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Weekly Macro and Markets View

8 January 2024

Highlights and View

Mixed signals from the US labour market

While payrolls grew at a decent pace, the participation rate fell and employment in the service sector weakened markedly.

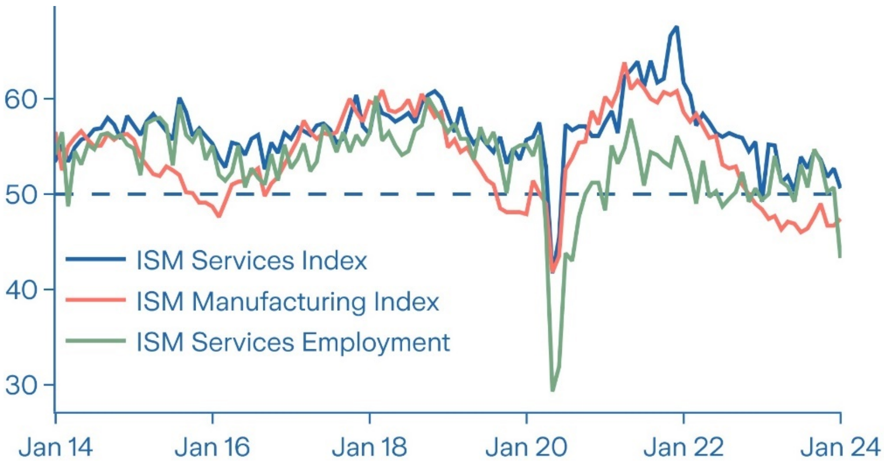
Eurozone HICP inflation picks up from 2.4% YoY in November to 2.9% in December, while core measures fall further

A faltering economy will likely see inflation move close to the ECB's target in 2024, but the path is unlikely to be as easy as the market is currently pricing and a March rate cut looks too aggressive.

January started with the usual deluge of new bonds in primary markets

Supply was expected to be high but there were signs of indigestion with wider spreads and widening new issue concessions.

Growth slows further in the US



Source: Bloomberg

US business activity slowed to a crawl in the final month of 2023. The ISM Manufacturing survey showed that manufacturing remained in contraction for the fourteenth month in a row with new orders pointing at further headwinds. While services held up better, activity hardly expanded in December with the index falling to 50.6 from 52.7 the month before. Weighed down by weaker consumer demand and increasing uncertainty, employment activity in the service sector has contracted at the fastest pace since July 2020. The weaker employment situation was only partially reflected in the latest batch of labour market data, however. Nonfarm payrolls increased by 216'000 although the combined two-month period beforehand was revised down by 71'000. At the surface, the labour market still looks tight with the unemployment rate stuck at 3.7%. However, the participation rate fell by 0.3% while the broader underemployment rate ticked up to 7.1%, indicating that the employment situation is deteriorating. This was confirmed by both the hiring and the quits rate falling below their pre-Covid levels. Markets had a weak start into the new year with the S&P 500 losing 1.5% during the first week while bond yields rebounded from their recent lows. Higher yields were a particular drag for the Nasdaq which dropped by 3.3%.

Eurozone

Inflation picks up, to no one's surprise

December Eurozone HICP inflation rose at 2.9% YoY in December 2023, up from 2.4% the month prior. This reading was in line with market expectations, and the bounce primarily reflects energy prices contributing less negatively to the reading. There is good news on core inflation, where the main measure fell to 3.4% YoY from 3.6% in November. All of these readings remain above the 2% target but are falling faster than the ECB anticipated in their forecast rounds across 2023. There are areas of concern, most notably services prices which remained at 4% YoY in December. Recent PMI sub-components provide a counter to the market's immaculate disinflationary narrative: 'Services Prices Charged' for December picked up again for the second month to 55.6. Overall, last week saw upward revisions to PMIs across the Eurozone, where initial estimates in December signalled further economic weakness. Newly revised figures suggest stagnation rather than renewed weakness in Eurozone data.

China

… they did it again!

