Confidence must be earned

Amundi
ASSET MANAGEMENT

CROSS ASSET

INVESTMENT STRATEGY

CIO VIEWS

LIMBO FOR MARKETS WILL NOT LAST FOREVER

THIS MONTH'S TOPIC

A BREXIT DEAL: PROBABLY, BUT NOT JUST YET

Research & Macro Strategy

CIO VIEWS

Limbo for markets will not last forever

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

Bad but not so bad news left the market in a limbo: equity markets were more or less flat in the month, treasury yields remained in the 1.5 / 1.8 range and credit spreads also remained within the trading range of the last few months. However, markets oscillated between weak US and Eurozone numbers, prospects of a US-China 'mini-deal' and tariffs on Europe. Geopolitics and Trump's impeachment was in limelight as Turkey started a military offensive in Syria. China witnessed subdued data, only partially offset by policy measures.

Global growth remains decent, but weaker than expected and **more vulnerable**. The dovish stance of central banks and more details on 'mini-deal', may save the day for risk assets allowing them to trade in a range. While this (resilient but vulnerable growth) remains our central scenario through the year end, there are other two possibilities for next year. First, an escalation in trade war causes a full-blown **contagion** from manufacturing into services, thereby affecting consumption. If this happens, we would be in for a **very defensive** stance. Secondly, **growth moderately reaccelerates** driven by fiscal and monetary policy and improvement in trade situation, a trigger for some repositioning in risk assets.

However, the limbo for the markets will not last forever. In our view, **four key themes will likely set the direction of opportunities and risks for investors.** (1) **More uncertain communication** from CBs as internal **disagreements grow** and **divergent views** within the Fed and the ECB affect markets. These contrasting views and lack of consensus will be the new source of volatility. Moreover, this comes just when market expectations on Central Banks actions are very high, too high in our view. (2) **Dispersion in growth** due to **less globalisation** and **rising idiosyncratic risks** (Brexit). (3) **Resilience of internal demand**. Countries with strong internal demand, relatively isolated from trade war and with higher visibility on fiscal policies would be better able to withstand the slowdown. In the US, we need to watch whether a manufacturing slowdown spills over to the consumer and services sector which could aggravate slowdown risks. At the moment, this risk is low: consumption is backed by growing disposable income and we do not anticipate big job cuts. (4) **Uncertain earnings path**: There is low visibility on earnings outlook in the short term: expectations have already come down for the next quarters, but the risk for further disappointment is not negligible. A profit recession can occur without an economic recession, and this is still not priced in by the market.

In light of these themes, we outline our **four convictions** below:

- **Cautious stance in risky assets** to continue amid increasing growth vulnerabilities and limited earnings visibility for the near future. Equities generally bottom out with ISM manufacturing indices, which are not likely to stabilize before next year. Earnings growth is already pointing south and there is no particular sign of euphoria but it is also not the time to be excessively negative in equities.
- **Biggest opportunities in equities will come from sector rotation, not from directional moves**. As most of the market directionality is likely behind us, being right in sector rotation will be important. Growth outperformance vs. value remains extreme. Value in Europe is at multi-year low. For value to outperform, some pick-up or stabilization in yield is needed: we are not there yet but looking for triggers (fiscal expenditure could be one) and good quality companies in the value space could be an opportunity to play moving into 2020. Companies that have sustainable balance sheets, adequate cash flows and strong business models can deliver strong risk-adjusted returns.
- We will witness more **dispersions among regions**, due to less globalisation that will renew focus on selection of themes/sectors and securities both in the developed and the EM world.
- As the overall picture is not rosy, it is important to **monitor the evolution** of the key risks in the market and **hedge** against a possible worsening of the scenario and prepare to be more defensive, should trade talks deteriorate and manufacturing recession spreads to services and affects consumption.

Overall risk sentiment

Risk off — = — Risk on

Keep a cautious stance in risk assets amid lack of visibility on future earnings growth.

Changes vs previous month

- Play equity rotation with a preference for quality value especially in Europe
- More positive in Euro High Yield

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

MACRO

Bottom of cycle not yet reached; stabilisation in sight

DIDIER BOROWSKI, Head of Macroeconomic Research
MONICA DEFEND, Global Head of Research

Most surveys have continued to deteriorate over the recent period, indicating that the bottom of the cycle has not yet been reached. There are also early signs of weakening on the side of services. But overall, the global **economy is resisting the manufacturing recession**. While investment in capital goods is affected by uncertainty in many countries, household consumption continues to benefit from job creation (although it has started to slow).

Not surprisingly, **global trade remains at half-mast**. The restart will be slow. It will take much more than a front agreement between China and the US to bring down the level of uncertainty which weighs on business investment. The ratio of world trade to world GDP is thus expected to continue to decline by the end of 2020.

Growth will slow further in advanced economies in 2020, particularly in the US. And China will also continue to slow down. However, the growth gap between emerging and advanced economies is expected to widen in favour of the former. Against this backdrop, we believe that the **world economy should stabilise by the first half of 2020** at the latest. Nevertheless, downside risks continue to dominate: on the one hand, there is **political risk**. On the other hand, there is **market risk**: a sudden repricing of risk premiums would tighten financial conditions and thus weaken the most indebted agents (starting with corporations).

The **uncertainty is there to last**. It should be noted, however, that the epicentre of political risk is gradually shifting from Europe to the US: the Italian government has finally opted for a measured fiscal programme; and the probability of a hard Brexit has fallen with the agreement reached on 17 October. In contrast, in the US, political noise related to the impeachment procedure, coupled with polls in favour of Senator Elisabeth Warren for the Democratic nomination is beginning to attract investors' attention.

> “While manufacturing data continue to deteriorate, strength of household consumption and emerging market growth could support the global economy.”

In this context, and in the absence of inflation, **central banks will remain pre-emptive**. On the ECB side, the publication of minutes and the positions of several heads of the core Eurozone central banks show that the **dissent has never been so pronounced** since the creation of the ECB, which reduces the probability of further easing. The priority for Christine Lagarde (who will take office at the beginning of November) will be to bring the various central banks together again. On the **Fed side**, the **monetary strategy will be opportunistic**. The dissensus is also very pronounced. In recent weeks, markets have sharply revised their expectations downwards, both on the Fed side (-60 bps expected by the end of 2020 vs. -125 bps a few weeks ago) and on the ECB side (-10 bps expected by the end of 2020 vs. -40 bps a few weeks ago). Market expectations are now more in line with our central scenario.

In the future, **central bankers will increase pressure on governments** to take over from monetary policy with a more accommodative fiscal policy. Many emerging countries have already relaxed their fiscal policies. The advanced economies should gradually follow suit. In the Eurozone, we can count on Christine Lagarde to remind governments of their duty.

The Strategist's view

Financials and geopolitical risks call for a strong USD

The fall of US ISM manufacturing below 50 for the August and September reading has failed to materially affect the USD. Historically, sharp falls in the ISM manufacturing index have been associated with USD strength, not weakness. This is because of the influence that the US economy wields over the global economy and the USD's status as a safe haven currency.

A weak US economic backdrop negatively affects global growth, causing economic pessimism across the world which eventually leads to a 'risk-off' environment. This risk-off environment, coupled with a lack of real alternatives for investors, is proving to be the main driver of USD strength. For instance in Europe, a deteriorating economic activity, negative carry vs USD, depressed inflation expectations suggest a weak EUR going forward.

Elsewhere, the high level of ambiguity over the US-China trade talks would exert pressure on the CNY, thus strengthening the USTW$. This is also the case for already depressed global trade-dependent currencies such as the SEK and AUD.

USTW$ = Trade-weighted US dollar, a measure of the value of the US dollar relative to other world currencies. CNY=Chinese Yuan. SEK= Swedish Krona. AUD= Australian Dollar.

MULTI-ASSET

Flexibility is essential amid an uncertain year end

MATTEO GERMANO, Head of Multi-Asset

The bottom of the cycle has not yet been reached and further slowdown can be expected both in Europe and the US. The former would be more impacted as it is a more open economy and accordingly countries such as Germany are under pressure from trade tensions. This trade weakness, coupled with weak domestic consumption, could see risks spreading from **manufacturing to the consumption side**.

However, we don't read this as the beginning of a recession. Instead, we believe **two closely linked themes** would likely play out in the near future – **uncertainty on interest rate movements and ambiguity on market directionality**, amid an ongoing deterioration in the macro-economic environment. In addition, from a (geo) political perspective, the situation is mixed with a new government in Italy, signs of an end to the Brexit saga and the US President Trump's impeachment that could still potentially impact market sentiment.

Therefore, now is not the time to increase risk. Instead, we prefer to remain cautious, maintaining a flexible approach, as a rebound cannot be ruled out.

High conviction ideas

Against this uncertain background, we outline three areas of conviction across asset classes.

