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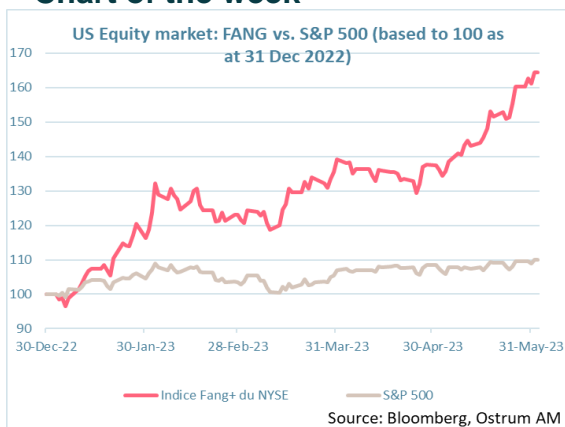
● Topic of the week: Towards a rapid return of Greek debt to investment grade

- The Prime Minister has a good chance of obtaining an absolute majority in the second round of the legislative elections on 25th June;
- He will thus continue the reforms and investments necessary to benefit from Next Generation EU funds;
- Sustained growth, fiscal prudence and the very long maturity of sovereign debt bode well for the continued fall in the public debt-to-GDP ratio;
- This suggests a rapid return of Greek debt to investment grade. Investors have begun to position themselves in this direction. Moody's will speak on June 9.

● Market review: Tensions ease on markets

- Disinflation quickens in Europe;
- Solid job gains in the US;
- 10-Yr note yields rally to 3.60% before a late sell-off on Friday;
- Stocks rally late last week with VIX plunging below 15%.

● Chart of the week



The US equity market remains driven by the theme of artificial intelligence.

The FANG index, which includes 10 leading stocks in the sector, has risen 64% since the start of the year. The broad S&P 500 index gained nearly 10% thanks to the contribution of these mega-cap stocks when in reality most stocks did not show any gain this year.

Bear in mind that concentrated performance on a few stocks could spark market sell-off in the event of disappointment in US tech.

● Figure of the week

1.7

Source : IAE

For every dollar invested in fossil fuels, \$1.70 now goes to clean energy technologies. Five years ago that ratio was 1:1..



Axel Botte
 Head of Market Strategy
 axel.botte@ostrum.com



Zouhoure Bousbih
 Emerging countries strategist
 zouhoure.bousbih@ostrum.com



Aline Goupil-Raguénès
 Developed Markets Strategist
 aline.goupil-raguenes@ostrum.com

• **Topic of the week**

Towards a rapid return of Greek debt to investment grade

The outgoing Prime Minister has a good chance of obtaining an absolute majority in the second round of legislative elections. This bodes well for the continuation of the economic policy combining robust growth, structural reforms and fiscal prudence. A triptych favorable to the continuation of the rapid decline in the debt-to-GDP ratio and auguring the imminent return of Greek debt to investment grade.

The Prime Minister is likely to win an absolute majority

In the legislative elections of May 21, the center right party of Kyriakos Mitsotakis, outgoing Prime Minister, recorded a large victory and strengthened its score compared to the 2019 elections, thus defying the polls. New Democracy won 40.8% of the vote, narrowly missing an absolute majority by obtaining 146 seats out of the 300 in Parliament. The far-left party, Syriza, came far behind with 20.1% of the vote, followed by the socialist party PASOK: 11.5%.

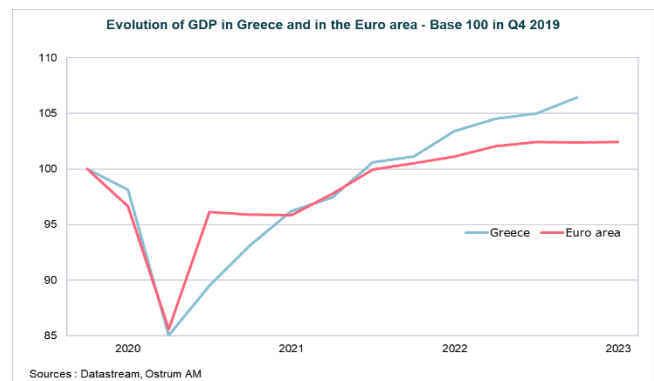
The Prime Minister ruled out the formation of a coalition government. A second round will therefore take place on June 25. This time, the voting system will be held in the form of a proportional plus. The winning party may obtain a bonus of up to 50 seats depending on the results. Given his big win in the first round, Kyriakos Mitsotakis should probably get an absolute majority.

