MyStratWeekly
Market views and strategy

Ostrum ASSET MANAGEMENT

N° 111 // **May 2, 2023**

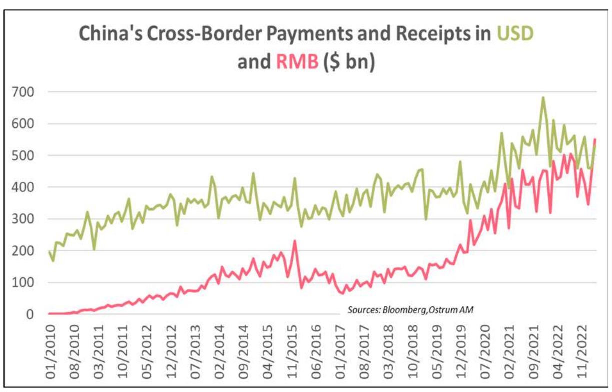
Topic of the week: The consumer: the new engine of Chinese growth?

- **The post-“Zero-Covid” recovery is supported by consumption;**
- **Its sustainability will depend on the nature of the savings accumulated by Chinese households;**
- **And the labor market and the private sector outlooks;**
- **The greening of the Chinese economy will allow the rebalancing of Chinese growth towards consumption;**
- **The main beneficiaries will be countries producing agricultural products and so-called “green” metals.**

Market review: Market confusion

- **The Fed and the ECB should raise their rates by 25bp this week;**
- **Low growth in the euro zone and the United States;**
- **Equities caught between banking risk and solid publications;**
- **The yen drops after the BoJ meeting.**

Chart of the week



For the first time, the yuan overtook the dollar in China's cross-border payments and receipts. Cross-border transactions rose to a record $549.9 billion in March from $434.5 billion in February. The Chinese Renminbi was used in 48.4 % of all cross-border transactions, while the dollar’s share declined to 46.7 % from 48.6 % a month earlier.

China has long been promoting the use of yuans as part of an effort to internationalize its currency. However, the yuan’s use in global trade finance remains low. The yuan’s share of global currency transactions for trade finance rose to 4.5 % in March, while the dollar accounted for 83.71 %.

Figure of the week

654

Source : Ostrum AM

It is the number of strikes in progress in the UK, a record high since 1931.

Axel Botte
Global strategist
axel.botte@ostrum.com

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

Aline Goupil- Raguénès
Developed countries strategist
aline.goupil-raguenes@ostrum.com

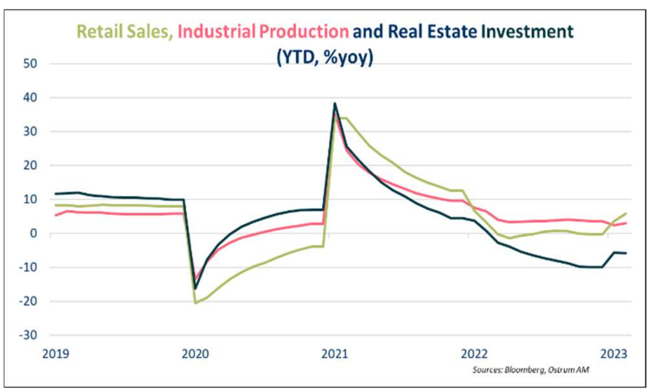
Topic of the week

The consumer: the new engine of Chinese growth ?

China's post-Zero-Covid recovery is consumer-driven. Is this the beginning of the rebalancing of the Chinese economic model towards consumption, to the detriment of investment?

A post-Zero-Covid recovery driven by the consumer…

After a catastrophic year 2022 linked to the Zero-Covid ideology, China is returning to growth in 2023. Chinese GDP growth rebounded strongly in Q1 to 2.2% GT, or 4.5% YoY, supported by the consumer. In fact, over the first three months of the year, retail sales increased by 5.8% YoY, while industrial production increased by 3% YoY, as shown in the chart below.

