Weekly Macro and Markets View

3 July 2023

Highlights and View

Eurozone activity data continue to disappoint while headline CPI inflation falls further

While growth momentum is slowing sharply, progress on inflation is insufficient and the ECB is expected to maintain its hawkish stance, with further tightening forthcoming.

US Q1 GDP growth was revised up substantially from 1.3% QoQ to 2%

While consumer spending was strong in Q1, it has weakened markedly in recent months.

Japan's Q2 corporate Tankan survey surprised to the upside

We believe the strong services sector will start to plateau, while capex will remain strong both in the manufacturing and non-manufacturing sector to tackle labour bottlenecks.

Eurozone activity data continue to disappoint as growth weakens

Source: Bloomberg (Note: Shows activity data surprises relative to market expectations)

Last week's data confirm that growth momentum is falling quickly in the Eurozone, with weakness in manufacturing spreading to services. The European Commission's economic sentiment survey disappointed in June, led by slowing momentum in Germany and other manufacturing hubs, but services also softened. Consistent with this, the German ifo survey deteriorated and German unemployment rose meaningfully on the back of weaker labour demand, with the unemployment rate also edging higher. Slowing growth is mirrored in soft Eurozone monetary and credit data, which showed credit stalling in May. The Eurozone CESI (Citigroup Economic Surprise Index), which tracks data outturns relative to expectations, has consequently slumped to the lowest level since the financial crisis (outside of the global pandemic). On a more positive note, CPI inflation fell sharply in June, down from 6.1% to 5.5%, though the core and services components ticked higher and remain elevated at 5.4% YoY. While slowing growth and falling inflation confirm that monetary tightening is working, we expect the ECB to hike again in July and maintain its hawkish guidance. This was also the message conveyed at the ECB forum on central banking in Sintra last week. While tightening should help to reduce inflation in the months ahead, the upshot is that economic growth may slow more sharply than desired.

US

Consumer spending is weakening

Strong consumer spending helped the economy to grow in line with trend in Q1. There are increasing signs, however, that households are becoming more reluctant to spend. Real personal spending was flat in May, down 0.2% MoM from the month before. The savings rate as a percentage of disposable income picked up from 4.3% to 4.6%. When compared to the low of 2.7% reached in June 2022, this indicates that the average US household is trying to rebuild their savings, potentially providing further headwinds to consumer spending in the months ahead. PCE Core ticked down to 4.6% YoY, slightly below consensus expectations. The marginally better inflation number triggered a rally in the stock market with the S&P 500 rising more than 2% over the week despite yields and rate expectations also rising. Finally, consumer confidence improved in June, lifted by both expectations and current conditions. However, buying intentions for houses, cars and major appliances have ticked down, pointing at an increasing reluctance to spend.

China

Sluggish economic activity continues, the Politburo convenes later this month

China's June PMIs suggest that the reopening boom continues to fade. The NBS Manufacturing PMI, which focuses on the big state owned enterprises (SOEs), recovered slightly, but remains just below the boom-bust line of 50 at 49. The Caixin PMI for small- and mid-sized manufacturing companies, mainly located on the East coast, fell 0.4 points to 50.5. The output and new export order components suggest sluggish conditions. Turning to the services sector, the official NBS PMI dropped a point to 52.8, which is below pre-Covid levels, while the Construction PMI tumbled 2½ points to 55.7 amid fading infrastructure spending due to fiscal constraints. The property sector remains weak as sales of the 100 main developers fell 28% YoY in June and were up only 12% MoM, which is disappointing considering seasonal patterns. Existing home sales remain sluggish as well, suggesting targeted public support in H2. Remarks by Premier Li Qiang and the Minister of Housing, Ni Hong, suggest policies are in the offing. We are focussing on the Politburo meeting later this month.

Japan

The Q2 Tankan survey exceeds optimistic expectations

Japan's Tankan survey is a rich source for getting a sense about corporate conditions. The Q2 survey, released today, came in even better than the optimistic consensus had expected. The headline diffusion index (DI) for manufacturing companies improved four points to 5, and the non-manufacturing DI gained another 3 points to 23. While the Q3 outlook for the prior improved further to 9, the outlook for the latter appears to be topping out, falling 3 points. Capex plans tend to improve continuously over the year, but we are impressed by the better than expected surge to +11.8% for all companies. Meanwhile, industrial production for May disappointed following surprisingly weak auto production statistics. However, the outlook for June suggests the recovery will continue. May retail sales growth remained solid for food and drug store items (mainly reflecting higher prices), but was weak for household appliances and clothes. Tokyo's core CPI came in lower than expected as travel subsidies have been prolonged, while electricity prices were hiked.

