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Weekly Macro and Markets View

30 January 2023

Highlights and View

Bankruptcies rise notably with 17 bankruptcies in the US in January so far

Default rates are expected to rise further due to high funding costs and an expected earnings contraction, but valuations seem relatively sanguine in global High Yield and US Investment Grade credit.

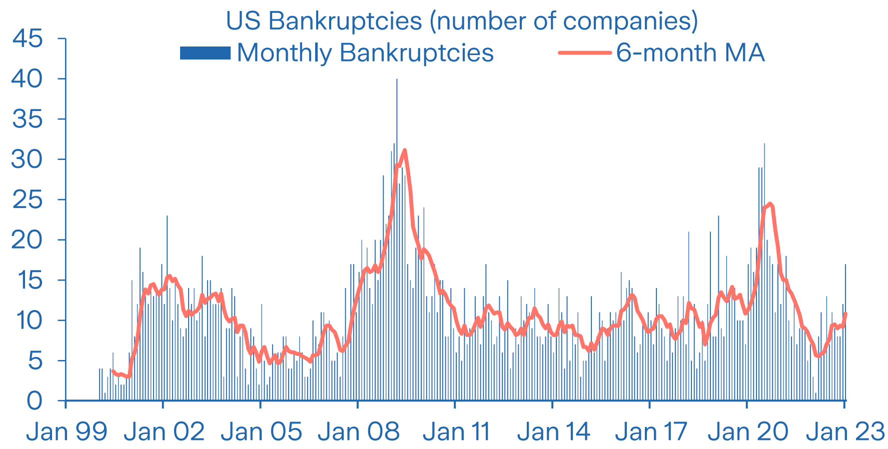
US GDP grows at a robust pace in Q4 2022 though domestic demand has weakened further

Overall, GDP numbers were flattered by rising inventories and falling imports both reflecting softer domestic activity.

The Eurozone Flash Composite PMI moves back above 50 in January

The improvement in business sentiment is a positive development and consistent with a less bad than feared slowdown over the winter. However, the Eurozone economy remains fragile.

Bankruptcies on the rise



Source: Bloomberg (Note: Chapter 7 and 11, private and public companies with liabilities above USD 50m)

Credit markets saw a continuation in positive momentum last week in both the primary and secondary markets, led by European credit. The mood in primary markets remained resilient as several borrowers were able to print deals at negative new issue concessions, while oversubscription levels remained robust. Supply/demand technicals have appeared generally supportive since the beginning of the year with continuing inflows, although they seem to be moderating now with US High Yield funds seeing outflows last week.

However, despite the upbeat tone in markets since the beginning of the year, which has sent valuations of US Investment Grade credit to nearly 2021 levels, evidence of underlying fundamental deterioration is increasing. As leading indicators point to a weak earnings environment ahead, the weakest borrowers are seeing their options dwindle. Indeed, January has already seen 17 bankruptcies in the US, with a few companies such as Bed Bath & Beyond likely to file for bankruptcy soon. A rise in default rates is to be expected this year with higher funding costs, tighter lending standards and a slowdown in earnings growth all likely to play a role. Moreover, despite the impending fundamental deterioration, valuations appear relatively sanguine in US Investment Grade credit and the global High Yield market.

Equities

US stocks take the baton as equities race higher

The glass is more than half full for equity investors as fears of inflation are assigned to history and expectations of easing monetary policy are tightly embraced. Last week saw a willingness to buy any intra-day pull-back, which indicates robust momentum. While we maintain that such optimism is misplaced, it has to be acknowledged that 'stocks want to go up', at least for now. There was a shift in leadership as the rally broadened. While the UK FTSE 100 index was actually down 0.1% on the week and the Euro Stoxx 600 up a modest 0.7%, the US markets came back strongly, led by the Nasdaq, up 4.3% and now 11% higher since the start of the year. Despite another slew of poor technology company earnings and guidance last week, led by Microsoft and Intel, investors are willing to look through short-term troubles towards lower interest rates and better times ahead. This seems too optimistic to us. With core inflation still problematic in most regions and the recent asset rally undermining policy tightening, we suspect a combination of further rate hikes and slowing growth leave risks firmly to the downside.

