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Japanese yen: what's next?

A summer of reality checks on market expectations

CROSS ASSET INVESTMENT STRATEGY

SEPTEMBER 2024

September 2024

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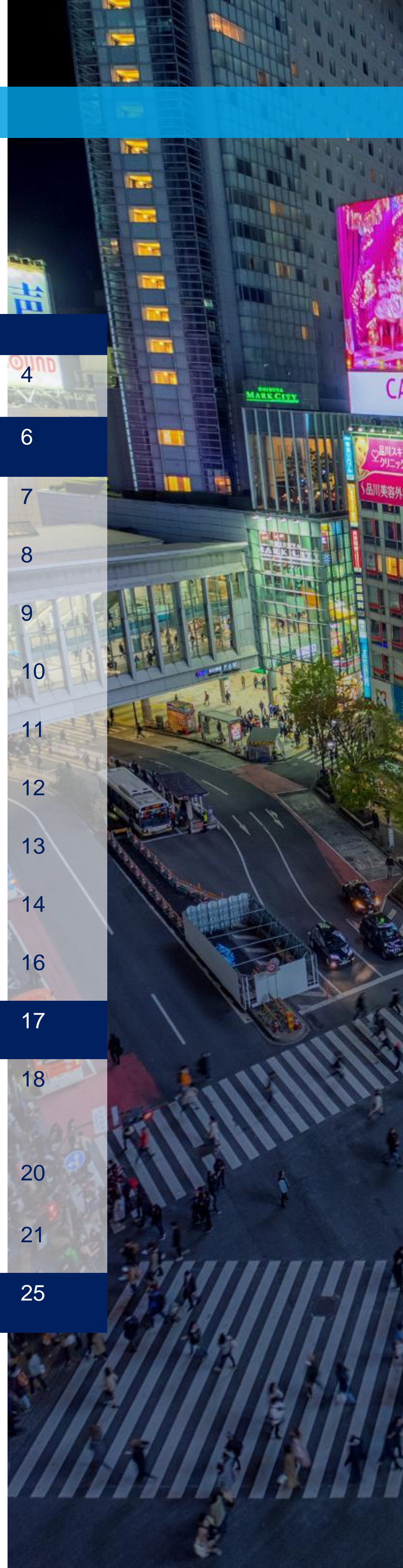

MONICA DEFEND
HEAD OF AMUNDI INVESTMENT INSTITUTE

"The Fed seems to have no fear of inflation and is more focused on preventing a deterioration in the labor market. This has allowed us to raise our rate cut expectations from two to three for the rest of the year."

"With central banks cutting rates and risks of a US recession limited, we remain disciplined and mildly positive on risk assets."

VINCENT MORTIER
GROUP CHIEF INVESTMENT OFFICER

MATTEO GERMANO
DEPUTY GROUP CHIEF INVESTMENT OFFICER

"We believe it is not a time for structural de-risking. Instead, investors should tactically and incrementally adjust their stance slightly out of areas of excessive valuations."

TOPIC OF THE MONTH

The JPY carry trade: what's next?

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KEY TAKEAWAYS

The yen carry trade* is being unwound sharply due to weak US data and a hawkish surprise from the BoJ, with the yen's dislocation from its fundamentals remaining large.

Weak global growth and the BoJ on diverging path from most Central Banks in the world are tailwinds for the JPY. A fast trade-weighted appreciation, though, would require 1) recession or 2) a persistent hike cycle from the BoJ.

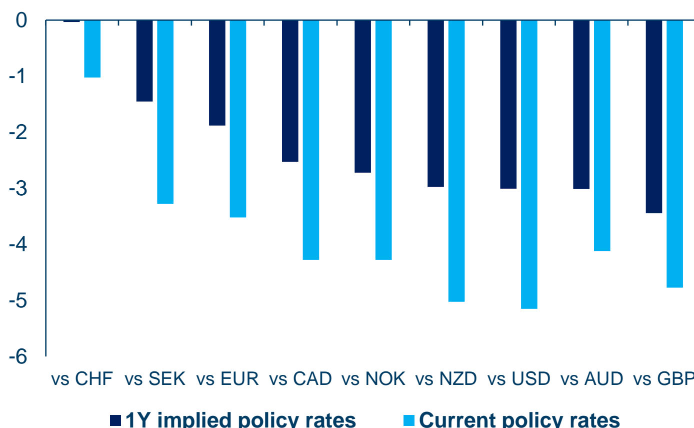
The repatriation of Japanese foreign assets is not a material risk for now, but its potential for a large market impact always warrants attention.

*Carry trades involve investors borrowing money in a currency (the funding currency) with low interest rates and then using those funds to invest in assets that offer higher returns in another currency.

The yen's great come-back.

A series of weak US data in July questioned the market narrative of a soft landing and brought back fears of recession. This was the main trigger, although a hawkish surprise from the BoJ undoubtedly added fuel to what turned out to be an unusually sharp unwinding of carry trades funded in JPY. The amount of exposure of these carry trades was at an all-time high due to the low level of overall market volatility and the volatility of the JPY itself. So is it over? Our Q2 2025 target for USDJPY has been revised to 135 (from 140), and a gradual appreciation is expected from there - the yen's valuation remains cheap and its hedging properties in a slowing global economy have not budged by much. On the other hand, our view is that it is not yet time for cross-JPY adjustments to be too aggressive. For this, a much weaker global growth environment or a more pronounced hiking cycle from the BoJ would be necessary conditions.

JPY funding status in 1 year to remain stable

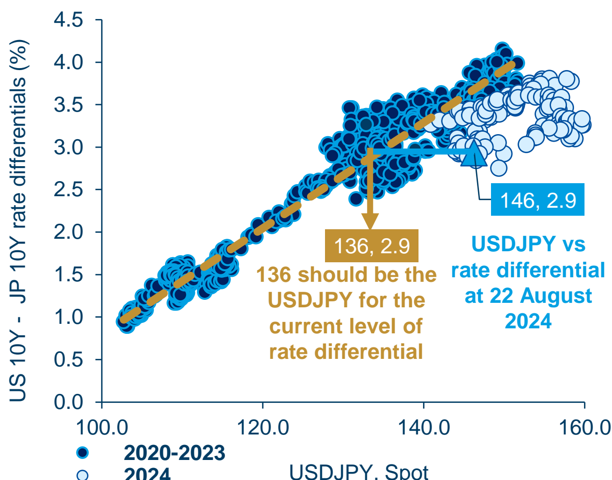


Source: Amundi Investment Institute, Bloomberg. Date as of 22 August 2024.

The BoJ's change in communication matters, but does not change the longer-term funding status of the yen.

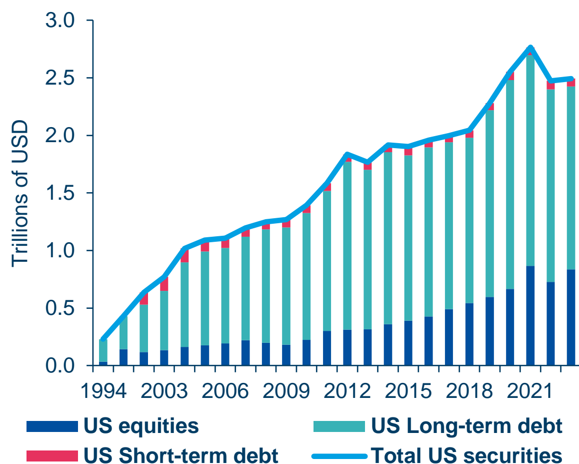
The July hike and the confidence the BoJ showed in sustainably reaching its inflation target bodes well for the **eventual normalisation of its monetary policy.** But its subsequent assurance that its hiking path would not be independent of market volatility (read yen and the Nikkei) reinforces our view while Japan's fundamentals are improving – particularly wage growth and consumption – these are not yet sufficiently firm. The uncertainty about the BoJ's near-term policy path limits investors' ability to short the JPY for now, but a sustained turnaround would require: **i) a persistent hiking cycle** – during the late 90s the BoJ hiked 200bps to limit the fall in the JPY; or **ii) much more dovish major CBs.** In their absence, the JPY will continue to be one of the main funding currencies. Paradoxically, higher yen volatility will constrain the BoJ's reaction function. Secondly, CBs will only turn more dovish than the market currently expects if the global growth markedly disappoints consensus expectations.

For most of 2024, the JPY traded cheaply relative to rate differentials at the long end



Source: Amundi Investment Institute, Bloomberg. Date as of 22 August 2024.

Holdings of US securities by Japanese investors



Source: Amundi Investment Institute, Treasury International Capital System. Data as of June 2023.

The yen is largely a (US) recession trade.

