

Weekly Macro & Markets View

Highlights and View

- **The Fed is expected to start tapering its asset purchases in November following the latest labour market report**

Payrolls rose only modestly in September, but the underlying labour market momentum is strong as reflected in a significant fall in unemployment and a pickup in wages.

- **Equities stage a lukewarm rebound, bond yields surge on a jump in energy prices**

Equity markets need to hold above key support levels for momentum to rebuild. The spike in natural gas prices, even if distorted, keeps inflation in focus and upward pressure on yields.

- **Credit markets were notably softer despite better investor sentiment seen in stocks**

We don't expect the recent softness to continue, but given credit's prior outperformance versus equities, last week's weakness suggests that upside is more limited in credit than stocks.

Stocks limp higher as rampant gas prices lift bond yields



Source: Bloomberg

Equity markets managed to post modest gains last week, following a challenging few weeks that saw some key support levels breached. The TOPIX in Japan was up on Friday for the first time in ten trading sessions, while several regions ticked back above their 100-day moving averages. Although we believe that the up track for stocks remains, it will be important for support levels to hold and momentum to rebuild. The combination of surging inflation, increasingly hawkish central banks, the Evergrande crisis and a run of weak data from China suggest that a lot of bad news may now be discounted. Consequently, the resolution on the US debt ceiling last week helped sentiment, though it merely bought a few weeks' time before the issue will need a longer-lasting solution. In addition, some easing in natural gas prices also contributed to the move in equities. A remarkable surge in European gas contracts, which rose more than 70% since the start of the month before falling back, based on an unfortunate combination of supply, inventory, and distribution issues, helped keep upward pressure on bond yields. 10yr gilt yields in the UK were up 16bps on the week at 1.16%, while US Treasury yields were up a similar amount, hitting a four-month high of 1.61%, as inflation fears persist. Though the recent move in yields has been sizable and may be due for a pause, the direction of travel is likely to be higher.

Credit: Notably soggy despite better broader sentiment

After outperforming stocks for many weeks, credit markets turned notably softer last week despite the more stable investor mood evident in stock markets. The weakness was widespread across both US and European credit markets in the investment grade and the high yield segments. Furthermore, weakness was not just restricted to secondary markets as some debt issuers paid new issue concessions in the primary market. Fund flows also turned negative for US investment grade funds, which reportedly experienced the largest weekly outflow since April 2020.

While we don't read last week's credit weakness as a harbinger of persistently negative returns, a near-term saturation point in credit outperformance to stocks seems likely to have been reached. While equities were more volatile during recent weeks, credit markets were much more stable, and it seems that the relative pricing between the two asset classes had become somewhat dislocated. In effect, credit markets had taken on somewhat of a risk haven status, which appears to now be normalising.

US: Modest growth in payrolls underestimates labour market strength

Investors focused on the latest set of labour market data as it sets the stage for the Fed's next move. 194'000 new nonfarm payrolls were created in September, which looks rather modest but underestimates the current strength of the labour market. A solid upwards revision of 169'000 for the last two months both underlines the current dynamic and reflects the monthly volatility of the data. The unemployment rate fell markedly to 4.8%, already reaching the Fed's year-end forecast, while initial jobless claims resumed their trend lower. Growth in average hourly

earnings accelerated to 4.6% YoY, reflecting the strong momentum and persistent labour market bottlenecks. Taken together, the latest batch of labour market data is unlikely to deter the Fed from tapering its asset purchases as soon as in November. Meanwhile, business activity remains buoyant as shown by the latest ISM services report. The headline number ticked up to 61.9 while strong new orders point at a continuation of solid momentum in the final quarter of the year.

Eurozone: Supply-chain problems remain acute as German output and orders fall

German factory orders fell 7.7% MoM in August, after increasing 4.9% MoM in July and 4.6% MoM in June. Autos and metal production saw the biggest declines in orders. Factory orders data are volatile and can be distorted by big-ticket items, so perhaps more worrying is that actual industrial output is also falling. German industrial output fell 4% MoM (after a 1% MoM increase in July) due to a 27.8% MoM fall in auto production in August. Admittedly the data is somewhat lagging, but there are few signs yet of improvement in chip supply chain issues and

we could see more weak data prints from the German industrial sector over the coming months. However, this should be offset by a still strong service sector. Meanwhile, in Italy, the government has approved an ambitious set of plans to reform and simplify the tax system, confirming how serious Prime Minister Mario Draghi is in his attempts to improve the economy and raise long-term trend growth.

North Asia: Hong Kong's big plans for the Greater Bay Area

Japan's Eco Watchers Survey diffusion index for September made up only half of its August losses, but what is more relevant to us is the fact that the outlook component surged to levels last seen in 2005 and 2013, which is encouraging. The JPYUSD rose to a three-year high. In China, travel expenditures during the Golden Week holidays were brisk, but are still 30% below pre-Covid 2019 levels. The Caixin Services PMI recovered by 6.7 points to 53.4 in September, following the Delta induced blip in August. Elsewhere, delegates from the US and China met in Zurich to discuss various

issues, which will be followed by a virtual meeting between Presidents Biden and Xi later this year, while virtual trade talks did not reveal major progress. In Hong Kong's policy address, Chief Executive Carrie Lam focused on medium- to longer-term projects to improve housing supply and affordability. Deeper integration within the Greater Bay Area is planned by the development of a Northern metropolis close to Shenzhen, which should add half a million housing units and create new jobs in the technology and information business.

LatAm: Accelerated inflation in Chile will lead to aggressive tightening

In Brazil, inflation reached 1.2% MoM in September, which was below market expectations. The data can be explained by lower-than-expected inflation in tradable goods, although inflation in services continued to speed up. Headline inflation accelerated from 9.7% YoY to 10.3% YoY, while core inflation increased from 6.1% YoY to 6.5% YoY. Retail sales disappointed in August, falling 3.1% MoM, while industrial production fell for the third consecutive month, dropping 0.7% YoY. In Chile, inflation surprised to the upside, rising by 1.2% MoM

in September. Although all components of inflation increased, food and beverages, together with transportation, contributed the most. Headline and core inflation accelerated, reaching 5.3% YoY and 4.4% YoY, respectively. This figure may be a sign of an overheating economy and considering the depreciation of the CLP and the increase in the probability of approval for the fourth withdrawal of pension funds, we expect the policy rate to rise by at least 75bps this week. In Mexico, inflation reached 6% YoY in September, in line with expectations.

What to Watch

- US inflation data are likely to reflect persistent price pressure while retail sales and consumer sentiment will give insights into the current state of US households.
- In APAC, we believe both the Bank of Korea and the Monetary Authority of Singapore will stand pat but expect tightening to be announced in the following MPC meetings. China will release September foreign trade, credit, and inflation data. Australia will publish labour market data as well as business and consumer confidence data. There will also be several market closures this week due to national holidays: Taiwan on Monday, Thailand on Wednesday, Hong Kong on Thursday, India on Friday.
- We expect the Central Bank in Chile to raise the policy rate by at least 75bps. In Brazil, monthly economic activity for August will be released. INEGI will publish industrial production for Mexico, and in Argentina the focus will be on inflation.

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