ZURICH

Weekly Macro and Markets View

21 March 2022

Highlights and View

The Fed initiates the tightening cycle with a 25bp rate hike

Taking a hawkish stance, the FOMC signals six more rate hikes this year followed by three to four in 2023. We doubt that the Fed will be able to lift rates as much as it intends.

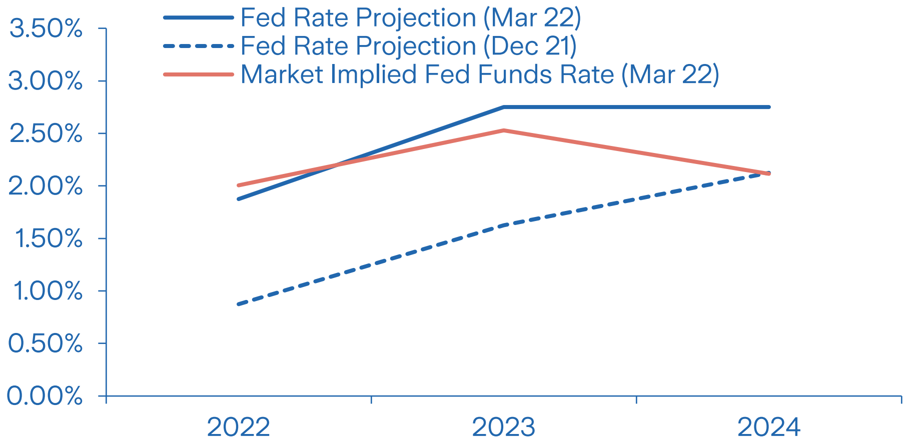
The Bank of England lifts the Bank Rate by another 25bps to 0.75%

Despite its somewhat dovish tone, the BoE is expected to tighten policy further in the coming months as inflation is expected to remain significantly above target.

Chinese equities tumble before recovering

Policy makers became concerned about the domestic impact of falling Honk Kong listed 'H' shares and US listed ADRs and acted swiftly to alleviate concerns

The Fed's rate projection looks too ambitious



Source: Bloomberg

As expected, the Fed started to tighten its policy by lifting the Fed funds target rate by 0.25% to a range of 0.25% to 0.5%, the first rate hike since 2018. Despite acknowledging that growth is expected to be significantly weaker than the Fed thought back in December, the FOMC set a relatively hawkish tone with regard to the projected rate path. The updated dot plot shows six more rate hikes this year, followed by another three to four next year. While it seems reasonable from the Fed's point of view to signal a strong willingness to fight against soaring inflation rates, particularly given that the market has already priced in more than seven rate hikes this year, we strongly doubt that the Fed will be able to lift rates by as much as they are currently projecting. We expect several more rate hikes at upcoming meetings but a more cautious outlook in the second half of the year. Given the hawkish stance, the risk of a policy error has increased. This is also reflected in the yield slope (10y minus 2y) dipping below 20bps last week, the lowest in two years. Finally, the FOMC did not provide a lot of details on the intended path of balance sheet reduction, although Jerome Powell indicated that quantitative tightening will soon begin and is likely to be the equivalent of another rate increase.

APAC

Central bank reactions differ following the Fed policy rate hike

Following the policy rate increase by the Fed and a shift higher in the dot plot forecast, it was no surprise that the Hong Kong Monetary Authority followed with a 25bp hike of its base rate. The USD-HKD peg urges the HKMA to follow in lockstep with a US policy rate change. What was more of a surprise was the fact that Taiwan's CBC also raised its policy rate by 25bps to 1.375%, its first rate hike in more than ten years. Consensus had expected a hike of only half the size later in June. CBC Governor Yang cited increased inflationary pressures and the solid economic recovery as reasons behind the quick action, while also adjusting the CPI and core-CPI forecast to the upside. Meanwhile, both the Bank of Japan and Bank Indonesia left their policy rates unchanged as expected, as inflationary pressures remain contained. Australia's RBA released its March minutes, which indicate that the RBA is sticking to its patient policy outlook. However, we note that the Board agreed that the risks to the outlook for wage growth were skewed to the upside.

