Weekly Macro and Markets View

27 November 2023

Highlights and View

Leading indicators keep signalling significant growth risks for the US economy

While the latest business surveys reflect a modest pickup in activity, the Conference Board's leading indicators emphasize persistent headwinds to growth.

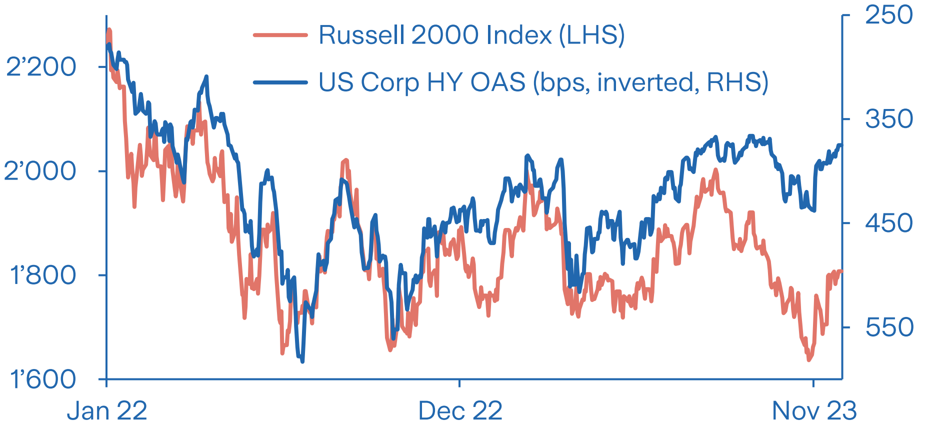
UK Chancellor Hunt announces tax cuts to support growth in an election year

Cutting the main rate of national insurance from 12% to 10% will support consumer spending while the permanent full-expensing tax relief will have a longer-term impact on investment.

China's authorities are urging financial institutions to speed up funding for property developers

This is another action point to help stabilise the property sector and should support ailing property developers in proceeding with the construction of unfinished, but already sold, residential buildings.

High Yield appears unfazed by the risks



Source: Bloomberg

Credit markets had a firm tone to them last week amid a general risk-on mood in markets that saw the MSCI World Index rise by around 1% on the week. Primary market was less active however, largely due to a holiday shortened week in the US and a winding down of activity as markets enter the last few active weeks of the year. The fund flow picture was also positive with most credit segments seeing inflows, although inflows into US High Yield slowed to a trickle of around USD 324mn after two strong weeks that saw around USD 10bn of inflows.

The recent rally has driven US and European High Yield spreads to around 375bps and 440bps respectively, levels that seem somewhat sanguine ahead of an expected recession. Typical recessions have seen spreads widening beyond 800bps, implying most investors are expecting a soft landing rather than a recession. However, many warning signals abound, with default rates already rising while the most vulnerable CCC rated credits have not been participating in the recent rally. Indeed, looking at the relative performance of spreads and stock prices, US High Yield has notably outperformed US small cap stocks, as represented by Russell 2000 Index, since last year. All in all, while supply/demand technicals have favoured High Yield this year, fundamentally stocks stand to benefit more in a soft landing.

UK

Chancellor Hunt announces tax cuts to stimulate growth

The latest business surveys show that manufacturing remains in contraction with the PMI at 46.7 in November, up from 44.8 in October. Service activity is holding up a bit better with the PMI at 50.5, up from 49.5. Reflecting these developments, the Composite PMI ticked up from 48.7 to 50.1, showing a largely stagnant economy. Ahead of the elections expected in 2024, Chancellor Hunt announced a number of measures to stimulate the economy in his Autumn Statement. The personal tax cuts that he presented will help to support consumer spending at the margin, although a part of the benefits through tax cuts is usually saved rather than spent. The second important tax announcement in the Autumn Statement was the decision to make the full-expensing tax relief for investment permanent. This measure will not have an immediate impact on the economy but should help to lift business investment in the longer run, which should, in turn, help to raise the modest productivity growth seen in recent years.

