ZURICH

Weekly Macro and Markets View

5 February 2024

Highlights and View

Meta rises more than 20% after its earnings release, the largest daily gain in market cap on record

While the Magnificent Seven pushed the index higher, the regional bank index lost more than 7%, indicating ongoing risks from financial tightening.

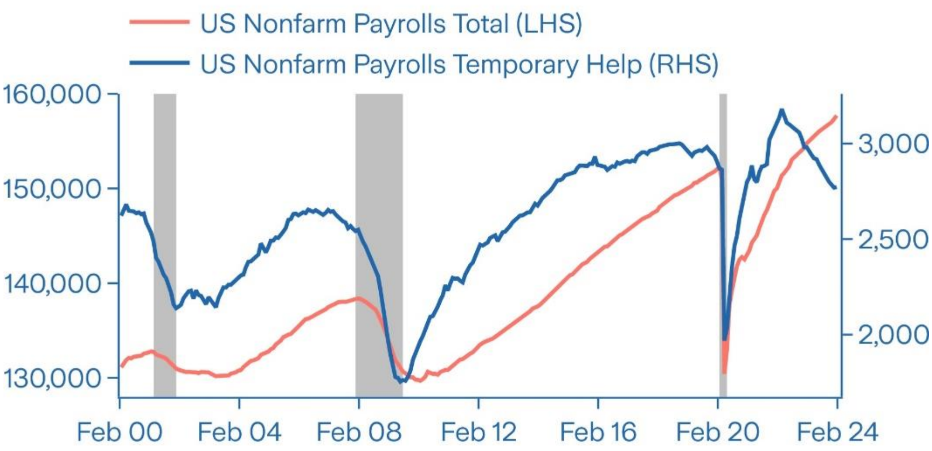
Credit lagged stocks while bank stresses re-emerged with regional bank stocks coming under pressure.

While banks came under pressure due to unique issues at one bank in particular, NYCB, we continue to believe that smaller US banks are still not completely out of the woods and that tight credit spreads limit upside.

The Bank of England left rates unchanged as expected

The BoE's message was tilted to the hawkish side given stubbornly elevated inflation, with two members still voting for another rate hike.

The US labour market gets off to a strong start in the new year



Source: Bloomberg (Note: Grey bars represent US recession periods)

Nonfarm payrolls rose by more than 300'000 in January following a similarly strong December, indicating that the US economy is expanding at a healthy pace. The unemployment rate remained at 3.7% while the broader underemployment rate ticked up to 7.2%. The solid picture was slightly tainted by the fact that the moderating demand for temporary workers cannot confirm the pickup in payrolls and average weekly hours worked dropped to the lowest since 2010, excluding March 2020 which was distorted by Covid. The pickup in employment and reaccelerating wage growth further undermined market participants' expectations of a Fed rate cut in March after Fed Chair Powell emphasized earlier in the week that such a step is unlikely. Both Treasury yields and the dollar soared in the aftermath of the stronger labour market data. The S&P 500 switched several times from positive to negative but ended the week on a positive note, rising 1.4%. In addition to the Fed's statement and the latest batch of economic data, the market also had to digest mixed corporate earnings reports. Sentiment turned sour following the results of Microsoft and Alphabet and Apple was an additional drag. The negative mood quickly evaporated, however, as investors cheered the latest news from Amazon and Meta with the latter soaring by more than 20% after its earnings report.

Credit

Performance lags stocks while bank stresses re-emerge

Credit markets were volatile and notably lagged stock markets last week. Most segments saw spread widening, triggered by comments from Fed Chair Powell who was perceived to be pushing back on the timing of the first rate cut, which investors were expecting would come in March. Regional US bank stocks were under pressure after New York Community Bank (NYCB) significantly reduced its dividends and sharply increased its provisions against potential losses in its commercial real estate (CRE) portfolio. Some of the issues at the forefront last week are unique to NYCB, as it must meet stricter requirements following its acquisition of Signature Bank last year and its exposure to CRE is larger and different compared to other banks. That said, we continue to believe that smaller US banks are not completely out of the woods and credit exposures are a key risk. All in all, despite the volatility in secondary credit markets, signs of underlying demand remain in place, with continuing fund flows and low new issue concessions seen in the primary market.

