Weekly Macro and Markets View

20 February 2023

Highlights and View

US inflation proves troubling, with both CPI and PPI rising MoM in January against a strong consumer backdrop

Though we see growth slowing sharply in the months ahead, the Fed needs to improve the consistency of its messaging regarding inflation commitments.

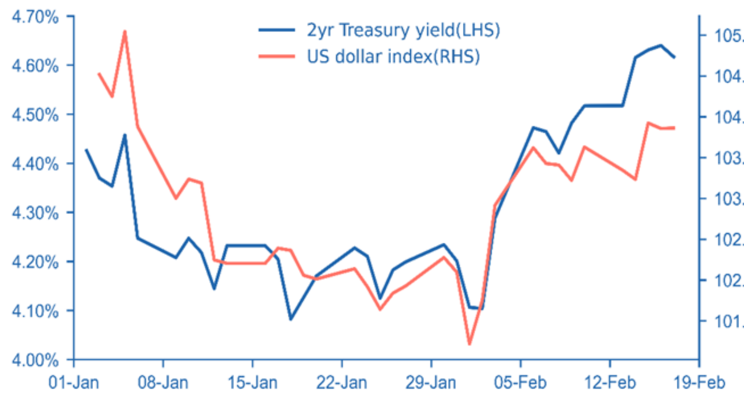
Government bonds sell off on strong US economic activity and inflation data, along with hawkish central bank rhetoric

While renewed downside to yields is likely with recessionary headwinds setting in, government bonds will likely remain under pressure near term as the rate outlook is reassessed.

New credit bond sales continue to surge, with Amgen selling the ninth largest IG deal ever at USD 24bn

Issuers continue to rush into the primary market to benefit from current tight credit spreads and to refinance ahead of economic data that may push rates higher.

US data paint a mixed picture that will trouble the Fed



Source: Bloomberg

A slew of US data last week highlighted the bifurcated economy and the challenges facing the central bank. US consumers remain in good health for now while the labour market is still hot. Another week of initial jobless claims below 200k surprised positively once again, while retail sales readings showed a jump in January. Strength was broad-based, from clothing to cars, though it follows weak prior readings and is subject to seasonal distortions. This contrasts sharply with other parts of the economy, with housing starts and permits again weak, while industrial production and the Philly Fed business outlook were also poor. Not only is the composition of economic activity mixed, the Fed is also faced with more troubling inflation news. While CPI and PPI inflation continued to fall, to 6.4%YoY and 6% YoY respectively, headline CPI strengthened to 0.5% MoM, with the core reading up 0.4%, in January. The trimmed mean CPI, a gauge watched closely by the Fed, rose the most in four months. While policy makers clearly have their work cut out for them, investors priced in a more hawkish outlook. 2yr Treasury yields reached 4.71% intraday, the highest since November, and the dollar bounced. Stock investors kept their faith, however, with the Nasdaq up on the week and broader indices off only fractionally, amid a continuation of strong retail flows. Risks persist, but momentum is strong.

Switzerland

inflation jumps on higher electricity prices, with more SNB tightening expected

Consumer and producer price inflation jumped in January as electricity prices were hiked by an average of 25% at the start of the year. Headline CPI rose 0.6% on the month, with electricity contributing by over 40bps to the increase. This left the annual rate at 3.3%, up from 2.8% in December, though still below the August peak of 3.5%. The electricity price hike had been flagged well in advance and CPI is now tracking broadly in line with the SNB's latest forecast. Core inflation was also benign, with core prices unchanged on the month, and only up 0.2% over the past three months (not annualised), helped by falling import prices. Inflation is also set to fall back in the second half of the year as the steep price rises in early 2022 fall out of the annual comparison. That said, the labour market remains very tight, with shortages persisting, and wages are set to drift higher in 2023. As signalled in its last meeting, we expect the SNB to continue to hike rates in March.

