June 28, 2021

Weekly Macro & Markets View

Highlights and View

- **The Eurozone flash Composite PMI surged to a 15-year high in June and other national surveys were also strong**

  Economic conditions are improving rapidly, setting the Eurozone up for a period of very strong growth. Activity will also be supported by the Next Generation EU initiative.

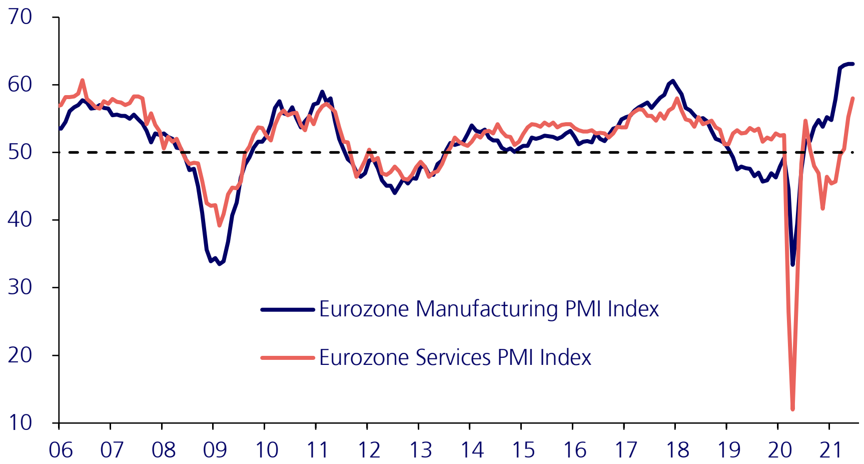
- **Biden announces agreement on infrastructure plan with a bipartisan group of senators**

  The slimmed down proposal covers crucial parts of core infrastructure investments, though an approval in Congress is not assured.

- **Export data in Taiwan and South Korea remain strong, but seem to be peaking**

  As Western demand starts to shift from goods to services the change will contribute to a slowdown in the Asian export boom.

Surging Eurozone services push business confidence to highs



Source: Bloomberg

Eurozone business confidence continues to surge higher according to various surveys released last week, setting the region up for boom-like economic conditions in H2. The flash Eurozone Composite PMI rose to a 15-year high in June, the expectations component of the German ifo survey rose to its highest levels in more than ten years, and the French INSEE national business confidence indicator surged by five points to its highest levels since June 2007. Consumer confidence in the Eurozone has also improved sharply. With lockdown restrictions gradually being eased and a large amount of monetary and fiscal stimulus continuing to be provided it is no surprise to see economic conditions improving. Nevertheless, one concern is that the Eurozone sometimes sees a surge in economic activity just before a global downturn as it often tends to be "late to join the party". However, we think we are still in the early stages of the global economic cycle this time. In addition, there will continue to be large amounts of fiscal stimulus in the years ahead due to the Next Generation EU (NGEU) initiative. This will see hundreds of billions of euros spent to make economic activity more environmentally friendly and to accelerate digitalisation. (For more on this please see our latest topical thought, NextGenEU: What we know so far). The upshot is that strong above trend Eurozone growth in H2 is likely to continue into 2022 as well in our view, supporting risk assets in the region.

US: Biden announces agreement on a slimmed down infrastructure deal

The S&P 500 quickly recovered from a short setback in the aftermath of the Fed's hawkish tilt and resumed its trend higher, reaching a new record last week. Investor sentiment was supported by President Biden's announcement that an agreement on a scaled down infrastructure package had been reached with a bipartisan group of senators. The proposed deal involves USD 579bn in new spending, mostly covering core infrastructure investments proposed in Biden's initial, bigger plan. While we welcome the bipartisan plan to modernise crucial parts of the US infrastructure, approval in both the Senate and the House is not assured as Democrats want to tie support to a broader fiscal package, which Republicans oppose. On the data front, the Markit PMI shows that business activity has slowed down in June, albeit from very high levels. Similarly, both new and existing home sales fell in May, reflecting slower momentum in the housing market. Finally, personal spending did not grow at all in May while PCE Core inflation picked up to an annual rate of 3.4%, in line with expectations.

