MyStratWeekly
Market views and strategy

N° 194/ **February 24, 2025**

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Axel Botte
Head of Market Strategy
axel.botte@ostrum.com

Zouhoure Bousbih
Emerging countries strategist
zouhoure.bousbih@ostrum.com

Aline Goupil-Raguénès
Developed countries strategist
aline.goupil-raguenes@ostrum.com

Topic of the week: Xi Jinping Shifts Toward the Private Sector in Response to Internal and External Challenges

by Zouhoure Bousbih

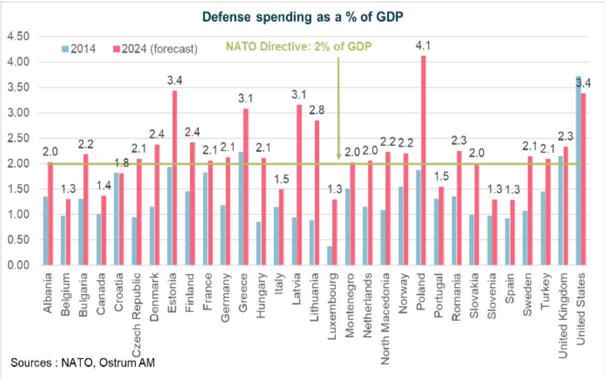
- Four years after the crackdown, the Chinese private sector has not managed to recover despite numerous declarations and gestures in its favor from the government.
- Instead of prioritizing a fiscal stimulus plan that would have had short-term effects on Chinese growth, Xi Jinping chose to encourage an innovative and autonomous private sector to ensure long-term economic success.
- This approach is fully in line with "The New Productive and Quality Forces" plan, which aims to increase China's productivity, which has remained stable since the 2008 financial crisis, while addressing the country's structural issues.
- The high-tech sector has now become the pilar of China's national competitiveness to face external pressures.
- The regulatory framework should be swiftly relaxed to enable private enterprises to play a crucial role in the national strategy.

Market review: Trump puts pressure on European sovereign bond markets

by Aline Goupil-Raguénès

- Concerns about an increase in bond issuances in Europe to finance military investments;
- Tensions on long-term European and Japanese rates contrasting with the easing of U.S. rates;
- The Yen below 150 against the dollar in anticipation of rate hikes by the BoJ;
- Stock markets slightly down following mixed earnings results.

Chart of the week



Recent comments from the new U.S. administration regarding the war in Ukraine suggest a reduced commitment from the United States to NATO, prompting European nations to significantly increase their defense spending.
Currently, only France and Germany are expected to meet NATO's target of 2% of GDP. Several financing options were discussed during the Paris Defense Summit, including the exclusion of defense expenditures from EU fiscal rules, the utilization of existing EU funds and facilities, and the creation of a new EU defense fund financed through joint debt issuance.
The impact has been significant: long-term European sovereign bond yields have risen, reflecting an increase in term premiums.

Figure of the week

85

85% of Switzerland's gold exports are destined for the United States! The country has seen an increase in transfers to the U.S. in recent months due to concerns that tariffs may impact the precious metal.
Source: Bloomberg

Topic of the week

Xi Jinping shifts towards the private sector in response to internal and external challenges

Four years after implementing a crackdown on the technology sector that penalized the private sector, the Chinese president recently convened a summit with business leaders. The private sector plays a crucial role in the Chinese economy, accounting for 60% of GDP and generating 80% of jobs in the country. Despite its importance, the sector has faced numerous challenges, including difficulties in accessing credit and obtaining the necessary permits to operate. What are Xi Jinping's motivations behind this shift?

The Long COVID of the Chinese Private Sector

The tightening of regulations and the zero-Covid policy have inflicted lasting damage on the private sector ...

Aggressive policies enacted by Chinese authorities since 2020 have inflicted lasting damage on the private sector, which had previously been a key driver of rapid economic growth.

