

# Weekly Macro and Markets View

8 May 2023



## Highlights and View

**Both the Fed and the ECB hike rates by 25bps to 5.125% and 3.25%, respectively**

While this was probably the Fed's last hike in this cycle we expect the ECB to tighten policy a bit further.

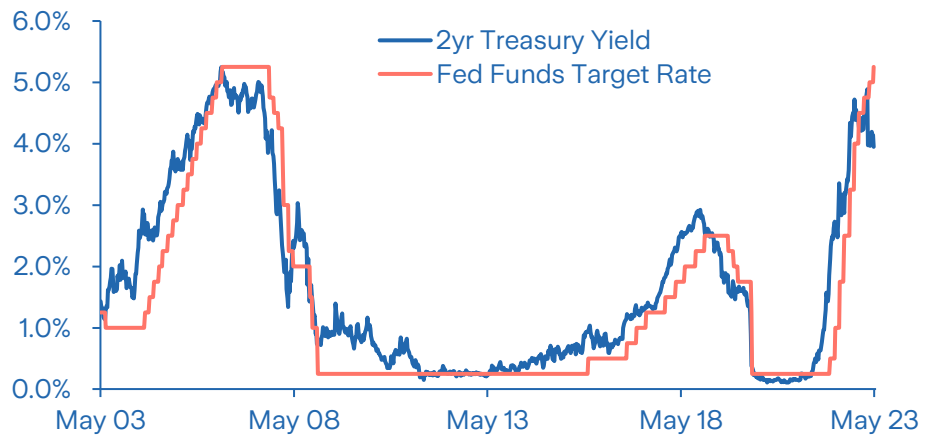
**US bank stocks tumble as sentiment sours on US regional banks after the sale of First Republic**

Regional banks remain exposed to fragile sentiment, raising the potential of a credit crunch. This week's Fed Senior Loan Officer Survey for Q1 gains particular importance in gauging this risk.

**Asia's PMIs show a divergence between services and manufacturing while electronic exporters remain under pressure**

China's reopening is expected to support domestic services and tourism in neighbouring countries, but semiconductor exporters are unlikely to benefit markedly.

## The Fed has probably hiked for the last time in this cycle



Source: Bloomberg

As was widely expected, the Fed lifted its target rate by 25bps to a range of 5%-5.25%, the highest since 2007. It was a unanimous decision and the Fed dropped the phrase that some additional policy firming may be appropriate, which opens the door to end the hiking cycle if economic data deteriorate further as we expect. The Fed emphasised inflation, labour market strength and credit conditions as factors they will be watching when deciding on future policy decisions. The latest batch of economic data was mixed in this regard. The ISM Manufacturing survey remained in contractionary territory in April for the sixth month in a row, with new orders pointing to continued weakness. Services ticked up slightly to 51.9 from 51.2 the month before though the activity component fell to a post-pandemic low. The number of job openings fell by about 400k to 9.6mn in March according to the latest JOLTS survey, with the quits rate ticking down to 2.5%. While this reflects a softening employment situation other data published last week do not. The unemployment rate ticked down from 3.5% in March to 3.4% in April while wage growth re-accelerated to a monthly rate of 0.5% from 0.3%, lifting the annual rate to 4.4%. Finally, at 253'000 new nonfarm payrolls came in above expectations, but taking into account a significant negative revision for the months before the smoothed trend still reflects a continued slowdown.

## Credit

### Banks drive volatility surge

Credit markets remained volatile last week, driven by swings in regional bank stocks following the collapse and sale of First Republic Bank. While regional bank stocks staged a recovery on Friday, the KBW US Bank Stock Index was still down 7.4% down on the week, with the regional bank stock index down by nearly 8% on the week. Single name stocks in focus fared even worse, and despite a recovery on Friday, Western Alliance Bancorp stock tumbled by around 27% and Pacwest Bancorp by around 43% on the week, taking year to date losses to

around 54% and 74% respectively. Unsurprisingly US financial credit spreads underperformed while the broader credit complex was notably weaker compared to stocks, which is a signal typically seen prior to recessionary downdrafts in markets. We believe that volatility and idiosyncratic issues are likely to continue in the banking sector although we don't expect a systemic crisis. However, risks abound and the potential of a credit crunch is rising. This week's Fed Senior Loan Officer Survey for Q1 will be keenly monitored by investors.

