Amundi
ASSET MANAGEMENT

Cross asset investment strategy

Research,Strategy and Analysis

WEEKLY

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May 8 - 12, 2017

Highlights of the week

- **Markets :** long-term yields without any real direction; the euro has depreciated. The euro and dollar credit markets performed well**;** the equity markets were rather calm
- **United States :** labour market in very good shape with job openings increasing to 5.74m in March.
- **Eurozone :** rise of European Commission's growth forecast for 2017 to 1.7%; fall in projected inflation; increase of Germany's GDP by 0.6% in Q1 2017.
- **Emerging markets:** China's PPI remained strong in April; inflation in Brazil fell below target to 4.08% in April.

Key focus

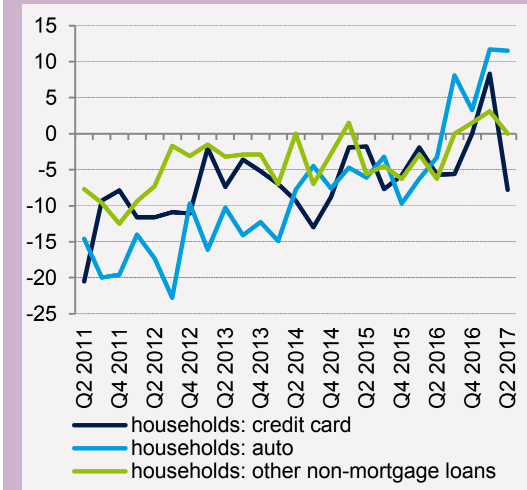
US household consumption: beware of credit conditions!

Investors are still perplexed about the US growth outlook, with the weakening observed in Q1 (0.7% qoq annualised). Indeed, the gap has widened between business surveys, which are good, and real business numbers, which are mixed. Household consumption, the US economy's main engine, has been disappointing amid flat private investment. However, this expansion cycle has also been characterized by very attractive financing conditions, a result of the Fed's highly accommodating monetary policy.

Where are we in the US credit cycle?

- **Corporate indebtedness is at an all-time high**. The IMF itself has issued a warning about the difficulties to perform debt servicing for a substantial proportion of US businesses, paradoxically in a very low interest rate environment.
- **Conversely, consumer spending has projected a rather reassuring image overall.** The current environment is totally different from the one seen in 2008: outstanding mortgage debt remains contained and concentrated on the least-risky households. However, it is best not to be overly optimistic: the risks associated with consumer loans (student, auto, and credit card) have risen sharply.
    I. The volume of student loans virtually doubled between 2008 and 2016.
    II. Auto debt is 40% higher than the peak of 2008, and a substantial share of the outstanding loans is exposed to the subprime risk.
    III. Growth in credit card debt has accelerated recently. At this rate, the peak achieved in 2008 will be surpassed in less than one year.

Net percentage of banks reporting tighter credit standards



Source: Datastream, Amundi Research

The credit conditions survey conducted by the Fed with the top US banks ("*Senior Loan Officer Opinion Survey*") confirms a less-optimistic scenario. Published on 8 May, it shows that bank loan demand among consumers and businesses is down. This decline in demand is especially marked for auto and "credit card" loans (remember that these two segments make up a little over half of non-real estate consumer debt). The *Senior Loan Officer Opinion Survey* also shows a distinct tightening of credit conditions for the auto loan segment over Q2, and mixed factors on the other bank loan segments. The worsening outlook on the auto segment should weigh down economic forecasts a bit. That is one of the reasons why the New York Fed is issuing relatively weak growth forecasts (just 1.75% for 2018, compared to 2.5% for the major players on the US Treasury bond market), explaining: *"For 2018, we expect real GDP growth to be close to our estimate of potential growth as financial conditions continue to tighten*".

The United States' position in the credit cycle will make any noticeable acceleration of US growth in the coming years difficult: the US auto sales slumped for the fourth month in a row and consumption growth remains supported by the growth in the credit card debt, which will probably fade in a two year horizon.

The week at a glance

> Economic indicators

Eurozone >

The European Commission raised its growth forecast slightly for 2017. It moved from 1.6% to 1.7%. The forecast for 2018 is unchanged at 1.8%. Projected inflation is down a little (from 1.7% to 1.6% for 2017, and from 1.4% to 1.3% for 2018). **Germany's GDP increases by +0.6% in Q1 (from +0.4% in Q4 2016).** Detailed components are not yet available but the official press release says investment was strong, household consumption slightly on the rise and exports rose more than imports.

The economic situation continues to improve. Growth is getting more balance with more contribution from investment. We recently increase our growth forecast, although we remain a bit more prudent than the European Commission (our figures are now 1.6% for 2017, 1.5% for 2018).

United States >

Slightly disappointing retail sales. April retail sales rose only +0.4% (vs. 0.6% expected and after an upwardly revised March rise of +0.1%). "Control group" retail sales (similar to household consumption as measured in GDP) rose only +0.2%. **Small decline in inflation.** April CPI vas 2.2% YoY (vs. 2.3% forecast and after 2.4% in March). Core inflation also declined to 1.9% (it was expected unchanged at 2%. **Strong labour market.** The number of job openings increased to 5.74m in March (from 5.68m in February). The NFIB small business confidence index fell slightly, but stayed high at 104.5 (vs. 104.7 in March).

