MARKET RECAP
WEEKLY

May 23, 2022

MARKET REVIEW

“DYNAMIC ZERO-COVID POLICY” BURDENS CHINA'S ECONOMY

- Shanghai is set to reopen in June, but in the rest of China the zero-covid policy will last through 2022 and possibly beyond, putting international trade recovery and future loosening of supply chain bottlenecks in jeopardy.
- Beijing will intensify fiscal support and monetary policy will be aimed at facilitating credit.

In April, Chinese economic data came in significantly below expectations, penalized by government imposed Covid lockdowns and restrictions since March, causing logistic breakdowns and widespread supply chain disruptions. April retail sales and industrial production plummeted, while credit weakened significantly. Specifically, nominal retail sales fell 4.9% in April and are far from February's 6.0% peak, while real retail sales fell 6.2% in April and are also far from February's 7.3% peak. Industrial production fell by 7% in April and 10.5% from February, and fixed investment fell by 2.3% in April and 3.9% from February. Meanwhile, the PMIs were significantly below the expansion threshold.

To date, the situation in Shanghai is improving, but the “dynamic zero-covid policy” to prove effective would require the reopening of the Chinese economy to be pushed back trough **2022, a politically important year, as President Xi is expected to run in the fourth quarter for a third term at the National Party Congress.**

In Shanghai, the government announced the gradual resumption of work and activities starting this week, but most traffic restrictions will remain in place until 21 May, when public transport and other services are expected to gradually resume. By June, the closure should be lifted, but residents will still be asked to undergo frequent mass coronavirus tests.

Chart 1: China Major Macro Indicator

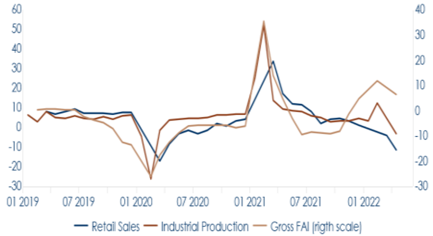
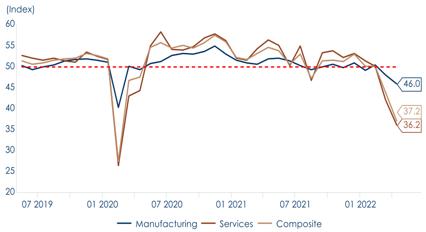


Chart 2: April PMI remain below 50



In the rest of the country, considerable uncertainties remain (in Guangan and Tangshan, covid cases have intensified and partial closures have been implemented). In Beijing, however, new infections keep emerging, despite the tightening of restrictions. The news that China will not host the Asian Cup in the summer of 2023 raises the question of whether China will maintain its zero-covid policy beyond 2022.

The “dynamic zero-covid policy” makes it less likely that China's economy will be able to repeat the rapid recovery it experienced two years ago, at the outbreak of the pandemic, and increases the risk of a slowdown in global trade as Chinese demand weakens and global supply chain disruptions worsen.

At the same time, the country's financial conditions are tightening, so China will continue with expansionary and supportive policies even if it may not intervene directly in the policy rate.

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WEEKLY RECAP

EQUITY MARKETS

CONSUMED MARKETS…

Markets continue to be very nervous indeed the week had a particularly heavy session on Wednesday when the S&P fell 3.5% and the Nasdaq more than 4%, its worst daily move in two years and the lowest level since March 2021. The reason for the drop was the profit warning of Walmart first (-11%) and then Target (-25%), which led the consumer staples and consumer discretionary index to very negative performance; the reasons are profit margin misses in Q1 and operating margin guidance downward revision, mainly due to the combination of higher energy, transportation and personnel costs and excess inventory on some commodity categories.

The S&P index closed the week at about -3%, with General Merchandise -22%, Hypermarket & Supercenters -17% and Computer & Electronics Retail -15% as worst performing sectors; Broadcasting +6%, Apparel retail +5%, Copper +4% as the best performers. European markets performed somewhat better, with the SXXP index roughly flat with Basic Materials +6%, Utilities +4% and Energy +3% the best sectors, Personal care Drug & Grocery Stores -5%, Consumer Products & Services and Food & Beverage -4% the worst sectors.

Reporting virtually ended in both the US and Europe with a proportion of companies beating expectations up on past quarters and close to historical range highs. The quarter's results generally showed that macro-level stagflation fears have not yet weakened the earnings picture, which still appears robust. Sentiment on the global economy worsened, due to fears of pressure on demand in the US, fears on the evolution of the conflict in Ukraine (and its consequences) and the repercussions of lockdowns in China; there was evidence among companies of a decline in optimism, which, however, did not translate into widespread cuts in guidance; **the outlook on dividends and buybacks remained fairly upbeat.**

EQUITY MARKETS	LEVEL		Δ WEEK
MSCI World AC	2 655,91	▼	-1,6%
S&P 500	3 901,36	▼	-3,0%
NASDAQ Composite	11 354,62	▼	-3,8%
SX5E	3 657,03	▼	-1,0%
DAX	13 981,91	▼	-0,3%
CAC 40	6 285,24	▼	-1,0%
FTSEMIB	24 095,00	▲	0,2%
IBEX 35	8 484,50	▲	1,8%
FTSE 100	7 389,98	▼	-0,2%
MSCI Emerging	1 035,31	▲	3,1%
CSI 300	4 053,98	▲	2,3%

VOLATILITY	LEVEL		Δ WEEK
VIX (S&P 500)	29,43%	▲	1,9%
V2X (SX5E)	28,66%	▼	-1,6%

Source : Bloomberg, as of 2022.05.23

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GOVERNMENT AND CORPORATE BOND MARKETS

Rates markets remain extremely sensitive to the evolving growth narrative and its impact on risky assets. During the week, bond yields diverged on both sides of the Atlantic. In the US, the term structure flattened out as short-term maturities rose and long-term maturities fell modestly, driven by a drop in breakeven inflation and an increase in real rates, while in the Eurozone there was a general rise in yields.

