we expect a status quo (regarding interest rates) in 2019 and 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); the technicalities are expected to be very accommodative: The ECB may ease further if growth slows further, with a new QE. 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 (25% probability): a marked trade-war-driven economic slowdown, a geopolitical crisis or a sudden repricing of risk premiums

- Rising trade tensions with no compromise between the US and China
- Risk of further protectionist measures from the US, followed by retaliation from the rest of the world.
- Repeated uncertainty shocks (global trade, Brexit, Italy) may 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, some inflation. That said, a global trade war would quickly become disinflationary by creating a shock to global demand. Counter cyclical fiscal and monetary policies would be rapidly put in place (but with a lag).
- An abrupt repricing of risk on fixed income markets and a decline in market liquidity.
- Recession fears in the US.
- 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. 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 pronounced soft patch. 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.

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Macroeconomic picture by area

United States

Normalisation progresses

- As the fiscal boost fades, key drivers of domestic demand are slowing progressively and getting closer to long-term trends, as monetary policy and financial conditions smooth and accompany this normalisation.
- Still-dynamic labour demand and wage growth, coupled with contained inflationary pressures, support resiliency in personal consumption, expected to be the main driver of domestic demand. Q1 personal consumption was weaker than expected but may be temporary (government shutdown, Q4 market correction).
- Business confidence has moderated appreciably compared to last year and this translates into a moderation in capex intentions and investments.
- Moderate domestic and external inflationary pressures are keeping both core and headline CPI in check, composing a benign inflation outlook until expectations remain stable. The Federal Reserve is expected to remain on hold this year, ending QT, and remaining alert to any changes in financial conditions, economic outlook and inflation dynamics

Risk factors

- **Tariffs risks may negatively impact economic performance, both directly (in prices and orders) and indirectly (in confidence). The longer the list of good included in tariffs, the higher the impact on U.S. domestic demand**
- **Renewed policy uncertainty may hold back new capex plans more than expected**
- **Geopolitical risks (Iran, Venezuela) could represent an upside risk to oil prices and our inflation outlook**

Eurozone

A gradual improvement expected despite significant risks.

- After a highly disappointing year in 2018, growth rebounded in Q1. However, despite robust domestic demand and a solid job market, industrial indicators remain very poor. We forecast a gradual improvement during the rest of 2019 but with lots of risks.
- The euro zone is still heavily exposed to international trade tensions, although the direct threat of US customs tariffs on European vehicles is less imminent. After a lull in April, the risk of a no-deal Brexit has also risen.

Risk factors

- **Rise in protest political movements**
- **External risks, including the trade war and a slowdown in the US and China**

United Kingdom

Lots of uncertainty in the run-up to Brexit

- Growth rebounded in Q1, but thanks in part to Brexit-related precautionary spending. The UK obtained an extension in the deadline from the EU until 31 October, but Prime Minister Theresa May was unable to reach an agreement with Labour to ratify the EU Withdrawal Agreement. The political situation is still highly volatile, with uncertainty regarding who will take over from May and a greater risk of a hard Brexit.
- Despite political uncertainties, the job market is still strong, and wages have risen in real terms, driven by the receding in inflation.

Risk factors

- **A non-deal Brexit**
- **The current account deficit is still very high**

Japan

Remains precarious

- Q1 GDP soared by 2.1% qq. However, this was due only to weak imports and inventory accumulation, both of which derive from ephemeral private demand. Both consumer spending and business investment retreated from Q4/18 levels.
- Industrial production remains lacklustre, with inventories climbing to their highest level in six years. Stalwart exports to the U.S. have not fully offset weak shipments to Asia.
- Investment in structure is buoyant on the back of urban development and office refurbishment. In contrast, spending on machines remains weak, as a green shoot in the Chinese economy has yet to stimulate manufacturers.
- Steady wage increases underscore consumption, whereas galloping prices of daily necessities are discouraging households. The transition to a new era under the new emperor should partly encourage consumers.

Risk factors

- **Capital spending plan for this year is subject to reduction**
- **Companies may stop, downsize or postpone business investment on anaemic corporate earnings and the escalating US-China trade dispute**

China

- The surprising turnaround in US/China negotiations and tariff increases on $200bn Chinese goods are adding new downward pressures to China's economy.
- Uncertainty increased in near term following the US announcement to restrict Huawei's purchases from US suppliers, but the window is still open for a trade deal ahead. Keep a close eye on the next steps by US and China in the run-up to the G20 in Japan in late June.
- Exports are expected to be hit again, but perhaps less so than in Q4, with less distortion.
- Policymakers look better prepared than last year, with all measures on the table ready to use if and when necessary.
- Meanwhile, there are signs that policy supports since Q3 are starting to pass through into real economy and are becoming more visible.
- RMB should be able to avoid large depreciation barring any further major escalations, helped by policy supports and capital control.

Risk factors

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

Asia (ex JP & CH)

- Q1 2019 growth figures have been broadly disappointing in the region, with few exceptions (China and Taiwan). Overall, the negative momentum has been confirmed by hard data, with very weak export figures and softening domestic demand, too.
- The region's inflation figures have remained very benign. Oil and food prices reverted their contribution from negative to positive, pushing inflation levels up mildly. CB targets are not at risk for the time being.
- Finally, we saw two central banks in the region (Philippines and Malaysia) cut their policy rates by 25bps on weaker economic conditions and low inflation. More easing is in the pipeline.
- Three important election outcomes have been officialised, in Thailand, Indonesia and India. In all three cases, the status quo prevailed with the victory of the incumbent president/ coalition. Modi's victory in India was much stronger than expected.

