Amundi
ASSET MANAGEMENT

Cross asset investment strategy

Research,Strategy and Analysis

WEEKLY

Letter finalised at 3pm Paris time **October 10 - 14, 2016**

Highlights of the week

● **Markets :** A slight increase in the yields of developed countries; the US dollar appreciated against almost all currencies. Slight consolidation on the equity markets.
● **Eurozone :** Industrial output and ZEW index up.
● **US :** Mixed retail sales. Decline in the number of job openings.
● **Emerging Economies (EMEs):** China's PPI is back in positive territory after 60 months; India's September wholesale prices yoy (WPI) weaker than expected.

Key focus

If Hillary Clinton wins, few changes are expected... at first

Hillary Clinton's chances of a victory on 8 November seem to be increasing. While her economic programme is not without ambition, it would meet with the opposition of a probably fragmented Congress.

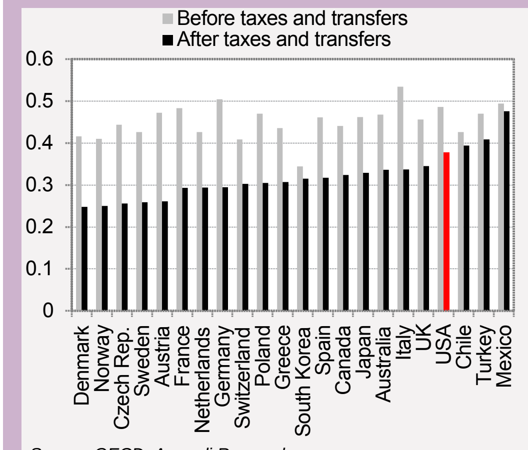
This programme includes substantial new public spending measures, mostly paid for by a rise in the taxation of high income and wealthy households and by measures intended to increase the efficiency of corporate taxation. They include:

- **An infrastructure investment plan**, whose amount is substantial, though not spectacular: $275 billion (1.5% of GDP) over five years.

- **Social spending** that could potentially involve bigger figures, including free tuition in public universities for students from lower-income families and an extension of family and sick leave policies. These promises have been ramped up after the unexpected trajectory of Hillary Clinton's Democratic rival Bernie Sanders over the summer. The CRFB (non-partisan *Committee for a Responsible Federal Budget*) says they could reach $800 billion over 10 years, even $1100 billion counting a plan to extend the "Obamacare" health-care reform.

Gini coefficient,

largest OECD countries



Source: OECD, Amundi Research

Although often criticized, the Gini coefficient remains one of the main indicators used to compare countries' levels of social unequatilities.The higher the Gini, the higher the level of unequalities.

- **In terms of taxes**, measures targeted at wealthy households include schemes to ensure that they pay at least a minimum rate of income tax, as well as increases in estate taxes. Measures targeted at corporations aim, among other goals, to limit corporate "inversion" (foreign domiciliation for tax purposes) and at increasing taxes on several types of "risky" behaviours by financial institutions. Taking into account (at least some of) these higher tax revenues, the CRFB is talking about only a very moderate budget overrun of $200 billion over 10 years for the entire programme (although subject to a number of fragile hypotheses).

- **Her promises also include raising the federal minimum** wage from $7.25 to $12 (with efforts to bring it to $15 recently added to move closer to Sanders' position) and **easing immigration rules**.

In theory, a substantial positive economic effect could be expected from the implementation of this entire programme, even in the short-term. In July, Moody's estimated the potential gain, in terms of GDP, to be 1.7% in 2020 (when the presidential mandate ends), as spending targeted toward infrastructures and lower-income households, together with increased immigration, would generate more activity than tax hikes and a higher minimum wage would destroy.

In reality, the short term economic impact of Hillary Clinton's victory would be limited, because while her party can retake the Senate, it will have to deal with a House of Representatives that will in all likelihood remain Republican. Bipartisan compromises can probably be reached on infrastructure spending. On the other components such as social spending and tax increases, they will be much more difficult, in a situation where the Republican Party, after the Trump episode, is likely to experience an identity crisis and fierce internal power struggles.

Therefore, if Hillary Clinton does win, we will probably not change our economic scenario for the US in 2017, which posits a continuation of the recovery at a pace between 1.5% and 2% per year (close to the economy's long-term potential), yet with the possibility of additional budgetary support should there be an unexpected slowdown.

This does not detract at all from the fact that this election will, very likely, have substantial long-term consequences for the "political offer" in terms of economic policies in the US. Indeed, the campaigns of Bernie Sanders and Donald Trump have showcased the expectations of a good many Democrat and Republican voters for the development of new policies – in opposite directions, but generally less free market-oriented than in the past – to respond to the middle classes' growing distrust with globalisation.

