



WEEKLY MARKET RECAP

10 May 2021

Central Banks are preparing to reshape their monetary policies

- As economic growth accelerates, Central Banks will have to calibrate carefully the exit from expansionary monetary policies.
- Efficient communication will play an important part in steering markets and avoiding counterproductive tightening of financial conditions.
- The structure of individual economies and the evolution of the vaccination rollout will dictate the timing for individual countries.

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Last week's Bank of England meeting closed the cycle of monetary policy meetings, confirming that central banks are now grappling with slowing down of largely expansive monetary policies. The main obstacle seems to lie in communicating adequately and effectively this transition to the new phase without jeopardizing the current economic recovery and triggering sudden tightening of financial conditions. After a year of largely synchronized monetary policies, central banks are now facing high growth prospects but asynchronous economic dynamics, dependent on both their economic structure and the vaccination rollout dynamics. Consequently, the exit from ultra-expansive monetary policies will occur at different times and in different ways across countries, potentially being reflected in exchange rate dynamics.

Firstly, on the 21 April the Bank of Canada decided to cut its weekly quantitative easing policies from \$4 billion to C\$3 billion per week. Secondly, last week the Monetary Policy Committee (MPC) of the Bank of England decided to slow its QE purchases from £4,4 billion to £3,4 billion per week, keeping the final target unchanged (at £895 billion, derived from 875 billion of gilts and 20 billion of corporate bonds, voted by a majority of 8 out of 9) and the bank rate at 0,10% (voted unanimously). The Bank of England Governor, Andrew Bailey, tried to smooth over the effects of this decision, stating that the slowdown in purchases is not "tapering" and does not convey any signal about future policy decisions. Still, the statement is contradictory since the decision reduces the likelihood of any future move in a more accommodative direction and, therefore, represents a turning point in monetary policy. The UK's QE program is not open-ended, so in order to reach the target of £895 billion of QE by year-end, some reduction in bond purchases was inevitable. Meanwhile, the MPC substantially upgraded its outlook for the UK economy with both demand and supply marked higher - with less persistent damage to supply than previously seen - but demand initially rebounding faster than supply, now forecasting growth at 7,25% for 2021 and estimating that GDP will reach its pre-covid level by year-end. According to the MPC, households will spend about 10% of the precautionary savings accumulated during the pandemic over the next three years. This additional spending, combined with the boost to activity from the measures announced in the March budget, has shifted the projected trajectory for GDP upwards, which is now higher for the entire forecast period than in the February projection. Regarding inflation, the MPC expects a temporary increase above the 2% target in the near term, driven by higher energy prices and other input costs. However, in the medium term, the inflation trajectory remains about 0,1% lower than the February projection, reaching an annual rate of 1,93% in 2024 Q1.

On the other side of the Atlantic, on the back of its monetary policy strategy review the FOMC kept its stability signal unchanged despite accelerating growth and rising inflation, reiterating its wait-and-see approach, waiting to see a solid recovery in the labor market before starting to talk about tapering. While tapering could be announced as early as the end of this year, the increase in the cost of money will occur no earlier than 2023. Nevertheless, markets expect the first-rate hike in the second half of 2022 and are looking for confirmation in any data and statement that may anticipate the monetary policy changes. This explains the market's reaction to Janet Yellen's statement, which stated that the acceleration of growth due to the large fiscal stimulus may entail that the Federal Reserve will have to raise interest rates. A correction in U.S. bond yields followed and Janet Yellen was led to give an interview to the WSJ in which she reiterated that a rate hike "is not something I am anticipating or recommending" and that the Fed is completely independent and acts as necessary to achieve its dual mandate. The change in tone allowed the US 10-year to return below 1,60%.

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More difficult is the ECB position, grappling with core inflation significantly below its target. The ECB has yet to review its monetary policy strategy and is attempting to stem the rise in government bond yields via correlation and an appreciation of the euro, which could change the inflation outlook in the Eurozone. Last week, ECB chief economist Philipp Lane described the rise in prices as temporary and therefore not worrying, with the aim of taking pressure off nominal yields. The June ECB projections will be an opportunity to discuss the evolution of purchases under the PEPP and the APP, within a Governing Council that seems to disagree on how to adapt the pace of its broadly accommodative monetary policies.

Fig. 1: Central Banks today are faced with high growth prospects and asynchronous economic dynamics...

