Helaba

CAPITAL MARKETS BRIEFLY

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Monetary policy as a safety net

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- The **US dollar** advanced slightly, with the currency being supported by the robust US economy and a higher yield advantage. On the flipside, the expansionary monetary and fiscal policy are a burden. As the year progresses, the euro, with more economic tailwind, should gain the upper hand.
- Negative parameters from the US and higher inflation form a toxic environment for **bonds**. The ECB wants to prevent speculations about interest rate hikes and rising yields and is temporarily expanding its purchasing program. As a result, the yield on 10-year Bunds should remain just barely in negative territory in the second half of the year.
- Sector rotation is currently the theme in the **stock** markets: out of technology and into cyclical stocks. But even the equities that have been neglected most recently were able to recover again somewhat. It would appear that risk appetite of investors is unbroken, although the air is getting thinner.

Financial market: review and outlook

	Performance			Helaba-Forecasts			
	year to date	1 month	current*	Q2/2021	Q3/2021	Q4/2021	Q1/2022
Currencies	cross rate, %		cross rate				
EUR-USD	2,4	1,6	1,19	1,20	1,25	1,25	1,25
EUR-JPY	-2,8	-1,6	130	125	128	128	128
EUR-GBP	3,8	0,5	0,86	0,85	0,85	0,85	0,85
EUR-CHF	-1,9	-1,4	1,10	1,10	1,12	1,12	1,12
Money/Bond Markets	in basis points		in %				
3M Euribor	1	1	-0,54	-0,50	-0,50	-0,50	-0,50
3M USD Libor	-4	2	0,20	0,20	0,20	0,20	0,20
10y Bunds	26	-1	-0,31	-0,30	-0,20	-0,20	-0,20
10y Treasuries	78	36	1,69	1,45	1,50	1,50	1,70
Stock Markets	in local currency, %		index				
DAX	6,8	4,7	14.657	14.500	14.200	14.000	14.100
Euro Stoxx 50	7,9	3,2	3.834	3.800	3.720	3.670	3.700
Dow Jones	6,9	3,9	32.731	32.500	31.800	31.500	31.700
Nikkei 225	6,3	-2,8	29.174	30.500	30.000	29.500	29.800

* 22.03.2021; Numbers in German notation — Sources: Bloomberg, Helaba Research

This publication was very carefully researched and prepared. However, it contains analyses and forecasts regarding current and future market conditions that are for informational purposes only. The data is based on sources that we consider reliable, though we cannot assume any responsibility for the sources being accurate, complete, and up-to-date. All statements in this publication are for informational purposes. They must not be taken as an offer or recommendation for investment decisions.

Christian Apelt, CFA

Currencies: dollar surge fails to materialize

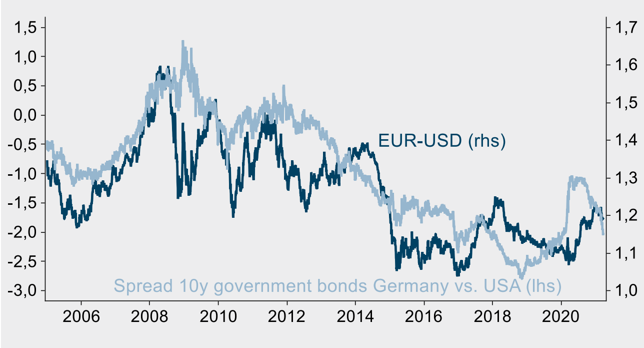
US President Biden is warning against conditions like those in Europe. That is what it has come to. The corona pandemic is currently hitting Europe harder than the US. In some European countries, corona restrictions are being tightened again because of rising new infections, while in the USA the numbers are trending downwards – even "spring break" is being celebrated. After all, vaccinations are accelerating in the USA, while in the euro area they are moving ahead only very hesitantly and with setbacks. The US dollar was able to benefit only marginally from these developments. The euro-dollar exchange rate stands at 1.19.

