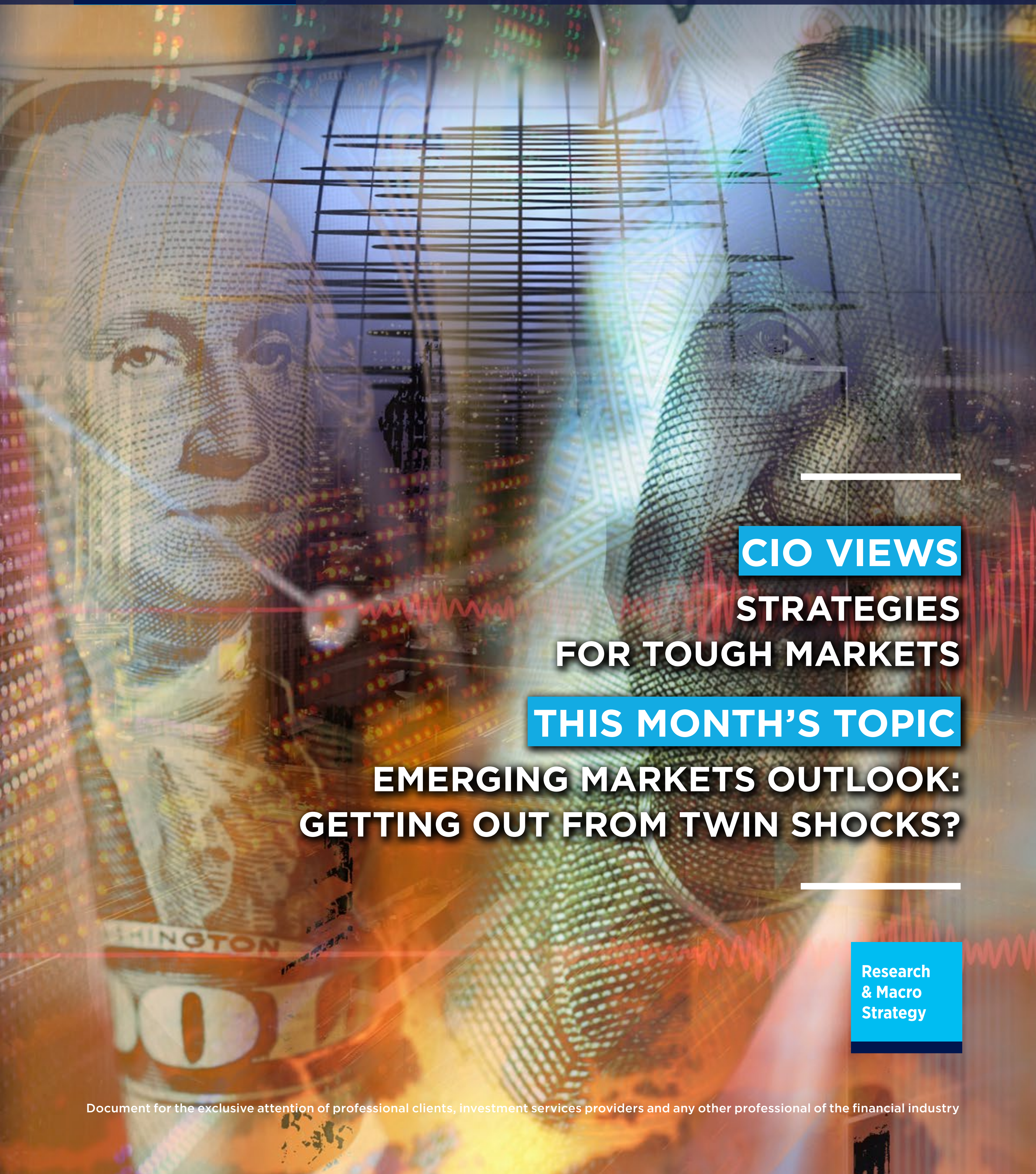
Confidence must be earned

Amundi ASSET MANAGEMENT

CROSS ASSET

INVESTMENT STRATEGY



CIO VIEWS

STRATEGIES FOR TOUGH MARKETS

THIS MONTH'S TOPIC

EMERGING MARKETS OUTLOOK: GETTING OUT FROM TWIN SHOCKS?

Research & Macro Strategy

CIO VIEWS

Strategies for tough markets

PASCAL BLANQUÉ, Group Chief Investment Officer
VINCENT MORTIER, Deputy Group Chief Investment Officer

This year has proven to be challenging for portfolio construction, as well as regarding returns. To put this into perspective, for 2009-17, our analysis shows that each year, on average, 76% of major asset classes (including different regional government bonds, equity, inflation-linked, currency and commodities) recorded positive performances. In 2018, the story has changed: we are heading towards an unprecedented year in which less than 20% of asset classes have been in positive territory*. Markets have started to price in a slowdown in global growth and tighter liquidity conditions, in a more complex than expected political environment (trade tariffs and populism). Vulnerabilities in the more stretched areas of the market (growth stocks in equities and credit markets) and idiosyncratic stories (Argentina, Turkey, Italy) are the main consequences of this new narrative.

Moving into 2019, Central Bank policy will be crucial again with regard to determining market sentiment. Given a potential slowdown in growth and weak financial conditions, a Fed shying away from further tightening would give new oxygen to the markets. Also, the ECB will likely be increasingly uncomfortable with raising rates in such a scenario. In the meantime, the risk of policy mistakes will remain high: How far can Trump trade policy go? What could the implications for input prices and corporate margins be? Can China growth hold on? These are all elements that could fuel volatility, but also lead to an opening up of opportunities in the market.

We think that, at least in the first part of 2019, there will be room to increase risk-taking in some areas of the market, given the more appealing valuations and the fact that most of the bond yield repricing is behind us. Signs of more dovish Fed could represent an additional positive trigger. We believe that a constructive earnings outlook will support a recovery in equities, based on a theme rotation. We continue to recommend a selective approach, with a focus on quality and valuations (and dividends later in the year) across the board, with the US equity market currently remaining our key call. Moving ahead, we would seek entry points to benefit from this year's price dislocations. One area of focus is Europe, once the political risk linked to next year's parliamentary elections in May, fades away. Emerging markets could be another area of interest, as the threat from rising interest rates and a strong dollar should dissipate with early signs of a slowdown in the US. Against a backdrop of economic and political uncertainty, we would continue to focus on drawdown management, as capital preservation will be at the top of the list of investor concerns. This means focusing on bottom-up research to select stocks and bonds with stronger fundamentals that could be more resilient to market downturns and to avoid concentration in the most risky areas of the market, where sustainability of returns could be under threat (ie, over-indebted companies, overvalued stocks).

**Analysis run on 30 indices for different asset classes with data as of November 20, 2018.*
ECB= European Central Bank, EM = Emerging Markets, DM = Developed Markets.

High Conviction Ideas

MULTI-ASSET

We remain cautious on risk assets and think investors should add regional equity diversification to support portfolio resilience to political risk and uncertainty on policy actions. A strategy is to play the rotation of themes in Europe, favouring EMU value vs. the broad market. We also have become more constructive on Japan, as the market remains cheap, with light positioning and resilience, despite the unexceptional earnings season. On DM credit, we maintain a reduced risk exposure in Europe.

FIXED INCOME

A slowing of growth momentum reduces the pressure on Central Banks to accelerate monetary normalisation. In this environment, the case for being short duration is receding, and we now have a neutral view in the US (more on government guarantee/mortgages securities than on US Treasuries). On credit, we stick to a conservative view, with a focus on less indebted companies due to the spillover effects from tighter liquidity conditions. In Europe, for tactical reasons and due to expected issuance in the financial sector, we have become even more cautious in the short term, but we remain more constructive in the medium term.

EQUITIES

Q3 earnings season confirms a positive outlook for the US, but, so far, a more mixed result for European and Japanese equity. A rotation towards more defensive themes is confirmed, as is a correction of growth vs. value. In the US, we are very cautious on high-growth/high-momentum stocks. In Europe, we focus on those companies regarding which we believe valuations have overshot to the downside and are effectively pricing in substantial/excessive earnings per share weakness.

REAL ASSETS

In a world of low interest rates, investors will continue to look for portfolio diversification and yield enhancement. In our view, selectively allocating to real assets can help to capture liquidity premiums in the market, as well as to potentially enhance income returns and protect against inflation, given the recurrent cash flow associated with some investments, such as infrastructure and real estate. These two areas (with natural resources) are expected to show the strongest asset growth in the next five years.

MACRO

Slowing growth, political uncertainties dominate

DIDIER BOROWSKI, Head of Macroeconomic Research
MONICA DEFEND, Head of Strategy, Deputy Head of Research
PHILIPPE ITHURBIDE, Global Head of Research

G20: a temporary but meaningful easing of trade tensions between the US and China. After the G20 talks, Presidents Trump agreed with Xi Jinping to temporary pause the increase in tariffs rates. With the midterm elections over, Trump could find an opportunity to deepen the negotiations. However, any appeasement would be likely short lived. The opposition between the two nations will return to the forefront in 2019, as their strategic interests tend to diverge (high technology, intellectual property rights) and because the opposition to China is supported by a large part of the American electorate (the campaign for the 2020 presidential elections will start in 2019).

