Weekly Macro and Markets View

22 July 2024

Highlights and View

Giving in to rising pressure, Joe Biden withdraws from the 2024 presidential race.

Financial markets have so far shown a muted reaction as Biden's decision was not unexpected and Donald Trump still has a substantial lead in polls and prediction markets.

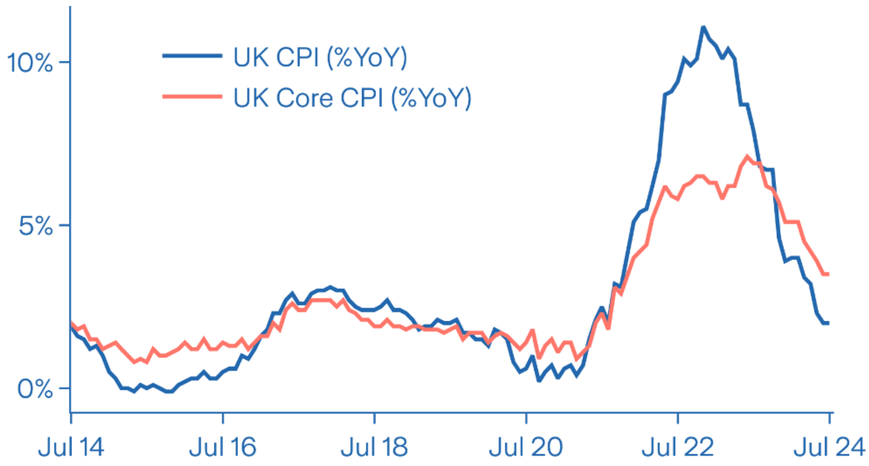
The ECB kept policy rates unchanged at their meeting last week, in line with market expectations, as they remain in a gradual policy easing cycle.

We think the ECB are in a new phase, where the path of policy is clearly lower and discussions are around when and how much to cut by. We continue to see easing in September and December.

China's Third Plenum policy targets were very general in nature, focusing on 'high quality development'

The Plenum was followed by today's policy rate cut by the PBoC, which was taken positively by H-share investors

UK inflation remains at the BoE's target of 2% in June



Source: Bloomberg

The monthly pick-up in UK consumer prices slowed to 0.1% MoM in June from 0.3% the month before. This left the annual headline inflation rate at the Bank of England's target of 2%. Core inflation was 3.5% YoY, the same as in May. While the latest batch of inflation numbers keeps the door open for a rate cut in August, it remains a close call as service inflation in particular remains stubbornly high at 5.7% YoY. Both dovish and more hawkish members of the MPC will find arguments to keep their stance for now. Meanwhile, wage growth (excluding bonuses) has slowed in line with expectations in May to 5.7% YoY from 6.0% YoY. The unemployment rate remained at 4.4%, the same level as the month before. The combination of stable inflation and unemployment helped to lift consumer sentiment to the highest level since September 2021. Despite the slightly better mood, retail sales slowed more than expected in June following the significant jump in May. Gilt yields were basically unchanged over the course of the week given the lack of major economic surprises. The FTSE 100 was dragged down by the sentiment shift in global equity markets but outperformed many of its peers, losing 1.7%. As in other regions, smaller capitalized stocks generally fared better than their larger peers.

US

Joe Biden withdraws from the 2024 presidential race

Giving in to rising pressure that had built up in recent weeks, Joe Biden over the weekend announced his decision to withdraw from the 2024 presidential race, endorsing Kamala Harris. Financial markets have shown a muted reaction so far as Biden's announcement came not fully unexpected and Donald Trump still has a significant lead in polls and prediction markets. Irrespective of Biden's decision, stock markets have been under pressure last week with the S&P 500 losing 2%, suffering its worst week since April. The setback hides even more severe rotations under the surface. The Nasdaq was down by 3.7% with the Magnificent 7 being a significant drag while the Russell 2000 gained 1.7%. Economic data published last week were mixed. Retail sales and industrial production were better than expected in June, pointing at a modest growth reacceleration at the end of the quarter. Meanwhile, both initial and continuing jobless claims keep rising, underlining the weakening employment situation.

