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Weekly Macro & Markets View

Highlights and View

- **The global all-industry PMI edged higher in November, helped by increased manufacturing output and an easing in supply constraints**

  Global growth has rebounded from a mid-year soft patch, but rising virus infections pose a risk, both to goods supply and services demand, with upside risk to inflation prevailing.

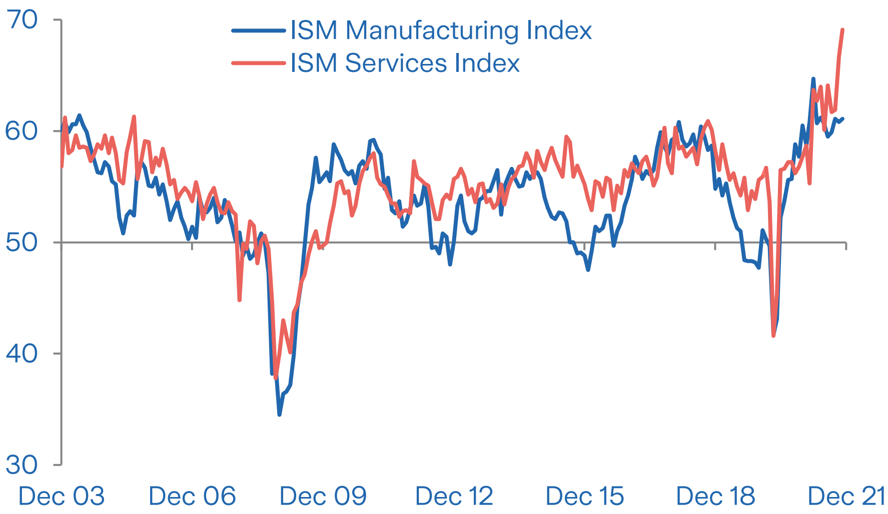
- **Intraday volatility in stocks picks up while credit markets show some concerning signs**

  Central bank tapering, especially by the Fed, seems inevitable. Caution is warranted in both stocks and credit until more clarity emerges on the Omicron variant.

- **Eurozone inflation surges from 4.1% in October to a record high of 4.9% in November**

  The increase was even higher than expected and will make the ECB's communication job challenging, but we could be close to a peak in Eurozone inflation.

The US economy is firing on all cylinders



Source: Bloomberg

The ISM Services Index reached a record high in November, underlining the current strength of the US economy. Similarly, the manufacturing survey remains significantly above pre-crisis levels, indicating that the expansion is broad-based. In both cases, the price component ticked down, raising hopes that price pressure will ease going forward. At the same time, the Conference Board's Consumer Sentiment Index continues to hover somewhere mid-way between pre-crisis levels and recession lows as inflation and rising infection rates weigh on households' minds while the economic outlook and the employment situation remain supportive. Although the notoriously volatile payroll number was below expectations in December most other indicators show a very solid labour market. The unemployment rate dropped from 4.6% to 4.2% in November even though the participation rate ticked up to 61.8%, a post-recession high. The broader underemployment rate even fell by half a percentage point to 7.8%. Despite the tighter labour market, wage growth decelerated on a monthly basis, leaving the annual rate at 4.8%. Given the robust growth momentum, a healthy employment situation and above target inflation it is very likely that the Fed will announce an acceleration of its tapering process at its meeting next week. Finally, Congress passed a stopgap measure to keep the government funded until February, avoiding a government shutdown.

Markets: Caution is warranted in stocks and credit

Choppy trading characterised equity markets last week. Although moves over the period were modest, with the MSCI World Index off less than 1.5%, the VIX volatility gauge hit the highest level since January. Hawkish tones from Fed Chair Powell had only a modest impact, with investors increasingly sharing our view that the pace of tapering needs to quicken, and it was noise around the new Covid variant and vaccines that dominated. Credit markets that had been softening ahead of the latest sell-off in stocks showed some unusual patterns last week, some of which are more concerning than others. While credit spreads in Europe tightened after the significant underperformance of prior weeks, US credit spreads did not tighten during the days when stocks rallied. That said, the tone changed slightly in US credit on Friday despite a late stock market reversal. Most importantly, primary activity in Europe slowed significantly while fund outflows were sizeable — both causes for concern in our view. We maintain that caution is needed in both stocks and credit until more is known about Omicron.

