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Weekly Macro and Markets View

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Highlights and View

Headline inflation in the US falls to 3% YoY while core inflation recedes to 4.8% YoY

Price pressure is rapidly fading with the monthly pickup in core inflation back below an annualised rate of 2% and producer prices barely rising.

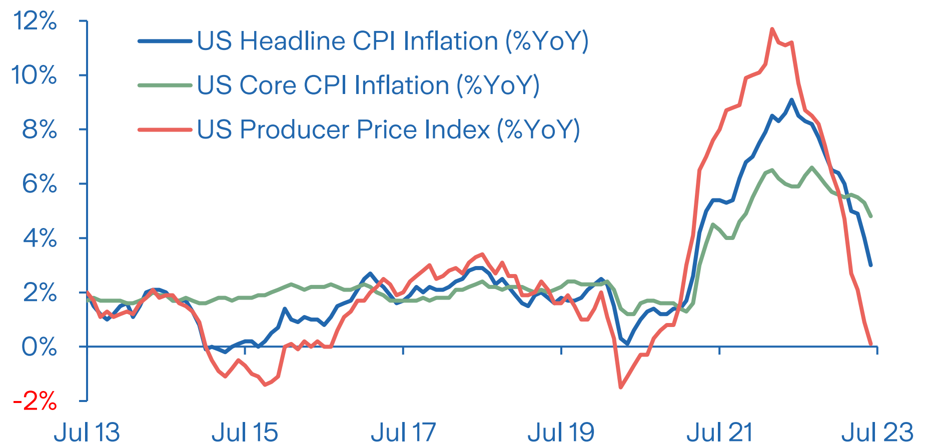
The UK unemployment rate rises to 4% in May, the highest since January 2022

Despite the looser employment situation, wage growth remains stubbornly high at 7.3% YoY, keeping the pressure on the BoE to maintain its hawkish stance for now.

China's Q2 GDP fell short of consensus expectations while credit data showed continued softening on a YoY basis

The country's disappointing economic performance suggests a potential need for additional stimulus measures.

US inflation rates fall significantly



Source: Bloomberg

Headline inflation continues to fall rapidly, slowing from 4% in May to 3% YoY in June, the lowest level since March 2021. The slowdown has been broad-based and includes many service components such as airfare and lodging, indicating that consumer demand in these sectors is beginning to fade. Importantly, core inflation also fell more than consensus expected with the monthly rate slowing to only 0.16%, returning to an annualised rate below 2%. Similarly, the Cleveland Fed's trimmed-mean measure receded to the lowest level since February 2021. Producer prices confirmed the fading price pressure with the annual rate falling back to a mere 0.1%. Bond yields dropped substantially in the aftermath of the soft inflation numbers with the 10yr Treasury yield falling back below 4%. Meanwhile, small business sentiment ticked up slightly in June but remains at very downbeat levels while some of the components reflect a deteriorating employment situation. Hiring plans weakened, matching the post-Covid low reached in March while the compensation component dropped to the lowest since May 2021, pointing to reduced wage pressure in the economy. While all this is unlikely to stop the Fed from hiking once again at its meeting next week the latest set of inflation data provide further evidence of rapidly falling price pressure.

Equities

The bulls are in full charge

Equity investors were in good cheer last week, pushing aside the old adage of 'sell in May and go away'. Indeed, the MSCI World Equity Index has posted gains of almost 8% since the end of May, tacking on 3.2% last week alone. The US inflation readings drove government bond yields and the dollar lower, while providing a further fillip to stocks' momentum. Tech was back leading the pack, with the Nasdaq index now up 35% year-to-date, against the 33% fall recorded last year. US earnings season kicked off with the biggest banks posting decent returns so far, helped by better than expected net interest rate margins as policy rate hikes are slow to be passed on to savers. As more companies report, earnings guidance will be key in helping to determine the robustness of profits. We see pressure ahead as growth slows and the impact of rate hikes makes consumers and businesses less willing to spend. For now, however, it would be a dangerous game to get in the way of the charging bulls, despite many indices now looking overbought in the short term.

