WEEKLY UPDATE

Of stimulus and prices

Recent discussions in Washington have strengthened hope that President Biden's $1.9 tn fiscal plan could make progress in Congress, while the rapid ramp-up in vaccinations – 10.2% of the US population, 15.8% in the UK (see the left-hand chart below) – has lent weight to the prospect of cyclical economic recovery later this year. With recent inflation figures in the euro zone and the US surprising on the upside, investors have continued to position themselves for reflation. What does all this mean for the economic outlook and for markets?

This week, Biden began talks with a group of moderate Republican senators who had proposed a $618 bn alternative plan. Although the Democrats' majority in Congress means bipartisan support for his package may not be necessary, the President is looking to the longer term. By seeking to build bridges and engage with the Republicans, he may slow approval of the current plan but he may also garner support for his separate $2 tn stimulus plan which is due later this year.

The two plans are very different in nature. The current proposal seeks to provide support for households (via $1,400 cheques), schoolchildren ($130 bn to accelerate school reopenings), the unemployed (an additional $400 per week in benefits) and state and local governments ($350 bn cash injection to prevent lay-offs of public sector employees). The second plan aims to focus on investment in green energy technologies and infrastructure, for example in transportation, electricity and construction. Where the first plan throws a lifeline to cope with the crisis, the second is designed to enhance long-term growth potential.

US core Personal Consumption Expenditure prices (i.e., ex volatile items like food and energy) rose 0.3% MoM in December, taking the YoY rate from 1.4% to 1.5%. While this still leaves the Federal Reserve's preferred measure below target, market expectations for inflation have risen sharply. The 10-year breakeven inflation rate – calculated by subtracting yields on inflation-linked bonds from those on nominal bonds – hit 2.17% this week, up from 0.55% last March and the highest since October 2018.

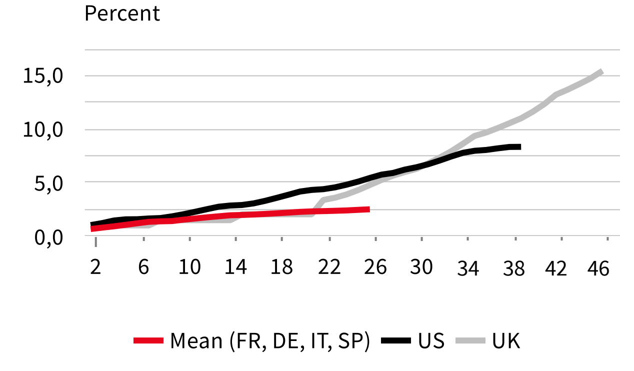
Inflation in the euro zone also appears to be on the rise. This week saw the publication of the consumer price index estimates for January which came in well above forecasts. Headline prices rose 0.9% YoY, having averaged -0.3% over the previous five months, while the core figure jumped from 0.2% in December to 1.4%. However, this upside surprise was driven by some one-off factors – in Germany for example, the cut in VAT from 19% to 16% expired, pushing up prices, while in some countries like France, traditional New Year sales were postponed because of lockdown restrictions, flattering YoY comparisons for prices of many household and personal goods.

In addition, there may be some early warning signs that the rise in inflation expectations has become extended. As illustrated in the right-hand chart, the difference between US 10-year and 2-year breakevens has recently inverted – i.e., short-term expectations are now higher – a configuration which has often preceded a decline in longer-term expectations.

Bottom line. The ramp-up in vaccinations will help countries ease restrictions later this year, first in the UK and the US followed some weeks later by the EU, where only 3.3% of the population has been inoculated so far. As a result, we expect a cyclical recovery in activity in H2 2021, with the fastest growth registered by those countries where lockdowns were the most severe. However, output gaps remain high and we do not expect the current bounce in inflation to be long-lasting. All told, we expect this year's economic backdrop to favour equity markets over fixed income, given historically low yields and tight credit spreads.

