



Document for professional investors only
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ECONOMIC VIEWS

Three themes for the markets

1- Monetary policy

The stress of the banking crisis seems to be fading. A systemic crisis seems very unlikely. The consequence, however, is a tightening of bank credit conditions which therefore helps to limit the need for central bank rates to rise.

So, the Fed and ECB are back to fundamentals. The Fed is close to the end of the upswing cycle, we're just expecting another upswing. The ECB is a little further ahead, three increases.

Persistent inflationary pressures will not allow banks to reduce rates by the end of the year.

2- Inflation

As expected, inflation continues to moderate due to lower energy prices.

Underlying inflation, on the other hand, shows no signs of slowing. Wage pressures suggest resilience at too high a level for central banks to settle for.

This high inertia implies the maintenance of high underlying inflation at the end of the year, especially in the euro area where it is difficult to envisage core inflation falling below 5%.

The reopening of China will also help to raise the price of raw materials.

3- Growth

The Eurozone has escaped recession, thanks to government support measures and the sharp drop in gas prices. Available data suggest a moderate growth in Q1 and a limited acceleration in Q2. The rise in wages should allow consumption to hold.

In the United States the beginning of the year is much more dynamic but the monetary tightening should lead the American economy to close the recession in the second half of the year.

Key macroeconomic signposts

Euro area

Euro Area	2022				2023				2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
GDP (QoQ)										
Ostrum	0.6	0.9	0.4	0.0	0.2	0.4	0.4	0.3	3.5	1.1
Consensus					-0.2	0.1	0.3	0.2		0.5
Inflation										
Ostrum	6.1	8.0	9.3	10.0	6.3	6.0	5.8	5.6	8.4	5.9
Consensus					8.0	6.3	4.7	3.1		5.5
Core inflation										
Ostrum	2.7	3.7	4.4	5.1	5.3	5.2	5.1	5.1	3.9	5.2

- We expected a very moderate recession in Q4 2022 and Q1 2023. The figures published for Q4 actually show a stabilization of the economy. On the other hand, the evidence for this year's Q1 shows growth, albeit low, but in all probability positive.
- As a result, the growth carry-over at the end of 2022 was already 0.4%. With moderate growth, average growth over the rest of the year should therefore be in the 0.5/1.0% range.
- The relative decline in inflation and the rise in wages, but also in government subsidies, should keep the purchasing power of wages at a very slightly positive level. Consumption would then be slightly upward over the year. Similarly, the accumulated investment lag should allow capex to progress, again moderately.
- As a result, we have a GDP trajectory that is still mediocre but displays a little acceleration at mid-year. This puts us on the high side of the consensus.
- A fundamental point in our forecast is the inflation trajectory. It's declining rapidly until this summer, largely because of the basic effects on the energy component. But the underlying part remains very stable and should not fall below 5% by the end of the year. This leads to a high year-end landing, 5% over the last quarter. This is fundamental to monetary policy.

2- USA et al.

USA	2022				2023				2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
GDP (QoQ)										
Ostrum	-0.4	-0.2	0.8	0.7	0.5	0.3	0.0	0.0	2.1	1.5
Consensus					0.1	-0.1	0.0	0.2		0.8
Inflation										
Ostrum	8.0	8.7	8.3	7.1	2.6	2.6	2.7	2.7	8.0	2.7
Consensus					5.8	4.1	3.5	3.2		4.2
Core inflation										
Ostrum	6.5	5.9	6.6	5.7	3.0	2.5	2.4	2.4	6.2	2.6

- Rising rates are a drag on growth, with the most directly exposed sectors, including real estate, showing very strong signs of slowing. While the figures available for the first quarter show, once again, a very resilient economy, on the other hand we think that the economy will approach recession at the end of the year.
- The U.S. economy has shown an unusual ability to absorb rate hikes. We believe that structural changes explain this resistance. As a result, we think the "soft landing" scenario is more likely than the "hard landing" scenario.

- The bankruptcies of SVB and Signature are a warning shot: we do not think this constitutes the beginning of a systemic crisis, the much more pessimistic alternative scenario can however be ruled out, even if its probability is limited.
- Finally, continued inflation above the Fed target remains the most likely scenario. Wage pressures in particular remain high. Again, this is a structuring element for the Fed.
- It should also be noted that China is rapidly reopening. This implies more sustained global growth, an improvement in the latest production problems related to supply chains, but also new potential inflationary pressures on raw materials. The reopening of China therefore bears out the idea of growth that surprises upward, as well as inflation.

Monetary policy

More limited rate hikes due to the risk of tighter credit conditions

1- The uncertainty linked to banking stress only pleads for a single rate hike

While J. Powell had signaled on March 7 that the Fed was ready to accelerate the pace of its rate hikes to deal with stronger than expected inflation, banking stress, linked to the bankruptcy of SVB and Signature Bank a few days later, came to limit its extent. The Fed raised rates by 25 bps on March 22, after taking sweeping measures to avoid contagion to the entire banking system. The Fed's communication became more evasive: "some additional tightening may be appropriate." The risk is a greater tightening of credit conditions likely to weigh on demand and therefore inflation. We therefore anticipate a single rate hike in May: +25 bps and a status quo until the end of 2023.



