

# Weekly Macro and Markets View

28 March 2022



## Highlights and View

**Government bond yields rise further on hawkish central bank positioning, with a steep Fed rate hike path now priced in**

A flat US Treasury yield curve signals a challenging outlook, with bond market volatility likely to remain elevated.

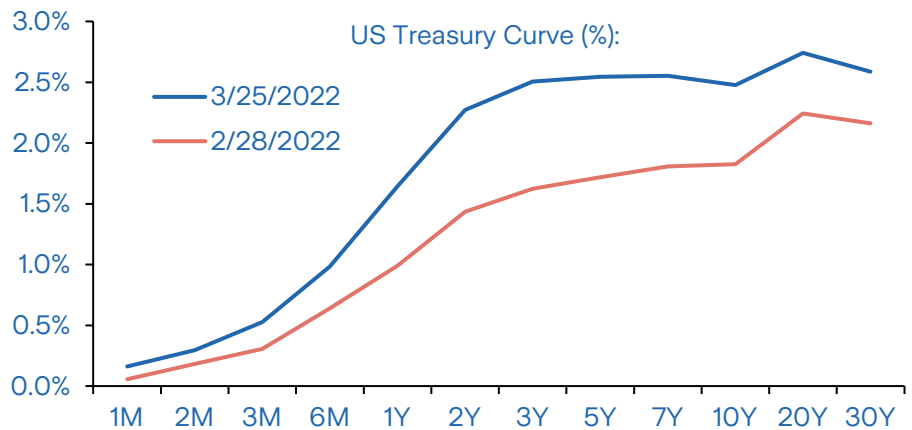
**Credit spreads tightened amid stabilising flows and returning investor appetite in primary markets**

Recent market dynamics could suggest a tentative turn in credit following the broad negative trend that has been in place the last few months, although any upside potential is muted relative to stocks.

**Eurozone business surveys present a mixed picture with the ifo survey falling sharply but the Flash PMIs more resilient**

The differences in the surveys result largely from the different weighting of the expectations component. So far confidence has taken much more of a hit than actual economic activity.

## Government bond yields spike but credit markets bounce



Source: Bloomberg

Government bond yields spiked last week, spurred by hawkish Fed talk. The 10yr Treasury yield rose by 32bps, following a similar move since the end of February, with eight more Fed hikes now priced for 2022. Last week also saw upward pressure at the longer end of the curve as the Fed signalled that they are moving towards balance sheet reduction. Part of the yield curve inverted this morning, with the 5yr yield above the 30yr yield for the first time since 2006, while the 2/10 yield spread remains narrow and signals challenges ahead. In Europe, the 10yr Bund yield breached the 0.5% level as inflation is elevated and the fiscal implications of the war in Ukraine are becoming apparent. Credit markets, by contrast, showed tentative signs of turning after having underperformed for several months. Despite volatile government bond yields, cash credit spreads rallied across the board for a second week in a row. Encouragingly, granular signs of investor appetite returning were seen as flows appeared to be stabilising after many weeks of outflows. Issuance picked up with negative new issue concessions making a comeback in Lowe's new debt, which saw an order book of USD 32bn for a USD 5bn deal size. While stability in credit markets is welcome, geopolitical risk remains and upside is likely to remain capped relative to stocks. Government bond market volatility is also likely to persist, given the cross-currents impacting on economies and markets.

## Eurozone

Resilient PMIs but sharp fall in ifo

Business surveys present a mixed picture of the impact of the war in Ukraine on confidence and economic activity. The Eurozone Flash PMIs were more resilient than expected, with the composite indicator only falling one point to 54.5 in March. However, the German ifo Business Climate indicator fell by almost ten points to 90.8 in March. The ifo Business Climate indicator is an average of current conditions and expectations components, and it was the expectations component that fell sharply by almost 15 points whilst companies'

assessment of current conditions was a lot more resilient. Eurozone consumer confidence surveys also fell sharply last week. Overall, the conflict in Ukraine appears to have hit sentiment and confidence a lot more than actual economic activity so far. Indeed, we still expect the Eurozone economy to grow at an above trend pace this year. Meanwhile, the EU and US agreed on a deal last week for the supply of LNG. However, reducing dependency on Russian energy supplies will still take some time, possibly many years.

