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Weekly Macro and Markets View

24 January 2022

Highlights and View

The equity rout continues, with investor sentiment plunging and earnings guidance proving critical

The 22% drop in Netflix's share price on disappointing guidance shows how fragile high-flying growth stocks are. We suspect declines in tech are becoming overdone but need to see stabilisation to turn bullish.

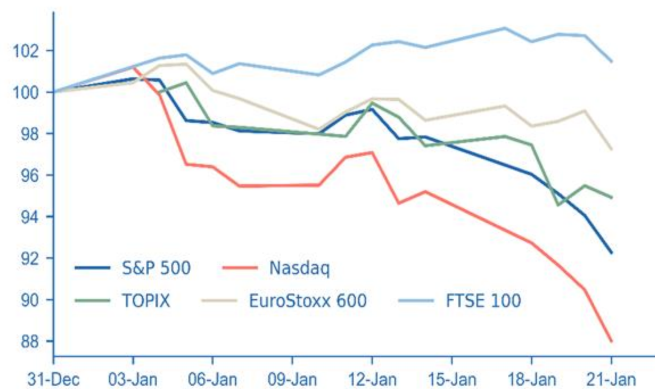
Credit has notably outperformed equities on a risk adjusted basis in the recent correction

Credit markets appear at high risk of gapping down if the stock market correction continues, while in a recovery, upside in credit seems limited due to tight spreads and structural headwinds

China's key policy rates have been cut by 10bps, while window guidance is stimulative

Enabling property companies to use some of their sales proceeds on escrow accounts should alleviate pressure and shows that policy support has become more proactive.

'Buy the dip' shifts to 'mind the gap' as equity sentiment unravels



Source: Bloomberg (Rebased to 100 as of Dec 31, 2021)

The holiday-shortened trading week in the US did nothing to improve the mood of equity investors as the tech-heavy Nasdaq index tumbled 7.6%, marking the fourth consecutive week of declines. Now in 'correction' territory, the index is off 14.3% from its November high, having broken technical support levels. Other equity markets also succumbed. The S&P 500 fell below its 200-day moving average for the first time since May 2020 as global indices were also dragged lower. Unusually, US markets have been leading the decline, with Eurozone stocks off relatively modestly and the UK FTSE 100 actually up 1.5% this year. While sentiment readings have plunged there is little evidence of outright panic so far. What is notable, however, is that the 'buy on dip' mentality seems to have subsided, at least for now, with the old investor adage of 'never catch a falling knife' back in vogue. The shift in sentiment stems from expectations of much more aggressive monetary policy. With almost four rate hikes from the Fed along with quantitative tightening now expected this year, hawkish fears may be overdone. Bond yields eased back from their multi-year highs, the German 10yr Bund yield having momentarily ticked into positive territory on Wednesday for the first time in three years. We are becoming more constructive on stocks but are looking to see signs of stabilisation before moving to a bullish stance.

Credit

Risks rise of a gap down

Credit markets have notably outperformed stock markets especially in the US since the beginning of the year. One peculiar aspect of the YTD price action in credit has been that higher quality credit suffered more than lower quality credit on a beta adjusted basis, largely due to its higher bond yield sensitivity. With US technology stock indices now in correction territory, we think credit markets are at risk of gapping down if the stock market weakness continues. Even if stocks recover, credit is unlikely to have a bumper rally, given that valuations appear expensive on an absolute basis, as well as relative to fundamentals. Structural headwinds from fading liquidity provision by central banks and higher government bond yield volatility should impact credit more than equities, with the latter having some inflation hedge characteristics. Indeed, investor demand for credit is weakening with European credit and US high yield seeing sizeable outflows last week along with only lacklustre inflows into US investment grade credit. All in all, credit seems likely to lag stocks in coming months.

