Letter finalised at 3pm Paris time **April 10 - 14, 2017**

Highlights of the week

- **United States:** vigorous labor market and disappointing retail sales.
- **Eurozone:** Industrial output fell slightly in February. The Europeans stand united against the Brexit challenge.
- **Emerging countries:** Chinese price dynamics oriented upwards. Rate cut by the BCB.
- **Markets:** Further recovery of US Treasuries and depreciation of the USD against other major currencies. credit spreads not significantly impacted by Geopolitical developments and political risks. Equity markets calm.

Key focus

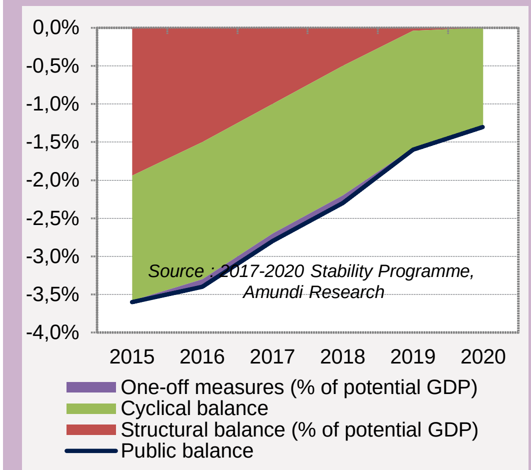
The stability programme's multiyear public finance projections: a benchmark for presidential candidates?

The French government unveiled its latest stability programme on Wednesday, April 12. The purpose of this document, which is required in the framework of the European semester for Eurozone countries, is to present France's public finance trajectory for a four-year period (2017-2020).

Due to the upcoming presidential elections, this multiyear path remains quite hypothetical. In fact, general government deficit projections and the underlying macroeconomic assumptions will probably be amended by the new government. Nonetheless, they are worth a closer look, because the trajectory, as well as the accompanying opinion from the French High Council of Public Finances (HCPF), will be a useful reference for the new government in place.

The stability programme presented last Wednesday projects a public deficit of 2.8% of GDP for 2017, then 2.3%, 1.6% and 1.3% of GDP for 2018-2020. This trajectory is based on real GDP growth projections of 1.5%, 1.6%, and 1.7%, and inflation projections of 1.1%, 1.4%, and 1.5% over 2018-2020. **In March 2015, the European Council gave France additional time to reach the 3% threshold for public deficit. It recommended excessive deficit be corrected by 2017.** If, as predicted, the public deficit actually came to 2.8% (or less) for 2017, it would be in compliance with the deadline granted by the Council to put an end to the excessive deficit and would help stabilize public debt.

Multi-year trajectory of the stability programme



Source : 2017-2020 Stability Programme, Amundi Research

Note: The cyclical balance captures the business cycle's effect on the general government balance. The structural balance matches the estimated government balance that would be seen if GDP were equal to its potential. These assessments are based on the government's potential growth estimates.

With regard to the upcoming elections, there are three important points to stress regarding how the government balance will change beyond 2017. **First, would GDP growth effectively come out below this programme's underlying forecasts, the public deficit would be** - all other things being equal - **widened**, due to lower general government revenues collected and the effect of automatic stabilisers. **Second, this trajectory is based on potential growth estimates that the HPCF finds to be overstated**. They therefore contribute to the estimate of a much wider output gap than the international organisations consider it, which "minimises the effort that must be taken to balance public finances in the medium term." **Accordingly, a reduced estimate of potential growth by the new government (as recommended by the HCPF) would lead to an increase in the required structural effort to achieve structural balance or ensure compliance with European recommendations** on the structural adjustment to be made. **Lastly, this public finance path claims compliance with the European rules** of the Stability and Growth Pact, which is not necessarily true of the presidential candidates' political programmes.

