MyStratWeekly
Market views and strategy

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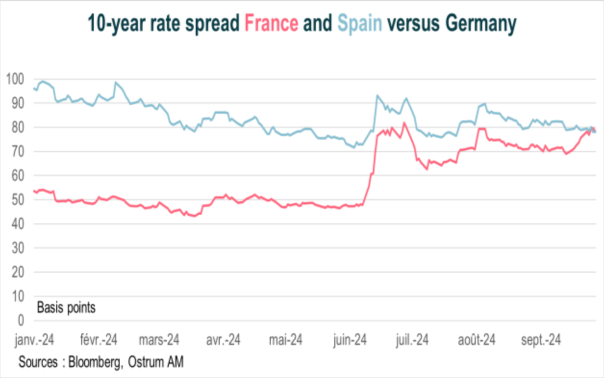
Topic of the week: Comparison of C. Lagarde to the 1920s: Be ready for change!
by Zouhoure Bousbih

- The ECB President has drawn a parallel between the current period and the 1920s;
- The similarities are concerning: the resurgence of protectionism, AI as a significant technological breakthrough, disruptions in maritime routes, and China's rise as a global manufacturing powerhouse;
- However, the comparison ends there. A key difference from the 1920s is the abandonment of the gold standard, which grants central banks increased monetary flexibility, enabling them to respond swiftly and decisively during crises;
- This also allows governments to effectively intervene in order to safeguard jobs and support their economies;
- C. Lagarde's comparison to the 1920s underscores a new world order and an elevated risk of macroeconomic volatility. "We must be prepared for change!".

Market review: When China awakens
by Axel Botte

- China : bold monetary and fiscal measures revive recovery hopes ;
- Chinese equities surge ;
- Curve steepening continues as weak PMI and falling oil prices fan expectations of ECB cut this month ;
- France spreads under pressure before PM Barnier’s policy statement.

Chart of the week



For the first time since 2007, the spread of the 10-year OAT has exceeded the Spanish spread on Thursday, September 26.

This reflects investors' concerns regarding French public finances. France is expected to experience a significant budgetary slippage for the second consecutive year in 2024.

This justifies deficit reduction measures that are expected to be announced by the government during the week of October 9. The task proves to be complex, as the National Assembly is highly divided, putting the government at risk of a vote of no confidence.

Figure of the week

27 %

This is the weekly performance of the Chinese stock market index CSI 300 since its low point on September 13. Announcements of monetary and fiscal stimulus from Chinese authorities have bolstered the rally in Chinese stocks and enhanced investor sentiment.
Source: Bloomberg

Topic of the week

Comparison of C.Lagarde to the 1920s: Be ready for change!

During her speech at the Michel Camdessus 2024 conference, honoring the former Managing Director of the International Monetary Fund, C. Lagarde made headlines by drawing a parallel between the current period and the 1920s. This era was marked by disruptions in global trade and rapid technological advancements fueling speculative bubbles. Is the President of the European Central Bank right to be concerned?

Worrying Similarities with the 1920s…

The End of Pax Americana

From the end of Pax Britannica…

The 1920s were defined by a period of relative peace in Europe known as Pax Britannica. During this time, Britain utilized its naval, economic, and diplomatic power to maintain global order and promote international trade, fostering a climate of economic prosperity. However, economic and imperial rivalries ultimately led to the decline of Pax Britannica.

..to the end of Pax Americana.

Since the end of World War II, the United States had moved away from its political neutrality in international affairs. The Marshall Plan for European reconstruction officially marked the beginning of Pax Americana, characterized by prolonged peace among major powers alongside U.S. dominance in economic, political, and military spheres. Pax Americana was essential for globalization, allowing global inflation to remain sustainably low. The election of D. Trump in 2016 marked a significant departure from this paradigm. His "America First" slogan indicated a return to U.S. neutrality in international matters. The vacuum left by the world's gendarme has created opportunities for emerging powers to assert territorial claims, exemplified by Russia's invasion of Ukraine in March 2022. For the first time since World War II, Europe is confronting a war that exposes its energy vulnerabilities.

