October 25, 2021

Weekly Macro & Markets View

Highlights and View

- **The fiscal outlook has deteriorated due to additional fiscal spending in the social program, negatively impacting Brazil's equity market**

  Financial assets should remain under pressure, while the Banco Central do Brasil may accelerate tightening as inflation expectations have increased.

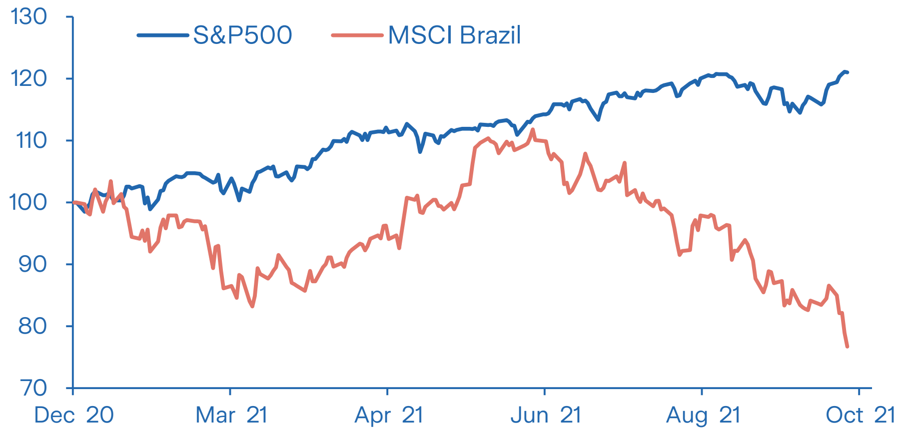
- **The S&P 500 index rises to a record high as investors' focus shifts from growth worries to solid earnings**

  Although the average earnings surprise is more modest than in recent quarters, the Q3 earnings season has started on a positive note, helping to lift investor sentiment.

- **China's property developer Evergrande avoids a default**

  We believe the situation for Evergrande will remain very challenging, not at least as China's property market conditions continue to deteriorate.

The Brazilian equity market is under pressure



Source: Bloomberg (rebased, 31 Dec 2020 =100)

While the S&P 500 index reached a new record high, financial assets in Brazil remained under pressure as the fiscal outlook deteriorated, with the Bovespa index falling 7.2% and the BRL depreciating 3.3% vs the USD last week. President Bolsonaro announced a new, boosted cash-transfer social program with monthly instalments of BRL 400 instead of the BRL 300 previously suggested. The program implies an additional fiscal expenditure of ~0.3% of GDP, above the spending cap. A special commission of the Lower House approved a constitutional amendment that reduces court-ordered payments and changes the methodology for calculating the spending cap, opening space for new spending. This proposal must now go through the Lower House and the Senate and looks likely to be approved. Several members of the Ministry of Economy resigned amid disagreements with the proposed changes. However, Minister Guedes will remain in the government. The proposal caused a deterioration in the market's perspective on fiscal sustainability and increased the risk for additional fiscal spending. Market-based inflation expectations increased widespread, reflecting an inflationary process that could be more persistent. One-year inflation expectations rose above 7%, compared to the 3.5% inflation target for 2022. We expect the central bank to accelerate tightening, and to raise the Selic rate by at least 125bps this week.

US: The S&P 500 index reaches an all-time high

The S&P 500 index concluded its turnaround last week by reaching a new record high seven weeks after the former high and a correction of more than 5% in between. The move higher was supported by another batch of positive earnings surprises. With about a quarter of the S&P 500 companies having reported, the average earnings surprise stands at 13% with a beat/miss-ratio of 81%. Both numbers are below recent quarters but help to reassure investors that have turned more cautious regarding the growth outlook although a significant part of the positive surprise so far is due to loan-loss reserve releases by banks. Investor sentiment was further lifted by a decent reacceleration in business activity signalled by the latest set of Markit's PMIs. While the expansion in manufacturing slowed slightly, weighed down by persistent supply chain disruptions, the service sector saw a healthy pickup in momentum. Finally, initial jobless claims fell to 290'000, marking a post-recession low and indicating further improvement of the employment situation.

