# MyStratWeekly
Market views and strategy

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N° 101 // **February 20, 2023**

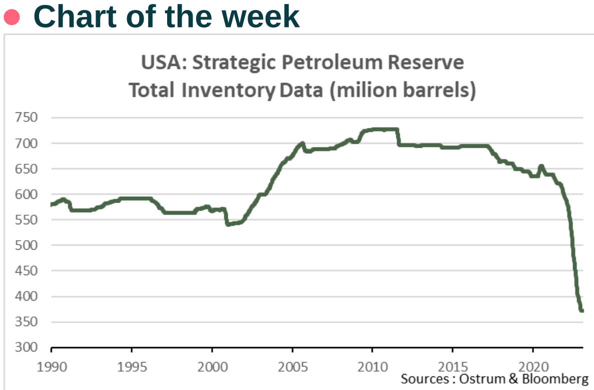
## Topic of the week: Food: the sword of Damocles

- **The surge in food prices seems behind us but the balance remains fragile;**
- **Uncertainty remains high on the outlook: climatic conditions, natural gas prices, policy of food protectionism, etc.;**
- **However, it is China's food security policy that poses the main threat to global food security;**
- **The lack of global coordination on a common food security policy risks increasing price volatility.**

## Market review: Central banks in doubt

- **Signs of slower disinflation sparks terminal rate debate**;
- **T-note yields near 3.90%;**
- **Credit spreads stable despite less supportive primary markets;**
- **European stocks resist higher yields.**

## Chart of the week




Strategic oil reserves in the United States continue to decline very rapidly. We have been at a rate of almost 20 million barrels per month for the past six months. This helps maintain supply in the market and therefore exert a price pressure.

Not only should this offer stop since reserves have been almost halved since early 2020. But in addition it will be necessary one day to replenish these reserves, and therefore the American State will become a net buyer.

At this point, the pressure to fuck on prices will be reversed. Part of the drop in prices is therefore purely artificial and temporary.

## Figure of the week

**19**

Flows on global IG credit funds reached 19 Bn USD according to EPFR.
An all-time high for the beginning of the year.

Source : Ostrum AM

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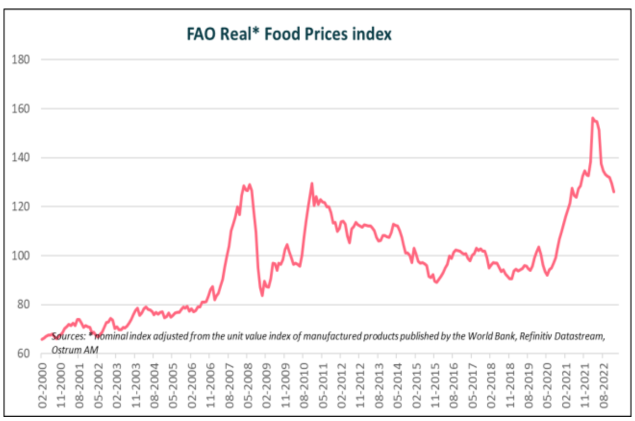
● **Topic of the week**

# Food: the sword of Damocles

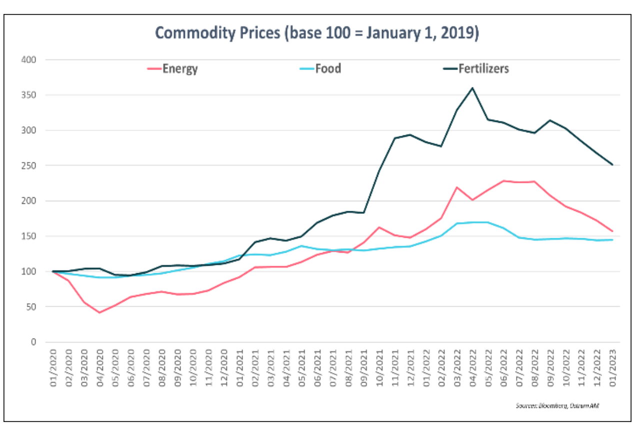
**The soaring food prices seem to be behind us, like the FAO food index which continued to fall at the start of the year for the 10th consecutive month, returning to its 2021 levels. Is crisis behind us?**

## Falling…

World food prices continued to fall in January for the 10th consecutive month. The FAO's global food price index has fallen 17.9% since its peak in March 2022, following the Russian invasion of Ukraine.




This downward trend was largely supported by the crucial Black Sea agreement signed on July 22, 2022 which helped to unlock Ukrainian grain exports, while lower natural gas prices helped to calm the rise of fertilizer prices, as shown in the graph below.



