# MyStratWeekly

Market views and strategy

Ostrum ASSET MANAGEMENT

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N° 113 // **May 15, 2023**

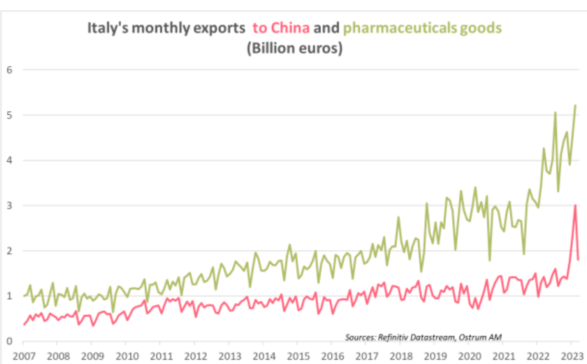
## Topic of the week: The Eurozone escapes recession

- **After a slight contraction, a timid recovery has begun;**
- **Domestic demand contracted in many countries as a result of losses in purchasing power suffered by households;**
- **The situation is contrasted between countries: Spain, Italy and Portugal are in the lead, benefiting from the recovery in tourism;**
- **France and Germany are experiencing a more limited rebound;**
- **Surveys point to an acceleration in service-led activity as manufacturing continues to contract;**
- **The recovery should firm up but remain limited due to the impact of the strong monetary tightening carried out by the ECB.**

## Market review: Disinflation continues in the US

- **US inflation dips below 5%;**
- **Nasdaq up strongly led by big caps;**
- **Banks lead European stock markets higher;**
- **Stability in sovereign and credit spreads.**

## Chart of the week




Italian foreign trade is experiencing a surprising development, particularly in the pharmaceutical sector. The lifting of mobility restrictions has led the Chinese to buy drugs massively.

The announcement of Italy's possible withdrawal from the partnership with China through the Belt & Road Initiative after 2024 could, however, strain relations between Rome and Beijing, and limit access to the Chinese market for Italian companies.

## Figure of the week

**78**

Source : US Treasury

Since 1960, Congress has acted 78 separate times to permanently raise, temporarily extend, or revise the definition of the debt limit.

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● Topic of the week

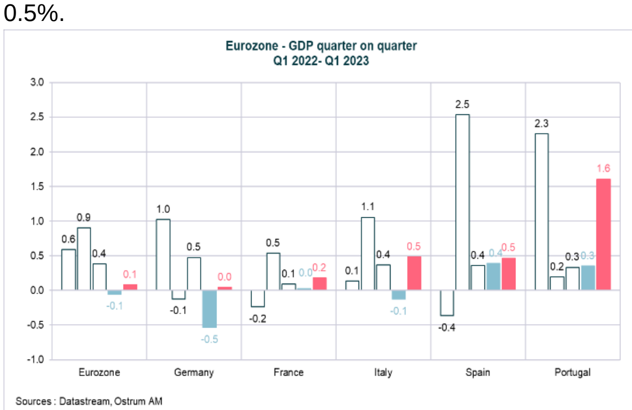
# The Eurozone escapes recession

**The euro zone escaped recession by recording a slight increase in GDP in the 1st quarter. The sharp fall in the price of natural gas, labor market resilience and government support measures are at the root of this. The dynamics are contrasted between countries. Spain and Italy benefit from their greater dependence on tourism and Germany is affected by the relatively greater weight of the manufacturing sector. Activity should firm up over the course of the year, with rising wages and moderating inflation, but the recovery will be very moderate due to the sharp tightening of credit conditions.**

## The Eurozone escapes recession

### Slight increase in GDP in Q1: +0.1% after -0.1%

In the 1st quarter, the GDP of the Eurozone rebounded slightly (+0.1%) after being revised downwards in the 4th quarter to -0.1%, against 0% initially published. The carry-over for 2023 (average growth over the year assuming stabilization of GDP over the next three quarters) stands at 0.5%.