Eurozone

Stagnation but not recession while services inflation remains sticky

Eurozone GDP was flat QoQ in Q4. This was marginally better than expected and means that a technical recession was avoided. Activity was divergent though, with Germany shrinking by 0.3% QoQ and growth stalling in France, while Spain grew by 0.6% and Italy surprised to the upside with a 0.2% gain. Inflation was also modestly stronger than expected in January, with headline CPI at 2.8% YoY, down from 2.9% but above market consensus of 2.7%. Goods disinflation drove the fall, while services inflation was flat at 4% for the third consecutive month. Labour market data were stronger too, with falling unemployment and a spike in Italian negotiated wage growth in December, reflecting an increase in public sector pay by 22% YoY. There were some one-offs and anomalies that should unwind going forward, but the data nevertheless highlights that it is too early for the ECB to assume away wage growth. Market pricing for the first ECB rate cut accordingly shifted towards June, with a reduced probability of an April cut.

Switzerland

Growth momentum improving from a subdued level

While the level of economic activity remains subdued, the latest data show that growth momentum is improving and that the trough for economic activity is likely to be behind us. The KOF economic barometer rose for the third consecutive month in January and is now tracking above its long-term average for the first time since March, when banking sector issues emerged. Improvements were broad-based, with construction, manufacturing, and foreign demand showing modest gains while services remained strong. The PMIs show a similar pattern, with solid services while manufacturing weakness is beginning to wane, but improvements are yet to be visible in more volatile export data. The latest data corroborate our view that a recession should be avoided in Switzerland despite weakness among its key trading partners. We anticipate that the SNB will maintain its recent dovish guidance in the March meeting, in part reflecting concerns around the strong franc, with rate cuts likely to be forthcoming later this year.

Northern Asia

Favourable data in South Korea

Despite only marginal changes in China's NBS and Caixin PMIs in January, sentiment appears to be slowly improving following various public stimulus measures. However, PMIs still hover below 2019 pre-Covid levels, and domestic orders remain lacklustre. While 'H'-shares have given up a good portion of last week's three-day rally and have lost nearly 10% year to date, 'A' and 'B' shares listed on the Shenzhen equity market have tumbled 22%. In Japan, although industrial production improved markedly in December, the outlook for January is gloomy due to cuts in auto production. Meanwhile, retail sales are rolling over on soft sales of textiles, household goods, and food. Consumer confidence picked up in January, possibly supported by a further rise in female employment. In South Korea, export and industrial production statistics for December came in favourably while the Manufacturing PMI for January jumped back above the boom-bust level of 50 to 51.2. The Kospi index rallied 5% on Thursday/Friday.

LatAm

The central banks of Brazil and Chile continue with their easing cycles

Last week in Chile, four of the five Board members voted to reduce the Monetary Policy Rate (MPR) by 100bps, leaving it at 7.25%. The decision was in line with market expectations and above our forecast of a 75bp cut. Since the cutting cycle began in July of 2023, it has accumulated 400bps in cuts. The Board considered that inflation would converge to the 3% target sooner than expected, so the MPR should reach its neutral level during the second half of 2024, although according to our estimates it could be below the neutral level. We anticipate a cut of 75bps in to the MPR April.

In Brazil, the central bank unanimously cut the Selic rate by 50bps in a unanimous decision, leaving it at 11.25%, in line with market expectations. There were not many changes in the statement, however, and uncertainty remains regarding the evolution of inflation, which could constrain the magnitude of the cuts, stopping the cycle of cuts. Rates remain at contractionary levels, and the real ex-ante rate is around 7%, above the central bank's neutral rate of 4.5%.

What to Watch

- Data on Eurozone retail sales and German factory orders and industrial production are expected to remain weak.
- In Mexico, we anticipate that inflation will have increased from 4.7% in December to 4.9% YoY in January and that Banxico will hold the benchmark rate at 11.25%. CPI data will also be published.
- In APAC, we expect both India's RBI and Thailand's BoT to keep policy rates unchanged. Japan's December wage data are likely to show a pickup while the Eco Watchers Survey is expected to remain strong. China will release January inflation, credit, and money supply data. Taiwan, Thailand, and the Philippines will report January CPI data. Taiwan will publish January export data. Several markets will be closed on Thursday and/or Friday on the Eve of Lunar New Year.

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