Amundi
ASSET MANAGEMENT

Cross asset investment strategy

Research,Strategy and Analysis

WEEKLY

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Highlights of the week

- **Eurozone:** The sovereign rating of Greece downgraded by the three rating agencies before the referendum. In the Eurozone as a whole, the unemployment rate was stable in May, inflation fell slightly in June.
- **United States:** Unemployment rate at its lowest since May 2008.
- **Markets:** A rocky week on the bond and credit markets; the dollar and the yen are climbing and biggest three weeks plunge for Shanghai index.

Key focus

Some key questions in the awaiting of the Greek referendum

At the time of writing, the outcome of the referendum is still uncertain. A few key questions need to be answered:

Can we bet on a “yes” vote or a “no” vote? Not really, as regard the latest polls. The Greek government supports the « no »vote, while creditors would prefer a « yes »vote ». The latest polls are unclear: the « no » vote seems to lead the polls, but the gap between the two options has dramatically shrunk in a few days, probably due the banks shut, a tough constraint for the Greeks: from 27 points gap three days ago, the gap would be at 9pts at present.

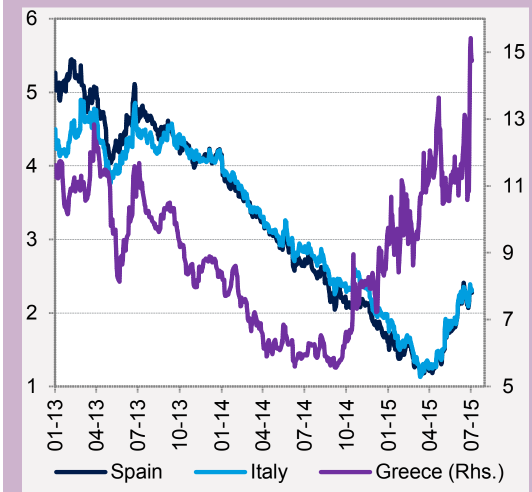
Will negotiations start again following the referendum? Do not consider a no vote as the end of negotiations. In fact, whatever the outcome of the referendum (a Yes victory or a No victory), negotiations will be revived should we refer to many Tsipras statements: the Greek government do want to reach a (good) deal and does not want to exit EU/EMU, while the creditors do not want (cannot) take the responsibility of a breakdown. Following the referendum, the major change will deal on the bargaining power. A no vote is a plus for the Greeks, a yes vote is a plus for creditors.

Is a yes vote the best-case scenario? Certainly, except if we enter into a phase of political chaos. The Greek government should step down (in line with Tsipras and Varoufakis comments), and two scenarios are probable:

- A government conducted by a large coalition party in favour of negotiations and a quick deal. To do so, around 50 Syriza members of the parliament have to join either Pasok socialists, or Potemi centrist party, or New Democracy right wing party.
- New elections within one month … but Syriza would remain a serious contender.

Is a no vote the worst-case scenario? Not necessarily. It is more complex. Of course, if creditors stop negotiating it would be the worst-case scenario. With a No vote, Tsipras obtains a plus in terms of bargaining power, and the Greek government do want a debt restructuring / cut be part of the deal, which would include reforms, and a bail-out. If creditors accept such a deal, this scenario is also a positive one for financial markets, including for the mid and long term. In the short term, a “no” vote will be badly perceived by the financial markets.

10-Year sovereign interest rates



Source: Bloomberg, Amundi Research

Will the potential deal take into account a debt renegotiation? This question is important for the mid-term perspectives. If yes, the deal will be perceived as a long term and sustainable one. If not, Greek problems (insolvency, debt burden …) will resurface soon, with the possibility to enter new phases of stress and chaos. However, in the short term, no doubt financials markets will be pleased with any deal aimed at solving the current political crisis.

How long can Greek banks stay shut? This issue is not much debated, which could turn as a mistake. Greek banks are supposed to reopen the day following the referendum, which seems to be an optimistic scenario in the absence of deal/bailout … The only way to reopen banks might be to reinforce capital controls. Will banks stay shut for long without major damages and without street protests and/or without any additional downgrade from rating agencies? We doubt on it. A deal between creditors and Greece is necessary.

Will the ECB continue to support Greek banks through the emergency liquidity assistance? Suppose they do not: in such a scenario, banks would be short liquidity and would default. So to say that the Greek economy would fall down, as Iceland did in 2008. Last week, banks have been downgraded further, one notch above selective default), but the ECB has decided to keep its support to the Greek banking system unchanged. No doubt that some members, who already voted against prior increases in the ELA ceiling for

Greek banks, firmly disagreed. However, in the absence of any additional downgrade of Greek banks, it is reasonable to consider the ECB will continue to accept them in the ELA programme, without haircuts. It should be the case … at least until July 20.

