Weekly Macro and Markets View

16 January 2023

Highlights and View

US inflation rates continue to fall rapidly

Headline inflation slowed from 7.1% to 6.5% YoY in December while core inflation receded from 6.0% to 5.7%. Monthly trimmed-mean measures ticked up slightly, however, and remain above pre-pandemic levels.

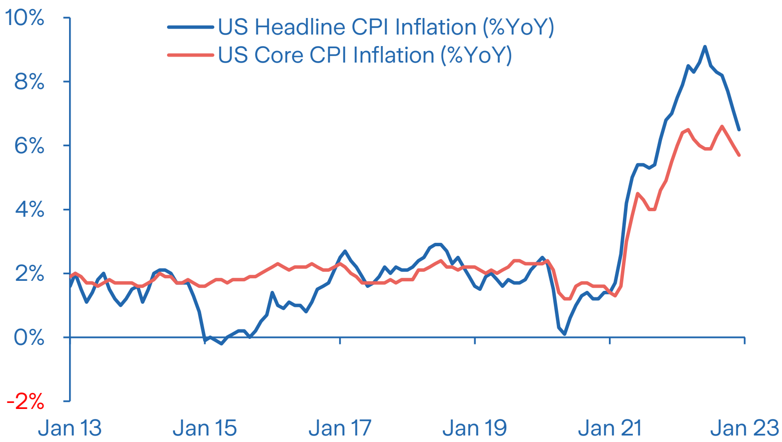
China's Omicron infections are exploding while mobility is returning to normal

We expect the reopening trend to bolster the recovery in domestic economic activity as well as to help re-accelerate Chinese tourist spending abroad.

Credit spreads tightened last week despite record issuance mostly from European banks

Funds experienced a strong start to the year with inflows of EUR 4.6bn in Europe and USD 6.5bn in the US. We think this should support spreads as issuance will slow during earnings season.

Inflation continues to fall rapidly in the US



Source: Bloomberg

Headline CPI inflation was negative on a monthly basis in December, weighed down by falling energy prices. This pushed the annual rate down to 6.5% from 7.1% the month before. While the slowdown in price pressure is reassuring, the Fed is unlikely to shift to a significantly more dovish stance in the near term as it will instead put its emphasis on core inflation, which ticked up to 0.3% MoM. The annual rate slowed to 5.7% from 6.0%, in line with expectations. Following last week's soft ISM numbers there was additional evidence of the current slowdown in business activity as small business optimism fell back to the second-lowest level in a decade, reflecting the challenging economic outlook. The survey's details also reveal a further softening in employment conditions. Hiring intentions continue to fall and are now at the lower end of the pre-pandemic range. Similarly, the jobs-hard-to-fill measure has fallen markedly from the record high levels it reached last May, signalling an increasingly looser labour market. Finally, there has been some relief on the consumer side with the University of Michigan's sentiment index improving in January, mostly thanks to an improved perception of the current situation, though expectations have also ticked up. Investors welcomed the positive news on inflation with the S&P 500 rising 2.7% last week.

Bonds

A dovish repricing in global markets

Government bonds have rallied since the start of the year, boosted by soft inflation data. US 10yr yields are down 37bps YTD and last week's CPI report triggered a further repricing of Fed rate hike expectations, with only 27bps of hikes now priced for the February meeting. European yields have also fallen, helped by lower gas prices. Italian spreads vs. Germany have continued to tighten, partly on speculation of further joint debt issuance at the EU level. While core yields have room to fall a bit further, the rally appears due for a pause. The hurdle for central banks to turn significantly more dovish near term is high, with sticky core inflation and tight labour markets. In addition, the ECB is notably hawkish and seems determined to tighten policy further in the coming months. China's reopening is also putting upward pressure on some commodity prices, with oil prices up 8% last week. The BoJ is finally under pressure to change its policy approach, and any surprises on this front would weigh on global bonds markets.

Eurozone

Recession likely still ongoing, but less severe than feared

Overall, we still think that the Eurozone is currently in recession, but it will likely be less severe than we had expected a few months ago given that the extremely mild winter weather so far has reduced considerably the likelihood of natural gas rationing. However, hawkish commentary from various ECB officials continued last week, singling out concerns around wage growth in particular. Overall, the hawkish comments point to further rate hikes from the ECB in the months ahead, which we think would be a policy mistake and could eventually slow growth down again later in the year.

