

Weekly Macro and Markets View

27 February 2023



Highlights and View

US data show a robust consumer and service sector, but an alarming tick up in inflation

The data confirm an increasingly bifurcated US economy. The higher inflation reading is putting further pressure on rate sensitive sectors as Fed policy is repriced.

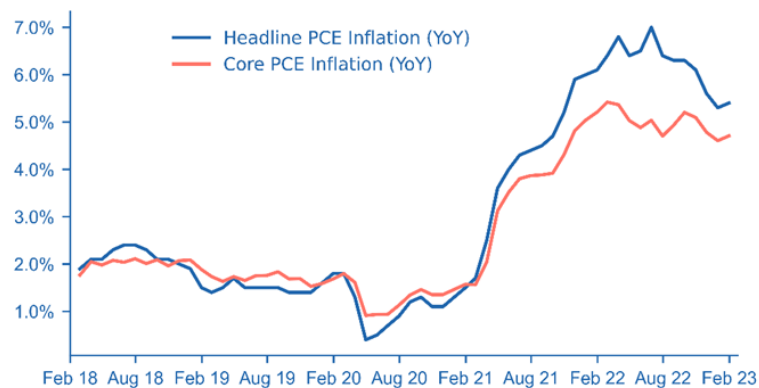
Both the UK and Eurozone Flash Composite PMIs surprise to the upside in February

The PMIs provide further evidence of a less bad than feared slowdown over the winter months in Europe, but the region's economy remains fragile and exposed to any shocks.

Credit markets weaken while US High Yield funds record the third largest outflow on record

Outflows in US High Yield are a reflection of investor angst regarding increasingly hawkish central banks, which, along with the heightened likelihood of a US recession, make credit appear vulnerable.

Sticky US inflation spooks markets



Source: Bloomberg

While one should never read too much into a single set of data, US PCE inflation for January proved to be potent enough to spook investors. In light of the solid improvement in the inflationary backdrop, January's readings were a reminder that economic variables seldom move in straight lines and that extrapolating the recent sharp pace of declines is unwise. Headline PCE rose 0.6% on the month, taking the year-on-year rate up to 5.4% with earlier data having been revised up. The Fed's favoured core reading offered little comfort, also rising 0.6% on the month, now 4.7% higher YoY. While the release of the Fed minutes showed that broad agreement to cut the pace of hikes from 50bps to 25bps was seen at the last meeting, various Fed members have sounded decidedly more hawkish since then and the latest inflation results will likely have hardened those opinions. Other data showed that existing home sales fell for a twelfth consecutive month and are now below pandemic levels, the Services PMI moved back into expansionary territory for the first time since June, and initial jobless claims and personal spending remain strong. Consequently, investors have increased their expectations of the Fed's terminal policy rate from 5.14% at the start of the month to 5.47%. 10yr Treasury yields hit 3.97%, before easing back, while the S&P 500 fell 2.9% on the week and is now off 5% from the high at the start of the month. Markets are expected to remain choppy with risks to the downside.

Eurozone

The Flash Composite PMI moves further above 50

There has been further improvement in various business and consumer confidence surveys in the Eurozone. In particular, the Flash Composite PMI rose more than expected, increasing from 50.3 in January to 52.3 in February. The gain was entirely due to a more than two-point gain in services confidence, while manufacturing confidence fell back slightly. The implication of the survey overall is that we may see modest growth in the first quarter of 2023. However, the Eurozone economy remains fragile as demonstrated by the fall in manufacturing

confidence and the continued depressed levels of consumer confidence despite a rebound in February. The European Commission's measure of consumer confidence rose by around two points but is still close to the lows seen in the 2008/09 Global Financial Crisis and the 2011/12 Eurozone debt crisis. Lastly, the final estimate of inflation in January was revised up by a tenth of a point on both the headline and core measures, to 8.6% and 5.3% respectively, and is likely to keep the ECB on a hawkish path.

