ZURICH

Weekly Macro and Markets View

27 March 2023

Highlights and View

Risk assets stabilised last week but European bank shares slid again on Friday, led by Deutsche Bank

Risk assets remain vulnerable amid weakening underlying fundamentals with further decisive policy action likely required to address investor angst around banks.

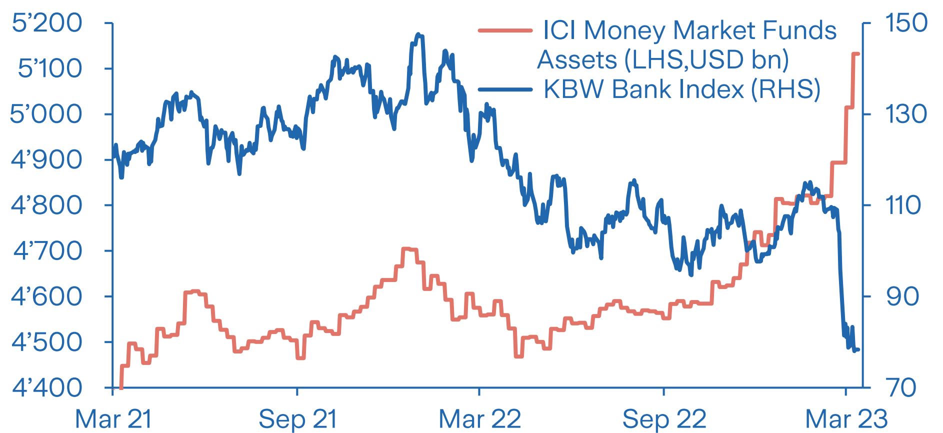
Major central banks hike rates further despite banking sector turmoil as inflation remains sticky and growth has been resilient

Policy rates are now expected to have reached their peak in key regions.

In the Eurozone, the Flash Composite PMI rose more than expected in March to 54.1

The survey suggests the Eurozone economy returned to growth in Q1, however, risks are to the downside for the rest of this year.

Flight to safety



Source: Bloomberg

Investor sentiment remains fragile despite some calm returning to markets last week following the sale of Credit Suisse to UBS over the previous weekend. Notably, a flight to safety continues with ongoing inflows to money market funds amid further evidence of deposit flight from US banks. While stocks rallied in the beginning of the week, angst around the banking sector returned sporadically with Friday seeing a sharp slide in European bank shares and a widening in bank credit spreads, especially for subordinated securities. On Friday morning, Deutsche Bank shares slumped by as much as nearly 15% before recovering to close down by 8.5%. Credit markets continue to underperform stocks with investors continuing to pull money from funds. Given the fragile sentiment, government bonds remained in demand, despite last week's rate hikes and hawkish guidance from major central banks. Treasury yields ticked lower, led by a repricing of the rates outlook, with sizable rate cuts now priced in later this year amid banking sector woes. In Europe, yields initially edged higher but slipped again on Friday as banking concerns returned. Further declines in bond yields are likely as credit tightening begins to impact the broader economy. Risk assets, however, are likely to remain vulnerable amid weakening underlying fundamentals while further decisive policy action may be needed to address investor angst around the banking sector.

US

The Fed hikes rates despite the turmoil in the banking sector

As expected, the Fed lifted its target rate by 25bps to a range of 4.75% to 5%, signalling that it is not overly worried about the detrimental impact of its aggressive monetary tightening on the banking industry or potential spillover effects of the recent turmoil in the sector. There was no change in the FOMC's guidance as the dot plot still signals further rate hikes in the coming months. Interestingly, even the lowest dot sees the year-end rate at the current level. We strongly doubt that the FOMC will sit tight if we are correct about the looming recession. Rather, the Fed will likely be forced into cutting rates once the full impact of monetary tightening becomes visible, a view that is now also reflected in the futures market. So far, however, the latest PMI surveys are still painting a decent picture in which robust service activity is more than compensating for the contraction in the manufacturing sector. The S&P 500 ended the week on a positive note with tech stocks once again benefiting from lower bonds yields.

UK

The BoE tightens further as annual inflation reaccelerates

As expected, the Bank of England lifted the Bank Rate by 25bps to 4.25% at its meeting last week. The Monetary Policy Committee kept its guidance unchanged, which is not a major surprise given the still tight labour market and elevated inflation rates. The rebound in CPI inflation in February following the fall in January was larger than expected, pushing the annual rate to 10.4% while core inflation accelerated to 6.2% YoY from 5.8% YoY the month before. An important driver of the reacceleration was services inflation, which rebounded strongly from the relatively modest figures in January. Going forward inflation rates are expected to fall substantially over the course of the year, helped by Chancellor Hunt's recent announcement of an extension to the Energy Price Guarantee. Consumer sentiment has improved slightly in March but remains far below pre-pandemic levels. Despite downbeat household sentiment, retail sales grew substantially in February. Finally, the latest PMI surveys are signalling a slowdown from last month but no imminent contraction of the economy.

Switzerland

The SNB hikes rates and signals that further tightening will likely be needed

The SNB hiked the policy rate by 50bps last week. This was in line with expectations given previous guidance and recent strong inflation prints. Despite the higher rates projection, the inflation forecast was revised up and still anticipates inflation will be above 2% by the end of 2025, signalling that the SNB expects further tightening to be required. While the SNB recognised that uncertainty around the outlook is high, the near-term GDP forecast for the Swiss economy was also lifted, with growth now expected to be around 1% in 2023, at double the previous forecast of 0.5%. While we had expected the economy to be resilient in 2023, given a solid labour market and strong household finances, it appears that the near-term growth outlook has become more challenged following the sale of Credit Suisse to UBS last weekend, along with global banking sector turmoil. Elevated uncertainty and tighter credit conditions in particular are likely to weigh on activity and demand going forward, potentially limiting the need for further SNB rate hikes.