In a stable/rising growth environment, investors typically increase risk exposure and build up carry positions. This is what happened in 2023 and in the first half of 2024 and what pushed the JPY to multi-year lows relative to most major currencies. **As growth stalls and corrects lower, however, market sentiment can change rapidly.** Being long JPY is the equivalent of being long volatility and short carry, strategies that worked well during past recessions. The evidence for this also stems from the high sensitivity the JPY has to interest rate differentials at the long end, which is higher than the average sensitivity for G10 currencies. **In the event of a US recession – not our base case – US long-end rates could fall further and USDJPY would register this through a depreciation.**

Conventional market carry trades have been unwound.

Most investors have closed short JPY positions, with non-commercial investors and asset managers turning net-long after being short for three years in a row. **In principle, this limits the possibility of another fast squeeze higher, but it does not guarantee an imminent reversal either.** Levered funds, while trimming their short JPY exposure compared to June levels, are still neutral given the drop in global market volatility. But another volatility event, including any hawkish BoJ communications, could prop up the JPY much faster than our 12-month baseline projection. This near-term uncertainty will make conventional carry traders more cautious than usual.

The repatriation of Japanese foreign assets is not a material risk for now, but its potential for a large market impact always warrants attention.

With the BoJ still on a different monetary policy path relative to the rest of the world, **Japanese institutional investors may have a different trade-off when it comes to capital allocation.** They hold $2.5 trillion in US securities, which accounts for almost 10 per cent of the value of foreign holdings of US securities. Public and corporate pension funds along with insurers may gradually repatriate or again hedge their overseas exposure. More than an imminent trigger for the JPY, we see it as a medium-term support for further JPY mean-reversion to fundamentals.

Key take-aways from the desk

We think that the yen will continue to be supported by expectations of:

1. Policy normalization from the BOJ. Kuroda indicating that the neutral rate could be less than 2% is further supporting the yen.
2. Narrowing UST-JGB yield differential, to which the yen is highly sensitive.
3. High volatility in some EM FX, which is an additional headwind for carry trade strategies.
4. Acceleration of Japanese public pension funds reallocation into domestic securities.

LAURENT CROSNIER
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MACROECONOMICS,
GEOPOLITICS,
AND STRATEGY

MACROECONOMIC FOCUS

Signs of deceleration, but not yet a recession, in the US economy

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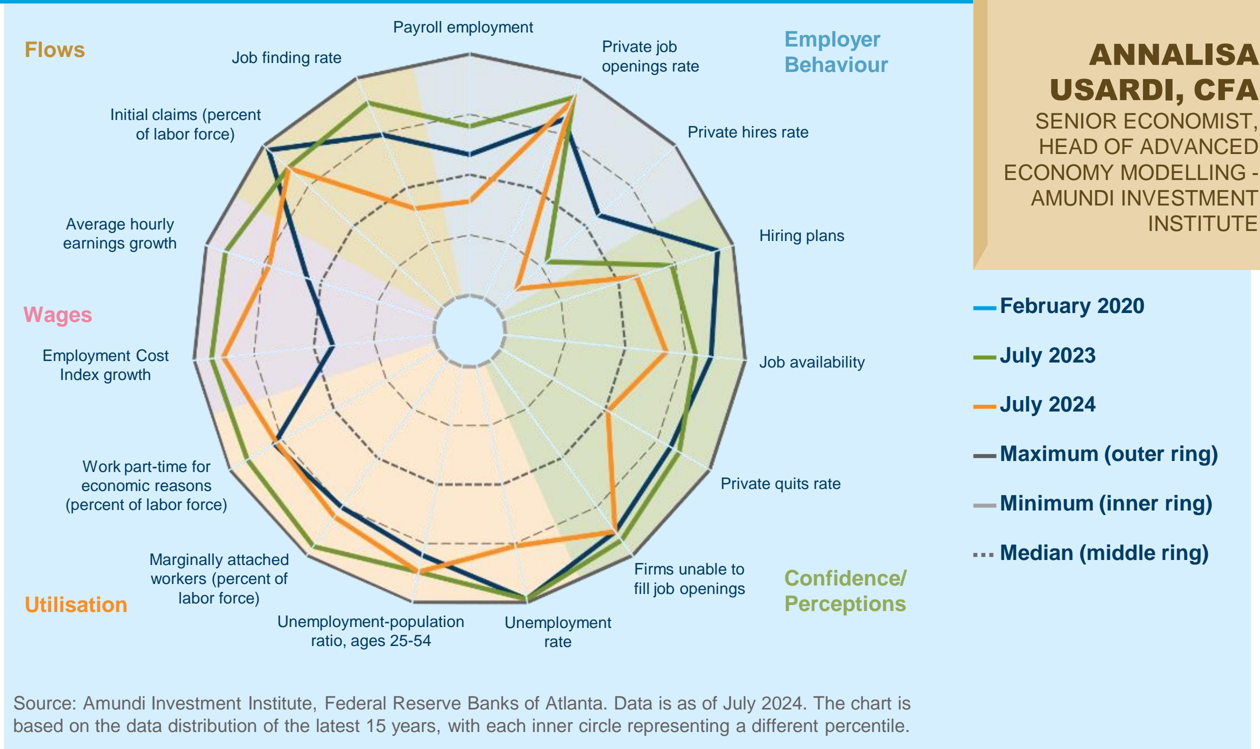
The US labour market is cooling down, but still out of a recession



Source: Amundi Investment Institute, Federal Reserve Banks of Atlanta. Data is as of July 2024. The chart is based on the data distribution of the latest 15 years, with each inner circle representing a different percentile.

The rise in the July unemployment rate to 4.3% (latest reading in August is 4.2%) triggered a significant market concern about a possible weaker-than-expected US labour market, raising the risk of an impending recession. **We do expect a significant slowdown of the US economy, but not a recession.** We expect a significant deceleration in the next few quarters, consistent with a broader weakening of many labour market indicators.

Thus far, labour market weakness has been relatively "soft": more a rebalancing of supply/demand imbalances than anything portending a contraction. **Declining demand for labour has been mainly visible in an incremental reduction in job openings and lower hiring, but, so far, we haven't seen any rapid acceleration in layoffs, especially permanent ones.** The gradual increase in unemployment has been largely due to an increase in labour supply, thanks to a higher participation rate, especially among younger age cohorts and immigrants. Consequently, wage growth has progressively cooled and it is set to moderate further as many leading indicators suggest. Signs of further weakness are already visible: **employment growth**, recently revised down with payrolls, has been **driven by non-cyclical sectors** like education, health care, and government; while, **in cyclical sectors, it has been less exuberant in recent months.** Continuing claims have shifted higher and stabilised around a higher level over the last few months. Similarly, layoffs are beginning to rise and the duration of unemployment is lengthening. As wage growth has been moderating, workers are no longer switching jobs as before.

Nonetheless, while all of these indicators are down from their peak levels, most of them are not at typical recessionary levels yet. We remain mindful, however, that in the past when growth slowed, labour market deterioration accelerated. **Thus, looking ahead, the statistics related to employers' behaviour, particularly the pace of permanent layoffs, will be key indicators to watch** – and will determine the difference between a soft patch and a deeper downturn.

CHINA

Weakening China's short-term outlook

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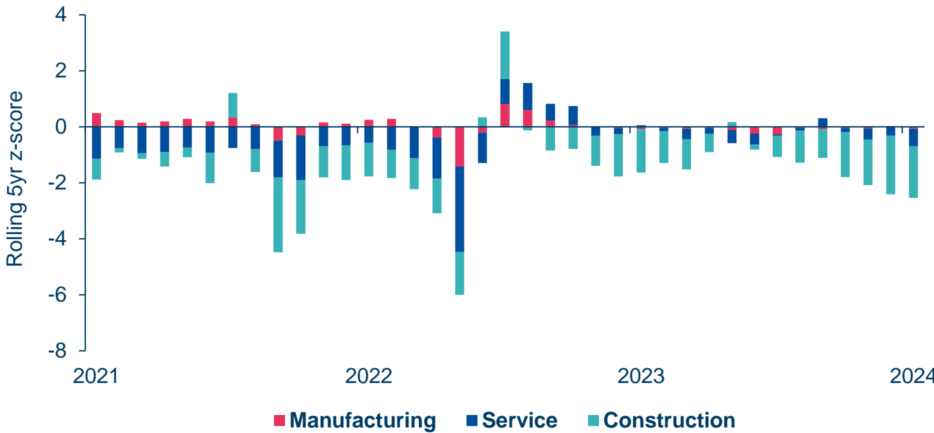
China’s PMI employment



Source: Amundi Investment Institute, CEIC. Data is as 28 August 2024.

China’s retail sales continued to grow at a tepid pace in July, climbing 2.7% YoY, reflecting soft consumer demand. The path ahead is not rosy. The average consumer in China has to deal with both increased uncertainties around the job market and shrinking wealth. For the former, PMI employment indices show heightened pressures of unemployment, particularly in the construction sector. For the latter, the ongoing declines in home prices and soft equity markets have led to a reduced propensity to consume. Lacking evidence on the policy side to address the demand issue, the slow burn among consumers will continue and start to weigh on overall growth as the exports-led recovery plateaus.

