Weekly Macro and Markets View

12 December 2022

Highlights and View

The US yield curve is the most inverted in 40 years as recession fears rise and stocks stumble

US stocks failed to break resistance levels and are now looking for support as our view of recession driving yields lower and a structural down-track for stocks gains credence.

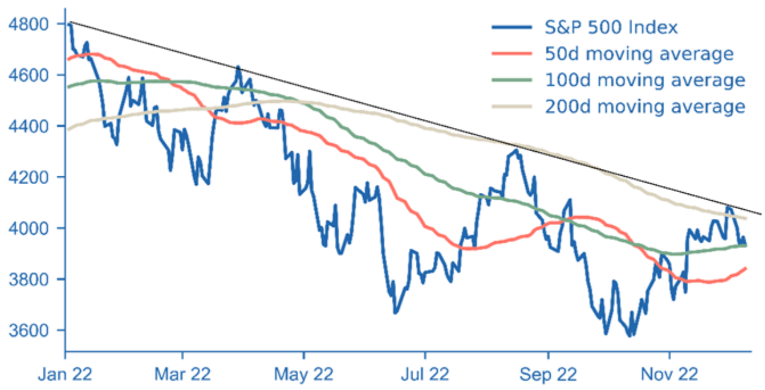
China appears to be giving up its zero-Covid policy

Economic and financial market activity are likely to continue to recover.

In the US, the ISM Services index rose to 56.5 in November, reflecting robust service activity

The underlying components paint a more modest picture with employment hovering around 50 and new orders slowing for the third month in a row.

A rollercoaster week for investors as bonds gyrate and stocks falter



Source: Bloomberg

As the year end closes in and the 'Santa rally' fades, investors were in a jittery mood last week, while a more pragmatic approach to Covid lockdowns in China offered a little cheer. Once again it was the back-and-forth economic data and the recession vs. no recession debate that set the tone. This was reflected in the rollercoaster ride for bond investors, with US 10yr Treasuries hitting 3.6% on Monday on strong ISM Services data that followed the better-than-expected jobs reports from the previous week, before rising fears of recession took yields to 3.4% mid week. It had all changed again by Friday with yields back at 3.6%. In the midst of this move, the 2s10s Treasury curve inverted even more, to a 40-year record, as investors increasingly price in recession ahead. This was also reflected in equity markets as cyclical sectors came under pressure and tech names were shunned. The Nasdaq Index fell 4% on the week, while the S&P 500 was off 3.4%. China was one of the few bright spots with the CSI 300 rallying more than 3% on signs that the Chinese authorities have heeded the message of frustration from the population and eased lockdown measures. Last week lent support to our cautious stance on risk assets versus bonds, and it was telling that the S&P has faltered at resistance levels. Despite the late rally in bond yields of Friday, signs are emerging of a disconnect between bonds and stocks as recession fears rise and safe havens are sought.

China

Chinese equities soar on relaxed Covid-policy measures

In a significant U-turn, China's government eased Covid-related restrictions in a 10-point plan that seems to prepare the path towards reopening. Excessive expansion of lockdown measures to whole residential districts in case of a single infection case will be banned, while cross-regional mobility will be eased. Schools without Covid clusters are to maintain normal teaching activities. Meanwhile, authorities must speed up booster vaccinations among the elderly to prevent a surge in mortality as experienced in Hong Kong. China's 'H'-shares surged 7.3%, while domestic 'A'-shares gained 3.3% in an overall lacklustre Asian market environment. Moving to economic statistics, we note that exports and imports plunged more than consensus had expected in November, both in Mainland China and Taiwan. A broad variety of product categories were affected, with Western Christmas related demand plummeting. China's exports to the US fell more than 25% YoY, for example.

