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Weekly Macro & Markets View

Highlights and View

- **US nonfarm payrolls increase modestly as hiring picks up again**

  Payrolls rose less than expected in January following a very weak December, but ISM employment components signal a promising improvement.

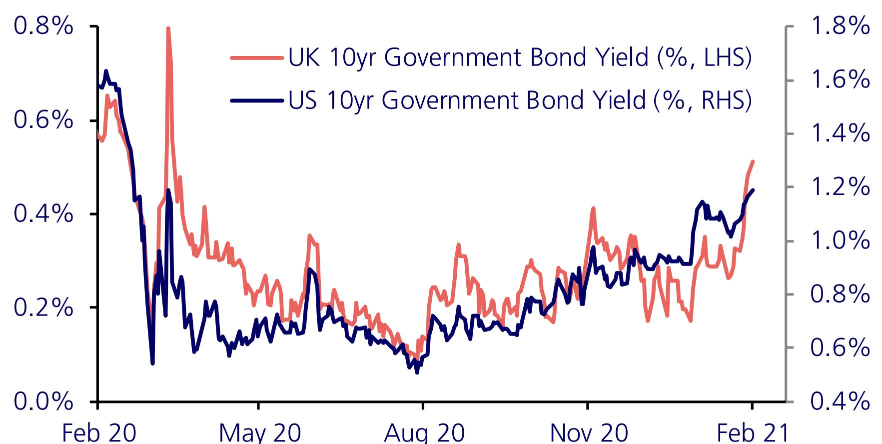
- **The BoE notes that the necessary preparations to get negative rates operational would take at least six months**

  Given our view of a solid rebound in the second half of the year, we see it as unlikely that the BoE will use negative rates during this policy cycle.

- **Former ECB President Mario Draghi is asked to lead a coalition government in Italy**

  Draghi is currently trying to assemble a coalition government and is likely to succeed. Whilst he is viewed as a safe pair of hands by investors he could still face considerable challenges in reforming the Italian economy.

Policy and politics trigger higher government bond yields



Source: Bloomberg

Government bond yields rose last week as investors opted for riskier assets. A soft US payroll report increased conviction for a larger fiscal package, and factors that have weighed on yields in Europe diminished. Bund yields snapped higher, driven by both a surge in inflation and Italy's President, Sergio Mattarella, tapping former ECB President Mario Draghi to lead a new coalition government. The move was received positively and spurred strong gains in Italian risk assets while demand for safe-haven assets slipped. Italian government bond yields fell as spreads relative to bunds narrowed. In the UK, the BoE signalled its willingness to use negative rates as a policy tool but noted that preparations would take at least six months. Given expectations of stronger growth in the second half of the year, this sent the message that negative UK rates are unlikely during this policy cycle, triggering higher gilt yields as well. In the bond market overall, one of the largest moves was indeed seen in the gilt market, where the 10yr yield rose by 15.5bps to 0.48%, while the 10yr US Treasury yield rose by 10bps to 1.16%. Investors are looking through the negative headlines around virus mutations and vaccine obstacles, choosing to focus on positive developments in policy and politics instead. Challenges remain, however, and we suspect that the ongoing repricing in bond markets may be due for a pause.

US: Hiring is regaining momentum

The S&P 500 rebounded strongly last week to reach a new record high, gaining 4.7% over the course of the week. Strong corporate earnings and solid economic data provided a positive environment for the stock market and helped to lift investors' mood. With more than half of the companies in the S&P 500 having reported their Q4 earnings so far, the beat/miss-ratio currently stands at a very high 81%. At the same time, economic data show a reassuring resilience. Both the ISM Manufacturing and Services surveys stood at 58.7 in January, reflecting a solid expansion in business activity. This is particularly positive for the service industry, which has been more affected by lockdown measures and social distancing. Although nonfarm payrolls only rose by 49'000 in January, this follows a very significant loss of jobs in December when payrolls fell by 227'000, reflecting a positive change in labour market momentum. The unemployment rate fell to 6.3% from 6.7%. Rising vehicle sales, construction spending and factory orders round off a promising start into the new year.