Credit

A mixed rally amid a bounce in risk sentiment

In a strong week for risk assets corporate bond performance was mixed, with the US strong but Europe weak, while CDS spreads tightened but underperformed stocks on a risk adjusted basis. This confirms our view that the upside in credit is limited while downside risks continue to gather momentum. A hawkish central bank environment along with volatility in government bond yields continues as bond yields widened while yield curves inverted further last week. The impact of higher rates and the related stress on weaker companies continues to manifest in higher default rates. The Fed released the results of stress tests on 23 of the largest US banks, with the results largely in line with expectations. Notably, the US entities of European banks such as Deutsche Bank, UBS and Credit Suisse underperformed US banks in the Fed's severe stress scenario. The Fed stress tests were welcome as banks were expected to announce further shareholder returns, spurring gains in both European and US bank stocks, although financial sector credit spreads tightened only in the US.

European Banks

Liquidity remains decent but profitability headwinds continue

Excess liquidity in the Eurozone banking system dropped sharply by EUR 550bn last week as anticipated with the repayment of one of the large, cheap three-year TLTRO loans from the ECB. However, even after this, liquidity remains abundant and the impact of the repayment on money market rates was negligible. Regular ECB lending tools experienced a surge in their usage with 75 banks borrowing EUR 18.5bn in the weekly refinancing operation, the largest amount since 2017, but we don't expect major stresses as banks have been expecting the TLTRO repayments. That was also confirmed by recent comments from Andrea Enria, chair of the ECB's Supervisory Board. However, while banks have been raising pre-emptive funding, as suggested by the EUR benchmark covered bond supply reaching record levels during the first half of 2023, the cheap loans are being replaced by more expensive funding. These higher costs of funding should lower bank's net interest margin and hurt their profitability, especially given the weak demand environment, leading to tighter credit conditions.

What to Watch

- In APAC, the urgency for the RBA to raise its cash rate this week has diminished given a downward surprise to the monthly CPI. Bank Negara Malaysia is expected to keep its policy rate unchanged. Japan will release wage data and the household survey for May. Final 'shunto' wage negotiation data will also be communicated. June CPI data will be reported in Taiwan, South Korea, Indonesia, Thailand and the Philippines. Australia and Taiwan will publish June foreign trade data.
- The ISM Manufacturing and Services surveys for the United States will give crucial insights into the current state of the US economy while the latest batch of labour market data is expected to show a softer employment situation.
- Eurozone data on industrial production, factory orders, retail sales and producer prices will show if demand weakness and disinflationary trends have persisted in the region.

Disclaimer and cautionary statement

This publication has been prepared by Zurich Insurance Group Ltd and the opinions expressed therein are those of Zurich Insurance Group Ltd as of the date of writing and are subject to change without notice.

This publication has been produced solely for informational purposes. The analysis contained and opinions expressed herein are based on numerous assumptions concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies. Different assumptions could result in materially different conclusions. All information contained in this publication have been compiled and obtained from sources believed to be reliable and credible but no representation or warranty, express or implied, is made by Zurich Insurance Group Ltd or any of its subsidiaries (the 'Group') as to their accuracy or completeness.

Opinions expressed and analyses contained herein might differ from or be contrary to those expressed by other Group functions or contained in other documents of the Group, as a result of using different assumptions and/or criteria.

The Group may buy, sell, cover or otherwise change the nature, form or amount of its investments, including any investments identified in this publication, without further notice for any reason.

This publication is not intended to be legal, underwriting, financial investment or any other type of professional advice. No content in this publication constitutes a recommendation that any particular investment, security, transaction or investment strategy is suitable for any specific person. The content in this publication is not designed to meet any one's personal situation. The Group hereby disclaims any duty to update any information in this publication.

Persons requiring advice should consult an independent adviser (the Group does not provide investment or personalized advice).

The Group disclaims any and all liability whatsoever resulting from the use of or reliance upon publication. Certain statements in this publication are forward-looking statements, including, but not limited to, statements that are predictions of or indicate future events, trends, plans, developments or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties and can be affected by other factors that could cause actual results, developments and plans and objectives to differ materially from those expressed or implied in the forward-looking statements.

The subject matter of this publication is also not tied to any specific insurance product nor will it ensure coverage under any insurance policy.

Zurich Insurance Company Ltd

Investment Management
Mythenquai 2
8002 Zurich

173008049 01/22) TCL