

Letter finalised at 3pm Paris time

September 19 - 23, 2016

## Highlights of the week

- **Markets:** a sharp flattening in the curve, sharp decline in the US dollar after Wednesday's FOMC. Yields narrowed on euro and dollar corporate bond markets, investors' attention stayed riveted on the central banks.
- **United States:** momentum for monthly data is still disappointing.
- **Eurozone:** strong rebound in construction, slight decline of business confidence.
- **Emerging Economies (EMEs):** Whereas the unemployment rate was stable in August (5.2%), households' disposable income and real wages continued to contract in Russia.

## Key focus

### Ben Bernanke's shadow looms over the BoJ and the Fed

In a series of posts in March and April on the Brookings website, Ben Bernanke, the former FOMC chairman, speculated as to what tools the Fed would have left if the U.S. economy were to slow down. The fact that Bernanke had theorised about QE policy as early as 2003 (he ultimately applied it in November 2008) gives his words even greater weight. **Ben Bernanke mentioned three types of reaction from the central bank:**

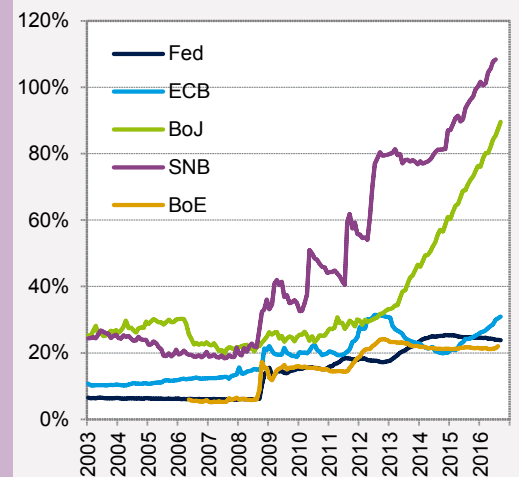
- 1) introducing negative rates,
- 2) targeting long-term rates,
- 3) a "helicopter money" policy.

The BoJ had already introduced a negative-rate system in January 2016, and on Wednesday it decided to adopt targeting long-term rates (the 10 y. JGB yield target is now explicitly 0%). It is especially interesting to see that the BoJ had consulted Bernanke in early July and that Bernanke blogged a few hours after the BoJ meeting his comments about the decisions. Hard to believe it's a coincidence: **apparently we still have to count on Bernanke to redefine monetary policy in the years to come.**

In addition, there are three points worth noting about the BoJ: 1) First, the fact that the BoJ has committed to its measures until core inflation is stable above the 2% target, which implicitly means that it will last a long time (the consensus predicts 0.4% inflation for 2017), 2) Short-term rates and the long-term target may be lowered if need be, and 3) The awareness that long-term rates set too low are a risk to banks' profitability and to financial stability, which is rather new (the introduction of negative rates in January was taken very badly by the markets).

**Bernanke's shadow is also on the Fed.** FOMC members are having great difficulty extricating themselves from the trap of fed fund projections (the so-called "dot plot") put in place under Bernanke. This cycle is radically different from previous ones, yet the "dot plot" was put in place at a time when that view had not yet been imposed within the Fed, hence their repeated downward revision. The new median fed fund projections show a rate increase in 2016 (December) and two in 2017, compared to two increases in 2016 and three increases in 2017, at the FOMC on 15 June. Decidedly, the camp of the Board of Governors, very cautious about the recovery, is beating the camp of the regional Feds' presidents, who are more optimistic and favour raising rates. **The FOMC statement says that the "Committee judges that the case for an increase in the federal funds rate has strengthened", but has "decided, for the time being, to wait for further evidence of continued progress toward its objectives."** A fed funds hike in December is likely, but a number of risks are still in the Fed's path: what about the markets' reaction, particularly long-term rates and the dollar, if Donald Trump is elected on 8 November? Economic indicators would also have to be somewhat reassuring, after the ISM indicators' nosedive in September. For the FOMC, the post-Bernanke era is not that easy.