Is the ant contagion set-up solid and credible? The answer is yes. Three years ago, it did not exist at all. This time is different: the ECB supports banks through the Emergency Liquidity programme, and might increase and accelerate its QE programme if needed (it maintains bond yields at low levels and protect peripheral countries). The ECB can also activate the OMT programme, recently legalised by the European Court of Justice. Last but not least, the European Central Bank, as they recently mentioned, could decide to buy corporate bonds (as suggested by this week's decision to make more state-backed companies eligible for QE buying). Greece is not systemic, and the anti-contagion set-up is highly credible.

The week at a glance

Other events

Eurozone >

Following the breakdown of negotiations between the Greek government and official creditors, and Greece's decision to organise a referendum, the three rating agencies downgraded Greece's sovereign rating further into junk this week. Standard and Poor's downgraded Greece's rating to CCC- from CCC with a negative outlook on June 29th, 2015. Fitch downgraded Greece on June 30th, 2015 to CC from CCC with a stable outlook. Moody's downgraded Greece to Caa3 (from Caa2) and placed it on review for further downgraded, on July 1st, 2015. The agencies see an increased likelihood of a default on commercial debt and a heightened probability of Greece leaving the Eurozone. In the meantime, Greece missed its €1.5 bn payment to the IMF due on June 30th, 2015.

We believe that further restructuring of Greek debt is inevitable since the debt burden of Greece – at 180% of GDP – is unsustainable given low economic growth prospects, the lack of progress on fiscal consolidation and structural reforms. Ongoing political challenges and the breakdown of negotiations imply an extended period of uncertainty.

Economic indicators

Eurozone >

The unemployment rate was stable in May, inflation fell slightly in June. The unemployment rate was 11.1% in the Eurozone in May (unchanged vs. April). Country by country, the unemployment rate continued to decline in Spain (22.5%), was unchanged in Germany (4.7%) and Italy (12.4%) but increased in France (10.3%) and Portugal (13.2%). Consumer prices rose +0.2% year-on-year in June (after +0.3% in May). The index excluding volatile components (energy and food) rose +0.8% (+0.9% in June).

Despite the economic recovery, the improvement in the employment market is still very uneven in the Eurozone. The slight decline in inflation puts the upward surprise in the previous month into perspective. However, the risk of seeing the Eurozone move into a self-sustained deflationary momentum appears to be less imminent than at the beginning of the year.

United States>

Unemployment rate at its lowest since May 2008 but job creations for June were slightly disappointing. The US economy created 223K net jobs in June (vs. 233K expected). In particular, job creations for April and May were revised downwards by a total of -60K. The unemployment rate fell to its lowest since May 2008 (5.3%). However, this can partly be explained by a further decline in the participation rate (62.6%), to its lowest since 1977. Wages decelerated, up +2.0% YoY, after +2.3% in May.

These mixed figures do not undermine the overall improvement in the US labour market. They are unlikely to lead to any substantial modification in monetary policy expectations: the decline in the unemployment rate (for the wrong reasons), which now has reached the upper limit of the Federal Reserve's latest forecasts for Q4, points to a rise in key rates, but wage deceleration, however, militates in favour of temporisation.

Financial markets

Fixed-income

A rocky week on the bond markets. After the shock announcement of the Greek referendum last weekend, German and US long-term interest rates fell sharply (between 15 bp and 20 bp) before climbing during the week with the hope of finding a resolution to the Greek issue. After widening markedly on Monday, peripheral spreads tightened slightly during the rest of the week.

Resolving the Greek issue would bring German and US interest rates up a few basis points. In contrast, if the

Greek situation slips out of control, we expect strong inflows for US and German bonds over the short term. In this case, given the already relatively high levels of US long-term interest rates, a long position on US bonds seems appropriate.

Central & Eastern Europe rates are feeling the pain of the Greek stress contagion. Over last 5 days, the Romanian curve has steepened 25 pb in its long end, Hungarian curve about 10 bp the polish remains more stable. These countries are pretty much dependent from ECB easing. For the broad index, GBI-EM global Diversified the yield-to-maturity keeps on rising. It now stands at 6.78% and is fuelled by rising Treasuries volatility.

The very challenge in European bond space lies into the fact that the stress is partially cancelling the accommodation deriving from the QE. Engineering further accommodation is challenging. Actually, expanding the QE without a composition change in asset purchase will fuel even more volatility in the core rates. ECB has announced that IG credit will be now part of asset purchase programme.