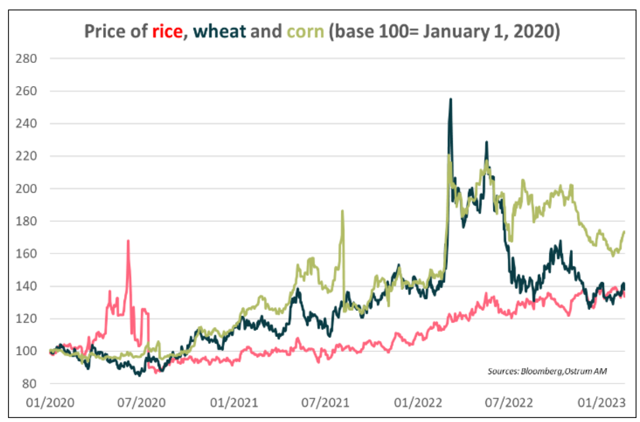

Note that the prices of fertilizers had risen more sharply than the prices of agricultural products, which had been an aggravating factor of the crisis.

The fall in prices has provided relief to emerging countries, particularly those that are closely dependent on Russia and Ukraine, such as Egypt, which imports 70% of its cereals from these two countries, Turkey (75%) and Tunisia. (52%). This price increase, which began in 2021, raised fears for the food security of the poorest countries whose public finances had deteriorated significantly due to the management of the epidemic. The war in Ukraine has only exacerbated an already tense situation.

## … But the balance remains fragile

### Persistent food inflation

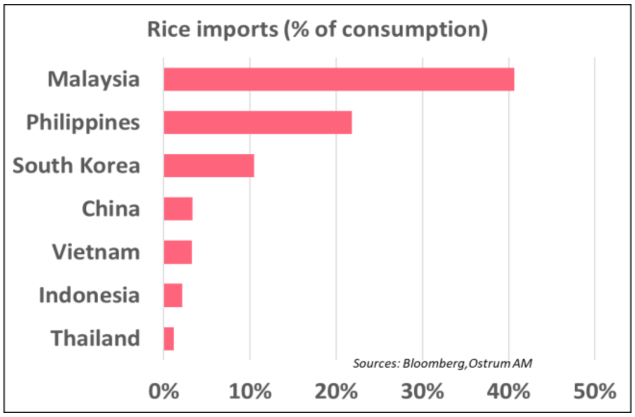
Despite the healthy drop, cereal prices remain well above their 2021 levels, such as wheat (+ 34%) and corn (+ 29%) prices, as shown in the graph following.




Rice prices have been at their highest since March 2021, but still far from their historic highs. The bullish trend started in 2022, as it served as a substitute for other cereals whose prices remain high.

Rice is the food consumed by more than half of the world's population, mainly in Asia. Asia has been protected until now from rising food prices, because of its heavy dependence on rice. Unlike wheat and other cereals, rice production is consumed locally and does not enter international markets. However, trading volumes globally have increased significantly, reflecting strong demand.

A continued rise in prices risks generating inflationary pressures, increasing the risk of social instability in the region. In Indonesia, the end of gasoline subsidies at the end of last year had caused strong social tensions in the country. The graph below shows the import share of several Asian countries according to their consumption.




The Philippines and Malaysia have the highest dependence on imports, and therefore on the price of rice. An increase in prices risks deteriorating their fiscal position, in a context rather of the consolidation of post-pandemic public finances.

### High uncertainty, particularly geopolitical

The outlook for food prices depends on several parameters: natural gas prices, climatic conditions, the policy of producing countries which could be encouraged to reduce their exports, to ensure their own food security, etc.

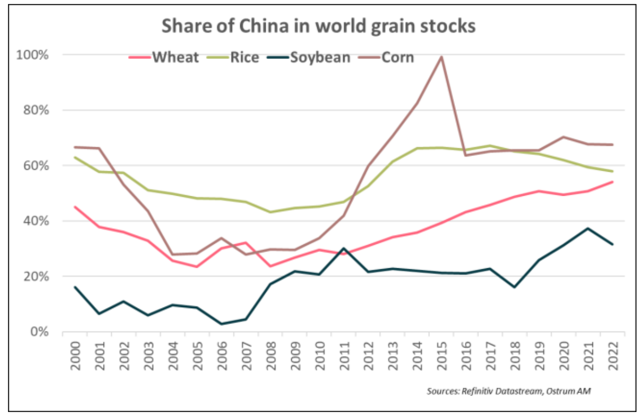
The Black Sea Agreement is the immediate danger. Any blocking of this agreement, which should be renewed next March, would spontaneously lead to a sharp rise in food prices.