1. **Low visibility on future earnings suggests** a cautious stance on equities. The relative value between equities and bond is shrinking, but it is too early to adopt a fully defensive stance. Instead, we think investors should be flexible and adopt option strategies to tactically adjust exposure and benefit from a potential market rebound. This is because stabilising PMIs could support equities, particularly in the cyclical sectors such as energy and consumer discretionary, both in the EU and the US, but directional bets are probably still too risky. **Sector rotation** could also present opportunities, as could **domestic** themes in EMs, in particular in China.
2. **The hunt for yield will continue as the amount of negative yielding bonds is at historical highs**. Expectations that Italian government will maintain fiscal discipline provide a positive backdrop for Italy 30y BTPs vs Germany 30y. On corporate bonds, we prefer EUR vs US and are now more constructive, tactically, on **EUR HY** (primarily for carry) on account of a benign default outlook, limited supply and dovish ECB. On EM bonds, the overall financial conditions (in EMs) which include attractive carry, dovish global central banks and subdued inflation in the developed world, are all supportive of the search for spread exposure in this space. In **currencies**, we believe investors should continue to seek carry opportunities in the EM FX space, where some positive developments on the US-China trade front led us to adjust our selection.
3. **Markets are counting on central banks policy actions which are supportive**. Here we remain positive on duration, but have adjusted some of our views on UK 10y real rates and Schatz, which will continue to be supported by the ultra-dovish ECB. We remain constructive on **US duration** in view of an accommodative Fed, and hence prefer US 10y and US 5y vs Germany 5y.

"Amid a structural deterioration, we believe it is better to stay cautious, but be ready to tactically adjust the risk stance. We are constructive on EUR credit."

Risks and hedging

Global recession, trade war uncertainty, failure of central banks to act and a downturn in Eurozone are all risks that could impact multi-asset portfolios. As a result, we recommend investors to put in place structural hedges such as JPY and gold to safeguard against an extreme downturn.

USD = US Dollar, JPY = Japanese yen, PMI = Purchasing Managers' Index, Schatz = Short-term German bunds, ECB = European Central Bank. BTP = Italian government bonds. EM FX = Emerging Markets Foreign Exchange.

Amundi Cross Asset Convictions

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

The table 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

Credit appetite is high, exploit carry and be selective

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

While the global economy is witnessing a slowdown, we don't expect a recession. In the US, consumption and services which are a large part of the US economy, should provide support. However, uncertainty over the ongoing trade war and manufacturing weakness lead us to expect a dovish stance from central banks. Therefore this is a time to be **cautious but not too conservative**. We believe investors should stay in credit to exploit carry and be selective because the appetite is high and this could lead to areas of market complacency. In this environment, should be **selective, well diversified and focused on liquidity**.

DM bonds

From a **global fixed income** perspective, we remain neutral on **duration** but with a preference for duration in the **US** compared to the Eurozone and Japan. We continue to favour the **UK curve steepening strategy**, extending the long end of the UK yield curve and we expect a flattening on the Euro curve, while in the US we continue to play curve opportunities. **In Europe**, a dovish ECB supports our favourable view on EUR IG credit, but we are negative on utilities and adjusted our outlook for the financial sector. We remain watchful of some idiosyncratic risks in high yield (HY). For sovereign bonds, we are constructive on peripheral European countries and slightly more positive on Italian BTPs now, given the improving political stability.

From a US investor perspective, the 10y Treasuries appear expensive as investors' continued to search for safety amid uncertainty on trade front and lower ISM data. However, given the strength of the services sector, the consumer and small businesses, the Fed is likely to evaluate data before additional monetary easing. Hence, in our view the US duration exposure should be limited. On US credit, we maintain a modest risk stance and focus on sectors that offer exposure to the domestic US consumer and allow us to enhance diversification in areas with attractive relative valuations. Accordingly, we remain positive on asset-backed securities (ABS), commercial mortgage-backed securities (CMBS) and residential mortgage-backed securities (RMBS). Agency MBS securities are also attractive. We also continue to expect a steeper treasury curve and

> **“We expect the economic slowdown to continue, but no recession. This underpins a positive stance on credit in Europe, and on sectors exposed to the consumer side in the US.”**

we have a slightly positive stance on Treasury Inflation-Protected Securities (TIPS) given a higher likelihood of upside inflation surprise (from wage growth and tariff related).

EM bonds

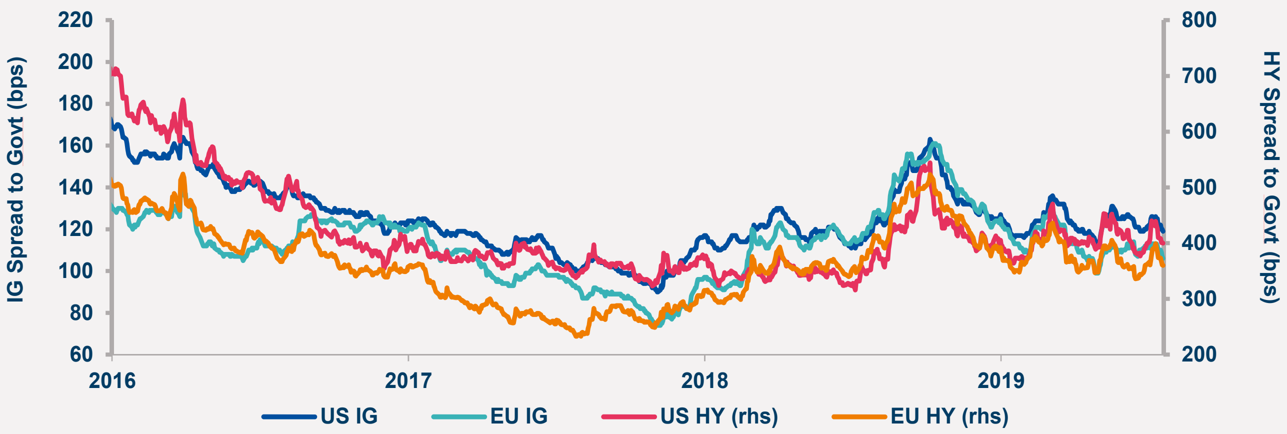
Although we think the asset class can be a net beneficiary of the tug of war between weaker growth and looser monetary policy, we prefer to maintain an overall **cautious stance** for the time being. Looking at fundamentals, Latin American countries are relatively more attractive at the moment but we are carefully looking at the commodity outlook, which could weigh on this area. We turned more constructive on Brazil (local currency and corporate), while we have reduced our positive stance on Indonesia and Russia.

FX

Given the liquidity and attractive yield offered by the **USD** and the protection offered by the **JPY**, we are positive on both these currencies. We also prefer a relative value trade **NOK vs SEK**, in light of the Norges Bank's hawkish views. The rate disadvantage and the ECB easing measures are a burden on the Euro. We are neutral on the GBP. **EM FX** should remain weak in this environment given that they are most exposed to global growth.

NOK = Norwegian krone. SEK = Swedish krona. JPY = Japanese yen. GBP = British Pound.

Credit spreads



Source: Bloomberg, Amundi as of 16 October 2019

EQUITY

Market dislocations in "value" may offer opportunity

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

Overall assessment

All in all, strong directional bets in equity markets may be too risky in the current environment (economic slowdown, uncertain global trade), however, active investors should keep an eye for opportunities presented by appealing areas of the market. **Valuations of value vs growth are extremely attractive** and this is leading some initial signal of a reversal in the multi-year trend of outperformance of growth vs value. We are actively watching such pockets, but we are extremely **selective** as we note that companies that do not meet expectations in the current uncertain environment, get overly punished by the market. Going forward, we believe investors should look more and more at the equity market with an income perspective. In a world of ultra-low/negative bond yields, the dividend from equity is extremely attractive.

DM equities

In Europe, there is an all-time high **dislocation between value and growth** and this dislocation provides investment opportunity. Value stocks trade at an all-time low levels relative to growth, and we think the former provides an attractive hunting ground for stock picking. In particular, the areas that have relatively higher quality and are less exposed to disruption are interesting. Such opportunities exist selectively within sectors such as building materials, industrials, consumer discretionary and financials.

However, we are **cautious** on the very **high valuation of certain pockets of the growth universe**. The current reporting season shows that there is little room for error when the high valuation names within growth disappoint, therefore caution **is needed.** At the portfolio level, we continue to seek **balance.** For this we prefer **health care and telecoms in the more defensive compartments over consumer staples** as the first two sectors offer a better margin of safety. We also look for emerging opportunities in the UK domestic sector which is trading at depressed levels.

> "Sector rotation has opened up attractive opportunities in quality value, with a preference for cyclicals."

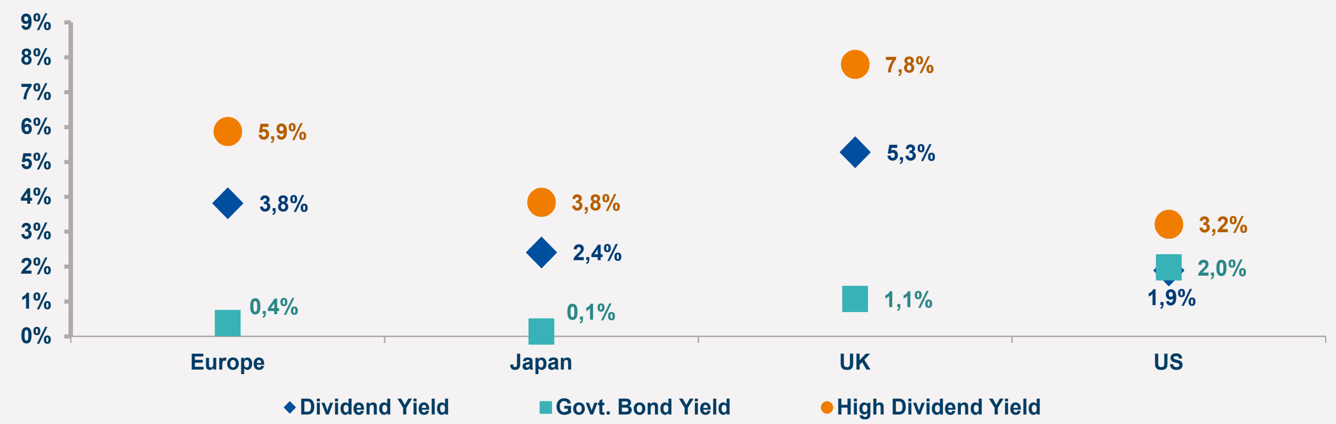
In the **US**, equity valuations remain attractive relative to fixed income, but the global slowdown and government policy uncertainty suggest a more **prudent** approach. While earnings growth in the upcoming season is expected to be weak, a crucial indicator would be the guidance for the next quarter and 2020. We are more constructive on **value over growth**. Despite challenging macro data and headlines (i.e., trade, impeachment, Warren presidency), cyclicals/value are compelling on relative valuation and sentiment suggests risk is to the upside right now. Therefore, this is not a time to be overly defensive. From a bottom-up perspective, we believe **high-quality cyclicals** could provide opportunities in case of an upside.

