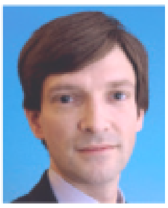
Confidence must be earned

Amundi ASSET MANAGEMENT

6 October 2017

# Catalonia crisis: Limited impact on European financial assets

INVESTMENT TALKS



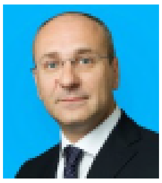

**Tristan Perrier**
Strategy and Economic Research



**Isabelle Vic-Philippe**
Head of Euro Rates & Inflation



**Herve Boiral**
Head of Euro Credit


**Diego Franzin**
Co-Head of Equities


***We expect the volatility on bonds generated by the Catalonia crisis to be short lived.***

## The Catalonia crisis: Is it a Spanish domestic problem or a symptom of a European political malaise?

**TP:** Regional pro-independence movements have been a major political issue in Spain as well as in several other Western European countries for decades. In the past years, the Eurozone crisis may have exacerbated tensions in Catalonia, by creating an open resistance towards central government, and potentially creating a reluctance for this prosperous region to share its wealth with the rest of the country. However, this issue is probably less concerning than rise of several far-right or far-left protest parties across Europe. It is also true that the Eurozone architecture leads pro-independence regional parties to believe, or at least to argue, that independence can be achieved through a smooth process within existing supranational institutions, even though this view runs counter to European treaties. While the current Catalan situation is officially considered by other European governments as a Spanish domestic problem, any advance of Catalonia towards independence would have major spillover implications for countries that are facing similar movements. In our view, Catalan independence is very unlikely over the next few years.

## Has your perception of the geopolitical risk changed, also considering the emergence of anti-European forces in the latest German election?

**TP:** Our perception has not changed radically, as neither the result of German election nor the situation in Catalonia carries immediate systemic risk to the Eurozone. Systemic risk diminished considerably after the Dutch and French elections in the first semester and remains low over a short-term horizon. The most likely consequence of recent German elections is that there will be slightly less appetite among Germans for strengthening Eurozone institutions in directions that imply more risk-sharing. That said, we expect Germany to remain very prudent on this matter. In Catalonia, while the situation could escalate further in the coming days, the most probable outcome remains a negotiated solution with no independence, although we cannot rule out early elections as a consequence.

## Would you see any impact of the Spanish political turmoil on the Euro and what is your medium-term outlook for the currency?

**TP:** The Catalan situation is not a direct threat to Eurozone institutions, and economic consequences are not expected to be massive, due to the small size of this region and the still vigorous recovery in Spain. Therefore, its impact on the Euro should remain muted. Over a one year horizon, we expect the Euro to moderately rise versus the US Dollar, on the back of the strong recovery in the Euro area and upcoming changes to the ECB's Quantitative Easing[1] program. Over the short-term, however, the situation could be complicated by the news flow from the other side of the Atlantic, including new announcements regarding US fiscal and monetary policies – both of which could drive a temporary rebound of the US Dollar.

## What's you view on peripheral spreads, would you expect the widening pressure to continue?

**VP-BH** On the government bond side, the spread between the 10-year Spanish government bond and the German Bund has widened about 20 basis points and about 10 basis points versus Italian BTP in the aftermath of the referendum. The move has so far been contained both in magnitude and flows. Domestic investors lightened their positions during the summer rally and could come back at some stage. We expect the volatility generated by the Catalonia crisis to be short lived. We think that Spanish bonds may offer opportunities over a longer term perspective as they are well supported by improving economic fundamentals, while the tail risk could be so detrimental that we don't see any value in Catalonia bonds.

[1] Quantitative easing (QE) 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.

### What would you expect to be the major drivers of European fixed income market up to year end?

**VP-BH:** We expect Central Banks' monetary policy normalization to remain the main driver for interest rates. In the US, the Fed continues to suggest they favour another rate hike in 2017, while the ECB has recently become more vocal about tapering. These two events, in our view, are the key events to watch heading into year end and into 2018. We maintain a defensive view on duration and we expect the yield curve to steepen. In Corporate Credits, we continue to see attractive and technically supportive conditions for corporate bonds both in the investment grade and in the high yield space. The impact on credit markets of the events in Spain has been relatively benign, with the exception of Catalan names. If this crisis should spread, we may see some more volatility and spread widening, but at the moment we see the solid economic growth both in Eurozone and in the US as the major supporting factor for the asset class.

***Improving macro conditions, earnings momentum and relatively attractive valuations continue to support European equities.***

### Do you expect the Catalan independence battle to hurt European equities or would you expect consequences to be limited to a very local segment of the market?

**DF:** Our expectations, at this point, is for the Catalan Independence battle to have a very limited medium-term impact on European equities. What we have seen in recent quarters has been a clear decline in political risk in the region, and we do not see this event as being a threat to this trend. We may see a possible increase in volatility as the situation evolves, but we believe that the positive trend will remain in place. For us, the major drivers for European equities, as we enter the last quarter of the year, is the more positive economic backdrop we are experiencing, and – even more – the positive earnings momentum that the companies in the region are delivering. While some domestic Spanish names (such as the domestic banks) may see some short-term volatility (and the Spanish market has underperformed the Stoxx 600 index since the end of August), we do not expect a more widespread deterioration in sentiment towards the asset class entering in 2018.

### Did you change your view on the market ahead of recent political events?

**DF**: Our constructive view on the market has not changed due to the recent events. Overall, we believe investors should focus more on a bottom-up stock selection approach that could also help to be less exposed to specific macro events.

### What will be, in your view, the key drivers of European equities heading into year end?

**DF:** The more positive market environment which we saw in September has helped to validate our more optimistic view for the asset class. Both global and European macro indicators are continuing to point to an improving underlying economy, earnings growth remains supported, while valuations remain relatively attractive compared to other asset classes. Euro strength in recent months has grabbed headlines and perhaps been a headwind for European equity markets, however this appears to have now stabilized and we do not believe it will derail sentiment at this point. Recognizing the ever present potential for market rotations, we continue to favour a balanced approach between styles and sectors. We believe investors should continue to focus on names with the potential to deliver consistent and reliable earnings growth, which we see as the key catalyst for further upside from here.

*With the contribution of:*
**Alessandro D'Erme**
Client Portfolio Manager



**AMUNDI** INVESTMENT INSIGHTS UNIT

The Amundi Investment Insights Unit (AIIU) aims to transform our CIO expertise, and Amundi's overall investment knowledge, into actionable insights and tools tailored around investor needs. In a world where investors are exposed to information from multiple sources we aim to become the partner of choice for the provision of regular, clear, timely, engaging and relevant insights that can help our clients make informed investment decisions.

**Discover Amundi investment insights at our Research Center**

***http://research-center.amundi.com/***

**Visit us on:**

www.amundi.com

Amundi
ASSET MANAGEMENT