

## Hot in the city

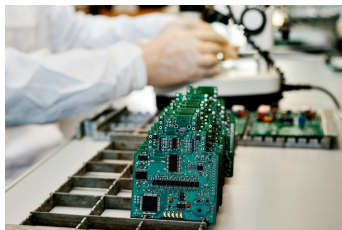
Analysis of next week's climate summit leads the pack of our top stories this week. Something else that's hot? Bonds. We look at why market rates are falling while the US economy is booming. The East-West divide as far as Covid's concerned is the theme of our podcast. And fancy a hard-seltzer? It's the next big thing for the drinks' sector

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China

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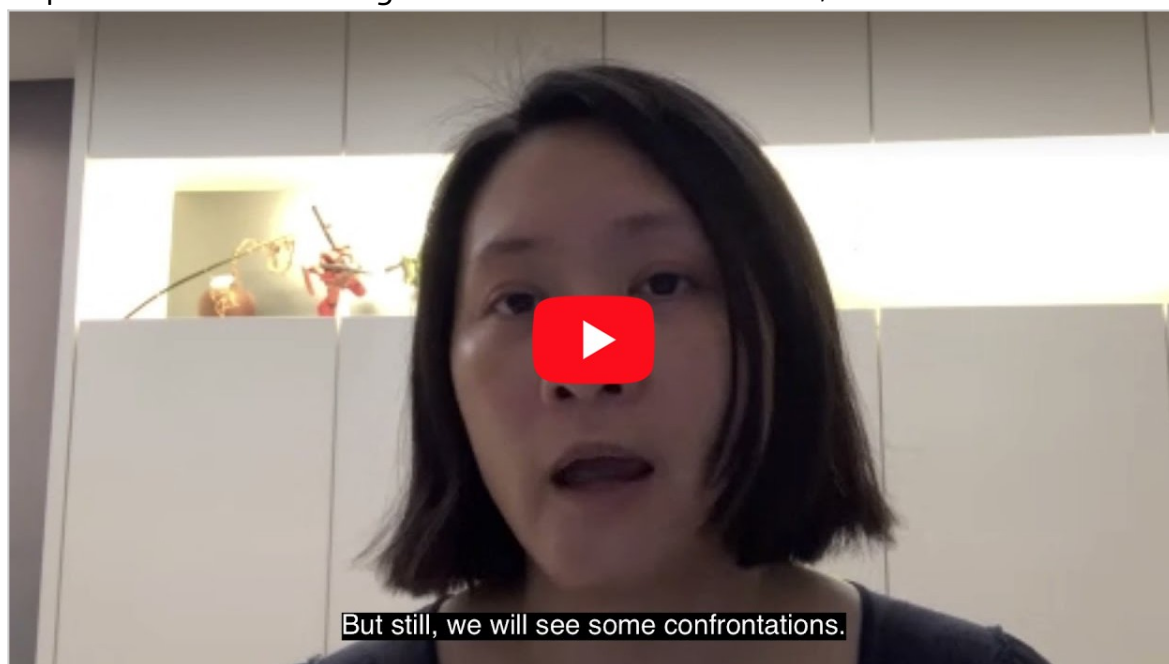
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## Pang: Agreement on climate action between the US and China is closer

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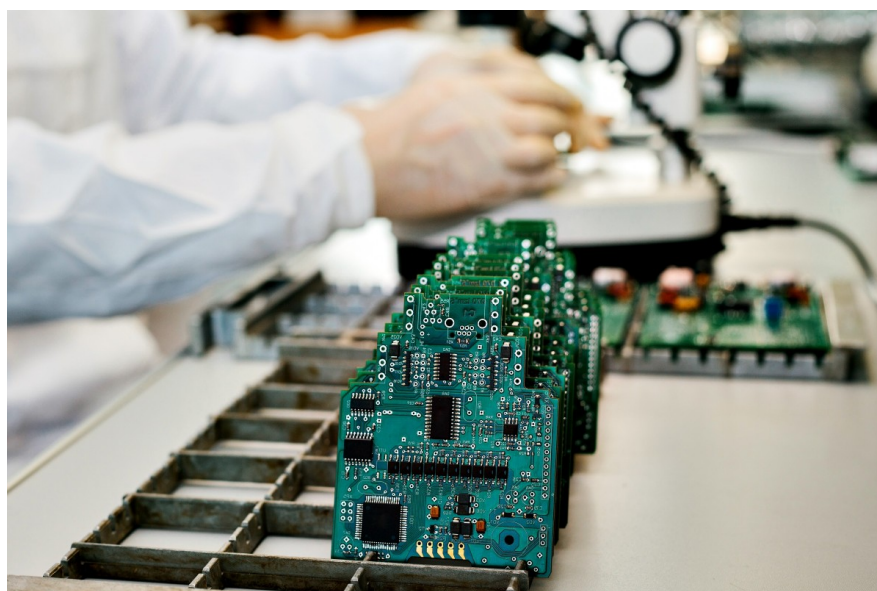
### Agreement on climate action between the US and China is closer

Next week's global climate summit could see some crucial breakthroughs between the US and China, according to ING's Iris Pang. Iris believes that China is committed to its 2060 net-zero carbon emissions targets and more wind and solar are coming online. Yes, there'll be confrontations and disagreements on various issues. But there's a sense that the mood has changed since the angry exchanges we saw the last time the two countries met in Alaska last month.

[Watch video](#)

## China: forget the super fast GDP growth, focus on chip shortage

High GDP growth in 1Q21 was a mix of base effects and genuine recovery. Without such base effects, China's GDP growth will appear more moderate over...



### Don't be overwhelmed by the high GDP growth figure

China's GDP growth was 18.3%YoY in 1Q21, our estimate was 12%YoY, which was the lowest estimate among economists in the survey, the highest estimate was 22%. The apparent strength of these figures relies on powerful base effects from last year's first quarter (-6.8%YoY in 1Q20). A slight difference in GDP levels estimates results in very different %YoY outcomes, so it is not appropriate to get overwhelmed by what looks like a high growth data release.

Apart from base effects, there was some recovery of activity in the Chinese economy. But again, we need to read those growth numbers with caution.

### Chip shortage is a risk to investment, production, exports and domestic sales.

- **Fixed asset investments** in 1Q21 (25.6%YoY in March) were dominated by railway infrastructure (66.6%YoY YTD) and technology-related investment (40.4%YoY) aimed

at improving cross-city / cross-province transportation networks and building faster momentum in technology R&D to achieve technology self-reliance. This will continue. We expect investment in technology to keep going as this is still important for China's future growth. But chip shortages may delay the process of both digital and transportation infrastructure.

- **Industrial production** (+14.1%YoY) was moderate compared to other activity measures due to slower export demand for clothing, slower production of smart devices (which could also be due to chip shortages), and tighter anti-pollution policies on commodity refineries.
- **Retail sales** (34.2%YoY) continued to recover well. Catering (+91.6%YoY), which is still affected by social distancing measures, has recovered to pre-Covid level. As international travel is still restricted and consumers are compelled to spend within China. We have to keep in mind that once international travel re-open, Chinese households will spend on overseas trips again, and domestic sales on luxury items could return to a lower level. Chip shortages could also affect retail sales.

## Looking forward: moderate growth, China-US relationship, chip shortage, monetary policy

There are several points we would like to highlight for the rest of 2021 on the Chinese economy.

1. The high GDP growth in 1Q21 will not persist over the rest of the year. Most quarters should experience moderate growth because without base effects to swell the comparison, "super-high" growth will be very hard to repeat. Quarter on quarter growth rates should continue to stabilise between 1% to 2%. Domestic consumption will continue to be the stabiliser of the economy, and digital infrastructure investment will be the backbone of future growth.
2. China-US relations will be critical for China's economic growth, mostly in technology development. It is likely that the US will continue to put more pressure on China on this topic.
3. Concern about chip shortages is becoming a practical issue for businesses, from investment to production to exports and domestic sales. How long this bottleneck will take to clear is unclear.
4. We don't think there will be any tightening of monetary policy. The central government has restarted deleveraging reform focusing on the weak cash flow of real estate property developers. So, there is room for a relaxation of monetary policy. Moreover, as the economy is recovering, too relaxed a monetary policy stance could induce asset bubbles rather than boosting investment in the real economy.

