GROUPE BPCE

GLOBAL FINANCIAL SERVICES

MIDYEAR OUTLOOK 2022

NATIXIS INVESTMENT MANAGERS | NATIXIS CORPORATE AND INVESTMENT BANKING

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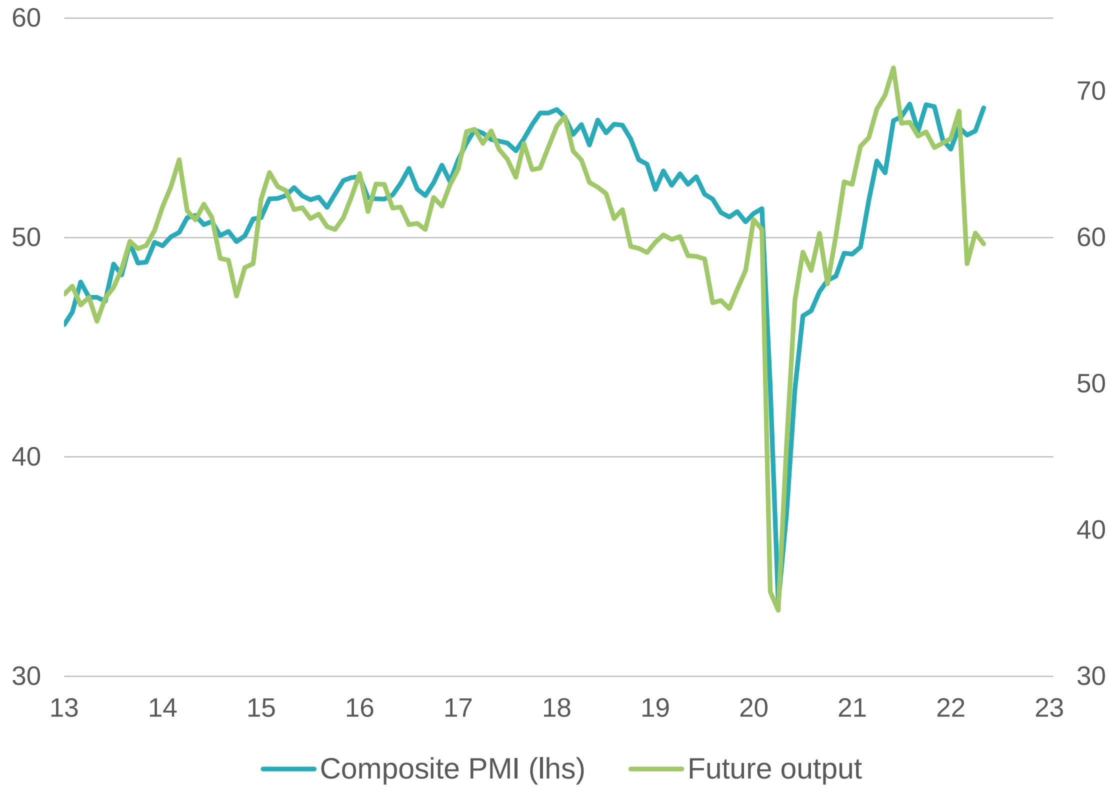
Stagflation in the making

Euro area: a challenging outlook

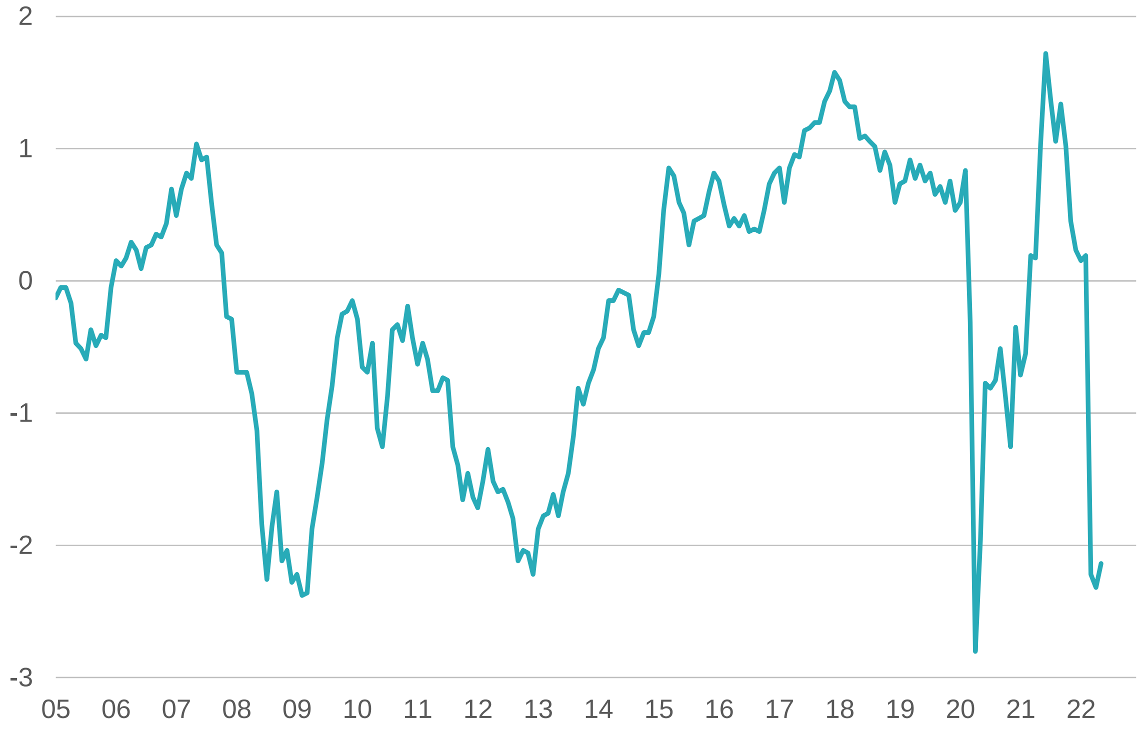
Supply chain problems, uncertainty and high inflation are weighing on the euro area economy. Business sentiment is holding up, but consumers are downbeat.

Euro area composite PMI (index)



Sources: Markit

Euro area consumer confidence (index)



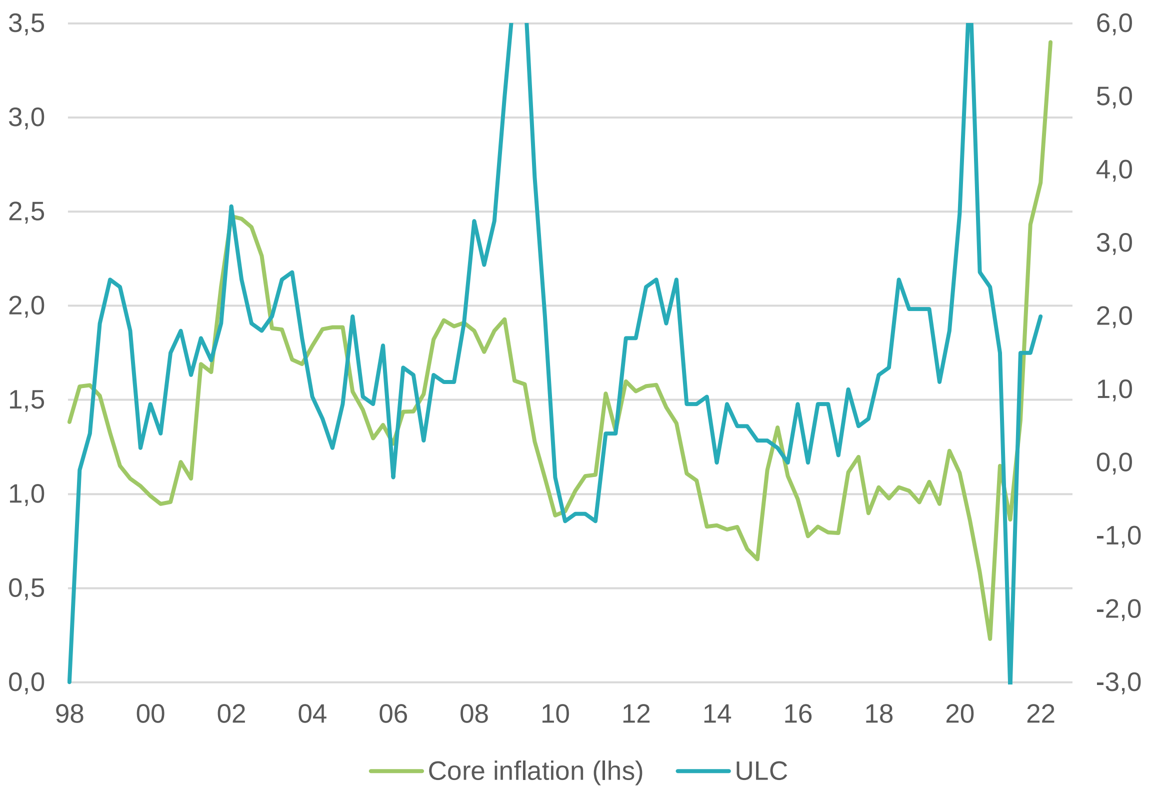
Sources: Datastream, Natixis

Euro area: inflation outlook

Cost shocks are still the main driver of inflation. The crucial question going forward is: how will wages develop?

Core inflation (% yoy); import prices (% yoy)

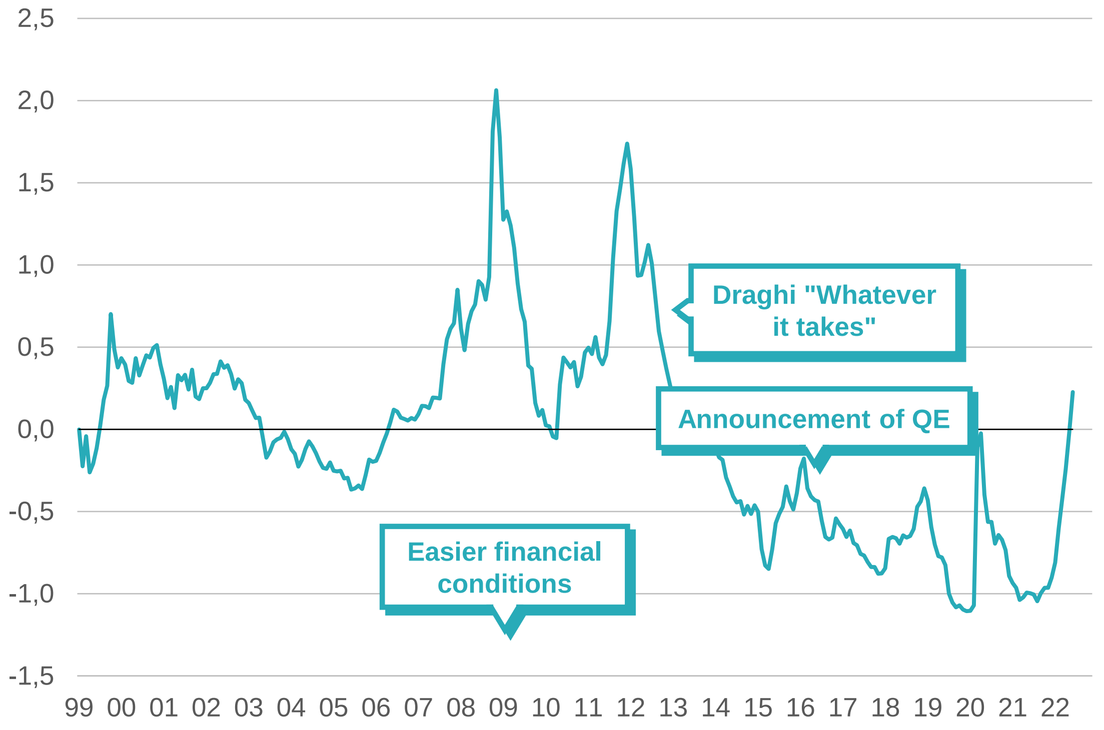
Core inflation (% yoy); Unit Labour Costs (% yoy)



Euro area: fragmentation

Financial conditions have tightened significantly, though in some place more than in others. The ECB will fight "fragmentation" - if need be with another purchase program. While Italy is vulnerable to high rates, fiscal policy has been "responsible".

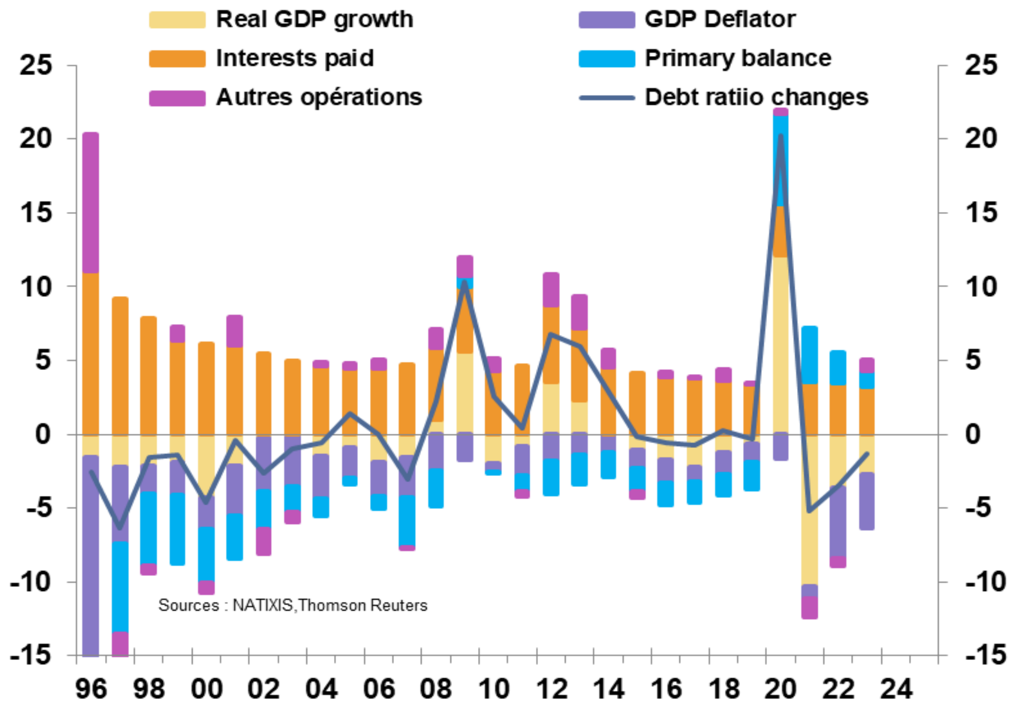
Natixis Financial Conditions Index



Source: Natixis

Sources: Natixis

Italy: evolution of public debt (% yoy)



Sources: Natixis, Thomson Reuters

Risk: Covid

Although China's dynamic zero Covid is still in place, inter-city mobility is improving but still lagging especially for Shanghai and Beijing. In other words, China's recovery in mobility after the Wuhan shock in February 2020 was much faster than in this occasion

Mobility Heatmap of China, by province (versus 2019 avg.)