Four years later, the private sector has struggled to recover despite numerous statements and gestures of support from Chinese leaders. The graph, based on data from the PIEE, indicates that the private sector has lost ground since 2021 to the benefit of state-owned enterprises. As of mid-2024, these enterprises represent 54% of the market capitalization of the top 100 Chinese companies, which is precisely the same share held by private enterprises at the end of 2020.

"New Productive and Quality Forces": The Evolution of the Chinese Economic Model

... Which has lost ground compared to state-owned enterprises.

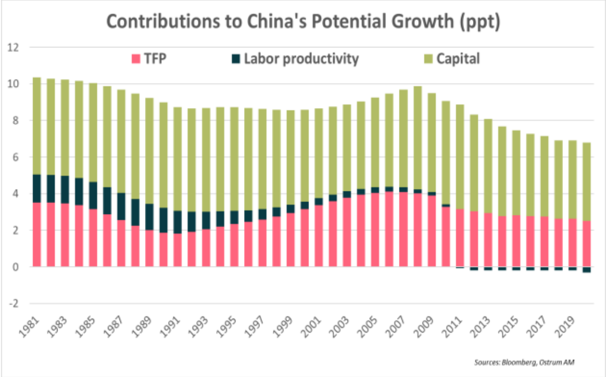
As key priority on Xi Jinping's economic agenda, the "New Productive and Quality Forces" program refers to the new growth drivers of the Chinese economy, focusing on innovative technologies in sectors such as information technology, biotechnology, artificial intelligence, new energy, and advanced materials.

This program aims to achieve three objectives: technological self-sufficiency, rapid industrial adaptation, and defense automation. Moreover, the "New Productive and Quality Forces" reveal the multifaceted approach of China's economic policy, which seeks to transform the economy toward a model of "high-quality growth" while addressing long-term structural challenges.

China must urgently increase its productivity to address the demographic challenge ...

This transition also entails a shift in the country's economic model from one initially based on capital and labor accumulation to a model primarily founded on total factor productivity (TFP). This concept, derived from economic growth theories, assesses how effectively an economy utilizes its resources (labor, capital, etc.) to produce goods and services.

The accompanying graph shows the contributions of labor, capital, and TFP to the potential growth of the Chinese economy, based on data from Bloomberg.



Over the past forty years, capital and labor have been significant factors driving China's emergence as a global economic power. While the reforms of 1978 increased productivity in China, it has stagnated since the 2008 financial crisis. During this period, Chinese authorities heavily supported the real estate sector and infrastructure investments, which have not yielded sustainable growth.

... And to avoid falling into the middle-income trap!

However, considering demographic challenges, China must urgently reconnect with productivity growth to achieve sustainable and more inclusive development. This context frames Xi Jinping's symposium with private sector leaders, particularly those from the technology sector.

The High-Tech Sector : A Pillar of China’s Global Competitiveness Amid External Pressures

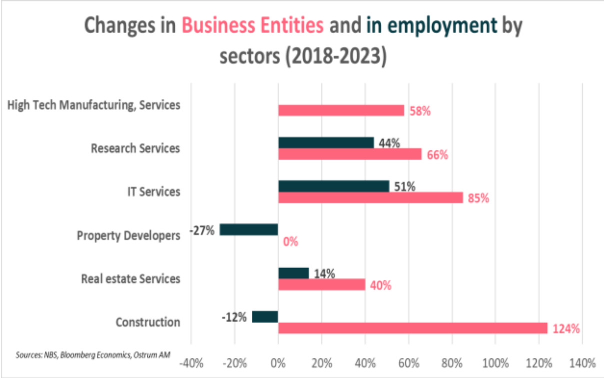
Xi Jinping preferred to encourage an innovative and self-sufficient private sector rather than implement a fiscal stimulus plan.

Rather than favoring a fiscal stimulus plan that would provide short-term boosts to growth, Xi Jinping has opted to encourage an innovative and self-sufficient private sector to ensure long-term economic success.