EM equities

In the **EM space valuations are supportive** and the market could benefit in case of a mini-deal on the trade front. We remain broadly positive on domestic consumption countries for the next few months (such as Brazil, Indonesia, Russia and India) and turned moderately constructive on China even though we expect some volatility in the near future.

At a sector level, we favour information technology (especially in Korea and Taiwan) and the energy sector where valuations and free cash flow yield are very attractive.

Bond yields vs equity dividends



Source: Bloomberg, Amundi as of 21 October 2019

Amundi asset class views

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	**US**	=		Earnings growth is expected to be weak and all eyes would be on forecasts for 2020. However, despite challenging macro-economic data and headlines (trade deal, Warren presidency, Trump impeachment) concerns there are certain pockets (cyclicals/value) of compelling valuation
	Europe	=/+		Deteriorating economic fundamentals are negatively affecting earnings expectations. The Brexit deal reduces the geo(political) risk in Europe. Corporate fundamentals remain solid, valuation are fair and heightened volatility and market dislocations could provide opportunities. Dovish ECB should be supportive.
	Japan	-/=		We maintain our cautious view on Japanese equities. Valuations are attractive and companies are becoming more shareholder-friendly. However, corporate earnings would be affected by the global slowdown, and appreciation in JPY is also a major headwind.
	Emerging markets	-/=		EM valuations look attractive on a relative basis. A mini-deal between the US and China, strong domestic demand and favourable monetary (rate cuts in India, Brazil) and fiscal policy should be supportive. However, idiosyncratic risks (Brazil, Turkey), trade-war escalation and Fed policy stance relative to market expectations are the key risks.
FIXED INCOME PLATFORM	**US govies**	=/+		While on a standalone basis US govies are not cheap, they remain attractive among core bond markets. Barring deterioration in the US growth and labor outlooks and further escalation in the US-China trade war, the Fed is likely to pause and evaluate data releases
	US IG Corporate	=/+		We maintain a relatively modest risk stance and believe investors should seek opportunities across multiple sectors and focus on quality. In this regard, securitised credit is attractively valued, provides strong credit protection, exposure to US consumer and avoids global growth risks
	US HY Corporate	=		We maintain a neutral stance as US HY spreads are lower than the long term average, but still exceed the cost of default. Given the economic growth risks, focus on selection and liquidity management is important.
	European govies	-/=		ECB delivered an easing package (QE, Tiering, Rate Cut), economic data worsened, inflation subdued and the 10y bund is near its lowest level at -0.55% with the entire part of the curve remaining negative. We remain positive on the main peripheral European countries (Spain and Italy) fuelled by ECB expectation and a new political coalition in Italy willing to find agreement with the European commission on the 2020 budget
	Euro IG Corporate	++		We are positive on Euro IG, particularly on the subordinated debt financials in Europe. Improving technicals, the appetite for yield and QE by the ECB will continue to drive the market. However, a focus on liquidity is important in this phase of the cycle
	Euro HY Corporate	+		We are aware of the idiosyncratic and liquidity risks and remain selective. However, a dovish ECB supports the overall environment for the Euro HY space and we prefer it due to the carry opportunities.

Amundi asset class views

	Asset Class	View	1M change	Rationale
FIXED INCOME P.	**EM Bonds HC**	+		Deteriorating economic conditions have affected sentiment, however, valuations are attractive and fundamentals are also solid. A low interest rate environment should be positive for EM HC bonds but we focus on fundamentals. We are also monitoring central banks policy decisions which would be key for this asset class
FIXED INCOME P.	**EM Bonds LC**	=		We prefer rates and remain cautious on currencies. Uncertainties around the global economic outlook are skewed on the downside and this could pressurize EM currencies. EM central banks (CBs) accelerated their monetary policy easing and further easing is also likely. However, we adopt a flexible approach to address potential liquidity issues.
OTHER	**Commodities**			Trade wars, weakening growth and USD appreciation amid GEM currency weakness remain the most relevant concerns. Demand/supply dynamics will also continue to affect prices as weakening demand offsets geopolitical risk premium and supply disruption worries. However, financial conditions should remain reasonably supportive due to accommodative CBs. Easing financial conditions and FED balance-sheet expansion will underpin gold in 2019 while USD weakness should support valuations. We keep 12M target at 1550 $/ounce. Base metals will be affected by China demand and global economic slowdown but the overall picture remains supportive.
OTHER	**Currencies**			EUR/USD is primarily driven by global growth and our macro scenario foresees a continuation in the current moderate slowdown in developed countries. Therefore, the currency is expected to remain close to current levels. Our 12M target is 1.13. However, in case global demand and trade environment improve the currency could move higher. The JPY remains supported by the current slowdown in global growth. Our USD/JPY target for 12M is 104. GBP/USD would remain under pressure amid prolonged uncertainty over the Brexit deal, our 12M target being 1.25

LEGEND

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Negative | Neutral | Positive | Downgrade vs previous month | Upgraded vs previous month

Source: Amundi, as of 22 October 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

A Brexit deal: probably, but not just yet

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Finalised on 30/10/2019

The essential

Risks of a no-deal Brexit have receded materially over the past few weeks, implying that the Bank of England is now more likely to keep its monetary policy on hold, in a wait-and-see mode over the next year. UK nominal yields have already removed most of the no-deal risk, having repriced up by almost 30bps from their October lows, and are seen moving more in line with the global trend in nominal rates going forward.

There were major developments in the Brexit saga in the last two weeks of October. The United Kingdom and the European Union reached a new Withdrawal Agreement on 17 October but while the UK parliament accepted the agreement in principle, it refused to ratify it under a fast-track procedure. This obliged the British prime minister to request, and obtain, a new extension of the Brexit deadline until 31 January 2020. The UK parliament thereafter gave the go-ahead for an early general election on 12 December, while the government announced there would be no new attempt to seek approval of the Withdrawal Agreement before then.

The main consequence of these events is that the risk of no-deal Brexit, which was still high a few weeks ago, has declined sharply. While the outcome of UK general elections is always difficult to predict due to the country's electoral system, most scenarios do not suggest the United Kingdom will crash out of the EU.

Victory for the Conservative Party (currently clearly ahead in opinion polls) would probably be followed by the ratification of the withdrawal agreement. This is a fundamental change, because before a Brexit agreement acceptable to both the EU and the pro-Brexit wing of the Conservative Party was reached, the scenario of a Conservative election victory was generally seen as increasing the risk of no-deal Brexit.

Conversely, if the opposition parties win, the United Kingdom could be heading for a second referendum. At present, the outcome of a new referendum remains extremely uncertain, all the more so because we do not know exactly what question would be asked (one of the choices would probably be to remain in the EU, but there are several possibilities regarding the other choice or choices). Nonetheless, a referendum would create a possible path to the UK remaining in the EU.

The few remaining paths leading to no-deal Brexit seem highly unlikely. It would require a combination of events such as, for example, an election that fails to produce a majority government, the rejection by voters of alternatives to a Hard Brexit in a referendum, or a toughening of the position of Conservatives seeking to renegotiate the Withdrawal Agreement, poisoning relations with the European Union. But even if these situations do arise, all possible alternatives would have to be ruled out before a Hard Brexit actually happens.

Having said that, the ratification of the Withdrawal Agreement, which now seems the most likely scenario, will be far from settling Brexit once and for all. Under the Agreement, as of the official departure date, the United Kingdom will enter a transition phase under which it will retain most of its access to the Single European Market (though without participating in decision-making bodies). The country will have to negotiate a lasting framework for its relations with the EU during this transition period (due to last until the end of 2020, with the possibility of an extension to the end of 2021 or 2022). This will not be an easy task given that free-trade agreement negotiations generally last several years.

Further surges in Brexit-related stress cannot therefore be ruled out even in the event of an orderly Brexit. For example, the hardest pro-Brexit conservatives could attempt to prevent an extension to the transition period so they can be free to sign trade agreements with third countries (in principle, the UK and the EU must agree on such an extension before 1 July 2020). Therefore, in theory the United Kingdom could lose its access to the Single Market at the end of 2020, without having had time to negotiate a free-trade agreement with the EU (note that in any case, the pro-Brexit Conservatives could try to use this threat to speed up negotiations with the EU). The fact that such a scenario seems fairly unlikely (Europe has shown many times that it can find solutions and extend deadlines when necessary), does not necessarily rule out that it could be temporarily perceived as a credible risk.