INDIA

The picture is still robust, despite softer Q2 24

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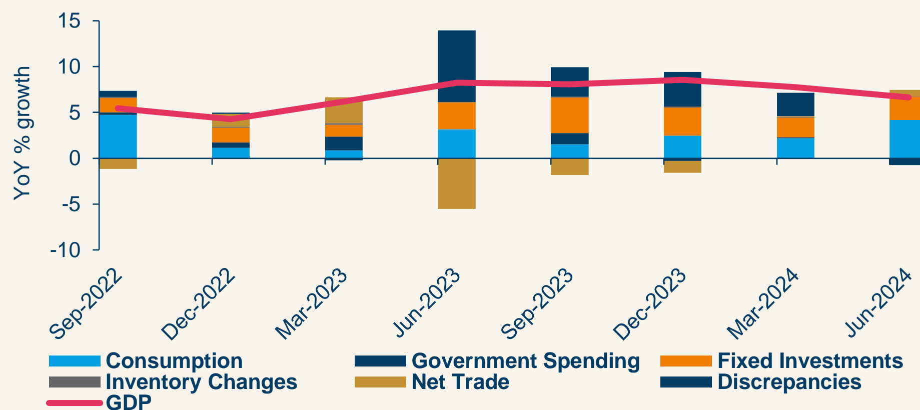
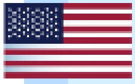
India’s GDP growth and components



Source: Amundi Investment Institute, CEIC. Data is as of 1 June 2024.

As expected, India’s Q2 Calendar Year (CY)-24 GDP moderated in comparison with the previous four quarters at 6.8% YoY versus an average of 8.2% YoY. On a positive note, Household Consumption was the strongest contribution to growth (4.2% out of 6.7%), highlighting more inclusive growth dynamics than in the previous quarters, and was dominated by the performance of Investments. Fixed Investments’ contribution remained sizable at 2.6% out of 6.7%. The data doesn’t change the picture of a country growing at a robust pace, 6.8% in CY-24 (up from previous expectations of 6.7%). Headline Inflation proves benign although looming upside risks stem from Food prices. Based on that macro backdrop, the RBI should start a mild easing cycle (25bps) in Q4 2024.

MACROECONOMIC SNAPSHOT



For the US economy, we expect a notable deceleration over the next few quarters in line with a broader weakening of many labour market indicators, although we do not expect a recession. Gains in productivity and softer demand will allow inflation to ease, even for the stickier services component, and reach its target by mid-2025.

We still expect Eurozone growth to firm and progressively reach potential as consumption recovers supported by improved real income growth as inflation eases, although wages continue to catch up and remain above trend. Growth and inflation patterns remain heterogenous across the Bloc's members as do vulnerabilities to external factors.

The UK economy surprised on the upside in H1, leading to an upward revision of our 2024 and 2025 forecasts, although we expect some moderation in growth in H2. Headline inflation continues to slow down towards target, with positive developments from services, thus underpinning real disposable income growth and domestic demand even in a context of a cooling labour market.

The BoJ hiked against our expectations in the summer. It projected confidence in achieving its 2% inflation target despite the softening of CPI prints, while signalling additional hikes to normalise the real interest rates bar market turbulence. We expect two more hikes in 2025, with a 0.75% terminal rate that will land in the lower bound of the estimated nominal neutral rate range. A risk to our forecast is an earlier hike if wage growth accelerates further.

The Bank of Korea (BoK) resisted the market pressure to cut in August by keeping policy rates unchanged at 3.5%, holding a hawkish bias and highlighting the risk of house price reflation and elevated household credit growth. With domestic financial risks staying well contained and overall growth running just below potential, the BoK is likely to pace its easing, cutting policy rates once per quarter. We expect the first cut in October, and four cuts in total to bring the policy rate down to 2.5% by the end of 2025.

In mid-August, Indonesian President Jokowi announced a draft budget for 2025. The fiscal deficit targets for 2024 and 2025 comply with the fiscal rule of 3% of GDP, at 2.7% and 2.5%, respectively. As anticipated, the free meal programme implementation has been prudently planned in steps, with the first accounting for 0.3% of GDP. While the commitment to fiscal prudence is there, some revenue or expenditure targets may change in the final version by the end of the year, as the new cabinet will only be set by 20 October.

The Brazilian economy is looking robust YTD benefiting from Lula's fiscal measures and interest rate cuts – GDP could expand by 3% this year and inflation has trended higher lately due to base effects. The BCB would like to stay high for longer but might have to undergo a small hiking cycle that would be highly out of sync with the Fed to boost credibility and stabilise inflation expectations. The 2024 fiscal target is now within reach, but still requires a small ($R10B?) budget freeze/additional revenue measures which we believe are likely.

Mexican economic activity has been much softer this year than in 2023 raising Banxico's concerns that outweigh malign headline inflation dynamics in the recent past – core inflation has been better behaved recently. The CB will likely cut policy rates at every meeting going forward in a split fashion, despite MXN underperformance amid the uncertainty relating to AMLO's reforms, the US elections, Mexico's tough fiscal starting point and also Banxico potential actions.

CENTRAL BANKS WATCH

Fed easing is coming and it is dominating also the EM narrative

Developed Markets

The Fed is likely to start cutting rates at its September meeting: the latest FOMC and messages from the Jackson Hole meeting show increased confidence in the disinflationary trend and the focus is turning to growth and the weakening labour market. **Our baseline scenario has moved from two to three cuts before year-end, each being 25bps.**

Following a July pause after June's first cut, **the ECB resumed easing in September**, as the disinflationary trend is supported by recent moderation in wage growth and slowing growth momentum.

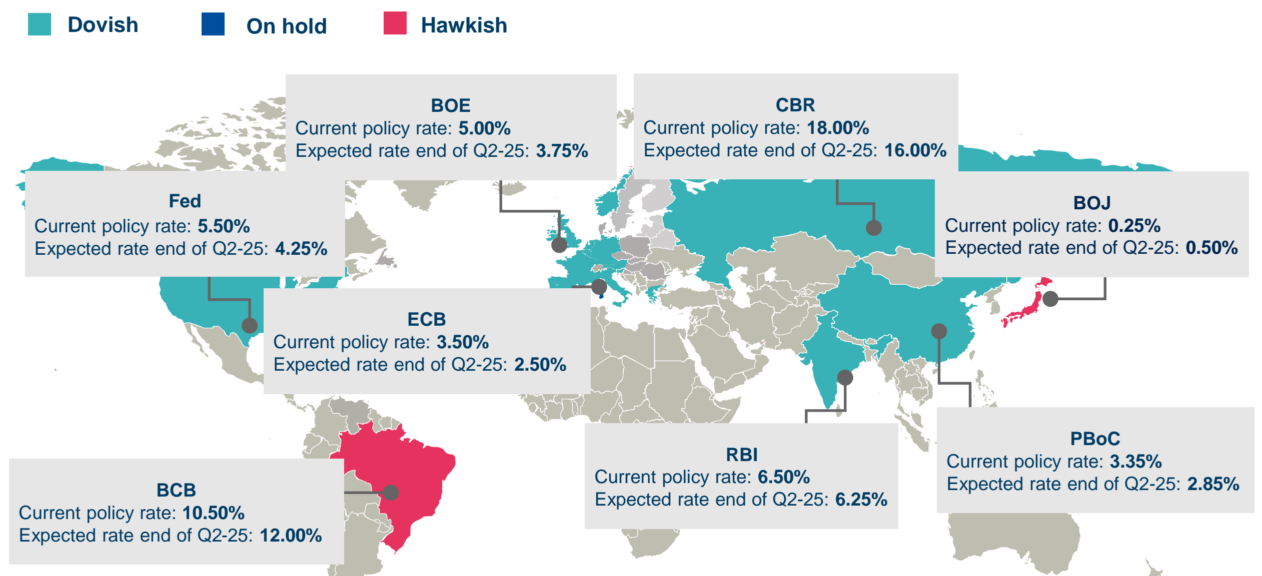
The **Bank of England** started cutting rates in August and, like the ECB, is expected to keep reducing policy tightness with **three** further **cuts before year-end.**

Following its surprise hike, and despite hawkish guidance, **the BoJ looks unlikely to move again until late Q1 next year**, probably after March's wage negotiations.

Emerging Markets

In August we kept seeing little easing action by EM Central Banks. It's worth mentioning that while Romania and the Philippines started their easing cycles, Peru and Mexico continued to unwind monetary policy restrictions at a softer pace. The upcoming **Fed cuts**, together with USD depreciation, **have dominated the narrative for EM CB actions** rather than any nasty surprises on the inflation side. This is particularly evident in the Philippines and Mexico, where higher-than-expected inflation didn't prevent monetary policy easing from starting/continuing. For the first time in a while, we haven't lifted next year's EM policy rates; in fact, **we see more easing along the way for several countries** (Poland, Peru, SA, Chile, Colombia and Mexico). Particularly in Brazil, where the BCB is possibly contemplating an out-of-step small hike as higher risk premiums stemming from fiscal targets appear more and more out-of-reach unless a further budget freeze is announced or new revenue sources are found.

