Weekly Macro and Markets View

15 January 2024

Highlights and View

The Eurozone unemployment rate defies market expectations to fall back to historic lows of 6.4%

The tight labour market remains the clearest upside risk to the Eurozone economic outlook, but some weakening looks highly likely given existing stagnation in economic activity.

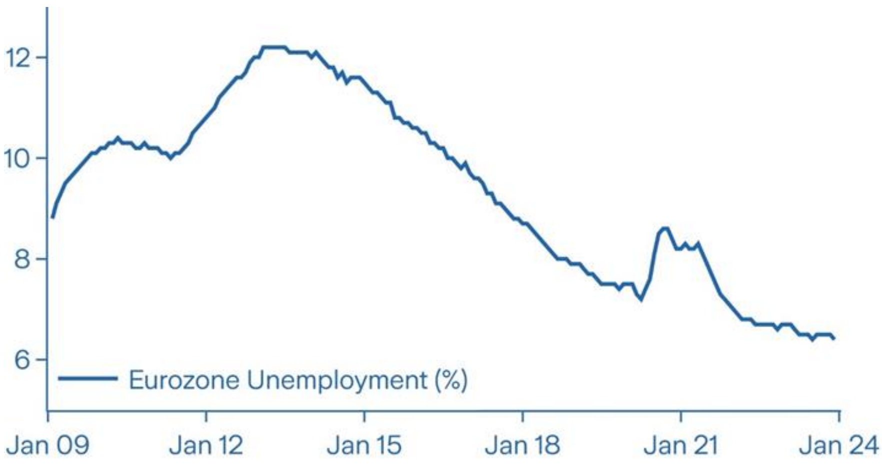
Airstrikes in Yemen against Houthi rebels shows an escalation in geopolitical tensions and rising risks

Rebel attacks on merchant shipping have forced a large part of global goods to be rerouted, doubling freight rates and posing headwinds for inflation.

Credit ETFs see a surge in inflows with the highest weekly inflows since 2020 recorded last week

While investors have increasingly embraced a soft landing narrative and flows are likely to be enticed by higher yields, credit spreads remain tight on a historical basis with limited upside potential.

The Eurozone labour market remains historically tight



Source: Bloomberg

Last week saw diverse Eurozone data that broadly confirmed the recent trend of weaker activity measures, though they were offset by tentatively improving forward-looking sentiment. Eurozone-wide unemployment, which defied market expectations to fall back to historic lows of 6.4% as of November was a highlight, however. The labour market is the bright spot in an otherwise dimming Eurozone outlook and remains the likely source of any upside surprise to the overall economic situation via stronger real wage growth and private consumption. Nonetheless, we expect a softening of the labour market this year consistent with the on-going stagnation in economic growth. Germany serves as a good example as the largest contributor to slowing Eurozone growth in 2023. There, employment growth is slowing, vacancy levels are normalising, and short-term work applications are gradually increasing. Sentiment survey data released by the European Commission continued its recent trend of improvement, albeit still consistent with economic contraction. On the negative side of the ledger, both industrial production and retail sales figures for November were disappointing and increase the likelihood of a recession being confirmed for Q4 2023. German and Italian industrial production fell considerably in November, likely contributing to a continued fall in the Eurozone measure.

US

The S&P 500 is back in positive territory, despite mixed inflation readings

The much anticipated US inflation readings for December offered mixed results, but were benign enough to encourage the equity bulls. Both headline and core CPI readings were a tad firmer than expected, rising 0.3% on the month to 3.4% and 3.9% YoY respectively. New and used car prices, auto insurance, and medical services helped lift headline readings, but broader trends still appear to be favourable in aggregate. In contrast to the CPI, PPI readings were a little better than expected, with the headline actually down 0.1% in December at 1% YoY or 1.8% ex food and energy. In combination with still-robust weekly jobless claims data, investor sentiment improved with market pricing implying a high likelihood that the Fed will cut rates in March. Stocks rebounded from the prior week with a 1.8% gain in the S&P 500, taking it into positive territory for the year, although the tech heavy Nasdaq remains marginally under water despite a 3% jump. Decent bank earnings, particularly from JP Morgan, kicked off the earning's season with investor expectations improving.

