AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

17.04.23

Main Events

US EXISTING HOME SALES	S&P GLOBAL PMI	US GDP	BOJ MEETING
Will existing home sales rebound as a result of the lower rates, or will they continue to fall because of the banking crisis?	How and to what extent were business confidence indexes impacted by the March-end banking crisis?	The first-quarter real GDP in the United States is predicted to expand by 2%. Will expectations be met?	Will the new governor of the Bank of Japan take the same strategy as Kuroda in his first meeting as chairman?
20.04	21.04	27.04	28.04

Azimut Global Network

- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

A CLOSER LOOK TO EUROPE

- **Even before the banking crisis in March, monetary aggregates in Europe were showing signs of decline.**
- **Individuals' still significant savings, continued salary increases, and strong cash reserves of firms in Europe suggest that a recession, if it ever occurs, will be moderate.**
- **However, it is important to closely monitor the evolution of home prices, since much of the wealth of Europeans as well as bank financing is tied to the housing sector**

The narrative of the global financial market has recently shifted from being entirely centered on inflation to being more concerned with systemic risks. This change has been prompted by recent events related to Credit Suisse and regional banks in the US, which have raised worries about the potential impact of a credit crunch and stricter lending standards on the global economy. This report will analyze the situation in the Eurozone and assess the probability of a recession occurring in the region. For the purpose of our analysis, we assume that there will be a certain level of decline in lending activity due to heightened scrutiny over credit standards.

Regarding recent monetary developments in the Euro Area, the February data released by the European Central Bank (ECB) shows a growth rate of 2.9% in M3 (broad monetary aggregate), down from 3.5% growth in January. Within the stock of money, the share of overnight deposits declined by 2.7%, while deposits other than overnight and money market funds increased by 18% and 12%, respectively. This movement is driven by the more attractive conditions that come from higher interest rates.

It is worth noting that currently, household overnight deposits continue to experience modest growth. However, corporations, which are more sensitive to changes in interest rates, are increasingly opting for deposits with an agreed maturity and, therefore, a higher yield.

(continued)

Table1. Monetary developments in the euro area: February 2023 (Eu bn and % year over year changes)

	End-of-month level	Monthly flow			Annual growth rate		
	Feb 2023	Dec 2022	Jan 2023	Feb 2023	Dec 2022	Jan 2023	Feb 2023
COMPONENTS OF M3							
1. M3	16099	-36	-21	-26	4.1	3.5	2.9
1.1. M2	15240	-46	-34	-62	3.7	3.0	2.0
1.1.1. M1	11143	-113	-87	-142	0.6	-0.8	-2.7
Currency in circulation	1540	-3	1	-1	4.7	3.8	3.9
Overnight deposits	9603	-110	-88	-141	0.2	-1.5	-3.5
1.1.2. Other short-term deposits (M2 - M1)	4100	68	74	79	14.3	15.2	17.5
Deposits with an agreed maturity of up to two years	1543	53	75	83	45.7	49.6	58.9
Deposits redeemable at notice of up to three months	2557	-16	-1	-3	2.3	2.1	1.7
1.2. Marketable instruments (M3 - M2)	859	7	1	38	11.4	13.7	21.3
Repurchase agreements	124	-15	15	-18	3.3	2.8	-8.1
Money market fund shares	654	11	-14	18	0.5	6.3	12.0
Debt securities issued with a maturity of up to two years	78	10	3	39	527.7	247.1	451.9