Upcoming rate decision meeting and Amundi's assessment for Q2 2025



Source: Amundi Investment Institute as of 12 September 2024. Illustrative map for monetary policies. CB: central banks. DM: developed markets. EM: emerging markets. Central Bank stance refers to expected changes in CB balance sheets, policy rates, or real rates until Q2-2025. CB Forecasts are by Amundi Investment Institute and are as of 23 August 2024. Fed: Federal Reserve, ECB: European Central Bank, BoE: Bank of England, BoJ: Bank of Japan, PBoC: People's Bank of China, BCB: Central Bank of Brazil, CBR: Central bank of Russia, RBI: Reserve Bank of India. For the Federal Reserve, current rate refers to the upper bound of the target range. For the BoJ, current rate refers to the upper bound of the target range. For the ECB, current rate refers to the deposit facility.

KEY DATES	18 September	19 September	17 October
	US Federal Open Market Committee (FOMC) meeting	BOE Monetary Policy Committee meeting	ECB Governing Council meeting

GEOPOLITICS

What to expect from Harris's foreign policy

Not much is known about Kamala Harris's stance on many foreign policy issues. **Overall, we can expect her to stay close to the foreign policy of the Biden administration.** Her advisors were close to both the Clinton and Obama administrations, and are seen as traditionalists and internationalists. On Russia/Ukraine, **Harris is expected to be more hawkish on Russia and more supportive of Ukraine** as her track record seems more concerned about Russia's aspirations over the longer term. On the Middle East, **she will likely continue to support Israel, but put more pressure on Netanyahu for a ceasefire and the need to find a two-state solution.** She has been a supporter of the Abraham Accords, which seek to improve Israel's ties to its Arab neighbours and wants to de-escalate US/Iran relations. In the past, she has been more hawkish on Saudi Arabia and has supported legislation restricting arms sales and military assistance. With regard to the US attitude **toward China and the South China Sea, we expect a continuation of the Biden policy.** She will likely continue initiatives to deepen alliances in Asia and the Pacific. **On Europe and NATO**, Harris has been supportive and will likely develop **deeper ties with the UK under Keir Starmer**, given their similar political and career background. Overall, Harris cares about climate change and the issue will likely also shape foreign policy.

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Harris cares about climate change and the issue will likely shape foreign policy.

POLICY

Fiscal direction for the Eurozone in 2025?

The fiscal stance in the Eurozone (EZ) was very expansionary between 2020 and 2023. The European Commission (EC) estimates the fiscal impulse over this period was 4% of GDP. **2024 was a turning point**: with the withdrawal of support measures, fiscal policy became restrictive (with a fiscal impulse of around -0.75% of GDP for the EZ). The situation varies greatly from one member state (MS) to another. **The good news is that investment spending financed at a national level has been preserved** or even increased, and spending financed by the grants from the Recovery & Resilience Facility (RRF) has had a positive, albeit small, contribution. **Assuming no change in discretionary policy, the EZ fiscal stance should become neutral again in 2025**. This is the working hypothesis of most forecasters, starting with those of the EC. But is this realistic? The new fiscal governance will apply from 2025. **MS with deficits in excess of 3% of GDP will have to reduce their spending further**. It is up to them to define the strategy for achieving this (the adjustment can be made in 4 or 7 years under certain conditions). They must communicate their plan to the EC this autumn. **The fiscal stance for the EZ as a whole should therefore be restrictive in 2025, unless there is a new shock to growth. According to EC simulations, the contractionary fiscal stance would be between -0.25% and -0.5% of GDP in 2025** (depending on whether the adjustment is carried out over 4 or 7 years). That said, those MS that have to make an effort will likely seek to smooth it out as much as possible, given the persistent weakness of domestic demand.

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Lean years after the fat ones: fiscal consolidation is inevitable in the Eurozone.

Main and alternative scenarios

	Probability 70% **MAIN SCENARIO** Resilient multi-speed growth	Probability 20% **DOWNSIDE SCENARIO** Renewed stagflationary pressure	Probability 10% **UPSIDE SCENARIO** More disinflation with productivity gains
GEOPOLITICS	▪ Ukraine/Russia: ongoing fighting (no ceasefire in sight). ▪ Israel: Higher risk of escalation. But military conflict to stay local. ▪ China/US: a controlled downward trajectory. ▪ More protectionism, friend-shoring	▪ Worsening Ukraine war. ▪ Widening conflict in the Middle East. ▪ More protectionism and increased retaliation to protectionist measures.	▪ De-escalation / ceasefire in Ukraine. ▪ Permanent ceasefire between Israel and Hamas ▪ Lower energy / food prices.
INFLATION & POLICY MIX	▪ Disinflation trend in place but slower, sticky core (services) especially in Europe ▪ DM CBs (Fed/ECB/BoE): -75bp by end-2024. ▪ Most EM CBs at peak rates. ▪ Different fiscal policies: restrictive stance in the EU; still supportive in the US; moderate targeted measures in China.	▪ Sticky or resurging inflation leads to tighter financial conditions. ▪ Financial stress. ▪ Central Banks initially refrain from cutting rates because of inflation. A possible recession could lead to rate cuts, but only in a second stage.	▪ Faster disinflation. ▪ More rate cuts than in the central scenario.
GROWTH PATH	▪ Resilient multispeed growth: slow recovery in Europe; a mild deceleration in the US; controlled slowdown in China. ▪ Growth gap still favours EM.	▪ Recessionary outlook.	▪ Growth returning to potential earlier. ▪ US potential growth revised up.
CLIMATE CHANGE	▪ Climate change hampers growth and exacerbates stagflationary trends.	▪ Further policy delays imply more adverse climate events.	▪ More decisive policy measures to address transition to Net Zero.

Risks to main scenario

LOW — Probability — HIGH

MARKET IMPACT				
	Positive for US Treasuries, cash and gold.	**Positive** for cash, JPY, gold, quality vs growth, and defensives vs cyclicals.	**Positive** for DM govies, cash, gold, USD, volatility, defensive assets and oil.	**Positive** for TIPS, gold, commodity FX and real assets.
	Negative for credit.	**Negative** for risky assets and commodity exporters.	**Negative** for credit, equities and EM.	**Negative** for bonds, equities, DM FX and EM assets.

Source: Amundi Investment Institute as of 30 August 2024. DM: developed markets. EM: emerging markets. CB: central banks. USD: US dollar. TIPS: Treasury inflation-protected securities. FX: foreign exchange markets..

AMUNDI INVESTMENT INSTITUTE MODELS

EMFX Process: the Tactical Signals

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This systematic and multi-faceted approach aims to **identify attractive opportunities and manage risks in the Emerging Markets FX space.** The model concentrates on signals that have empirically proven valuable in forecasting currency movements. These individual signals are then combined into **a composite indicator for each currency.** The signals generally exhibit low correlations among themselves. The model is composed of three key elements:

1. FX Score: This combines various input factors to arrive at a composite score for each currency. It's based on:

- **Valuations:** The model looks at the deviation from the Real Effective Exchange Rate trend as well as short-term dislocations.
- **EM FX Momentum:** The model employs a momentum-based investment strategy. Momentum trading has been one of the most popular and historically successful investment approaches.
- **Economic Surprise Indices:** They measure data surprises relative to market expectations. Positive readings indicate stronger-than-expected data, and vice versa.
- **Commodity Momentum:** The model aims to capture the relationship between commodity price momentum and its impact on EM currencies.

2. Macro Risk: The EM Macro Risk Indicator (from Citi) measures economic risk in emerging countries.

3. Carry: The model takes into account the carry (interest rate differential) of each currency, as it represents a relevant portion of the overall FX return performance.

FX Score, Macro Risk and Carry all contribute to identifying opportunities in the EM FX space.

The final investment call is as follows:

- **Buy-signal** if the FX score is supportive, the carry score is also supportive (above the cross-average plus one standard deviation) and the macro risk is decreasing.
- **Sell-signal** if the FX score is negative and the carry is also not supportive.
- Otherwise, the overall call is for a **neutral position.**

Country	Currency	FX Score	Carry Score	Macro Risk	Final Call
Brazil	BRL	✓	!	↑	Neutral
Chile	CLP	✓	✗	↑	Neutral
Colombia	COP	✓	✓	↓	Long
Czech Rep.	CZK	✗	!	↑	Neutral
Hungary	HUF	✓	!	↑	Neutral
India	INR	✓	✓	↑	Neutral
Indonesia	IDR	✓	!	↓	Neutral
Israel	ILS	✓	!	↓	Neutral
S. Korea	KRW	✓	✗	↑	Neutral
Malaysia	MYR	!	✗	↑	Neutral
Mexico	MXN	✓	✓	↑	Neutral
Peru	PEN	!	!	↓	Neutral
Philippines	PHP	✗	!	↓	Neutral
Poland	PLN	✓	!	↑	Neutral
Romania	RON	!	!	↑	Neutral
South Africa	ZAR	✓	✓	↑	Neutral
Taiwan	TWD	✓	✗	↓	Neutral
Thailand	THB	!	✗	↓	Neutral
Turkey	TRY	✗	✓	↑	Neutral

Source: Amundi Investment Institute, Bloomberg. Data is as of end of August 2024. In the next Cross Asset editions we will present also the single score components.

