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Weekly Macro and Markets View

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Highlights and View

The ECB hikes interest rates by 75bps

The large rate increase by the ECB still leaves interest rates quite low given where headline inflation is, and further large rate hikes are likely over the next few months.

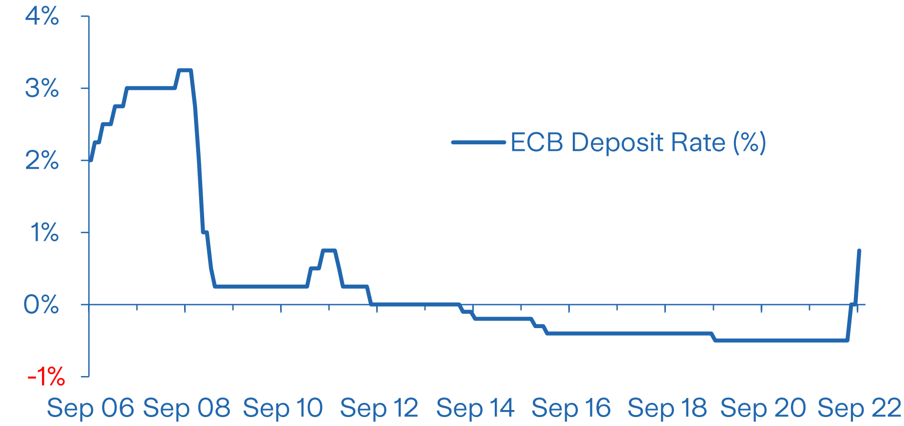
New UK PM Liz Truss announced an energy price cap that will freeze household energy bills at roughly their current levels

The support scheme could cost up to GBP 150bn, but it will help to put a lid on inflation rates that accelerated to more than 10% YoY recently.

China's economy remains weak with aggregate financing growth retreating, export volumes below start of the year levels and inflation receding further

We do not expect a recovery before the 20th Communist Party Congress has ended in late October and the current Omicron related lockdowns and travel restrictions are loosened.

The ECB embraces jumbo rate rises, the EU debates energy policy



Source: Bloomberg

The ECB increased its policy rate by 75bps last week, taking the deposit rate to 0.75%. ECB President Christine Lagarde said that it was 'front-loading' rate increases due to inflation hitting fresh record highs for ten months in a row. The ECB seems determined to get the deposit rate to at least neutral by the end of the year, estimated to be around 2%. This implies further large rate increases at the October 27 and December 15 monetary policy meetings. Indeed, President Lagarde indicated that the ECB was planning 'several' more rate increases.

Meanwhile, the European Union held an emergency summit of energy ministers on Friday to discuss the energy crisis. While there was no final agreement on policy, various options were discussed including taxing the windfall profits of producers not using expensive natural gas to generate power, coordinating reduced energy consumption, capping natural gas prices, and providing help with liquidity and guarantees for energy firms having to meet large collateral requirements when trading energy. More details and a final agreement are likely to be announced later this week. The European natural gas price has already fallen substantially in the past couple of weeks from EUR 350 /MWh at its peak on August 26 to around EUR 200 /MWh, but prices remain extremely elevated compared to their long-run history.

China

Disappointing economic indicators for August

Some market commentators explained Friday's recovery in global equity markets with China's strong credit data for August, with aggregate financing more than tripling within a month. We beg to disagree. In YoY terms, aggregate financing was up only 10.5% YoY, a four-month low. Credit demand remains lacklustre, with Omicron related travel restrictions and lockdowns unhelpful, while local government bond issuance quotas are exhausted, and the housing market remains in the doldrums. Furthermore, as we had anticipated, solid export growth is now visibly slowing, not only reversing the post Shanghai lockdown boost, but even falling below the level at the start of the year in volume terms. Meanwhile, inflation continues to creep lower. Producer price inflation continued to fall for the tenth month in a row in August to 2.3% YoY on cheaper commodities, while consumer price inflation fell to 2.5%. Even food prices fell despite the latest heat wave and rising pork prices. Weaker demand is taking its toll.

