

Weekly Macro and Markets View

6 November 2023



Highlights and View

The US economy has slowed down markedly entering the fourth quarter

The ISM surveys reflect increasing headwinds for business activity while the labour market is softening.

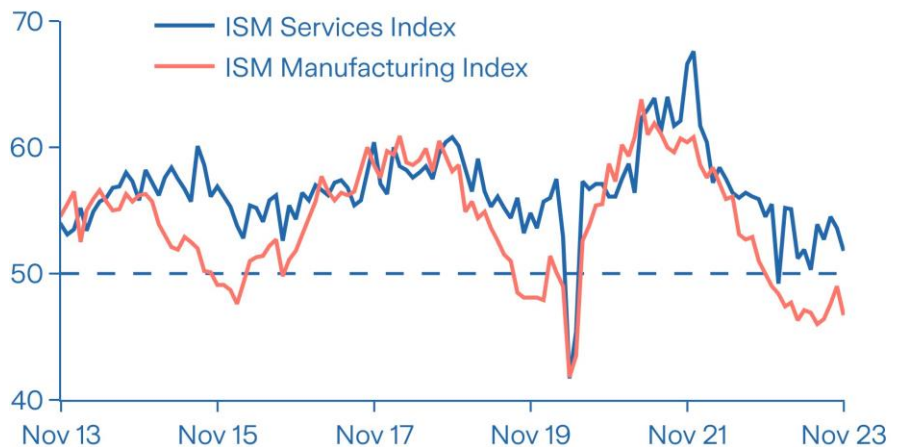
The Bank of England leaves rates on hold at 5.25% as expected

The decision came with a hawkish tilt as three members voted for another rate hike. However, given the expected growth slowdown, the threshold for further hikes is high.

The Central Bank of Brazil cuts the Selic rate in line with market expectations

In a unanimous vote, the central bank reduced the Selic Rate by 50bps, maintaining the rate cutting cycle, although the BCB has adopted a cautious tone in the face of escalating global risks.

The US economy is slowing down



Source: Bloomberg

The latest batch of data points reflect a significant growth slowdown in the US and a softening employment situation. Receding to 46.7, the ISM Manufacturing survey fell deeper into contractionary territory in October with new orders pointing at further headwinds. Similarly, activity in the service sector slowed more than consensus had expected, with the employment component falling to the lowest since May. The unemployment rate ticked up to 3.9% from 3.8% in September while the broader underemployment rate rose to 7.2%, both the highest since the beginning of 2022. Total hours worked ticked down to match the post-pandemic low while growth in average hourly earnings slowed to 4.1% YoY, the lowest since June 2021. Finally, although still low, initial jobless claims ticked up. However, continuing claims have climbed markedly over the past few weeks, pointing at an increasingly more challenging job situation. The overall softer employment situation and the slowdown in wage growth should help convince the Fed to take a less hawkish stance. As widely expected, the FOMC left rates unchanged but kept open the option for further rate hikes at upcoming meetings. However, we remain convinced that we have reached the peak of the Fed's hiking cycle as growth headwinds continue to build and inflation is likely to fall further in the coming months.

Bonds

Falling government yields as further rate hikes are avoided

Government bonds staged an impressive rally last week as the Fed left rates on hold and key US data surprised to the downside. The US Treasury funding announcement also provided welcome guidance, with Treasury supply planned to increase by less than expected over the coming quarter. Treasury yields slumped, with a 26bps decline in the 10yr yield, marking the largest weekly decline since last March when US regional banks were under pressure. Gilt yields also repriced sharply on the BoE's decision to leave rates on hold, despite the

hawkish tilt with three members voting for another hike. The key outlier was Japan, where the BoJ's decision to tweak its yield curve control led to a further rise in yields, with the 10yr JGB yield closing above 0.95% mid-week, the highest level since 2012. Looking forward, the shift in bond market sentiment is welcome and will provide relief for the broader economy. Bond market conditions are expected to remain volatile, however, as concerns around inflation remains and as central banks may well push back on the dovish repricing near term.

