December 20, 2021

Weekly Macro & Markets View

Highlights and View

- **The Fed doubles the pace of tapering and signals three rate hikes for 2022**

  Having fallen behind the curve, the FOMC is shifting to a more hawkish stance, signalling its commitment to reach its average inflation target.

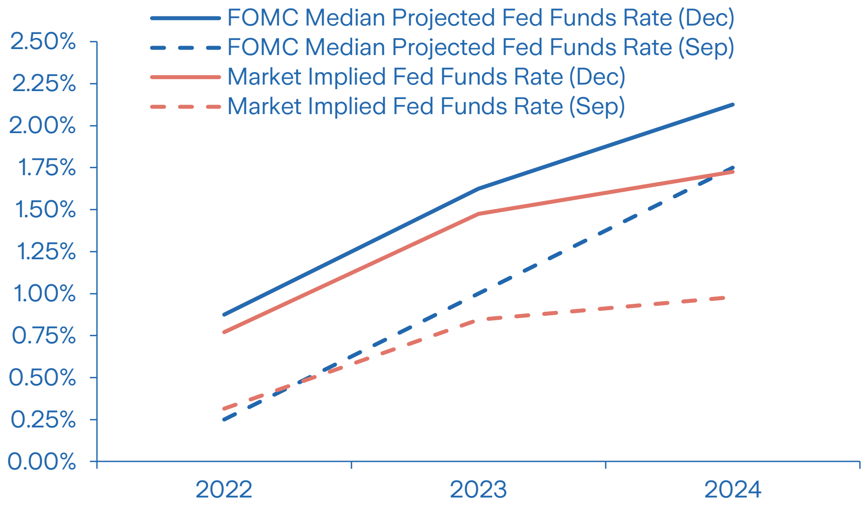
- **The Bank of England lifts the Bank Rate from 0.1% to 0.25%**

  Putting near-term uncertainty caused by Omicron aside, the BoE tightens its policy with more rate hikes expected in the first half of 2022.

- **China's PBoC has cut the one-year Loan Prime Rate by 5bps to 3.8%**

  We believe more targeted stimulus measures are in the offing amid disappointing retail sales and property investment statistics for November, while policy makers focus on stability.

The Fed is becoming more hawkish



Source: Bloomberg

As expected, the Fed announced that it will double the pace of tapering to USD 30bn per month in January. If the FOMC keeps this pace the taper process would conclude in March, opening up the possibility for rate hikes to start tightening monetary policy. As we previously noted, the Fed has fallen behind the curve given strong growth, high inflation and a robust labour market. The FOMC is now signalling that it intends to close the gap with the latest dot plot showing three rate hikes in 2022 compared to just one back in September. Bond yields barely moved in the aftermath of the decision while the S&P 500 rallied before falling back and ending the week with a loss of almost 2%. Meanwhile, Markit's latest Flash PMI survey for December shows that business activity is expanding at a brisk pace in both manufacturing and services. At the same time, price pressure remains high as rising input costs keep weighing on firms' sentiment. This is also reflected in producer price increases accelerating to 9.6% YoY and small businesses' price plans soaring to the highest on record. On a positive note, the PMI survey shows that the pace of inflation of prices charged for goods and services softened for the second month running. This indicates that price pressure is about to weaken going forward unless a new wave of Covid causes further major supply chain disruptions.

Eurozone: ECB ends PEPP, while services confidence falls on Covid concerns

The ECB monetary policy meeting last week was somewhat more hawkish than expected. The ECB confirmed that the Pandemic Emergency Purchase Programme (PEPP), currently running at around EUR 70bn per month in asset purchases of mainly Eurozone government bonds, would end in March as expected. However, it only announced an increase in the Asset Purchase Programme (APP) from EUR 20bn to EUR 40bn per month in 2022 Q2, which will then fall back to EUR 30bn in Q3 and EUR 20bn in Q4. This represents a total increase relative to the baseline APP of only EUR 90bn, on the low end of expectations. Meanwhile, business confidence surveys released last week, such as the Eurozone Flash PMI and German ifo, showed a sharp fall in service sector confidence, understandable given the latest Covid Omicron developments. Services confidence and activity is likely to remain under pressure until this latest wave of infections diminishes. One piece of positive news is that manufacturing confidence held up better with tentative signs of supply chain issues improving.

