# Market Watch

## When it rains, it pours

### Summary

- Credit Suisse shares and bond prices plummeted on the back of rising concerns over its future, dragging European banks and broader equities and the EUR sharply lower.
- The Swiss National Bank offered a liquidity backstop for Credit Suisse (similar to the Fed's backstop for US banks). Central banks and regulators clearly have an incentive to get ahead of this, but they are fighting fires at the moment.
- The Fed, ECB face a difficult balancing act as consumer inflation stays elevated. They are likely to go with smaller rate hikes than previously anticipated and may even pause hiking cycle until banking worries blow over. Weak US producer price and retail sales offer glimmer of hope.
- Elevated financial stresses merely reinforce our view that we are in the late stage of the US economic cycle and a recession is on its way. We continue to look for opportunities to add to income assets to secure yields, while retaining an underweight allocation to DM equities.

### When it rains, it pours

What a week! At the end of last week, two US regional banks were effectively shuttered, which led to the Fed putting in place measures to limit the potential contagion, primarily by guaranteeing all deposits and offering liquidity to banks on favourable terms to weather any short-term funding issues.

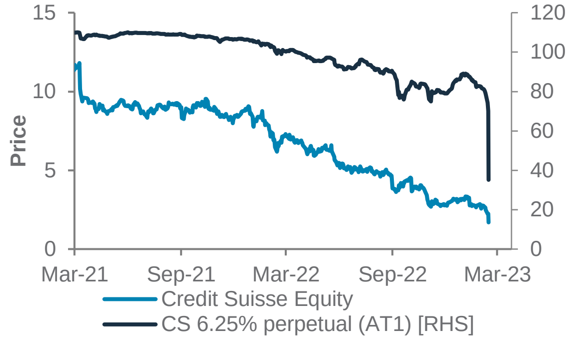
Just when it looked like things might be coming under control, yesterday saw a sharp decline in the value of Credit Suisse's stock and bond prices after it told investors it found "material weakness" in its financial reporting.

This begs the question, what next? Clearly the most immediate issue is the regulatory response and investor confidence. Credit Suisse said it will borrow up to CHF 50bn from the Swiss National Bank to boost liquidity, which should help sentiment.

Thereafter, markets will be on edge regarding what, if anything, will be the next shoe to drop. Unfortunately, the linkages are incredibly difficult to predict and therefore, while the authorities have every incentive to get in front of these threats to financial stability, the reality is more likely to be that they remain in reactive mode in the short term, leading to market volatility.

**Credit Suisse securities plummet**

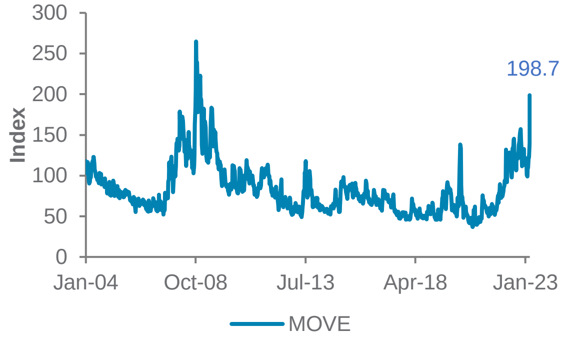
Credit Suisse share price and bond price




Source: Bloomberg, Standard Chartered

**Interest rate uncertainty at its highest since the Global Financial Crisis**

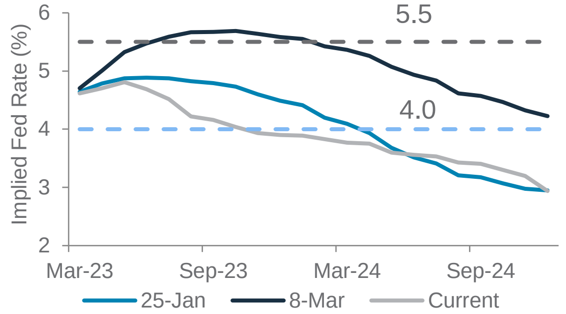
US government bond volatility index (MOVE)




Source: Bloomberg, Standard Chartered

**The market is now expecting Fed rate cuts by the middle of this year**

Market implied Fed rate expectations




Source: Bloomberg, Standard Chartered

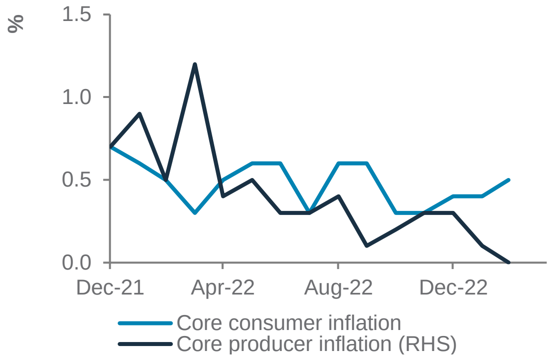
## Who wants to be a central banker?

Central banks face a dilemma. Even after a year of rapid rate hikes, growth and inflation in the US and Europe have been more resilient than expected, with US job creation and consumer inflation for February beating expectations. As a result, even until last week, central banks were focussed on subduing inflation, rather than worrying about the impact of rising rates on growth.

The two US bank failures late last week and the crisis at Credit Suisse this week have turned the focus back to financial stability. Hence, we now expect the ECB to hike by only 25bps tonight, instead of a 50bps signalled by ECB President Lagarde as recently as last week. We also see a 60% probability of a 25bps Fed rate hike on 22 March, and a 25% chance the Fed pauses. This compares with market expectations of a 50bps Fed rate hike just last week, after Chair Powell's testimony to the US Congress. Post-meeting guidance from Lagarde and Powell will be watched to assess the extent to which financial stability issues will influence the policy stance going forward.

**Elevated consumer inflation still warrants tight monetary policy, although slowing producer price inflation points to a cooling of prices ahead**

US core consumer and producer price inflation, m/m




Source: Bloomberg, Standard Chartered

## Asset class implications – Add to income

The events of the past week have likely brought forward the timing of recessions both in the US and Europe. As such, they confirm our SAFE investment strategy for 2023:

1. US and European government bonds have both delivered as safe-haven assets over the past week, significantly outperforming equities, as yields plummeted. The US government bond market volatility index (MOVE) has soared to its highest level since the 2008 Global Financial Crisis. High-quality bonds remain our preferred asset as a source of income and a short-term volatility hedge. Bond yields are likely to rebound if central bank efforts to support bank liquidity alleviate investor concerns. We would add exposure to high quality bonds and a broader basket of income assets on any rebound in yields.
2. We would continue to rebalance out of Developed Market Equities into Asia ex-Japan as we see further downgrade of earnings estimates. European financial sector equities could face some pressure in the short term given recent jitters. However, the elevated volatility gives opportunities for investors to gain exposure via structures.
3. The USD is likely to see further near-term upside as the banking woes spreads to Europe. The USD index is testing a key resistance around 104.7; the next support levels for EUR/USD are at 1.0560 and 1.0515.

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