WEEKLY UPDATE

When doves fly off… to politics

In recent weeks, the most recent presidents of the world's two most powerful central banks have moved into the political arena. First, Janet Yellen – the ex-president of the US Federal Reserve (Fed) – was appointed as the Biden administration's Treasury Secretary. And then last week, the Italian president asked Mario Draghi – the ex-president of the European Central Bank (ECB) – to form a new coalition government. What do these two appointments signify? And what does all this mean for the economic outlook and for markets?

The appointment of Janet Yellen to replace Steven Mnuchin at the Treasury has reinforced our conviction that the Biden White House will pursue expansionary economic policies. During her four years at the head of the Federal Reserve (Fed), she gained a reputation as a "dove", despite having overseen the start of normalisation of monetary policy from December 2015 onwards. Before chairing the Fed, her career spanned academia (specialising in labour market economics) and public services (for example, as Chair of Clinton's Council of Economic Advisors).

For his part, Mario Draghi left the ECB with the reputation of having saved the euro zone. His most famous moment came in July 2012. During a speech in London, he held that "the ECB is ready to do whatever it takes to preserve the euro… and, believe me, it will be enough". These simple words began to calm the market's fears. And then, a week later, he announced the creation of a new monetary policy tool, known as Outright Monetary Transactions (OMT) – this programme involves massive secondary market purchases of the most neglected sovereign bonds in order to bring their yields closer to Germany's. OMT were never actually used but their mere presence in the ECB's "tool box" proved enough to convince investors that Draghi's "whatever it takes" was credible.

Draghi and Yellen's experience as central bankers will certainly be a key determinant in their political agendas. They both presided over the launch of zero or negative interest rates and advocated the extension of asset purchase programmes in order to ensure ample liquidity and to keep the cost of bond and bank borrowing at low levels. And both placed much less emphasis on price stability than their predecessors.

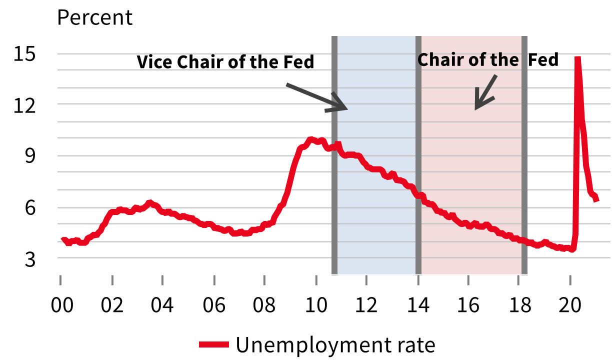
During her time at the Fed, Yellen pushed for less focus on the headline unemployment rate and more emphasis on labour market exclusion and participation rates. This approach dovetails with the Fed's new focus on "maximum employment" (see our September 4 Weekly Update) and seems particularly apposite at present. January's job data again disappointed economists, while weekly initial claims for unemployment benefits still remain well above the highs registered during previous recessions.

For his part, Mario Draghi has kept a high degree of credibility with both investors and the Italian electorate. However, will he have the political skills to succeed as prime minister? In our view, his greatest success leading the ECB may not have been his ability to convince markets that he could save the euro. It may in fact have been his ability to convince Angela Merkel not to stand in his way, despite fierce opposition from the Bundesbank. Which stands as a testament to high levels of political skill.

Bottom line. Yellen and Draghi's successors have held their course of extremely easy monetary policy, which has kept real bond yields (after accounting for inflation) at negative levels. And enormous asset purchases have eased the financing of ambitious fiscal support programmes on both sides of the Atlantic, which are designed to mitigate the negative effects of lockdown and to encourage a cyclical recovery in H2 2021. In this context, equity markets still have the potential to outperform other asset classes.

Continuing downward trend of unemployement

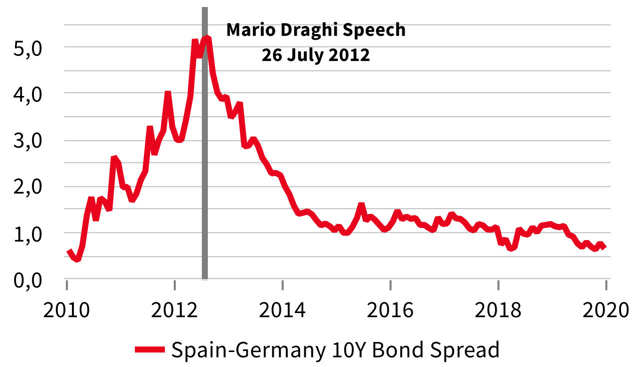
Unemployment rate in % during Yellen's mandate



Sources: SGPB, Macrobond, BLS, BEA, 01/2021

Markets calmed down just after Dragi's speech

Evolution of the Spain-Germany 10 year spread



Sources: SGPB, Macrobond, 01/2021

Past performance should not be seen as a guarantee of future returns.