North Asia: Export growth seems to be peaking

Japan's Manufacturing PMI dipped 1.5 points to 51.5 in June, with its output component tumbling 4.6 points below the 50 watermark. We suspect that prevailing supply-chain delivery problems are the main cause behind the soft outcome. Japan's Services PMI recovered 0.7 points to 47.2. We expect it to improve not only to above its pandemic high of 49.5, but to rise above 50 this autumn as progress in the vaccination campaign becomes visible. All measures for Tokyo's CPI came in at zero in June. Moving to export data in China, Taiwan and South Korea, we note that they remain brisk, but have started to level off, which may be an early confirmation of our view that demand in the US and Europe will shift from goods like electronics and furniture towards services such as travelling, dining and entertainment. South Korea's export values for the first twenty days of June did not match the record high seen in May and Taiwan's export orders rose less than expected. One of China's major harbours, Yantian in Guangdong province, has resumed operations, which should ease transport bottlenecks.

ASEAN: New virus outbreaks continue to cloud the growth outlook

The central banks of Thailand and the Philippines kept their policy rates unchanged last week as widely expected by market participants. Regional central banks will probably stand pat this year given the limited room for additional rate cuts as well as a sharp drop in the value of major currencies. Singapore's and Malaysia's CPIs were mostly flat in May. As new COVID waves and additional restrictions continue to dampen domestic demand in ASEAN, inflation is likely to stay modest this year. Thailand's exports expanded by 7.7% MoM in May, supported by vehicle parts and electronic shipments. Singapore's industrial production experienced a strong and broad-based improvement, up by 7.2% MoM in May. Indonesia became the latest COVID hotspot, with new cases surging rapidly from 5k to 20k per day within less than a month. The current outbreak is mainly due to the spread of the infectious delta virus variant. Overall, ASEAN's economic recovery is bumpy and largely dependent on the ability to contain the pandemic in each country.

LatAm: Central Bank of Mexico (Banxico) surprises the market

Banxico surprised the market by raising the policy rate by 25bps to 4.25%. The decision was divided, with three of five members voting in favour. While they consider the current inflation pressure to be transitory and expect inflation to converge to the target in Q3 '22, they justified the tightening arguing that the diversity, magnitude and duration of the shocks could imply a risk for the price formation process and left the door open for further increases depending on how inflation and its expectations evolve. Mexico joins Brazil and Chile in the monetary normalisation process, with the former having already begun to tighten the policy rate while the latter has signalled it will start soon which we expect is likely to be in July. The implicit expectations in the swap curves show increases in policy rates for the next six months of 115bps in Mexico, 300bps in Brazil and 150bps in Chile, which is well above market expectations. The MSCI LatAm continued to outperform emerging markets last week. The Mexican peso appreciated 1.7% and the yield curve flattened.

US Municipal Credit: Ready to fund the new infrastructure package

US municipal bonds underperformed Treasuries last week and yield ratios jumped a few points higher, impacted by the volatility in Treasuries and higher issuance of municipal bonds. But YTD performance remains strong with total return just below 1% for the first half of 2021. The weakness seen last week should remain transient as both supply/demand technicals and fundamentals remain supportive. Muni mutual funds continue to enjoy decent inflows with only three weeks of outflows during the past 52 weeks. State and local government tax collections were boosted by various federal stimulus plans and direct payments to households, growing by 10% YoY during the first quarter. President Biden announced a bipartisan agreement on an infrastructure package with investment earmarked for transportation and infrastructure. While details are lacking on the funding mechanism, we think that the municipal market will benefit from these projects. We expect the USD 579bn of new federal spending announced in the package to boost investments at the local level.

What to Watch

- In the US, the ISM Manufacturing survey will show whether business activity kept up its pace towards the end of the quarter while labour market data are expected to show further improvement.
- In the Eurozone, the final PMI data should confirm the very strong readings seen in the flash estimate while the European Commission's Economic Sentiment Indicator may also rise further
- In APAC, Japan's quarterly Tankan survey and most of the relevant economic indicators for May will be closely watched. Australia's May exports should show a strong print given brisk iron ore shipments. May home loans and June house prices are likely to remain elevated. China's and ASEAN's June Manufacturing PMIs will be released. South Korea and Thailand will report industrial production data for May while Hong Kong will release retail sales data for May. China's Communist Party will mark its centenary on July 1.
- PMIs in Brazil and Mexico will be published this week. In Chile, we expect monthly economic activity to continue improving in May.

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