The stability programme's multiyear fiscal projections mark out a point of reference for the incoming government. It will be a benchmark for all: for the candidates who advocate for controlled public finances (François Fillon and Emmanuel Macron, aiming for a public deficit of 0% and 1% of GDP, respectively, in 2022), for Benoit Hamon (who recommends moving away from this trajectory with a return to 2.7% of GDP in 2022, and proposes the establishment of a new European treaty, considering a mutualisation of a portion of sovereign debts), and for those who want to cast off the European recommendations (Jean-Luc Mélenchon and Marine Le Pen).

The week at a glance

Other events

Brexit >

The Europeans stand united against the Brexit challenge. On Tuesday 11 April, EU governments provided their support for the principles of negotiation proposed by Union President Donald Tusk. In particular, the EU intends to begin negotiations on a free trade agreement with the United Kingdom, only after the contentious issues related to its exit from the EU have been resolved (particularly expatriate rights and the €60 billion payment the EU is demanding from Britain to settle all accounts). Britain, meanwhile, would prefer to tackle negotiations on all the issues. Meanwhile, no European government has objected to the principle that any agreement on Gibraltar must be approved by Spain.

While for now, the Europeans are displaying their solidarity, the road to reaching agreements on the many, many aspects of Brexit will be long and full of opportunities for divisions to appear. A summit of the heads of state, without the UK, is scheduled for 27 April to officially approve the negotiating positions, but the next big step is really the French election season (between late April and mid-June), which will determine who makes the decisions on behalf of the eurozone's second-largest economy.

Economic indicators

Eurozone >

Industrial output fell slightly in February. Industrial output fell back by -0.3% in February in the eurozone (vs. +0.1% expected). Country by country, the change in industrial output in February was +0.8% in Germany, -1.6% in France, +1% in Italy, and -0.3% in Spain. **Housing prices rose in Q4 2016.** Average housing prices rose by +0.8% in Q4 2016 in the eurozone. The increase was +1.7% in Germany and +0.3% in Spain, but prices were stable in Italy and fell back by -0.3% in France. Over the four quarters of 2016, the gain was +4.1% in the eurozone, +6.7% in Germany, +1.9% in France, and +0.1% in Italy.

The erosion of industrial output in February could drag down Q1 GDP growth figures a little, an initial estimate of which will be published at the end of April. However, this slight disappointment (which involves an especially volatile series) is not enough to compromise the overall picture of an economic recovery that is improving. The real estate market recovery (starting from very diverse situations in different eurozone countries) should contribute to the rebound in construction, a sector badly weakened in some countries in recent years.

United States >

More jobs open in February. In February, 5.74 million jobs were open for hiring (compared to 5.65 million expected and after 5.63 million in January). This is the highest level since July 2016. **Retail sales** fell by 0.2% in March after a 0.3% decline (revised downwards) the previous month. **Inflation** came to 2.4% in March, after 2.7% in February (with core inflation at 2.0% in March, vs. 2.2% in February).

Core inflation remains under control. Retail sales so far this year are not favourable to Q1 GDP growth. However, the high number of job openings in February is one more sign of the US labour market's vigour, even though it applies to a period before the one (March) concerned by the latest – disappointing – figure on job creation (but remember, other numbers from the jobs report in March were more encouraging). As business climate indicators are also good, weakness in retail sales may be only a passing phenomenon, but this will depend mostly on the economic policy decisions actually made by the White House and Congress. The US economic environment trends will depend on these measures that could have an impact on growth and inflation.

Japan >

An improvement in labour substitution investment and productivity are essential in Japan. Simulations by the government-owned National Institute of Population and Social Security Research compounded concerns about demographic woes in the face of an uncharted aging and shrinking society. The latest projection revealed that the production age population will decrease 20% by 2040 and 40% by 2065. Currently 2.1 people in the tranche cover the social security burden of one elder. However, the working population declines by 500,000 each year and the pace of contraction is expected to accelerate. The research institute foresees that 1.2 working people will have to support one elder in 2065.

