

Weekly Macro and Markets View

23 January 2023



Highlights and View

ECB President Christine Lagarde maintains a hawkish stance, commenting at the WEF that 'Stay the course' is her policy mantra

Most ECB policymakers still appear committed to a series of 50bp rate hikes over the coming months, but this could tighten financial conditions in the Eurozone too much.

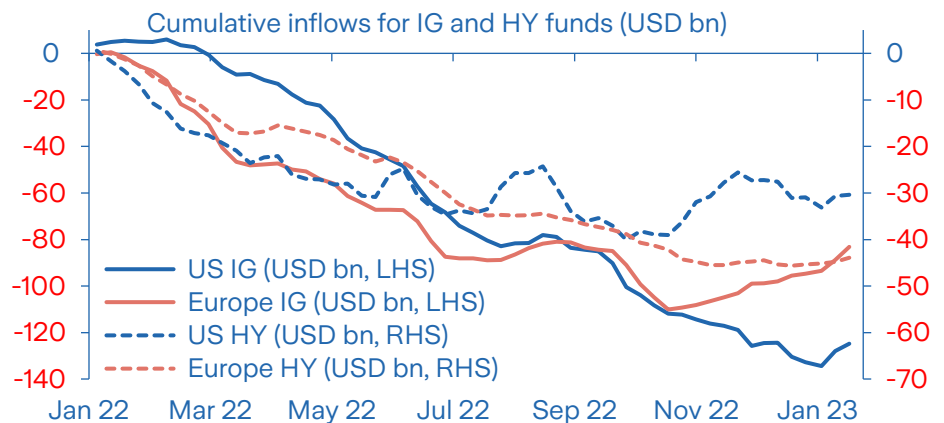
The Bank of Japan sticks to its Yield Curve Control (YCC) policies

We expect YCC to remain a controversial topic that needs to be handled swiftly by the next BoJ governor.

Credit markets retain their resilience with a tentative stabilisation of flows

While credit has benefited from the risk-on tone so far this year, a deterioration in fundamentals caused by falling earnings and rising defaults is still likely this year and warrants some caution.

Flows stabilise in European Investment Grade



Source: EPFR, Lipper-FMI (Note: US flows include ETFs, European flows only mutual funds)

Credit markets retained their resilience last week despite a mid-week wobble in stocks, with spreads tightening strongly in European credit while CDS indices lagged. Credit markets had initially lagged the upward move in stocks at the beginning of the year, weighed down by heavy supply. However, the last one and a half weeks have seen spreads catch up versus stocks, especially in European Investment Grade corporate bonds. Encouragingly, demand in primary markets appears to be strong as evidenced by new issue concessions turning negative. Moreover, flows into credit funds have shown signs of stabilisation recently, especially into European Investment Grade credit where inflows picked up notably.

Despite the rally so far, it is notable that a deterioration in credit fundamentals is still ahead of us. We continue to expect a rise in defaults and downgrades while economic data seem to be confirming the likelihood of a US recession. Indeed, last week stock markets fell mid-week on poor US retail sales data, in a departure from the recent trend when weak economic data was cheered as it dampened rate hike expectations from central banks. All in all, while European Investment Grade credit spreads still appear wide, other parts of the credit market appear vulnerable ahead of the US recession that we are expecting.

US

Consumer spending remains under pressure

In a holiday-shortened week the S&P 500 receded by 0.7% after partially recovering from a loss of almost 3% triggered by a number of weak economic figures. Retail sales fell by 1.1% MoM in December, the biggest drop in a year following an already weak November. Consumer spending is expected to remain under pressure as households continue to feel the headwinds of a real income squeeze and a deteriorating employment outlook. Meanwhile, industrial production fell for the third month in a row with manufacturing production receding by

1.3% MoM following the 1.1% drop in November. While economic data are showing an increasingly weak economic environment, price pressure is easing too. Producer prices fell 0.5% MoM in December, more than consensus expected, lowering the annual rate to 6.2% from 7.3% in November. Finally, although building permits and housing starts kept falling in December, the National Association of Home Builders' survey showed a slight pickup in sentiment in January, though it remained far below pre-Covid levels.