However, overall, we consider that Brexit should cause fewer tensions in 2020 than in 2019. This is a positive development, primarily for the UK economy, which we expect to grow by 1.1% in 2020, though we believe that if the country indeed opts in the end for a permanent trade regime that severes its access to the Single European Market, itspotential growth will be negatively affected. The decline in the no-deal ris is also positive – albeit to a lesser extent – for the euro zone economy, where the negative effects of Brexit on industrial confidence and foreign trade (in particular in Germany) have been visible in 2019.

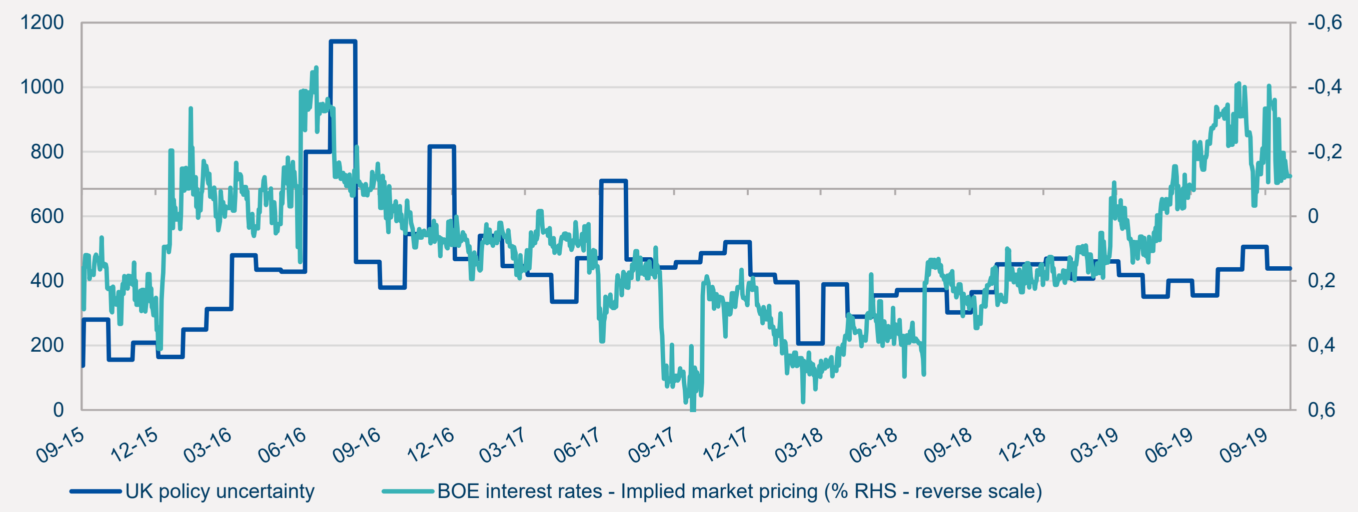
Perspective on the Bank of England

Since the Brexit referendum on 23 June 2016, the Bank of England (BoE) has travelled a difficult path. The central bank has been calibrating its monetary policy, while seeking to strike a balance between inflation's being pushed high by the prolonged depreciation of the pound, and the weakening in economic activity, resulting from the uncertainty due to the UK's negotiation with the EU on the features of the withdrawal agreement.

Monetary policy resulted in a 25bps cut to interest rates in the aftermath of the referendum (August 2016), in order to sustain the economy, given the expectation of a strong weakening path ahead, followed by two rate increases (of 25bps each) in November 2017 and August 2018. The two rate hikes were predicated upon inflation's being consistently above target and an economy that has proved more resilient than projected in the central bank's forecasts. Despite the constant and very elevated level of political noise, the BoE's forward guidance has always been centred around its willingness to tighten monetary policy to a limited and gradual extent in the event of a smooth Brexit. However, with the global slowdown started to unfold in the second half of 2018, becoming since then a serious market concern, major central banks have tilted their stance to more dovish, and the BoE has conditioned its forward guidance not only on an orderly exit from the EU but also to seeing some recovery in global growth.

Currently, amid yet some uncertainty, the probability of a hard Brexit has receded materially (from 40% at its peak, to currently around 5%, as priced by the bookmaker Betfair) since the UK and the EU produced a shared draft of the withdrawal agreement at the European Council meeting during the week of 17 October. A deal is now looking like the most probable outcome, given the clear willingness of the Conservative party to promote its approval by the UK Parliament.

1/ UK policy uncertainty and BOE implied interest rates change



Source: Bloomberg, Baker, Bloom and Davis, Amundi Research. Data as of 28/10/2019

In our view therefore, the three-month extension period to Article 50 will be conducive to a deal but will not offer the BoE significant space to normalize interest rates. The likeliest attitude, in our reading, would be for the central bank to keep rates on hold, unless the global picture deteriorates further, creating the conditions for a cut, rather than a hike. There are two major factors supporting an "on hold" stance. One is one more domestic, represented by the Brexit cliff uncertainty at the end of the transition period, as trade deals usually take years to be discussed and ratified. The other is more global and has to do with the profound changes that took place in monetary policies over the last quarters, now clearly tilted towards a synchronized easing stance.

Bank of England Chatterbox - Recent Policy Comments and Decisions

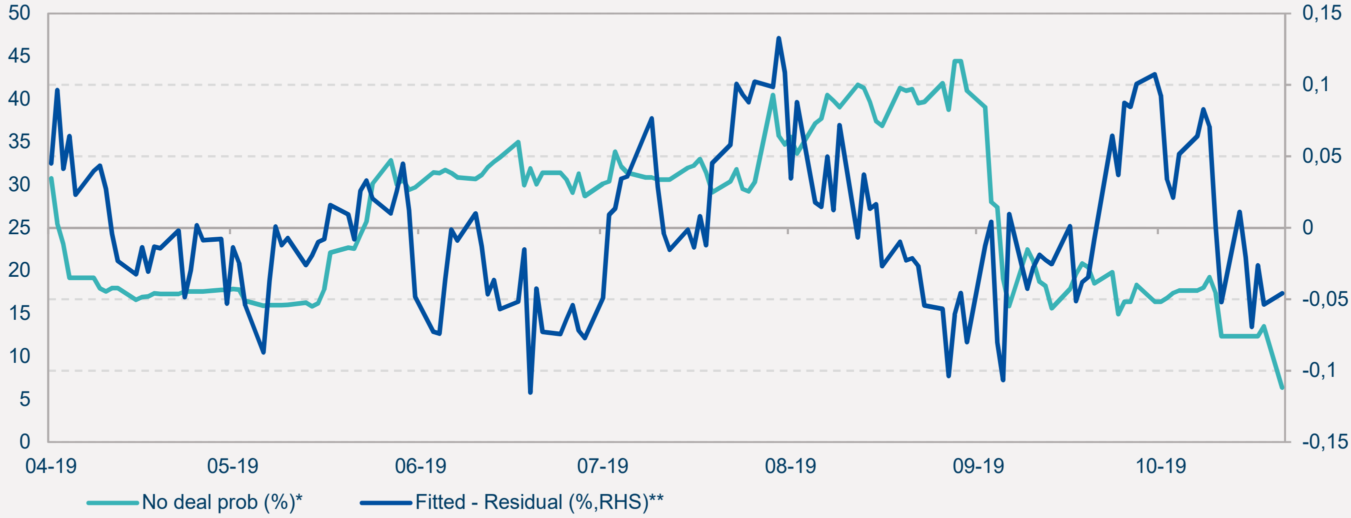
Date	Speaker	Key Quote(s)	Venue
18 October	**Mark Carney Governor**	"If this is adopted (i.e., Brexit deal) it would remove much of that uncertainty, we would expect a rebound in some of that investment."	Interview with Bloomberg TV
16 October	**Mark Carney Governor**	"We don't see negative interest rates as being part of the toolkit at the Bank of England."	Speech at Harvard
15 October	**Gertjan Vlieghe, MPC member**	"A near-term Brexit deal that reduces uncertainty and gives businesses adequate time to prepare for any future changes in the UK-EU trading relationship might yet stimulate investment sufficiently to prevent the need for easier monetary policy, and put gradual and limited rate hikes back on the agenda, eventually. A scenario of entrenched Brexit uncertainty is likely to keep economic growth below potential, and require some monetary stimulus. Finally, a "no deal" Brexit is more likely to require monetary stimulus than tightening, but given that supply, demand and the exchange rate are likely to experience significant declines, the direction for interest rates is not automatic."	Speech in London
14 October	**Jon Cunliffe, Deputy Governor**	"Low for long makes demand management of the economy more difficult in downturns, reducing the space for monetary policy easing with conventional tools."	Speech in London
13 October	**David Ramsden, Deputy Governor**	"I see less of a case for a more accommodative monetary position."	Interview with the *Daily Telegraph*
27 September	**Michael Saunders, MPC member**	"If the U.K. avoids a no-deal Brexit, monetary policy also could go either way and I think it is quite plausible that the next move in bank rate would be down rather than up."	Speech in Barnsley

UK rates

On the back of the recent encouraging developments in Brexit negotiations, and to some extent also driven by a broader global trend in bond markets, UK nominal rates moved rapidly higher over the second and third week of October. Relative to early October lows, 10-yr paper moved higher, going from the 40bps area to the 65/75 bps range at the time of writing. No doubt, the fall of the no-deal Brexit scenario to very low or even marginal levels of probability played quite a role in this move. The markets' implied probabilities of an easier stance by BoE rapidly changed as well, as they moved closer to a more neutral attitude, while more than one 25bp cut was discounted at the peak of uncertainty in the aftermath of the latest developments.

