January 18, 2021

Weekly Macro & Markets View

Highlights and View

- **China's December economic data were a mixed bag**

  Despite weaker numbers for retail sales and public investment, our outlook for China's economy remains upbeat into the first half of this year.

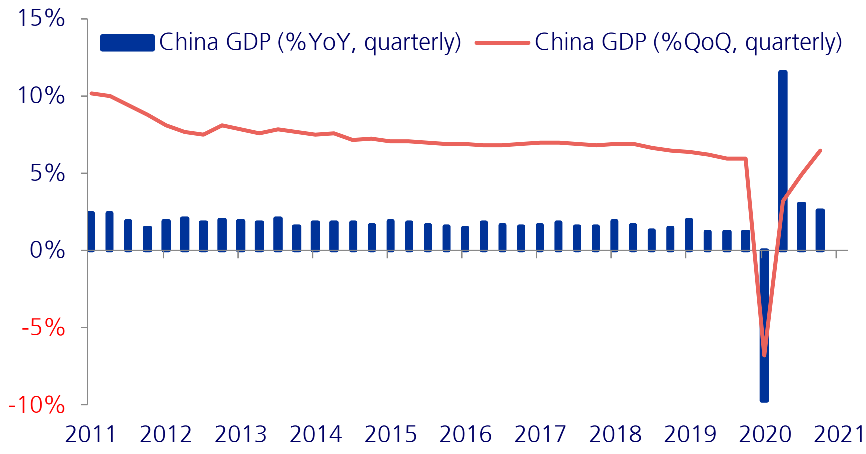
- **US President-elect Joe Biden wants more fiscal stimulus while consumer spending weakens**

  It's unlikely that the full USD 1.9tn plan will be passed by Congress, but the fiscal boost will support consumer spending in the coming months.

- **COVID-19 infections continue to surge globally while vaccination rollouts hit logistical difficulties**

  Additional lockdowns and some delays in scaling up mass vaccination will inevitably impact economic activity, supporting the rationale for our below consensus Q1 GDP growth estimates.

China's growth is back to pre-COVID levels



Source: NBS, Bloomberg

China's GDP was up 2.3% last year, fully in line with our long-standing forecast. China, along with Taiwan and Vietnam, is one of the few economies that managed to grow last year despite the heavy economic impact of the pandemic in Q1. Overall, China is on a healthy path into the first half of this year, but we expect growth to slow down in the second half on policy normalisation as some fiscal and monetary support is likely to be withdrawn. Looking back to Q4 2020, both manufacturing and construction picked up steam, but the biggest growth contribution came from the service sector that grew 6.7% YoY vs. 4.3% in Q3. However, we need to distinguish between booming service activities like IT, financials and real estate and the still lagging service segments like catering, travel and hospitality. Meanwhile, December data released today paint a somewhat mixed picture. Industrial production remained healthy, showing the strongest growth for almost three years, while services production growth retreated slightly. We note that retail sales growth slowed to only 4.6% YoY, driven by weaker online spending. We believe that consumer confidence is taking a hit amid the resurgence of COVID-19 cases in the province of Hebei, where several major cities are locked down. Finally, public investment growth faltered significantly. It remains to be seen whether this was just a blip or the start of a phase of moderation.

US: Joe Biden presents his economic rescue plan

Joe Biden presented an USD 1.9tn stimulus package aimed at supporting an economy that will face further headwinds in the coming months. The most prominent part of Biden's plan is another direct stimulus payment to individuals of up to USD 1'400 per person. If implemented, that would inject roughly USD 465bn in cash into the private household sector. Further measures under the new plan include an extension of emergency jobless benefits and aid to state and local governments, both instruments amounting to another USD 350bn each. It is unlikely that the full plan will be passed by Congress, but we expect a substantial amount of the plan to be implemented, which would provide a significant boost to the economy. Consumer spending is losing momentum as reflected by a 0.7% MoM fall in retail sales in December, following a drop of 1.4% the month before. A weakening labour market and a high rate of new infections weigh on consumer sentiment while small business optimism fell back to the lowest since May.

