April 6, 2021

Weekly Macro & Markets View

Highlights and View

- **Strong economic data show evidence of an impressive rebound in the US**

  Both the ISM Manufacturing and Services indices rose to the highest in decades while labour market data reflect a significant improvement in the employment situation.

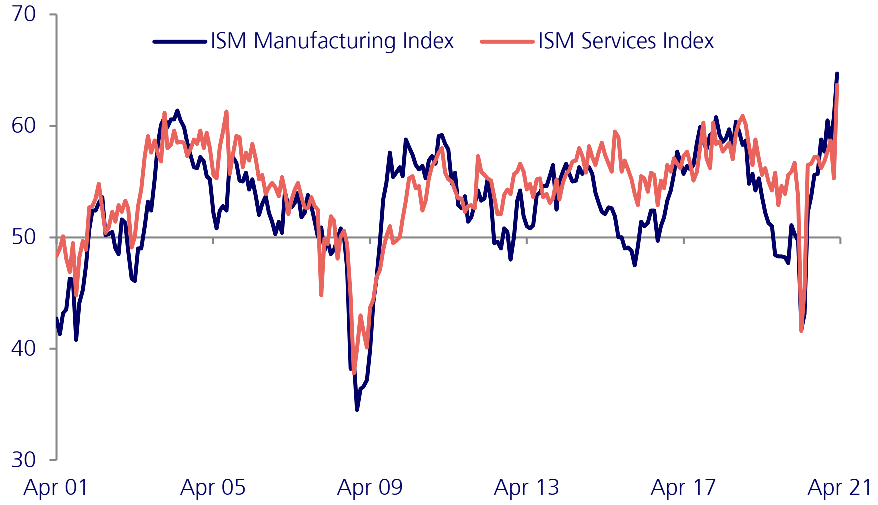
- **Stocks push to new highs despite upward pressure on bond yields**

  Investors look through potentially higher US taxes and rising bond yields as strong momentum and rising earnings expectations drive the rally, with European markets leading the charge.

- **Japan's Tankan corporate survey is painting a rosier picture than consensus had expected**

  We suspect that Q1 GDP growth will surprise to the upside, while the improving corporate earnings outlook should continue to underpin Japanese equities.

US business activity soars as the economy reopens



Source: Bloomberg

The latest set of economic data provide further evidence that the US economy is on track for an impressive rebound. The ISM Services Index soared to 63.7, the highest on record. Individual components underlined the strength of the recovery with both new orders and employment rising sharply. Similarly, manufacturing activity accelerated further in March with the ISM Manufacturing Index rising to 64.7 with new orders and employment pointing to strong momentum. The improving employment situation is also reflected in the latest labour market data with 916'000 new payrolls added in March following 468'000 in February. The unemployment rate ticked down to 6% from 6.2% while the broader underemployment rate fell to 10.7% from 11.1% the month before. Consumer sentiment jumped to the highest in a year, supported by an improving labour market and the latest round of fiscal stimulus. Last week, President Biden presented the first part of his plan to modernise broad parts of the country's infrastructure. Amounting to a total of USD 2.3tn, the focus lies on transportation infrastructure, green initiatives, R&D, manufacturing subsidies as well as elder and disability care. The plan is likely to meet resistance in Congress, not least given that it is meant to be financed by a substantial increase in corporate taxes.

Markets: Equities power ahead as investors digest higher yields

Equity investors were in good spirits in a holiday-shortened week with several indices hitting new highs, pushing through potential headwinds. Further robust economic numbers in many regions, notably industrial surveys and sentiment indicators, confirm the strong recovery and keep upward pressure on bond yields. This was particularly evident in the US, where 10yr Treasury yield reached a pre-crisis level of 1.77% before easing back only modestly. Equity investors appear to have accepted the higher bond yields as a function of improving economic and earnings prospects rather than fretting about deteriorating relative valuations and higher discount rates. We would concur for the time being and see the powerful uptrend and strong momentum in stocks remaining intact. However, investors are a fickle bunch and with massive additional stimulus being considered in the US to 'build back better', and inflation likely to spike higher in the short term, vigilance will be required to spot any turn in sentiment a bit further down the line.

