Macro Outlook Summary

March 2023

It would be tempting to say the March US banking crisis was a game changer which will tighten liquidity, will lead to a halt in central bank hiking and brings forward the start of rate cuts. We think this is overly optimistic but we are not pessimistic either. Our case last month was that the banking crisis should become transitory and that central bank policies will soon revert to business as usual. We believe that's still the right call given what central banks have done.

In the midst of the banking crisis, the US hiked by 25bps to 5% on 22nd Mar while the ECB hit harder with a 50bps hike to 3.5%. The BoE followed a day later with 25bps to 4.25%. Though this may sound overly hawkish, we stick to our view that terminal rates around 6%, 5% and 4% for the US, UK and Europe are plausible as central bankers universally proritise inflation suppression over economic growth. The US banking crisis will undoubtedly reduce credit availability and tighten lending standards which helps the Fed's agenda. In the US clear progress has been made towards reducing inflation which peaked at 9.1% in Jun'22 and now stands at 5%. M2 has also contracted steadily by 4% over the same time period and is likely to remain on a downward path.

Europe has made similar progress from a peak rate of 10.6% in Oct'22 down to 6.9% currently. The UK picture is more disconcerting with the peak at 11.1% in Oct'22 marginally down to 10.1% currently but now with 12 months of readings over 9% and core inflation still over 6%. So to be clear, US inflation is half the UK but US rates are 75bps higher. One of these is surely wrong and we think it's UK rates.

In the midst of ongoing rate hikes we do not think the outlook for equities is very bearish yet. Setting aside a few notable exceptions it looks like inflation is receding and central bank rate hikes are approaching their peak. We think that may well be enough to support an equity rally in some parts of the world so trying to plot the path and timing of rate reductions seems unnecessary at this juncture because rate cuts are not a precondition to an equity rally. In particular we think there is an interesting case for Asian equities where inflation is waning and growth is picking up, hence our theme which we are building out moderately.

Currently data in the US is pointing to a slowdown. Some extrapolate this into a recession but again we think that is premature and by no means a certainty. It may well be mild which would not support a bearish positioning just yet. The worry is the US debt ceiling and the political fighting which seems almost certain to take the issue to the wire. Markets won't like that one bit. Clearly if US equities break downwards then all markets are likely to follow regardless of the local story but we don't see this as an imminent risk and like the positive stories in EM and Asia in the meantime.