Date FOMC	Ostrum	Chg.
03-May-23	5.25	25
14-Jun-23	5.25	0
26-Jul-23	5.25	0
20-Sep-23	5.25	0
01-Nov-23	5.25	0
16-Dec-23	5.25	0
01-Jan-24	5.25	0

2- ECB: "Inflation should remain too high, for too long"

As it reported in February, the ECB raised rates by 50 bps on March 16 to bring the deposit rate to 3%. This time, the Bank was careful not to indicate what it intended to do at the next meeting, insisting that it would depend on the data. However, core inflation accelerated again to a historic high in March (5.7%) and the results of wage negotiations presage a stronger contribution from wages to domestic inflation, even though those from the unit profits do not show significant signs of moderation. This argues for continued ECB rate hikes but at a more moderate pace due to the risk of tighter credit conditions. We therefore now anticipate 3 rate hikes by the ECB of 25 bp in May, June and July to bring the deposit rate to 3.75%.



Date ECB	Ostrum	Chg.
04-May-23	3.25	25
15-Jun-23	3.50	25
27-Jul-23	3.75	25
14-Sep-23	3.75	0
26-Oct-23	3.75	0
14-Dec-23	3.75	0

3- Very reactive central banks to limit the contagion effect

The Fed, via the creation of a new loan facility accepting as collateral bonds valued at par, therefore without any loss in value linked to the rise in interest rates, and the Swiss National Bank, by providing all the necessary liquidity to Credit Suisse, have been very reactive in stabilizing the banking system.

STRATEGIC VIEWS

Markets arm wrestling central banks

Synthetic market views: The aborted systemic crisis

The financial stress in March seems to be fading even if interest rate volatility or swap spreads remain high. The banking crisis is dissipating so that even Tier 1 bonds are regaining momentum. The decline in headline inflation fosters expectations of monetary easing, which nevertheless seem premature given wage pressures and more generally the inertia of underlying inflation. A fight is underway between markets and central banks as data comes in on the soft side in the US and a recovery unfolds in Europe. The depreciation of the greenback also spurs long bets on risky assets. Credit and sovereign debt weathered this bout of volatility unscathed. However, this is not the case for securitizations of commercial real estate.

Allocation recommendations: A conditional risk-on bias

The favorable risk bias and low equity volatility are de facto conditioned to hypothetical rate cuts. Sovereign and credit spreads are in fact less volatile than the asset deemed to be (default) risk-free. This rare situation creates a vacuum for stocks that offer protection against inflation. High yield also offers a comfortable premium amid low default rates. In this context, the status quo on rates would be almost harmful by erasing the relief demanded by the markets.

Market views

		11-Apr-23	Forecast	
			May-23	Dec-23
International Sovereigns				
USA	Fed Funds	5.00	5.25	5.25
	10-year	3.43	3-3.3	4.25
Euro Area	BCE, deposit	3.00	3.25	3.75
Germany	10-year	2.31	2.1-2.4	3.25
	30-year	2.39		0.00
Japan	10-year	0.46	0.51	
UK	10-year	3.54	3.70	
European Sovereigns				
France	10-year	2.83		3.85
	Spread	52	57	60
Italy	10-year	4.17		5.50
	Spread	186	170/195	225
Spain	10-year	3.36		0.00
	Spread	105	100	0
Portugal	10-year	3.17		0.00
	Spread	86	85	0

Views

The emergence of financial risks has increased uncertainty on the terminal rates of the main central banks. We believe that the aggressive rate cuts anticipated by market operators are excessive, particularly for the Fed. The 2/10-year curve segments remain inverted, erasing the March pentification. We are revising downwards our Key Interest Rate Outlook, maintaining the view that key interest rates will remain persistently high until inflation converges towards its target. On the month, we maintain a downward bias on US and stable on European long-term rates.

The "risk-on" mood benefited the perihical sovereign spread which had weathered bank stress well. We believe that the potential for tightening is limited as fiscal issues are expected to become the focus of investors again in the coming months. On the other hand, in the longer term, the effect of the reduction in the ECB's balance sheet (QT) and the programme of sovereign and supranational issues should lead to a moderate spread spread.

	11-Apr-23	Forecast	
		May-23	Dec-23
Credit / Spreads			
Euro Inflation Swap 10-ans	2.45	2.50/2.60	
Libor OAS Spreads			
IG	96	93	
HY	401	395	
OAS Spreads vs. Souv			
IG	168	150/170	
BB	363	360/400	
EMBI Spread	488	450	450
FX/Equity/Commodities			
EUR/USD	1.09	1.08	1.15
Euro Stoxx	4333	3800	
Brent Oil Prices	86	100	

Views

Credit: the rapid compression of credit spreads encourages us to remain neutral.

Inflation: In the face of uncertainty about the trajectory of European inflation, the asset class remains attractive.

EM external debt: the end of the Fed’s cycle of rate hikes should support emerging external debt.

The euro is expected to benefit from the weak greenback linked to the end of the Fed’s cycle of rate hikes. The surprise drop in OPEC+ earlier this month, coupled with continued robust global demand, should support crude oil prices. In European equity markets, persistent inflation helps to keep corporate margins high. However, by the end of the year, Euro stoxx remains subject to a downward bias, reflecting the impact of aggressive rate hikes on activity.

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