Weekly Macro and Markets View

13 March 2023

Highlights and View

The collapse of Silicon Valley Bank (SVB) caused US bank stocks to plunge and prompted a broader flight to safety

While SVB was unique in some respects and US regulators have acted to shore up confidence, vulnerabilities from rapid rate hikes could play out in unexpected ways and caution is warranted.

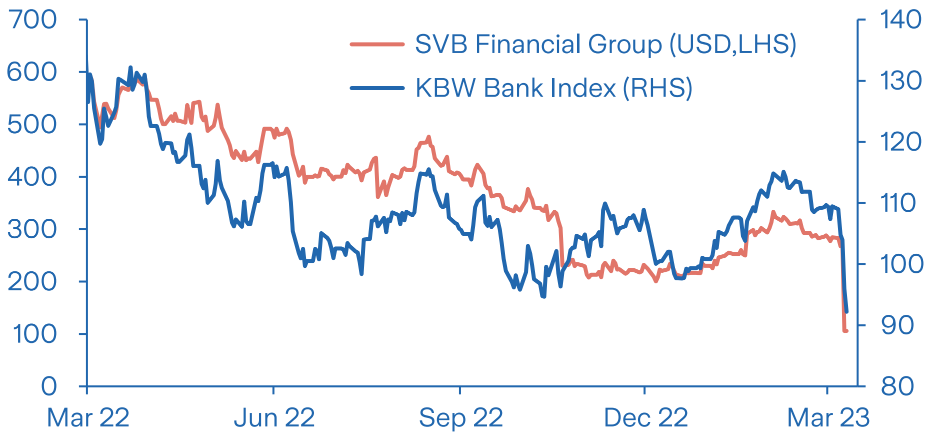
Eurozone 2022 Q4 GDP is revised down from 0.1% QoQ to 0.0% QoQ

The downward revision confirms the fragility of the Eurozone economy despite an extremely mild winter, which helped to reduce the impact of the energy crisis.

US nonfarm payrolls rise by 311'000, but other indicators point at a slowdown in the labour market

Job creation remained strong in February though the unemployment rate rose. The quits rate dropped to the lowest in two years reflecting employees' reduced willingness to leave their jobs.

SVB collapse jolts the banking sector



Source: Bloomberg

The rapid collapse of Silicon Valley Bank (SVB) last week caused US bank stocks to tumble, although sentiment is better this morning after US regulators announced new measures yesterday to protect all depositors and allow banks to borrow against high quality bonds in order to weather deposit outflows. SVB, a US lender playing a key role in the technology and life sciences start-ups, saw its stock plunge by over 60% on Thursday after selling part of its bond portfolio for a loss and announcing a share sale to plug the hole. The collapse was worsened by a bank run, with around 25% of deposits facing withdrawal requests on Thursday. This caused the bank to be declared insolvent by the US Federal Deposit Insurance Corporation (FDIC) on Friday. The impact on the broader sector was palpable with the KBW US Bank Index tumbling 11% on Thursday and Friday and even the Eurostoxx 600 Bank Index dropping by 4% on Friday. While SVB was unique, given its disproportionately large bond holdings and the dominant share of less stable uninsured deposits, banks' government bond holdings have grown rapidly since the Global Financial Crisis, while deposits have been leaking out of the US banking system. Last week's events show that vulnerabilities from rapid interest rate hikes could play out in unexpected ways, while an expected recession is likely to worsen credit losses.

Markets

Gripped by a flight to safety

The collapse of SVB and the consequent tumbling of bank stocks roiled broader investor sentiment towards the end of last week, causing a whole-hearted flight to safety. Global stocks dropped with the MSCI World Index dropping by 3.6% on the week, gaining downward momentum on Thursday and Friday in an already somewhat fragile market backdrop from the early part of the week due to hawkish central bank expectations. Credit spreads widened notably, with the US Investment Grade Financial Index spread widening by 20bps on the week. Government bonds surged on safe haven demand. After moving downward 20bps on Thursday, the 2yr Treasury yield slumped another 28bps on Friday, marking the largest daily decline since 2008, while the 10yr Treasury yield fell by 25bps on the week. Although last week's collapse of SVB was sudden, the sheer magnitude of rate rises seen over the last year was expected to have after-effects, as we have seen in rising bankruptcies, making risk asset pricing seem vulnerable.

