Weekly Macro and Markets View

21 February 2022

Highlights and View

Geopolitical tensions keep risk markets nervous

Favourable economic fundamentals and reasonable valuations should underpin equity markets, while credit markets remain vulnerable to persistant headwinds.

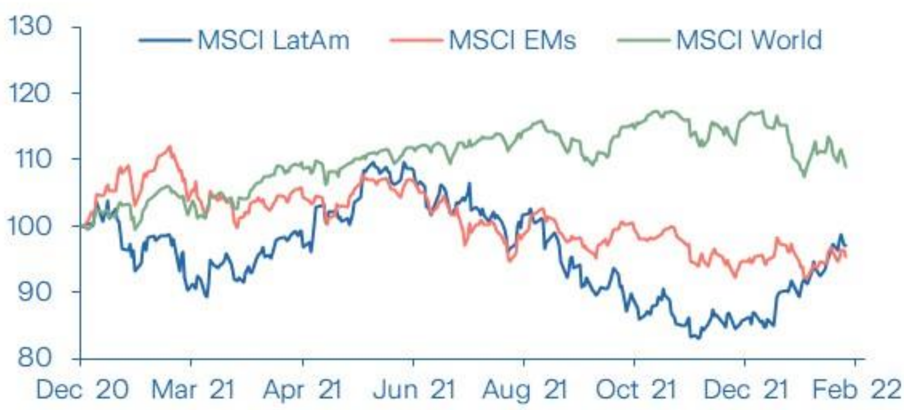
Credit spreads widen amid cautious primary demand while US leveraged loan prices drop sharply

As geopolitical and monetary policy angst persists, credit is likely to remain fragile as its initial resilience to negative sentiment seems to have diminished.

The latest Fed minutes provide little new information on the FOMC's next steps

The lift-off in March is almost certain but the FOMC is keeping all its options with regard to the pace of rate hikes as well as its balance sheet reduction open.

LatAm equity market shows resilience and outperforms global markets



Source: Bloomberg (rebased Dec 31, 2020 = 100)

After a challenging start to the year for the global equity markets, investor sentiment has deteriorated due to increased geopolitical risks and the expectation that the Fed will tighten more aggressively. However, LatAm equities have outperformed both their emerging and developed market peers, reducing the gap with global markets. The MSCI LatAm, led by Brazil and Chile, has returned 11.6% YTD, while the MSCI World has dropped by 6.8%. LatAm's performance is mainly explained by the increase in commodity prices, attractive valuations and dividend yield, and improved operational results thanks to deleverage in the corporate sector. The rotation to value and the high level of buybacks are also supporting equities. On the other hand, political and fiscal risks remain stable and negativity is already priced in. In Brazil, YTD cumulative foreign flows to the Bovespa are 85% above what was seen during the same period in 2021, as investors are tempted by valuations that are among the most attractive globally and an interest rate tightening cycle that is close to its end. The MSCI Brazil forward P/E is currently more than one standard deviation below its ten-year average while the dividend yield has reached ~7.3%, significantly above the ten-year average of 3.8%. We continue seeing a potentially good return in LatAm, but tactical, selective, and timely strategies will be the keys to benefitting in this volatile market.

Credit

The market remains fragile

Credit markets remained volatile last week. While credit spreads in both cash and CDS markets started the week on a better note, they reversed course mid-week and ended wider as geopolitical tensions flared. Primary markets also showed notable signs of investor caution. US investment grade bond sales gathered steam ahead of the FOMC minutes release on Wednesday. However, investors were discerning, with order books less than two times covered and new issue concessions a hefty 19bps on Wednesday. The US high yield market was notably weak, with no primary sale since February 10 and continued outflows. Even US leveraged loans came under pressure despite inflows from retail investors. The S&P/LSTA Leveraged Loan index fell to a six-month low on Friday, a sharp drop after reaching its highest level since 2007 in January. Indeed, US banking regulators warned last week that risks associated with leveraged loans are still high despite improvements in corporate creditworthiness in 2021. All in all, credit markets seem fragile, with their initial resilience now diminished.