Risk factors

- **Q1 2019 GDP generally weaker than expected**
- **Inflation still very benign. Oil and food prices are driving inflation up**
- **Central banks in the region start to move on the easing side**
- **Election outcomes in Thailand, Indonesia and India confirm the status-quo**

Latam

- Overall, Q1 GDP in the region has shown a broad based weakness in several countries (Mexico, Chile and Colombia to name few). Domestic demand has been impacted by specific temporary factors.
- On the inflation front, the overall environment remains benign. However, in the region's main economies inflation went up: in Mexico to 4.4% YoY (above Banxico's target) and in Argentina to the worrisome level of 55.1% YoY.
- The region's main central banks left their monetary policy rates unchanged. The Argentina central bank has made its no-intervention zone to defend the peso more flexible.
- The approval ratings of the presidents of the two main countries (Brazil and Mexico) are on very different paths. Bolsonaro's is sliding fast while AMLO's is holding high. Recently, AMLO announced a halt in tax breaks for many companies. These kinds of decisions will add little to revenues but they'll work in term of popularity.

Risk factors

- **Overall poor Q1 GDP figures released so far**
- **Inflation is benign overall, but higher than wanted in Mexico and Argentina**
- **BCRA makes the no-intervention zone more flexible**
- **Brazilian President Bolsonaro's popularity is sliding**

EMEA (Europe Middle East & Africa)

Russia: Real GDP growth was 2,2% in 2018 and should be slightly lower in 2019. However, 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 has kept its key rates on hold, but we expect a rate cut in Q4.

South Africa: exit from recession, but no miracle

- High-frequency indicators are still very weak, and recent currency pressures due to a weak external environment for emerging countries and a cabinet reshuffle are only making things more complicated. With a null Q1 GDP figure, we have revised our forecast for 2019 from 1.4% yoy down to 0.8% yoy.
- Despite a weak economic and subdued inflation environment and a dovish Fed, we expect the SARB to remain cautious and to keep a neutral stance at least for the first half of the year.

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

- Turkey's GDP decreased by 2.7% yoy in Q1-19, slightly less than in the previous quarter (-3% yoy). While private consumption slowed down less than in Q4-18, investment fell again by 13% yoy. As expected, the Government's expenditure increased sharply (+ 7.2% yoy).
- The CBRT is still under pressure, with CPI inflation set to remain high and pressures on the currency to continue in an unfavourable political environment.

Risk factors

- **Drop in oil prices, stepped-up US sanctions and further geopolitical tensions**
- **Increased risk aversion, risk of sovereign rating downgrading, rising social demands in the run-up to elections and risk of fiscal slippage**
- **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
(4 June 2019)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	**2.9**	**2.4**	**2.0**	**2.4**	**2.0**	**2.4**
Japan	**0.8**	**0.9**	**0.7**	**1.0**	**0.9**	**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**	**2.4**	**2.2**	**2.2**
Brazil	1.1	1.3	2.1	3.7	4.3	4.7
Russia	2.2	1.5	1.7	2.9	4.8	4.0
India	7.4	6.2	6.6	4.0	3.4	4.6
Indonesia	5.2	5.0	5.3	3.2	3.5	4.2
China	6.6	6.2	6.1	2.1	2.2	2.5
Turkey	2.9	-1.5	1.5	16.2	15.6	12.9
Developed countries	**2.2**	**1.7**	**1.7**	**2.0**	**1.6**	**2.0**
Emerging countries	**4.9**	**4.4**	**4.7**	**4.0**	**3.9**	**3.9**
World	**3.8**	**3.3**	**3.5**	**3.2**	**3.0**	**3.1**

Source: Amundi Research

Key interest rate outlook

	24/05/2019	Amundi + 6m.	Consensus Q4 2019	Amundi + 12m.	Consensus Q2 2020
US	2.50	2.50	2.50	2.50	2.50
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

	24/05/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.16	2.20/2.40	2.05	2.20/2.40	1.99
Germany	-0.63	-0.60/-0.40	-0.67	-0.60/-0.40	-0.66
Japan	-0.15	-0.20/0.00	-0.17	-0.20/0.00	-0.18
UK	0.66	0.60/0.80	0.61	0.70/0.90	0.62

10Y. Bond yield

	24/05/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.32	2.40/2.60	2.35	2.40/2.60	2.39
Germany	-0.12	0.05/0.20	-0.02	0.05/0.20	0.05
Japan	-0.07	0.00/0.10	-0.03	0.00/0.10	0.01
UK	0.97	1.10/1.30	1.05	1.15/1.35	1.10

Currency outlook

	23/05/2019	Amundi + 6m.	Consensus Q3 2019	Amundi + 12m.	Consensus Q1 2020
EUR/USD	1.12	1.13	1.14	1.17	1.17
USD/JPY	110	109	110	107	108
EUR/GBP	0.88	0.87	0.86	0.86	0.85
EUR/CHF	1.12	1.14	1.13	1.15	1.15
EUR/NOK	9.80	9.40	9.54	9.30	9.43
EUR/SEK	10.75	10.40	10.50	10.20	10.35
USD/CAD	1.35	1.32	1.32	1.30	1.31
AUD/USD	0.69	0.70	0.72	0.69	0.74
NZD/USD	0.65	0.66	0.67	0.66	0.68
USD/CNY	6.91	6.70	6.72	6.70	6.70

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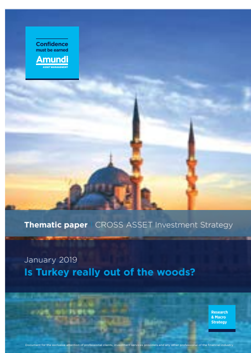

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