UK: The BoE raises the Bank Rate from 0.1% to 0.25%

Putting more weight on rising inflation rates than potential disruptions caused by Omicron, the Bank of England decided to lift the Bank Rate from 0.1% to 0.25% at its meeting last week. There was strong agreement for the rate hike within the Monetary Policy Committee, with only one member voting against the decision. A strong labour market and elevated inflation rates justify the beginning of the tightening cycle with more rate hikes likely in the first half of next year unless the economy is severely disrupted by the latest rise in Covid infections. Data published last week underline the current strength of the economy. The unemployment rate ticked down to 4.2% in October, which is reassuring given that the end of the furlough programs doesn't seem to have had a significant impact on the labour market. An improving employment situation and strong wage growth have helped to support retail sales, which grew at 1.4% MoM in November. The flip side of strong spending is accelerating inflation with headline CPI rates rising to 5.1% YoY in November from 4.2% the month before.

China: LPR cut confirms monetary loosening, while 'stability' is core CEWC message

Economic activity data for November revealed a mixed picture. Retail sales disappointed amid another pickup in Covid cases in several provinces followed by the usual mobility restrictions. The surveyed jobless rate inched up to 5%. Infrastructure and property investments continued to be weak, the latter accompanied by accelerated falling home prices. However, while construction activity tends to lag, we believe that home sales are likely to stabilise and then recover amid a pickup in mortgage lending to households. The core message of the Central Economic Work Conference (CEWC) under the helm of President Xi is 'stability', which makes it unlikely that the economic downswing will continue. Today actions followed words as the one-year loan prime rate (LPR) was cut by 5bps to 3.8%, and we believe that quantitative restrictions on lending will also be relaxed in a targeted manner. On a positive note, industrial production and manufacturing investment growth picked up some steam amid an improvement in coal shortages and brisk exports.

Japan: Strong improvement in the services sector, while exports surge to a record high

Japan's quarterly corporate Tankan survey showed a remarkable improvement in the non-manufacturing diffusion index for both large and small companies amid the recovery of the services sector following a notable improvement of the Covid situation. Meanwhile, current conditions in the manufacturing sector are perceived as stable, as supply chain issues in the auto sector are getting resolved. However, the outlook component suggests a cautionary stance, which is also confirmed by the deterioration in the December PMIs. While both the Manufacturing and the Non-manufacturing PMIs remain above the boom/bust line of 50, fears about the Covid Omicron variant are starting to impact consumer confidence and with that the outlook for services. The Bank of Japan maintained its dovish stance but extended special Covid related financing programs exclusively for SMEs until the end of September 2022. Both export and import values surged to record highs, with the former driven by strong volumes, while the latter was mainly driven by higher import prices.

LatAm: Central banks continue to focus on inflation, with more hawkish statements

With a hawkish statement, Banxico accelerated its tightening in Mexico, raising the policy rate by 50bps to 5.5%. All five members voted in favour of a hike, with only one dissenter who voted for maintaining a 25bps movement as in previous meetings. They also removed any mention of inflation being transitory and significantly reviewed the upward core inflation forecast for 2022. They noted that the balance of risk for inflation has deteriorated further and retains an upward biased. In unanimous decision, the Central Bank of Chile raised the policy rate by 125bps to 4%, above the neutral level. The Board expects to continue to hike the policy rate in the short term and remain above its neutral level for most of the policy horizon. The quarterly inflation report reaffirmed the forward guidance, reviewing the inflation forecast upward and painting a very poor scenario for growth in 2022 and 2023. Finally, the left-wing candidate Gabriel Boric was elected President with nearly 56% of the votes, obtaining almost one million more votes than the right-wing candidate Jose Antonio Kast.

What to Watch

- In the US, the latest batch of labour market data is expected to show further improvement while the ISM surveys are likely to reflect a continuation of strong business activity.
- The BoE is expected to hike rates soon, though it may wait longer given uncertainty around new Covid variants and rising case numbers.
- In the Eurozone, the remaining PMIs as well as business and consumer confidence data for December will be published.
- Several Asian countries will release their December PMIs. In Japan, most of the remaining economic activity indicators for November will be published.

We wish our readers happy and relaxing holidays and all the best for 2022.

The Weekly will return with a new layout on January 10.

Disclaimer and cautionary statement

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