March 22, 2021

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Weekly Macro & Markets View

Highlights and View

- **The Fed keeps signalling no rate hike despite expecting to reach both its mandates**

  This reflects the Fed's new stance of not acting simply based on forecasts but on actual progress, thus expecting to temporarily overshoot both its targets.

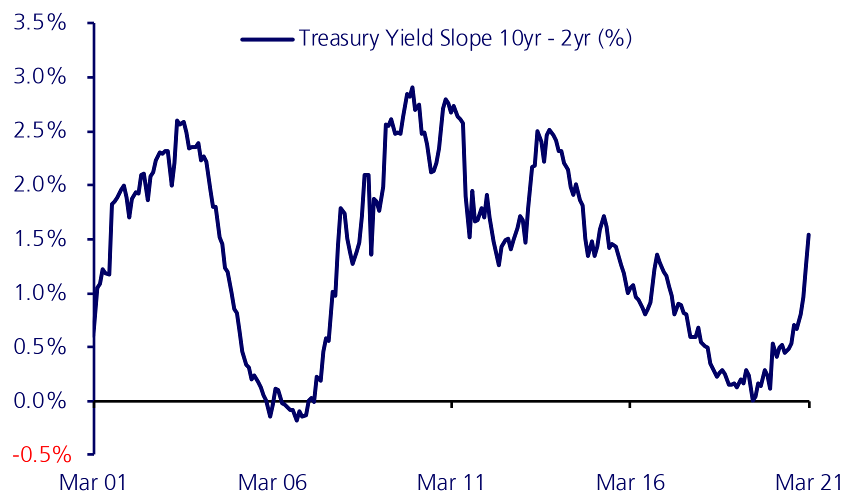
- **France and other Eurozone countries extend their lockdowns into Q2**

  As long as these renewed lockdowns are not too lengthy, investors are likely to look through them.

- **Higher inflation and fiscal uncertainty force the Central Bank of Brazil to raise the Selic rate**

  Nonetheless, inflationary pressures and uncertain fiscal and political outlooks remain, which will force the BCB to continue tightening monetary policy despite the economic impact of the pandemic.

The US yield slope reaches a six-year high



Source: Bloomberg

The S&P 500 climbed to a new record high last week before falling back and closing the week with a modest loss. Rising bond yields in the aftermath of the Fed meeting provided headwinds and injected some volatility into the markets. Investors were relieved that the FOMC kept its median rate projection unchanged though some had hoped for a more resolute message regarding the recent rise in longer-term yields. Jerome Powell reiterated his view that higher yields reflect a significantly improved economic outlook. Importantly, the FOMC refrained from signalling a rate hike over the forecast horizon despite expecting to reach both its mandates, projecting inflation to rise above 2% and the unemployment rate to fall below its longer-term target. This reflects the FOMC's new stance that it will not act based on forecasts but wants to see actual progress. In the past, the Fed's pre-emptive hikes often proved to be premature as inflation hardly ever reached the target level in more than a decade. Meanwhile, economic data were a bit more mixed last week. Retail sales fell by 3% MoM in February, but that was on the heels of a stimulus-induced surge of 7.6% in January – an indication of what to expect following the latest round of fiscal stimulus. Finally, the housing market is showing signs of losing momentum though activity is likely to remain high given the latest home builder survey.

Eurozone: The ECB clarifies its policy, lockdown restrictions are extended into Q2

Last week, ECB Chief Economist Philip Lane and Executive Board Member Sabine Schnabel clarified the ECB's new policy with respect to increasing the pace of asset purchases in Q2. They explained that the ECB is not targeting a specific level of bond yields (i.e. yield curve control), but that it is trying to prevent an undue tightening in financial conditions by preventing yields from rising too quickly, and in particular much more quickly than inflation. This clarification was helpful to better understand the ECB's policy, but the risk is that the market will test the ECB's resolve some time in Q2. Meanwhile, lockdown restrictions have been re-introduced or extended in various countries in the Eurozone. France, for example, has put around 40% of the country (in terms of economic activity) into lockdown for at least four weeks as it struggles to bring new virus case numbers down and the vaccine rollout remains slow. The renewed lockdowns will likely push back the Eurozone economic recovery to later in Q2, but as long as they are not too lengthy the lockdowns should not be too disruptive to investor sentiment.