Current tailwind for the US dollar

The current environment is giving the US dollar a boost. Instead of taking a dip or even contracting, as in Europe, the gross domestic product in the US is likely to grow very solidly in the first quarter. The labour market continues to improve. Business sentiment remained optimistic. The recent set-back in the retail sector pales in comparison to the previous strong increase in sales. Strong economic growth of 4.7 % is expected for the year as a whole. Given the huge stimulus package – the $1.9 trillion programme has now been passed – the risks are more on the upside. Because of economic optimism and related inflation concerns, ten-year Treasury yields seem to be climbing unceasingly. Not even the very hesitant Federal Reserve could stop this. Accordingly, the US yield advantage over the euro increased significantly. Although all this has helped the US dollar, the great surge did not materialize.

Long-term US yield advantage has grown

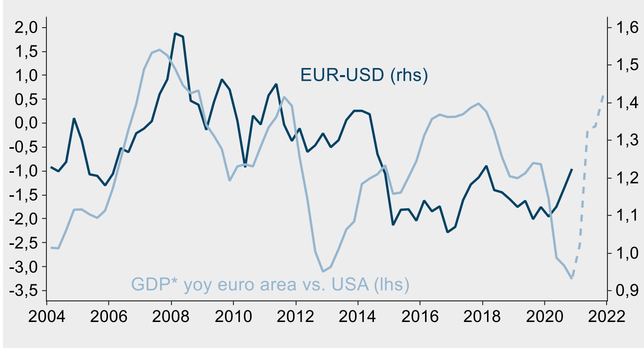
% points USD



Sources: Macrobond, Helaba Research

US growth advantage only temporary

% points, difference, 4-quarter average USD



Sources: Macrobond, Helaba Research

Expansionary policy a burden for the dollar

However, the economic invigoration in the US has come at a high price. The budget deficit, as a percentage of GDP, will be well into the double digit zone also in 2021, much higher than in the euro area countries. In this context, the US current account deficit is also rising, i.e. more capital must be attracted from abroad. In the past, high "twin deficits" weighed on the US currency unless monetary policy was very restrictive. But, as the Fed has just confirmed, this policy will remain very expansionary for a long time to come. In its projections, the central bank does not hold out the prospect of a turnaround in interest rates. Consequently, the US yield advantage for two-year maturities against the euro is only marginally above the lows of the last five years. There are not even signs of a reduction in bond purchases, even though the M2 money supply is growing at almost 26 % year-on-year, more than twice as fast as in the euro area. And this even though the ECB's policy is already extremely expansionary. This upswing, driven by fiscal policy and financed by the money printing press, does not really inspire confidence. Even the US vaccination advantage will dissipate if vaccinations in the EU accelerate considerably in the course of the year. Since there is also more pent-up demand in the euro area, the economy there should then be more dynamic than in the US. And even the yield advantage on ten-year bonds will probably diminish again. In the short term, the dollar will probably remain stable, i.e. fluctuate around current levels. By the end of the year, however, the euro-dollar exchange rate should climb to 1.25.

Ulf Krauss

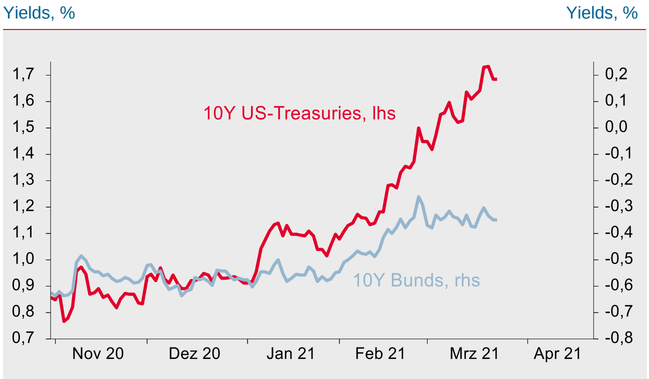
Bonds: ECB pushing against rising yields