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OUR MACRO COMMENTS

This week and next

EUROZONE

- Germany's industrial production stalled in December, after a 1.5% MoM rise in November, while economists had forecast a 0.3% rise. In 2020, output was 8.5% lower than 2019. French industrial production fell by 0.8% in December, following a 0.9% decline in November, while consensus expected +0.2%. In Italy, output fell 0.2% MoM following a 1.4% slide in November, against forecasts of a 0.3% increase.
- Final German headline inflation rose 0.8% MoM in January, following a 0.5% increase in December, in line with estimates. The annual rate of inflation accelerated from -0.3% to 1.0%, in January, which was also in line with flash figures.

Next week's key events		*Per.*	*Prev.*	*Cons.*
18 Feb	Consumer confidence P.	Feb	-15.5	-15.0
19 Feb	Flash services PMI	Feb	45.4	45.9

UNITED KINGDOM

- GDP contracted by 9.9% in 2020, the largest annual fall since records began. GDP shrank by 3.0% QoQ in Q1, followed by a record-breaking 18.8% slump in Q2, due to the first national lockdown. The economy then posted 16% growth in Q3, before the second wave led to fresh restrictions, slowing the recovery to 1% in Q4.
- Industrial production growth came in below expectations at 0.2% MoM, taking the YoY fall in output to -3.3%.

Next week's key events		*Per.*	*Prev.*	*Cons.*
17 Feb	Headline CPI YoY	Jan	0.6%	0.5%
19 Feb	Flash manufacturing PMI	Feb	54.1	53.0

UNITED STATES

- While January's headline CPI rose 0.3% MoM and 1.4% YoY, in line with forecasts, the core rate came in at 0% MoM rather than the 0.2% expected, leaving the annual rate of core inflation at 1.4%, down from 1.6% in December.
- Last week's initial claims for unemployment benefits improved slightly to 793k versus 812k the previous week but well above expectations at 757k. Continuing claims decreased from 4.69 million (revised from 4.59 million) to 4.55 million.

Next week's key events		*Per.*	*Prev.*	*Cons.*
17 Feb	Retail sales MoM	Jan	-0.7%	1.0%
19 Feb	Flash manufacturing PMI	Feb	59.2	58.7

ASIA & EMERGING COUNTRIES

- China's producer prices rose 0.3% YoY in January, while CPI unexpectedly slipped into deflation with a fall of 0.3% YoY. This is the first-time in over two years that upstream prices have risen faster than downstream costs.
- Chinese banks extended 3.58 trillion yuan ($555.31 billion) in new loans in January, the highest on record and topping January 2020's 3.34 trillion yuan.
- China's M2 money supply grew 9.4% YoY in January.
- Brazilian retail sales slumped 6.1% in December, the second biggest fall recorded after April's 17.2% plunge.

Next week's key events		*Per.*	*Prev.*	*Cons.*
15 Feb	India WPI inflation YoY	Jan	1.2%	1.1%
18 Feb	Russia unemployment rate	Jan	5.9%	6.0%

Sources: DataStream, Bloomberg, 12 February 2021. Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, PMI = Purchasing Managers' Index.

Our 3-month targets for currencies and commodities

	Thursday close	3mth target
EUR/USD	1,21	1.22
GBP/USD	1,38	1.35
EUR/CHF	1,08	1.09
USD/JPY	104,7	104.0
Brent	$61,2	$52.5
Gold (oz.)	$1837	$1850

NB No changes to our 3-month targets this week.

Forecast figures are not a reliable indicator of future performance.

THIS WEEK'S Q&A

What is the outlook for the Hong Kong Dollar against USD?

As a reminder, the Hong Kong dollar has been pegged to the US dollar at a rate of HKD 7.8 since October 1983, making this one of the longest-lasting official currency boards in financial market history. Since 1985, it has been allowed to trade between 7.75 and 7.85 and, as shown in the chart, has been remarkably stable ever since. The peg has survived numerous crises ranging from 1998's Asian financial crisis to last year's imposition of a new national security law for Hong Kong, which severely curtailed democratic freedoms.