DeepSeek reflects the rapid technological advancements made by China since the introduction of U.S. trade sanctions that restricted access to sophisticated chips and integrated circuits, aimed at curbing its technological ascent. This situation has forced China to innovate with limited resources. As such, artificial intelligence is fully aligned with the "New Productive and Quality Forces" initiative, as it requires minimal resources. Consequently, the Chinese government aims to accelerate the transition toward a technology-driven growth model, moving away from reliance on the real estate sector.

The Chinese government aims to accelerate the transition of the growth model toward the high-tech sector.

The accompanying graph illustrates the changes in business entities and employment across various economic sectors from 2018 to 2023 (Source: Bloomberg Economics).



The real estate sector has experienced the most significant employment contraction, with a decline of 13% over the past five years, whereas the technology services sector has seen the fastest growth, with an increase of 51% compared to 2018. This trend is expected to accelerate and strengthen.

Regulatory obstacles to the private sector will be removed to give it an active role in the national strategy.

During the symposium with leaders from the Chinese technology sector, President Xi Jinping committed to providing robust and consistent support for the private sector while encouraging entrepreneurs to leverage their skills and make meaningful contributions. Authorities are expected to implement targeted measures to address the challenges faced by private enterprises and create a favorable business environment to enhance sector confidence.

Several measures have been proposed to support the development of the private sector. China plans to expedite the revision of its negative list to eliminate market access barriers for private enterprises. The government also seeks to involve private enterprises actively in the implementation of national strategies and infrastructure improvement programs. Legislation favoring the private sector should also be strengthened, particularly concerning the legal protection of businesses.

Conclusion

In the face of external pressures, Xi Jinping has pivoted toward the private sector, positioning it as a cornerstone of national competitiveness. This strategy aligns with his plan for "New Productive and Quality Forces," aimed at reviving productivity, which has remained stagnant since the 2008 financial crisis. This approach also addresses structural issues such as demographic challenges and aims to avoid the middle-income trap. The Chinese government therefore seeks to accelerate the transition of its economy toward high-tech sectors, particularly artificial intelligence, breaking away from its previous growth model based on real estate. Chinese authorities are considering expediting the removal of financial barriers and access constraints to ensure that private enterprises play an active role in implementing national strategies.

Zouhoure Bousbih

Market review

Trump puts pressure on European sovereign bond markets

The prospect of increased bond issuances to finance the rise in military spending weighed on European interest rate markets.

The week was once again marked by Trump's statements and the first discussions between the United States and Russia regarding a ceasefire, sidelining the EU and Ukraine. While the American market was closed on Monday, European sovereign rates rose sharply in response to the Munich conference. The EU suddenly realized that it could no longer rely on the United States for its defense. The prospect of increased bond issuances to finance military spending weighed on European rates. In this context, the European Commission proposed suspending the rules of the Stability and Growth Pact for defense investments for requesting countries. Discussions are underway to find sources of European funding, such as unused funds from NextGeneration EU; however, disagreements persist regarding any potential new European financing. In this context, the German 10-year yield rose to close at 2.56% on Wednesday, before easing for the rest of the week, ending up 4 basis points for the week at 2.47%. This easing at the end of the week was partly linked to the S&P global survey, which revealed stability in eurozone activity for the second consecutive month in February. The French spread remained relatively unchanged despite a report from the Court of Auditors revealing a significant deterioration in the financial situation of the pension system over the next 20 years. The Italian spread tightened by 2 basis points, benefiting from the success of the BTP Valore Piu issuance, aimed at households (with demand of €14.9 billion). Tensions were stronger on British and Japanese rates (+7 basis points). This led Governor Ueda to state that the central bank might intervene in the event of excessive pressure on rates. Stronger-than-expected growth and inflation at a two-year high (4% in February) foreshadowed another rate hike by the Japanese central bank. The Reserve Bank of Australia, on the other hand, lowered its rates by 25 basis points for the first time in over four years while being cautious about the pace of future cuts due to a tight labor market. American rates, however, slightly decreased over the week: -2 basis points for the 10-year rate, at 4.46%, after experiencing pressure on Tuesday. The Fed Minutes indicated that it was not in a hurry to lower rates again, given somewhat high inflation and risks related to upcoming measures from the new administration.