While the trend in the growth outlook in Germany is worsening due to continuing corona uncertainties, the US economy is doing surprisingly well. In this context, the yield forecast for 10-year US Treasuries for the end of the year was raised from 1.2 % to 1.5 %. There is currently no need to adjust German bonds. The expected rise in yields at the beginning of the year has taken place. For the second half of the year we are sticking to the gravitational value of -0.2 % for 10-year Bunds. The momentum of the rise in yields has already weakened recently.

ECB temporarily expanding the purchase programme

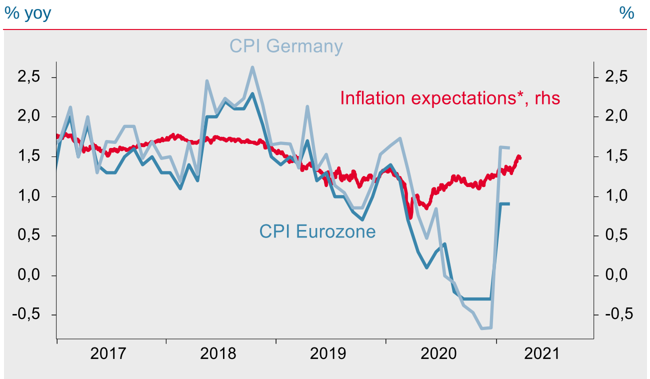
The decisive reason for only moderately rising yields in this country is rooted in monetary policy. In view of the difficult economic situation in the euro area, the ECB has made it clear that it will not accept rising yields. New lockdowns in the euro area are likely to have recently strengthened ECB President Christine Lagarde's opinion. Since interest rate cuts are – more than ever – not an option due to rising consumer prices, the only option left was to accentuate the purchase programme. The "war chest" for the PEPP pandemic purchase programme, which has not yet been exhausted, still amounts to about one trillion euros. Therefore, the ECB did not have to adjust the total volume. The programme's flexibility in terms of what, when and how much is bought is also a major advantage: purchases under the PEPP are expected to be much more extensive in the coming months than recently. The likelihood is increasing that the 1.85 trillion euro programme to combat the consequences of the pandemic will be fully exhausted.

Economic optimism driving US yields



Sources: Datastream, Helaba Research

Inflation expectations in an upward trend



*5Y5Y Inflation Forward euro area
Sources: Datastream, Helaba Research

Inflation picking up

At 1.6 % yoy, Germany, together with the Netherlands, currently has the highest inflation in the euro area. The overall euro rate was unchanged in February at 0.9 %, which represents a significant increase compared to the December value of -0.3 %. And the end of the line has not yet been reached: the cyclical low of the oil price was around 20 US dollars per barrel last March. Currently the oil price is above 60 US dollars. In Germany, inflation rates of over 3 % are therefore likely to be reached in the course of the year. In the euro area, rates of over 2 % are to be expected. Inflation expectations have recently continued their upward trend and, at around 1.5 %, have reached their highest level in two years. Normally, such a development would have an impact on interest rate expectations, but the ECB is doing everything in its power to prevent that. It sees the rise in inflation as only temporary and forecasts average euro inflation of only 1.2 % for the coming year. We, on the other hand, expect a value of 1.6 %, which is significantly closer to the ECB's inflation target of just under 2 %.

The environment for German bonds thus remains difficult. However, the yield curve is not likely to become very steep in the next few years. Currently, the gap between two-year and ten-year Bunds is 0.4 percentage points. If the ECB continues to succeed in maintaining investor expectations of a very loose monetary policy for many years to come, the scope for noticeably rising yields will remain modest.