# China's sword

With a population of 1.4 billion, or 18.5% of the world's population and only 12% of arable land, having a food security policy is therefore essential for China. However, it is not without consequences for global food security.

### China's Food Security Policy Threatens Global Security

The country has built up large stocks of agricultural products during the pandemic for fear of shortages, contributing to higher world prices in 2021. The graph below shows the level of Chinese grain stocks compared to world stocks.




China's wheat stocks represent 54% of world stocks, 58% for rice, 32% for soybeans and 68% for corn. The accumulation of large stocks by China does not improve global food security, but reduces the available supply, unbalancing the market and therefore making it sensitive to external shocks.

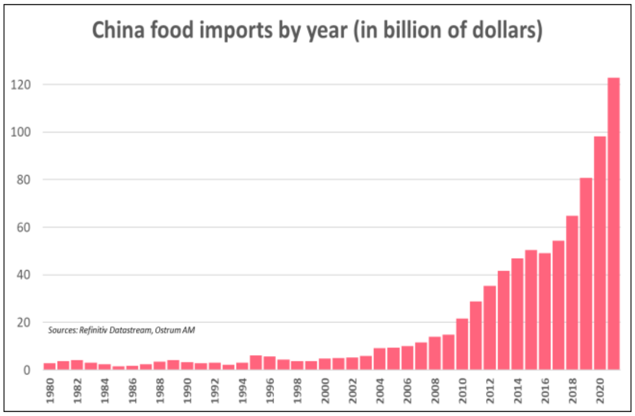
On the other hand, the Chinese authorities had put in place restrictions on the export of fertilizers (rock phosphate and export licenses), from August 2021, therefore well before the war in Ukraine and until December 31, 2022, contributing to rising prices and accentuating the food crisis. Fertilizer prices remain at high levels, which could encourage farmers to use less, thus reducing their agricultural production. For poor countries, the price increase is a brake on purchasing, directly threatening their food security.

### Too much dependence on imports of agricultural products

China is a major producer of agricultural products worldwide: it is the world's largest producer of rice, wheat, and the world's second largest producer of corn. Its cereal production reached a historic high of 686.53 million tons in 2022, despite the Covid-19 supply distortions and bad weather conditions.

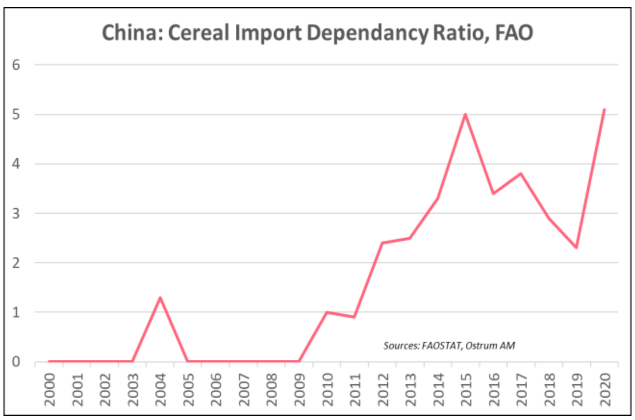
However, China imports massively, as its domestic production is unable to keep up with its consumption. The emergence of a middle class has changed the eating habits of the Chinese population, contributing to the increase in the consumption of products with better nutritional qualities, such as meat and cereals. The other factor is the pursuit of food security. In 2008, infant milk contamination killed six babies and poisoned 300,000 children. Since then, Chinese families have preferred infant milk produced abroad.

In 2021, its food imports hit an all-time high of $122 billion, up 52% from 2019, as shown in the following chart.




The acceleration started in 2018 against a backdrop of deteriorating relations with the United States and Australia, both major global producers of agricultural products, posing great uncertainty about its food security.

This is particularly the case for agricultural products. China has been a net importer of agricultural products since 2004. The graph below represents the FAO cereal import dependency ratio for China.




To ensure its food security, China has diversified its supply sources of agricultural products. Brazil has become its main supplier for agricultural products representing 20% of its agricultural imports. China has also undertaken a warming of its relations with Australia, for the first time in three years –witness the visit, on February 6, of the Australian Minister of Commerce. The risk is therefore that China could favor bilateral agreements, rather than coordination at the global level, which could bring volatility to food prices and increase the frequency of crises.

