Monthly Market Views

International Private Banking Division

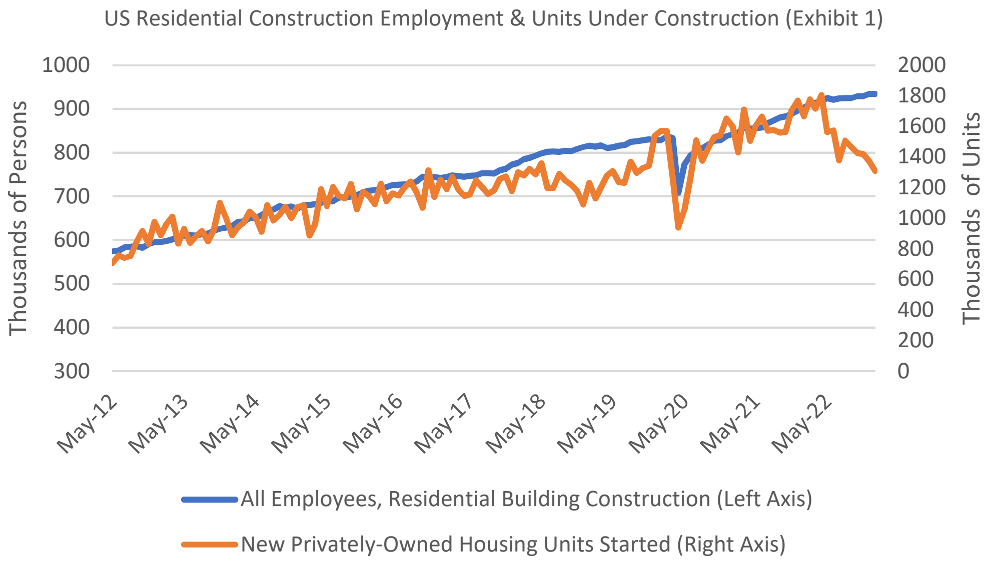
MARCH 2023

In today's increasingly uncertain economic environment, it's important for investors to remain focused on the big picture, and think long-term.

Fixed Income markets have been oscillating at a frantic pace, shifting from pricing in concerns of lingering inflation, to concerns of a forthcoming recession, and back again. This heightened level of uncertainty around a fundamental directional view of economic activity is understandable, given the recent incongruity of economic data points. Over the last few decades, underlying economic data has generally improved in relevancy and reliability. Since the start of the Covid-19 pandemic however, the level of past data revision and decoupling has made relying on previously reliable data-points more difficult. Given this heightened level of uncertainty, how should investors interpret data in this environment?

Several examples of the data incongruity investors are witnessing can be found in the housing sector. Since the US Federal Reserve began raising the Fed Funds rate in early 2022, interest rates on longer-maturity Treasuries and mortgage rates has been ticking up. 30-Year mortgage rates in the US have gone from 3.1% on December 30 2021 to 6.7% on March 3 2023. This has had the result in decreasing buyer demand as well as the level of new home construction (Exhibit 1 – Orange Line[1]).

The housing market has traditionally been one of the primary transmission mechanisms for US Federal Reserve policy. By raising interest rates, the level of construction slows, leading to an increase in unemployment in both the construction sector and ancillary sectors (e.g. furniture, appliance, building material production & sales).

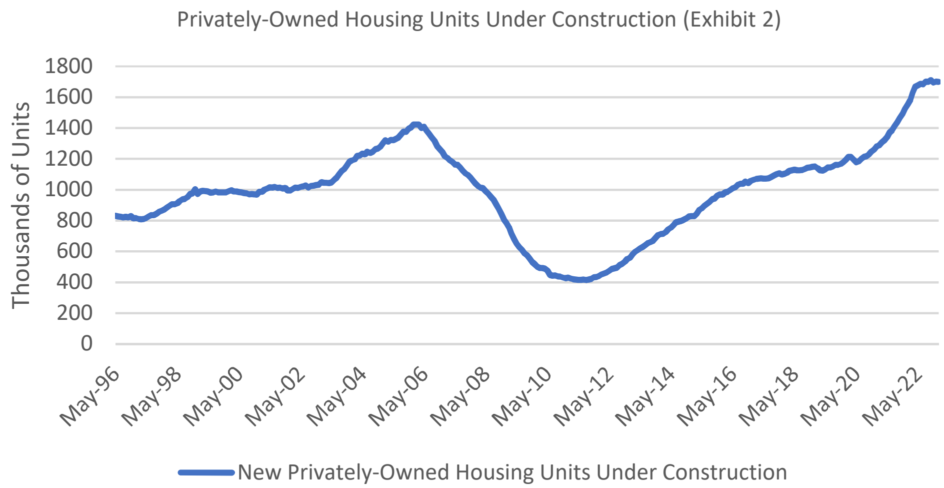


Because of this relationship, the level of new home starts has historically been closely tied to the employment in the residential construction sector (Exhibit 1 – Blue Line). In the current environment however, while the level of new home starts has declined from 1.8 Million in April 2022 to 1.3 Million in January 2023 (a decline of ~28%), employment in the sector has INCREASED from 918,300 in April 2022 to 934,100 in January 2023 (an increase of 2%).

[1] U.S. Census Bureau and U.S. Department of Housing and Urban Development, New Privately-Owned Housing Units Started: Total Units [HOUST], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/HOUST, March 6, 2023.