Similar trajectory in vaccination programmes

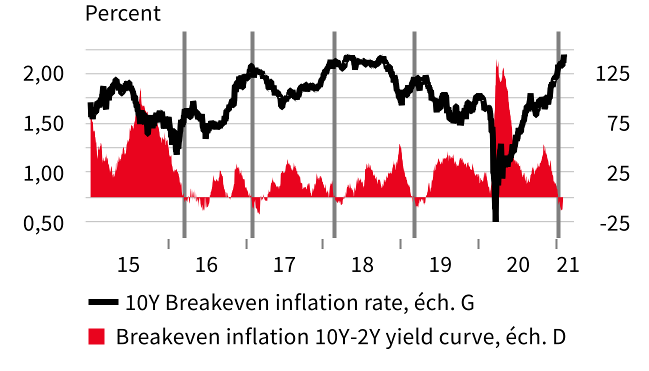
Covid-19 vaccinations as % of population



Sources: SGPB, Macrobond, Our world in Data, 03/02/2021

Inflation expectations have become extended

Short-term inflation expectations vs long-term inflation expectations



Sources: SGPB, Macrobond, Fed, 29/01/2021

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

All data taken from Bloomberg, Macrobond, (04/02/2021). In accordance with the applicable regulation, we inform the reader that this material is qualified as a marketing document. CA012Jan2021

OUR MACRO COMMENTS

This week and next

EUROZONE

- The first GDP estimate showed a 0.7% QoQ decline in Q4, better than expected taking total growth in 2020 to -5.1%.
- The final PMI surveys for January were little changed from the flash figures. Confidence in manufacturing was revised up to 54.8 but has dipped from December's 55.2. The services PMI was also revised up to 45.4, but still down from December's 46.4. Finally, the composite PMI came in at 47.8, revised up from the flash 47.5 but still a decline from December's 49.1.
- Headline consumer price rose 0.2% MoM in January for a 0.9% YoY jump.

Next week's key events		Per.	Prev.	Cons.
8 Feb	German Ind. output MoM	Dec	0.9%	0.3%
10 Feb	German HICP F YoY	Jan	1.6%	1.6%

UNITED KINGDOM

- The manufacturing PMI was revised higher to 54.1 in January from the 52.9 flash estimate while the final services survey printed at 39.5, a sharp fall from December's 49.4 and clearly in recession territory.
- The construction PMI slipped to 49.2 in January from 54.6 in December, its lowest since May.
- For the first time since June, Nationwide house prices in the UK fell in January, down 0.3% MoM. The YoY increase slipped from 7.3% in December to 6.4%, as the stamp duty holiday deadline nears.

Next week's key events		Per.	Prev.	Cons.
12 Feb	GDP P QoQ	Q4	16.0%	0.5%
12 Feb	Manufacturing output MoM	Dec	0.7%	0.6%

UNITED STATES

- The ISM manufacturing PMI slipped to 58.7 in January, compared to 60.5 in December and falling short of the 60 consensus estimate.
- The final manufacturing PMI rose to 59.2 in January from 57.1 in December, and slightly higher than the 59.1 flash estimate.
- Last week's initial jobless claims for unemployment benefits improved slightly to 779k versus 812k the previous week.

Next week's key events		Per.	Prev.	Cons.
10 Feb	Headline CPI MoM	Jan	0.4%	0.4%
11 Feb	Michigan consumer sent. P	Feb	79.0	80.8

ASIA & EMERGING

- China's Caixin PMI, which gives a snapshot of the manufacturing sector, dropped to 51.5 in January from 53 in December.
- The Brazilian services PMI fell to 47.0 from 51.1 in December. The composite PMI to 48.9 from 53.5, after five months of expansion.
- India's manufacturing PMI rose to 57.7 in January from 56.4 the previous month.
- The Russian manufacturing PMI rose to 50.9 in January, up from 49.7 in December and above 50 for the first time since last August.

