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Weekly Macro and Markets View

6 February 2023

Highlights and View

ISM Manufacturing new orders fall to 42.5, a level usually only seen around recessions

While manufacturing new orders are signalling a recession, service activity is holding up and the labour market remains very strong.

In the first estimate, Eurozone GDP for Q4 2022 grows 0.1% QoQ

The Eurozone may have escaped a technical recession, but the region's economy remains fragile.

The Bank of England lifts the Bank Rate by 50bps to 4%

The rate hike was in line with expectations, with a minority voting to leave rates unchanged, though the statement leaned to the dovish side, weighing on gilt yields and sterling.

Manufacturing new orders signal an imminent recession in the US

Source: Bloomberg

Business activity in the US softened further at the beginning of the year with the ISM Manufacturing Index falling to 47.4, thus moving deeper into contractionary territory. Ominously, new orders fell to 42.5, a level that is usually only seen in a recession or shortly before one is about to hit. Meanwhile, services were holding up better with the ISM Services Index rebounding to 55.2, though part of the recovery is a reflection of normalisation following last month's weather-related distortions. Defying the ISM Manufacturing's recession signal the labour market remains very robust. Nonfarm payrolls jumped by more than 500,000 in January, the unemployment rate ticked down to 3.4% and initial jobless claims dropped to 183,000 while job openings rose back above 11mn. Nevertheless, despite the tight labour market, wage growth has slowed from 4.8% to 4.4% YoY, which will help to alleviate the Fed's worries about a potential wage-price spiral. As expected, the Fed lifted its target rate by 25bps to a new range of 4.5%-4.75% at its meeting last week. Interestingly, Fed Chair Powell did not even try to push back against looser financial conditions triggering a substantial rally in the S&P 500. In another sign of solid stock market momentum, the Nasdaq outperformed most of its global peers last week despite a set of mixed earnings reports from a number of large tech companies.

Eurozone I:

The ECB moderates its hawkish tone, government bond yields fall sharply

As expected, the ECB raised its deposit rate by 50bps to 2.5% last week. ECB President Christine Lagarde said that it intended to raise rates by a further 50bps at the March meeting. However, Lagarde was less committed than she has been in the past about what would be done after March, saying simply that '…we will then evaluate the subsequent path of our monetary policy'. Previously, Lagarde had indicated an intention to pursue a series of 50bps rate hikes. These latest comments were therefore interpreted as less hawkish.

Interest rate futures moved to price in a peak ECB deposit rate of 3.25% by mid-2023, rather than 3.5% as had previously been expected. Eurozone government bond yields also fell sharply, with 10yr Italian government bond yields down by around 40bps on the day. The bond yield moves seemed like an overreaction and reversed partially the next day. Nevertheless, we would welcome a slightly less hawkish ECB as we have argued previously that tightening interest rates too much in a weak economy could be counterproductive and a policy mistake.

Eurozone II

Q4 GDP stronger than expected while inflation falls more than anticipated

Q4 GDP grew more than expected, up 0.1% QoQ (1.9% YoY), versus expectation of a small decline of 0.1% QoQ. However, the overall figure for the Eurozone was flattered by a huge contribution from Ireland of 3.5% QoQ, without which GDP growth would have been negative. At the country level, two of the big three Eurozone economies saw contracting GDP in Q4, Germany with -0.2% QoQ and Italy with -0.1% QoQ, while France saw growth of just 0.1% QoQ. Regardless of the technical details, the Eurozone economy remains fragile. This was highlighted by the ECB's lending survey for Q4, which showed a substantial tightening in credit standards on loans to enterprises and households and a sharp reduction in loan demand as well. Meanwhile, Eurozone inflation continues to fall, down from 9.2% in December to 8.5% in January, helped by a further sharp fall in energy inflation. However, the figures could be revised up somewhat when the final estimate is released as German inflation numbers were not available for the flash HICP estimate.

China

January PMIs confirm strength in high-frequency indicators

Both PMIs for January as well as high-frequency data confirm that economic activity is returning swiftly after Covid related restrictions were dissolved before the Lunar New Year. Indeed, the NBS Services PMI spiked from 39.4 to 54 in January while the construction PMI rose by two points to 56.6 and the Manufacturing PMI, as well as its new-order component, climbed back above the boom-bust line of 50. Though the new export order component recovered as well, it remains below the 50 mark. The Caixin PMIs for January improved less, reflecting that the survey was taken earlier and did not fully reflect the Lunar New Year recovery. There is evidence that pent-up travel-related consumer demand was particularly brisk in lower tier cities, including expenditures for baijiu liquor during banquets and for gift-giving purposes. Overall, despite the solid recovery versus the last two years, Lunar New Year passenger traffic has surprisingly only reached about half the pre-Covid level, according to official statistics.

Global PMIs

Growth momentum improves, led by services while manufacturing remains in the doldrums

The global PMIs indicate that global growth edged higher in January, but from a low level. While the Global Manufacturing PMI ticked up from the December low, it still sits below the boom-bust line of 50, consistent with contraction in the sector. The improvement partly reflected better activity in the Eurozone, where mild weather and falling energy prices have eased headwinds. Key manufacturing hubs, including Germany, Taiwan and South Korea are still seeing very weak activity, however, along with depressed export orders. Even Switzerland, which has benefitted from resilient external demand so far, saw a slump in manufacturing activity in January, with a sharp contraction in orders. The Global Services PMI, by contrast, retraced to just above 50 as activity surged in China upon reopening. Some weather-related distortions that weighed on the sector in December also waned. Overall, China's reopening is leading service activity higher, but the global industrial cycle remains weak, with global growth still well below trend.

Credit

A strong week but idiosyncratic risk is rising

Credit markets had a strong tone to them last week, led by European Investment Grade credit. The rally in risk assets was driven by investors increasingly believing in a move closer towards the end game of a monetary policy pivot amid moderating inflation. Spreads tightened even on Friday despite a fall in both government bonds and stocks after strong US payroll data reignited concerns that interest rates could remain high for some time. Despite the strong tone, idiosyncratic risk is rising as evidenced by Bed Bath & Beyond's missed interest payment and seemingly imminent bankruptcy filing. Adani bonds dropped sharply amid the volatility, triggered by a negative report by the US research firm Hindenburg, which caused the group to pull a share sale. That said, a systemic fallout on broader EM credit seems unlikely, although the impact on Indian USD IG spreads has been visible. Furthermore, all three major rating agencies left their ratings on Adani's companies unchanged while the Indian central bank reassured investors regarding the resilience of the local banking sector.

What to Watch

- In the Eurozone, December industrial production data for various countries will give additional clues as to the state of the economy in Q4 2022.
- In APAC, media reports hint at that Bank of Japan's deputy governor Amamiya will be selected as new BoJ governor by Japan's government. Japan's Q4 GDP data and January producer price statistics will be released. China will publish inflation and monetary data for January. In Australia, we expect the RBA to lift its policy rate by 25bps to 3.35% and to update its Statement on Monetary Policy. Q4 retail sales and December foreign trade data will also be published. India's RBI is likely to hike its repurchase rate by 25bps to 6.5%. Malaysia and Indonesia will report Q4 GDP data. Taiwan will release January export data. Indonesia's markets will be closed on Tuesday.

Disclaimer and cautionary statement

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