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Weekly Macro and Markets View

8 July 2024

Highlights and View

Both the ISM Manufacturing and Services surveys show a contraction in activity and employment

So far, investors have focused on the positive effect of weaker growth, but a further deterioration of the employment situation could weigh on consumer spending and corporate earnings.

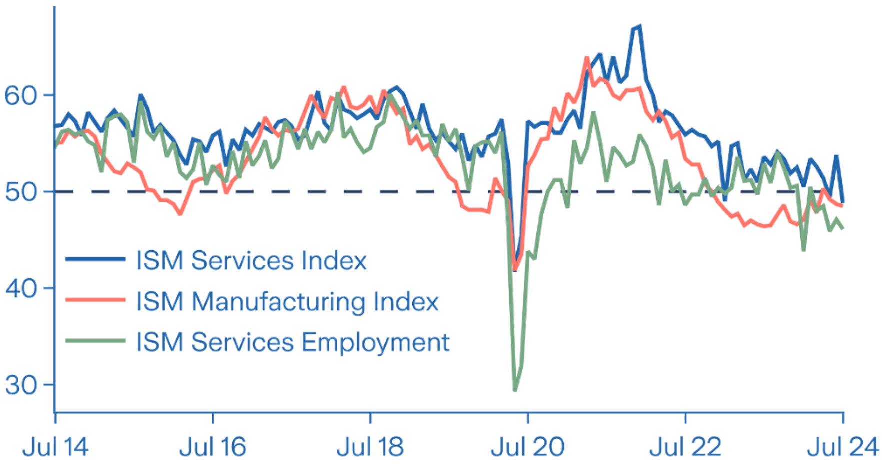
As was widely expected, Labour won a large majority in the UK general election

Labour's manifesto was relatively vague on concrete measures, but limited fiscal leeway will be a drag for many policy initiatives.

The French election resulted in an extremely divided Assembly, with the second-round pact between left and centrists unexpectedly seeing the National Rally drop into third place.

Uncertainty reigns as coalition building looks difficult, and the Macron government is in a weaker position than before the snap election.

US services activity is slowing



Source: Bloomberg

Last week brought more evidence that the US economy shifted down a gear in the first half of 2024. Manufacturing activity continually contracted in 19 of the last 20 months, with both new orders and employment still under pressure. More importantly, the services sector has also dipped back into contraction following last month's rebound. At 48.8, the ISM Services index stands at the lowest level since the depths of the Covid downturn with new orders pointing at further weakness. Services employment has contracted for five months in a row at an accelerating pace. The softer employment situation is slowly but steadily becoming more visible in other labour market data as well. While the number of new nonfarm payrolls slowed only a bit in June from a significantly revised down number the month before, the unemployment rate ticked up to 4.1%, the highest since November 2021. Similarly, while initial jobless claims have risen only modestly over the past few weeks, continuing claims have picked up to the highest in years, indicating that the risk of losing a job remains low, but the ability to quickly find a new position after a job loss has become increasingly difficult. So far, investors are focusing on the positive effects of slower growth as price pressure fades and bond yields fall, lifting the S&P 500 to another record high last week.

Eurozone

France divided

After riding high in polls, and in confidence, the National Rally's outlook was steadily downgraded by pollsters last week as electoral pacts offered voters a stark choice of hard-right vs. anyone else. They won 143 seats, far short of the 289 required for a majority, and behind the NFP left-alliance on 182 and Macron's centrists on 163. It's tough to say that Macron's gamble paid off as he lost 82 seats and his parliamentary party broadly refused to mention him during the campaign. Coalition building looks difficult, although various options exist. Among them are a left-centrist alliance, a broader centrist coalition excluding Mélenchon's LFI, a technocratic government, or a simple deadlock. Such uncertainty can weigh on markets, particularly in relation to France's worrying deficit and debt outlook. However, larger structural concerns about the RN's euroscepticism and a diminished voice for France in the EU are no longer a concern. Equity markets can still thrive in an environment of political stasis, and we see grounds for the CAC 40 to claw its way back from recent underperformance.