In light of global monetary policy prospects and because of political uncertainties persisting in the short-term, we expect the UK 10Y yield to have limited space to move further up. According to the result of regressions run on Gilts using US Treasuries, markets' expectations on BoE monetary policy and the probability of "no deal", the UK 10Y looks fairly priced. Space for some overshooting to the upside is there, mainly on the back of technical factors, in case of a deal sooner than expected but this move may prove to be temporary in our view. In a nutshell, we tend to assess current market yield levels as already discounting most of the recent evolution in Brexit scenarios and forecast therefore: UK 2Y @ 0.30/0.50 and UK 10Y @ 0.60/0.80 in 12 months.

2/ UK 10Y fitted vs No deal probability



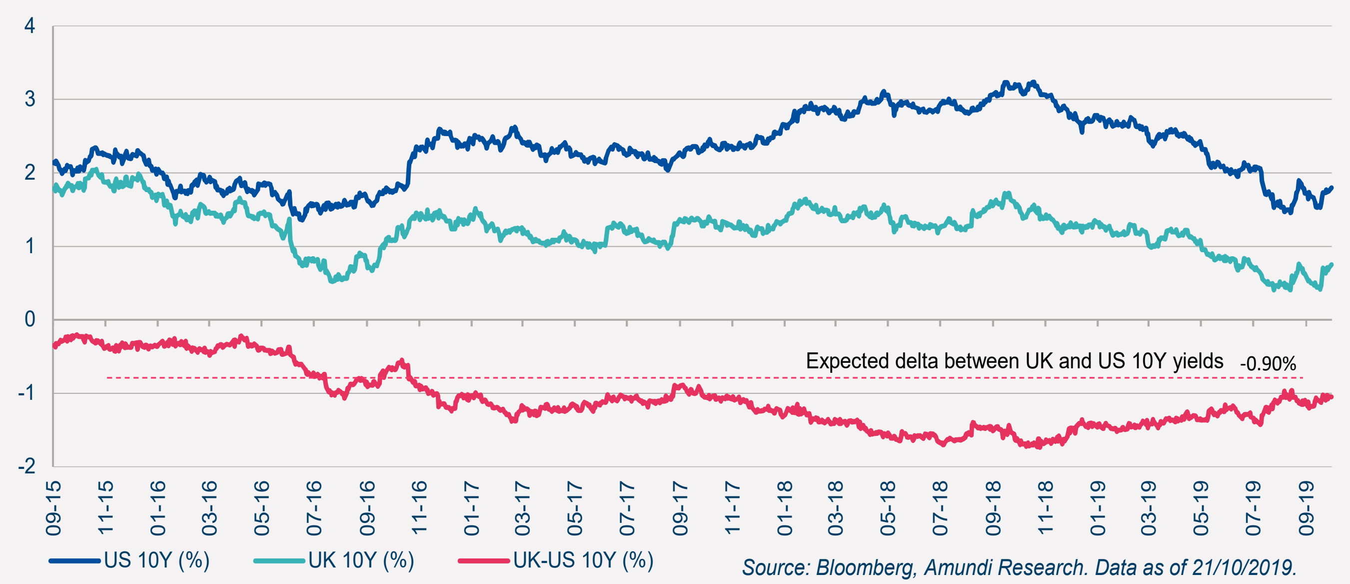
* According to Betfair

Source: Bloomberg, Amundi Research - Data as of 21/10/2019

** UK 10Y function of US 10Y, BOE 1Y implied interest rate, Probability of no deal Brexit by 31st of October 2019

In the current state of the art, the probability of a no-deal Brexit is very low but cannot be ruled out completely. Were this tail event to materialize, we would see the BoE embarking on rate cuts, which could ultimately bring interest rates down to 0% (from the current 0.75%). Nominal rates would rally, as a result of investors' seeking safe haven assets, although the extent of the fall in the UK 10Y yield would be conditional to the size of the fiscal package, delivery of which could be expected in order to limit the damage to the economy. In a no-deal scenario, we would forecast: UK 2Y @ 0/0.20 and UK 10Y @ 0.10/0.30 in 12 months.

3/ UK vs US 10Y



Source: Bloomberg, Amundi Research. Data as of 21/10/2019.

Risk factors

Macroeconomic Research Team

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

Finalised on 30/10/2019

Risk # 1 | 20% probability | Major European slowdown

Analysis | There are significant risks that Germany slipped into a technical recession in the third quarter. The French economy, in contrast, turned in a positive surprise in the third quarter, with +0.3% growth, the same pace as in the two previous quarters, despite the downturn in manufacturing surveys. The main risk at this point is that the manufacturing recession will worsen and spread to services. Many factors could aggravate the situation, particularly a new escalation in Sino-US tensions (European manufacturing is heavily exposed through its global value chains), additional US duties on the European auto sector (a decision could be made in November), and Brexit. That said, there have been many signs of easing in all these areas. Although there is still some uncertainty, the new Italian government is more moderate and looks more stable than previously, and the risk of a no-deal Brexit has almost vanished. The roll-out of fiscal measures (at the national, or even EU, level) could help stabilise domestic demand vs. external uncertainties, but there seems to be little appetite for a coordinated effort. Against this backdrop, a significant upturn in growth in 2020 is unlikely, and risks are weighted to the downside. Moreover, in most euro zone economies the job market is still a key factor in support of household consumption. Services, which are more sensitive to domestic demand than to global trade, should continue to hold up well.

Market impact | A major slowdown would be clearly be bad news for European assets and the euro. But in this case, the policy mix would become even more accommodative, in both monetary and fiscal terms, and that would help stabilise growth expectations. Any negative market impact (from a more serious than expected slowdown) is therefore likely to be of short duration, as investors would hurry to price in the policy mix's positive impact on the economy.

Risk # 2 | 20% probability | US recession

Analysis | The US economy is gradually slowing: growth peaked in Q2 2018 and since then the US economy has been gradually decelerating towards potential. Incoming data support the view that domestic demand is gradually slowing due to weakening investments and a labour market shifting into lower gear. Looking forward, we expect muted growth in investments and diminishing US consumer spending (as total labour income is decelerating somewhat and confidence in the future is worsening). Although a mini-deal is on the cards by the end of November, uncertainty on the trade front and persistent geopolitical issues represent key risks to our outlook, which still remains tilted to the downside. According to the most recent updates, both the macro and financial data we monitor are showing signs of an increased probability of recession, with the probability increasing over the 12-18 month horizon, at non-negligible levels, though still far from previous spikes (currently in the 20% region).

Market impact | The markets are likely to become more circumspect with regard to 2020 growth expectations as deceleration could become more pronounced and as signals point to slower domestic demand. In this context, the Federal Reserve will keep attempting to facilitate a macroeconomic soft landing by countering the forces that could drag down US growth and we expect protracted dovishness, with the possible return to balance sheet expansion, in order to keep rates in the target range by keeping a higher level of liquidity in the system.

Risk # 3 | 15% probability | US & China: negotiations resume

Analysis | A truce has recently been announced based on more purchases by China of US agricultural products and no increase in tariffs by the US. Details are still not completely out and as far as we know, the most complex issues (intellectual property rights, technology transfers, tariffs already in place, and the Huawei case) are still on the table. Talks have resumed and once the Phase One Deal is signed, a phase two should start. The two sides have approached the recent talks with a more constructive tone. Having said that, the risk remains sizeable because we have to bear in mind that hostility towards China goes far beyond the Republicans. Regardless of who is elected US President next year, opposition between the two countries on strategic issues could worsen their relations in the coming years. It is therefore important not to misunderstand the context. Protectionist rhetoric will not disappear from the radar screens. The likelihood of a comprehensive agreement is very low.

Market impact | Along with the tit-for-tat approach, the most relevant impact on the markets following recent events has been the CNY depreciation above the psychological threshold of 7 against the USD. The trade-weighted dollar is now historically high, and EM currencies had a short period of instability in the aftermath of the CNY depreciation. That instability is likely to grow in the event that the CNY depreciates much further.

Risk # 4 | 15% probability | Major geopolitical crisis in the Middle-East

Analysis | Although there are always geopolitical risks in the Middle East, tension between the United States and Iran have escalated in recent months after Donald Trump 1/ cancelled exemptions that allowed some countries to import Iranian oil, and 2/ introduced new sanctions against Iran. Recent security incidents (attack against a major Saudi oil facility) and aggressive statements from both sides have only worsened matters. However, the US President is unlikely to want to embark on an armed conflict with Iran, the outcome of which would be extremely uncertain, at the start of an election year in the USA. Although the situation remains volatile and despite the large number of complex issues in the Middle East, the White House's latest decisions (withdrawal of US forces from the border between Syria and Turkey) do not point towards an increase in US military presence in the region.

Market impact | Oil prices are the main thing to watch, while open confrontation between the United States and Iran could be detrimental to the most risky asset classes and could trigger a rise in safe-haven investments in the dollar. However, at this stage we are not expecting a major upsurge in oil prices given the high level of US shale gas production and statements by Saudi Arabia and the UAE to say they would make up any reduction in Iranian exports.