US

Consumer spending remains under pressure

The first estimate of GDP for Q4 2022 shows that economic activity was still robust in the final quarter of last year with growth slowing to an annualised rate of 2.9% from 3.2% in Q3. However, the underlying picture was weaker than the headline number suggests as rising inventories and a marked fall in imports flatter the overall number despite reflecting modest domestic demand. The continued slowdown in activity was also confirmed by S&P Global's Manufacturing and Services PMIs both remaining in contractionary territory in January, though slightly less so than in December. Companies continue to highlight subdued customer demand. In addition, the rate of job creation was one of the weakest since July 2020. Personal consumption expenditure fell the second month in a row, reflecting the persistent headwind to household spending. Meanwhile, the Conference Board's leading index, which is a combination of already known factors, fell to -6.0% YoY, a level that has indicated an imminent recession in the past.

Eurozone

The Flash PMI moves back above 50, but the economy is still fragile

The mild winter weather and China's reopening continue to lead to a rebound in business confidence in the Eurozone. The Flash Eurozone Composite PMI moved back above 50 in January, to 50.2 from 49.3 in December. However, the Composite PMI for both Germany and France (also available in the Flash report) remained below 50, suggesting that the improvement was driven mainly by sentiment in the Eurozone's periphery countries. Overall, we still think that the economic recovery in the region will be fragile this year, given a likely slowdown in the US and a central bank that seems determined to continue tightening monetary policy. Indeed, the ECB is expected to deliver another 50bp hike this week and announce further details of its planned Quantitative Tightening (QT) policy. This is despite the fact that the latest Eurozone money supply data, also released last week, showed a further slowdown in lending growth in December to both households and businesses.

North Asia

Tokyo's CPI climbs to a 42-year high of 4.4%

Another surge in fresh food prices lifted Tokyo's CPI inflation from 4% to 4.4% YoY in January, the highest since 1981. The impact of lower prices from travel discounts faded as the program was halted over the New Year holidays. Looking forward, a stronger yen and falling commodity prices, including food, should help to alleviate inflationary pressures, while, on the contrary, major utility companies plan to raise their electricity rates at the start of the new fiscal year in April, or in June. Meanwhile, the decline in Japan's Manufacturing PMI ended after nine months, remaining unchanged at 48.9, with some subcomponents suggesting a turn for the better. The Services PMI climbed 1.1 points to 52.4. For strength in the services sector to remain intact, inbound travel demand must stay robust, while inflation needs to subside. December exports were weaker than consensus had expected in Hong Kong, the Philippines and Thailand, while Korea's GDP contracted by 0.4% in Q4, bringing the growth rate for 2022 to 2.6% YoY.

Australia

Inflation shows no signs of moderating

Inflation in Australia remained elevated in Q4, with the headline CPI accelerating from 7.3% to 7.8% YoY and the trimmed mean from 6.1% to 6.9% YoY, both surpassing market expectations. The primary drivers were travel costs, reflecting increasing demand for travel post-Covid, as well as rising electricity prices, robust rents, and home-building costs. The monthly inflation rate, which covers approximately 70% of the items in the CPI basket, jumped from 7.3% to 8.4% YoY in December. The fading fuel subsidies and electricity rebates from the government have partly contributed to the rising prices. With the persistence of high inflation and the lack of meaningful signs of a receding trend, the Reserve Bank of Australia will need to maintain its hawkish stance for longer. Additionally, the Flash PMI for December remained in contractionary territory for both the manufacturing and service sectors, and business confidence remained negative despite some improvement.

What to Watch

- In the US, the Fed is expected to hike rates by 25bps though investors will look for hints as to the future path. The latest set of ISM numbers and labour market data will give further insights into the current state of the economy.
- In the Eurozone, the ECB is expected to deliver another 50bp rate hike. The first estimate of Q4 GDP growth for the region and for many individual countries will also be released
- In APAC, Japan will report December labour market, industrial production, retail sales and housing starts data as well as consumer confidence for January. Australia's housing data are likely to continue to paint a gloomy picture of the housing market. December retail sales and Q4 business confidence data will also be reported. China will release its NBS and Caixin PMIs for January, which are expected to show some improvement. Hong Kong will report GDP Q4 and December retail sales data, while December industrial production data will be reported in Taiwan, South Korea, and Thailand. Malaysia's markets will be closed on Wednesday.

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