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Weekly Macro and Markets View

19 June 2023

Highlights and View

China's economic activity and credit demand data continue to deteriorate

We believe the PBoC's policy rate cuts precede more targeted stimulus measures to follow over the summer.

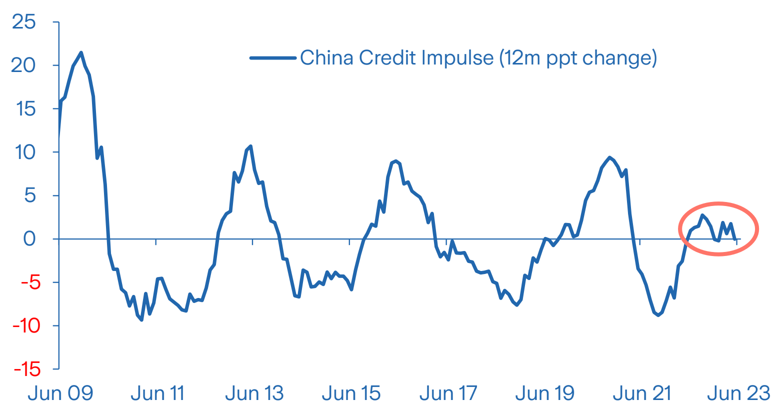
The Fed pauses its tightening cycle but signals further rate hikes ahead

While additional rate hikes are possible, we think that economic and inflation data will soften enough for the FOMC to refrain from tightening its policy further.

Wage growth accelerates to 7.2% YoY in the UK while the labour market remains very tight

The tight employment situation and accelerating wage growth will keep the BoE on its toes and force it to tighten its policy further.

China's credit demand growth tumbles as economic malaise intensifies



Source: Bloomberg (Note: Credit impulse measures the acceleration of credit versus GDP growth)

As we predicted in our Weekly China section last week, the PBoC, China's central bank, reacted quickly to a dismal set of monetary and economic data for May. Several policy rates were cut by 10bps. Though the size of the cut may appear small, we believe that the PBoC sent a signal and will follow up with more measures to spur lending and economic activity.

Aggregate financing growth fell from 10% to 9.5% YoY in May on weak corporate and government credit demand as well as weakening mortgage demand by private households. As can be seen in the chart above, the credit impulse is faltering, hovering around the zero line and unable to gain steam compared to previous recovery phases during the last 15 years. Meanwhile, economic activity data for May came in weaker than the already cautious consensus expectations. Retail sales, infrastructure investment and particularly property investments disappointed when using a two-year CAGR rate to avoid the base effect trap amid the Shanghai lockdown last year. It is difficult to find any bright spots among the latest economic indicators, but following a deep dive we note that online sales as well as auto production growth statistics came in favourably. Overall, we believe that pressure on the authorities has intensified to come up with more targeted stimulus measures even before the next Politburo meeting in July.

US

A hawkish pause

As was widely expected, the Fed refrained from hiking rates for the first time since the beginning of the current tightening cycle, which began in March 2022. Nevertheless, the dot plot reveals that the FOMC is tilted towards further rate hikes and doesn't see any rate cuts till the end of 2023, a point emphasized by Jerome Powell during his press conference. The hawkish stance comes despite a further slowdown in inflation with the headline rate falling from 4.9% YoY in April to 4.0% in May. In recent months, however, core inflation has proven to be sticky with the monthly rate still at 0.4%, the same as in April. The annual rate receded from 5.5% to 5.3% and remaining significantly above the Fed's target. Reassuringly though, producer prices keep falling at a rapid pace with the annual rate slowing to only 1.1%, confirming that price pressure continues to fade. Meanwhile, initial jobless claims stayed at 262'000, the same as the week before, which was the highest level since October 2021 and reflects the weakening employment situation.

Japan

Smooth sailing for the Bank of Japan

The fact that Japan's exports were up slightly YoY in May masks the fact that export volumes were down 6.4%. While auto exports to the US and China were strong, we note that weak IC and semiconductor production equipment exports to China were a drag. The trade deficit continued to shrink amid falling imports, particularly for mineral fuels. Machinery orders came in stronger than expected in April, though still down nearly 6% YoY. Digging deeper reveals strong divergences between different product categories. Meanwhile, the second Bank of Japan Monetary Policy Meeting under the helm of Governor Ueda did not reveal major changes to the BoJ's assessment of the economy nor monetary policy. The fact that Japan's bond market is operating smoothly does not seem to urge immediate monetary changes by the BoJ. The upcoming Q2 Tankan report will be in focus. In tourism, inbound visitors have reached 72% of the pre-Covid level, or even 89% if Mainland Chinese tourists are excluded. Visits by the latter are expected to gain steam this autumn.

