July 5, 2021

Weekly Macro & Markets View

Highlights and View

- **The mood of US households brightens as the employment situation improves further**

  Consumer spending is expected to slow in the second half of the year, but the stabilisation in buying intentions for homes, cars and major appliances is a positive signal.

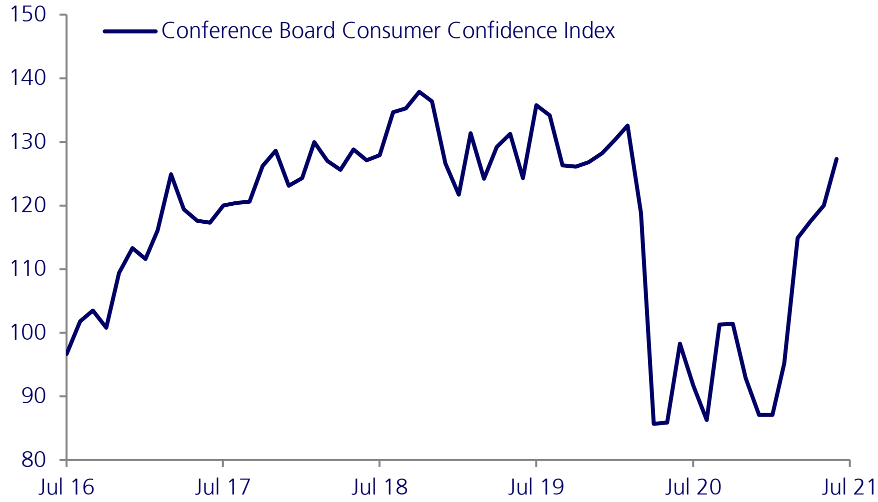
- **Japan's Tankan survey reveals improving corporate conditions despite some challenges**

  Our outlook for Japan's manufacturing and service sector activity remains optimistic for the second half of 2021.

- **Additional lockdowns are being imposed in emerging ASEAN in an effort to fight the spread of the infectious delta variant**

  With limited vaccine supply, lockdowns remain the key option for those countries to cope with new waves of COVID. We expect the economic recovery in the region will significantly lag the developed world.

US consumer sentiment rises back to pre-crisis levels



Source: Bloomberg

The Conference Board's Consumer Sentiment Index climbed further in June, reaching the highest level since February 2020, lifted both by the present situation as well as expectations. Following several months of decline, plans to buy homes, cars and major appliances ticked up again. The improving employment situation was an important driver of the brighter mood amongst households. In June, 850'000 new payrolls were created in the US, showing a marked acceleration over the months before. Payroll numbers have thus finally started to move more in line with other recent labour data that already reflected an increasingly positive employment situation. Meanwhile, the ISM Manufacturing survey shows a further deceleration in momentum in June, though activity remains at very high levels and strong new orders point at a continuation of solid growth in the manufacturing sector as we enter the second half of the year. The rise in house prices has accelerated further and reached an annual rate of almost 15% in April. As higher house prices usually have an impact on rents this is likely to feed into shelter costs and core inflation rates. Bond markets interpreted the macro data favourable, with a decline in yields despite strong job growth and improving consumer confidence. This likely reflected a small tick up in the unemployment rate, which, for now, helps to contain fears around Fed tapering.

Switzerland: Economic growth is rebalancing and possibly peaking

After the sharp rebound in activity in the first half of the year, the Manufacturing PMI edged down from an all-time high in June as current output fell back to a more sustainable level. Likewise, the KOF leading indicator edged lower, reflecting weaker activity in the goods producing sector. By contrast, services picked up momentum, following a successful vaccination campaign and continued reopening. This is encouraging, as demand needs to shift towards services to limit the risk of excessive price and supply-chain pressures in the industrial sector. Inflation also edged lower, reflecting downward pressure on goods prices and confirming our view that underlying price dynamics remain weak in Switzerland. That said, rent inflation has shifted higher. This is linked to the strong housing market, which the SNB has already flagged as a concern. Taken together, the growth outlook remains favourable, though the second half of the year is likely to see some return towards normality with growth momentum set to moderate.