This therefore suggests the continuity of the economic policy put in place for four years with the continuation of structural reforms, the increase in investments and the maintenance of a prudent fiscal policy likely to generate a further reduction in public debt. At the end of the first round, the rating agency Moody's declared that these results constituted a positive event for the credit of Greece.

Robust growth

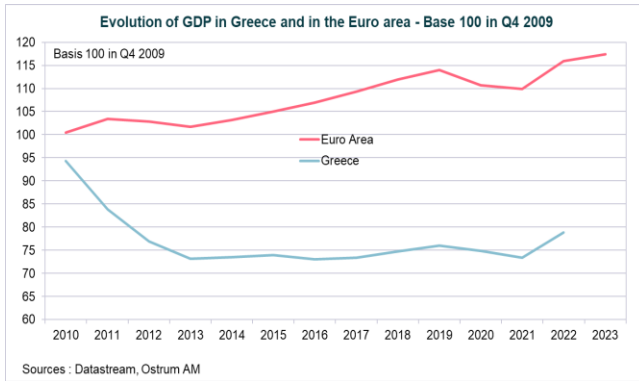
A strong post-Covid recovery...

The voters chose stability and particularly welcomed the strong recovery in growth since the Covid-19 crisis. As shown in the following graph, while Greece and the Eurozone experienced a fall in GDP of the same magnitude during the 1st half of 2020 (-15% compared to Q4 2019), following the shock linked to the sudden closure of economies, the recovery is stronger and more resilient in Greece. This is due in particular to the sharp rebound in tourism and the importance of this sector in Greek growth, as well as the dynamism of investment which benefits from strong support from the European Union. In 2022, Greek growth remained sustained (6.1%) while that of the Eurozone slowed down significantly (3.5%). It was driven by consumption as well as strong investment. In the 4th quarter of 2022, Greek GDP was thus 6.4% higher compared to the level at the end of 2019, versus 2.4% for the Eurozone, in the 1st quarter of 2023.



... after a growth slump in 2010-2012

This recovery must be viewed against the sharp contraction of Greek GDP during the sovereign debt crisis. Between 2010 and 2012, the GDP contracted by almost 30% reflecting the austerity policy implemented in return for the loans granted by the European Union, the ECB and the IMF in order to avoid a payment default of Greece and the risk of an exit from the Eurozone.



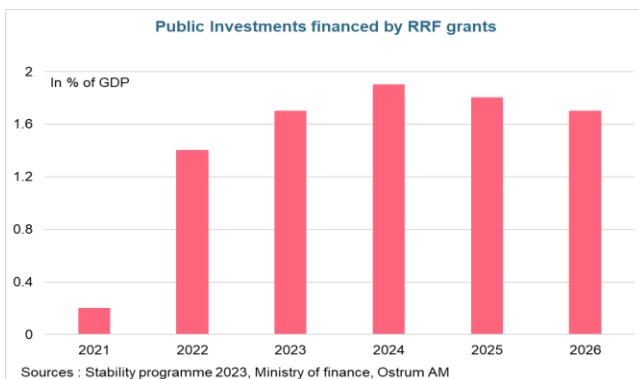
This was followed by a long period of stagnation. Today, GDP is still nearly 20% below the level that prevailed before the outbreak of the sovereign debt crisis.

Growth should remain resilient

The growth carry-over for 2023 is 1.5% (average growth assuming GDP stability over the year as a whole), whereas in the Eurozone, it comes out at just 0.4% at the end of the 1st quarter of 2023. Tourism should continue to support growth, the job market should remain well oriented and investment should remain robust. The European Commission anticipates growth of 2.4% in 2023 and 1.9% in 2024.

Dynamic investment linked to Next Generation EU

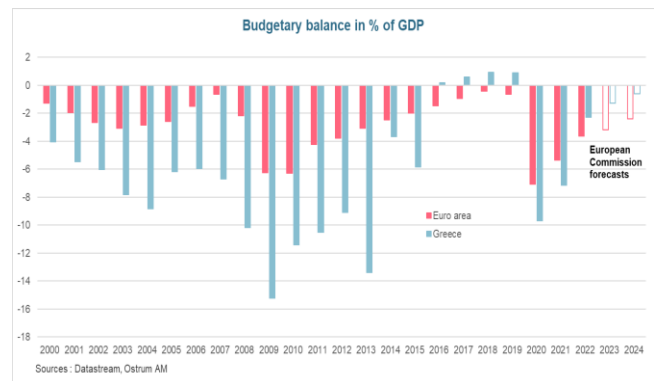
Greece was one of the few countries, along with Italy, to have requested from the European Union the entire envelope of loans under Next Generation EU in addition to grants. In total, Greece has requested 30.5 billion euros under the Recovery and Resilience Facility (RRF), which represents 18% of 2020 GDP. It is colossal. Payment is subject to implementation of structural reforms and investments to green the economy and develop digital technology. The implementation of the plan, which initially focused on reforms, is now more oriented towards investments. The stability program presented by the government in April expects a significant increase in the share of public investment financed by subsidies to 1.7% and 1.9% of GDP in 2023 and 2024.