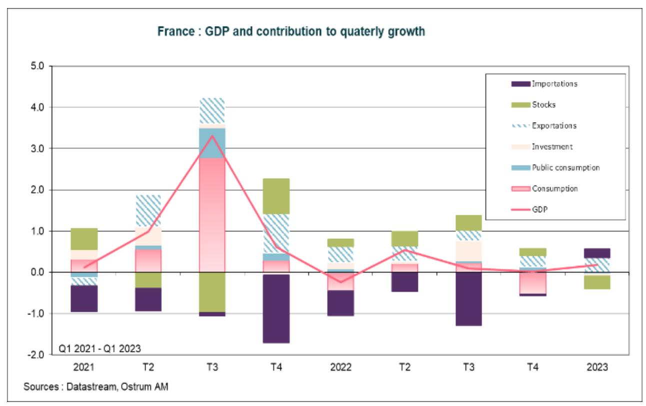

On the available figures, the peripheral countries recorded the strongest recovery at the start of the year: 0.5% in Italy and Spain (compared to -0.1% and 0.4% respectively in Q4) and 1.6% in Portugal (after 0.3%). Growth is more limited in France (0.2% after 0%) and Germany narrowly escaped recession: 0% after -0.5% (compared to 0% in the first publication).

The detail of the GDP of the Eurozone is not yet available but the results of France and Spain, as well as the indications delivered by various institutes of statistics, reveal the continued weakness of the internal demand.

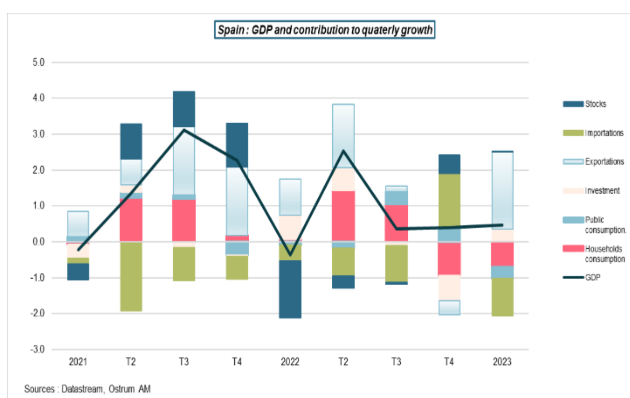
### Negative contribution of domestic demand in France and Spain

**In France,** domestic demand again contributed negatively to growth in Q1, but to a lesser extent: -0.1 percentage point (pp) after -0.4 pp in Q4. This results from the sluggishness of household consumption (zero contribution in Q1 after -0.5 pp in Q4) and the negative contribution of investment (-0.1%). Residential investment fell again and businesses invested weakly. In particular, they have reduced their investments in capital goods. The carry-over is 0.4%.

The 0.2% growth in Q1 is thus linked solely to foreign trade (contribution of 0.6 pp) due to the rise in exports and the decline in imports. Foreign trade was thus able to offset the negative contributions from domestic demand and inventories (-0.3 pp).




**In Spain,** we observe roughly the same breakdown. The 0.5% growth is linked to foreign trade (+1.1 pp). Internal demand weighed in at -0.7 pp (after -1.2 pp) and inventories made no contribution.




The finer detail nevertheless differs compared to France.

Household consumption is once again making a negative contribution to growth (-0.7 pp after -0.9 pp) and public spending is shrinking. The investment had a slightly positive contribution. The strong contribution of foreign trade comes from that of exports, linked to services, while imports increased to a lesser extent. The carry-over is 1.6%.

**In Germany,** the statistical organization Destatis indicates that household consumption and public spending fell in the 1st quarter. Their decline was compensated by the increase in investment and exports. The carry-over comes out at -0.2%.

**In Italy,** the statistical body Istat reveals that the 0.5% growth is linked to internal demand (stocks included) and to foreign trade, without further details. The carry-over is 0.8%. Monthly retail sales figures suggest a decline in household consumption in Q1 at a more moderate pace than the previous month. Retail sales in volume fell 0.1% in the quarter.

Finally, **in Portugal,** the marked acceleration in growth in Q1 is linked solely to foreign trade, reflecting the dynamism of exports, according to INES. Domestic demand contributed negatively to growth. The carry-over is 2.1%.