Source: ECB

Table2. Breakdown of deposits in M3 by holding sector and type: February 2023

	End-of-month level	Monthly flow			Annual growth rate		
	Feb 2023	Dec 2022	Jan 2023	Feb 2023	Dec 2022	Jan 2023	Feb 2023
BREAKDOWN OF DEPOSITS IN M3							
Total deposits	13827	-67	-15	-71	3.6	2.9	1.8
1. Deposits placed by households (b)	8419	19	11	-21	3.7	3.3	2.8
1.1. Overnight deposits	5612	-28	-25	-53	3.1	1.9	0.4
1.2. Deposits with an agreed maturity of up to two years	521	30	37	36	20.2	31.6	42.7
1.3. Deposits redeemable at notice of up to three months	2286	11	1	-3	2.4	2.2	1.8
1.4. Repurchase agreements	1	0	0	0	20.6	-3.1	-25.8
2. Deposits placed by non-financial corporations	3372	-23	-7	-6	3.7	3.2	2.8
2.1. Overnight deposits	2656	-33	-48	-42	-3.1	-5.0	-7.1
2.2. Deposits with an agreed maturity of up to two years	573	9	41	36	113.8	100.0	87.9
2.3. Deposits redeemable at notice of up to three months	135	3	-1	0	4.6	3.9	4.1
2.4. Repurchase agreements	9	-2	2	2	-17.2	-28.1	-30.6

Source: ECB

Regarding the credit dynamics, the annual growth rate of total credit to residents of the Euro Area declined from 3.1% in January to 2.6% in February 2023. The annual growth rate of loans to the private sector, adjusted for loan sales, securitization, and notional cash pooling, decreased to 4.3% in February, down from 4.9% in January. Among the borrowing sectors, the annual growth rate of adjusted loans to households decreased to 3.2% in February, down from 3.6% in January, while the annual growth rate of adjusted loans to non-financial corporations decreased to 5.7%, down from 6.1% in January.

Now that we have a clear picture of the current monetary stock in Europe, we can assess the potential impact that credit tightening would have on the region's growth dynamics.

So what are the drivers of GDP, and how have they contributed to Eurozone GDP in recent quarters? The following table shows how each of the main elements of GDP contributed to the aggregate nominal production in the past four quarters.

We will focus on the personal consumption and private investments components. Starting with the first, this has been a very important component for recent GDP growth, and now worries are mounting that after a period of household spending growth, credit limitations for individuals will affect their willingness to spend more than what they spent last year. We would like to highlight two main elements against this thesis that would support the view of personal consumption growth at least for the rest of 2023.

First, after a period of negative real wages, the Eurozone is finally experiencing positive real wage growth, with agreed wage increases in many countries averaging 5%

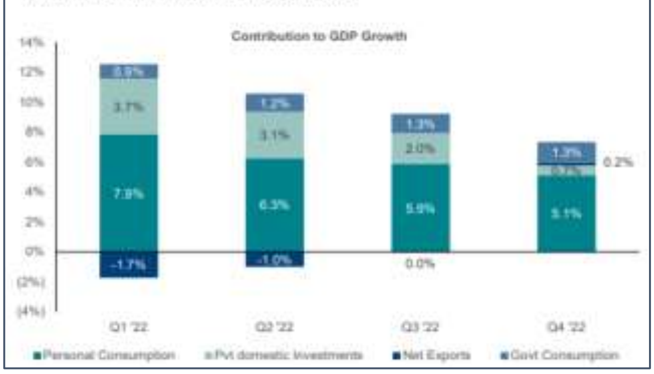
Secondly, the excess savings accumulated during the pandemic in Europe are still abnormally high as a percentage of disposable income. Therefore, European consumers have ample room to draw down cash from their accounts before needing extra credit from banks.

Table 3. Breakdown of private sector loans by borrowing sector, type and original maturity: February 2023

	End-of-month level	Monthly flow			Annual growth rate		
	Feb 2023	Dec 2022	Jan 2023	Feb 2023	Dec 2022	Jan 2023	Feb 2023
BREAKDOWN OF LOANS AS COUNTERPART TO M3							
1. Loans to households (b)	6680	4	1	5	3.8	3.4	3.2
Adjusted loans (c)	6864	8	18	7	3.8	3.6	3.2
1.1. Credit for consumption	722	2	0	2	2.3	3.1	2.8
1.2. Lending for house purchase	5226	5	2	5	4.4	3.9	3.7
1.3. Other lending	718	2	-1	-2	0.1	0.0	-0.4
of which: sole proprietors	373	1	-1	-1	0.0	-0.8	-1.8
2. Loans to non-financial corporations	5130	-28	1	-4	6.3	5.3	4.6
Adjusted loans (c)	5161	-12	1	-2	6.3	6.1	5.7
2.1. up to 1 year	998	-35	4	-11	8.6	7.5	5.5
2.2. over 1 year and up to 5 years	1001	15	3	-6	7.7	6.6	6.2
2.3. over 5 years	3102	-18	6	5	3.0	3.6	3.5
3. Loans to non-monetary financial corporations except insurance corporations and pension funds (d)	1074	-22	8	-12	13.4	8.7	6.4
Adjusted loans (c)	1088	-12	8	-14	14.7	10.6	7.1
4. Loans to insurance corporations and pension funds	149	-3	1	2	-7.9	-12.6	-11.8
Adjusted loans (c)	154	-3	-3	1	-8.4	-13.7	-12.7