The US cycle: economic slowdown in sight. Towards a pause in the Fed's tightening in 2019. The recent rise in credit spreads, if it continues, will tighten the financing conditions for heavily indebted companies. It will therefore be taken seriously by the Fed, also considering that fiscal multipliers will gradually fade in the course of next year. Recent rhetoric of FOMC* members has been on the dovish side. The Fed's communication aims to pave the way for a change in its 'dots', signalling a stop in monetary tightening sooner than expected next year. This is in line with our expectations and it is consistent with the three rate hikes we expect (one in December and two in H1 2019). It does however clearly tell us that the risk is that the Fed will do less.

Europe: fog thickens with political uncertainty. No thinning before spring? In the EU, growth has slowed, but is expected to remain above potential. Monetary conditions are still accommodative and oil prices have dropped recently. The only caveat is that politics prevails over economics. **In the UK**, we expect a favourable vote in parliament on the withdrawal agreement negotiated by Theresa May. Even if it fails to be adopted on 10 December, this plan can still be amended (at the margin) and be the subject of a second vote at the beginning of 2019. The majority of Tory Eurosceptic Members of Parliament, being moderate, would probably vote positively to avoid a "hard Brexit" at the end of March. Under these conditions, the UK would benefit from a long transition period during which trade rules would be unchanged. With less uncertainty, UK growth should be able to regain some of the ground lost since mid-2016. **In Italy**, tensions with the EU Commission will remain alive, probably until the European elections in May 2019. However, general elections cannot be ruled out by then. The League has continued to gain ground in polls at the expense of M5S. Such an evolution, if confirmed, would open the door, after new elections, to a coalition League / Forza Italia (which would likely abandon some stimulus measures). Italian growth slowed sharply in Q3 and bank credit conditions have begun to tighten. It will be necessary to monitor closely whether rising bond yields are tightening bank credit conditions to the point of deteriorating the economic outlook. Risks to growth are skewed to the downside.

> "Political risks will keep market volatility high."

** FOMC=Federal Open Market Committee.*

The Strategist view

Euro credit re-pricing

European credit repriced wider, together with weaker equity markets and political uncertainties. **Valuations are much better now,** while positioning lightened further, as market players further cut their exposure. The primary market saw initial encouraging signs of improving activity from European names and financials, but these failed to act as a tailwind for secondary markets and currently prevailing de-risking finally reduced liquidity and activity. The results of the 2018 **stress test** on EU banks were credit-friendly, as they showed a solid outcome for the EU banking industry, with strongly improved capital and asset quality positions with respect to the previous test, held two years ago. Among non-financial issuers, the earnings season confirmed that credit metrics remain overall sound, as financial leverage remain at low historical levels.

S&P's decision to revise its outlook but not its rating on Italy represented a partial positive surprise. In this situation, short maturities outperformed medium to long-term maturities after the S&P decision, confirming that the search for yield is still a focus in this segment. However, the following persisting confrontation between the government and the EU commission kept pressure and volatility on periphery issuers. In conclusion, and despite a still cautious investors' sentiment on risky assets, **the mix of stronger valuations, still sound credit metrics and lighter market exposure looks overall encouraging for European credit, looking forward.** Political developments and more clues from ECB in terms of next year reinvestments are likely to represent the major drivers in the short-term. In a late cycle phase, the focus will continue to be on security selection, avoiding over-indebted securities, and on monitoring market liquidity.

MULTI-ASSET

Play regional diversification in a risk cautious setting

MATTEO GERMANO, Head of Multi-Asset

Investors have so far dealt with tight valuations and meagre returns in 2018. So what are the main themes asset allocators should consider for the coming months? Firstly, the **late cycle narrative** remains in place, with its features of slower growth, a modest rise in inflation, and a peak in earnings growth. Secondly, heightened **geopolitical and idiosyncratic risks** continue to weigh on sentiment. We therefore confirm our view for **low absolute exposure on risk assets**. However, we still think we are in the "**last race**" for risky assets, hence the idea of playing tactical opportunities or investing in mispriced assets, like Japanese equities or EMU Value stocks. On the other hand, we believe investors should reduce exposure to expensive assets, especially the areas of the credit market where spreads do not compensate for market risk and reduced liquidity. The deteriorating liquidity outlook, combined with the low expected returns are among the challenges for investors: focusing on effective portfolio diversification and effective liquidity management will be key.

> "Geopolitical themes unfolding in tighter liquidity conditions, call for defensive risk asset allocation."

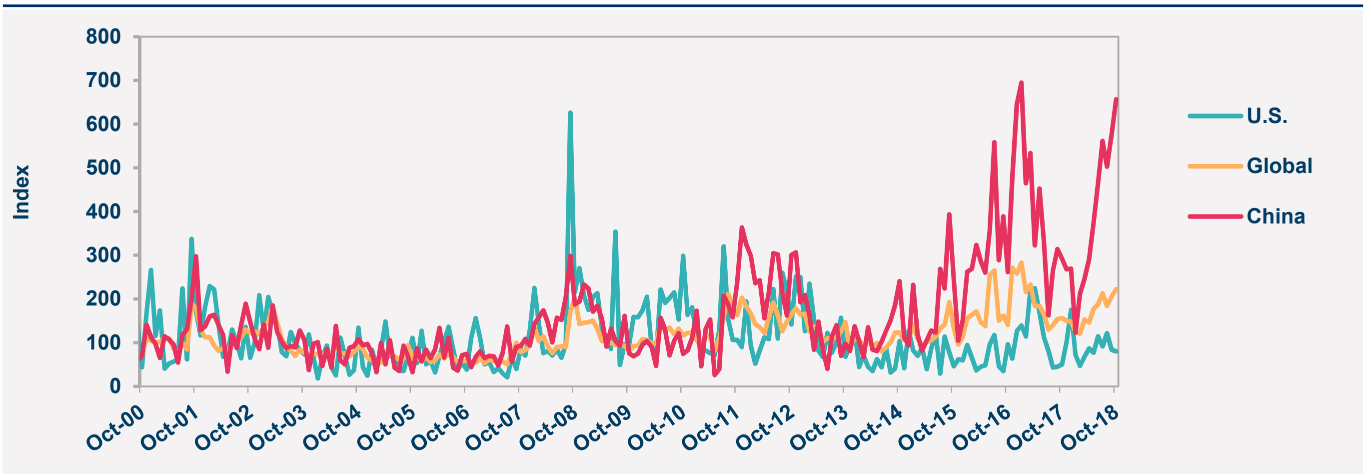
High conviction ideas

The current high level of uncertainty calls for a cautious stance on risk assets. On equities, we keep a marginally positive/close to neutral overall view, trying to diversify the regional allocation, with a strong focus on value. In particular, we prefer areas that are less exposed to current geopolitical risks: eg, Japan, which has been resilient despite the mediocre earnings season, has limited exposure to the US-China trade disputes or to the European political crisis. This factor, combined with cheap valuations and light positioning makes the NIKKEI appealing in our view. In US equities we maintain a positive tilt as they appear attractive, based on macro fundamentals (growth outlook, earnings and buybacks). In Europe we have now a preference for the EMU Value index as a defensive stance, supported by valuation aspects and technical factors.

In EM markets, we favour China vs Global EM, as we think that the proactive stance of Chinese policymakers through different channels should be sufficient to avoid derailing growth, especially considering the risks coming from tariff threats.

In fixed income sovereign markets, we believe investors should maintain a modest under-weight exposure on the German curve (where yields could bottom out, and move higher) whilst we are more positive on US Treasuries

Policy uncertainty on the rise



Source: Amundi, Bloomberg, Data as of 20 November 2018 (which could benefit from their perceived safe haven status in volatile periods). Strategies that benefit from inflation surprises (ie, inflation linked bonds) are also recommended in the current late cycle phase to deal with potential inflation surprises. With Brexit confusion remaining high, UK rates remain vulnerable to corrections: however, we would note that conditions are still supportive for a cautious position on UK 10Y real rate. On credit, we have a neutral view, having gradually trimmed our preference in the past months, due to tight valuations and increased geopolitical risks, as well as less favourable liquidity conditions.

Risks and hedging

We continue to suggest exposure to gold, both as a hedge against rising geopolitical tensions and to take advantage of a possible softer stance from the Fed. In case of volatility spikes, the yen would tend to outperform the US dollar. We also suggest implementing options strategies to protect against spread widening in high yield.