Foreign exchange

The dollar and the yen are climbing, primarily due to their traditional role as safe-haven securities. The EUR/USD exchange rate is slightly down. The Canadian dollar lost ground against the US greenback this week after very disappointing growth figures were released on Tuesday. The Swedish krona is down against the euro following the Riksbank's unexpected interest-rate reduction.

The main deciding factor for changes in the EUR/USD exchange rate remains the difference in short-term interest rates between Germany and the United States. Resolving the Greek issue could remove one of the barriers before the Fed raises interest rates for the first time, and may benefit the dollar. If this happens, the yen would fall slightly. In contrast, the yen would be the major beneficiary if the Greek situation slips out of control.

Central & Eastern Europe currencies are pricing in mounting pressures in local rates. CEE currencies have fallen under pressures, as well Latin America and high beta currencies: Hungarian forint depreciates -1.3% against USD, Romanian Leu -1.3%, Polish zloty -1.3%, Czech Koruna -0.8%. Central Europe currencies are pricing-in rise in local rates. By opposition, in the derivatives space, things seem to be much quieter. Emerging currencies volatility index (EM-VXY) keeps trending down and it currently stands at 8.9% that is 100 bp below its DM counterpart.

More concerning is the current rise in Treasuries volatility which bears a threat for EM stability. The risk ahead lies in the investor mood turning fully “risk-off”. We view as encouraging that emerging implicit volatility remains below developed currencies volatility.

Credit

The Greek saga continues to drive investor sentiment and to keep a certain level of volatility in credit markets. However, despite uncertainties and somewhat confusing developments on the political side, spreads generally tended to stabilise or to even regain some ground after last week’s correction following the referendum announcement. Performance looks mainly beta-driven and corporate bonds are likely to take their lead from peripheral sovereign spreads, which, after returning to the previous weeks’ highs also recovered some ground in the most recent trading sessions. While the primary market saw lower volumes of new issuance (for good reason), flows into European HY bonds show that dedicated investors were not impacted too much by recent Greek developments.

The ECB’s commitment and readiness to use available tools are keeping volatility and spreads from rising further, despite uncertainties about the outcome of the Greek referendum. Furthermore, QE is probably going to have a stronger impact in the coming weeks as net issuance of government bonds will be negative or lower than in the last months. According to data regarding investment flows, dedicated investors in European HY bonds proved to be much more resilient than their American counterparts with respect to the global re-pricing of bond yields since end-April. They turned to suffer from some limited outflows only in the very last two weeks on the back of the risk-off mood triggered by the lack of a deal from the Greek negotiations. Despite uncertainties regarding Greece, our stance remains positive on EUR corporate bonds because of the combination of better macro and micro fundamentals, the commitment of the ECB to keep QE working and valuations that remain attractive.

Equity

The suspense never ends: once the two deadlines on 30 June – for the IMF and the European bailout – slipped past without an agreement, the market quickly focused on the 5 July referendum. After some hesitation over whether or not there would be a referendum, the president of the Eurogroup and the German chancellor temporarily ended the discussion by saying that negotiations will not start up again before the referendum is held. Against this backdrop, Eurozone markets (MSCI EMU) fell by a total of 3.9% on Thursday night. Given that the same index rose by 4.3% the preceding week, up to this point the decline is more of an orderly consolidation than a true correction. It's also worth noting that the drop was relatively consistent from one market to the next. With decreases of 4.5% in Portugal, 4.6% in Spain and 4.7% in Italy, pressure in the peripheral countries has remained limited up to now, especially given that these three markets rose by a respective 3.9%, 4.1% and 4.6% the previous week.

The turmoil over Greece is expected to continue weighing on markets in the Eurozone for some time because, whatever the referendum result, some uncertainty will still remain after 5 July (see Key Focus). Whatever happens, after a cumulative drop of more than 10% after their record high on 13 April, Eurozone equities are expected to regain their upward momentum and return to that record high within a year. This relative optimism is based primarily on their potential to increase their earnings, which should rise to double digits in 2015 and 2016. The main risks are deviations that turn out to be worse than expected (Greece, interest rates, China, etc.)

Biggest three weeks plunge for Shanghai index. The latter tumbled 12% over this week. Since June the 12th, the Shanghai index has fallen close to 29%. Considering the amazing pace at which this index is falling, Chinese regulator has announced investigating potential market manipulation.

The current correction seems not to spread to other emerging markets. We expect PBoC to implement further steps to stabilize the Shanghai. Time is ticking before investors get actually nervous. Current stall in Greece is diverting investors from the macro risk this correction is bearing for China.

Key upcoming events

Economic indicators

United States: the ISM non-manufacturing index is expected to be up in June. **Eurozone:** Germany, which still has a trade surplus, may have seen its industrial production and industry orders rise slightly in May. **Emerging markets:** June inflation is expected to have risen somewhat in China and Brazil, where it is still very high.

