Weekly Macro and Markets View

26 June 2023

Highlights and View

Eurozone PMI data disappoint in June, with both service and manufacturing readings sharply down

The data indicate that Eurozone growth stalled at the end of Q2 as weakness spread from manufacturing to service, while soft new orders suggest weak conditions will persist.

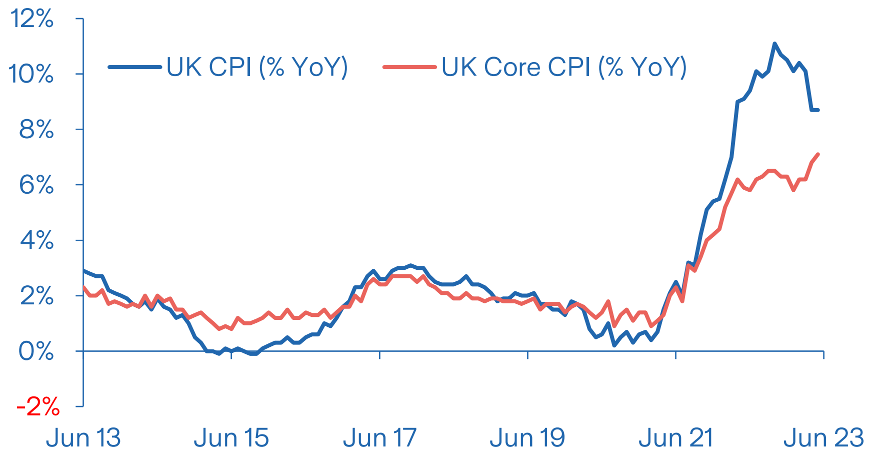
Major Latin American central banks keep their policy rates unchanged

We expect the rate cutting cycle to start in the second half of this year with Chile leading in

Following last week's policy rate cuts of 10bps, China cuts one and five-year Loan Prime Rates (LPR) by 10bps

While it is disappointing that the five-year LPR, which is relevant for mortgage loans, was not cut by 15bps as consensus had expected, the government is obviously preparing various other stimulus measures to support the economy.

The Bank of England lifts rates to the highest since 2008



Source: UK office for National Statistics, Bloomberg

While inflation rates are falling back rapidly in many regions they remain very elevated in the UK. Headline inflation remained at 8.7% YoY in May and although the monthly rate slowed from 1.2% to 0.7% it is still far above the Bank of England's target rate. Core inflation even accelerated to 7.1% YoY, the highest level in 31 years. Consistently high inflation rates paired with a still very tight labour market and accelerating wage growth finally led the BoE to step up its tightening process. Although the decision was not unanimous, the Monetary Policy Committee raised the Bank Rate by 50bps to 5% at its meeting last week, the highest level since 2008, acknowledging that it hasn't done enough to bring soaring inflation rates under control. While we do expect inflation rates to fall back substantially in the second half of the year as growth slows down and base effects kick in, the BoE will probably have to tighten its policy further in the near term. Meanwhile, economic activity keeps slowing, with the Composite PMI receding to 52.8 in June from 54.0 the month before. The slowdown was driven by weaker service activity and a deepening contraction in the manufacturing sector. Finally, despite the real income squeeze and a deteriorating growth outlook, consumer sentiment continues to recover though remains significantly below pre-Covid levels.

Bonds

Yield curves invert further on hawkish central banks and disappointing activity data

Disappointing Flash PMI data and hawkish central banks triggered a snap back in longer maturity government bond yields as growth concerns resurfaced. The 10yr Bund yield fell 14bps on Friday, which was the largest daily decline since late April, leaving it 12bps down on the week, with a similar weekly move in the gilt market while Treasury yields held up better. By contrast, yields at the shorter end stayed high, boosted by a string of hawkish hikes in Europe last week. This led to further inversion of yield curves, to the lowest levels in decades. The spread between the 10yr and the 2yr yield reached -85bps for gilts, down from zero in late May, and -75bps for Bunds, not far behind the Treasury inversion at -100bps. Historically, a deeply inverted yield curve has been a good predictor of recession, and we suspect fears of a hard landing for the economy will continue to cap yields to the upside given the hawkish positioning of central banks along with weaker growth momentum.