UK

Wage growth accelerates in a tight labour market

The FTSE 100 struggled to keep up with the strong momentum it enjoyed during the first two weeks of the year, receding by 0.9% last week. Retail sales fell 1% MoM in December, following a drop of 0.5% MoM in November. Household spending is likely to remain under pressure as high inflation rates keep eating into consumers' purchasing power. Headline inflation slowed to 10.5% YoY in December from 10.7% the month before but the pickup in monthly rates to 0.4% shows that the cost-of-living crisis is not over yet although inflation is expected to fall

substantially over the course of the year. Meanwhile, the labour market remains very tight with the unemployment rate still at 3.7% in November though a pickup in jobless claims in December points to some moderation. Reflecting the continuously strong employment situation, wage growth accelerated to 6.4% YoY in November from 6.1% the month before. This will keep the pressure on the BoE to further tighten its policy despite the expected growth slowdown.

Japan

The BoJ sticks to YCC, while economic indicators disappoint

The Bank of Japan's Monetary Policy Board left monetary policy broadly unchanged despite severe market pressure to give up Yield Curve Control (YCC). While the 10yr JGB yield briefly moved above the upper YCC limit of 0.5% before the meeting, pressure subsided after the decision, and the yield stabilised around 0.4%. Changes to, or even the abolition of YCC will be a task handed over to the next governor, who will take over in April and is likely to be the current or a prior deputy governor. Meanwhile, several economic indicators

such as November machinery orders, December machine tool orders, December exports and the Reuters Tankan for January revealed weakness in the economy while both consumer and producer prices for December edged higher. Core CPI (excl. fresh food and energy) climbed to a 30-year high of 3% YoY, while the headline number came in at 4%, a 42-year high. Producer price inflation climbed to 10.2% YoY.

China

China enters the Lunar New Year on a strong note

Economic statistics for December and Q4 came in much better than both we and consensus had expected, with GDP growth in Q4 up 2.9% YoY versus consensus expectations of 1.6%, a remarkably huge gap. Growth was unchanged versus Q3. This brings real growth for 2022 to 3%, better than expected, but clearly below the government's target of above 5%. Nominal retail sales for December were reported as falling only 1.8% YoY versus -5.9% in November. Again, the gap to consensus expectations of -9% is huge, which causes

some doubts about how these statistics are calculated. Meanwhile, high frequency indicators suggest that economic activity has picked up significantly in the last few weeks, which lifts our above consensus growth forecast for 2023 from 5% to 5.4%. This is roughly in line with the weighted growth forecasts of China's 31 provinces of 5½%, down by about half a percentage point versus the 2022 forecast. Usually the national forecast, revealed at the National People's Congress in March, tends to be a bit lower.

ASEAN

Policy rates are peaking in Indonesia and Malaysia

Bank Indonesia (BI) raised its policy rate by 25bps to 5.75%, in line with market expectations. The central bank emphasised that the accumulated rate hike of 225bps so far was 'sufficient' to ensure core inflation remains within its target range. BI's guidance suggested that the policy rate has probably peaked in Indonesia. In Malaysia, headline inflation fell from 4% to 3.8% YoY in December, a touch lower than consensus forecasts. Similarly, core CPI edged down from 4.2% to 4.1% YoY. Moderating inflation in Malaysia justified the decision of Bank

Negara Malaysia to hold its policy rate unchanged at 2.75%, a pause that came sooner than consensus had expected. Not surprisingly, December export data for Indonesia, Malaysia and Singapore came in weaker than expected, notably in Singapore, given its strong link to the global semiconductor cycle. Singapore's non-oil exports dropped by more than 20% YoY, the sharpest decline in almost ten years. Despite that, we think China's reopening should help cushion the region's export weakness to the West in the months ahead.

What to Watch

- In the US, the PCE inflation measure is expected to have slowed further in December while the first estimate of Q4 GDP will give insights into how the economy developed in the final quarter of last year.
- In the Eurozone, various economic data, including the Flash PMIs, will give further clues as to the state of the economy over the winter months.
- We expect the Bank of Thailand to lift its policy rate by 25bps to 1.5%. Japan will publish January PMIs and Tokyo's CPI data. Australia will release Q4 inflation and business confidence data. South Korea and the Philippines will publish Q4 and 2022 GDP data. December export data will be released in Hong Kong, Thailand, and the Philippines. Several markets in China and ASEAN will be closed for parts of or the whole week due to Lunar New Year. Australian and Indian markets will be closed on Thursday.
- In LatAm, we expect the Central Bank of Chile to keep the policy rate unchanged at 11.25%, with a hawkish tone. In Mexico, monthly economic activity will likely decline while the unemployment rate is expected to increase slightly

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