Source: ECB

Table 4. Contribution to Eurozone GDP



Source: Exane BNP

(continued)

Table 5. Eurozone real wage growth

Source: Exane BNP

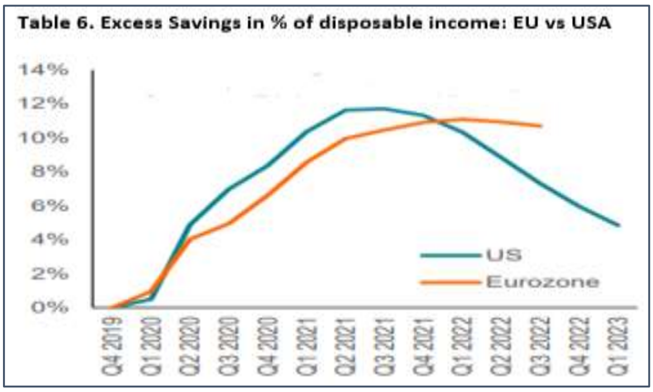


Table 6. Excess Savings in % of disposable income: EU vs USA

Source: Exane BNP

When looking at private domestic investments, there are again elements that play in favor of growth, even in a scenario of a credit crunch and tighter lending standards. It is worth looking at how different the financial profile of corporates in the Eurozone is now compared to the scenario in 2008 (the main occasion in recent history that saw a credit crunch-driven recession). At the time of the Lehman crisis, which culminated in a massive deceleration of credit availability for corporates around the world, EU corporates had EUR 1.4 trillion in deposits (cash and cash equivalents in simple terms). The counterparts to this were $4.8 trillion in loans. Today, corporations have nearly the same amount of outstanding loan balance (Eu5.1 trillion) against a 2.5x higher amount of cash (Eu3.4 trillion). Just looking at these numbers, it is reasonable to assume that European companies are in a completely different situation and would be able to cope with a certain level of credit crunch without compromising their investment cycle. In support of this, the stress that global supply chains have faced in the past two years and the need for continental independence when it comes to energy sources are two important factors that will drive unpostponable massive investments with the help of the Europe Inflation Reduction Act (IRA).

Based on this evidence, we believe it may be possible for Europe to avoid a recession or at least mitigate its severity, given the ample liquidity for both households and businesses. We are not focusing our analysis on the job market because we start from the assumption that if the corporate ecosystem avoids a liquidity crisis, employer demand would not change meaningfully in the region.

On the other side of the coin, we do not want to be naive in ignoring how concentrated household investments are in Europe (see Table 3). The housing market has been a massive driver of wealth creation in the Eurozone. For the past 10 years, low interest rates have driven demand and valuations to new highs during the 2021 bull market. Since then, higher interest rates have cooled down demand; however, the house prices have remained resilient so far, except for some pockets of weakness in the Nordics and Germany. We would like to highlight that Eurostat data on house prices is quite lagging (today we only have data up until the last October-December quarter), and the market could well be below the reported levels.

