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Weekly Macro & Markets View

Highlights and View

- **Longer-term Treasury yields rise to the highest in almost a year**

  The prospect of an economic normalisation supported by a massive fiscal stimulus package lifts bond yields without hurting equities so far.

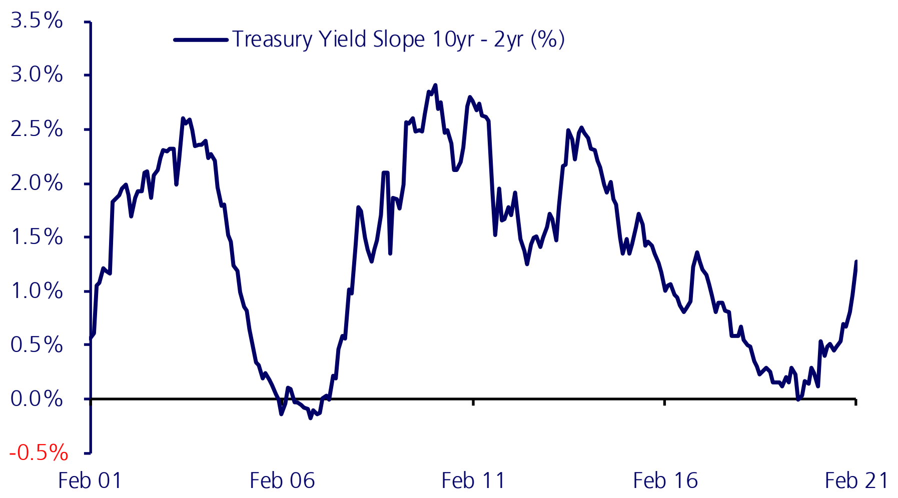
- **China's Lunar New Year passenger travel tumbles**

  Instead, urban consumers enjoy spending online and visiting cinemas.

- **The Eurozone Flash Composite PMI stayed below 50 in February, broadly unchanged from January**

  Encouragingly, the survey is consistent with only a modest contraction in the economy in Q1, but the report also shows some pricing pressures emerging in the manufacturing sector.

The Treasury yield slope rises to the highest in four years



Source: Bloomberg

Bond yields continued their move higher last week with longer-term Treasury yields rising to the highest level in almost a year, driven by the broadening out of the vaccine programs and the prospect of a massive fiscal stimulus program likely to be approved by Congress in the near future. The slope of the yield curve rose to the highest in four years reflecting the expected growth acceleration in the coming quarters. Interestingly, inflation expectations fell modestly last week leading to a jump in real yields, though they are still deeply in negative territory. So far, rising bond yields have not spooked investors as they reflect a better economic environment and remain low from a historical perspective. The S&P 500 receded only slightly from its new all-time high reached at the beginning of a holiday-shortened week. Economic data published last week confirm that growth momentum is improving. Retail sales rebounded strongly in January, rising by 5.3% MoM, boosted by the stimulus checks sent out at the beginning of the year. Producer and import prices picked up markedly in January pointing to the expected rise in inflation later this year. The Fed minutes underlined the FOMC's broadly communicated stance that the economy remains far away from reaching the Fed's dual mandate, indicating no urgency to even consider any tightening of its monetary policy.

Credit: The rally is undeterred by higher yields, though CDS lags cash

Corporate bonds continued their rally last week, undeterred by higher yields and soggy equity markets, although derivatives saw a notable lag. Corporate bond spreads tightened across the board last week, with investment grade outperforming high yield on a beta adjusted basis, particularly in the US. While higher yields do weaken the value proposition of credit versus government bonds, we think this is unlikely to change drastically unless yields rise significantly from current levels. In fact, larger investors with duration matching needs tend to be drawn in when yields are higher as they tend to have yield targets. These so called 'yield bogeys', which are predominant in the investment grade space, continue to drive flows into credit, as was seen in the latest fund flow data in both the US and Europe. That said, total return oriented investors and those investing in high yield were seen pulling money from ETFs and high yield funds. A notable trend emerging recently is the renewed appetite for floating rate debt as seen in primary markets as well as in flows into leveraged loans from high yield funds.