Markus Reinwand, CFA

Stocks: investors betting on cyclicals

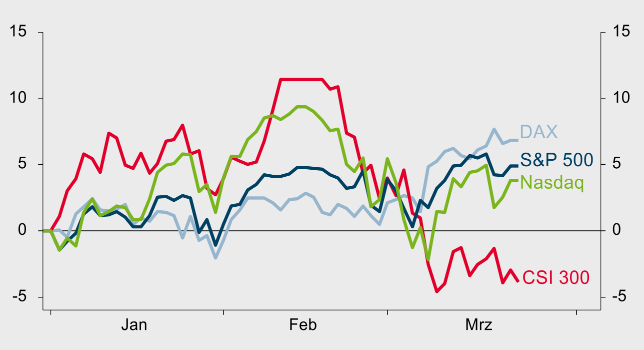
The horses have been changed, the chase for records in the stock markets continues. In the past few weeks, the previous stock market darlings have come under visible pressure. The tech-heavy Nasdaq Composite temporarily lost more than 10 % since its peak in February. The decline in the Chinese stock market barometer CSI 300 was even greater, at times almost 15 % from its high for the year. However, this obviously did not really unsettle investors, even though China is one of Germany's top export destinations and plays the role of a growth engine. Despite this headwind, the DAX recently set new records. Cyclical stocks in particular were in demand.

A lot of positive factors have been anticipated

The concerns of some market participants that rising bond yields could have a severe impact on equities seem to have receded into the background for the time being. Instead, the arguments that have so far supported rising equities continue to be valid: massive support from economic stimulus programmes, continued ultra-loose monetary policy, the lack of investment alternatives and improved growth prospects due to progressing vaccinations. However, much of this has already been anticipated in current prices. Investors have already turned their portfolios very offensive in recent months. In the US, the share of corporate equities in the financial assets of private households hit 38 % in the fourth quarter of 2020, thus reaching the previous highs from the first quarter of 2000 at the height of the New Economy boom.

DAX showing relative strength

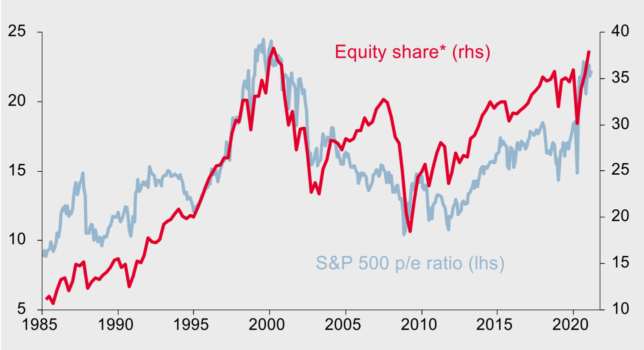
% change year to date, in local currency



Sources: Datastream, Helaba Research

US equity share at record level

Ratio %



* Corporate equities as a % of total financial assets of private households

Sources: Datastream, Helaba Research

The – in part – already very high valuation of stocks also indicates that a strong upswing is now priced in. This is particularly pronounced in the US. The price-earnings ratio of the S&P 500, based on earnings expectations for the coming twelve months, has almost reached the peak levels of the year 2000. Other key ratios for the US market also remain well above the long-term normal range. Even if the overvaluation of German equities is less pronounced, they too are now expensive. So far, this has been accepted by the majority of investors in view of the low interest rates on government bonds. However, the significant rise in yields in recent weeks has made stocks less attractive in relative terms. The global volume of negative yielding bonds has fallen by around 30 % since its high in December 2020. The investment emergency has thus eased at least somewhat.

Risk-reward profile not attractive

There is hardly any room for a further expansion on valuation. Sustainable price potential could therefore only be derived if corporate profits in the coming quarters could rise above the previously assumed level. In view of the already high expectations, however, this is likely to become increasingly difficult. At current price and valuation levels, the risk-reward profile on both sides of the Atlantic is not particularly attractive. Broad new investments are therefore not advisable for the time being. ■