## Conclusion

Although the fall in food prices is beneficial, the balance of the market for agricultural products remains fragile. Uncertainty remains high on the outlook: climatic conditions, natural gas prices, food protectionism policy... Fertilizer prices remain high, which could encourage farmers to reduce the quantities used, reducing agricultural yields, and exerting upward pressure on the costs. However, China's food security policy is the main threat to global food security. The emergence of bilateral trade agreements between China and the main producers of raw materials, rather than coordination at the global level, risks accentuating the volatility of agricultural prices, threatening the social and political stability of poor countries.

## Zouhoure Bousbih

## Market review

# Central banks in doubt

### Slower-than-expected disinflation raises the risk of further monetary tightening.

Financial markets are vulnerable because asset prices are pricing in a perfect disinflation scenario. This warning from Isabel Schnabel reflects both the excessive optimism of stakeholders and the doubts of central bankers faced with the stubbornly high inflation. The situation is similar in the United States, Mexico, India and Australia. The terminal rate of the ongoing monetary cycle must indeed be reassessed. This inflation backdrop is causing renewed tensions on bond markets. The 2023 bond rally was briefly erased by a rapid Bund yield upturn towards 2.57% (last year's close). Inflation breakevens make up for about half the weekly increase in euro nominal bond yields. The T-note hovers about 3.90%. In currency space, the US dollar is regaining momentum after the broad-based unwinding of long greenback positions at the start of this year. The dollar-yen exchange rate is back up near the 135 threshold. This trend could last until the next BoJ meeting on March 10. The slowdown in euro IG credit fund inflows and heavy sovereign bond supply in the euro area are now slowing down the narrowing in spreads. The upshift in 10-year bond yields also weighed on growth stocks. The horizon is darkening for an equity market that probably believed too quickly in a pause in the monetary cycle.

US household consumption data echoes the latest employment statistics in the United States. Retail sales in January (+3%M) reflected a pickup in consumer spending that erased the decline of the previous two months. GDP growth is expected to be around 2% (at annualized rate) between January and March. At the same time, inflation fell slightly to 6.4% in January (6.5% the previous month). The improvement is mainly attributable to the prices of imported consumer goods. The recession in China last year, the normalization of global supply chains and even the strong dollar all contributed to slower inflation. However, the Fed cannot ignore that domestic pressures remain. Annual inflation in the service sector is still above 7%. Such price trend appears inconsistent with the sacrosanct 2% objective. In the euro area, with a recession now unlikely, inflation is once again becoming the main concern for market participants and the ECB. The message is clear: a 50-bp rate hike will be announced in March. Other central banks will have to re-examine their monetary strategies. The BoC must take the Fed's decisions into account, especially as employment in Canada remains solid. The Riskbank has pledged to reduce its balance sheet by selling securities for a total of SEK 3.5 billion each month from April in addition to ongoing repo rate increases. In turn, the RBA and RBNZ will also have to deal with the persistence of inflation. The monetary cycle may have entered its second stage.

Against this background, global bond yields are adjusting to the upside. The T-note broke the upper end of its 3.30-3.75% trading range to reach 3.90%. Short US Treasury bond futures positions, covered up during the brief return to 3.30% at the start of the month, are accumulating again. The asymmetry to the downside in interest rate volatility has also increased. Leveraged funds and other speculative accounts are targeting a return to October highs on 10-year yields near 4.30%. However, the inflation scenario priced in by the markets does not seem to incorporate an inflation risk premium. Besides the technical factors related to the ongoing debt ceiling drama, the inversion of the US yield curve reflects a now dubious convergence of prices towards the 2% target. In the euro area, the Bund, close to 2.50%, took note of Isabel Schnabel's statements which heralded the need for monetary tightening. The comments helped to pull Schatz yields towards 3%. François Villeroy de Gahlau then Fabio Panetta bring some nuance, which only foreshadows intense debates likely to take place at the next governing council on March 16th. The deposit rate also acts as a floor for German yields across maturities.

In turn, swap spreads are gradually tightening, with an inverted term structure. Sovereign spreads proved insensitive to the sharp increase in German yields, but the large syndications of 30-year bonds in Belgium and Italy are giving rise to some portfolio reshuffling. Italy's 10-year BTPs (188 bps) underperforms Greek debt around the 30-year bond syndication. Meanwhile, the credit market is digesting its very good start to the year. Flows on credit funds now tend to fade (or concentrate on the short end of the curve) and the primary market takes a heavier toll on spreads. Two-thirds of bonds (financial and non-financial combined) are trading at wider spreads than when issued earlier in February. High yield however continues to benefit from fund inflows, which keep spreads stable around 425 bps. However, we are seeing a turnaround in index spreads. The Crossover is once again close to the 400 bp mark.