The relatively weak retail sales do not change our view that the US recovery will continue, with some improvement probable later in Q2. The strong labour market remains the main supportive factor of this recovery. Relatively weak inflation means that the Fed continues to have room to increase policy rates only very gradually.

Japan >

Wage data continue to betray investors. Total monthly earnings unexpectedly dropped by 0.4% y/y in March, contracting for the first time in 10 months. Accordingly, real earnings plunged by 0.8% y/y, the biggest fall since June 2015.

The negative surprise partially reflects the situation in March last year, when cash earnings soared 1.5% y/y. More importantly, though, an anaemic rise in basic monthly wages of some 0.2% y/y is vulnerable to a decline in overtime compensation and smaller bonus payments. Companies remain reluctant to raise fixed costs before witnessing a clear omen for higher productivity and profitability.

Somehow the reading appears contradictory to the fact that the unemployment rate has fallen to 2.8%, unseen for 23 years. The BOJ Tankan survey reveals that a vast range of companies claim there is a labour shortage. The surge in the jobs-to-applicant ratio, which soared to 1.45, the highest since 1990, demonstrates serious difficulties in recruiting. On the employment front, payrolls are constantly rising at 2.5% y/y. However, new employees are essentially the young, whose monthly pay cheques are relatively low. Companies simultaneously restrain the wages and salaries of employees aged 40 and over in order to flatten the "seniority wage curve", that has been outweighing productivity growth. Aggregate wages will not show a substantial increase without broad and comprehensive efforts to boost labour productivity.

China >

China's Producer Price Index (PPI) momentum remained strong in April. In terms of price data, April 2017 PPI came in slightly weaker than expected at +6.4% (vs. consensus 6.7% and previously 7.6%), and CPI yoy came in slightly stronger than expected at 1.2% (vs. consensus 1.1% and previously 0.9%). In terms of trade data, China's April export growth yoy in CNY terms was slightly worse than expected at 14.3% (vs. consensus 16.8% and previously 22.3%), while import yoy growth in CNY terms came in slightly weaker as well at 18.6% (vs. consensus 29.3% and previously 26.3%).

Within the April price and trade data, there are several highlights: 1. PPI remained strong in April, but it still made real interest rates at -2.1% very positive for corporate earnings; 2. Imports were still relatively strong in April 2017, with coal imports at 32% yoy growth (vs. 12% in March), and crude oil at 6% yoy growth (vs. 19% in March). We think the correction in PPI and commodity prices is temporary due to the slight excess inventory near term and destocking has to happen. However, it would not last long, and most likely take place before the end of the second quarter. We continue to believe China stabilisation will be sustainable through to end-2018, and Chinese economic stability is the biggest contributor to global economic stability and recovery.

Brazil>

Inflation drops from 4.57% yoy in March to 4.08% in April i.e below the BCB target set at 4.5%. Inflation of regulated prices fell substantially to 4.24% in April, against 5.59% in March. On the other hand, market prices fell less: 4.03% against 4.25% in March. Underlying inflation contributed to this movement from 5.62% in March to 5.2% in April.

Inflation has fallen below the target and without any external shock will continue to decrease. The current economic environment – well-anchored inflation expectations, quite stable Real, very weak labor market and low/slow recovery - is favorable to a further rate cut at the 31st May BCB meeting. However, due to the recent volatility in oil prices, the BCB could be cautious and not deliver more than in April i.e a decrease of 100 bp.

Financial markets

Fixed-income

Long-term yields without any real direction. US and German 10-year yields ended the week almost where they began the week, at 2.35% and 0.41% respectively. After the significant tightening of the last two weeks, euro sovereign spreads very marginally widened.

In the absence of fiscal stimulus measures in the United States, with central banks in no hurry to withdraw accommodative monetary measures and with the subsiding of base effects on inflation, there is no immediate catalyst prompting long yields to rise again. That said, we believe European long yields will rise again significantly in the second half of the year.

Foreign exchange

The euro has depreciated after its strong outperformance in recent weeks. The EUR/USD exchange rate ended the week at 1.09 (-0.8%). Note the substantial underperformance of the Swiss franc, with the EUR/CHF exchange rate close to 1.10. Emerging currencies continued to outperform on average the developed currencies. It is also worth highlighting the remarkable stability of the USD/RMB exchange rate.

The euro is taking a break in its appreciation movement. Confirmation by ECB Board members of a gradual withdrawal from accommodative monetary measures should enable the euro to continue to appreciate.

Credit

The euro and dollar credit markets performed well this week. The euro primary market saw renewed activity after several weeks of relative calm due to the French presidential elections and the earnings season.

Eurozone: The removal of political uncertainty had a very positive influence on the markets. The Euro IG index spread tightened by almost 20bp, to 105bp, i.e. still 15bp higher than the low reached at the beginning of 2015. Credit should continue to perform well even though spread tightening potential is now more limited. However, questions generated by continued QE and the political risk in Italy could lead to volatility in the credit markets in H2. We believe these risks remain contained: (1) our scenario includes the continuation of QE in 2018 and (2) the Five Star Movement currently attracts only a third of the votes. On the euro market, we favour issuers offering yield.

