

Reflation resurgent?

Despite rising concerns about the proliferation of new variants of the covid-19 virus, markets seem to be focusing hard on reflation, with the 10Y US Treasury yield pushing above 1.30% - this is almost pre-Covid level



Source: Shutterstock

One topic wonder

Financial markets may be a synthesis of all the available information, but typically, seem to incorporate news only one piece at a time. The current theme of that data incorporation is centered on reflation. We have seen inflation expectations rising since late November, but the latest move seems to also be being driven by a return in real yields. That basically means markets are getting more optimistic about economic growth expectations, which is, in very simple terms, what real yields reflect. A 10bp rise in US 10Y Treasuries overnight has taken us a good way towards our house forecast of 1.75% year-end. It was looking non-consensus, but I wonder for how much longer?

With such a big move in Treasury yields so suddenly, bond investors may think about a little pullback before the next move up. Though there is nothing particularly noteworthy on the economic calendar today from the US to drive yields in either direction unless we see a big surprise in the January retail sales figures released tonight, or perhaps PPI data. Neither seems all that

likely.

EUR not liking the bond yield moves

The surge in US bond yields has put more strain on the EUR, and our 1.30 end-of-year call is looking a bit off-kilter this morning as the EURUSD moves back below 1.21. Daily moves in US Treasury yields could be the main influence for the EURUSD over the next few days so if we do see bond yields pulling back a bit, then EURUSD could manage to nudge higher again.

Rising real yields also challenge yield-free dollar-substitutes such as gold, as does a stronger USD, and spot gold has tumbled to \$1790/oz overnight, though the generally positive outlook for growth is keeping oil prices bid, with front-month Brent futures still above USD63/bbl and nosing higher as of writing.

Looking at other markets, European bond yields followed Treasuries, though not even in the 1-for-2 basis point ratio that they often exhibit, with increases of between 3-4bp depending on the issuer, and that doubtless helped the EURUSD currency moves. Yields were more closely matched in 10Y Australia, but that didn't prevent the AUD from coming under selling pressure against the USD, pulling back below 0.78 to the 0.774 area as of writing.

And despite there being a virtual lock on the front end of the US yield curve, we note that distant fed funds futures (December 23) are up about 10bp since the New Year, suggesting that doubt is beginning to creep into investors' minds about the Fed's claim to do nothing until at least 2024. I think they are right to do so.

All these market moves could see some unwinding if US Treasuries show some retrenchment over the next day or two, or if the market decides to switch its focus elsewhere. But overall, this deflation story has legs, and our house view suggests that we anticipate it will run a lot further given time.

Asia today (and a bit of yesterday)

We've already had some Japanese trade data for January, with the main story here being the continued weakness in imports (-9.5%YoY), hinting at softer domestic demand during Japan's numerous states of emergency across a number of different prefectures. Core machine orders figures for December, however, show that business investment finished strongly in 2020, which may well already be reflected in the stronger than expected 4Q20 GDP figures we received a few days back.

Prakash Sakpal has been watching Singapore's non-oil domestic export (NODX) release, also just out, and has this to say, "Singapore's export-led recovery is still in full swing. January non-oil domestic exports surged by 12.8% YoY (+7.0% MoM), which was more than double the market consensus and up from a 6.8%YoY rise in December. This strength occurred despite the pandemic raging in some of Singapore's main export markets and reflected in still large year-on-year declines in exports to the US, Europe and Japan.

By product type, electronics remained the key driver with steady growth of over 13% YoY, though shipments were almost flat on the month. Pharmaceuticals strength returned with a massive 140% MoM surge in the last month, though that was still not enough to pull year-on-year growth into positive territory. We see no reason for the Monetary Authority of Singapore to alter its

neutral policy stance targeting zero appreciation of the trade-weighted SGD exchange rate (S\$-NEER) in its April policy statement".

And Singapore also released its latest budget proposals yesterday, Prakash notes: "As expected, Singapore's Budget for fiscal year (FY) 2021 carried on the expansionary stance aimed at pushing economic growth towards 4-6% this year. A 9% YoY rise in spending on top of 20% surge in FY2020 is met by a more ambitious projection of 19% revenue growth, leaving a fiscal deficit equivalent to -2.2% of GDP (-13.9% in FY2020). Besides the S\$11 billion Covid-19 Resilience Package and additional support for businesses and workers worth S\$24 billion, the Budget also sets in motion the "Green Plan 2030" announced last week. The key initiatives here are enhancing infrastructure for E-Vehicles and making them more affordable, \$19 billion of long-term infrastructure projects to be funded with green bonds, and driving Singapore to be Asia's strategic hub for sustainability and green finance. That said, the overall green thrust appears to be small within the more than 20% GDP equivalent spending programme. More could have been done".

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