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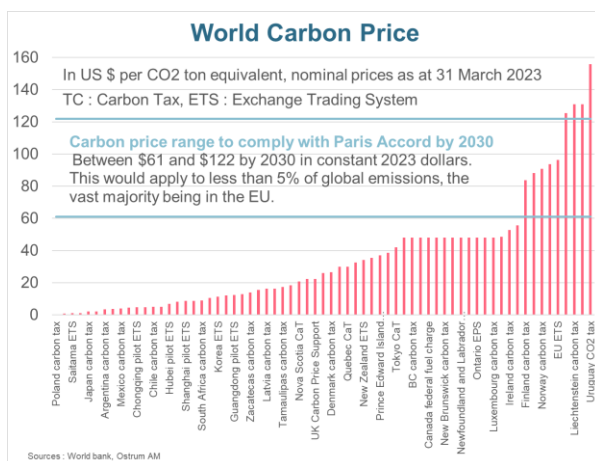
● Topic of the week: COP28, in a (too) indebted world

- 2023 marks a turning point in global public debt;
- The trajectory of public debt has been significantly revised upwards compared to previous pre-covid projections;
- Rising borrowing costs discourage ESG bonds issuance by non financial enterprises;
- This may hinder the green transition and the achievement of climate goals;
- The interconnection between debt and climate in developing countries increases their vulnerability, requiring significant financial support from rich countries to finance their green transition.

● Market review: The Fed plays with the markets again

- Fed: perilous communication to frame expectations;
- Historical monthly performance on stocks and bonds;
- Stabilization in the US dollar;
- Spreads still well oriented.

● Chart of the week



The fight against climate change requires an unprecedented level of international cooperation in a troubled international context.

This cooperation will notably take the form of homogenizing carbon prices. The price of carbon is determined either through taxes or through an emissions trading system. Current prices range from 0 in Poland to \$160 per tonne in Uruguay.

The price objective per ton of carbon in constant dollars integrated into the Paris agreements is between \$61 and \$122 by 2030.

At the end of March 2023, less than 5% of global greenhouse gas emissions were covered by a carbon price within this target or above, mainly in European Union countries. This is very insufficient.



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● Figure of the week

8.9%

Source : Bloomberg

The S&P 500 rose by 8.9% this month, its second-best November since 1980, behind the pandemic-fueled rebound in 2020, according to data compiled by Bloomberg

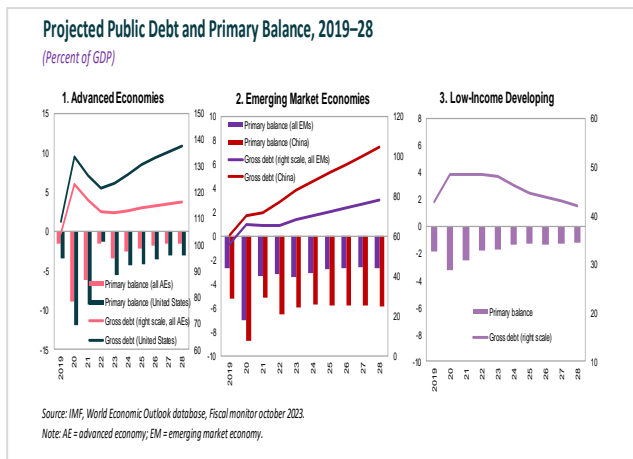
• **Topic of the week**
**COP28, in a (too)
indebted world**

After the Covid crisis and the war in Ukraine, public finances have deteriorated significantly around the world, especially in developing countries, limiting their budgetary leeway to finance the green transition. Tighter global financial conditions are also a constraint for companies that become more cautious about issuing debt. These are important points of concern at COP28 and will have implications for the challenge of the green transition.

2023: a turning point for public debt

US and China: the two drivers of global public debt

Public debt is high all over the world and borrowing costs have risen, significantly raising the trajectory of public debt compared to previous pre-Covid projections. The graphs below show the IMF's projections for the so-called advanced and emerging countries.