FIXED INCOME

Credit is bearing the burden of tightening liquidity

ERIC BRARD, Head of Fixed Income
YERLAN SYZDYKOV, Head of Emerging Markets
KENNETH J. TAUBES, CIO of US Investment Management

Overall assessment

This year has been challenging for bond investors, as they've had to deal with rising rates in the US, idiosyncratic stories (EM, Italy), and repricing of credit markets. A critical factor for next year's outlook will be monetary policy orientation: if, as we believe, the Fed pauses, amid a risk of economic deceleration due to implications related to trade issues, conditions for active bond investors could improve. They will have more levers than this year to benefit from price dislocations (wider EM and credit, depressed EM FX). On rates, some upside pressure remains in the short term, as the US labour market is very tight. But, the weaker momentum in global growth, which will ultimately occur in the US as well, the late cycle narrative, and the elevated market uncertainty will tend to exert downside pressure on rates. In this environment, we recommend staying closer to neutrality on duration, especially in the US. In credit, the view is cautious: this asset class is suffering from higher rates and tighter liquidity conditions. Selection is key, as is an increased focus on debt dynamics, to avoid overleveraged situations. EM could return to being attractive sources of carry, with a dovish Fed, but investors should be ready for volatility and focus on appropriate investment horizons.

> **"Increase duration and reduce credit risk, as markets adjust for tighter."**

DM government bonds

The case for being too defensive in core bonds is receding, as real rates repriced higher in the US and the tightening path is fully discounted, and in Europe the ECB will find it increasingly difficult to raise rates in a slowing environment; we suggest keeping duration positions close to neutrality. We believe investors should try to add value from the movements of the curves and from relative positioning. On the curves, we prefer flattening positions in EU and steepening positions in the US. We continue to like inflation trades in the US. In EU, with a neutral view on peripheral bonds, we are cautious on Italy, but we expect that wider spreads will open up new opportunities in 2019.

Credit

Fundamentals and valuations are favourable for the Euro credit but the expected future issuance in the financial sector would suggest a tactical underweight. In the US, the expensive valuations suggest a cautious stance. Selection and focus on quality remain crucial. In particular in IG space long dated US industrials (Energy and Telecom) may offer selective opportunities. We are cautious on the high yield sectors, which are more exposed to idiosyncratic risks and overall look expensive.

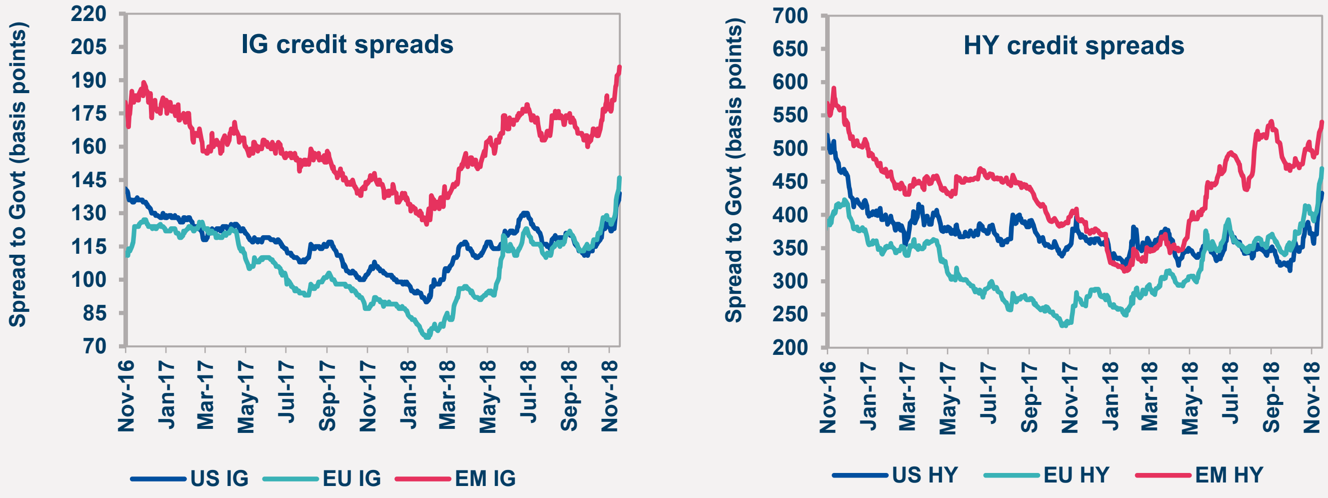
EM bonds

The short-term outlook remains tough. Risk appetite is low amid a deceleration of global growth and a slowdown in China. These factors justify a reduction of risk regarding the asset class (ie, in Mexico, which enjoyed a rally post the NAFTA agreement), while seeking selective value stories in some oversold countries and sectors. With less rationale for US rate increases and most of the USD strengthening behind us, we expect EM bonds to regain appeal over the course of 2019. Local debt has suffered from the strong USD, with inflows likely to slow, so, we remain cautious. Corporate debt has been resilient so far and we continue to prefer it to sovereign.

FX

We are still positive on the USD, given persisting CB divergences. We are neutral on GBP, as volatility is very high.

Spread widening in credit markets



Source: Amundi, Bloomberg, ICE BofA Merrill Lynch Bond Indices. Data as of 20 November 2018.

EQUITY

Strong rotation of themes

ALEXANDRE DRABOWICZ, Deputy Head of Equity
YERLAN SYZDYKOV, Head of Emerging Markets
KENNETH J. TAUBES, CIO of US Investment management

Overall assessment

The recent correction confirmed a rotation of themes in equities, from growth to value and towards more defensive stocks. We believe that this trend will continue, in markets that should remain supported by decent earnings growth, but with higher volatility as the cycle advances.

Europe

For the first time in a decade, value has outperformed in a market correction. The earnings season confirms positive earnings growth, but negative surprises, with the market penalising most companies that missed expectations instead of rewarding the ones that beat expectations. Results show that the increase in input costs, trade war/tariffs and FX dynamics were among the top three factors negatively impacting company results among the Stoxx600. These will continue to be elements to monitor regarding stock selection. We believe that investors should focus on those companies where valuations have overshot to the downside and are pricing in substantial/excessive earnings per share (EPS) weakness.

United States

The US equity market corrected in October, with a rotation of themes against high growth/high momentum stocks. In the short term, some price adjustments could still happen as a consequence of the slight deceleration of industrial activity. However, we believe that the positive trend has not been compromised. In the past, bear markets have been driven by recessions (except in 1987), and the indicators for an early recession are still missing. The earnings season has been very strong in Q3. With 90% of S&P 500 firms having reported, results were characterized by strong EPS growth (+27%) and revenue growth (+12%). EPS growth was not solely attributable to tax reform; pretax earnings grew by 14% year on year through the first three quarters of 2018. For next year, we expect a normalisation of earnings growth, and believe the market will carefully assess the sustainability of results. Margins will be under increasing pressure from tariffs, higher interest rates, a potentially flat yield curve, and rising input costs, including wage inflation. A key issue to watch will be infrastructure spending and regulation on health care/drugs post the midterm election results. These factors call for a strong focus on selection. At the sector level, we find value in capital goods, housing repair & remodel-levered stocks, financials, and telecom.

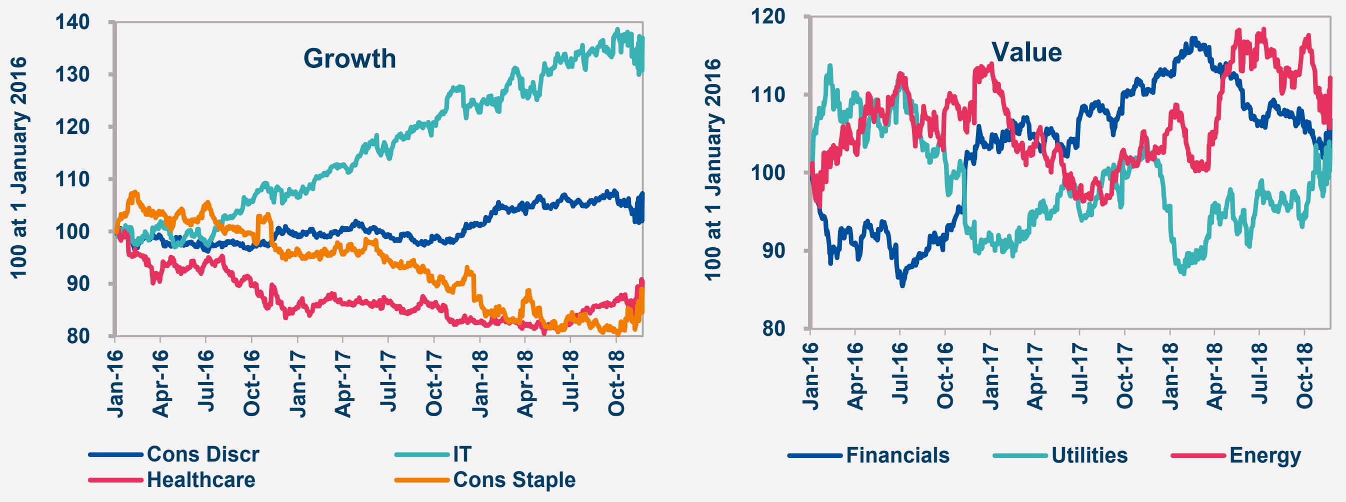
> "Markets are pricing a too negative scenario for growth and earnings."