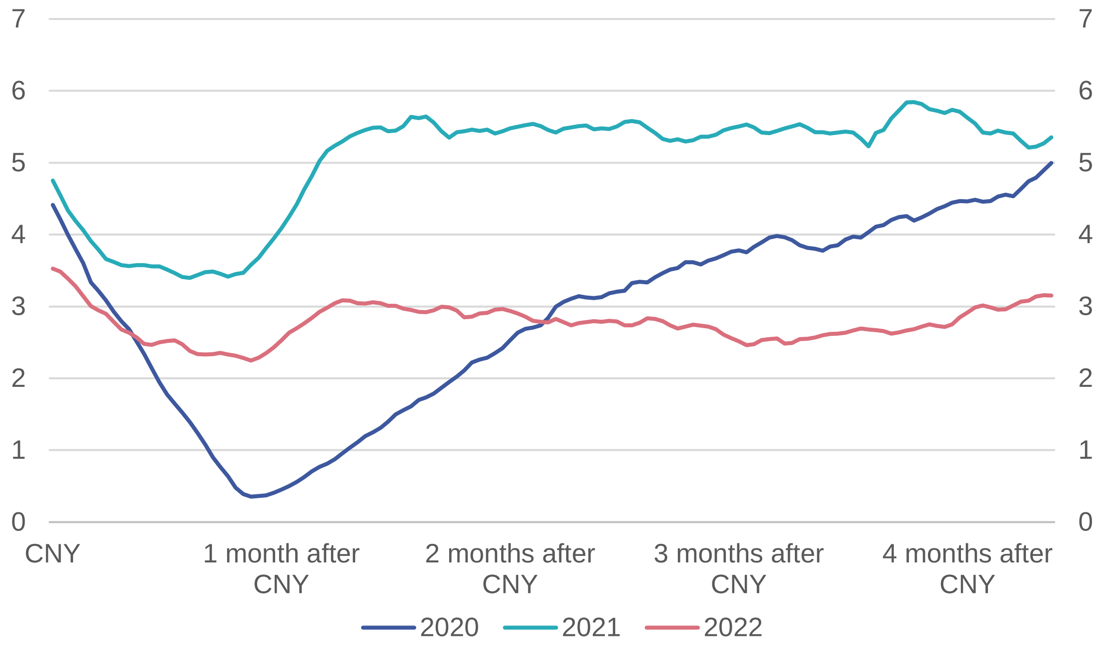
	2020											2021												2022					
	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6
Total	-66	-10	26	24	13	19	28	30	54	25	22	12	12	38	57	60	26	39	15	44	59	29	24	21	36	-11	-25	-3	26
Shanghai	-80	-31	17	13	10	17	22	30	32	16	16	6	-25	27	49	44	35	30	3	36	41	24	15	24	-19	-48	-90	-83	-71
Heilongjiang	-67	-29	-8	-48	-5	21	35	36	60	7	4	-35	-40	19	36	47	31	64	16	21	-14	-29	-46	-18	19	-60	-76	-49	6
Jiangsu	-68	-9	35	27	11	16	23	29	56	24	20	13	4	35	55	60	35	29	-14	38	60	22	23	35	26	-30	-71	-40	12
Beijing	-80	-63	-36	-11	-34	-25	4	19	29	10	4	-56	-57	-4	32	33	19	20	-25	14	11	-30	-20	-35	-51	-65	-67	-82	-68
Liaoning	-52	-6	31	13	25	39	27	53	83	34	13	-39	-6	36	56	59	39	65	26	63	63	16	23	18	25	-29	-55	-8	27
Jilin	-62	-13	11	-21	-1	30	47	48	81	36	17	-18	-30	37	55	67	40	73	29	45	25	16	1	16	34	-40	-64	-25	21
Tianjin	-73	-24	19	28	10	23	33	38	47	12	10	-22	-32	28	47	53	37	43	19	39	45	24	17	-32	-28	-41	-38	-31	-34
Hebei	-71	-23	21	30	5	16	34	39	57	24	19	-39	-33	31	50	62	41	44	13	43	49	10	16	-11	-3	-34	-50	-35	-24
Anhui	-53	3	25	27	5	8	20	19	64	13	14	18	68	38	49	57	29	30	9	43	75	25	23	54	136	-4	-53	-11	37
Shandong	-68	-3	37	37	24	31	44	41	59	28	21	10	9	41	58	77	48	57	25	54	73	34	31	28	43	-12	-35	3	32
Henan	-61	2	34	27	11	19	33	31	63	22	17	20	57	45	56	69	38	44	-33	33	70	4	21	-18	69	2	-39	-30	9
Shanxi	-62	-9	54	39	18	22	41	46	71	29	22	-28	-19	46	60	78	39	51	19	47	78	22	29	14	7	-22	-53	-12	6
Jiangxi	-26	26	32	22	11	15	24	19	66	16	16	23	97	46	54	54	27	38	28	38	74	10	24	54	183	-9	-43	-19	32
Xinjiang	-80	-34	0	-7	-9	-19	-62	10	29	18	9	21	-19	4	12	19	14	61	10	17	8	23	26	74	-6	-25	-33	-26	-20
Hunan	-48	-3	22	17	11	10	26	23	65	15	13	20	72	26	43	49	26	34	-8	39	63	23	22	51	125	-3	-11	22	46
Fujian	-60	0	34	31	21	25	30	27	62	34	34	33	39	53	70	76	50	61	34	-7	25	50	50	59	71	2	-7	46	49
Ningxia	-69	-24	39	28	10	31	61	48	97	5	-7	-21	-26	7	26	56	19	66	11	36	59	-38	-14	-12	3	-34	-31	-3	22
Gansu	-72	21	37	13	8	15	40	27	70	-4	-11	-14	-20	26	25	36	14	78	8	20	43	-32	-11	-8	20	-26	-24	-8	6
Hainan	-52	-15	8	9	-11	5	19	5	36	28	47	34	60	68	83	71	10	37	1	18	41	33	57	84	150	27	-8	31	38
Inner Mongolia	-61	-22	24	12	-11	-6	17	18	44	1	-8	-30	-39	1	16	35	4	25	5	22	41	-8	-3	-5	-36	-40	-17	-2	-9
Guizhou	-37	21	43	26	8	9	32	11	48	5	2	6	61	26	32	44	14	37	15	23	35	-11	4	35	111	-9	-14	4	13
Zhejiang	-75	-4	38	32	23	27	36	36	62	36	30	24	0	47	69	70	49	48	36	59	73	41	12	26	20	14	-16	9	39
Guangxi	-1	39	42	21	2	7	24	17	78	18	17	20	117	49	78	49	9	35	22	32	72	17	17	43	194	4	-5	8	16
Chongqing	-2	37	23	6	-8	1	20	4	43	-2	-8	6	94	35	29	41	11	36	2	20	48	-10	6	41	214	-7	-5	-2	2
Yunnan	-51	24	44	16	-1	2	31	30	30	12	19	52	18	33	37	30	5	19	12	21	33	-1	3	53	34	1	7	4	2
Hubei	-88	-55	-9	-1	-3	-4	17	14	50	8	11	18	53	24	41	54	24	34	-10	32	61	15	19	52	83	-5	-6	11	32
Sichuan	-49	1	29	17	4	5	21	15	67	11	-4	18	78	21	42	53	24	25	7	36	72	-10	19	65	93	2	7	13	32
Guangdong	-66	-10	21	19	18	23	28	29	45	29	29	22	11	42	60	54	-1	38	34	51	56	46	35	18	22	2	18	34	54
Shaanxi	-77	-7	31	32	23	30	44	46	69	46	34	20	32	72	82	91	63	70	43	58	64	46	-3	-64	54	17	35	64	71
Provinces with Mobility Lower than 2019	29	19	3	5	9	4	1	0	0	2	5	10	12	1	0	0	1	0	5	1	1	9	6	9	6	20	25	17	6

N.B. Data as of June 13, 2022. Data show average daily highway traffic into and out of prefectures as index based on 2019 average / Source: Natixis, AutoNavi, CEIC

Risk: Real estate

Chinese government has eased macroprudential measures in containing the real estate sector, the property market is still under pressure as the number of housing transactions remains low

House Transaction Volume after Chinese New Year (thousand, 30-day rolling avg.)



Source: Natixis, WIND

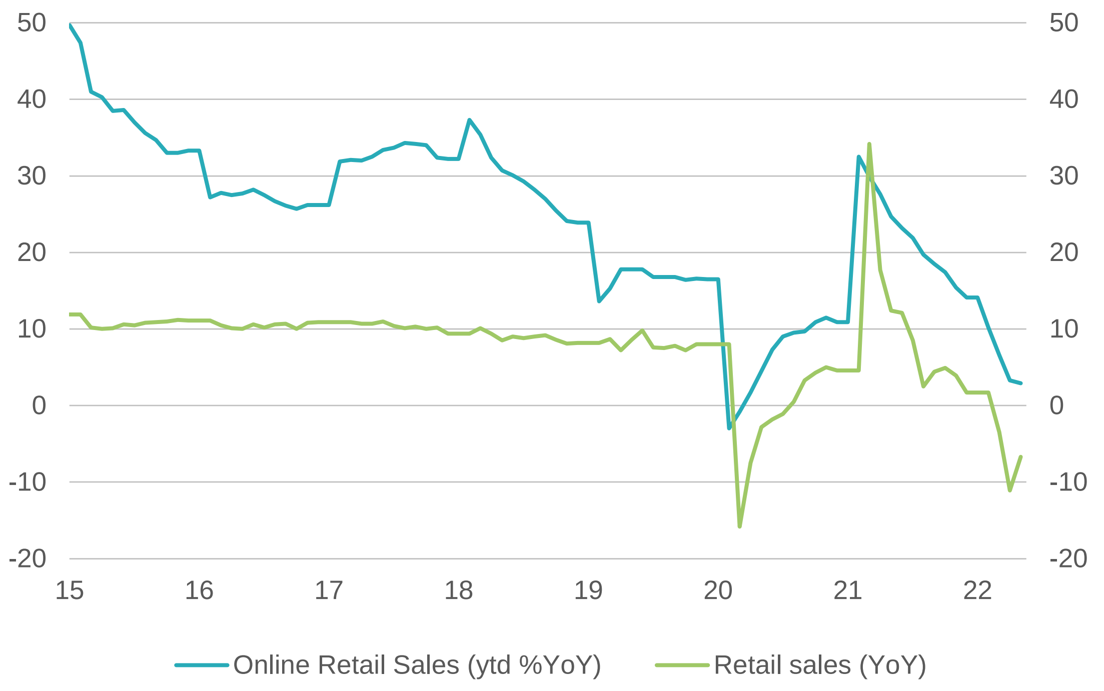
China Property Price (primary market, % YoY)

N.B. Data as of May 2022. / Source: Natixis, WIND

5.5% growth target does not seem achievable

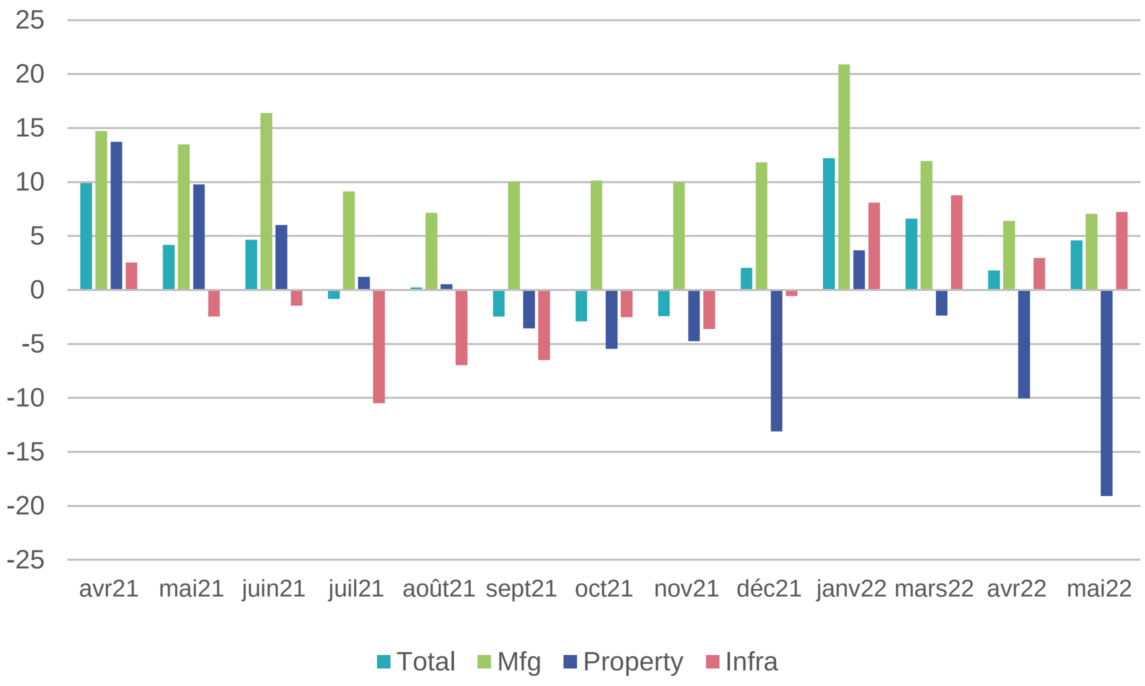
An obvious consequence of the "zero-Covid" strategy is its negative impact on household consumption, which has recovered only slightly with recent easing of lockdowns. Instead, fixed asset investment remains downbeat especially for real estate

Retail Sales and Online Retail Sales



Source: Natixis, NBS

China's Investment Breakdown (%YoY)

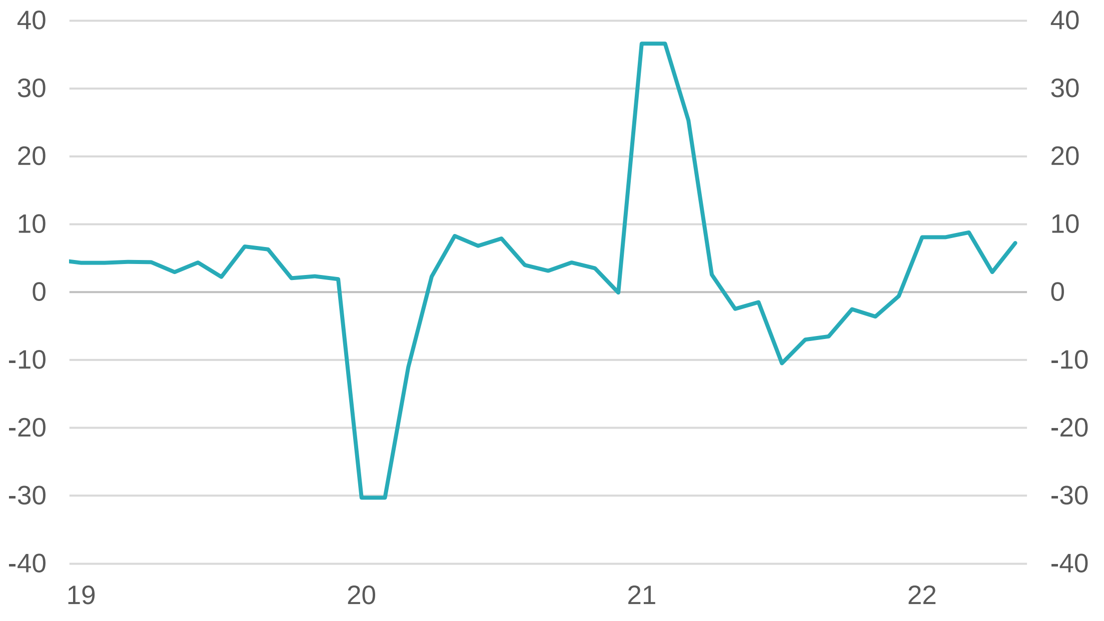


Source: Natixis, CEIC

5.5% growth target does not seem achievable

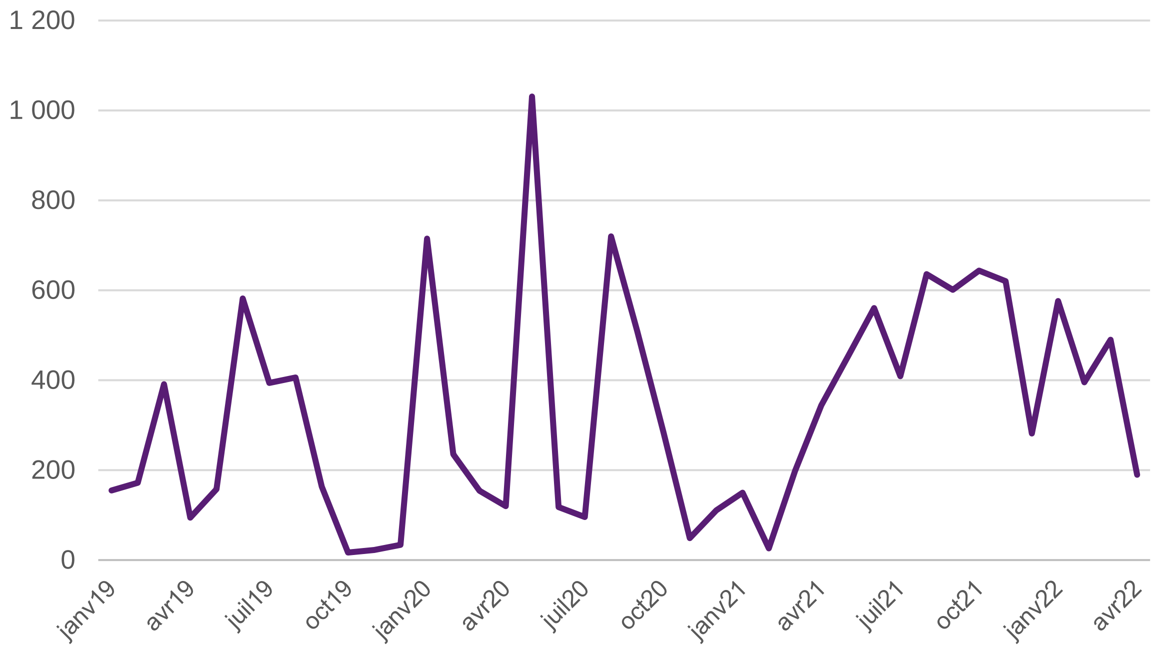
Against the backdrop, China has announced huge infrastructure projects to be financed by local governments' issuance of special purpose bonds but impact not yet very visible

Infrastructure Investment Growth (% YoY)



N.B. Data as of May 2022. / Source: Natixis, CEIC

Local Government Special Bond Issuance (RMB bn)