Industrial production in the Eurozone rose 1% MoM in November, but industrial output and overall GDP is still likely to have declined in Q4 as a whole. Eurozone industrial production fell 2% MoM in October. In Germany, the positive gap between factory orders and industrial production that existed for many months closed following a 5% fall in German factory orders in November.

North Asia

The BoJ is under pressure while the BoK hikes and China's reopening advances

Markets are putting severe pressure on the Bank of Japan following newspaper reports that it may expand its yield target band further or even give up yield curve control (YCC) at its MPC meeting this week as the 10yr JGB yield moved above the new upper band ceiling of 0.5% during trade on Friday. The BoJ spent a record amount on bond-buying operations for the second day in a row.

The Bank of Korea lifted its policy rate by 25bps to 3.5%, suggesting that the terminal rate may have been reached in this cycle as economic activity and inflationary pressures soften.

China's reopening process is advancing rapidly with Covid infection rates having moved to the 70-90% range in several provinces, while mobility indicators are bouncing back towards normal conditions despite surging mortality. This, as well as stronger policy support for the property sector, is likely to lift economic activity going forward.

Australia

Inflation persists while the housing market continues to face pressure

November data revealed ongoing inflation pressure in Australia, with YoY headline inflation rising from 6.9% to 7.3% and trimmed mean CPI from 5.4% to 5.6%. Despite weak consumer sentiment, retail sales increased by 1.4% MoM, exceeding consensus expectations. Job vacancies, while falling, stayed elevated. The tight labour market and buoyant retail spending suggest continued price pressure. Notably, the reopening of China will push demand for Australian goods and services, potentially exacerbating inflation. We expect the RBA to raise its cash rate by 25bps in February and again in March. However, if inflation persists, additional rate hikes might be warranted. That said, the RBA will need to consider the downside of tighter monetary policy given that recent rate hikes have caused quite some damage to the housing market. Building approvals collapsed by 9% MoM and 15% YoY in November, while home loans fell by 3.7% MoM and 24% YoY. Following news of China's reopening, Australian stock markets rallied with the ASX 200 rising more than 4% year to date, led by material stocks.

Brazil

Economic activity continues falling in November

Monthly headline inflation for December reached 0.62%, above market expectations, mainly explained by apparel and health/personal care prices. Annual inflation decelerated from 5.9% to 5.8% but ended the year above the upper limit of the inflation target. The average of the core measures accelerated and increased by 0.66% MoM, with annual core inflation reaching 9.1%. Retail sales contracted by 0.6% MoM, while services, after solid growth in Q2 and Q3, are showing signs of deceleration. Monthly economic activity fell 0.55% MoM in November, the second consecutive monthly contraction, confirming the economy's slowdown. The Minister of Finance, Fernando Haddad, announced measures intended to reduce this year's expected primary fiscal deficit of 2.3% of GDP. If the measures and their estimated impact are fully realized, it could turn the primary deficit into a surplus of 0.1% of GDP. Nevertheless, Haddad acknowledges that some measures may fail to hit their estimates, and a more realistic deficit forecast would range between 0.5% and 1% of GDP.

What to Watch

- In the US, producer price measures are expected to show more evidence of reduced price pressure while retail sales will give more insights into the current state of household spending.
- Various ECB officials in the Eurozone, including ECB President Christine Lagarde, are due to speak and the ECB will release the account of its most recent monetary policy decision.
- In APAC, we expect both Bank Negara Malaysia and Bank Indonesia to lift their policy rates by 25bps. Mainland China and Taiwan will release Q4 and 2022 GDP data. China's December economic activity data are likely to soften further. Japan will publish inflation and foreign trade data for December. We expect Australia's labour data will continue to point to a historic tight labour market. Australia will also release consumer confidence data for January. Exports in Malaysia, Singapore and Indonesia should soften further given slowing global tech demand. Markets will be closed in Taiwan and Vietnam due to Lunar New Year's Eve.

Disclaimer and cautionary statement

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