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Switzerland: Manufacturing activity surges in a lopsided recovery

Economic activity has reaccelerated, despite rising infection rates and postponed reopening plans. The recovery is notably lopsided, with gains mainly reflecting strong industrial activity. The Manufacturing PMI surged to a 15-year high in March, boosted by a build-up in unfilled orders and delivery times, indicating booming conditions. The broader KOF leading indicator also spiked higher, by far outpacing expectations, but this reflected strong manufacturing activity while other parts of the economy were weaker. Alongside services, retailers are suffering from weak conditions, with a 20% MoM decline in retail sales volumes in February (ex food and fuel), following a 34% decline in January. While conditions should improve over the coming months, we suspect pressure will remain on this sector, reflecting online and cross-border trade. Given this, it is not surprising that consumer price inflation came in a touch weaker than expected, with core CPI dipping deeper into negative territory, at -0.4% YoY in March.

Japan: The Corporate Tankan survey comes in better than expected

Japan's Q1 Tankan, the quarterly corporate survey conducted by the Bank of Japan, came in much stronger than consensus had expected. The headline diffusion index for large manufacturing companies surged from -10 to 5. We prefer to look at the 'all industry index', comprised of large companies and SMEs in manufacturing, construction, and service-related industries. The spike from -15 to -8 is encouraging. Even though small non-manufacturing companies tend to show negative numbers across the board, we want to highlight the positive direction. We also note that capital expenditure plans for the new fiscal year that started on April 1 are strong in a historical context and surprised consensus expectations to the upside as well. Firms intend to increase capex by 3%, but this is just a first shot as companies tend to become more optimistic over the course of the year. Stable financing and employment conditions add to the overall positive trend while prices are expected to rise. We suspect that Q1 GDP growth will come in better than consensus expects, which should also be reflected in stronger corporate earnings.

Asian PMIs: Diverse prospects with an 11-year high in Taiwan and a slump in Myanmar

Asian countries see diverging prospects. Taiwan's Manufacturing PMI surged to an 11-year high of 60.8, with all components contributing positively, while South Korea's PMI remained at a high level of 55.3. Both are benefitting from strong electronic exports. Meanwhile, China's PMIs painted a mixed picture. The official NBS Composite PMI as well as the Caixin Services PMI rebounded post Lunar New Year, while the Caixin Manufacturing PMI moderated, even though both its new export orders and employment components rose. The ASEAN Manufacturing PMI hovered above 50 in March, supported by a noticeable pickup in Vietnam and Indonesia. Malaysia and Thailand also saw an improvement, though their PMIs remained below 50. By contrast, India and the Philippines experienced a slight decline in their Manufacturing PMIs in March, likely reflecting the negative impact of a new wave of COVID-19 in both countries. Myanmar's figure plunged from 47 to 27, suggesting that the military coup has severely impacted economic activity.

Australia: Fiscal tapering ahead

February retail sales dipped slightly by 0.8% MoM, partly due to the negative impact of new local lockdowns in some states. Despite that, retail sales remained above pre-COVID levels, suggesting that the underlying trend was buoyant. The expiry of the JobKeeper program in March will be the first test as to how sustainable the current economic recovery in Australia is. The unemployment rate could potentially edge higher as the JobKeeper program had artificially deflated the actual number of unemployed. Meanwhile, the boom in housing demand drove March home prices up by 2.6% MoM, the fastest growth since 1988. We envisage the housing frenzy possibly losing steam as households face the headwind of fiscal tapering ahead. Even if housing demand does not recede, authorities, including the RBA and the Australian Prudential Regulation Authority (APRA), are keeping an eye on the potential tightening of lending standards. They have several policy options to prevent a financial bubble from developing in the housing market, without having to hike interest rates.

What to Watch

- In the US, the latest Fed minutes are expected to provide further insight into the FOMC's current stance while producer prices are likely to indicate more price pressure in the pipeline.
- In APAC, the RBI is likely to keep its policy rates unchanged. Japan's Eco Watcher and consumer confidence surveys for March will be released. China will publish inflation, credit and money supply data for March. Taiwan's March exports are likely to confirm a strong performance. Philippine February exports should have remained supportive on the back of robust electronics shipments.
- In the Eurozone, the Services PMIs will show how the sector is coping given the latest lockdown measures.
- Inflation for LatAm countries will be published, with Brazil and Mexico the most relevant due to their potential effect on policy decisions.

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