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Weekly Macro and Markets View

2 May 2023

Highlights and View

US GDP growth slowed from 2.6% in the final quarter of last year to 1.1% in Q1

Underlying activity was stronger, however, as consumer spending rebounded, though the outlook for households is deteriorating.

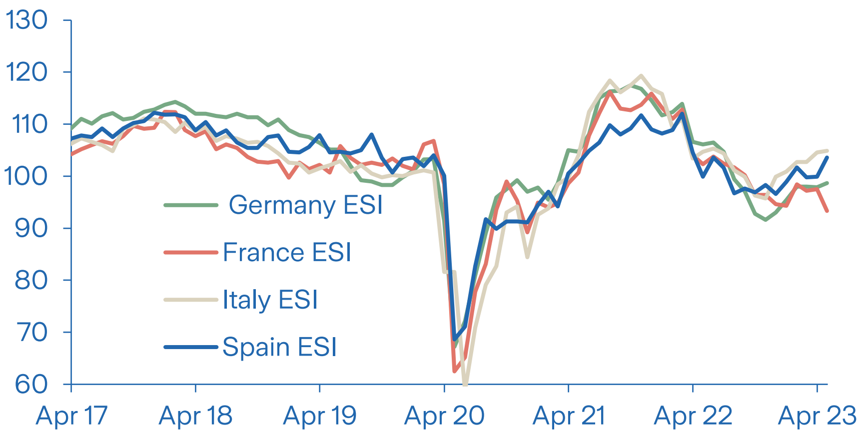
The Bank of Japan keeps policy unchanged and announces a broad policy review

With the announcement of a comprehensive policy review, the BoJ, under the leadership of the new Governor, Kazuo Ueda, appears to be opting for a patient and cautious approach towards unwinding its ultra-loose monetary policy.

An emergency government-led intervention leads to the sale of First Republic Bank to JPMorgan Chase

Banking sector issues are likely to linger as effects of substantial rises in rates take their toll, but a systemic bank crisis seems unlikely as policymakers should try to protect depositors.

Data confirm the fragility of the Eurozone, but the ECB will still hike rates



Source: Bloomberg (Note: ESI is the European Commission's Economic Sentiment Indicator)

Last week saw the release of a batch of underwhelming data for the Eurozone. Q1 GDP came in lower than expected at 0.1% QoQ versus expectations of a 0.2% increase. What's more, growth in Q4 2022 was revised down to -0.1% QoQ from zero. In addition, the German ifo business climate indicator only recorded a modest increase in April and the current conditions part of the survey fell. Finally, the European Commission's (EC) Economic Sentiment Indicator came in at 93.3 for April, almost unchanged from March. Digging into the details reveals some reasons for the soft outturns. Eurozone Q1 GDP was dragged down by a large fall in Ireland of -2.7% QoQ. Irish data tend to be particularly volatile because of the difficulty in dealing with the economic contribution from large multi-national companies domiciled there. Excluding Ireland, the Eurozone GDP grew by around 0.2% QoQ in Q1. The EC's economic sentiment indicator was dragged down by France, where sentiment took a hit in April due to the ongoing demonstrations and strikes over pension reform. Outside of France the survey was more robust. Overall last week's data indicate a Eurozone economy that is recovering from the winter energy crisis, but not growing at a very strong pace. However, the ECB is currently focused on inflation and recent generous wage deals for the public sector in Germany will have done little to assuage its concerns. We therefore expect another rate increase at this week's ECB monetary policy meeting on Thursday.

Credit

A volatile week culminating in the collapse and rescue of First Republic

The collapse and sale of First Republic to JP Morgan after an emergency government-led intervention during the weekend confirms our view that the issues around the banking sector are likely to continue, even though a systemic bank crisis is unlikely due to policy intervention. Importantly for investors, however, bank equity and bond holders are likely to see haircuts or complete wipeouts in banks entering resolution and the risk premium for this likelihood needs to be appropriately priced. Consequently, credit markets were volatile last week, along with equity and bond markets, as investors had to navigate through concerns not only around First Republic but also around mixed economic data in the US. Credit spreads closed the week modestly wider in cash markets and modestly tighter in CDS markets. Spreads have been somewhat resilient lately due to light positioning and also lighter supply in the last two months. That said, fundamentals have been deteriorating and downgrades, defaults and bankruptcies have already been accelerating since Q1.