## Forecasts

Our GDP forecasts are 5.5%YoY, 5.0%YoY and 5.5%YoY for 2Q21, 3Q21 and 4Q21 respectively.

And therefore, the full-year forecast has changed to 8.6% from 7.0%.



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Podcast | 16 April 2021

## Listen: Covid's East-West divide

In Asia, second and third waves of the coronavirus are raging in some countries, with India reporting more than 200,000 new cases in its latest figures....



With some notable exceptions, Asia has handled the Covid crisis better than the West, [with far fewer cases in total, and many fewer casualties](#). This week, the IMF raised its forecast for the Asia-Pacific economy overall, calling for it to expand more than 7.5% in 2021. [In this podcast](#), Rob Carnell, Head of Research, Asia-Pacific, tells Senior Editor Rebecca Byrne, what the continent has been doing right and what it means for the region's economy and markets this year.

### Authors

#### Robert Carnell

Regional Head of Research, Asia-Pacific  
[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)

#### Rebecca Byrne

Senior Editor and Supervisory Analyst  
[rebecca.byrne@ing.com](mailto:rebecca.byrne@ing.com)

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Opinion | 15 April 2021

## Here's why US market rates are falling

A US economy littered with super-buoyant readings would typically place upward pressure on market rates. That is clearly not what is happening right now....



### It's supposedly a booming economy, but rates have been falling of late - why?

Some have argued that the prior rise in market rates was aggressive enough to fully discount the realized data. Maybe. Others have pointed to more recent instances of volatility, stretching from the Archegos collapse to Turkish central bank complications to the Covid crisis still gripping Brazil/India to the more recent upping the ante on US sanctions on Russia. Perhaps. These are certainly arguments that explain why market rates could fall. But surely we need more.

The absolute level of the US 10yr yield at around 1.5% is significantly deviant from a likely 10% nominal expansion in the US economy this year. And if that was not enough, within that 10% there is a 3-4% inflation experience to come. Bond markets hate inflation, as bonds pay fixed payments that get quickly eaten up it. The typical reaction to a spurt of inflation is a spurt of higher yields as bond participants demand more protection for their real returns.



## The demand for bonds and realized negative total returns are factors

Which bring us to one explanation for why yields are remaining so low. Simply put, there is remarkable demand for bonds, all the way from US Treasury auctions that were snapped up last week, to primary deals right out the credit curve that get gobbled up on a routine basis. This is partly a consequence of the Fed pitching front end rates at zero and the generation of excess liquidity. Cash has to go somewhere, and it can't all go into equities.

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*We see strong fixed rate receiver interest, where corporates look to lock in high positive carry and super low funding.*

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The lure of 1.5% in the 10yr is not nothing. We see this in fixed rate receiver interest, where corporates look to lock in high positive carry and super low funding, while getting paid a much higher rate (equivalent to being long bonds).

What makes this a tad unusual is that 2021 is likely shaping up to be an official bear market for bonds. These are quite rare; there have been just four in the past four decades (2013, 2009, 1999 and 1994). The worst saw negative returns of 3.6% in 2009, closely followed by -3.4% in 1994. Currently US Treasuries are running on negative returns of -3.7%. And it was much worse, before the recent fall in yields.

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*We are already at the worst to total returns for bonds seen in the last 40 years, so is enough enough?*

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There is an argument that the bond market feels compelled not to deviate too far from the prior annual negative returns experience.

Even the bond market rally of 8% in 2020 is not dramatic enough to warrant the biggest bear market in modern times (in 2021); 8% is high, but there have been 9 occasions on the past 40 years when total returns were higher, and typically double digit. And then they were not always followed by a bond bear market.

## Another route is to question whether there really is inflation, or is it just a base effect

Another theory is the spurt we are seeing in inflation and growth just takes us back to where we were and makes no guarantee on the future. So, when Covid struck there was for example a collapse in hotel room prices. As we move forward prices rise back to where they were, officially registering inflation though a negative base effect.

There is a perfect storm here where price falls happened practically bang on a year versus price rises, making the inflation spurt look exaggerated. And if the aforementioned hotel room prices

simply return to their previous state, and then stay there, well then there is in fact no inflation.

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*Is there in fact no inflation at all, just base effects. And we're left with something rotten in the macro system?*

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Then the argument goes that something remains rotten in the macro system; a similar feeling to the one had in 2019 (pre-Covid) when the market anticipated recession. The difference here is we are not anticipating a recession, as we have just had one. But that does not mean there can't be question marks about where we will be in say 2023? Making bold macro calls for 2021 is easy, but after that?

## **Real rates have turned deeper negative again - not great bond market signaling**

This is where the messaging from real yield space comes into its own. For a long time we've been uncomfortable with the notion of a full blow deflation ahead of us while at the same time the 10yr real yield trades deeply negative. So when it rose from -1% to -0.6% in February, that made sense. And indeed, it would have made sense for it to continue to de-negativize. But that is not what has happened. In fact, in recent weeks it has drifted back down to -75bp.

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*When you see a negative 10yr real yield it does not tell us anything positive about the future.*

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The correlation between the real rate and real growth is quite poor, because the a high real rate is often used to dampen real growth, and vice versa. But theoretically, a long-term positive real rate co-exists with long-term real growth in productivity, and by extension in economic growth. So, when you see a negative 10yr real yield it does not tell us anything positive about the future. It is a stimulative rate for sure (as it's practically 1% below implied inflation). But the signal it emits is not good.

There are structural issues that can be put forward to negate some of this negative thinking. One is the Federal Reserve has a massive markets rates reduction effect through it's bond buying program, and even when the Fed eventually tapers its purchases, it has still taken a huge chunk of the available securities away from investors, maintaining downward pressure on rates.

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*The Federal Reserve is a factor. Zero front end rates and a bond buying program; both act to bully market rates lower*

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This filters all the way down to real space through both crowding out and the need to price in a sensible implied inflation breakeven. This is a key area to keep an eye on, like lifting the hood to

take a closer look at the workings.

## But we are still looking through this as no more than a tactical test lower

So where does this leave us?

Our considered judgement sees this downdraft in market rates is a tactical a test of the downside; one that will by definition reverse. We still hold to a reversion towards a 2-handle for the 10yr as a 2021 view.

However, we are not blind to what is happening, and we are watching real yields carefully, and indeed the curve structure (e.g. the still rich 5yr is a bond bullish signal), as bond markets are a shrewd predictor of the future.

We view fixed rate receiver interest for exceptional carry as a viable tactical explanation, we'd throw in the big negative returns already suffered, alongside strong demand for fixed income. And we also have to acknowledge that zero front end rates force cash out the curve, helping to richen that belly area. Add in the impact of the Federal Reserve as a vanilla but persistent big buyer of bonds.

These are not all new, accepted. But at times they can gel to produce what we have seen in the past few weeks, and it can persist as the test continues.

### Author

**Padhraic Garvey, CFA**

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

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Article | 16 April 2021

## ECB preview: Silence is golden

To use the ECB's language - the risks to next week's meeting are tilted to the downside, so very little to gain, only to lose. And even if we...



Source: Shutterstock

ECB President Christine Lagarde in Brussels

After all the excitement ahead of the March meeting and speculation about how the European Central Bank would react to higher inflation rates and bond yields, it took a while for the ECB to communicate its reaction function. Almost six weeks later and after several speeches, interviews, blog entries and minutes later, the ECB has finally brought clarity.

In short, the ECB will look through any temporary increases in headline inflation and will not accept any increases in bond yields unless they are the result of improved growth prospects. The front-loading of asset purchases was meant to support this view.

