Global macro and markets 2021

A synchronous global upturn?

Rob Carnell

February 2021

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The big questions for 2021

The big questions for 2021

1. What will happen to the Pandemic?

2. How will the vaccine rollout go / will it work?

3. A synchronous global recovery?

4. USD to keep weakening?

5. Is inflation about to return?

6. Will bond markets over-react to rising inflation? Issuance?

7. Return of the Trade / tech War?

8. A good year for Asia?

House Forecasts

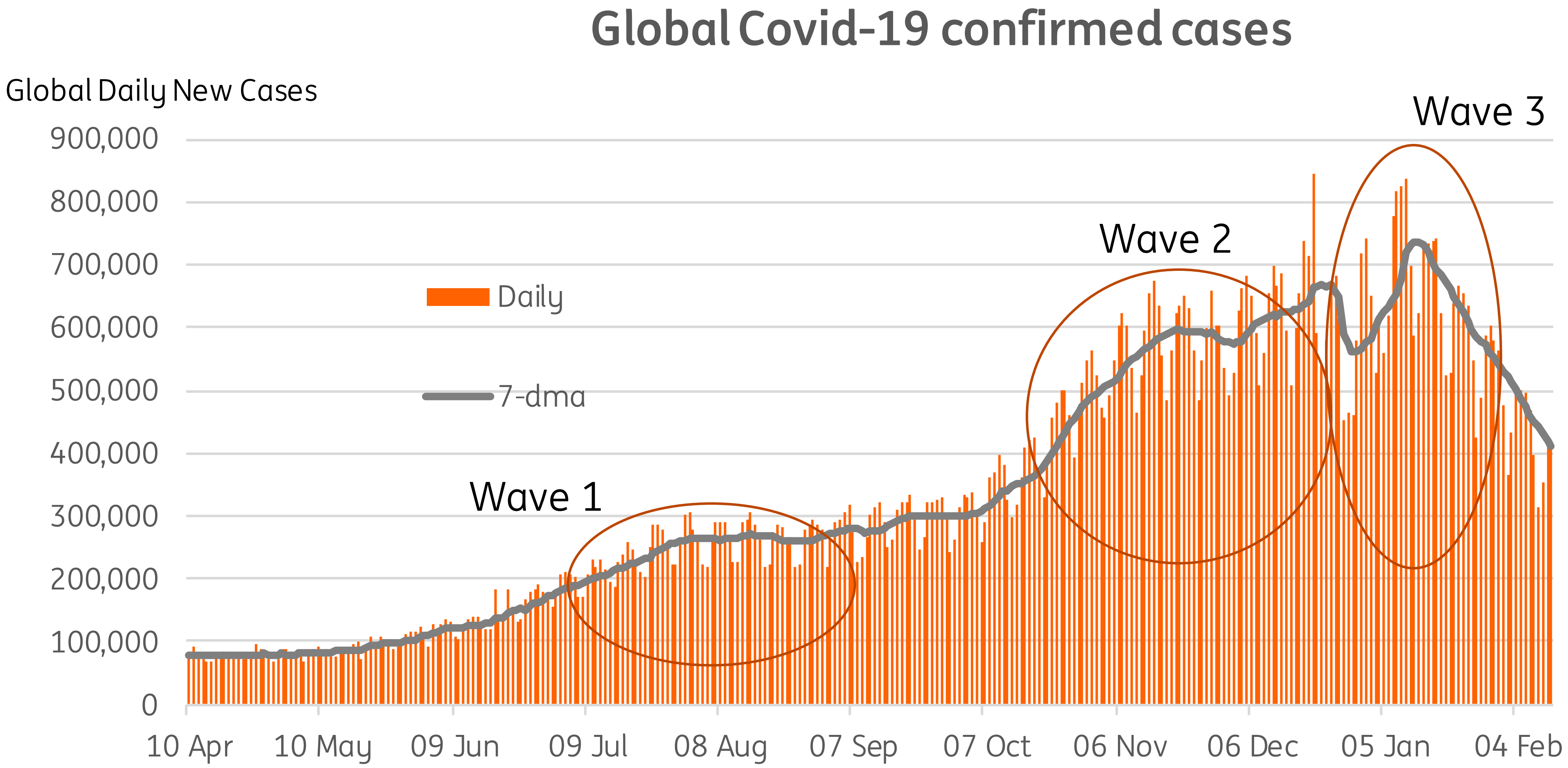
	Spot	1Q21	2Q21	3Q21	4Q21	1Q22	4Q22
EURUSD	1.2120	1.22	1.25	1.28	1.3	1.3	1.25
USDCNY	6.4582	6.4	6.3	6.25	6.2	6.15	6
USDJPY	104.94	102	100	100	100	102	105
USDKRW	1102.97	1120	1100	1080	1070	1050	1040
UST 10	1.2082	1.25	1.5	1.5	1.75	1.75	2
GER 10	-0.4290	-0.5	-0.4	-0.3	-0.3	-0.2	-0.1

As at 10:45am SGT 13 Feb 2021

- Major non-consensus forecasts are EURUSD and UST 10s
- EURUSD consensus is about 1.22/23 for end 21 and for UST10 about 1.4%
- See also https://think.ing.com/forecasts/

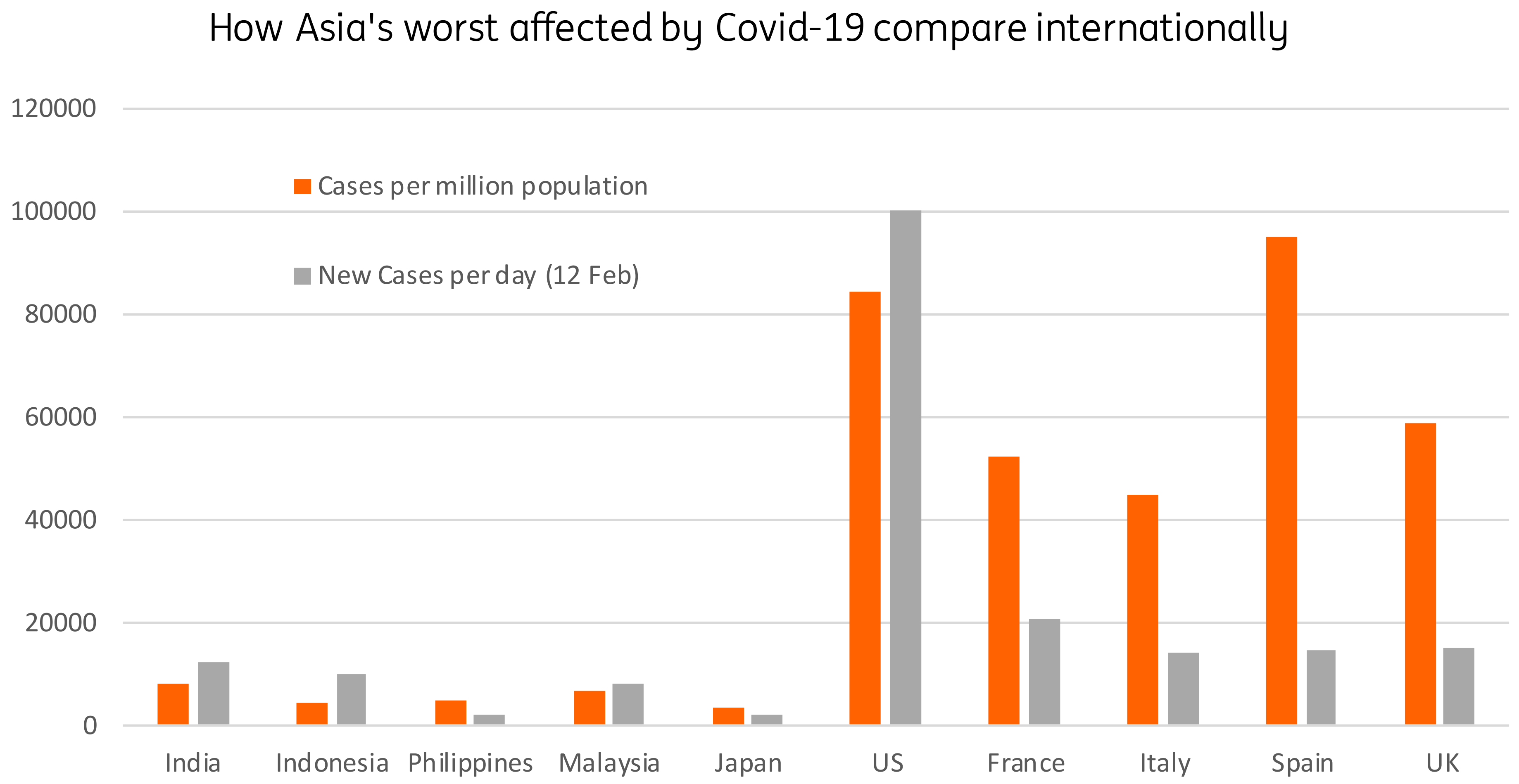
Pandemic in 2021

Pandemic



- After a shaky start, 2021 has begun to offer hope of an end to the current pandemic wave, it not the pandemic itself
- Things have improved in some of the worst affected countries – US, UK, India

Pandemic Asia vs rest of the world

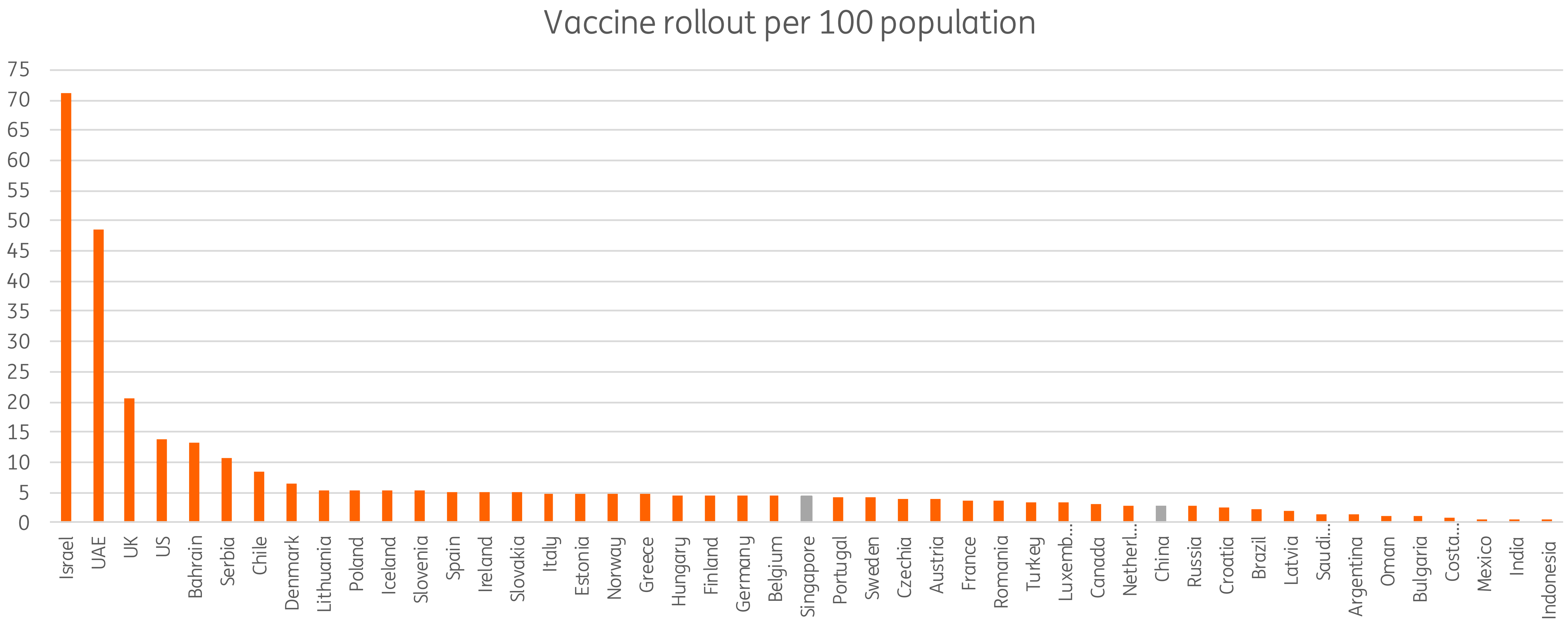


As at 13/02/21

- Asia is not doing as well as it was…but it is doing far better than its Western peers
- …However, the hurdle for restrictive measures is a LOT lower, so negative GDP affects may still occur

Vaccine Rollout

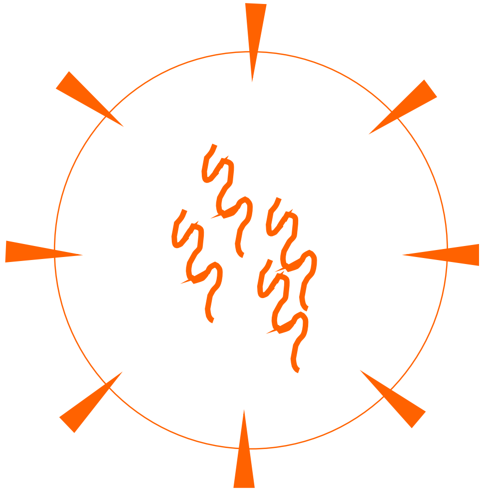
Vaccine rollout – the quicker they come, the quicker the recovery



- Vaccine rollout is so far extremely slow https://ourworldindata.org/covid-vaccinations
- And Asia has barely started the process
- While there is on average, one to two mutations per month of the Sars-Cov2 (Covid-19) virus

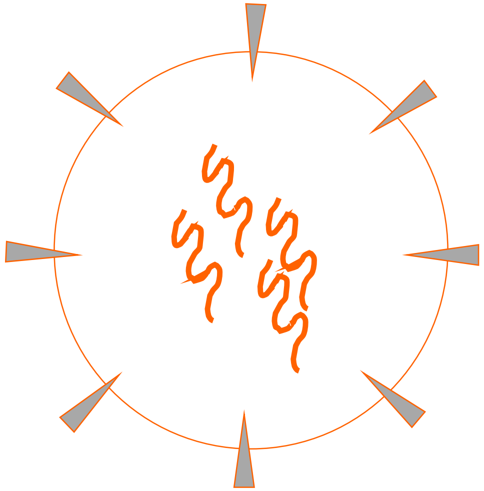
New Mutations in SARS-Cov-2 (about 1-2 per month)

UK Variant B 1.1.7



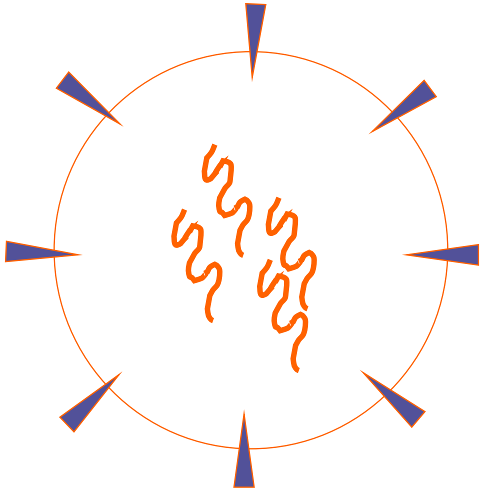
- Discovered Dec 14
- More infectious +70%)
- More deadly (+30%)
- Not more vaccine resistant
- Detected in 70 countries

South African Variant B 1.351



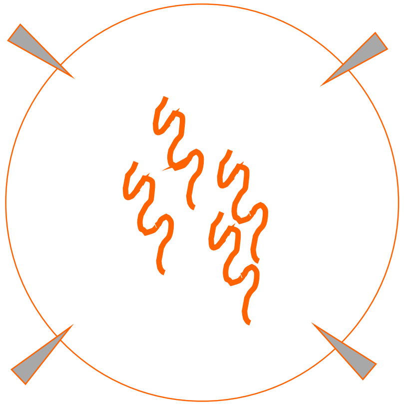
- Discovered Dec 18
- Probably more infectious
- Relative severity not clear
- More vaccine resistant
- Detected in 31 countries