UK: Economic momentum reaccelerates in October

Business activity regained momentum in October with the Composite PMI rising to 56.8 from 54.9 the month before. The recovery was led by service providers while manufacturing activity was still weighed down by staff shortages and ongoing supply chain disruptions. Supply shortages and higher wages keep driving up input price inflation. Although headline CPI inflation ticked down to 3.1% YoY in September, we have not seen the peak yet as input price pressure is expected to feed through to higher inflation in the coming months. Core inflation slowed down slightly more to 2.9% YoY from 3.1%. The Bank of England is increasingly worried about the inflationary environment with several members of the MPC signalling a potential rate hike in the near future. Nevertheless, given strong opposition to a near-term hike, any decision will be a close call. Finally, retail sales receded slightly in September, at least partially affected by the fuel shortage, as households restricted themselves to essential journeys from home.

North Asia: China's property market conditions deteriorate, while Japan's PMI data are encouraging

China's major property developer Evergrande averted a default by making a last-minute interest payment and has re-started working on major development projects. However, it seems likely that a default has just been postponed. China's property sector has continued to deteriorate rapidly in October in terms of home sales, land sales and house prices. In Japan, both the Manufacturing PMI, including all its major components, and the Non-manufacturing PMI have recovered in October, with the latter climbing back above the 50 watermark for the first time since January 2020 following a rapid improvement of the Covid situation. September exports suffered from a more than 40% YoY fall in auto exports due to supply chain issues hampering auto part imports from Malaysia and Vietnam as well as chip supply problems. Meanwhile, early statistics for South Korea's exports for the first 20 days suggest that October is on track to set a new record, while Taiwan's export orders and China's industrial sales for exports in September confirm strong global demand.

ASEAN: Slow recovery

After a quarter largely under lockdown, most countries in ASEAN have eased restrictions in an attempt to get economic activity back on track. However, uncertainty remains. Singapore's daily new cases continued to rise despite high vaccination rates, preventing the country from fully reopening. Last week, Malaysia became the second ASEAN country crossing the threshold of having 70% of the population fully vaccinated. In Vietnam, Thailand and Indonesia vaccination progress, while improved, remains slow. As the region gradually reopens, production output should slowly pick up, alleviating some supply bottlenecks in the region. On a separate note, Singapore's non-oil exports rebounded by 1.2% MoM in September after a few months in decline. Shipments to the US were robust, offsetting weaker exports to China. Meanwhile, Malaysia's CPI edged slightly higher in September, driven by food prices. Underlying inflation remains weak, however, reflecting still fragile domestic conditions.

Credit: Softness shows tentative signs of ebbing

Credit markets have had a decent tone to them, although US investment grade lagged a little. That said, their performance trailed that of stocks, which were cheered by a good start to the earnings season. Robust inflows and strong demand in primary credit markets also confirmed investor appetite. The US primary market saw a number of jumbo deals being placed, some of them driven by M&A activity. AerCap sold USD 21bn of bonds, the second largest bond deal this year, to fund the acquisition of GE capital aviation services. Deal execution remains strong with high oversubscription levels and limited new issue concessions. The high yield market was also strong amid the 'risk-on' sentiment and the stabilisation in energy markets while high yield mutual funds reported their largest weekly inflow in six months. The softer tone in credit over previous weeks now tentatively seems to be ebbing and the credit rally seems likely to resume amid a decent economic outlook and a strong earning season. That said, given tight spread levels, performance should continue to lag that of stocks on a risk adjusted basis.

What to Watch

- US GDP data for Q3 are expected to show a marked growth slowdown while the Conference Board's consumer confidence survey will give us insights into the current state of private households.
- Q3 GDP for the Eurozone as well as October CPI inflation data will be released, while the ECB is expected to keep policy unchanged.
- Japan's Lower House elections will take place on Sunday. The Bank of Japan is expected to stand pat, while most of Japan's relevant economic indicators for September will be released. China will publish its PMIs for October. Australia's retail sales are likely to remain fragile in September. Malaysia's budget 2022 should show a narrower fiscal deficit in 2022 given a potential rise in tax revenue. September export and industrial production data will be release for several countries. South Korea and Taiwan will release Q3 GDP data.
- The focus in LatAm will be in Brazil, where we expect the Banco Central do Brasil to raise the Selic rate by 125bps. In Mexico, Q3 GDP will be published, while in Chile, several monthly economic indicators will be released.

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