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*In short, the ECB will look through any temporary increases in headline inflation*

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With clarity on the reaction function and very little news on economic and inflation development since the last meeting, next week's meeting should be an unexciting one. The ECB should try to bridge the time to the June meeting without any new communication accident. In June, the

eurozone should have seen some reopenings, there will be new staff projections and the ECB will reassess the pace of its asset purchases.

If the positive and optimistic vaccination and economic scenario play out over the summer, there will be calls to bring the pandemic emergency purchase programme to the planned end in March 2022. In exchange, we could see the ECB stepping up the traditional asset purchase programme. Moderating this rotation in asset purchases, while at the same time reducing the monthly pace will not be easy as fears of a taper tantrum could return easily.

Consequently, the ECB will have to avoid getting involved in any such discussion in public. There is very little to gain from such a debate, only to lose; in the form of turmoil and the so-called unwarranted tightening of financing conditions. Therefore, instead of a long press conference with holistic, multifaceted upstreams and downstream, the ECB could simply play an evergreen song from the Tremeloes next Thursday.

## Implications for rates: It's all for real

The debate about the ECB's reaction function has spotlighted real rates as a key metric (among a range of other indicators) to assess how supportive monetary policy is.

Also, their relevance extends not only to economics and ECB policy but also to risk appetite in financial markets. In short, the lower real rates are, the more of an incentive investors have to chase returns on other markets.

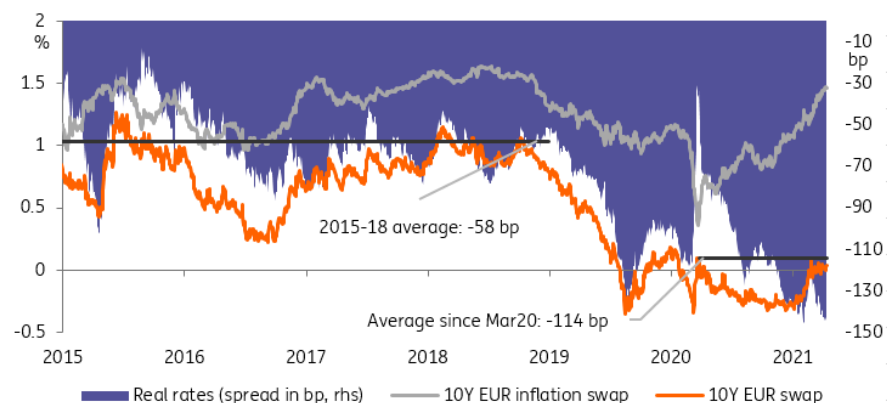
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*The debate about the ECB's reaction function has put the spotlight on real rates*

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Put in historical context, the -140 basis points in negative rates currently prevailing in the eurozone (using as an example the difference between 10-year EUR inflation swap and 10-year EUR nominal swaps) are close to a record low. For comparison, they averaged -58bp in the first four years of quantitative easing (2015-18) and -114bp since the launch of PEPP, the ECB's new asset purchase programme in 2020.

## EUR real rates are near record lows despite the imminent recovery



Source: Refinitiv, ING

This current state of play results from rising inflation expectations, with 10-year inflation swaps just shy of 1.5%, while nominal swap rates have remained relatively contained around 0%. Barring a major accident on the road to recovery, we find it difficult to envision inflation swaps falling materially this year, especially taking the US recovery into account. This suggests that at most, the adjustment higher in nominal rates we're expecting for the rest of the year, by roughly 30bp to 0.35% in 10Y swaps, will bring real rates to -110bp.

*Our forecast for higher EUR rates this year, is relatively benign*

By all account, this would still be extremely accommodative levels for the economy. This would also provide a tailwind to asset valuations across financial markets. This also goes to show that our forecast for higher EUR rates this year, is relatively benign, and not something that would keep the ECB up at night.

### Author

**Carsten Brzeski**

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

# Why banks need to pay attention to where a digital euro is heading

The European Central Bank makes clear that the development of its “digital euro” will take several years. Yet given the geopolitical context...



This week, the ECB published an [overview](#) of the consultation responses it received on its digital euro survey.

The results show a variety of demands a digital euro would need to fulfil, including privacy, security, low costs and ease of use. Before discussing the ECB's next steps, it's worth recapping how we got here.

## From tech gimmick to must-have in a few years

Central bank digital currencies (CBDC) discussions were mostly academic when bitcoin appeared on stage.

Back then, technical aspects of blockchain and monetary aspects of running a currency in a decentralised context drove interest. Central banks were comfortable discussing pros and cons in a non-committal way, and experimenting a bit, as it all remained a rather abstract discussion. A few central banks went further exploring specific use cases, such as the Swedish Riksbank facing declining use of physical cash.

*The prospect of a private stablecoin pushing central banks into irrelevance turned into a real possibility*

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This all changed profoundly when Facebook launched its ideas for a global stablecoin (Libra, now called Diem) back in 2019. All of a sudden, the prospect of a private stablecoin crowding out fiat currencies and pushing central banks into irrelevance turned into a real possibility, given Facebook's vast global user base.

The response was two-pronged: on the one hand, strong pushback against Libra/Diem, which subsequently watered down its plans considerably. On the other hand, central banks such as the ECB started to look into CBDC more seriously. Around the same time, it became clear that China had been quietly working on its own CBDC (called DC/EP) at least since 2014. DC/EP pilot projects were launched in 2020, and there are persistent rumours about a broader rollout, perhaps in 2022.

## □ Digital currency as tool in global power play

For Europe, it is important to understand the geopolitical context in which the ECB is considering the digital euro. There is a widely shared concern among policymakers about Europe's dependence on foreign big tech platforms and Europe's "strategic autonomy". There is a lot to be said about both, but the euro and digital payments have been identified as an important factor reducing foreign dependence and strengthening Europe's role in the world.

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*China and Europe share a wish to become less dependent on the dollar for international payments.*

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China and Europe share a wish to become less dependent on the dollar for international payments. As for the former, the DC/EP might be an instrument to achieve this, though its focus is mostly domestic. Next to DC/EP, China has been developing its Cross-border Interbank Payment System (CIPS) to facilitate renminbi payments since 2015. The PBoC joined the Multiple CBDC (mCBDC) Bridge project, which explores multi-currency cross-border payments on a Distributed Ledger Technology (DLT) infrastructure.

## □ Different goals, different solutions

In this context, and faced with these developments, it makes sense for the ECB to explore its options for a digital euro. Simultaneously, a multitude of goals is a problem for the digital euro project because different goals may require very different, and even conflicting, design choices.

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*Different goals may require very different, and even conflicting, designs*

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Building a digital euro to bolster the international role of the euro requires an infrastructure that is



accessible by foreign institutions that can settle large-value payments and allows easy exchange with foreign currencies. Applying the appropriate lingo requires a multi-currency wholesale CBDC solution. But building a digital euro for small domestic retail payments, on the other hand, may require an infrastructure that is interoperable with existing point-of-sale terminals and a variety of digital platforms, works offline too, and has guaranteed user privacy while preserving transaction monitoring to avoid money laundering and terrorist financing.

An overarching condition for any CBDC solution is that it does not destabilise the financial system by draining commercial bank deposits in unpredictable ways.

## □ Where we're heading

It is far from certain that a single digital euro solution can satisfy all of these different requirements. Rather, different solutions may need to be considered for the different goals. Projects by other central banks and private parties typically distinguish domestic retail oriented use cases (like the Riksbank's e-krona) from cross-border, large value and cross-currency ones (like mCBDC and its predecessor project). It is not entirely clear yet which direction the digital euro will take, although it appears to move more in the retail direction. That said, we expect the ECB to keep an eye on the geopolitical context as well, which means the wholesale cross-border direction is not out of scope yet.

Another important distinction to make is that between the payment *method* and the underlying *currency*. The digital euro as a currency could be incorporated into existing payment methods. If payment schemes can [incorporate bitcoin](#) in their offering, adding a digital euro will surely not be a problem. If the ECB wants to offer the digital euro as a solution where payments data are never processed by private sector players, as Panetta suggested, then launching it as a currency only is not enough. The ECB may also have to develop its own payment method as well -- or at the very least, it will have to regulate payment processing by private parties strictly.