Emerging markets

Sentiment continues to be weak. We don't see major macro imbalances, but weak economic (and earnings) momentum and uncertainty regarding the depth of the Chinese slowdown are impacting the asset class. Market valuations are cheap, and a rebound through year-end looks possible, in case of a broader relief equity rally. But, in order to see a structural recovery of EM, we need a stabilisation of the USD, easing of trade disputes, and for the risk of a hard landing in China to be averted. The results of the US midterm election (less fiscal boost) and no further deterioration in trade are potential positives to watch for next year.

On themes, we are now more cautious on oil, which is under pressure, due to supply/demand imbalances. We favour Brazil and Mexico, but these need to be watched regarding execution of reforms (Brazil) or market friendly policies (Mexico). We have a positive view on Russia.

MSCI World Growth and Value sectors



Source: Amundi Research, Bloomberg, As of 22 November 2018. Rebased to 100 on 1 January 2016

REAL ASSETS

The case for (selectively) allocating to real assets

PEDRO-ANTONIO ARIAS, Global Head of Real & Alternative Assets

Appeal for long-term sources of diversification

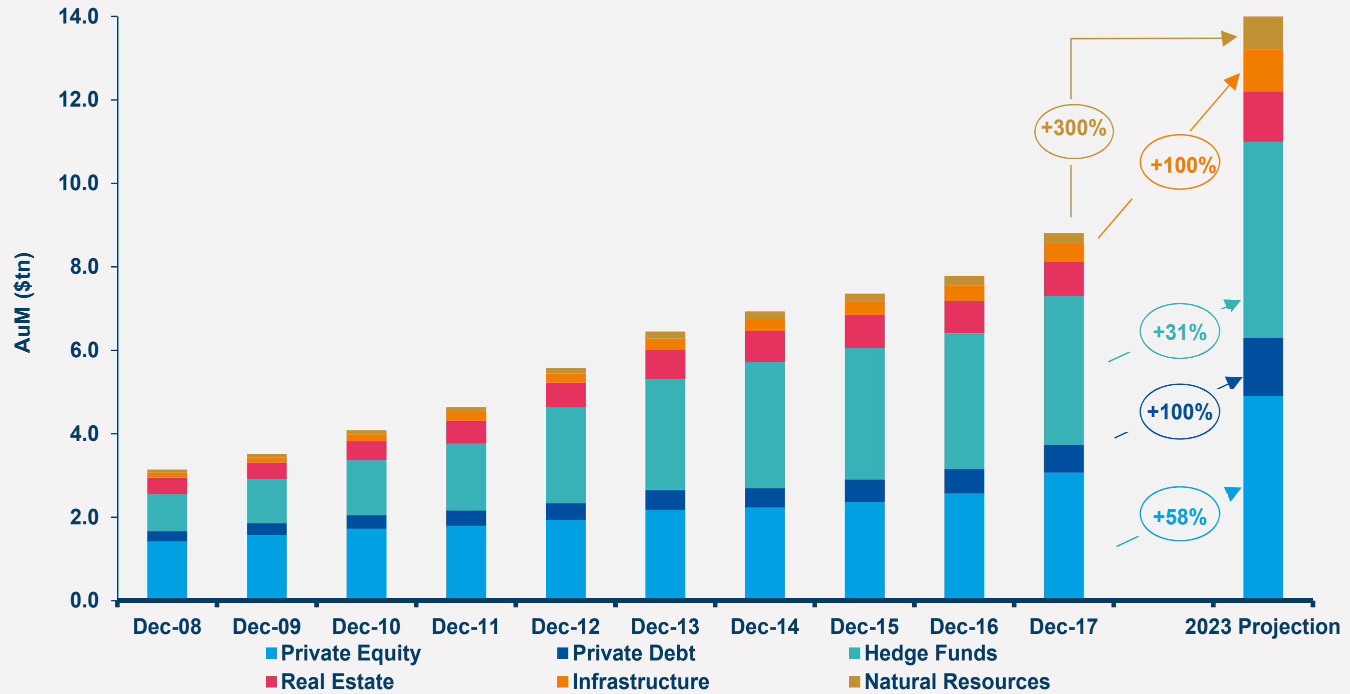
The drivers for real assets in 2019 are set to remain broadly unchanged from this year. In a low yield environment, especially in Europe where the ECB remains broadly accommodative, investors are structurally more inclined to invest in alternative asset classes that, thanks to their ability to capture illiquidity premia, can potentially deliver higher income and returns while diversifying risks. As a result, fundraising in private markets and real assets, which have just recovered to their pre-crisis levels, could even accelerate.

On fixed income, investors still have a positive view on private debt and credit continuum solutions (which combine liquid and illiquid instruments), given the benefits they may provide to portfolios both in terms of diversification (out of the most crowded areas of the traditional credit market) and potential yield enhancement. Therefore, we are expecting an acceleration in demand for this asset class over the next year. Beyond market conditions, prudential regulation in the financial sector could also continue to boost demand for alternative sources of financing to complement banks' intermediation in financing the real economy.

Real assets investments, in particular infrastructure and real estate, potentially act as a structural hedge against inflation, an important feature for investors since the risk of higher inflation remains on the radar. On infrastructure investing, we believe that the current outlook will be sustained due to the focus by policymakers on further supporting the recovery beyond this cyclical phase. The current economic outlook in Europe could also favour real estate due to the demand for space and the expected increases in rent (expected to be the main driver of performance), as anticipated in France, Spain, Germany and Benelux. In our view, active management strategies in real estate will be critical to dealing with current high valuations and trying to protect against the future risk of rising interest rates. On private equity, the outlook is more challenging. A complex macro environment requires investors to be even more selective in terms of geographic areas and appropriate target companies. We think Europe still offers a positive economic backdrop and we expect private equity to remain in demand in this geographic area. However, it will be vital to identify those factors that make a company well equipped to create value for investors over the long term. Among them, we highlight the following: the quality of the management team and its involvement in the capital structure; having solid fundamentals and a history of profitability; the ability to gain a competitive advantage by having consistent organic growth and a strong desire to seek external growth through internationalisation; and a flexible approach and the agility to adapt rapidly to changing environment conditions. We would note, however, that private equity remains one of the best performing asset classes over the long run. For investors with a sufficient time horizon (8-10 years), we think that private equity remains a valuable source of returns and illiquidity premium. Based on all market and structural conditions considered above, we believe that in the long run, real assets will likely continue to be in strong demand. Recent Preqin's projections estimate that alternative assets under management will hit $14.0 trillion by 2023, up by 59% from $8.8 trillion as of the end of 2017. Among the rising trends in alternative investing, there is also the higher focus on ESG considerations as a key element to identifying best business practices

> **"Real assets market projections show strong asset growth in the next five years."**

Assets under management by asset class



Source: Preqin, Amundi. As of 20 November 2018

Asset allocation: multi-class outlook

	1 month change	---	--	-	0	+	++	+++
Equities vs govies	→				■			
Equities vs credit	→				■			
Credit vs govies	↘				■			
Duration	↗			■				
Oil	→					■		
Gold	→					■		
Euro cash	→				■			
USD cash	→				■			

The table above represents cross asset assessment of 3 to 6 month horizon, based on views expressed at the most recent global investment committee. The outlook, changes in outlook and opinions on the asset class assessment reflect the expected direction (+/-) and the strength of the conviction (+/++/+++).

Relative outlook and convictions by major asset class

	Asset Class	1 month change on view	Underweight	Neutral	Overweight
GOVIES	US	→		●	
	Euro core	→	●		
	Euro peripherals	→		●	
	UK	→	●		
	Japan	→	●		
CREDIT	US IG	→		●	
	Euro IG	↘	●		
	US HY	↘	●		
	Euro HY	↘			●
	GEM debt hard cur.	→		●	
	GEM debt loc. cur.	→		●	
EQUITIES	US	→			●
	Eurozone	→		●	
	UK	→		●	
	Japan	↗			●
	Pac. ex Jap.	→		●	
	Global EM	→		●	

Currency and real assets

FOREX	EUR vs USD	→
	EUR vs GBP	→
	EUR vs JPY	→
	USD vs JPY	→
REAL ASSETS	Real estate	→
	Global Infrastructure	→
	Private Debt	→

LEGEND

↘	Downgrade
→	Unchanged
↗	Upgrade
● (red)	Underweight
● (black)	Neutral
● (green)	Overweight

Source: Amundi, as of 20 November 2018. The 3-6 month return outlook refers to research views based on expected returns by asset class. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding any fund or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. **This information does not represent the actual current, past or future asset allocation or portfolio of any Amundi product.**

THIS MONTH'S TOPIC

Emerging markets Outlook: getting out from twin shocks?

