April 12, 2021

Weekly Macro & Markets View

Highlights and View

- **The global PMIs are consistent with a reacceleration in the global economy, helped by improving services activity**

  The latest data indicate a broadening out of the recovery and are in line with our view that the global economy will expand at a strong above trend pace over the coming year.

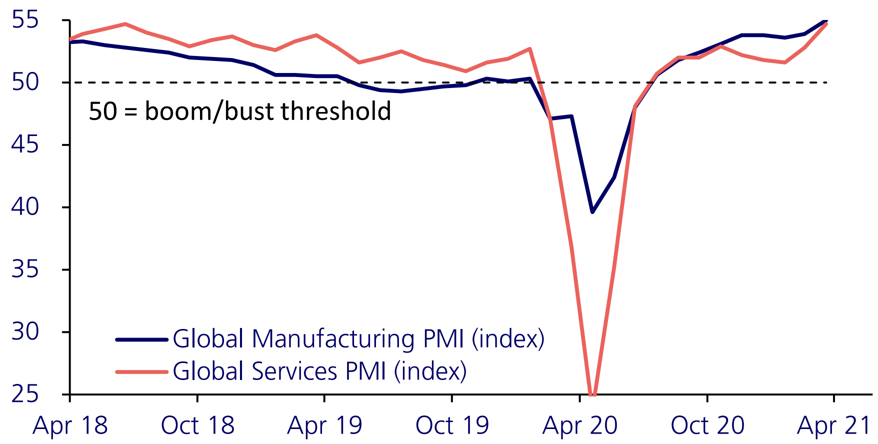
- **US producer prices rose by 4.2% YoY in March, the fastest pace in a decade**

  As expected, inflation measures jump as base effects kick in and strong pent-up demand fuels spending. However, most of these price rises are expected to be transitory.

- **Credit markets remain strong with US credit spreads approaching pre-Financial Crisis tights**

  The strong search for yield dynamic in credit markets remains undeterred by higher bond yields, and we believe US credit spreads could breach the levels seen during the pre-Financial Crisis era.

Global economy gains momentum, setting stage for strong Q2



Source: Bloomberg

Global economic growth has gained momentum, with both manufacturing and services recording strong gains towards the end of Q1. While the manufacturing sector has been powering ahead for some time now, supported by a surge in goods demand during lockdowns, services continue to face more challenging conditions. As a result, the recovery has become unbalanced. Goods producers are reporting rising pressures on supply chains, including a lack of critical components, delays, and elevated transportation costs that will likely cap further gains in the sector. It is therefore critical that the recovery broadens out, and the latest PMIs suggest that this is now happening. While a solid recovery in business services should be expected, given the strong industrial cycle, consumer services are also improving. The sector is still in recession but stronger sentiment and a pickup in new orders suggest that activity will rebound as economies progress on vaccinations, with demand also supported by elevated savings. Indeed, the latest data confirm our view of a pickup in global growth as we exit Q1, with a strong expansion at an above trend pace likely over the coming year. Vulnerabilities are large though and it is still too early to actively withdraw support measures, with many regions and sectors still facing difficult conditions.

US: Producer prices soar at the highest rate in a decade

The S&P 500 ended last week at a new record high, rising 2.7%. The move was fuelled by a strong performance of large technology firms, reflected in the Nasdaq 100 rising 3.9% and the FANG+ Index jumping by almost 5%. Tailwinds were provided by dovish remarks from a number of Fed members and longer-term Treasury yields falling back from their 14-month high. Yields fell despite producer prices rising more than consensus expected in March with the annual PPI rate accelerating to 4.2%. In February, the trade deficit rose to the highest on record in absolute terms, reflecting the pickup in consumer spending fuelled by several rounds of fiscal stimulus and the strong rebound in economic activity in the US, particularly compared to other regions that fell behind with regard to vaccinating their populations and reopening their economies. The Fed minutes published last week did not provide any further insights, underlining the FOMC's view of a temporary spike in inflation and their current focus on the labour market.

