June 21, 2021

Weekly Macro & Markets View

Highlights and View

- **The Fed brings forward the expected date of its first rate hike, now signaling two hikes in 2023**

  While the Fed remains fully flexibile regarding the future rate path, it is signaling a willingness to slowly move away from its very dovish stance.

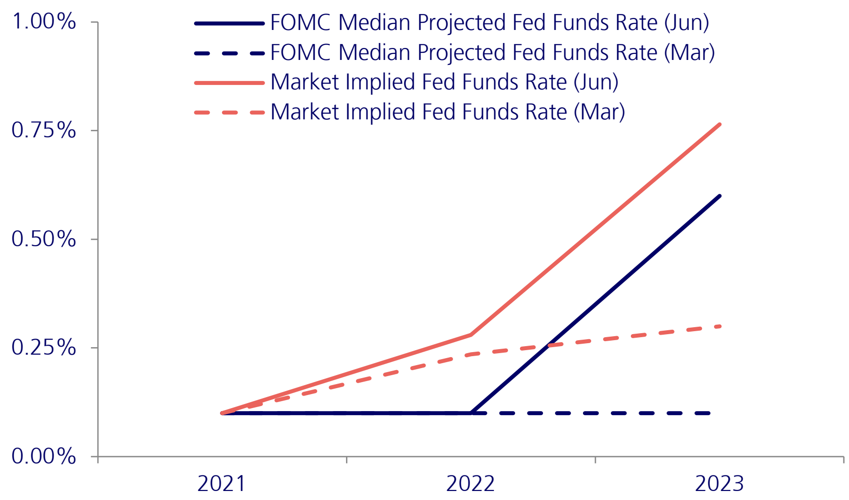
- **The EU issued EUR 20bn of Next Generation EU (NGEU) bonds at a yield 0.086%**

  The bonds saw strong institutional investor demand, an encouraging sign for the NGEU initiative. Over the next few years, up to EUR 800bn in bonds could be issued by the EU.

- **China's economic activity slowed further in May**

  Not least amid the upcoming 100th anniversary of the Communist Party, we believe China's authorities will cut back some deleveraging policies and implement cautious, targeted stimulus to avoid a downward spiral of economic conditions in H2.

The Fed has blinked and gets slightly more hawkish



Source: Bloomberg

In a hawkish tilt compared to its recent communication, the Fed moved forward the expected date of the first rate hike with the latest dot plot now signalling two rate hikes in 2023, in line with our own forecasts. Although Fed Chair Powell made clear that the projected path is not set in stone, the FOMC seems to have been somewhat surprised by the strength of the rebound in activity and the surge in inflation. Accordingly, it raised both its expectations for GDP growth and inflation rates for 2021 with only minor changes for the following years. While the Fed has still not defined the exact parameters of the average inflation framework it adopted last year, a majority of FOMC members obviously feel that they have moved closer to the target since their last meeting in March. Powell did not provide any news regarding the Fed's intention to start reducing its asset purchases, but an announcement is likely to be made soon with some initial steps possible later this year. Economic data published last week were mixed with retail sales falling in May following the stimulus-induced pickup the months before. Producer input prices were 6.6% higher than a year ago in May, underlining the current price pressure observable in a number of sectors. Finally, the latest NAHB home builder survey points to a further loss of momentum in the housing market, albeit from a very high level.

Markets: Investors have mixed views on the Fed's pivot

The change in Fed tone had a mixed market reaction with bonds seeing the largest impact. As market implied inflation expectations eased on signs that the Fed had not lost its inflation fighting credentials, global bonds rallied and curves flattened, with the 30yr Treasury closing the week at 2% against 2.4% in March. While bond investors were quick to react, equities had a delayed response with markets only really selling off on Friday. The S&P 500 was down 2% on the week and is now at the bottom of its up track, while the tech heavy Nasdaq fared better, off just 0.3%. We believe that the fundamentals for equities remain good and do not see the move on Friday as a sign of a protracted decline ahead, while bond yields seem stretched. Credit markets remained unfazed by the shift in tone from the Fed, although CDS index spreads widened. Strong demand was seen in both primary and secondary credit markets, with even lower rated segments of the market remaining resilient. That said, CDS should underperform bonds and equities given less supportive supply/demand technicals and tight spreads.