## □ Why banks should pay attention to the ECB's next steps

In a European Parliament hearing, ECB Board Member Fabio Panetta has indicated that a formal decision will be made over the next few months to start a formal investigation phase. Taking about two years, this phase would "carefully analyse possible design options and user requirements". Only on the conclusion of this phase, so in 2023, the ECB would decide on the design. The next phase, taking "several years", would include actual testing and live experimentation. And only after that, the ECB would take a go/no go-decision. The ECB has indicated that this will not be before 2025.

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*A digital euro might have a strong impact on the structural availability and cyclical volatility of deposit funding*

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While this looks far off, banks should continue to pay attention. A digital euro might have a strong impact on the structural availability and cyclical volatility of deposit funding. We do not expect the ECB to allow a digital euro to blow a hole in commercial banks' balance sheets, but the discussion about what is needed to avoid this is still ongoing. Moreover, a digital euro would pose new

challenges to the relationship banks want to maintain with their clients, on top of the already intensifying competition by fintech and big techs.

Non-bank service providers might also offer a digital euro wallet. In combination with adjacent policy developments such as payments data sharing under the Payment Services Directive 2 and forthcoming Open Finance, as well as the increasing popularity of cryptocurrency and growth of “decentralised finance”, banks may increasingly have to ask themselves how they may serve their customers’ future needs, and how they can distinguish themselves from their bank and non-bank competitors in doing so.

## Russia: Bracing for new sanctions

The US is reportedly about to announce a new round of Russian sanctions that may involve sovereign debt, prompting a negative reaction in the local FX and...



US media [reported](#) that the Biden administration may announce today wider Russian sanctions involving both diplomatic measures, such as the expulsion of diplomats, and a ban on the participation of US financial institutions in the primary placement of Russian sovereign debt. Presumably, the sanctions would be a response to alleged cyber activity, election meddling, and threats to US soldiers in Afghanistan. Sanctions related to Alexei Navalny's chemical poisoning are not covered and are to be announced before 2 June. It remains unclear if US banks or all individuals would face the ban, and if the rouble section of sovereign debt (OFZ) will be targeted, but if news reports are true in general and cover all US citizens and OFZs, then this is a negative development for the Russian FX and debt market, at least for the near-term.

The local market has been speculating on the likelihood of OFZ sanctions for several years, and since mid-2020, the perceived risk of sanctions has gone up. Following a series of political events related to Belarus and opposition activist Navalny, as well as the change in US administration and accusations of Russian cyber activity, the RUB discount to EM/commodity peers doubled from 8% to 16%, a two-year high. However, in recent days, a phone call between Presidents Biden and Putin, and an agreement to meet, were taken as a sign of softening in the diplomatic tensions, thus today's news comes as a negative sign for the market.

Fundamentally, a ban on foreign participation in new OFZ issues is not a threat to Russia's financial stability as the state debt is low (around 20% GDP), local banks with \$1.5tr (100% of GDP) assets have the balance sheet capacity to absorb the Minfin placement appetite, especially with the Bank of Russia's refinancing tools available. Year-to-date, Minfin placed \$17bn worth of OFZs amid \$3.7bn of foreign portfolio outflows (as 10-year yields went up over 130 basis points), and will need to place \$31-32bn worth of OFZs (\$850 mln per weekly auction) until year-end to fulfil the annual plan. The latter could be reduced in the event of higher than expected non-fuel revenue collection, which based on the 3Q21 budget fulfillment seems to be the case, however a potential increase in spending following the presidential address on 21 April ahead of the September Parliamentary elections could be an obstacle.

The lack of non-residents would affect prices through reduced demand. In successful years (2015-2017, 2019) non-residents bought two-thirds of the net placement volumes. In 2020, Minfin gross placed \$73bn worth of OFZs, with non-residents buying only \$5bn. As a result, the share of non-resident holdings of OFZs went down from 35% as of March 2020 to below 20% currently.

In terms of the direct effect of the potential lack of foreign portfolio inflows on the balance of payments - it should also be small relative to capital flows exercised by residents. For example, in 2018, non-resident outflows from OFZs were \$7bn vs. \$63bn of private capital outflows by local banks and the non-financial sector. Still, OFZ flows will steer the rouble's direction in the medium term. It is therefore critical to see whether current non-resident OFZ holders of \$37bn decide to dump the paper or keep it as an antique asset, given Russia's strong financial solvency. A full exit of non-residents from OFZs (not a base case) would lower RUB's fair value by USD/RUB 5, but the near-term market reaction could be sharper.

In terms of the potential response by authorities to sanctions against new OFZs, we find additional key rate hikes unlikely. In the event of an administrative ban on foreign participation and possible pressure on Russia's weighting in the bond indices, a higher real rate would fail to increase RUB assets' attractiveness for residents. However, a higher key rate might be prompted if the rouble were to depreciate sharply and this resulted in higher inflationary expectations. A 10% RUB depreciation leads to an extra 0.5-1.0ppt rise in the CPI. Currently, the Russian CPI has peaked at 5.8% YoY and is on track for a gradual deceleration, with the Central Bank of Russia poised to elevate the key rate from 4.5% to the 5-6% range, assuming CPI returns to 4% next year, and GDP shows signs of a strong recovery.

The Russian government and Finance Ministry in particular could react by pulling forward the pre-announced programme of investing RUB1 trillion of FX from the sovereign wealth fund (NWF) into local infrastructure projects, which would potentially lower the amount of FX to be purchased on the market by the CBR by \$4-5bn per year in 2021-2023, providing some support to the FX market.

We would not exclude, however, that the Bank of Russia might consider halting FX purchases to reinforce the balance of payments, similar to the situation in August-December 2018, especially if USD/RUB hits 80, as that level would [correspond](#) to a widening in the RUB's lag to its peers and oil to levels equivalent to the situation of 2H18. The adverse foreign policy backdrop reduces the likelihood that USD/RUB will strengthen out of the current 75-80 range in the near-term.

We also note that the latest news reports have suggested that the timing of US sanctions on Russian debt is uncertain. If the US administration opts only for the sanctions on individuals and entities at this point, RUB downside should be limited, as the market seems to be currently reacting to the sharply rising risk of debt sanctions (which may not come just yet). This would suggest

USD/RUB stays below the 78 level and possibly experiences a modest rebound – assuming no decision on sanctions on debt is made at this point.

## Takeaways from the sanctioning of Eurobonds in the primary market for OFZs

Gauging the potential impact on OFZs we can look at the experience of Russia's Eurobonds. On 2 August 2019, the US administration imposed a ban on US financial institutions participating in the primary market for non-rouble denominated Russian sovereign debt through the second round of the Chemical and Biological Weapons Control and Warfare Elimination Act of 1991 (CBW Act).

This initially weighed on bond spreads (36bp widening for 10yr US\$-denominated bonds in subsequent days) in the secondary market as well but the risk premium disappeared rapidly, given Russia's strong credit fundamentals, which have mitigated the impact from reduced Eurobond issuance going forward while technically, this should also see a gradual reduction in the amount of Eurobonds outstanding over time. Nonetheless, geopolitical risks have continued to weigh on bonds since then, and we note that they have traded wide vs peers in recent weeks.

In the primary market, Russia has been still able to issue Eurobonds, with the sovereign raising €2bn of EUR-denominated bonds in November 2020. The new bonds don't trade with an additional risk premium over outstanding ones, albeit we do not rule out that some US investors have steered clear of the bonds in the secondary market. All in all, the share of non-resident holdings in Eurobonds has however remained stable (55.1% in end-2020 vs 54.9% in mid-2019) while the share of Russian debt in the JPM EMBI Global Diversified index has equally remained largely unchanged (3.4% currently vs 3.2% in July 2019).

