Weekly Macro and Markets View

4 April 2022

Highlights and View

China's PMIs deteriorate further below the 50 line

Additional fiscal and monetary support is likely to spur economic activity later this year.

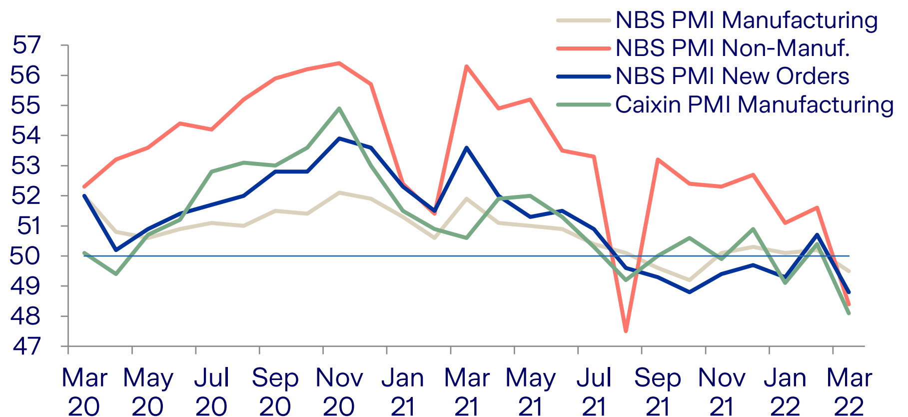
The US yield curve inverts for the first time since 2019, evoking recession worries

Although we don't expect a recession in the near term, the inversion signal should not be taken lightly as other indicators also point at a marked slowdown in growth in the coming quarters.

Eurozone inflation surged to a fresh record high of 7.5% in March

A jump in natural gas and oil prices in early March was the main reason for the surge in inflation, but other components also saw increases such as food and core goods inflation.

China's PMIs suffer from severe Covid related activity restrictions



Source: NBS, Caixin, Bloomberg

While Shenzhen resumed normal work and production after a seven-day lockdown, activity in Shanghai came to a standstill during the two-stage lockdown in the East and West of the city. The surge in nationwide Covid infections is close to the Wuhan highs from early 2020, though mortality remains low. The economic impact of China's dynamic zero-Covid measures are also reflected in a larger than expected slump in China's March PMI readings. Both the NBS and the Caixin Manufacturing PMIs as well as the NBS Non-Manufacturing PMI fell below the boom/bust line of 50, with the Caixin Services PMI, to be released on Wednesday, likely to follow suit. All subcomponents of the NBS Manufacturing PMI contributed to the drag, while new export orders, a separate measure, also fell as global demand weakened. Meanwhile, the Construction PMI remained strong and climbed higher, though its new order and business outlook components also deteriorated. Though we have some sympathy for the drastic downward revisions of GDP growth forecasts by many economists for this year, we are looking through the current downswing and believe that the government will take appropriate measures to spur growth in the remainder of the year, mainly through higher infrastructure related spending but also by taking measures to improve housing demand, which may support the ailing property sector.

US

Consumers become more downbeat regarding the economic outlook

After switching signs several times during the week, the S&P 500 eked out a tiny gain in the end. While economic activity continues at a healthy pace some headwinds are visible in the latest batch of data. The ISM Manufacturing Index receded to 57.1 in March, robust but nevertheless the lowest since September 2020. New orders were relatively weak while prices paid have rebounded reflecting the impact of the recent spike in commodity prices. Meanwhile, the Conference Board's consumer sentiment index improved slightly, lifted by households' perception of the current situation. However, expectations dropped to the lowest in eight years. In the near term, consumer confidence and spending will be supported by a strong labour market. The unemployment rate fell to 3.6% in March, a post-pandemic low, which helped to push up growth in average hourly earnings to 5.6% YoY. The labour market remains very tight but a tick up in initial jobless claims as well as a reduction in average weekly overtime could be early signs of easing pressure.

