Weekly Market Update

28 March 2021

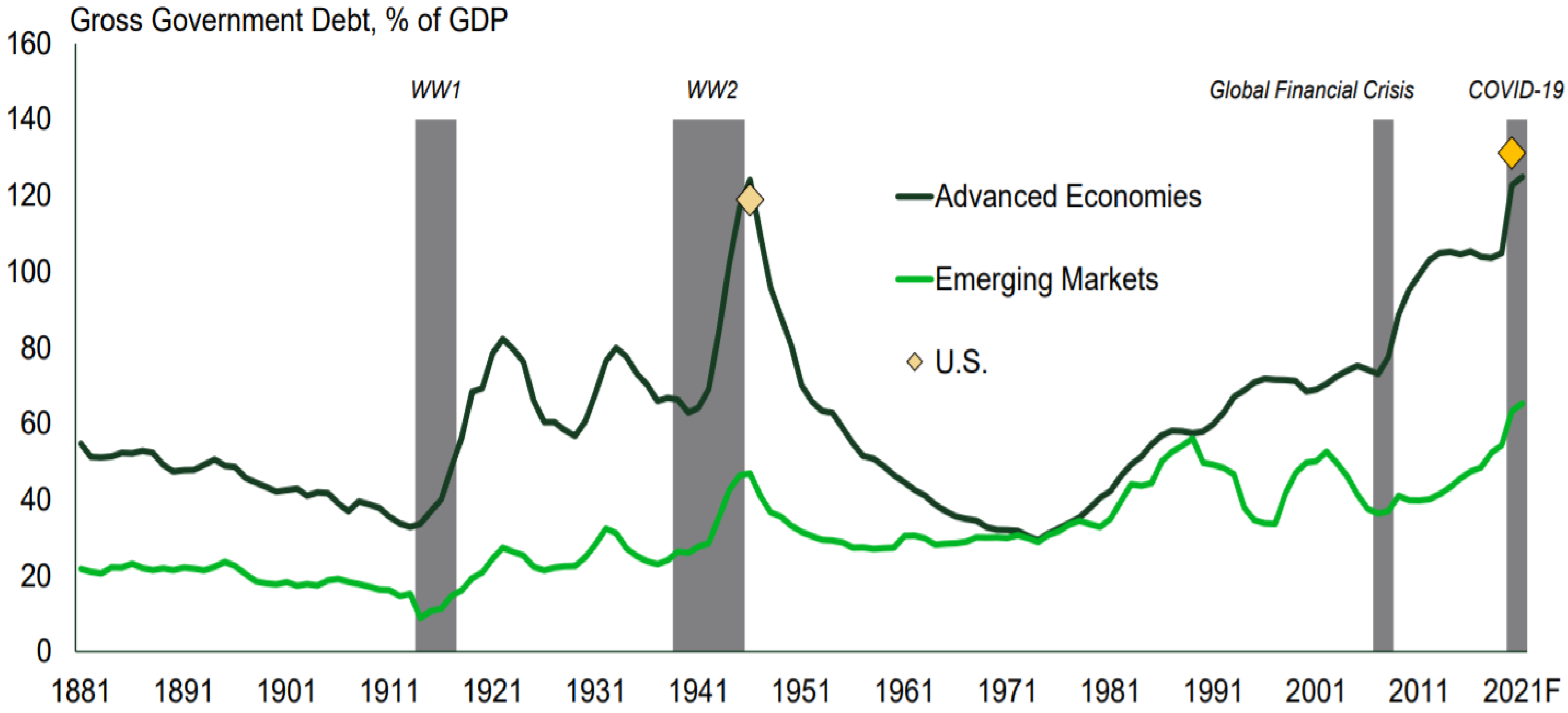
Divergent Macro trends

- Expectations are for a strong US economic recovery as fiscal policy takes the baton and vaccinations move fast.
- Rising US real yields is an indication that markets believe in a strong US recovery, which is supportive of the dollar.
- US economy could be above the pre-pandemic level in Q2 this year., whereas the Asian/European outperformance of 2020 has faded on the back of the Chinese slowdown and the outlook for a switch towards more service consumption post-lockdowns.
- Overall, Economic gravity is shifting more towards US vs. Europe and Asia. More importantly , US assumes the pivotal role in global growth similar to what China played during GFC.
- EUR/USD has turned more cyclical and moves lower on US-EU relative macro surprises and higher US real rates.
- The stronger USD and higher US real rates add headwinds to global inflation prospects in the medium term.
- The combination of higher energy prices and US yields have weighed on JPY recently, while the cyclical GBP has sofar extended its strong performance on the strong UK vaccination process and higher growth expectations.