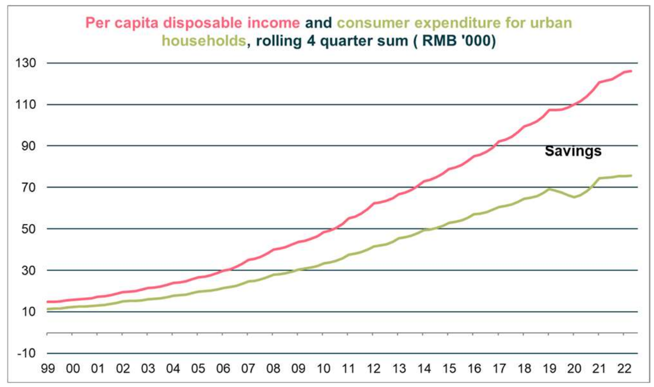


Retail sales detail suggests this is a form of "revenge shopping" by the Chinese consumer. Indeed, the strongest increases for the month of March were recorded in the following items: clothing (28% GA), sports and leisure items (22% GA), gold and jewelry (+ 40.6% GA).

Note: real estate investment stabilized at -5.8% YoY over the first three months of the year, reflecting the Chinese authorities' support measures for the sector. Property developers received more funding, after authorities cracked down on them for two years. Rising sales and financing will allow property developers to complete unfinished construction projects, a key factor impacting buyer confidence that had held back sales last year.

… And whose sustainability depends on household savings…

China is therefore beginning to see a revival of the role of consumption as the engine of growth. Is this rebound in consumption temporary or permanent? The answer to this question lies in the nature of the savings accumulated by Chinese households during the three years of Zero-Covid ideology. The chart below shows disposable income per capita and household consumption expenditure.



The difference between the pink and green curves can be compared to a proxy for Chinese household savings. In 2021, per capita disposable income increased by 8.2% compared to 2020 and urban household consumption expenditure increased by 10% compared to 2020, reflecting the end of the first mobility restrictions. In 2022, disposable income per capita increased by almost 4%, but urban household consumption expenditure increased by only 0.3% compared to 2021! Lockdowns in major Chinese cities, as well as the real estate crisis, have really penalized Chinese consumption in 2022. The challenge therefore lies in these savings. China is one of the few countries that has not embarked on a "whatever it takes" policy that has resulted in a stimulus to consumption.

Employment and the private sector: key factors for restoring confidence

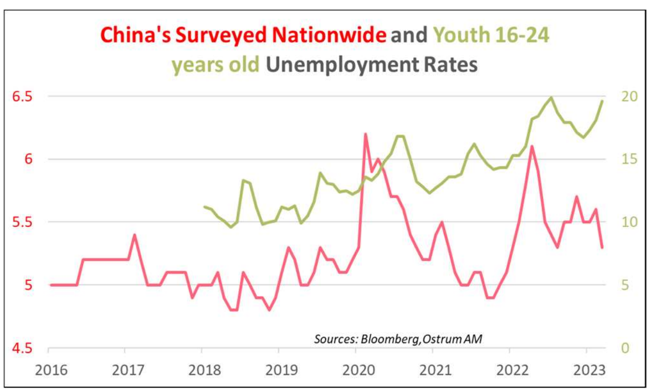
Xi Jinping's main challenge is to restore confidence...

Chinese consumer confidence deteriorated sharply in 2022, reaching an all-time low in November, as shown in the chart below.

Consumer confidence improved at the start of the year, in line with the end of the Zero-Covid policy and the stabilization of the real estate market but remains at historically low levels. An index below 100 means that the Chinese consumer is pessimistic; an index higher than 100 is positive. For the recovery in consumption to be sustainable, the Chinese authorities must restore household confidence.

… By giving jobs to young people…

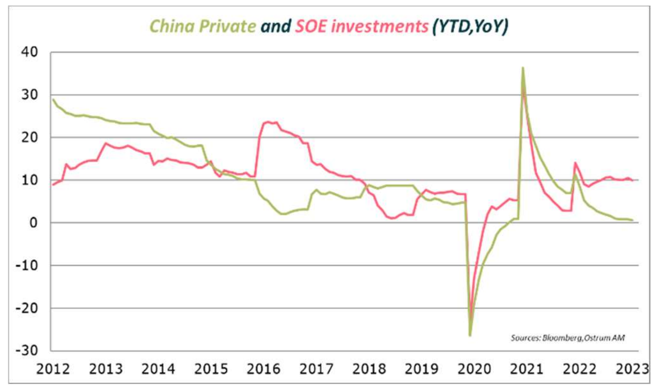
Despite the strong rebound in growth in the first quarter, the Chinese labor market is not improving. The national unemployment rate fell in March to 5.3% but remains still at a high level. The unemployment rate for young people aged 16-24 remains at a historically high level at 19.6%, as shown in the following chart.



