Weekly Macro and Markets View

13 May 2024

Highlights and View

Central banks in Latin America continue the cycle of rate cuts with signs of moderation

As inflation trends downward, the central banks of Brazil and Mexico make differing monetary policy decisions.

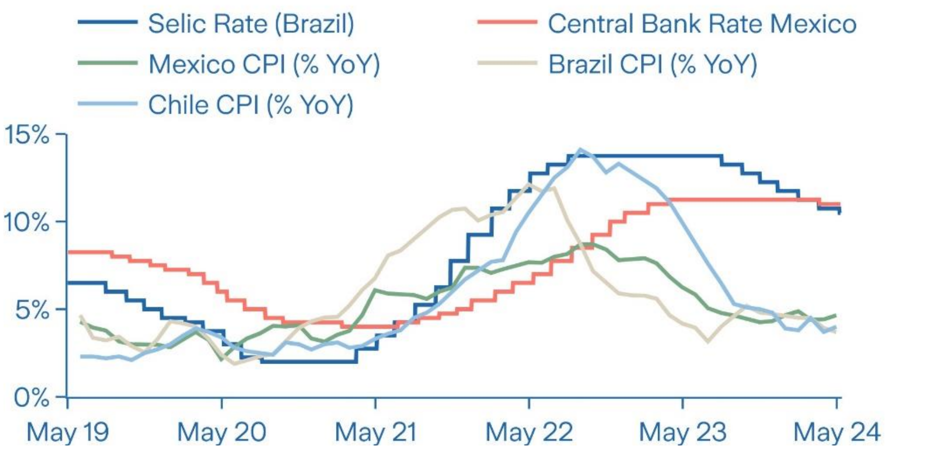
The UK economy grows 0.6% QoQ in the first quarter, the fastest rate since Q4 2021

A strong pickup in investment helped by a recovery in consumer spending lifted growth in Q1.

Credit lags stocks while US lending standards imply default rates could remain sticky

The move towards easing lending standards stalled last quarter, largely driven by small banks. If this continues, it will imply that default rates are likely to remain elevated for some time.

Differing monetary policy decisions and decelerating inflation in LatAm



Source: Bloomberg

Monetary policy decisions in Mexico and Brazil have taken divergent paths, accompanied by slowing regional inflation indicators.

In Mexico, Banco de México kept the monetary policy rate at 11% after having cut it by 25bps in March. The decision was reached through a split vote with the official statement leaving the possibility of future rate cuts open, contingent upon new data and the actions of the US Federal Reserve. Meanwhile, in a decision that was similarly met with internal division, the Central Bank of Brazil (CBB) reduced the Selic rate by 25bps, bringing it to 10.50%. Our analysis suggests that forward guidance points toward further moderation.

Turning to inflation data, April showed an increase of 0.38% MoM in Brazil, reaching a 3.69% YoY, which is still within the CBB inflation target range of 1.5% to 4.5%. Inflation in Mexico also rose by 0.18% MoM, leading to an increase of 4.65% YoY, and Chile saw an increase of 0.5% MoM and 4.0% YoY, up from 3.7% in March. It's worth noting that volatile components continue to play a significant role in driving inflation.

UK

The economy starts 2024 on a strong note

The UK economy rebounded strongly from its shallow recession in the second half of 2023. With growth accelerating to 0.6% QoQ, Britain was one of the fastest growing developed countries in the first quarter. It still lags other economies compared to its pre-Covid levels, though. Recovering consumer spending helped to lift growth, but a solid pickup in investment was a major driver of the dynamic. Meanwhile, the Bank of England left rates unchanged at its meeting last week, in line with expectations. The committee moved towards a more dovish stance, however, with two members now voting for a rate cut. During the press conference Governor Bailey kept the door open for a rate cut in June and suggested that the reductions in the Bank Rate could be more pronounced than is currently priced into market rates. Gilt yields initially dropped before rebounding in line with global bond yields while the FTSE 100 hit yet another record high, benefitting from a solid economic environment and a relatively dovish central bank, rising 2.6% over the week.