### What can we deduce from this?

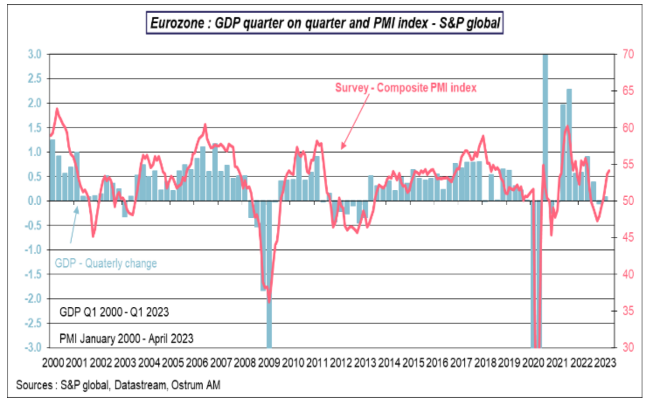
Consumption was once again affected by losses in household purchasing power linked to high inflation. This has slowed since October, due to the decline in energy prices, but is still too high: 7% in April. It is progressing at a faster pace than the rise in wages: 5.7% in Q4 for hourly labor costs.

At the same time, the sharp tightening of monetary policy implemented since last July by the ECB (+375 bp increase in key rates) is beginning to have an impact on demand.

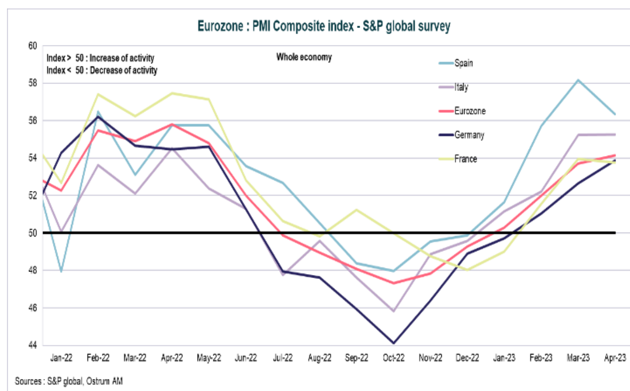
The extension of government support measures for households and businesses to protect them from the rise in energy prices, as well as the sharp fall in the price of raw materials and in particular natural gas, have made it possible to avoid a more marked decline in internal demand and thus avoid a recession in the Eurozone. Spain and Italy recorded the strongest recovery due to the importance of tourism in their growth, the latter benefiting from the recovery of the leisure and travel sector. This can be seen in the rise in services exports.

# Towards an acceleration of growth

The latest survey of business leaders by S&P global predicts an acceleration in growth. The composite index stood at 54.1 in April, compared to an average of 52 in Q1, reaching an 11-month high. It is well above 50, signaling an increase in activity.




This is linked solely to the services sector (index of 56.2) whose activity accelerated again under the effect of increase in demand. This impetus comes in particular from the tourism sector, according to S&P global. The dynamic is stronger in Spain and Italy due to the greater dependence of their growth on this sector.




On the other hand, the divergence has increased between the services sector and the manufacturing sector. The latter contracted, at a slightly more sustained pace in April, the index being below 50 (45.8). This is the result of the decline in both global and foreign demand. Germany is the most affected due to the relatively greater weight of the manufacturing sector in growth.

# Conclusion

**The Eurozone escaped recession due to the resilience of labor market, the extension of government support measures to protect households and businesses from rising energy prices. The decrease of natural gas price also contributed. Surveys predict an acceleration in growth linked to services,**

**driven in particular by the tourism sector. Consumption will benefit from higher wages, as predicted by the latest wage negotiations, a buoyant job market and more moderate inflation due to a lower contribution from energy prices. The recovery will nevertheless remain limited due to the gradual impact of the tightening of monetary policy on demand. The latest survey carried out by the ECB among commercial banks has indeed revealed a new sharp tightening of credit conditions for companies and households as well as a drop in the demand of loans. We anticipate growth of 1.1% for the year 2023.**

