Weekly Macro and Markets View

3 April 2023

Highlights and View

In Brazil, the newly proposed fiscal framework includes a target for increased spending and a commitment to a primary fiscal surplus

The proposal is feasible but challenging and will likely ease fiscal uncertainty, reducing the equity risk premium and supporting the equity market.

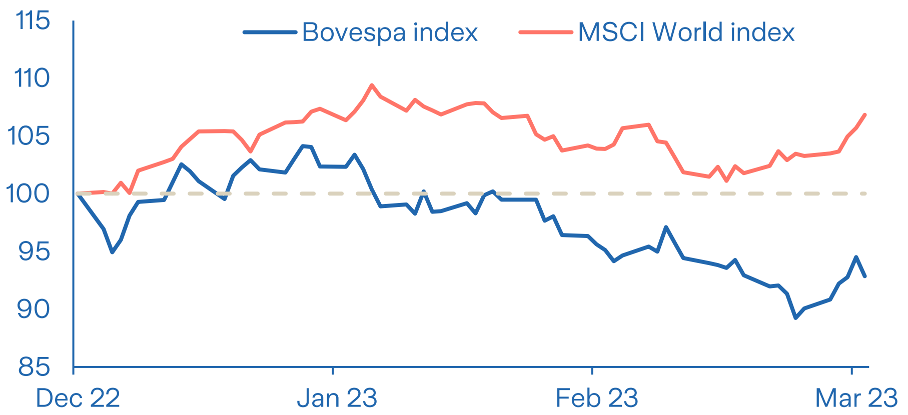
Japan's quarterly Tankan corporate survey reveals a mixed picture

Conditions in the manufacturing sector remain soft while the service sector keeps doing well. Capex plans appear weak but are likely to improve during the new fiscal year.

Eurozone headline inflation fell sharply in March to 6.9% YoY from 8.5% in February, but core inflation ticked higher to 5.7%

The continued stickiness of core inflation will worry the ECB enough for them to keep their hawkish bias.

The equity market in Brazil seems to have priced in the downside risks



Source: Bloomberg

In Brazil, the government revealed the details of the new fiscal framework proposal, which will now be discussed in Congress. It aims for a balanced primary fiscal result in 2024 that turns into a 0.5% of GDP surplus in 2025 and 1% in 2026. Public spending growth will be limited to 70% of real primary revenue growth from the previous year. Nevertheless, spending growth cannot be lower than 0.6% or higher than 2.5% in real terms. The finance minister mentioned that a goal of this proposal is to stabilise public debt between 76.5% and 77.3% of GDP in 2026. We believe that the new fiscal target is feasible and mitigates some of the problems of the previous one. However, debt stabilisation is challenging and will likely require a higher fiscal surplus. The equity market reacted positively, rising 1.9% on the day of the announcement. We expect the easing in fiscal uncertainty will reduce the equity risk premium, supporting the equity market. Furthermore, the Bovespa index is lagging compared with other markets and seems to have price in the downside risks.

In Mexico, the central bank hiked the policy rate by 25bps to 11.25%, as expected. However, the statement's tone was surprisingly neutral and did not signal an additional hike in the policy rate at the forthcoming meeting. We expect that 11.25% is the terminal rate for Banxico, and the easing cycle will likely start in Q4 2023.

Eurozone

Headline inflation falls sharply, but core remains sticky

The economic data from the Eurozone were mixed last week. Headline inflation fell sharply from 8.5% YoY in February to 6.9% in March. Continued falls in energy inflation, which is now negative YoY, were the main reason even though food inflation remained elevated. However, the good news on falling headline inflation was tempered by a further uptick in core inflation from 5.6% YoY in February to 5.7% in March. This suggests the ECB will maintain a hawkish bias going forward. However, the risk is that in the process of tightening monetary policy they increase financial stresses.

Meanwhile, the European Commission's Economic Sentiment Indicator for March fell back slightly, with industrial and services confidence softer and consumer confidence flat but at very weak levels. This may be an early indication that the bounce in business confidence that we have seen so far in Q1 may be petering out. More data will be needed over the next few months to confirm whether this is the case or not.