Nigerian variant



- Discovered Dec 24
- Infectiousness not clear
- Severity not clear
- Vaccine resistance not clear

Brazilian Variant P1, or B.1.1.128



- Discovered Jan 2
- Infectiousness not clear
- Relative severity not clear
- Vaccine resistance unclear
- Detected in Japan and Brazil

Vaccine rollout – plenty to choose from

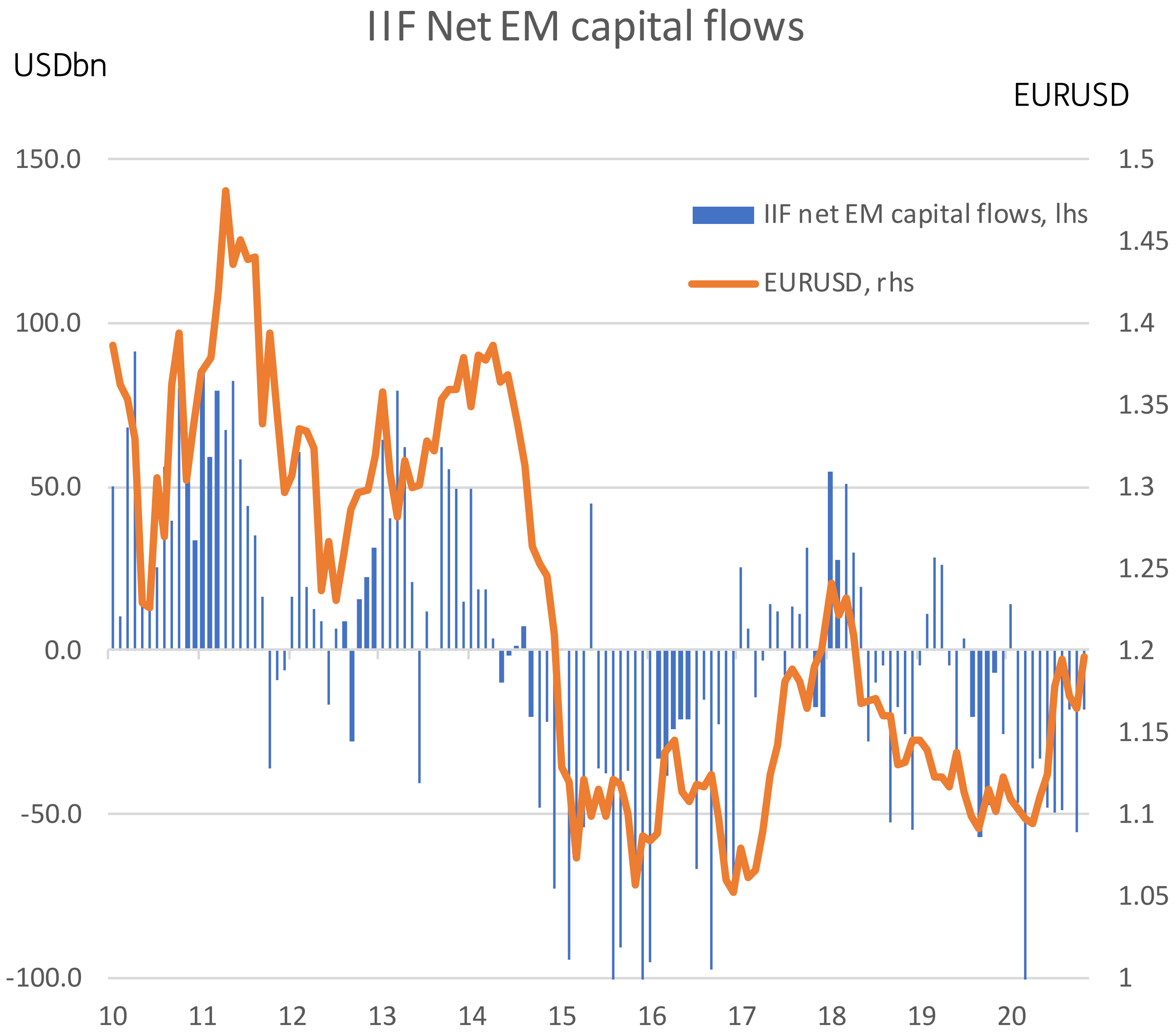
Vaccine	Efficacy	Cost ($ per dose)	Doses	Type	Production in 2021*
Pfizer BioNTech	95	19.5	2	mRNA	2000
Moderna	94.5	25 to 37	2	mRNA	600
Astra Zenecca	70 (average)	2 to 5	2	Adenovirus	1300
Johnson and Johnson	66	10	1	Adenovirus	1000
Gamaleya (Sputnik)	91.4	10	2	Adenovirus	1000
Sinovac Biotech	50.38 to 91.25	60	2	Attenuated virus	600
Novovax	86-89	15	2	Protein	1000
Sinopharm	86	30	2	Attenuated virus	1000

*** based on commercial claims and can be lower**

- Based on the claims of the major vaccine producers, there should be enough vaccine by end 2021 to immunize about half the global population with the full 2 doses usually required
- How much is needed for herd immunity? Estimates range from 50% to 90%
- But this should also reduce the severity of the disease, depending on the evolution of variants, and take pressure of strained health systems

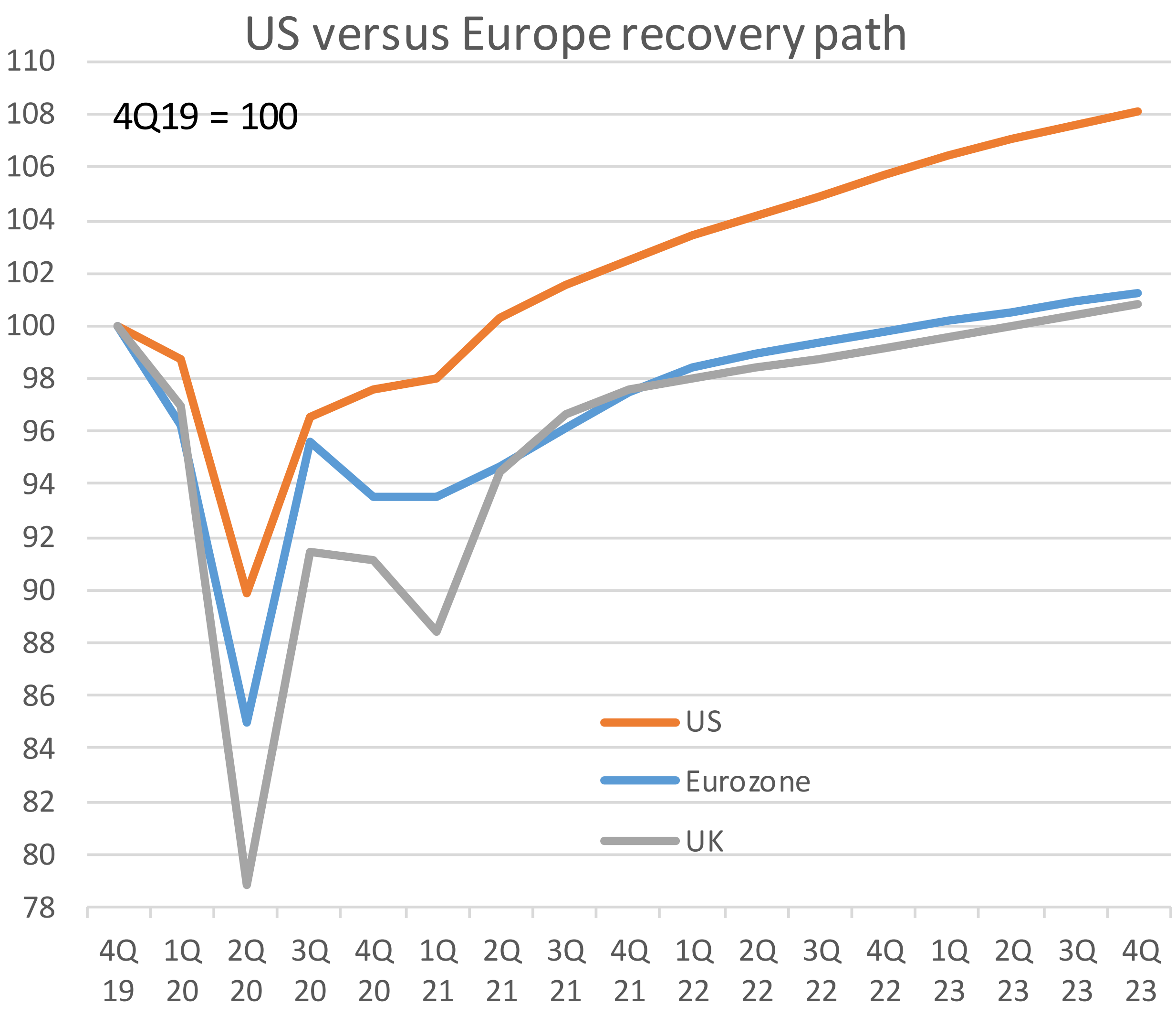
Synchronous global recovery

USD to smile?



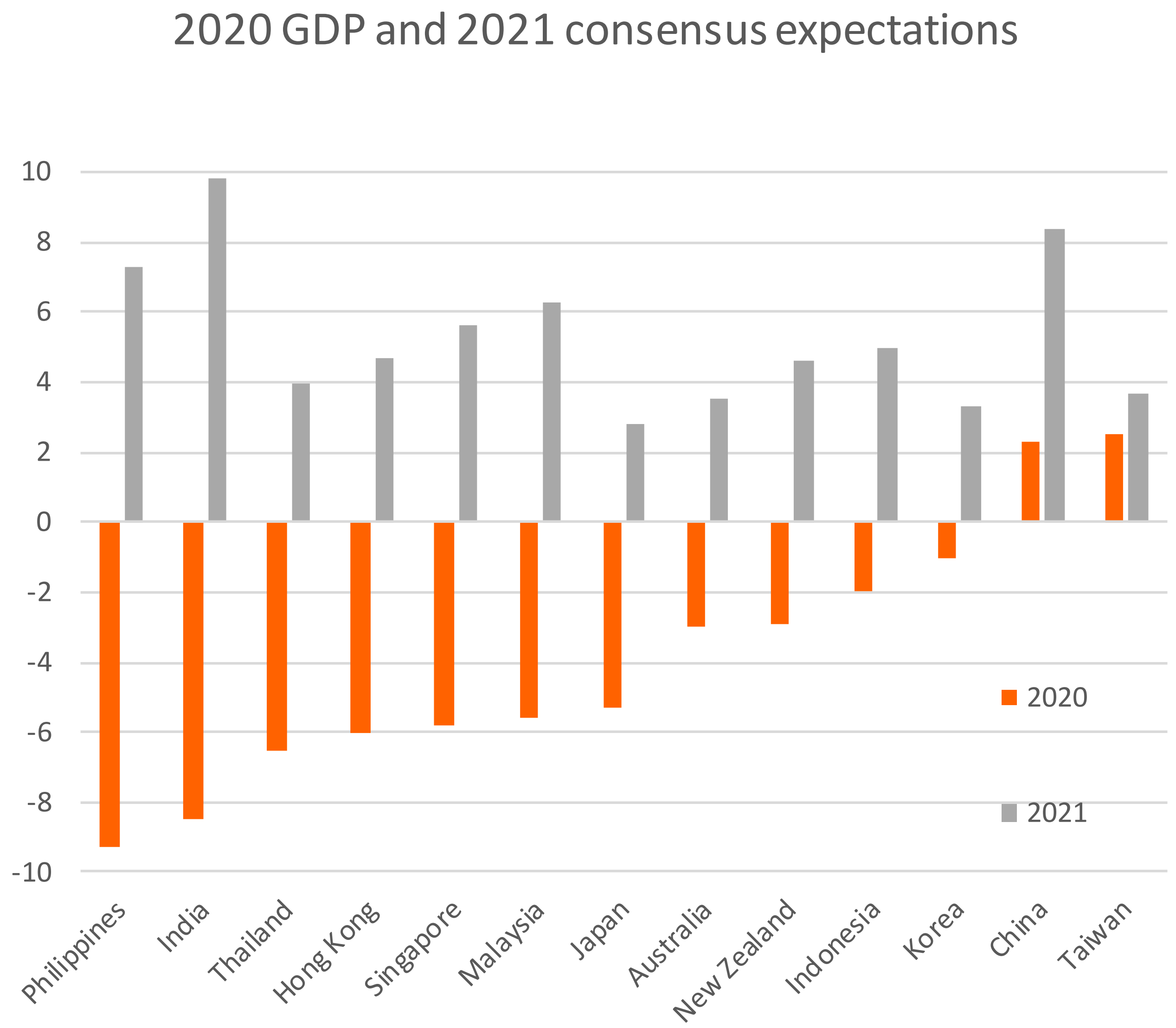
- House view of EURUSD 1.30 4Q21 based on idea of synchronous global recovery as vaccine rollout allows growth to recover
- That leads to outflow of capital from US, predominantly to EM, but EURUSD brought along for the ride.
- Idea of US Smile, where USD does well in boom, and in crisis, but not so well when things are just ok
- But there are good reasons to be cautious about this view, not least about its timing

The shape of the recovery



- US edging closer to 1 million vaccinations a day, but with Anthony Fauci talking of 90% vaccination rate for herd immunity it could take more than a year
- The US is well ahead of Europe on the vaccination front and it is down to state governors to decide when to re-open
- $400bn being thrown at the issue in the US so hopefully an acceleration in injections & warmer weather can see hospitalizations fall sharply with a re-opening in 2Q 2021
- Massive fiscal stimulus of $1.9 tn followed by a large infrastructure & green energy plan can fuel the recovery
- Huge consumer pent up demand with household balance sheets in the best position for decades GDP could exceed 5% in 2021
- Capex set to take off after 12M of being on hold
- Weaker dollar to boost international competitiveness
- UK could actually outperform Europe despite Brexit given very successful vaccination roll out

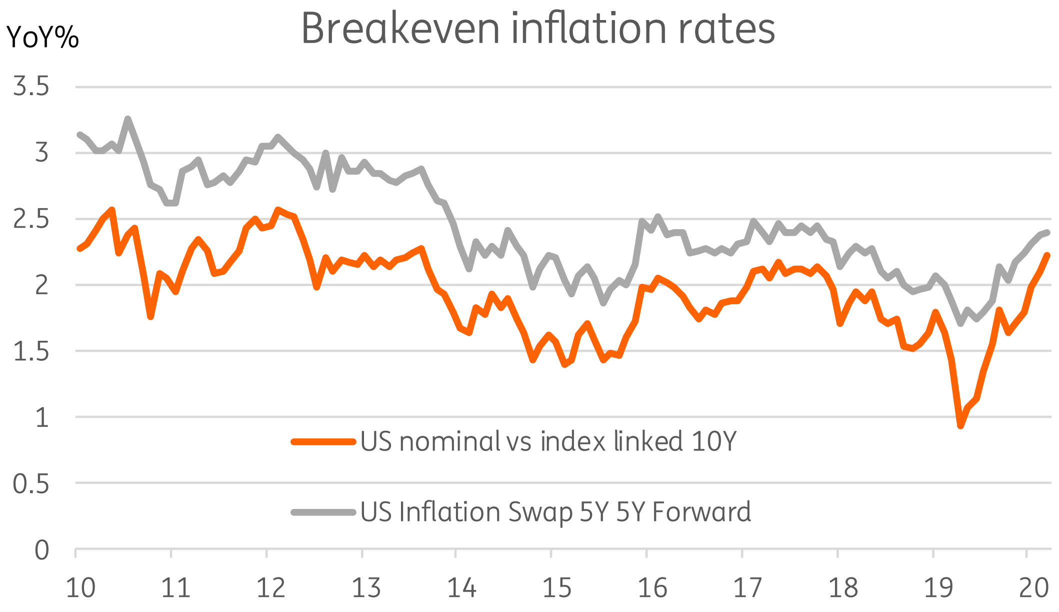
China (nearly) the only Asian economy to grow in 2020