Marked improvement in public finances

Return to primary surplus from 2022

Following the period of strong austerity following the sovereign debt crisis, public finances have improved significantly. Greece recorded a budget surplus between 2016 and 2019, unlike the Eurozone, after recording a deficit of just over 13% of GDP in 2013.

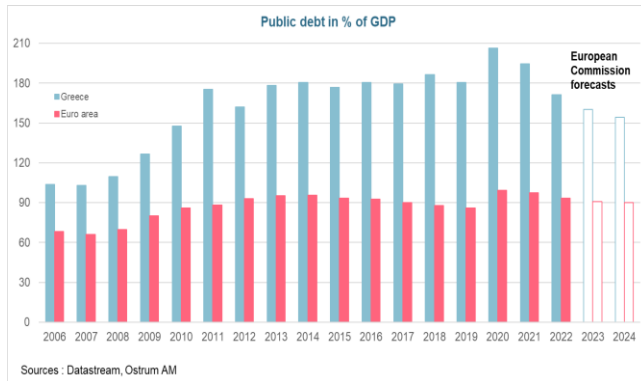


Then, as in the rest of the zone, the Covid-19 crisis resulted in a sharp deterioration in public deficits. Revenues fell due to the sharp contraction in GDP while at the same time governments took massive stimulus measures. Greece has been one of the most affected countries due to the importance of tourism. However, it is the one that has recorded the greatest improvement in public finances post-Covid due to its strong recovery, the increase in revenue linked to inflation and the control of expenditure. The deficit fell from nearly 10% of GDP in 2020 to return to around 2% in 2022. This is to be compared to a deficit of 7.1% of GDP in the Eurozone in 2020 and another 3.6% in 2022. Greece was thus one of the few economies in the zone to record a slight primary surplus (0.2% of GDP in 2022). The latter corresponds to the public deficit excluding interest charges on the debt.

The Prime Minister presented his stability program in April, continuing to anticipate an improvement in public finances. The latest EC forecast is based on this. In 2023, the deficit is expected to continue to decline due to the total cessation of post-Covid measures and the reduction of support for households and businesses in the face of rising energy prices. At the same time, the increase in expenditure will remain limited. The European Commission expects a deficit of 1.3% of GDP in 2023 and 0.6% in 2024. The primary surplus should therefore improve significantly. It is expected at 2.3% of GDP in 2024 by the EC. The government expects it at 2.5% in 2026.

Rapid decline in public debt to GDP ratio

The high nominal growth and the sharp improvement in the deficit translated into a rapid reduction in the post-Covid public debt-to-GDP ratio. It remains the highest of the Eurozone countries at just over 170% of GDP in 2022, compared to 93% for the eurozone, but it registers the largest reduction compared to 2020: -35 percentage points, compared to -11 pp for Italy and - 6 pp for the Eurozone. Maintaining dynamic growth and the government's fiscal prudence should allow a further sharp reduction in public debt to 154.4% of GDP in 2024 according to the EC, i.e. a little over 50 pp drop compared to 2020!



Very high maturity of public debt

Greece is less exposed than many Eurozone countries to rising interest rates due to the very high average maturity of its public debt. According to the public debt management agency, the average maturity is 17.5 years as of March 31, 2023. This results from the various European programs (EFSF, ESM, EIB, SURE, NGEU) whose loans were granted over a very long period. The debt is thus protected from the recent rise in interest rates, the impact being felt only very gradually.

Public debt is essentially made up of loans from the EU, in the forefront of which are those of the EFSF (32%), followed by the ESM (14.9%). Bonds represent only 20% of Greek debt as of March 31, 2023.

Soon the return to the IG category

Return to IG likely by the end of 2023

The major efforts made by Greece to clean up its public finances have resulted in an almost continuous upgrade of its sovereign debt rating since 2016, after having come close to default between 2011 and 2013. Greece is now just one notch from investment grade (BBB-) according to S&P and Fitch, with a rating of BB+. It is still rated 3 notches below

the IG category by Moody's, at Ba3 with a positive outlook. As we have seen, the results of the 1st round of the elections should prompt it to raise its rating, probably on September 15, to Ba2 and move closer to the IG category (Baa3 for Moody's).