Date	Country	Upcoming macroeconomic data	Consensus	Prior
6 July	Germany	Factory orders, MoM, May	-0.4%	1.4%
	Spain	Industrial production, YoY, May		2.7%
	US	Non manufacturing ISM, June	56.4	55.7
7 July	Germany	Industrial production, MoM, May	0.1%	0.9%
	UK	Industrial production, MoM, May	-0.2%	0.4%
8 July	Brazil	CPI, YoY, June	9.0%	8.5%
9 July	China	CPI, YoY, June	1.3%	1.2%
	China	PPI, YoY, June	-4.6%	-4.6%
	Germany	Trade balance, May	€ 20.8 Bn	€ 21.8 Bn
10 July	Portugal	CPI, YoY, June		1,0%
	India	Industrial production, YoY, May		4.1%

Source: Bloomberg, Amundi Strategy

Auctions

Watchlist: demand for auctions of Greek securities with six-month maturities.

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
6 July	France	Short-term, € 7 Bn
7 July	Germany	10 years (inflation-linked bonds), € 1 Bn
	ESM	Short-term, € 1.5 Bn
8 July	Greece	Short-term, amounts not available on Friday
	Germany	2 years, € 3 Bn
10 July	Italy	Short-term, amounts not available on Friday

Source: Bloomberg, Amundi Strategy

Key events

Watchlist: the results of the Greek referendum will be a key factor in the rest of the negotiations between Greece and the Troika.

Date	Upcoming monetary policy committee meetings
9 July	Bank of England (BoE)
15 July	Bank of Japan (BoJ)
16 July	European Central Bank (ECB)
29 July	Federal Reserve (Fed)
17 September	Federal Reserve (Fed)

Date	Upcoming political events
5 July 2015	Greek referendum on the reforms called by creditors
July 2015	General election in Mexico
October 2015	General election in Argentina

Source: Amundi Strategy

Market snapshot

Equity markets	03/07/2015	Over 1 week	Over 1 month	Ytd
S&P 500	2077	-1,2%	-1,8%	0,9%
Eurostoxx 50	3449	-4,7%	-3,7%	9,6%
CAC 40	4816	-4,8%	-4,3%	12,7%
Dax 30	11086	-3,5%	-2,9%	13,1%
Nikkei 225	20540	-0,8%	0,3%	17,7%
MSCI Emerging Markets (close -1D)	971	-0,9%	-2,4%	1,6%
Commodities - Volatility	**03/07/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	61	-1,0%	-3,1%	8,9%
Gold ($/ounce)	1168	-0,6%	-1,4%	-1,2%
VIX	17	2,8	3,1	-2,4
FX markets	**03/07/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1,11	-0,7%	-1,6%	-8,4%
USD/JPY	123	-0,8%	-1,1%	2,6%
EUR/GBP	0,71	0,1%	-3,4%	-8,5%
EUR/CHF	1,05	0,2%	-0,7%	-13,1%
Fixed Income markets	**03/07/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0,12	-	+2 bp	-27 bp
Euribor 3M	-0,02	-	--	-9 bp
Libor USD 3M	0,28	-	-	+3 bp
2Y yield (Germany)	-0,26	-7 bp	-7 bp	-16 bp
10Y yield (Germany)	0,82	-11 bp	-7 bp	+28 bp
2Y yield (US)	0,63	-8 bp	-5 bp	-4 bp
10Y yield (US)	2,38	-9 bp	+2 bp	+21 bp
Eurozone Sovereigns 10Y spreads vs Germany	**03/07/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+46 bp	+9 bp	+17 bp	+18 bp
Austria	+43 bp	+10 bp	+31 bp	+33 bp
Netherlands	+31 bp	+7 bp	+14 bp	+17 bp
Finland	+15 bp	+7 bp	+13 bp	+4 bp
Belgium	+49 bp	+9 bp	+18 bp	+20 bp
Ireland	+81 bp	+7 bp	+14 bp	+10 bp
Portugal	+216 bp	+37 bp	+17 bp	+2 bp
Spain	+145 bp	+26 bp	+19 bp	+38 bp
Italy	+147 bp	+25 bp	+18 bp	+13 bp
Credit markets	**03/07/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+75 bp	+9 bp	+10 bp	+12 bp
Itraxx Crossover	+326 bp	+36 bp	+36 bp	-20 bp
Itraxx Financials Senior	+92 bp	+15 bp	+17 bp	+24 bp

Source: Bloomberg, Amundi Strategy *3:00 pm Paris time*