US

Solid payrolls, but more signs of a cooldown in the labour market

At 311'000 the number of new nonfarm payrolls was above consensus expectations in February but significantly below January's very strong level of more than half a million. While this still reflects strong momentum in job creation, other indicators are pointing at a cooldown in the tight labour market. The unemployment rate rose to 3.6% from 3.4% the month before, helped by a small pickup in the participation rate. Importantly given the Fed's recent hawkish comments, wage growth slowed to 0.2% MoM from 0.3% in January, though the annual rate still ticked up from 4.4% to 4.6%. The number of job openings fell back significantly in January to 10.8m, which is welcome from the Fed's point of view although it is still at an elevated level. Importantly, the quits rate, which is a leading indicator for wage growth, has fallen back to 2.5%, not very far above the pre-pandemic level of 2.3%, indicating that employees are increasingly less willing to leave their jobs given the deteriorating outlook.

Japan

Sayonara Kuroda san

Monetary policy was kept unchanged at Governor Kuroda's last Bank of Japan MPM meeting while the Diet confirmed new BoJ Governor Ueda and his two new deputies. We do not foresee any major changes to YCC before the June meeting. Meanwhile, the headline business conditions indicator from the Business Outlook Survey BSI, conducted by the Ministry of Finance, fell back into negative territory from 0.7 to -3 in Q1, but the outlook component is rising steadily showing 0.7 in Q2 and 5.2 in Q3. The Eco Watchers Survey for February shows that Japan's household-related diffusion index rose for the first time in four month, with activity reaching pre-pandemic levels. Food/beverages, services and retail were the major positive contributors. The corporate diffusion index recovered as well, though the outlook component is somewhat murky. Surprisingly, Q4 GDP growth was revised down close to zero. Nominal wages grew a meagre 0.8% YoY in January, leaving real wages down 4.1% YoY, as the positive bonus impact from last month waned.

China

The NPC concludes as the credit impulse turns positive again

The National People's Congress (NPC) concluded with the re-appointment of President Xi Jinping for a third five-year term and the expected new appointments of Premier Li Qiang and his deputy He Lifeng. Surprisingly, Yi Gang and Liu Kun kept their positions as PBoC Governor and Finance Minister respectively. Following several months of deteriorating growth, aggregate financing growth recovered, up 9.9% YoY, supported by front-loaded government bond issuance and a recovery in home sales. However, we note that loans extended by non-deposit financial institutions have been added to the statistics, which distorts the comparison somewhat. Fortunately, the credit impulse has turned back into positive territory, even though the PBoC has urged banks to contain lending. Meanwhile, exports continued to contract in January/February, though not as much as expected, while imports contracted more than 10% YoY. Finally, consumer price inflation dropped to only 1% on falling pork prices while producer prices fell 1.4% YoY, but stabilised on a sequential basis.

LatAm

Chile's tax reform proposal falls short of securing a simple majority in the Lower House

In Chile, the Lower House rejected the tax reform bill, which had been expected to increase fiscal revenues by 3.5% of GDP by 2026, by one vote. The Minister of Finance will begin negotiating revisions to the bill so that it can be resubmitted to Congress. The rejection of the legislation will likely put the government's policy agenda at risk, particularly pension reform, which will require significant changes to pass. Inflation surprised to the downside, falling 0.1% in February, and decelerating from 12.3% to 11.9% YoY. Despite the positive surprise in the headline inflation, the annual ex-volatile inflation (the preferred measure used by the Central Bank) remained under pressure and accelerated from 10.6% to 10.7%. We expect no changes to the policy rate until inflation decelerates for at least three consecutive months. In Brazil, headline inflation reached 0.84% in February, above market expectations, mainly driven by the seasonal adjustment in school fees and increased health insurance costs. Annual headline and core inflation gradually decelerated, reaching 5.6% and 8.4%, respectively.

What to Watch

- In the US, investors will focus on the latest inflation numbers, which have the potential to trigger a more hawkish Fed rate hike if they come out higher than expected.
- In the Eurozone, the ECB is expected to hike the deposit rate by another 50bps, but the focus will be on the commentary and the ECB's intentions for monetary policy going forward.
- In APAC, we believe that Bank Indonesia will keep its policy rate stable at 5.75% when its MPC convenes. In Japan, we will focus on the first 'shunto' wage hike announcements. China will report combined January/February data for retail sales, industrial production, and fixed asset investments. Export data will be reported in Japan, India, Indonesia, Malaysia, Singapore, and the Philippines. India will release CPI and WPI data for February.

Disclaimer and cautionary statement

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