Weekly Macro and Markets View

15 July 2024

Highlights and View

US inflation readings post lowest gains in years

CPI inflation surprises positively at both the headline and core levels, increasing the odds of a Fed rate cut in September.

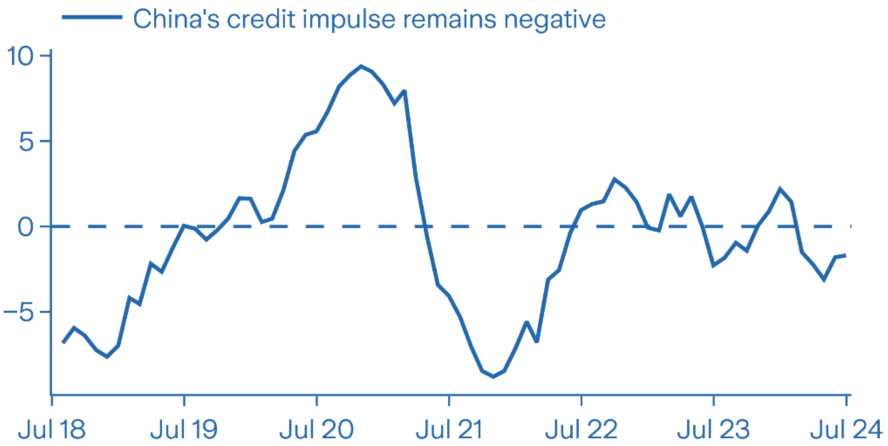
A second round of apparent Bank of Japan intervention strengthens the yen from its 38-year high of around 161.80 to 157.40

The estimated volume of USD 22bn was lower than that during the previous intervention in late April, but was enough to push the rate back to its 55-day moving average.

China's economic data for June and Q2 continue to disappoint, with exports remaining the bright spot, while domestic demand struggles

The focus will be on reform measures during the Third Plenum and stimulus measures during the Politburo meeting later this month.

China's domestic economy continues to suffer



Source: Bloomberg

China's latest economic data continue to paint a mixed picture. Q2 GDP growth came in weaker than consensus had expected, falling from a prior 5.3% to 4.7% YoY. Diverging trends continue to be visible with export growth remaining solid. As EV exports to Europe make up less than 1% of China's overall exports, we do not expect a major negative impact from higher EU tariffs. Booming exports have a positive impact on industrial production, which was up 5.3% in June and 6% in H1. On the flipside, domestic demand remains soft. June retail sales were far weaker than consensus expectations, up only 2% in June or 3.7% in H1 given the soft '618 online shopping campaign' and disappointing Dragon Boat Festival tourist turnover. The property sector remains the Achilles heel of China's economy, with June home sales, home prices and property investment caught in a downward spiral, though we see demand for secondary homes starting to pick up somewhat. Finally, China's credit impulse remains negative, with weak credit demand from both household and the corporate sector. Layoffs and pay cuts across major industries continue, with wage growth coming close to a standstill. While we do not expect any major stimulus from the Third Plenum that started today and will conclude by Wednesday, we believe the Politburo meeting at the end of July will focus on targeted stimulus to bring the domestic economy back on track.

US

Falling inflation rates fail to lift consumer sentiment

The much anticipated US CPI inflation readings for June gave a welcome surprise, with the headline actually falling 0.1% on the month, with the core up only 0.1%. Inflation, at 3.0% and 3.3% YoY respectively, is still elevated, but moving in the right direction. After a disappointing start to the year, the last three CPI readings have been better than expected, with market pricing now fully reflecting two Fed rate cuts this year, starting in September, in line with our long-held view. Importantly, the sticky housing-related elements of rent and owners' equivalent rent slowed. That noted, the Michigan survey of consumer confidence fell once again. Despite a booming stock market, rising home prices, and a robust labour market, consumers are still feeling the pain of the high inflation of the past few years, which will take a fair bit of time yet to dissipate. It also suggests an increasing divide between wealth brackets, with the asset rich benefiting from high investment returns in excess of inflation. We remain optimistic on further improvements in inflation in the months ahead.

