Weekly Macro & Markets View

Highlights and View

- **Japan's consumption is hit by the pandemic, while capital goods related industries enjoy strong foreign demand**

  We believe Japan's growth outlook will improve in H2 as vaccinations are gaining speed, consumption subsidy programs will resume, and supply shortages will peter out.

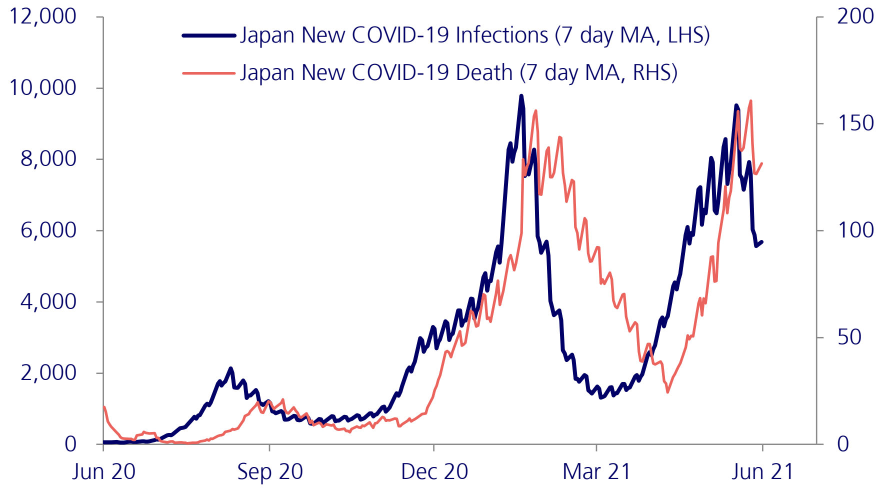
- **Various surveys of Eurozone business confidence, such as the German ifo, the French INSEE survey and the EC's Economic Sentiment Indicator, surge higher**

  The Eurozone is about to enter boom-like economic conditions, providing a supportive environment for risk assets in the region.

- **Negotiations between Switzerland and the EU about a new framework agreement break down**

  This increases medium term uncertainty, with the manufacturing sector, which is highly integrated with EU supply chains, particularly vulnerable to disruptions.

Japan's outlook is slowly improving



Source: Bloomberg, WHO, JHU

As outlined in our latest Topical Thoughts paper, Japan's last mile before the Olympics, the pandemic and the postponed 2020 Summer Olympics/Paralympics, which will start on July 23, 2021 in Tokyo, dominate both public discussion and the political agenda. The service sector remains negatively impacted as the state-of-emergency in ten prefectures, which together cover more than half of Japan's population, has been extended to June 20. While new infections are slowly receding, following the recent top of the fourth wave, the shortage of intensive care units (ICUs) and medical personnel in hospitals in the most impacted regions remains an issue. However, we believe the situation should slowly improve going forward. The speed of vaccinations is finally picking up, with 6½% of Japan's population having received the first shot, public subsidy programs to support travelling and dining are expected to resume after the Paralympics, and services related sectors are expected to recover in the second half of the year. So far, consumption remains weak with retail sales contracting 4½% MoM in April, while consumer confidence deteriorated for the second month in a row in May. Meanwhile, the manufacturing sector is benefitting from strong external demand for capital goods. Industrial production picked up in April and production plans suggest that Q2 production should gain speed as the auto sector is expected to recover from semiconductor shortages.

US: Consumers become more reluctant to buy big ticket items

Not surprisingly given the earlier boost from the latest fiscal stimulus package, personal income fell by 13.1% MoM in April following the 20.9% surge in March. Personal spending normalised to 0.5% MoM after it jumped by 4.7% the month before. Consumer spending will be supported in the coming months by the substantial savings set aside during the pandemic. Nevertheless, although overall consumer sentiment held steady in May, expectations deteriorated markedly and plans to buy houses, cars or major appliances have dipped. Higher prices are one reason why households turned less optimistic. Core PCE, the Fed's favourite inflation measure, jumped to 3.1% YoY in April, the highest level since 1992. While the surge is unlikely to shift the Fed's current wait-and-see attitude, the FOMC is expected to begin signalling its path to a less supportive policy soon. Finally, there are increasing signs that momentum in the housing market has levelled off with both new and pending home sales falling in April.

