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Weekly Macro and Markets View

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Highlights and View

The relentless upward trend in bond yields reverses as the drivers become more balanced

More central bankers are talking about pausing further rate hikes, citing high bond yields as restrictive. Despite elevated volatility, the bond environment is becoming less negative.

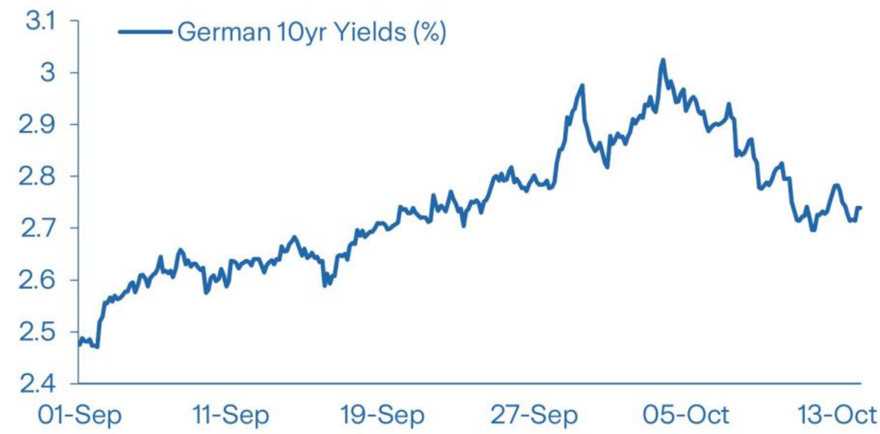
US headline inflation remained at 3.7% YoY in September while core CPI slowed to 4.1% YoY

The trend in most components is reassuring, but core service inflation remains sticky, driven by rising shelter costs.

China's first batch of indicators for September disappoints: Deflation risks linger, private credit demand remains soft and imports continue to contract

While further fiscal stimulus seems to be in the offing, rebuilding consumer, business and investor confidence remains a long and winding road.

A rare week of respite for bonds



Source: Bloomberg

After trading above 3% on October 4, German 10yr bonds ended last week below 2.75%. Other government bond yields, including US Treasuries, followed a similar trajectory. While it is too early to announce a definitive end to the bond rout as the rising yield trend line from 2022 is still intact, the outlook is now more balanced. Geopolitical tensions contributed to the shift, but central bank rhetoric was the larger driver. Some policymakers are of the view that policy rates are high enough, and bond yields too. The Fed's Lorie Logan and Susan Collins suggested that current yield levels have reduced the need for further policy action. Centrist figures from the ECB, such as France's Francois Villeroy, see policy rates as sufficiently restrictive and are concerned by weak growth. Others disagree, but the debate is now more two-sided. Bond yields now offer considerable capital appreciation potential in a flight-to-quality scenario, while positive real yields offer attractive inflation-linked returns to long-term debt buyers.

Yet, central bank balance sheet reduction is an active negative for bonds. Inverted curves are dampening demand as bonds compete with attractive cash rates. Inflation, too, remains a key uncertainty. In Sweden, which is often seen by investors as a bellwether for the global and other similarly small economies, inflation fell at a slower rate than widely expected.

US

Service inflation remains sticky as shelter costs rise

In a holiday-shortened week investors focused primarily on the latest batch of inflation data. Headline CPI inflation slowed to 0.4% MoM in September from 0.6% the month before, leaving the annual rate at 3.7%, both marginally above consensus expectations. Core CPI rose 0.3% MoM, the same as in August, leading to a slowdown in the annual rate from 4.3% to 4.1%, both in line with expectations. Although most components moved in the right direction, core services accelerated to 0.6%, mostly driven by rising shelter costs. While we expect these to slow down in the coming months, price pressure remains too elevated for the Fed to move away from its hawkish stance in the near term, although it looks unlikely that they are going to hike rates at their next meeting in November. Meanwhile, the University of Michigan's survey shows that consumer sentiment deteriorated markedly in October, weighed down by a substantial fall in expectations. Finally, small business optimism ticked down in October, remaining close to its multi-year lows.