Uncertain Maritime Routes Disrupt Global Trade

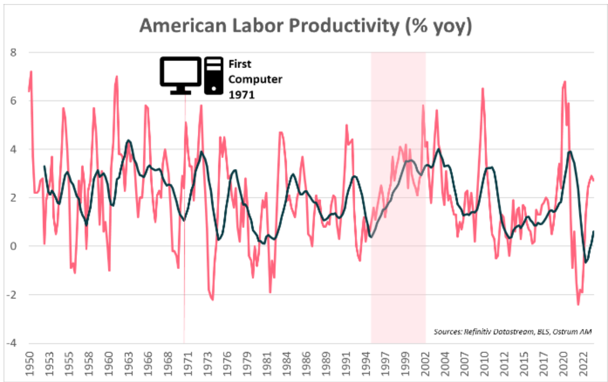
The security of maritime routes should become a primary concern for economic powers.

The Russian invasion of Ukraine has vividly illustrated Russia's ambition to capture Ukrainian ports, particularly the port of Odessa, to secure access to warm waters. This situation has triggered a rapid rise in agricultural commodity prices, threatening global food security, especially in poorer nations. The Black Sea Grain Initiative, facilitated by the UN and Turkey, has helped mitigate upward price pressures and ensured supply for affected countries, thereby averting a potential global food crisis.

Escalating tensions in the Middle East have restricted access to the Red Sea, particularly at the Suez Canal, a crucial artery for global trade. This has resulted in increased maritime transport costs and longer delivery times, as merchant vessels are forced to reroute around the Cape of Good Hope. For Egypt, which is grappling with a severe economic crisis, this has had a profound impact on its budget revenues. Revenue from the Suez Canal has continued to decline, dropping over 24% compared to June 2023 and more than 50% from the previous year.

The Technological Revolution of AI

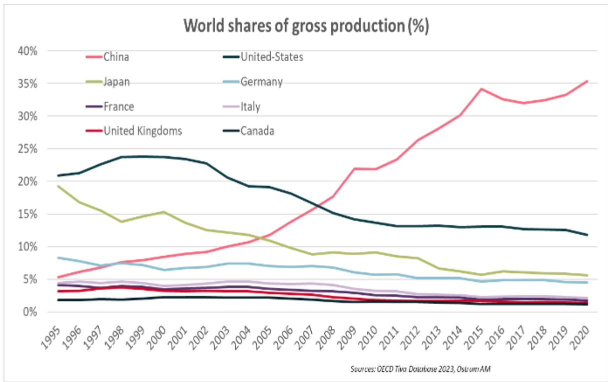
Just like the invention of railways, electricity, or the first personal computer, AI is expected to quickly enable productivity gains.



The current period is also characterized by significant technological advancements. Generative artificial intelligence (AI) utilizes powerful computer models to produce high-quality content based on the data on which they are trained. Recent advancements in AI are expected to bring about the long-awaited increase in productivity that has been anticipated for several years. The graph above shows that productivity gains associated with the invention of the first computer in 1971 were only observed in the early 2000s. Two properties of AI should enable rapid productivity gains: its accessibility and versatility. Accessibility to a broad audience without prior knowledge of programming languages on platforms like ChatGPT—developed by OpenAI—or Google's Gemini. AI also possesses versatility in that its fields of application are wide and varied. Indeed, AI can be used to draft legal documents or rental contracts.

Rivalry with China and the Return of Protectionism

China has become the global manufacturing powerhouse, marking the resurgence of protectionism.



China has rapidly become a manufacturing powerhouse (accounting for 35% of global production), shifting the balance of power on a global scale. Its swift rise in emerging technologies, particularly in electric vehicles, has prompted protectionist measures from the United States and the European Union in the form of increased tariffs. The aim is to protect the European and American automotive sectors, which are significant sources of employment. Relations with China have changed since the Trump administration, which implemented the first tariff increases on Chinese products in 2018. China is no longer viewed as a competitor but rather as a serious rival threatening the global order established by the United States since the end of World War II.

… But the comparison ends there due to notable differences.

The most notable difference from the 1920s is the end of the gold standard…

The End of the Gold Standard

One of the notable differences from the 1920s is the end of the gold standard. The gold standard significantly limited the ability of central banks to respond to economic crises, leading to severe and prolonged recessions, such as the Great Depression of the 1930s. Indeed, the amount of money in circulation was directly tied to the gold reserves held by central banks. During periods of lost investor confidence, as was the case during the stock market crash of 1929, they could not easily intervene to stabilize financial asset prices.