Eurozone

Growth contracts as inflation falls faster than expected

This week saw Q3 Eurozone GDP releases, as well as October inflation prints and labour market data. Overall growth contracted, although less than sentiment measures had suggested. The Eurozone Q3 GDP QoQ number came in at -0.1%, below market expectations of 0%. Italy disappointed with 0% QoQ growth, while France grew 0.1% as expected. Germany's GDP fell -0.1%, although markets had forecasted a larger contraction. Headline October Eurozone HICP inflation came in at 2.9% YoY, lower than the market (and the ECB) had expected.

This is partially explained by October 2022 being the high point for inflation (10.7% YoY) and the subsequent large falls in energy prices. Core inflation is higher at 4.2% YoY, but recent inflation prints are genuinely good news for the ECB. In Germany, the Bundesbank's unemployment claims rate increased to 5.8%, up from lows of 5% in 2022. Lastly, the Eurozone's overall unemployment rate for September ticked up unexpectedly from 6.4% to 6.5%, adding to evidence of weakening labour markets.

Japan

The BoJ did it again

The Bank of Japan tweaked its Yield Curve Control (YCC) again. Having expanded the upper limit of its 10yr JGB yield target from 0.5% to 1% before, it has now re-defined the 1% barrier as a reference line, giving it the option, instead of a rule, to intervene once broken to the upside. BoJ Governor Ueda clarified that the BoJ is unlikely to intervene if fundamental reasons were behind the move, but would defend the 1% line if pure speculation by traders were behind the breach. We believe the next potential change in the BoJ's policy is likely to happen

in April once the results of the first rounds of the 'shunto' wage negotiations have been released. The BoJ also revised its GDP growth and core CPI forecasts for this and the next two fiscal years. Japan's economy is now expected to grow 2% this fiscal year (up from 1.3%) and 1% in each of the next two fiscal years, while core inflation was revised up to 3.8% this fiscal year and 1.9% for each of the next two fiscal years. Meanwhile, industrial production in September rose marginally, far below expectations.

China

The Central Financial Work Conference focuses on the Communist Party's dominance

China's 'Central Financial Work Conference', a twice-in-a-decade event, convened for two days in Beijing, focusing on medium to longer-term issues for China's financial development. To us, the main dogmatic policy target was a greater focus on the Communist Party's guidance and President Xi's priorities instead of the government. Financial institutions are requested to adhere to political guidance instead of purely targeting profits. Private banks are required to guide financial support towards private instead of purely state-owned

developers, even if this is deemed to be less profitable. Regional banks need to be more stringently regulated, while the role of major state-owned banks will be prioritised. Several sectors, particularly in the fields of green development, technological innovation and modern manufacturing, will be prioritised. More measures need to be taken to solve the local government debt crisis. Meanwhile, October PMIs disappointed, though we believe they might be somewhat distorted due to the 'Golden Week' holidays.

Equities

Global stock markets soar as bond yields plunge

In the week of Halloween, it was a case of treats rather than tricks for equity investors as global markets jumped sharply higher. The MSCI World Index posted a hefty 5.6% gain for the five trading days, but the US Nasdaq index was up 6.6%, only to be outdone by the small cap Russell 2000 that tacked on a gain of 7.6%. The latter has been under significant pressure, with the index still flat on the year as high funding costs and reduced credit availability have undermined many business models. With the key central banks holding off on further rate hikes and

bond yields falling sharply, investors took advantage of oversold conditions to add positions, however, a few 'tricks' are still possible. While we are encouraged by the move at a time of year that historically favours gains into year end, it is notable that most markets remain in a technical down channel, with a series of lower highs and lower lows. It will be important for US stocks to break back above the October highs to signal a turn in the trend and rising momentum.

What to Watch

- In APAC, Japan will release the Reuters Tankan for November and the Eco Watchers survey for October, as well as wage statistics and the household survey for September. China will publish inflation and foreign trade data for October. We expect Australia's RBA to hike its policy rate by 25bps to 4.35%. Indonesia and the Philippines will report Q3 GDP data. Taiwan will release export and CPI data for October, while India will publish industrial production data for September.
- In Latin America, inflation data from Brazil, Chile and Mexico will be published, which we anticipate will continue to stabilise. We expect that the central bank of Mexico will maintain the MPR on Thursday for the fifth consecutive time.

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