Next week's key events		Per.	Prev.	Cons.
10 Feb	China headline CPI YoY	Jan	0.2%	-0.1%
10 Feb	Brazil retail sales YoY	Dec	3.4%	5.0%

Sources: DataStream, Bloomberg, 4 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	1.20	1.22
GBP/USD	1.37	1.35
EUR/CHF	1.08	1.09
USD/JPY	105.6	104.0
Brent	$58.9	$52.5
Gold (oz.)	$1790	$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 South African Rand against USD?

South Africa has suffered from chronically low growth in recent years (+0.2% in 2019 on IMF data compared to +3.6% for the whole emerging market complex) and was teetering on the brink of recession before the pandemic hit. Moreover, South Africa is the hardest-hit country in Africa, registering over 1.4 million infections among a population of 60 million and over 43,000 deaths, a 3% fatality rate.

The IMF's latest World Economic Outlook published last week projects modest growth of 2.8% this year and 1.4% next, well below the 6.3% and 5.0% expected for the EM universe. 2021 has got off to a difficult start as the government renewed lockdown restrictions, closing land borders, tightening the curfew and banning most public and social gatherings. These measures come in reaction to the swelling of a second wave of infections, driven by a locally-identified mutation of the virus which is more virulent (although no more deadly) than the original.

The government announced its vaccine rollout strategy in early January with enough doses on order for 10% of the population. Then on Wednesday January 27, the Department of Health announced emergency use approval of the AstraZeneca vaccine and that 1.5 million doses would be delivered by end February. While this is a step in the right direction, the quantities on order are far below what would be needed, meaning that South Africa will continue to face overload of its healthcare system and lockdown restrictions on activity. Moreover, recent studies suggest the South African strain is more resistant to current vaccines than others.

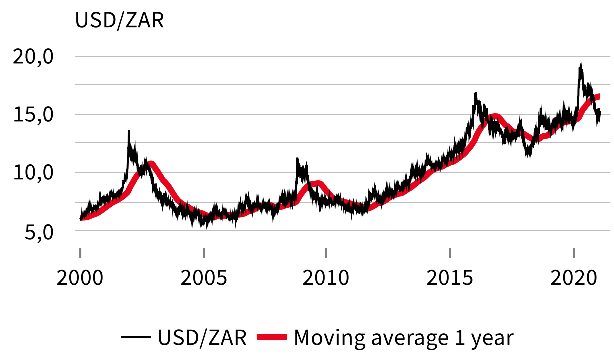
The weak economy, worsening pandemic and power cuts from state-owned utility Eskom have weighed on business and household confidence. The Markit/Standard Bank PMI is expected to dip back into contraction territory in Q1 while the Q4 2020 consumer confidence is still well below the average of the past decade and may fall further as households adjust to the second wave of infections. Moreover, unemployment remains far too high – in Q3 2020 (the latest available data), it reached a multi-decade high at 30.8%. All told, the economy is likely to dip back into recession in Q1 2021.

Economic weakness in 2020 fostered a marked deterioration in public finances. The budget deficit is likely to reach over 13% for the year as tax revenues fell and the government reduced its spending cut targets. This means that the primary balance (before debt service costs) is likely to hit -8.5%. The IMF approved a $4.3bn emergency loan last year and recently warned South Africa about its spiralling debt ratios, calling for urgent fiscal consolidation, an unlikely prospect given the current macro backdrop. In this context, rating agencies have South Africa on negative watch and downgrades are likely.

With the sharp decline in consumption last year, imports fell faster than exports, pushing the trade surplus to record highs at over 16% of GDP. This has contributed to improving the current account balance, which has moved from a 2-5% deficit in recent years to a 2.1% surplus in 2020.

In this context, the South African Reserve Bank kept rates on hold at 3.5% following its January policy meeting. The average repo rate started last year at 6.5% and saw five successive cuts as the SARB eased policy to combat economic weakness. However, headline inflation also slumped last year, from 4.5% in January to 3.1% in December, and it is by no means certain that it will reach the SARB's 2021 forecast at 4.0%, given the weak start to the year. Perhaps for this reason, voting was split at January's meeting with three members preferring the status quo and two calling for a 25bp cut. We see further cuts in key rates in 2021 unless there is dramatic turnaround in growth.

