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Weekly Macro and Markets View

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Highlights and View

Both US headline and core inflation fall more than consensus expected

While still elevated, it is a promising signal that core inflation is receding, particularly given that the slowdown is broad-based and not only driven by a few outliers.

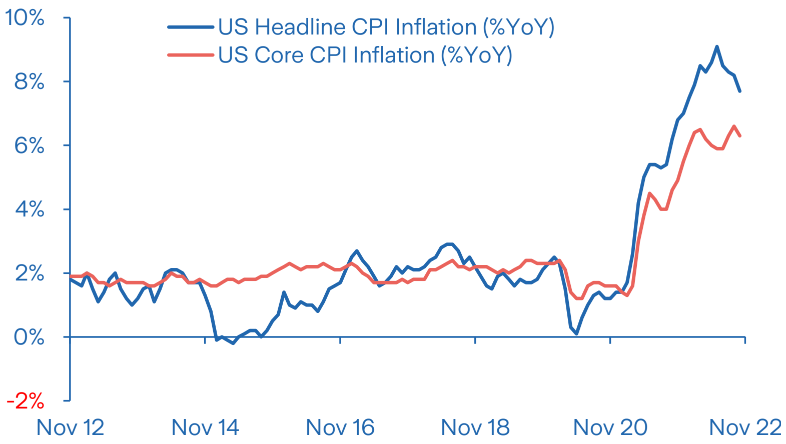
Financial markets jump on hopes of a moderation in policy tightening, despite plunging crypto assets

The bounce in asset prices highlights pent up demand from investors who had been sitting on large cash positions, but it remains too early to call an end to the bear market as fundamentals continue to deteriorate.

China's export and credit data came in far below consensus expectations in October

We expect a recovery to start in Q2 next year, by which time the Covid vaccination rate will have increased, the National People's Congress will have passed, and the property market will have likely stabilised.

A substantial slowdown in inflation fuels stock markets



Source: Bloomberg

In line with our view, inflation rates fell more than consensus expected in October. Headline inflation slowed from 8.2% YoY to 7.7% while Core CPI receded from 6.6% YoY to 6.3%. The monthly rate of core inflation dropped to 0.27%, the slowest since September 2021. Crucially, the decline in inflation was broad-based with the Cleveland Fed's trimmed mean measure seeing its slowest monthly growth since April 2021 at 0.37%. While still elevated there are more and more signs that inflation rates will continue to fall significantly in the months ahead. Meanwhile, economic sentiment continues to deteriorate. The NFIB's small business optimism survey ticked down to 91.3 from 92.1 with both hiring intentions and capex plans receding. The University of Michigan's Consumer Sentiment Index fell back more than consensus expected after having slightly recovered from its recent record low, reflecting persistent headwinds for households and a deteriorating outlook for consumer spending. While we are still waiting for the final results, the midterm elections did not bring the substantial Republican victory predicted by polls and supported by historical patterns. A small Republican majority in the House of Representatives looks more likely than not, but the Democrats were able keep their thin majority in the Senate after winning crucial votes in several states.

Bonds

Government bond markets rally on inflation relief

The downside surprise on US CPI inflation was a positive catalyst for a bond market rally. The Treasury curve repriced, with the 2yr yield down 33bps on the week, with one rate hike fully priced out, while the 10yr yield slumped by 35bps to 3.81%, down from the peak of 4.2% in October. The daily moves in yields were large, matching declines last seen during the Covid crisis. With inflation fears receding, attention is likely to shift to the challenging growth outlook. Indeed, despite easing rate expectations, the Treasury curve is still deeply inverted, signalling elevated recession risk. European bond markets initially rallied with Treasuries, but Friday saw Bund yields rebounding as the near-term inflation outlook remains highly challenging. While we see sovereign bonds more reasonably priced at their current levels than compared to a few weeks ago, yields are set to remain volatile and highly data dependent as investors grapple with recessionary forces amid still elevated inflation.

