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Weekly Macro and Markets View

2 October 2023

Highlights and View

The US Congress avoids a government shutdown shortly before reaching the deadline

In a change of course, House Speaker McCarthy relied on Democratic votes to pass the bill, which is only a temporary solution, providing funding until November 17.

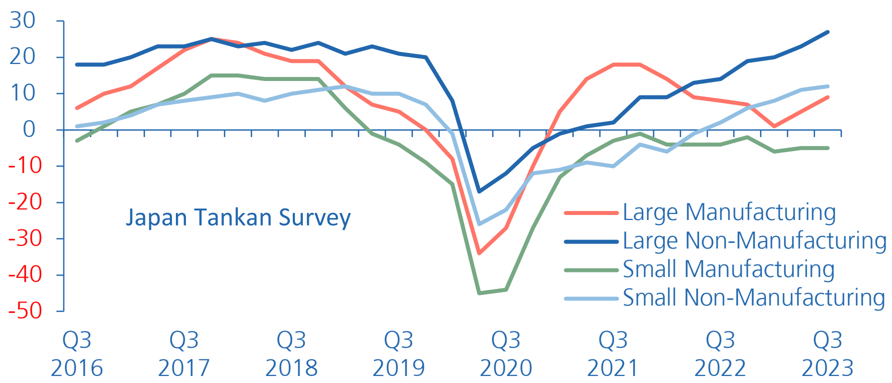
China's NBS and Caixin PMIs for September are giving divergent messages about the change in economic activity

Various high frequency data as well as Golden Week travel bookings suggest that the economy is picking up some steam despite the remaining problems in the property market.

Government bonds sell off on hawkish central bank guidance and fiscal concerns

Given the backdrop of slowing growth and inflation, bond yields look attractive should momentum weaken.

Strong Tankan survey and a stimulus package boost economic growth



Source: Bank of Japan, Bloomberg

Today's release of the corporate Tankan survey for Q3 was even stronger than the Q2 survey and came in above consensus expectations, suggesting that Japan's economy will keep expanding at a healthy pace. The headline diffusion index across all industries and company sizes increased from 8 to 10, while the index for large non-manufacturing firms spiked to a 32-year high of 27. Business conditions for large manufacturing firms increased four points to 9, while small manufacturing firms continued to suffer, with the respective index stable at -5. Capex plans for the current fiscal year increased further to a healthy +13.6%.

Various monthly economic indicators for August support our view that Japan's economy remains strong. However, we note that capital goods production continues to soften while weaker auto production negatively impacted durable goods production. Plant shutdowns due to typhoons are likely to have been a negative impact, but the corporate outlook for September and October suggests a solid recovery is in the offing. Meanwhile, August retail sales maintained their healthy growth pace, though we note a slight drop in consumer confidence in September. PM Kishida announced that a fiscal stimulus package will be put together to help consumers digesting the impact of higher inflation and to promote domestic semiconductor production, with a supplementary budget to be formed in November.

US

Government shutdown avoided

In a surprise move, House Speaker McCarthy changed course, pushing a bill through Congress with the help of Democratic votes to avoid a government shutdown shortly before the deadline. This is positive for the economy and financial markets, though fundamental questions remain and funding has only been provided for until November 17, so the spending fight is likely to pick up again soon. Meanwhile, economic data remain mixed. Consumer confidence deteriorated in September as expectations dropped substantially and buying intentions for houses, cars and major appliances receded. Personal spending slowed more than consensus expected in August with the savings rate falling to the lowest this year. On a positive note, PCE core inflation slowed further in August to only 0.1% MoM, pushing the annual rate down from 4.3% in July to 3.9%. Finally, the third estimate of GDP for the second quarter reveals that consumer spending had slowed markedly to only 0.8% on an annualised basis.