The week at a glance

> Economic indicators

Eurozone >

Industrial output and ZEW index up. In August, **industrial output** was up +1.6% (vs. +1.5% expected), after a downturn in July (-0.7%) that was less pronounced than initial projections. Country by country, the increase in industrial output over one year was 3.1% in Germany, 2% in France, 1.7% in Italy, and 1.8% in Spain. The **German ZEW** index (investor confidence) rebounded sharply in October to 6.2 (vs. 4.3 expected and after 0.5 in September). Finally, housing prices rose by 2.9% between Q2 2015 and Q2 2016 (+5.3% in Germany, +0.8% in France, and +3.8% in Spain, but -1.4% in Italy).

The recovery is moving along in the eurozone, a bit better than expected in view of the many political risks. The rebound in Italian industrial output is an encouraging signal in view of recent fears that the country was heading back into a recession (Italian economic growth was zero in Q2).

United States >

Mixed retail sales. Decline in the number of job openings. Retail sales advanced 0.6% in September, in line with forecast (their August decline was a bit less than initially announced, at -0,2%). Control Group retail sales (used to forecast household consumption in the GDP figures) were disappointing, though, advancing only +0.1% vs +0.4% forecast. Only 5.4 million **jobs were open for hiring** in August (compared to 5.7 million expected and after 5.8 million in July). The drop-out rate was still at its low (1.1 per thousand).

Household consumption should not be expected to accelerate, after it has been the recovery's almost sole engine for many quarters. It will not grow in H2 as strongly as in H1. However, some improvement should be expected from other contributors to GDP (notably investment).

China >

China's PPI is back in positive territory after 60 months. In terms of price data, September CPI yoy was slightly higher than expected at 1.9% (vs. consensus 1.6% and 1.3% in August), and the PPI provided another upside surprise (which is good) at +0.1% (vs. consensus -0.3% and -0.8% in August). In terms of trade data, China's September exports growth yoy in USD terms was worse than expected at -10% (vs. consensus -3.3% and -2.8% in August), while import yoy growth also provided a downside surprise with -1.9% (vs. consensus 0.6% and 1.5% in August).

What is striking today is that since we observed the PPI number's initial stabilisation last October (both August and September 2015 at -5.9%) and made this call, it has seen 12 months of consecutive improvement and entered positive territory after 60 months (5 years!) in September 2016 (+0.1%). It has also confirmed our call again back in August/September 2016 that the PPI number would be back in positive territory in one or two months' time (whereas markets are worried it might even be negative). The market shouldn't worry about weaker than expected trade data from China in September. Why are exports low? This is due to the G20 meeting in September in Hangzhou when all surrounding factories suspended production for more than one month, which delayed the delivery of export orders. Also, exports reflect overseas demand but not Chinese domestic demand. Within the breakdown of imports, there is still very strong growth in iron ore (+8% yoy growth), coal (+36% yoy growth), and steel (+12% yoy growth), which reflects strong Chinese domestic demand.

India >

India's September wholesale prices yoy (WPI) were weaker (i.e. better) than expected at 3.57% (vs. consensus 3.90%, and 3.74% in August). India's September CPI yoy came in better (i.e. lower) than expected at 4.31% (vs. consensus 4.60%, and 5.05% in August), hitting a 6-month low.

The weakness in both the CPI and WPI is driven by lower than expected food prices as a result of a better than expected normal monsoon season. We continue to hold our view that the RBI's inflation outlook has been lagging in that inflation has been behaving much weaker than the RBI expected. Hence we believe the RBI has to remain accommodative longer than the market expected, and ease more than the market expected.

> Financial markets

Fixed-income

A slight increase in the yields of developed countries. German and US 10-year yields ended the week at respectively 0.05% and 1.77%. There was fairly little movement with regard to sovereign spreads, with the exception of Portugal whose 10-year spread with Germany tightened by -28bps.

We do not think German long yields can rise significantly from current levels, given that we believe it is unlikely that the ECB will decide to reduce the amount of its asset purchases.

Foreign exchange

The US dollar appreciated against almost all currencies... except the Mexican peso and the Canadian dollar. The EUR/USD exchange rate is back near 1.10, level which was not seen since late July. The pound continued to tumble, hitting a new low: in particular, the EUR/GBP exchange rate reached 0.91 during the week. The pound has lost 17% against the dollar since the start of the year. The dollar's effective exchange rate is at its highest level since early March. Interestingly, the USD/CNY exchange rate has climbed up to its highest levels since September 2010, while the CFETS basket, followed by the PBoC, remains very stable.

The US dollar's appreciation is essentially due to the increasing likelihood of a fed funds increase in December, after the speech given by Vice-Chair Stanley Fischer last weekend on the sidelines of the IMF's annual meetings, with rather reassuring numbers these past few weeks... but also to Donald Trump's decline in the polls. That said, the margin of appreciation for the dollar remains weak.

Credit

The markets remained relatively stable this week. However, it is important to note the slight widening of the US High Yield.

The ECB's QE programme has helped maintain a favourable technical configuration over the last few months. In addition, activity observed in the primary market has remained relatively moderate, in line with activity in 2015. The Euro's performance since the QE announcement has clearly been positive. Spreads have tightened by 40bps to 112bps, well above the historic lows recorded in 2005 (36bps). The potential for spread tightening is limited by the low absolute yield (0.7%).