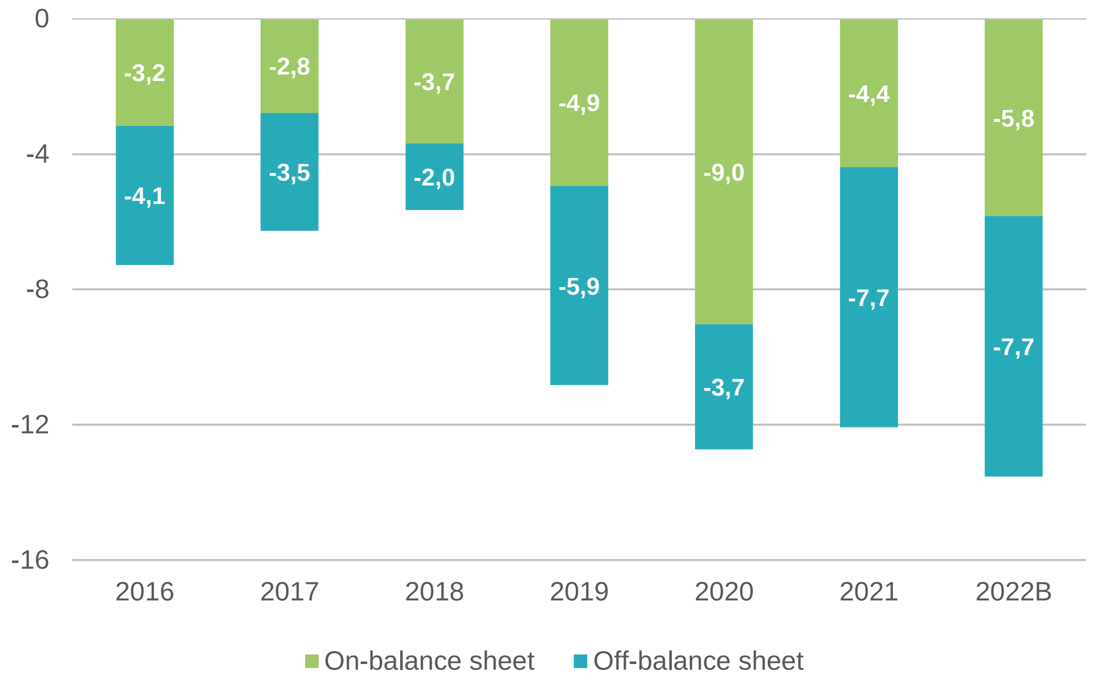


Source: Natixis, WIND

5.5% growth target does not seem achievable

China’s fiscal condition is thus expected to further deteriorate given the massive costs of zero-Covid policies both in terms of health-related expenditure but also fall in fiscal revenue, including land sales

Breakdown of China's augmented fiscal deficit (% of GDP)



N.B. 2022B stands for the budget number compared to the actual number in the years before. We assume the same absolute number for off-balance sheet deficit in 2021 as in 2020. / Source: Natixis

Government Land Sales Revenue (%YoY)

N.B. Data as of Q1 2022. / Source: Natixis, CEIC

Risk: Geopolitics

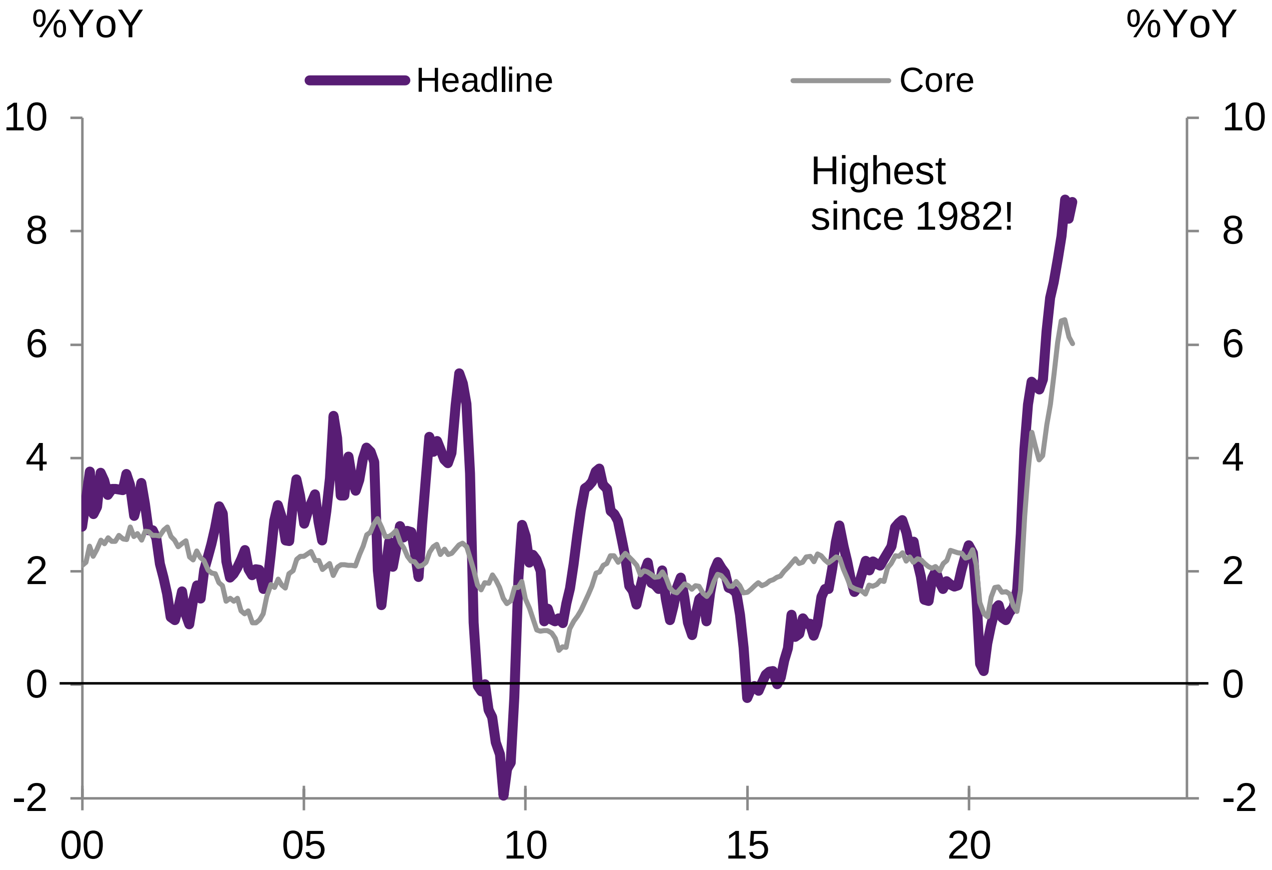
Externally, China's relationship with the US/EU is under further stress following Russia's invasion of Ukraine and China's ambiguous position on the conflict

China's narrative is supportive of Russia but actions are not as China is not supporting Russia financially (or military) to stay away from secondary sanctions

Sources: China Briefing

The Biggest Problem

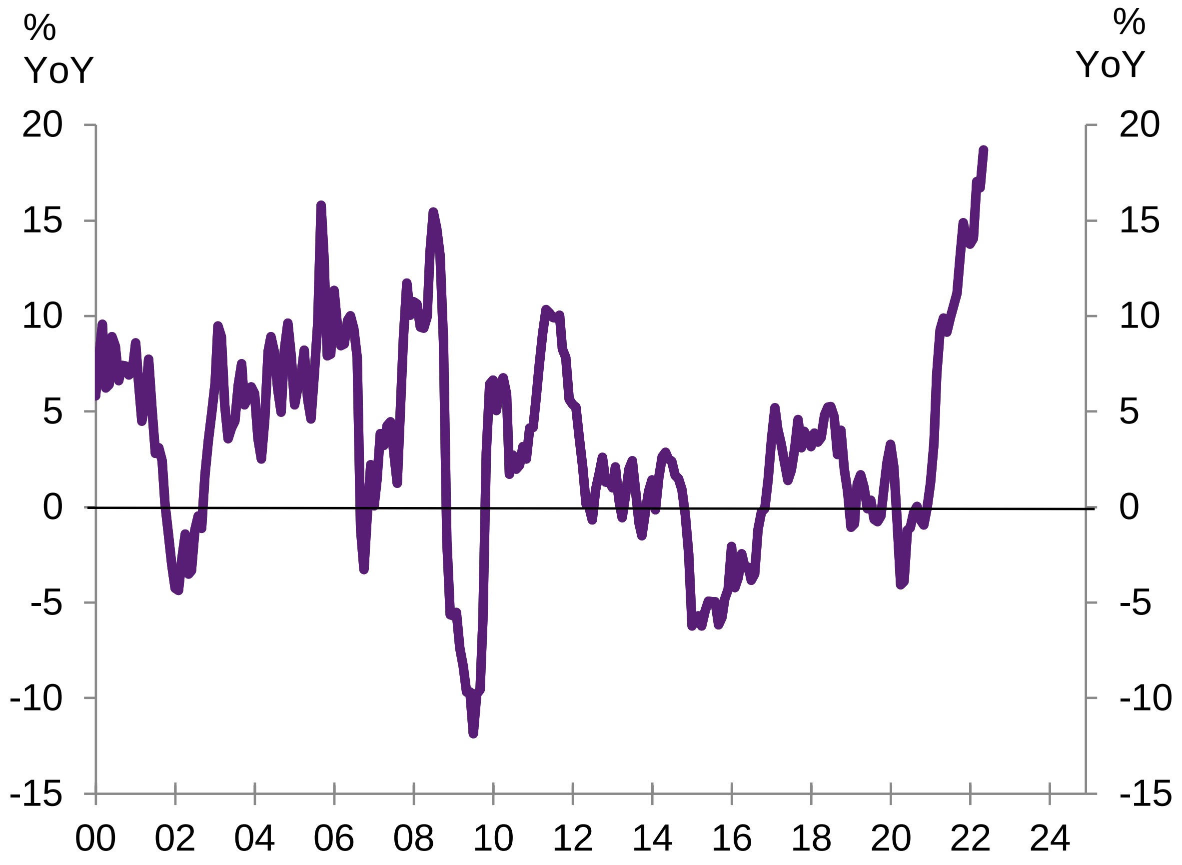
Consumer Price Index



Sources: Natixis, BLS

The rising cost of necessities is gobbling up incomes

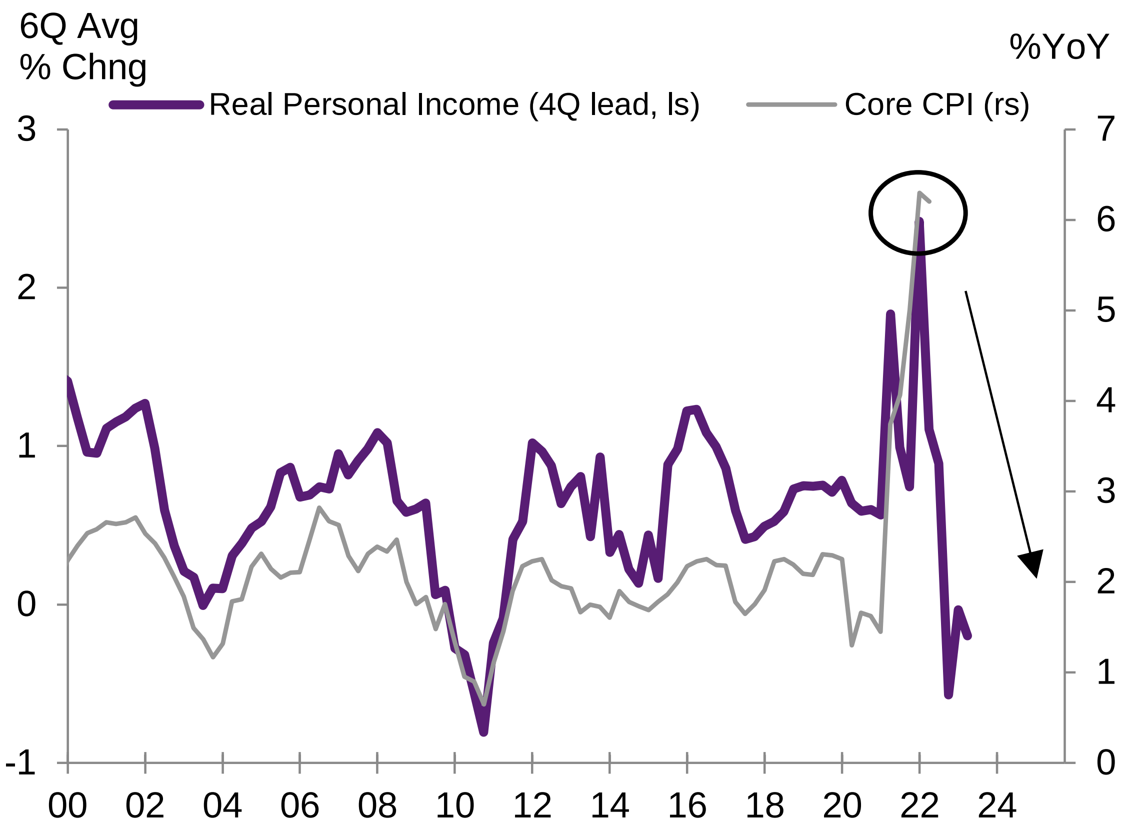
Food and Energy Prices



Sources: Natixis, BLS

The good news: A softening in demand means we're probably past peak inflation

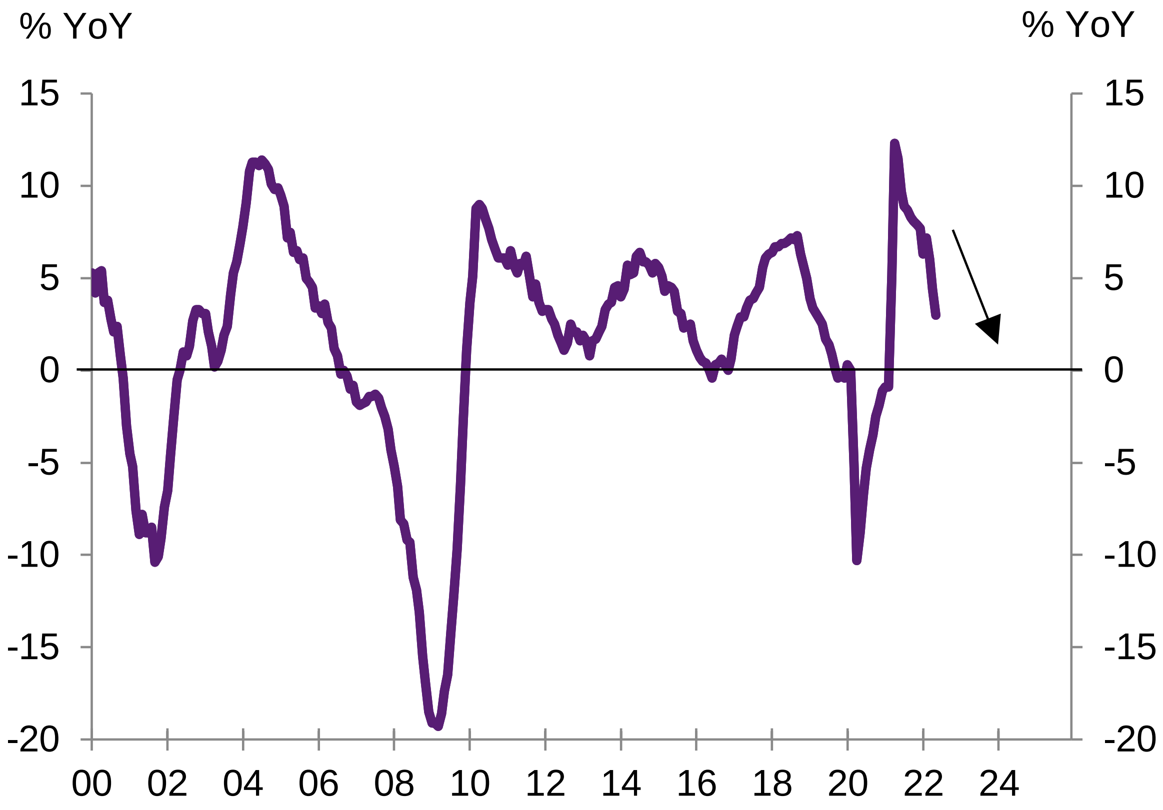
Moderating Incomes Lead the Way



Sources: Natixis, BEA, BLS

Forward looking indicators are turning south

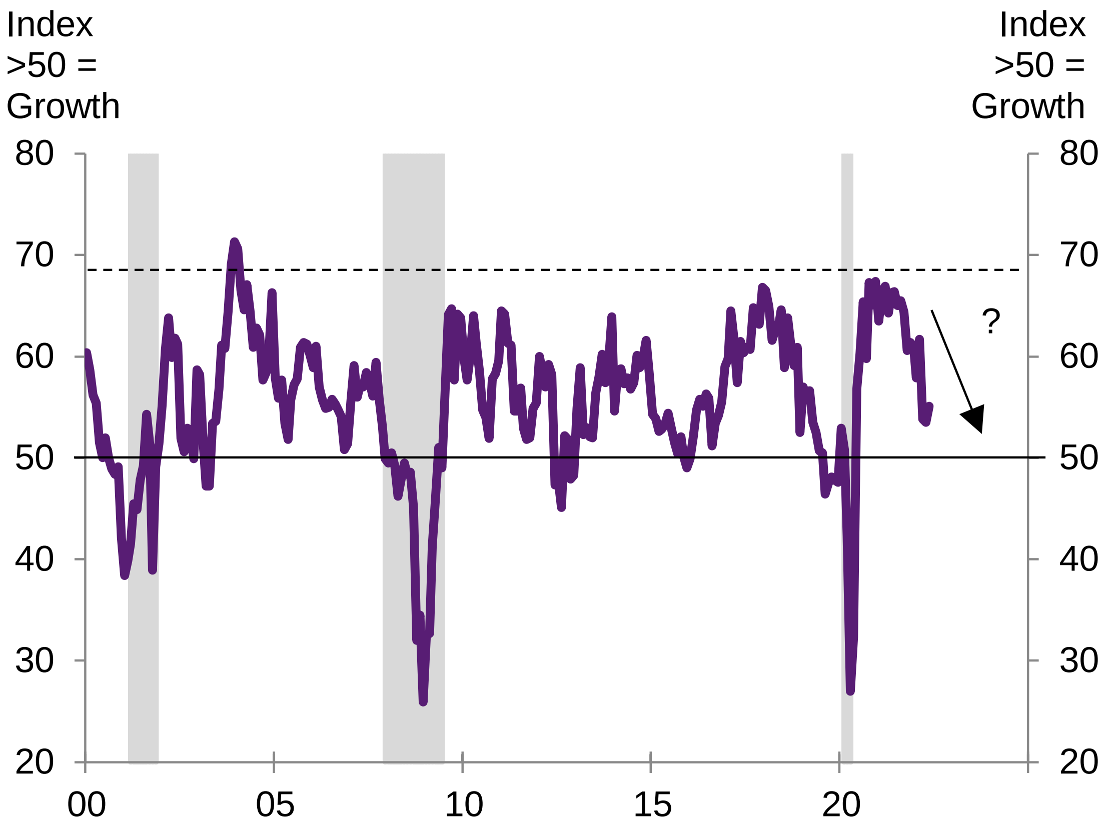
Index of Leading Economic Indicators



Sources: Natixis, Conference Board

Manufacturing new orders are weakening sharply, signaling a pullback in capital spending

