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ACCOMMODATIVE CENTRAL BANKS: THE FORCE AWAKENS

The central banks took centre stage once again in March, with the ECB meeting early in the month followed by the Fed a couple of weeks later. Given the impact their decisions have across all asset classes, a number of aspects merit a closer look:

The ECB has adopted an extremely accommodative tone, on a range of issues:

- Change in forward guidance by promising not to raise its key interest rates before the end of 2019 (vs summer 2019 previously);
- Launch of a new series of TLTROs from September, each with a maturity of two years;
- Bigger than expected downward revision in growth and inflation forecasts.

We could also mention the "tiering" system Mario Draghi has alluded to since the meeting, which if implemented, could enable the ECB to lower its policy rates again.

The Fed, meanwhile, was even more accommodative than the ECB relative to market expectations:

- End of balance sheet shrinking in October 2019;
- Downgrade in Fed members' median forecasts, which now indicate a single hike to end-2020, versus three previously;
- Growth forecast for 2019 cut to 2.1% from 2.3% previously.

These decisions by the Fed are surprising in view of the current situation in the US economy, which has barely changed since September, whereas the Fed's message is markedly different.

On the other hand, these decisions are not so surprising given the financial conditions (and movements on equity markets) over this period. However, we wonder if it was really necessary to go so far at the last meeting, when the financial conditions are already generally better than they were at the start of the year.

The macroeconomic environment has looked to be improving in recent weeks, with reassuring figures coming out of China, which is consistent with the substantial fiscal, budgetary and monetary stimulus implemented a few months ago; this improvement is likely to have further to go. The eurozone seems to be stabilising, despite the German automotive sector continuing to weigh on the bloc as a whole; however, we think that the downgrades to eurozone growth forecasts are now behind us.

What should we do in this environment? With growth stabilising, inflation risk low and the central banks extremely accommodative, the scenario for income-generating assets is very favourable overall. Moreover, this situation should also favour equity assets, provided the exogenous risks remain in check. Lastly, given the very sharp drop in returns on risk-free assets and an improving macroeconomic outlook, we could see a modest rise in these assets in the coming weeks.

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FIXED INCOME

NEW OPPORTUNITIES ON GREEK DEBT

1.9%

Greece's GDP growth in 2018*

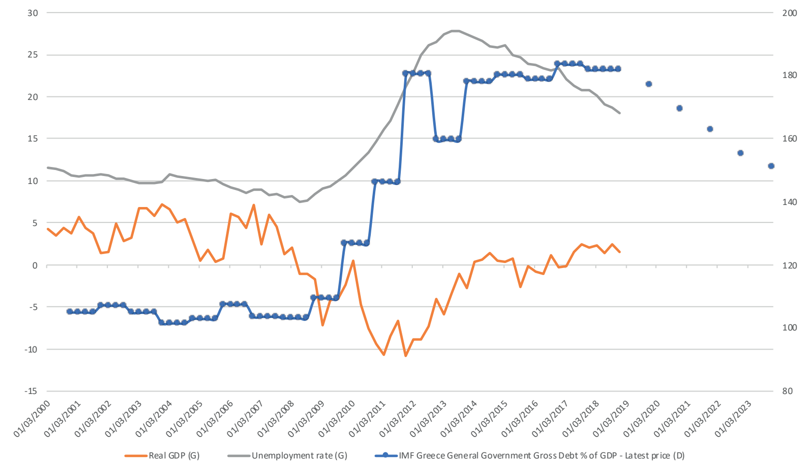
Greece became the 10th member state of the European Union in 1982. In May 2010, the Troika (ECB-European Commission-IMF) agreed the first €110 billion bailout for Greece, in exchange for an economic adjustment programme. Having failed to honour a repayment on 5 June 2015, the country's crisis escalated further, with massive outflows from Greek banks. A new plan emerged after the Eurogroup meeting of 12 July 2017. And there was no Grexit...