Japan

While preliminary Q4 GDP data show positive growth, it was weaker than expected

The initial release of GDP showed Japan's economy grew by 0.2% QoQ in Q4, weaker than consensus expectations of a 0.5% expansion. Growth was supported by resilient private consumption and buoyant net exports, despite declining inventory and private investment. Based on the Q4 figure, annual growth is estimated to have been around 1.1% in 2022. Core machine orders inched up 1.6% MoM in December, mainly driven by the manufacturing sector. The non-manufacturing sector, however, experienced a strong decline. Overall, machine orders fell by around 5% QoQ in Q4, consistent with a drop in private capital expenditure suggested by the GDP data. Meanwhile, January exports slowed from 11.5% to 3.5% YoY but still exceeded market expectations of -1.7%. All eyes are now on the Bank of Japan's next meeting in March and its decision on the Yield Curve Control policy following Kazuo Ueda's appointment as Governor last week.

Australia

The labour market shows tentative signs of cooling

Amid a period of labour market tightness, Australia's latest job figures showed tentative signs of loosening. The unemployment rate rose from 3.5% to 3.7%, nearing the central bank's year-end forecast of 3.75%. The 11.5k drop in employment was driven by full-time jobs while total hours worked fell by 2.1% MoM, a third consecutive month of decline. Of note, the January figures may have been skewed by the holiday season, given an unusually high number of people taking extended time off. Hence, next month's data will be crucial in confirming whether this trend endures. In his speech last week to the Senate, RBA Governor Lowe emphasised that inflation is 'way too high' and the RBA's job is to bring inflation back to its target. However, with initial signs of cooling in the job market and softer household spending data, we think the RBA will not need to hike as much as the current market pricing of the terminal rate of above 4%. We retain our forecast of the RBA's terminal rate at 3.85%.

LatAm

Annual inflation in Argentina recorded its highest level in 32 years

In Argentina, monthly inflation surprised, reaching 6% in January, led by increased food and service prices. Annual inflation accelerated from 94.8% to 98.8%. We believe it is unlikely that the government will implement a stabilisation plan to reduce macroeconomic imbalances to try and tackle inflation as it would initially create a jump in inflation. Instead, the government will continue with its price control policy, which could provide some relief in the short term but will likely fail to spur disinflation. In Brazil, after contracting for four consecutive months, monthly economic activity grew 0.3% in December, mainly explained by the service sector's improvement. Nevertheless, the economic outlook remains challenging for H1 '23. After weeks of speculation over changes in the inflation target, the Monetary Council announced it will maintain the current targets. However, we expect the inflation targets to be modified during the year. Furthermore, the Minister of Finance promised to deliver a proposal for the new fiscal framework in March, which is earlier than his previous commitment of April.

Covered Bonds

Banks favour issuing covered bonds, seizing the opportunity to get the ECB on board

The issuance of credit bonds had a very strong start across Europe and the US for both IG and HY markets. European covered bonds sales continue at record rate, even after the record yearly issuance amount in 2022. Banks have already sold EUR 67bn of covered bonds this year, well above any previous year-to-date amount. It seems that part of the activity was front loaded, with borrowers wanting to take advantage of the ECB's participation in primary deals. The ECB announced during its last press conference that it will ends its reinvestment of redemptions into the primary market next March. The ECB's participation level has already dropped, down to 10% last week compared to the average of 25% during the past years. Despite the record level of issuance, covered bond spreads have outperformed other European credit sectors. We think that they may also benefit from their safe-haven status if volatility rises and/or the risk of a potential economic recession materialises later in 2023.

What to Watch

- The Flash PMIs will show whether global growth dynamics continued to improve in February.
- Attention in the US will be on PCE inflation, which is expected to be unchanged at 5% YoY, with the core reading down a tenth to 4.3% YoY.
- German GDP data will give more detail on Q4 growth while the IFO, ZEW, and consumer confidence surveys will show how sentiment is holding up.
- The Bank of Korea is likely to keep its policy rate unchanged. Australia's housing data, Q4 GDP, CPI, and wage growth data will give some hints about growth and inflation momentum. Inflation data for Malaysia and Singapore and industrial production for Taiwan and Singapore are also worth watching.

Disclaimer and cautionary statement

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