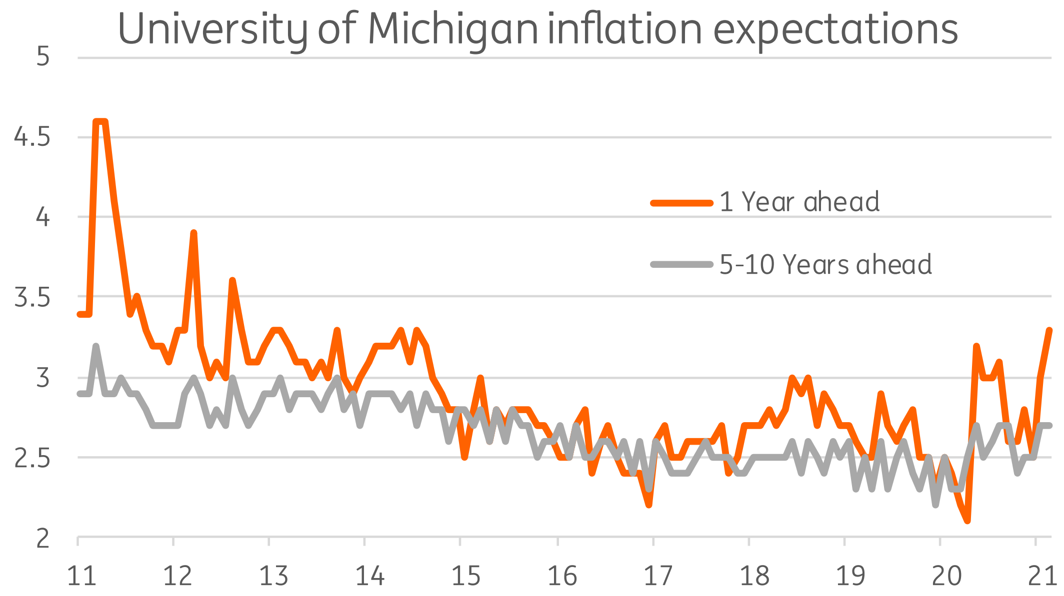


- To some extent, growth in 2021 in Asia is an inverse function of growth in 2020
- So for example, the Philippines contracted the most of any economy in Asia in 2020, more than 9.5%...
- ...it will show the second highest growth rate in the region in 2021 according to the consensus view...
- ...but that is mainly a mark of how bad the economy was in 2020, not how good it will be in 2021...
- ...and GDP will still be lower than it was Pre-Covid
- That will be true for most economies, with the exception of: Australia, New Zealand, Indonesia, Korea, Taiwan and of course, China

Is inflation about to return?

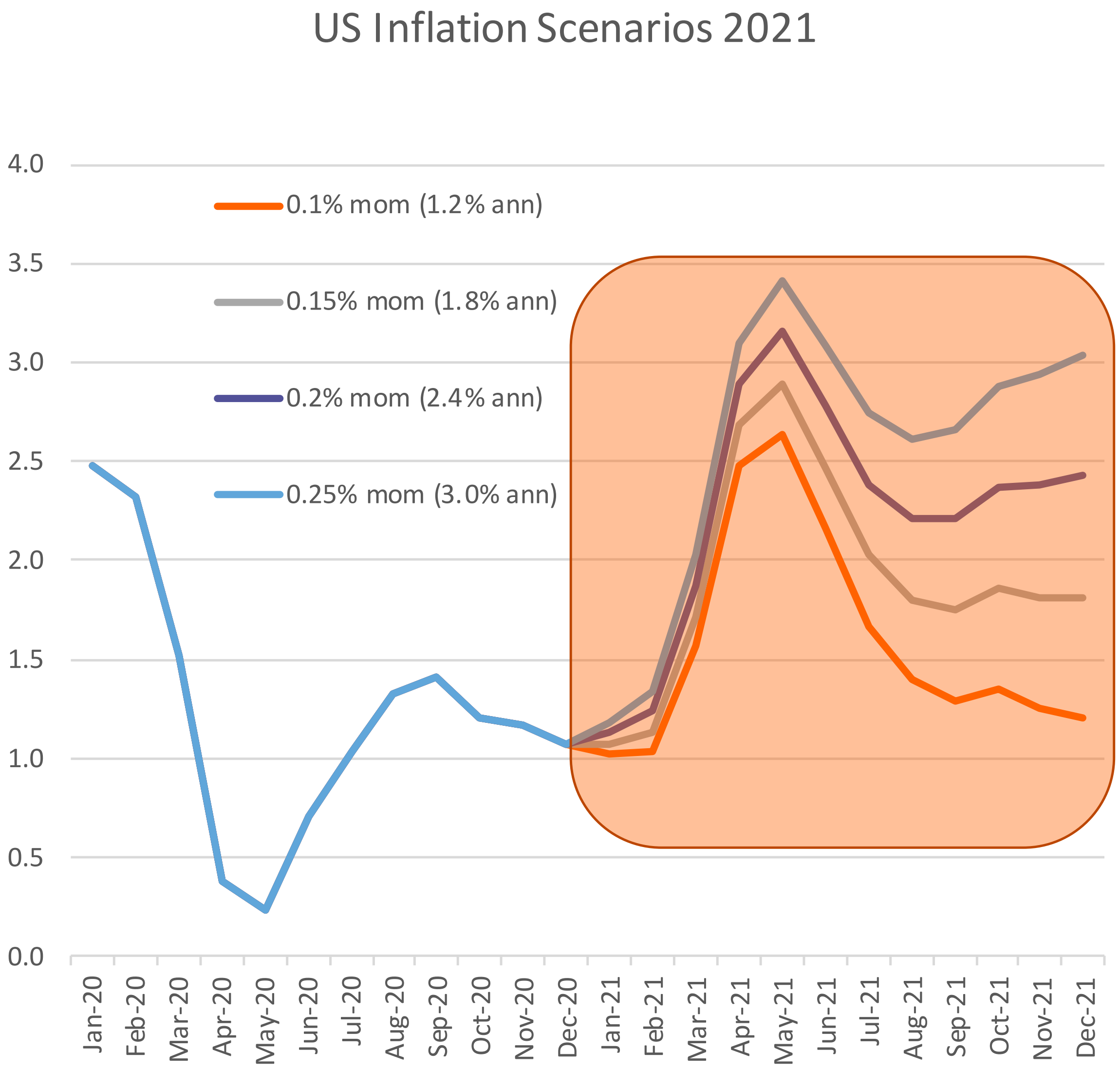
The return of US inflation?





- Inflation expectations are rising as implied by financial market products
- Though this could just be a liquidity effect
- They are also rising in consumer surveys
- And for once, don't look too silly
- In service sector economies, wages are the biggest cost input and are the key driver of inflation
- The pandemic has created rigidities in key parts of the economy with businesses reducing capacity – airlines, restaurants, bars, hotels, car hire
- When demand returns, supply may be tight and wider margins, higher prices may result
- Oil has jumped on Saudi production cut. As travel resumes, fuel prices may also start to rise…
- … while rising house prices/bond yields may translate into higher housing costs within the inflation basket

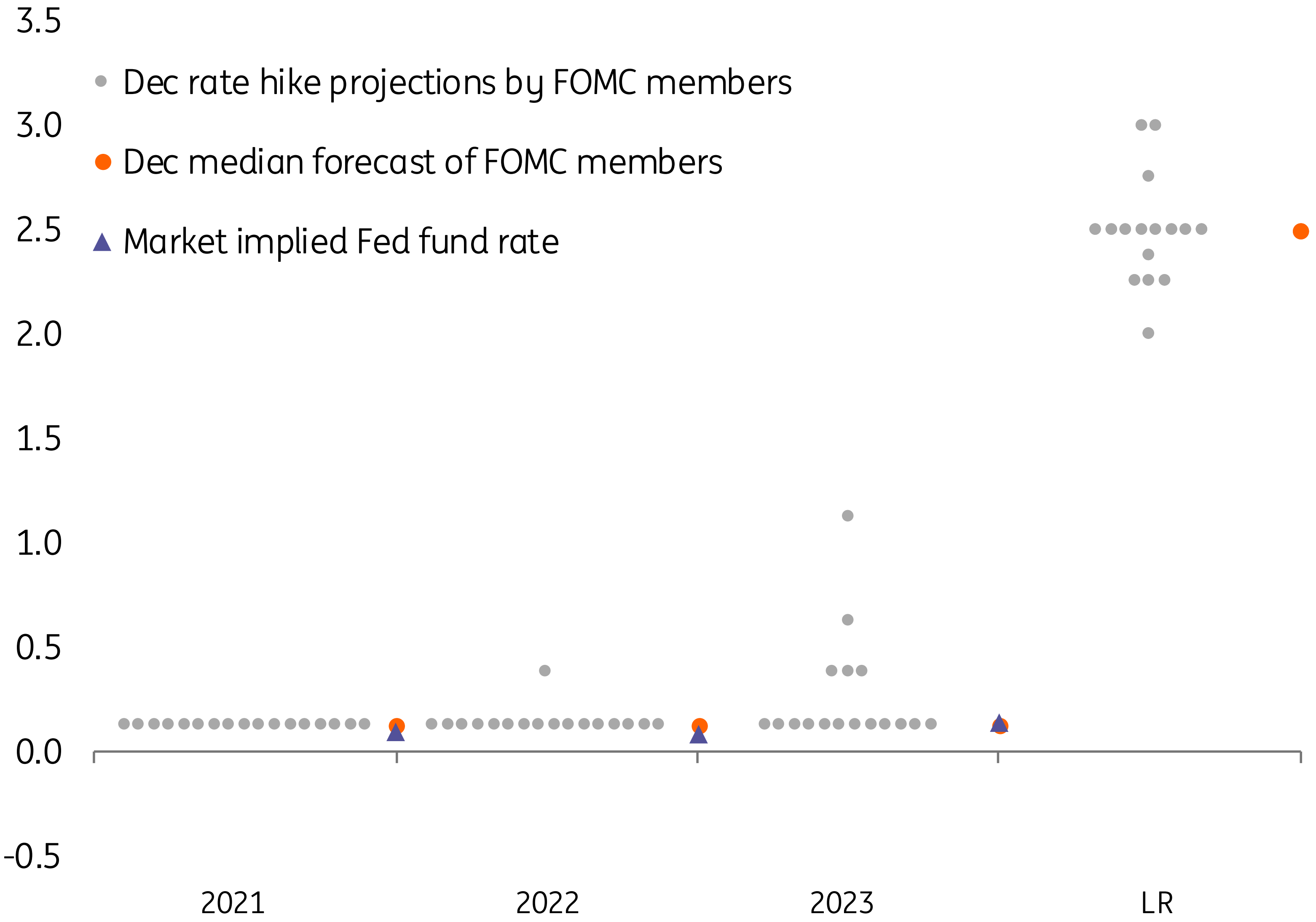
US inflation to hit 3% this year – maybe more



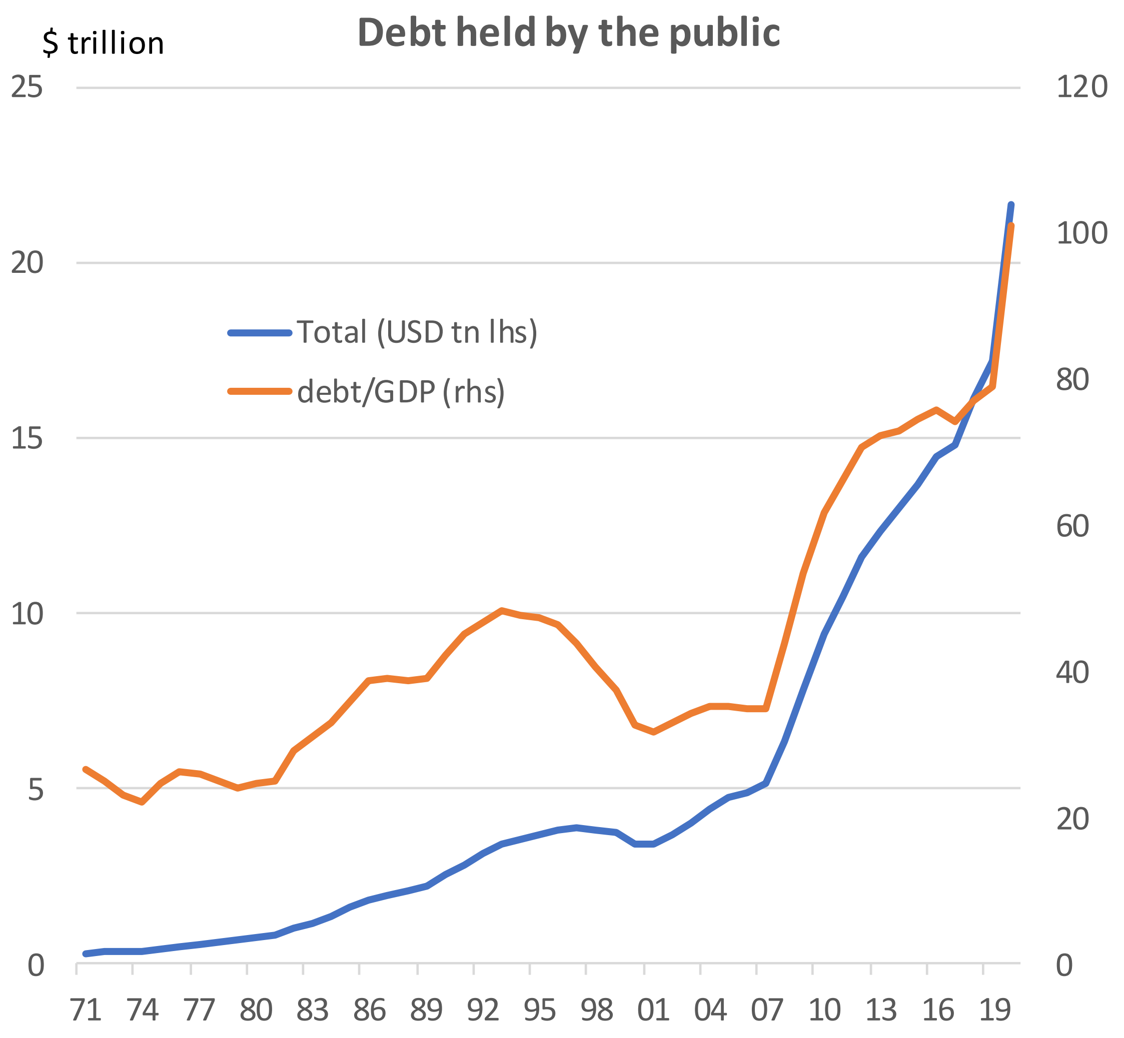
- In the last decade, US inflation (PCE measure, not CPI as shown here) has hit 2.0% (the historical target) on only 13 times (e.g. 13 out of 120)
- And that is despite massive QE, zero rates, huge fiscal stimulus
- This year, it will not only hit 2.0%, it may exceed 3.0%
- We know that this is mainly base effects
- There may also be some price level adjustment
- But will markets simply look through this?
- Is it possible that the Fed's claims that rates will be on hold at least through to 2024 be challenged?
- Even if only for a while?
- Its easy to be dovish when inflation is only 1.3%