Eurozone: Inflation surges in November, but a peak is probably close

Inflation moved even higher than expected in November, up from 4.1% in October to 4.9% YoY, a record high. Higher energy inflation due to oil and gas prices was a large contributor. Some statistical distortions also boosted inflation. Because the Covid crisis affected consumption of some items more than others in 2020, different weightings were applied to the consumption basket for 2021, distorting the impact of leisure travel price inflation. This effect should reverse soon. Although the numbers are alarming, we may be close to a peak in inflation. In January, the German VAT cut in the last six months of 2020 will fall out of the annual price comparison, subtracting around three tenths of a percentage point from Eurozone inflation. Base effects from high oil prices should also diminish substantially next year. However, one wild card is the extent to which high natural gas prices have yet to feed through to household energy bills. Overall, the current inflation prints are making the ECB's communication job challenging, but we still expect it will continue with asset purchases next year.

Asia: PMIs suggest a decent expansion in activity

PMIs pointed to a moderate improvement in manufacturing activity across Asia. India, Australia, Japan and Taiwan led the pack with Manufacturing PMIs between 54 and 57, implying a strong expansion momentum. ASEAN's readings edged a touch lower following robust rebounds in October. The weakest spot was China as the Manufacturing PMIs painted a mixed picture. The Caixin Manufacturing PMI, which focuses on sentiment among SMEs, weakened slightly from 50.6 to 49.9, sliding into contractionary territory. Yet the NBS Manufacturing PMI, which covers large corporates, moved from 49.2 to 50.1, suggesting a slight expansion in activity. Overall, we remain optimistic about the recovery of Asia's manufacturing sector, given that PMI components such as order backlogs and input prices suggested a steady easing of supply disruptions. Also, Japan's and Australia's Services PMIs show further improvements as these economies reopen.

Australia: Another quarter of positive surprises

Q3 GDP came in at -1.9% QoQ, faring far better than consensus expectations of -2.7% QoQ decline. The drop in private consumption was the main contributor, while the strength of government spending and the resilience of capex offset the weakness. Notably, saving rates shot up from 11.8% to 19.8%, suggesting that households should have plenty of space for spending post-lockdown. The latest retail sales data signalled the recovery in consumption is already well underway. Meanwhile, trade data appeared less encouraging. Iron ore exports continued to drop in October on the back of a sharp correction of iron ore prices due to a fall in China's demand. On a separate note, home prices continued to inch higher. Yet other data, including building approvals and home loans, deteriorated. We think the housing market will soon cool off on the back of tighter financial conditions and lending standards.

Brazil: A technical recession in Q3 2021

GDP contracted at an annualised rate of 0.37% in Q3, putting the economy in a technical recession. On the demand side, investment and the external sector were the main drag on GDP growth, while private and government consumption grew 3.7% and 3.3%, respectively. On the supply side, agriculture dropped 28.3%, explained by the frost and the drought. Supply chain bottlenecks and energy shortages affected the manufacturing and electricity sectors, which fell 4% and 4.4%, respectively. The services sector partially offset the drop, growing 4.6%, driven by the reopening of the economy. Surprisingly, industrial production fell 0.6% MoM in October, pressuring economic activity in the Q4. The Senate approved the constitutional amendment to cap the payment of court orders in 2022 and recalculate the spending cap, allowing for the implementation of the new social program. The modified bill earmarks the new fiscal space on social security, assistance, and health and now must be ratified in the Lower House.

What to Watch

- Annual US inflation rates are expected to remain high, though the focus will be on whether monthly rates show signs of abating price pressure. The University of Michigan's latest survey will give insights into households' current mood.
- Japan's Household Survey for October, the December Reuters Tankan and the Business Outlook Survey for the fourth quarter are likely to suggest improvements in sentiment and consumption. China's money and financing statistics are in focus, while inflation and trade data will be released for China and Taiwan. In Australia, the RBA should maintain its dovish stance on the policy rate.
- In Brazil, the focus will be on the monetary policy meeting where we expect the BCB to hike the Selic rate to 9.25%. Inflation for November will be released in Brazil, Chile, and Mexico.

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