ZURICH

Weekly Macro and Markets View

23 October 2023

Highlights and View

China's latest economic indicators remain a data pool that delivers joy both for optimists and pessimists

While the property sector will remain a major drag for some time and the credit impulse continues to be negative, we believe already announced as well as upcoming public economic support measures will support growth.

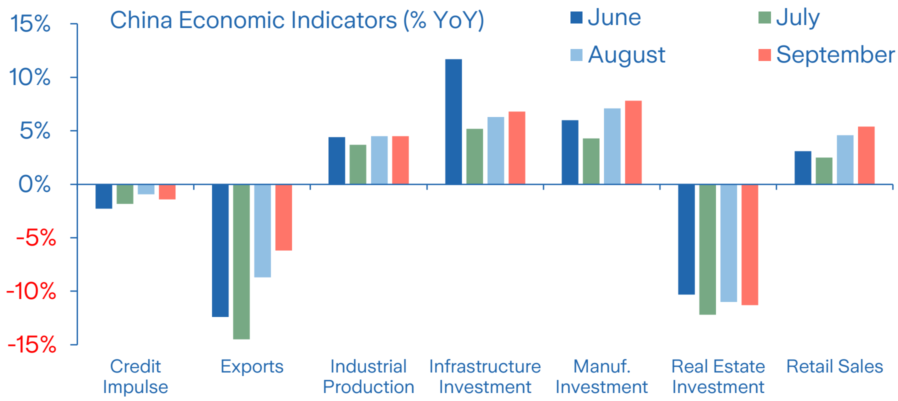
The US yield curve steepens substantially as long-term yields rebound

The curve is now the least inverted since July 2022, with the Fed signaling its willingness to hold rates at the current level.

Headline inflation remains at 6.7% YoY in the UK while core CPI slows to 6.1% YoY

Price pressure from rising fuel costs compensated disinflation in other components, but inflation rates are expected to fall further in the months ahead.

China's economic data remain a mixed bag



Source: NBS, Bloomberg

China's Q3 GDP growth came in better than consensus had expected, up 5.3% on an annualised sequential basis versus Q2, and up 4.9% YoY. We share the doubts of various economists about the untransparent seasonal adjustment calculation methods, as quarterly growth rates for the prior quarter have been revised downwards while YoY rates remained unchanged. Our growth target for the year remains at 5%, which, coincidentally, is the government's target. Meanwhile, economic indicators for September were a mixed bag, with retail sales surprising to the upside, up 5.5%, while property investment continued to decline by 11.3% YoY and home sales remained weak, down 20.2% YoY. Home prices continued to fall 0.3% MoM, with property prices overall down 0.6% YoY. The property sector remains the Achilles heel of China's economy. Big developers, including Country Garden, Evergrande, Shimao and Sunac, are struggling with servicing their debt, forcing them into restructuring. Buying land has been suspended, hitting a main income source of local governments. The September credit impulse remained negative for the fifth month in a row. At this point in China's economic cycle, the credit impulse should already have moved into deeply positive territory. On a more positive note, we note that some high frequency indicators are slowly improving, and mortgage lending is picking up following the government's stimulus measures.

US

The housing market is suffering from tighter financial conditions

Although consumer sentiment remains downbeat households keep spending, defying headwinds from tighter financial conditions and a softening employment situation. Retail sales grew by 0.7% MoM in September, slightly less than in August but still stronger than expected. Industrial production picked up modestly, growing 0.3% MoM in September after being flat the month before. One sector that clearly feels the tighter monetary environment is housing. Housing starts recovered less than expected in September from a severe downturn in August while building permits and existing home sales dropped by 4.4% MoM and 2.0% MoM, respectively. The Home Builders' Market Index for October dipped more than consensus expected, indicating further headwinds for the housing market. Emphasising the growth risks ahead, the Conference Board's leading index is signalling an accelerating slowdown. The Fed is now in its blackout period ahead of its next meeting but a number of Fed speakers including Chair Powell have revealed their willingness to hold rates for now.

Eurozone

German data suggest a slightly brighter future in a gloomy present

This week in Europe we had German-centric data releases. Firstly, we saw both wholesale (WPI) and producer (PPI) price inflation data for September fall year-on-year, and PPI fall -0.2% on the month. This outright deflation in upstream prices will continue to weigh on consumer prices in coming months.