EQUITIES IN CHARTS

DM: Summer panic in a range bound market

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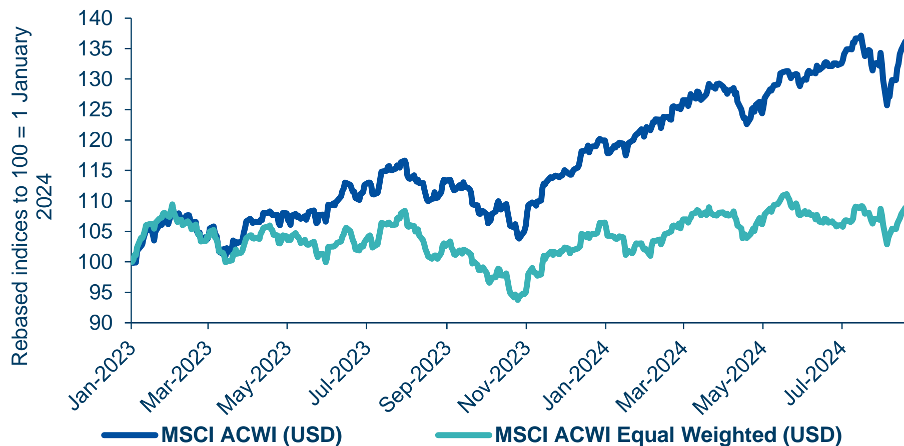
MSCI ACWI & MSCI ACWI Equal Weighted



Source: Amundi Investment Institute, LSEG Refinitiv. Data is as of 26 August 2024.

The case for a range-bound market has been clear for the MSCI ACWI equal-weighted index since April 2024, while the market cap-weighted index has been more volatile. Both are now trading back in their upper range. Seasonality and the US election suggest that this trend will continue for now.

EM: Second positive reporting season in a row confirms earnings recovery

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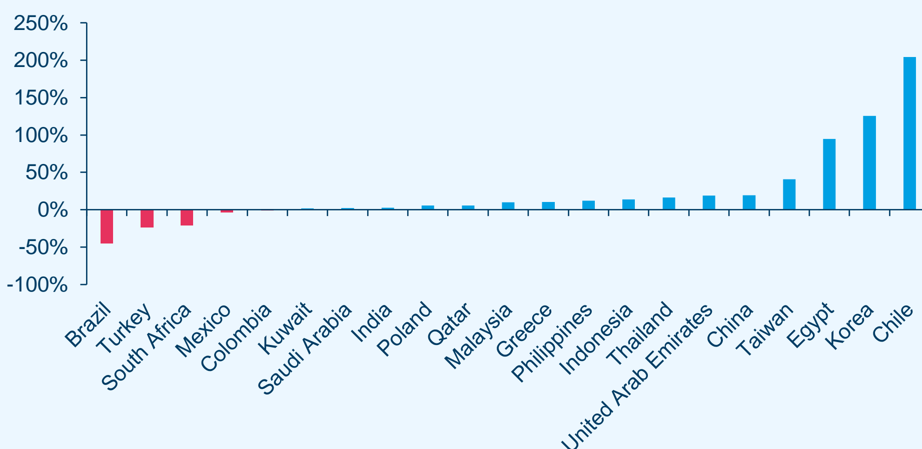
Q2 2024 reporting season - results (still partial)



Source: Amundi Investment Institute, S&P Capital IQ. Data is as of 19 August 2024.

About 50% of MSCI EM constituents have reported (as of 19 August). GEM Q2 2024 net income YoY growth is positive (+11% in USD) for the second reporting season in a row confirming a recovery in earnings, which has been expected for a while, and also includes the tech sector. Negative YoY results were only recorded in Mexico, Turkey and Brazil. At a sector level, the best results (on average) were in IT, HC and Industrials; the worst in Energy.

BONDS IN CHARTS

DM: Markets have been repricing potential cuts from the Fed

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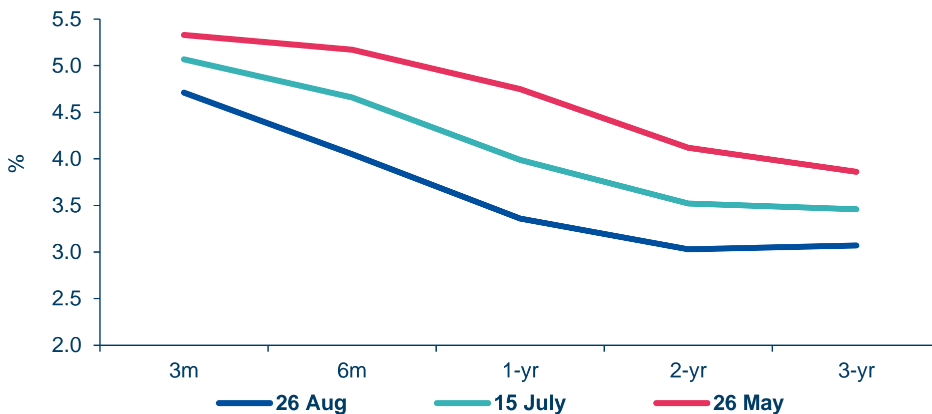
Market pricing of Fed rates



Source: Amundi Investment Institute, Bloomberg. Data is as of 27 August 2024.

Over the last three months, markets have significantly repriced both short-term and medium-term potential cuts from the Fed: doubling the expected move by year-end from 50bps to 100bps, the market currently expects the Fed rate to land close to 3% in 2 to 3 years time.

EM: There is still room for EM Local Bond yields to fall before the Fed pivot

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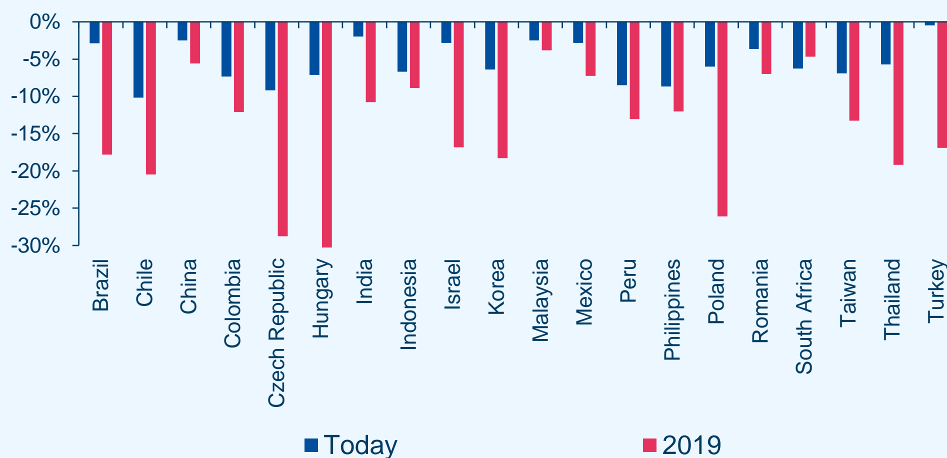
Comparison of 2019's vs today's yield fall 60-15 days before Fed cut

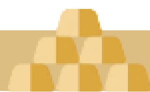


Source: Amundi Investment Institute, Bloomberg. Data is as of 28 August 2024.

EM Local bond yields have decreased in recent days, as the first Fed rate cut approaches which is now largely expected to take place on 18 September. However, uncertainties linked to the Fed's willingness to start the cutting cycle – and ongoing worries about inflation – have created some hesitation among investors, in recent months, about buying EM local bonds. As of today, the decrease in yields over the last 45 days has been much lower compared to the 2019 Fed cutting cycle, with the only exception being South Africa. We can expect an acceleration in the fall of yields over the coming months, as soon as the Fed confirms its decision to cut.

COMMODITIES

Gold

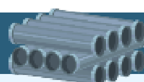


Gold is likely to remain supported by monetary pivots, despite temporarily softer fundamentals (pause in China jewelry demand and central bank purchases) and stretched positioning and valuations. The upside will rely on the magnitude of easing. Our targets (in $/oz): 3M 2500, 12M 2700.

Oil

Oil fundamentals moderate, due to weak Chinese demand and prospects of higher supply. Yet, oil markets remain slightly tight, positions are low and valuations are cheap. We see a mild premium from geopolitics. We maintain our target ranges for Brent (in $/b): 3M [80-85], 12M [75-80].

