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Amundi
ASSET MANAGEMENT

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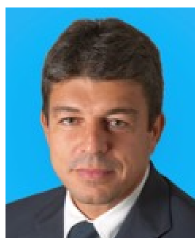
ECB ON HOLD, BUT MORE DETAILS ON WHAT'S NEXT

INVESTMENT TALKS

Bastien DRUT
Fixed Income and Forex Strategist

Eric BRARD
Head of Fixed Income



Matteo GERMANO
Head of Multi-Asset

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What are the major take aways from the European Central Bank (ECB) meeting?

Drut: Mario Draghi acknowledged that the economic recovery has been stronger-than-expected. In particular, the ECB now expects GDP growth to reach 2.2% in 2017, the highest growth pace since 2007. However, Mario Draghi said that the 'recent volatility in the exchange rate' represented a 'source of uncertainty' for the medium-term outlook for price stability and a downside risk for the growth outlook. We should remember that the Euro has appreciated by 7% in effective terms since April, which prompted the ECB staff to downgrade its 2019 core inflation forecasts from 1.7 to 1.5%, which is quite low.

What is your expectation for the ECB's monetary policy going forward?

Drut: We expect the ECB to announce a reduction of its asset purchases for 2018 in October. Mario Draghi has reiterated that the ECB has no intention of changing the sequence of the removal of unconventional monetary policy measures: interest rate hikes will intervene after the end of net QE purchases.

What is your short and medium-term outlook on the Euro?

Drut: We expect the Euro to continue to appreciate in the medium-term. The EUR/USD exchange rate has climbed this year mostly because of the tightening of the long-term interest rate spread between the United States and Germany. In the short-run, US yields might rebound should there be an easing of the geopolitical tensions between North Korea and the US, and this would benefit to the Dollar. However, in the medium-run, we believe that long-term interest rate spread between the United States and Germany will tighten. A rise in European bond yields would likely make portfolio investment flows less negative and even turn them around into positive territory. Against a backdrop of the Eurozone's substantial current account surplus (€340bn for the last 12 months), future portfolio rebalancing is likely to benefit the Euro.

What are the implications of the September ECB decision on Euro fixed income?

Brard: It is rather a no decision for the time being. By postponing decisions regarding QE to October, the ECB opens the door to more of the same for the fixed income markets. The stronger economic backdrop supported by internal dynamics should not suffer a lot from a stronger Euro, while the currency trend should contribute to maintain inflation low. This could translate into continued downward pressure on long-term rates and favors credit as a whole.

How could a Euro fixed income investor play the current market phase?

Brard: The summer carry could well morph into an autumn carry trend. This said, the perspective of a turnaround in monetary policy is not going to vanish, and the tapering topic will be back probably sooner than later. Consequently, we maintain our cautious short duration stance with a view to minimize interest rate risk, and we stick to our preference for credit. However, we believe it is key to get ready to reduce the overall risk level in European fixed income investing as soon as we see signs of a more decisive move from the ECB.

ECB: European Central Bank.
Quantitative Easing (QE): it is a type of monetary policy used by central banks to stimulate the economy by buying financial assets from commercial banks and other financial institutions.
Carry trade: a strategy that involves borrowing at a low interest rate and investing in an asset that provides a higher rate of return.

We continue to believe investors should focus more on positive economic momentum, growth perspective and profits recovery.

How do you expect Central Bank asyncrony themes to play in the future?

Germano: Central Bank asynchrony has been an important investment theme in the past three years in Multi-Asset. We think it will be less relevant going forward as Central Banks will be more coordinated due to the more synchronized global cycle. We continue to believe investors should focus more on positive economic momentum, growth perspective and profits recovery. In this scenario, we keep a constructive view on global equities. Valuations are not cheap anymore after a 9-year bull market, however, the global equity outlook remains constructive in relative value terms (versus fixed income).

Global profits recovery is ongoing and the speed of growth is more balanced among regions compared to the past. European equity should benefit the most from more coordinated Central Banks and a less volatile Euro, while the end of the QE should be a catalyst for taking an even more cautious view on Euro credit. Against this backdrop, we do not think that government bonds offer value in relative terms.

How should Multi-Asset investors play a phase of less accomodative Central Banks?

Germano: We think Central Banks will be less accommodative as the economic backdrop improves and deflation risk is fading. Sovereign bond curves should progressively price in increasing interest rates. We maintain a positive view on inflation linked bonds in US, Germany and Japan, which should benefit from an upside revision of inflation expectations. As long as this normalization process remains gradual and mild, equity and credit valuations are likely to remain sustained. European equities should gain from the expected normalization of the monetary policy, due to the relevant exposure to the banking sector (which benefits from higher rates), while ongoing profit recovery should underpin all the other companies. Value style should perform well in this environment and Japan should gain consequently as it's still the cheapest market. All in all, the overall picture should remain moderately supportive for risky assets. However, due to the high level of uncertainty in the market (North Korea, US debt ceiling issue and Trump administration troubles), we believe that a strong focus on hedging will continue to be crucial.

With the contribution of:
Valentine Ainouz, CFA, Credit Strategist
Lorenzo Portelli, **Silvia di Silvio** Global Asset Allocation Research

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