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## Eurozone

The ECB shifts down to 25bp rate-hiking increments

The ECB raised policy rates by 25bps last week, bringing the deposit rate from 3.0% to 3.25%. This represents a step down from the 50bp rate increases at the last few meetings. However, the central bank also announced that it would end completely reinvestments from its Asset Purchase Programme as of July, representing an increase in the pace of quantitative tightening (QT). What's more, ECB President Christine Lagarde indicated that the ECB was expecting to increase interest rates further saying, '...we are on a journey and we are not pausing.'

Inflation remains uncomfortably high for the central bank, with the flash estimate for April showing headline inflation up by a tenth of a percentage point to 7.0% YoY and core inflation still elevated at 5.6%. However, some recent activity data may be indicating the beginning of weakening, with Germany factory orders down sharply in March for example. The ECB will face a difficult balancing act in the coming months in trying to further tighten monetary policy without slowing down the economy too abruptly or creating additional financial market stresses.

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## Bonds

Markets steady amid further central bank rate hikes

Global government bond markets were steady last week, despite further rate hikes by the Fed and the ECB and strong US payroll data. While 10yr yields were little changed on the week, though with some intra-week volatility, yields for shorter maturity bonds edged lower. The 2yr Treasury yield declined by 9bps as concerns around the banking sector led to a further dovish repricing of the Fed outlook, with the Fed funds rate implying close to three rate cuts by year end. The 2yr Bund yield also edged lower despite relatively hawkish ECB

positioning. As a result of the ongoing repricing of the policy outlook, curves saw a further modest re-steepening, though both the Treasury and the Bund curve remain deeply inverted. Looking forward, we suspect yields have got some further downside as policy and credit tightening weigh on activity and sentiment and as peak policy rates approach. Lingered banking sector concerns and the US debt ceiling could well drive significant volatility, however.

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## Australia

The Reserve Bank of Australia delivers a 25bp hike

The Reserve Bank of Australia (RBA) surprised the market by raising its cash rate 25 bps to 3.85%, which aligns with our expectations, however. This decision came after a rate pause in April, allowing the central bank more time to evaluate the impact of previous rate hikes. While keeping the possibility of future rate increases open, the RBA emphasised the need to balance bringing down inflation while navigating a 'narrow path' to avoid a recession. Unless there is a resurgence in inflation, we believe the RBA is likely to maintain a pause going

forward. Meanwhile, retail sales showed a slight improvement in March but remained weak over a three-month period. Housing data improved, with home prices rising for the second consecutive month in April, and home loans also increasing in March. However, the year-on-year growth in home loans and house prices still remained significantly negative. With the RBA further increasing its cash rate, the housing market continues to face strong policy headwinds.

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## LatAm

Not yet time for rate cuts in Brazil

The central bank of Brazil kept the policy rate unchanged at 13.75%, as expected. The statement was less hawkish than the previous one, but the Central Bank continues with a cautious strategy to ensure the convergence of inflation. We expect the BCB to start cutting rates in Q4 2023. In Chile, economic activity contracted 2.1% YoY in March, mainly explained by commerce and mining. The performance of the service sector remains solid, growing 0.9% MoM. Although economic activity showed positive quarterly growth in Q1 2023, we expect it will

contract in Q2. In the Constitutional Council election, the centre-right and the right parties won 33 of the 50 members of the council. In Mexico, gross fixed investment grew 1.9% MoM in February, driven by non-residential construction and machinery and equipment. The labour market remained dynamic, with the unemployment rate reaching 2.4% and the participation rate increasing by 0.2pp to 60.9%. The Manufacturing PMI rose from 49.6 to 50.6, while non-manufacturing declined, but it is still in expansive territory, reaching 52.2.

## What to Watch

- In the US, small business optimism is expected to remain downbeat while CPI and PPI will reveal whether price pressure weakened further in April.
- In the Eurozone, industrial production data from various countries for March will give more indications as to the state of the economy.
- Eco watcher surveys, wages and spending data will be published in Japan. China's inflation is expected to remain muted while money data will help gauge credit demand across sectors. China's exports as well as Q1 GDP for Malaysia and the Philippines along with India's industrial production will be released. In Australia, the 2023-24 budget will be in focus.
- Inflation will likely continue to decelerate in several countries in LatAm. In Chile, we expect the Central Bank to maintain the current policy rate without signalling any cut in the short term.

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