Equities

Stocks surge despite crypto crisis

Equity investors rejoiced on the US inflation news, and even the implosion of the crypto currency markets, with the much-hyped FTX filing for bankruptcy protection, failed to dent the mood as hopes swung back to a Fed pivot. While Bitcoin was dragged down 20% on the week, the tech-heavy Nasdaq Index surged 8% and the broad-based MSCI World Equity Index tacked on a whopping 6.7%, taking it back above both its 50- and 100-day moving averages. Undoubtedly, the market action showed both the desire and cash resources of investors to play a recovery, which may well have further to run as funds are deployed and momentum builds. The 13% rally in global stocks since the lows of October is now higher than the typical bear market rally of 8-10%. That noted, fundamentals are a challenge. Interest rates will continue to move higher for some time yet, a global recession is underway, and earnings and margin expectations are ludicrously high. Risk is still to the downside, though we acknowledge market technicals are improving and sentiment is shifting.

Credit

Not as cheerful as stocks, but supply surges on better sentiment

Credit spreads tightened notably last week, although the pace of spread tightening of corporate bonds after the release of the US inflation data was not as strong as that seen in the stock and bond markets. Furthermore, while European credit rallied notably especially on Friday, US credit lagged the rally last week. That said, several encouraging signs emerged last week, most important of which was a surge in issuance. Supply jumped in both US and European investment grade markets with a healthy oversubscription of deals, although new issue concessions remained hefty. GE Healthcare priced a jumbo USD 8.25bn bond, while Credit Suisse placed bonds in both USD and EUR, albeit at nearly junk level spreads and yields and at hefty new issue concessions. The US High Yield market also saw supply pick up last week, while funds saw inflows for the third week in a row. Our view remains that while a moderation in US inflation is a positive development, a recession seems likely in Europe and the US, and apart from European Investment Grade, credit markets are not priced for it.

China

Weak October data and a property sector rescue plan

China's October export and credit data came in far below consensus expectations. We have expressed our view for some time that weaker foreign demand will hit China. Exports fell 0.3% YoY versus consensus expectations of a 4.5% rise, while imports fell 0.7%. Deliveries in all major goods categories took a beating, with a pronounced fall in electronics exports. Meanwhile, credit data were also disappointing. Aggregate financing came in at CNY 908bn versus expectations of 1'600bn, with YoY growth down 30bps to only 10.6%. Loans to households even decreased as issuance was lower than redemptions. Amid the weak property sector and zero-Covid policy, private sector credit demand should remain soft, despite the property and Covid policy emergency measures announced last week. Although inflation is a major topic in the Western world, China has slipped into deflation when referring to producer prices. PPI inflation fell by 1.3% YoY in October and barely rose from the prior month, while CPI inflation fell to 2.1% YoY on lower fuel and food prices.

LatAm

Fiscal uncertainty increases again in Brazil

A positive inflation surprise in Chile confirmed the change in trend. CPI for October was 0.5%, while annual inflation decelerated from 13.7% to 12.8%. In a split decision, the Central Bank of Mexico raised the policy rate by 75bps to 10%. The statement also mentioned that the board expects to reduce the hiking pace. Inflation surprised to the downside, reaching 0.57% in October and 8.4% YoY. Nevertheless, core goods inflation remained under pressure. In Brazil, headline and core inflation increased by 0.6% and 0.55%, respectively, above market expectations. However, annual inflation decelerated from 7.2% to 6.5%. Fiscal uncertainty increased as the constitutional amendment to increase expenditures in 2023 will likely include additional fiscal spending of around 1.7% of GDP, above the 1.2% of GDP expected. Furthermore, Lula's party has proposed that "Auxilio Brasil" cash transfers should be removed from the spending cap, increasing the risk of permanently weakening the fiscal framework. Market reaction was adverse, with the Bovespa falling 5% during the week.

What to Watch

- In the US, PPI figures will give insights into the current price pressure in the pipeline while retail sales will show whether downbeat consumer sentiment has translated into weaker spending.
- In the Eurozone, various data, including industrial production and the ZEW survey, will give more indications as to the state of the economy.
- In APAC, we expect policy rate hikes by Bank Indonesia of 50bps to 5.25% and by the Philippine BSP of 75bps to 5%. Japan will report Q3 GDP, October CPI and export data. Australia will release Q3 wages and October labour market data. China will report October retail sales, industrial production, and fixed asset investment data. Indonesia, Malaysia, and Singapore will release October export data. Presidents Biden and Xi will meet at the G20 summit in Bali.

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