Its all about Vaccine

- UK had administered 45 vaccine doses per 100 people, the US 40 doses, and the EU just 13 doses.
- The daily pace of vaccinations also continues to be much higher in US and UK, which are inoculating around 0.8% of their populations per day, while EU is running at around 0.3% per day.
- Indeed, the suspension of AstraZeneca vaccinations meant that an expected acceleration in EU vaccinations over the past week did not materialise, although this lost ground can be made up for in the coming weeks.
- Despite the problems with vaccine supply that we have seen in Europe in the first quarter of the year, there have also been some positive developments, including a front-loading of additional Pfizer/BioNTech deliveries, the approval of the Johnson & Johnson single shot vaccine, and the likely approval of Curevac in May.
- The ramping up of the Pfizer/BioNTech vaccine in particular will drive a doubling in vaccine supply over the coming weeks, which should enable EU to inoculate around 0.6% of the population per day, i.e. not far off the current US and UK pace.

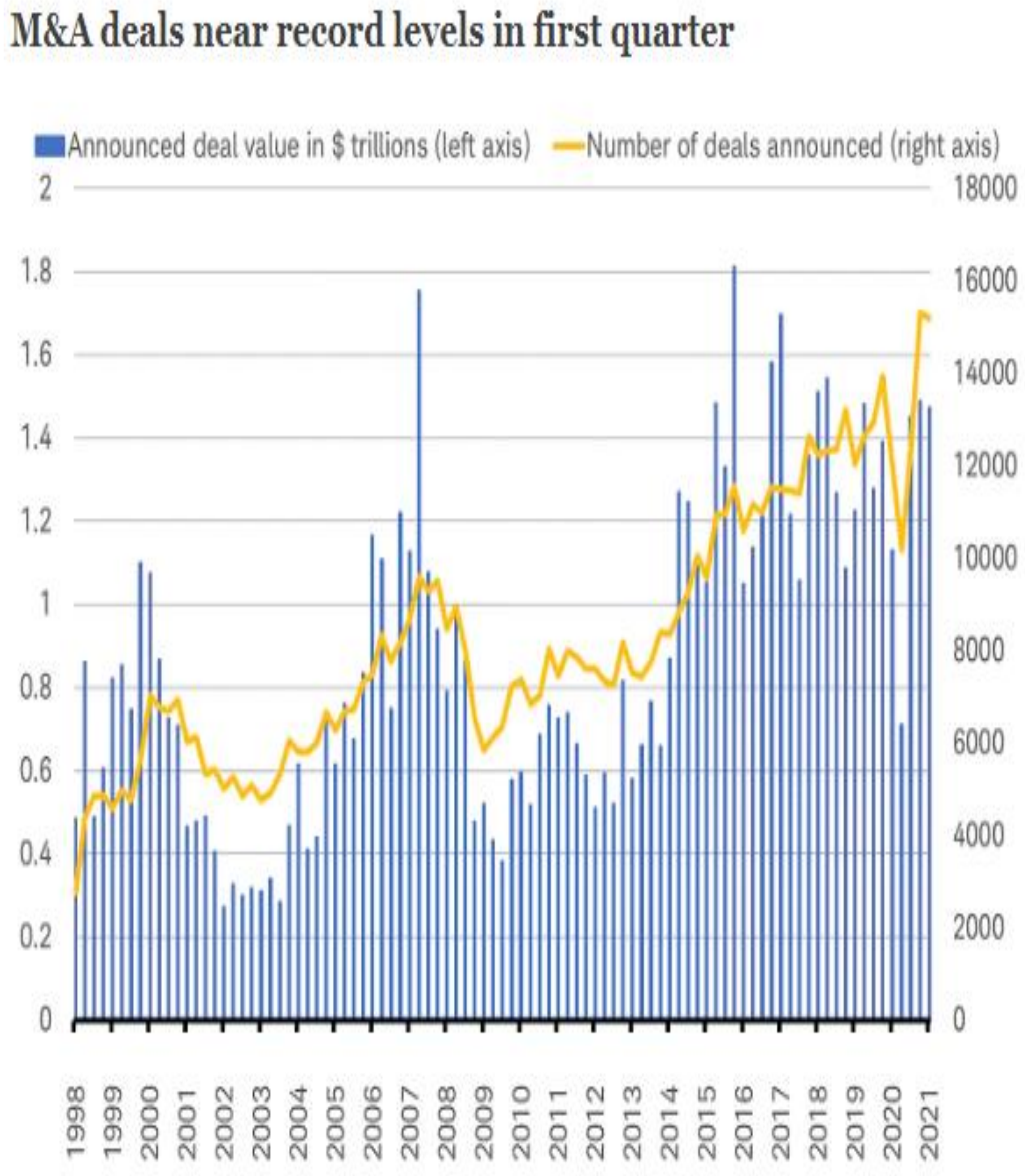
Gross Global Govt debt exceeds that of WWII



