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Weekly Macro and Markets View

9 October 2023

Highlights and View

Nonfarm payrolls jump by 336'000 while the ADP report shows only 89'000 new jobs

Overall, the labour market seems to be holding up well, though the fall in demand for temporary workers is an indication of weaker growth ahead.

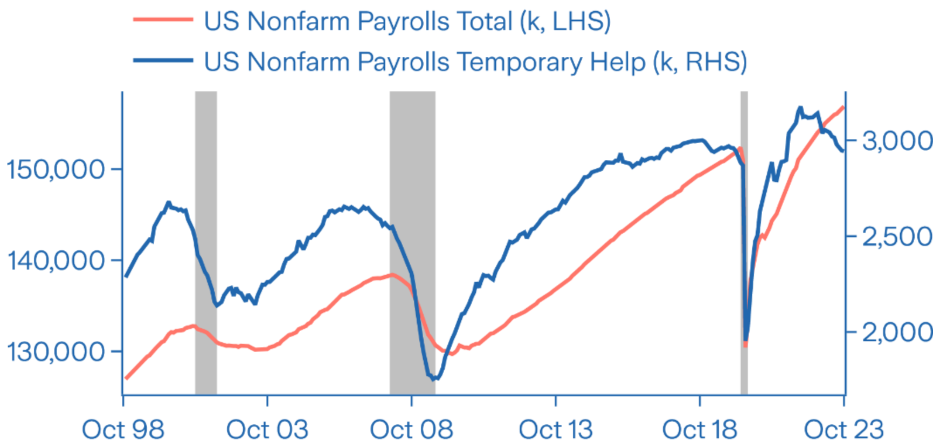
While there was an arrest in the precipitous decline of Eurozone PMI sentiment, outright levels remain in contractionary territory

Italian and Spanish PMIs improved in September, yet the numbers are consistent with negative growth for Q3 and official sector forecasts for 2023 GDP look wildly optimistic.

Credit markets finally succumb to the continuing volatility in stocks and bonds

Given tight spread levels, credit seems vulnerable in a recessionary scenario as well as in a higher-for-longer rate environment, which has also resulted in weakness in bank stocks.

Strong payrolls, but falling demand for temporary workers



Source: Bloomberg, Note: Grey columns represent recession periods.

Economic data published last week show that US business activity has been holding up and the labour market remained resilient at the end of Q3. Nevertheless, beneath the surface more cracks are appearing, suggesting weaker growth ahead. The ISM Manufacturing survey picked up to 49.0 in September, though it remains in contractionary territory for the eleventh month in a row. Service activity is holding up better, with the survey receding from 54.5 to 53.6, but new orders dipped from 57.5 to 51.8, the lowest level this year. The reported number of new nonfarm payrolls was significantly stronger than expected, but the demand for temporary workers keeps falling, which has been a good predictor of slowing growth in the past. Contradicting the strong payrolls number, the ADP national employment report shows that private sector employment increased by only 89,000 jobs in September, the slowest pace since January 2021. Finally, although the number of job openings rose in August according to the JOLTS report, the actual hiring rate was below pre-pandemic levels and the quits rate remained at 2.3%. The stock market initially reacted negatively to the strong payrolls number, but rebounded strongly with the S&P 500 ending the week in positive territory for the first time in five weeks.

Eurozone

Faint hope amid the malaise, but the outlook remains weak

This week lacked truly premium data releases in the Eurozone, but we received confirmatory evidence of an arrest in consecutive sentiment declines. PMI data from Spain and Italy completed the picture for the largest Eurozone economies, with the Eurozone Composite PMI confirmed at 47.2. September's sentiment figures broadly rose at the composite level across the bloc. However, absolute levels remain below the key 50 level and are consistent with negative GDP growth for Q3.

Two exceptions to the bounce are worth mentioning. First, France, having contributed significantly to aggregate Eurozone growth so far this year, is still experiencing rapid declines in both service and manufacturing indicators. Second, Germany's lesser-discussed Construction PMI fell to 39.3, (below Covid levels) amid evidence of plummeting hiring intentions in the sector. At ~6% of GDP the direct aggregate impact is muted, but this is evidence of rate increases in action.

