November 23, 2020

ZURICH®

Weekly Macro & Markets View

Highlights and View

- **Resilience gives way to a rally in credit, while the Fed will likely end some credit support programs**

  Credit market demand/supply dynamics are very strong and while the end of Fed credit programs is disappointing as it removes an important backstop, it is less critical today than it was in March.

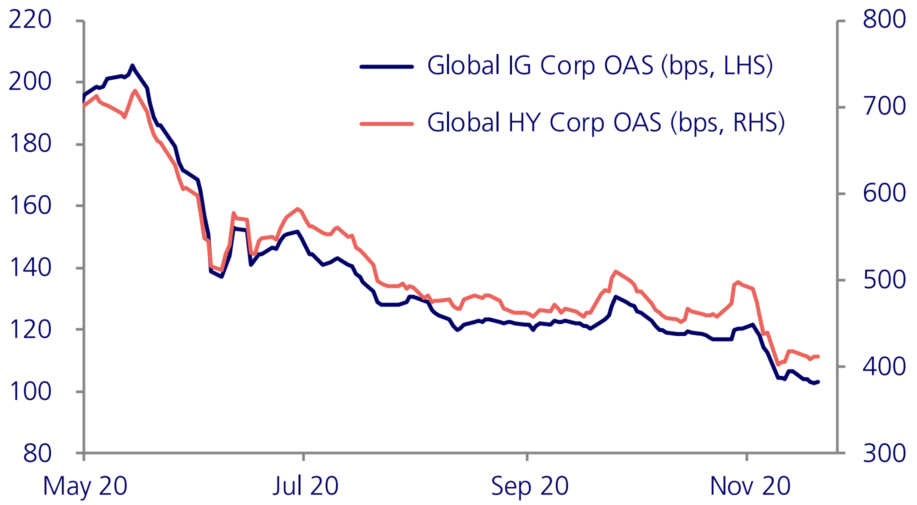
- **US retail sales growth slows down in October as households become more cautious**

  Partial shutdowns due to high infections rates and rising job uncertainty may create headwinds to consumer spending.

- **Poland and Hungary veto EUR 750bn EU Next Gen initiative and EU multi-annual budget agreement**

  The EU Next Gen initiative is vital to making the region more resilient economically. A compromise still appears to be the most likely outcome over the next few weeks.

Credit: from resilience to rally



Source: Bloomberg

Credit markets were remarkably resilient when equities were jittery over the last three months, and they have now rallied sharply in the past few weeks amid an equity surge. This is largely a testament to the very strong current supply/demand technicals in credit markets. The global liquidity glut, along with a substantial relative income pickup versus government bond yields is driving strong investor demand evident in fund flows. Moreover, after record issuance, net supply is likely to slow down in coming months as companies seem to be flush with liquidity. Encouragingly, the strong sentiment is trickling down to the weakest borrowers. Cruise line operator Carnival successfully placed around USD 1.4bn and EUR 500mn of debt last week, its first bonds that are not secured against its ships since the pandemic started. Issuance in high yield markets has notably picked up while the CCC rated segments of the market are rallying. Strong primary markets are fundamentally positive for high yield and indeed, default rates have been normalising following a spike in Q2. Disappointingly, however, the US Treasury wants to recall unused capital backing some of the Fed's credit programs, thus removing an important backstop, although it is less critical today than it was in March as companies have raised substantial cash from markets.

US: Retail sales slow down in October

The S&P 500 took a breather last week, receding by 0.8%, following an almost 10% rise over the two weeks before. On the other hand, small cap stocks represented by the Russell 2000 continued their move higher, adding another 2.4% and thus bringing the three-week total to more than 15%. Investors seem undeterred by continuously high numbers of new COVID-19 infections, partial shutdowns to fight the pandemic, and a potential premature end to some of the Fed's lending measures. Economic data were mixed last week. Retail sales growth slowed to 0.3% MoM in October, a post-recession low, following a revised down 1.6% in September. It will be important to see whether spending momentum recovers in the crucial weeks ahead or whether renewed job uncertainty will keep households from spending into year end. The housing market, on the other hand, continues to show strength with the pace of housing starts receding only slightly to 4.9% MoM in October. The number of building permits was flat, however, indicating that the strong momentum may be levelling off in the months ahead.

msme@zurich.com

North Asia: Record high infections and a somewhat disappointing PMI hit Japan

In Japan, record high infection rates were reached after a third pandemic wave gained steam. Tokyo issued its highest alert status. The 'Go To' travel campaign may be interrupted, but other regions, like Hokkaido, are excluded. Neither the Manufacturing PMI nor Non-Manufacturing PMI were able to crawl back above the 50 boom/bust line but instead even rolled over following a sharp rebound. The export order index slowed as well and fell back below 50, although exports fell far less than expected in October, with volumes even back to pre-crisis levels.