Eurozone

inflation falls sharply while the economic outlook remains bleak

Eurozone CPI inflation slumped in September, down from 5.2% YoY to 4.3%. Core CPI also fell at a sharper pace than anticipated, by 0.8pps to 4.5%. The declines reflected disinflationary food, energy and core goods prices. Services inflation also slowed, with easing price pressures in tourism and a favourable base effect related to transportation in Germany. While some of these effects will fade, it was nonetheless good news. Other data were weak but did not deteriorate further. The German ifo survey remains consistent with economic stagnation, but the expectations component edged up in September, having fallen for the past five months. Similarly, the EC economic confidence indicator surprised slightly to the upside, led by a tick higher in business confidence. While this is encouraging, credit data showed a sharp decline in lending growth to the private sector, down 100bps to 0.6% YoY in August. This will weigh on the economy in the months ahead.

China

Stronger activity into the Golden Week

Various high frequency data such as satellite pictures around major shopping malls and data about cement production and coal burnt at power plants show a stabilisation or even an early pickup in China's economic activity. Home sales at China's top-100 property developers were up 17.9% MoM, though still down 29.2% YoY and 74.4% from the 2020 highs. Following a four-month long drop, house prices stopped falling, though the increase was only a meagre 0.05% MoM. We are encouraged by the fact that the official NBS Manufacturing Index for September jumped above the boom-bust line of 50 for the first time since April, while the Construction PMI rose 2.4 points to 56.2. The Services PMI increased marginally from an eight-month low to 50.9. Unfortunately, these encouraging data were not confirmed by the Caixin PMIs, representing smaller export-oriented companies. Both the Manufacturing and Services PMIs fell, though they remain above 50. Travel during the Golden Week is expected to be strong, with flight and train bookings significantly above pre-Covid levels.

Bonds

Markets sell off on hawkish central bank guidance and fiscal concerns

Investor angst around policy and inflation helped to trigger a sell-off in government bonds last week. The sell-off was led by real yields and concentrated in longer maturity bonds, with the 10yr Treasury yield up 14bps to 4.57%, decisively above the 4.5% resistance level and the highest since 2007. Other bond markets were also under pressure, with the 10yr Bund yield rising 10bps to 2.84%, having peaked at 2.98% intraday on Thursday. Gilts were initially more resilient, likely reflecting the dovish shift from the BoE, but caught up later in the week. Yields at these levels are attractive given the backdrop of falling inflation and slowing growth, but a further overshoot is still on the cards given strong sell-off momentum. Elsewhere, fiscal concerns are resurfacing in the Eurozone as nominal growth is slowing while deficits remain sticky. The Italian government agreed on its multi-annual budget plan last week, which highlighted these issues. The 10yr yield spread vs. Germany widened to 193bps, up from around 160bps mid-year. Spreads could widen even further if concerns intensify.

US Municipal Bonds

September volatility erases gains for the year

Municipal bonds underperformed notably in September due to the volatility in Treasury yields and have now erased all their gains for the year. Funds invested in municipal bonds have suffered continuous outflows. There have been only eleven weeks of positive inflows since the start of the year, and cumulative YTD outflows have now reached more than USD 7bn. However, the absolute yield appears to be attractive, and the wider ratio between Munis and Treasury yields provides some cushion for investors. Higher coupon payments in October and relatively low issuance should also provide positive cashflow to investors and technically support the market. The late deal to avert a shutdown of the US Government is also a positive development, removing potential disruptions of tax revenue collection for local states. All in all, we expect the market to benefit from better technicals and to start stabilising if the volatility in the Treasury market were to abate.

What to Watch

- In the US, the ISM surveys are expected to reveal a further slowdown in activity while the latest batch of labour market data will offer important insights into the current state of the employment situation.
- In the Eurozone, retail sales, factory orders and PMI data will show how economic momentum held up in the end of Q3. Swiss CPI data will show whether there was further progress on inflation.
- In APAC, India's RBI is expected to keep policy rates unchanged while Australia's RBA is likely to keep its cash rate at 4.10%, though the new Governor, Michele Bullock, may be considering a 25bp hike. Australia's August building permits, September CoreLogic house prices and August foreign trade data will also be reported. Japan will release August household spending and wage data. September CPI data will be published in Taiwan, South Korea, Indonesia, Thailand and the Philippines. India and Taiwan will report September PMIs. Capital markets will be closed in China during the mid-autumn Golden Week and National Day holidays while markets in South Korea will be closed on Monday and Tuesday.

Disclaimer and cautionary statement

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