Japan

The Tankan reveals soft manufacturing conditions while the service sector remains upbeat

The headline figure for Large Manufacturers in the quarterly Tankan business conditions report, which was released today, was disappointing compared to consensus forecasts, but not that surprising when referring to monthly surveys like the Reuters Tankan or Eco Watchers survey. The diffusion index (DI) fell from 7 to 1, with the outlook DI inching lower from 6 to 3. Non-Manufacturing conditions remain resilient, with the headline DI up one point to 20. The service sector remains in good shape, confirmed by strong retail sales growth in February. Capex plans tend to move higher throughout the new fiscal year, which has to be kept in mind when interpreting the expected conservative rise of only 3.9%. Software investments will remain a prime driver. Meanwhile, industrial production bounced back in February, though the trend remains weak on a three-month sequential basis. Tokyo's March inflation data confirm that food and lodging prices continue to climb while energy inflation seems to have peaked. At 3.4%, the new core CPI reached a 33-year high.

China

Alibaba reorganises, and the Construction PMI hits a record high

Alibaba, the internet giant and index heavyweight listed in both New York and Hong Kong, has announced that it intends to list its eligible assets separately. Investors' belief that this will give a significant boost to the company's operational and cost efficiency lifted the stock price by more than 20% following the announcement. We also note that the government's recent charm offense towards related companies in the sector should help convince foreign investors that Chinese equities remain investable. Meanwhile, the NBS PMIs for March were released, showing that service-related sectors keep improving, with the service business PMI spiking from its December low of 39.4 to 56.9, while the construction business PMI gained more than five points in March to reach a record high of 65.6. We note, however, that the increase was mainly driven by public infrastructure spending, while private property investments remained soft. The Manufacturing PMI retreated slightly to 51.9, and as we anticipated, new home sales accelerated in March.

Australia

Inflation is likely to pass its peak

In February, monthly inflation fell from 7.4% to 6.8% YoY, below consensus expectations of 7.2%. The slowdown was evident across various components of the indicator, suggesting a broad-based trend. The steady decline in monthly inflation since December is a positive sign that inflation had peaked, a welcome development for the Reserve Bank of Australia (RBA), as its tightening efforts appear to have helped dampen inflation. Retail sales for February grew by 0.2% MoM or 6.4% YoY, down from January's 1.9% MoM and 7.5% YoY. Headwinds to consumption remain strong given the contraction in real household disposable income and savings, along with numerous fixed mortgages that are going to expire in the coming months. The market is anticipating a pause in policy rate hikes this week with the possibility of rate cuts towards the end of the year. While it will be a close call for the RBA in its April meeting, we anticipate that the central bank will go ahead to deliver another 25bps, bringing its terminal rate to 3.85% in this cycle.

Credit

Uneasy calm

Credit and other risk assets continued to recover last week from the mid-March sell off that was driven by angst around banks. The primary market came back to life with decent demand seen in the subscription of new deals, although High Yield primary market activity was still muted and flows remain negative. While the relief from the banking sector stress was palpable in investor sentiment, it seems too early to conclude that the sector has turned a corner as both impending credit losses in the expected US recession and the potential for further deposit flight remain key vulnerabilities. Moreover, not only are corporate bonds lagging the rally in stocks as is typically seen ahead of recessions, but US bank stocks are still bumbling along at their recent lows. Furthermore, we are seeing increasing signs of deterioration in broader credit conditions with rising bankruptcies of smaller companies and an increased likelihood that credit standards will tighten further in both Europe and the US. In essence, some caution is still likely warranted despite the lack of news on banks.

What to Watch

- In the US, the latest set of ISM surveys and labour market data are expected to show a deceleration in economic activity.
- In the Eurozone, various economic data will give us a sense of the strength of the bounce back in activity in Q1.
- In APAC, our view that Australia's RBA will hike policy rates by another 25bps is a close call, while the probability is higher for India's RBI. Japan will report February wages and household spending data. Australian housing data should continue to be fragile. February CPI data will be released in South Korea, Indonesia, Thailand, and the Philippines. Markets will be closed on various days across the region due to Easter, Tomb Sweeping and other holidays.
- *Please note, the Weekly will not be published on April 10, 2023 due to the Easter holiday.*

Disclaimer and cautionary statement

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