Under the currency board system, the Hong Kong Monetary Authority (HKMA) holds USD reserves equal to or exceeding the value of its currency base (the total value of domestic currency in circulation). At present, the currency base stands at some HKD 2.12 trillion while the HKMA's official foreign currency reserves were USD 493.5 billion at end-January (HKD 3.82 trillion at current exchange rates). Thus, the HKMA can always exchange HKD for USD on demand at the official exchange rate.

If capital outflows threaten the higher bound at HKD 7.85, the HKMA will buy HKD from local banks, which reduces liquidity in the banking system, thereby pushing market rates higher which, in turn, tends to attract inflows back into Hong Kong. On the other hand, if the HKD strengthens towards the lower bound, the system goes into reverse – the HKMA sells HKD to banks, causing a surge in liquidity which duly brings market rates lower to discourage inflows.

However, the design of the peg means that Hong Kong has in effect delegated the setting of benchmark interest rates to the Federal Reserve – when the Fed cuts rates, the HKMA follows suit, meaning that it has no ability to adjust the benchmark rate according to prevailing local conditions.

Last year's events – the suppression of pro-democracy protests, the new national security law, the loss of the "special status" granted by the US – have raised the question of whether Hong Kong might not be better served by re-pegging to the Chinese renminbi (CNY) as a prelude to adopting the CNY when Hong Kong is finally subsumed into China in 2047.

At present, this seems unlikely – for a number of reasons, the peg serves all parties' best interests.

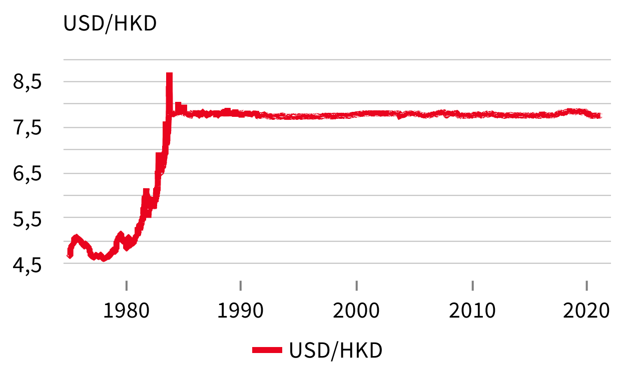
The currency board has shown its resilience over time and provides Hong Kong businesses with stability and visibility. Moreover, its suits Hong Kong's role as a major trading hub to be so closely tied to the USD, the world's dominant currency for commerce.

Secondly, the peg provides China with a sizeable pool of offshore dollar liquidity. This is very useful for as long as the CNY is not fully convertible.

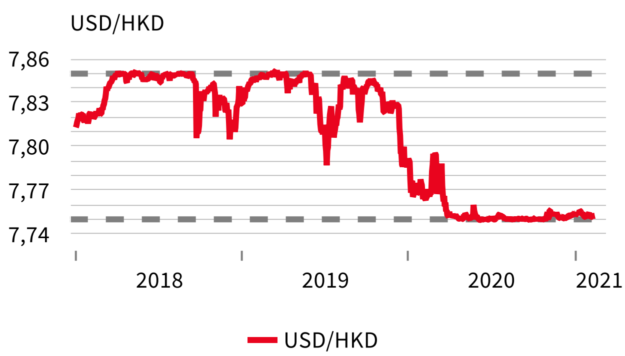
Of course, full convertibility of the renminbi will be necessary for China to achieve its ambition of making the CNY a major reserve currency and promoting its use for international trade, but that will not happen overnight. The first stage towards convertibility has been the development of an active offshore renminbi market, in particular via Hong Kong trading in the CNH (the code for the offshore CNY traded there). In a recent speech at the Asian Financial Forum, the PBoC's Deputy Governor stressed Hong Kong's crucial significance in building a thriving offshore renminbi business.

However, China appears to be in no hurry to promote wider adoption of the CNH for now. According to the HKMA, CNH deposits currently amount to 600 billion, down from almost 1,000 billion in 2015. This shrinkage coincides with efforts by Beijing to restrict the capital account in order to clamp down on capital outflows from mainland residents.