The simulation is based on the assumption that the fertility rate will remain at 1.44 (currently 1.45) and will be subject to a more severe challenge. Prime Minister Abe made maintaining 100 million citizens a top priority and set the target birth rate at 1.8 in 2015. Better childcare and higher wage increases have helped push the rate up to 1.45 from 1.35 since then, although it remains well below target. Some critics propose accepting 750,000 foreign workers each year to help keep the total population stable at 127 million. However this would require a national consensus.

The demographic crunch has already led to serious labour shortages as the jobs-to-applicant ratio in the construction, transportation and nursing care industries exceeds 3:1. Meanwhile many regional towns and cities, even just outside Tokyo, have entire blocks of small shops that are shuttered up as their owners are either retired or deceased and their children have left these small towns in search of work.

The government is set to reinforce urgent measures to counter these demographic issues in the revised principal for economic and structural reform which will be released in June. This reform will facilitate the increased participation in the labour force of women and seniors, provide better childcare and care for the elderly, and revamp their pension and health systems accordingly. Also the government will encourage the upgrading of factories, a broader use of ICT and the introduction of artificial intelligence to substitute human jobs. According to estimates by the Cabinet Office, real GDP will constantly shrink beyond 2040 without any improvement in productivity.

China >

China's Producer Price Index (PPI) momentum extended strongly in March. In terms of price data, the **PPI** surprised to the upside once again in March (which is very positive) at +7.6% (vs. the consensus of 7.5% and prior figure of 7.8%), and the **CPI** came in weaker than expected (better) at 0.9% yoy (vs. the consensus of 1.0% and prior figure of 0.8%). **In terms of trade data, China's export growth** measured in USD came in better than expected at 16.4% yoy in March (vs. the consensus of 4.3% and prior figure of -1.3%), while **import growth** measured in USD also surprised to the upside at 20.3% yoy in March (vs. the consensus of 15.5% and prior figure of 38.1%).

Within the March price and trade data, there are several highlights: 1. The much stronger PPI makes China's real interest rate even more negative at -3.3%, which is hugely positive for corporate earnings. The widening difference between CPI and PPI to as high as 6.7% now is also putting corporates in an amazing sweet spot. 2. Iron ore imports were still strong in March 2017, increasing 11% yoy (vs. 13% in February), as were coal imports, which grew 12% yoy (vs. 31% in February), and crude oil, which increased 19% yoy (vs. 0% in February). The global commodity rally both in 2016, 2017 and likely beyond are being driven demand from China and domestic over-capacity reduction in China. The longer than expected Chinese economic stabilisation cycle from 2016 to 2018, is helping shape an upturn in the global cycle, which clearly benefits global cyclical sectors, commodities and also emerging markets, in our view.

> Monetary policy

Brazil >

The Brazilian central bank (BCB) cut its key rate by 100bp, to 11.25% through an unanimous decision of its monetary policy committee. The press release once again mentioned uncertainty in the global economic environment, the importance of implementing ongoing reforms, second-round effects created by the favourable supply-side shock of falling food prices and the gradual nature of the recovery as factors likely to have consequences on its underlying economic scenario.

This key rate cut had been anticipated by the markets and is part of the monetary easing cycle started by the BCB last October. The consensus forecast is for a Selic at 9.5% at the end of 2017. Barring a major external shock the BCB could go well beyond that, and we would not rule out the possibility that the Selic could fall below 9% by yearend 2017.

> Financial markets

Fixed-income

Geopolitical tensions and US President Trump's comments about the USD getting too strong both supported a further recovery of US Treasuries, together with the depreciation of the USD against other major currencies. The 10-year Treasury yield finally fell below the lows of the trading range in place in recent months, with levels between 2.3% and 2.6%. On the other side of the Atlantic, the 10-year Bund yield also fell below its recent lows but sovereign spreads failed to widen further and tended to be more stable. The approaching Easter break probably helped to amplify these recent moves.

Higher market perception of global geopolitical tensions and persistent political risks are visible in both higher equity implied volatility and lower bond yields in advanced economies. The approaching first round of the French presidential election is likely to keep volatility high next week, therefore sustaining the demand for risk free assets and keeping peripheral bonds from tightening significantly from current spreads for the time being. European markets, in particular, remain in a wait and see attitude.

