Weekly Macro and Markets View

17 April 2023

Highlights and View

US headline inflation falls by a full percentage point to 5% in March

As expected, inflation is falling substantially, and the significant drop in producer prices points at further fading price pressure.

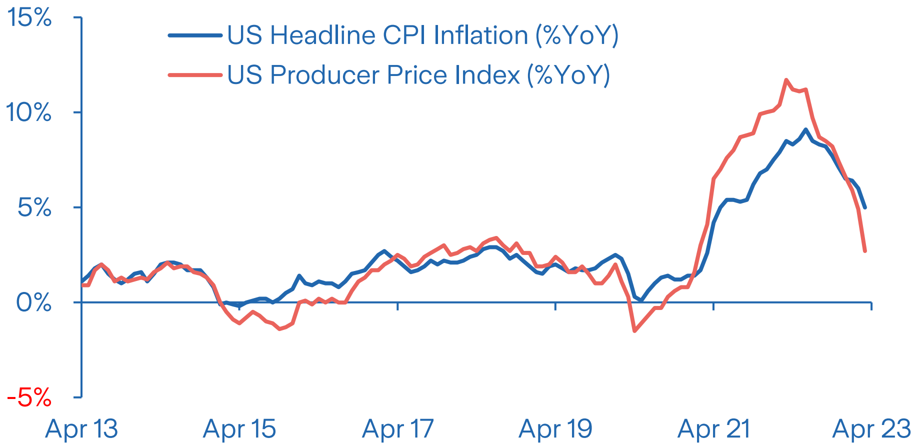
Credit markets continue to recover while the US bank earnings season is kicked off by major banks

It seems too early to sound the all clear on US banking sector woes as smaller bank earnings are still likely to be the focus of investors trying to assess any potential risk of a credit crunch.

China's economic data for March were solid while inflation data came in softer than expected

Surging exports to ASEAN and healthy European demand for electric vehicles were highlights while corporate and private loan demand keeps rising. We will focus on additional Q1 and March data that will be released on Tuesday.

US inflation falls to 5% YoY in March, the lowest in almost two years



Source: Bloomberg

Helped by significant base effects, headline CPI inflation decelerated a full percentage point from 6.0% YoY in February to 5.0% in March, the lowest rate since April 2021. While core inflation also slowed on a monthly basis, from 0.5% MoM to 0.4%, the annual rate ticked up slightly from 5.5% the month before to 5.6%. Producer prices confirmed the disinflationary trend with both headline and core PPI falling on a monthly basis in March, pushing down the annual rates to 2.7% and 3.4% respectively. The slowdown in inflation is welcome but it is also a reflection of a slowing economy. Retail sales fell by 1% MoM in March while consumer sentiment remains very downbeat despite a small pickup in April. Similarly, small business optimism remains close to a decade low with both capital expenditure plans and hiring intentions weakening further, the latter to the weakest since May 2020. Interestingly, the latest Fed minutes show that the Fed staff are now forecasting a mild recession starting later this year, moving closer to our long-held view. Stock markets rose last week as investors focused mostly on the positive news around weaker inflation while ignoring increasing risks to growth and earnings. Rising bond yields were a drag for tech stocks, however, with the Nasdaq falling behind most of its peers, showing only modest gains.

Credit

Reluctantly chasing stocks higher

Credit markets had a strong tone to them last week though corporate bonds continue to lag the more upbeat tone in stocks. While broader stocks have almost entirely shrugged off the weakness seen in March triggered by banking sector concerns, spreads are still wider compared to the tights of early March and interestingly US bank stocks still remain depressed. The US bank earnings seasons kicked off with better than expected results from major banks such as Citigroup, JP Morgan and Wells Fargo. However, it is guidance and earnings from smaller banks as well as lending standards data from both the Fed and ECB that are likely to be closely watched to assess any risk of a credit crunch. The Fed's lending standards, historically one of the best predictors of default rates, had already been foreboding a jump in default rates, which does seem to have been borne out by the sharp uptick in bankruptcies seen this year. All in all, while recession signals are gathering momentum, credit spreads seem to be driven more by light positioning rather than by fundamentals.