Risk # 5 | 10% probability | Political instability in Italy with renewed stress on BTP

Analysis | The new government has delivered the first and most urgent of its tasks, the Draft Budgetary Plan, which it submitted to the EU Commission on time, and in which it seeks to obtain the highest level of flexibility possible while complying with EU rules. The political situation remains complex as the majority has been undermined by local election results in favour of the opposition parties, while internal disputes are showing its fragility. Despite the sharp reduction in near-term risks relating to a potential debt crisis or a long-lasting political confrontation with the European authorities, structural issues, which are a medium-term concern (public debt burden and limited fiscal space), remain unresolved. Political instability remains a key risk as local elections will be held in key regions in the next few months and could represent a further challenge to the current government coalition.

Market impact | Italian financial markets welcomed the avoidance of further uncertainties that would have been inevitable in the case of a snap election. As a result, BTP vs. Bund spreads tightened strongly, falling back to mid-May 2018 levels. Moreover, the flattening of the Italian curve confirmed that easing political uncertainties make longer Italian bonds more attractive, one of the few remaining oases in the European yield desert. While a small premium for political risks is likely to remain priced in given the latent fragility of the coalition, there is still room for yields to decline, especially at the longer end of the curve.

Risk # 6 | 10% probability | Major political crisis in Europe

Analysis | The European Parliament is more fragmented, although European elections offered a small "pro-institution" surprise (instead of the wave of Euroscepticism that had been forecast), and European institutions and governments were entangled in a phase of negotiations that was more protracted than usual for appointments to key EU posts (European Commission, Council, Parliament and ECB), which could point to future complexity in the negotiations for increased integration. This is unlikely to trigger a major crisis on the European level, but there is no guarantee that voter support for "anti-system' parties has peaked, and, in the near term, the presence of these parties in national parliaments is making it harder to establish government majorities. Policy-making is therefore becoming less predictable, particularly in major countries where that had previously not been the case, such as Germany and Spain. This is manageable during prosperous times but could become more challenging in the event of an economic downturn.

Market impact | With the economy still on a firm footing, we doubt that a systemic crisis is possible in Europe. Traditional political forces who are able to govern (such as in Italy) have shown that they want to challenge European political institutions but don't want to leave the euro zone. However, the difficulty that foreign investors have in understanding European institutions will not vanish overnight, which means that European assets will continue to price in a specific political risk premium.

Risk # 7 | 10% probability | Major slowdown in the "emerging world"

Analysis | The recent trade war escalation has caused growth to slow once again in the EM universe and elsewhere. However, the growing dovishness on the part of the main central banks (namely the Federal Reserve and the ECB) is making the global financial environment easier for the emerging markets. A more pronounced USD depreciation is the missing factor. The rosier financial picture will only worsen if there is any abrupt readjustment in the very dovish market expectations if the Fed/ECB should pursue a more cautious monetary policy. Having said that, the amount of dovishness announced and realistically put through should prevent idiosyncratic risks from becoming systemic, as happened in Argentina in August. On the real economy side, spillover from the external demand shock to domestic demand (mainly via capex) has been considerable in Asia, more so than in other regions. In order to see the expected stabilisation in growth and not a major slowdown, an orderly solution to the trade dispute (Phase one signed at least) is needed sooner rather than later.

Market impact | In the risk case, spreads and equity markets would once again be significantly impacted. This is particularly true as the emerging currencies would once again be under pressure due to capital outflows. However, emerging markets are far from being a homogeneous block, and the markets would worsen more in the countries that are the weakest and most vulnerable due to their poor external positions or fragile fiscal and political conditions.

Risk # 8 | 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 it remains on a manageable slowdown path. Recent data indicate that the trade war is biting and a supportive policy mix is required. The country's economic model is fragile: signs of excessive credit are visible, and non-financial corporate debt has surged since the GFC. The good news is that the NFC debt-to-GDP ratio had been declining since late 2017 (although it has mildly increased lately). We will continue to monitor the trend in Chinese private debt closely, especially if the economy slows. If a harder landing looks likely, the Chinese authorities still have enough ammunition to offset the shocks, including more depreciation, an expansion of credit in the property market, and more expansionary fiscal and monetary policy.

Market impact | A hard landing triggered by a bursting of the credit bubble would have a very negative impact, and its cascading effects would be particularly disastrous, including 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, and so on.

Risk # **9** | **5%** probability | **No-deal Brexit**

Analysis | The UK government and the EU reached a new Brexit agreement on 17 October. The UK parliament approved the principle of the agreement but refused to ratify it in a fast-track procedure. This refusal obliged the British prime minister to request an extension to the Brexit deadline to 31 January 2020, a request accepted by the EU. It now seems clear that the Brexit agreement will not be ratified before early UK elections, expected to be held on 12 December. Whatever the outcome of the election (the Conservative Party is currently clearly ahead in opinion polls), the risk of no-deal Brexit is low. Victory for the Conservatives will probably be followed by ratification of the agreement of 17 October, even though a Conservative win was still seen as increasing risks just a few weeks ago. A win by the opposition parties could lead to a second referendum and comes with the possibility that the UK will remain in the EU (though the outcome of such a referendum remains highly uncertain). A no-deal Brexit would now require a combination of problematic events (for example, failure to form a majority government after the general election, a new compulsion to renegotiate the agreement with the EU, or a rejection by voters of the choices put to them in a referendum) and the failure to find any other solution to avoid a hard exit.

Market impact | The risk of no-deal has fallen sharply, justifying a contraction in the risk premium on UK assets and a rise in Sterling. However, it is important to remember that the Brexit process is far from being over. Even if the agreement of 17 October is ratified, the UK will still have to negotiate a permanent framework for its future trade relations with the EU during a transition period. The markets could be affected by the risk that the transition period may expire at the end of 2020 (if the UK does not request an extension), which would prevent the UK from accessing the Single European Market before a full free-trade agreement can be finalised.

MACROECONOMIC CONTEXT

Our convictions and our scenarios

Macroeconomic Research Team

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

CENTRAL SCENARIO (60% probability): resilient domestic demand and services despite the uncertainty adversely affecting trade

- **Slower global growth:** the economic weakness seen worldwide during the summer has continued into the fall with very few exceptions. Industrial surveys and data continue to show that the global manufacturing sector is in recession. However, domestic demand remains more resilient, due primarily to household consumption, which continues to be buoyed by very low inflation and in certain economies by a vibrant labour market. Still, services have proved more resilient than manufacturing.
- **Global trade expected to bottom out in H1 2020:** global trade has plummeted over the last 18 months, due to protectionist rhetoric. Assuming that: (1) the trade truce between China and the US is signed by mid-November and (2) the next round of tariffs planned by mid-December is delayed and remains part of an ongoing negotiation, we believe the damage to world trade dynamics at this point is done. We expect global trade to recover slowly in 2020. That said, global trade is expected to remain under pressure in the short run and to grow at a slower pace than global GDP next year. Note that the impact on economies differs from one region to another. European exports are being hit strongly by generally weak intra-EU demand and declining ex-EU demand for intermediate and capital goods (Italy and Germany). The US is advancing persistently on the path of import substitution (imports of industrial supplies and materials have decreased from 27% in 2007 to 18% out of total imports in 2019). EMs are trying to transform the challenges posed by trade tensions into opportunities. In the two winners of the trade war, Mexico and Vietnam, early trends are emerging. Vietnam is benefitting from small business relocation out of China, and Mexico is benefitting from import diversion by the US (ex-auto, exports to US are increasing in electrical and electronic equipment). In addition, we must not underestimate the resilience of domestic demand at the global level. While global trade has indeed made a strong contribution to global growth over the last few decades, this is less and less so, as global growth is now being driven primarily by domestic demand. And services are less and less correlated to industry, which can be attributed to the relative importance of consumption in relation to investments and trade since the 2008 crisis.
- **United States:** a gradual return to potential, with slightly higher downside risks. The US economy, boosted by very accommodative fiscal policy in 2018, began decelerating in H2 2018 and continued to do so in the following quarters. After peaking at 3.2% YoY in Q2 2018, GDP growth gradually slowed to 2.0% YoY in Q3 2019. Fixed investments have been trending down markedly since the second half of 2019, while personal consumption expenditures have remained resilient overall. Protracted weakness in global trade and manufacturing, coupled with uncertainty over the implementation of tariffs, may have played a role in discouraging investments, partially offsetting the benefits of fiscal policy. Corporate and consumer confidence indeed worsened and only recently stabilised somewhat, raising concerns of a sharper slowdown in domestic demand. At this stage, while the probabilities of recession have risen, we don't think a recession is likely in the near term. And yet, signals are starting to appear that the labour market is decelerating, with a slower pace of growth in payrolls and new hiring intentions supporting the view that domestic demand will keep decelerating into 2020. Even so, risks remain tilted to the downside: if trade and geopolitical tensions persist, doubts on the extension of the current cycle could intensify over the next few quarters (with less support from fiscal policy, and domestic demand under pressure with contagion from manufacturing to services). Moreover, it is important to bear in mind that below-normal growth and tighter financial conditions could trigger a contraction in profits. With this in mind, the Federal Reserve should stick to its dovish stance, signalling reasonable pragmatism and cautiousness in using its "policy ammunition", yet keeping on check financial conditions (mainly driven by the USD's trade weighted strength).

