Weekly Macro and Markets View

13 November 2023

Highlights and View

LatAm's fixed income and foreign exchange markets show high volatility affected by global risks

Influenced mainly by North American rates, local rates in LatAm reflect the high volatility seen there, while the risk-off markets have played a role in currency depreciation.

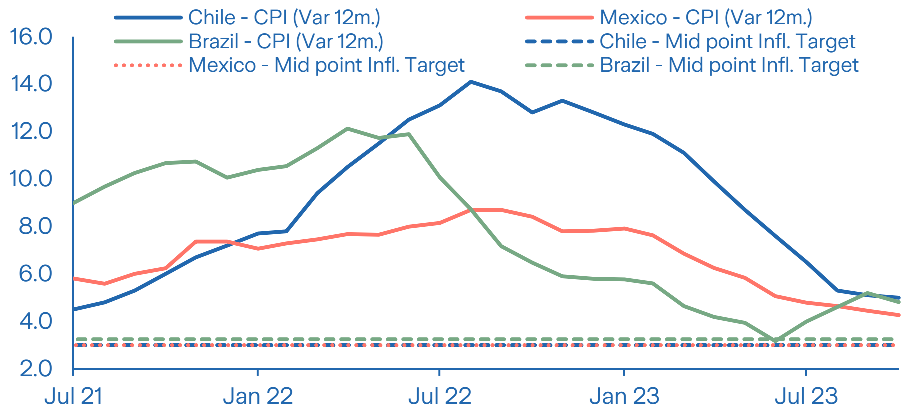
The Q3 lending standards from the Fed's survey show continued tightening, albeit at a slower pace

Tight bank lending standards were to be expected given the pressures reflected in bank stocks and forebodes a continuation of the elevated pace of defaults amongst the weakest borrowers.

The Reserve Bank of Australia delivers a 25bp rate hike, bringing its cash rate to 4.35%

Along with the rate hike, the central bank has softened its tightening stance. While the cash rate has likely peaked, we expect the 'higher for longer' approach to remain in place, with rate cuts being pushed further out.

Inflation continues to slow in Latin America, although risks persist



Source: Bloomberg

In Chile, inflation reached 0.4% MoM in October and slowed from 5.1% YoY in September to 5.0%. Inflation as measured without the volatile components also slowed, from 6.6% to 6.5% YoY, but remains high and above general inflation. Inflation is currently above the target range of 2-4%, and we maintain our view that it will remain slightly above the high end of the range at the end of the year.

In Mexico, the CPI was 0.38% MoM in October vs 0.44% in September. Driven by components that have shown upward persistence, such as services, inflation remains above the target range of 2% - 4% at 4.26% YoY. Banxico maintained the MPR at 11.25%, although it has moved its communication forward, opening the door to start the cutting cycle.

Finally, in Brazil the IPCA price index reached 0.24% MoM in October and 4.82% YoY. With this data, the way is paved for the central bank to close 2023 with a cut of 50bps.

US

The Fed wants to keep its options open

Pushing back against the perception that the central bank is done hiking, Fed Chair Powell stated that the FOMC would not hesitate to tighten policy further if it becomes appropriate. Both short-term and longer-term yields rose after Powell's speech but remain significantly below the recent peaks. While the Fed wants to keep all its options open, we think that further rate hikes are unlikely. Data published last week show a further deterioration in the economic environment. Initial jobless claims were basically unchanged while continuing claims rose for the seventh week in a row to the highest level since April. Households are becoming increasingly more downbeat with the University of Michigan's consumer sentiment survey falling to the lowest since May, driven by both current perception and expectations. The latest data released by the NY Fed confirmed that credit card balances grew by 16.6% YoY, but delinquencies are also rising rapidly as interest rates charged to borrowers are now north of 22%.