Eurozone

Inflation surges on rising energy prices

Eurozone inflation surged in March, to 7.5% YoY from 5.9% in February, mainly on the back of higher natural gas and oil prices because of the war in Ukraine. Energy inflation increased from 32% YoY in February to 44.7% in March. Inflation in other components of the HICP, such as core goods and food prices also increased. The increase in core goods prices suggests that previous increases in commodity prices and raw material costs are feeding through the production chain. There are also further upside risks to food prices given the ongoing conflict. Services inflation was still relatively subdued in March at 2.7% YoY and there is not yet evidence of a wage-price spiral developing in the Eurozone, though the annual wage bargaining rounds will need careful monitoring. Many Eurozone countries are implementing cuts to diesel and petrol taxes as of April, which will help at the margin, but inflation is likely to remain at current high levels through most of H1, before declining in H2 assuming oil and gas prices do not rise further.

Japan

Tankan survey reveals a cautious corporate outlook

As we had suspected, disappointing retail sales and industrial production data for February revealed that Japan's economy weakened in Q1. We even assume a real GDP contraction is likely. This is also in line with the weakness revealed by Japan's well known corporate survey, the quarterly Tankan. Following an impressive rise over the last seven quarters, the headline manufacturing diffusion index fell 3 points each for large and small manufacturers, to 14 and -4 respectively, slightly better than consensus had expected. The performance of large non-manufacturing companies was mixed, with accommodation as well as eating and drinking being a drag due to infection control measures. The outlook for Q2 deteriorated further across the board, though we suspect that the remarkable yen depreciation should improve the outlook for exporters, while rising input prices remain a drag. Capex plans were mildly positive for large companies, though clearly negative for SMEs, but both tend to improve as the new fiscal year progresses.

Australia

With improving economic data the election-year budget shows increased spending and a decline in fiscal debt

The rally in commodity prices and better than expected economic data have afforded the Australian coalition government the luxury of delivering a moderately stimulatory budget while reducing the forecasted fiscal deficit. The government announced new policy measures totalling AUD 35.4bn (1.5% of GDP) over the next four years. The budget combines one-off payments, tax offsets and a cut to fuel excise for a total of approximately AUD 8½ bn, with funding for programs focused on increasing the participation rate and productivity. The 50% cut in fuel excise to 22.1 cents will remain in place for the next six months, offsetting a significant portion of the inflationary impact of increased fuel prices during the first quarter. The budget is not expected to significantly change the timing of RBA rate hikes, and the current market pricing of seven rate hikes for 2022 seems excessive. In economic data, Australian retail sales exceeded expectations by increasing 1.8% for February, driven by growth in the discretionary sector, which benefited from a decline in Omicron cases.

Credit

Further signs of a turn emerge

Credit markets, especially corporate bonds, continued to show signs of strength last week, despite the lacklustre performance of stocks. Spreads tightened across sectors and geographies, with financials outpacing corporates. Primary markets continued to roar back, especially in Investment Grade, with the US credit market churning out USD 230bn of deals in March, with strong subscription levels and minimal new issue concessions. High Yield primary markets, which saw issuance largely grind to a halt for many weeks are also showing signs of thawing. Flows also continue to tentatively stabilise, with European credit seeing inflows after substantial outflows seen in most of Q1 across credit and equity markets. All of this said, fundamental credit risks are slowly building up. While we expect leverage to rise modestly, higher interest rates should start impacting US corporate loan borrowers as the interest rate floors could be breached soon. All in all, while risks and uncertainties remain, it seems that pent up demand has built up and the recent strength in credit markets could continue for some time.

What to Watch

- In the US, investors will focus on the latest Fed minutes for clues regarding the expected pace of quantitative tightening. In addition, the ISM Services Index will provide insights into the state of the service sector.
- In APAC, it is highly likely that both Australia's RBA and India's RBI will keep monetary policy unchanged. In Australia, the first rate hike is expected for either June or August. Australia's trade balance is likely to have contracted in February but should increase again going forward. In Japan, we will focus on the Eco Watchers survey for March. China will release the Caixin Services PMI for March, which is likely to have contracted. Markets will be closed on Monday and Tuesday in China and Taiwan, on Tuesday in Hong Kong and on Wednesday in Thailand.
- Inflation is expected to continue accelerating in several countries in LatAm, and the upside pressures on core inflation are unlikely to subside. In Mexico, the minutes of the last policy meeting will be released.

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