



MAY 2023

ECONOMIC VIEWS

Three themes for the markets

1- Monetary policy

The principle of separation of central bank objectives continues to prevail. Systemic risk seems to have been contained in the United States, so that the inflation target remains predominant in the conduct of US monetary policy. The Fed thus made a final hike of 25 bps before an extended status quo at 5.25%.

The ECB will still have to raise its deposit rate twice to 3.75%. Monetary tightening also involves a reduction in the balance sheet with TLTRO repayments and the end of APP reinvestments from July.

2- Inflation

As expected, inflation is moderating in the United States, due to the drop in the price of energy and imported goods. Core inflation, however, remains stable. Wage pressures fuel inflation in services.

This strong price inertia, also observed in the euro area, means underlying inflation will remain high at the end of the year, close to 5% in the euro area.

The reopening of China is taking place without price pressures.

3- Growth

The euro area escaped recession, thanks to government support measures and the sharp drop in gas prices.

Growth in Q1 stands at +0.1% so that an acceleration is expected in Q2. The rise in wages should allow consumption to pick up.

In the United States, consumption is robust, but the monetary tightening should weigh on US activity which may skirt 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	-0.1	0.1	0.4	0.4	0.3	3.5	1.1
Consensus						0.1	0.2	0.2		0.6
Inflation										
Ostrum	6.1	8.0	9.3	10.0	8.0	6.6	5.8	5.1	8.4	6.4
Consensus						6.4	4.9	3.3		4.9
Core inflation										
Ostrum	2.7	3.7	4.4	5.1	5.5	5.6	5.7	5.6	3.9	5.6

- The euro area escaped recession. Activity finally contracted by 0.1% in 4Q before gathering some pace at the start of the year at a reduced rate: 0.1%.
- The extension of government measures to protect households and businesses from rising energy prices was partly responsible for this, as well as the fall in the price of natural gas. Consumption remained low.
- The surveys available to us in April point to firmer growth. The composite PMI index hits an 11-month high.
- This is linked to the dynamism of services, benefiting in particular from the higher demand in the tourism sector. On the other hand, activity contracted more sharply in the manufacturing sector due to less buoyant world trade.
- Spain and Italy appear to be the most dynamic due to the importance of the tourism sector in their growth.
- The relative decline in inflation and rising wages, as well as public support, should improve the dynamics of real incomes. Consumption will increase over the year. Similarly, the accumulated investment backlog should be addressed.
- As a result, we have a GDP trajectory that remains mediocre, but reaccelerates a little in the middle of the year.
- Inflation is expected to decline rapidly until the summer, mainly due to base effects on the energy component. But the underlying part remains very stable and should not fall below 5% by the end of the year.

2- USA

USA	2022				2023				2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
GDP (QoQ)										
Ostrum	-0.4	-0.2	0.8	0.7	0.3	0.5	0.0	0.0	2.1	1.5
Consensus						0.0	-0.2	-0.1		1.1
Inflation										
Ostrum	8.0	8.7	8.3	7.1	5.8	3.8	2.8	2.9	8.0	3.8
Consensus						4.2	3.6	3.2		3.7
Core inflation										
Ostrum	6.5	5.9	6.6	5.7	5.6	5.2	4.4	4.1	6.2	4.8

- Rising interest rates are eating into growth: the banking turmoil in March is creating a localized tightening of credit conditions, both sectorally and geographically.
- The systemic risk seems limited at this stage given 1/ the rapid and orderly reaction of the regulators and the Fed and 2/ the weak interconnection with the markets of the institutions in difficulty.

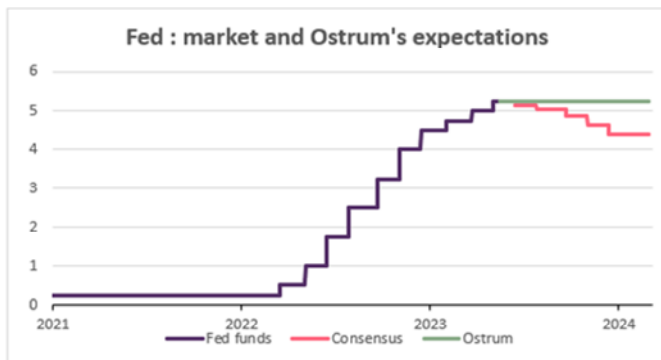
- Growth should be zero in the second half. Accordingly, we believe that the "soft landing" scenario is more likely than the "hard landing" scenario.
- The figures available for the first quarter show a resilient economy (annualized growth of 1.1%) thanks to the good performance of private consumption. Housing is showing signs of stabilizing after six quarters of contraction. Business investment (R&D), on the other hand, is less buoyant.
- The external balance stabilizes in Q1 2023. The recovery in growth in China and the eurozone will improve the contribution from abroad.
- Finally, inflation persisting above the Fed's target remains the most likely scenario. Wage pressures, in particular, remain elevated. This is a structuring element for the Fed.
- We expect the debt ceiling to be raised before the start of June.

Monetary policy

Divergence between the Fed and the ECB

1- The Fed leaves the door open for a pause in June

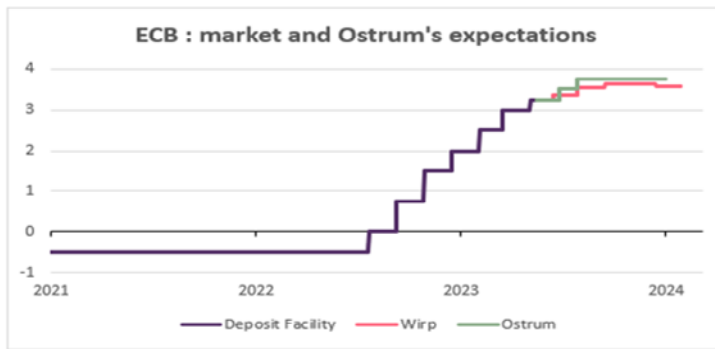
As expected, the Fed raised its rates by 25 bp in May to bring the Fed funds range to [5; 5.25%]. In its press release, the central bank removed the sentence relating to the need for further rate hikes. Uncertainty related to turbulence in some regional banks and its impact on credit conditions weighed in on this decision. This leaves the door open for a pause at the June meeting and a status quo thereafter. However, it does not rule out raising them if necessary, depending on the data. It is a "hawkish" pause signaled by the Fed, and rightly so given a still tight labor market. Markets wrongly anticipate rapid rate cuts.



