November 8, 2021

Weekly Macro & Markets View

Highlights and View

- **As signalled well in advance, the Fed will begin to reduce its asset purchases in November**

  The Fed is somewhat behind the curve, in our view, and it would take a significant deterioration of the economic environment for the Fed to slow down the tapering process.

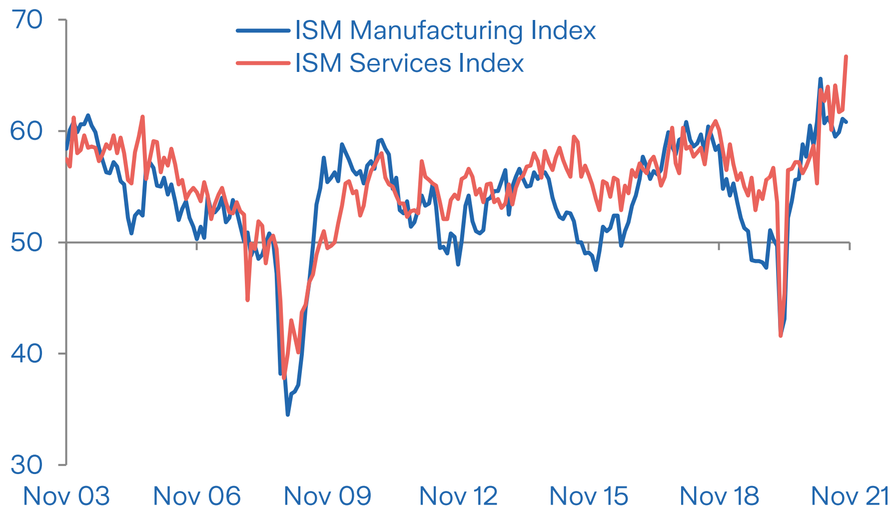
- **The global composite PMI rises to an above trend level in October**

  We expect global growth to remain firm into 2022 and the latest PMIs are consistent with this view, with a broadening out of growth particularly encouraging.

- **The RBA removes its three-year yield curve control but maintains its QE and policy rate**

  The RBA has shifted its narrative away from an ultra-dovish to a more cautiously dovish stance. We expect the first policy rate hike to come through in early 2023.

The Fed begins tapering in a strong economic environment



Source: Bloomberg

As was widely expected, the Fed announced the beginning of the tapering process at its latest meeting. It will reduce its asset purchases by USD 15bn a month, with a first reduction taking place in November. The FOMC has retained some flexibility by making the future pace of tapering conditional on the economic development, but it would take a significant deterioration of the economic environment for the Fed to slow down the tapering process in our view. Interestingly, Powell signalled a more relaxed stance towards the Fed's mandate of full employment, acknowledging that the participation rate is unlikely to rise back to pre-crisis levels anytime soon. This will allow the Fed to start raising rates sooner than initially thought. Meanwhile, the economic environment remains very strong. Both the ISM Manufacturing and Services indices signal a continuation of strong business activity, though input price pressure remains an issue for many companies. The labour market continues to heal at a healthy pace with 531'000 new nonfarm payrolls created in October. In addition, earlier numbers have been revised up substantially. The unemployment rate keeps falling faster than consensus expected, receding to 4.6% from 4.8% the month before while growth in average hourly earnings accelerated to 4.9% YoY. Slightly disappointing, the participation rate still failed to move higher despite being significantly lower than before the recession.

Bonds and Stocks: Dovish central banks give wings to bulls

Equity and bond markets surged last week as surprisingly dovish central bank meetings pushed back the market pricing of rate hikes. The Fed announced tapering would start this month, but showed no hurry to lift rates, with the first hike most probably not coming until the second half of next year. The BoE provided the biggest surprise, however, with a 7:2 vote to keep rates on hold, having previously set the stage for a hike. Bond markets surged, with gilt yields plunging on both Thursday and Friday, the 2yr ending the week down 30bps at 0.4%, while US 10yr Treasuries closed at 1.45%. Given our expectations of high growth and sticky inflation into next year, we suspect the latest move in bonds is overdone, with yields likely to move higher. The rally in stocks is also becoming a little stretched, with many markets up 2-3% last week. While emerging markets continued to languish, the US Russell 2000 index of small cap stocks posted a remarkable 6% jump. Good earnings prospects and a still benign rate environment bode well, though some consolidation from recent gains would be healthy.