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Japan: The Bank of Japan tweaks its monetary policy tools

The Bank of Japan (BoJ) explained its new monetary policy assessment in a 60-page report, but without announcing any major surprises. The short-term policy rate target remains at -0.1% and the 10yr JGB target at 0%, while the target band has been widened from +/- 20bps to +/- 25 bps for Yield Curve Control (YCC) operations. Rising trading volumes within the new band should support business for banks active in the JGB market. The BoJ also introduced a new JGB buying initiative to limit the rise in long-term interest rates and scrapped its average ETF buying target. We expect the BoJ to be an active buyer of TOPIX ETFs only during severe equity market correction phases. Meanwhile, machinery orders snapped back a bit in January following a record high improvement in Q4, while exports for February came in weaker than expected. Notably, the Reuters Tankan for February showed the ninth month of improving manufacturing conditions to levels last seen in June 2019. The lifting of the COVID-19 induced state of emergency for greater Tokyo should help non-manufacturing conditions to catch up.

Brazil: The Central Bank of Brazil (BCB) raises the Selic rate by 75bps to 2.75%

Economic activity in Brazil increased 1.04% MoM in January. This figure does not reflect the worsening of the pandemic nor the recent lockdowns, which have increased the uncertainty of an economic recovery and increased the pressure for additional fiscal stimulus. The BCB raised the Selic rate by 75bps to 2.75%. The decision was expected, but the magnitude surprised the market (+50bps had been expected). An adjustment of the same magnitude is anticipated for the next meeting in May unless inflation conditions and risk balances change significantly. The BCB argued that the current conditions no longer require an extraordinary adjustment as inflation expectations have risen above the target and maintains its view that the current shocks are transitory. However, pointing to the partial normalisation of monetary policy, the BCB suggested that the policy rate would remain accommodative at the end of the cycle. We anticipate that uncertainty around the political and fiscal outlook as well as inflationary pressures will continue and expect additional rate hikes despite the pandemic's economic impact.

Credit: Resilient despite rising rates and elevated issuance

Credit was resilient last week, despite a notable rise in US Treasury yields, which pushed YTD total returns in the USD IG corporate bond market below -5%. Despite this, fund flows have been solid. In contrast to the outflows from total return-oriented investors in USD IG ETFs, YTD cumulative net flows into USD IG mutual funds have stayed positive, suggesting that institutional credit demand remains strong despite higher yields. Spreads have tightened since touching 100bps on March 9 and are now basically flat YTD. We do not expect outflows to materialise as long as earnings continue to improve. Issuance also continues to be elevated, even more so than expected, and on track for the strongest first quarter on record. Notably, spreads have shown resilience amid the supply-related technical pressure given the allure that credit still commands versus Treasuries. Having said this, we expect issuance to moderate considering the already high leverage and substantial cash positions.

European Banks: Strong TLTRO take-up adds to abundant liquidity

Last Thursday the ECB announced the results of the latest TLTRO 3 auction. This was the first operation after the adjustment and easing in conditions that were decided upon at the ECB's December 2020 meeting. Take-up was much stronger than expected with 425 banks getting EUR 330bn, far above the EUR 220bn forecasted by market participants. This additional liquidity boost should support economic recovery and is a strong signal that banks are confident about their ability to increase lending, a key condition necessary to benefit from the extra discount on the rate charged. This cheap new funding source and the better market conditions, with relatively higher yields and a steeper curve, should mitigate the constant pressures on European banks' profitability. On the other hand, the TLTRO funding will maintain the downward pressure on the already low supply of covered bonds as excess liquidity in the euro area is now climbing to a new historical high of close to EUR 4tn.

What to Watch

- The G3 PMIs are expected to show that growth momentum remains firm in the global economy.
- In the Eurozone, various business surveys are likely to indicate that sentiment remains relatively resilient, especially in the manufacturing sector.
- We do not expect any policy rate changes when the central banks of Thailand and the Philippines convene this week. PMIs for March will be released in Japan and Australia, while industrial production data for February will be published in Taiwan, Singapore and Thailand. Statistics for Tokyo's March CPI and February department store sales will be in focus.
- No change is expected from the Swiss National Bank is this week's policy meeting.

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