Date FOMC	Ostrum	Chg.
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

2- For the ECB, rate hikes must continue to fight inflation

The ECB raised its rates by 25 bp as expected, bringing the deposit rate to 3.25%. The latest ECB survey of commercial banks was key in explaining the 25 bp rise, not 50 bp, as in April. Christine Lagarde insisted on the fact that the slowdown in the rise in rates was in no way a pause and that the central bank should continue to raise them in order to bring them back into sufficiently restrictive territory. The ECB also announced the end of reinvestments of APP maturities as of July 1. We anticipate two rate hikes by the ECB of 25 bp in June and July to raise the deposit rate to 3.75%.



Date	Ostrum	Chg.
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- BoE and RBA hike rates

The BoE also hiked its rate by 25 bp (7 votes, vs. 2 for a pause), to 4.5%, and signaled that it would not reach its inflation target of 2% before early 2025. The Reserve Bank of Australia surprised markets by raising its rates by 25 bp in June, to 3.85%, after having paused in April.

STRATEGIC VIEWS

The return of the issue of debt sustainability?

Synthetic market views: the effect of rate hikes spreads through the economy

The monetary tightening cycle is beginning to have a tangible impact on the economy. The Fed is entering a period of rate stability while the ECB still must adjust its policy. In addition to the banking difficulties in the United States, the downgrading of France's sovereign rating by Fitch to AA- or the difficult negotiations on the raising of the American debt ceiling are illustrations of this. US yields appear to have peaked in October 2022, coinciding with those of the dollar and inflation. Credit conditions are tightening in Europe and the United States, rekindling fears of recession.

Allocation recommendations: "Pause" does not mean "pivot"

Public debt issues militate for neutrality on sovereign spreads and European credit, whose valuation levels and fundamentals remain attractive. The default rate on the high yield remains close to zero, but a recovery of the failures is expected. Equity markets remain attractive due to the absence of a sharp downward revision in corporate earnings, equities remain on a favorable trend in the short term. The second semester could prove more difficult. The downward trend in the dollar is expected to persist and particularly benefit emerging external debt.

Market views

		11-May-23	Forecast	
			Jun-23	Dec-23
International Sovereigns				
USA	Fed Funds	5.25	5.25	5.25
	10-year	3.38	3.30	4.25
Euro Area	BCE, deposit	3.25	3.50	3.75
Germany	10-year	2.23	2.2/2.5	3.25
	30-year	2.41		
Japan	10-year	0.40	0.51	
UK	10-year	3.71	3.80	
European Sovereigns				
France	10-year	2.80		3.85
	Spread	58	57	60
Italy	10-year	4.12		5.50
	Spread	189	170/195	225
Spain	10-year	3.31		
	Spread	108	100	
Portugal	10-year	3.05		
	Spread	83	85	

Views

The Fed made one final hike while the ECB will continue to tighten by two times 25bp. Deteriorating credit conditions on both sides of the Atlantic are expected to dampen economic activity. In the United States, the difficult negotiations on the debt ceiling are also an element that could exert downward pressure on interest rates. The potential for interest rate increases is therefore limited. We have a long duration position stance on US bonds and hold a neutral stance on euro bonds. We believe that the 10/30 year spreads should steepen in both the US and euro markets.

Budget issues resurfaced following the lowering of France's sovereign rating (AA-) by Fitch. Uncertainty also remains high over the review of Italy's sovereign rating by Moody's and Fitch. On the other hand, the budgetary outlook is improving for Greece, whose government bonds recorded the best monthly performances. Spreads remained relatively stable despite the ECB announcing the end of APP reinvestments from 1 July. The catalyst for a spread widening should be a recession in the euro zone.

	11-May-23	Forecast	
		Jun-23	Dec-23
Credit / Spreads			
Euro Inflation Swap 10-ans	2.40	2.50/2.60	
Libor OAS Spreads			
IG	96	98	
HY	401	391	
OAS Spreads vs. Souv			
IG	170	150/170	
BB	384	360/400	
EMBI Spread	489	450	450
FX/Equity/Commodities			
EUR/USD	1.09	1.08	1.15
Euro Stoxx	4310	3800	
Brent Oil Prices	76	80	

Views

On credit, the IG euro universe remains attractive in terms of valuation despite the recent banking turbulence. However, flows are slowing so that a slight widening of spreads seems possible in the short term. Regarding inflation, the slowdown in prices and monetary tightening limit the upside potential of breakevens; especially since oil is showing signs of weakness. Finally, the Fed's monetary status quo is supportive for emerging external debt in dollars. Issuance flows on the primary market also remain limited.

The euro should benefit from the weakness of the greenback given the plateau reached on the Fed funds. The single of \$1.10 is however hard to break due to the strong long positioning. The drop in OPEC+ quotas did not stem the fall in crude oil. As for European equities, the normalization of corporate margins is proving to be very gradual in a context of high inflation. However, looking to the end of the year, the Euro Stoxx 50 remains subject to downside risk, also reflecting the impact of rate hikes on valuations.

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