Eurozone

And suddenly, nothing happened

The ECB held rates at 3.75% last week, as they had widely signalled beforehand. This was in many ways a straightforward decision. The ECB cut in June, and have emphasised a conservative approach to easing, dependent on the data. The most recent inflation and wage data warrant a pause, as although the trends in both remain down the pace of the fall is not quite as fast as the ECB had hoped. ECB President, Christine Lagarde, tackled this in the press conference by emphasising that current elevated wage figures were already incorporated into their thinking. Moreover, the tone has shifted more negative on the growth outlook. Recent economic activity data has slowed somewhat, and the ECB have taken note. We continue to see easing in September and December, and expect a gradual pace towards 2-2.5% through 2025. The year-on-year numbers for both headline and core inflation start with a "2". Policy does not need to be as restrictive as when we were dealing with double-digit inflation in 2022.

China

The PBoC cuts lending rates following the CPC's Third Plenum

China's Third Plenum, organised by the 20th CPC Central Committee, is a meeting held once every five years where 364 full and alternate members discuss longer-term policy priorities. Expectations that short-term policy stimulus measures were to be announced had been unrealistic. Instead, 'deepening reform and advancing modernisation' was the main topic. The statement highlighted 'high-quality development' as a priority in building a modern socialist country. Most targets appear very general, such as: 'ensuring and enhancing the people's well-being'. The improvement of the social security and income distribution system as well as reforming the healthcare system were highlighted. Other core reform targets include: deepening fiscal reform including a better cooperation between central and local governments, defusing risks in the property sector, supporting the private sector and deepening reform of foreign investments. Today, the PBoC responded to disappointment by market participants by cutting the 7-day reverse repo rate by 10bp.

Brazil

Economic activity in Brazil remains strong in May, driven by a healthy labour market

In Brazil, the economic activity indicator increased 0.25% MoM in May, up from 0.26% in April, slightly below market expectations of a 0.30% increase. The expansion of economic activity occurred despite the floods that hit southern Brazil in late April and early May. In fact, the outsized retail sales print was likely bolstered by efforts to rebuild damaged property and replenish lost food inventories. At the sector level, retail drove economic activity with a 0.8% MoM increase, while services were flat and the industrial sector contracted by 0.9% MoM. Given the latest data, it is very likely that GDP figures will show a second quarter expansion, driven by a solid labour market. However, economic activity in the second half of the year is likely to be affected by higher interest rates, as Brazil's central bank has moderated its easing cycle. Additionally, inflation could be boosted by the recent depreciation of the Brazilian real.

Credit

Stability but increasing dispersion

Last week credit spreads were largely stable, despite volatility in equity markets. US High Yield (HY) closed the week 4bp tighter, while US Investment Grade (IG) was 2bp wider. In Europe, IG and HY were 1bp and 4bp wider, respectively. This resilience suggests that credit has been less impacted by the changes in positioning affecting equities, aided by its smaller exposure to tech and AI-related sectors. Sentiment as reflected by credit fund flows was also positive, both in the US and in Europe, with inflows into IG and especially HY funds, according to LSEG Lipper and EPFR. Despite the stability of index spreads, under the hood spread dispersion across ratings has increased both in IG and HY in the last several weeks. In US HY, CCC-rated bonds have continued to underperform, driving the CCC/B spread ratio to its highest historical level. Our view continues to be that index spreads remain tight, on an absolute basis as well as relative to corporate fundamentals, and offer limited risk reward in the face of growth and geopolitics uncertainty.

What to Watch

- In the US, the PMIs will give crucial insights into the current state of the US economy while investors will also focus on the latest corporate earnings reports.
- This week brings Eurozone PMIs, which will be closely watched for a continuation of the negative news in June. Similar sentiment data is available from the German ifo and the European Commission consumer confidence figures.
- India's Union Budget will be presented on Tuesday. Japan and India will release June PMIs. Tokyo's CPI for July will be a leading indicator for nationwide inflation. South Korea will publish Q2 GDP data, while Taiwan, Singapore and Thailand will report industrial production statistics for June. Hong Kong and Thailand are scheduled to report June export data. June CPI data will be reported in Singapore and Malaysia.

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