US

Growth slows markedly in Q1 despite a rebound in consumer spending

The first estimate for GDP shows a significant growth slowdown in the first quarter from an annualised rate of 2.6% to 1.1%. However, underlying activity was stronger than the headline number suggests as business investment has been distorted by inventory adjustments. Consumer spending was a solid 3.7%, a marked improvement from 1.0% at the end of last year. The more forward-looking data published last week paint a mixed picture. Durable goods orders picked up but capital goods orders and shipments as well as a number of regional manufacturing indicators are pointing to a continued deterioration in the economic environment. Meanwhile, the Employment Cost Index shows a marginal pickup in Q1, indicating that wage pressure remains elevated while PCE core inflation has decelerated from 4.7% in February to 4.6% YoY in March. The S&P 500 managed to climb back up to end the week in positive territory after having fallen by more than 2% at some point. Strong earnings reported by a number of large tech companies helped to lift investor sentiment and stock markets.

Switzerland

Slowing growth led by manufacturing weakness

Macro data shows a further slowdown in growth momentum in April. The Manufacturing PMI was weaker than consensus expectations and fell further into contractionary territory, to 45.3. Weakness was led by a sharp decline in current output, and the orders backlog also slipped. Employment ticked higher, however, indicating that businesses remain relatively confident about the outlook. The Services PMI also weakened, led by softer new orders and a sharp drop in input prices. Last week's KOF leading indicator, which tracks a whole-economy measure of economic activity, also ticked lower, pointing to below trend growth. While the economy remains relatively resilient given its highly diversified nature and strong household finances, we expect demand and activity to continue to weaken in the months ahead as a reflection of past policy tightening and bank issues. The upshot is that slowing growth should help to contain inflation and limit the need for further monetary tightening.

Japan

The BoJ maintains its loose policy

In Kazuo Ueda's first meeting as Governor, the Bank of Japan (BoJ) decided to maintain its policy rate at -0.1% and the target yield of 10yr Japanese Government Bonds (JGBs) within a range of 0% +/-50bps under its Yield Curve Control framework. Despite inflation exceeding the BoJ's 2% target, the central bank continues its ultra-loose monetary policy. In March, core CPI, excluding fresh food, rose 3.1% YoY while Tokyo core CPI increased from 3.4% to 3.8% in April. However, the BoJ's latest forecasts anticipated core CPI will remain close to 2% over the next two years. Governor Ueda stressed that there is now hope that the 2% inflation target is achievable compared to in the past, and that the risk of premature tightening is greater than the risk of high inflation. Notably, the BoJ announced a comprehensive monetary review to be conducted over the next one to one and a half years. Following the BoJ's dovish stance, Japan's equity market rallied, with the Topix Index gaining around 1.2% while the Japanese yen weakened and yields on 10yr JGBs dropped notably.

LatAm

Economic activity in Mexico remains solid

In Mexico, according to the preliminary figures, Q1 GDP grew 1.1% QoQ, above market expectations. The industrial and services sectors were the main driver for the expansion, rising 0.7% and 1.5%. The non-oil trade balance for March delivered a surplus on the back of a double-digit increase in auto exports. In Brazil, monthly economic activity in February surprised to the upside, growing 3.3% MoM. This figure likely reflects a positive temporary effect from the agriculture sector, particularly the soybean and corn harvest. Service output and headline retail sales also increased by 1.1% MoM and 1.7% MoM, respectively. By contrast, the labour market continues to soften, and the unemployment rate increased for the third consecutive month, reaching 8.8%. In another tough week for the Argentine economy, pressures against the currency continued, forcing the central bank to raise the reference rate by 1000bps to 91% (equivalent to an effective annual rate of 141%) to achieve positive real interest rates and increase the demand for local currency assets.

What to Watch

- In the US, the ISM surveys and labour market data for April will give crucial insights into the shape of the economy at the beginning of Q2 while the Fed is expected to hike rates by another 25bps.
- In the Eurozone, the ECB is expected to tighten monetary policy further on Thursday by raising interest rates.
- China's Caixin PMIs and Manufacturing PMIs across Asia will provide further data on China's ongoing recovery and any potential spillover effects to regional economies. Australia's housing data, retail sales and exports, as well as Indonesia's Q1 GDP and CPI in various countries will be released.
- In Brazil, we expect the central bank to keep the policy rate unchanged with a less hawkish tone and April PMIs will be published. In Chile, the focus will be on the Sunday election for the 50 members of the new Constitutional Council for writing the new constitution proposal.

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