

# Weekly Macro and Markets View

26 September 2022



## Highlights and View

### UK Chancellor Kwarteng's fiscal plans send sterling to an all-time low against the USD

The broad-based measures are unlikely to bring the hoped-for economic benefits, putting the government's debt sustainability at risk.

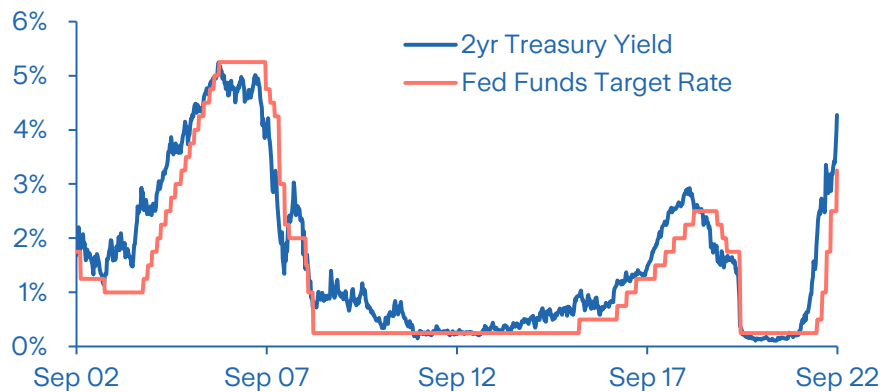
### The Swiss National Bank hikes rates by 75 bps to 0.5%, ending the era of negative rates in Europe

The SNB reiterates its preference for a stronger currency. Further rate hikes are expected.

### The right-wing coalition wins in Italian elections, as expected, with around 44% of the vote

Although the right-wing coalition has a comfortable majority of MPs in parliament, it lacks the two-thirds majority that would allow it to change the Italian constitution.

## A hawkish Fed triggers tumultuous period in bond markets



Source: Bloomberg

As expected, the Fed lifted its target rate by 75bps to a range of 3.00 to 3.25%. While the move was less aggressive than some investors feared the overall message was still on the hawkish side. The FOMC's latest projections see the Fed funds target rate at 4.375% by year end, a full percentage point higher than in June. The rate is then projected to rise to 4.625% by the end of 2023 despite an expected pickup of the unemployment rate to 4.4% and the annual growth slowing to 1.2%. This is the clearest signal so far that the Fed is willing to keep tightening even as a recession becomes increasingly likely.

In a tumultuous week for bond markets, the Fed's hawkish stance led to a further sell-off in sovereign bonds, amplified by similarly aggressive announcements from central banks across the world. This was followed by the UK mini-budget, which shook market confidence and triggered a surge in risk premia and rate hike expectations. The 2yr gilt yield jumped 82bps on the week, compared to 33bps for the US, and is up another 50bps this morning. The long end of the curve also sold off sharply, with 10yr gilt yields up 69bps compared to 24bps for the US. While recession risk has risen further and global supply chain price pressures are easing, fiscal concerns are likely to remain intense in the weeks ahead and some read across to other markets cannot be ruled out.

## Equity Markets

Stocks breach June lows as sentiment on rates and growth takes a dive

It was another grim week for stocks as the impact from the latest wave of central bank tightening further dispelled the notion of efficient markets. Intraday volatility was high, exemplified by the moves in the S&P 500, first falling by over 1.5% on Thursday on news of the Fed hike, then rallying by over 2% minutes later, and finally closing the day down 2%. Global stocks fared even worse on the week, falling by 5%, taking the MSCI World Index back to pre-pandemic levels and down 25% since the January highs. We have been making the point that the lows of

June would be retested and likely breached before a new bull-cycle set in and this appears to be panning out. There is no doubt that looming recessions in Europe and the US have been highly anticipated and that sentiment is grim. The AAII bull/bear reading of US investors hit a record low last week. However, while a bounce from oversold levels is again likely, until there is evidence of an easing policy stance or a dramatic decline in inflation, the coming weeks are going to be tough going for investors.