Switzerland

The growth outlook remains muted, but is no longer deteriorating

The Manufacturing PMI has slumped in November as output and order backlogs have fallen back following the tentative rebound in October and weak external demand persists. The Services PMI is holding up better, still above the boom/bust threshold of 50, with brisk domestic demand on the back of resilient consumers. The KOF leading indicator, which tracks the broader economy, was unchanged in November and is signalling weak but stable growth dynamics in Q4. Inflation, finally, remains benign, with the headline unchanged at 1.7% in October, though some services components were strong. The November CPI print will be important as it will show the initial impact of the increase in the regulated reference rate for rents. A rebound in inflation is expected, with stronger price pressures in the months ahead. While the SNB left the door open for further rate hikes, the hurdle is high given the downside inflation surprises since the last policy meeting, a downbeat growth outlook, and a strong currency.

North Asia

A disappointing week for China's equities and economy

China's H-shares and Hong Kong stocks were the main Asian losers last week. Disappointing export and inflation data, a liquidity squeeze among major banks, a cyberattack on the US division of one of China's major banks, and weak earnings reports by Macau casinos spoilt the mood among investors. Exports slowed markedly, particularly to Europe, as only trade with Russia booms. As for inflation, intensifying food deflation was the main reason for the CPI's drop back into negative territory, with rising energy prices not able to compensate. Meanwhile, Japan's Reuters Tankan for November revealed strong retail sentiment and steady, though tepid, manufacturing conditions. The Eco Watchers Survey for October, however, shows the current conditions index down for a third month in a row with retail weakening. Contradictions between both surveys tend to be rare, though not this time. Nominal wages accelerated to +1.2% YoY in September and summer bonuses were up 2%, but real wages contracted 2.4%.

US Municipal Bonds

Supportive supply/demand gets a boost from lower yield volatility

Municipal bonds outperformed notably last week, benefiting from the rates rally and lower volatility in Treasury yields. The Muni-UST ratios have moved largely sideways during the past weeks and remain higher than YTD average levels. Performance is now back in positive territory for 2023, and we think that technicals will remain supportive until year end with lower supply expected in the primary market. With yields remaining near decade highs, we think that current municipal bond prices offer a good entry point and should attract demand from retail investors. Fund outflows have slowed, and more retail investors have increased their purchases through direct investment or managed accounts. Municipal issuers are also benefiting from the better credit outlook as strong consumer spending and economic data have helped tax collection to rebound from the weaker levels experienced during first half of 2023. All in all, we expect the market to benefit from these better conditions and municipals bonds to outperform if rate volatility remains contained.

Credit

Risk-on action persists despite fundamental risks rising

Credit markets continued to have a risk-on tone last week, with spreads tightening broadly. Investor demand was seen in both the primary and secondary markets, with the former seeing a sharp uptick in supply. UBS issued a new AT1 bond that saw very strong demand, a few months after a similar Credit Suisse bond was written down during its sale to UBS in March. Fund flows in US High Yield surged last week although other credit segments remained more mixed. However, despite the risk-on tone in markets, credit fundamentals continue to deteriorate. The latest lending standards for Q3 from the Fed's Senior Loan Officers Survey continued to tighten from already tight levels, albeit at a reduced pace from the previous quarter. The tight bank lending conditions were to be expected given that US bank stocks still show the pressure continuing. Together with muted supply in High Yield primary markets over last two years, this implies that bankruptcies are likely to continue amongst the weakest borrowers. In the news, WeWork Inc. became another high-profile casualty of deteriorating credit fundamentals.

What to Watch

- In the US, investors will focus on the latest set of inflation numbers, which are expected to show a fall in price pressure. Retail sales are expected to have slowed down from last month.
- In the Eurozone, GDP and industrial production data will be watched, along with the ZEW survey for Germany.
- In APAC, we expect Japan's GDP to show a small sequential decline in Q3. October exports and producer prices as well as machinery order data will be reported. In China, October credit and economic activity data as well as home prices for October will be published. In Australia, Q3 wage data and October labour market data as well as consumer and business surveys will be released. India will report foreign trade and inflation data for October. Following strong Q3 GDP data, we believe it is a close call as to whether the Philippine's BSP will hike its policy rate by a final 25bps to 6.75%. Indonesia and Singapore will release October export data. Singapore and Malaysia will celebrate Deepavali on Monday.

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