This tense situation on the labor market is likely to deteriorate further. This year, China will register a record number of 11.6 million new graduates! High youth unemployment is a risk to the country's social stability.
According to the Financial Times article, *"China urges jobless graduates to 'roll up their sleeves' and try manual work"*, the Chinese authorities recently launched a television campaign asking new university graduates to lower their professional ambitions and to accept low-skilled trades. This explains the growing anger of young people at the lack of social mobility. The Zero-Covid ideology and repression on the private sector have weighed on the Chinese economy, further worsening inequalities.

… And by supporting the private sector

The private sector is vital to the Chinese economy, as it contributes to 60% of GDP and is responsible for 80% of employment in China. However, the sector has been heavily penalized by regulatory repression and the Zero-Covid policy. The chart below shows the growth rate of private investment and state-owned enterprises (SOE).

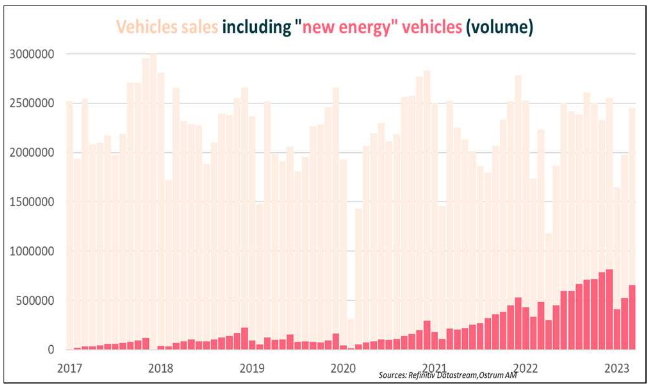


Investment by private companies remained sluggish in March, posting a timid increase of 0.6% YoY over the first three months of the year, compared to the increase of 10% YoY for investment by State-owned companies.

At the April Politburo meeting, Chinese authorities approved new guidelines to promote the private sector. Thus, the institutional barriers, which prevent private companies from fair competition in the market, should be abolished. As of now, details of these new guidelines have not been released. The growing role of state-owned enterprises and government intervention in the Chinese economy deprives the private sector of a level playing field. Political risks are high. Private companies that are in difficulty, in most cases, merge with state companies, and those that grow too quickly face a problem of confidence on the part of the authorities. To restore confidence in the private sector, the State must support the development of the private sector, as it has done over the past two decades by financing their technological development but must not constrain it.

Towards a beginning of rebalancing through consumption thanks to greening?

China's economic recovery is just beginning. However, signals of possible consumption-driven rebalancing seem to be emerging. The greening of the economy is a way to rebalance the Chinese economic model towards consumption. The Chinese automotive sector has undergone significant transformations in recent years. The chart below shows the share of "new energy" vehicles in vehicle sales in China.



Sales of "new energy" vehicles represent nearly 30% of total vehicle sales in China, compared to 5% in 2019. The rating agency Fitch Rating predicts that "new energy" vehicles will represent 35% of total vehicle sales in 2023. This trend should therefore increase over the next few years. Indeed, rebalancing the Chinese model towards more consumption-driven growth will decrease the energy intensity of China's GDP and therefore lower the country's energy demand and ease its pressure on its energy security. According to the IMF, rebalancing can reduce carbon emissions by around 15% by 2050, allowing China to meet its 2060 carbon neutrality target. Greener investments will bolster China's greener economic development.

Conclusion

The post-Zero-Covid Chinese recovery is supported by consumption. Its sustainability will depend on the prospects of the labor market and the private sector, which have been heavily penalized by the Zero-Covid policy and the repression by the authorities. However, China's economic recovery is still in its beginnings. Signals of consumption-driven growth rebalancing are beginning to emerge, as the greening of the Chinese economy is expected to accelerate. Countries that produce agricultural products and green metals should be the main beneficiaries.