The dollar slightly declined over the week despite Trump’s threat of new tariffs: +25% on cars, semiconductors, and pharmaceuticals. He has until April 2 to make a decision. The yen benefited from the prospects of rate hikes by the BoJ, falling back below 150 against the dollar. Stock markets experienced a slight decline over the week: -0.50% for the S&P 500 and -0.7% for the Nasdaq. Walmart's weaker-than-expected outlook notably raised concerns about the robustness of American household consumption. In Europe, the Eurostoxx 50 fell by 0.3%, as did the CAC 40. Both have seen a significant increase since the beginning of the year (nearly 12% and just over 10%, respectively), catching up with their lag behind the United States. Finally, in China, the Hang Seng index rose by 3.8%, driven by Alibaba's profit outlook.

Aline Goupil-Raguénès

Main market indicators

G4 Government Bonds	24-Feb-25	1wk (bp)	1m (bp)	2025 (bp)
EUR Bunds 2y	2.09%	-6	-21	+0
EUR Bunds 10y	2.46%	-3	-11	+9
EUR Bunds 2s10s	37 bp	+2	+9	+9
USD Treasuries 2y	4.21%	-5	-5	-3
USD Treasuries 10y	4.42%	-6	-20	-15
USD Treasuries 2s10s	20.5 bp	-1	-15	-12
GBP Gilt 10y	4.56%	+3	-7	-1
JPY JGB 10y	1.43%	+7	+14	+13
€ Sovereign Spreads (10y)	**24-Feb-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
France	75 bp	+3	+1	-8
Italy	107 bp	+1	-2	-8
Spain	63 bp	+2	+2	-6
Inflation Break-evens (10y)	**24-Feb-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
EUR 10y Inflation Swap	1.99%	+1	-5	+6
USD 10y Inflation Swap	2.56%	-3	+2	+9
GBP 10y Inflation Swap	3.53%	-1	-6	+1
EUR Credit Indices	**24-Feb-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
EUR Corporate Credit OAS	87 bp	-2	-10	-15
EUR Agencies OAS	52 bp	-1	-5	-10
EUR Securitized - Covered OAS	48 bp	-3	-4	-9
EUR Pan-European High Yield OAS	294 bp	-2	-21	-24
EUR/USD CDS Indices 5y	**24-Feb-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
iTraxx IG	52 bp	+1	-1	-5
iTraxx Crossover	285 bp	+6	-4	-29
CDX IG	48 bp	+2	+1	-1
CDX High Yield	303 bp	+11	+7	-9
Emerging Markets	**24-Feb-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
JPM EMBI Global Div. Spread	320 bp	+7	0	-6
Currencies	**24-Feb-25**	**1wk (%)**	**1m (%)**	**2025 (%)**
EUR/USD	$1.048	-0.048	-0.172	1.2
GBP/USD	$1.264	0.135	1.266	1.0
USD/JPY	JPY 149	1.467	4.474	5.3
Commodity Futures	**24-Feb-25**	**-1wk ($)**	**-1m ($)**	**2025 (%)**
Crude Brent	$74.2	-$1.1	-$3.4	-0.1
Gold	$2 941.1	$44.5	$170.5	12.1
Equity Market Indices	**24-Feb-25**	**-1wk (%)**	**-1m (%)**	**2025 (%)**
S&P 500	6 013	-1.67	-1.44	2.2
EuroStoxx 50	5 461	-1.07	4.62	11.5
CAC 40	8 117	-0.88	2.39	10.0
Nikkei 225	38 777	-0.95	-2.89	-2.8
Shanghai Composite	3 373	0.51	3.70	0.6
VIX - Implied Volatility Index	18.21	23.29	22.63	5.0

Source: Bloomberg, Ostrum AM

Additional notes

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