

Weekly Macro and Markets View

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Highlights and View

President Biden and Republican House Speaker McCarthy have announced an agreement on raising the debt ceiling

The deal now needs to pass both houses of Congress, which is expected to happen ahead of June 5th, the hard deadline announced by Treasury Secretary Yellen.

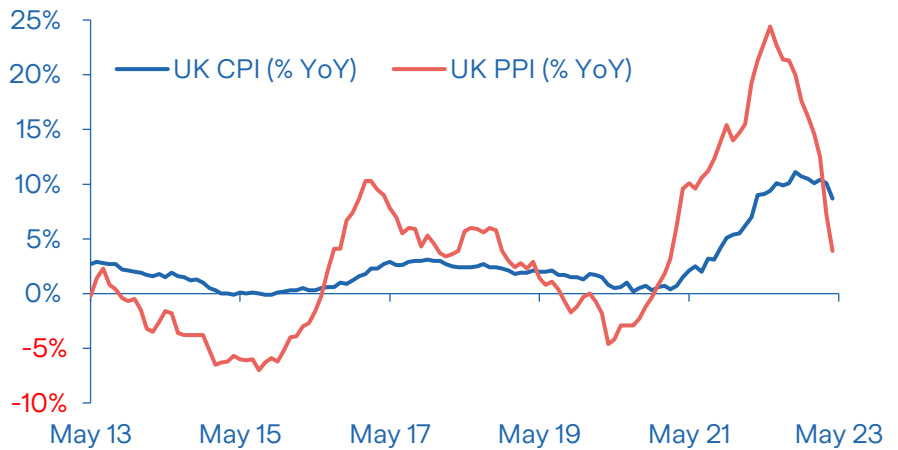
The Eurozone Flash PMI falls more than expected, dragged down by weak manufacturing confidence

The manufacturing sector tends to lead the overall economy and the weak PMI report suggests that the bounce in Eurozone economic activity in Q1 may already be fading.

Strong UK inflation data trigger a gilt-led sell-off in government bond markets, with a material repricing of the near term policy outlook

Slowing growth and a peaking of policy rates should lead yields lower, but conditions will remain volatile and dependent on inflation data in the months ahead.

UK inflation rates fall substantially, but remain far too high



Source: Bloomberg

Headline CPI inflation fell from 10.1% YoY in March to 8.7% YoY in April, helped by significant base effects. Despite the big drop, price pressure was stronger than expected. The acceleration of the monthly rate from 0.8% to 1.2% as well as the pickup in core inflation from 6.2% YoY to 6.8% YoY show that inflation remains far too high. External factors like commodity prices are less relevant now and price pressure has increasing domestic roots. It is therefore very likely that the BoE will continue to tighten its policy. Gilt yields have risen substantially as investors are pricing in a higher target for the Bank Rate. On the other hand, stubbornly high inflation and a deteriorating growth outlook have weighed on UK stocks, which have been lagging many of their peers recently, particularly those in the US. On a more positive note, producer input prices are decelerating substantially indicating that broader inflation rates will keep falling rapidly in the months ahead. Meanwhile, the economy is losing momentum with the Manufacturing PMI falling from 47.8 in April to 46.9 in May. Service activity is still holding up better, with the Services PMI ticking only down from 55.9 to 55.1. Finally, retail sales partially recovered in April from their dip the month before, though sales are still 3% lower than a year ago despite a steep rise in prices.

US

Debt ceiling deal

President Biden and Republican House Speaker McCarthy have announced an agreement on raising the debt ceiling, with both sides making concessions to their initial demands. The deal will now have to pass both the House of Representatives and the Senate, which is expected to happen in the coming days, ahead of June 5th, the hard deadline that Treasury Secretary Janet Yellen indicated in a recent statement. The agreement removes a potential tail risk for financial markets and helped lift investors' spirits and support equities, although a deal

was expected by most market participants. Meanwhile, the latest batch of PMI data is pointing at a continuation of modest growth momentum, with service activity holding up while manufacturing has contracted in May. Personal spending recovered in April and PCE core inflation ticked up to an annual rate of 4.7%, which will keep the Fed at its toes and led investors to price in a 50% probability of another rate hike in June.