Bottom line. Given the weakness in the economy and persistently high levels of inflation, we expect the rand to weaken against the USD over time. Over the next 3 months however, USD/ZAR should trade in a narrow range between 14.5 and 15.9. On a 12-month view, we expect some ZAR weakness – our target in 16.9.



Sources: SGPB, Macrobond, Fed, 29/01/2021

MARKET PERFORMANCE

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-0,48 %	0 bp	➡	-1 bp	2 bp	-3 bp
3mth Euribor (EUR)	-0,54 %	0 bp	➡	-3 bp	0 bp	-15 bp
3mth Libor (USD)	0,19 %	-1 bp	⬇	-4 bp	-5 bp	-154 bp
3mth Libor (GBP)	0,04 %	0 bp	➡	0 bp	1 bp	-72 bp
10-year US Treasury bond	1,14 %	8 bp	⬆	37 bp	23 bp	-46 bp
10-year German bond	-0,45 %	9 bp	⬆	18 bp	12 bp	-5 bp
10-year French bond	-0,23 %	7 bp	⬆	13 bp	11 bp	-9 bp
10-year UK bond	0,44 %	15 bp	⬆	23 bp	25 bp	-13 bp

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

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1,20	-1,3 %	⬇	2,0 %	-2,1 %	8,3%
EUR/CHF	1,08	0,4 %	⬆	1,1 %	0,0 %	1,1%
GBP/USD	1,37	-0,3 %	⬇	5,3 %	0,0 %	4,9%
USD/JPY	105,6	1,3 %	⬆	1,0 %	2,2 %	-3,6%
USD/BRL	5,43	-0,3 %	⬇	-4,2 %	4,5 %	27,6%
USD/CNY	6,47	0,3 %	⬆	-2,7 %	-0,8 %	-7,5%
USD/RUB	75,5	-0,7 %	⬇	-2,7 %	2,0 %	19,8%

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	-0,1 %	⬇	-0,4 %	-0,4 %	5,2 %
United Kingdom (3-7yr)	-0,5 %	⬇	-0,7 %	-0,7 %	1,5 %
Germany (3-7yr)	-0,4 %	⬇	-0,8 %	-0,2 %	-0,4 %
Japan (3-7yr)	-0,1 %	➡	0,0 %	0,0 %	-0,4 %

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	667	1,9 %	⬆	15,6 %	3,3 %	19,8 %
Eurostoxx 50	3 642	2,5 %	⬆	15,6 %	2,8 %	0,3 %
DAX	14 060	2,9 %	⬆	14,1 %	2,5 %	5,9 %
CAC 40	5 609	1,8 %	⬆	14,3 %	1,2 %	-3,3 %
S&P 500	3 872	2,3 %	⬆	12,9 %	3,2 %	19,6 %
FTSE 100	6 504	-0,3 %	⬇	11,1 %	0,7 %	-9,7 %
SMI	10 861	0,1 %	➡	5,7 %	1,5 %	4,1 %
Topix	1 865	1,4 %	⬆	14,8 %	3,4 %	13,4 %
IBOV Brazil	119 261	0,3 %	⬆	21,9 %	0,2 %	3,2 %
MICEX Russia *	3 372	0,9 %	⬆	21,0 %	2,5 %	8,9 %
MSCI EM	1 388	2,9 %	⬆	22,7 %	7,6 %	31,1 %
SENSEX 30 India	50 614	8,0 %	⬆	24,7 %	6,0 %	25,6 %
Hang Seng (H-K)	29 114	2,0 %	⬆	17,1 %	6,9 %	12,6 %
Shanghaï Composite	3 502	-0,1 %	➡	6,8 %	0,8 %	25,8 %

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$58,9	6,1 %	⬆	42,6 %	13,6 %	7,1 %
Gold	$1 790	-3,6 %	⬇	-5,8 %	-5,7 %	15,1 %
Copper	$7 826	-0,7 %	⬇	14,6 %	1,0 %	39,9 %

Source: DataStream, on 4 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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