Industrial Metals



Metals volatility is likely to stay above par amid global and Chinese growth uncertainty. But most bad news looks priced and derisking is well advanced. A core allocation still offers a decent medium-term risk/reward in our view. We keep our Copper targets (in $/t): 3M 9500, 12M 10000.

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Extra gains for Gold from pivot. Metals look fundamentally cheap.

CURRENCIES

Euro

Despite the weak growth outlook for the Eurozone and China remaining a drag, speculative investors increased exposure to the EUR, which finally broke 1.10. High absolute interest rates and a structural balance of payments improvement suggest the move may extend into 2025.

Dollar

The path towards USD depreciation has started and it is not over yet. In our view, any sell-offs in risky assets that come along with higher cuts expectations for Fed will not find the USD to be the best diversifier. Despite the higher probability of a US recession, liquidity remains abundant and refinancing activities remain low.

Sterling

Stronger growth and stickier core inflation made the BoE cut almost a non-event for GBP. With the UK debt-service ratio still contained relative to its historical average, we do not expect a less restrictive BoE to be a strong headwind for GBP. The currency remains cheap to fundamentals and may outperform in a weaker USD environment.

Yen

Fears of recession and a hawkish BoJ were responsible for the sharp unwinding of carry trades funded in JPY since July. Our Q2 2025 target for USDJPY was revised to 135 from 140. Our view is that it is not yet time for cross-JPY adjustments to be too aggressive.

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The USD is not the best diversifier when the Fed is repriced.

GLOBAL INVESTMENT VIEWS

GLOBAL INVESTMENT VIEWS

A summer of reality checks on market expectations

Market moves over the summer have served as a reminder that, at a time of high valuations, any mismatch on corporate earnings or monetary policy expectations and any scare on growth could be triggers for sudden falls. While most major markets have recovered from the volatility seen in early August owing to the Fed put, we cannot ignore the fact that some segments are still priced for perfection. This points to corporate earnings and policy actions coming under the spotlight even more, particularly as inflation cools, economic activity weakens and the noise around US elections increases.

- **US soft landing, no-recession scenario in the US is confirmed**. Slowing but not collapsing labour markets and weak fixed investments all point to a mild deceleration. For the UK, we marginally upgraded growth forecasts for this year but there are still question marks on domestic demand.
- **Disinflation trend confirmed in US and Europe.** We revised down our Q4 2024 headline consumer price inflation projections for the US due to weakness in unit labour costs and the employment cost index. An improvement in labour productivity should also foster disinflation. In Europe, the speed of disinflation is linked to services inflation, which could be sticky.
- **The phase of central bank divergences may be coming to an end**, with Japan an outlier. We expect three rate cuts from the Fed, and three each from the ECB and the Bank of England for the remainder of year*.
- **China is facing a difficult road to recovery.** Support for the housing markets has been short lived even as labour markets deteriorated. Corporate profitability is being affected by worsening consumer confidence.

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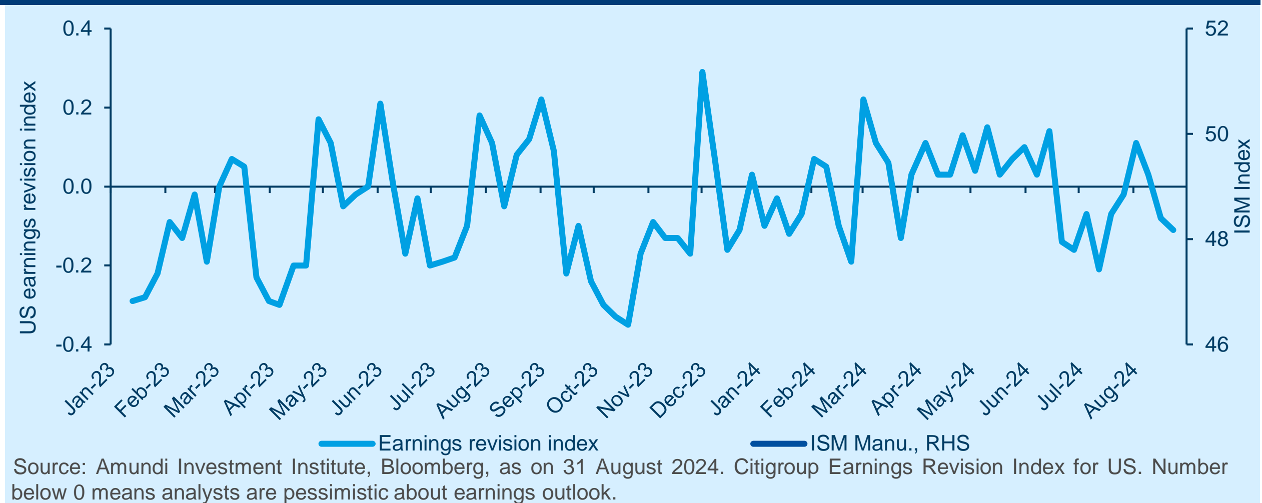
MATTEO GERMANO
DEPUTY GROUP CIO

US: weakness in earnings revisions and economy may be reflected in stock prices



Source: Amundi Investment Institute, Bloomberg, as on 31 August 2024. Citigroup Earnings Revision Index for US. Number below 0 means analysts are pessimistic about earnings outlook.

*From beginning of September to the end of the year.

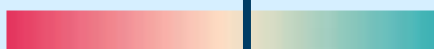
Markets are likely to remain range bound in the short term, without any strong directionality. However, there are areas of value to be explored across a broad range of assets:

- **Cross asset.** A mild US economic deceleration, vulnerabilities to European growth and inflated valuations in select segments call for a prudent adjustment to risk but not for a structural de-risking. Hence, we tactically reduced our stance on the US, European small caps and EM. We remain slightly positive on equities overall through the UK and Japan. Elsewhere, although we continue to be positive on EM debt, we think volatility around US elections could affect some currencies and local debt. US Treasuries and European bonds continue to offer attractive yields, but investors should consider raising safeguards. Geopolitical tensions and the safe-haven allure of gold induce us to stay positive on the metal.
- **The sharp yield movements over the summer call for a flexible/active stance on duration.** We are positive on US Treasuries from a long-term view but we have tactically reduced our stance slightly. We think the short end (2Y) of the curve is now expensive but there is still value in the intermediate parts. In core-Europe, our constructive stance is maintained but we downgraded UK to neutral. Elsewhere, the US securitised market looks attractive but we are selective. We like auto ABS and believe a dovish Fed is supportive of agency MBS spreads. Corporate credit offers opportunities and we prefer IG to HY, in both the US and Europe.
- **Stay balanced and play market anomalies.** The market stress in the beginning of August supported the broadening of the rally outside of US large caps. We believe as earnings outside these segments catch up, the broadening is likely to continue but it may not be linear. Hence, we stay cautious on expensive names, US growth and large caps. In contrast, we favour an equal weighted approach and US value. In Europe, where valuations are cheaper, we stay balanced with positive stances on cyclicals and defensives.
- **Emerging markets growth remains on a solid footing** but there could be near-term pressures from protectionism, given the US elections. In China, although the government is implementing piecemeal efforts to boost the real estate market, we remain vigilant. Instead, we like equities in markets such as Indonesia, India and Brazil. The carry in EM debt is robust but we are selective and are monitoring any headwinds to local currency debt.

When central banks are cutting rates and risks of a US recession are limited, we remain disciplined and mildly positive on risk assets.

Overall risk sentiment

Risk off **Risk on**



A mild risk-on stance, with tactical adjustments and caution towards areas of excesses.

Changes vs previous month

- Cross asset: Tactically neutral on US, Europe small caps and EM equities.
- Fixed income: Less positive on US and UK duration, moved closed to neutrality in an overall flexible approach.

*Overall risk sentiment is a qualitative view towards risk assets (credit, equity, commodities) expressed by the various investment platforms and shared at the global investment committee (GIC) held on **30 August 2024**. It reflects views over a one month horizon, from one GIC to the other. Our stance may be adjusted to reflect changes in the market and economic backdrop.*

ECB= European Central Bank, DM= Developed Markets, EM = Emerging Markets, CBs = central banks, IG = investment grade, HY = high yield,. BTPs = Italian government bonds, JBGs = Japanese government bonds. For other definitions see the last page of this document.

Three hot questions

1

How do you see central bank policies evolving this year?

Earlier, we pointed out temporary divergences in central bank policies. Now, we notice these divergences are ending. We expect a total of three rate cuts* (25 bps each) from the Fed this year, and three each from the ECB and the BoE in addition to the rate cuts already implemented. While markets are pricing in slightly more than four Fed cuts, we think this is too dovish and may be questioned if the last mile of inflation comes in sticky. Slowing wage growth and inflation in the EZ would support the case for ECB easing. The BoJ, however, is an exception. It is likely to consider wage growth, inflation and financial market stability before taking further decisions. We think the bank should refrain from raising rates this year, but we do expect a hike in the second quarter in 2025.