US

Housing starts rebound

The latest batch of housing data published last week indicate that activity in the housing market is recovering following the steep fall last year. Housing starts rebounded substantially in May, partially helped by a significant downward revision for the month before, but also reflecting stronger demand. Building permits have also risen, though the recovery is far more modest than for housing starts. Meanwhile, existing home sales have barely budged and remain significantly below pre-Covid levels, reflecting homeowners' reluctance to sell their homes at current price levels, which could be a driver behind the above mentioned strong pickup in housing starts. While the housing market is showing signs of stabilisation, broader economic activity keeps softening with the S&P Composite PMI receding from 54.3 in May to 53.0 in June, driven by weaker growth in the service sector and a deepening contraction in manufacturing. Initial jobless claims remained at 264'000 which marks the highest level since October 2021.

Switzerland

The SNB hikes rates and leaves the door open for further tightening

The SNB hiked rates by 25bps last week, scaling down the pace of hikes but signalling more to come. The 2023 inflation forecast was cut as inflation has fallen quicker than expected, but it was bumped up for 2024 and 2025, reflecting second-round effects, higher rents and electricity prices, and persistent inflation abroad. With inflation at 2.1% at the end of the forecast horizon, the SNB sent a strong signal that they intend to hike further, while also being active in the forex market to strengthen the franc. However, with growth now slowing in Switzerland and globally, as well as service demand weakening, price pressures should continue to moderate in the months ahead, also helped by the strong currency. Additionally, credit conditions are tightening and housing market vulnerabilities persist. While the labour market remains strong, wage growth is still tracking below 2% and job growth is softening. If conditions moderate further in the months ahead as we anticipate, prospects for further rate hikes may be reduced.

LatAm

The easing cycle is ready to start in Chile

The Central Bank of Chile kept the policy rate unchanged at 11.25%. The decision was not unanimous, with two out of five board members voting for a cut of 50bps. The statement was dovish and mentioned that if the disinflation trend persists, the policy rate will start a downward process in the short term. The Central Bank also revised down its inflation forecast for the year-end for the first time in several months. We expect monetary easing will start in July with a cut of 75bps. In Brazil, the Central Bank kept the policy rate unchanged at 13.75%. The statement was dovish, recognising the improvement in current inflation. Nevertheless, the Central Bank noted that inflation expectations remain de-anchored, which demands 'caution and parsimony'. The forward guidance signals that the next decisions will be data dependent and does not suggest any rush to start cutting rates. We expect the easing cycle to begin in September or November. In Mexico, the Central Bank maintained the policy rate at 11.25%. The tone remains cautious, despite the recent lower-than-expected inflation.

Credit

High Yield underperforms due to hawkish central bank rhetoric

Rate hikes and hawkish central banks moved equities and credit lower last week. Credit spreads widened in both cash and CDS markets. Notably, both in the US and in Europe, Investment Grade (IG) outperformed High Yield (HY) on a weekly basis and though IG still lags HY on a monthly basis, the gap between them has narrowed. While IG index spreads in the US and Europe are 30-40bps tighter than the March highs, some sectors have lagged. Notably, banks and real estate sectors trade at relatively wide spreads versus non-financials. Sentiment, as indicated by the weekly fund flow data from June 21, held up in the US where IG and HY bond funds posted another week of inflows. However, flows were mixed in Europe, where IG bond funds suffered outflows, driven by exit from long-duration funds. In our view, medium-term risks continue to be skewed towards a likely widening of credit spreads as yield curve inversion, further tightening in credit conditions, higher defaults, and weakening fundamentals such as deteriorating interest coverage continue to emit ominous signals.

What to Watch

- Eurozone CPI data will show whether inflation fell further in June while data on economic confidence, German retail sales, and the IFO survey will show how sentiment and activity are holding up.
- Japan will publish industrial production and retails sales data for May as well as June consumer confidence and Tokyo CPI data for June. Australia will report various housing related data and CPI, retail sales and private credit data for May. China will release its NBS PMIs for June. Taiwan, South Korea, Singapore and Thailand will release industrial production data for May, while South Korea, Hong Kong and Thailand will publish foreign trade data. Markets in Indonesia, Malaysia, India and the Philippines will be closed on various days in the second half of the week.

Disclaimer and cautionary statement

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