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Japan: A tale about the ups and downs in consumer confidence

Based on consumer confidence data and the Eco Watchers survey for March as well as the household survey for February we conclude that economic activity and consumer behaviour had clearly started to improve once the COVID induced state of emergency for several prefectures was taken off in March. This is also confirmed by alternative data sources like credit card payments and GPS mobility data. However, we are afraid that these signals of improving consumption may be short-lived, as infections with new strains have picked up significantly in the Kansai region (to a record high), in Miyagi prefecture around Sendai and on the Southern islands of Okinawa. A pickup, which may develop into a fourth wave, is also becoming visible in the Greater Tokyo area. As Japan is lagging significantly in vaccinating, new waves of infections are likely to keep consumers cautious. Household income has suffered from less overtime hours and a lower winter bonus. The Tokyo Olympics are unlikely to give a boost as it is uncertain whether even domestic spectators will be allowed with foreigners already having been excluded.

India: QE in India?

The Reserve Bank of India (RBI) kept its policy rate unchanged at 3.35% last week as widely expected. The surprising move was the RBI's commitment to purchasing INR 1tn of government bonds in the secondary market for Q2 2021. This is much larger than the usual open market operations and signals that the RBI is now venturing into QE for the first time. This move came as rising US Treasury yields have made emerging market (EM) investors nervous about EM asset prices and currencies. In India, the consequences of QE can be complex. It puts downward pressure on the Rupee and might even lift long-term inflation expectations. India's inflation outlook is still very uncertain. Supply disruption issues might return because of the second wave of COVID-19. More pressure is also coming from rising global oil prices. With QE, we think the RBI might face major challenges as it seems to target multiple goals including growth, inflation, bond yields and financial stability. This could become counterproductive and a potential source of confusion among market participants.

LatAm: Although inflation is in line with or below expectations, it continues to accelerate

In Brazil, inflation was below expectations but remained high after rising 0.93% MoM and reaching 6.1% YoY. Core inflation also continues to accelerate, returning to pre-pandemic levels. We estimate that the BCB will raise the Selic rate by 75bps in the next policy meeting. In Mexico, inflation continues to accelerate, rising 0.83% MoM, while annual inflation reached 4,67%, its highest level since December 2018. While this is partly related to a low comparison base of energy prices, it is also the result of accumulated increases in recent months. Although the last monetary policy meeting minutes gave mixed signals regarding the easing cycle, we estimate that Banxico will maintain the policy rate at 4% during 2021. In Chile inflation rose 0.4% MoM, accelerating to 2.9% YoY. We estimate that higher inflation will continue in the coming months, mainly due to the low base effect. Although we expect inflation to be above the target, the Central Bank would maintain the policy rate during 2021 since transitory factors explain inflation increases.

Credit: US credit spreads approach pre-Financial Crisis tights

Credit markets remain strong with many indices now close to YTD tights. US credit spreads are now a whisker away from tights recorded in the pre-Financial Crisis era, although European credit still has some gap to pre-Financial Crisis tights. We believe that previous tights are more likely to be breached for US credit markets as demand remains strong amid the search for yield environment, with the recent rise in bond yields barely denting this dynamic. While high yield supply remains robust, investment grade supply has slowed, although some of this is due to the so called 'earnings blackout' ahead of the earnings season when companies pause issuance. Demand in the primary market remains strong with negative new issue concessions becoming common again. The most crucial question amid tight credit spreads is how companies will use their cash piles. We expect more capital expenditure and debt refinancing, but further financial engineering will be credit negative. Credit investors will be keenly watching the upcoming US bank earnings and leverage trends in the earnings season.

What to Watch

- In the US, small business sentiment is expected to show further improvement as the economy reopens while CPI is likely to have accelerated in March. Several large banks will report their Q1 earnings, kicking off the reporting season for the first quarter.
- In APAC, we will keep a close eye on Japan's Reuters Tankan for April as well as machinery and machine tool data. In China, the most important economic indicators for March and Q1 GDP data will be released. We expect the Bank of Korea to stand pat. Indonesia's and Singapore's exports are expected to be buoyant in March, in line with the strength of exports seen elsewhere in Asia. Singapore's GDP, Australia's employment data and India's CPI are key to watch next week.

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