### Size of central banks' balance sheet as % of GDP




Source: Datastream, Amundi Research

*Ben Bernanke is on the main "quantitative easing" theorists. This policy has been applied by many central banks: Fed, ECB, BoJ, BoE, Riksbank. The BoJ said this week it expects its balance sheet will reach 100% of GDP in one year.*

## The week at a glance


### > Other Events

**Italy >** **Referendum : The Italian PM backs away from his earlier promise to resign if he loses the referendum.** PM M. Renzi said this promise was a “mistake” intended to show that he was serious. He also indicated that the referendum would take place either on 27 November or on 4 December (the final date will be announced on 26 September).


 Many voters will still use the referendum to show their discontent with the government. The latter would be very weakened by a (plausible) victory of the No, even if M. Renzi does not resign. The reform momentum in Italy, the Eurozone's large country that is very late in the recovery cycle, would probably be interrupted at least until the 2018 election.

### > Economic indicators


**United States >** **Momentum for monthly data is still disappointing.** The **NAHB** index (which tracks housebuilders' confidence) rebounded strongly in September to 65 (vs. 60 expected and 59 in August). Conversely, housing starts (1,142,000 vs. 1,190,000 expected, after 1,212,000 in July) and building permits (1,139,000 vs. 1,165,000 expected, 1,144,000 in July) were a let-down, as were sales of existing homes (5.33m vs. 5.45m expected, after 5.38m in July). The Conference Board's leading economic indicators fell back by -0.2% in September, driven down by declines in the average length of the work week and in the New Orders component of the ISM Manufacturing index.

 These numbers are not conducive to the economy re-accelerating in the short term, after the first quarter's disappointing growth. Nor, however, are they enough to challenge the continued recovery.

**Eurozone >** **Strong rebound in construction, slight decline of business confidence.** Construction output rebounded by 1.8% in July, after August's number was revised upward. The rebound was especially strong in France (+4.8%). Regarding France, the INSEE's business survey on industry rebounded in September (103 vs. 101 expected and after 101 in August). The Flash estimate of the Eurozone's PMI Composite Index declined to 52.6 (vs expected 52.8 and after 52.9 in August). Its industry component improved but its services component retreated (notably because of a decline in Germany).


 Construction, long a negative item but one that stabilised in H1 in France, should make a positive contribution to growth in H2. The PMI Composite index is probably negatively impacted by the rising political risks (Brexit and Italian referendum) but still points to a continuation of the recovery.

**Russia >** **Whereas the unemployment rate was stable in August (5.2%), households' disposable income and real wages continued to contract.** Disposable income fell 8.3% year-on-year in August: the deterioration was more marked than in July (-7.3%) than expected by the consensus (-5.7%). After coming out up 0.6%, real wages were revised down (-1.3%) in July year-on-year. They apparently continued to contract in August (-1%), whereas the consensus was forecasting +0.8%. Retail sales came out at -5.1% as expected and as in the previous month.

 Households continue to be under pressure which is having an adverse effect on the recovery. However, inflation is expected to continue to decelerate and the decline in the Central Bank's key rate last week should support activity.

### > Monetary policy

**Turkey >** **Turkey's Central Bank (CBRT) has cut its lending rate by 50bps to 8.25%** and has kept its repo and borrowing rates unchanged at 7.5% and 7.25% respectively.

 Since the CBRT announced its strategy of simplifying its monetary policy, i.e. convergence towards a single key rate, it has cut its lending rate by 250bps. Although the CBRT considers the growth outlook in H2 to be lower and the conditions for financing the economy remain restrictive, its communiqué signals that the high level of inflation remains a major factor in its monetary policy decisions. Therefore, there is good reason to think that a further rate cut is possible between now and the end of the year but it could be limited to 25bps if inflation does not decline significantly.

**South Africa**

**South Africa's Central Bank (SARB) has left its key rate unchanged at 7%** as expected by the consensus.

The MPC Minutes suggest that the SARB could adopt a more accommodative monetary policy due to the downward revision of its inflation forecasts and its concerns regarding growth. The SARB is currently confronted with a decision between supporting growth and stabilising the exchange rate. While the macroeconomic environment advocates a rate cut, this could lead to pressure on the Rand which is already heavily impacted by the current political turmoil. We believe that the SARB's decision will be data dependent and that any publication of lower than expected economic indicators will point to a rate cut.