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Japan: Crawling out of the doldrums

With the exception of Okinawa, all prefectures have lifted the COVID-19 state-of-emergency. However, seven prefectures will move to a quasi-state-of-emergency with some restrictions still in place until July 11, including in the Greater Tokyo area. Tokyo may see restrictions extended until the Olympics end on August 8. Vaccinations have accelerated to about one million per day, with 16½% of the population having received their first jab. Vaccinations for those aged under 65 years will begin today at offices, factories, and universities. Meanwhile, the Bank of Japan left policy rates unchanged, as expected, but extended the emergency loan facility by six months to the end of March next year. One of its fund provisioning measures will be replaced to support lending aimed at addressing climate change. The Reuters Tankan for June remained positive for the manufacturing sector but deteriorated slightly for non-manufacturing sectors, driven by the retail sector. However, the outlook is more encouraging. Export growth remained strong in May but seems to be faltering.

China: Slower economic activity in May

China is now leading in the global vaccination league, with 72.2% of its population having received the first dose. This translates into more than one billion vaccinations. However, there is less reason for joy when looking at the disappointing economic indicators for May. Retail sales remain soft, not at least due to lower income particularly among migrant worker households, but also because of changing consumer habits. The auto sales boom in H2 last year was front-loaded and has come to a standstill while household expenditure for dining, entertainment and travelling has fallen below pre-COVID levels. Manufacturing investment is holding up well, driven by those sectors that are benefitting from global demand for PCs, communications equipment, and pharmaceuticals. Both infrastructure and property investment growth are slowing. Though property sales remain brisk, the contraction in floor space started and weaker mortgage loan growth is indicating that this strength will subside. Finally, the margin squeeze due to accelerating producer price inflation is hitting industrial output.

Australia: Unemployment falls below the pre-COVID rate

May employment data were exceptionally robust, with 115k new jobs created, far exceeding the consensus forecast of 30k. Around 85% of new jobs were related to full-time employment. The part-time sector, which was hit hard by lockdowns last year, already experienced a swift rebound in H2 2020. Full-time job growth has outpaced that of part-time this year. With that, the unemployment rate fell to 5.1% in May, fully returning to below the pre-COVID rate. Recent business surveys suggested that hiring people is becoming harder now. With such vigorous labour data, we wonder whether the RBA may blink. So far, it doesn't seem so. In his latest speech, Governor Lowe reiterated that wage growth is likely to be weak despite a tightening labour market. He argued that firms remain very cost-conscious, making wage growth less responsive to improving economic conditions than employment data. Indeed, the latest weekly payroll jobs and wages survey suggested that wage growth remained relatively modest. We expect rate hikes to come only in 2023, while QE tapering seems likely towards the end of this year.

LatAm: The normalisation process on monetary policy accelerates

The Central Bank of Brazil (BCB) raised the Selic rate by 75bps to 4.25% as expected. This was the third consecutive increase of the same size since the normalisation process started in March. The BCB also signalled another hike of the same magnitude in August. The most relevant announcement in this meeting was the change of tone towards a more hawkish stance, indicating that it now deems appropriate the normalisation of the policy rate to a neutral level. Despite the worsening of the pandemic, the faster-than-expected economic recovery and the persistence of inflationary pressures, which could affect inflation expectations on the policy horizon, were the main drivers of the change in forward guidance.

In Chile, the Central Bank also announced that monetary policy normalisation will begin during H2. The faster than expected closing of the output gap led by solid growth in private consumption and the fiscal stimulus implemented this year are the main drivers of the change in forward guidance.

What to Watch

- The G3 flash PMIs are expected to show strong growth led by services, while manufacturing activity should remain brisk
- In the Eurozone, the German ifo survey is likely to confirm a strong economic rebound is just beginning.
- In APAC, the central banks of Thailand and the Philippines are expected to keep their policy rates unchanged. Australia's PMI for June and May export data will be released. We will also focus on Taiwan's and Singapore's industrial production data as well as Thailand's export statistics for May. Hong Kong, Singapore, and Malaysia will report CPI data for May.
- The Central Bank of Mexico is expected to remain on hold, but with a hawkish statement. The inflation report and the minutes of the last monetary policy meeting in Brazil will give us more insight into the tightening cycle.

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