

# Weekly Macro and Markets View

3 June 2024



## Highlights and View

**Eurozone inflation rises from 2.4% YoY in April to 2.6% in May, slightly higher than the market estimated beforehand**

While a June cut remains highly likely, the inflation details give the ECB some cause for concern and will prompt a conversation about how far and fast any cutting cycle will be.

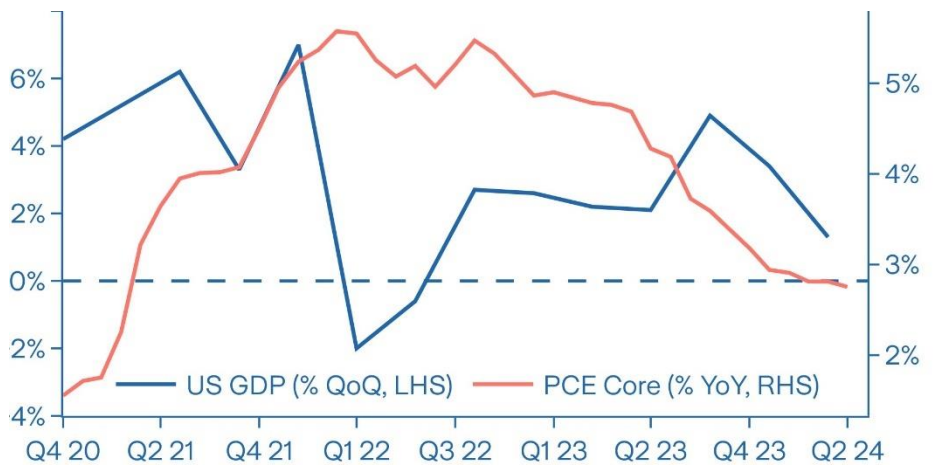
**China's PMI data present a mixed picture of the recovery in manufacturing**

The Caixin PMI, with a focus on private firms, indicates a rise in activity, while the NBS survey, which emphasises large and state-owned firms, suggests a contraction. This highlights the fragility of the economy and the need for additional stimulus.

**US High Yield supply surges in May to the highest monthly total since September 2021**

High Yield supply had been lacklustre for the past two years, and we expected a pent up surge this year to refinance looming maturities. That said, supply is likely to further cause High Yield to lag stocks.

## The US economy slows markedly in the first quarter



Source: Bloomberg

The second GDP estimate shows that growth slowed even more than initially thought in the first quarter of this year. With an annualised rate of only 1.3% QoQ the economy expanded at the weakest pace in almost two years. While trade and government spending were the main drags, consumer spending also slowed to 2% from more than 3% in the final two quarters of last year. Consumer confidence improved somewhat in May according to the Conference Board's latest survey, although households' perception of the labour market remains below the levels seen at the beginning of the year and purchase plans for larger items have not changed a lot. Expenditure data published by the Bureau of Economic Analysis reveal that consumer spending slowed to a modest 0.2% MoM in April meaning that real spending actually fell once inflation is taken into account, underlining the persistent headwinds to growth. Weaker household spending helped to put a lid on price pressure with PCE Core inflation slowing to 0.2% MoM, pushing the annualised rate closer to the Fed's inflation target, although prices are still 2.8% higher than a year ago. The softer growth data helped to keep Treasury yields in check despite an initial rise after a weak auction, but modestly weighed on investor sentiment with the S&P 500 losing 0.5% over the week.

## Eurozone

Are we measuring the same thing?

Eurozone HICP inflation rose to 2.6% YoY in May, bucking the broad disinflationary trend since the end of 2022. Inflation had been expected to increase slightly, primarily due to statistical quirks. Nevertheless, the numbers were slightly hotter than the market expected, particularly in core inflation, which rose from 2.7% YoY to 2.9%. We think these numbers will lead to a vigorous debate at the ECB around the future path of rate cuts, but are unlikely to derail the first cut this week. The details paint a more nuanced picture around the inflation outlook. The HICP

measure uses a statistical harmonisation technique to equate inflation across the Eurozone, which leads to differences in weights compared to some national measures. This month German, French and Spanish inflation was actually slower than the market expected on their own national measures. An example of this is the calculation and weight of Germany's EUR 49 train ticket. French service inflation actually fell to 2.7% YoY on their own measure, much lower than the Eurozone HICP's measure of 4.1%.