Equity

The equity markets were rather calm after the French elections, the outcome of which had been expected. In addition, corporate earnings publications continued their positive drive. 81% of companies have published in the United States, 71% in Europe, and 41% in Japan. Earnings have risen by +14% in the US, 5% better than expected. In Europe they have climbed +24%, 11% better than expected. They have also risen in Japan, by +25%.

Though legislative elections in France still await, the electoral issue is now a domestic factor for France and no longer carries a systemic risk for the eurozone. As expected, the removal of this risk has been a catalyst for the eurozone markets in recent weeks. We think they still have potential, in relative terms. After profiting from the political risk premium, there is, in fact, a relative risk premium to be recovered; European equities are much less expensive than their American counterparts. This seems feasible as long as profit momentum stays strong.

Key upcoming events

Economic indicators

US : Industrial production should have stabilized in April. **Eurozone :** Inflation should have increased in April.

Date	Country	Upcoming macroeconomic data	Consensus	Prior
May 15	China	Industrial production. YoY. April	7.0%	7.6%
May 16	UK	CPI. YoY. April	2.6%	2.3%
	Eurozone	GDP. YoY. Q1	1.7%	1.7%
	Eurozone	Trade balance. March		€ 17.8 Bn
	US	Industrial production. MoM. April	0.4%	0.5%
May 17	Japan	Industrial production. MoM. March		-2.1%
	UK	Unemployment rate. March	4.7%	4.7%
	Eurozone	CPI. YoY. April	1.9%	1.5%
May 18	Japan	GDP. YoY. Q1	0.4%	0.3%
	UK	Retail sales. MoM. April	1.0%	-1.5%
	US	Philadephia Fed survey. May	19.5	22.0
May 19	Eurozone	Consumer confidence. April	-3.0	-3.6

Source: Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
May 15	France	Short-term, € 6.6 Bn
May 16	Spain	Short-term, amounts not available on Friday
May 17	Germany	30 years, € 1 Bn
May 18	France	Long-term, amounts not available on Friday
	Spain	Long-term, amounts not available on Friday

Source: Bloomberg, Amundi Strategy

Key events

Date	Upcoming monetary policy committee meetings
June 8, 2017	European Central Bank (ECB)
June 14, 2017	Federal Reserve (Fed)
June 15, 2017	Bank of England (BoE)
June 16, 2017	Bank of Japan (BoJ)

Date	Upcoming important events
June 8, 2017	United Kingdom - Parliamentary Elections
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	12/05/2017	Over 1 week	Over 1 month	Ytd
S&P 500	2394	-0.2%	2.1%	7.0%
Eurostoxx 50	3626	-0.9%	4.5%	10.2%
CAC 40	5389	-0.8%	5.6%	10.8%
Dax 30	12731	0.1%	4.7%	10.9%
Nikkei 225	19884	2.3%	7.2%	4.0%
MSCI Emerging Markets (close -1D)	1000	2.3%	4.4%	16.0%
Commodities - Volatility	**12/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	51	3.9%	-8.7%	-10.2%
Gold ($/ounce)	1231	0.8%	-4.3%	6.9%
VIX	11	0.0	-5.2	-3.4
FX markets	**12/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1.09	-0.8%	2.3%	3.8%
USD/JPY	113	0.6%	4.0%	-3.1%
EUR/GBP	0.85	0.0%	-0.4%	-0.8%
EUR/CHF	1.10	1.1%	2.6%	2.4%
Fixed Income markets	**12/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0.36	--	--	-3 bp
Euribor 3M	-0.33	-	-	-1 bp
Libor USD 3M	1.18	-	+2 bp	+18 bp
2Y yield (Germany)	-0.67	-	+16 bp	+9 bp
10Y yield (Germany)	0.41	-1 bp	+21 bp	+20 bp
2Y yield (US)	1.31	--	+11 bp	+12 bp
10Y yield (US)	2.35	-	+11 bp	-9 bp
Eurozone Sovereigns 10Y spreads vs Germany	**12/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+45 bp	+2 bp	-28 bp	-3 bp
Austria	+25 bp	-1 bp	+1 bp	+4 bp
Netherlands	+21 bp	-	-5 bp	+6 bp
Finland	+7 bp	+1 bp	-5 bp	-7 bp
Belgium	+41 bp	+2 bp	-15 bp	+8 bp
Ireland	+46 bp	-	-28 bp	-8 bp
Portugal	+299 bp	+2 bp	-67 bp	-57 bp
Spain	+123 bp	+9 bp	-24 bp	+5 bp
Italy	+185 bp	+11 bp	-25 bp	+25 bp
Credit markets	**12/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+63 bp	-1 bp	-14 bp	-9 bp
Itraxx Crossover	+257 bp	+1 bp	-38 bp	-32 bp
Itraxx Financials Senior	+68 bp	-1 bp	-24 bp	-25 bp

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