Greece has come a long way since then. Its growth forecast is 2.2% this year and next, according to Eurostat, after 1.9% in 2018, its best performance for a decade. For the first time in 15 years, Greece could post growth in the region of 2% for three years in a row, displaying considerable resilience to the economic slowdown in the eurozone over the last year. The domestic economy, which has benefited from a rise in real incomes and a marked fall in the unemployment rate (HSBC estimates a 10-point drop between 2014 and 2020), is rebounding strongly. However, investment is still at low levels and the banking sector remains weak, although the banks have not had recourse to the emergency liquidity assistance (ELA) to access ECB liquidity since the end of 2018, and deposits by Greek households are growing, albeit slowly.

And while its recovery in growth is gathering pace, Greece has achieved a notable fiscal performance, with a primary surplus estimated at 6.6% this year by the IMF, and debt now going in the right direction, projected to fall from 188% of GDP in 2018 to 177% in 2019, plus a budget that should be in balance from this year. Although this is extremely positive, there is an important factor to consider: whether or not the reforms passed on pensions and public sector pay cuts are constitutional. The IMF has warned that there will be a significant cost if these measures were to be deemed unconstitutional.

The rescue plan extends until 2022, and the country is continuing to pay down its debt. Moreover, the country's refinancing needs will be fully covered by the government's liquidity reserves (close to €40 billion) until 2023. Greece has made its return to the bond markets and should proceed with fresh issues this year given the level of yields (3.50% on the 10Y). In view of the positive fundamentals and the appeal of Greek yields, with volatility at standard levels, Greek debt presents real investment opportunities.

Changes in Greek debt (and projections from 2018 onwards), **GDP and the unemployment rate**



*Source: Eurostat

EQUITY MARKETS

INNOVATION REMAINS KEY IN A POLITICAL ENVIRONMENT WHERE CREATIVITY IS IN SHORT SUPPLY

This first quarter of 2019 went beyond our expectations, with the markets recovering almost all of the losses of the last quarter of 2018. Equities have been rising steadily since 24 December. The quarter closed with something of a flourish: the S&P 500 has risen by more than 17% YTD (11 April) (the best Q1 since 2009) in a scenario in which monetary policy has become accommodative 'again'. Oil prices have also shot up, reaching $68.39/barrel (+25.74%) on 29 March. In Europe, the Stoxx 600 has jumped by almost 16% YTD (+12.27% in Q1). All sectors have seen gains. Investors particularly favoured defensive growth sectors, notably consumer goods (+18%) and retail (+20.26%). Among cyclical sectors, basic resources also did very well (+19.20%) thanks to the support of China's central bank and the positive vibes around a US-China agreement.

While we are again close to equity market highs, the equity fundamental indicators remain stretched. Analysts continually revised down their EPS forecasts for 2019 (from +8% at end-January to +5% at end-March) over a quarter that saw investors triggering major outflows and stock market trading volumes remaining very low.

In short, everything seems to be under control from the Fed's point of view, if we disregard the political noise.

5G
the factory of the future

Elsewhere, we have been to the Hanover Messe trade show, when we observed the latest technological advances and growth drivers, particularly 5G and its use in industrial applications. In particular, we attended the presentation by Bosch Rexroth, in partnership with Qualcomm and Nokia, of a factory "of the future". The arrival of 5G will enable the creation of private networks that are essential to the safe operation of fully automated factories. Previously, with 4G, each machine had to be physically configured, together with the accompanying human-machine interactions (HMI). With 5G in factories, it will be possible to communicate remotely with several machines and robots using "network slicing" in a single HMI system, which will reduce operating costs and optimise production.

In the case presented by Bosch Rexroth, using two key elements - a smart floor and 5G - robots can carry out production and logistics tasks by moving autonomously while avoiding the obstacles in their way and communicating with the factory's other machines. Using a computer, a member of staff controls each machine operating on the surface while being informed of any malfunctions; the computer can also flag up the potential for a fault before it happens, enabling the staff member to take pre-emptive action. These installations are currently in the test phase, and could be on sale in a year.

This technology will support our efforts to reduce carbon emissions, helping to cut energy consumption through the optimisation and digitisation of production processes. Innovation remains a key driver.

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