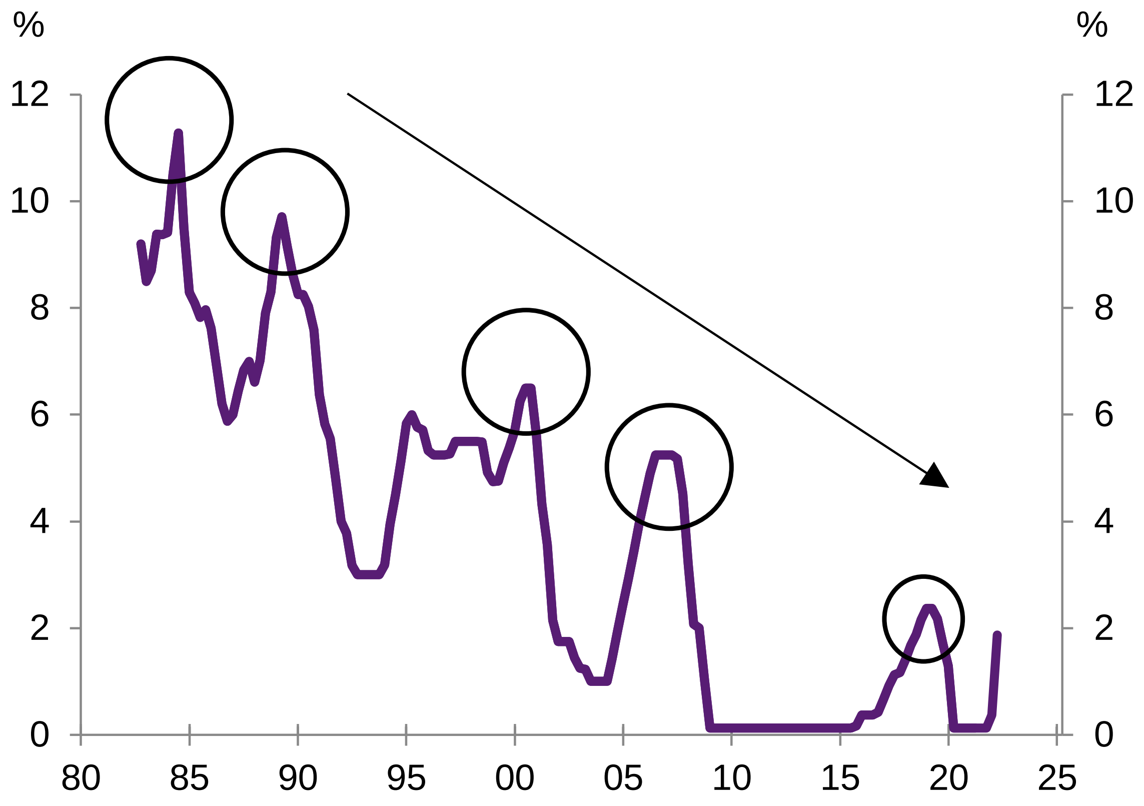
ISM Manufacturing New Orders



Sources: Natixis, ISM, NBER

Will the fed funds rate really rise as far as policymakers are telling us?