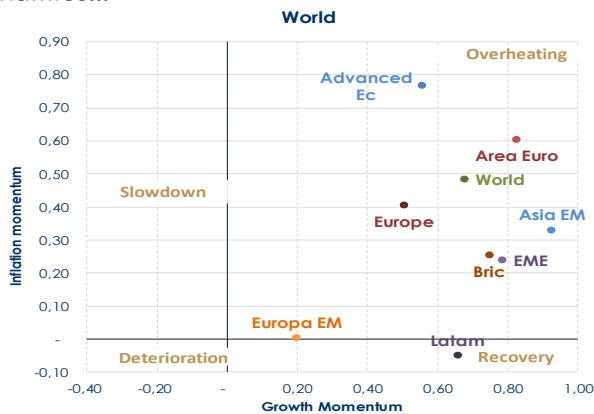
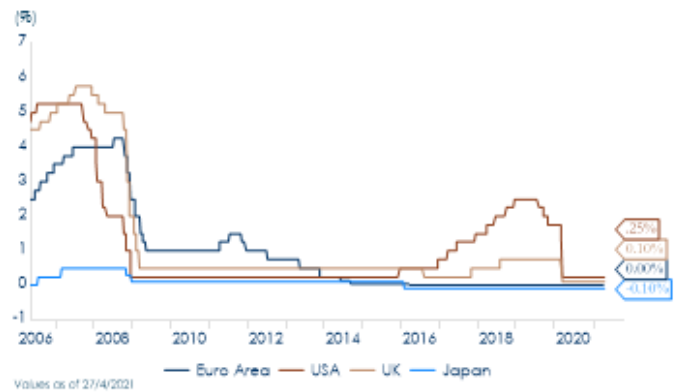


Fig. 2: ... and will have to properly calibrate the exit from expansive monetary policies



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NAME	LEVEL	Δ WEEK
MSCI World AC	2 979,41	▲ 1,4%
S&P 500	4 232,60	▲ 1,3%
NASDAQ Composite	13 752,24	▼ -1,5%
SX5E	4 034,25	▲ 2,0%
DAX	15 399,65	▲ 1,7%
CAC 40	6 385,51	▲ 2,4%
FTSEMIB	24 612,04	▲ 2,0%
IBEX 35	9 059,20	▲ 2,8%
FTSE 100	7 129,71	▲ 2,4%
MSCI Emerging	1 348,57	▲ 0,1%
CSI 300	4 992,42	▼ -2,5%

Strategic View

Figures on vaccine effectiveness triggered a new risk-on phase. The forward-looking components of the key leading indicators accelerated, the stock markets reacted with a reduction in risk premiums, a marked increase in prices and sector rotation.

EQUITY MARKETS

Equity markets remain "hung up" on reporting season and rate rises, Yellen confirms.

Last week Yellen's comments regarding the "possibility of a rate increase" triggered an equities drop led by the Tech sector with investors switching to more defensive sectors such as Materials and Financials. In addition, in their latest macro research the major international investment banks show ISM levels have peaked, with consequent repercussions and correction risks for more cyclical stocks such as Industrials, Chemicals and Autos although the optimism for the re-opening trade. That said, post declarations and watching in "astonishment" as the market instantly shrank, Janet Yellen necessarily clarified that she did not expect a rate hike to contain inflation stimulated by Biden's proposed spending and that "it's not something she's predicting or recommending". Despite the clarification, the effect on the markets was a discreet bull flattening on the US curve, with the 30y almost 2,24% and a sell-off in the tech sector (Nasdaq -2,55% with Peloton's sharp move down 15% due to the withdrawal of some of its products from the market). A few days later, thanks to positive US economic data and a strong reporting season, equities rallied in both the US and Europe, with Technology and Energy companies leading the rally. Speaking of data, the various PMIs in the Eurozone were a mixed result, with Italian (60,7 vs 61 expected) and Spanish (57,7 vs 59 expected) data improving on the previous month but falling short of expectations, while French (58,9 vs 59,2 expected), German (66,2 vs 66,4 expected) and Eurozone (62,9 vs 63,3 expected) data were all revised down slightly not only on expectations but also on the previous data. Q1 earnings growth rate over 20% above 2019 levels, with the S&P 500 up ~30% and the market pricing in "trailing" given implied "fair" P/E valuations above 2019 levels. In the US, the Dow Jones posted another record high after jobless claims fell below 500k, beating analysts' estimates; S&P500 up 1,3% (at 4232 pts) with Steel, Oil and Copper the best sectors. The EuroStoxx closed the week up driven by Basic Resources +6%, Energy and Materials +4% versus Real Estate, Tech and Healthcare -1,50%.