Zouhoure Bousbih

Market review

Market confusion

A directionless market between monetary tightening, banking risk, high inflation, and solid quarterly publications.

Market sentiment is sometimes elusive, turning from panic to euphoria in just 36 hours. The fate of First Republic (FRC) is in the hands of US bank regulators and the 11 banks that backed the ailing institution in March. The two camps observe one another, hoping to minimize their losses. Then, some encouraging US data releases and an optimistic communication from Meta led to an upward acceleration of the Nasdaq index accompanied by a rise in the T-note yields towards 3.50%... before a relapse at the end of the week and a rebound of the dollar, which remains the ultimate barometer of risk aversion. The almost expected non-decision of the BoJ amplifies the rebound in the greenback. The implied volatility of equities remains quite low, which temporarily benefits carry assets such as credit. Sovereign spreads are widening slightly with Italian BTP once again hovering near 190 bps.

The economic environment is broadly in line with our economic forecasts. US GDP growth stood at 1.1% at annualized rate in the first quarter thanks, once again, to solid household consumption (+3.7%). Spending on consumer durable goods jumped 16%. However, business investment slowed (-7% on equipment, +3.8% on R&D) and a drawdown in inventories shaved 2.2 pp off GDP growth. This first estimate does not seem to take into account the improvement in residential investment seen in the pickup rebound in new home sales. The fall in US imports, which echoes the decline in inventory levels, will probably be revised. Persistent high inflation remains a concern. The consumption deflator is above 4% year-on-year. In the euro area, quarterly GDP growth was 0.2% in the first quarter with contrasting backdrops across the economic region. Germany stalled in the first quarter after -0.5% in the three months to December, whilst Italy and Spain posted stronger expansions (+0.5%). France posted a flattering +0.2%. French household consumption is limited by inflation which came in above expectations in April (+6.9% according to the HICP). Price dynamics are more favorable in Spain (+3.8%) than in Germany (+7.6% HICP).

Central banks are meeting this week. The principle of separation of economic objectives and financial stability will prevail as long as inflation remains too high. For this reason, both the Fed and the ECB will proceed with rate hikes. A final move of 25bp is consensus at the FOMC. The deflator at 4.2% in March or the increase in employment cost (+1.2% in 1Q 2023) validate further monetary tightening. The ECB Governing Council is divided. Given elevated underlying inflation and persistent wage pressures, Isabel Schnabel is leaning towards 50 bps, whilst other members appear more measured. Inflation justifies three increases until July knowing that other instruments (QT, TLTRO) contribute to monetary tightening. Moreover, the Riksbank (+50bp) is continuing its inflation-fighting effort despite the recession and real estate downside risk. The BoE is also battling double-digit inflation. In Japan, the BoJ announces a review of its monetary arsenal which should last 12 to 18 months. Japanese procrastination is unsurprising, but this decision has dealt a blow to market participants expecting a rapid adjustment in the 10-year yield targeting policy.

Market sentiment, which was quite pessimistic at the start of the week due to the collapse of FRC shares, has turned in favor of positive publications. Profit margins are holding up much better than expected in this high inflation environment. Price increases at the expense of volumes are winning in an economy subject to multiple successive supply shocks. Meta's earnings release gives a further boost to US tech which has been outperforming since the start of the year. The big tech stocks jumped 3.6% last Thursday. In Europe, bank stocks are plunging back with FRC and falling bond yields. Upside surprises account for two-thirds of the earnings releases so far. Sales increased by an average of 7% despite the sharp declines recorded by the energy and basic materials sectors.

On the fixed income markets, leveraged players are trying to spark an upward yield movement. Their short positioning on futures contracts is unprecedented. However, other surveys indicate a position closer to neutrality. Ten-year yields were bouncing around 3.50% at the end of last week. The initial decline in bond yields after the FRC news was later offset by high inflation. Treasuries are also subject to political tensions over the debt ceiling. The House Republicans voted a bill allowing an increase of $1,500 billion with strings attached that may be unacceptable to the Biden Administration. Political infighting puts pressure on 1-month T-bill rates, which mature before the so-called X-date of potential US default. This recurring debt ceiling crisis prevents the US Treasury from extending its debt portfolio, which keeps the yield curve inverted beyond 2 years.