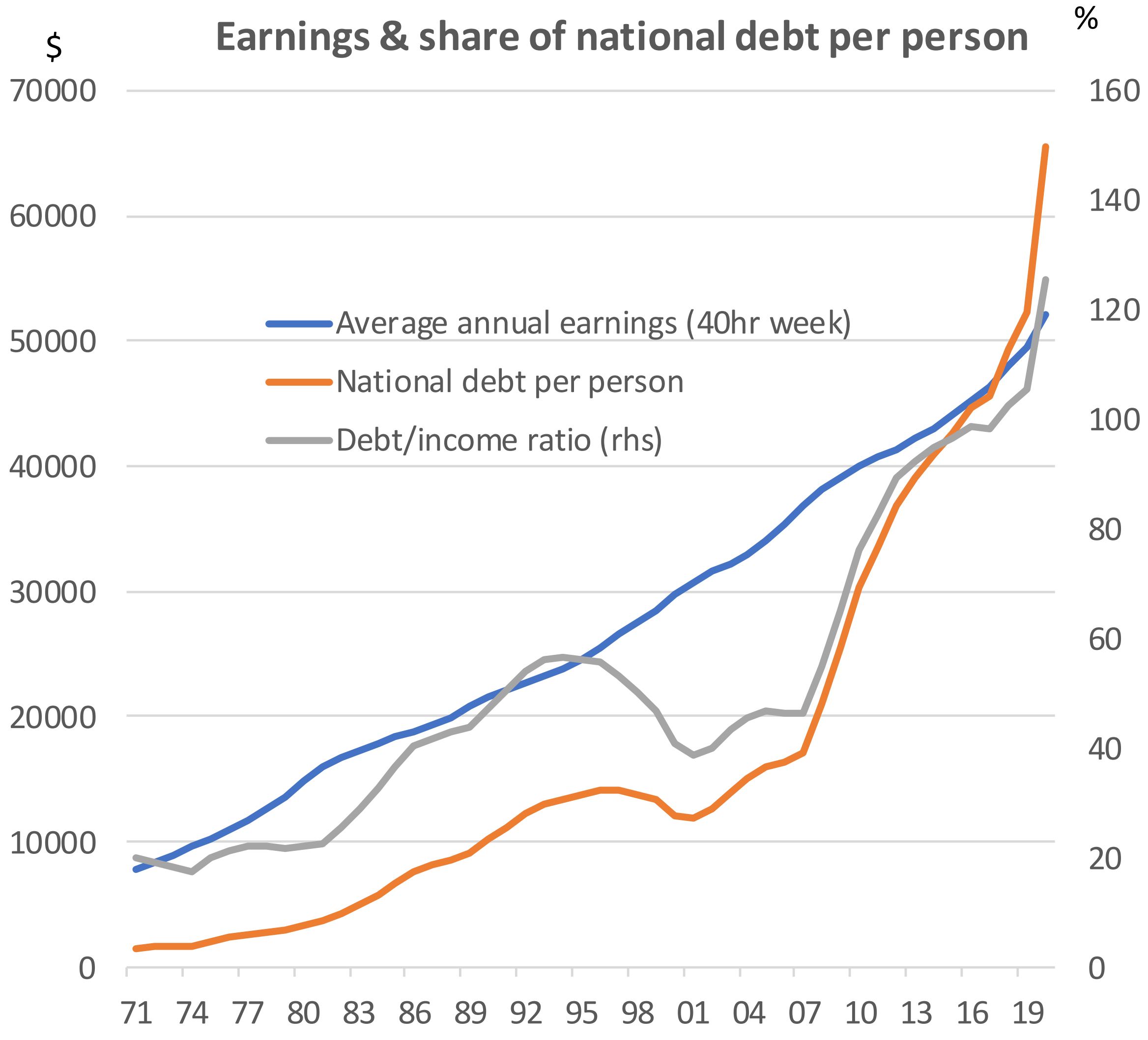
Bond market response to inflation – over-reaction?

Fed dot plot set to change?

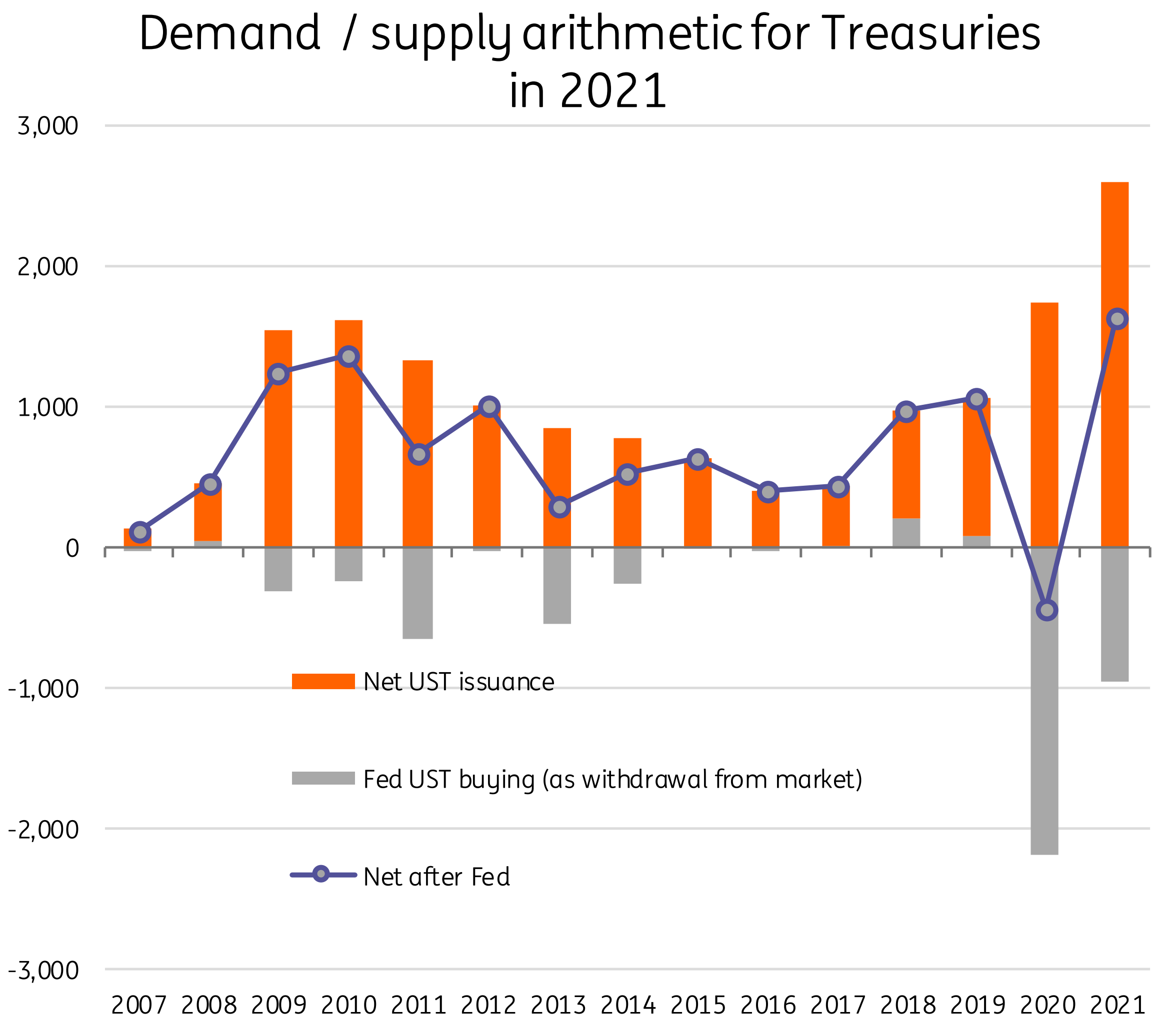


US government debt is growing… fast





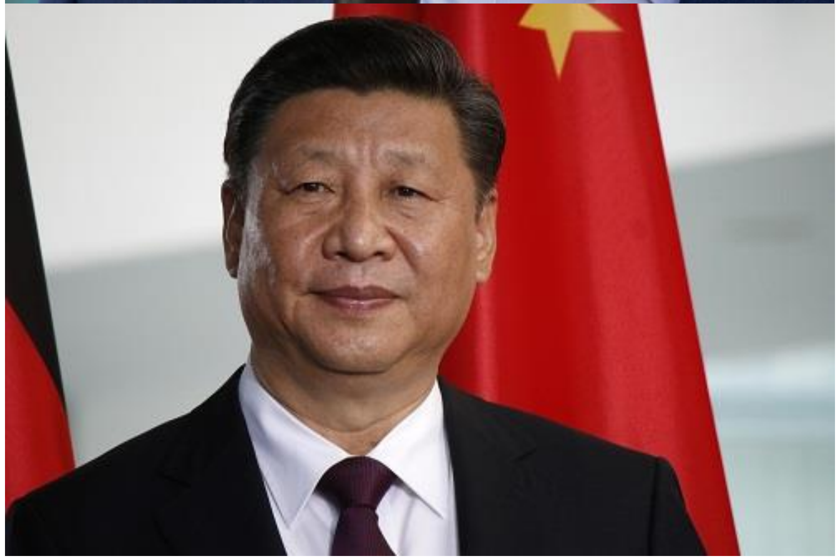
Yields to rise this year on supply issues?



- Treasury is skewing more issuance towards longer maturities and easing back on bill sales which were used to pay for the pandemic
- Fed will buy less in secondary market than in 2021
- So private investors will have to absorb much more coupon bearing debt
- Calculation here assumes no tapering – Fed buying as now, $80bn per month of USTs.
- Could combine a taper at year end with focus on longer end, and buying less short-term paper – a sort of twist operation, masquerading as an informal yield curve control
- Will result in steeper yield curve

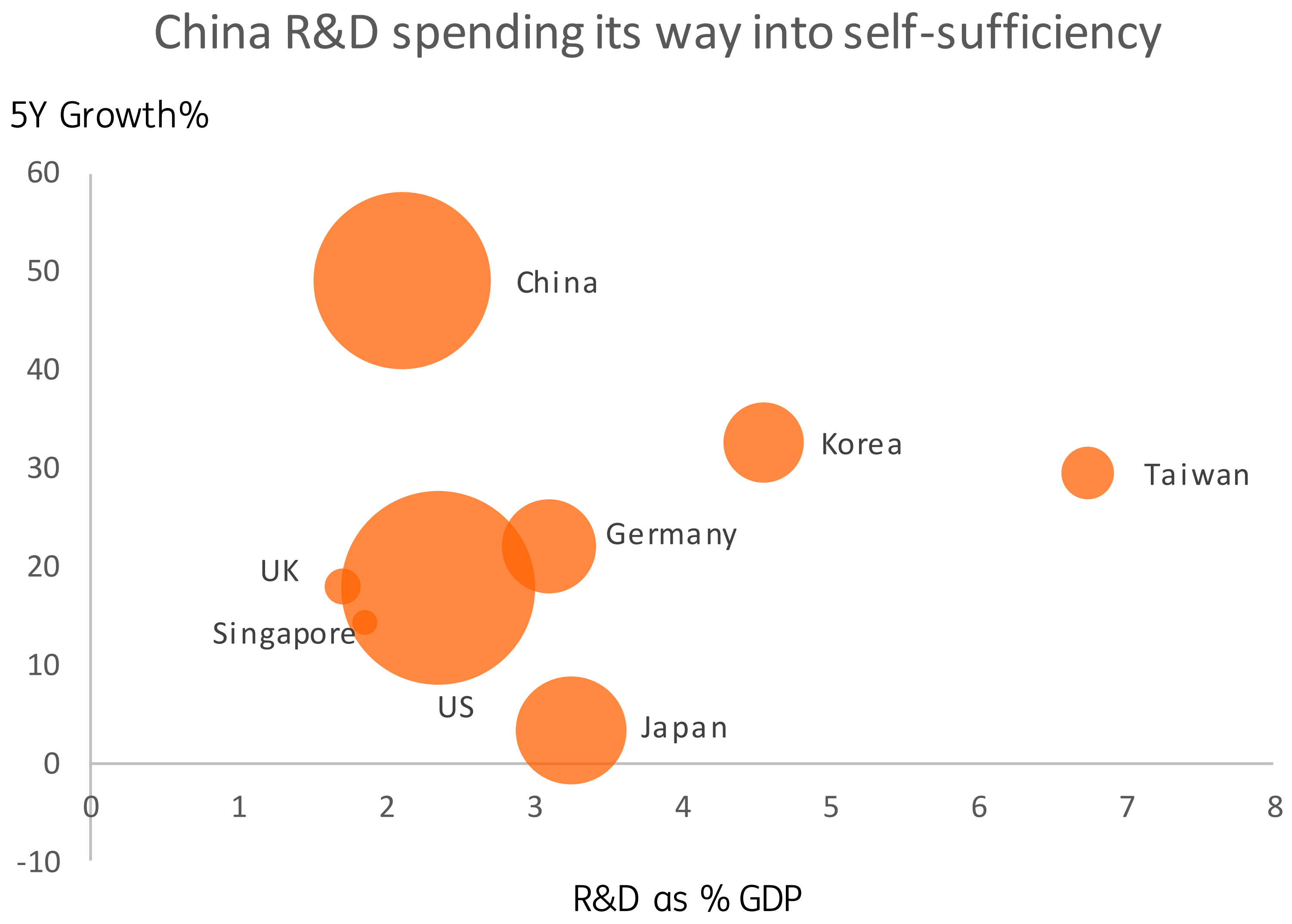
Return of Trade / tech War

Trade and Tech War?



- Secretary of State Antony Blinken on China:
- ***"there is no doubt" China posed the most significant challenge to the United States of any nation"***
- First 30 days of policy?
- ***"I think we should be looking at making sure that we are not importing products that are made with forced labor from Xinjiang … we need to make sure that we're also not exporting technologies and tools that could be used to further their repression. That's one place to start."***
- On Tariffs – nothing yet, but these are a strong source of revenue for the US Treasury – unlikely to give them all up
- On Taiwan relations with the US that have started to be re-affirmed:
- ***"I want to see that process through to conclusion if it hasn't been completed, to make sure that we're acting pursuant to the mandate in the (Taiwan Assurance) act that looks at creating more space for contacts."***

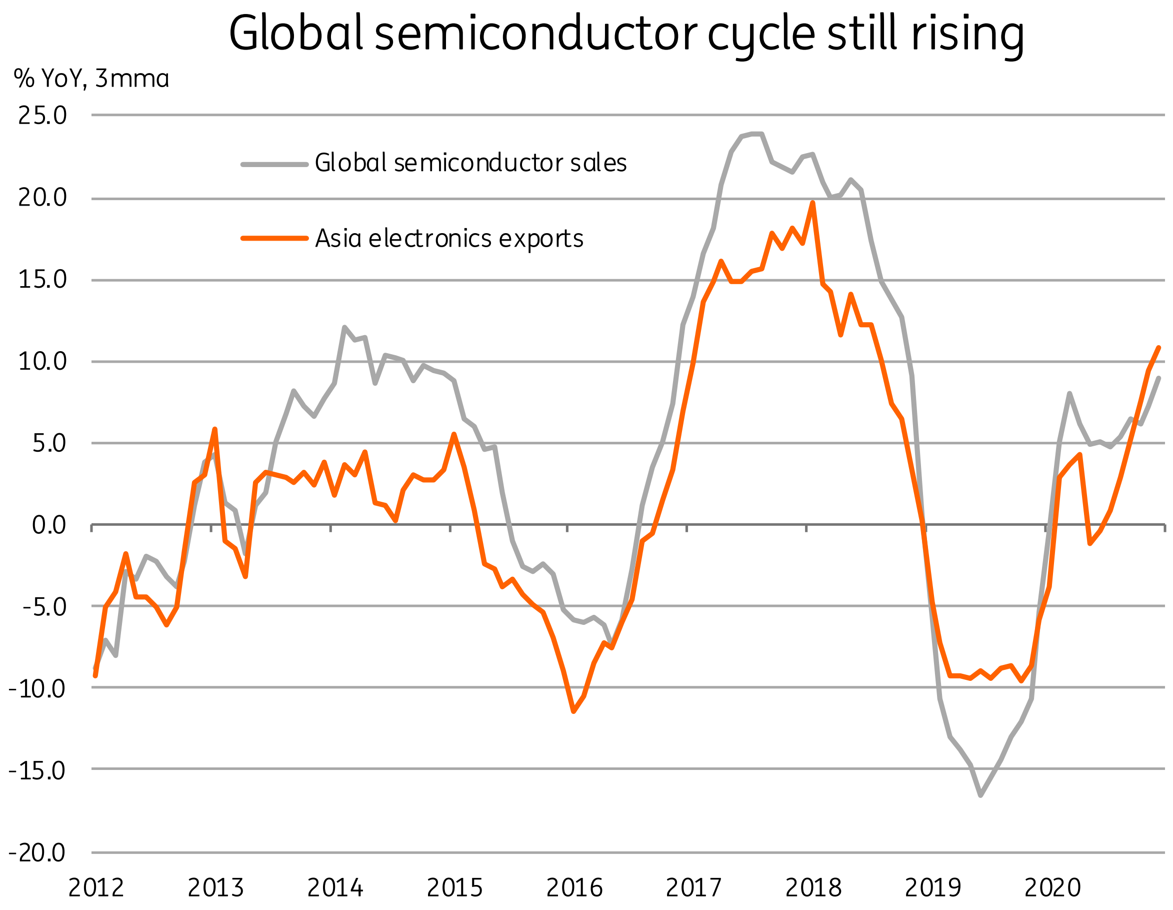
China and tech self-sufficiency?