Eurozone

Something for everyone

There was little by way of unifying theme in last week's Eurozone data releases, but we can say that incoming data still leans broadly positive. Starting with the good, investor sentiment continues to improve in May, with the measure at its highs since early 2022. Retail sales also improved, growing for the first time in two years, although levels still remain far below trend. Disinflationary trends look intact, with PPI falling further in March and running at -7.8% YoY. Industrial production numbers for March bring a bit of pessimism. While the Eurozone overall figure will be released this week, the figure is likely to be disappointing given the national releases we have seen. While German data came in a bit stronger than the market thought, they still fell for the month of March. The same measures from Italy and Spain were both unexpectedly disappointing too, and both measures continue to contract year-over-year. We see room for overall production levels across the Eurozone to improve from low levels throughout the year.

Japan

Real wage growth should pick up meaningfully in the coming months

In Japan, cash earnings, referring to nominal wages, increased by 2.2% year-over-year in March, slightly higher than February's 1.9% rise. Scheduled cash earnings, which are core wages excluding bonuses and overtime, mirrored this growth at 2.2% YoY. However, real wages, adjusted for inflation, fell by 2.5% YoY, a more significant drop than consensus had anticipated. Negative real wage growth has dragged on household spending, which saw a 1.2% drop in March. The April Eco Watcher Survey, gauging the sentiment of businesses that directly service consumers, revealed deteriorations in both current conditions and the future outlook. Despite these challenges, real wages are expected to rise meaningfully in the coming months following this year's 'shunto' wage negotiations, which secured a 5.2% increase and has resulted in a 3.5% rise in base wages. We think the Bank of Japan will closely monitor the interplay between wage increases and inflation in the coming months to guide its policy direction.

Equities

Investors keep the faith

Stocks continued to push higher last week, with European bourses holding the reins of the bull market. A number of indices in the region powered to record highs, with both the Euro Stoxx 50 and UK FTSE 100 tacking on an additional 3% for the week, with Germany's DAX up 4%. While the Swiss market is still some 10% below its 2021 high, the 5% gain last week was helped by UBS returning to profit on better than expected numbers, lifting the stock 11%. With European markets having been in the shadow of the US for so long, the prospects of an imminent rate cut by the ECB in June, combined with better growth and inflation data have clearly boosted sentiment. That noted, some of the relative moves of late, particularly by UK stocks, are now looking a bit stretched and we expect the US to take back leadership in due course. US market gains lagged last week, not helped by disappointing earnings from Disney, with the stock down 7%. Once again investors show that punishment is swiftly dealt for those who dare to underwhelm in a market that is increasingly rewarding the skills of stock pickers.

Credit

Credit lags stocks while lending standards forebode some caution

Credit markets were lacklustre last week despite a positive tone in stocks. Spreads were mostly close to unchanged with US corporate bonds seeing some weakness. Supply surged last week across both Investment Grade and High Yield credit, especially in the US, with decent demand that allowed issuers to achieve low to negative new issue concessions. While investor demand in credit is underpinned by attractive all-in yields, spreads have little room to tighten from current levels. The Fed's Senior Loan Officer Survey for Q1 showed that lending standards remain tight for both corporate loans and commercial real estate (CRE) loans. Somewhat worryingly, improvement in the pace of tightening also stalled. What seems most interesting is the notable divergence between small and large banks. It is small banks that are continuing to tighten lending standards while large banks have stopped or are close to stopping tightening. We believe this is being driven by the heavier exposures of small banks to CRE loans and implies that the weakest corporate borrowers are still vulnerable.

What to Watch

- In the US, the latest batch of inflation data will give crucial insights into the potential path of monetary policy in coming months.
- Tuesday brings us the German ZEW survey, which is expected to signal improved investor confidence. On Wednesday we will see a detailed breakdown of Eurozone Q1 GDP as well as aggregate industrial production numbers for March.
- China's upcoming activity data, including industrial production, retail sales, and fixed asset investment, will be key to watch, along with April's credit data release. Japan's Q1 GDP is expected to be weak. In Australia, Q1 labour market data and wages are likely to indicate a persistently tight labour market. India will release data on industrial production, inflation, and exports. The central bank of the Philippines is expected to keep rates unchanged.

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