**Aline Goupil-Raguénès**

## Market review

# Disinflation continues in the US

### Nasdaq rises thanks to disinflation, but the volatility in long-term bond yields persist.

The issue with the debt ceiling in the United States or the possibility of a rating downgrade for Italy do not seem to worry market participants, who appear to be focused exclusively on the possibility of a cut in Fed funds rates this summer. US consumer price inflation, now below the 5% threshold, maintains the hope for monetary relief that would be particularly beneficial to growth stocks. The Nasdaq is up 3% last week as US equity indices are pulled higher by the largest caps. In Europe, stock market indices are flat on the week. In parallel, fixed income markets remain volatile. The T-note yield fluctuates between 3.30% and 3.50%. Sovereign or credit spreads were broadly stable through Friday. However, there are persistent tensions on swap spreads in the euro area. On the foreign exchange market, the US greenback rebounded late last week. The euro is struggling to break through the $1.10 threshold. The New Zealand dollar fell on lower inflation expectations which may curb RBNZ tightening going forward. The BoE proceeded (somewhat reluctantly?) with another 25 bp rate hike.

On economic grounds, US CPI inflation stood at 4.9% year-on-year in April. Excluding energy and food, inflation remains virtually stable at around 5.5%. Rents (actual or in owner-equivalent terms) should start to slow during the second quarter, gradually bringing underlying inflation back to about 4% at the end of the year. The prices of imported goods are beginning to fall. Price dynamics will mainly depend on the evolution of labor costs and the behavior of corporate margins. The excess demand for labor seems to be declining through a reduction in vacancies or an upward shift in jobless claims and redundancy plans. This easing of the labor market conditions is a necessary first step towards lasting disinflation. Nevertheless, household inflation expectations must be monitored in both the United States and in Europe, where the ECB consumer expectations survey showed an increase in expected inflation. The ECB still needs to act on rates, probably twice in June and July. The BoE raised its repo rate by 25 bps to 4.50%, despite two dissenting votes preferring a status quo. UK GDP was up 0.1% in the first quarter thanks to a surprising contribution from business investment. Household consumption was slowed by inflation, but the loss of purchasing power should ease over the course of the year. The BoE's optimism on inflation raises questions, however, especially since the monetary authority no longer foresees a recession in 2023 (+0.25%). In China, consumer price inflation was close to zero (+0.1% in April) and producer prices fell by more than 3%. In this context, China is once again exporting disinflation, which is filtering through US consumer prices. The manufacturing recovery has turned out to be less strong than expected, so that industrial metal prices have now been falling for several weeks.

Equity market valuations are hanging on a hypothetical Fed funds cut. The Jackson Hole meeting, scheduled for the end of August, is already shaping up to be a possible turning point in Jerome Powell's communication for 2024. The markets are always impatient, and the monetary status quo envisaged until the end of 2023 could justify a correction in valuation multiples. On the contrary, the most rate-sensitive stocks are leading the market. The performance gap between the top five stocks of the S&P 500 and the rest of the equity market is quite impressive. Speculative positioning, still largely short, has been reduced since the end of April. The market pressure on US regional banks continues and the most fragile institutions are under attack. The European indices are off to a strong earnings season. European banks stand out with solid earnings.

On the US Treasuries market, volatility remains substantial. The 2-year yields dipped below 4% after the CPI release, leading to a fall in the 10-year yield to the 3.40% area. On the other hand, the 10-30 year curve segment (34 bps) has been steepening for a few weeks and has now reached the July 2022 highs. In the euro area, the Bund is moving within a range of 2.20% to 2.50%. The scarcity factor in Bund markets has contributed to wider swap spreads since the lowering of government deposit remuneration to ESTR - 20 bps. This temporary measure cannot make up for the lack of a proper ECB securities lending policy that would match market standards. The 2-year swap spread is traded above 80 bps, only seen in banking crises. This also means that sovereign debt remains in high demand so that the reaction of OAT spreads following the downgrade of France’s sovereign credit rating, for example, has remained limited. The BTP spread is also capped around 190 bps.

The euro IG credit market performed well this week with a slight tightening of spreads. The balance of fund flows, or even the level of spreads, could push spreads a bit wider over the next few weeks. The primary bond market is active with more than €16 billion issuance from non-financial issuers last week. The 20 financial bond deal added €14 billion to the weekly tally. Likewise, high yield even tightened by 3 bps to 515 bps against Bunds.