Eurozone

A hawkish ECB hikes rates and signals more tightening to come

As expected, the ECB hiked rates by 25bps last week, taking the deposit rate to 3.5% and signalling more tightening to come. The biggest surprise was the chunky increase in the inflation forecast, with core inflation 0.5pp higher in 2023 and 2024 compared to the March forecast, leaving core inflation at 2.3% in 2025. While the revisions reflected brisk wage growth in combination with recent weak productivity developments, the ECB is also taking the view that the tightening delivered—400bps on the deposit rate—is not sufficient to stamp out inflation pressures. Despite the claim of hikes being data dependent, it was also signalled that rates will very likely be increased again already in July. We believe that a pause in the hiking cycle is now warranted to monitor the impact of past tightening, particularly given weakness in the industrial and housing sectors. Given the hawkish ECB positioning, the risk is of course that in its attempts to deal with inflation, the ECB chokes off the modest economic recover.

Credit

The market, and CDS in particular, is lagging equities.

Credit, especially CDS, has been lagging the recent rally in risky assets. CDS index spreads tightened only marginally on the week, with US IG index spreads staying within a range of 1-2bps for the last two weeks. Cash credit performed better, but still lagged equities. Within cash credit, HY has outperformed IG so far in June, both in the US and in Europe. Moreover, the HY/IG spread ratio has continued to compress and the US BB-BBB spread differential to decline. In a week centered on monetary policy meetings, issuance was light and fund flows mixed, with inflows into US funds, but outflows from European funds. In Europe, banks applied for a total of EUR 30bn in voluntary TLTRO repayments in June, in addition to the EUR 470bn that is maturing. That is the biggest reduction of the ECB's balance sheet ever. Even if the excess liquidity amount remains large in the Eurozone, it should increase the average cost of funding for banks and add to the tightening in financial conditions already in place these past months.

Equities

Global stocks surge as investors capitulate and play the momentum

The bulls were charging last week, with Japan's Nikkei 225 gaining 4.5%, now up 29% YTD, and fighting with the US Nasdaq for top honours in H1 performance. With many markets having broken into bull market territory (deemed gains in excess of 20% from their lows) momentum continues to build. The S&P 500 slipped modestly on Friday, but had posted gains in the six prior sessions during the longest winning streak in a year and a half. US market breadth has also improved recently, with the equally weighted S&P 500 making inroads into the substantial relative outperformance of the benchmark capitalisation weighted index, though they were broadly matched last week. Investors were prepared to look through hawkish Fed comments, dismissing forecasts of two additional rate hikes and the ECB's continued march higher in rates in the hope that the elusive rate 'pivot' is finally nearing. While we suspect it is, this is based in our view of weakening growth, earnings and margins. Currently, it would be painful to fight stock momentum, but neither is it time for complacency.

What to Watch

- In the UK, the Bank of England is expected to hike rates at its meeting this week given that inflation remains far above target, although the latest batch of data is expected to show some moderation.
- The Swiss National Bank is expected to hike rates in this week's policy meeting.
- In APAC, we do not expect any policy rate changes in Indonesia and the Philippines, while we believe China's NIFC will announce a 10bps cut of the one-year LPR rate, in line with the PBoC's cut in the SLF, OMO and MLF rates last week. Japan will publish its June PMIs, the June Reuters Tankan and CPI data for May. Taiwan, Malaysia and Thailand will announce May export data, while Hong Kong, Malaysia and Singapore will release CPI data for May. Markets will be closed in Mainland China and Taiwan due to the Dragon Boat Festival on Thursday and Friday and in Hong Kong on Thursday.
- The central banks of Brazil, Chile, and Mexico are expected to keep the policy rate unchanged, with a less hawkish statements and Chile likely signalling the first cut for July. In Argentina, the focus will be on Q1 GDP growth.

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Investment Management
Mythenquai 2
8002 Zurich

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