- **Eurozone:** the Eurozone economy remains under heavy pressure as trade uncertainties and manufacturing weaknesses keep undermining growth expectations. Despite the resilience of domestic demand, which is helping to keep the economy growing, signals of potential spillovers from manufacturing to services may be materializing. Spillover risks are more evident in Germany and Italy, as services are more dependent on manufacturing, and companies' significant reliance on foreign trade further increases the underlying exposure. Moreover, Germany likely slipped into technical recession in the third quarter of 2019. Risks are clearly tilted to the downside as uncertainties are not expected to fade in the coming months as further trade war escalations may become reality, and Brexit, despite the recent developments, remains overall unresolved. Uncertainty is playing a key role in shaping investments within the Eurozone. Accordingly, companies have started to rein in investments, leading to a weaker demand for intermediate and capital goods. Despite the gloomier economic outlook, the labour market is improving, as the unemployment rate continues to stabilize gradually at historical lows in several member-countries, holding up consumer consumption and confidence. Growth in smaller economies remains supported, despite the risk of potential contagion in the event that a sharp and prolonged deterioration in the core economies becomes more evident. The reiterated need for fiscal stimulus, along with already extensive monetary easing to trigger a rebound in the Eurozone economy seem to be a paper-tiger for the moment, as countries struggle to design a common and coordinated intervention plan. Countries with fiscal room announced that fiscal intervention might be pursued in the event of a sharper economic deterioration.
- **United Kingdom:** October was an eventful month with 1/ a new Brexit agreement with the EU, 2/ the UK parliament's refusal to apply a fast-track procedure to ratify the agreement, 3/ a further extension to the withdrawal date to 31 January 2020, and 4/ the announcement of an early general election on 12 December. While the Brexit agreement will now not be ratified until the very end of 2019 or the beginning of 2020, the risk of no-deal Brexit has considerably diminished since there is now a solution acceptable to both the UK Conservative Party (well ahead in opinion polls) and the EU, which was not the case before. Victory by the opposition parties would probably be followed by a second referendum, with the possibility that the UK will remain in the EU (although at this stage it is unclear what alternatives would be put to voters). So there is unlikely to be a major trade crisis in the months to come, and this should benefit the UK economy. However, we cannot rule out a renewed rise in uncertainty when the matter of extending the transition period that will follow Brexit arises (the transition could expire at the end of 2020, which allows a very short amount of time to finalise a free-trade agreement).
- **China:** September's string of data (released in October) confirmed the weak economic conditions, but the economy hasn't decelerated any further since the summer months. At this point, we confirm our view of a GDP decelerating at the range floor of 6% YoY in H2 2019 (Q3 GDP released at 6% as expected) and below 6% YoY in 2020 (at 5.8% YoY). Chinese authorities have signalled their determination to keep growth above 6% in 2019. Again, the latest data haven't shown a uniformly gloomy picture. Housing, retail sales (included auto) and infrastructure investments have been resilient or moderately growing. The authorities have very mildly ramped up their stimulus to accommodate the deceleration mentioned above. More stimulus has to come in the form of monetary policy easing (RRR), and the PBoC has recently kept the LPR on hold. Credit growth has bottomed out, while local government generic and special bonds didn't contribute to the Total Social Financing increase because the annual quota allowed by the Government has almost been met. China has agreed to buy more agricultural products by the US in the new truce announced.
- **Inflation:** core inflation is still very low in advanced economies, despite continued improvements in labour markets (unemployment rates are low in relation to historical averages in both the United States and the euro zone). There are many reasons why inflation is low. First, there is a problem with the quality of most job creations (low-paid and/or part time jobs), and those employed in these jobs are not in a position of strength to obtain wage increases. Second, structural changes in goods and services markets (new technologies in trade, in particular) can have a disinflationary impact. In addition, after years of very low inflation, inflation expectations are low, which can be a self-fulfilling prophecy. Lastly, in the euro zone, recent reforms (to the labour market and goods and services markets) have created a more competitive environment. Despite these hindrances, and while the growth cycle has not come to an end, we still believe that inflation should rise, driven by wage rises. However, the increase will be very gradual and the ECB's target ("below, but close to, 2%") seems out of reach for the time being.
- **Oil prices:** despite the volatility recently caused by geopolitical events (September's attack against Saudi oil facilities), fears of a global slowdown and the increase in US production are still putting downward pressure on prices. Having said that, efforts at coordination by OPEC+ members (production

cut agreements in July) should limit supply. As a result, on balance we are upholding our scenario of almost no change in prices, with a target of $60-$70/barrel for Brent and $55-$65/barrel for WTI.

- **Central banks: back to a "wait and see" attitude in AEs.** As expected, the Fed lowered the fed funds rate to 1.5-1.75% for the third consecutive time at the October FOMC. This decision was taken in response to continued uncertainty about the trade war and the global manufacturing recession, in a context where inflation remains low. President Powell basically said that the current monetary policy stance was now appropriate given the moderate growth outlook, which means that the Fed's decisions will depend on the data. We expect the Fed to cut its key rates further by 25bp over the next 12 months, slightly less than currently priced-in by markets. The bottom of the cycle has not yet been reached, which will probably keep the Fed under pressure next year. A pause is widely expected in December given recent positive trade news (an agreement between the US and China seems to be about to be concluded). In addition, we expect the Fed to continue to manage its balance sheet very actively. For the ECB, the situation is quite different. There have been strong disagreements on the restart of the QE and Christine Lagarde will have to rebuild a broad consensus. We expect little additional accommodations unless some downside risks materialise. We however continue to expect a final rate cut (-10 bp to -0.6%) by mid-2020 due to (1) subpar growth, (2) inflation that is consistently below the ECB's target and (3) downside risks.

DOWNSIDE RISK SCENARIO (30%): full-blown contagion to domestic demand

Two "families" of risks with different conclusions on monetary policies and scenarios

1. Trade-related risks: global trade takes longer to "normalise", additional escalation on trade war, and full-blown contagion into consumption:

- **Growth falls further, profit recession** / the global recession comes back to the forefront
- **Central banks:** even more accommodative monetary policies than what are currently priced in by markets
- **Fiscal policies:** would gradually take over from monetary policy to support growth

2. Market-related risks: sudden repricing of risk premia with a large impact on financial conditions, exacerbated by low liquidity (various triggers: wars (e.g., Middle East), crisis in HK, credit event (HY) etc.)

- **The policy mix** (fiscal & monetary) would become much more proactive (i.e. pre-emptive) in that case, while it would likely come somewhat later with trade tensions alone..

UPSIDE RISK SCENARIO (10%): modest reacceleration of global growth in 2020

- We have substantially revised down our growth forecasts since the start of the summer, by embedding part of the downside risk scenario into the central scenario. By definition, this means that it's now much easier to be "positively surprised". For instance, on the political level the most recent news flow is more positive (pro-European coalition in Italy, possible trade de-escalation, a hard Brexit scenario that has became highly unlikely).
- Subsequently, going forward, we may see at the same time lower (political) risks and a more expansionist policy mix worldwide, which would pave the way for a rebound in confidence and a quicker normalisation of global trade.
- A modest reacceleration of growth (slightly above potential) – vs. subpar growth in the base case – is a distinct possibility.

Macroeconomic picture by area

Macroeconomic Research Team

Finalised on 30/10/2019

United States

US growth gradually decelerates; monetary policy easing continues

- The drivers of domestic demand keep slowing, so far with investment spending hit worse than private consumption. Business climate surveys are showing a weak spot in manufacturing and services.
- Consumer confidence signals are mixed, but, on average, suggest that confidence is worsening. Softening growth in payrolls, weaker new-hiring intentions, wages and salary growth moderating are all pointing to a gradual deceleration in consumption. On the investment front, spending plans are shrinking. Inflation remains low (1.7% overall and 2.4% for core inflation) but remains close to the Federal Reserve's target.
- The Fed delivered a third cut in October FOMC, remaining open to act. The Fed also announced it will buy Treasury bills each month at least into Q2 2020, initially at a rate of $60bn/month, to maintain an appropriate level of reserves, produce rapidly supportive effects on money markets, and create some leeway and flexibility for the future.

Risk factors

- While a mini-deal with China is in sight, uncertainty remains high, and domestic demand and confidence is worsening. The longer the list of goods included in tariffs, the higher the impact on U.S. domestic demand
- Geopolitical risks and tariffs could pose an upside risk to oil prices and to our inflation outlook.

Eurozone

The economy is still sputtering along

- Manufacturing indicators are still sending out no signal of rebounding. Depending on the weight of manufacturing in their respective economies, the slowdown's impact on member-states has varied widely (with France and Spain holding up better than Germany and Italy).
- Manufacturing's difficulties are spilling over into services to an increasing, albeit still limited, extent.

Risk factors

- Trade war and the threat handing over the European automotive sector from US customs duties
- A no-deal Brexit

United Kingdom

No-deal Brexit risk has receded markedly

- Although the agreement reached on 17 October between the UK and the EU will probably not be ratified until after the December elections, the risk of a no-deal Brexit now looks very low. The Conservatives are leading in the polls.
- After the Q2 contraction in the economy (with a 0.2% decline in GDP), figures improved in Q3. Real wages are being supported by the combination of a solid job market and the receding of inflation.

Risk factors

- Uncertainty on the future framework of trade relations with the EU

Japan

Problem is not the VAT hike but awful weather

- Weaker foreign demand has filtered through the domestic economy. In the BoJ's Tankan survey large manufacturers' business outlook slipped to a six-year low. However, exports finally started narrowing the scope of the y/y decline in Q3/19, thanks to a stabilization in global manufacturing PMI. The Tankan survey also illustrated that the service sector is successfully dodging a spill-over of the global economic slowdown.