**Financial markets**

Fixed-income

**A sharp flattening in the curve**, which more or less cancels out the previous week's steepening. Overall, long-term rates are to the downside. The probability of a fed funds hike in December, as implied by the options market, is hovering around 50%. In the Eurozone, peripheral spreads tightened slightly, with the notable exception of Portugal, where it is still at its high point for the year.

For the Fed, 2016 looks like a 'copy paste' of 2015, with strong media buzz around a possible increase in fed funds in September, the FOMC's status quo, the downward revision of the fed funds projections to just one increase for the year in question, and probably an increase in fed funds in December (see Editorial). With regard to the US yield curve, the short-end could rise somewhat, but the movement will be limited. That being said, US long-term rates have been pretty well correlated to the likelihood of Donald Trump winning the US presidential elections.

Foreign exchange

**Sharp decline in the US dollar after Wednesday's FOMC.** Before Wednesday's FOMC, the US dollar (in effective terms) was close to its highest level of the year, with recent losses by the Mexican peso and Canadian dollar. The USD/JPY exchange rate closed out the week at 100. The South African rand appreciated the most over the week (+4% against the US dollar). Note that the pound sterling is back at a one-month low in effective terms. Average implied volatility of the G10 currencies has fallen to a low point since the end of 2014

The increased likelihood of Donald Trump's winning the election has driven the Mexican peso and, to a lesser extent, the Canadian dollar down in recent weeks. The Canadian dollar and the Mexican peso together make up nearly one-quarter of the currency basket tracked by the Fed. To put it another way, if Trump is victorious on 8 November, the dollar's effective exchange rate could be a source of worry for the Fed as it moves closer to December's FOMC.

Credit

**Spreads tightened on euro and dollar corporate bond markets.** High yield indices outperformed. The markets reacted positively to the results of Fed's and BoJ's latest monetary policy committee meetings. The euro and dollar credit markets remained active.

The CSPP is a key factor in the performance of euro corporate bond markets. 20% of CSPP-eligible assets are now trading at negative yields. As a result, non-eligible euro market segments are supported by bond investors' (forced) quest for yield. Financial issuers in particular offer attractive opportunities.

US companies' debt leverage stabilised in the second quarter – at all-time highs. In an environment of persistently low interest rates and ultra-accommodating monetary policy, yields on this market are attractive. But watch out for the very significant increase in hedging costs, which can have a significant impact on flows.

Equity

**Investors' attention stayed riveted on the central banks.** After a wait-and-see start to the month, the equity markets took off on Wednesday, encouraged by the BoJ's initiatives to limit the impact of negative rates and the Fed's new status quo. Since at the same time, oil prices took off again against a backdrop of declining inventory, this also supported the market. All in all, Thursday evening the MSCI World AC was up 2.3%, of which +3.1% in Japan, +1.8% in the US, +3.7% in the eurozone, and +2.8% for the emerging markets. In terms of sectors, which were boosted by the BoJ's statements, the takeaway is the spectacular rebound by financial securities in Japan.

While the effectiveness of the central banks' policy is increasingly subject to debate, they have managed to stimulate the equity markets yet again. Fundamentally, though, the game has not changed, with the same questions about the economic recovery's sustainability and the collateral damage by negative interest rates. So it remains to

be seen whether the recovery will be confirmed in the US, and whether the BoJ's action on long-term rates will have a lasting effect. If not, we can be sure the central banks will resume the initiative one way or another. Between the desire to check the fall of long-term rates in negative territory and rather good short-term earnings, the equity markets should stay healthy.

## Key upcoming events

### > Economic indicators

**US** : GDP should be slightly better in Q2 **Japan**: Industrial Production is expected to positive in August

Date	Country	Upcoming macroeconomic data	Consensus	Prior
26 September	Germany	IFO business climate. September	106.3	106.2
27 September	US	Consumer confidence. September	98.8	101.1
	US	Services PMI. September	51.1	51.0
28 September	France	Consumer confidence. September	97.0	97.0
29 September	US	GDP. QoQ. Q2	1.3%	1.1%
	Germany	CPI. YoY. September	0.6%	0.4%
30 September	Eurozone	CPI. YoY. September	0.4%	0.2%
	Eurozone	Unemployment rate. August	10%	10.1%
	UK	GDP. QoQ. Q2	0.6%	0.6%
	Japan	CPI. YoY. September	-0.5	-0.5%
	Japan	Unemployment rate. August	3.0%	3.0%
	Japan	Industrial production. MoM. August	0.5%	-0.4%
1 October	China	Manufacturing PMI. September	50.1	50.0