North Asia

Taiwan's production plunges while Japan's core CPI climbs to a 42-year high

In Japan, the Lower House Diet hearing for the nominee for BoJ Governor and his two deputies went smoothly, with Kazuo Ueda avoiding expressing any aggressive monetary views. Upper House hearings are scheduled for this week. Regarding policy, we believe a cautious retreat from Yield Curve Control (YCC) is more likely than a sudden exit. Meanwhile, both the PMI and the Reuters Tankan Survey for February indicate that the services sector is likely to recover further over the next few months as Covid infections are retreating and inbound

tourism will improve further. Japan's core CPI climbed to a 42-year high of 4.2% in January, driven by higher accommodation, durable goods, and insurance charges. In China, high frequency data are confirming a further normalisation of consumption close to pre-Covid levels while home sales remain lacklustre despite increasing foot traffic to property showrooms. Finally, we highlight that Taiwan's industrial production plunged 20.5% YoY in January, with all major product categories affected amid weak foreign demand.

Australia

The latest data show strong capex and gradual wage growth

Following three quarters with a subdued trend, private capital expenditure strengthened in Q4, up by 2.2% QoQ, materially beating consensus expectations of 1.1%. While mining investment experienced moderate growth, construction capex rose robustly by 3.6% QoQ despite being oddly out of sync with construction work done, which showed a slight decline. Overall, capex figures suggest business investment should positively contribute to growth in Q4. Also, capex intention surveys implied a resilient trend in investment ahead. Notably,

Q4 wage growth surprised consensus to the downside, growing only 0.8% QoQ and 3.5% YoY, while staying around the range of wage growth that is in line with the inflation targets of the Reserve Bank of Australia (RBA). Modest wage growth should offer certain relief to the RBA, given inflation has been elevated in the last few months. It will also allow the central bank to moderate its rate hikes in the months ahead, limiting the potential damage of tightening monetary policy to the economy and the housing market.

LatAm

The equity market in Brazil remains under pressure

The MSCI LatAm fell 2.6% last week. Fiscal uncertainty continues to hit the equity market in Brazil while a confirmed case of mad cow disease also affected the market, with the Bovespa Index falling 3.1%. Even though no other cases have been reported, the Brazilian government has suspended beef exports to China. If the outbreak is short, the impact on exports and the financial market will likely be limited. If more cases appear or the export suspension lasts longer, however, the risk of a more significant impact on the economy will increase.

In Chile, the peso was the worst performing emerging market currency last week, depreciating 4.5%, driven mainly by the fall in copper prices, but CLP has still appreciated 3.1% YTD. In Mexico, annual GDP grew by 3.1% YoY in 2022. Consumption remains robust, while remittances and tourism support economic activity. In Q4 2022, the service sector continued to improve and the construction sector grew 2.2% QoQ. Conversely, manufacturing is showing signs of decelerating growth, falling 0.57% QoQ after rising for four consecutive quarters.

Credit

Signs of weakness as High Yield outflows mount

Credit markets were weaker across the board last week, with corporate bonds finally buckling under the negative sentiment seen in government bonds over the last few weeks. Despite last week's sell-off, corporate bonds, and within that European credit, have outperformed over the month, although CDS has underperformed. A higher for longer inflation narrative is being increasingly priced into government bond markets, which are already pricing in a more hawkish near-term interest rate outlook compared to just a few weeks ago. Given the consequent move

in yields, credit has been relatively resilient so far, and we would not be surprised to see further spread widening in credit markets. Credit valuations, especially in the US, appear sanguine in the face of a possible recession and a more hawkish rate outlook. Primary market activity was lacklustre last week, although deals that were printed saw reasonable demand. US High Yield funds experienced the third highest outflows on record amid elevated government bond yield volatility, disrupting the tentative stabilisation in flows seen previously.

What to Watch

- US ISM data are expected to confirm a mixed economy, with services expanding and manufacturing contracting, while further declines are expected on monthly home prices.
- Various data for the Eurozone will provide clues as to the strength of the economy in the region.
- In APAC, Japan will publish various economic indicators for January, Tokyo's CPI for February, and MoF Corporate Statistics for Q4. Australia's February home prices and January retail sales are likely to be weak, while GDP data should show resilience in Q4. January CPI data will help gauge the inflation trend. Manufacturing PMIs across Asia will hint at the trajectory of trade and production in manufacturing hubs. India's GDP and Indonesia's CPI are also worth watching. Korea, Hong Kong, and Thailand will report export statistics. China will report NBS PMIs for February while the National People's Congress will convene on Sunday.
- In Chile, economic activity is expected to continue decreasing, while unemployment will likely increase. GDP growth and fiscal data in Brazil should show signs of economic deceleration. In Mexico, the focus will be on Banxico's inflation report.

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