Foreign exchange

The US dollar weakened against almost all the major currencies this week. The most remarkable performances came from the Turkish lira and the South African rand, which gained, respectively, 1.5% and 2.5% against the dollar. Political events gave support to both currencies. In Turkey, polls show a tight split between the 'yes' and the 'no' camp for the constitutional referendum to be held next Sunday (51-52% for 'yes') to create an executive presidency. While the yes vote would be very negative for the country in the medium term by increasing President Erdogan's power, it is perceived by the markets as providing political stability in the short term. In South Africa, despite the ongoing political crisis, the rand was supported by a slightly improved sentiment after parliament postponed a motion of no-confidence in President Jacob Zuma. The USD/JPY gained 2% to reach the 108.90 level and the EUR/USD was relatively stable at 1.06.

Donald Trump's comments saying the US dollar was "getting too strong" hit the performance of the dollar this week. The "wait-and-see" phase regarding the US fiscal stimulus together with Trump's comments certainly add pressure on the dollar and tend to favour EME currencies. We do not expect a further rally of the dollar in the short run unless we have a positive surprise from US data, which would trigger a stronger hawkish stance from the Fed.

Credit

Geopolitical developments and political risks were the major drivers of the rise in equity implied volatility on both sides of the Atlantic. This trend, however, failed to significantly impact credit spreads which proved to be resilient with respect to the usual pattern. Pre-Easter mode began to set during the week, with lower liquidity probably contributing to the limited reaction of credit markets to rising equity implied volatility.

Over the next few weeks credit markets are likely to be driven by both micro factors and political risk developments. On one side, in fact, the 1Q17 earnings season will move into full swing and on the other, the first round of French presidential election is going to show up large on the markets' radar screens. Macro data suggest that European companies' positive 4Q16 earnings momentum may also be confirmed in the first quarter of 2017, but at the same time political risk is likely to keep volatility higher for some time. The search for yield continues to support short duration HY and subordinated debt in the Euro area.

Equity

Equity markets keep calm. Between the tensions with North Korea on the one hand and Syria and Russia on the other, the rise of a new Eurosceptic candidate for the French presidential election, and the two-stepping by Donald Trump on US tax reform, there was no shortage of reasons for doubt. Still, the equity markets stayed relatively calm. After a record first quarter with +4.7%, the MSCI World Index lost only 0.9% over the week. There were slightly steeper erosions in Japan (-2.0%), Spain (-2.3%) and Italy (-2.6%) yet Switzerland (+0.1%), the UK (-0.3%) and the US (-1.1%), which are generally more defensive, managed to survive. The emerging markets, though more volatile than average, also did well (+0.2%) because of the easing of relations between the US and China. As for the Japanese market, a large portion of its decline is due to the yen's appreciation. Meanwhile, Spain and Italy were penalised by renewed tension on financials (an increasing spread with Germany, and the capitalisation of Banco Popular in Spain).

While geopolitical tensions proliferate, and a fall-back toward safe-haven assets is emerging – US 10Y rate at its lowest point since Trump's election, gold prices and VIX at their highest – the equity markets have remained relatively calm. Beyond the political roller coaster, US equities are, above all, sensitive to progress in tax reform in the United States and changes in trade relations with China. From this viewpoint, last week there were paradoxical developments, with signs of delay on taxes, but on the other hand, unexpected détente with China. In the end, Wall Street, the leading market, remained calm, especially since, in the short term, the earnings season is expected to remain promising.

Key upcoming events

Economic indicators

United States: PMIs should rebound slightly in April. **Eurozone:** PMI expected to stabilize in April and trade balance to improve in February.