ALESSIA BERARDI, Deputy Head of Macroeconomic Research

Finalised on 04/12/2018

The essential

In 2019, we do expect some further economic deceleration until the middle of the year followed by a mild re-acceleration in the second half, barring any recessionary scenario in the US and in China.

A still constructive but very clouded outlook led us to assess the kind of policy mix that the different EM countries can afford to implement in the event that the economic conditions slip more significantly from our central scenario.

We believe that the countries where the monetary policy could turn more supportive are those that are the least externally vulnerable, with better anchored inflation expectations. On the other hand, the built-up fiscal buffers will allow EM to better navigate any challenging times in the future.

Since the half of 2018, macroeconomic conditions in the emerging markets have been deteriorating to the extent that we have been downgrading our main scenario outlook in terms of growth expectations. Since the beginning of the year, we have constantly raised the probability of downside risk to our projections, almost eliminating any upside risk. As of now, we have a 25% probability for downside risk, compared to 5% for the upside. The growth differential between EM and DM has turned decisively in favour of DM, thanks to a solid extended cycle in the US.

Moving to 2019, we do expect some further economic deceleration until the middle of the year followed by a mild re-acceleration in the second half, barring any recessionary scenario in the US and in China. Emerging markets' economic and financial performances in 2018 have been hit by twin shocks, namely a senseless trade policy marking a change in the globalisation process, as we know it, together with the continuation of the Federal Reserve's monetary policy normalisation process. We can argue that the latter didn't come as a surprise; however, the sudden US dollar appreciation that started last April immediately changed the perspective for many EM central banks, in light of the resulting turmoil on their domestic financial markets (equity and local currencies primarily). The rhetoric adopted by Fed Chairman Powell has only recently been giving some signs of relief, in terms of a more dovish monetary policy stance with a hiking cycle that is probably closer to its end than previously expected. However, the trade tensions and the confrontational approach on trade by the US administration towards Chinese business practices (not always considered fair) is still fuelling high geopolitical risks around the world and supporting a strong US dollar as a core asset, somehow preventing a clean and more positive outcome for EM in the short term.

Structurally, the world appears to be moving towards less multilateralism and the future global trade environment is now more uncertain. However, still there are good practices to pursue with the aim of maintaining some sort of cooperation, such as the modernisation of the WTO and/or more customised regional agreements.

A still constructive but very clouded outlook led us to assess the kind of policy mix that the different EM countries can afford to implement in that event that the outlook slips more significantly from our central scenario. On one hand, it's worth assessing which central banks have more room to revert their stance and to ease in order to support their economic cycle, keeping a balance between poorly-anchored inflation expectations (with important currency pass-through) and still high external vulnerability. On the other, it's worth assessing which countries can now benefit from a more prudent fiscal policy adopted in the recent past.

During 2018, a straightforward change of perspective for EM central banks has taken place: the focus has clearly shifted from prevailing domestic considerations at the very beginning of the year, to more global/external factors driving monetary policy stance since April 2018 when the USD started a more convincing strengthening path.

For 2019, we do expect this trend to continue up to a point when the end of Federal Reserve's hiking cycle will become clearer. However, currently deteriorating macroeconomic conditions (mostly externally driven) will soon start to gain more relevance in EM monetary policy decisions, conditioning the future MP path as much as possible. We believe that the countries where the monetary policy could turn more supportive of the economic cycle are those that are the least externally vulnerable (safer in a strong US dollar environment), with better anchored inflation expectations (more stable inflation outlook within or closer to the CB target range). Having said that, monetary authorities should preserve the flexibility in their currencies with the caveat that the impact of FX volatility must be strictly monitored. For a healthy economic development, the exchange rate should remain the ultimate shock absorber and interventions in the FX market should be allowed only in very disorderly and highly volatile FX environments.

With regard to the second tool to the rescue, the different governments that have not already done so should make progress on building up fiscal buffers via more sustainable debt trajectories together with prudent and credible fiscal targets, a higher tax base, more efficiently targeted subsidies policies (if any) and more transparent fiscal rules. When fiscal targets are fixed together with external institutions like the IMF, they should be credible and realistic. In one of the most recent cases, we do not believe that Argentina's fiscal target as set out in the revisited IMF plan is credible or affordable. At some point, it will probably be renegotiated. The built-up fiscal buffers will allow EM to better navigate any challenging times in the future.

Chart 1: EM policy room (Monetary and Fiscal Policy apacity)

Monetary policy capacity \ Fiscal capacity	LOW	MEDIUM	HIGH
LOW	Poland Turkey	Philippines South Africa	Mexico Colombia Indonesia
MEDIUM	Brazil Hungary India		Chile Czech Republic Malaysia Peru Russia
HIGH		China South Korea	Thailand

Source: Amundi Research, as end November 2018.

Risk factors

DIDIER BOROWSKI, Head of Macroeconomic Research
PHILIPPE ITHURBIDE, Global Head of Research

The table below presents risk factors with judgmental probabilities (i.e. not market based). It also develops the possible market impacts.

Risk # 1 | 40% probability | Renewed escalation in trade tensions between the US and China

Analysis | US and China ceased fire after a temporary deal reached by President Trump and President Xi during G20 meetings at Argentina. The planned increase of tariff rates in January 2019 paused and the risk of an additional tranche of tariffs on the rest of US imports from China ($267bn) seems to have been also delayed, while negotiations resumed, with signs of China to deliver some of commitments before 90 days of deadline. This should at least help to reduce some downside risks in the near term, with direct impacts on trade to be less concerned, and market sentiment to recover slightly from being very downbeat. That said, this deal is still temporary, and it could take much longer to ultimately solve the problems, as many complicated topics are involved. The arrest of the CFO and daughter of the boss of Huawei, one of the most famous Chinese tech company, in Canada on the request of US reminded that the challenges between the two economies could reach beyond trade issues. As so, we could not rule out severe confrontation between the US and China to come back.

Market impact | Trade tensions have begun to weigh on business climate (especially in the manufacturing sector in Europe) and on the Chinese economy. Subsequently some private-investment projects might be postponed. Even in the absence of a large-scale trade war, global trade, which has started to slow, may thus slow down further. A chain reaction would cause a fall in global trade of goods while exacerbating local inflationary pressures in the short run (mainly in the US), putting central banks in a corner. This would cause a general rise in risk aversion (fear of a global downturn). At the end of the day, a more severe confrontation would only make losers.

Risk # 2 | 20% probability | Major European slowdown

Analysis | Eurozone GDP growth slowed down to only 0.2% QoQ in Q3, after 0.4% in Q1 and Q2 and 0.7% in Q3 and Q4 2017. While Q3 weakness was largely the result of temporary negative factors (a sharp drop in German car production due to a new emission testing regime), the underlying momentum is slower than what we anticipated a few months ago. The central scenario remains a continuation of the recovery at a slightly above-potential pace, but risks are tilted to the downside. Indeed, the combination of continuing internal political stress and external negative factors (notably a slowdown in the US and/or Chinese momentum) could cause growth to fall further. Lower oil prices are currently a supportive factor into 2019. However, a reversal of this trend would be another drag for the European economy.

Market impact | As the ECB would be left with few tools to face a slowdown, and as a coordinated fiscal stimulus would be very difficult to decide due to the complex European institutional and political environment, a major slowdown would clearly be negative for European assets and the euro.

Risk # 3 | 15% probability | Political instability in Italy with renewed stress on sovereign spreads in the Eurozone

Analysis | The government coalition in Italy (between M5S and the League) maintained very tense relations with the EU , particularly in terms of fiscal policy and migration policy. After the announcement of an unprecedented material and significant deviation of its deficit targets far from those consistent with the correction path required by the EU commission to avoid an excessive deficit procedure, the EU Commission made the first step in November to start an Excessive Deficit Procedure for excessive debt for Italy as the projected fiscal slippage is not compatible with medium-term debt sustainability. Incoming data on contracting economic growth in Q3 and weak coincident and leading indicators for Q4 increased the risks of another dip that prompted the Government to tone down rhetoric and seek for compromise. Discussions on revising down deficit targets are currently ongoing. EDP likely will not be avoided with the revisions discussed currently, but could be less harsh.

Market impact | There is no systemic risk in our opinion. The rise in Italian bond yields has tightened local financial conditions and that weigh on the ongoing recovery in Italy. Since negotiations started to become less confrontational, spreads tightened giving some short-term relief. Yet, as the tightening concerned more the short term part of the curve rather than the long part, it looks like that the market expectations are for short-term positive developments although the long-term outlook did not change much. We perceive risks as remaining domestic. Moreover, the ECB has anti-contagion tools that it could mobilise to avoid a contagion to other peripheral markets. All of this could maintain contained contagion risk on peripheral sovereign spreads and on corporate credit spreads.

