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Nordea ASSET MANAGEMENT

MACRO OUTLOOK 2021: Interview with Sébastien Galy, Senior Macro Strategist

Please note the conference call occurred on the 2nd of December 2020. All market commentary and information refer to the period before then.

Key takeaways

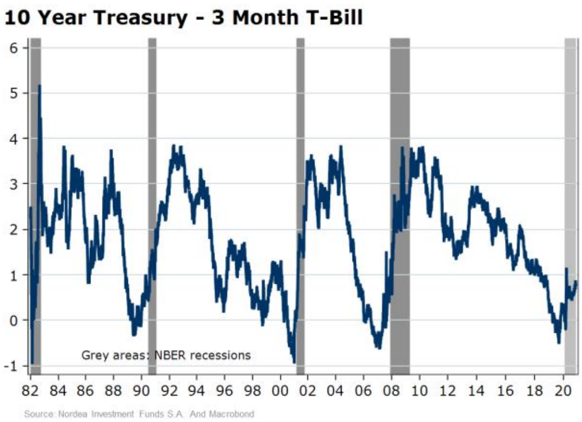
- US curve likely to continue steepening, with some dollar weakness – primarily versus emerging markets.
- China tensions likely to simmer, as China-centric rebound spreads through Asia Pacific.
- ECB monetary policy set to stay easy for the next three years, while EU-UK brinkmanship could spill over into next year.
- We remain focused on the China-led rebound, infrastructure spending, continued regulation and product development in relation to ESG, and the need for flexible solutions.

With major spending plans likely under the new Biden administration, what are your views on the current US fiscal situation?

Biden's plans include a major fiscal package – with $700bn for infrastructure under the 'Build Back Better' plan. It will have an impact on the country's old infrastructure, as well as areas like data centres and decarbonisation. There are also other packages to benefit the middle class and people of lower income, which will result in increased consumption. Nevertheless, the reality is the Senate will likely be held by the Republicans, so the value of the package could be much smaller. However, what we are seeing in the US goes beyond fiscal spending. The US is going to re-join the World Health Organisation and reengage with NATO – essentially reversing course from the Trump administration.

Moving to fixed income, what are you seeing from the US yield curve?

The yield curve is steepening, which is the 10-year yield rising against the front end. It is rising for a multitude of reasons, with the economy doing better as well as the fact people are viewing the deficit in the US – which is about 5% of GDP – as not sustainable. If it is not sustainable, investors require a credit risk premium, meaning the back end of the curve has to move higher versus the front end. This chart shows the 10-year minus the 3-month, which shows a recent reversal - driven by the back end of the curve, as the front end has been fixed. Placing yourself in the shoes of China or Russia, they will require a steeper curve to invest in the US, and a weaker currency. This dollar weakening is good news for investing in emerging markets. It is also creating carry trades, particularly in Chinese fixed income.



Looking to China, while the economy is structurally slowing down, we are seeing a cyclical upswing. Are you positive on the Chinese rebound?

The Chinese economy has been structurally slowing for a number of years. There are many reasons for this – namely its ageing population and its desire to become service oriented. There are also other factors, such as inefficient entities of the state and the credit bubble. However, within the structural slowdown, we are seeing a

*investing for their own account – according to MiFID definition cyclical upswing of the economy – which could see growth hit as high as 8% next year. This is incredibly strong relative to other advanced economies. Consumption has not been weak, but it has not been very strong. This should improve over the next few quarters and support growth, which for now is being supported by exports and infrastructure.

What is your view on China's renminbi currency and the broader investment opportunity available in the country?

The renminbi has been appreciating significantly. As mentioned, while this is partly due to the weaker dollar, you can also obtain higher yields in China for a low level of volatility. The amount of currency risk is moderate relative to the euro/dollar or dollar/yen. Another important element is growth has been strong. Having said this, not everything is a buy. For example, we have seen defaults in some sovereign entities. Of course, if you are going to buy into corporates, a significant amount of research and analysis is necessary. As for equities, Chinese stocks are expensive relative to history on some metrics, but cheap relative to Europe or the US. Also, EM stocks have tended to outperform as the dollar weakens.

Source: Nordea Investment Funds S.A. And Macrobond

Moving to Europe, what do you expect from the ECB meeting next week?

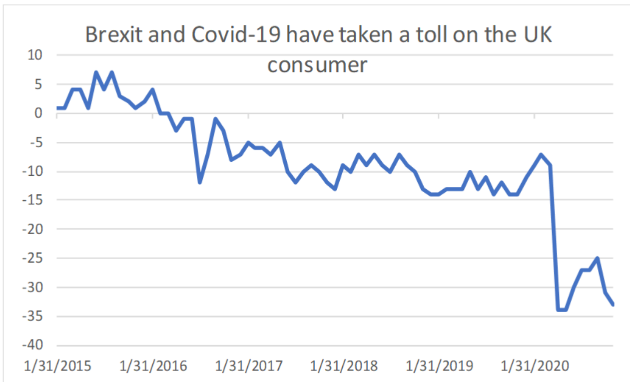
Consensus expects €500bn in additional spending under the pandemic emergency purchase programme, or PEPP. The surprise could be we do not get the €500bn, which would not be welcomed by markets. Having said this, yields in the periphery are incredibly low – so the ECB has essentially won the war. We could also see other announcements, such as a sweetener to the TLTRO.

How are economies dealing with the second lockdown we are seeing across Europe?

Looking back to the first shock, it was incredibly brutal, but very short lived in the case of Germany – particularly as we saw strong demand from China. The current lockdowns are not as stringent as the first one for some countries, so the expected impact is likely to be much smaller.

On the UK, how concerned are investors about a 'no deal' Brexit?

If you look at euro/sterling volatility, it seems the market believes we will see a deal. However, the Covid-19 shock and Brexit uncertainty have been brutal for the UK consumer. If these risks are resolved, there should be a significant rebound in activity in the UK as confidence returns. Having said this, there is talk of a fiscal contraction, which would be deeply unhelpful. On the Brexit negotiations, we have spent about eight months arguing on roughly the same topics – namely fishing and the level playing field. We need to find some form of resolution on these issues, but there is not much time left.



Source: Nordea Investment Funds S.A. and Bloomberg

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