COMMODITIES AND VOLATILITY

The week saw commodity prices on the rise. The Bloomberg Commodity Index hit its highest level since 2011, with oil prices remained around \$65 per barrel, and copper rallied to all-time highs as bets on a global rebound from the pandemic spurred a surge across commodities markets. Food commodity prices also rose. Strong difficulties regarding the quantity of available supply clash with the robust demand coming from the recovering economies, generating strong upward pressure on prices. The monthly FAO analysis, which paints a picture of strong upward pressure on prices throughout 2021, reports that food commodity prices rose for the eleventh consecutive month in April. Sugar led the increases along with cereals, which resumed their upward trend.

NAME	LEVEL	Δ WEEK
Gold	1 831	▲ 3,5%
Silver	27,45	▲ 5,9%
WTI	64,90	▲ 2,1%
Brent	68,28	▲ 2,3%

NAME	LEVEL	Δ WEEK
VIX (S&P 500)	16,69%	▼ -10,3%
V2X (SX5E)	18,38%	▼ -10,9%

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NAME	LEVEL	Δ WEEK
US 10-year Yield	1,58%	▼ -4,9 bp
GER 10-year Yield	-0,22%	▼ -1,3 bp
FRA 10-year Yield	0,17%	▲ 1,3 bp
ITA 10-year Yield	0,97%	▲ 6,1 bp

Strategic View

US government bonds. Treasury yields showed a modest upward trend, driven by the reset of the economic growth expectations and increased fiscal stimulus. Economic normalization should put some pressure on long rates, which will however only see modest increases as they are manipulated by the Fed. We express a neutral view.

Euro government bonds. European government bonds showed a decoupling from US bonds and a downward trend in the wake of expectations of further monetary easing by the ECB in October, justified by negative inflation and a weak economic outlook.

NAME	LEVEL YTW	Δ WEEK
USD Invest. Grade	2,13%	▲ 0,51%
EUR Invest. Grade	0,34%	▲ 0,12%
USD High Yield	3,91%	▲ 0,29%
EUR High Yield	3,06%	▲ 0,06%
Emerging Local ccy	3,55%	▲ 0,71%
Emerging Hard ccy	3,50%	▲ 0,63%

NAME	LEVEL	Δ WEEK
Itraxx Main	50,18	▲ 0,3 bp
Itraxx Xover	250,808	▲ 2,2 bp
Itraxx Sub Fin.	110,38	▲ 2,7 bp
CDX North Am. IG	50,363	▼ -0,1 bp
CDX North Am. HY	286,35	▼ -0,1 bp

Strategic View

Corporate IG: Monetary policy support through direct purchases and forward guidance on "low rates for a long time" justify compressed spread levels. During the year, the improving economic cycle will further bolster fundamentals. We maintain a neutral view.

HY Corporate: Positive outlook but renewed volatility phases could provide buying opportunities. Low default rates with a peak in Q1, but still lower than previous cycles. Market support due to positive technical factors and the search for yield. We maintain a neutral view.

GOVERNMENT BOND MARKETS

U.S. government bond yields continue to move in a narrow range, driven by statements from FOMC members reiterating their patient stance in predicting an exit from ultra-expansionary monetary policies, with the 10y Treasury trading at rates well below the highs seen in late March. On the other side of the Atlantic, European government bonds continue to "chase" U.S. yields, having registered new period highs in the core segment on Monday, especially on the longer maturities of term structures.

During a forum on the economy, commenting on the massive spending programs of the US administration, Yellen said that "it may be that interest rates will have to rise somewhat to make sure our economy does not overheat" under Biden fiscal programs. A few hours later, Yellen herself clarified that her statements were not intended to predict or recommend any move by the Fed, emphasizing her firm belief in the central bank's independence. She made it clear that her considerations were those of an economist, given an economic scenario of probable excess demand, albeit temporary. The retracement also found support in the words of various FOMC members, who intervened to reiterate the wait-and-see stance of monetary policy.