Central bank rates forecasts

- Year end forecasts: Fed (upper bound) 4.75%, ECB (deposit facility rate) 3.00% and BoJ 0.25%.

2

What's your view on the US economy and labour markets?

A lot is being said about the US economic activity. Our view has not changed over the summer and we still believe a recession is unlikely at this stage. We do see, however, a mild slowdown concentrated in the second half of the year as labour markets continue to weaken. Labour markets are the key variable for assessing US consumption and economic growth. At this stage, permanent layoffs, which we think are especially relevant, are under control. Overall, our real GDP growth expectations are unchanged at 2.5%, year-on-year, for 2024. On the inflation front, a sustainable downward trajectory is likely to be maintained.

Investment Implications

- Close to neutral on US equities.
- EUR/USD: 1.15 for Q2 2025.

3

Do you think gold prices can maintain the upward trajectory seen so far this year?

Gold prices have been boosted by a weak dollar, geopolitical tensions and expectations of a Fed pivot. In addition, from a long-term view, fiscal profligacy and ballooning public debt could pressure fiat currencies, which improves the appeal of gold as a store of value. Hence, we stay positive on the precious metal. On copper, economic activity matters more for cyclical commodities than a Fed pivot. But a lot of the uncertainty on global growth deceleration and Chinese demand appears to be priced into commodities such as copper. Thus, we maintain a slightly constructive stance.

Investment Implications

- 12 month target: Copper $10000/tonne; Slightly upgraded gold to $2,700/ounce.

The Fed seems to be in no fear of inflation and is more focused on preventing a deterioration in labour markets. This has allowed us to raise our rate cut expectations from two to three for this year.

MONICA DEFEND
HEAD OF AMUNDI INVESTMENT INSTITUTE

*From beginning of September to the end of the year.

MULTI-ASSET

Recalibrate risks as markets sail choppy waters

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Markets are shifting their focus to economic growth, as inflation continues to decline. The primary reason for this shift seems to be weakening consumption, which is now extending to wider sections of the economy. In the EZ, a multi-speed recovery with divergences across countries is the main theme. In addition, fiscal policies could be a drag on growth in the medium term. Collectively, these factors call for a more prudent stance, and a tactical, incremental risk reduction rather than a structural de-risking. Overall, we are marginally positive on risk assets and stay well-diversified.

The spike in volatility in early August led us to revise downward our views on equities mainly through US, European small caps and a basket of EM stocks due to an uncertain growth environment and a need to minimise idiosyncratic risks. We remain vigilant for any pullbacks in the near term. We stay slightly constructive on DM through UK and Japan. The former displays attractive valuations, a strong dividend-potential and should benefit from policy easing by the Bank of England. Japan, which suffered from sharp volatility earlier, is a long-term play that offers diversification.

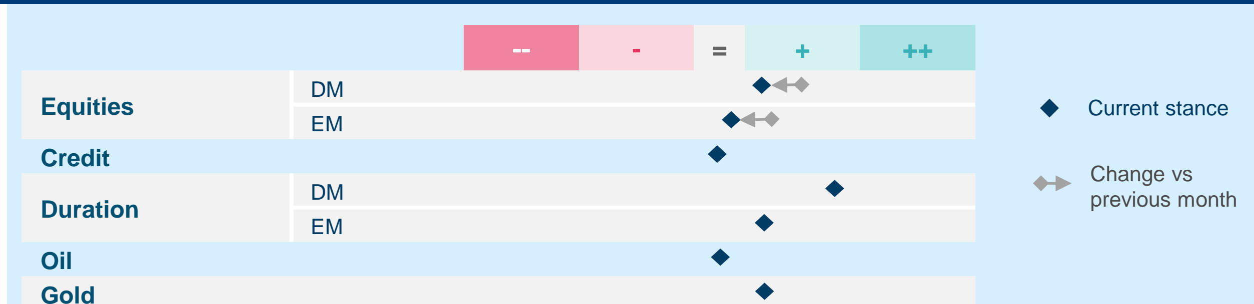
The summer volatility allowed us to downgrade our stance on equities for risk management purposes as we await more clarity on the economic direction.

Declining inflation should encourage the Fed and ECB to cut rates and that allowed us to maintain our positive views on US and core Europe duration. We stay vigilant after the recent yield movements and wary of any potential fiscal risks. We are also positive on Italian BTPs as they should benefit from a move lower in core European yields. In Asia, our cautious stance on Japanese bonds is retained because we expect yields to go up after the BoJ turned less dovish.

Fundamentals in EU IG corporate credit are robust, demand is strong and yields are attractive. This keeps us constructive on the segment. We like the carry offered by EM bonds, but we turned cautious on the FX component of local bonds. Geopolitical risks and higher for longer Fed rates could negatively affect select currencies. However, we continue to see value in BRL/EUR for the positive macro backdrop in Brazil and in INR/CNH for its carry and stability. The USD should do well vs the SEK and CHF in the near term as these central banks have already begun a monetary easing cycle.

Finally, gold's appeal to protect from geopolitical stress, amid its strong demand, is maintained. Investors may also consider raising hedges on US duration and maintaing safegaurds on equities, to protect from higher yields.

Amundi Cross-Asset Convictions



Source: Amundi. The table represents a cross-asset assessment on a three- to six-month horizon based on views expressed at the most recent global investment committee held on 30 August 2024. The outlook, changes in outlook and opinions on the asset class assessment reflect the expected direction (+/-) and the strength of the conviction (+/++). This assessment is subject to change and includes the effects of hedging components. FX = foreign exchange, BTP = Italian government bonds, BoJ = Bank of Japan, JGB = Japanese govt. bonds, BoE = Bank of England, NIRP =.Negative interest rate policy, DM = Developed markets, EM = Emerging markets. For other definitions and currency abbreviations see the last page.

FIXED INCOME

Flexibility in duration is crucial at this stage

Reaffirmations of the Fed put by Chair Jerome Powell primarily due to continued progress on inflation have shifted the market's focus towards labour markets and economic growth. While we are seeing signs of slowing labour markets that would encourage the Fed to cut rates, a lot of that monetary easing is already priced into the markets. In Europe, the story is similar with respect to inflation falling, but some components such as services are sticky. As a result, the extent of central bank easing would actually depend on the macro data. Hence, we think it is important for investors to be agile on duration in order to take into account market moves and they should maintain their long-term convictions. In credit, quality in DM and EM may be explored to benefit from a high carry.

Global & European fixed income

- Before summer we moved constructive on duration. Although yields have declined, we believe duration is still attractive and there are regional divergences.
- We are positive on core Europe but have tactically turned neutral on the UK and are vigilant on any surprises on growth. We maintain our curve steepening views in US.
- Carry is attractive in credit, but we favour Euro financials, and IG over HY.

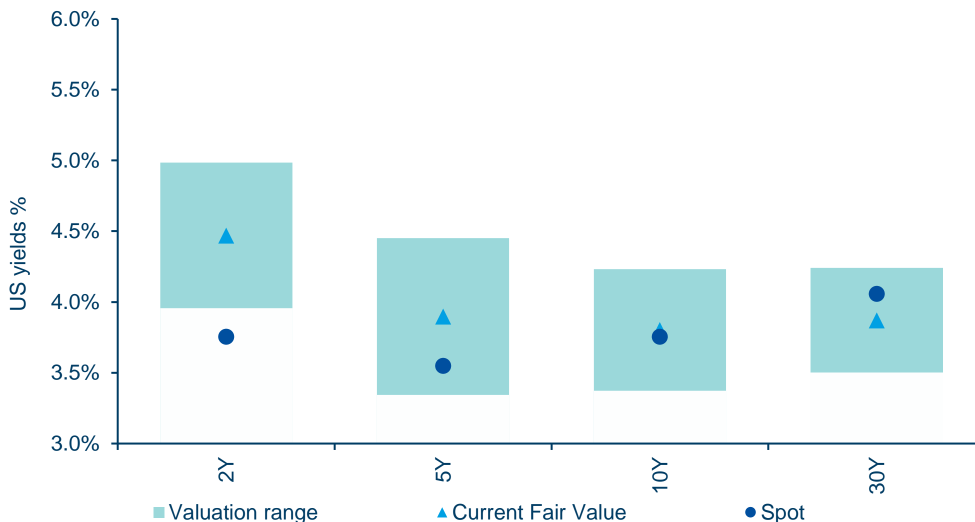
US fixed income

- We stay active and slightly positive on USTs but have tactically reduced our stance as we think some parts of the curve have become expensive. In particular, the intermediate part of the curve offers reasonable risk/reward.
- In credit, we maintain our quality bias and also see selective opportunities in new issues whose risks are mispriced.
- In securitised markets, some agency MBS and auto ABS look attractive.