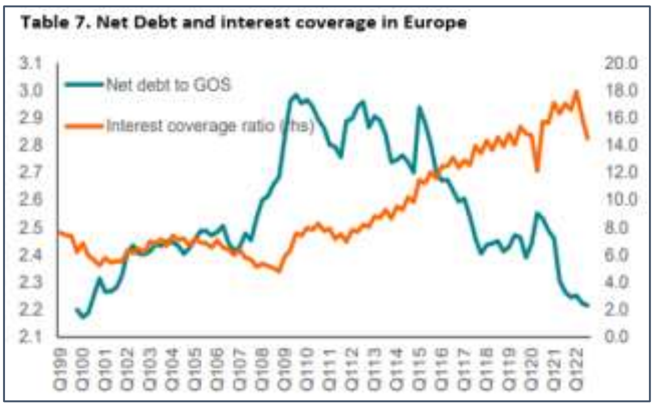


Table 7. Net Debt and interest coverage in Europe

Source: Exane BNP

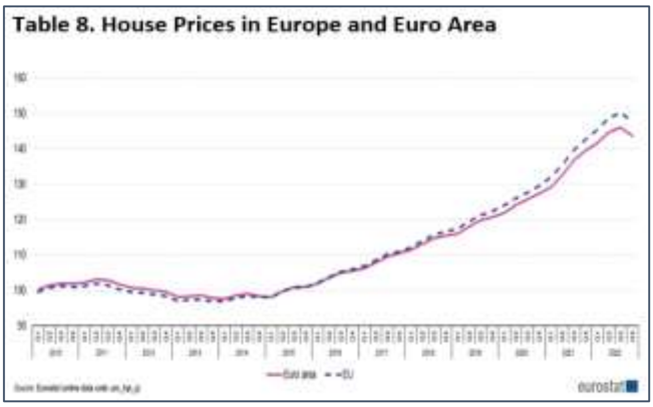


Table 8. House Prices in Europe and Euro Area

Source: Eurostoat

(continued)

The obvious question is: what has happened to house prices during other periods of high inflation (and high interest rates)?

Despite the lack of such data for Europe, we found the answer for the United States: only once did house prices go negative (in 2008), and this was attributable to other issues rather than interest rates (such as the MBS crisis).

Even during the massive inflation wave of the 1970s, house prices never fell.

Table 9. House prices in the USA

Source: Exane BNP

According to this analysis, the elephant in the room that could cause trouble in Europe is the housing market. Therefore, we will monitor this closely by also looking at real-time indicators, such as data on prices from market operators like real estate brokers.

Finally, another important caveat to our supportive view of the European economy for 2023 is how the USA will fare in relation to the data presented. This is especially important given the lower cushion of excess savings in percentage of disposable income in the US, and how a potential slowdown in consumption there would affect Europe and European exporters.

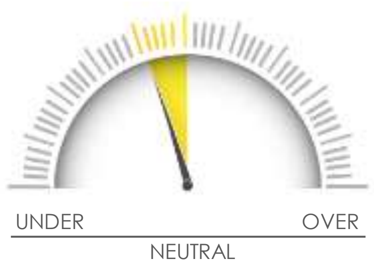
Asset Allocation View

	−	=	+
Equity			
Developed Markets	■		
Emerging Markets	■		
Fixed Income			
Developed Markets Sovereign		■	
Developed Markets Corporate	■		
Emerging Markets	■		
Commodities			■
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

Equity

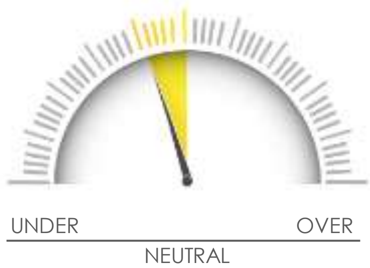
Developed Markets



We maintained our **Slightly Underweight** recommendation on Developed Markets Equities. Despite the fact that central banks are likely nearing the conclusion of their rate hike cycle, values remain high, and major market indices are likely at the upper end of a probable trading range. Another element that advises a cautious attitude for the time being is the uncertainty associated with the reporting season that has just begun.