- They are not there yet, and in key areas such as advanced semiconductors vital for some of their production, they are still very heavily reliant on imports
- But they also know that this presents a very big risk
- Spending growth on R&D in China is faster than anywhere else in the region, and that will shift their R&D as a % of GDP towards the current leaders, Korea and Taiwan in time
- Will they get there – its hard to think of a good reason why this is not just a matter of time

A good year for Asia?

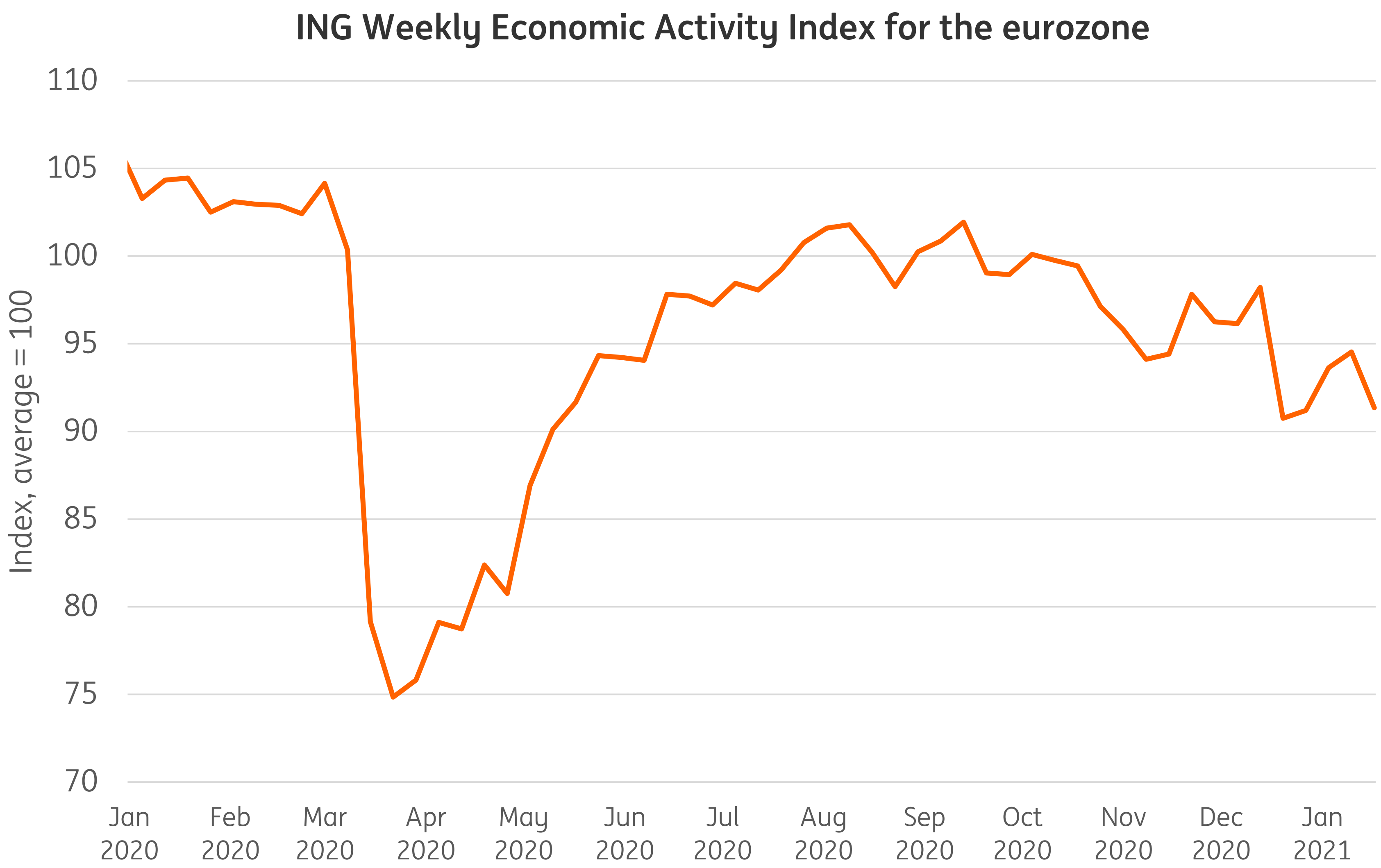
Semiconductor (electronics demand) cycle still rising



- The semiconductor cycle is still alive and well, and should push through 2021 and into 2022
- A strong semiconductor cycle is generally good news for all Asian economies (maybe not so much Indonesia and India)
- Shifts in working from home and greater demand for home entertainment during lockdowns has pushed this
- We should expect re-opening to spur demand from other sectors, such as autos
- But vulnerable to the tech war

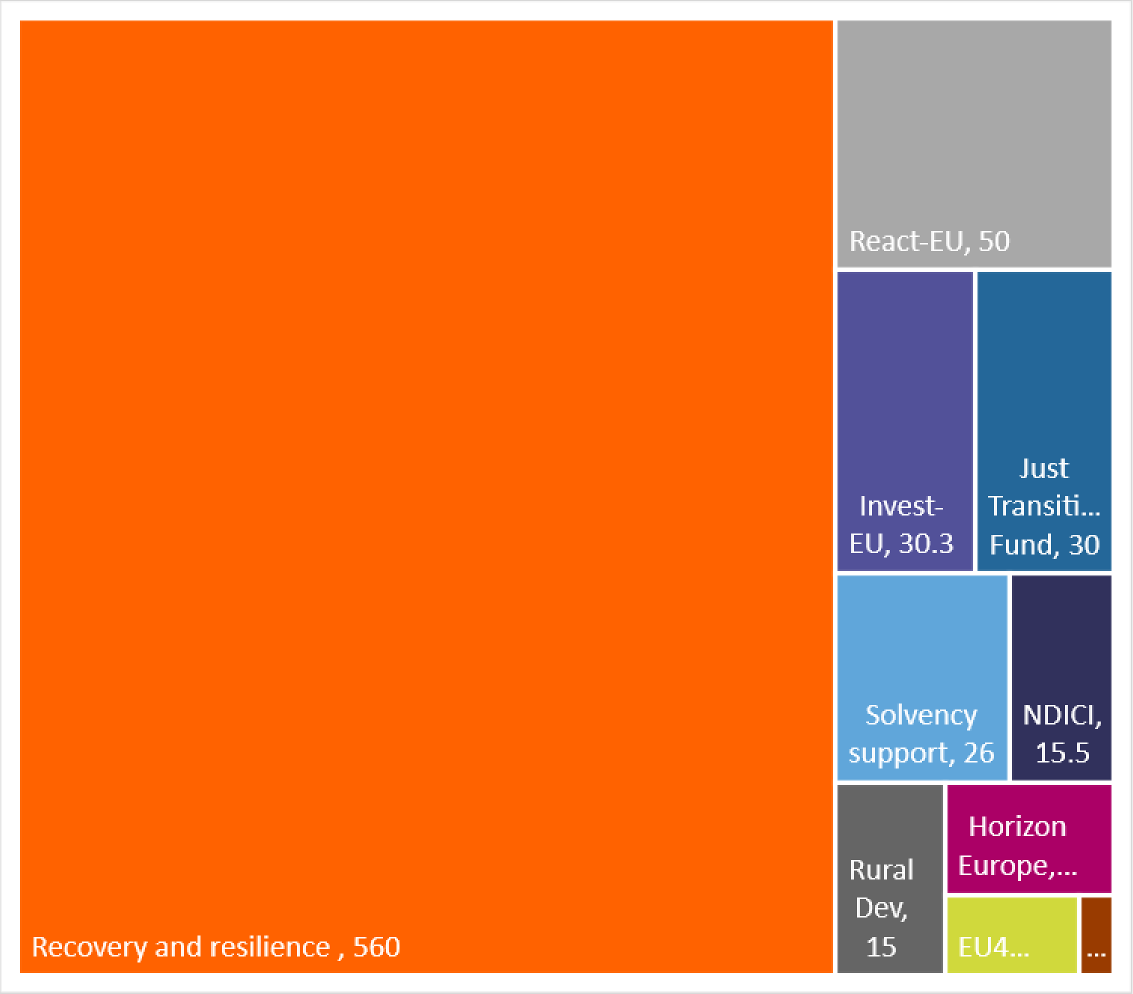
Europe – double dip, but then recovery

Second wave damages the economy as lockdowns tighten…

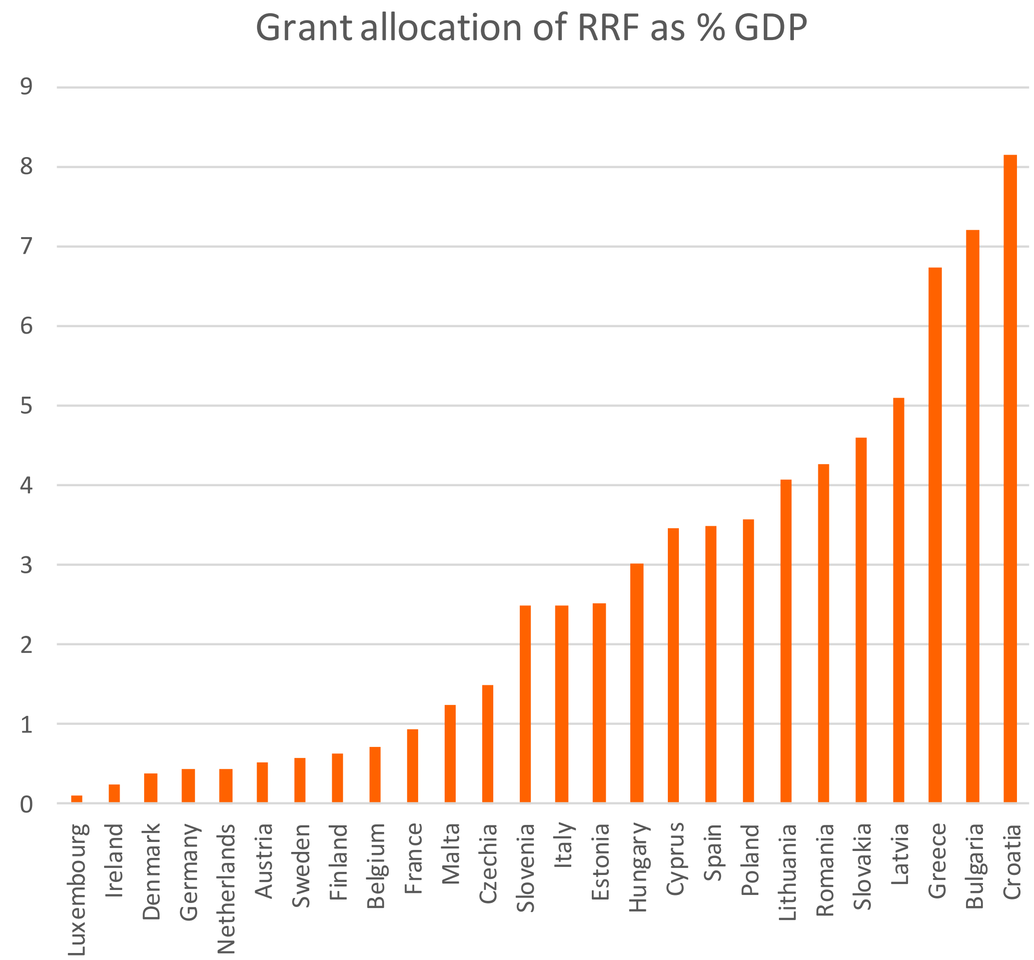


- Restaurants and bars closed, or limited hours open, with few exceptions
- Schools closed in many countries
- Curfews across much of Europe
- Retail services: some non-essential closures, but differs by country.

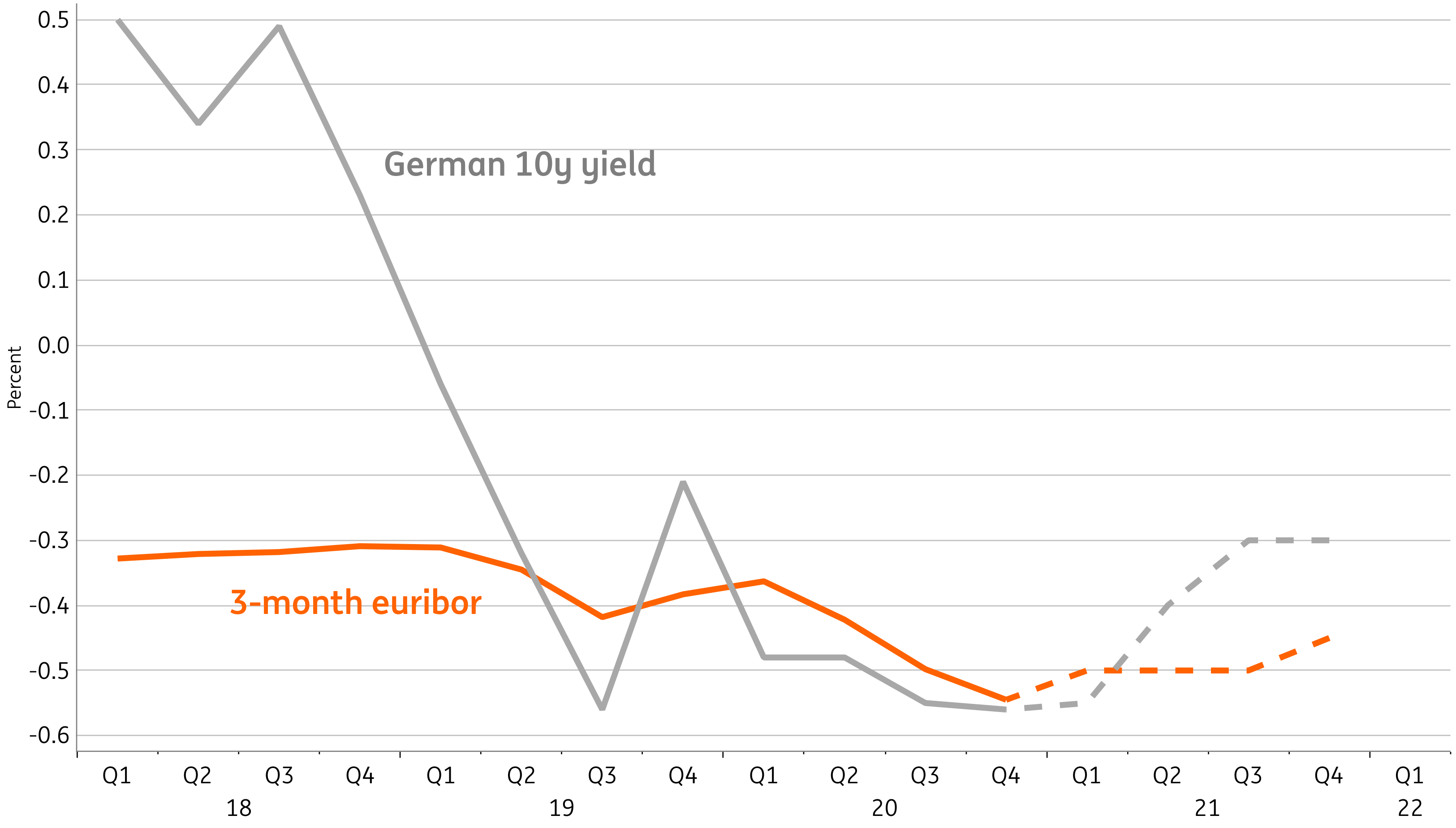
EUR750bn recovery and resilience fund won't hurt



EUR750bn



Despite a decent eurozone recovery, a mild reflation trade beckons



- Inflation is recovering…
- …base effects as seen elsewhere, though smaller and later than US…
- …and some one-off rebuilding of margins in service sector…
- …as well as improving growth outlook and overseas market developments…
- …should see Euro bond yields rise – though may remain negative

2021: Bounce back year?