US IG credit has enjoyed positive flows over the last few weeks. Robust investor appetite can be attributed to the attractive yield of this segment, a weaker than expected rate rise cycle and less aggressive corporate behaviour. The debt leverage of US companies has stabilised over the last few quarters at historic highs.

Equity

Slight consolidation on the equity markets. The S&P 500 pulled back slightly to its previous highs, which it had tested several times beginning February 2015 before exceeding them in July 2016. There was consolidation also elsewhere, but without casting doubt for the moment on the slightly bullish trend that has prevailed since February. The euro zone fared a little better than other regions on the week.

The combination of rising long bond yields as earnings reporting season gets off to a worse-than-expected start (disappointing numbers from Alcoa, Ericsson profit-warning, etc.) is holding back risk appetite. Nor should we overlook the US election campaign context and the rally by the dollar, which, if it continues, would not be good news for US earnings. The markets need support from at least one of these two factors (low interest rates or improved earnings) to continue posting gains.

Key upcoming events

Economic indicators

United States : industrial production is expected to increase in September **China**: GDP should remain stable in Q3

Date	Country	Upcoming macroeconomic data	Consensus	Prior
17 October	Eurozone	CPI. YoY. September	0.4%	0.4%
	US	Industrial production. YoY. September	0.2%	-0.4%
18 October	UK	CPI. YoY. September	0.9%	0.6%
	US	CPI. MoM. September	0.3%	0.2%
	Brazil	Retail sales. MoM. August		-0.3%
19 October	China	Industrial production. YoY. September	6.4%	6.3%
		Retail sales. YoY. September	10.7%	10.6%
		GDP. YoY. Q3	6.7%	6.7%
20 October	UK	Retail sales. MoM. September	0.3%	-0.2%
21 Octobre	Eurozone	Consumer confidence. October	-8.0	-8.2

Source : Bloomberg. Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
17 October	France	Short-term, € 6.4 Bn
19 October	Spain	Short-term, amounts not available on Friday
19 October	Germany	30 years, € 1 Bn
20 October	France	Long-term, amounts not available on Friday

Source: Bloomberg, Amundi Strategy

Key events

Date	Upcoming monetary policy committee meetings
19 October	Bank of Canada (BoC)
20 October	European Central Bank (ECB)
2 November	Federal Reserve (Fed)
8 December	European Central Bank (ECB)
14 December	Federal Reserve (Fed)

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

Source: Amundi Strategy

Market snapshot

Equity markets	14/10/2016	Over 1 week	Over 1 month	Ytd
S&P 500	2133	-1,0%	0,3%	4,3%
Eurostoxx 50	3030	1,0%	2,2%	-7,3%
CAC 40	4486	0,8%	2,7%	-3,2%
Dax 30	10583	0,9%	2,0%	-1,5%
Nikkei 225	16856	0,0%	1,5%	-11,4%
MSCI Emerging Markets (close -1D)	891	-2,6%	0,6%	12,1%
Commodities - Volatility	**14/10/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	52	0,5%	13,8%	40,0%
Gold ($/ounce)	1254	-0,3%	-5,2%	18,1%
VIX	16	2,2	-2,5	-2,6
FX markets	**14/10/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1,10	-1,7%	-2,2%	1,4%
USD/JPY	104	1,3%	1,8%	-13,5%
EUR/GBP	0,90	0,2%	6,1%	22,3%
EUR/CHF	1,09	-0,5%	-0,6%	0,1%
Fixed Income markets	**14/10/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0,35	-	-1 bp	-22 bp
Euribor 3M	-0,31	-1 bp	-1 bp	-18 bp
Libor USD 3M	0,88	-	+3 bp	+27 bp
2Y yield (Germany)	-0,66	+1 bp	-1 bp	-31 bp
10Y yield (Germany)	0,05	+3 bp	+3 bp	-58 bp
2Y yield (US)	0,85	+2 bp	+9 bp	-20 bp
10Y yield (US)	1,77	+5 bp	+7 bp	-50 bp
Eurozone Sovereigns 10Y spreads vs Germany	**14/10/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+27 bp	-2 bp	-2 bp	-9 bp
Austria	+19 bp	-3 bp	+1 bp	-8 bp
Netherlands	+10 bp	-2 bp	+1 bp	-6 bp
Finland	+13 bp	-1 bp	-	-17 bp
Belgium	+22 bp	-1 bp	--	-12 bp
Ireland	+44 bp	-3 bp	-2 bp	-8 bp
Portugal	+328 bp	-28 bp	+3 bp	+139 bp
Spain	+107 bp	+7 bp	+1 bp	-8 bp
Italy	+132 bp	-4 bp	+5 bp	+36 bp
Credit markets	**14/10/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+73 bp	--	+4 bp	-4 bp
Itraxx Crossover	+331 bp	-2 bp	+1 bp	+16 bp
Itraxx Financials Senior	+99 bp	--	+8 bp	+22 bp

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