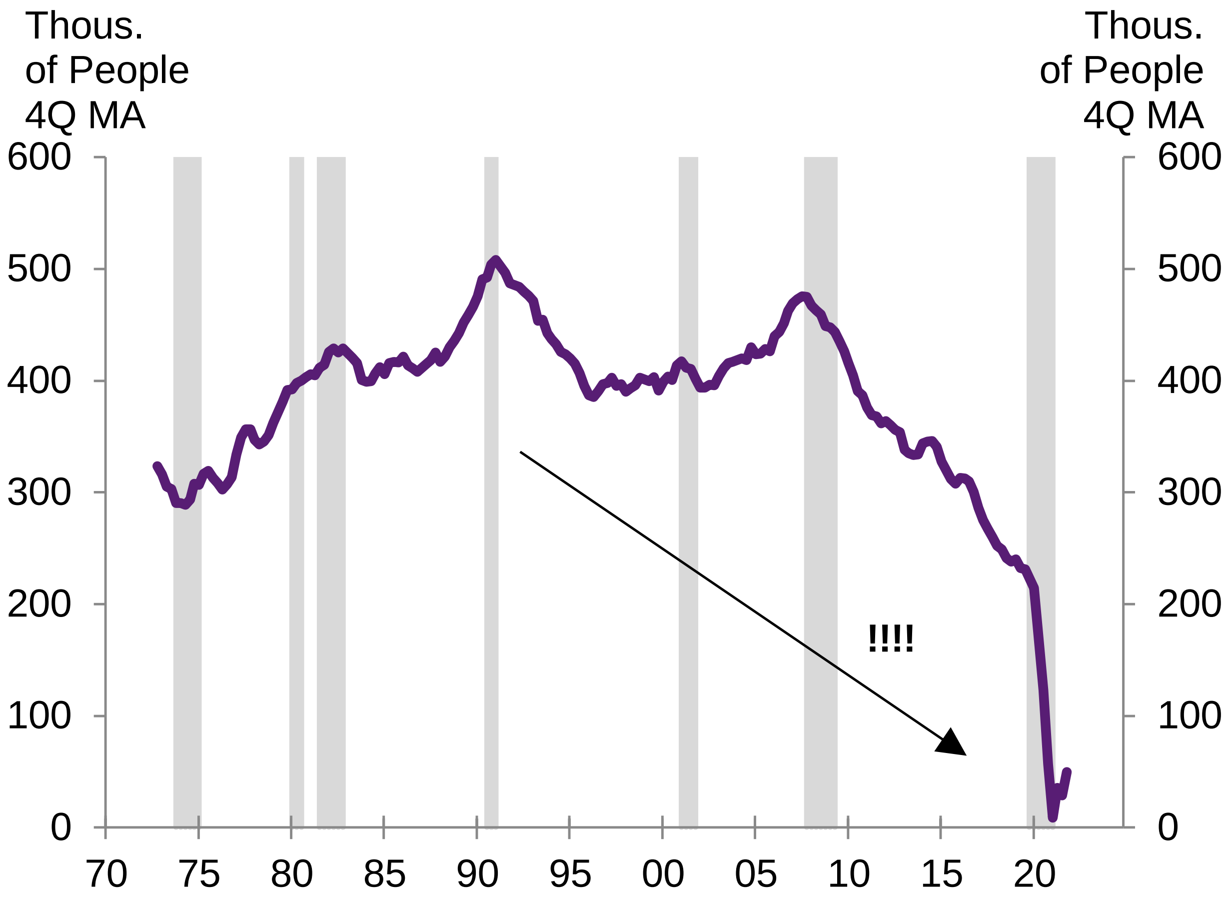
Successively Lower Federal Funds Rate



Sources: Natixis, Federal Reserve

Demographics point to a low and falling neutral funds rate

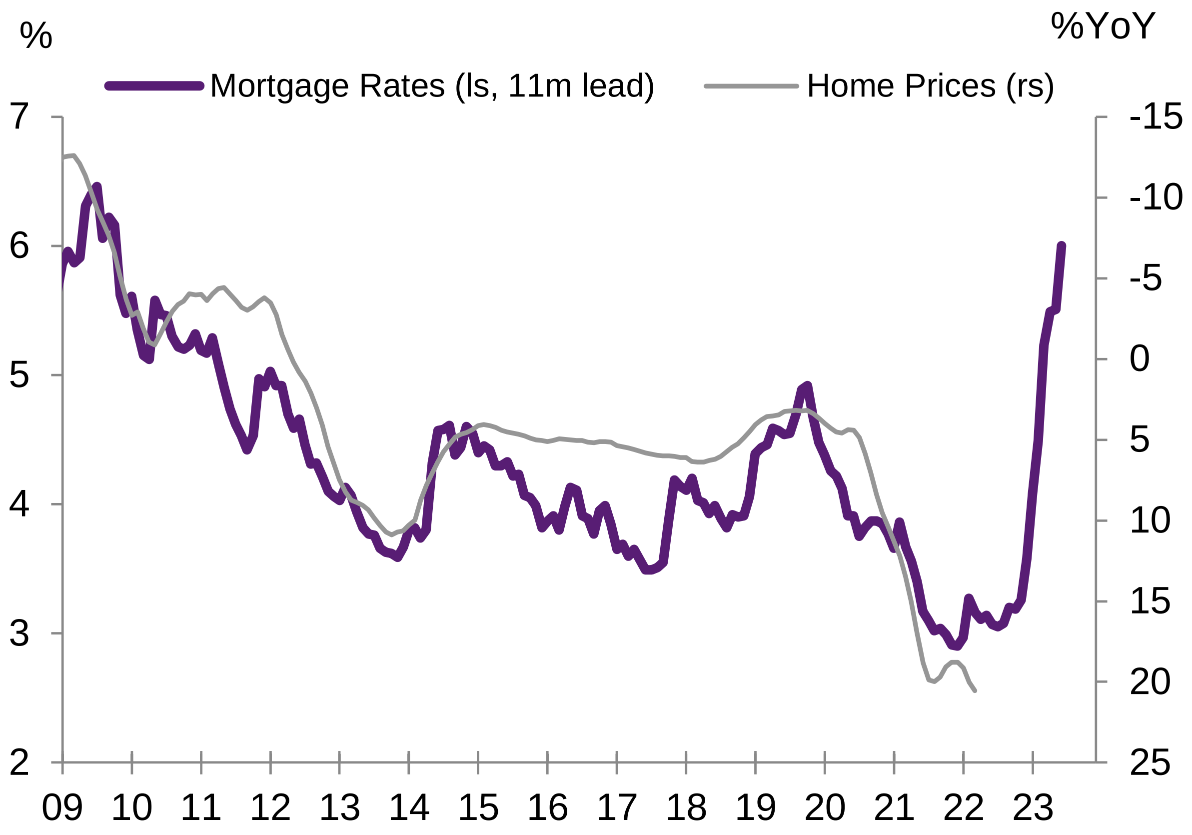
US Net Births/Deaths



Sources: Natixis, National Vital Statistics Report, NBER

The surge in mortgage rates points to a deterioration in home prices

Ominous Sign for Home Prices

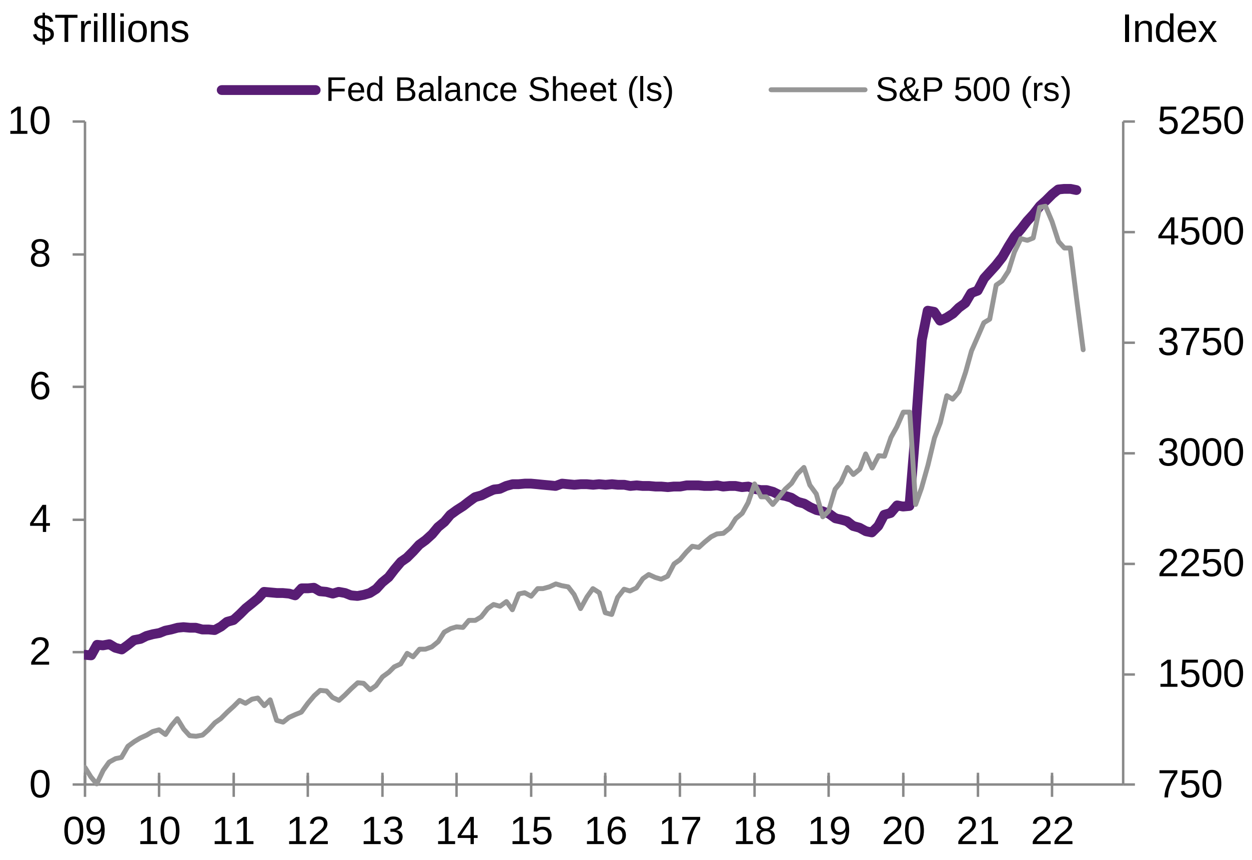


Sources: Natixis, WSJ, S&P

GLOBAL FINANCIAL SERVICES

The Fed plans to shrink its balance sheet and raise rates aggressively

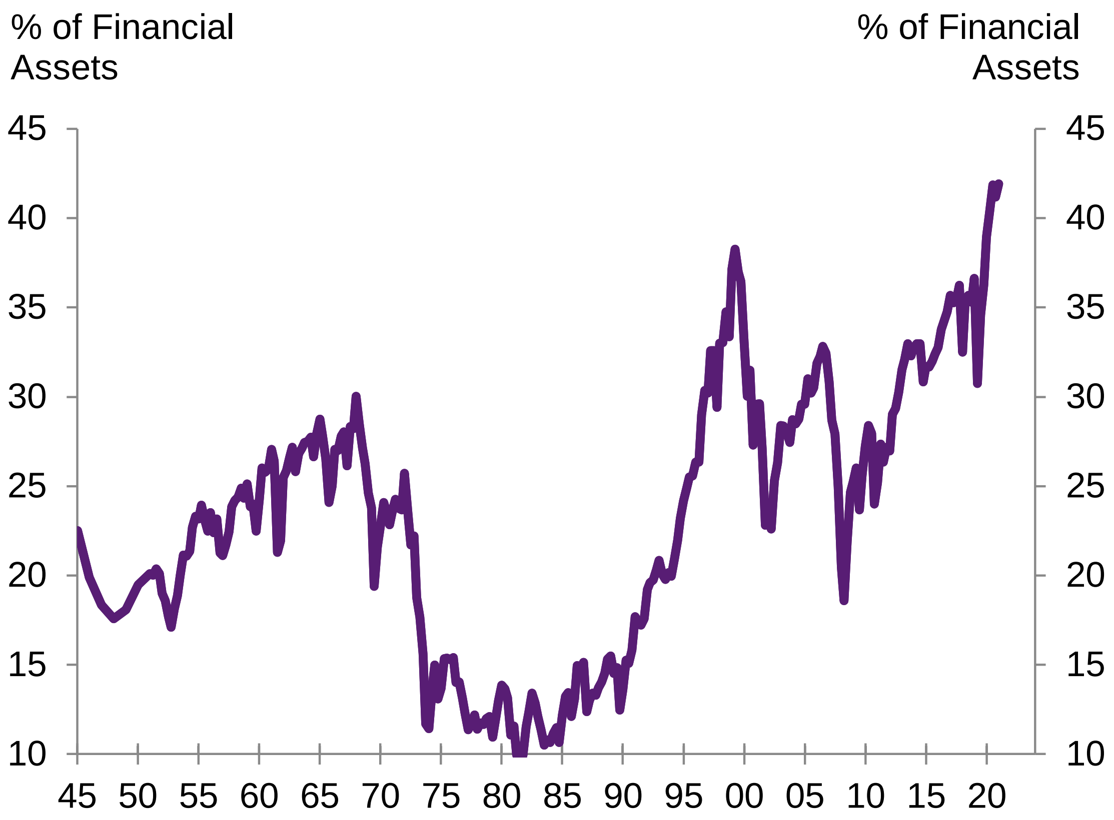
Follow the Fed



Sources: Natixis, Federal Reserve Board, S&P

Major headwinds considering households' equity exposure

Households' Equity Exposure

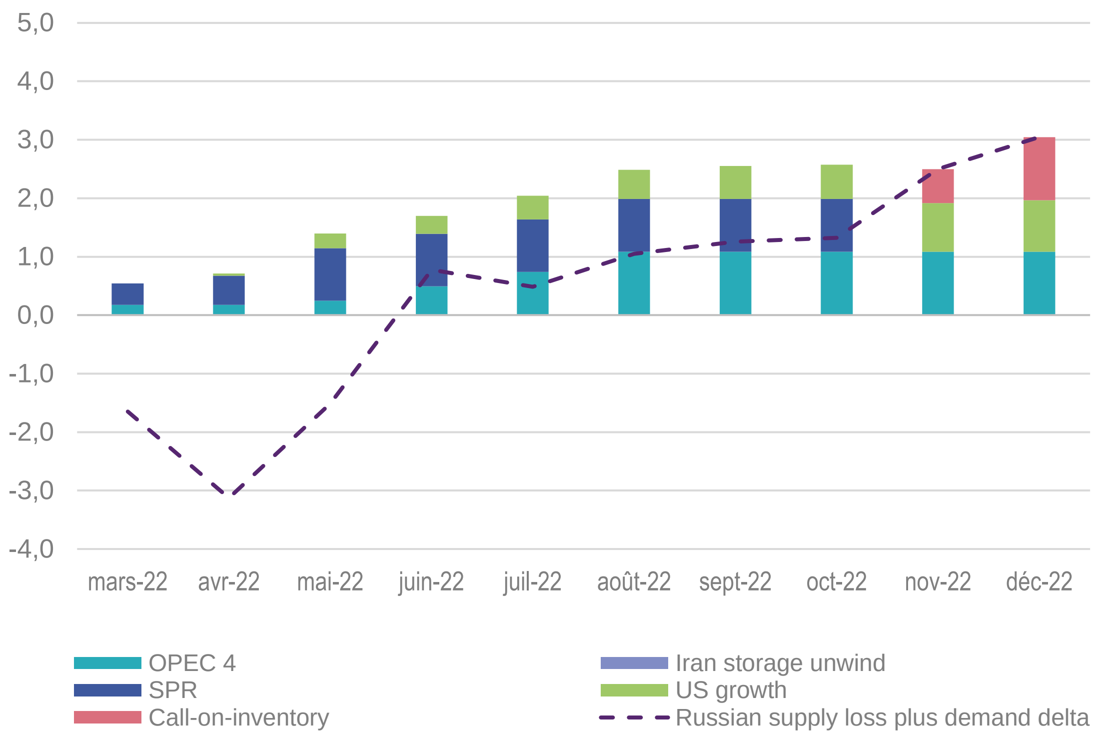


Sources: Natixis, Federal Reserve

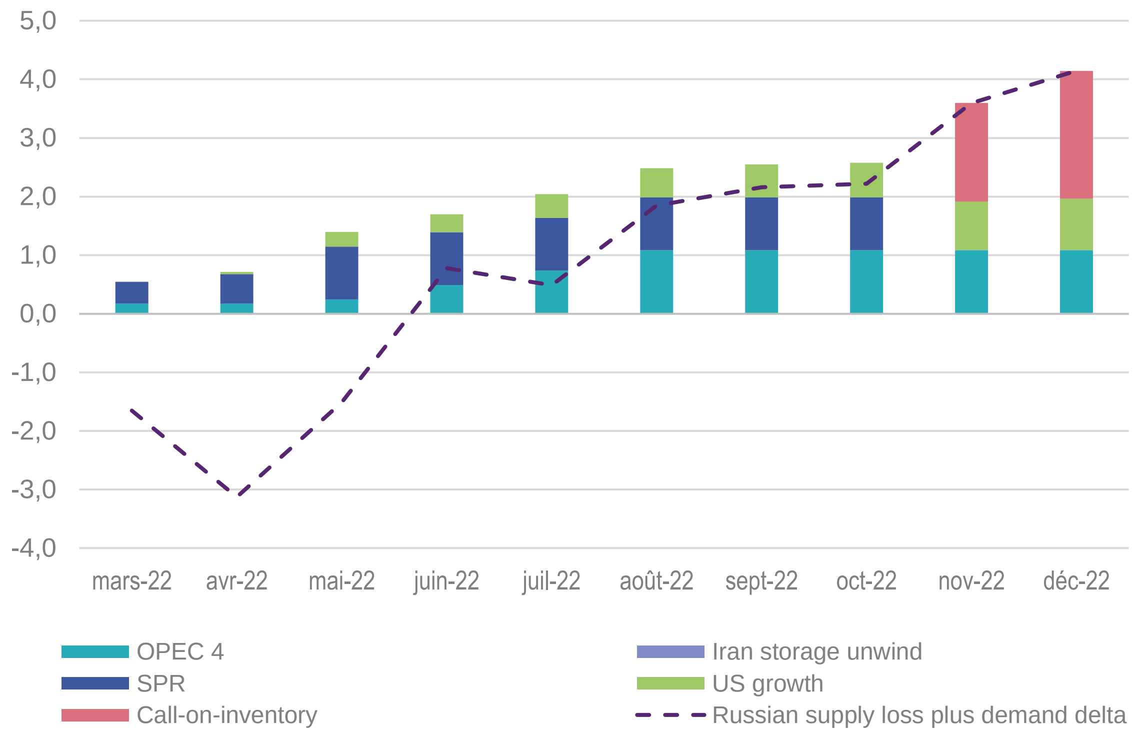
Energy prices : lost in translation

In the absence of structural replacement barrels, oil demand destruction required into Q4-22 at higher Russian oil supply loss assumptions

Temporal supply balance – 1mn b/d Russian supply loss



Temporal supply balance – 2mn b/d Russian supply loss

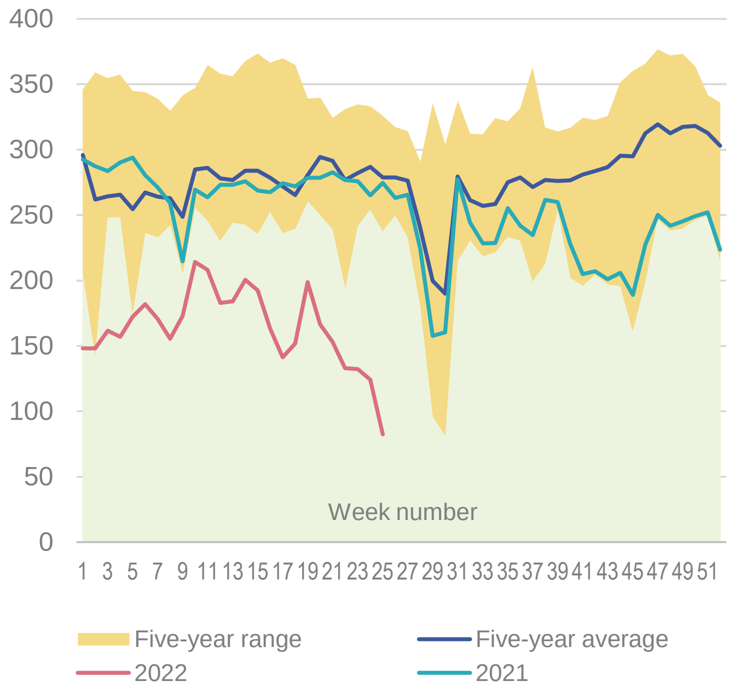


*high case assumes an additional 1mn b/d of lost Russian exports to Europe do not clear to Asia

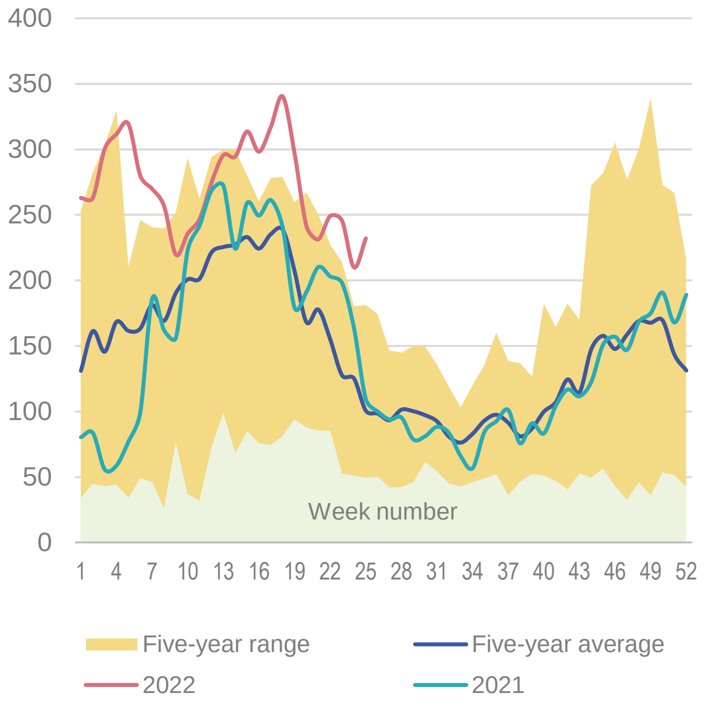
Sources: Natixis, IEA, OPEC, EIA

Drop in Russian flows has been offset by higher LNG imports, although Russian exports must continue to flow through the winter to avoid stock-outs

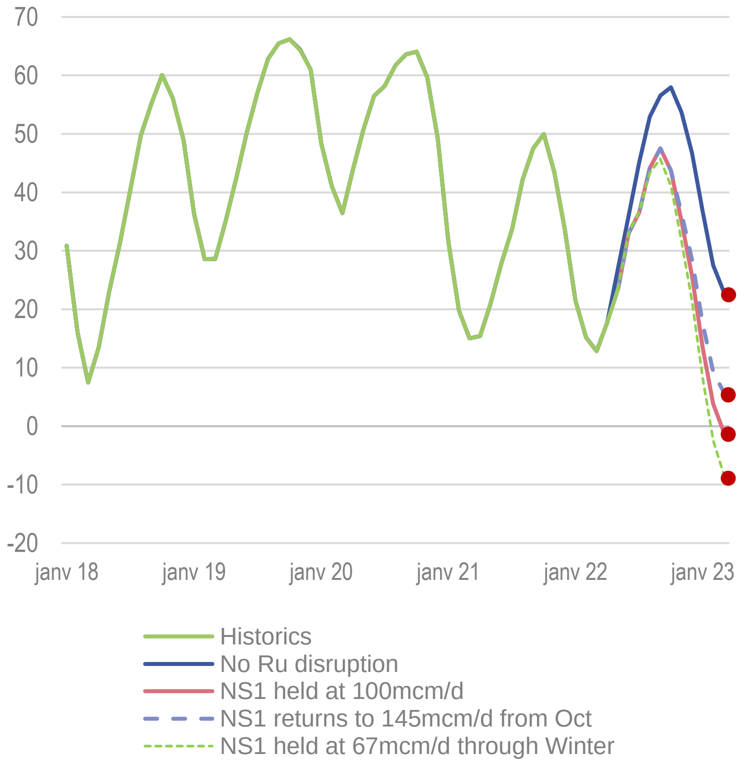
Russian gas flow to NW Europe, mcm/d



NW Europe LNG imports, mcm/d



NW Europe gas inventory scenarios, bcm



Sources: Natixis, Bloomberg

RepowerEU, a bold push to end EU's dependency on Russian gas supplies by 2027

A series of sequenced, demand and supply-oriented energy measures

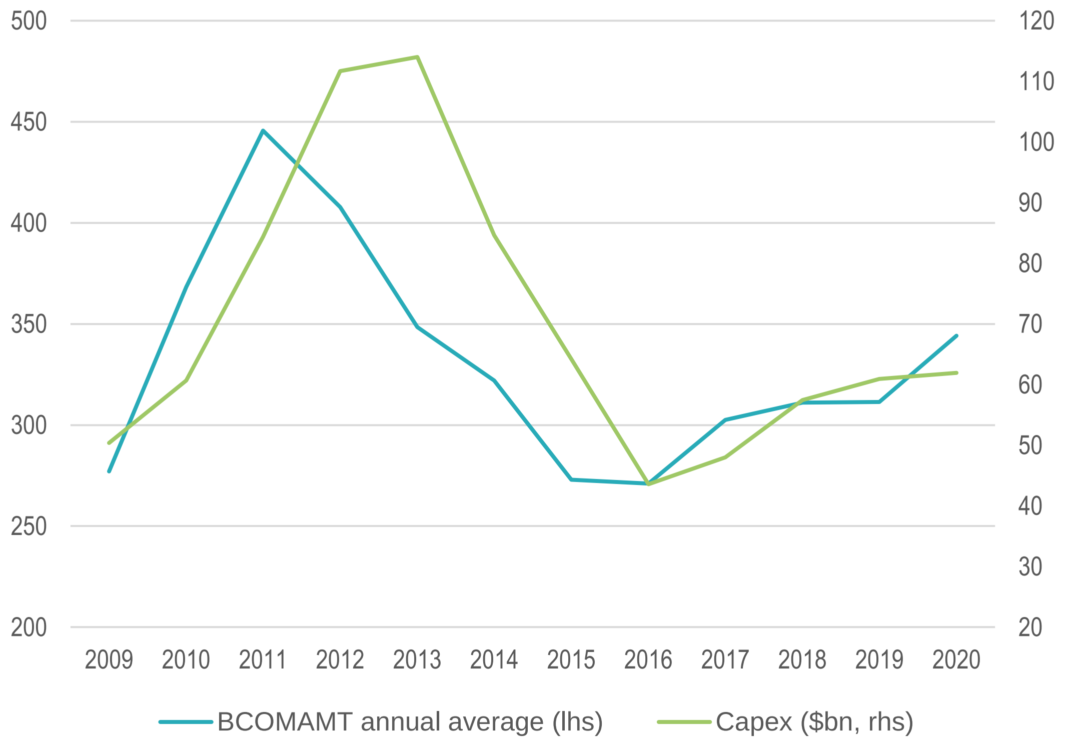
Timing	Measure(s)	Bcm (in 2030)	€bn investments (2022-2030)
FF55 savings by 2030	Total of all FF55 measures	116	NC
ST preparedness	Diversification of gas supplies using existing infra. (LNG terminals & pipelines)	60	
	Delayed phase-out & increased operating hours for coal	24	2
	Abandoned nuclear phase-out	7	0
	Fuel switch in the residential and service sectors	9	
	EU Save: demand measures	10*	**
MT preparedness (until 2027)	New LNG infra. and pipeline corridors	0	10
	Additional investments in the power grid / storage / PV / wind	21*	125
	Biomass in power gen	1	2
	Energy efficiency and heat pumps	37	56
	Sustainable biomethane	17	37
	Reduced use in industry	12	41
LT preparedness (by 2027 & beyond)	Renewable hydrogen (domestic & imported)	27	27
	Total	**310**	**300**

**bcm figures followed by an asterisk are provided for information but not included in the total / **investment cost included in investments for other power technologies & infrastructures*

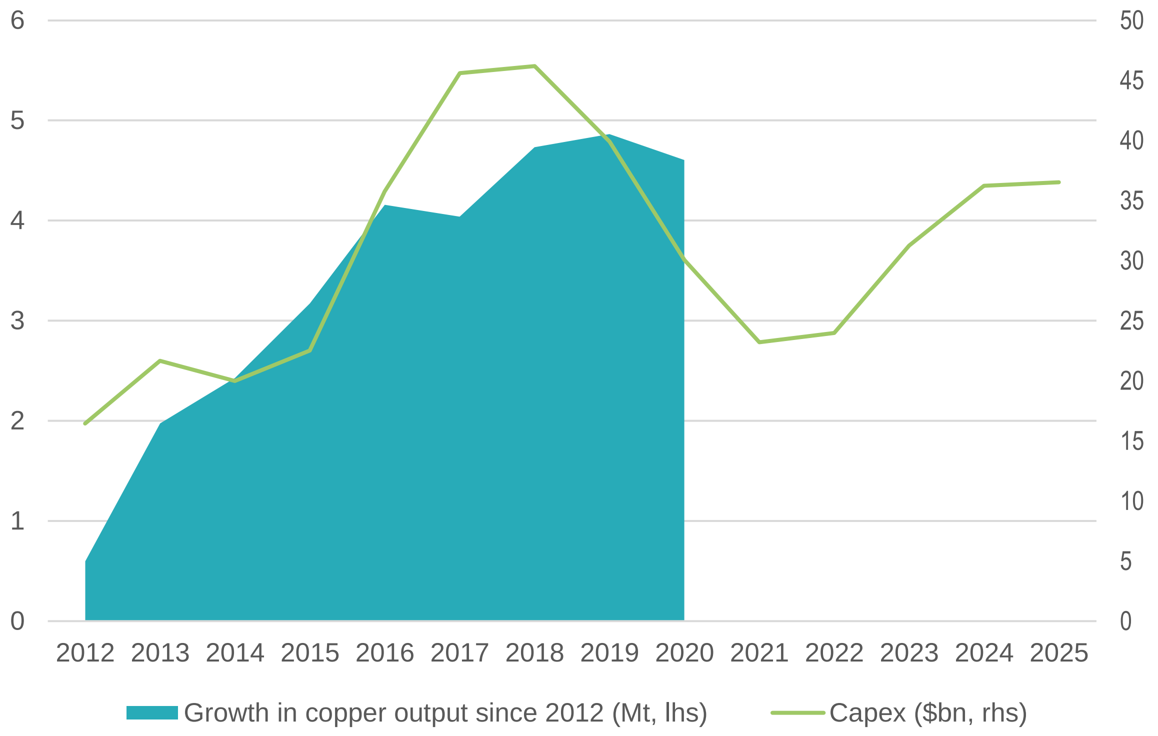
Metals

An underinvestment story

Mining Capex *vs.* Prices (sample of largest 50 miners)



Copper: Capex *vs.* output



Sources: Natixis, Bloomberg.