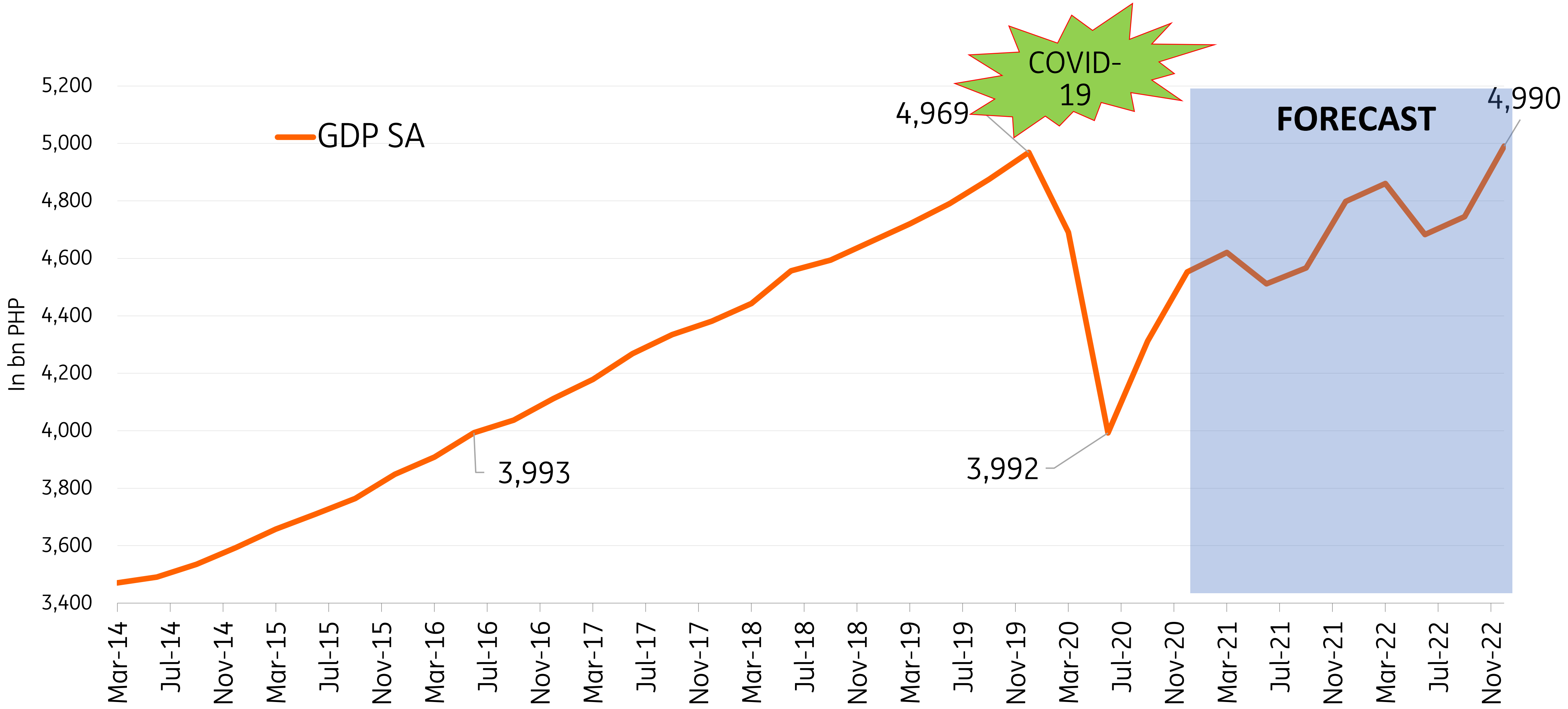
Growth vs recovery

Nicholas Mapa

January 2021

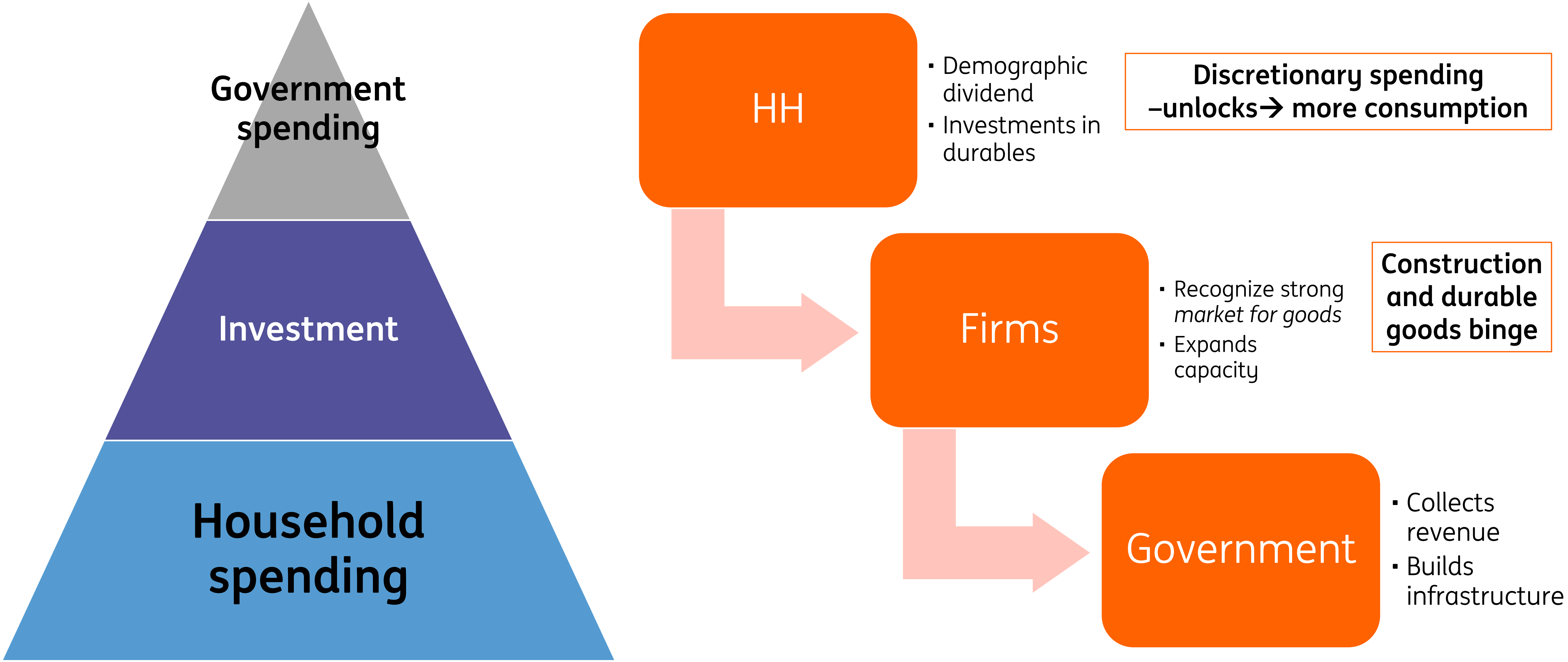
It's all about the base, about the base, "growth" no trouble..

Covid knocked us back to 2016 GDP levels, won't be difficult to grow from a low base



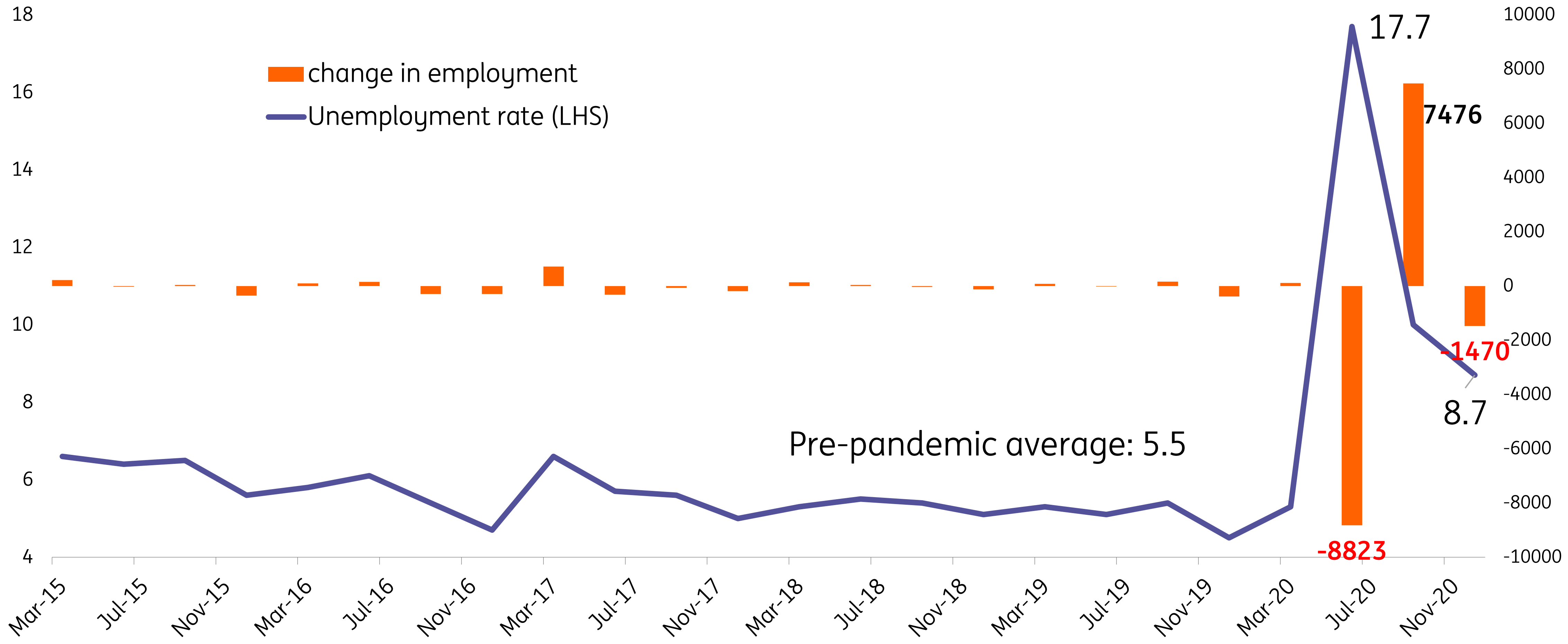
Source: PSA

Anatomy of the Philippine 6% pre-pandemic growth



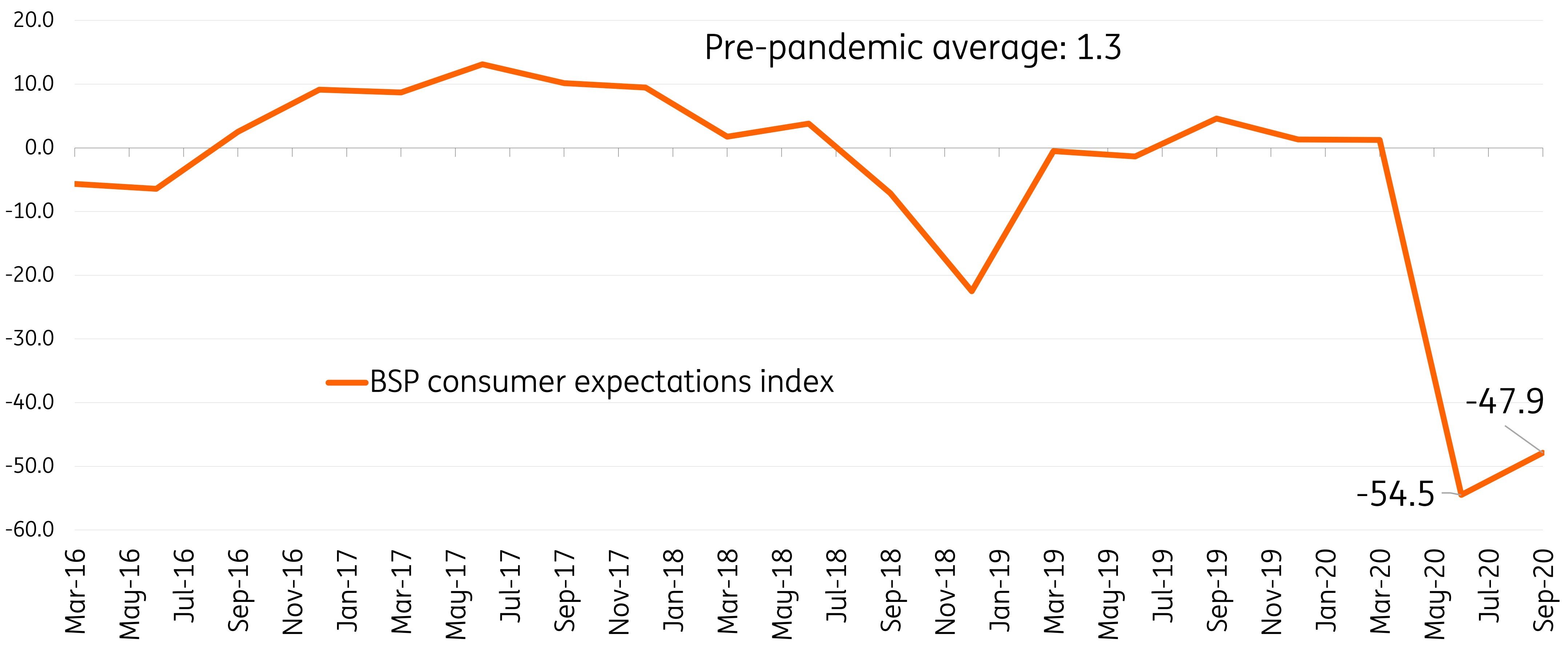
PHL: Lockdown knocks out jobs with job market reeling

