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Weekly Macro & Markets View

Highlights and View

- **US election results jolt equities and credit higher while bond yields decline modestly**

  Clarity on the election outcome and diminished prospects of corporate tax hikes improves the outlook for risk assets, although some of the rally seemed to be driven by the unwinding of hedges.

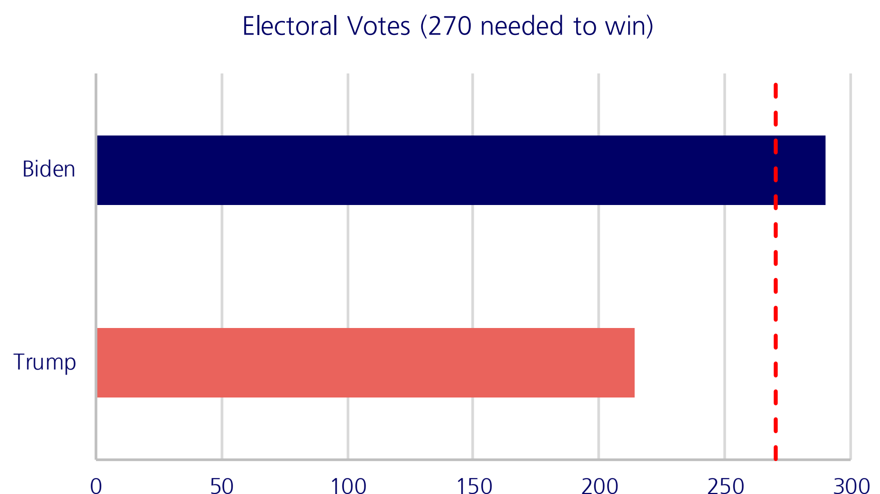
- **In a unified effort, the BoE and the Chancellor announced further supportive measures**

  The BoE's expansion of its QE program and the Chancellor's extension of the Job Retention Scheme until March 2021 will provide relief as economic activity faces severe headwinds.

- **The RBA cuts its key rates, expands QE, and confirms interest rates will remain low for at least three years**

  The central bank's dovish forward guidance guarantees low interest rates for an extended period. Together with significant fiscal stimulus, it will help businesses and households continue to recover post crisis.

Joe Biden will become the 46th president of the United States



Source: Associated Press

Four days after the polls closed Joe Biden was declared the winner of the US presidential election. Donald Trump has not yet conceded and there will be recounts in several states, but these are unlikely to change the overall result given Biden's lead in these states. While Joe Biden won the election with a record number of votes the 'Blue Wave' predicted by the polls has not flooded into Congress. Democrats will keep a slightly smaller majority in the House of Representatives while the Republicans are likely to keep a thin majority in the Senate. The outcome for the Senate is dependent on two run-off elections in Georgia that will take place in January. Stock markets cheered with the S&P 500 rising 7.3% last week, the biggest weekly gain since April. At the same time 10yr Treasury yields faced the largest daily drop since March as significant fiscal stimulus now becomes unlikely. Relief and reduced uncertainty are key reasons for the market rebound, but the market narrative has changed several times over the past few weeks. Investors now favour a divided government as this makes it unlikely that Biden will be able to implement substantial tax hikes or regulatory burdens for the corporate sector. However, Biden will need support from Congress to fight the pandemic, which has come back with a vengeance and poses a threat to economic activity in the weeks and months ahead.

US Data: Manufacturing activity rises to a two-year high

The latest batch of data shows that the economy entered the fourth quarter on solid footing. The ISM Manufacturing survey rose to 59.3 in October, the highest in two years. The acceleration of manufacturing activity was broad-based with new orders reaching a 16-year high. Not surprisingly given the significant reacceleration of COVID-19 infections, activity in the service sector was a bit more modest but nevertheless improving with the survey at 56.6, down from 57.8 in September. The ongoing improvement is also visible in the labour market. Overall, 638'000 new payrolls were created in October. The picture looks even better in the private sector with more than 900'000 new jobs (government employment fell, partially driven by a loss of temporary 2020 Census workers). The unemployment rate fell to 6.9% from 7.9% in September, although the true number would be about 0.3% higher according to the Bureau of Labor Statistics given that some workers affected by the pandemic should have been classified as unemployed on temporary layoff.

