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Weekly Macro and Markets View

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Highlights and View

Xi Jinping is re-elected as the Communist Party's General Secretary for an unusual third term, while most Politburo members are Xi's prior aides, and all are male

The new leadership will need to balance development and security, two of the main political issues discussed during the Party Congress, while Xi's ideology will dominate future politics.

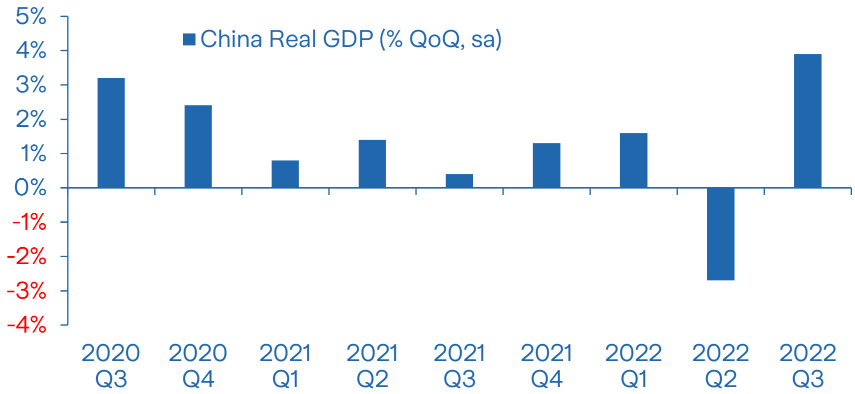
Liz Truss resigns, becoming the shortest-serving PM in UK history

Rishi Sunak is the frontrunner to succeed Truss as PM, but whoever follows will face significant economic challenges as the UK is heading for recession with inflation still above 10%.

Treasury yields surge on hawkish Fed expectations, amid volatile trading conditions

Bond markets are set to remain volatile as investors grapple with political uncertainty, rising rates and the looming unwinding of central bank asset purchases.

China's recovery remains tepid as the 20th CPC ends



Source: Bloomberg

China's 20th Communist Party Congress (CPC) and the first Plenary Session concluded over the weekend with Xi Jinping reconfirmed as the General Secretary of the Central Committee and Chairman of the Central Military Commission. Prior rules that the CPC's General Secretary cannot be re-elected for a third term have been changed. Four of the other six members of the Politburo's Standing Committee are new, and most Politburo members are prior aides of Xi Jinping. The four replaced members will retire, including prior Premier Li Keqiang, who is likely to be replaced by Li Qiang, Party Secretary of Shanghai. Xi's role has been elevated further, and all party members and the nation are requested to be loyal to him. Former President Hu Jintao, sitting next to Xi, was escorted out of the meeting for unknown reasons, an incident not reported by Chinese media. Hong Kong 'H' shares tumbled 7.3% today, only slightly above the 2008 lows, as the CPC results were not perceived as market friendly, a view we can understand.

Statistics for Q3 and September were released today after a significant delay. Q3 GDP growth came in stronger than expected, up 3.9% both in QoQ and YoY terms. September infrastructure investment, exports and industrial production were also stronger than awaited, while property market related indicators, retail sales and the jobless rate were weaker.

UK

Liz Truss resigns as Prime Minister

After only six weeks in office Liz Truss resigned as Prime Minister after having scrapped most of the tax cut plans that caused massive market turmoil and led to an intervention by the Bank of England to avoid a collapse in the gilt market. Under Truss, the Tories' polling position has tumbled and helped the Labour Party reach the largest poll lead in decades. Rishi Sunak is the frontrunner to succeed Truss as the next Prime Minister. Sterling stabilised and 30yr gilt yields fell back below 4% after soaring to more than 5% in the past few weeks.

However, whoever follows Truss as PM will face a challenging economic environment. The economy is heading for a recession, business surveys are pointing at slowing activity, headline inflation is above 10% and consumer sentiment is close to the lowest on record. This is also reflected in weaker consumer spending with retail sales falling by 1.4% MoM in September, pushing down the annual rate to -6.9%, the weakest since the pandemic-induced lockdowns in spring 2020.