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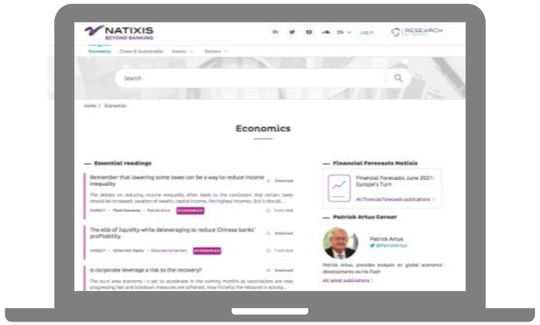
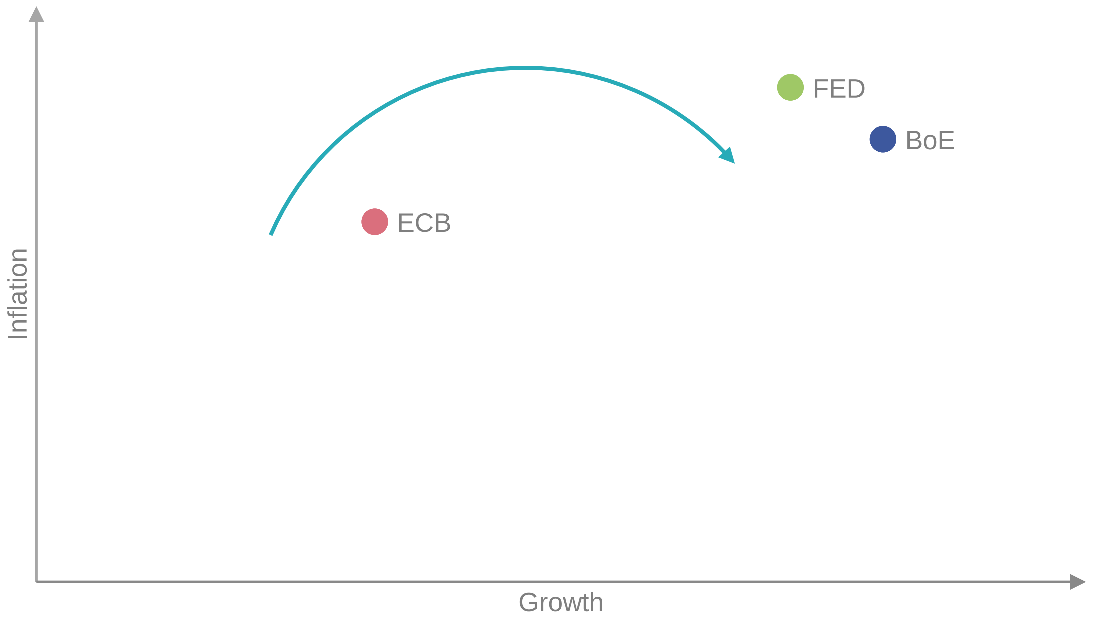


Asset Allocation: the great discount

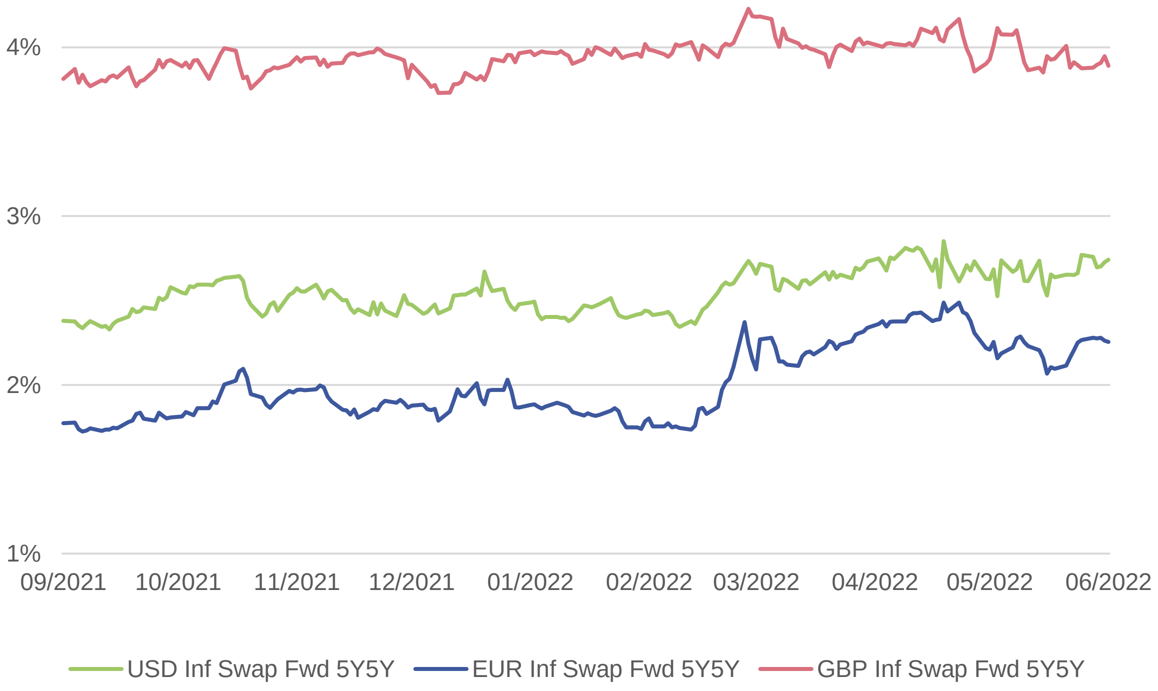
Expected CB path versus Inflation & Growth

Prevalence of each thematic in the CB expected path

Inflation *vs.* Growth



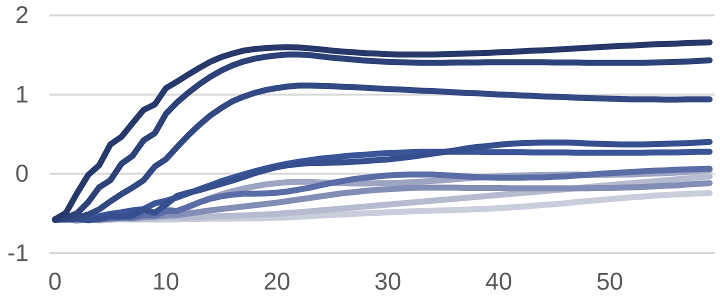
Inflation Fwd Swap 5Y5Y

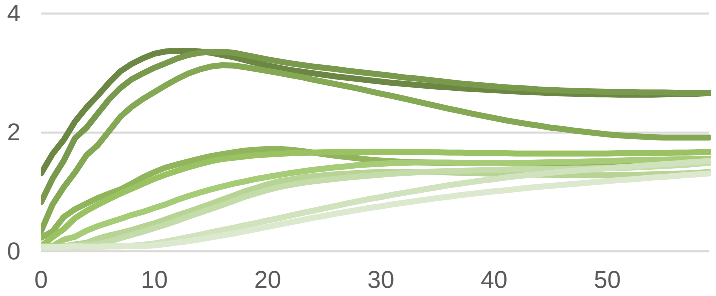


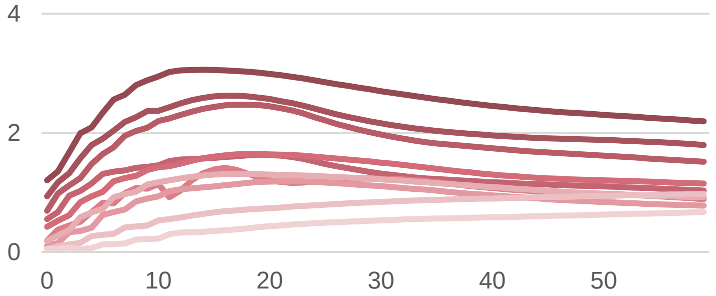
Sources : Bloomberg, Natixis

Money market strips: peak CB expectations?

	OIS markets	NATIXIS CORPORATE AND INVESTMENT BANKING
OIS EUR ESTR	1.25%	0.75%
OIS USD	3.5%	3.25%
OIS GBP	2.75%	2%







Interest rates & Spreads: How high can we go?

Key forecasts for H2 2022

Will I keep my BTP exposure? The key question

2.20%
10Y Bund
Dec. 22

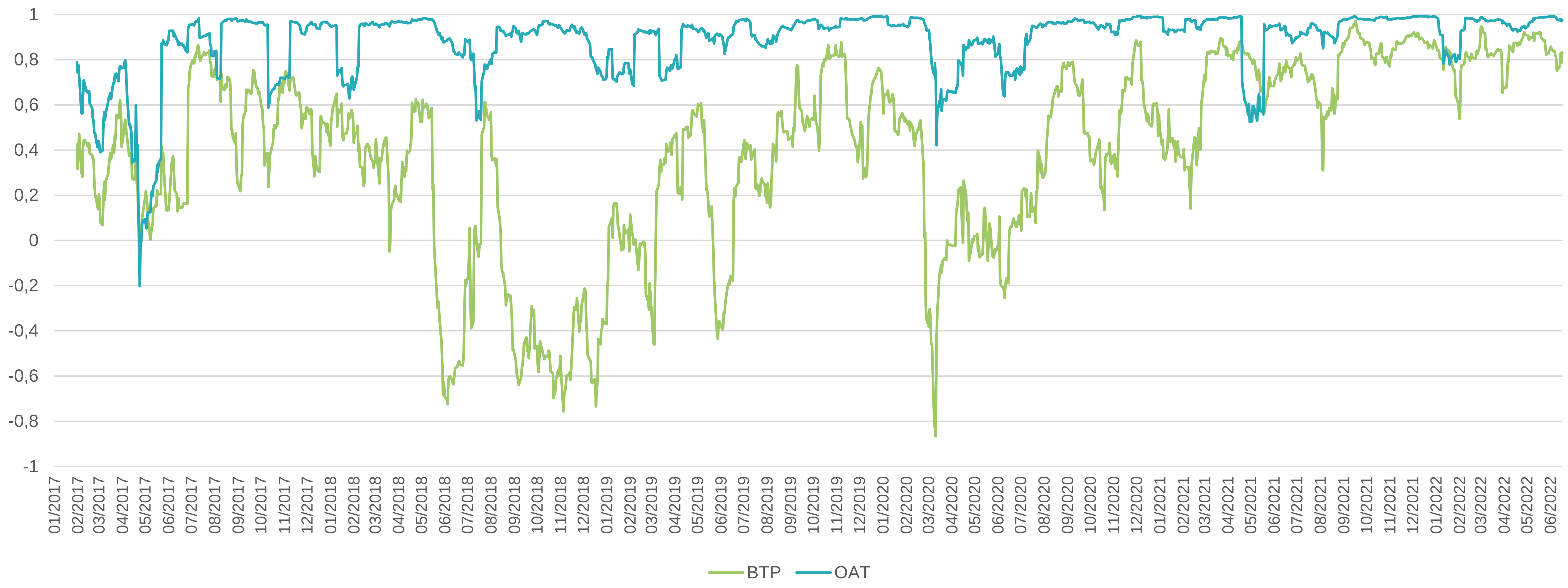
3,5%
10Y UST
Sep. 22

65bp
10Y German swap spread
Dec. 22

250bp
10Y BTP-Bund
Dec. 22

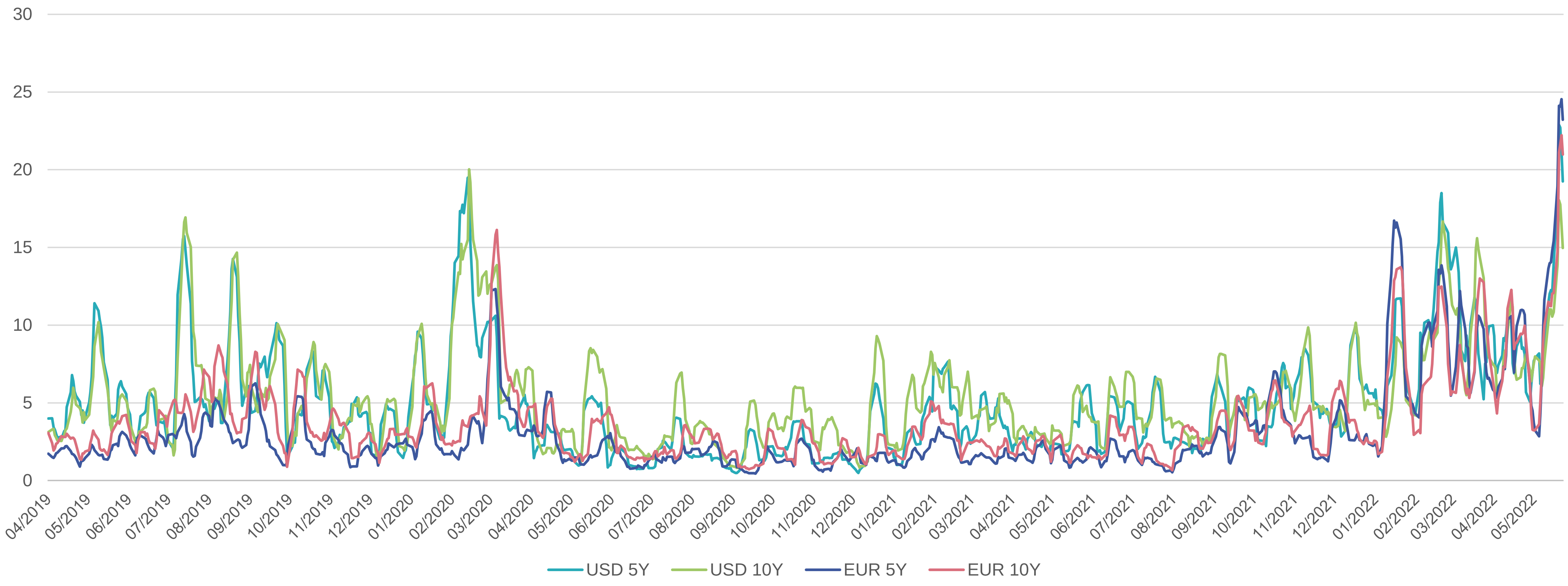
Contagion risk: rather contained, for now

1m rolling correlation of daily change *vs.* Bund



A good time to buy?