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Japan: Tankan survey confirms improving corporate conditions, with more to come

Japan's quarterly corporate Tankan survey revealed a significant improvement in manufacturing conditions, but a more gradual recovery in non-manufacturing conditions. As usual, SMEs are lagging large companies, with their diffusion indices remaining in negative territory. Overall, the improvement was weaker than expected. Manufacturing companies, particularly in the auto sector, are still grappling with semiconductor supply shortages, while the service sector recovery is lagging due to the COVID induced state-of-emergency for major prefectures that has only recently been relaxed. Our focus looking forward is on the positive corporate outlook for sales, profits, and capital investment. Indeed, manufacturing confidence has already surpassed the level of late 2018, and digital transformation is driving strong software investments. We also believe that the profit outlook has even more room to the upside amid the fact that yen weakness is not yet fully discounted in the corporate profit outlook. Service sector activity is also expected to improve as the vaccination rollout gains speed.

EM Asia: Lockdowns are impacting economic activity

While the West is emerging from the pandemic with the help of vaccines, some parts of developing Asia are still combating the virulent delta variant. Malaysia announced a lockdown extension while Indonesia imposed additional lockdowns in Java and Bali. Vietnam, the only bright spot last year, is now experiencing its worst wave of COVID, triggering targeted lockdowns across big cities. While new cases in India trended down drastically, retail mobility is still 30% lower compared to pre-pandemic levels. That explains the sharp fall of manufacturing PMIs in some countries. Malaysia's index dropped from 51.3 to 39.9 while Vietnam's reading was down from 53.1 to 44.1. Despite very limited fiscal space, India's and Malaysia's governments announced additional fiscal support packages, mainly in the form of non-cash spending. Meanwhile, China's Caixin Services PMI also tumbled by nearly five points to 50.3, which can partly be explained by consumer uncertainty following infections in the province of Guangdong, though the speed of nationwide vaccinations is far superior to the rest of Asia.

Australia: The housing market upswing continues

House prices across eight capital cities rose by 1.9% MoM and 13.5% YoY in June. Home loans are at a record high. Since the beginning of the year, investor loan value has grown faster than that of owner-occupiers. With the further participation of investors in the housing market, there are signs of excess liquidity due to extra loose monetary conditions now flowing into the property market. We suspect the rise in house prices has further to run. Building approvals have surged in the last couple of months and hit a record high. However, it will take some time before more supply becomes available on the market to turn down the heat from exuberant demand. The main driver of the housing upswing remains low mortgage rates on the back of ultra-low interest rates. Despite this,the RBA made it clear that hiking interest rates is not in the cards. Indeed, we think interest rates will stay low until 2023, but macro-prudential policy tightening is likely should house prices rise to unsustainable levels.

US Auto ABS: Stimulus and used car price surge create a boost

Auto ABS supply has ballooned this year, driven by higher vehicle sales and stronger loan origination. Spreads continue to grind tighter and are now at post-GFC lows for most US ABS sectors, including autos. Despite the rise in loan volumes, lenders remain vigilant on lending criteria. The proportion of subprime borrowers has declined to the lowest level since 2010. Collateral performance also remains robust, despite elevated unemployment levels, which based on historical correlations would have implied much higher defaults. Indeed, direct payments to households from the various stimulus plans have helped weaker borrowers service their debt. Delinquencies and defaults remain low and are declining. The surge in used car prices, up 36% YoY in June, has also pushed the recovery rate to historically high levels, helping to lower the net losses even where defaults occurred. That said, used car prices should eventually decline. Given the labour market recovery, we expect the positive trend in credit performance to continue in the second half, which should support the auto ABS market.

What to Watch

- In the Eurozone, the ZEW survey as well as other surveys and economic data are likely to confirm a strong recovery is taking place in the region.
- In APAC, we expect Australia's RBA and Malaysia's BNM to keep policy rates unchanged, though the RBA is likely to make its QE programme more flexible. Australia will also publish building permit and retail sales statistics for May. Other May data releases include Japan's household survey, exports data in Taiwan and the Philippines, and CPI data for China, Taiwan, Thailand and the Philippines.
- Inflation for Brazil, Chile, and Mexico should get investors' attention this week due to the potential impact on the monetary policy normalisation process in LatAm. In Brazil, retail sales data will be released.

Disclaimer and cautionary statement

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