Eurozone

A divergent outlook

Last week's Eurozone data highlighted a divergent outlook as the industrial sector benefits from China reopening and lower energy prices while consumers retrench. Eurozone industrial production (IP) rose 1.5% MoM in February, boosted by a rebound among energy intensive sectors and with Germany posting solid gains. Unless conditions reverse in March, IP is now on track to rise well above 1% in Q1 (QoQ). By contrast, retail sales volumes fell by 0.8% in February and are down 3% compared to a year ago. While labour markets remain strong, depressed consumer sentiment and falling real wages are weighing on spending. These data pre-date the banking sector turbulence and we suspect tighter credit conditions and higher uncertainty will weigh on activity going forward. The ECB is also on track to tighten policy further, with recent hawkish ECB commentary indicating a close call between a 25bp and a 50bp hike in the May policy meeting. The upcoming bank lending survey along with CPI data will play key roles in that decision.

China

The economic recovery is gaining steam while inflation is no concern

China's economic recovery following its reopening policies was evident in the favourable set of economic data for March. The rise in aggregate financing, up 10% YoY, was mainly driven by stronger bank lending and off-balance sheet financing. Corporate credit demand reflects solid infrastructure investment growth, while private household loan demand is being driven by mortgages. Export data are also encouraging, up 14.8% YoY, with export volumes at a record high, driven by strong demand for electric vehicles in the EU and UK as well as a 35.4% YoY surge in exports to ASEAN, a record high. However, the increase may be distorted by earlier festival demand in some countries. Meanwhile, the Caixin Services PMI reached a 28-month high of 57.8 in March while the Manufacturing PMI softened to 50 on weaker export orders. Consumer price inflation fell to only 0.7% YoY in March, driven by lower food prices, while producer price deflation intensified to -2.5% YoY. CPI inflation is expected to remain below the official ceiling of 'around 3%'.

Australia

No cracks in the labour market yet

Australia's unemployment rate stayed at a multi-decade low of 3.5%, with 53,000 new jobs added in March. Overall, job market tightness persists despite a decline in job vacancies signalling a potential loosening. Of note, the strong influx of immigrants, with a record of around 50k in Q1, should help ease labour shortages in the near to medium term. Consumer and business sentiment has improved but remains fragile, with a significant gap between expectations and current conditions for businesses. The Reserve Bank of Australia kept its cash rate unchanged at 3.6% with Governor Lowe leaving the possibility of further tightening open. Market projections suggest a terminal rate of 3.6%, but we suspect another 25bp hike remains on the table given still elevated inflation. The housing market continues to struggle, despite a surprising 0.6% increase in house prices. Home loans, a good leading indicator for home prices, declined further, indicating that challenges persist.

LatAm

Inflation pressures are falling in Brazil while inflation reaches a historically high level in Argentina

In Brazil, monthly headline inflation reached 0.7% in March, below market expectations. The slowdown in food, durable goods, and service prices mainly explained the positive surprise. Nevertheless, the tax hikes on gasoline and energy prices offset the downward pressure. Annual inflation stood at 4.65%, returning to the target band for the first time since Q1 2021. Furthermore, core inflation decelerated from 8.4% to 7.8%. The Central Bank's governor recognized that it was positive news but mentioned that it is still too early to start cutting rates. The equity market reacted positively, rising 5.4% during the week, while the BRL appreciated 3%. We expect inflation will continue to decelerate during Q2 2023 due to the base effect. The service sector contracted by 3.1% in January, confirming that economic activity is decelerating. In Mexico, industrial production grew 0.7% MoM, driven by a rise of 4.1% in mining. However, the manufacturing sector is slowing down and declined by 0.5% MoM. In Argentina, inflation continues accelerating, reaching 104.3%, the highest annual level since 1991.

What to Watch

- The Flash PMIs for major regions will indicate how broader sentiment and economic activity has held up amid banking sector turbulence.
- In the UK, inflation is expected to have slowed down in March while the latest batch of PMI data will give insights into the current state of the economy.
- In APAC, we believe Bank Indonesia will keep policy rates unchanged on Tuesday. Our focus will be on China's release of Q1 GDP and March data for retail sales, industrial production, and fixed asset investments. Japan will release its Reuters Tankan survey for April as well as foreign trade and CPI data for March. Australia's spending intention survey will reveal the underlying consumption trend. Malaysia's exports are likely to stay subdued while inflation should not be a big concern. Starting on Wednesday, Indonesian markets will be closed for five consecutive trading days due to Hari Raya Aidilfitri.

Disclaimer and cautionary statement

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