8.7% an improvement but still much worse pre-pandemic average of 5.5%



It's all about confidence..or the lack of it

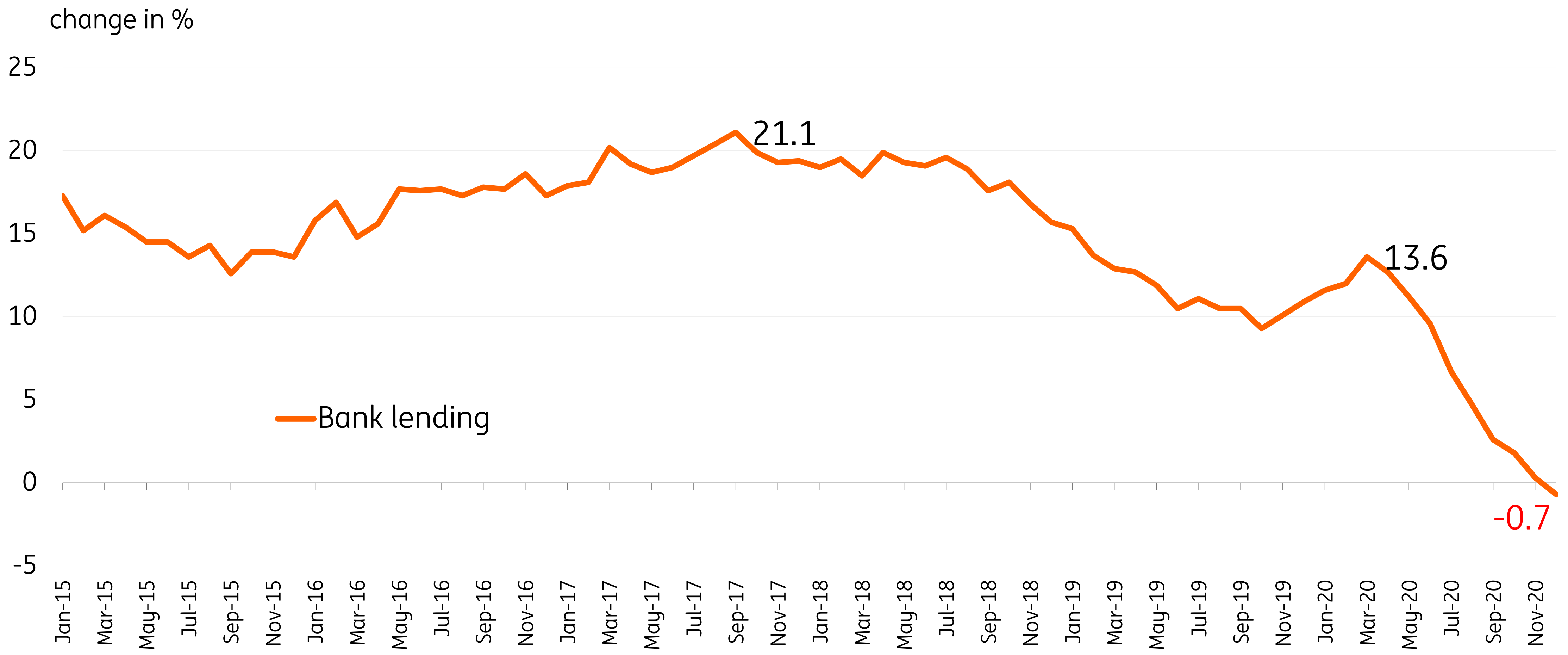
Challenging job market, anxiety over the virus get consumers worried



Source: BSP

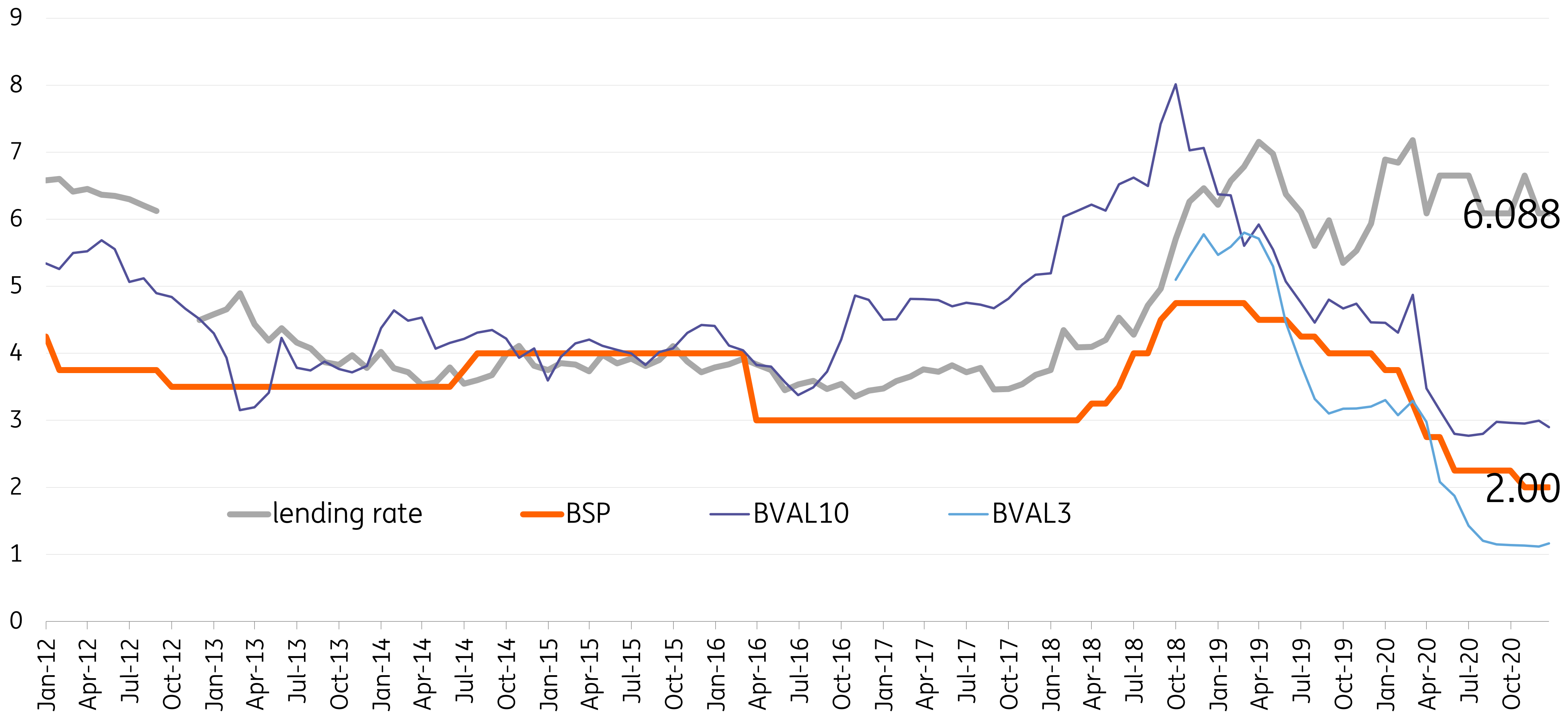
Investments grounded: Bank lending now in contraction

Capital formation not likely to return soon as bank lending grinds to a halt



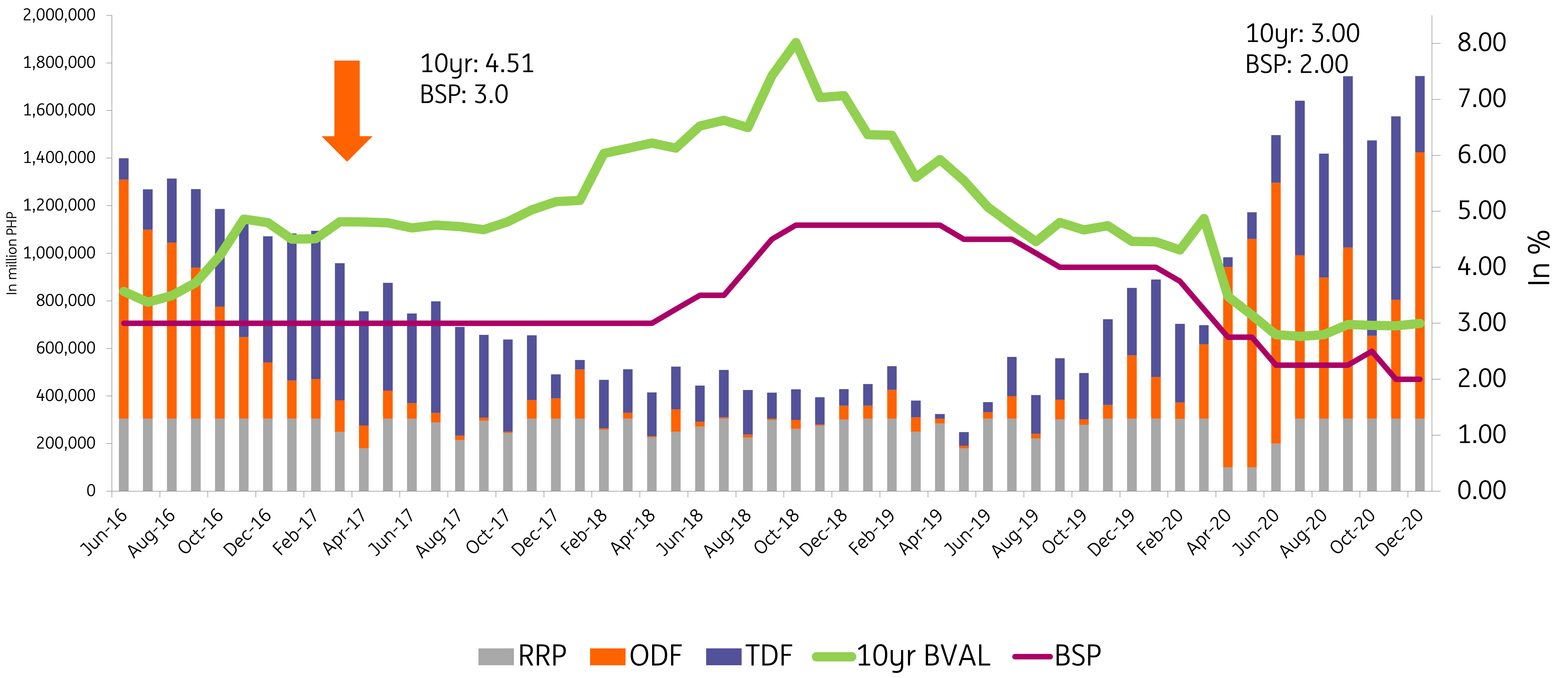
Transmission not received: BSP rate cuts affect GS but not lending

Excess liquidity and rate cuts forced secondary market yields lower but lending not affected



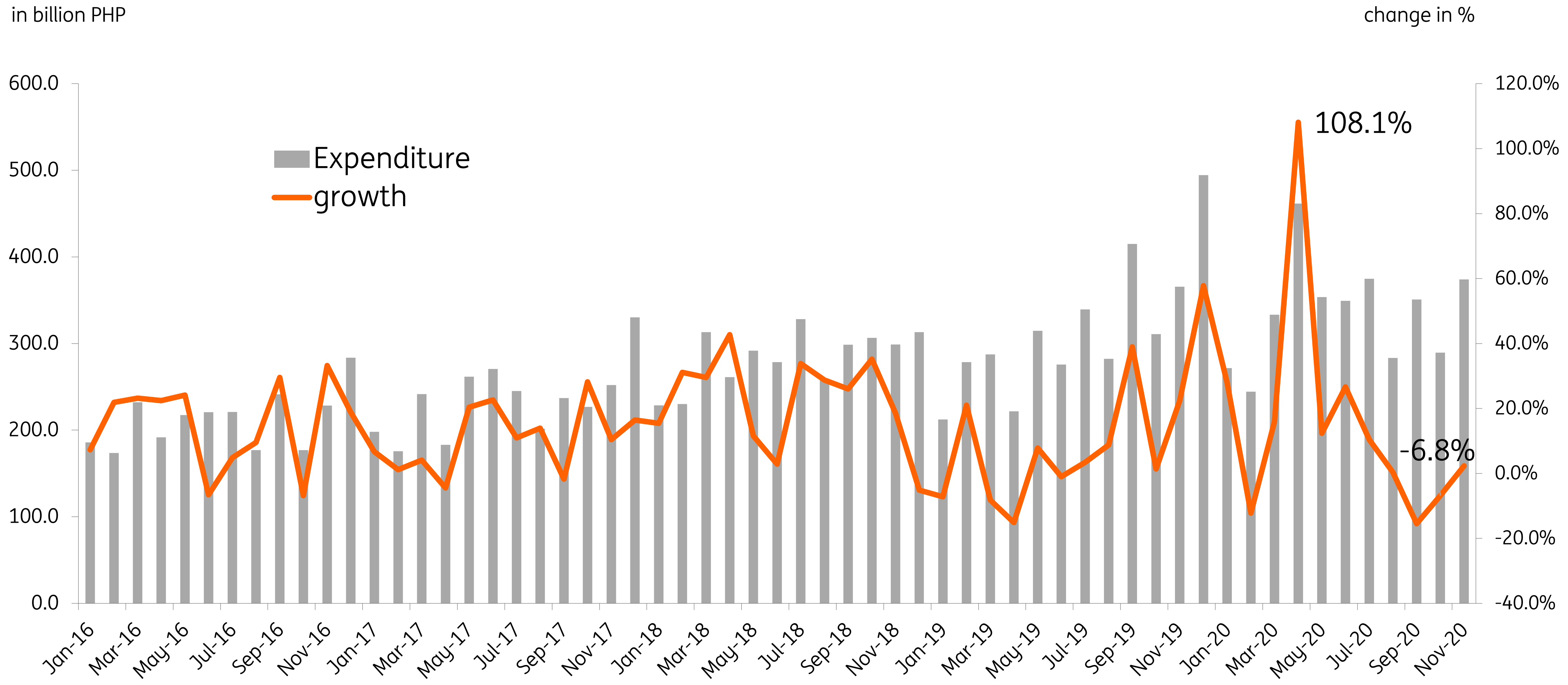
Return to sender: Liquidity all dressed up and nowhere to go