Eurozone

EU leaders agree on further intervention in energy markets

At their summit meeting last week, EU leaders agreed on the principles of further intervention in energy markets, including a dynamic price cap corridor for natural gas prices, delinking gas prices from electricity prices and introducing a new complimentary gas price benchmark in 2023. However, the measures will not be able to prevent a deep recession over the winter months in our view. Meanwhile, Eurozone CPI inflation hit 9.9% YoY in September on the headline measure and 4.8% on the core measure. Around two-thirds of total inflation is due to energy and food prices. Consumers' real spending power will be severely affected, adding to the downturn. Finally, the German chemical workers union agreed with employers to a pay increase of 3.25% for both January 2023 and January 2024, plus some additional one-off cash payments. Overall, this confirms the trend seen in other pay deals recently that wage growth is picking up, but not to extreme levels that could make the ECB fear a wage-price spiral is developing.

Japan

USDJPY above 150, CPI at 3%, export and import values at record highs

For the first time since 1990, the USDJPY has moved above 150, which is purely an eye-catching psychological mark, though not relevant in terms of technical analysis. It follows rising US yields, while Japan's 10yr yield remains anchored close to 2.5% due to the Bank of Japan's monetary policy. Despite intensifying market speculation, we do not believe that any decisive monetary policy actions will be taken before Governor Kuroda retires from his position in spring 2023. Meanwhile, the core CPI ex fresh food for September climbed to 3%, a level last seen 31 years before, excluding consumption tax hikes, largely reflecting higher food and home appliance prices. We expect inflation to peak in Q1 2023 and then fall back toward the BoJ's 2% target at the end of 2023. Export and import values reached record highs in September, but export volumes stalled and import volumes contracted versus the prior month. The Manufacturing PMI for October was roughly unchanged at 50.7, while the Services PMI bounced back to 53.

Bonds

Treasury yields surge on hawkish Fed expectations

Sovereign bonds suffered another sell-off last week as inflation data continued to surprise on the upside in some regions, while the BoE ended its emergency bond buying facility, which has been in place since end September. A more hawkish outlook for the Fed was priced in, implying a peak in the expected Fed policy rate at above 5%, while the 10yr yield surged 20bps on the week, topping above 4.3% intraday on Thursday. In Europe, gilts outperformed on political developments, while Bund yields rose further ahead of this week's ECB meeting. The tone improved slightly on Friday on a news report that suggested that the Fed would be debating whether and how to slow the pace of rate hikes in its December meeting, leading to a re-steepening of the Treasury curve and a tick down in Fed rate expectations. With ECB and BoJ policy meetings later this week and the Fed in a blackout period, bond markets are expected to remain volatile, with poor liquidity contributing.

Credit

Covered bonds are well bid while swap spreads narrow

Primary market activity rebounded in Europe, but investors continue to focus on the safest deals and issuers. New covered bond issuance reached EUR 7bn last week, more than half of the financial sector's overall volume issued, with bond sales concentrated in the three-to-five-year tenor range. With yields now in significantly positive territory in Europe, demand for collateral has spiked as more investors are looking to lend cash on a secured basis in the money markets. Increased margin calls from clearing houses linked to higher volatility are also amplifying the scarcity of collateral, which in turn has widened swap spreads. To relieve the situation, the German Finanzagentur decided to increase its own holdings of German bonds by EUR 54bn and make them available to the repo market, which caused swap spreads to tighten notably. We believe swap spreads should compress over time which is likely to benefit corporate bond spreads.

What to Watch

- In the Eurozone, the ECB will meet to decide monetary policy and is expected to raise rates by another 75bps, bringing the deposit rate to 1.50%. Various business surveys will also be important to watch.
- No change is expected from the BoJ's monetary policy decision this week, while a new economic stimulus package will likely be announced Friday. Taiwan and South Korea will publish Q3 GDP, Hong Kong and Thailand export data, and Singapore and Thailand industrial production statistics, while Australia will release Q3 CPI data.
- In the US, Q3 GDP is expected to reflect a rebound from the negative distortions weighing on H2 figures while investors will also focus on the latest PCE Core inflation numbers and Q3 employment costs.
- In Brazil, all eyes will be on the second-round presidential election being held on Sunday, October 30, with former President Lula leading the polls against the incumbent President Bolsonaro by a tight margin. The Central Bank is expected to keep the Selic rate on hold at 13.75%.

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