Risk # 4 | 15% probability | No-deal Brexit

Analysis | The political situation in the UK is very unstable, with a government, a majority and a parliament that are particularly divided. We identify 3 broad categories of scenarios: (1) Deal (65% probability) meaning that a deal (which can be May's deal or another one, including an EEA membership with customs union regime) can be ratified by the UK Parliament, so that the UK exits the EU in March 2019 (or a few weeks after) and enters a transition period where it remains in the Single Market at least until end 2020 (or open-ended). However, it is important to note that this probability covers very rocky paths that include a political crisis and, possibly, new elections, but nonetheless a deal in the end. (2) No deal (15% probability), although there would probably be mitigation measures meaning that the probability for EU/UK trade relations to be regulated only by the WTO regime is lower. (3) A prolonged uncertainty (20% probability) well beyond March 2019 through a granted extension or unilateral repeal of Art. 50 by the UK. This could lead to new negotiations or to a new referendum, with probably new elections in between. This category of scenarios could then lead to various outcomes in the end (including a different deal, a Brexit reversal or new risks of no deal).

Market impact | Scenario 1 should bring relief in the end, but as the road to the deal ratification will probably be difficult it will be a source of temporary stress. Scenario 2 would cause major turbulences: In the event that the outcome is ultimately unfavourable for the UK, we would see a weakening of the GBP and below-trend GDP growth. Scenario 3 includes complex paths, with probably many episodes of stress and relief.

Risk # 5 | 15% probability | Continuation of the contagion in the "emerging world"

Analysis | Emerging markets have been suffering since the start of the year, impacted by (1) the Fed's rate hikes and strong USD; (2) by the trade war rhetoric; (3) by the tightening in domestic monetary conditions (many EM central banks have risen their key rates); (4) by the deterioration of the outlook in several countries at the same time (Argentina, China, Turkey and South Africa). In fact, even though the systemic risk is lower than in the past (given the lesser vulnerability of emerging countries), most EM assets have dropped since the beginning of the year. Fears of a still strong USD, of a continuous liquidity draining by the main CB and of a renewal (after G20 agreement) of escalation in the trade war between the US and China would undoubtedly push to a larger contagion (because value chains are very integrated).

Market impact | Credit spreads and equity markets would be highly hurt; it all the more true that emerging currencies would remain under pressure with more capital outflows. However, the emerging world is not a homogeneous block, and the market will deteriorate more in the most vulnerable countries, whether due to poor external positions whether due fragile fiscal and political conditions. Some caution about emerging markets is still required at present but the risk probability has reduced. Indeed, we believe EM markets have already priced in most bad news, and at some point, they should become attractive again.

Risk # 6 | 10% probability | US Recession

Analysis | The robust performance of the US economy in 2018 has led to the supremacy of US risk assets compared to the rest of the world. Moving towards the end of the year and into 2019, global investors have started to raise questions about whether the US economy and business sector will continue to shine, how inflation will evolve, and which direction the Federal Reserve will take going forward. On the macroeconomic front, we think that US growth will continue, with some modest deceleration in 2019 that should prevent a more dangerous overheating of the economy. After the US midterm elections, two possible paths have emerged. The first path is a divided government, leading to very little meaningful legislation enacted. The second path is a constructive one where there are areas of commonality between Trump and the Democratic leadership in the House (infrastructure spending). All eyes will instead be on the Federal Reserve, as the major assumption of the outlook is for a gradual tightening in monetary policy conditions with no abrupt increase in rates amid only moderate upside pressures in wages and prices. No major imbalances are on the radar at the moment. Hence, an economic recession does not appear to be in the cards next year.

Market impact | Markets are likely to become more circumspect with regard to 2020 growth expectations as the deceleration could become more pronounced and economic signals increasingly mixed as the cycle extends. The best choice for investors is to limit exposure to credit, diversify the portfolio smartly and to take a flexible duration management (close to neutrality at this stage. On the equity side, selection of themes, sectors and single names will be increasingly relevant, as the maturity of the cycle could eventually become a headwind.

Risk # 7 | 10% probability | A Chinese "hard landing"/ a bursting of the credit bubble

Analysis | Chinese economic growth is slowing down but the authorities are working hard to stimulate the economy (through FX management, monetary and fiscal policies) so that the economy is expected to remain resilient. That being said, the country's economic model is fragile: the excess of credit is visible, non-financial corporate debt has surged since the GFC.

The good news is that the NFC debt to GDP ratio had started to drop since late 2017. We will continue to monitor closely the trend in Chinese private debt, especially if the economy slows. Meanwhile, a cease of fire with US on trade tensions could gain valuable time for China to adjust their policy implementations and to better manage short-term risks. In the case of hard landing or the bursting of the credit bubble, the Chinese authorities would be unable to avoid a stronger depreciation of the Yuan.

Market impact | A hard landing linked to a burst of the credit bubble would have a very negative impact and its cascading effects would be particularly disastrous: vulnerability of banking systems (in China and elsewhere), vulnerability of the global financial system, vulnerability linked to China's public and private debt, negative impact on regional and global trade, and thus on commodities and emerging countries, impacts on the currencies of commodity-exporting countries, advanced countries and emerging countries, etc..

Risk # **8** | **10%** probability | **Major political crisis in Europe**

Analysis | European politics is becoming less predictable due to the rise of various non-mainstream political forces in several countries. In September, the non-mainstream Italian government coalition announced a 2019 budget in breach of European rules, thus opening an episode of tensions with the rest of the Eurozone that is not yet resolved. In France, where the situation had been stable since the 2017 presidential election, sudden and violent social movements caught the government off guard at the end of 2018 and appeared to seriously threaten at least the continuation of its supply-side reform agenda. Although less immediately worrying, the political outlook is also uncertain in Germany (due to the leadership change at the head of Merkel's CDU party and uncertainty regarding the future of the government coalition) and in Spain (due to the lack of a proper majority in Parliament and the recent rise of a far-right party). More generally, the combination of strong anti-immigrant feelings and frustration towards European institutions seem to give a strong impetus to anti-system political forces, with the May 2019 European election seen as a major gauge of their progress.

Market impact | Given the still positive economic backdrop, we do not believe that these events will trigger a new round of systemic crisis in Europe. Non-mainstream political forces that are in a position to rule countries (such as in Italy) have shown that they want to blame European political institutions and try to modify them, but not exit the Eurozone. However, this problematic political news flow will continue to generate market stress in 2019 while the difficulty to understand European institutions for outside investors means that European assets will continue to carry a specific political risk premium. Italian government spread vs. Bund could continue to be volatile.

MACROECONOMIC CONTEXT

Our convictions and our scenarios

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This section provides a reminder of our central scenario and alternative scenarios.

Central scenario (75% probability): global growth slows gradually but surely

- **Growth is slowing worldwide:** 2018 began based on the theme of a synchronised global recovery. But, this did not last. Since the spring, the protectionist measures taken by Donald Trump have changed the game. Emerging economies, some of which are heavily indebted in dollars, have been weakened due to the broad-based appreciation of the US currency. The depreciation of their currencies has generated local inflation and led their central banks to tighten monetary policies, which has weighed on economies already negatively affected by massive capital outflows. Advanced economies have begun to slow down. In our view, the year will end with a global economy that is evolving in a disjointed fashion, with increased downside risks. A new factor that arrived lately in the picture has been the oil price drop (well below our fair value at USD 75/br for the Brent) that should offer a much needed support to European economies and to the EM oil Importers such as India and Turkey.

- **World trade:** Global trade keeps weakening; it started 2018 at around 5% YoY and in September it has grown by 2.3% YoY. Protectionist rhetoric has pushed down business confidence, particularly in Europe. That said, uncertainty is tending to drag down investment and disrupt value chains that have developed in lock-step with the expansion in global trade over the past 15 years. In light of the above, we continue to expect the global trade to global GDP ratio to decline, with growth in trade lagging slightly behind global GDP. However, last G20 meeting in Argentina has resulted in a more positive than expected short-term scenario, where the further increase in US tariffs towards China from 10% to 25% at the 1st of January 2019 has been postponed by 90 days (1st of March 2019).

- **United States:** The economy has been driven by very accommodative fiscal policy that is likely to continue to produce effects for some time; but, the fiscal multipliers should progressively erode next year. We expect growth to decelerate to its potential, but not before late 2019/ 2020, meaning that the US economy should lose 1pp of growth by 2020. This situation will have a negative impact on corporate profits, especially if inflationary pressures intensify by then, which is possible, given the fact that the economy is operating at close to full employment. We do confirm our expectation that a recession is highly unlikely in 2019, but the cycle-end story will probably return to the fore at some point by next summer, as the fiscal multiplier impact fades and as the effects of ongoing monetary policy tightening show up. We therefore forecast a slowdown in growth by 2020, with GDP growth closer to 2% by then and we keep our scenario of a moderate hiking by the Federal Reserve.