Switzerland

Soft inflation and activity data justifies the SNB's dovish outlook

CPI inflation was weaker than expected in June, with prices unchanged vs. May and the annual rate ticking down to 1.3%. Excluding housing rentals, which have risen as a reflection of past increases in the regulated reference rate for rents, inflation is tracking at a modest 0.9% YoY. Weakness continues to be driven by deflationary goods, for which the annual rate slumped 40bps to -0.2% YoY in June, while services prices are still rising at above 2% YoY. The divergence mirrors the real economy and, although a recovery is underway in the manufacturing sector, conditions remain fragile, with excess capacity still in place and external demand remaining sluggish. This was confirmed by the Manufacturing PMI, which suffered a setback in June and remains in a deep contraction zone, while the Services PMI rebounded. With softer inflation and persistent weakness in the manufacturing sector, the data justifies the SNB's rate cut and dovish outlook in the June decision, and we maintain our view of further policy loosening ahead.

North Asia

Encouraging economic statistics in Japan and South Korea

Japan's May wage statistics released today can be interpreted in two ways: Real cash earnings have deteriorated further to -1.4% YoY, which is likely to keep dampening consumer sentiment. However, nominal wages were up 1.9% YoY vs. a downward revised 1.6% in April. We prefer to look at the 'same sample' statistics, which reveal a rise of 2.3% YoY, up from a prior reading of 1.8%. Press reports refer to a study by the Bank of Japan, which is expected to be released soon, showing that 'shunto' wage hikes are now spreading to smaller firms, which make up the bulk of Japan's labour force. Meanwhile, the June Eco Watchers survey reveals an improvement of 1.3 points to 47.9 in its outlook component. Inbound spending by foreign tourists increased by 41% in May compared to pre-Covid levels. In South Korea, exports remained brisk in June, rising 12.4% YoY on a working day adjusted comparison, driven by strong DRAM exports.

Asian June PMIs

Export driven economies keep doing well

A drop in the Services PMI below 50 in both Japan and China indicates vulnerabilities in Asia's two biggest economies, although both Manufacturing PMIs remain resilient. India continues to be the star performer with a Manufacturing PMI of 58.3, while its Services PMI hovers above 60. Across ASEAN, Headline Manufacturing PMIs remain in expansionary territory, except for Malaysia, which experienced a small blip. Vietnam saw its readings spike from 50.3 to 54.7, in part driven by a notable rise in new export orders, while Thailand also recovered further in June. Overall, despite the month-to-month volatility, the narrative of a gradual recovery in trade and manufacturing in the region remains intact, with the tech sector continuing to lead the way, particularly in major tech export driven countries like Taiwan and Korea. A concern that needs to be watched is the steep drop in Thailand's New Export Order PMI from 44.8 to 33.

Equities

Another week and more records for stocks

Investors in US equities had reason to celebrate in the holiday shortened week of the Fourth of July. The Nasdaq posted a quick 3.5% gain during the four-day week as the index climbed to new records, and is now up almost 80% in the past year-and-a-half. The S&P 500 was no slouch either, hitting its own record in a 2% gain on the week, helped by declining Treasury yields. The slower, but still decent economic trajectory has increased the odds of our September Fed rate cut view and stoked investor sentiment. We continue to see gains ahead as the momentum-driven rally seems set to last a while longer. However, we suspect that a pull-back is nearing, though we see this as another pause that refreshes the bull market. Elsewhere, there was also good news in Japan, where the Topix index also managed a new record, finally breaching 1989 levels. Here, too, we see further upside after trending sideways over the spring, though we still prefer US stocks for the time being. Europe again lagged, though the French election outcome may create opportunities.

What to Watch

- In the US, investors will focus on the latest batch of inflation data and the beginning of the earnings reporting season.
- We expect central banks in South Korea and Malaysia to keep policy rates on hold. Japan will release data for May machinery and June machine tool orders as well as June PPI and M2. China will release June inflation, foreign trade, money supply and lending data. Our focus in Australia will be on business and consumer confidence surveys. India will publish June CPI and May industrial production data, while Singapore will report Q2 GDP data.
- Inflation data will be released in Latin America, where a temporary slowdown in inflation of -0.1% MoM is expected in Chile, resulting in 4.3% YoY. June CPI inflation for Brazil is expected to be 0.31% MoM and 3.93% YoY. In Mexico an increase of 0.31% MoM and 4.86% YoY is expected.

Disclaimer and cautionary statement

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