Eurozone

Lagarde justifies the ECB's less aggressive monetary policy path compared to the Fed

Last week, ECB President Christine Lagarde said that the US and Eurozone were 'in very different situations' and '[w]e have every reason to not react as quickly and as abruptly as we could imagine the Fed might'. The final estimate of Eurozone inflation in December confirmed the flash estimate of 5.0% YoY, but we expect inflation to fall back sharply early this year. Meanwhile, the German ZEW expectations index, a useful leading indicator of industrial production saw a large monthly jump of around 20 points in January, suggesting further gains in manufacturing output are likely as the auto sector recovers from supply-side disruptions. However, one risk that needs monitoring is that of renewed lockdowns in China due to the effect its zero-Covid policy will have on supply-chains again going forward. Finally, Eurozone consumer confidence, as measured by the European Commission's survey, only fell slightly in January, which is encouraging given that Omicron has been surging recently, and points to spending holding up well.

UK

Inflation soars to the highest in three decades

Headline CPI inflation accelerated to 5.4% YoY in December, the highest level since 1992. The rise was driven by higher goods prices including clothing, furniture, and food. While price pressure is high, distorted seasonal data blur the current picture. Given the expected rise in Ofgem's price cap in April, headline inflation is likely to remain elevated in the near term but is expected to fall back significantly over the course of the year. Soaring inflation rates and the rapid rise in new Covid infections are weighing on households' minds. Consumer sentiment deteriorated this month to the lowest since February 2021. Omicron and the squeeze on real income dragged down household spending. Retail sales fell 3.7% MoM in December, following a 1% rise the month before. Part of the marked fall can be attributed to households bringing forward some spending in autumn due to concerns regarding supply chain disruptions ahead of Christmas. Some headwinds are likely to persist in the near term but falling infection rates and a strong labour market should help to support spending in the coming months.

Asia

Exports remain solid across the region

Asian exports continue to remain brisk. China's December exports were a bright spot in a difficult economic environment, supporting solid industrial production and manufacturing investment, while Japan's exports got a boost from the recovery of auto exports following prior supply chain constraints. It is encouraging to see Japan's New Export Order component in the January Flash PMI, which was released today, moving up from 58.1 to 58.8, suggesting that exports keep holding up well. South Korea reported solid export data for the first 20 days of January for all major product categories, suggesting that even a record high may be reported for the full month. Singapore's exports showed a strong print in December as well, surprising consensus on the upside. Export strength was supported by pharmaceutical, electronics and gold exports. Indonesia's exports moderated in December, partly affected by the government's coal export ban to address supply shortages in the domestic market. However, the underlying trend remains solid.

Australia

Labour market conditions remain solid

The December unemployment rate came in at 4.2%, better than consensus expectations of 4.5%. This was the lowest rate since 2008. Hours worked rose by 1% MoM and 3.7% YoY while the participation rate returned to its pre-pandemic level. The labour market tightened swiftly after the Delta lockdowns, bolstered by robust demand coupled with limited labour supply. We think labour supply will improve in the months to come, thanks to the border reopening and the permission for international students to work longer hours. However, job vacancies remain at a record high, suggesting labour demand is also high. We think wage growth will rise noticeably from here. Whether it will reach 3% to lift core inflation sustainably into the RBA's target range of 2-3% remains to be seen. We now see more uncertainty around the inflation outlook and would not be surprised if the RBA decides to bring its first-rate hike forward to Q4 this year. Given the strong economic recovery, the RBA will likely end its QE program in the February meeting.

What to Watch

- PMI data for January will start being published, giving a snapshot of how businesses are coping with the Omicron wave.
- The US earnings season is gathering steam while investors watch out for signals from the Fed at its first meeting this year.
- In the Eurozone, the Italian presidential election starts on Monday, but with a number of rounds of voting by Italian legislators likely before a new President is appointed.
- Taiwan, South Korea, and Hong Kong will report GDP data for Q4 and 2021 while Japan, China, and Australia will release January PMIs. Various countries will report export and industrial production data for December. Australia will release Q4 inflation data as well as December business confidence. Markets will be closed on Wednesday in India and Australia.

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