- **Eurozone:** Last month, we revised our growth forecasts slightly downward, to 1.9% for 2018 and to 1.6% for 2019. Despite a recovery that has started well after that in the US, national economies have begun to slow in 2018. The output gap has closed in most countries, and Italy is the only one in the Eurozone (excluding Greece) where GDP has not recovered to pre-crisis levels. Several factors have contributed to the slowdown in growth in 2018: the slowdown in world trade and until recently a high oil price have been the most relevant. In addition, political uncertainties have muddied the waters (Brexit, Italian budget). The possibility of a coalition change in Germany following the defeat of the two major government coalition parties (CDU and SPD) in local elections marks the end of the Merkel era. The loss of the chancellor's leadership may hinder initiatives to strengthen the integration of the Eurozone that were under consideration. It will probably be necessary to wait for European elections in May 2019 and a new parliament, a new European Commission, a new Chancellor in Germany, and clarification regarding leadership of the institutions of the EU (Commission, ECB) to make significant progress in strengthening the financial architecture of the Eurozone. In Italy, incoming data on contracting economic growth in Q3 and weak coincident and leading indicators for Q4 increased the risks of another dip that prompted the Government to tone down rhetoric and seek for compromise. Discussions on revising down deficit targets are currently ongoing. The Excessive deficit procedure (EDP) likely will not be avoided with the revisions discussed currently, but could be less harsh.

- **United Kingdom:** The political situation in the UK is very unstable: December parliamentary vote has been postponed the day before being held. We identify 3 broad categories of scenarios:
  (1) Deal (65% probability): a deal (which can be May's deal or another one, including an EEA membership with customs union regime) can be ratified by the UK Parliament. So, the UK exits the EU in March 2019 (or a few weeks after) and enters a transition period where it remains in the Single Market at least until end 2020 (or open-ended). However, it is important to note that this probability covers very rocky paths that include a political crisis and, possibly, new elections, but nonetheless a deal in the end.
  (2) No deal (15% probability), although there would probably be mitigation measures meaning that the probability for EU/UK trade relations to be regulated only by the WTO regime is lower.
  (3) A prolonged uncertainty (20% probability) well beyond March 2019 through a granted extension or unilateral repeal of Art. 50 by the UK. This could lead to new negotiations or to a new referendum, with probably new elections in between. This category of scenarios could then lead to various outcomes in the end (including a different deal, a Brexit reversal or new risks of no deal).

- **China:** Chinese economic growth is slowing down but the authorities are working hard to stimulate the economy (through FX management, monetary and fiscal policies) so that the economy is expected to remain resilient. That being said, the country's economic model is fragile: the excess of credit is visible, non-financial corporate debt has surged since the GFC. The good news is that the NFC debt to GDP ratio had started to drop since late 2017. Meanwhile, a cease of fire with US on trade tensions could gain valuable time for China to adjust their policy implementations and to better manage short-term risks. In the case of hard landing or the bursting of the credit bubble, the Chinese authorities would be unable to avoid a stronger depreciation of the Yuan.

- **Inflation:** Core inflation remains low at this stage of the cycle in advanced economies, and should recover gradually. That said, the slowdown in inflation in recent years is primarily structural in nature, as it is tied to supply-side factors, while the cyclical component of inflation has weakened (with a flattening of the Phillips curve). Core inflation is likely to pick up only slightly in advanced economies. An "inflationary surprise" remains possible with rising oil prices and the pick-up in wages (United States, Eurozone) but would not last long (due to a lack of pricing power) and would drag down corporate margins more than final sale prices, all the more so if global growth slackens. Things are different in emerging economies, where inflationary pressures are greater in many countries, in reaction to which many central banks have raised their key rates.

- **Oil prices:** Oil prices have decreased sharply: from $86/bbl for Brent as of 4 October to $60 the 12th of December. The main trigger at the very beginning of the decline have been the large amount of waivers conceded by the US administration to different countries with regard to the sanctions imposed to Iran oil exports. A moderate OPEC and Non-OPEC production cut decided at the beginning of December together with fear of a more pronounced economic slowdown are keeping oil prices at low levels.

- **The main central banks will continue to remove monetary accommodation at a gradual pace.** The Fed will continue to raise its key interest rates. We expect the Fed to follow through with one more 25bp hike in December 2018 and two additional hikes in H1 2019, followed by a pause, and for it to reduce its balance sheet at the announced pace (with a gradual non-replacement of maturing securities. Meanwhile, the ECB will halt its monthly asset purchases at the end of December, as announced. However, it will continue to replace maturing securities (between €160 and 200 bn in 2019) without clarifying its reinvestment policy in order to retain some flexibility. Its first rate hike (deposit rate) is not expected until late 2019 in the best case scenario. The ECB has no room for manoeuvre to normalise its monetary policy.

Downside risk scenario (20% probability): a marked trade-war-driven economic slowdown, a geopolitical crisis or a sudden repricing of risk premiums

- The risk of further protectionist measures from the US (even after the 90 days agreed during last G20 meeting), followed by retaliation from the rest of the world, remains high. China and the EU are particularly exposed to this risk.
- Aggravation of geopolitical tensions in the Middle East with a possible oil price resurface.
- Uncertainty regarding rising trade tensions (primarily between the US and China) against a backdrop of geopolitical risks, crises in several large emerging economies (e.g., Turkey, Argentina), political risk in Brazil, a slowdown in China, and political tensions in Europe (a deterioration in the budget situation in Italy, Brexit) is encouraging companies to remain cautious.

Consequences:

- All things being equal, a trade war would drag down global trade and trigger a synchronised slowdown in growth and, in the short term, inflation. That said, a global trade war would quickly become deflationary by creating a shock to global demand.
- An abrupt repricing of risk on fixed income markets, with an across-the-board rise in government or credit spreads, for both advanced and emerging economies, and a decline in market liquidity.
- The resulting financial turbulence, the end of the cycle risk would resurface in particular in the US.
- Central banks would cease recalibrating their monetary policies and, in the worst - albeit highly unlikely - case would once again resort to unconventional tools, such as expanding their balance sheets.

Upside risk scenario (5% probability): a pick-up in global growth in 2019

Donald Trump makes an about turn, reducing barriers to trade and engaging in bilateral negotiations with China. Domestically, the theme of increasing infrastructure spending could return to centre stage and extend the cycle in the United States.

- Acceleration driven by business investment and a rebound in global growth.
- Pro-cyclical US fiscal policy generating a greater-than-expected acceleration in domestic growth. Growth is reaccelerating in the Eurozone after a dip. Growth picks up again in China on the back of a stimulative policy mix in H1.
- Central banks would react late, initially maintaining accommodative monetary conditions.

Consequences:

- An acceleration in global growth would boost inflation expectations, forcing central banks to consider normalising their monetary policies more rapidly.
- An increase in real key rates, particularly in the US.

Macroeconomic picture by area

United States	Risk factors
United States: few signs of deceleration • The overall pace of economic growth remains above potential, consistent with a gradual slowdown. • Domestic demand remains the key driver of growth, although data started to show a change in growth composition, with a higher contribution from consumption over investments. • Business confidence remains strong but data show a moderation in capex intentions, non-residential investments and a slowdown in durable goods orders, which point to a deceleration in business investments that bears watching. • The labour market remains strong. • The inflation outlook remains aligned with the Fed's projections, with modest domestic inflationary pressures as CPI remains at 2.5% YoY and Core CPI at 2.1% • The Fed met on 8 November, leaving rates unchanged in the 2.00% to 2.25% range as expected; the Fed's rhetoric has become somewhat more dovish during the month. The next FOMC meeting will take place on 19 December. • On the trade front, the G20 meeting reopened negotiations between China and US, suspending escalation for 90 days.	• Fed tightening impacting interest rate-sensitive segments (housing, consumer credit) • Abrupt, protracted and severe tightening of financial conditions • Tariffs and retaliation negatively impacting economic performance, both directly (prices) and indirectly (confidence) • Geopolitical risks linked to a more hawkish shift by the US Administration
Eurozone	
The recovery continues despite disappointing figures and rising political risks • After a disappointing start to the year (GDP only rose 0.8% in H1), growth stalled again in Q3 at just +0.2%. Temporary negative factors (auto sector in Germany) played a role, but cannot be the only reason behind this weakness. Rising oil prices (until October), tension over trade and political risks also dragged down growth. The recovery will continue, but at a slower pace than previously expected (2019 growth forecast lowered from 1.8% to 1.6%). • The Italian budget continues to fuel tensions. In France, government reforms are coming up against increasingly fierce resistance.	• Stronger political protest movements • Euro appreciates • External risks (especially of a trade war)
United Kingdom	
Major uncertainty as Brexit approaches • Growth picked up in Q3 (+0.6%) after having already rebounded in Q2. The labour market remains in good shape and real wages are trending up once again. • However, the lack of visibility over Brexit is dragging down confidence and investment. There is great uncertainty over whether the UK Parliament will ratify November's deal struck by the UK and the EU, and many scenarios are possible, although we believe that a "no deal" situation is unlikely.	• "No Deal Brexit" • The current account deficit remains very high
Japan	
Buoyant domestic economy versus wobbly exports • The economy rebounded sharply in October, as producers and retailers recovered in an attempt to recoup earlier losses in the disaster-affected third quarter. Disaster relief projects (0.2% of GDP) should boost growth in the near term. • The government revealed a blueprint for more economic stimulus, showing a strong commitment to preventing any setback after a VAT hike in October 2019. The government has already decided on benefits to pensioners and free nursery school tuition. These plans will be included in the FY2019 plenary budget. • Meanwhile, exports have been weakening, not because of the stepped-up US-China trade dispute but because of a synchronized economic slowdown in the non-US sphere.	• GM's decision to shut down factories could fuel criticism of the car industry by the Trump administration

