29 April 2019 /// n°14-2019

US growth surprises on the upside

Key Points

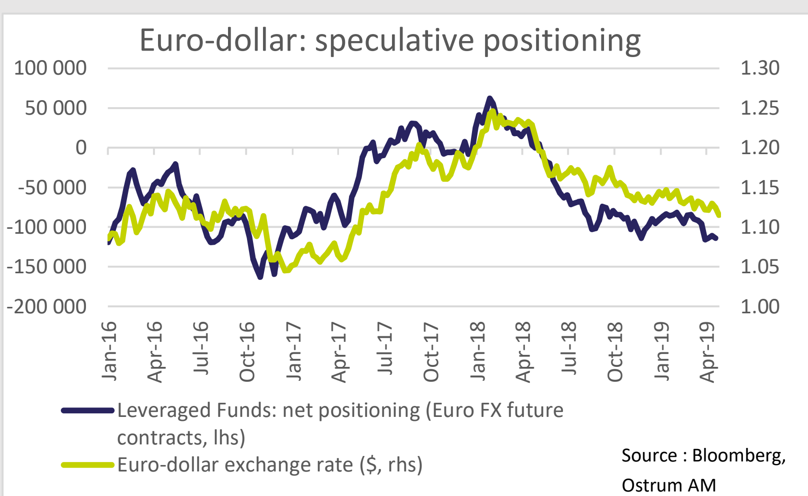
- **US growth above expectations in 1q 2019**
- **Currency markets: the euro below $1.12, cheapest in 2 years**
- **Fed status quo anticipated**
- **Bund yields near 0%, T-note hover about 2.50%**
- **Profit-taking in European high yield**

Both bond and equity markets were well oriented last week. US growth above expectations amid tame inflation was well received by equity market practitioners and bondholders. The S&P index hit a high close to 2940 points whilst 10-year yields fell back towards 2.50%. The Fed, which meets later this week, may insist on low inflation to justify keeping policy easy. European stocks lost 0.5% trimming 2019 gains slightly. Shanghai stocks corrected by about 5%.

Bund yields near 0% with little movements in sovereign spreads. S&P confirmed Italy's sovereign rating last Friday, which led to some BTP spread narrowing early on Monday. Credit spreads continued to shrink. Indeed, ITraxx crossover is trading below 250bp despite some profit-taking in cash high yield bond markets (+16bp in five trading days). The average spread on USD emerging bonds increased by 8bp last week.

Oil prices declined after a short-lived move up as Donald Trump threatened importers of Iranian oil. In currency space, the US dollar remains strong across the board. The euro broke the $1.12 threshold to the downside. The yen is weak but relatively stable near 112.

Chart of the week



Speculative accounts continue to run massive short positions on the euro vs. the US dollar.

Negative interest rates in the euro area and stronger growth across the Atlantic do support the US dollar.

Speculative short positioning increased recently and seems to foreshadow further euro weakness.

That said, the end of the Fed's balance sheet run-off from October should limit the upside on the greenback.

US growth stronger than expected in 1q19

Activity grew at a strong pace in the three months to March. US GDP expanded at a 3.2%qa clip in the first quarter. Private consumption slowed in spite of solid job increases. Durable goods expenditure went through a soft patch in January-February but picked up nicely towards the end of the first quarter. Residential investment contracted for the fifth consecutive quarter. The housing investment decline came as a surprise given higher readings in new home sales recently. That being said, these demand components (durable goods spending and housing) are the most sensitive to interest rates and are approaching critical levels in terms of share of GDP. Thus discretionary household demand appears unlikely to remain the drivers of US growth going forward. The good news came from exports which increased at 3.7%qa pace in the first quarter. Combined with lower US imports, external demand's contribution to GDP growth reached 1pp. Business investment expenditure was uneven. Research and development and software spending were upbeat but structures investment fell. Equipment expenditure was stagnant. This pattern may hint at efforts to raise productivity at the expense of capacity expansion. Hence, 3.2% growth can be split into 1.5pp from domestic demand, 1pp from external demand and roughly 0.7pp from inventory building. Growth rebalancing is welcome after a decade of strong household demand. Foreign demand developments are nevertheless uncertain. In parallel, inflation slowed. The GDP deflator increased less than 1%qa in 1q19. Core consumer price inflation was just 1.6%y in March.

Stocks higher despite final investor selling

Financial markets are still well oriented. The pullback in oil prices and a few mediocre earnings releases late last week limited weekly gains to 0.5% on the S&P 500. Yields on 10-year Treasuries declined to about 2.50%, as inflation numbers reassured market participants as regards future monetary policy.

The Fed will meet later this week. Monetary status quo is a given. Jerome Powell may hence choose to insist on inflation developments and 'uncertainty' to justify current accommodative policy. The Fed has already erased three hikes to prop up asset markets. The rise in US stock markets rests on surprising investment flow dynamics. On BofA ML data, equity funds, all categories combined, record outflows in excess of $95b so far this year. Funds hence flow significantly out of equity markets into safer bond markets. Demand for equities continue to emanate from corporate share buyback programs as lacklustre earnings releases fail to lure final investors unwilling to pay 19x multiples. US EPS are up some 2% from a quarter ago on average. Health care recorded upside earnings surprise which helped to close part of the sector's recent underperformance. In bond markets, yield curve steepening beyond 5 years' maturities resumed. Such steepening indeed reflects Fed caution and current asymmetry in its analysis of macro-financial conditions. It is worth keeping a long duration bias and maintain exposure to 10s30s wideners.