In the euro area, the 4% weekly plunge in bank shares amid higher swap spreads. The Schatz is trading at -80 bps against swaps. At the margin, the reduction in the remuneration of government deposits with the ECB (ESTR-20 bps) could add to collateral scarcity. At the same time, breakeven inflation rates are falling with oil prices whilst sovereign spreads are slightly wider. Finally, credit spreads seem to have stabilized despite less favorable fund flows down since the end of March.

Axel Botte
Global strategist

Main market indicators

G4 Government Bonds	02-May-23	1wk (bp)	1m (bp)	2022 (bp)
EUR Bunds 2y	2.74%	-10	+6	-2
EUR Bunds 10y	2.35%	-3	+6	-22
EUR Bunds 2s10s	-39.3bp	+7	+0	-19
USD Treasuries 2y	4.11%	+15	+8	-32
USD Treasuries 10y	3.52%	+12	+5	-36
USD Treasuries 2s10s	-59.3bp	-4	-3	-4
GBP Gilt 10y	3.75%	+6	+26	+8
JPY JGB 10y	0.42%	-6	-8	-6
€ Sovereign Spreads (10y)	**02-May-23**	**1wk (bp)**	**1m (bp)**	**2022 (bp)**
France	58.87bp	+2	+2	+4
Italy	187.82bp	-1	+2	-26
Spain	105.21bp	+1	+1	-3
Inflation Break-evens (10y)	**02-May-23**	**1wk (bp)**	**1m (bp)**	**2022 (bp)**
EUR 10y Inflation Swap	2.47%	-2	-1	-8
USD 10y Inflation Swap	2.52%	+1	-2	-1
GBP 10y Inflation Swap	3.73%	-9	-18	-18
EUR Credit Indices	**02-May-23**	**1wk (bp)**	**1m (bp)**	**2022 (bp)**
EUR Corporate Credit OAS	164bp	+8	-6	-3
EUR Agencies OAS	81bp	+4	+5	+2
EUR Securitized - Covered OAS	91bp	+4	+2	+7
EUR Pan-European High Yield OAS	503bp	+15	+6	-9
EUR/USD CDS Indices 5y	**02-May-23**	**1wk (bp)**	**1m (bp)**	**2022 (bp)**
iTraxx IG	84bp	0	-1	-7
iTraxx Crossover	442bp	-4	0	-32
CDX IG	77bp	+0	+1	-5
CDX High Yield	477bp	-1	+4	-7
Emerging Markets	**02-May-23**	**1wk (bp)**	**1m (bp)**	**2022 (bp)**
JPM EMBI Global Div. Spread	473bp	-22	-11	+21
Currencies	**02-May-23**	**1wk (%)**	**1m (%)**	**2022 (%)**
EUR/USD	$1.097	-0.064	0.615	2.4
GBP/USD	$1.247	0.484	0.443	3.2
USD/JPY	JPY 138	-2.741	-3.687	-4.7
Commodity Futures	**02-May-23**	**-1wk ($)**	**-1m ($)**	**2022 (%)**
Crude Brent	$78.8	-$1.8	-$0.9	-6.37
Gold	$1 981.1	-$16.3	-$3.5	8.61
Equity Market Indices	**02-May-23**	**-1wk (%)**	**-1m (%)**	**2022 (%)**
S&P 500	4 168	0.75	1.43	8.6
EuroStoxx 50	4 345	-0.75	0.69	14.5
CAC 40	7 464	-1.45	1.93	15.3
Nikkei 225	29 158	1.88	3.98	11.7
Shanghai Composite	3 323	0.67	1.54	7.6
VIX - Implied Volatility Index	16.45	-12.31	-12.03	-24.1

Source: Bloomberg, Ostrum AM

Additional notes

Ostrum Asset Management

Asset management company regulated by AMF under n° GP-18000014 – Limited company with a share capital of 50 938 997 €. Trade register n°525 192 753 Paris – VAT : FR 93 525 192 753 – Registered Office: 43, avenue Pierre Mendès-France, 75013 Paris – www.ostrum.com

This document is intended for professional, in accordance with MIFID. It may not be used for any purpose other than that for which it was conceived and may not be copied, distributed or communicated to third parties, in part or in whole, without the prior written authorization of Ostrum Asset Management.