US

Retail sales rebound in January

Consumer spending points to a strong start into 2022 with retail sales surging by 3.8% MoM in January after falling 2.5% in December. While the positive trend underlines the economy's strong momentum, recent months of elevated volatility reflect the distortions caused by Omicron as well as the challenging seasonal adjustments. Industrial production picked up by a solid 1.4% MoM supported by higher than usual electric and gas utilities production given cold temperatures in January. Meanwhile, overall price pressure remains high as indicated by the latest set of PPI numbers. Producer prices rose 1.0% MoM in January, up from 0.4% the month before. Nevertheless, despite the marked monthly pickup the annual rate of both headline and core PPI ticked down slightly. Finally, activity in the housing market cooled down in January. Building permits grew by 0.7% MoM after surging by almost 10% in December while housing starts fell 4.1% MoM, held back by bad weather. The NAHB home builder index ticked down in February but remains at elevated levels.

Eurozone

Data confirm industrial sector rebound

Industrial production increased 1.2% MoM in December in the Eurozone, after a 2.4% gain in November. Particularly encouraging was the third consecutive large monthly gain in motor vehicle production, up 17.7% MoM in December. This is more evidence that supply-chain problems are easing. Meanwhile, there were a further flurry of comments from various ECB policymakers last week. ECB Executive Board member Isabel Schnabel emphasised that she continues to worry about so-called second round effects on inflation as well as the impact of house prices, which would have added further to core inflation in 2021 if they had been included in the inflation statistics. Separately, French central bank Governor Villeroy de Galhau said that QE asset purchases could be reduced every one or two months and end sometime in Q3. Overall, various comments from ECB officials last week tend to further support our view that there has been a shift in thinking within the ECB recently, with tapering of asset purchases likely to be accelerated in order to raise interest rates in Q4.

Japan

Both services consumption and manufacturing production are suffering

Economic indicators for Q4 confirm that Japan's economy did very well until early December. Though somewhat artificial because of the statistical overhang effect, this underpins our solid GDP forecast for this year. However, growth seems to have slowed down early this year. The surge in Omicron cases hit services consumption significantly but bolstered goods demand, similar to the first wave of Covid in 2020.

Weak consumer surveys are now coupled with deteriorating manufacturing conditions, as today's PMIs and the Reuters Tankan for February as well as export data for January reveal. Following a strong revival towards the end of last year, auto production is suffering once again from supply-chain bottlenecks and staff shortages while other manufacturing sectors are being hit by higher input costs. Auto exports were weak not only to the US, but also China, which may be related to slower pre-Lunar New Year demand. On a positive note, we believe these negative factors should subside into Q2.

Asia ex Japan

Resilient Asian exports versus weak property market data in China

Early indicators suggest that the downturn of China's property sector is intensifying. Land sales are contracting sharply, negatively affecting the outlook for new home starts and sales. Some smaller cities are starting to relax mortgage policies, whereas the PBoC has refrained from cutting the LPR rate today. New home prices keep falling, though only marginally. In the industrial sector, we believe production cuts are related to the Winter Olympics and are likely to reverse soon. A closer look at Asian export data for January reveals an overall resilient picture. The strong electronics segment boosted exports in Singapore while Indonesia's exports remained solid despite the coal export ban, which is expected to be lifted soon. Malaysia's exports contracted on a sequential basis, with electronics exports somewhat disappointing compared to those from Singapore, but we do not want to read too much into this setback. Meanwhile, trade data released today, such as Taiwan's export orders for January and South Korea's exports in the first twenty days of February, remain solid.

What to Watch

- In Australia, our focus will be on wages and private capex statistics for Q4. In South Korea, we do not expect a policy rate hike when the BoK's MPC convenes on Tuesday, but hawkish comments could lay the ground for a rate hike in Q2. January export data will be reported in Hong Kong and Thailand, while Taiwan will release Q1 GDP statistics as well as industrial production and labour market data for January. In Japan, markets will be closed due the Emperor's birthday on Thursday.
- In a holiday-shortened week in the US, investors will focus on the latest set of Markit's PMI data and the Conference Board's consumer confidence survey.
- In the Eurozone, there will be various business surveys released this week that will be important to watch to see whether service sector confidence in particular is stabilising.

Disclaimer and cautionary statement

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