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## UK

Chancellor Sunak provides only limited relief to households

In his Spring Statement Chancellor Sunak announced a number of measures intended to dampen the impact of rising living costs. Lifting the threshold for National Insurance contributions will mostly benefit households at the lower end of the income spectrum while the temporary cut in fuel duty will also help to mitigate expected headwinds for consumers' disposable income caused by rising inflation and soaring energy prices. Meanwhile, inflation rates keep accelerating with headline CPI reaching 6.2% YoY while core CPI picked up to 5.2% YoY. Higher

living costs keep weighing on households' minds with consumer sentiment falling to the lowest since November 2020 in March. More promising, however, business sentiment remains upbeat with the Composite PMI remaining close to 60, indicating a continuation of solid activity, mainly driven by a strong outlook in the service sector. Robust growth with a shift to more balanced spending is the basis for a sustainable expansion, though the real income squeeze is still expected to provide headwinds to growth in the coming months.

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## Switzerland

The SNB maintains a dovish stance

The SNB left policy unchanged in last week's meeting while revising up the 2022 inflation forecast to 2.1%, compared to 1% previously. This reflected expectations of higher energy and commodity prices and the impact of supply bottlenecks, with inflation still projected to come down rapidly in 2023, to 0.9%. The growth forecast was lowered and the SNB now expects GDP growth of around 2.5% in 2022, down from 3%, mainly reflecting the impact of the war in Ukraine on commodities. In contrast to most other central banks, the SNB maintains a dovish

stance and guidance. Although we expect inflation to be a bit stickier than the SNB projects, an accommodative stance appears justified given benign domestic price pressures and a strong franc. Despite the relatively dovish outlook, market expectations remain for an SNB lift off in the first half of 2023, with three rate hikes currently priced in over a 12-month period. We suspect the SNB will be more cautious when lifting rates.

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## APAC

Convincing PMI, export and industrial production data, despite some caveats

Though still below the 50 'boom/bust' line, it is encouraging to see Japan's Services PMI for March bounce back 4½ points to 48.7. The continuous reduction in new Omicron infections is obviously improving consumer confidence. While the Manufacturing PMI also recovered slightly, we are more concerned about the steep deterioration of the new-export-order index to 46.6, the steepest drop since the outbreak of Covid in 2020, with geopolitical problems certainly having an impact. Meanwhile, Australia's Composite PMI improved further to a solid

level of 57.1, supported by both the manufacturing and services components. Moving to regional exports and production, the latest statistics from Taiwan, South Korea, Singapore, and Thailand are very encouraging, mainly driven by technology related sectors. The Philippine central bank, BSP, left policy rates unchanged as expected, but revised its inflation forecast up, believing inflation remains anchored. In South Korea, the director of APAC at the IMF, Changyong Rhee, has been nominated as the new Bank of Korea Governor.

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## LatAm

Banxico unanimously hiked 50bps, while the BRL is the best performing currency YTD

In the first unanimous decision for this hiking cycle, Mexico's central bank increased the policy rate by 50bps to 6.5% after President Obrador released the news before the meeting, raising some concern about central bank autonomy. Obrador apologized for the mistake, saying he thought the decision had already been made public. Banxico also revised its inflation forecast to the upside, from 4% to 5.5% on average for Q4. We expect Banxico to continue hiking the policy rate by 50bps during the next meetings as core inflation remains high, inflation

expectations have deteriorated, and the upward pressure on food and energy prices due to the geopolitical crisis continues. In Brazil, the Central Bank's minutes signalled that the hiking cycle should end after a 100bp hike at the next meeting, with a terminal Selic rate of 12.75%, which according to the committee, is very restrictive and will impact next year's inflation. The BCB also kept its GDP forecast at 1% for 2022, above market expectations. The BRL reached its strongest level since Mar 2020, appreciating 17.6% YTD.

## What to Watch

- In the US, the latest batch of labour market data is likely to reflect a continuation of a solid employment situation while the ISM Manufacturing Index is expected to show that business activity remains robust.
- In the Eurozone, the flash estimate of inflation in March and the European Commission's business and consumer sentiment survey will be watched closely.
- The Bank of Thailand is expected to stand pat. China's NBS PMIs as well Caixin Manufacturing PMI are likely to have experienced a setback in March. Hong Kong's February retail sales will show a steep plunge following the outbreak of Covid infections and mortality rates at record highs. South Korea will release industrial production data for February. Australia will publish March house price data, February building permits and retail sales data.
- In Chile, monthly economic indicators will be released, while we expect the Central Bank to hike the policy rate by 200bps and significantly review the upside inflation forecast. Unemployment will be published in several LatAm countries.

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