North Asia

Taiwan's election outcome leaves status quo intact

As expected, Lai Ching-te from the ruling Democratic Progressive Party (DPP) won Taiwan's presidential elections with 40.1% of all votes ahead of Hou Yu-ih (33.5%) from the Kuomintang (KMT) and Kou Wen-je (26.5%) from Taiwan People's Party (TPP), with the latter two considered as having a pro-Mainland China tilted policy. This marks the first time in twenty years that the ruling party did not achieve an absolute majority in the legislature. Lai will start his presidency on May 20. Mainland China's foreign minister Wang noted that 'China will eventually achieve complete reunification and Taiwan will return to the embrace of the motherland.' Meanwhile, in Japan, the Eco Watchers Survey for December, which was taken shortly before the Noto earthquake, was stronger than expected. The Bank of Korea left its policy rate unchanged but shifted towards a more dovish tone. Taiwan's exports surged in December on solid demand for electronics, including semiconductors by Western and ASEAN countries, while Mainland China's share shrank further.

China

Stimulus needs to intensify

China's credit data for December disappointed. Instead of focussing on nominal bank loans, we prefer to watch the YoY comparison, which came in at +10.6%, down from a prior +10.8%, marking the lowest level since early 2002. Broad credit, or 'total social financing', ticked up marginally from a low base, but we are concerned that credit growth by firms and private households will continue to shrink amid low demand for financing. Today, the PBoC missed the opportunity to cut the MLF rate, which disappointed market expectations. Instead, it now seems likely that the RRR will be cut by 25bps before the Lunar New Year holidays that start on February 9. Weak domestic demand is also reflected in the third negative CPI print in a row. Consumer prices fell 0.3% YoY in December, while PPI, down 2.7% YoY, remains in deflationary territory since October 2023. Core inflation was stuck at a subdued 0.6% YoY. On a positive note, exports remained brisk in December, mainly driven by strong auto exports.

LatAm

CPI inflation data in Brazil, Chile and Mexico continue to decline and maintain a downward trend

At the beginning of the week Chile inflation showed a drop of -0.5% MoM in December, down from 0.7% in November and well below expectations of -0.1%, an increase of 3.9% YoY, down from 4.8% in October. Given that inflation closed below 4%, we anticipate that the Central Bank will cut the MPR by 75bps in January, bringing it to 7.50%. In Mexico inflation showed an acceleration from 0.64% to 0.71% in December, above expectations of 0.62%. The YoY measure of 4.66% was down from 4.32%. We expect that Banxico will begin the cut cycle at the beginning of the second quarter, although it could be brought forward depending on what the US Federal Reserve does. In Brazil, inflation in December came in at 0.56% versus 0.28% the previous month and was above the 0.5% anticipated by the market, with an increase of 4.62% YoY, down slightly from 4.68% in November and above expectations of 4.55%. Easing demand pressures are behind disinflation in Brazil and should persist, leaving room for the central bank to continue its cycle of cuts.

Credit

ETF flows surge amid strong supply

A distinctly better tone emerged last week in credit with spreads erasing some of the widening seen at the beginning of the year. High Yield spreads outpaced the spread tightening seen in Investment Grade last week while the price action was stronger in bonds than in credit derivative indices. Supply was strong across both US and European credit markets, with US IG now already seeing around USD 100bn of new debt supply for the year. Encouragingly, US High Yield markets continue to see activity with issuers increasingly coming to the market. We expect this trend to continue as companies had pushed out refinancing during the last two years and cash buffers seem to have been pared down. Supporting the technical picture was the surge in ETF flows especially in the US, which saw the highest level of inflows since 2020. While investors are increasingly embracing the soft landing view with higher than expected US CPI also failing to dent sentiment, credit spreads remain tight offering limited upside in positive scenarios versus other assets such as stocks.

What to Watch

- US retail sales, housing, and sentiment indicators will attract attention in the week ahead with readings expected to be mixed.
- This week will see top-tier data for the UK economy. Labour market statistics will be released on Tuesday including average hourly earnings, which are expected to fall below 7%. Wednesday brings UK inflation data where a further fall in CPI is expected.
- In APAC, we believe Bank Indonesia will keep its policy rates stable at 6%. Japan will release the Reuters Tankan for January as well as CPI and PPI data for December. China will publish Q4 GDP and 2023 CPI data as well as various December economic activity data. Australia will report December labour market data and consumer confidence statistics for January. India, Indonesia, Malaysia and Singapore will release foreign trade data for December.

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