Central banks were not prepared to act as lenders of last resort, exacerbating financial and economic crises.

Increased Monetary Flexibility…

... giving increased monetary flexibility to central banks, allowing them to act quickly and decisively during crises...

Central banks now have a wide array of tools at their disposal, allowing them to stabilize the economy quickly and significantly during crises. Since 2008, in response to the financial crisis, they have implemented unconventional measures that go beyond traditional policies. After reducing their key interest rates to very low levels, they introduced new tools to improve economic financing. The Fed reacted swiftly at the onset of the crisis by establishing a currency swap system to provide dollar liquidity to other central banks, thereby stabilizing the global financial system. In the eurozone, these policies have been crucial in managing the sovereign debt crisis as well as the Covid-19 crisis.
Unconventional measures have varied based on the priorities of central banks and the characteristics of financial systems. Among these measures, some central banks have applied negative interest rates to incentivize lending, used forward guidance, eased access to liquidity, and practiced quantitative easing by purchasing financial securities on a large scale. In the eurozone, these measures included accommodative interest rates, expanded liquidity access for banks, and programs for purchasing both private and public financial securities.

…Enabling Governments to Act Effectively During Crises

Government measures have also been essential for responding swiftly to economic crises, complementing the actions of central banks.
During the 2008 financial crisis, the U.S. government implemented the American Recovery and Reinvestment Act, injecting approximately $800 billion into the U.S. economy through tax cuts, infrastructure investments, and aid to states and municipalities. The Troubled Asset Relief Program (TARP) was also established to purchase toxic assets from banks, recapitalizing them and stabilizing the U.S. financial system.

... and to complement their actions with those of governments.

During the Covid-19 crisis, the Paycheck Protection Program (PPP) provided loans to U.S. small businesses to maintain employment. Checks were also distributed to citizens to boost consumption, while unemployment benefits were increased to assist workers affected by the pandemic. On the European side, recovery plans ("whatever it takes") were implemented to protect businesses and preserve employment, particularly in Germany and France. The European Union also created financial support funds, such as the Next Generation EU program, to stimulate post-pandemic recovery with a focus on sustainability and digitization.

To address the energy shock related to the war in Ukraine, European and American governments have also allocated various financial aids to households and businesses to offset rising energy prices and help cope with increased costs.

Conclusion

Christine Lagarde is right to express concern about the disturbing similarities between our time and the 1920s: the resurgence of protectionism, artificial intelligence as a major technological advancement, the emergence of China as a new manufacturing power, and disruptions in maritime routes. However, unlike the 1920s, the monetary flexibility of central banks has increased, enabling them to act swiftly and decisively during crises. Additionally, governments can complement the actions of central banks to stabilize their economies. Her comparison with the 1920s highlights a new world order and an increased risk of macroeconomic volatility. "We must be ready for change." This is the message that the President of the European Central Bank aimed to convey.

Zouhoure Bousbih

Market review

When China awakens

China finally takes the bull by the horns, leading to a surge in Asian stock markets. European pessimism is fading as the drop in oil prices may accelerate monetary easing in the euro area.

The global economy may be at an unexpected turning point. The Beijing government and the People's Bank of China (PBoC) seem to be shifting gears to revive domestic demand. Monetary measures are being implemented to support stock markets, while whispers suggest that the fiscal package could reach 3% of GDP. The yuan and commodity prices rise on this positive outlook, and short equity positions are being rapidly covered in Shanghai. The decline in crude oil prices (with Brent at $71) further fuels expectations of interest rate cuts by the European Central Bank as early as October. In Japan, Ishiba's victory in the LDP elections bolsters the yen. Long-term yields are stabilizing around 3.75% for the T-note and 2.15% for the Bund.

Chinese authorities have long resorted to half-measures without successfully reviving growth. The government aims to put an end to the decline in housing prices, which undermines consumer confidence and constrains credit channels. Major banks will also be recapitalized by 1 trillion yuan. The PBoC has cut rates by 30 basis points, effectively neutralizing the impact of lower mortgage rates on bank interest margins. In the United States, growth has been stronger than expected since 2020, and current activity remains solid. The eurozone sees the drop in oil prices as potential support, even as the German economy stagnates and budget consolidation is expected to be challenging.