U.S. Bureau of Labor Statistics, All Employees, Residential Building Construction [CES2023610001], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CES2023610001, March 6, 2023.

The cause of this anomaly appears to be the level of residential housing units currently under construction (Exhibit 2[2]). Due to a number of factors, ranging from significant housing demand starting in early 2020, to supply chain delays in goods and materials, to insufficient workers; home construction times increased significantly over the past three years. This increase in construction times has led to completion delays, resulting in a record number of homes under construction; Going from 1.2 Million in January 2020 to 1.7 Million in January 2023.

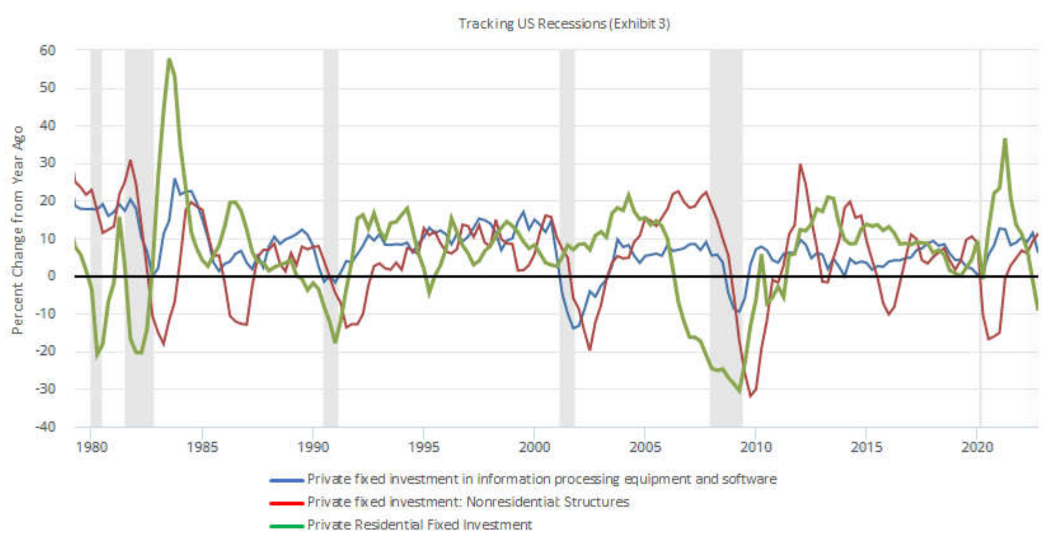


This backlog of unit completions appears to be adding to the continued employment demand in the construction sector. The big unknown is how residential employment will change as a large share of these units are completed in 2023, especially if new construction continues to remain depressed.

Factors such as these make it difficult for investors to ascertain the path of economic activity. With the additional complication of discerning the rate path that the US Federal Reserve will follow, as they digest similarly complex data. We would therefore advise investors to keep their eye on the big picture.

In the case of forecasting US economic slowdowns, Exhibit3[3] below characterizes a likely path based on a sequential slowdown of three major economic components of Gross Domestic Product (GDP). 1) A slowdown in Residential investment (Green) 2) Followed by a slowdown in Equipment/software investment (Blue) 3) Followed by a slowdown in Non-residential investment (Red).

As we can see from Exhibit 3, residential investment (Green) has turned negative; without the traditionally accompanying decline in employment, as illustrated in Exhibit 1. Looking ahead, two key data points to follow are residential construction sector employment; and the path of point #2 above, Equipment/Service investment (Blue).



[2] Freddie Mac, 30-Year Fixed Rate Mortgage Average in the United States [MORTGAGE30US], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/MORTGAGE30US, March 6, 2023.

[3] U.S. Bureau of Economic Analysis, Gross Domestic Product [GDP], retrieved from FRED, Federal Reserve Bank of St. Louis (https://fred.stlouisfed.org/graph/?g=XdYD)

Economic Overview

	GDP Forecast (2023)	GDP Forecast (2024)	Inflation Forecast (2023)	Inflation Forecast (2024)	Currency vs. USD	IG Credit Downgrade
Argentina	0.0%	1%	95%	71%	-10.5%	N/A
Brazil	0.8%	2%	5%	4%	1.5%	N/A
Chile	-1.0%	2%	8%	4%	4.7%	Low
Mexico	1.3%	2%	6%	4%	7.6%	Medium
Peru	2.1%	3%	6%	3%	0.6%	Low
Uruguay	2.4%	3%	7%	6%	1.7%	High
Israel	2.9%	4%	4%	3%	-4.2%	Very Low
USA	0.7%	1%	4%	3%	1.4%	Very Low

Data Source: Bloomberg Terminal, as of March 3, 2023

COVID-19 Overview

	Vaccine Doses / Population	Total Cases	Total Cases/ Population	Last 30 Day Growth Rate
Argentina	230%	10,044,125	21.10%	0%
Brazil	221%	37,063,464	17.12%	0%
Chile	311%	5,169,139	25.85%	1%
Mexico	159%	7,459,860	5.67%	1%
Peru	247%	4,486,282	13.19%	0%
Uruguay	244%	1,034,303	28.91%	0%
Israel	212%	4,799,631	55.81%	0%
USA	187%	103,510,435	31.56%	0%

Data Source: Bloomberg Terminal, as of March 3, 2023

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