

Weekly Macro and Markets View

24 June 2024



Highlights and View

UK headline inflation falls back to the BoE's target of 2%

While the recent trend is reassuring, core and particularly service inflation remain too high.

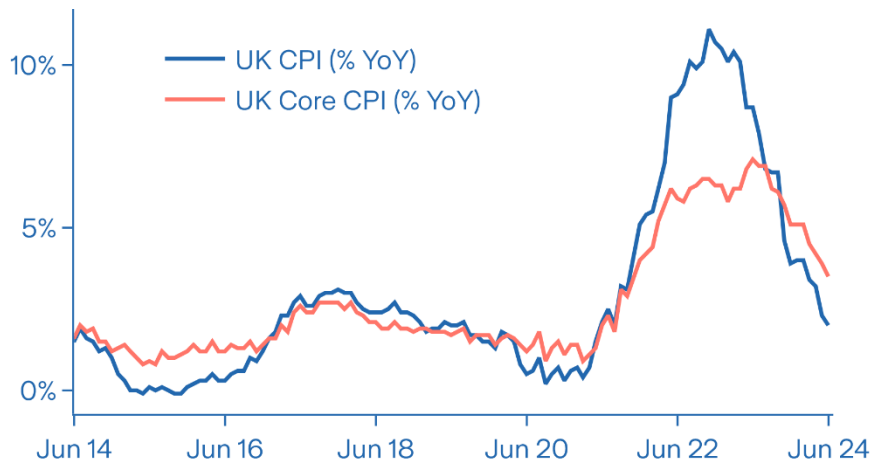
The Swiss National Bank delivers a second rate cut while lowering the inflation forecast, with inflation now seen at 1% in 2026

The strong franc and a broadening out of disinflationary pressures motivated further policy loosening, and the SNB has left the door open for further easing.

US services activity is holding up while growth in manufacturing remains modest

While most of the economic data were on the softer side, the Composite PMI stood at 54.6 in June, indicating solid growth.

UK headline inflation falls back to 2%



Source: Bloomberg

In May, UK headline inflation fell back to the Bank of England's target of 2% for the first time since July 2021, a long way down from its peak of more than 11% in October 2022. While the fading price pressure is a promising sign, the BoE's fight against inflation is not over yet. Core inflation also fell substantially to 3.5% YoY from 3.9% the month before but remains elevated. This is even more the case for service inflation, which was still at 5.7% YoY, down from 5.9%. The BoE decided to keep rates unchanged at its meeting last week, although two members again voted for a rate cut, but the statement indicates that the Monetary Policy Committee is open to cutting rates at its next meeting in August should the incoming data confirm the recent trends. Meanwhile, growth is expected to moderate in the second quarter as underlined by the latest set of PMI data, with the Composite PMI receding from 53.0 in May to 51.7 in June. Both manufacturing and services activity expanded only modestly in June according to the surveys. Consumer sentiment continues to improve, however, rising in June to the highest level since November 2021. Gilt yields remained range-bound last week. The stock market benefitted from a decent economic outlook and the prospect of rate cuts in Q3 with small caps outperforming their larger peers in the FTSE 100.

Switzerland

A dovish SNB cuts rates again

The SNB cut interest rates again last week, in line with our expectations but not priced in by the market. The strengthening of the franc on French political turmoil is likely to have been a key factor driving the decision. In addition, while inflation has rebounded in Q2 on higher rents and energy prices, underlying inflation pressures have softened, with a sharp decline in wage growth in Q1 and deflationary producer prices. The manufacturing sector is also weak, with rising unemployment in some sectors, and the SNB also highlighted some vulnerabilities in

the real estate sector. The outlook was dovish, with a lower inflation forecast for 2025 and 2026, and the SNB reiterated that it remains willing to be active in the foreign exchange market as necessary. We continue to expect one further rate cut in 2024, likely towards the end of the year. The rate decision triggered a sharp decline in the 10yr yield, which is now trading at 0.6%, and a moderate weakening of the franc.