Risk factors

- Delay in recovery in Southeast Asian economies may hamper capital investment by export-oriented firms

Macroeconomic picture by area

Finalised on 30/10/2019

Japan

- Nevertheless, the economy will stall in Q4/19, not because the consumption tax was raised but because disastrous typhoons and subsequent floods disrupted business activity and consumer spending. Despite the tax hike, Tokyo CPI did not accelerate in October when the government set the preschool free. Heavy price discounts by retailers are underpinning consumer demand. The government is considering a sizable supplementary budget.

Risk factors

- **Stagnant global vehicle sales spoil the broad pyramidal structure of automobile industry**

China

- At the end of the latest round of negotiations, a truce was announced between China and the US, based on more agriculture product purchases by China and no tariffs rate increase by the US. The truce details are not out yet, and a joint statement is expected to be signed in the second half of November.
- Chinese macroeconomic data showed some stabilization in September in households consumption. The private manufacturing sector has been suffering, while SOE infrastructure decoupled towards higher growth.
- The policy mix continues to support the economy in a limited way, through both the monetary and fiscal levers. The PBoC left the LPR on hold in September.
- Credit growth data bottomed out in September, driven by the Core component of RMB Loans. Local Government Bonds almost met their annual quota in August and September.

Risk factors

- **A truce announced by the US and China delegations is likely to be signed in the second half of November**
- **No further deterioration in macroeconomic conditions**
- **The policy mix is still mildly supportive**

Asia (ex JP & CH)

- Economic conditions in the region remained quite weak in September but didn't worsen any further. External demand has been stabilizing at low growth levels. The outlook for exports is still poor, due to the number of tariffs in place. The latest round of negotiations between China and the US offered some hopes of an interim agreement soon.
- The region's inflation figures have remained very benign. Noteworthy September figures came from India and China, with higher-than-expected food basket components (pork prices in particular for China), at 4.0% YoY and 3.0% YoY, respectively.
- In October, the Bank of Indonesia continued its easing with a 25bps rate cut, while the Bank of Philippines lower its RRR by 400bps to 14%.
- Malaysia's 2020 budget has projected a FD at 3.2% of GDP, lower than 3.4% in 2019 but higher than envisaged in the country's fiscal consolidation plan.

Risk factors

- **Still weak macro momentum in the region. A trade deal is crucial**
- **Inflation still very benign, with a pick-up in China and India**
- **Central banks in the region still accommodative**
- **Malaysia's 2020 budget moderately less consolidating**

Latam

- Macro momentum in the region has been deteriorating slightly in Colombia and Brazil, but both countries still have marginally positive momentum. We reduced our growth projections for Mexico for 2019 to 0.3% from 0.5% and for 2020 to 1.2% from 1.3%, based on very weak domestic demand.
- On the inflation front, the overall environment remains benign. Mexican inflation has converged nicely towards the central value of the target, with its latest figure at 3% YoY, marginally down from 3.2% YoY. Argentina inflation is still above 50%, and will not converge soon.

Risk factors

- **Economic conditions continued to weaken; Mexico growth revised down**
- **Inflation is overall benign but in Argentina**

Macroeconomic picture by area

Finalised on 30/10/2019

Latam

- Banxico started its easing cycle, cutting the Policy Rates by 25bps. An inflation more comfortably within the target range will open up more monetary policy space.
- Pension reform In Brazil has finally been approved. Fiscal reform will take time. The $5.4bn tranche of disbursement by the IMF to Argentina is definitely off the table pending debt restructuring and the new IMF plan definition.

Risk factors

- **Banxico started to cut the policy rates by 25bps.**
- **Argentina is heading towards restructuring its debt.**

EMEA (Europe Middle East & Africa)

Russia: Real GDP growth is expected to slow down to 1.2% in 2019. However, growth is expected to accelerate in 2020 and over the medium term on the back of a significant infrastructure spending programme from 2019 to 2024 and a lower interest rate environment.

- Despite the threat of potential US sanctions down the road, the macroeconomic scenario remains supportive. Russia is one of the few emerging market sovereigns with "twin surpluses" in 2019, while accumulating assets in its National Wealth Fund.
- The CBR cut its policy rate again in October by 50bps to 6.5%. We expect another 50bp cut in the next twelve months, given decelerating inflation.

South Africa: exit from recession, but no miracle

- Recently released Q2 GDP showed more resilience than the market was expecting mainly thanks to post strike recovery in mining. We confirm our 2019 GDP forecast of 0.8% YoY with downside risks.
- Given weak GDP growth and inflation surprising to the downside, and despite deteriorating fiscal dynamics, we expect the SARB to adopt a more accommodative stance.

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

- The growth report for the second quarter of the year showed only a marginal improvement in the recessionary phase that Turkey is going through. We expect GDP growth of -1.8% in 2019, and a rebound in 2020 accompanied by a lax fiscal stance.
- The Central Bank of Turkey cut its policy rate significantly in October, by 250bps to 14%. We expect some more easing to come in support of very weak economic conditions

Risk factors

- **Drop in oil prices, stepped-up US sanctions and further geopolitical tensions**
- **Increased risk aversion, risk of sovereign rating downgrades, rising social demands, and the risk of fiscal slippage**
- **Excessive easing by the central bank, a loose fiscal stance, escalation of geopolitical tensions, and a slowdown in Eurozone activity**

Macro and **Market forecasts**

Macroeconomic forecasts
(4 November 2019)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	**2.9**	**2.3**	**1.7**	**2.4**	**1.8**	**2.3**
Japan	**0.8**	**1.0**	**0.5**	**1.0**	**0.6**	**0.8**
Eurozone	**1.9**	**1.1**	**1.1**	**1.8**	**1.3**	**1.3**
Germany	1.5	0.5	0.8	1.7	1.6	1.7
France	1.7	1.3	1.3	2.1	1.4	1.4
Italy	0.7	0.1	0.4	1.1	0.6	0.9
Spain	2.4	2.0	1.6	1.7	0.9	1.3
UK	**1.4**	**1.2**	**1.1**	**2.5**	**1.9**	**2.0**
Brazil	1.1	0.9	1.6	3.7	3.7	3.9
Russia	2.2	1.2	1.7	2.9	4.0	3.5
India	7.4	5.6	6.5	4.0	3.4	4.3
Indonesia	5.2	5.0	5.1	3.3	3.0	3.1
China	6.6	6.2	5.8	2.1	2.6	2.6
Turkey	3.1	-1.8	1.5	16.2	15.6	12.1
Developed countries	**2.2**	**1.7**	**1.4**	**2.0**	**1.6**	**1.8**
Emerging countries	**4.9**	**4.2**	**4.4**	**4.0**	**4.0**	**3.9**
World	**3.8**	**3.2**	**3.2**	**3.2**	**3.0**	**3.1**

Source: Amundi Research

Key interest rate outlook

	25/10/2019	Amundi + 6m.	Consensus Q2 2020	Amundi + 12m.	Consensus Q4 2020
US	2,00	1,50	1,50	1,50	1,50
Eurozone	-0,50	-0,60	-0,60	-0,60	-0,60
Japan	-0,1	-0,2	-0,1	-0,2	-0,1
UK	0,75	0,75	0,75	0,75	0,70

Long rate outlook

2Y. Bond yield

	25/10/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1,56	1.30/1.50	1,54	1.30/1.50	1,56
Germany	-0,657	-0.80/-0.60	-0,71	-0.80/-0.60	-0,73
Japan	-0,244	-0.30/-0.20	-0,27	-0.30/-0.20	-0,27
UK	0,523	0.30/0.50	0,39	0.30/0.50	0,36

10Y. Bond yield

	25/10/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1,74	1.50/1.70	1,80	1.50/1.70	1,85
Germany	-0,40	-0.50/-0.30	-0,35	-0.50/-0.30	-0,31
Japan	-0,14	-0.20/0.00	-0,10	-0.20/0.00	-0,05
UK	0,68	0.60/0.80	0,72	0.60/0.80	0,77

Currency outlook

	23/10/2019	Amundi + 6m.	Consensus Q2 2020	Amundi + 12m.	Consensus Q4 2020
EUR/USD	1.11	1.10	1.13	1.13	1.15
USD/JPY	109	105	105	104	105
EUR/GBP	0.86	0.85	0.89	0.86	0.88
EUR/CHF	1.10	1.11	1.10	1.11	1.13
EUR/NOK	10.16	9.95	9.87	10.07	9.70
EUR/SEK	10.73	10.65	10.70	10.56	10.50
USD/CAD	1.31	1.30	1.31	1.28	1.30
AUD/USD	0.69	0.69	0.68	0.70	0.70
NZD/USD	0.64	0.64	0.64	0.65	0.65
USD/CNY	7.07	7.20	7.20	7.10	7.11

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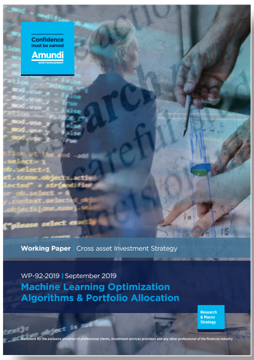

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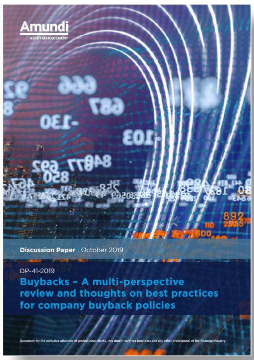

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