ECB deposit rates still debated

In Europe, indicators still point to the downside. The IFO survey lost further ground due to reduced expectations. That said, euro area growth likely reached 0.3%q in the first quarter. Spain's economic strength and fiscal stimulus in France may have cushioned the euro area economy against foreign trade developments. In this environment, Bund yields remain close to 0%. Curve flattening resumed after a short respite in the first half of April.

Benoit Coeuré, a possible successor to Mario Draghi, made some comments and spread doubt regarding ECB deposit tiering. Bank stocks reacted negatively and financials underperformed in corporate credit markets. Likewise, swap spreads widened slightly (+2bp in 2-year space). As concerns sovereign bonds, Standard & Poor's left Italy's rating unchanged at BBB with a negative outlook reflecting the expected deterioration in debt-to-GDP ratio going forward (132% of GDP at present). The unchanged rating sparked a relief rally in BTP spreads early on Monday. Spanish election results suggest that the current minority government led by socialist Pedro Sanchez will stay in power. The election outcome (unlikely to alter fiscal consolidation prospects) was well received by the bond market. Spanish Bonos trade 100bp above German Bunds on 10-year maturities. Portuguese bonds were also in good demand as spreads shank to 112bp. In credit markets, investment grade spreads tightened. Conversely, spreads rose in high yield space. CDS indices still remain at tight levels (250bp on iTraxx Crossover).

Dollar: rise by default?

The greenback strengthened last week despite lower US bond yields. Forward Fed Funds rates even indicate a higher probability of cut next year. Nevertheless, the euro-dollar exchange rate dropped below $1.12, its cheapest reading since 2017.

Main Market Indicators

G4 Government Bonds	29-Apr-19	-1wk (bp)	-1m (bp)	Ytd (bp)
EUR Bunds 2y	-0.58 %	-1	+2	+3
EUR Bunds 10y	0.00%	-2	+7	-24
EUR Bunds 2s10s	59 bp	-1	+5	-27
USD Treasuries 2y	2.29 %	-9	+3	-19
USD Treasuries 10y	2.53 %	-6	+13	-15
USD Treasuries 2s10s	24 bp	+4	+9	+4
GBP Gilt 10y	1.16 %	-4	+16	-12
JPY JGB 10y	-0.04 %	-1	+4	-4
€ Sovereign Spreads (10y)	**29-Apr-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
France	36 bp	+2	-3	-11
Italy	258 bp	+0	+2	+8
Spain	101 bp	-4	-16	-16
Inflation Break-evens (10y)	**29-Apr-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
EUR OATi	100 bp	-2	+9	+0
USD TIPS	197 bp	+1	+9	+25
GBP Gilt Index-Linked	331 bp	+1	+11	+14
EUR Credit Indices	**29-Apr-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
EUR Corporate Credit OAS	109 bp	-3	-15	-43
EUR Agencies OAS	53 bp	+1	-1	-7
EUR Securitized - Covered OAS	51 bp	+1	-2	-12
EUR Pan-European High Yield OAS	375 bp	+16	-32	-138
EUR/USD CDS Indices 5y	**29-Apr-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
iTraxx IG	58 bp	+0	-8	-31
iTraxx Crossover	248 bp	+1	-23	-106
CDX IG	57 bp	-1	-7	-31
CDX High Yield	325 bp	-3	-25	-125
Emerging Markets	**29-Apr-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
JPM EMBI Global Div. Spread	347 bp	+8	-7	-68
Currencies	**29-Apr-19**	**-1wk (%)**	**-1m (%)**	**Ytd (%)**
EUR/USD	$1.117	-0.8	-0.45	-2.48
GBP/USD	$1.292	-0.47	-0.85	+1.4
USD/JPY	¥111.8	+0.13	-0.84	-1.91
Commodity Futures	**29-Apr-19**	**-1wk ($)**	**-1m ($)**	**Ytd ($)**
Crude Brent	$72.1	-$1.9	$4.5	$17.6
Gold	$1 278.6	$4.2	-$13.8	-$3.0
Equity Market Indices	**29-Apr-19**	**-1wk (%)**	**-1m (%)**	**Ytd (%)**
S&P 500	2 943	1.20	3.83	17.39
EuroStoxx 50	3 502	0.08	4.48	16.68
CAC 40	5 581	0.01	4.31	17.97
Nikkei 225	22 259	0.26	4.97	11.21
Shanghai Composite	3 062	-4.74	-0.91	22.80
VIX - Implied Volatility Index	12.89	3.78	-5.98	-49.29

Source: Bloomberg, Ostrum Asset Management

Writing

AXEL BOTTE
STRATEGIST
axel.botte@ostrum.com

Legal information

www.ostrum.com

Ostrum Asset Management
Asset management company regulated by AMF under n° GP-18000014 – Limited company with a share capital of 27 772 359 euros
Trade register n°525 192 753 Paris – VAT: FR 93 525 192 753 – Registered Office: 43, avenue Pierre Mendès-France, 75013 Paris – www.ostrum.com
Tél. : 01 58 19 09 80

Ostrum ASSET MANAGEMENT

Un affilié de NATIXIS INVESTMENT MANAGERS