Note: Data for 2020 and 2021 are based on the January 2021 IMF Fiscal Monitor update.

M&A : Booming Confidence

- Strategic corporate M&A deals have multiplied.
- As of March 12, announced global merger and acquisition deals totaled $1.1 trillion for this quarter, putting Q1 CY 2021 on track to be one of the biggest ever.
- Although these deals were likely in the making for some time, the ongoing rise in bond yields hasn't slowed their pace or kept them from being announced, implying that business leaders' outlook on investment remains positive even as interest rates continue to climb.



Suez Blockage - Implications

- The 193-km waterway Suez Canal which connects Asia and Europe is so important to world trade that world powers have fought over it since it was completed in 1869.
- Last year about 19,000 ships, or an a billion tonnes passed through the canal, providing an important source of revenue for Egypt ($6 billion). About 12 % of total global trade moves through the Suez Canal -nearly $10 billion worth of goods pass through the canal every day,
- Without Suez, a supertanker carrying Mideast crude oil to Europe would have to travel an extra 6,000 miles around Africa's Cape of Good Hope, adding some $300,000 in fuel costs.
- The extended blockage of the Suez Canal is yet another challenge for global supply chains already strained by the pandemic. It will delay a range of raw materials for European products such as cotton from India, petroleum from the Middle East, and auto parts from China. As a result, Europe's manufacturing industry and auto sector, including auto suppliers, will be hit hardest, as they operate 'just-in-time' supply chains.
- Inventories were already tight before the latest disruption, and with delays coming at a cost, the inflationary pressure stemming from the goods sector is not likely to go away soon.The supply chain bottleneck could make the price of goods used in everyday consumption dearer. The shipping delays could impact everything from the clothes and shoes ordered online to electronics, food, and energy supplies
- There would be limited impact on US which receives most shipments from Asia on the West Coast. , whereas Asia and Europe could be under stress if the blockage persists longer