Markets

Weak CPI triggers rotation

Last week saw a catch up by growth sensitive assets that have been lagging the sharp gains in technology driven assets. Russell 2000, KBW US Bank and KBW Regional Banking indices outperformed the Nasdaq 100 by around 6%, 5% and 9% respectively last week. Moderating US inflation prints caused bond yields to sink on Thursday, triggering the rotation in stocks while credit markets including High Yield were mixed to being modestly firm. Rate cut probabilities rose after the US CPI print and a September cut by the Fed is now fully priced in, which led to optimism that segments of the market that are burdened by debt will see a reprieve. While this rotation is healthy and we had expected that a catch up of value is overdue, it remains to be seen whether last week's price action has legs or turns out to be a one-time wonder. Risk assets seem stretched at current levels and a modest pull back or a consolidation is likely to be healthy in prolonging the current bull run and if it is accompanied by the rotation seen last week, it should lead to healthier market dynamics in the longer term.

UK

Consolation prize

It may not have been England's day on Sunday, but it's not all bad news in Britain. The UK economy grew at twice the pace of consensus expectations in May, with GDP growth of 0.4% compared to the previous month. This leaves an often quoted figure of the most recent 3 month GDP growth total compared to the 3 month prior at around 0.9%. These are impressive figures when compared to most estimates coming into this year, including from the Bank of England, and the UK economy looks to be breaking out of a post-pandemic malaise. We also received labour data from the KPMG/REC survey which painted a contrasting picture. Permanent staffing and staff demand continued to decline, but wage pressures increased and remain at unusually high levels. The sub-index that measures wage increases among permanent staff increased at its fastest pace in the last 8 months. The Bank of England have made good progress on inflation, and will likely ease policy in coming meetings. Yet, these sort of data releases highlight the complexity of the situation, and will encourage caution on the speed of a cutting cycle.

Asia ex China:

The manufacturing sector continues to recover

While the Bank of Japan has apparently intervened in the currency markets to support the yen, Bank of Korea kept its policy rate unchanged at 3.5%. We note a slightly more dovish tone, as two policy board members now believe there is room for a rate cut within the next three months. Meanwhile Taiwan's June exports, up 23.5% YoY, were driven by a significant rebound in AI servers, with exports to Japan, the US and the EU rising in double digit percentage terms MoM. Moving south, so far India's exceptional growth has mostly been driven by the construction and services sectors, but manufacturing is now showing promising momentum. Malaysia's industrial production growth slowed to 2.4% YoY in May, dragged by a contraction in mining output. Nevertheless, the manufacturing sector continues to expand at a healthy pace. Similarly, Singapore's flash GDP suggests the manufacturing sector is rebounding for the first time after two consecutive quarters of contraction. These trends align with PMI data, indicating a gradual recovery in manufacturing.

LatAm

June inflation data are softer across Latam

In Brazil, inflation slowed to 0.2% MoM in June, below market expectations of 0.3%. On a YoY basis, inflation rose by 4.2%, slightly up from the previous month, driven by still elevated food prices. Core inflation, however, continues to decelerate. In Chile, June inflation fell by 0.1% MoM, weaker than consensus expectations. On an annual basis, headline CPI came in at 4.2%. Within the inflation basket, volatile products, including food, fruits, and vegetables, were the primary drivers, while inflation excluding volatile components was down by 0.6% MoM. In Mexico, inflation rose by 0.4% MoM and close to 5% YoY, slightly stronger than the May readings.

All in all, the latest inflation prints were softer with core inflation remaining steady. Despite that, we suspect concerns about price pressures will continue to persist for the second half of the year.

What to Watch

- US retail sales are expected to be largely unchanged in June, while a slew of housing data will be watched for signs of gains in building permits and housing starts.
- The ECB meet on Thursday. The governing council are likely to keep policy rates unchanged, as the market looks to the September meeting for a possible cut. The ECB also release their quarterly Bank Lending Survey.
- China will hold its 3rd Plenum to discuss longer term policy topics. Japan will publish the July Reuters Tankan survey as well as June CPI and foreign trade data. Australia will release June labour data. We expect Bank Indonesia to keep policy rates unchanged. India, Singapore and Malaysia will report June foreign trade data.

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