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Eurozone: Germany's CDU party votes for continuity, while Italian PM faces a confidence vote

Germany's largest party, the CDU, elected Armin Laschet to replace Angela Merkel as its leader later this year. In a tight runoff, Laschet beat Friedrich Merz, a Merkel and EU critic. The election of Laschet, a centrist who emphasises continuity, removes the risk of more disruptive changes within the party. As leader he will not, however, automatically become the chancellor candidate for the September elections. The party's nomination remains to be decided. In Italy, Prime Minister Conte faces a confidence vote in parliament this week as former PM Renzi withdrew his party's ministers from the ruling coalition. While PM Conte hopes to emerge from the crisis stronger, it will be a tight vote. Investors chose to look through Italian political events, with only a small increase in the spread of Italian government bond yields over those of Bunds, reflecting the potent ECB backstop that remains in place. Meanwhile, extended and strengthened lockdowns were announced across Europe. Conditions are difficult and a political crisis needs to be avoided.

Australia: The recovery remains intact

Australia's economic indicators consistently beat consensus expectations by a sizable margin. Job vacancies jumped by 23.4% QoQ in Q4 while consumer confidence remained elevated. Retail sales hit a record level in November, fuelled by the full reopening of Victoria and a one-off boost from the year-end sale season. We expect the vigour of retail spending to eventually recede as Victoria's pent-up demand diminishes. Nevertheless, household spending should remain supported by the current record-high savings rate. The housing market saw further signs of improvement with house prices rising by 0.9% MoM and 2% YoY in December. Home loans surged to a record high as home buyers attempted to lock in ultra-low mortgage rates. With the economic recovery well on track and improving labour market conditions, house prices are likely to trend up further in the months to come, but we do not foresee an overheated housing market anytime soon.

Chile: The Central Bank announces a reserve accumulation program

The Central Bank of Chile (BCCh) will launch a program this week to increase its international reserves by USD 12bn (~30% of the current level). One aim of the program is to repurchase the USD 2.55bn sold during the FX interventions implemented in December 2019 and January 2020 to mitigate social unrest's impact on the FX market. The remaining amount will be used to increase the level of international reserves to 18% of GDP. The measure will be implemented over the next 15 months, with a daily purchase of USD 40mn. The Central Bank will stabilise the monetary impact by issuing 90-day discount bills. The program does not represent an FX intervention given the BCCh's commitment to a free-floating FX regime. We estimate that the program will not affect the medium-term trajectory of FX. On the political front, the Lower House rejected a bill that would have allowed annuity withdrawals of up to USD 2.8bn, corresponding to 66.7% of Chile's insurance companies' net worth. The draft bill will now be shelved, and members will not be able to discuss it for 12 months.

Covered Bonds: Investors undeterred by negative yields in 98% of bonds

Covered bonds should remain supported, despite the negative yields offered by 98% of European covered bonds. Indeed, spreads were stable last week amid a mini surge in supply. Issuance had a slow start in 2021 but then notably picked up last week with seven banks pricing around EUR 5bn of bonds. The issuer base was diverse and included a debut euro deal from a Czech bank and the first green covered bond of 2021. The Italian bank Mediobanca returned to the market for the first time in 18 months and sold a 10yr covered bond at a -0.08% yield, far below BTP yields. Despite this pickup in issuance, net supply will likely remain low, with more than EUR 26bn in redemptions in January. The ECB alone will likely need to buy more than EUR 5bn in bonds for reinvestment purposes. The ECB's TLTRO financing is a cheaper funding alternative to covered bonds for banks, and if the strong demand for these loans is any indication, covered bond supply should remain muted. Hence, despite negative yields, safe-haven characteristics and favourable supply, demand dynamics are likely to keep the sector well supported.

What to Watch

- The flash G3 PMIs will reveal whether economic momentum remained resilient into the new year.
- The ECB is expected to leave policy unchanged in this week's policy meeting.
- We believe the Bank of Japan, Bank Indonesia and Bank Negara Malaysia will stand pat this week. Labour market data for Australia in December should remain encouraging. December foreign trade data for Japan, Taiwan, Singapore, Thailand and the Philippines will be released, while Korea's export data for the first twenty days of January should confirm strength. The CPI for December will be published in Japan, Hong Kong and Malaysia.

Disclaimer and cautionary statement

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