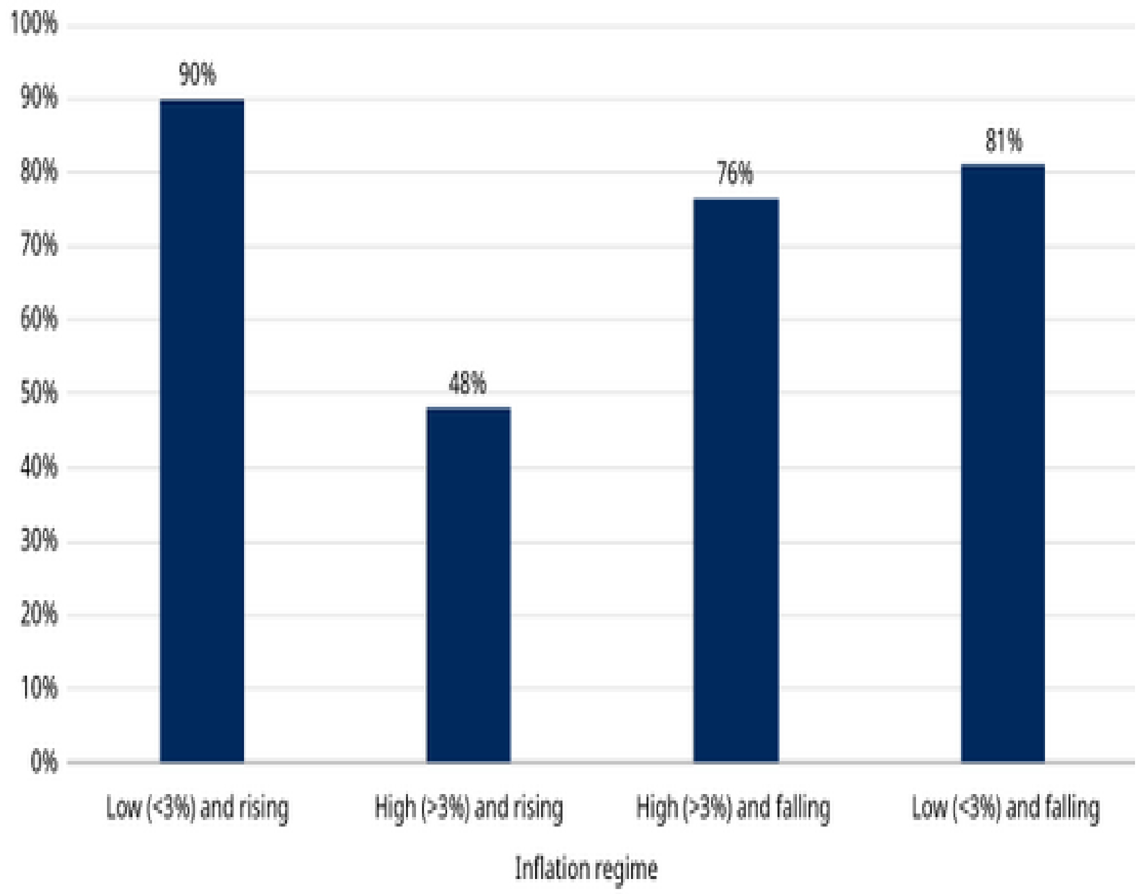
US Economy : Higher Growth and Yields

- Last week, markets were caught between the bookends of the worries over rising rates countered by the confidence seen in booming business investment.
- Prices have yet to show much movement, but the prospect of an unbridled economy's surge amidst the post-pandemic spending splurge could stoke higher inflation has undoubtedly unsettled the markets.
- U.S. dollar notched another weekly rally, breaching an important technical level in the process.
- While the 10-year U.S. Treasury bond yield had risen more than one percentage point since early August, surveys of business optimism and investment continue to rise as well. This suggests higher rates are having no negative impact on business sentiment
- However , if interest rates continue to make their way higher just as rapidly as they have over the past 6 months, climbing at an annualized pace of two percentage points, that could begin to weigh on growth.
- When U.S. economy exited recession during the last four recessions, the spread between the 10-year yield and the two-year yield peaked at about 2.4% . Right now, the spread is about one-and-a-half percent. So that would imply the 10year US Treasury yield probably has further upside here to go.

Inflation and Equity

- Five-year inflation expectations, as measured by the yield difference between nominal and inflation-protected US Treasury bonds, have rebounded sharply from their pandemic lows and are now at 2.5% - their highest level since 2008.
- Moderate inflation is generally good for equities because it tends to be associated with positive economic growth and rising profits. However, things can quickly turn ugly for stock market investors if the economy overheats and inflation rises too high.
- Equities outperformed inflation 90% of the time when inflation has been low (below 3% on average) and rising. But when inflation was high (above 3% on average) and rising, equities fared no better than a coin toss.

Percentage of Rolling 12m periods when US equity returns exceeded inflation rate 1973-2020



US Economic Data : Revving back up

- Larger-than-expected declines in durable goods orders as well as new and existing home sales do not signal a shift in the economy's strong underlying momentum. Some payback in home sales was widely expected and monthly data are particularly volatile in the normally slow winter months
- Survey data for the factory sector however suggest that production and employment are still in the early stages of revving back up, and the latest weekly first-time unemployment claims fell to the lowest level since they spiked, following the onset of the pandemic.
- University of Michigan also revised its gauge of March consumer sentiment higher
- Inflation data—perhaps at the top of the list of recent investor concerns—remained muted. The core (excluding food and energy) personal consumption expenditure index increased by 1.4% year over year in February, down from 1.5% in January and still well below the Fed’s 2% target.
- Both Powell and Yellen testified before Congress that they saw little danger of an overheating economy