Out of the chorus was the voice of Kaplan (Dallas Fed) regarding the timing of tapering. In his view, with the recovery faster than expected, the time to implement the turnaround on purchases is also closer. Kaplan would like to "start talking and opening discussions to talk about tapering of purchases" to do so "sooner rather than later." According to Kaplan, achieving the "substantial progress" required for tapering will come (at least in his view) sooner than he predicted a few months ago. Kaplan pointed out that purchases have side effects and can create imbalances and excesses in financial markets, and it would be "much healthier" for the economy to start reducing its dependence on the Fed's program.

CORPORATE BOND MARKETS

Last week the corporate market was rather stable without offering any cues, closing almost unchanged in all its sectors but with positive total returns thanks to the recent fall in government yields. The primary market activity was intense: Investment Grade credits provided new issues (more than 6bn placed) and High Yields continued to be active, with some deals priced and others announced during the week. HY Credit markets indexes closed recording positive returns (+0,06% in Europe and +0,29% in the US), meanwhile IG indexes closed +0,12% in Europe and +0,51% in the US.

In Europe CDS Spreads marginally wider with IG (Itraxx Main) closing at +0,3bp, while on HY (Itraxx Xover) +2,2bp. In the U.S. spread dynamics were more stable with CDX IG and CDX HY almost flat.

On the primary market, two deals were brought on AT1 bank subordinates, Santander (BB+ 750Mio Perp NC7y 4,125%) and Deutsche Bank (BB- 1250Mio Perp NC7y 4,625%), while on senior

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bonds we had Barclays double tranches (BBB 750Mio 4y 0,468%, 1250Mio 11y 1,106%) and Westpac (BBB+ 1000Mio Sub 9Y 0,766%).

On IG subordinated multitranche, new issues for Eni Spa (BBB- 1Bio Sub Perp nc6y 2% and nc9y 2,75%) while on senior the multitranche of Euronext (BBB 600Mio Senr 4y, 0,125%, 9y 0,75%, 20y 1,5%), as well as Emirates Telecom Group (AA- 500Mio Senr 7Y 0,375% and 12y 0,875%), Imerys (BBB- 300Mio Senr 10Y 1%), Sagax (BBB- 300Mio Senr 8Y 1%), Holding D'Infrastructure (BBB- 600Mio Senr 7Y 0,625%). In the HY market, three issues have been priced, Tui Cruises (CCC 300Mio Senr 5Y 6,5%), Verallia (BB+ 500Mio Senr 7Y 1,625%) and Mahle (BB+ 750Mio 7y 2,375%).

EXCHANGE RATES

FX market did not offer any meaningful movement during the week. All G10 currencies gained against the dollar, in particular the commodity currencies (Australian Dollar and Canadian Dollar). On Tuesday, Mrs. Yellen made a comment on the possibility to see higher rates in US to prevent an overheating of the economy; the equity market sold off and the USD gained against almost all the main currencies. Mrs. Yellen provided a clarification on her statement few hours later, which helped to stop the appreciation of the USD.

Macroeconomic data provided further support to the idea that the Eurozone could recover at a faster pace than that registered in the first quarter; the service sector showed signs of improvement in Spain and France. Thanks to those increase, the service PMI (a leading indicator that offers a gauge of service activity in the euro area) finally went above 50, signaling an expansion for the whole sector.

Emerging Markets currencies continued their strengthening trend against USD. Brazilian Real during the week appreciated more than 2%, thanks to the decision by the Brazilian Central Bank to hike rates by 75 bps. However, the short-term real interest rate in Brazil stands now at -3%, remaining one of the lowest in Emerging Market space.

NAME	LEVEL		Δ WEEK
Dollar Index	90,23	▼	-1,1%
EUR/USD	1,2166	▲	1,2%
GBP/USD	1,3984	▲	1,2%
EUR/GBP	0,8698	▼	0,0%
EUR/CHF	1,0955	▼	-0,2%
USD/JPY	108,60	▼	-0,6%

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THE WEEKS AHEAD: UPCOMING DATA

Europe: Friday's report from the ECB Governing Council's latest policy meeting may throw more light on the debate over whether PEPP purchases should be modified again.

United States: Industrial production, the consumer price index, wholesale inventories and retail sales for April will be announced. Regarding the housing market, MBA will publish mortgage applications.

Asia: China will release the consumer price index and producer price index for April. Year-over-year M2 money supply, trade balance and new yuan loans data will be announced. From Japan, data on the current account of the balance of payments, monetary base and trade balance for March will be released.

Source: CMB Monaco, Mediobanca SGR

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