February 15, 2021

Weekly Macro & Markets View

Highlights and View

- **Mario Draghi is appointed as Prime Minister of Italy after gaining wide-ranging political support**

  Draghi's appointment is supportive for Italian markets and reduces near-term risks. His focus on managing the health crisis, streamlining the tax and justice systems and ensuring effective use of NextGenEU funds could also help reform the Italian economy.

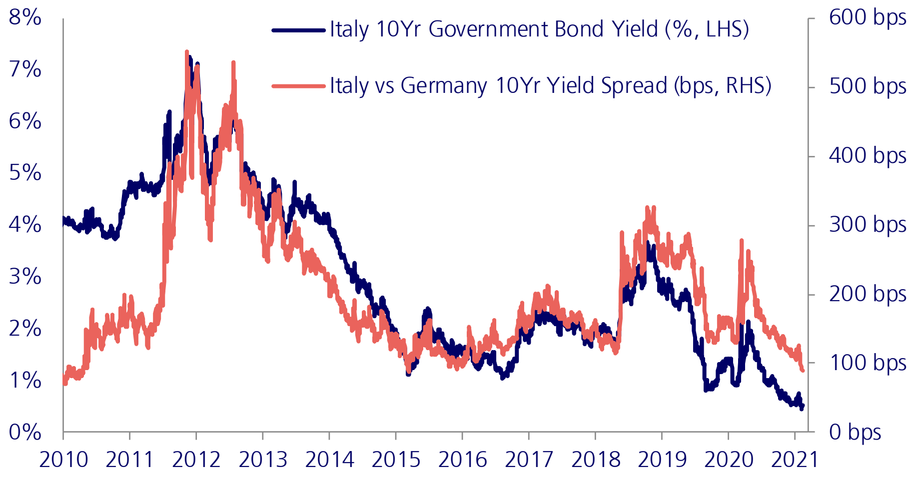
- **US consumer sentiment falls as job market recovery slows down**

  The prospect for more fiscal stimulus and the expected reopening of the economy should help to lift household sentiment and consumer spending in the months ahead.

- **The yield of the US High Yield Index drops below 4% for the first time ever, making issuance alluring**

  It is key to monitor funding usage as lower rated, highly leveraged companies cannot afford to be profligate.

Italian bond yields hit record lows as Draghi confirmed as PM



Source: Bloomberg

On Friday, former ECB President Mario Draghi was confirmed as Italian Prime Minister after gaining support from a number of political parties. The Lega Party gave him their backing and changed its policy with respect to implementation of the NextGenEU funding initiative. In an online vote, members of the Five-Star Movement also gave their support to Draghi last week. Bond markets have welcomed his appointment. Italian 10yr bond yields fell to a record low of 0.45%, and the spread between Italian and German 10yr government bond yields fell to their lowest levels since 2015. Draghi is viewed as a competent technocratic by investors. His appointment reduces the chances of snap elections being called this year and improves the chances of a relatively smooth roll-out of the EU recovery and resilience funds, which could amount to around EUR 200bn for Italy over the next few years. Draghi has said that his other priorities will include dealing with the health crisis and focusing on simplifying the tax and justice systems. Overall, the wide-ranging support for Draghi amongst political parties is encouraging and suggests that he will be able to carry out some much-needed reforms to the Italian economy. This is likely to be supportive for local equity and bond markets. Nevertheless, given the starting point of a very high debt-to-GDP ratio and weak trend growth, medium-term challenges will remain. Political instability could also resurface in 2022 or 2023.

US: Small cap stocks keep racing ahead

Stock markets kept rising to new record highs last week with small cap stocks once again beating the broader market. The Russell 2000 has now soared more than 10% in the last two weeks. Investors' upbeat mood regarding small cap companies is not fully reflected in current small business optimism, however. The NFIB survey fell back to the lowest since last May and remains well below pre-crisis levels. Similarly, the University of Michigan's consumer sentiment index receded to the lowest levels since August, driven by both current conditions and expectations. The prospect of more fiscal support as well as the expected reopening of the economy thanks to a broadening out of the vaccination program should help to lift households' mood in the coming months. This will be supported by the expected improvement in the employment situation. Recently, the pace of healing in the labour market has slowed down, with initial jobless claims falling to a still high 793'000 from 812'000 the week before.