US

Service activity is holding up

Other than the recently published Services PMI, the ISM Services survey showed a pickup in service activity in November. New orders on the other hand fell to the weakest since June, pointing to a slowdown in the coming months. Interestingly, new export orders have collapsed over the past two months to the third weakest on record, having fared worse only during the pandemic and the financial crisis in 2008. Meanwhile, initial jobless claims only ticked up slightly to 230'000 but continuing claims have risen from 1.4mn in September to 1.7mn at the end of November. This pattern is in line with our view that firms are still reluctant to let people go but are becoming more cautious with regard to new hires, making it more difficult for jobless people to re-enter the labour market. Finally, producer prices slowed markedly but somewhat less than expected to an annual rate of 7.4% in November from 8.1% in October. Core PPI slowed from 6.8% YoY to 6.2% YoY.

Eurozone

Retail sales fall but the ECB is preparing further rate increases and QT

We are starting to get the first hard data for Q4 in the Eurozone, and it is presenting a mixed picture. Eurozone retail sales fell -1.8% MoM (-2.7% YoY) in October, with declines broad-based across categories and countries. Retail sales volumes have been on a gradually declining path over the past few months, due to the squeeze on households' real spending power because of record high inflation. Separately, industrial production in Germany was flat in October at -0.1% MoM (0.0% YoY) as falls in manufacturing output in the energy-intensive sectors were offset by gains in construction. Overall, the data so far support our view that recession started in Q4 in the Eurozone, though the severity of the recession will depend in large part on the winter weather, which so far has been milder than usual. Meanwhile, the ECB is preparing to raise interest rates further this week and is also expected to announce the details of its plans to begin quantitative tightening (QT) in 2023, highlighting how monetary policy is unlikely to support the economy next year.

LatAm

Mixed surprises in the November inflation figures

In Chile, inflation surprised to the upside in November. Headline inflation rose 1% MoM, accelerating from 12.8% to 13.3% YoY. Prices continued increasing widely, with food and transport prices being the main drivers, but also with challenging core inflation. The central bank kept the policy rate on hold at 11.25%, confirming the end of the tightening cycle. The statement signalled that the policy rate will remain at the current level until inflation expectations converge to the inflation target. In Brazil, headline and core inflation reached 0.4% and 0.3% MoM, below market expectations, mainly explained by larger-than-expected Black Friday discounts. The central bank kept the Selic rate at 13.75% for the third consecutive meeting. The statement was more dovish than expected, with only a soft warning about the upward risk for inflation linked to an increase in fiscal spending. Therefore, we maintain our view that the easing cycle should start in H2 2023. Incoming President Lula nominated Fernando Haddad from the Workers Party as the next Finance Minister.

Credit

Corporate bonds outperform bonds and stocks

Corporate bonds have been outperforming other assets since last month and last week was no different when spreads tightened while both stock and government bond prices fell. European Investment Grade credit notably outperformed over the last four weeks, as was to be expected given that valuations had nearly cheapened to those seen during the depth of the Covid crisis. However, even the relatively less alluring US Investment Grade and High Yield markets saw spreads decline in recent weeks as bond yields fell and supply slowed down. Indeed, primary credit markets seem to be entering the year end lull earlier than usual. Flows seem to have tentatively stabilised, but a turn is required for a sustainable rally. On a separate note, European banks continued to prepay TLTRO loans, this time by around another EUR 450bn following EUR 300bn in November leading to a record reduction in the ECB's balance sheet. This week is critical for investor sentiment as many major central banks meet and will set the tone for coming months.

What to Watch

- This is a big week for central banks, with further rate hikes expected from the Fed, the SNB, the BOE and the ECB, albeit at a less aggressive pace.
- In the US, the Fed is likely to raise its target rate by 50bps while the focus will be on the FOMC's future projections, which will be influenced by the latest batch of inflation data to be published this week.
- As well as raising interest rates, the ECB is expected to announce details of its plans for Quantitative Tightening (QT) in 2023, though we anticipate that the initial reduction to the balance sheet will be modest.
- We expect Taiwan's CBC to hike its policy rate by 0.125bps to 1.75% and Philippine's BSP to hike by 50bps to 5.5%. China will publish retail sales, industrial production, and fixed asset investment data for November. In Japan, we expect to see improved non-manufacturing conditions reflected in the quarterly Tankan Survey. Australia will report November labour data and its latest business and consumer confidence data. Japan, Indonesia, the Philippines, and Singapore will release November export data.

Disclaimer and cautionary statement

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