Switzerland

Downside surprises on inflation while manufacturing momentum rebounds

Inflation surprised to the downside in September, led by weakness in services and other domestic components. Both headline and core prices fell 0.1% MoM, leaving the annual rates at 1.7% and 1.3% respectively. This leaves inflation a touch below the SNB's forecast, though price pressures are likely to pick up again on rising rents. By contrast, momentum in the real economy seems to have picked up pace at the end of Q3. The Manufacturing PMI rose sharply and is now up from a 14-year low of 38.5 in July to 45 in September. This is still consistent with contraction, but the data indicate that Q3 may have marked a low for the sector. The Services PMI also ticked higher and is now back in expansion territory, though it is still tracking below its longer-term trend. Events around Credit Suisse naturally weighed on sentiment and activity in Switzerland during Q2 and Q3, but it appears that some of those effects are starting to wane. Looking forward, the global growth backdrop remains challenging, however, and a further sharp reacceleration is not anticipated.

Chile

Economic activity continues to deteriorate as does inflation, which continues its downward trend

At the beginning of this week the Central Bank of Chile published the Monthly Economic Activity Index (IMACEC) for August, which surprised to the downside, showing a contraction of -0.5% MoM, down from 0.3% in July and below market expectations 0.2%, accumulating a drop of -0.9% YoY. The main detractor was non-mining activity, which was only partially offset by mining activity. On the other hand, September inflation data, published last Friday, reached 0.7% MoM, above market expectations of 0.6%. Year on year inflation continued to slow to 5.1%, down from 5.3% in August. Inflation without the volatile components included also decelerated, from 7.4% YoY to 6.6%. Although inflation currently remains above the target range of 2-4%, we anticipate that it will close the year at 4.1%. Finally, we anticipate that the decrease in price pressure without the volatile components, which are affected by the deterioration in domestic demand, would result in the central bank reducing the MPR by 75bps in the next meeting, leaving it at 8.75%.

Credit

Cracks appear as bond volatility continues

Credit markets were showing signs of stress before experiencing an intraday reversal on Friday after the strong US employment report. Despite the rally on Friday, most segments of credit ended the week with notably wider spread levels. The continuing volatility in stocks and government bonds is now finally filtering into credit, which was to be expected. Apart from wider spreads, other signs of weakness were also seen in subdued issuance last week as well as in flows. US Investment Grade credit, for example, saw the largest weekly outflow during 2023 last week. Outflows were also seen in US High Yield, leveraged loans, and in European credit. Volatility in yields is also taking its toll on banking sector stocks that have been declining with the US KBW Bank Index hovering around its March lows. The upcoming bank earnings will be carefully parsed by investors for further clues as to the health of the banking sector. All in all, at current tight spread levels, credit seems vulnerable to both a recession as well as a higher-for-longer rate environment.

Covered Bonds

Safe haven demand keeps the market resilient

Covered bond spreads outperformed other credit sectors last week with spread widening limited to a couple of basis points. Given the market turmoil, activity slowed in the primary market with only two covered bonds deals for a mere EUR 1bn. However, the most subscribed deal in Europe's debt market was a social covered bond. Frequent issuer Compagnie de Financement Foncier from France was able to attract more than EUR 3bn for its EUR 500mn tranche, although they paid a slightly higher than usual new issue concession of 5bps, confirming that investors are favouring better quality assets in response to the rate shock and renewed volatility. After a busy primary market in August, issuance has slowed since September but YTD supply remains above 2022 levels. We expect issuance to remain muted as banks enter blackout periods ahead of earnings. This should give the market a pause and help covered bonds outperform due to positive supply/demand technicals.

What to Watch

- In the US, investors will focus on the latest batch of inflation numbers while the University of Michigan's sentiment survey will give crucial insights into the current state of US households. Earnings season will kick off with results from several US banks.
- In Europe this week, the ECB will release their Consumer Expectation Survey, with one- and three-year inflation expectations. We also await German and Italian industrial production for August, and Swedish September inflation.
- Mexico will publish August inflation data at the beginning of the week, which we expect to decelerate from 4.6% YoY to 4.5%. In Brazil, the IPCA (National Consumer Price Index) will be published on Thursday. We anticipate a variation of 0.35% MoM and 5.2% YoY.

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