US	=	**Europe**	=	**Japan**	=

Emerging Markets

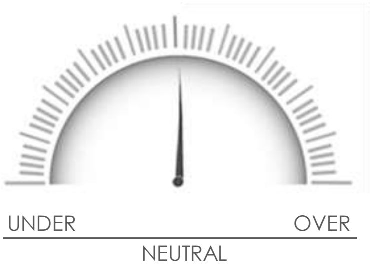


We kept our recommendation on Emerging Markets Equities unchanged at **Slightly Underweight**. On the one hand, emerging countries may suffer more if there is a global credit crunch and/or a slowdown, a possibility that cannot yet be ruled out. They continue, nevertheless, to trade at far lower multiples than developed countries. We are relatively more optimistic about Asia ex-Japan among emerging markets.

Asia ex-Japan	+	**EEMEA**	−	**LATAM**	=

Fixed Income

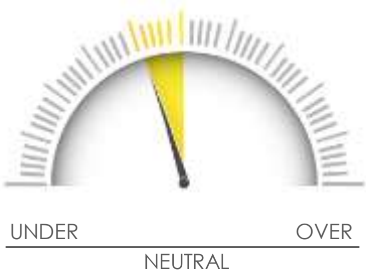
Developed Markets Sovereign



We maintained our **Neutral** recommendation on Developed Markets Sovereign Bonds. After falling substantially at the start of the banking crisis, interest rates have gradually began to rise again, based on signs that the sharp rate cuts predicted for next year are appearing increasingly implausible.

EU Core	EU Periphery	US Treasury	Japanese JGB
=	=	=	=

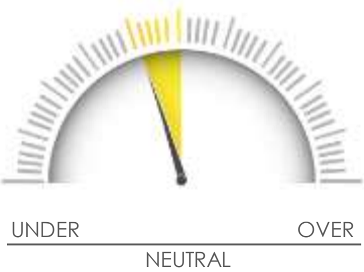
Developed Markets Corporate



We have confirmed our **Slightly Underweight** recommendation on Developed Markets Corporates. Credit spreads, although wider than pre-banking crisis levels, have continued to narrow and do not seem adequate in view of the worsening macroeconomic scenario precisely due to the banking crisis. We continue to be more constructive on investment grade corporate bonds over high yield bonds.

IG Europe	IG US	HY Europe	HY US
+	+	−	−

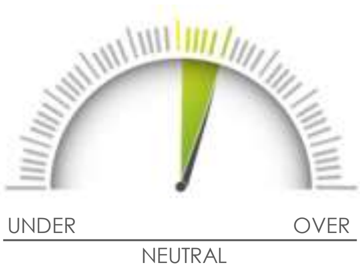
Emerging Markets



We kept our recommendation on Emerging Market bonds as **Slightly Underweight**. Emerging country bond spreads have not widened significantly since the March events, and do not adequately reflect the risks of a credit crunch or global economic slowdown.

Local Currency	Hard Currency IG	Hard Currency HY
+	−	−

Commodities



We maintained our **Slightly Overweight** recommendation on Commodities. Fears unleashed by the banking crisis in the U.S. and Europe, coupled with expectations that this will lead to a premature end to the rate hiking cycle, are both driving forces for the price of precious metals. Among other commodities, the positive momentum for energy commodities could continue on the back of the production cut announced by OPEC, although the risk of facing an economic slowdown in the months ahead greatly mitigates the optimism on non-precious metals commodities.

Precious	Energy	Industrial	Agricultural
+	+	=	=

Currencies

The Committee confirmed its **Neutral** view on the US Dollar, but **with a bearish bias**. On the one hand, the U.S. rate differential vs. the rest of the world is continuing to narrow, with negative implications for the dollar, but on the other hand the increased likelihood of another rate hike by the Fed (previously completely ruled out) may limit the downside of the greenback.

The Euro is also **Neutral**, but **with a bullish bias**. Inflation data that continue to surprise to the upside in Europe could force the ECB to keep raising rates longer than other central banks, supporting the single currency in the medium term.

The view on the **Chinese Renminbi** and on **other emerging market currencies** is also confirmed **Neutral** waiting for more clarity about the effective impact of a possible credit crunch and/or an economic slowdown.

Euro	=	USD	=	CNY	=	Other EM	=