Eurozone

The slowdown slows down

The newest round of sentiment data has further solidified the economic stagnation outlook for the Eurozone. November PMI data for the Eurozone, as well as for France and Germany specifically, ticked up marginally on the previous month across indicators. The numbers remain below the crucial 50 level across services and manufacturing, consistent with a further slowdown in activity. German ifo figures painted a similar picture. While participants' current assessment of the German economy remains at extremely low levels, future business expectation are improving.

In a surprise, we saw Geert Wilder's right-wing PVV party win a plurality of votes and 37 seats in the Dutch election. Government formations are complicated and lengthy in the Netherlands, with Mark Rutte's last two cabinets only agreed upon over 200 days after the election. The coalition negotiation process will necessitate tempering of the PVV's nationalist agenda, but Wilder's presence in the Dutch government will increase hurdles to further EU integration.

North Asia

Taiwan's thrilling election opera

We would not read too much into Japan's inflation spike in October from 3% to 3.3%, which was caused by a temporary rise in fresh fruit prices and a reduction in gas and electricity subsidies. Indeed, Japan's various measures of core inflation mostly came in below consensus expectations. Japan's Manufacturing PMI for November fell 0.6 points to 48.1, with most of its major sub and reference indices confirming weaker manufacturing conditions. The Service PMI rose marginally to 51.7, having contracted by 2.2 points in the two prior months. In China, authorities have urged financial institutions to provide ample funding for property developers. A white list of 50 developers, both SOEs and private companies, has been drafted. Turning to Taiwan, we note that both industrial production and export orders for October, though still down YoY, are showing a remarkable improvement in tech supply. Meanwhile, the two main opposition parties, the KMT and TPP, failed to form a coalition for the presidential elections on January 13, leaving the ruling DPP better positioned to win the election.

Argentina

President-elect Milei chooses his cabinet; uncertainty remains regarding future policy implementation

After the euphoria of victory, President-elect Milei has begun to set up his cabinet. Milei is facing an economy affected by triple-digit inflation, currency devaluation, a series of macroeconomic imbalances, and a drought that has affected agricultural production, exports, and tax revenues. In the short term, he will have the task of getting overwhelming inflation under control. In order to do so he is willing to apply a fiscal adjustment that would seek a financial zero deficit. Among the reforms proposed during his campaign, we highlight four: 1. A reduction in the number of ministries from 18 to eight; 2. Closure or privatization of public companies; 3. Tax reduction; and 4. Monetary reform, which includes the dollarization of the economy and the closure of the Central Bank. However, Milei lacks the majority in Congress needed to implement his proposals. Currently, his coalition has 38 deputies in a chamber of 257 members and eight senators amongst a total of 72. Milei mentioned during his campaign that if he had difficulties progressing in Congress, he would be willing to hold a plebiscite.

Covered Bonds

2023 on track to be a strong year for supply

Covered bond spreads underperformed broader credit and ended flat to slightly wider last week. While supply took a pause last week with only three new issues, there was strong demand from investors. Cumulative issuance volume for the year to date is lagging 2022 but is still expected to be the second strongest year for gross supply, almost reaching the record set last year. We expect issuance to slow down only marginally next year despite the weak demand for residential loans across Europe reported in the latest ECB lending surveys.

Covered bond supply is expected to fund forthcoming redemptions and the EUR 450bn in maturities remaining from the long-term funding operations from the ECB. Furthermore, banks are likely to favour covered bonds issuance to mitigate their rising funding costs as most of them have now filled their loss-absorbing junior bonds requirements. However, we don't expect this robust issuance to drag on spreads in coming quarters as covered bonds should still have a safe haven bid in an expected US recession we, which believe is likely in 2024.

What to Watch

- This week in the Eurozone brings November inflation numbers. A slowdown in both headline and core HICP is expected. We also see unemployment for the Eurozone (October) and Germany (November). The risks are for both of these rates to increase.
- In Switzerland data on GDP, retail sales, PMI and the KOF Leading Indicator are expected to show growth remaining weak
- In APAC, we believe the Bank of Korea and the Bank of Thailand will keep policy rates unchanged. Japan will release the MoF Corporate Survey for Q3, in addition to a series of October economic indicators. China will publish its November PMIs. Australia will release its private capex survey for Q3, November house prices and October CPI, retail sales and building permits. Taiwan and India will report Q3 GDP data. South Korea, Hong Kong and Thailand will release export data.

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