For OFZs, this means that new sanctions could very well result in an initial sell-off but unless sanctions also include debt in the secondary market (not our base case), we believe that the impact is manageable. We also see a low risk of index exclusion as long as liquidity and foreign investor access are established, with Russia's country weight in the iShares JPM EM Local Government Bond ETF currently at 6.1%.

### Author

#### Dmitry Dolgin

Chief Economist, CIS

[dmitry.dolgin@ing.de](mailto:dmitry.dolgin@ing.de)

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Article | 15 April 2021

# Asia and the great reflation trade in charts

How Asia compares to the rest of the world in its battle against Covid-19 and its race to recovery

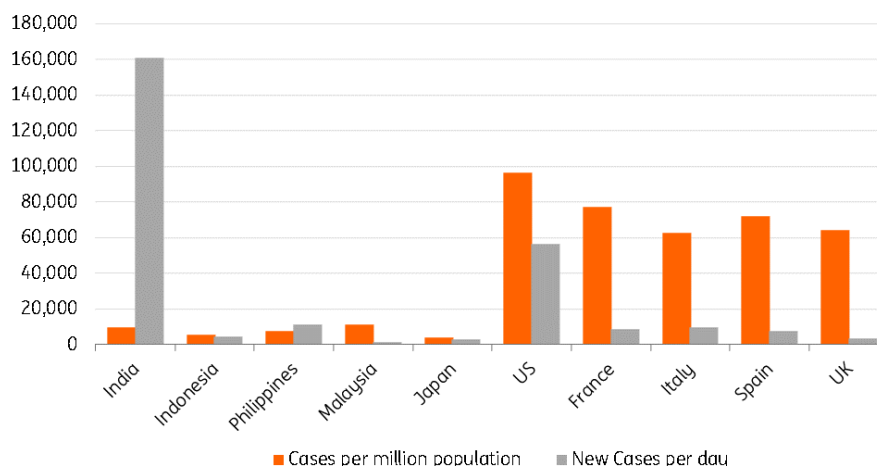


## Pandemic in Asia vs Rest of the World

When it comes to the Covid-19 pandemic, Asia is not doing quite as well as it was, with India seeing a new surge in cases, and Indonesia and the Philippines both struggling to keep case numbers low. But on the whole, the Asia-Pacific region has managed far better than its Western peers, with far fewer cases in total, and many fewer casualties.

However, the hurdle for restrictive measures on movement in Asia is a LOT lower than it is in Europe or the US. And as a result, the impact in terms of the GDP outcome in Asia has not been much better.

## How Asia's worst affected by Covid-19 compare internationally



Source: CEIC, WHO as at 12/04/21

## We may never know why Asia dodged a bullet

We may never have a complete picture of why the Asia experience (with some glaring exceptions) has been better than that in the West. The graphic below is not intended to be definitive. Scientists do think that for example, mask-wearing, as well as reducing the likelihood of infection, [can reduce the severity of cases](#). But [there is still disagreement over the mechanism](#). The only point we wish to make here is to note that Asia has largely seen far fewer cases of Covid-19 as a proportion of the population. The suggestions below may or may not have contributed to that outcome.

## Why has Asia seen fewer cases of Covid? Here are 7 suggestions

- 

**1 Variant type**  
Asia has mainly faced the original variant of Covid-19. Although nasty, it is less infectious/deadly than subsequent variants that have ravaged Europe and elsewhere. Asia is only beginning to see these other variants, catching most of them in quarantine.
- 

**2 Political tolerance for covid-19**  
Asia has a much lower political tolerance for Covid than Europe or the US, demonstrated by lockdowns and restrictions at much lower levels of the infection in their countries. They have maintained these restrictions even as cases have fallen.
- 

**3 Rapid closure of international borders**  
Much of the early European spread came from returning ski-holidaymakers, and then subsequent European summer travel. Asia quickly introduced international travel bans and quarantine and they mostly remain in place.
- 

**4 Climate**  
Although unlike influenza, hot weather and sunlight do not kill Covid-19, this virus does seem to persist better on surfaces in cold, damp, murky climates. This may have provided some protection especially for hot sunny SE Asia.
- 

**5 Mask wearing**  
Mask wearing was normal practice in Asia prior to the pandemic, so no backlash when introduced and not limited to indoors or public transport etc. Not considered an affront to human rights, but a sensible precaution to protect yourself and others.
- 

**6 Cultural differences**  
There may be little truth behind stories of Europeans in certain countries removing masks to "Mwah" each other in greeting. But maybe there is something to this. Bowing in Japan, Korea etc avoids the same contact as even a handshake or fist-bump.
- 

**7 Test Trace isolate**  
Some countries avoided lengthy national lockdowns by rapidly wheeling out efficient test, trace isolation measures. Korea was especially good at this (also Taiwan), building on experience with MERS, requiring minor adjustment to fit for Covid-19.

Source: ING Research

## Following the Covid crash, now the bounce

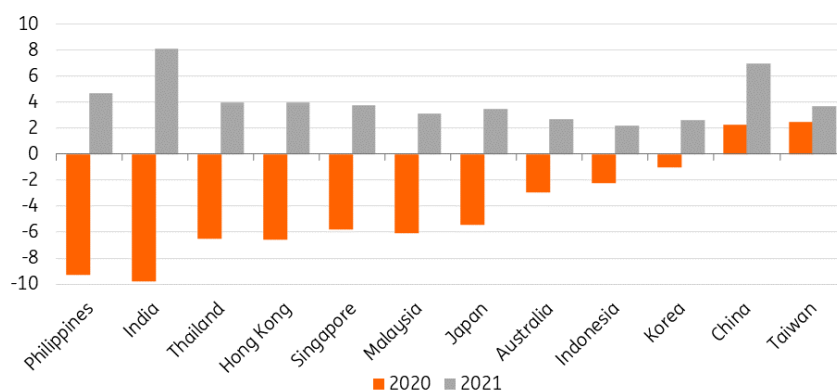
Despite limited cases in most Asia Pacific countries, strict social distancing measures and border closures dealt considerable damage to Asian economic activity in 2020. To a large extent,

economic 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%. But it will show the second-highest growth rate in the region in 2021, according to our own in house forecasts. This 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 economic activity in 2021 will still lag pre-Covid levels will be true for most Asia-Pacific economies, with the exception of Australia, New Zealand, Korea, Taiwan and of course, China.

## 2020 GDP and 2021 ING Forecasts

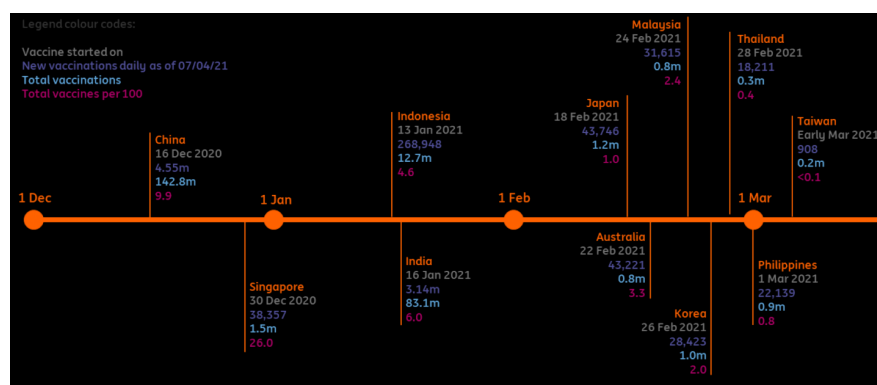


Source: ING Research

## Vaccine rollout is slow

One reason why 2021 growth will not be even higher is that vaccine rollout in the region is proving quite slow. Many countries in Asia only got their first physical vaccines in March. Authorities have not always been quick to authorise vaccines for use. Local aversion to vaccinations is often high, mixed with a sense that with low case numbers, vaccination might not be so urgent. And a mixed history with previous vaccines has meant a slow rollout and slow uptake. As a result, social and movement restrictions have not been relaxed as much as they might otherwise have been. Border controls remain tightly controlled. All of this may have led to weaker growth, though the counterfactual is hard to pin down.