On June 9, Fitch will speak out. The outlook should probably change from stable to positive given the results of the 1st round and the stability plan presented by the government in April. This will pave the way for a switch to IG probably as soon as December 1st. S&P will decide on October 20. The outlook being positive, the agency could be the first one to upgrade Greek debt to the IG category.

	Notation	Outlook	Next rating date	
Fitch	BB+	Stable	9-Jun	1-Dec
Moody's	Ba3	Positive	15-Sep	
S&P	BB+	Positive	20-Oct	

Sources : S&P, Moody's, Fitch, Ostrum AM

Investors position themselves

Investors have started to position themselves for a quick return of Greece to the IG category. This resulted in a net tightening of the Greek spread (interest rate spread between the Greek 10-year and the German 10-year) reflecting a reduction in risk. The movement intensified following the results of the legislative elections suggesting an absolute majority for the outgoing Prime Minister. The spread is at 140 bp, well below that of Italy (180 bp) while Italian sovereign debt is in the IG category (rated BBB).



We believe there is further potential for spread reduction. Indeed, the return of Greek debt to the IG category by at least two of the three rating agencies (Fitch, S&P and Moody's) will allow Greece to be included in Barclays Bloomberg's IG indices. This will broaden the base of potential investors and result in a repositioning of those who could no longer invest in Greek debt since the sovereign debt crisis, foremost among which are insurers.

Conclusion

Greek debt is likely to return to the IG indices by the end of the year due to robust growth, a rapidly declining debt-to-GDP ratio and a very supportive debt structure. Investors have begun to position themselves in this direction. There is potential for further spread

tightening with the return of certain categories of investors, notably insurers. In addition, Greece has made significant progress on the environmental, societal and especially governance level over the past five years. This is a key element for investors.

Aline Goupil-Raguénès

- **Market review**

Tensions ease on markets

Interest rate pressures are dissipating thanks to accelerated disinflation in Europe. Sentiment is improving on equities as the dollar weakens.

Fixed income markets enjoyed a week of calm driven by disinflation in the Eurozone and comments from US central bankers suggesting a pause in the monetary cycle in June. The Bund thus plunged back below 2.30%. The 10-year T-note is also coming back around 3.60%, before digesting the good news on employment in the United States (3.69% at Friday's close). The rebound in US stock market indices is traceable to the largest technology stocks remains predominant. Price reversals during trading sessions are violent and probably linked to the use of OTE strategies. European equities continue to suffer from profit taking. In contrast, spreads are trading sideways. Credit benefits from greater visibility on the next monetary policy decisions. However, European high yield spreads wiped out earlier tightening. The US dollar remains the main barometer of risk aversion. Its drop at the end of the week is the flipside of a strong risk-on rebound led by the Nasdaq. The euro is rising above \$1.07.

The ability of the US economy to create jobs continues to surprise. The total of job vacancies recovered to over 10 million in April, almost twice the number of available workers. In May, job creation reached 339k and April data was revised upwards (294k). Yet layoff plans announced last month have increased to 80k and unemployment is rising towards 3.7%. In addition, the manufacturing ISM (46.9) is below 50 for the 7th month in a row and new orders do not bode well for a rebound in production. In this context, growth fueled by household demand risks worsening the trade balance. We forecast 1.6% annualized growth in the second quarter. In the euro area, disinflation is faster than expected. Prices are surprisingly lower in France, Germany, and Spain. Headline euro area inflation slowed to 6.1% in May. Excluding volatile items, there was an improvement of 0.2 pp to 5.3%, echoing the slowdown in service prices in Germany (4.5%). However, wage negotiations led to a 4.3% increase in compensation in the 1st quarter, which may limit disinflation going forward. In China, the improvement in the manufacturing PMI remains anecdotal (50.9 on the Caixin indicator) given the weakness in industrial activity observed between January and April.

The fixed income markets partly erased the tensions seen in the previous weeks. A Fed pause, likely in June, would be a

welcome development for investors in long-term bonds. T-note yields drifted lower towards 3.60% after a high point on May 26 at 3.84%. The pause looks justified by the need to take a step back from the data flow, but the employment or the upward revision to the PCE deflator suggests an additional upside risk on Fed rates in July. Money market inflows remain solid, especially as the debt ceiling issue is out of the way for two years. In Europe, the ECB is approaching the end of its interest rate cycle, knowing that monetary tightening will rely more heavily on quantitative policies in the second half. Disinflation in May reduces the risk of monetary policy overshooting. The Bund yield fell below 2.30% with both lower breakeven inflation (-14 bps) and real yields (-8 bps). Carry strategies are always favored by lower volatility. Thus, sovereign spreads ended the week on a favorable note. The OAT has remained subject to the rating decision by S&P but French bonds took part of the tightening movement (-2 bps). Market participants continue to ignore the deterioration in the Italian fiscal budget (179 bps against Bund).