US Equities : Heading into a Bunny Market

- With one-year anniversary of market bottom this past week, stock-market performance over the last 12 months has been exceptionally strong. Three primary factors have powered this rebound: the vaccine (first development, then distribution), monetary-policy stimulus, and fiscal aid (PPP loans, stimulus checks, etc.). This trifecta has formed a solid foundation upon which the economic recovery commenced.
- The unemployment rate has fallen by 8.6% (from a peak of 14.8%), reflecting just how severe the recession was, as well has how sharp the initial recovery has been. In previous recoveries, there were peak-to-trough drops of 5.7% in the 1950s, 5.8% in the 1980s, and 6.5% in the 2010s.However, unemployment rates in those instances took over 80 months, on average, to improve.
- However , CY 2021 seems to be more of a “bunny” market with the global stock market hopping up and down. This probably is not the start of a bear market, but it may feel like lot less a bull market compared with last year’s charge.
- The progress on vaccinations and re-openings coupled with the rise in interest rates and worries over the potential withdrawal of central bank stimulus next year has led this to be more like a “bunny” market, with the stock market hopping up and down.

Europe : Two speed Economy

- Concerns over Europe’s slow vaccine rollout amid the onset of a fresh wave of virus infections.
- German government extended its lockdown to mid-April but was forced to abandon plans to keep people at home over the Easter break after a backlash from businesses, politicians, and the public.
- Health experts said the current surge in infections in Germany could be worse than the two previous waves. There is a clear risk that the turning point is delayed into May, as vaccinations are much slower
- The preliminary March PMIs for Eurozone showed a vibrant manufacturing sector that is only partially offsetting a service sector that remains largely stuck in the mud.
- The manufacturing PMI climbed 4.5 points to 62.4 in March, the highest reading in at least 20 years .
- In contrast, the service sector PMI rose 3.1 points to 48.8, but it remained below 50 for the seventh consecutive month. The composite PMI rose to 52.5, the first reading above 50 since October 2020.
- German businesses are increasingly optimistic about economic momentum picking up this year. The Ifo Institute’s gauge of expectations for the next six months rose to 94.2 in February, beating estimates.

China : Signs of Slowdown

- After a strong growth rebound in 2020, the 2021 *PMI's* point to a peak in the cycle supported by slowing credit growth .
- PMI’s have come down over the past months and growth in credit, electricity generation and rail freight has come down.
- The economy is expected to moderate towards trend growth this year -around 5.5 % at the end of the year primarily due to less stimulus. In Q1, though, look out for a jump in GDP growth rate to around 20% y/y. This is solely due to base effects, as the GDP level in Q1 will be measured against the very depressed level in Q1 2020.
- In a sign of slowing growth in infrastructure and construction, the price on iron ore has moved lower lately and is down 8% from the peak .Slowing credit growth, a shift from goods to service driven growth on export markets and a fading 'catch-up' effect mean fewer tailwinds to growth.
- The Chinese economy is slowing down, whereas the US is set to gain pace this year.
- As the centre of gravity of the global economy moves to the US, we believe the tide is turning for USD/CNY

China – Surge , Pause and Surge

- Since reaching a record high on February 18, the CSI 300 has fallen 15%, while the SSEC is 8% below a 5½-year high also touched on February 18 mainly on worries over monetary tightening .
- After a meeting with major lenders to discuss expectations for credit growth in 2021,PBoC said that monetary policy should remain “neutral” since “the recovery of the real economy is not yet solid and weak links still need to be adjusted,”
- Post this assurance, Chinese stocks recorded a weekly gain and a strong northbound Stock Connect inflows from Hong Kong boosted sentiment as well.
- Beijing depends on China’s property bubble for revenue and has been managing it by keeping a lid on inflation .
- Yuan's soft peg to the dollar implies that the hardening US yields impact China’s asset prices. Hence Beijing appears to be serious about managing China’s property bubble. Tightening measures have been put in place to cool the market.
- If the past pattern persists, tightening will continue until worries about economic growth dominate again.
- This surge-pause-surge pattern has defined China’s property market for the past two decades

UK Economy : Dissipating Strength

- Despite a vaccine rollout that has been even more impressively fast than in the US, the UK economy will take much longer to return to its pre-pandemic level, and the recovery path is remarkably similar to that of the Eurozone.
- This is due to two factors:
  - A much weaker starting point, with the strictest and most prolonged lockdowns of any major advanced economy
  - A very cautious reopening plan, seemingly driven by a desire to avoid past policy mistakes, and in particular the premature easing of restrictions last December.
- The net effect is that both the UK GDP is expected to return to their pre-pandemic level only in Q2/Q3 2022
- UK can see light at the end of the Covid-19 tunnel but the economy will never fully return to its pre-pandemic pattern .