Eurozone

PMIs suggest the Q1 bounce is already fading

The Eurozone Flash PMIs failed to meet expectations, suggesting that the bounce in economic activity and business confidence in Q1 following the less-bad-than-feared winter is already fading. While the overall Composite PMI fell from 54.1 in April to 53.3 in May, which is a modest drop still consistent with growth in Q2, the most forward-looking components of the survey were particularly weak. The Manufacturing PMI fell from 45.8 to 44.6 and the new orders sub-index fell three points from 44.9 to 41.9. Services activity and employment

remain decent, suggesting that the economy is still growing, but the underlying pace of growth is likely modest and the economic recovery fragile. Indeed, last week's release of the German ifo survey showed a fall back in business confidence led by the manufacturing sector. Other national business confidence surveys for France and Italy also fell back in May. Q1 German GDP was revised down from zero to -0.3% QoQ, meaning that the German economy was in recession over the winter even though the Eurozone may have escaped it.

Switzerland

Solid expansion in Q1, but the outlook is weakening

Swiss GDP rebounded in Q1, up 0.3% on the quarter (based on unadjusted data), following zero growth in Q4. This was stronger than consensus expectations, led by solid domestic demand and broad-based strength across sectors, with construction also showing signs of stabilisation after a period of stagnation. The shift away from goods to services demand was noticeable, with solid tourism and travel while goods consumption was weak. On a positive note, investment spending was solid, boosted by healthy R&D activity. Looking forward, we

expect Q1 to mark a peak in growth, with a slowdown underway in the broader economy. The KOF leading indicator fell sharply for a second consecutive month in May, with weakness led by the financial sector and manufacturing. The KOF and the Manufacturing PMI now convey a consistent message of relatively weak below trend growth in the months ahead, reflecting the more challenging domestic and external backdrop.

North Asia

A boom in Japan, weak production and exports in Taiwan and Korea

Japan released PMIs and the Reuters Tankan for May. Both reports show a strong improvement in the manufacturing sector above the neutral lines of 50 and zero respectively, with output, new orders and supplier delivery times contributing positively. It is also worth noting that the service sector continued to improve in both surveys, reaching a record high level of 56.3 in the PMI survey. Meanwhile, Tokyo's CPI statistics for May reveal a mixed picture, depending on which core CPI definition is used. While energy inflation retreated

substantially, hotel charges (less subsidies) and prices for daily necessities increased. April data released today revealed strong labour market conditions. Both Taiwan's new export orders for April (-18.1% YoY) and South Korea's exports for the first twenty days in May (-16.1% YoY) fell more than expected. Taiwan's industrial production tumbled by 22.9% YoY as the excess inventory drawdown continued, particularly in the chip, assembly and machinery industries.

Covered Bonds

Likely to remain favoured over senior financial bonds

European credit primary market activity was robust last week, with the largest weekly volume for corporate bonds year to date. In the covered bond market, despite the deluge of issuance in the first quarter, banks continue to issue regularly, with cumulative volume remaining well ahead of 2022 figures for the same period. Covered bond spreads have outperformed those of senior financial bonds since the US banks turmoil in March and remain the cheapest source of funding for banks. German DZ Hyp came to the market last week and was able to sell a 10yr

tenor bond with almost no new issue concession. With the ECB slowly paring back its bond holdings and the upcoming EUR 470bn redemption at the end of June from the cheap TLTRO ECB facility, we expect the covered bond market to remain an important source of funding for European banks. Given the persistent risk of potential economic downturn and more corporate defaults still to materialise, we believe that investors will continue to favour covered bonds in coming months due to their perceived safety.

What to Watch

- In the US, the ISM surveys will give insights into the current state of the economy while the latest batch of labour market data is expected to show a softer employment situation.
- In the Eurozone CPI data should show headline inflation falling sharply, but still too high for the ECB's liking.
- In APAC, Japan will publish April data for industrial production, retail sales and housing starts as well as the MoF corporate survey for Q1. Australia will release April CPI and private sector lending, May house prices and Q1 capex and construction statistics. China's May PMIs may give indications as to whether the economy is starting to stabilise. The Bank of Thailand is expected to lift its policy rate by 25bps to 2%. India will release Q1 GDP data, while Korea will publish Q1 GDP, May export and April industrial production data. Markets will be closed in Indonesia on Thursday and Friday and in Singapore on Friday.
- In Brazil, we expect an acceleration in GDP growth for Q1 2023. In Chile, several economic activity figures will be released. In Mexico, the focus will be on the last monetary policy meeting minutes and labour market data.

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