## Vaccine rollout in Asia has been super slow



Source: Local sources, ING



## Asia Vaccine Update

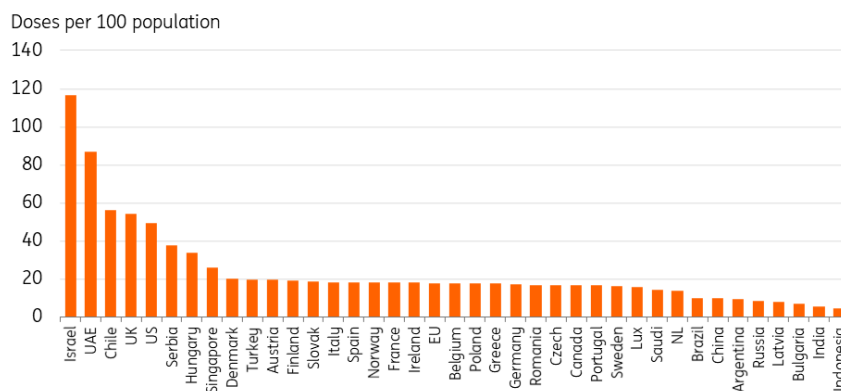
<b>China</b>	<ul style="list-style-type: none"> <li>➤ Beijing city set a target to <b>complete vaccinations for Beijing city residents by May 2021</b>.</li> <li>➤ We expect other major cities to follow suit to set a timelines target for vaccination completion.</li> </ul>
<b>Singapore</b>	<ul style="list-style-type: none"> <li>➤ The vaccination drive started with the front-line workers.</li> <li>➤ It has been extended to encompass 45Y and older population.</li> <li>➤ The planned <b>completion of vaccination drive by late 2021</b>.</li> </ul>
<b>Indonesia</b>	<ul style="list-style-type: none"> <li>➤ The authorities have decided to <b>vaccinate the population between 18-59 years first</b> as it needs to cover two-thirds of total population to reach the herd immunity.</li> </ul>
<b>India</b>	<ul style="list-style-type: none"> <li>➤ One of the biggest vaccination drives in the world started in mid-January.</li> <li>➤ The authorities' <b>aim is to inoculate 22% of total 1.4 billion population by July</b>.</li> </ul>
<b>Japan</b>	<ul style="list-style-type: none"> <li>➤ Japan has been <b>very slow to authorise vaccines</b> due to low public trust in vaccines, and is being very cautious with its rollout.</li> </ul>
<b>Australia</b>	<ul style="list-style-type: none"> <li>➤ The vaccination started with priority population and will be rolled out in stages depending on age and other risks to the rest of the population.</li> <li>➤ Following concern over the safety of the Astra Zeneca vaccine, the authorities are <b>no longer aiming to inoculate the whole population by October 2021</b>.</li> </ul>
<b>Malaysia</b>	<ul style="list-style-type: none"> <li>➤ Vaccination started on 24 February with PM Muhyiddin.</li> <li>➤ The government <b>aims to vaccinate at least 80% of the 32 million population by February 2022</b>.</li> </ul>
<b>Korea</b>	<ul style="list-style-type: none"> <li>➤ The vaccination programme has been delayed due to late arrival of vaccines from Covax, and concern over the Astra Zeneca vaccine.</li> </ul>
<b>Thailand</b>	<ul style="list-style-type: none"> <li>➤ Thailand started its vaccination on Sunday 28 February, with ministers, health officials and medical professionals.</li> <li>➤ The mass <b>vaccination campaign is expected to go in full swing by mid-2021</b> when the authorities plan to administer 10 million doses a month.</li> </ul>
<b>Philippines</b>	<ul style="list-style-type: none"> <li>➤ The first vaccines were given to Ministers on 1 March - Sinovac vaccines donated by China.</li> <li>➤ Legislators are still debating a bill that would grant vaccine producers protection from lawsuits.</li> <li>➤ The government <b>aims to vaccinate 70% of the 110 million population</b> but timelines have varied.</li> </ul>

Source: ING Research

## Global vaccination update - Asia lags the rest of the world

Daily case numbers are low, but in terms of vaccines and opening up economies, Asia lags a long way behind. Singapore is ahead of the Asian pack but broadly in line with the EU. Most other economies in Asia are barely on the scoreboard yet (measures only to one decimal place).

### Vaccine rollout



Source: Our World in data

## 2021 will see "tighter" fiscal policy

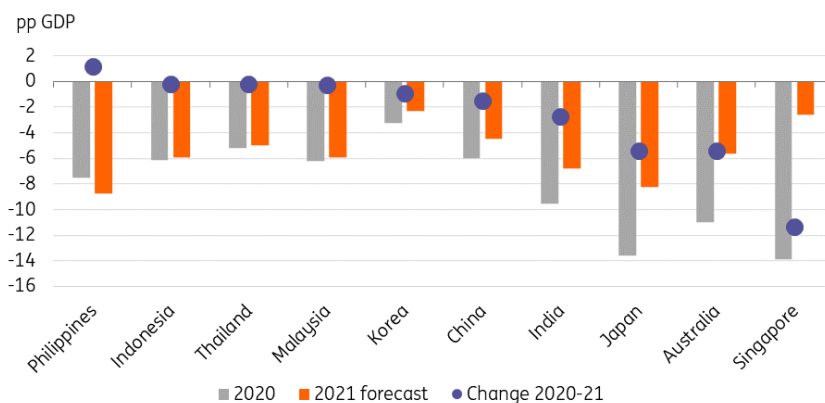
Even as governments try to remain accommodative to support stricken economies, there is no way that the fiscal generosity of 2020 can be repeated in 2021 or beyond. There's no Biden plan for Asia. Fiscal deficits are going to be large but smaller than in 2020. The Philippines is the one

exception to this rule.

Fortunately, not all of this represents a cyclically adjusted primary balance shift- or fiscal drag- to put it another way. But some of it is, and this may eat a little into the 2021 bounce.

Put it another way, there is a penalty for trying to kickstart an economy, which is that this needs endlessly repeating if it is not to turn into a drag.

## Deficits and fiscal "thrust"



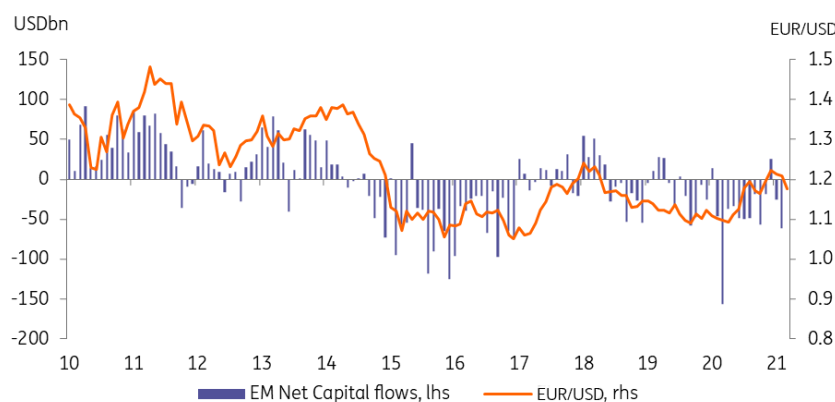
Source: ING Research

## IIF net EM inflow chart resumed outflows in latest published data

The IIF says that capital inflows to emerging markets (EM) were only about \$10bn in March- their latest published data on net flows go to February (show increased outflows).

Outflows would be consistent with recent USD strength, but this is more a flight to the US and USD than a flight out of EM. So far at least, financial markets are remaining circumspect about global deflation, even if they are convinced about the US story.