EMFX : Dependence on China

- Positive EM sentiment is fading as commodities are levelling off and dollar yields have been rising. The better part of EM strength against USD is beginning to end.
- Asian currencies as well as South African rand have performed strongly since the start of the pandemic, driven by Chinese policy support, which fuelled both manufacturing orders (helping all manufacturers) and industrial metal prices (of which ZAR benefitted).
- However, Chinese manufacturing cycle appears to have peaked . This has become increasingly clear in both the macro data as well as stronger USD versus Asia.
- Strong US data would be seen as a negative for Emerging Markets as rising dollar yields force EM to either hike or face FX pressures

India : Mixed undertone -1/2

- While RBI Governor said RBI is unlikely to lower its growth forecast for next year, analysts have actually raised the forecast in recent days. Fitch Ratings scaled up its GDP growth forecast by 180 bp to 12.8%. However, it now expects "milder growth" in Apr-Jun
- According to the recent currency and finance report of the RBI, a central bank digital currency–or CBDC, as these proposed instruments are now known–could help promote financial inclusion through direct benefit transfers and direct public consumption to certain goods and services, acting as a direct instrument of monetary transmission. Further, should the central bank digital currency be interest bearing, it can increase the economy's response to policy rate changes .
- India's exports during March 1-14 up 17% at $14 billion: India's exports grew 17.27 % to USD 14.22 billion during March 1-14 as compared to the year-ago period,. Imports during the period increased 27.77 % to USD 22.24 billion, leaving a trade deficit of USD 8.02 billion.
- WPI inflation was 4.17% in February, higher than 2.03% in January and was led by a rise in fuel and food inflation thereby firming up manufactures' pricing power. The previous high of 4.47% was in Nov 18
- Extending the sharp decline seen in H1 FY2021, gross External commercial borrowings (ECB) approvals eased to USD 10.8billion in Oct-JanFY2021 from USD15.3billion in Oct-JanFY2020. Overall, ECB to decline by USD 20 billion in FY2021 from USD 52.0 billion in FY2020

India : Mixed undertone -2/2

- One year post the nation-wide lockdown, uncertainty related to the near-term outlook has risen considerably. Vaccinations are picking up pace, but if the ongoing second wave of infections overwhelms the population, even sporadic, localized lockdowns will make the recovery sluggish.
- Growth in total financing through bank credit to large industry and services, commercial paper and bonds rose mildly to 5.4% at end-Dec 2020 from 5.3% at end-Dec2019, led by an increase in the YoY growth of bonds outstanding to 11.2% at end-Dec 2020 from 6.7% at end-Dec 2019, as well as, by narrower contraction of CP outstanding (to -12.0% from -16.8%).However, the growth of bank credit to large industry and services (to +2.5% from +7.3%) declined sharply during the period.
- The non-food bank credit growth increased to 6.6% from (6.1% in 2020),amidst improved credit flows to MSMEs under the Emergency Credit Line Guarantee Scheme and signs of recovery in the economy. Similarly, deposit growth rose to 12.1% from 9.0% given subdued discretionary private spending, as well as a preference for liquidity
- 10-year G-sec yield declined to 6.14% today from 6.18% -accordingly, the spread between the 10-year SDLs and G-sec narrowed considerably to 69bps on March 23, 2021 from 97bps last week

Nifty : Weaker bias

- The confluence of domestic negatives continues and the synchronicity with US equity markets is less likely from here on and the global cues would only have muted impact
- Conviction was clearly lacking in the intraweek up move, which eventually resulted in a sharp decline thereafter. However, similar to the previous week, this Friday too brought some positivity back .
- Key support is visible at 89 EMA 14160 and the 78.6% retracement of the up move from 13596.75 to record high of 15431.75. So long 14875 resists,, the short term trend remains bearish.
- Truncated Week amidst fiscal close – 13880 14440