The European equity market resists tensions on risk-free interest rates. The Euro Stoxx 50 remains above 4200 points. Intra-day volatility does not seem to be fully reflected in the 1-month volatility indices, which fluctuate around 20%. The steady outflows during 2022 have begun to reverse course in 2023. The earnings season is okay (+5%), with sales growth broadly offsetting downward pressure on profit margins. Technology, basic resources or real estate face significant headwinds.

**Axel Botte**
Global strategist

## Main market indicators

| G4 Government Bonds | 20-Feb-23 | 1wk (bp) | 1m (bp) | 2022 (bp) |
|---|---|---|---|---|
| EUR Bunds 2y | 2.88% | +10 | +31 | +12 |
| EUR Bunds 10y | 2.45% | +9 | +28 | -12 |
| EUR Bunds 2s10s | -44bp | -2 | -3 | -23 |
| USD Treasuries 2y | 4.62% | +10 | +45 | +19 |
| USD Treasuries 10y | 3.81% | +11 | +34 | -6 |
| USD Treasuries 2s10s | -80.6bp | +2 | -11 | -25 |
| GBP Gilt 10y | 3.5% | +10 | +12 | -18 |
| JPY JGB 10y | 0.51% | -1 | -1 | +8 |
| **€ Sovereign Spreads (10y)** | 20-Feb-23 | 1wk (bp) | 1m (bp) | 2022 (bp) |
| France | 45.56bp | +0 | -1 | -9 |
| Italy | 183.69bp | +3 | -3 | -30 |
| Spain | 95.91bp | +2 | -3 | -13 |
| **Inflation Break-evens (10y)** | 20-Feb-23 | 1wk (bp) | 1m (bp) | 2022 (bp) |
| EUR 10y Inflation Swap | 2.42% | +5 | +18 | -13 |
| USD 10y Inflation Swap | 2.58% | +3 | +19 | +5 |
| GBP 10y Inflation Swap | 3.75% | -3 | +15 | -16 |
| **EUR Credit Indices** | 20-Feb-23 | 1wk (bp) | 1m (bp) | 2022 (bp) |
| EUR Corporate Credit OAS | 144bp | +2 | -15 | -23 |
| EUR Agencies OAS | 70bp | +0 | -3 | -9 |
| EUR Securitized - Covered OAS | 78bp | +1 | +0 | -6 |
| EUR Pan-European High Yield OAS | 432bp | +4 | -45 | -80 |
| **EUR/USD CDS Indices 5y** | 20-Feb-23 | 1wk (bp) | 1m (bp) | 2022 (bp) |
| iTraxx IG | 78bp | 0 | -4 | -13 |
| iTraxx Crossover | 406bp | +1 | -23 | -68 |
| CDX IG | 73bp | +0 | -3 | -9 |
| CDX High Yield | 445bp | +6 | -8 | -39 |
| **Emerging Markets** | 20-Feb-23 | 1wk (bp) | 1m (bp) | 2022 (bp) |
| JPM EMBI Global Div. Spread | 454bp | +9 | +6 | +2 |
| **Currencies** | 20-Feb-23 | 1wk (%) | 1m (%) | 2022 (%) |
| EUR/USD | $1.069 | -0.326 | -1.548 | -0.2 |
| GBP/USD | $1.203 | -0.890 | -2.952 | -0.4 |
| USD/JPY | JPY 134 | -1.304 | -3.406 | -2.3 |
| **Commodity Futures** | 20-Feb-23 | -1wk ($) | -1m ($) | 2022 (%) |
| Crude Brent | $83.8 | -$2.8 | -$3.9 | -2.14 |
| Gold | $1 845.0 | -$8.5 | -$81.1 | 1.15 |
| **Equity Market Indices** | 20-Feb-23 | -1wk (%) | -1m (%) | 2022 (%) |
| S&P 500 | 4 079 | -0.28 | 2.68 | 6.2 |
| EuroStoxx 50 | 4 275 | 0.79 | 3.76 | 12.7 |
| CAC 40 | 7 342 | 1.85 | 4.94 | 13.4 |
| Nikkei 225 | 27 532 | 0.38 | 3.68 | 5.5 |
| Shanghai Composite | 3 290 | 0.19 | 0.78 | 6.5 |
| VIX - Implied Volatility Index | 21.01 | 3.29 | 5.84 | -3.0 |

Source: Bloomberg, Ostrum AM

## Additional notes

### Ostrum Asset Management



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