The euro credit market remains stable, with Friday's session seeming to erase the slight widening at the start of the week. The IG spread in euros is trading at 171 bps. Covered bonds are benefiting from a slight easing of swap spreads, the historically high level of which continues to raise questions. The 2-year swap spread is trading just below 80 bps. Meanwhile, allocations to credit funds are marginally positive. On the primary markets, total issuance reached €119 billion in May, split almost evenly between financial and non-financial bonds. The high yield market is faced with profit taking and fund outflows. The low default rate remains a major support for the asset class which offers a premium of almost 500 bps against Bunds.

On equity markets, the outperformance of technology stocks in the United States is fueled by unprecedented buying flows betting on the theme of artificial intelligence. This sectoral 'bubble' is pushing the outperformance of the Nasdaq 100 versus the Russell 2000 to new heights. Generally, the low implied volatility reflects bullish sentiment in US stock markets. In Europe, net outflows have been recorded for three months after a reallocation movement towards Europe around the turn of the year. The major European indices fell back, losing just under 1%.

Flows favorable to the dollar ahead of last month's close are being unwound at the end of the week as investor sentiment improves. The euro is back above \$1.07. The weakness in the yen persists given reduced visibility on the BoJ's next policy decision.

Axel Botte

● Main market indicators

G4 Government Bonds	05-Jun-23	1wk (bp)	1m (bp)	2023 (bp)
EUR Bunds 2y	2.87%	-2	+29	+10
EUR Bunds 10y	2.37%	-6	+8	-20
EUR Bunds 2s10s	-49.4bp	-4	-21	-29
USD Treasuries 2y	4.53%	-3	+62	+11
USD Treasuries 10y	3.74%	-6	+30	-14
USD Treasuries 2s10s	-80.2bp	-4	-32	-24
GBP Gilt 10y	4.21%	-12	+43	+54
JPY JGB 10y	0.43%	-1	-2	-12
€ Sovereign Spreads (10y)	05-Jun-23	1wk (bp)	1m (bp)	2023 (bp)
France	55bp	-2	-2	+0
Italy	177bp	-7	-3	-37
Spain	100bp	-6	-5	-9
Inflation Break-evens (10y)	05-Jun-23	1wk (bp)	1m (bp)	2023 (bp)
EUR 10y Inflation Swap	2.49%	-5	+11	-6
USD 10y Inflation Swap	2.48%	-4	-2	-6
GBP 10y Inflation Swap	3.71%	-8	+3	-18
EUR Credit Indices	05-Jun-23	1wk (bp)	1m (bp)	2023 (bp)
EUR Corporate Credit OAS	169bp	+1	+5	+2
EUR Agencies OAS	80bp	-1	-2	+1
EUR Securitized - Covered OAS	89bp	-2	-3	+5
EUR Pan-European High Yield OAS	485bp	+5	-21	-27
EUR/USD CDS Indices 5y	05-Jun-23	1wk (bp)	1m (bp)	2023 (bp)
iTraxx IG	77bp	-3	-10	-13
iTraxx Crossover	413bp	-14	-40	-61
CDX IG	71bp	-4	-10	-11
CDX High Yield	451bp	-24	-46	-33
Emerging Markets	05-Jun-23	1wk (bp)	1m (bp)	2023 (bp)
JPM EMBI Global Div. Spread	464bp	-14	-26	+12
Currencies	05-Jun-23	1wk (%)	1m (%)	2023 (%)
EUR/USD	\$1.070	-0.149	-2.922	-0.1
GBP/USD	\$1.240	0.332	-1.860	2.6
USD/JPY	JPY 140	0.071	-3.886	-6.5
Commodity Futures	05-Jun-23	-1wk (\$)	-1m (\$)	2023 (%)
Crude Brent	\$77.6	\$0.5	\$2.5	-7.2
Gold	\$1 944.8	\$1.2	-\$72.0	6.6
Equity Market Indices	05-Jun-23	-1wk (%)	-1m (%)	2023 (%)
S&P 500	4 282	3.16	3.53	11.5
EuroStoxx 50	4 322	0.05	-0.42	13.9
CAC 40	7 262	-0.57	-2.30	12.2
Nikkei 225	32 217	3.15	10.49	23.5
Shanghai Composite	3 232	0.34	-3.06	4.6
VIX - Implied Volatility Index	15.20	-15.32	-11.58	-29.9

Source: Bloomberg, Ostrum AM

Additional notes

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