

Weekly Macro and Markets View

9 January 2023



Highlights and View

The Global Composite PMI edged higher in December, helped by a stabilisation in services activity while manufacturing saw further weakness

Global growth remains well below trend and weakness is likely to continue with downbeat new orders and depressed global trade dynamics.

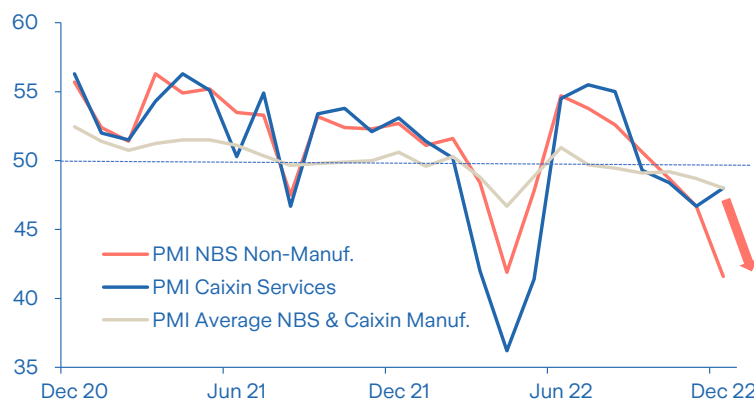
Both the US ISM Manufacturing and the US ISM Services indices are now in contractionary territory

Services have been holding up better than manufacturing, but a collapse in new orders points at increasing headwinds for the broader economy.

Headline inflation fell sharply in the Eurozone in December, but core inflation rose

Headline inflation is likely to fall further over the next few months, but the ECB is likely to maintain its hawkish bias given sticky core inflation.

From zero-Covid to all-in-Covid in China



Source: NBS, Caixin, Bloomberg

China's economic developments remain turbulent. Following the government's decision to make a U-turn in its Covid policy from a dynamic zero policy to withdrawing all Covid regulations and virus tracing, infections and mortality exploded in major cities, with hospitals under severe strain. Economic activity plunged as even non-infected consumers preferred to stay at home. This is visible when looking at the two services-oriented PMIs for December. While the December Caixin Services PMI (blue line in the chart) picked up steam by 1.3 points to 48, the NBS Non-Manufacturing PMI (salmon line), which covers services and construction, tumbled by 5.1 points to a post-Covid-breakout low of only 41.6. The prior PMI was collected in mid-December, when public stimulus measures were announced, while the latter was collected towards late December, after Omicron infections started surging and services consumption plunged. That noted, reopening dynamics have already kicked in both in the economy and particularly the equity market. Similar to previous Covid surges like those experienced in Hong Kong and India, infections tend to fall significantly once having peaked. However, we note that the peak of infections is likely to occur during the busy Lunar New Year season, when millions of workers travel to their families in the countryside, which may cause another surge of victims amid a lagging medical infrastructure.

US

Service activity weakens substantially

Business activity slowed markedly towards the end of last year with the drop in service activity particularly pronounced. While the ISM Manufacturing Index ticked down from 49.0 to 48.4 in December, the ISM Services Index fell from 56.5 to 49.6. The fall in new orders was even more severe with both manufacturing and services down to 45.2, well in contractionary territory. Meanwhile, the labour market remains strong with growth in nonfarm payrolls slowing to a still solid 223'000 in December, job openings receding only marginally and initial jobless

claims falling back to 204'000. Reassuringly, with regard to potential inflationary pressure, wage growth has slowed to 0.3% MoM, bringing the annual rate, which had already been revised down from 5.1% to 4.8% in November, to 4.6% YoY in December. Finally, it's worth mentioning that average weekly hours kept falling in December and are now at the lower end of the pre-pandemic range, pointing at a softening of the tight employment situation in line with weaker wage growth.