Eurozone

Industrial production stagnates while inflation expectations tick up

In the Eurozone this week we saw the release of August Industrial Production figures for Germany and Italy. The German measure fell -0.2% MoM, further than expected, while Italy rose by 0.2% MoM despite a fall having been expected. These data are volatile, but smoother, longer-term series paint a more negative picture overall. Although Italian production levels recovered to pre-Covid levels, they have subsequently stagnated. German production figures have been in steady decline since the end of 2020, in line with other weaker German data this year. Forward-looking indicators suggest both of these respective trends will remain intact for the remainder of the year.

Separately, the ECB released their consumer inflation expectations surveys for one and three years into the future. These August based surveys lag slightly, but are closely watched by policymakers. Both increased by 0.1% MoM. They are within recent ranges, but further increases will concern the ECB.

North Asia

Economic data are tilted to the downside with the notable exception of Taiwan's exports

In China, broad credit growth remained stable in September at +9% YoY as aggregate financing benefitted from higher government bond issuance and an increase in off-balance sheet lending while corporate loan demand contracted. Meanwhile, both exports and imports weakened further, with shipments to most major export destinations remaining soft. Inflation data came in weaker than consensus had expected, with consumer prices unchanged on a YoY basis, core CPI stable at 0.8% and producer price inflation down 2.5%. Rumours about a revision of the budget deficit target to finance further infrastructure investments need to be monitored.

In Japan, we note that the Eco Watchers Diffusion Index fell below the neutral 50 mark in September, while August machinery orders continued to contract.

On a positive note, Taiwan's September exports were far stronger than consensus had expected, up 3.4% YoY. Both tech and non-tech products, particularly chemicals and minerals, contributed positively.

ASEAN

A mixed bag

The Monetary Authority of Singapore (MAS) kept monetary policy settings stable, highlighting that it believes its FX policy targets are sufficiently tight. Q3 GDP growth was stronger than consensus had expected, up 0.7% YoY, rising 1% on a sequential basis compared to only 0.1% in Q2. The driving force behind this positive surprise came from a sequential swing in manufacturing production from contraction to growth, while growth in construction and services moderated. Meanwhile, Indonesia's September exports and imports contracted more than consensus had expected. It seems the sequential export recovery in August was just a blip following falling exports in the prior six months, with copper and palm oil exports being the major drag. The even steeper drop in imports was behind the further increase in the trade surplus. We note that semiconductor exports recovered in the Philippines in August, suggesting a turn for the better in the electronics cycle. Finally, Malaysia's 2024 budget draft underscores the path to fiscal sustainability.

European ABS

A pickup in supply, but spread widening should be limited

Increased volatility in equity and bond markets as well as blackout periods due to earnings season led to limited activity in primary markets for the past weeks, but new issuance of European ABS maintained decent momentum. September was particularly busy and had the highest placed monthly supply since the GFC. Auto ABS is still the most active sector, but diversity increased with deals backed by consumer loans and the first French RMBS issuance of 2023. Demand from investors remains strong and allowed French BPCE to upsize its RMBS offer to EUR 900mn. Despite this better tone in primary markets, we don't believe that volume will increase materially in the coming quarters. With loan growth limited by tighter lending standards and covered bond programs providing a cheaper source of funding, we think that ABS will only remain a diversification tool for the largest banks. Given the limited supply and renewed investors' interest in floating-rate bonds, ABS spreads should be supported and relatively immune to significant widening if broader credit markets deteriorate.

What to Watch

- In the US, the latest batch of housing data is expected to reflect ongoing headwinds while retail sales will give insights into households' current spending behaviour.
- In the UK, inflation numbers, labour market data, retail sales and consumer confidence are expected to reflect a slowdown in activity.
- In APAC, we expect policy rates to remain unchanged in China, South Korea and Indonesia. Japan will report September export and CPI data. China will release Q3 GDP and September retail sales, industrial production and investment data. Australia will publish September labour market data and release the Q3 business confidence report. September export data will be reported in Taiwan, Indonesia, Malaysia and Singapore. Hong Kong will release CPI and labour market data for September.

Disclaimer and cautionary statement

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