Meanwhile, US President Trump prohibited US investors from investing or trading in 31 companies with links to China's military, raising concerns that he will increase tensions with China. In Korea, exports were up 7.6% YoY in the first twenty days of November on a working-day adjusted basis. Semiconductor exports were up 18% YoY, while mobile phone exports surged 32%. Auto exports improved as well. The EU and the US showed the biggest improvement as importers of Korean products, despite suffering from new waves of COVID infections.

ASEAN: Surprising moves by central banks

In ASEAN, the Bank of Thailand (BoT), Bank Indonesia (BI) and Bangko Sentral ng Pilipinas (BSP) convened individually last week, with surprising policy rate cuts of 25bps each coming from BI and BSP to 3.75% and 2% respectively. BI cited a need to expedite the economic recovery and favourable conditions, including low inflation and external stability. The Indonesian Rupiah has made a strong recovery recently, supported by an improvement in global risk sentiment. This has allowed BI to resume its policy easing, with less of a concern over FX instability.

In the Philippines, BSP decided to go ahead and lower the benchmark rate although it had appeared relatively hawkish in previous statements. The Philippines' economy has suffered significantly on the back of additional lockdowns, coupled with damage caused by the recent typhoon, which justified the BSP's easing. Overall, we expect the rate cut cycle in ASEAN to slow given less space for further easing and improving global economic conditions.

Australia: Victoria emerges from the lockdown

October retail sales improved by 1.6% MoM, led by a 5.2% increase in Victoria, notably in restaurants and cafes. Despite the MoM jump, Victoria's retail sales were still down 4.7% YoY. We suspect there is still sizable pent-up demand to fill the gap and Victoria's recovery has further to run. Retail turnover in other states continued levelling off after having risen above the pre-crisis level. This was a natural path towards normalisation as pent-up demand faded away. Meanwhile, Australia's employment growth was surprisingly strong, with around 180k new jobs created. Victoria also experienced an initial rebound in employment and hours worked. Despite that, the headline unemployment rate edged higher to 7%, driven by an increase in the participation rate. Q3 wage growth remained subdued at 0.1% QoQ. We expect wage inflation will stay lacklustre for some time given plenty of spare capacity and slack in the labour market. Overall, data were encouraging with clear signs of a forthcoming recovery in Victoria.

Chile: A record rebound in Q3

Q3 GDP shows a significant rebound following the worst economic slump in decades. According to the Central Bank, real GDP rose 5.2% QoQ in Q3 (seasonally adjusted) after falling 13.5% in Q2. The rise was driven by domestic demand, +9.2% QoQ, with investment increasing 4% and private consumption soaring by 18.3%. The increase in domestic demand can be explained by the lifting of lockdowns, the fiscal stimulus measures and the 10% withdrawal allowance from pension funds. Despite the rebound, the pandemic's economic damage has left GDP 9.1% lower than the same quarter a year ago, and although these figures are promising, economic recovery remains uncertain. The outcome depends on how the handling of the virus and the sociopolitical situation develop, including several elections within the next 20 months. Meanwhile, a second opportunity to withdraw pension fund assets was passed by the Constitutional Committee of the Senate and will now be discussed in the Senate at large. As a result, the government presented an alternative project to reduce its costs.

What to Watch

- In the US, Markit's PMI will show whether the economy kept its pace despite high infection rates and partial shutdowns, while consumer confidence will reveal the mood in which households are entering the final weeks of the year.
- In the Eurozone, various business and consumer sentiment surveys are likely to show a hit to activity in November because of renewed lockdowns, however, confidence should bounce back as these restrictions are gradually eased in December and January.
- In APAC, we expect the Bank of Korea to keep policy rates unchanged at 0.5%. Tokyo will report CPI data for November, while industrial production data for October will be released in Taiwan, Thailand and Singapore. Australia and Hong Kong will report foreign trade data for October. Taiwan's Q3 GDP is expected to come in at around 3% YoY. India's GDP for Q2 FY2021 will likely point to a stabilisation, but elevated virus transmissions should keep a lid on the recovery. Japan's financial markets are closed today, Monday, for a national holiday.

Disclaimer and cautionary statement

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL

ZURICH®