Eurozone

Headline inflation falls sharply but the ECB remains hawkish

Headline inflation fell sharply in the Eurozone at the end of last year, from 10.1% in November to 9.2% in December. However, core inflation rose further from 5.0% to 5.2%. Indeed, recent comments from ECB policymakers suggest that the central bank will maintain its hawkish bias. The decline in headline inflation from 35% YoY in November to 26% YoY in December was driven by a sharp fall in energy inflation. This was partly because of the so called 'free December' for utility bills in Germany when the government promised to reimburse

households' gas bills for the month. Nevertheless, the downward pressure on headline inflation from lower energy inflation should continue given that early this year natural gas prices fell below their levels before the Russian invasion of Ukraine. However, core inflation is likely to prove much stickier, especially given recent relatively generous wage deals in Germany. Hence the ECB's continued hawkish bias and the likelihood that it will raise policy rates by another 50 bps at its next monetary policy meeting in February.

Switzerland

Growth holds up and inflation edges lower at the end of 2022

The Swiss economy is enjoying a more favourable mix of growth and inflation compared to its European neighbours. CPI inflation surprised to the downside in December, with prices declining 0.2% MoM. This left the annual rate at 2.8%, down from 3.5% in August, but core CPI remains sticky at 2%. Inflation should rebound in January due to energy price hikes before peaking later in H1. The Manufacturing PMI surprised to the upside at the end of 2022, with growth stabilising at a reasonable pace, though the Services PMI slumped as pent-up demand

waned. Looking forward, we expect activity to hold up, supported by resilient foreign demand and improved supply conditions. Domestic demand should also be decent, given a strong labour market and elevated savings. As such, and with inflation remaining above the range that the SNB views consistent with price stability, further rate hikes are likely to be forthcoming in the coming months.

ASEAN & India

Vietnam lags in ASEAN while India's strong PMI leads the pack

ASEAN's aggregate Manufacturing PMI decreased slightly from 50.7 to 50.3 in December. Notably, PMI readings for Vietnam, Singapore and Malaysia were well below 50, showing a marked slowdown in activity on the back of slowing global trade. Supply chain bottlenecks have diminished further with suppliers' delivery times and order backlogs normalising. However, surging Covid infection rates in China pose a new risk to the regional supply chain.

India's Services and Manufacturing PMIs were the strongest in Asia at 58.5 and 57.8, respectively. However, PMIs do not prove reliable in gauging economic activity in India, given the low correlations between PMIs and GDP. Indeed, we expect India's growth to slow in 2023, given that the post-Covid recovery has run its course while the negative impact of tighter monetary policy will continue.

Markets

A New Year brings new joys for investors

Investors returned in good spirits following the holiday festivities, with bonds and stocks enjoying one of the strongest rallies in the opening week of a New Year. While US stocks moved rather grudgingly higher, with the S&P 500 up 1.5%, European stocks were on a tear, with the Italian equity market up over 6.2%, and the broader Euro Stoxx 50 gaining 5.9%. Bonds were also gobbled up, taking 10yr Treasury yields down over 30bps to close the week at 3.6%, while in Europe, 10yr Bund yields plunged 36bps to 2.2%. Certainly, there was cause for some

optimism in the data releases, though the scale of the market moves suggests some technical buying to realign portfolios. The significant fall in European headline inflation lifted sentiment and bolstered hopes that the peak is behind us, though we suspect still rising core inflation will keep the ECB in hawkish mode. US data were also taken positively, particularly easing wage growth, though we believe investors are overlooking, for now, deteriorating growth readings, which we suspect may take some wind out of the market's sails in the weeks ahead.

What to Watch

- In the US, investors will focus on the latest batch of inflation data where a further substantial slowdown is expected.
- In APAC, Bank of Korea's MPC is split on whether or not to increase its policy rate by another 25bps. We tend to believe in the latter option. China will report inflation, foreign trade, and monetary data for December. Japan will report December CPI data and release its November household survey. India and Malaysia will report industrial production data for November. Japan's markets are closed today due to a holiday.
- Annual inflation for 2022 is expected to be the highest in three decades in Argentina and ended the year above the central bank target in Brazil. Monthly economic activity is likely to continue decelerating in Brazil, while in Mexico, the focus will be on several economic activity indicators for Q4 2022.

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