On the foreign exchange market, we note a rebound of the dollar despite the anxiety due to the debt ceiling issue.

**Axel Botte**

## Main market indicators

| G4 Government Bonds | 15-May-23 | 1wk (bp) | 1m (bp) | 2023 (bp) |
|---|---|---|---|---|
| EUR Bunds 2y | 2.6% | -2 | -28 | -16 |
| EUR Bunds 10y | 2.3% | -2 | -14 | -28 |
| EUR Bunds 2s10s | -30.8bp | +0 | +14 | -10 |
| USD Treasuries 2y | 3.98% | -2 | -12 | -44 |
| USD Treasuries 10y | 3.47% | -3 | -4 | -40 |
| USD Treasuries 2s10s | -51.1bp | -1 | +8 | +5 |
| GBP Gilt 10y | 3.8% | +2 | +13 | +13 |
| JPY JGB 10y | 0.41% | -1 | -11 | -12 |
| **€ Sovereign Spreads (10y)** | **15-May-23** | **1wk (bp)** | **1m (bp)** | **2023 (bp)** |
| France | 58bp | -1 | +0 | +3 |
| Italy | 188bp | -4 | +2 | -26 |
| Spain | 107bp | -1 | +2 | -2 |
| **Inflation Break-evens (10y)** | **15-May-23** | **1wk (bp)** | **1m (bp)** | **2023 (bp)** |
| EUR 10y Inflation Swap | 2.37% | -4 | -17 | -18 |
| USD 10y Inflation Swap | 2.49% | -3 | -7 | -5 |
| GBP 10y Inflation Swap | 3.72% | +5 | -17 | -18 |
| **EUR Credit Indices** | **15-May-23** | **1wk (bp)** | **1m (bp)** | **2023 (bp)** |
| EUR Corporate Credit OAS | 168bp | +0 | +1 | +1 |
| EUR Agencies OAS | 82bp | +1 | +3 | +3 |
| EUR Securitized - Covered OAS | 91bp | +0 | +5 | +7 |
| EUR Pan-European High Yield OAS | 511bp | +1 | +14 | -1 |
| **EUR/USD CDS Indices 5y** | **15-May-23** | **1wk (bp)** | **1m (bp)** | **2023 (bp)** |
| iTraxx IG | 85bp | -1 | +4 | -5 |
| iTraxx Crossover | 447bp | -4 | +14 | -27 |
| CDX IG | 81bp | 0 | +6 | -1 |
| CDX High Yield | 497bp | +1 | +33 | +13 |
| **Emerging Markets** | **15-May-23** | **1wk (bp)** | **1m (bp)** | **2023 (bp)** |
| JPM EMBI Global Div. Spread | 484bp | -5 | -5 | +31 |
| **Currencies** | **15-May-23** | **1wk (%)** | **1m (%)** | **2023 (%)** |
| EUR/USD | $1.088 | -1.469 | -0.431 | 1.5 |
| GBP/USD | $1.248 | -1.290 | 0.971 | 3.3 |
| USD/JPY | JPY 136 | -0.847 | -1.031 | -3.5 |
| **Commodity Futures** | **15-May-23** | **-1wk ($)** | **-1m ($)** | **2023 (%)** |
| Crude Brent | $74.0 | -$3.0 | -$11.9 | -12.1 |
| Gold | $2 018.3 | -$8.9 | $26.7 | 10.7 |
| **Equity Market Indices** | **15-May-23** | **-1wk (%)** | **-1m (%)** | **2023 (%)** |
| S&P 500 | 4 124 | -0.29 | -0.33 | 7.4 |
| EuroStoxx 50 | 4 305 | -0.41 | -1.37 | 14.2 |
| CAC 40 | 7 439 | -0.02 | -1.07 | 14.9 |
| Nikkei 225 | 29 626 | 2.34 | 3.98 | 13.5 |
| Shanghai Composite | 3 311 | -2.48 | -0.82 | 7.2 |
| VIX - Implied Volatility Index | 17.03 | 0.29 | -0.23 | -21.4 |

Source: Bloomberg, Ostrum AM

# Additional notes

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