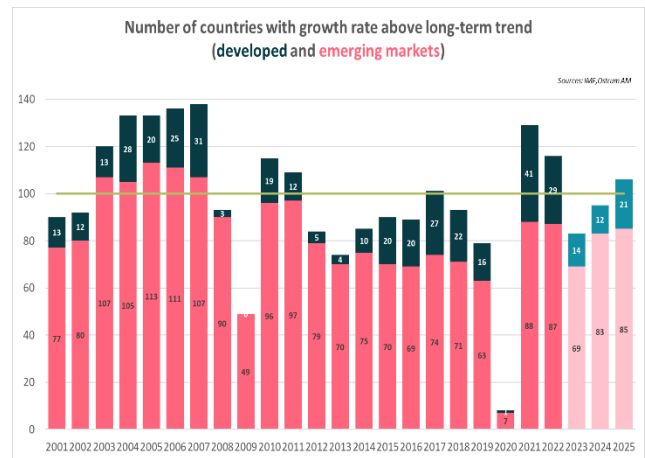


The increase in global public debt is due to the United States (140% of GDP in 2028) and China (104% of GDP in 2028)! After the decline in 2021-2022, the public debt/GDP ratio is expected to continue to rise by 1 ppt/year over the medium term. Excluding China and the United States, the ratio is expected to fall by 0.5 ppt/yr. However, at this rate, global public debt is expected to reach 100% of GDP by the end of this

decade. In developing countries, public debt seems low, but the interest expense often represents a very large share of the revenues.

Growth under the long-term trend increases debt burden

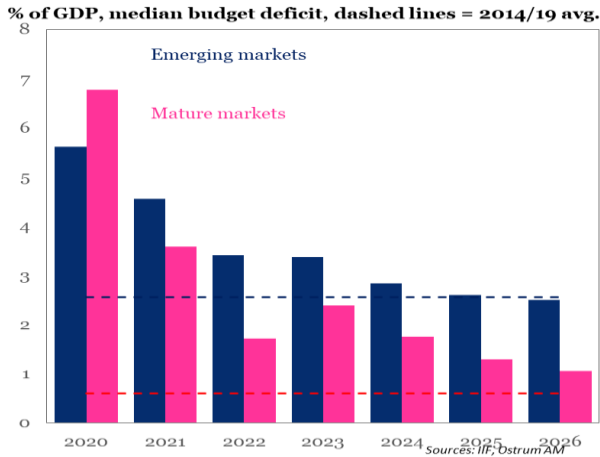
The graph below shows the number of countries whose growth is above the long-term trend, with a breakdown between developed and emerging countries.



To build it, we calculate from the IMF database the average growth over the last 20 years for developed and emerging markets that we then compare with the growth forecast. The number of countries expected to grow above the long-term trend is below the long-term average (100) for 2024 and 2025. Only 12/40 so-called developed countries and 85/154 so-called emerging countries will record growth above their long-term trend in 2024. A slowdown in growth increases the debt burden.

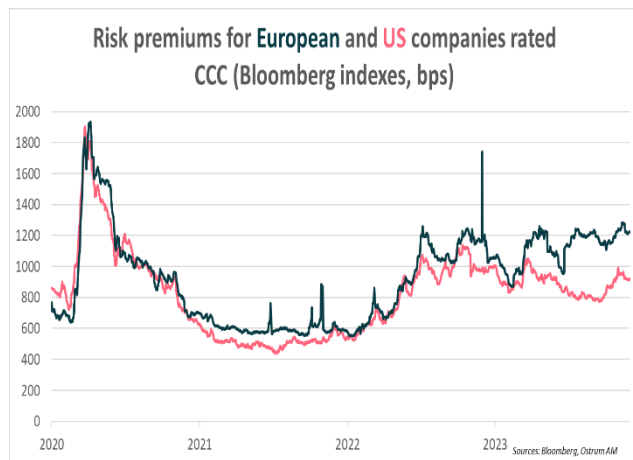
Budget deficits dipping further into the red

The rise in real interest rates and the widening of budget deficits that remain above their level before the Covid crisis, particularly in developed countries (graph below, taken from the IIF), should help maintain the upward trajectory of public debt. This means that the debt burden will increase, requiring a medium-term adjustment, to rebuild fiscal buffers.