Source : Bloomberg, Amundi Strategy

### > Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
26 September	France	Short-term, amounts not available on Friday
	Germany	Short-term, € 1.5 Bn
27 September	Italy	Long-term, amounts not available on Friday
28 September	Germany	2 years, € 4 Bn

Source: Bloomberg, Amundi Strategy

### > Key events

Date	Upcoming monetary policy committee meetings
20 Octobre	European Central Bank (ECB)
2 November	Federal Reserve (Fed)
8 December	European Central Bank (ECB)
14 December	Federal Reserve (Fed)

Date	Upcoming political events
October 2016*	Italian Constitutional Referendum
November 2016	Presidential elections in the United States
November 2016	OPEC Summit - Vienna, Austria

Source: Amundi Strategy

\* Estimated

**> Market snapshot**

Equity markets	23/09/2016	Over 1 week	Over 1 month	Ytd
S&P 500	2177	1.8%	-0.4%	6.5%
Eurostoxx 50	3032	3.3%	1.3%	-7.2%
CAC 40	4483	3.5%	1.4%	-3.3%
Dax 30	10634	3.5%	0.4%	-1.0%
Nikkei 225	16754	1.4%	1.6%	-12.0%
MSCI Emerging Markets (close -1D)	921	4.0%	1.6%	16.0%
Commodities - Volatility	23/09/2016	Over 1 week	Over 1 month	Ytd
Crude Oil (Brent, \$/barrel)	48	4.0%	-4.7%	27.7%
Gold (\$/ounce)	1338	2.1%	0.0%	26.1%
VIX	12	-3.1	-0.1	-5.9
FX markets	23/09/2016	Over 1 week	Over 1 month	Ytd
EUR/USD	1.12	0.5%	-0.8%	3.3%
USD/JPY	101	-1.3%	0.7%	-16.3%
EUR/GBP	0.87	1.0%	1.2%	17.5%
EUR/CHF	1.09	-0.3%	0.1%	0.2%
Fixed Income markets	23/09/2016	Over 1 week	Over 1 month	Ytd
EONIA	-0.34	-	--	-22 bp
Euribor 3M	-0.30	--	--	-17 bp
Libor USD 3M	0.86	+1 bp	+4 bp	+25 bp
2Y yield (Germany)	-0.67	-2 bp	-4 bp	-33 bp
10Y yield (Germany)	-0.09	-9 bp	+1 bp	-72 bp
2Y yield (US)	0.77	-	+2 bp	-28 bp
10Y yield (US)	1.61	-8 bp	+6 bp	-66 bp
Eurozone Sovereigns 10Y spreads vs Germany	23/09/2016	Over 1 week	Over 1 month	Ytd
France	+29 bp	-1 bp	+6 bp	-7 bp
Austria	+20 bp	+1 bp	-	-7 bp
Netherlands	+11 bp	-	--	-5 bp
Finland	+12 bp	-1 bp	-3 bp	-17 bp
Belgium	+23 bp	-1 bp	+1 bp	-12 bp
Ireland	+47 bp	+1 bp	-4 bp	-5 bp
Portugal	+346 bp	+5 bp	+35 bp	+157 bp
Spain	+103 bp	-4 bp	--	-11 bp
Italy	+129 bp	-5 bp	+7 bp	+32 bp
Credit markets	23/09/2016	Over 1 week	Over 1 month	Ytd
Itraxx Main	+70 bp	-1 bp	+3 bp	-7 bp
Itraxx Crossover	+325 bp	-11 bp	+13 bp	+10 bp
Itraxx Financials Senior	+97 bp	+2 bp	+6 bp	+20 bp

Source: Bloomberg, Amundi Strategy

3:00 pm Paris time

**WEEKLY**  
**Research, Strategy and Analysis**

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