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## Credit

An oasis of relative calm amid the broader mayhem

Credit was remarkably resilient last week. While the MSCI World Index dropped by around 5% and bond yields widened notably, US and European corporate bond spreads barely widened by around 5bps. Strong supply/demand technicals appear to be at play in credit as the highest overall yield in US Investment Grade credit since 2009 seems to be drawing investors with reportedly high cash levels. At the same time, high volatility in government bond yields is deterring issuers from printing new deals. Indeed, given that September is an

important month for issuance, it is notable that month to date supply is tracking at around half of estimates from the beginning of the month in US Investment Grade. The supply/demand technicals are even stronger in High Yield where net supply, defined as gross supply ex redemptions, is at record negative levels. While credit spreads are likely to eventually recouple with other assets, strong technicals and cheaper valuation, especially in European Investment Grade, could mean that credit outperformance will continue for some time.

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## UK

Kwarteng's mini-budget sends sterling into tailspin

Financial markets were spooked by Chancellor Kwarteng's mini-budget. Sterling tumbled to an all-time low against the USD while gilt yields soared as investors worried about the longer-term sustainability of the government's elevated debt load. Aside from the policies to protect households and firms from the impact of soaring energy prices, the Chancellor's announcements centered on broad-based tax cuts for households and corporates. Although the tax cuts are likely to have some effect on the economy, a more targeted approach would have a more

substantial impact on business investment and consumer spending. Meanwhile, economic activity continues to soften with consumer sentiment falling to a record low and the Composite PMI receding further into contractionary territory in September to 48.4, the lowest level since January 2021. Finally, the BoE lifted its target rate by 50bps to 2.25% as expected, but the additional fiscal stimulus will make the BoE's task to rein in inflation more challenging and it may have to step up its tightening path given the massive market moves in gilts and sterling.

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## North Asia

Japan's core inflation rate climbs to a 31-year high, while the MoF's intervention helps to stabilise the yen

While Japan's Manufacturing PMI retreated by 0.5 points to 51 in September, its Services PMI managed to climb back above to boom/bust line of 50 to 51.9, in the wake of the latest Covid wave. Japan's core CPI (ex. fresh food) climbed to a 31-year high of 2.8% in August, driven by food, hotel, and mobile phone charges. However, this did not impress the Bank of Japan enough to change its monetary policy settings. Meanwhile, the MoF intervened in the forex market to stem yen depreciation for the first time in 24 years, as we had expected.

Taiwan's CBC continued its gradual tightening in two steps - including a 12.5bp policy rate hike and a 25bp increase in its deposit RRR. Taiwan's August industrial production, up 3.7% YoY, was boosted by strong chip production in line with new Apple products. However, machinery and electronic display panel production is slowing. South Korea's exports contracted in the first twenty days of September, but these statistics are distorted. Hong Kong ended its mandatory Covid hotel quarantine requirements as of today.

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## LatAm

The Central Bank of Brazil announces the end of the tightening cycle

The Central Bank of Brazil (BCB) maintained the Selic rate at 13.75%, ending the tightening cycle that started in March 2021. Nevertheless, the decision was not unanimous, with two board members voting for a residual hike of 25bps. In a hawkish statement, the BCB stated that it will remain vigilant and maintain the current policy rate until the disinflationary process consolidates and inflation expectations anchor around its targets. Furthermore, it also emphasized that the current forward guidance could be adjusted and that they will not hesitate to

resume hiking if inflation disappoints. We believe the BCB will maintain the Selic rate at 13.75 and start cutting in H2 2023. Nevertheless, inflation risks are biased to the upside, and the expected additional fiscal spending at the beginning of the next government will also increase inflation pressures. In Chile, the finance minister mentioned that in 2023 the government plans to increase fiscal spending by 3-4% in real terms, after the historical reduction of 25% in 2022, and issue sovereign debt of USD 12bn.

## What to Watch

- In the US, consumer confidence is likely to stabilise while PCE Core inflation is expected to have ticked up slightly in August.
- In the Eurozone, various business confidence data are likely to indicate that the region will enter recession in Q4, and that Germany may have already entered recession in Q3.
- In APAC, we expect the Bank of Thailand to raise its policy rate by 50bps to 1.25%, while India's RBI is expected to raise its repurchase rate by 50bps to 5.9%. Australia will release its first new monthly CPI as well as retail sales for August. Japan will publish August indicators, including labour market data, industrial production, retail sales and housing starts. China will release PMIs for September. South Korea and Thailand will publish August industrial production statistics.
- In Brazil, all eyes will be on the first-round presidential election being held on Sunday, October 2, with former President Lula and the incumbent President Bolsonaro currently leading the polls. In Mexico, Banxico is expected to lift the policy rate by 75bps.

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Investment Management  
Mythenquai 2  
8002 Zurich