UK: With contradictory signals the BoE loses credibility

Projections of the BoE's rate path had risen markedly ahead of last week's meeting as several members of the Monetary Policy Committee stoked expectations about imminent steps to tighten monetary policy. In full contradiction to these signals the BoE not only decided to stay on hold but also voted and communicated a more dovish stance, causing volatility and a violent repricing in financial markets. Yields on 10yr gilts lost almost a quarter of a percentage point in just two days while sterling lost more than 1.5% against the USD before stabilising. We agree with the BoE's decision to stay on hold, particularly given that the end of the furlough program's full impact on the labour market is not yet known and the BoE could always step up the tightening process should inflation expectations get out of hand. However, by sending out highly contradictory signals the BoE has unnecessarily stirred the markets and lost credibility.

Switzerland: Growth is resilient, despite a dearer Swiss franc

Growth remains solid after having peaked from an unsustainably high level. The economy is benefiting from the strong global industrial cycle, but domestic demand is also a tailwind, with retail sales volumes up over 12% compared to the pre-crisis level. The Manufacturing PMI edged lower in October, but underlying dynamics are strong, with solid new orders and employment growth. The broader KOF leading indicator, which fell sharply in Q2 and Q3, has stabilised and is consistent with above trend growth, helped by continued improvements in the services sector. While growth dynamics are similar to those in the Eurozone, inflation is notably weaker, with core CPI at 0.6% YoY compared to over 2% in the Eurozone. This helps to explain why the Swiss franc has come under renewed appreciation pressure against the euro, with EURCHF roughly matching the levels reached in the midst of the Covid crisis last year. The latest sight deposit data does not yet indicate sizable FX interventions from the SNB.

Asian PMIs: Vietnam's big rebound

ASEAN's Manufacturing PMIs experienced considerable rebounds in October, with Indonesia's reading surging from 52.2 to 57.2 and Vietnam's from 40.2 to 52.1. The strength of the Manufacturing PMIs was driven by rising output, new orders, and new exports orders. Vietnam's new export order component surged from 27.4 to 51.5, despite its still challenging Covid situation. Nevertheless, other components, including order backlogs, input prices and employment, still reveal some fragility. While production disruptions and supply bottlenecks due to lockdowns might take time to dissipate, the healing process seems well underway. China's official NBS Manufacturing PMI fell to 49.2 and remains the only Asian PMI below 50, though the Caixin Manufacturing PMI recovered to 50.6, as it reflects more export-oriented SMEs. Finally, Manufacturing PMIs in Japan, Taiwan, and India, climbed higher and remain in the solid mid-50 range. Meanwhile, Taiwan reported record high exports of more than USD 40bn for October today, up 24.6% YoY, driven by strong technology related demand and rising prices.

Australia: The RBA starts shifting its narrative away from an ultra-dovish stance

In its meeting last week, the RBA removed the three-year yield curve control (YCC), which was supposed to expire in Feb 2022. The RBA clarified its decision by citing 'the earlier than expected progress towards inflation target'. The central bank also upgraded its trimmed mean inflation forecast from 1.5% to 2.25% in 2022 and expected core inflation to stay at 2.25% in 2023. The inflation outlook has become increasingly uncertain given prolonged global supply disruptions and local labour shortages. We have brought forward our rate hike expectation from Q4 2023 to early 2023. Meanwhile, October house prices continued to edge higher, leaving the YoY growth rate at above 21%. We think the removal of the YCC will put upward pressure on mortgage rates and help cool the housing market. On a separate note, September exports were down by 6% MoM, reflecting a slump in iron ore prices and deteriorating demand from China.

What to Watch

- In the US, investors will focus on the latest inflation numbers while the small business survey will give us more insights into the current state of the business sector.
- In APAC, the October Eco Watcher Survey will be released in Japan, where PM Kishida will nominate his new cabinet on Wednesday. China will hold its 6th CCPCC Plenum and publish inflation and credit data for October. Australia's October employment data should show a recovery amid economic reopening. The Bank of Thailand looks to keep rates unchanged. The Philippines and Malaysia Q3 GDP will likely reveal economic damage from severe lockdowns. India's October CPI and September industrial production data are also key.
- Inflation data will be published in several LatAm countries, which will be an indication as to the path monetary policy will take in the coming months. In Mexico, we expect Banxico to raise the policy rate by 25bps. On the political front, the focus will be on the midterm elections in Argentina.

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