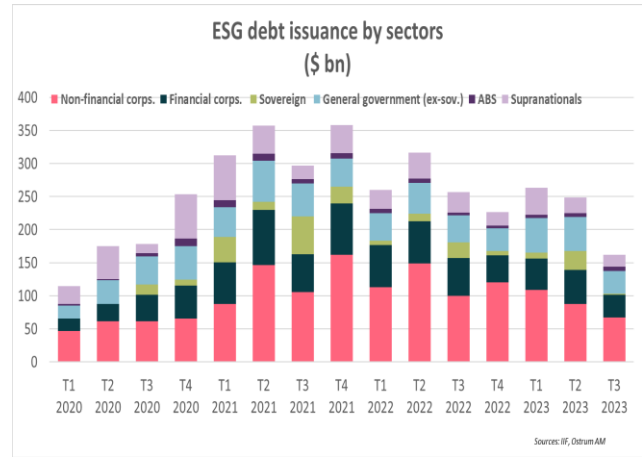
What about non-financial corporate debt?

Tighter financial conditions are also weighing on companies whose borrowing costs have risen significantly. The following graph shows the divergence between the risk premiums of European and American companies, rated «CCC».



The impact of monetary tightening has been stronger for European companies than for American ones.

This also has an impact on their “green” ESG bond issues which fell in Q3 2023, returning to their 2020 level, as shown in the chart below.



The decline in ESG green bond issuance in Q3 2023 is related to non-financial companies. This acts as a constraint to financing the green transition.

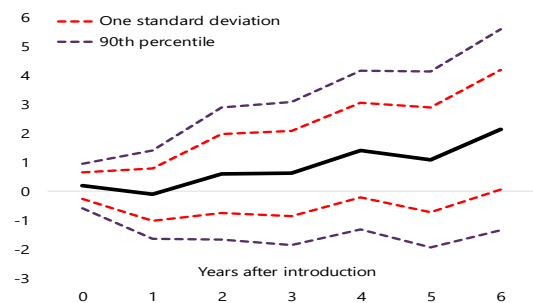
What implications for the green transition?

Governments face three challenges: how to reconcile debt sustainability, climate goals and political feasibility?

Carbon pricing

Carbon pricing appears to be one of the solutions to easing fiscal pressure, but, like other income-related measures, can be politically unpopular, despite its effectiveness in reducing emissions and generating potential revenues. The graph below shows the IMF’s projections of the impact of a \$40 per ton carbon tax on European Union GDP.

Impact of Carbon Prices at \$40 a Ton on Real GDP for EU Countries, 1990–2019 (Percentage points)



Source: IMF staff estimates based on Metcalf and Stock (2023).
Note: The carbon tax covers 30 percent of emissions.

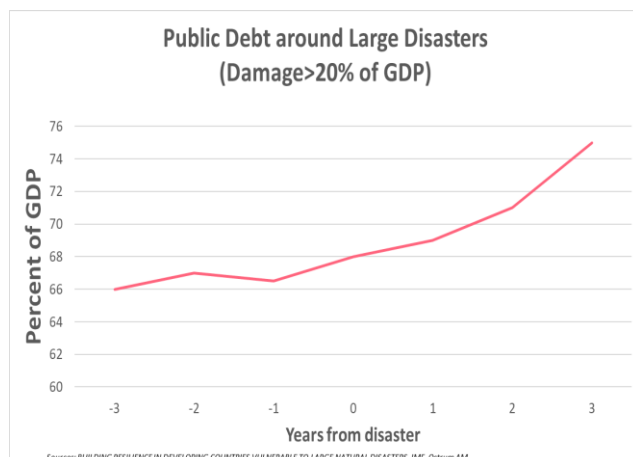
Confidence intervals are wide... Six years after introducing the carbon tax, the model suggests that European GDP could increase by 2 ppt. However, while carbon pricing is a necessary tool for reducing CO₂ emissions, it is not sufficient and must be accompanied by other policies to address market failures and catalyze private financing and investment in low-carbon technologies. Moreover, budget transfers will be needed to protect households, workers, and vulnerable populations during the green transition.