Japan

Metropolitan land prices keep rising

Leading indicators like the PMIs and the Reuters Tankan for March confirm that the services sector is improving further in segments like travel, dining, and entertainment. Indeed, the Non-manufacturing PMI has reached a ten-year high. Meanwhile, the manufacturing sector is improving as well, but is still lacklustre as the Manufacturing PMI and its major subcomponents remain below the boom/bust line of 50. It is interesting to note that the outlook component of the Reuters Tankan is recovering for the manufacturing industries but appears to be rolling over for the non-manufacturing sector. Japan's headline CPI dropped in February due to the impact of public subsidies for electricity and gas charges, while core inflation remains sticky, mainly due to rising prices for food and daily necessities. Japan's land prices have continued to move higher by 1.6% in 2023 versus 0.6% in 2022. We note that land price inflation gained steam in the 23 central wards of Tokyo, where commercial land prices were up 3.6% and residential prices spiked by 3.4%.

LatAm

Brazil's equity market remains under pressure

The Central Bank of Brazil kept the Selic rate unchanged at 13.75%. The statement was less hawkish than the previous one but still signalled high rates for longer. The decision escalated the tense relationship between the government and the central bank, increasing the odds of reviewing the inflation target to the upside. Lula extended his criticism against the central bank, calling it irresponsible for maintaining the Selic rate at a six-year high, and said that the governor of the central bank is not fulfilling its mission. The equity market reacted negatively, and the Bovespa index fell 3.8% last week, one of the worst-performing globally. We are still waiting for the government to release its new fiscal framework proposal, which will be one of the most critical drivers for the equity market in the coming weeks. In Mexico, the good momentum in economic activity from beginning of the year, particularly in commercial activity, remains in place. Retail sales and monthly economic activity surprised the upside, growing 1.6% MoM and 0.6%, respectively.

What to Watch

- In the US, house prices are expected to have receded further in January while consumer sentiment and personal spending data will give insights into the current state of households.
- In the Eurozone, the European Commission's business and consumer survey and ECB bank lending data will give further clues to the state of the economy, however, the results may predate the full impact of recent banking and financial market stresses.
- In APAC, we expect Bank of Thailand to hike its policy rate by 25bps to 1.75%. Japan will report February data for retail sales, industrial production, housing starts and the labour market, as well as Tokyo's CPI for March. Australia will report February data for retail sales, private sector lending and the CPI. China will release PMIs for March while Hong Kong will report export and retail sales data for February. Korea will release industrial production data for March and export data for February.
- The Central Bank of Mexico will likely increase the policy rate by 25bps to 11.25%. In Chile, the focus will be on several economic activity indicators, which we expect confirm a better growth in Q1 2023.

Disclaimer and cautionary statement

This publication has been prepared by Zurich Insurance Group Ltd and the opinions expressed therein are those of Zurich Insurance Group Ltd as of the date of writing and are subject to change without notice.

This publication has been produced solely for informational purposes. The analysis contained and opinions expressed herein are based on numerous assumptions concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies. Different assumptions could result in materially different conclusions. All information contained in this publication have been compiled and obtained from sources believed to be reliable and credible but no representation or warranty, express or implied, is made by Zurich Insurance Group Ltd or any of its subsidiaries (the 'Group') as to their accuracy or completeness.

Opinions expressed and analyses contained herein might differ from or be contrary to those expressed by other Group functions or contained in other documents of the Group, as a result of using different assumptions and/or criteria.

The Group may buy, sell, cover or otherwise change the nature, form or amount of its investments, including any investments identified in this publication, without further notice for any reason.

This publication is not intended to be legal, underwriting, financial investment or any other type of professional advice. No content in this publication constitutes a recommendation that any particular investment, security, transaction or investment strategy is suitable for any specific person. The content in this publication is not designed to meet any one's personal situation. The Group hereby disclaims any duty to update any information in this publication.

Persons requiring advice should consult an independent adviser (the Group does not provide investment or personalized advice).

The Group disclaims any and all liability whatsoever resulting from the use of or reliance upon publication. Certain statements in this publication are forward-looking statements, including, but not limited to, statements that are predictions of or indicate future events, trends, plans, developments or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties and can be affected by other factors that could cause actual results, developments and plans and objectives to differ materially from those expressed or implied in the forward-looking statements.

The subject matter of this publication is also not tied to any specific insurance product nor will it ensure coverage under any insurance policy.

This publication may not be reproduced either in whole, or in part, without prior written permission of Zurich Insurance Group Ltd, Mythenquai 2, 8002 Zurich, Switzerland. Neither Zurich Insurance Group Ltd nor any of its subsidiaries accept liability for any loss arising from the use or distribution of publication. This publication is for distribution only under such circumstances as may be permitted by applicable law and regulations. This publication does not constitute an offer or an invitation for the sale or purchase of securities in any jurisdiction.

Zurich Insurance Company Ltd

Investment Management
Mythenquai 2
8002 Zurich

173008049 01/22) TCL

ZURICH®