China: Credit demand remains vigorous, but the money supply tightens

Credit data were stronger than consensus had anticipated. Aggregate financing surged from RMB 1.7tn to 5.2tn, driven by bank acceptance and corporate bonds issuance. New yuan loans jumped from RMB 1.3tn to 3.6tn, bolstered by both the household and corporate sectors. Part of this strength was due to the seasonality effect, but underlying credit demand was clearly robust. Nonetheless, January money supply M2 slowed from 10.1% to 9.4% YoY amid actions by the PBoC to withdraw some liquidity from the market. Currently, the PBoC is maintaining its neutral tone amid additional COVID-19 restrictions. However, financial stability should remain a crucial aspect of monetary policy. Meanwhile, authorities tightened travel restrictions in cities where local clusters recently developed. This move came ahead of Chinese New Year to discourage mobility across the country as hundreds of millions of people potentially travel to gather with their families. Renewed restrictions are likely to weigh on holiday consumption, notably in the services sector such as dining out and lodging.

Japan: Q4 GDP surprises to the upside

Q4 GDP 2020 rose by 3% QoQ on a seasonally adjusted basis, beating consensus expectations and leaving output just 0.5% below pre COVID-19 levels. Both exports and domestic activity advanced at a solid pace. Exports were up by 11.1% QoQ while private consumption increased by 2.2%. Notably, business investment rose by 5.2% QoQ, showing the first growth after two consecutive quarters of contraction. While the current state of emergency to curb renewed outbreaks is likely to affect economic activity, the impact will probably be limited compared to the lockdown imposed last spring. The main reason is that restriction measures have been much more targeted and less draconian this time. The January 2021 Eco-Watcher Survey showed the current conditions deteriorated from 34.3 to 31.2, but the outlook conditions improved from 37.1 to 39.9, with household and corporate expectations experiencing an uptrend. Consumers and businesses are likely looking through the current difficult period given the prospect of upcoming large-scale vaccine rollouts.

LatAm: Inflation above target, while fiscal and montary stimuli continue

In Brazil, retail sales fell 6.1% MoM in December, while inflation in January was below market expectation but still above the target, reaching 4.56% YoY. Pressure to renew emergency aid, which expired in December, has increased. The government mentioned that they expect to extend pandemic emergency cash transfers but added that the payments must come with compensating cost reduction measures. The new round of transfers could be BRL 250 per month, spread over three or four months, and must be included in an emergency 'war budget' (constitutional amendment), meaning the government's spending cap and the 'golden rule' on borrowing would not be broken. Congress approved the central bank autonomy bill, which sets price stability as the monetary authority's main objective, with financial stability, smooth economic cycles, and fostering employment as secondary objectives. In México, the central bank resumed its easing cycle with a 25bps cut to 4% and left the door open for additional easing. Inflation in January was above market expectation, reaching 3.54% YoY.

Credit: A hot winter season for the US high yield market

In credit markets the themes we highlighted recently were still at play last week. Spreads tightened further amid a continuation of demand chasing supply. This dynamic was especially visible in the US high yield market, during the second busiest week of 2021 just after a record January. Even troubled issuers received a warm welcome. On Wednesday cruise line operator Carnival, which on the same day had its B2 rating placed on review for a downgrade by Moody's, issued a USD 3.5bn bond to refinance existing debt. In its fifth offering since last April, Carnival was able to price the new unsecured bond with a 5.75% coupon, half of what it paid last April with a bond secured by ships as collateral. With the yield of the US high yield index below 4% for the first time ever, more deals are likely to materialise. Amid the strong issuance, we believe monitoring how funding is used is crucial as companies in lower rated segments of the market cannot afford to be profligate given high leverage levels.

What to Watch

- In the US, retail sales are expected to have recovered in January while the home builder survey will provide insights into the current state of the housing market.
- Various data including the Flash PMIs and ZEW survey will give an indication as to the state of the Eurozone economy in Q1
- Japan's seasonally adjusted trade balance should show a further surplus in January while December core machine orders should remain weak. Bank Indonesia is expected to deliver a 25bps policy rate cut while Singapore's government will release the 2021 Budget Statement.
- Several Asian markets remain closed amid the Lunar New Year holiday. Hong Kong will reopen on Tuesday, Taiwan on Wednesday and China on Thursday.

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL