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Weekly Macro & Markets View

Highlights and View

- **Economic activity has been picking up steam in Japan, China, South Korea and Taiwan**

  A third wave of the pandemic is likely to hit consumer confidence in Japan and South Korea and may also impact foreign demand for Asian goods.

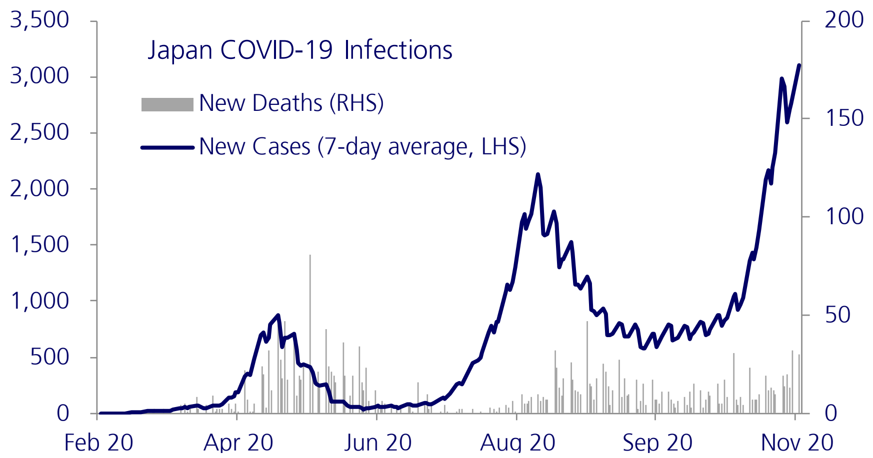
- **Eurozone business sentiment surveys such as the PMIs and German ifo fall sharply in November**

  Activity should bounce back as restrictions are gradually eased. Manufacturing confidence has been encouragingly resilient.

- **US municipal bond yields retreat below Treasury yields, ending the unusual market distortion**

  US municipals should remain supported given potential tax hikes, economic recovery aided by more fiscal stimulus and strong technicals amid the global liquidity glut.

Economic activity is strong in North Asia, but COVID-19 a concern



Source: Bloomberg

North Asia's latest economic indicators are encouraging. China's NBS Composite PMI for November climbed to 55.7, an eight-year high, while the construction PMI surged to 60.5 and the new export order PMI improved further. Industrial profits were up 28.2% YoY in October. Meanwhile, South Korea's economic activity remains brisk, with electronics and semiconductor related exports surging and auto exports also picking up. Inventory restocking is driving production. Both business and consumer surveys confirm the economic upswing. Taiwan's economy is in an even better shape, with real GDP revised up to nearly 4% YoY in Q3. In Japan, industrial production increased for the fifth month in a row in October. Retail sales, up 6.4% YoY on a favourable base effect, have been recovering, driven by Japan's successful 'Go To' travel and dine campaign. However, we expect economic activity to slow as a third wave of COVID-19 is hitting Japan. Regional suspensions of the 'Go To' campaign as well as restrictions imposed by local governments are already taking their toll on consumption and production. Weekend newspaper reports suggest that PM Suga will forgo holding snap elections in January, while the supplementary budget is likely to be bigger than planned. Despite record high infection cases, Japan is faring much better than Europe or the Americas. On a per capita basis, confirmed infection cases are 36 times higher in the US, while mortality is 50 times higher.

US: The Russell 2000 heads for a record month

In a holiday-shortened week the S&P 500 regained its momentum after a short pause the week before to close within a hair's breadth of a new record high. The Russell 2000 showed an even stronger performance, adding almost 4% for the fourth solid week in a row. On the economic front, the picture was a bit more mixed. Markit's Composite PMI rose to 57.9 in November, the highest level in more than five years, indicating that business activity remained strong in Q4. On the other hand, the Conference Board's Consumer Confidence Index slipped back, driven by lower expectations. One aspect is the deteriorating employment situation while infection rates remain high. Initial jobless claims rose for the second week in a row with further headwinds expected in the coming weeks. Households had to dip into their savings again in October. Personal spending slowed down to 0.5% MoM while personal income fell by 0.7%. Meanwhile, the housing market remains a bright spot with almost one million new homes sold in October, only slightly less than the month before.

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Eurozone: Surveys confirm the lockdown's hit to the economy, but investors stay positive

Various business and consumer sentiment surveys confirmed the sharp hit to the economy as lockdowns were tightened across Europe in November. However, although the declines in the surveys were sharp, they were not unexpected. Furthermore, manufacturing confidence has held up with most of the falls concentrated in services and household confidence. The flash Eurozone November Composite PMI, for example, showed a decline of around five points to 45.1, led by the services component falling to 41.3 in November from 46.9 in October. Manufacturing was much more resilient and only fell by around 1 point to 53.6. Various countries have released their lockdown plans for December and January involving a gradual relaxation of restrictions. While activity should pick up as restrictions are gradually eased, it is still likely that Q4 overall will see a decline in GDP in the Eurozone. Nevertheless, the anticipation of a roll out of vaccines in 2021 is keeping investor sentiment positive, as they look through this likely short-term hit to growth.

Chile: Senators align with the government in the second pension withdrawal bill

The Chilean labour market continued to improve in October, creating 302k jobs, increasing the participation rate, and reducing the unemployment rate to 11.6%. The stock market rose 16% in November while the exchange rate has continued to appreciate. The Senate voted last week on two similar bills to allow for a second withdrawal of 10% of pension funds, but with different political implications. The Senate rejected the opposition's bill and approved the government's bill, which will be voted on in the Lower House shortly where broad approval is expected. The difference between the initiatives is that withdrawals will be subject to personal income tax under the government's bill and free of taxes under the opposition's bill. However, the government's primary objective in presenting this bill was to prevent Congress from continuing to push policy through constitutional changes and imposing its views over those of the executive branch. Although we estimate that this withdrawal will stimulate economic activity, its impact would be less than the first withdrawal.

Credit: Indices hover near record low yields

Corporate bond yields in US and Europe are hovering around record lows for both investment grade and high yield, largely due to low government bond yields and a spread rally that has nearly reversed the spread widening from the COVID-19 crisis. Cyclical laggards are outperforming the broader market, while CCC rated bonds had another strong week. Investor sentiment in high yield is supported by reduced expectations of default rates, as companies have been building cash buffers. Indeed, oversubscription levels for high yield companies have been strong, with issuance gathering momentum over the last few weeks. It is notable to see order books for select bond deals reach high single digits to low double-digit multiples of the deal size across credit markets. As expected, the ending of some of Fed's credit facilities had a muted impact last week, with some transient spread widening seen in CDS indices at the time. Flows continue to remain strong, while primary market activity is expected to slow into the year end, implying credit markets could remain well-bid into the year end too.

US Municipal Credit: Strength likely to continue into 2021

US municipal credit has resumed its outperformance versus Treasuries after languishing for many months, and we expect this should continue into 2021. Investor sentiment in the sector should remain bolstered by the upcoming new Federal stimulus plan, infrastructure projects and potential income tax hikes outlined by President-elect Biden during his campaign. Indeed, US municipals bonds outperformed in November, with ratios between tax-exempt and Treasury yields now back below the 100% level across the entire curve. While municipal bonds benefited from the rise in broader risk appetite, the sector also saw decent inflows. During the last six months, cumulative flows reached USD 28bn with only two weeks of outflows during this period, with primary market also recovering. The Municipal Liquidity Facility is unlikely to be extended beyond this year, but we don't expect this to be major disruption. Although it was an important backstop to support the market, it is worth noting that only two issuers used it for a cumulative USD 1.65bn, well below the USD 500bn program size.

What to Watch

- In the US, the ISM surveys will show whether business activity is holding up despite the surge in COVID-19 infections while employment data will reveal more about the current state of the labour market.
- In the APAC region, the RBA and the RBI should leave monetary policy unchanged. Most Asian November PMIs will be released, as will Japan's Q3 MoF Corporate Survey, November consumer confidence and October labour market data. We will also monitor Hong Kong's October retail sales data, South Korea's November export data, various Australian data, and a broad range of regional CPI releases.
- In the Eurozone, German factory orders data for October should indicate that the manufacturing sector was holding up at the beginning of the fourth quarter.
- GDP and PMI data for Switzerland will reveal the strength of the recovery in Q3 and whether momentum is holding up in Q4.

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