In the financial markets, U.S. stock indices are hitting record highs, following a 12% rebound in the Chinese market last week. The appreciation of gold is the only anomaly in this favorable environment for risk assets. Recovery expectations are benefiting metals, with copper prices returning to the $10,000 per ton mark. The steepening of yield curves continues as the drop in oil prices—due to the return of Libyan and Saudi supply—accelerates the market's anticipated timeline for interest rate cuts. The T-note is trading within a 10-bp range centered around 3.75%, while the Bund hovers around 2.15%, with hopes of a move from the ECB in October. Sovereign spreads are generally well positioned. Primary market activity is robust, with China raising €2 billion. The BTP (130 bp over the Bund) is buoyed by upward revisions to Italy's GDP, which have lowered the debt ratio since 2020. Conversely, France’s OATs (80 bp) are under pressure, leading to a mechanical widening of Belgian OLO spreads. The French deficit, now projected at 6% for 2024, requires unprecedented fiscal consolidation to reassure the markets. In corporate credit markets, the narrowing of swap spreads is driving asset swap spreads on investment-grade bonds up slightly, although this has little impact on an asset class offering spreads of 117 bps over the Bund. High yield remains stable despite challenges in the automotive sector. Emerging market debt (362 bp over UST) benefits from the Fed's easing and Chinese stimulus. Chinese and Hong Kong stocks surged 12% last week, lifting European equities exposed to China.

Axel Botte

Main market indicators

G4 Government Bonds	30-Sep-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Bunds 2y	2.06%	-9	-34	-35
EUR Bunds 10y	2.13%	-2	-17	+11
EUR Bunds 2s10s	7.5bp	+7	+17	+46
USD Treasuries 2y	3.56%	-3	-36	-69
USD Treasuries 10y	3.76%	+1	-15	-12
USD Treasuries 2s10s	19.5bp	+3	+21	+57
GBP Gilt 10y	3.99%	+7	-3	+45
JPY JGB 10y	0.86%	+1	+0	-38
€ Sovereign Spreads (10y)	**30-Sep-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
France	80bp	+2	+7	+27
Italy	133bp	-2	-7	-34
Spain	80bp	+1	-3	-17
Inflation Break-evens (10y)	**30-Sep-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR 10y Inflation Swap	1.92%	-2	-11	-21
USD 10y Inflation Swap	2.38%	0	0	-3
GBP 10y Inflation Swap	3.47%	+1	+1	-6
EUR Credit Indices	**30-Sep-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR Corporate Credit OAS	117bp	+2	+1	-21
EUR Agencies OAS	67bp	+2	+3	-3
EUR Securitized - Covered OAS	61bp	+2	+1	-17
EUR Pan-European High Yield OAS	355bp	-8	-11	-44
EUR/USD CDS Indices 5y	**30-Sep-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
iTraxx IG	58bp	-1	+5	-1
iTraxx Crossover	308bp	-6	+19	-6
CDX IG	53bp	0	+3	-4
CDX High Yield	330bp	+19	+8	-26
Emerging Markets	**30-Sep-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
JPM EMBI Global Div. Spread	368bp	-2	-27	-16
Currencies	**30-Sep-24**	**1wk (%)**	**1m (%)**	**2024 (%)**
EUR/USD	$1.116	0.351	0.886	1.1
GBP/USD	$1.339	0.345	1.880	5.2
USD/JPY	JPY 142	0.851	3.293	-0.8
Commodity Futures	**30-Sep-24**	**-1wk ($)**	**-1m ($)**	**2024 (%)**
Crude Brent	$73.0	-$0.9	-$4.0	-3.1
Gold	$2 659.3	$31.1	$158.7	28.9
Equity Market Indices	**30-Sep-24**	**-1wk (%)**	**-1m (%)**	**2024 (%)**
S&P 500	5 738	0.62	1.59	20.3
EuroStoxx 50	5 067	3.72	2.21	12.1
CAC 40	7 792	3.78	2.11	3.3
Nikkei 225	37 920	0.52	-1.88	13.3
Shanghai Composite	3 335	21.31	17.32	12.1
VIX - Implied Volatility Index	16.96	5.02	13.07	36.2

Source: Bloomberg, Ostrum AM

Additional notes

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