Credit: Markets surge after the US election

Credit markets rallied sharply last week as the outcome of the US elections is seen as constructive by investors, spurring them to remove some of the hedges that had been put on. Investor angst was evident in the elevated levels of implied volatility before the election, in both equity and credit derivative option markets. We believe that some of last week's rally was driven by an unwind of hedges as implied volatility declined notably. A split US Congress is seen as supportive for credit in general but particularly for high yield, as angst around corporate tax hikes ebbed.

Investment grade credit also rallied sharply despite having been resilient over the last two months, although CDS indices outpaced the rally in corporate bonds. Bond yields declined on expectations of reduced stimulus going forward, although they pared the decline in the latter part of the week. Looking ahead, credit markets seem supported not only by the relative value versus very low government bond yields, but also by central banks, with the ECB likely to announce more stimulus in December.

Australia: Monetary policy is back

The RBA cut its cash rate, the Term Funding Facility rate on new loans, and the three-year Yield Curve Control target to 0.1%, as well as announced a broad-based AUD 100bn Quantitative Easing (QE) program, aiming to buy government bonds with tenures between five and 10 years over the next six months. While these moves were widely anticipated, the speed of the QE deployment was faster than market expectations. Notably, the RBA was very dovish in its forward guidance, mentioning that 'the Board is not expecting to increase the cash rate for at least three years' until 'actual inflation is sustainably within the 2-3% target range'. It was a significant shift in the RBA's narrative, moving from a general emphasis on employment to a specific inflation target. This showed the central bank's conviction to keep interest rates low for an extended period. We expect that ultra-low rates and a sizable deployment of QE will support risk assets going forward given that the economy is gaining a more solid footing and COVID-19 infection rates have significantly abated.

APAC PMIs: A mixed bag

China's Caixin Manufacturing and Services PMIs continued to surge in October, reaching 10-year highs. This suggests that the environment for medium to small-sized companies in the private sector is improving further. Australia and Taiwan's Manufacturing PMIs also showed strong readings in the mid-fifties, while Korea's climbed above the 'boom/bust' line of 50. These data are consistent with a broad-based recovery, which is also confirmed by the rising and forward-looking new orders-to-inventory ratio. Among the major countries, only Japan is lagging.

India reported its strongest Manufacturing PMI in a decade, increasing from 56.8 to 58.9 in October. The strength was seen across various subcomponents, except for employment. Meanwhile, most of ASEAN's PMIs were rather lacklustre overall. Malaysia's Manufacturing PMI deteriorated as a new wave of virus infections triggered restrictions in several states. It is worth noting that employment conditions remain sluggish in most countries with the notable exceptions of China, Vietnam and Australia.

Latam: US election boosts equity markets, economic activity continues to recover

Last week, the MSCI Latin American Index rose 11.2%, its best week since last June, and outperformed the MSCI EM Index, which rose 6.6%. Furthermore, the region's main currencies appreciated, in line with the dollar index's depreciation, highlighting the Brazilian real. These asset performances are also in line with the economic data released last week. In Chile, as a result of the easing of virus containment measures, fiscal stimulus, and the impact of the withdrawal of pension funds, monthly economic activity continued to recover in September, growing 5.1% MoM, above market expectation. Business confidence also improved in October and is in optimistic terrain for the first time in 12 months. Inflation in October was above market expectations, but slowed to 3.0%. In Brazil, industrial production increased 3.4% YoY in September, exceeding market expectations and breaking a 10-month streak of decline. The Manufacturing PMI stood at 66.7, the highest level since the series began. Inflation continues to accelerate, reaching 3.92% YoY in October.

What to Watch

- In the US, the NFIB index and the University of Michigan's consumer sentiment survey will reveal whether the mood among small firms and households has been holding up despite a significant re-acceleration in new COVID-19 cases.
- In APAC, Q3 GDP will probably show a decent rebound in Malaysia while the Philippines' Q3 recovery is likely to underwhelm given local lockdowns and high infection rates in the last quarter. Signs of recovery should start showing up in India's industrial production and trade data. Japan's Eco Watcher Survey for October is expected to edge higher. China's October CPI will fall further on lower pork prices, while producer price deflation is likely to remain roughly unchanged. In Australia, we will focus on business and consumer confidence data.
- In the Eurozone, industrial production data from various countries and the ZEW survey will give an indication of the strength of the recovery.

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