EM bonds

- Fed policy, USD and US elections are the main global factors affecting EM debt that we are monitoring closely. While we see Fed easing as favourable for the asset class, there are country-specific risks that allow us to be selective.
- In LatAm, we like Brazil and Peru and in South Africa, slowing inflation is positive.
- Elsewhere, we slightly trimmed our constructive view on Turkey (inflation) but await attractive levels to raise our stance later.

The short end of the US yield curve is now expensive



Source: Amundi Investment Institute, Bloomberg, as on 4 September 2024. The grey box represents the upper and lower ranges of fair value of yields. If the spot value is below the lower range, the bonds are expensive and vice versa. The upper and lower valuation ranges have been calculated by using the current fair value and the standard error of the historical fair values and spot values.

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EQUITIES

Play market anomalies led by fundamentals

The August turmoil that began after negative surprises on earnings of some US tech companies was later exacerbated by weak macro data. We have been saying for quite some time that there is ambiguity about whether companies can quickly translate their AI-related investments into a sustainable growth in earnings. Now, the markets seem to be questioning that as well, as valuations in select corners are still a concern, along with weak macro dynamics. Even in the EZ, where the economic recovery is moving up towards its potential, the path is vulnerable and dependent on exports. In this environment, fundamentals like earnings and balance sheet strength become even more important. We believe investors should play market dislocations, favouring segments such as US equal weighted, value and emerging markets.

European Equities

- While we took advantage of the market moves, our barbell view is maintained. This is mainly through cheap defensives and quality cyclicals.
- We are positive on staples and health care but cautious on tech. The recent pullback could open up opportunities in the tech consulting space.
- Recent earnings have been strong, but for export-oriented sectors such as luxury, weakness in China is becoming apparent.

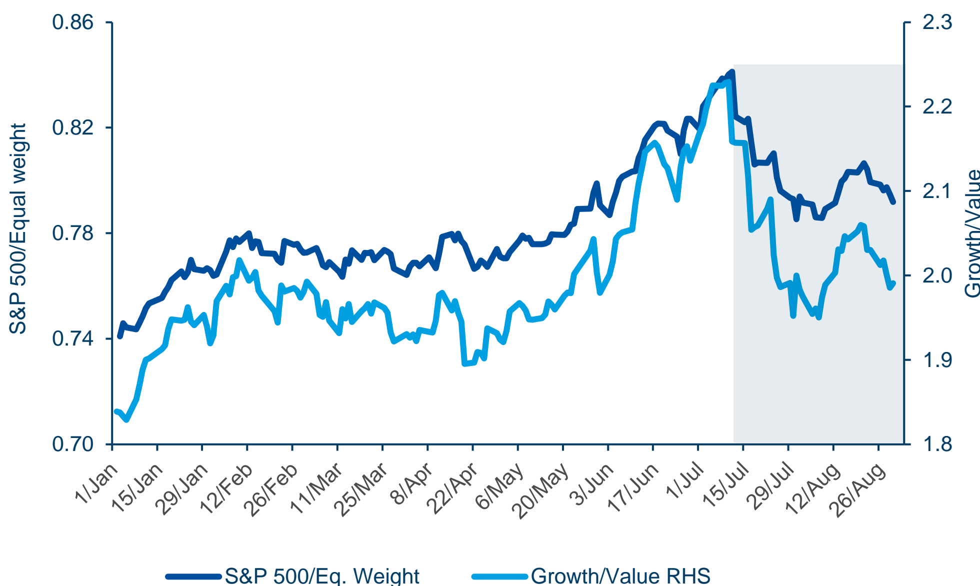
US & Global Equities

- The valuation gap between market-cap weighted indices and the broader markets is huge. We think in case of a liquidity scare, the top-of-the-market stocks would suffer more.
- EPS growth in the broader markets is likely to improve and could support a rally-broadening outside of large caps/AI-driven segments.
- We stay balanced, positive on financials (large banks) and materials, and also on defensives through specific investment cases.

EM Equities

- Economic growth remains strong and earnings recovery is on track. But we could see some volatility on US elections (Harris vs Trump presidency) and discussions on trade barriers, etc.
- In LatAm, we raised our stance on Brazil given its attractive valuations and are also positive on Mexico.
- India and Indonesia offer strong long-term potential. We are also positive on South Korea but reduced our views on some banks.

Rally broadening outside US large caps continues this quarter



Source: Amundi Investment Institute, Bloomberg, 30 August 2024. Ratio of US market indices.

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VIEWS

Amundi asset class views

In focus this month

- **USD/JPY:** A hawkish BoJ and fears of a recession were responsible for the recent unwind of carry trades funded in JPY. Our 12-month target for the USD/JPY is revised slightly from 140 to 135. Any further JPY adjustments would require a weaker global growth or a more pronounced hiking cycle from the BoJ

Equity and global factors

Regions	Change vs. M-1	--	-	=	+	++
US				◆		
Europe					◆	
Japan					◆	
EM					◆	
China				◆		
EM ex China					◆	
India					◆	

Global Factors	Change vs. M-1	--	-	=	+	++
Growth			◆			
Value					◆	
Small caps					◆	
Quality					◆	
Low Volatility				◆		
Momentum				◆		
High Dividend				◆		

Fixed income & FX

Govies	Change vs. M-1	--	-	=	+	++
US	▼			◆		
EU core					◆	
EU periph.				◆		
UK	▼			◆		
Japan				◆		

Credit	Change vs. M-1	--	-	=	+	++
US IG				◆		
US HY			◆			
EU IG					◆	
EU HY			◆			

EM Bonds	Change vs. M-1	--	-	=	+	++
China govt.				◆		
India govt.					◆	
EM HC					◆	
EM LC				◆		
EM corp.					◆	

FX	Change vs. M-1	--	-	=	+	++
USD					◆	
EUR			◆			
GBP				◆		
JPY					◆	
CNY			◆			

Source: Summary of views expressed at the most recent global investment committee held on **30 August 2024**. Views relative to a EUR-based investor. Views range from double minus to double positive, = refers to a neutral stance. This material represents an assessment of the market 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. FX table shows absolute FX views of the Global Investment Committee.

▼ Downgrade vs previous month
▲ Upgrade vs previous month

FORECASTS

Macroeconomic forecasts

Macroeconomic forecasts as of 5 September 2024						
Annual averages, %	Real GDP growth, YoY, %			Inflation (CPI), YoY, %		
	2023	2024	2025	2023	2024	2025
Developed countries	**1.5**	**1.6**	**1.6**	**4.7**	**2.8**	**2.2**
United States	2.5	2.5	1.9	4.1	3.0	2.2
Eurozone	0.5	0.8	1.2	5.4	2.5	2.2
Germany	*0.0*	*0.2*	*1.0*	*6.1*	*2.4*	*2.3*
France	*1.1*	*1.2*	*1.2*	*5.7*	*2.6*	*2.0*
Italy	*1.0*	*0.8*	*1.0*	*5.9*	*1.3*	*2.0*
Spain	*2.5*	*2.7*	*1.8*	*3.4*	*3.3*	*2.3*
United Kingdom	0.1	1.1	1.6	7.3	2.5	2.1
Japan	1.7	0.5	1.4	3.3	2.5	2.0
Emerging countries	**4.3**	**4.3**	**3.8**	**5.8**	**5.6**	**4.2**
China	5.2	4.8	3.7	0.2	0.4	0.5
India	7.8	6.8	6.2	5.7	5.2	6.0
Indonesia	5.0	5.2	4.9	3.7	2.4	2.7
Brazil	2.9	3.0	2.1	4.6	4.3	3.8
Mexico	3.2	1.4	1.3	5.6	4.9	3.9
Russia	3.6	3.5	1.0	6.0	8.0	6.2
South Africa	0.7	0.8	1.4	5.9	4.7	4.2
Turkey	4.5	5.3	2.9	53.4	59.7	29.5
World	**3.2**	**3.2**	**2.9**	**5.3**	**4.5**	**3.4**

Central Banks' official rates forecasts, %					
	4 September 2024	Amundi Q4 24	Consensus Q4 24	Amundi Q2 25	Consensus Q2 25
United States*	5.50	4.75	4.29	4.25	3.30
Eurozone**	3.75	3.00	3.03	2.50	2.20
United Kingdom	5.00	4.25	4.50	3.75	3.83
Japan	0.25	0.25	0.29	0.50	0.41
China***	3.35	3.15	3.25	2.85	3.25
India****	6.50	6.25	6.25	6.00	5.90
Brazil	10.50	10.50	10.25	12.00	10.25
Russia	18.00	19.00	18.25	16.00	15.55

Source: Amundi Investment Institute. Forecasts are as of 5 September 2024. CPI: consumer price index. *: Upper Fed Funds target range. **: Deposit rate. ***: One-year loan prime rate. ****: Repurchase rate. Q4 2024 indicates end of December 2024; Q2 2025 indicates end of June 2025.

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