UK

Cracks appear in a tight labour market

The very tight labour market is beginning to show some cracks. The unemployment rate ticked up to 4% in May from 3.8% in April. That is the highest level since January 2022 and compares to the low of 3.5% reached in August last year. The number of vacancies drifting lower, albeit from elevated levels, as well as a pickup in jobless claims in June, are further evidence of a cooling labour market. Nevertheless, wage growth remains stubbornly high at 7.3% YoY, unchanged since April. Despite the unemployment situation, the Bank of England is unlikely to change its hawkish stance in the near term due to its concerns regarding the potential inflationary impact of continuously high wage growth. However, given the growth headwinds and the expected fall in inflation and wage growth in the months ahead market-implied expectations for the Bank Rate look too high. Reflecting the deteriorating economic environment, industrial production dropped another 0.6% MoM in May after falling 0.2% the month before.

Switzerland

Swiss franc strength

Price pressures continue to ease in Switzerland, with the producer and import price index in disinflationary territory, down by -0.6% YoY in June. The producer price component showed falling prices of manufactured goods destined for exports, while prices on sales for the domestic market held up better. This suggest that the strong Swiss franc is becoming a headwind for Swiss exporters, especially given the weak global demand backdrop. Last week also saw a further strengthening of the currency as the franc surged to the strongest level vs. the USD since January 2015 while remaining at a multi-decade high vs. the Japanese yen. Currency strength partly reflects the lower inflation rate in Switzerland, but the SNB is also intervening in the FX market to bolster the currency. This helps contain imported price pressures but adds to the challenges faced by manufacturers. Given the already stretched levels, further near-term upside to the franc is likely to be limited.

China

Growth disappoints in Q2

China's GDP growth slowed from 2.2% to 0.8% QoQ in Q2, with YoY growth coming in at 6.3%, below the consensus expectation of 7.1%. Although industrial production improved from 3.5% to 4.4%, retail sales weakened markedly from 12.7% to 3.1%, in part distorted by base effects. The service sector remained the primary driver of growth, while goods consumption showed lacklustre performance. Investment improved moderately, led by infrastructure investment, but property investment continued to contract. Notably, the unemployment rate for youths reached 21.3%, setting another record high. June exports contracted by 12.4% YoY, marking the sharpest decline since March 2020, and imports fell by 4.1%, reflecting weak processing imports and soft domestic demand. In June, China's aggregate financing and new bank lending, while exceeding expectations, still showed softer YoY growth compared to May. Overall, the latest data indicate downside risks to China's growth in the second half of the year, highlighting the necessity for additional stimulus measures.

Credit

No time for complacency

Last week credit spreads tightened with US High Yield closing the week at 379bps. In US leveraged loans the Morningstar LSTA price index rose to the highest level since last August, while US Investment Grade lagged. Spread levels seem to reflect the view that a recession seems unlikely, with a Goldilocks scenario increasingly priced in. We maintain the view that current spreads are pricing too benign an outlook. Not only does the macro environment warrant a cautious approach, but the micro trends also raise concerns. While rising stars (HY firms transitioning to IG) have outnumbered fallen angels (IG firms transitioning to HY) in 2023 thus far, transitions between rating buckets show that the lower the quality the worse the rating migration, with net downgrades dominating in the BB and lower-rated buckets. Looking forward, the divergent paths between the high and low quality segments is likely to persist as the amount of bonds that have a negative rating outlook is, on net, predominantly below the BB bucket, which also implies defaults rates could remain elevated once recession hits.

What to Watch

- While the PBoC will likely continue its targeted support to sustain credit growth and the property market, the central bank is expected to maintain its lending prime rate after the cut in June. Other key data for the region include Australia's labour market, exports for Malaysia and Taiwan will be published this week.
- In the UK, investors will focus on the latest set of inflation data, which is expected to show substantially lower price pressure, while retail sales and consumer confidence will give insights into the current state of households.

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