2week realized volatility (close/close)



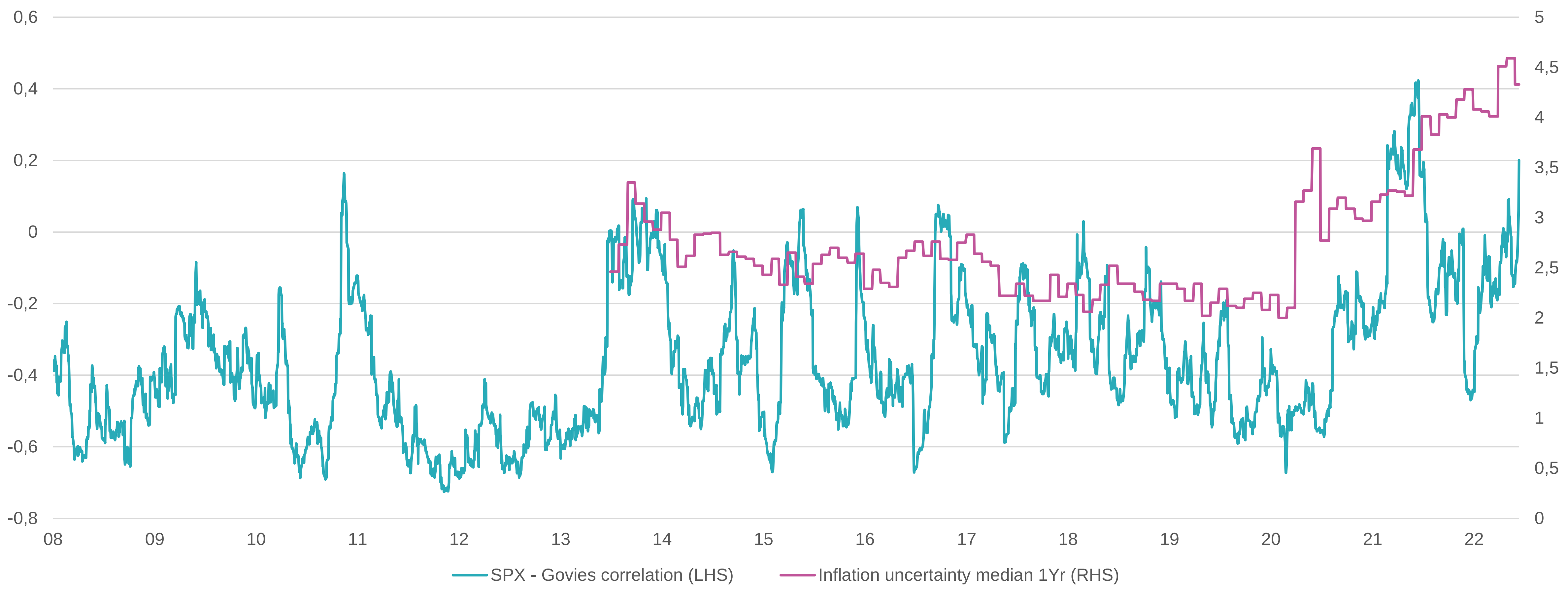
Three key thematics to watch out for in H2

Externally, China's relationship with the US/EU is under further stress following Russia's invasion of Ukraine and China's ambiguous position on the conflict

Terminal rate volatility	Contagion between realized and medium-term inflation expectations	Volatility / Financial Conditions
Shape of the curve	Equity bond correlation, real rates and inflation risk premium	Sustainability of balance sheet reductions, recession / financial crisis risks

Real rate risk

Inflation uncertainty, correlation shocks, nowhere to hide?

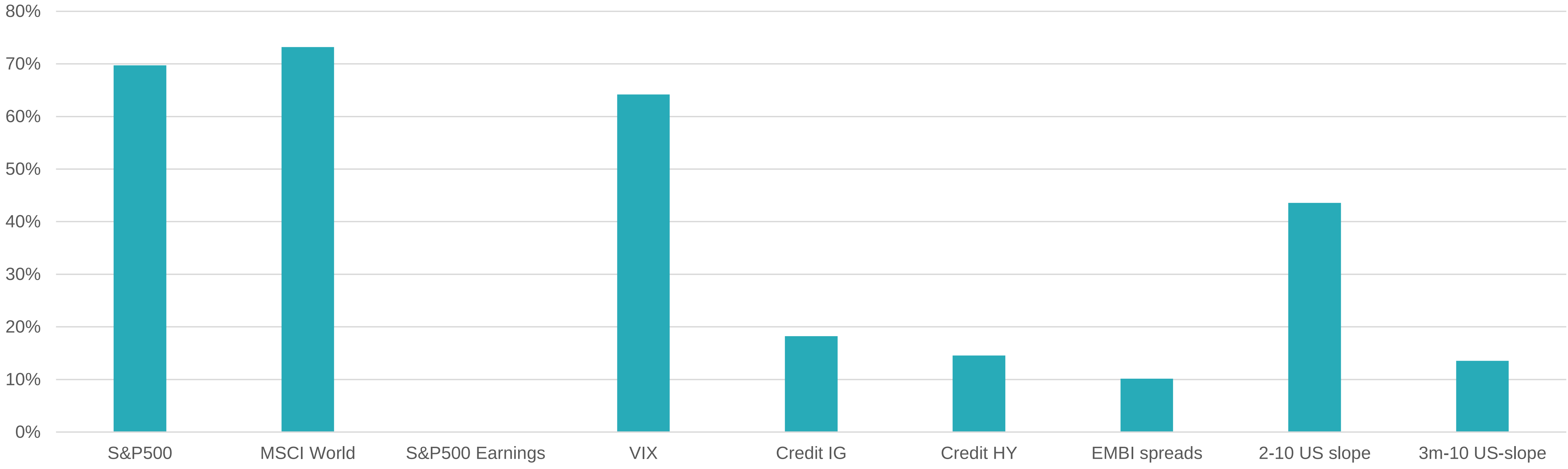


Sources: Natixis, Bloomberg

Recession is not fully priced in

Expect EPS downward revisions and credit spread widening

Implied probability of recession in asset prices

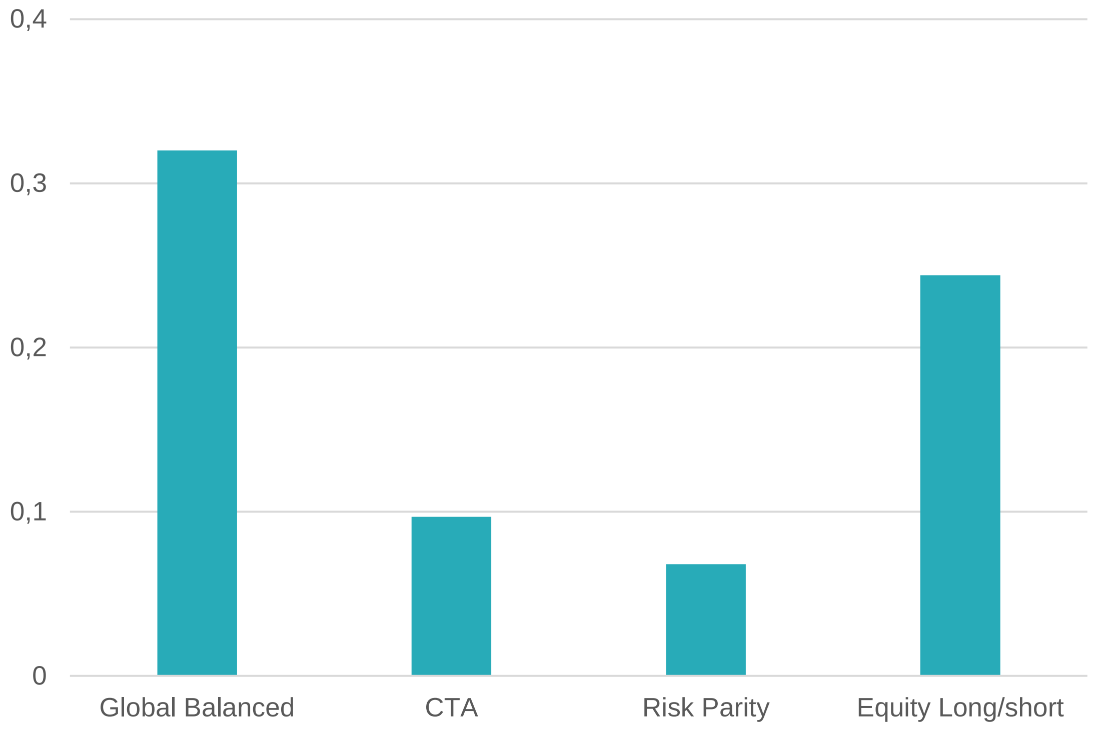


Sources: Natixis, Bloomberg, Refinitiv. Recession probabilities are computed using current either drawdowns or spreads or levels and comparing them with recession and non-recession values.

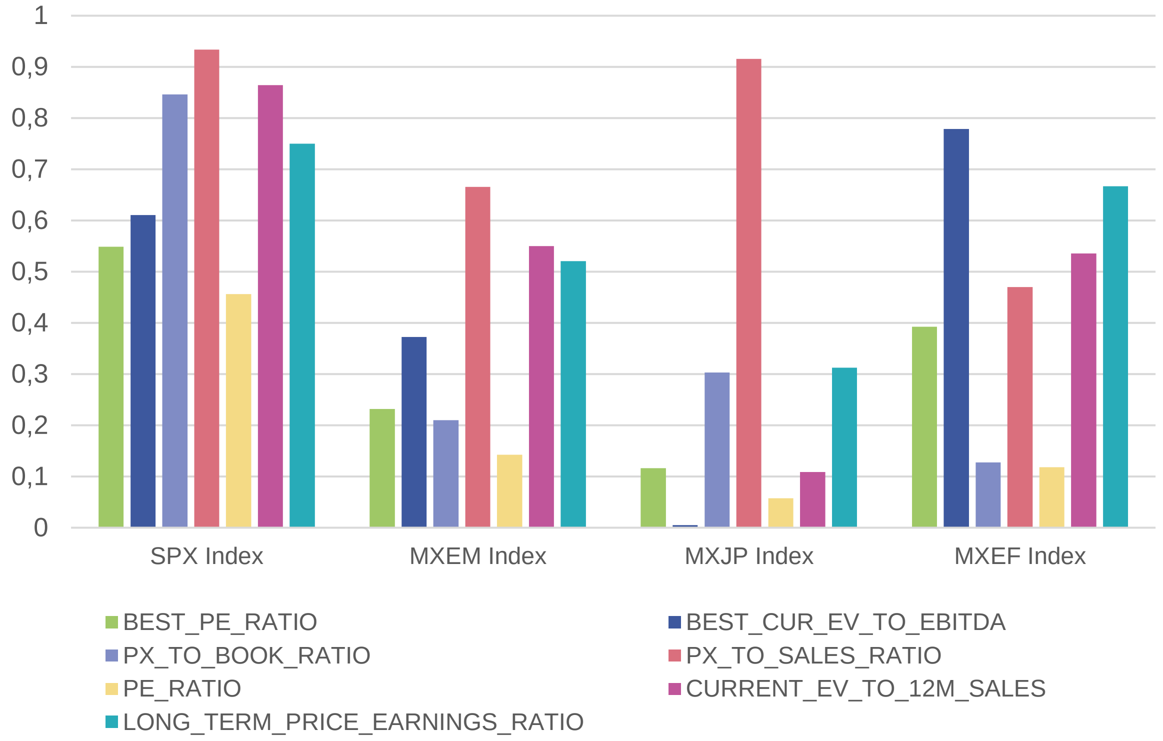
Macro catalyst, Positioning, Valuation

Still some room on the downside

Implicit equity beta rank (since 2015) of money managers



Equity valuation metrics: US equities are cheaper but not cheap



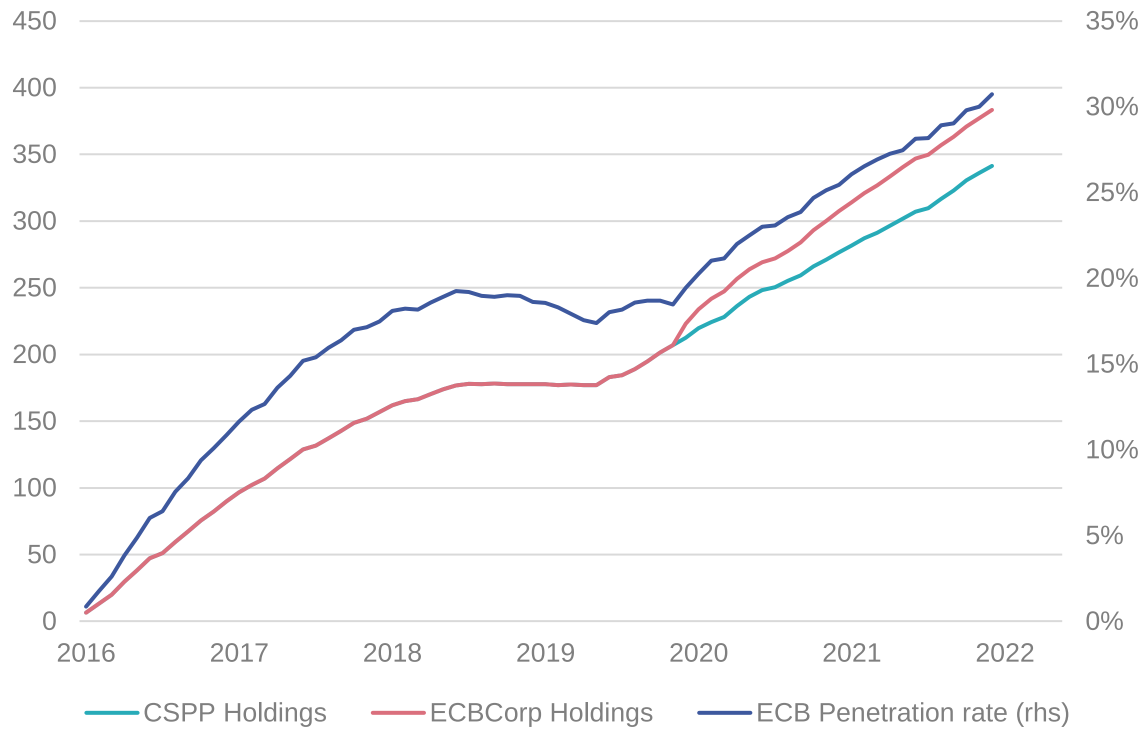
Sources: Natixis, Bloomberg, Refinitiv.

Is it a “perfect storm” for credit?

Flow *vs.* stock effect

Eligible *vs.* non eligible spreads

ECB corporate holdings and penetration rate

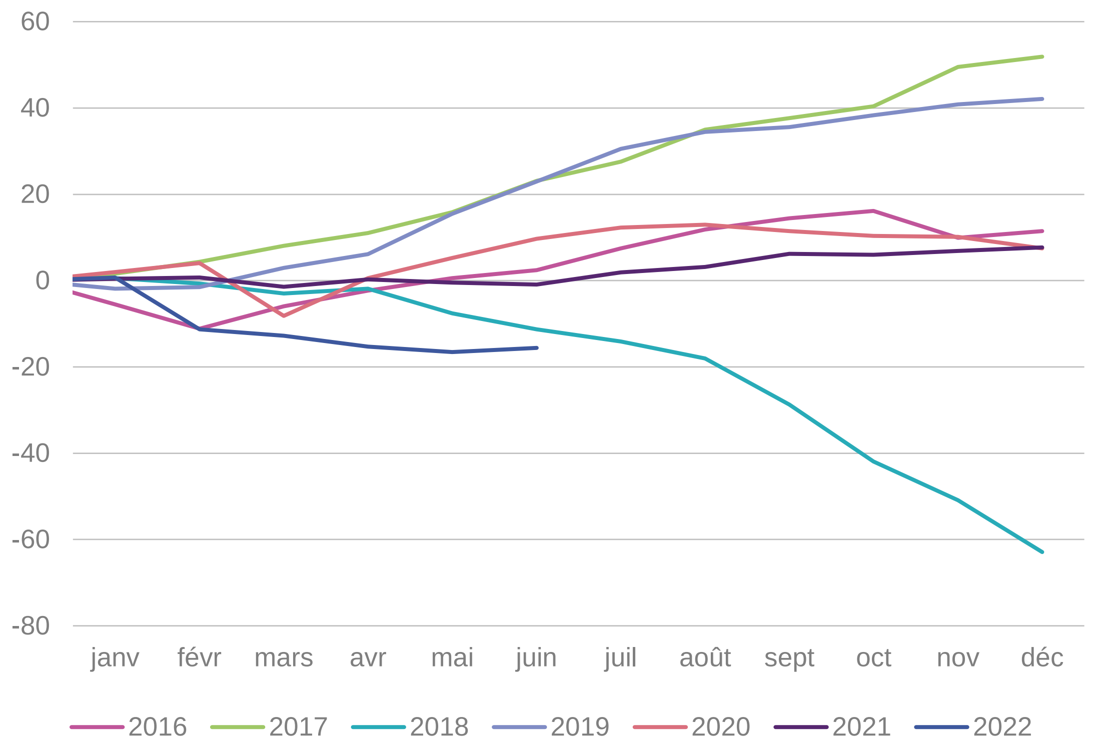


Sources: Natixis, Bloomberg, ECB

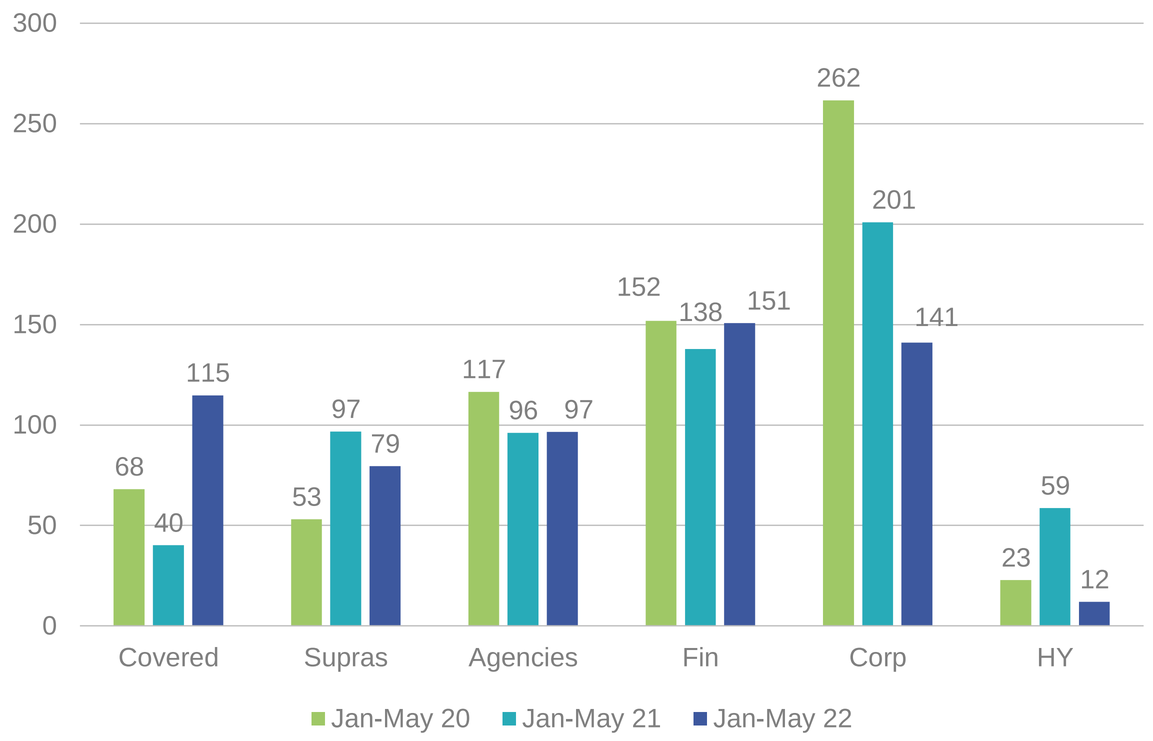
Is it a “perfect storm” for credit?

