Weekly Macro & Markets View

Highlights and View

- **Eurozone service sector confidence moves back into expansion territory**

  Improving service sector confidence and better news on vaccination roll-out is setting the region up for a period of very strong growth over the next few months and quarters.

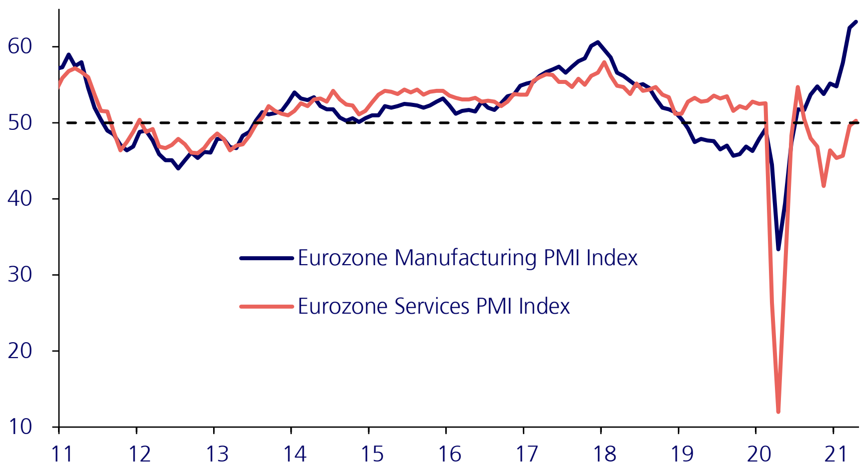
- **US high yield supply continues to remain robust with the strongest April on record**

  We are encouraged by the ongoing strong primary market activity seen in high yield as it implies lower default rates, resulting from improved debt profiles and access to liquidity.

- **Ambitious emission targets are announced at the climate summit, requiring annual CO2 emissions to fall by over a third by 2030**

  Momentum around climate change is increasing. Even if detailed plans are lacking, this will be a key driver of change for the global economy and financial markets over the coming decade.

Eurozone services confidence and vaccination roll-out improve



Source: Bloomberg

The Flash PMI survey for the Eurozone was stronger than expected in April with the Composite PMI survey rising to 53.7 from 53.2 in March. Manufacturing sentiment remained strong while services sentiment moved back above the 50 expansion/contraction line, despite ongoing restrictions and lockdowns in various Eurozone countries. The survey suggests that as these lockdown restrictions are gradually eased, the region will see very strong growth. However, there are also some signs of inflationary pressure emerging. The Manufacturing PMI input price component, for example, increased to 81.5, close to a record high, while businesses reported higher output prices in both the manufacturing and services sectors. On the vaccination front, the EMA (European Medicines Agency) announced that it would permit the use of the Johnson & Johnson vaccine with around 50 million doses expected to be delivered this quarter. Indeed, Ursula von der Leyen, European Commission President, said this week that the EU has brought its estimate of when it expects to have 70% of the population vaccinated (the threshold for herd immunity) forward by two months to July. Finally, the German Constitutional Court has said that it will not block the ratification of the EUR 750bn Next Gen EU fund. Altogether, last week was an encouraging one for the Eurozone on the policy, vaccination and the economic data fronts, which we think will ultimately be reflected in higher risk asset prices as well.

UK: Business activity and retail sales soar as the economy reopens

Economic data point to a strong rebound in activity at the end of the first quarter and expected to pick up steam in the second. Retail sales grew by 5.4% MoM in March following a 2.2% increase the month before. The Composite PMI rose to 60.0 in April, signalling the strongest overall increase in private sector output since November 2013. For the first time since the beginning of the COVID-19 pandemic, service activity grew at a faster pace than manufacturing production. Positive sentiment about the economic outlook strongly supported private sector employment in April. The latest data point to the steepest rate of job creation since August 2017. The unemployment rate ticked down to 4.9% in February though that number was still distorted by the furlough program. As expected, inflation rates are starting to pick up but remain contained for the time being. The annual headline CPI rate rose to 0.7% in March while core CPI picked up to 1.1% YoY. However, the annual PPI rate accelerated to 5.9%, pointing to a significant pickup in inflation in the coming months.

North Asia: Strong export dynamics prevail

The latest export statistics for March and April remain encouraging. South Korea's exports for the first twenty days of April were up 36% YoY on a working day adjusted basis, not only driven by semiconductors and mobile phones, but also by strong auto and auto parts exports. Vietnam, as an assembling base for Korean manufacturers, is benefitting as well, with both experiencing a surge in imports of intermediary goods as well as strong re-exports. Taiwan's export orders remained brisk, up 33.3% YoY. While base effects distort these statistics to the upside, the fact is that orders for electronic goods and components remain very strong, as global inventories need to be replenished. Meanwhile, Japan's exports were up 16.1% YoY in March, stronger than consensus had expected, while export volumes were not able to compensate for the sequential drop seen in February. Overall, we do not expect net trade to contribute to GDP growth in Q1. However, turning to April data, the diffusion index for new export orders within the Manufacturing PMI survey spiked higher, which is encouraging.

LatAm: COVID-19 continues to drive policy decisions

In Chile, the governing coalition puts together the needed votes for Congress to approve a third withdrawal of up to 10% of pension savings. This time, the bill also allows pensioners to withdraw up to 10% of the technical reserves in their annuity holdings. The government challenged the bill in the Constitutional Court, claiming that it violates the constitution, and announced an alternative bill that would still allow the withdrawal, but establishes a mechanism for the recovery of the funds. In Brazil, uncertainty regarding the 2021 budget ended after President Bolsonaro signed it into law while vetoing BRL 19.8bn in spending and signalling an additional freeze of BRL 9bn in discretionary expenditures so as to avoid breaching the spending cap. Bolsonaro also approved a bill allowing the government to increase spending for COVD-19 measures by up to BRL125bn, thus avoiding unlimited fiscal easing, which may explain the recent favourable reactions of domestic assets. However, it could trigger further fiscal easing if the pandemic remains uncontrolled during 2Q21.

Equities: Stocks are becoming vulnerable in the short term

Although most markets were down only fractionally last week, we are becoming more cautious on the near-term outlook. Given the stellar performance of stocks in recent months some profit taking seems warranted as several indicators move into overbought territory and headwinds appear to be overlooked. That noted, the macro backdrop remains supportive as evidenced by further strong data last week while the earnings season in the US is off to the races. FactSet reports that S&P 500 earnings are coming in 24% ahead of expectations. Good as this is, complacency is becoming evident as the VIX index, one measure of volatility, has fallen to 17, versus 37 in January and 82 at the hight of the crisis last year. Investors largely looked through the record levels of new COVID infections last week and reports of a potential doubling of US capital gains taxes for the wealthy, following on the heels of the corporate tax hike proposals. While we remain constructive on stocks longer term, a modest pull-back would provide a healthy pause to refresh a bull market that is getting ahead of itself.

Credit: Robust high yield supply lowers default expectations

The high yield primary market in the US continues to see robust activity, with monthly supply already the highest ever recorded during April. A strong primary market in high yield has a fundamental implication – it forebodes lower default rates as companies term out their debt and liquidity access improves. Indeed, some rating agencies have recently lowered their year-end default forecasts. We believe that while default rates are indeed trending downward, they are still likely to remain above average this year. US banks were big issuers in investment grade credit. Several large money centre banks brought jumbo deals to the market after benefitting from robust earnings driven by trading gains and lower expectations of loan losses. All in all, increasing evidence of improvement in credit fundamentals can be seen in rating trends, default rates and lower loan losses expected by banks. There is no room for complacency around balance sheet focus for corporate management, however, as leverage remains high and around USD 1.5 trillion of BBB/BBB- debt across the US and Europe retains a negative outlook.

What to Watch

- In the US, investors will focus on the corporate earnings season with more than a third of the S&P 500 companies releasing their numbers for Q1. Meanwhile, no actions are expected from the Fed.
- The first estimate of Q1 GDP data for the Eurozone is likely to confirm that the region experienced a double-dip recession, however, investors are likely to instead focus on the more positive outlook for growth going forward.
- In APAC, we believe the Bank of Japan will stay pat, even though the inflation outlook may be adjusted somewhat. We will also watch most of Japan's relevant economic indicators for March. In China, the NBS PMIs for April will be released, while Q1 GDP statistics will be published in Taiwan and South Korea. Export data will be released in Australia, South Korea, Hong Kong, and Malaysia as well as industrial production data in South Korea and Thailand. Finally, Australia's Q1 inflation data will need attention.

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