Eurozone: COVID's impact in Q4 is confirmed as less bad than initially feared

Eurozone-wide data confirmed the picture already indicated by national data. Eurozone Q4 GDP declined by only 0.7% QoQ, less bad than initially feared. However, headline Eurozone inflation rose to 0.9% in January from -0.3% in December and core inflation to 1.4% from 0.2%. The increase reflected several one-off factors, including the return of Germany's VAT to normal levels and a re-weighting of the HICP consumption basket. Eurozone inflation is likely to remain volatile in 2021 as these and various other effects continue to play out. Indeed, as base effects from low oil prices in H1 2020 kick in, headline inflation could rise above 2% early this year, though core inflation will likely remain well below the ECB's target. We expect that the ECB will look through the spike in inflation and continue with large-scale asset purchases, keeping periphery government bond spreads tight as a result. If Mario Draghi succeeds in forming a new coalition government in Italy, this should also help reassure investors and keep Italian government bonds well bid.

APAC: PMIs a mixed bag

Manufacturing activity remained brisk in most APAC economies in January, with some Manufacturing PMIs even reaching 10-year highs. Taiwan remains the shining star, with a PMI of 60.2, while several other economies showed rising PMIs above the critical 50 level, including Korea, Australia, India, Indonesia and the Philippines. Those in Japan, Malaysia and Thailand remained or slipped back below 50. Despite the rather rosy picture, we note a deterioration below the surface when looking at the PMIs for new export orders, which weakened in Japan and most ASEAN countries. The situation is different in Australia, India, Korea, Taiwan and Singapore, with the latter three economies benefitting from strong electronics exports. In China, the official NBS, as well as the Caixin PMIs representing more SMEs, deteriorated for the manufacturing industries and particularly for the service sector. The former may have been impacted by harsh winter conditions and environmental restrictions, while rising COVID-19 cases have hit service-oriented firms. Construction activity remains strong.

Australia: The RBA adds another AUD 100bn of QE

The RBA's decision was more dovish than our expectation. Upside economic surprises regarding job growth, consumer spending and housing demand led us to envisage that the RBA would pause its bond purchases after April. Yet, the prospects of continuing high unemployment, the near-term tapering of fiscal support and AUD strength prompted the central bank to deliver more. This move helped addressing 'taper tantrum' fears from the investor community and provided a shot in the arm for risk assets. Last week, the ASX 200 Index posted the best week since the November 2020 rally. January house prices continued to rise on surging housing demand. Home loans advanced by 8.6% MoM in December, the fastest growth since 2009, suggesting that a sizable amount of liquidity was flowing into real estate. Ground-level mortgage rates and the liquidity deluge should remain conducive for the housing sector. However, the tapering of fiscal support and the ending of the First Home Builder grant will help take some heat off the property market before long.

Credit: The rally resumes but lags equities

Credit markets resumed their rally last week after being marginally softer during the prior two weeks. That said, returns lagged that of equity markets where stock indices in US and Europe surged by nearly 5%. While credit should remain supported, more so in corporate bonds than in derivatives, upside appears limited relative to equities given tight spread levels. Strong investor demand for credit continues to be seen in flow data, where both US and European credit markets saw strong inflows, especially in investment grade. The spread tightening in credit last week occurred amid a backdrop of heavy issuance. Last week's robust supply has taken the run rate of gross issuance above that of 2020 so far, with Apple, Boeing, Altria, Alibaba and Lufthansa notable issuers last week. New issue concessions are minimal, even for the so called 'jumbo' deals, while oversubscription levels are healthy if not robust. All in all, calm seems to have returned to risk assets and credit should remain supported, albeit with limited returns, especially compared to 2H 2020.

What to Watch

- In the US, small business optimism is expected to stabilise after last month's drop while consumer sentiment will reveal whether households are continuing to look through the current difficulties.
- In the Eurozone, industrial production data for various countries will be released, but all eyes will be on Mario Draghi's attempt to form a coalition government in Italy.
- In the APAC region, China will report inflation, credit and money supply data for January. Malaysia's Q4 GDP should reflect weakness due to the resurgence of COVID-19, while Australia will publish business and consumer confidence data. BSP, the central bank of the Philippines, is likely to stand pat.
- Markets in most Asian countries in our coverage, except Japan and India, will be closed due to Lunar New Year, starting between Wednesday and Friday this week and lasting until Monday to Wednesday next week. Japan's markets will be closed on Thursday due to a local holiday.

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