## EM net capital flows and EUR/USD



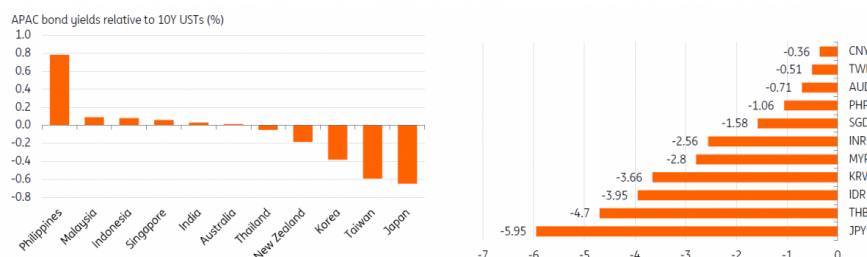
Source: IIF

## APAC bonds and FX since 1 Jan

Bond markets in Asia have not been particularly hard hit as US Treasuries have sold off (yields have risen).

- Yields on local currency bonds in the Philippines have risen the most, partly because the inflation figures there have been disappointingly high (resulting in a very negative "real rate") exceeding the central bank's (BSP) target despite weak growth. But this is mainly a food price effect caused by African Swine Fever. It will not persist, and as inflation dissipates, bond yields should converge to reflect the regional pattern. We do not expect BSP to respond, though it perhaps hampers its ability to ease further (not that there was much expectation for this).
- Again, there is no strong evidence of an emerging market effect at work - increases in Indonesian yields are not much higher than those for the regions' developed markets.
- North Asian (China, Korea, Taiwan) bonds have seen yields rise far less than those of South East and South Asia.
- In the foreign exchange space, the same absence of EM angst is evident, with the Philippine peso outperforming even the Singapore dollar and Korean won.
- The Indian rupee was outperforming in the FX and bond space until the Reserve Bank of India recently introduced a quantitative easing programme.

## APAC 10Y yields (left) and APAC FX since 01/01/2021 (right)



Source: CEIC

## Nominal Effective Exchange rates (NEERs) spreading out

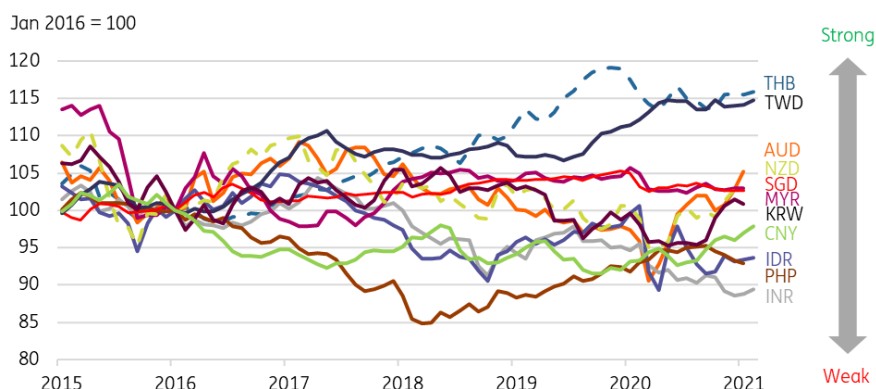
Though most effective (or trade-weighted) exchange rates are bunched in the middle of the pack, there are a few outliers at both ends that could hint at a future correction.

At the stronger end, the Taiwan dollar benefits from equity inflows given the positive semiconductor cycle. That looks set to persist.

The Thai baht is the victim of its huge current account surplus - mainly a reflection of very weak domestic demand. That also looks set to persist.

The Indonesian rupiah, Indian rupee and Philippine peso are all on the weaker side. PHP has held up well in recent weeks with external imbalances contained by weak domestic demand. INR strength has been undermined recently by RBI policy.

## Trade-weighted exchange rates



Source: CEIC

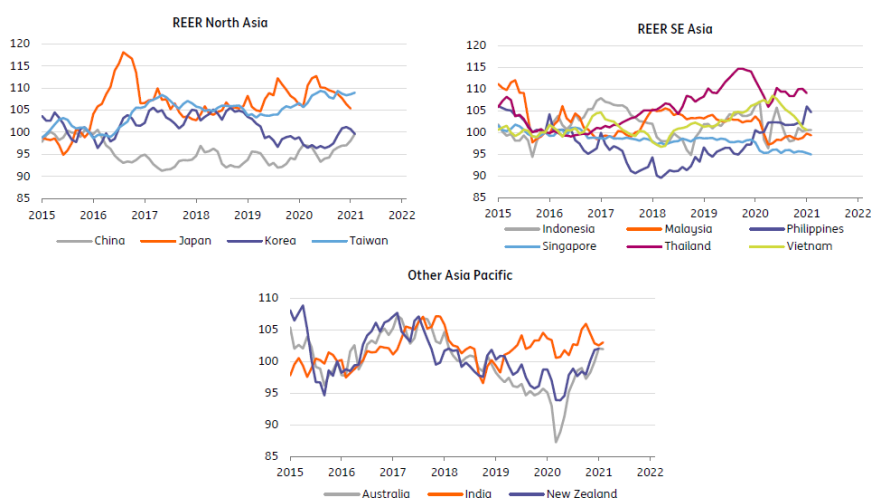
## Real currency rates

Real effective exchange rates - one measure of the competitiveness of a currency - are all quite close to "neutral" levels after the Australian and New Zealand dollars appreciated substantially in recent months.

The Japanese yen and Taiwan dollar are both quite strong relative to neutral REER levels. That could weigh on future export strength, though more likely, it reflects export strength from these two tech-heavy economies.

In South-East Asia, the Thai baht is on the strong side, the Singapore dollar a bit weak, and the rest are unremarkable.

## Real effective exchange rates



Source: CEIC

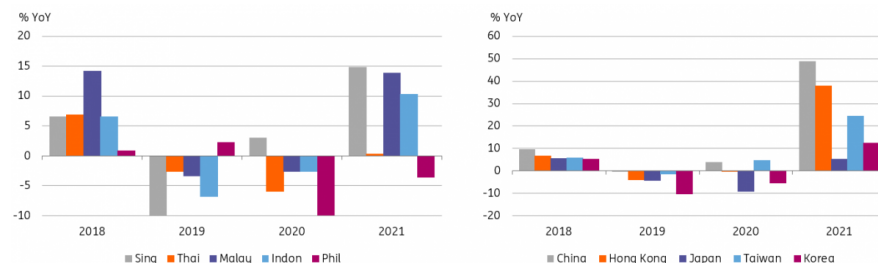
## Trade competitiveness

The export picture looks to be rebounding well, particularly for North Asia, home of the world's biggest electronics manufacturers, though Japan is lagging behind a bit - perhaps reflecting its broader goods export basket. In SE Asia, exports have also recovered well from their 2020 declines,

though for Thailand, this remains anaemic, and the Philippines has not yet joined the export party.

Most of the trade pick-up in Asia is intra-regional. Extra-regional exports are still weak due to Covid in Europe, the US and elsewhere. Strong global demand for semiconductors and other electronics is likely to be driving much of this Asian strength.

## ASEAN export growth (left) North Asia export growth (right)



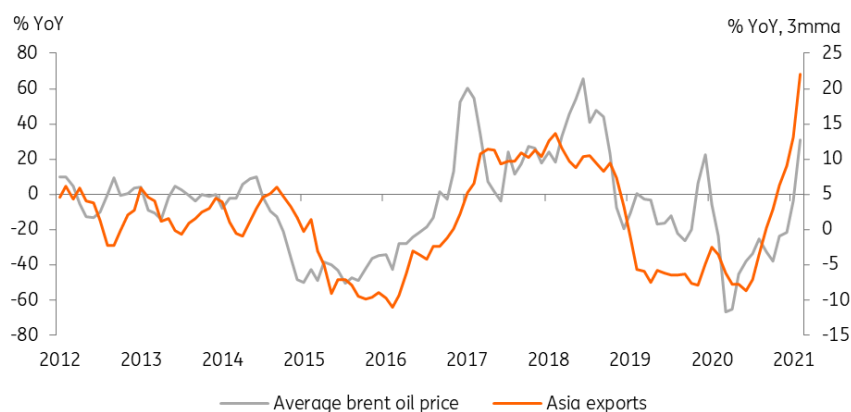
Source: CEIC

## Asian trade and oil

Although correlation is not the same as causation, and both series may represent a broader pick-up in global demand, there could also be a terms-of-trade impact from oil producers to Asian exporters.