Secondly, the ZEW Financial Markets survey showed future economic expectations improving compared to September. Slightly fewer participants now expect the German and Eurozone economic outlook to deteriorate further, although on balance more still expect further slowing. The survey also asks for views on the current economic situation, which is at historically low levels and fell even further this month. Zero percent of participants ranked the Eurozone economic situation as 'good' (down from 1.8% previously), while a patriotic 0.6% gave a positive rating to the current German economy.

UK

Energy prices keep inflation elevated

Headline inflation remained at 6.7% YoY in September while core inflation ticked down to 6.1% YoY from 6.2% the month before. The moves were largely in line with expectations as upward pressure from rising fuel costs is compensating for disinflation in other components. A slowdown in food price inflation will be welcome news for consumers with producer prices signalling further substantial falls in the months ahead. Although these numbers won't change the BoE's current stance, the MPC will remain vigilant to any signs of a potential reacceleration in price pressure. Wage growth slowed marginally to 7.8% YoY in August from 7.9% in July. More recent labour market data including employment and vacancies are pointing towards increasing slack, which is expected to lead to a further slowdown in wage growth. The weaker employment outlook is likely to weigh on consumer sentiment, which deteriorated markedly in October. Reflecting the growing headwinds for UK households, retail sales fell by 0.9% MoM in September.

LatAm

Brazil's economic activity slows

The Brazilian economic activity indicator for August showed a slowdown in momentum, registering a drop of -0.77% MoM, versus expectations of -0.6% MoM, and accumulated growth of 1.28% YoY, up from 0.83% the previous month.

The IBGE services indicator showed a contraction of -0.9% MoM with four of the five main sectors analysed falling during the period. The transport sector showed the greatest drop at -2.1% MoM while retail sales showed a contraction of -0.2% MoM, versus -0.7% expected by the market, and a slight decline in accumulated annual growth, dropping from 2.4% YoY the previous month to 2.3%. At the component level, in year-on-year terms, four of the eight components showed falls, led by the drop in books/magazines.

If the economy continues to show signs of further weakening, it is likely that the Central Bank of Brazil will continue with the cycle of cuts and will eventually have to accelerate the pace going forward.

US ABS

Bank earnings shed a light on credit card borrowing surge

US ABS spreads ended the week marginally wider but still outperformed the broader credit market. The latest consumer credit data from the Fed showed that revolving credit (which is largely credit cards) experienced strong growth at an annual rate of 13.9% as of the end of August. Credit card borrowing was a likely driver of stronger retail sales in September as more households reported that they have to rely on credit cards or loans to meet their spending needs. This was also confirmed by the latest earning releases from banks and specialised lenders that showed strong growth in the credit card business. While the deterioration in delinquencies remains limited and below pre-pandemic levels as of now, banks have indicated higher net charge-off (or write down) guidance for the next few quarters and most have chosen to increase their provisions. Given that margins in the credit card business are close to historical highs, it is likely that banks' profitability will remain protected in a recession and consumers will bear the burden of credit card borrowing, paying interest rates of 22-23%.

What to Watch

- In the US, PMIs are expected to show ongoing headwinds to business activity while GDP figures for Q3 are likely to reflect the resilience of consumer spending despite tighter financial conditions.
- Next week's main Eurozone event is the ECB monetary policy meeting on Thursday. We expect unchanged policy rates, but will watch for discussion on further balance sheet reduction. Other upcoming releases include Eurozone Flash PMIs (we expect further stabilisation at contractionary levels), the German GfK Consumer Confidence Study and the ifo Business Climate Survey.
- In APAC, Japan and Australia will release October PMIs. Japan will publish Tokyo CPI data for October, while Australia will report a broad set of inflation data for Q3. The 2023 Hong Kong Policy Address will be in focus. South Korea will publish Q3 GDP data, while both Taiwan and Singapore will release industrial production data for September. Hong Kong, Thailand and Vietnam will report export data. Markets in Hong Kong and Thailand are closed on Monday, India's on Tuesday.
- In Latin America, we expect the Central Bank of Chile to cut the monetary policy rate by 75bps, leaving it at 8.75%.

Disclaimer and cautionary statement

Zurich Insurance Group Ltd

Investment Management
Mythenquai 2
8002 Zurich

173008049 01/22) TCL