Financing the green transition in developing countries

This is one of the most controversial issues to be addressed during COP28. Who will pay for the green transition of developing countries? According to the UN, these countries will need \$200 billion a year by 2030 to adapt to climate change.

It is with this in mind that the “loss and damage” fund was created. It is expected to release \$100 billion by 2030. Rich countries are reluctant to live up to their commitments. The “loss and damage” fund is still to be developed: let’s bet that concrete progress will emerge during COP28, since these are countries with a high vulnerability to climate change.

There is even an interconnection between debt and climate for developing countries. According to a 2019 IMF study, which analyzed 11 cases of major natural disasters between 1992 and 2016 in developing countries – resulting in a 20% contraction in GDP – public debt increased on average from 68% to 75% of GDP on average, three years after the disaster, as shown in the graph below.



Climate disasters are an important debt catalyst for developing countries, limiting fiscal space for other spending sectors such as education and health also two other important areas of action in the fight against the consequences of climate change.

Conclusion

High public debt and rising borrowing costs have implications for the green transition, limiting fiscal space and ESG green bond issuance. Carbon pricing appears to be one of the solutions easing the fiscal pressures. It is a necessary tool to reduce carbon emissions, but not sufficient, and must be accompanied by policies to offset the social costs it generates. In developing countries, the interconnection between debt and climate increases their vulnerability, requiring significant financial support from rich countries to finance their green transition. The heavy electoral calendar in 2024 risks delaying fiscal consolidation and postponing the achievement of climate objectives.

Zouhoure Bousbih

- **Market review**

The Fed plays with the markets again

The return of soundbites from central bankers to regulate rate levels calms minds after a month of stellar performance on stocks and bonds.

The financial markets had a historic month in November. The S&P 500 rallied almost 10% while global bond markets returned 5%, the best monthly performance since 2008 during the financial crisis. Disinflation is accelerating and fueling expectations of rate cuts from the second quarter of 2024. The Fed, which had considered at the beginning of November that the rise in long-term rates between August and October reduced the need to act on Fed funds, is now faced with the opposite problem. Financial conditions have loosened considerably with the combined fall in bond yields, credit spreads and the US dollar and the sharp rise in equities. Equity implied volatility remains very low at less than 13% on the VIX index. The T-note seems to settle in a range of 4.25 to 5%. The Bund (2.40%) follows the same movement as a decision from the ECB on the PEPP reinvestment policy looms in December. Spreads remain well oriented with a strong compression trend and thus the outperformance of high yield. Japanese bond yields display unusually high volatility. The 10-year JGB yield hovers around 0.70%. The US greenback stabilized last week. The euro is trading around \$1.09 as the RBNZ's extended status quo on interest rates supported the New Zealand dollar.

The Federal Reserve seems forced into verbal intervention again to reshape market rate expectations. The blackout period imposed before the FOMC on December 13 is fast approaching. Thus, John Williams and Mary Daly, two usual doves of the Fed, hastened to recall the need to hold rates steady mitigating earlier remarks from Governor Christopher Waller. These verbal interventions seem to limit the US 10-year bond yield between 4.25% and 5%. Jerome Powell agreed with this on Friday, judging that inflation was not yet at target. OPEC's decision to reduce its oil production quotas raises the risk of a rebound in energy prices in the first half of 2024.

As regards the economic situation, household consumption slowed in October but spending growth should be around 2.3 % in the 4th quarter. Productive investment seems better directed and public support continues. A negative contribution from inventories and foreign trade is expected. In the euro area, like in the US, statements from central bankers abound and the debate on PEPP reinvestments is resurfacing. At the same time, rapid disinflation to 2.4% in November translates into expectations for policy rate cuts from April. Core inflation falls below 4% (3.6%). Taking into account the increase in wages (4.7% in the 3rd quarter), the purchasing power of households in the euro zone is improving at the turn of 2024.