In the Eurozone, the end of QE and negative interest rates is approaching, while the discussion among the Governing Council members on the appropriate step for normalising monetary policy. The 50-bp proposal of Klaas Knot, Dutch central banker and ECB Governing Council member, appears to be gaining support within the Governing Council and the majority of members would be willing to support at least two 25-bp hikes this year to bring ECB policy back to 0%. At the same time, Rehn and De Cos suggested the bank may move out of negative territory relatively quickly and continue the gradual process of normalizing monetary policy since upside risks to inflation projections and core inflation are "clearly" above medium- and long-term expectations of around 2%.

Although a hike in July is all but inevitable, continued references to the need to return to positive rates by year-end have led money market curves to expect a 25-bp hike at each of the subsequent meetings, for a total of 100 bps.

During this week, the ECB's accounts confirm an ongoing hawkish shift at the ECB and confirmed the line then expressed by several members of the central bank that it is necessary to raise rates to offset price acceleration, with some members emphasising that it is necessary to 'act without undue delay'. Conversely, other members were of the view that too aggressive an adjustment could prove counterproductive, given the further increase in uncertainty about the overall scenario. The Council also dwelt on the fragmentation of the monetary policy transmission mechanism, stressing that flexibility in the use of its instruments is crucial to counter it.

Credit markets again performed negatively with widening spreads in a week marked by riskoffs related to growth fears induced by the restrictive phase of monetary policy.

GOV'T BONDS	LEVEL		Δ WEEK
US 10-year Yield	2,78%	▼	-13,7 bp
GER 10-year Yield	0,94%	▼	-0,4 bp
FRA 10-year Yield	1,47%	▲	1,0 bp
ITA 10-year Yield	3,00%	▲	14,8 bp

CORP BONDS	LEVEL YTW		Δ WEEK
USD Invest. Grade	4,36%	▲	0,44%
EUR Invest. Grade	2,31%	▼	-0,20%
USD High Yield	7,80%	▼	-0,69%
EUR High Yield	7,10%	▼	-0,25%
Emerging Local ccy	4,31%	▲	1,94%
Emerging Hard ccy	6,22%	▲	0,17%

BOND SPREADS	LEVEL		Δ WEEK
Itraxx Main	100,12	▲	7,7 bp
Itraxx Xover	488,066	▲	42,3 bp
Itraxx Sub Fin.	211,85	▲	15,9 bp
CDX North Am. IG	90,586	▲	5,2 bp
CDX North Am. HY	522,89	▲	38,6 bp

Source : Bloomberg, as of 2022.05.23

WEEKLY RECAP

COMMODITIES

Oil prices recorded a volatile week, however, holding above USD 110 per barrel. On Wednesday, the oil price retested the first support levels in the 106 area, due to general fears of slowing growth. **Moreover, according to market rumours, China is buying cheap oil from Russia to replenish its strategic inventories, which would offset the European sanctions and release more supply on the market, putting pressure on prices.** EIA oil inventories showed crude inventories fell by 8.4 million barrels in the week to 13 May, whereas gasoline inventories fell by 4.8 million barrels owing to good domestic demand and exports to the US.

COMMODITIES	LEVEL		Δ WEEK
Gold	1 847	▲	1,9%
Silver	21,78	▲	3,1%
WTI	110,28	▲	1,5%
Brent	112,55	▲	0,9%
Copper	428,10	▲	2,4%
Iron Ore	133,66	▲	1,0%
Baltic Dry Index	14,08	▲	0,1%

Source : Bloomberg, as of 2022.05.23

EXCHANGE RATES

During the week, equity markets went under a considerable stress, related with the growing fear of a pronounced global slowdown. The war in Ukraine, the Lockdown in China and the worst than expected sales by retailers in US were among the factors inducing investor in defensive mode.

The USD tends to return good performance during period of market stress, but not in this situation. The Federal Reserve continued to point at inflation as its main worry and, consequently, the US curve flattened. However, there wasn't an increase in the expected terminal rate, but rather a return to the previous maximum level, just a tad above 3%, expected during the first quarter of 2023.

The euro gained against the USD, as the majority of ECB governors seemed to agree on a possible hike in July, and it will not be an isolated move but rather the beginning of a cycle. The repricing of the Eur front end supported the common currency that climbed back above 1.05 toward the end of the week. Also, the Yen and the swiss franc posted gains against the greenback: the reason behind these moves is probably a stretched positioning by investors that stacked short positions in the recent past.

EXCHANGE RATES	LEVEL		Δ WEEK
Dollar Index	103,15	▼	-1,4%
EUR/USD	1,0564	▲	1,5%
GBP/USD	1,2480	▲	1,8%
EUR/GBP	0,8456	▼	-0,4%
EUR/CHF	1,0295	▼	-1,3%
USD/JPY	127,88	▼	-1,0%
Bitcoin/USD	29 117	▼	-2,2%

Source : Bloomberg, as of 2022.05.23

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