ASEAN

Fuel subsidy cuts spark protests in Indonesia, Malaysia's OPR is raised for a third time

The Indonesian government announced a hike of subsidised fuel prices, its first move in eight years. The President stated that it had been trying its best to shield Indonesians from rising global energy prices but could not do that without swelling the state budget deficit. With the approximate 30% hike in fuel prices, headline CPI is forecasted to average 5.2% in 2022 and might jump to around 7% in September, forcing BI to continue tightening monetary policy in its upcoming meeting on September 22. In Malaysia, as widely expected, BNM increased its policy rate, the OPR, by another 25bps to 2.5%. The decision marked the third consecutive hike of a quarter percentage point this year as the brisk domestic economic recovery and improving labour market conditions warrant continued rate normalisation by the central bank. Domestic inflationary pressure is projected to peak in Q3 before normalising subsequently, in line with the expected easing of global commodity prices. Consensus is expecting one more 25bp hike for the last meeting of the year in November.

Chile

The Central Bank of Chile signals the end of the hiking cycle

The Central Bank of Chile (CBC) hiked the policy rate by 100bps to 10.75%, above market expectations. It was a split decision, with three board members voting for 100bps, one for 75bps and the other for 125bps. The CBC mentioned that incoming decisions will be data driven, and removed the statement that further hikes are needed, signalling the end of the hiking cycle. Nevertheless, the statement and the monetary policy report recognize that inflation risk remains elevated, with inflation expectations still above the target. Furthermore, the CBC revised its GDP forecast for 2023 downward from -0.5% to -1%. Headline inflation reached 1.2% MoM in August, accelerating from 13.1% YoY to 14.1% YoY. Inflation pressures remained widespread, with all the various measures showing price increases. Food and gasoline prices were the main contributors to monthly inflation. Core inflation stayed high and sticky at 0.9% MoM, reaching 10.9% YoY. We expect inflation has already peaked and will start to decelerate. Nevertheless, it will remain above the inflation target in 2023.

Covered Bonds

Perceived safety continues to drive strong investor appetite

We believe that covered bonds should continue to benefit from strong demand as new buyers are enticed by the perceived safety of short-dated covered bonds to park money amid higher yields and fears of a recession. During the ECB press conference, President Lagarde explained that now is not the time to end APP redemption reinvestments. With large amounts of covered bonds maturing before the year end in its portfolios, we think ECB activity in secondary markets should continue to support covered bonds markets. Covered bonds spreads had a strong performance last week and tightened in line with European IG unsecured credit bonds. Primary issuance continued at a fast pace with the EUR 8.3bn weekly volume being the highest since early March. The cumulative YTD issuance volume is already the third-highest volume on record with another three months to go before year end. Investor appetite continues to remain strong, especially for safer names that are able to bring new deals without any material new issue concession.

Credit

Primary activity surges as spreads tighten

Last week cash and CDS spreads tightened in the US and in Europe. US IG and HY CDS rallied, correcting a large part of the recent underperformance, with spreads, which had reached the highest levels since mid-July two weeks ago, recovering half of the widening. The primary market sprung back into action after US Labor Day, with the US IG market having one of the busiest weeks of the year. Deals were generally well accepted, with new issue concessions below the YTD average. In a stark contrast to IG, US HY issuance remained subdued. YTD net issuance in US HY stood at USD -41bn at the end of August according to Barclays figures, a positive technical for spreads, but a clear negative from a fundamental point of view. Despite spread tightening, IG and HY fund outflows resumed from both European and US funds in the week ending September 7. Outflows accelerated versus the week prior in Europe but decelerated in the US. Despite resilient spreads and an active IG primary market, the resumption of outflows in the last three weeks shows that sentiment continues to be fragile.

What to Watch

- In the US, investors will focus on the latest batch of inflation data, which are expected to show a further slowdown in price pressure.
- Various economic data will be released in the Eurozone while the EU is expected to announce details of how it intends to intervene in energy markets.
- In APAC, China will release the remaining economic indicators for August, while Japan, Indonesia and Singapore will publish export statistics for August. Australia and South Korea will announce August labour market data. Our focus will be on Japan's Q3 Business Outlook Survey and the Reuters Tankan for September. Markets in China and Hong Kong are closed on Monday due to the mid-autumn festival (enjoy your moon cake), while Malaysian markets are closed on Friday due to Malaysia Day.

Disclaimer and cautionary statement

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