Date	Country	Upcoming macroeconomic data	Consensus	Prior
April 17	China	GDP. YoY. Q1	6.8%	6.8%
	China	Industrial production. YoY. March	6.3%	6.0%
April 18	US	Industrial Production. MoM. March	0.5%	0.1%
	Eurozone	Trade balance. February	16.2B	-0.6B
April 19	Eurozone	CPI. YoY. March	1.5%	1.5%
April 20	Japan	Trade balance. March	605 Bn ¥	813 Bn ¥
	US	Philadephia Fed survey. April	25.0	32.8
	Eurozone	Consumer confidence. March	-4.8	-5.0
April 21	Eurozone	Manufacturing PMI. April	56.0	56.2
	Eurozone	Services PMI. April	56.0	56.0
	US	Manufacturing PMI. April	53.8	53.3
	US	Services PMI. April	53.6	52.8
	US	Existing home sales. March	5.60M	5.48M

Source: Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
April 18	France	Short-term, € 6 Bn
	Spain	Short-term, amounts not available on Friday
	ESM	6 months, € 1.5 Bn
April 19	Germany	30 years, € 1 Bn
April 20	France	Long-term, amounts not available on Friday
	Spain	Long-term, amounts not available on Friday

Key events

Date	Upcoming monetary policy committee meetings
April 27, 2017	European Central Bank (ECB)
	Bank of Japan (BoJ)
May 3, 2017	Federal Reserve (Fed)
May 11, 2017	Bank of England (BoE)

Date	Upcoming important events
April 23, 2017	France- First round of Presidential election
April 29,2017	European Council on Brexit
May 7, 2017	France - Second round Presidential election
June 11, 2017	France - First round of Legislative Elections
June 18, 2017	France - Second round of Legislative Elections
24 September 2017	Germany - General Election

Source: Amundi Strategy

Market snapshot

Equity markets	14/04/2017	Over 1 week	Over 1 month	Ytd
S&P 500	2329	-1,1%	-1,5%	4,0%
Eurostoxx 50	3448	-1,4%	1,4%	4,8%
CAC 40	5071	-1,2%	1,9%	4,3%
Dax 30	12109	-0,9%	1,0%	5,5%
Nikkei 225	18336	-1,8%	-6,5%	-4,1%
MSCI Emerging Markets (close -1D)	963	0,1%	2,4%	11,7%
Commodities - Volatility	**14/04/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	56	1,2%	9,8%	-1,6%
Gold ($/ounce)	1286	2,5%	7,2%	11,6%
VIX	16	3,1	3,7	1,9
FX markets	**14/04/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1,06	0,3%	0,2%	1,0%
USD/JPY	109	-2,2%	-5,3%	-7,1%
EUR/GBP	0,85	-0,9%	-2,8%	-0,6%
EUR/CHF	1,07	-0,2%	-0,5%	-0,5%
Fixed Income markets	**14/04/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0,36	--	--	-3 bp
Euribor 3M	-0,33	--	--	-1 bp
Libor USD 3M	1,16	-	+2 bp	+16 bp
2Y yield (Germany)	-0,86	-5 bp	-5 bp	-9 bp
10Y yield (Germany)	0,19	-4 bp	-26 bp	-2 bp
2Y yield (US)	1,21	-8 bp	-17 bp	+2 bp
10Y yield (US)	2,24	-14 bp	-36 bp	-21 bp
Eurozone Sovereigns 10Y spreads vs Germany	**14/04/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+73 bp	+7 bp	+9 bp	+25 bp
Austria	+23 bp	+3 bp	+3 bp	+2 bp
Netherlands	+25 bp	-	-2 bp	+10 bp
Finland	+12 bp	+1 bp	-	-2 bp
Belgium	+57 bp	+3 bp	+6 bp	+24 bp
Ireland	+74 bp	+6 bp	+5 bp	+20 bp
Portugal	+370 bp	+6 bp	+18 bp	+14 bp
Spain	+152 bp	+13 bp	+9 bp	+34 bp
Italy	+213 bp	+14 bp	+23 bp	+52 bp
Credit markets	**14/04/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+77 bp	+2 bp	+3 bp	+5 bp
Itraxx Crossover	+294 bp	+11 bp	+5 bp	+6 bp
Itraxx Financials Senior	+93 bp	+5 bp	+5 bp	--

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