Eurozone: PMI survey shows economy's resilience to renewed lockdowns

The Eurozone Flash Composite PMI increased to 48.1 in February from 47.8 in January. After falling sharply below 50 in November when lockdowns were re-introduced and subsequently rebounding in December this widely followed indicator of economic activity has remained broadly stable at just below 50 since then. This is consistent with the Eurozone economy contracting in Q1, but only modestly. Indeed, it shows the resilience of economic activity compared to when the first lockdowns were introduced in March/April last year. What's more, we anticipate growth will rebound sharply from Q2 onwards as we expect lockdown restrictions to have been eased by then. However, within the detail of the survey pricing pressures are emerging with the manufacturing input price subindex increasing to 73.0 in February from 68.3 in January, the highest since 2011. Eurozone equity markets were rangebound last week overall with the EURO STOXX 50 Index up just 0.5%, though the banks subindex was up 3.8% over the week, buoyed by higher bond yields.

UK: Retail sales tumble, but consumer sentiment improves

Service activity stabilised in February following a significant dip in January with the PMI rising back to 49.7 from 39.5 the month before. Despite severe supply chain disruptions to several sectors caused by strong global pickup in demand for raw materials, worldwide shipping delays and Brexit-related trade frictions, manufacturing activity continued to expand with the corresponding PMI rising to 54.9 from 54.1. Business expectations for the next 12 months picked up to the highest level since April 2014 supported by the expected economic rebound in the wake of the vaccine rollout. While business activity showed signs of stabilization retail sales slumped by more than 8% MoM in January despite a pick-up in online sales. Overall retail sales are 5.9% lower than a year ago. On a more positive note, consumer sentiment has improved to the highest since last April this month indicating that households are increasingly looking through the current headwinds.

China/Japan: Encouraging activity data

China's Lunar New Year holiday passenger traffic fell about 77% compared to two years ago after the government requested limiting travel following the outbreak of COVID-19 infections in some hotspots. Conversely, factory operation rates were higher than in prior years as factories encouraged workers to stay on by paying special bonuses. Compared to the pre-pandemic level two years ago, courier services surged by 260%, box-office ticket sales exceeded the prior record by one third, home sales were up 41% in the 30 major cities, and retail sales rose nearly 5%.

Meanwhile, Japan reported strong activity data, with GDP up 3% QoQ in Q4 driven by strong consumption, capital investment and net exports, while core machinery order growth marked a new record, up 16.8% QoQ. The Reuters Tankan Manufacturing Index finally moved into positive territory, while the Manufacturing PMI climbed above 50 in February. We expect a reactive slowdown of economic activity in Q1 due to the surge in COVID-19 infections earlier this year and some disruptions following the major earthquake on February 13.

ASEAN: Monetary and fiscal policy remain expansionary

Bank Indonesia (BI) delivered a 25bps policy rate cut to 3.5%, in line with consensus expectations. BI has purchased around IDR 40.8tn (USD 2.9bn) in government bonds in the primary market year to date. The focus is on BI's exit strategy from its debt monetisation scheme. We believe much will depend on the return of offshore investors, whose activity so far has been rather underwhelming. In Singapore, the government announced its 2021 budget, expecting a 2.2% GDP fiscal deficit, a sharp decline from 13.9% in 2020. However, 2.2% is considered expansionary given the conservative stance of the government regarding budget deficits in the past. The upswings in the global tech and commodity cycle continued to fuel Singapore's and Indonesia's exports in January. Meanwhile, Thailand released its 2020 GDP, showing a 6.1% drop, the worst record since the Asian Financial Crisis. We expect the Thai economy will continue to struggle given little prospect of a meaningful recovery in the tourism industry.

What to Watch

- In the US, the Conference Board's consumer confidence survey will reflect households' mood as the pandemic is ebbing while durable goods orders will show whether business activity is likely to pick up further in the coming months.
- In the Eurozone, various macro data should confirm the economy's relative resilience to lockdowns.
- In the APAC region, January export data are likely to have remained brisk in Australia, Hong Kong, Taiwan and Malaysia while India's GDP for Q4 is likely to show a further recovery. Industrial production data for January in Taiwan, Thailand and Singapore as well as Australia's credit data are also worth watching. Various important economic indicators for Japan will be released on Friday, while China's February NBS PMIs will be published on Sunday. In Korea, we expect the BoK to stand pat. Japan's markets will be closed on Tuesday due to the Emperor's birthday.

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