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Eurozone: National business confidence surveys surge

Last week's data gave further indication that we are about to see a boom in economic activity in the Eurozone. The German ifo Business Climate Index rose more than expected, to 99.2 in May from 96.6 in April. It is now well above its levels immediately prior to the Covid epidemic. Meanwhile, the French INSEE measure of business confidence surged 12 points to 108 in May from 96 in April. At the Eurozone level, the European Commission's Economic Sentiment Indicator rose to its highest levels since late 2017/early 2018, which were the highest levels of confidence since the early 2000s. However, the ECB is unlikely to reduce its large amount of assets purchases under the PEPP just yet in our view, which is supported by various comments from ECB officials last week. The combination of a supportive macro environment and abundant liquidity could create a favourable backdrop for risks assets in the region. The Euro Stoxx 50 index was up around 1% last week and the German Dax Index hit a fresh record high.

Switzerland: Near-term outlook bright, but breakdown in EU negotiations creates uncertainty

Macro data remain very strong. Following a surge in April, the broad KOF leading indicator reached another new high in May, reflecting an acceleration in services and booming manufacturing conditions. Trade data show brisk activity, with both imports and exports recovering to pre-Covid levels. Watch exports have surged from depressed levels, with further gains likely, helped by a gradual reopening of international travel. Consumer and investor sentiment have snapped higher, both reflecting the strong recovery and a perceived decline in health risks. We suspect this week's Q1 GDP data will surprise on the upside and the manufacturing PMI should rise further as growth is unlikely to have peaked yet. While the near-term outlook is bright, the breakdown in negotiations with the EU about a new framework agreement clouds the medium-term outlook. Though existing bilateral agreements remain in place for now, the manufacturing base, which is highly integrated with EU supply chains, is particularly vulnerable to disruptions.

Equities: Investors look beyond the inflation spike, pushing stocks higher

Equity investors were in a sanguine mood last week as the jump in inflation readings failed to prevent several markets hitting record levels. A strong conclusion to the earnings season and further evidence of a broadening economic expansion boosted sentiment following a few weeks when stocks failed to make much headway. While momentum continued to build in European stocks, with both German and French markets posting new highs, emerging markets came back into favour having been drifting lower since February's record high. The bullish sentiment even spilled over into Japanese stocks following a protracted period of relative underperformance. We are encouraged by this. Japanese stocks appear to be at a turning point, having more than fully priced in the additional COVID-19 restrictions and the challenges that the domestic economy faces. We also see further upside for stocks more generally and concur with market pricing and the subdued move in bond yields that suggest the spike in inflation needs monitoring but should not be extrapolated.

Credit: US high yield supply hits another monthly record driven by debut issuers

As sentiment improved for most risk assets, corporate credit spreads ended tighter last week. The tightening was mostly visible in the US investment grade market, where the index spread dipped below 84bps, just 9bps above pre-Global Financial Crisis tights. The US high yield market, in addition to seeing April and May issuance each mark a record for the corresponding month, has also seen a significant increase in debut issuers. This shows that demand is strong not only for bonds of established issuers, who are mostly using issuance proceeds to refinance existing debt, but also for new issuers. Despite the ongoing search for yield, investors pulled USD 1.37bn from US high yield funds for the week ending May 26 according to Refinitiv Lipper data. That is the fourth consecutive week of outflows, but we don't expect a significant impact on returns. We see this trend as simply a reallocation within portfolios as leveraged loan funds are getting a boost at the expense of high yield funds, given loans' limited interest rate exposure.

What to Watch

- In the US, the ISM surveys will give an indication as to whether business activity shows more signs of levelling off while the labour market is expected to have improved further.
- In APAC, we believe Australia's RBA and India's RBI will keep a dovish tone but will not change policy rates. Japan's Q1 corporate capex survey and household survey for April, China's Caixin PMIs for May and South Korea's export data for May will be in focus. May CPI data will be released in South Korea, Indonesia, Thailand, and the Philippines. Hong Kong's April retail sales should show further improvement.
- In Mexico, the focus will be on the legislative elections scheduled to be held on June 6 and on the Q1 inflation report, including Banxico's new economic projections. We will also get May PMIs and April remittances. Q1 GDP will be published in Brazil, while sectorial figures and economic activity for April will be released in Chile.

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