Currently, the momentum is strongly positive, and peaks in Asian exports can be extended as we saw in 2017/18.

## Asian exports and crude oil price



Source: ING, CEIC

## Asian Inflation- mainly low, but mostly picking up

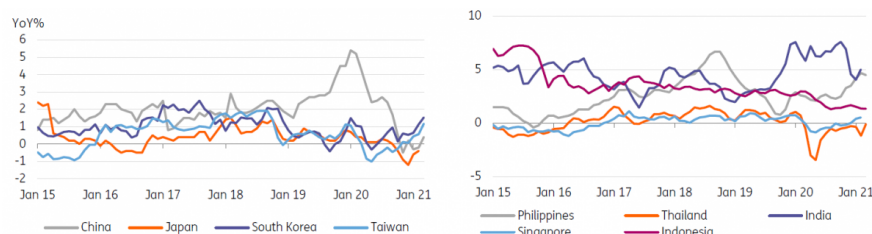
Inflation was battered in North Asia by the pandemic. But the next few months will see a combination of base effects and real acceleration in monthly "run-rates" push inflation higher in year-on-year terms before it eases back again.

Some South Asian economies (especially emerging market ones - e.g. India, the Philippines) experienced rising prices during the initial stages of the pandemic as supply chains were disrupted. Coupled with natural supply shocks (African Swine Fever, typhoons, flooding etc.) this has pushed

up inflation, mainly through food prices.

Such disruptions are temporary, and these will moderate in the coming months.

## North Asia (left) South East Asia (right)



Source: CEIC

## Conclusion

Generalising about a region as diverse as Asia is never a good idea, but with a number of caveats, we feel we can safely make the following observations:

- Asia's pandemic has so far been less widespread than in many other economies around the world.
- But due to aggressive social distancing measures, 2020 GDP growth was still badly hit, though this does set up 2021 for a bounce-back.
- That bounce would be stronger if accompanied by broader reopening measures, but the slow speed of the vaccine rollout has limited this.
- For most North Asian economies, inflation will pick up in the coming weeks and months as base effects from last year start to kick in. But for some South East and South Asian economies, inflation was already running quite high due to the disruptive impact of the pandemic on supply chains as well as food price shocks. These countries will see inflation moderate.
- Central banks will largely ignore inflation spikes.
- The US Treasury sell-off has had a more pronounced impact on bond yields of SE Asian economies and reflects how low real short-term yields have fallen.
- But there is little evidence of a broader emerging market issue arising in either bond or FX markets.
- Asian currencies have lost some ground to the US dollar since the beginning of the year, but strong external positions sometimes reflecting still very weak domestic demand means that such moves have been limited for most.

## Author

### Robert Carnell

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)

# Hard seltzer: The spiked water beverage trend that could be the next big thing

During the summer of 2019, when we were still allowed to enjoy summers, the US was overrun by a new hype: hard seltzer - a carbonated, alcoholic and...



Source: Shutterstock

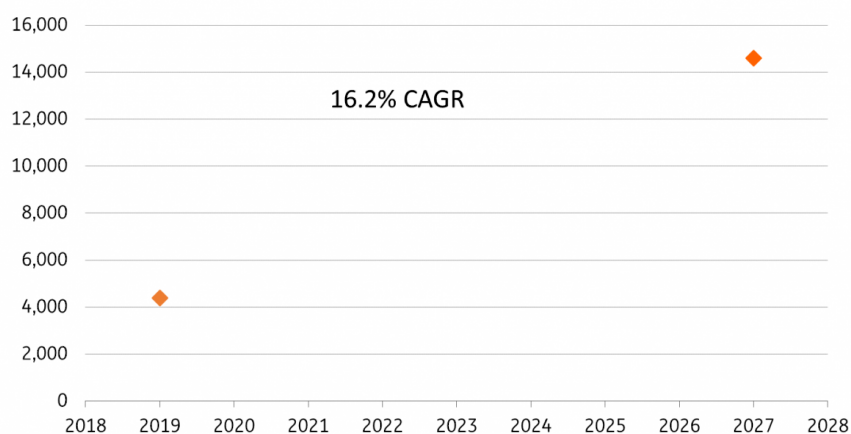
## What is a hard seltzer?

In the US, consumers quickly embraced the hard seltzer drink, but beverage companies initially had some hesitation to bring the concept to other regions.

Part of the reason is that in the US, 'seltzer' is a more commonly used word than outside the US. By now, most beverage companies have either acquired a hard seltzer brand or introduced their own, and it seems that outside the US, consumers are also ready to accept the product.

The global hard seltzer market was valued at US\$4.4bn in 2019 and is expected to grow at a compound annual growth rate of 16.2% from 2020 to 2027.

## Expected growth of the hard seltzer market



Source: Nielsen, ISWR

## A key driver

And we believe hard seltzers are a key driver for growth behind the 'Ready to Drink' category.

Within the ready-to-drink category, alcohol beverages are estimated to grow 3.32% per annum between 2019-2027, and hard seltzers seem to have been a key driver. For example, in the US in 2019, the hard seltzer category accounted for 43% of premixed drinks, according to SWR.

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*In the US in 2019, the hard seltzer category accounted for 43% of premixed drinks*

---

So why is RTD so relevant for beverage companies? Although it sounds almost exotic, a hard seltzer is actually a very straight forward product with a surprisingly similar production process to beer: a hard seltzer is brewed and fermented. However, while in beer, malted grains are used as the sugar content to support the fermentation process, in the process of hard seltzer, it's just sugar or sugar cane. This results in clear alcoholic, carbonated water. Add some flavours, put it in a can and job done.

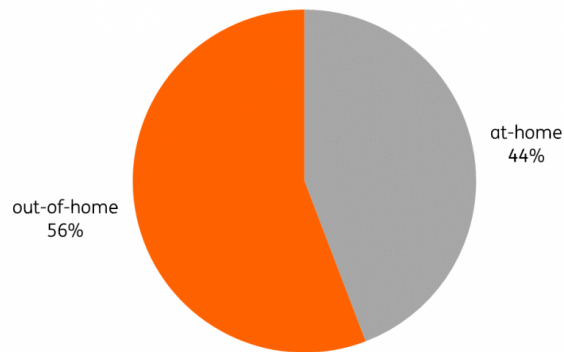
## Indulging is easier, with healthier alternatives

Although, in general, alcoholic beverages are not usually labelled 'healthy', consumers look for healthier and better-for-you alternatives to cut down alcohol and sugar intake. But even those on a health kick, there's sometimes room for a little indulgence. The average can of hard seltzer contains around 5% ABV, 90-110 calories per serving, a low sugar content that ranges from zero to four grams and often hard seltzers are gluten-free.

Also, consumers who don't like the taste of beer or spirits seem to be attracted to the beverage. Younger generations like Generation Z are falling behind in beer consumption, and hard seltzers are a way for beverage companies to tap into this group.



## Hard seltzer sales channels (2019)



Source: Nielsen

### Cannibalisation in craft and premium segments

The majority of hard seltzers are sold in the at-home channel: in 2019, this was 54%, but we expect that sales in the 'out-of-home' channel will grow as consumers choose hard seltzers as an alternative or use it as a mixer.

Throughout 2021, the expectation is that beverage companies will invest further into hard seltzers and look for expansion in new local flavours and different types of RTD beverages, such as spirit or vodka-based. We expect beverage companies, in particular brewers, will face cannibalisation, in particular in their craft and premium segments.

Craft beer purchasers are twice as likely as the average drinker to buy hard seltzer. Given that pricing is fairly similar, a positive price mix impact from higher hard seltzer volumes is limited.

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