None of the information contained in this document should be interpreted as having any contractual value. This document is produced purely for the purposes of providing indicative information. This document consists of a presentation created and prepared by Ostrum Asset Management based on sources it considers to be reliable.

Ostrum Asset Management reserves the right to modify the information presented in this document at any time without notice, which under no circumstances constitutes a commitment from Ostrum Asset Management.

The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change without prior notice. There can be no assurance that developments will transpire as may be forecasted in this material. This simulation was carried out for indicative purposes, on the basis of hypothetical investments, and does not constitute a contractual agreement from the part of Ostrum Asset Management.

Ostrum Asset Management will not be held responsible for any decision taken or not taken on the basis of the information contained in this document, nor in the use that a third party might make of the information. Figures mentioned refer to previous years. Past performance does not guarantee future results. Any reference to a ranking, a rating or an award provides no guarantee for future performance and is not constant over time. Reference to a ranking and/or an award does not indicate the future performance of the UCITS/AIF or the fund manager.

Under Ostrum Asset Management's social responsibility policy, and in accordance with the treaties signed by the French government, the funds directly managed by Ostrum Asset Management do not invest in any company that manufactures, sells or stocks anti-personnel mines and cluster bombs.

Final version dated 02/05/2023

Natixis Investment Managers

This material has been provided for information purposes only to investment service providers or other Professional Clients, Qualified or Institutional Investors and, when required by local regulation, only at their written request. This material must not be used with Retail Investors.

To obtain a summary of investor rights in the official language of your jurisdiction, please consult the legal documentation section of the website (im.natixis.com/intl/intl-fund-documents)

In the E.U.: Provided by Natixis Investment Managers International or one of its branch offices listed below. Natixis Investment Managers International is a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. Italy: Natixis Investment Managers International Succursale Italiana, Registered office: Via San Clemente 1, 20122 Milan, Italy. Netherlands: Natixis Investment Managers International, Nederlands (Registration number 000050438298). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. Spain: Natixis Investment Managers International S.A., Sucursal en España, Serrano n°90, 6th Floor, 28006 Madrid, Spain. Sweden: Natixis Investment Managers International, Nordics Filial (Registration number 516412-8372- Swedish Companies Registration Office). Registered office: Covendrum Stockholm City AB, Kungsgatan 9, 111 43 Stockholm, Box 2376, 103 18 Stockholm, Sweden. Or,

Provided by Natixis Investment Managers S.A. or one of its branch offices listed below. Natixis Investment Managers S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of Natixis Investment Managers S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. Germany: Natixis Investment Managers S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Senckenberganlage 21, 60325 Frankfurt am Main. Belgium: Natixis Investment Managers S.A., Belgian Branch, Gare Maritime, Rue Picard 7, Bte 100, 1000 Bruxelles, Belgium.

In Switzerland: Provided for information purposes only by Natixis Investment Managers, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich.

In the British Isles: Provided by Natixis Investment Managers UK Limited which is authorised and regulated by the UK Financial Conduct Authority (register no. 190258) - registered office: Natixis Investment Managers UK Limited, One Carter Lane, London, EC4V 5ER. When permitted, the distribution of this material is intended to be made to persons as described as follows: in **the United Kingdom**: this material is intended to be communicated to and/or directed at investment professionals and professional investors only; in Ireland: this material is intended to be communicated to and/or directed at professional investors only; **in Guernsey:** this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Guernsey Financial Services Commission; **in Jersey**: this material is intended to be communicated to and/or directed at professional investors only; in the Isle of Man: this material is intended to be communicated to and/or directed at only financial services providers which hold a license from **the Isle of Man** Financial Services Authority or insurers authorised under section 8 of the Insurance Act 2008.

In the DIFC: Provided in and from the DIFC financial district by Natixis Investment Managers Middle East (DIFC Branch) which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients or Market