China

- Downward risks should have eased somewhat, at least in the near term, with a temporary deal reached by the US and China during the G20 meeting.
- For now, US has agreed to pause the tariff increase planned for 1 January 2019, with negotiations to begin immediately for 90 days.
- Despite questions regarding how real this trade truce was, contrary what some suspected, China has already matched its words with deeds, by announcing some detailed measures on intellectual property protection.
- Looking ahead, we expect more structural measures to come, which the US asked for but that China also needs, in order to facilitate its own structural transition.
- Meanwhile, policymakers have made new efforts to unblock the pass-through into the private sector, which should become more visible in coming months, to help partially offset an ongoing slowdown.
- In such a case, downward pressures on RMB should also ease somewhat.

Risk factors

- **Uncertainty remains in US/China trade talks**
- **Policy mistakes in managing near-term risks and the structural transition**
- **Geopolitical noise regarding North Korea**

Asia (ex JP & CH)

- Notwithstanding all the noise related to the escalation of the trade issue between China and Overall growth in the area deteriorated: our GDP forecasts have been revised down throughout the region, with the contribution of external demand weaker than domestic demand.
- The region's inflation figures remained benign, with the usual exception of the Philippines, where headline inflation stayed put, at 6.7% YoY, well above the CB target. India's inflation surprised to the downside at 3.3% in October, on the back of weak Food prices.
- The BSP and BI increased their rates by 25bps once again. Despite the August announcements from the Governor the BoT is yet to change its Monetary Policy stance.
- During the last two months a clash between the RBI and the Indian Government was brought to the public's attention. In the run-up to the elections, the government would like to see the RBI more proactive in letting Public Banks ease credit conditions for SMEs.

Risk factors

- **Growth outlook revised downwards in the region**
- **Inflation still very benign with the exception of the Philippines**
- **BSP and BI continue their hiking cycle**
- **The RBI signals interferences from the Government**

Latam

- The recently released Q3 2018 GDP figures highlight a mixed macroeconomic picture in the area: Brazil and Peru accelerated more than expected, while Colombia, Chile and Mexico slowed down.
- On the inflation front, the overall environment remained benign. In Mexico, inflation finally reversed and after a 5-month long increase started to decelerate mildly in October. In Peru inflation picked up quite significantly yet remaining within the CB's target.
- The region's main Central Banks maintained monetary policy unchanged in their recent meetings, while Banxico and Chile Central Bank raised their policy rates by 25bps at 8% and 2.75% respectively.
- In the area's two main countries, fiscal policy is in the spotlight: in Brazil a very diluted Social Security reform is expected in a relatively short term and in Mexico, more details about budget implementation are expected.

Risk factors

- **Brazil still on track for recovery**
- **Inflation turning more benign in Mexico**
- **Tighter monetary policy in Chile and Mexico**
- **Contrasting signals on the fiscal side by the new Mexican administration**

EMEA (Europe Middle East & Africa)

Russia: we forecast 1.7% YoY growth for 2018 and slightly lower for 2019

- Despite the threat of potential US sanctions down the road, the macroeconomic scenario remains supportive. Russia will be among the few emerging market sovereigns with the "twin surpluses" in 2018, while accumulating assets at the National Wealth Fund.
- The Central Bank may hike sometime in 2019 depending on rouble weakness and inflation expectations.

Risk factors

- **Drop in the price of oil, stepped-up US sanctions and further geopolitical tensions**

South Africa: exit of recession but no miracle

- South Africa emerged from recession in Q3 thanks to the recovery of manufacturing and services. On the expenditure side, household consumption rebounded as well as inventories while private and public investment declined. The contribution of net exports was also negative.
- In terms of policy mix, there is very little room for manoeuvre. The SARB has raised its rates and it is not excluded that it still has to do it in 2019.

Risk factors

- **Increased risk aversion, rising social demands, lack of structural reforms**

Turkey: we expect double-digit inflation and recession in 2019

- The strong tightening of interest rates, the rebound in the Turkish lira, the fall in the price of oil and the implementation of discretionary measures on some goods, have provided some respite to inflation. However, it should not fall below 20% for several months.
- In this context, household purchasing power and corporate margins are at their lowest. We therefore expect a sharp drop in activity in the second half of 2018 and a GDP recession of 1% in 2019.

Risk factors

- **A too rapid easing of the central bank, a cooling of budgetary policy, a slowdown in activity in the euro zone**

Macro and Market forecasts

Macroeconomic forecasts
(10 December 2018)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	2.9	2.7	2.0	2.5	2.4	2.3
Japan	0.9	1.2	0.4	0.9	1.0	1.5
Eurozone	1.9	1.5	1.5	1.8	1.7	1.7
Germany	1.7	1.6	1.7	1.9	1.7	1.6
France	1.6	1.4	1.5	2.1	1.6	1.5
Italy	0.9	0.5	0.6	1.3	1.7	1.7
Spain	2.7	2.3	1.7	1.5	1.5	2.3
UK	1.3	1.5	1.6	2.3	2.3	2.4
Brazil	1.3	2.2	2.1	3.7	4.8	5.2
Russia	1.7	1.5	1.7	2.9	4.6	4.1
India	7.8	6.9	7.1	4.1	4.1	5.2
Indonesia	5.1	5.3	5.4	3.2	3.6	4.3
China	6.6	6.2	6.1	2.2	2.2	2.4
Turkey	2.8	-1.0	1.5	16.3	17.4	13.0
Developed countries	2.2	2.0	1.6	2.0	2.0	2.1
Emerging countries	5.0	4.7	4.8	4.1	4.0	3.9
World	3.8	3.6	3.5	3.3	3.2	3.2

Source: Amundi Research

Key interest rate outlook

	06/12/2018	Amundi + 6m.	Consensus Q2 2019	Amundi + 12m.	Consensus Q4 2019
US	2.25	3.0	3.0	3.0	3.0
Eurozone	0	0	0	0	0.1
Japan	-0.1	-0.1	-0.1	-0.1	-0.1
UK	0.75	1.0	1.0	1.0	1.0

Long rate outlook

2Y. Bond yield

	06/12/2018	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.76	2.9/3.0	2.83	2.8/3.0	2.83
Germany	-0.62	-0.5/-0.4	-0.56	-0.4/-0.3	-0.50
Japan	-0.14	-0.2/0.0	-0.13	-0.1/0.1	-0.13
UK	0.74	0.8/1.0	0.75	0.8/1.0	0.74

10Y. Bond yield

	06/12/2018	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.90	3.10/3.25	2.92	2.90/3.10	2.94
Germany	0.26	0.40/0.60	0.33	0.35/0.55	0.40
Japan	0.06	0.15/0.25	0.10	0.10/0.20	0.14
UK	1.30	1.40/1.60	1.36	1.40/1.60	1.41

Currency outlook

	05/12/2018	Amundi + 6m.	Consensus Q2 2019	Amundi + 12m.	Consensus Q4 2019
EUR/USD	1.13	1.18	1.17	1.20	1.20
USD/JPY	113	109	110	107	109
EUR/GBP	0.89	0.89	0.88	0.88	0.88
EUR/CHF	1.14	1.20	1.15	1.24	1.17
EUR/NOK	9.65	9.17	9.34	9.12	9.19
EUR/SEK	10.19	9.97	10.00	9.48	9.80
USD/CAD	1.34	1.28	1.29	1.25	1.26
AUD/USD	0.73	0.75	0.73	0.75	0.75
NZD/USD	0.69	0.70	0.68	0.67	0.68
USD/CNY	6.85	6.80	6.93	6.70	6.82

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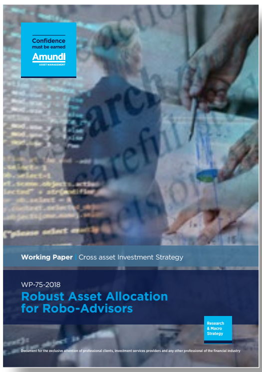

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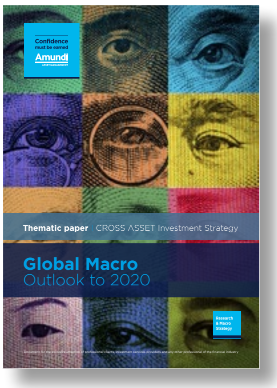

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