BSP flooded market with liquidity but its not going to lending



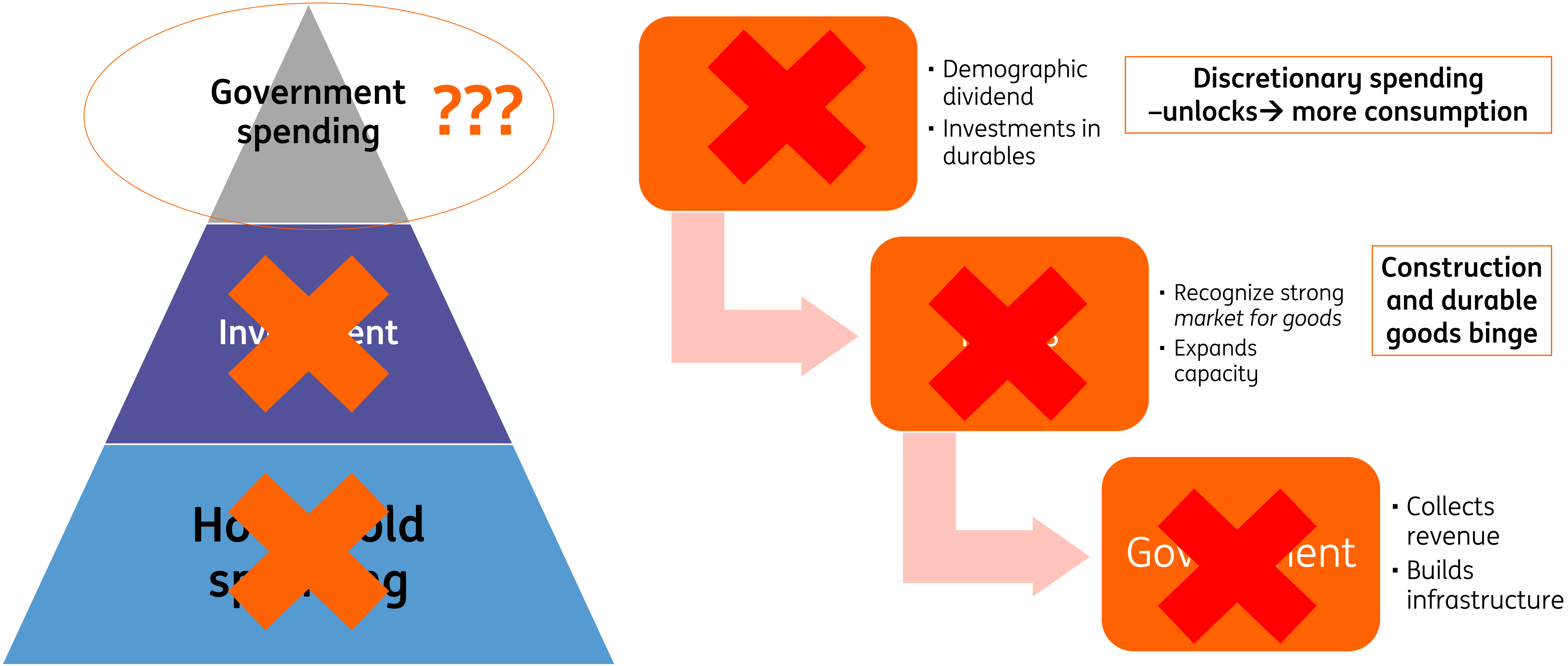
Fiscal authorities rein in spending

After surge in April, government has been shy about spending



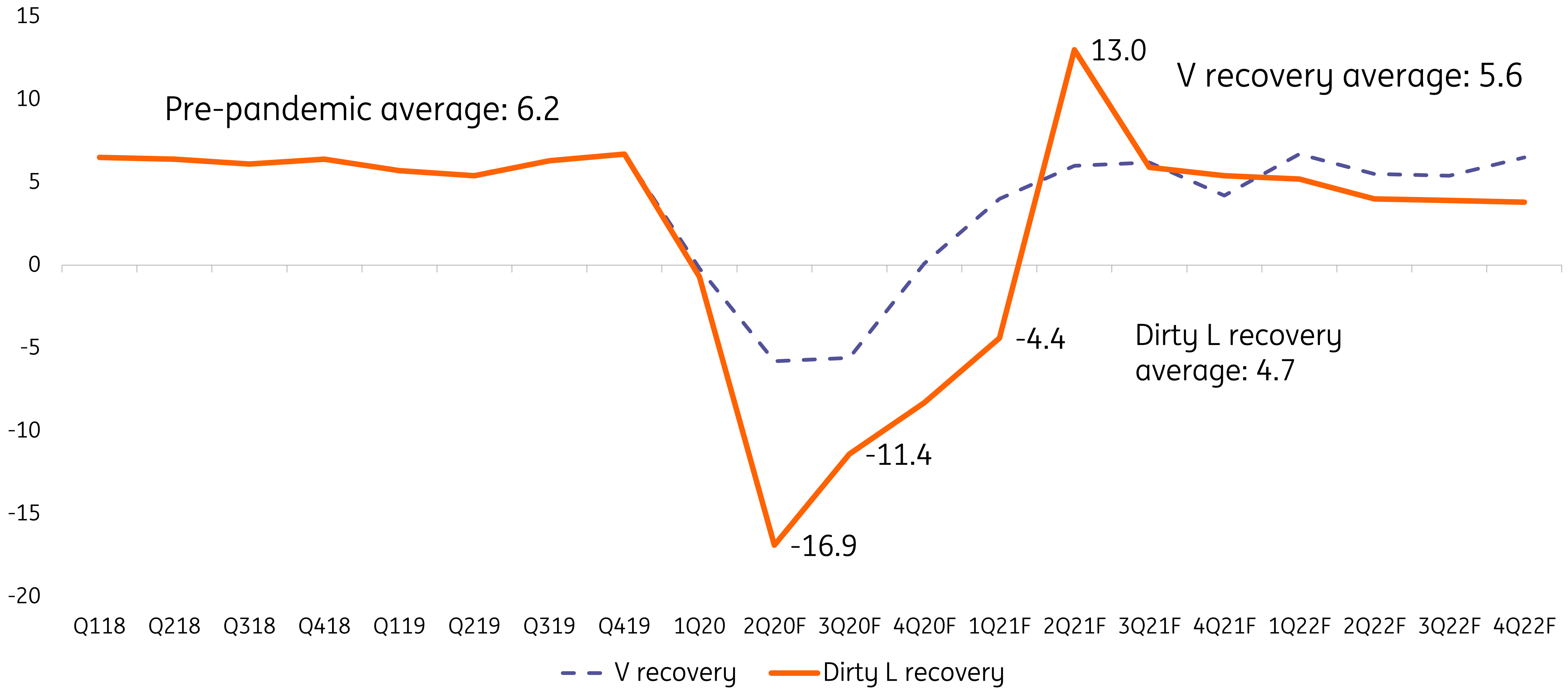
Anatomy of the Philippine 6% pre-pandemic growth

Only government has the space to move..



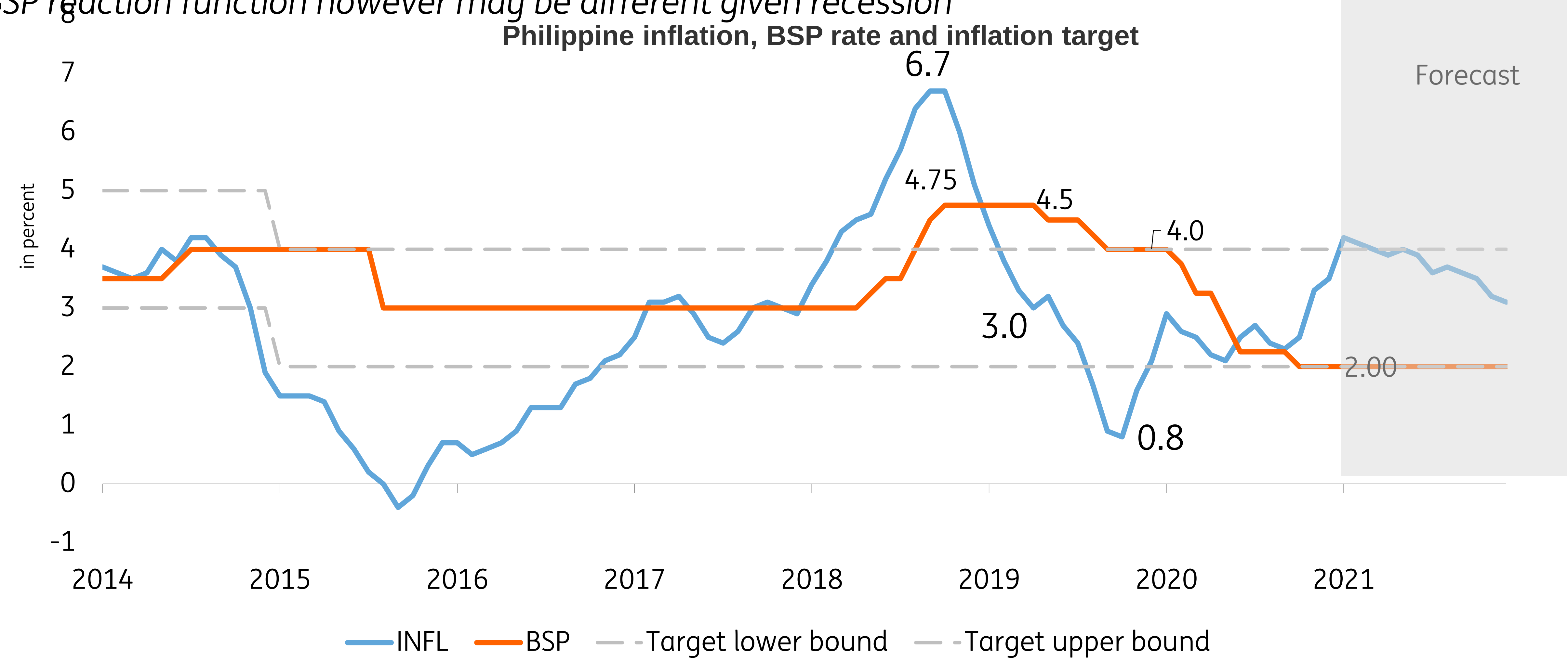
PHL: What goes down, must go up..

Dirty L-shaped recovery as economy fails to return to pre-pandemic trajectory of 6.2%



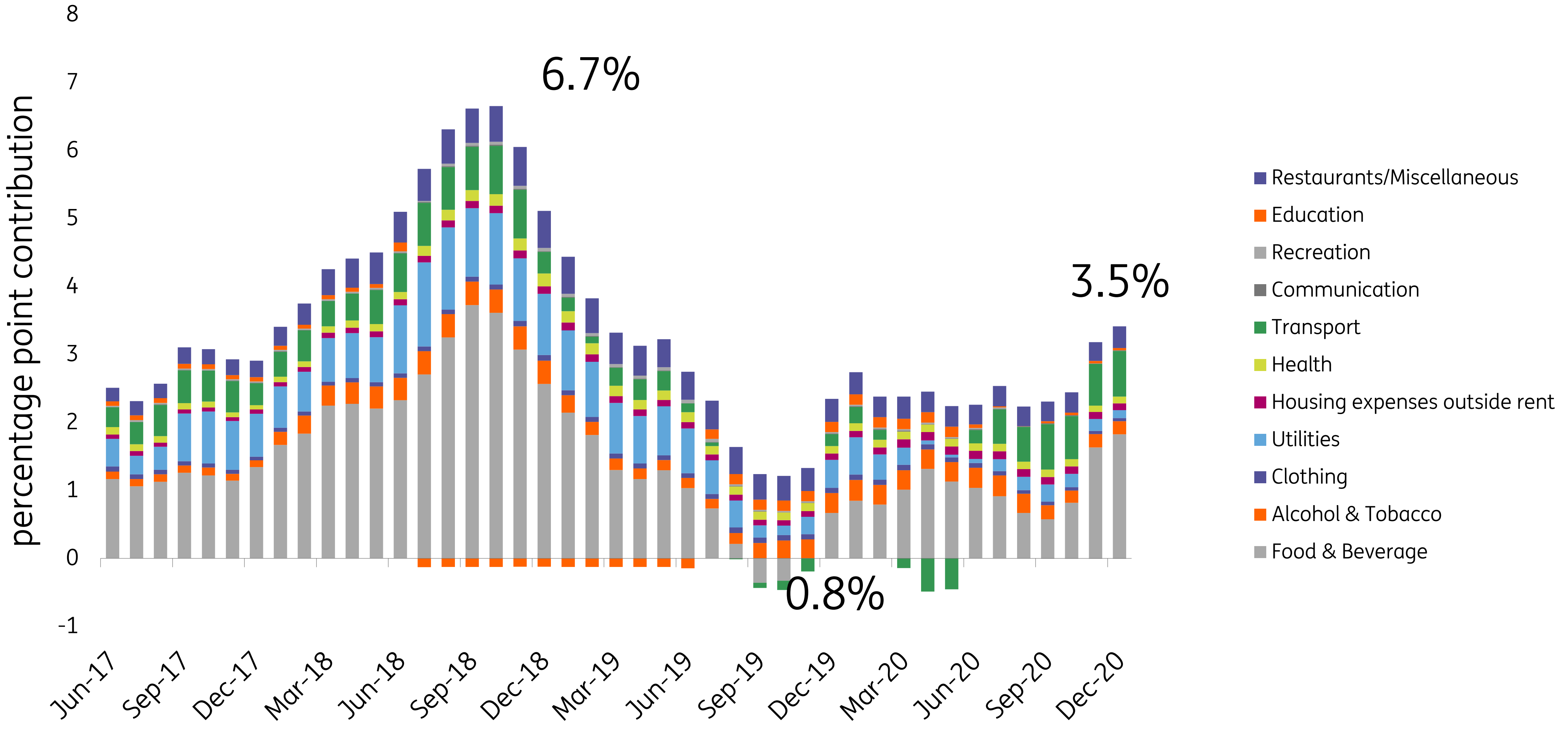
Inflation could threaten target as early as May

BSP reaction function however may be different given recession



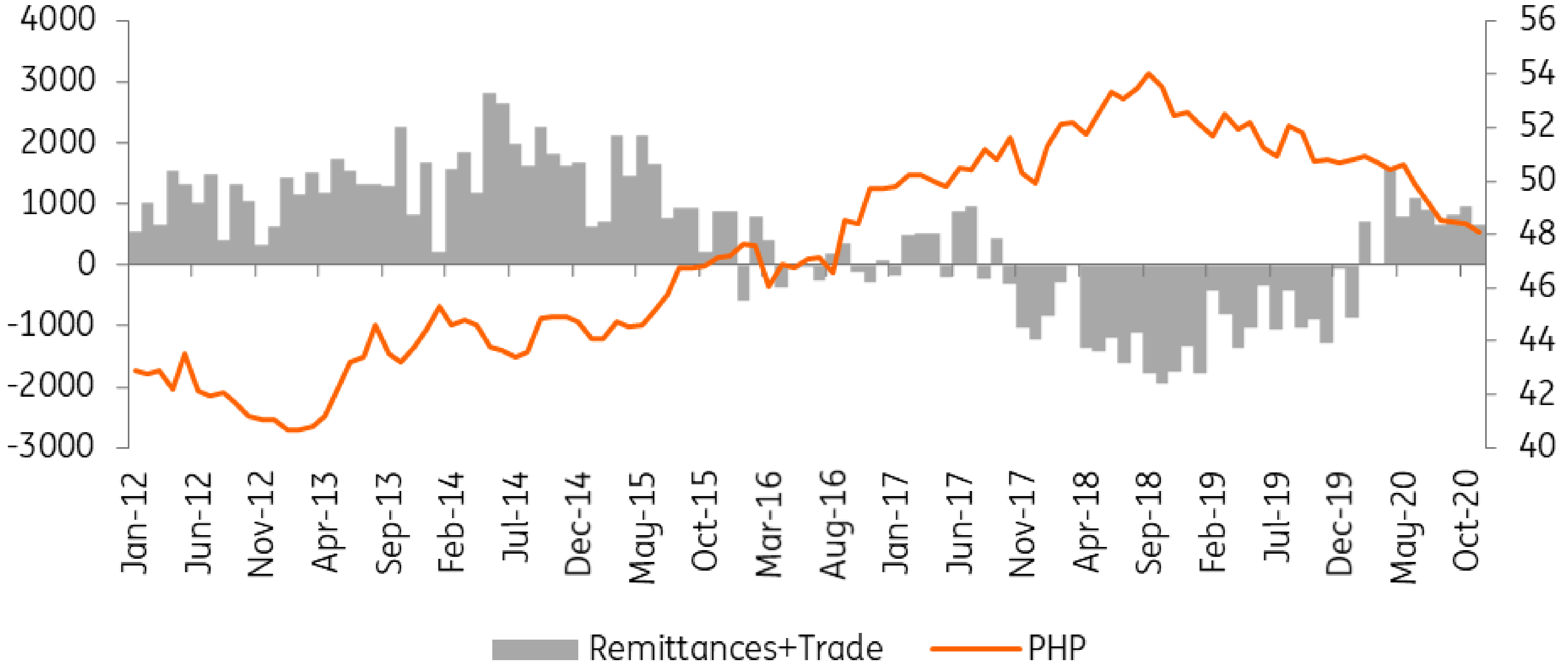
2021: The return of inflation..

Supply chain bottlenecks may force inflation to rise, breach possible but BSP not expected to react



PHP may enjoy slight appreciation in near term

Php strength also compounded by global USD weakness



Source: PSA and PDS

ING Economic outlook table

	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
GDP	-4.4	13.0	5.9	5.4	5.2	3.8	3.9	4.0
Inflation	3.5	3.4	3.8	3.6	2.9	3.0	3.3	3.2
BSP policy rate	2.00	2.00	2.00	2.00	2.25	2.25	2.50	2.50
10-yr GS	3.08	3.09	3.23	3.61	3.90	4.13	4.35	4.46
USD/PHP	48.09	47.87	47.51	47.78	47.79	48.09	48.47	48.90

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