Action by China's supervisory authorities struck another blow to Chinese equities over the holidays. What was intended as a measure to protect gamers ended in a sweeping loss of confidence amongst investors, igniting strong selling of stocks active in the gaming software sector. MSCI China's heavyweights Tencent and NetEase collapsed 12% and 25% respectively, pulling the index down by 3% amid strong selling by retail investors. Ministry officials tried to backpedal amid the market reaction, helping to stabilise the equity market. The most affected gaming related equities were able to recover about two-thirds of their losses. Meanwhile, the PBoC injected CNY 350bn into policy banks to support infrastructure investments and the property sector via its 'Pledged Supplementary Lending' (PSL) scheme. Finally, while the NBS PMIs for December disappointed, the Caixin PMIs surprised to the upside, suggesting that East coast SMEs are doing better than the big SOEs.

Brazil

PMI indicators point to a slowdown in activity, in contrast to industrial production which continues to surprise positively

Early last week, PMI indicators for November were published in Brazil. PMI Manufacturing remained in contractionary territory, falling from 49.4 in October to 48.4 while the PMI Services, although remaining in expansionary territory, fell from 51.2 in October to 50.5. Thus, the Composite PMI fell from 50.7 to 50. In contrast to expectations of a deterioration in economic activity, industrial production in November showed growth of 0.5% MoM, up from 0.1% in October and above market expectations of 0. 3%. This resulted an increase of 1.3% in the 12 months, up from 1.1% the previous month and above the market consensus 0.9%. On a monthly basis, all components showed an increase: capital goods 1.7% MoM, intermediate goods 1.6% MoM, and consumer goods 0.2% MoM. In year-on-year terms, only capital goods production remained in negative territory, showing a decrease of -14.8%.

Credit

A weak start to the new year

The year-end rally came to a halt last week and credit spreads widened amid weaker equity markets and heavy supply. Primary markets had a strong start with corporate and financials issuers selling USD 56bn and EUR 42bn Investment Grade rated bonds, in line with issuance volume of the previous years. Activity was dominated by European banks issuing both in USD and EUR as US domestic banks are already in a black-out period with the earnings season starting this week. Following two strong years of issuance, covered bonds remain a very large part of the primary market, demonstrating that banks are trying to lower the increasing cost of funding. Large European banks sold more than EUR 13bn of covered bonds, including longer tenors with two 10yr tranches. Heavy supply in the global IG space was expected and issuers had to slightly increase their new issue concession. We expect issuance to remain robust during the following weeks, which should add pressure to credit spreads given the expensive levels reached at the end of 2023.

Equities

Interest rates still determine the path of stocks

In light trading volumes, equity markets eased back following the strong close to 2023. The MSCI World Index was down a relatively modest 1.5%, but the more interest rate sensitive stocks came under greater pressure as expectations for interest rate cuts were tempered. The tech heavy US Nasdaq index slipped 3.3% while the Russell 2000 small cap index was off 3.8%. Although European stocks fared better, Chinese stocks remain under significant pressure, posting further losses. Stronger payroll data in the US, robust wage growth, and more hawkish Fed minutes, suggested that market implied pricing of Fed rate cuts as soon as March had been too optimistic. Indeed expectations were lowered on the data, and 10yr Treasury yields moved back above 4%. Higher rates in both the US and Europe weighed on stocks, and it seems that equity investors are still dancing to the tune of the bond markets. With trading activity likely getting back to normal in the coming week, more discernible trends may start to emerge and we would not read too much into last week's moves.

What to Watch

- In the US, investors will focus on the latest batch of inflation data while large banks will kick off the earnings reporting season for the final quarter of 2024.
- In the Eurozone, retail sales for November will be released, with a contraction expected in Germany. Eurozone wide unemployment is expected to be unchanged at 6.5%. The Economic Sentiment Indicator and Sentix Investor Confidence indices will also be published.
- In APAC, we believe the Bank of Korea will leave policy rates unchanged. Japan will publish Tokyo CPI data for December and wage data for November. We will watch the BoJ branch manager meeting for guidance. China will release CPI, PPI, export and monetary aggregate data for December. Australia will publish CPI, export and retail sales data for November. India's December CPI and November industrial production data will be released.
- In Chile, CPI inflation data for December will be published.

Disclaimer and cautionary statement

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