Bottom line. The HKD is currently trading close to the bottom of the USD/HKD trading band – i.e., close to its strongest level – where it has been since last March. It would appear that currency traders have been reassured by recent events in Hong Kong. Given the solidity of the currency board, the advantages for China to keep it in place and Beijing's reluctance to hurry the move to full CNY convertibility, we would expect USD/HKD to remain within its trading band over the next 12 to 18 months.



Sources: SGPB, Macrobond, 11/02/2021



Sources: SGPB, Macrobond, 11/02/2021

MARKET PERFORMANCE

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-0,48 %	0 bp	→	-1 bp	2 bp	-2 bp
3mth Euribor (EUR)	-0,54 %	0 bp	→	-2 bp	0 bp	-13 bp
3mth Libor (USD)	0,20 %	1 bp	→	-2 bp	-4 bp	-151 bp
3mth Libor (GBP)	0,05 %	1 bp	→	1 bp	2 bp	-71 bp
10-year US Treasury bond	1,16 %	2 bp	↑	19 bp	25 bp	-43 bp
10-year German bond	-0,46 %	0 bp	→	5 bp	12 bp	-7 bp
10-year French bond	-0,23 %	0 bp	→	3 bp	11 bp	-9 bp
10-year UK bond	0,47 %	3 bp	↑	6 bp	27 bp	-10 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0,1%	↑	0,7 %	0,0 %	1,6 %
BAML EURO Corp HY	0,3%	↑	3,8 %	1,4 %	3,3 %
BAML GBP Corp IG	0,1%	↑	2,3 %	-1,7 %	4,3 %
BAML US IG	0,2%	↑	1,2 %	-1,3 %	5,9 %
BAML US HY	0,5%	↑	4,3 %	1,4 %	6,6 %
BAML Global EM Sov. External Plus	0,5%	↑	3,1 %	-0,7 %	4,1 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1,21	1,4 %	↑	3,0 %	-0,7 %	11,1%
EUR/CHF	1,08	-0,2 %	↓	-0,1 %	-0,2 %	1,3%
GBP/USD	1,38	1,1 %	↑	4,5 %	1,0 %	6,7%
USD/JPY	104,7	-0,8 %	↓	-0,6 %	1,4 %	-4,6%
USD/BRL	5,37	-1,1 %	↓	-0,5 %	3,3 %	23,9%
USD/CNY	6,46	-0,2 %	↓	-2,6 %	-1,0 %	-7,3%
USD/RUB	73,7	-2,4 %	↓	-4,4 %	-0,5 %	16,2%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0,0 %	→	0,2 %	-0,3 %	5,2 %
United Kingdom (3-7yr)	0,0 %	→	-0,1 %	-0,7 %	1,5 %
Germany (3-7yr)	0,1 %	↑	-0,2 %	-0,2 %	-0,2 %
Japan (3-7yr)	-0,1 %	→	-0,1 %	-0,1 %	-0,4 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	680	2,0 %	↑	12,8 %	5,3 %	20,3 %
Eurostoxx 50	3 672	0,8 %	↑	6,2 %	3,6 %	-1,5 %
DAX	14 041	-0,1 %	↓	6,2 %	2,4 %	3,0 %
CAC 40	5 670	1,1 %	↑	4,4 %	2,3 %	-4,2 %
S&P 500	3 916	1,2 %	↑	10,1 %	4,4 %	18,8 %
FTSE 100	6 529	0,4 %	↑	2,8 %	1,1 %	-10,1 %
SMI	10 853	-0,1 %	→	3,2 %	1,4 %	1,2 %
Topix	1 931	3,5 %	↑	11,8 %	7,0 %	15,0 %
IBOV Brazil	119 300	0,0 %	→	13,8 %	0,2 %	3,4 %
MICEX Russia *	3 414	1,3 %	↑	13,2 %	3,8 %	10,2 %
MSCI EM	1 428	2,9 %	↑	21,6 %	10,7 %	33,2 %
SENSEX 30 India	51 532	1,9 %	↑	18,3 %	8,0 %	26,6 %
Hang Seng (H-K)	30 174	3,6 %	↑	15,1 %	10,8 %	12,9 %
Shanghaï Composite	3 655	4,4 %	↑	9,4 %	5,2 %	26,0 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$61,2	3,9 %	↑	39,6 %	17,9 %	12,9 %
Gold	$1 837	2,6 %	↑	-1,5 %	-3,2 %	17,4 %
Copper	$8 289	5,9 %	↑	20,7 %	7,0 %	44,7 %

Source: DataStream, on 11 February 2021.

1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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