

# Weekly Macro and Markets View

9 May 2022



## Highlights and View

### The Fed lifts its target rate by 50bps, the largest step since 2000

More tightening is expected in the coming months, but we doubt that the Fed will be able to provide all the rate hikes it is currently signalling.

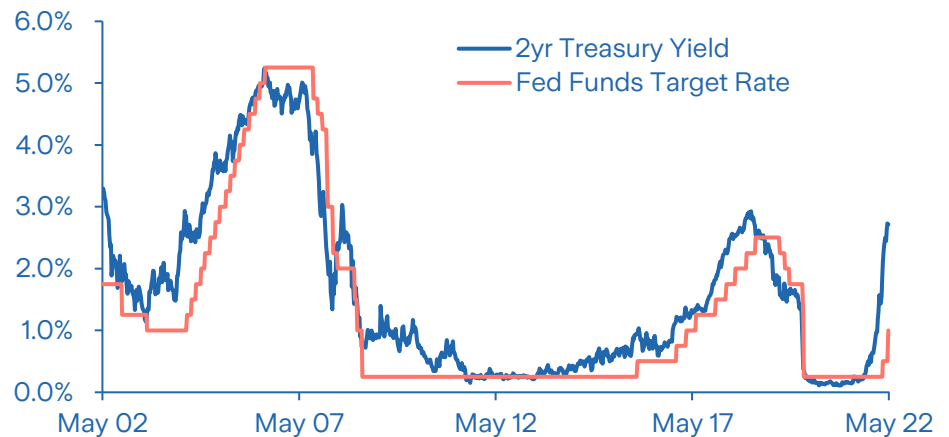
### The Bank of England hikes rates by 25bps for the fourth time to 1%

Given soaring inflation, the BoE feels obliged to tighten its policy further despite a relatively gloomy economic outlook.

### The Global Composite PMI declined further in April as headwinds from war in Europe and China lockdowns intensified

Global growth is slowing but should remain secure as strong labour markets and excess savings provide a buffer.

## The Fed is trying to catch up with economic reality



Source: Bloomberg

As expected, the Fed lifted the fed funds target rate by 50bps to a range of 0.75% - 1% at its meeting last week. While Jerome Powell indicated that a faster pace of rate hikes is very unlikely, he also pointed out that more tightening is needed. We expect another 50bps move at the FOMC meeting in June but are less convinced than consensus about the meetings thereafter. By then the impact of the already significant tightening of financial conditions should be clearly visible in growth and employment data potentially causing the Fed to proceed at a more measured pace.

Nonfarm payrolls rose by a solid 428'000 in April, but reduced weekly overtime, a rise in initial jobless claims, softer employment components in both ISM surveys, a tick higher in the underemployment rate as well as a slowdown in average hourly earnings growth all point at a marginally less tight labour market. While the employment situation remains strong and will help to support consumer spending in the coming months, we expect tighter financial conditions and a slowdown in growth to increasingly show up in softer labour market data.

Meanwhile, business activity has slowed further but is keeping a healthy pace. While the ISM Manufacturing Index dropped to 55.4 in April, the lowest since September 2020, the ISM Services survey ticked down to 57.1.

## Markets

Equities continue to slide, while bond yields surge to cycle highs

In another tough week for investors the S&P 500 posted a fifth consecutive week of declines, marking it the worst losing streak in more than a decade, while 10yr Treasury yield breached 3%. Although the S&P 500 was actually only down 0.2% on the week, this masked huge volatility. The index surged 3% on Fed Chair Powell's perceived dovish Q&A session following the first 50bp hike in US rates in 22 years, only to nosedive by 3.5% the following day. It was the Eurozone, however, that bore the brunt of the beating. Hawkish rhetoric from the ECB unsettled

investors, appearing to set the scene for a rate hike as early as July. The Stoxx Europe 600 Index plunged 4.6% on the week, with German bund yields surging to the highest reading in eight years and Italian 10yr BTP spread hitting 200bps. Conditions in both bond and equity markets appear to suggest oversold territory in our opinion, with markets poised for a bounce. However, until evidence of peak inflation and signs of a more benign policy path become evident, a protracted rally seems challenged.

