Weekly Macro and Markets View

17 June 2024

Highlights and View

Eurozone equity and bond markets reacted sharply to French electoral uncertainty, with the CAC40 down 9% from its recent highs

Electoral mechanisms and rapidly changing political factions complicate predictions, but a ‘cohabitation’ period is highly likely as France eschews centrist and traditional parties.

Most measures show a broad-based slowdown in US inflation

Headline, core, supercore and trimmed-mean measures slowed to the lowest levels in years, emphasising the falling price pressure.

Credit spreads widen due to French election angst while US stocks rise led by the technology sector

Credit markets are vulnerable to global downside risks due to financial sector interlinkages with tight spreads offering little risk premium, implying credit should lag more resilient US stocks.

Tectonic shifts

Source: Bloomberg

Global markets saw significant moves following Macron’s unexpected decision to call for snap legislative elections beginning on June 30. Eurozone stocks fell sharply and sovereign debt spreads rose, with France driving the weakness in both cases. The political situation is highly volatile and investors are grappling with the possibility of a fundamental shift in priorities within France and the EU. Concerns also stem from deficit-boosting pledges across both the left and right wings. The nationalist-right Rassemblement National (RN) look highly likely to return the most delegates to the National Assembly and are current polling at around 33%. On the other side of the political spectrum, four left-wing parties have announced an emergency coalition for the election and will run as the “New Popular Front (NFP)”, polling at 27%. Between these two blocs sit the embattled centrists, with Macron’s liberal coalition polling around 19%. The role of the traditional right “UDC” coalition (most recently poling at 7%) is unclear while the Republicans (LR) are experiencing an internal war. The situation is evolving rapidly, as evidenced by the incredible scenes in the LR offices where the chairman locked himself inside to prevent a vote of no confidence against him for seeking an electoral pact with the RN. The electoral system complicates predictions, but current likely scenarios are: (1) a RN minority/centrist coalition, (2) a RN majority, or (3) a NFP minority/centrist coalition. Macron has publicly stated he will not resign and will work with the new Assembly.

US

A broad-based slowdown in inflation

The latest batch of inflation data shows that price pressure keeps fading. Headline inflation was 0.0% MoM in May, which is the first time in almost two years that prices did not rise on a monthly basis and led to a slowdown of the annual rate to 3.3%. The monthly core rate was a modest 0.16%, the lowest since August 2021, pushing the annual rate down from 3.6% to 3.4%. Similarly, both supercore inflation and the Cleveland Fed’s trimmed-mean measure have been at their weakest levels in years. The slowdown in inflation, further emphasised by a significant drop in producer prices, pushed Treasury yields down to levels last seen in March. Despite the benign inflation numbers the Fed took a more hawkish stance with the latest dot plot now only projecting a single rate cut in 2024 compared to three cuts after the March meeting. That is probably too conservative given the expected moderation in consumer spending triggered by a weaker labour market. Initial jobless claims picked up to the highest since last summer.

Japan

The BoJ plans to scale down its bond-buying program, with a detailed plan to be unveiled in July

In its meeting last week, the Bank of Japan (BoJ) decided to maintain its policy rate within the range of 0.0-0.1%, aligning with market expectations. The BoJ also signalled its plans to scale down its bond purchase program, with a detailed schedule to be announced at the next meeting. Following the BoJ's meeting, yields for Japan's 10yr government bond (JGB) traded notably lower, while the yen weakened slightly. Meanwhile, PPI came in stronger than expected, rising from 0.9% YoY to 2.4%, partly driven by a 6.9% YoY increase in the cost of imported materials amid a weak yen. Machine tool orders rose meaningfully in May, turning positive for the first time since December 2022, indicating a recovery in the manufacturing sector. Sentiment remains fragile, however, as evidenced by a weaker Eco Watchers Survey and a still slightly negative Business Outlook Survey (BSI).

China

Weakness endures

Economic data for May indicate ongoing weak aggregate demand in the economy. Industrial production and fixed asset investments were disappointing. The property sector remains troubled, with home prices continuing to fall. The only bright spot was retail sales, which rose 3.7% YoY and surpassed expectations thanks to government measures encouraging household spending. Total social financing showed a slight rebound from record lows, driven primarily by government bond issuance, while household and corporate lending stayed subdued. CPI for May came in at 0.3% YoY, falling short of expectations, with core CPI at a tepid 0.6%. Input prices remained negative at -1.4% YoY. The People's Bank of China (PBoC) maintained its medium-term lending facility rate at 2.5%, aligning with market expectations. The upcoming third plenum meeting will be crucial as top policymakers convene to discuss economic reforms and development strategies, with hopes pinned on the announcement of further stimulus measures.

Bonds

Government bond yields slump on political turmoil and soft US inflation data

Government bonds rallied last week as US inflation data were softer than anticipated, with moves amplified by a search for safety amid unsettling developments around the French elections. The relatively hawkish signalling of the Fed, with only one rate cut projected this year in the updated dot plot, was ignored by investors, with market pricing now implying close to two cuts in 2024. US debt auctions were also met with robust demand, leaving the 10yr at 4.22% at the end of the week, down from 4.5% at the end of May. Bund yields slumped by 26bps to 2.36% as investors priced in more ECB rate cuts and as concerns around the French election triggered sharp repricing within the Eurozone, with spreads between French OATs and Bunds widening by close to 30bps for the 10yr and wider spreads for Spain and Italy. Looking forward, we see the US inflation print as genuine good news, confirming our view that falling inflation will cap yields, while politics will remain in investor focus near term, likely driving further volatility.

Credit

Spreads rise despite calm in US stocks

Credit spreads rose last week across the US and Europe as the call for snap elections in France reignited fears around Eurozone risks. European credit was hit hard, with the spreads of the Bloomberg Euro Financial and High Yield indices widening by 17bps and 47bps respectively. French banks suffered the brunt of the selloff. The stock of national champions Société Générale and BNP Paribas were down by over 16% and 13% respectively while the spreads of their bonds widened notably. US credit markets reacted less strongly but were still impacted by the weakness seen in Europe. This was in contrast to the price action seen in US stocks, with the S&P 500 and Nasdaq indices up by nearly 1.6% and 3.5% respectively despite a 4% drop in the MSCI Euro index. Favourable sentiment around the US technology sector continued after strong earnings reports, a lift in sentiment from lower-than-expected inflation prints, and a fall in Treasury yields. Last week showed again that credit remains vulnerable and susceptible to downside risks at current spread levels.

What to Watch

- In the UK, inflation is expected to have slowed further while retail sales and consumer confidence will provide important insights into the current state of households.
- The market will continue to follow electioneering in France closely. We will receive a variety of economic confidence surveys, including the German ZEW and broader PMIs later in the week. Eurogroup finance ministers will meet on Thursday.
- In a finely balanced decision, the SNB is expected to maintain a dovish outlook and potentially also cut rates.
- The Reserve Bank of Australia and Bank Indonesia are likely to maintain their current policy rates. Several countries will release export data, including Korea's 20-day exports for June and Taiwan's export orders and trade data across ASEAN for May. India's PMIs are expected to remain strong, while Japan will publish its CPI data for May.

Disclaimer and cautionary statement

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