Eurozone

Good while it lasted

Economic and market optimism has been consistently rising this year, but a harsher reality is beginning to hit. While the situation in France has once again brought inherent tensions in the Union's construct to the fore, a more specific economic concern was the snap lower in Eurozone PMIs last week. The overall Eurozone composite number unexpectedly fell to 50.8, whereas the market had expected a further increase from last month's 52.2. The composites within Germany and France fell too, with France already below the crucial 50 line last month

and now printing at 48.8. An already weak manufacturing sector is driving overall confidence lower. Despite a small improvement in recent months, Germany's Manufacturing PMI fell to 43.4, while actual Industrial Production measures contracted YoY. Services remain somewhat more buoyant, but are showing signs of fatigue. While Q3 will bring a tourism boost, data are seasonally adjusted against a backdrop of previously strong summers. We maintain our view of positive but below-trend growth for the Eurozone overall this year.

Japan

A mixed bag of data

Japan's Manufacturing PMI fell slightly to 50.1 in June, driven by the weaker new order component, while the output subindex contributed positively. However, the Services PMI tumbled four points to 49.8, which does not match with the positive June Reuters Tankan for the non-manufacturing sector. The latter was driven by a boost in the real estate/construction subindex as well as the hotel/restaurant services component, which was supported by booming foreign inbound tourism. May export growth remained brisk, driven by higher prices, though export

volume contracted both on a MoM as well as on a YoY basis. Export volume was particularly weak to Europe and China, but improved towards the US, and was particularly strong for semiconductor production equipment. We prefer not to dig deeper into the May inflation data due to the big variety of CPI statistics in Japan, but do want to highlight that tariffs for renewable energy have been hiked significantly.

LatAm

The central banks of Brazil and Chile continue to moderate

In Brazil, the Central Bank of Brazil made a unanimous decision to maintain the Selic rate at 10.5%, aligning with market expectations. This pause follows seven consecutive cuts totalling 325bps since August 2023. The BCB hinted that it intends to keep the Selic rate at the same level beyond what the market previously anticipated, maintaining a restrictive stance to control inflation. Additionally, inflation projections were revised up from 3.8% to 4.0% for 2024 and from 3.3% to 3.4% for 2025. The Central Bank of Chile saw four out

of five Council members vote for a 25bps cut in the monetary policy rate, resulting in a reference rate of 5.75%. This move aligns with market expectations and our previous projections. The Council emphasised greater moderation in their statement, indicating that most of the cuts for this year have already been implemented. Future decisions will depend on "...the evolution of the macroeconomic scenario and its implications..." for the inflation trajectory. Consequently, the margin for larger cuts appears to have narrowed.

Credit

Softness continues amid lacklustre issuance

Credit spreads tightened somewhat last week but are still set to end June wider. The announcement of snap elections in France has been a catalyst for volatility. The rally in US Treasuries, which led to lower yields, also likely contributed to the weakness in US credit by denting the appetite of yield-hungry investors, especially in IG. Heavier than expected issuance earlier in June likely played a role as well. Last week sentiment continued to be mixed. US IG issuance was below expectations despite a strong start to the week, and European IG issuance was the

lowest of the year according to Bloomberg data. Credit fund flows were also mixed. In the US, there were outflows out of IG and small inflows into HY while in Europe, there were healthy inflows into IG and only modest inflows into HY. While French corporate bonds continued to underperform, non-French issuers have also come under pressure. While the repricing in risk premium has been sizable and abrupt, and could partially reverse, investors have been reminded that tight spreads indeed provide poor risk-reward.

What to Watch

- In the US, consumer confidence and personal spending data will give important insights into the current state of households.
- This week will see sentiment data in Germany, Italy and the Eurozone overall. The first round of the French election will be held on Sunday, June 30. Polls show RN winning the most seats, but falling short of a majority.
- Japan will report May data for industrial production, retail sales, and the labour market as well as the Tokyo CPI for June. June PMIs and May data for industrial profits will be released in China. We will also keep an eye on May data for Hong Kong exports and industrial production in South Korea, Taiwan, Singapore, and Thailand. May CPI data will be released in Singapore and Malaysia. We expect the Philippine BSP to keep policy rates unchanged for now.
- Banxico is expected to maintain the reference rate at 11.0%. This decision comes amid volatility surrounding constitutional reforms and the Federal Reserve's commitment to keeping interest rates elevated longer than expected.

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