On the financial markets, the classic 60/40 allocation takes full advantage of disinflation accelerated by the decline in the barrel of crude oil. The fall in long-term rates improved stock market valuations, particularly on growth stocks. The Nasdaq soared 11% in November. Global bonds rose 5%, the best monthly performance since the financial collapse of 2008. On US Treasuries, the 2-year T-note is trading around 4.70% after a weekly rally of 25 bp. The steepening of the US Treasuries yield curve resumed with expectations of monetary relief. The pattern is similar on German Bunds. The market participants are questioning the commitment of central bankers to maintain a restrictive policy while inflation is approaching the sacrosanct 2% target. Sovereign spreads are stable at tight spread levels of around 56 bp on the 10-year OAT and 175 bp on the Italian BTP.

The credit market has tightened in the wake of CDS indices. The iTraxx IG is trading around 70 bp while the Crossover has plunged more than 100 bp from the October peak. Three-quarters of primary market deals over the past month are now trading at tighter spreads than at issuance.

The adjustment of the US dollar is the usual corollary of the rebound in risk assets. Stocks jumped 7-11% for the major equity indices. Like in credit markets, flows have picked up globally in the past few weeks. The Euro Stoxx 50 is now trading at the upper limit of the 2023 price range. As such, the hope of monetary relief overshadows all other risks.

Axel Botte

● Main market indicators

G4 Government Bonds	04-Dec-23	1wk (bp)	1m (bp)	2023 (bp)
EUR Bunds 2y	2.69%	-31	-27	-7
EUR Bunds 10y	2.36%	-18	-28	-21
EUR Bunds 2s10s	-33.1bp	+12	-1	-12
USD Treasuries 2y	4.59%	-30	-25	+16
USD Treasuries 10y	4.24%	-15	-33	+36
USD Treasuries 2s10s	-35.2bp	+15	-8	+21
GBP Gilt 10y	4.17%	-4	-12	+50
JPY JGB 10y	0.7%	-8	+3	-15
€ Sovereign Spreads (10y)	04-Dec-23	1wk (bp)	1m (bp)	2023 (bp)
France	57bp	+1	0	+3
Italy	176bp	+3	-2	-37
Spain	101bp	+2	-2	-8
Inflation Break-evens (10y)	04-Dec-23	1wk (bp)	1m (bp)	2023 (bp)
EUR 10y Inflation Swap	2.22%	-10	-19	-33
USD 10y Inflation Swap	2.47%	-5	-20	-6
GBP 10y Inflation Swap	3.67%	-7	-16	-24
EUR Credit Indices	04-Dec-23	1wk (bp)	1m (bp)	2023 (bp)
EUR Corporate Credit OAS	146bp	-2	-14	-21
EUR Agencies OAS	73bp	+1	-4	-6
EUR Securitized - Covered OAS	81bp	+1	-2	-3
EUR Pan-European High Yield OAS	439bp	-1	-50	-73
EUR/USD CDS Indices 5y	04-Dec-23	1wk (bp)	1m (bp)	2023 (bp)
iTraxx IG	67bp	-2	-11	-24
iTraxx Crossover	366bp	-14	-52	-108
CDX IG	61bp	-2	-9	-21
CDX High Yield	396bp	-12	-73	-88
Emerging Markets	04-Dec-23	1wk (bp)	1m (bp)	2023 (bp)
JPM EMBI Global Div. Spread	412bp	+1	-30	-40
Currencies	04-Dec-23	1wk (%)	1m (%)	2023 (%)
EUR/USD	\$1.088	-0.712	1.474	1.6
GBP/USD	\$1.268	0.388	2.690	4.9
USD/JPY	JPY 147	1.426	2.367	-10.6
Commodity Futures	04-Dec-23	-1wk (\$)	-1m (\$)	2023 (%)
Crude Brent	\$77.7	-\$2.1	-\$6.7	-3.7
Gold	\$2 074.2	\$60.1	\$96.0	13.7
Equity Market Indices	04-Dec-23	-1wk (%)	-1m (%)	2023 (%)
S&P 500	4 595	0.77	5.42	19.7
EuroStoxx 50	4 408	1.23	5.59	16.2
CAC 40	7 316	0.70	3.81	13.0
Nikkei 225	33 231	-0.65	4.01	27.3
Shanghai Composite	3 023	-0.29	-0.26	-2.1
VIX - Implied Volatility Index	13.24	4.33	-11.20	-38.9

Source: Bloomberg, Ostrum AM

Additional notes

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