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## Switzerland

GDP expands but the economy is lopsided

GDP grew by 0.3% QoQ in Q1 (adjusted for sporting events), in line with expectations. This left the level of GDP up 0.4% compared to a year ago, which is weak and well below trend, with manufacturing a drag on the economy, down 4% YoY. Growth is lopsided, with resilient private consumption while other components of demand struggle. Equipment and software investment and goods exports are both down over 4% YoY, and construction investment also in contraction. This weakness reflects sluggish global and Eurozone demand, a strong franc

over the past year, and tight credit conditions. The latest PMI data suggest, however, that the gap is starting to narrow with the Manufacturing PMI rebounding in May, consistent with Eurozone data that showed a notable pickup in sentiment, while services weakened. Looking forward, we expect conditions to continue to improve modestly as the industrial sector recovers from prolonged weakness, helped by the sharp weakening of the franc since the beginning of the year.

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## China

PMI data suggest a fragile recovery

China's Caixin PMI and official NBS PMI, leading indicators for the manufacturing sector, showed divergence in May. While the NBS PMI fell below 50, indicating a contraction, the China Caixin PMI rose to 51.7, slightly better than consensus expectations. The Caixin PMI, which focuses on private firms, consistently remained above 50 in the past six months, while the NBS PMI exhibited volatility, indicating fragility in the recovery of large and state-owned firms. Both surveys revealed a contraction in new export orders, suggesting

weak external demand. Overall, the PMI data indicate fragility in the economy and the need for further stimulus. After a nearly 20% rally since April, the MSCI China Index experienced a healthy correction amid increased policy measures for the property sector. With attractive valuations, limited foreign investor exposure, and potential additional policy support, Chinese stocks still show upside potential.

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## Japan

10yr government bond yields reach the highest level since decade

Fuelled by speculation of further rate hikes by the Bank of Japan (BoJ) and reduced bond-buying, the yield on Japan's 10yr government bond has climbed above 1%, the highest level in over a decade. Market expectations are pricing in around three rate hikes for this year. The next BoJ meeting in mid-June will provide further clarity on its monetary direction. Last week, the Ministry of Finance confirmed spending around JPY 9.7tn (around USD 62bn) to stabilise the JPY in the FX market between April and May. The JPY has been weighed down in

part by policy divergence between the BoJ's ultra-loose policy and the tightening bias of most other central banks. Meanwhile, retail sales in April rose 2.4% YoY, suggesting a potential recovery after a consistent downtrend since last year. The anticipated rise in real wages from the 'Shunto' wage negotiation is expected to improve consumer sentiment and support spending. Despite weak headline industrial production, chip production showed a decent uptick in April. Tokyo CPI rose from 1.8% to 2.2% YoY in May, in line with expectations.

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## Bonds

Markets remain volatile; the S&P downgrades France

Government bond markets were volatile last week. Brisk Eurozone inflation initially pushed yields higher while the 10yr JGB yield rose further above 1%. US Treasuries outperformed, given benign core PCE inflation data and evidence of slowing growth, with the 10yr yield back below 4.5% following a rally on Friday. Real yields are elevated as inflation has moderated, and we expect this will continue to cap nominal yields to the upside. Elsewhere, we see fundamental changes in the perceived credit worthiness in Eurozone sovereign bonds.

The majority of issuers this year have seen their yields fall closer to German bunds, and support should continue given anticipated ECB easing. We see Spanish bonds likely to outperform French OATs as Spain is benefitting from impressive GDP growth, and their debt dynamics now screen better than France's. Risks remain on the political side, but investors and ratings agencies should slowly converge in their assessment of these two nations. After Friday's close S&P downgraded France to AA-, citing a worsening debt and deficit outlook.

## What to Watch

- In the US, the latest ISM surveys and labour market data will give crucial insights into the current state of the economy.
- This Thursday the ECB is widely expected to cut interest rates by 0.25%, and investors will be watching keenly for hints as to the pace of further easing. We will also receive additional details on the PMIs and Eurozone retail sales for April.
- India's election results will be announced tomorrow. China's export data, Japan's wages and Australia's GDP are the key to watch.
- In LatAm, inflation is expected to have increased 4.8% YoY in April in Mexico and 0.3% MoM and 3.5% YoY in May in Chile. It's anticipated that Chile's economic activity indicator will increase of 2.3% YoY while Brazil's Q1 GDP should expand 0.7% QoQ.

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