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## Eurozone

Production slumps on war related supply disruptions

With Eurozone stocks and bonds selling off amid hawkish ECB rhetoric, macro data point to more divergent growth in the region. Services are benefitting from the improving pandemic situation while manufacturing suffers another round of supply disruptions. The final April Eurozone PMIs, at 55.5 for manufacturing and 57.7 for services, remain consistent with solid above trend growth, but the details were patchy, particularly for manufacturing. The PMI new export orders component is below 50, indicating contraction, with weakness coming from

Germany in particular. Consistent with the PMI data, German industrial production (excluding construction) and factory orders both slumped by close to 5% MoM in March, as war related supply disruptions weighed on output, with the auto sector and energy output marking the biggest declines. Auto sector disruptions were anticipated and partly reflect problems with wire harnesses from Ukraine, but the broader weakness is concerning and, with China lockdowns causing another round of disruptions, may persist.

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## APAC PMIs

Solid and expanding, but China risks are looming

April PMIs in the APAC region picked up steam within expansion territory. 'Reopening' after the Omicron wave has certainly helped, and orders as well as exports remain solid. Australia's Manufacturing PMI even moved up to a solid level of 58.5, while Hong Kong's Composite PMI recovered nearly 10 points to 51.7. However, there are a few caveats: China's Caixin Manufacturing PMI fell to 46, while the Services PMI tumbled to 36.2 following the lockdowns and supply-chain bottlenecks in many provinces and cities, particularly Shanghai. Going forward, this is

likely to affect the rest of Asia negatively. The setback in Taiwan's PMI and orders may reflect this already. We also note that while exports remain brisk, PMI new export orders have fallen in Emerging Asia ex India in April. Weakening export growth is also visible in China's April exports, reported today. Exports fell about 3% compared to March, while in YoY terms dropped from 14.7% to 3.9%, mainly due to slowing global demand.

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## Australia

The RBA hikes the policy rate by 0.25% and lifts its inflation forecast

The RBA increased the cash rate by 25bps to 0.35%, exceeding market expectations for a 0.15% rate increase. In the RBA's Statement on Monetary Policy (SOMP), the forecast for underlying inflation had increased to 4.6% by the end of 2022, significantly higher than its forecast in the February SOMP, when the RBA had predicted underlying inflation to reach 2.75% by the end of 2022. The RBA has become more concerned about inflation in the past few months with the Ukraine conflict, China's Covid lockdowns, and the tightening of the

domestic labour market all adding to near-term inflation pressures. In this environment, we expected the RBA will need to be more aggressive in the early part of this hiking cycle. Domestic economic data remained positive, with retail sales for March increasing by 1.6% MoM, higher than the market forecast of a 0.5% increase. The change in the RBA inflation forecast and positive retail sales data caused three-year government bond yields to increase by 30bps to 3.01% for the week.

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## LatAm

Higher inflationary risk will likely spur additional tightening, but with limited space

In Chile, inflation accelerated and surprised to the upside in April, mainly driven by the shock on food and energy prices from the war in Ukraine and the currency depreciation. Headline inflation rose 10.5% YoY, the highest level since 1994, while monthly inflation stood at 1.4% MoM. Core components also show concerning momentum, with the CPI ex-volatile increasing by 1.1% MoM. The Central Bank hiked the policy rate by 125bps to 8.25%, above market expectations. Higher inflationary risk and consumption resilience

were the main drivers for raising the rate to a level consistent with the ceiling of the policy rate corridor published in March. We expect the tightening cycle is close to its end, with a final hike at the June meeting. In Brazil, the BCB hiked the Selic rate by 100bps to 12.75%, signaling a smaller-sized hike in June, which we expect to be the last one considering the statement included the need for more caution in the way the monetary policy is conducted. Composite PMI improved from 56.6 to 58.5 in April, driven by the Service PMI.

## What to Watch

- In the US, investors will focus on the latest set of inflation data while the University of Michigan's consumer sentiment survey will provide insights into the current state of US households.
- Eurozone industrial production and the ZEW survey will show how activity and sentiment are holding up in the region.
- In APAC, we will focus on Monday's presidential elections in the Philippines. Bank Negara Malaysia may hike its policy rate by 25bps to 2%. In Japan, the Household Survey for March will be released. In Australia, May consumer and April business confidence, Q1 retail sales and May CPI expectations will be reported. China will release inflation, export, and credit data for April. Q1 GDP data will be published in Indonesia, Malaysia, and the Philippines.
- In Mexico, we expect the central bank to hike the policy rate by 50bps, while inflation is likely to continue accelerating. In Brazil, the focus will be on Copom minutes and inflation.

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Investment Management  
Mythenquai 2  
8002 Zurich