Eurozone

The ZEW collapses, but actual economic activity may be more resilient

Last week the German ZEW economic expectations indicator, seen as a leading economic indicator for the Eurozone as a whole, saw one of its sharpest falls in history, falling from 54.3 in February to –39.3 in March. This has raised concerns that the Eurozone could fall into recession because of Russia's invasion of Ukraine and the resulting spike in oil and natural gas prices as well as the wider impact on business and consumer confidence. However, sentiment surveys often fall sharply on geopolitical events only to rebound a few months later. Our view is that the current spike in oil and gas prices is not enough to wipe out growth completely in 2022. Although growth will be significantly weaker in Q1 and Q2 than previously forecast, the predictions of very strong growth were based on the recovery from Covid and ongoing monetary and fiscal stimulus. This means there was some growth cushion in the Eurozone economy going into this crisis. We therefore still expect the Eurozone to see above trend growth this year, though the region is now vulnerable to any further internal or external shocks.

China

The equity market slump is followed by a 'V'-shaped recovery

Following encouraging signals from the government that it will do its utmost to stabilise markets the MSCI China fully recovered from its nearly 20% loss within just three trading days. There were several reasons why both foreign and domestic investors had intensified selling. Delisting fears accelerated as Chinese US-listed ADRs had pushed the growth-oriented Nasdaq Golden Dragon Index down by 75% within a year. Concerns about the US opting for sanctions on China as a perceived supporter of the Russian invasion in Ukraine added to investor fears. The increase in Covid infections to a post-Wuhan high with fears about lockdowns, mobility restrictions and supply chain issues, particularly in the Greater Bay area including Shenzhen, added momentum to the sell-off. Vice Premier Liu He's statement urging ministries and government agencies to quickly tackle investor concerns and to support capital markets initiated a strong counter-rally, while a statement by China's ambassador to the US alleviated concerns about imminent sanctions.

LatAm

The tightening cycle is likely ending in Brazil

In Brazil, the central bank hiked the Selic rate by 100bps to 11.75%, as expected. The statement signalled another adjustment of the same magnitude in its next meeting. The BCB will likely end the tightening in May as the size of the hiking cycle assumed in its inflation forecast (12.75% for the Selic) appears to be enough for inflation to converge to the target over the policy horizon. However, the bank is prepared for additional movements if the inflationary shock is more persistent. Monthly economic activity disappointed in January, falling 1% MoM, below market expectations, suggesting a weak performance in the agricultural sector after the drought in the South at the beginning of the year. The Government announced several measures that will inject ~USD 32bn, aiming to increase economic growth during the current election year. These measures will not have a fiscal cost but could add additional inflation pressures. In Argentina, inflation remains high, accelerating from 50.7% to 52.3% YoY in February.

Markets

Investors look to the bright side as war continues to rage

Despite the ongoing battles and bloodshed in Ukraine, investors were prepared to look towards potential resolution, with assets rallying. The improving sentiment is consistent with previous periods of war when equity markets have typically rallied and indeed the MSCI World Index jumped 6% on the week. Stocks had become oversold, with record outflows from European markets and were poised for a bounce. Credit spreads tightened although investor conviction still appeared fragile given outflows and subdued primary market activity, while government bond yields marched higher. Commodity prices were again volatile, with Brent oil prices falling to USD 98 on Thursday, a long way from the USD 139 posted in the prior week, before recovering to USD 108. While we suspect a floor may have been found for risk assets, potential downside remains elevated with little clarity on any resolution to the war. One hurdle that was overcome, however, was the first rate hike by the Fed, which had been fully priced in, while the commentary around it offered no surprises.

What to Watch

- The G3 Flash PMIs will give a first glimpse as to the impact that events in Ukraine and the related sanctions will have on the global economy.
- In the Eurozone, various business surveys such as the German ifo are expected to show sharp falls in sentiment in March, but this may not translate into as sharp a decline in actual economic activity.
- The SNB is expected to maintain a dovish stance in this week's policy meeting.
- Australia and Japan will release their March PMI data. Tokyo's CPI is likely to creep higher in April, though core CPI ex fresh food and energy will still show a negative print due to special factors. Taiwan, Singapore, and Thailand will release export data for February. We do not expect the BSP to change the Philippine policy rate due to the rather fragile economy.

Disclaimer and cautionary statement

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