Negative technicals

Net inflows in € IG funds (cumulative, €bn)



Supply YtD in €bn by segment

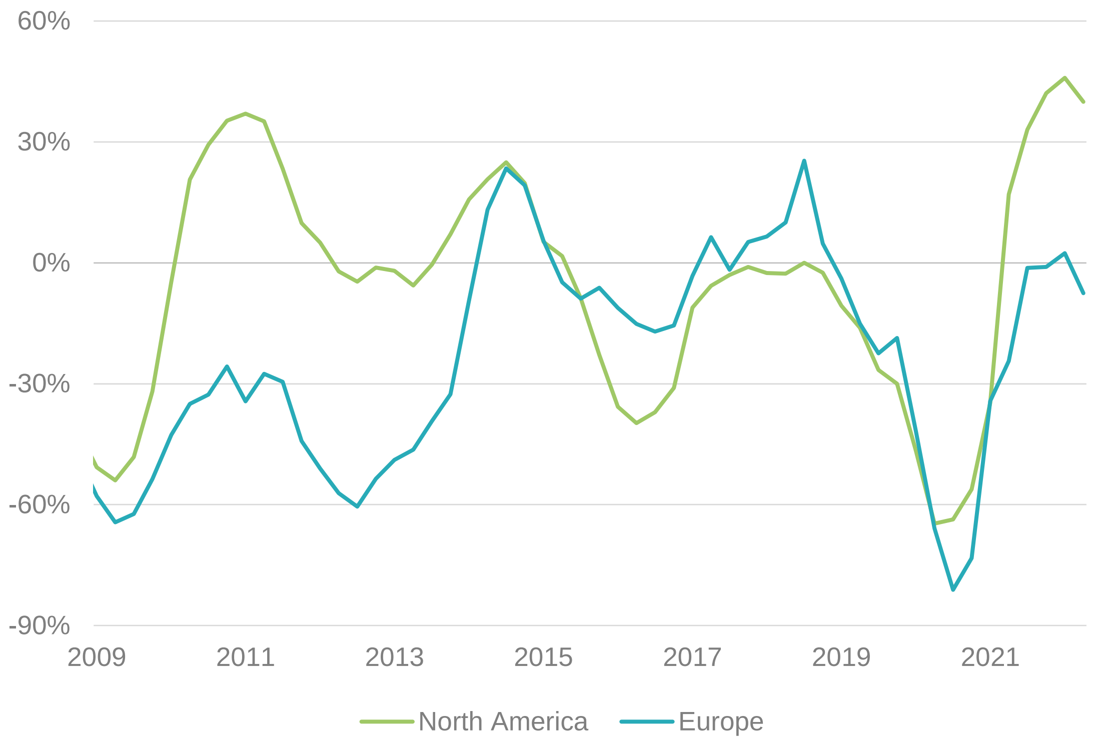


Sources: Natixis, Dealogic, ECB

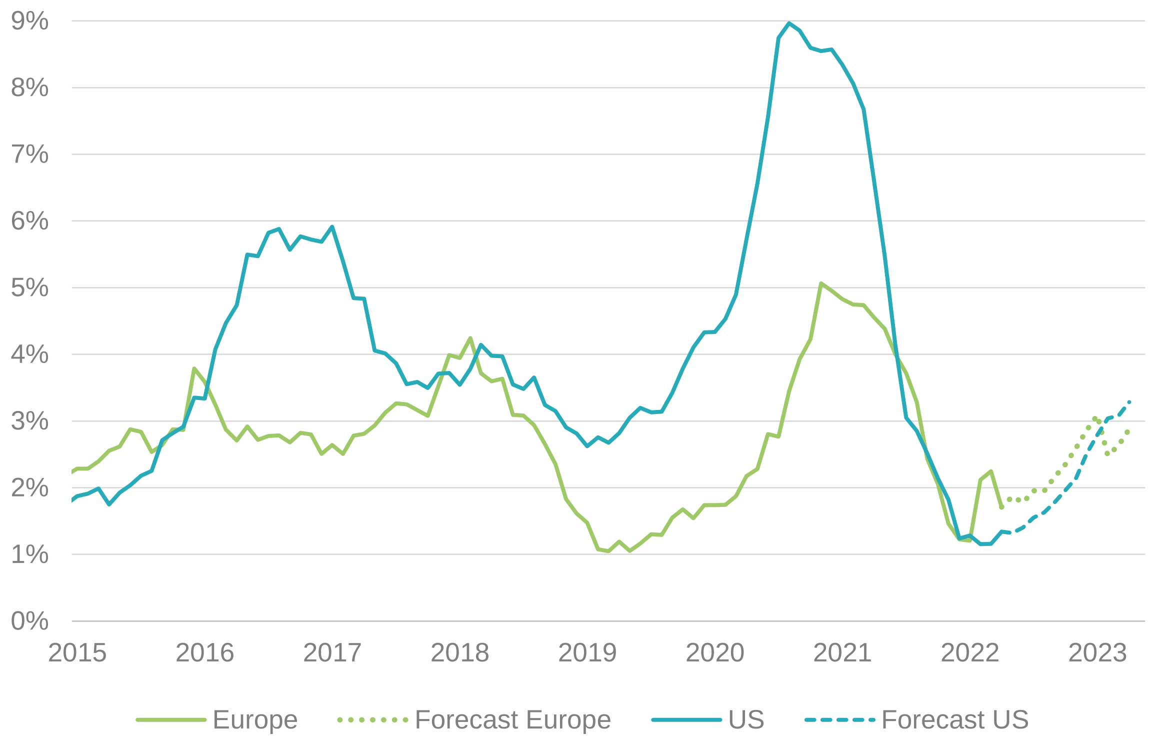
Fundamentals: how bad can they get?

Default rates to trend higher but below the peak of end 2020

Rating drift for corporate issuers



Moody's HY default rate forecasts

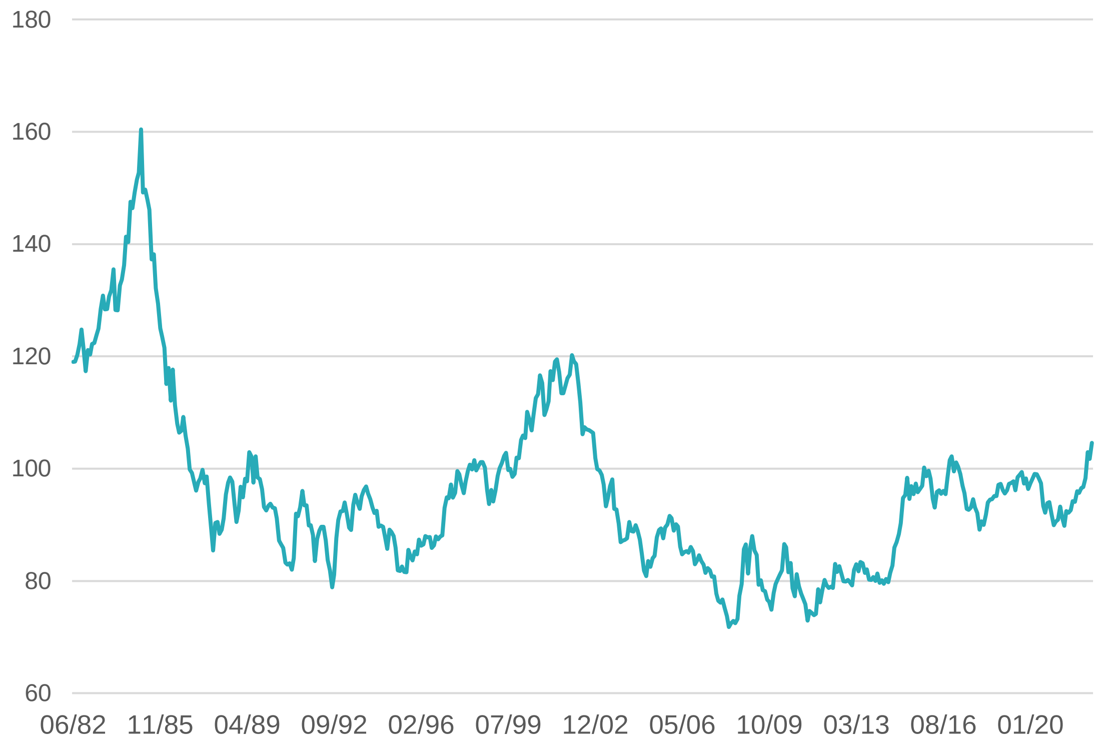


Sources: Natixis, Moody's, Bloomberg

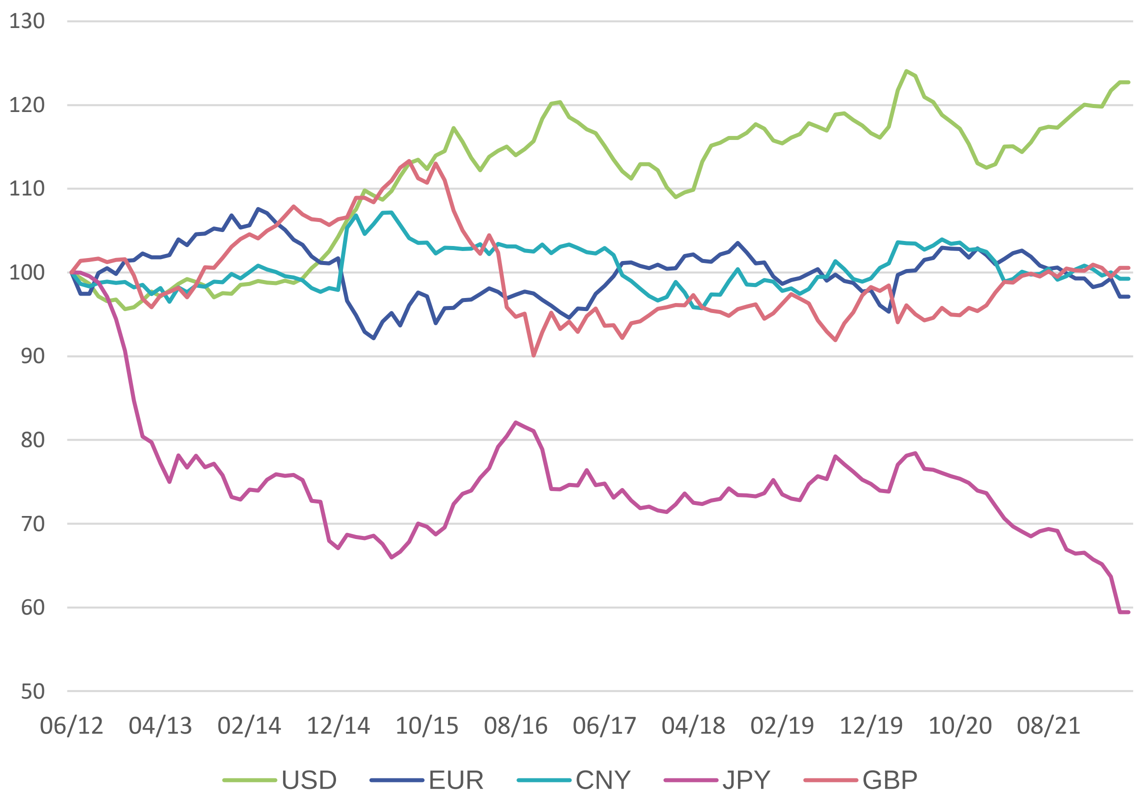
Has the dollar tested its peak in this cycle?

The dollar should remain strong over the summer before to start to recede in Q4 on weaker US growth

New high on the dollar DXY index



Dollar is over valued in terms of Real Effective Exchange Rate

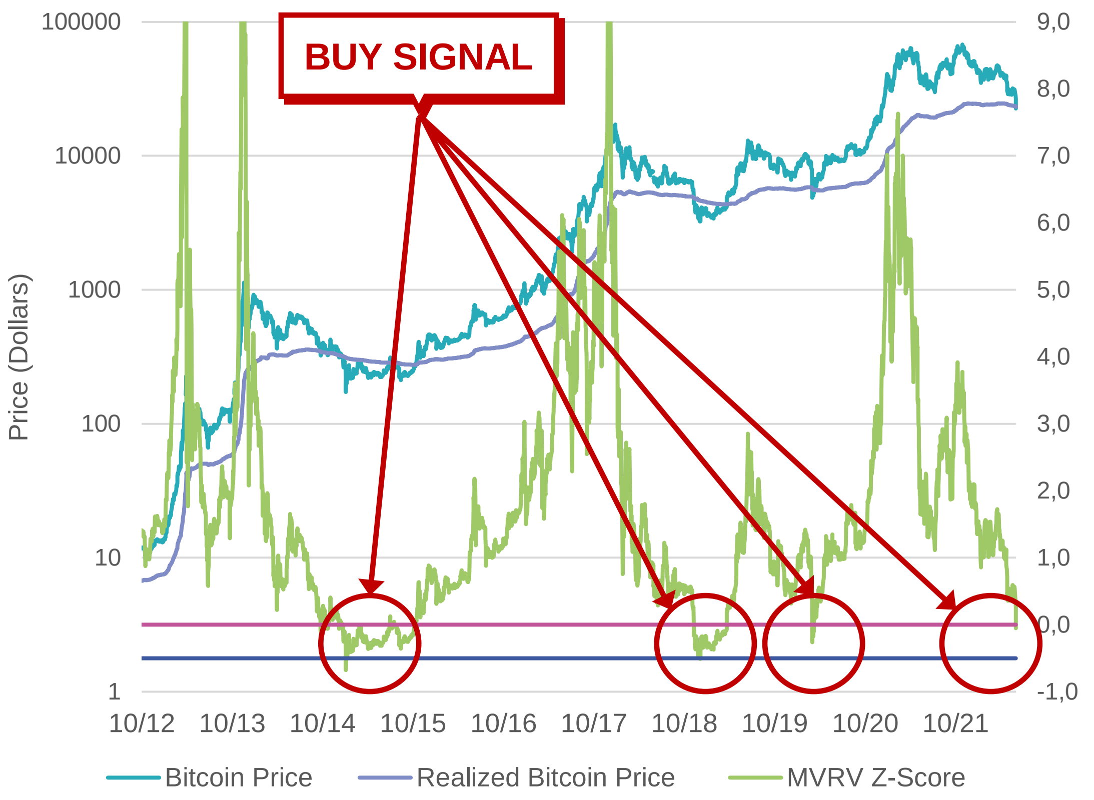


Sources: Bloomberg, Natixis

Is it time to buy Bitcoin?

Miners, Institutions, Short-Term Holders are selling. Only Long-Term Holders, Entities and Whales are accumulating. Bitcoin could decline to a new range between 12,000 and 19,000 on capitulation.

The market is close to a capitulation



Whales have been accumulating bitcoins since March 22

Sources: Glassnode, Coinshares, Natixis

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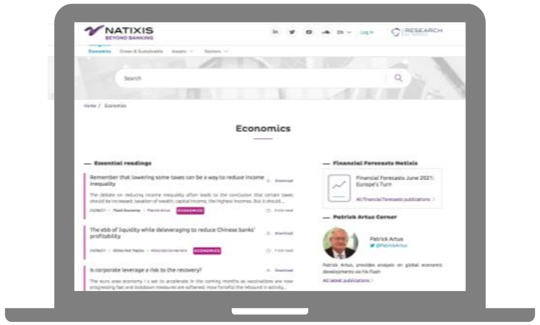

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