ZURICH

Weekly Macro and Markets View

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Highlights and View

A surprisingly dovish Fed provides markets with an early Christmas present

We have long expected looser policy in 2024 but the timing of the announcement looks odd as recent data have not been significantly weaker than expected.

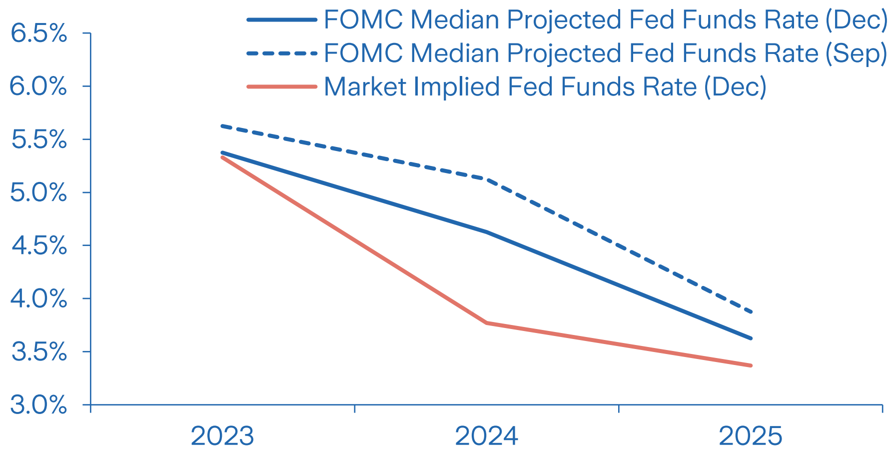
Japan's corporate Tankan survey for Q4 came in above consensus expectations

We believe the nearly 3% sequential annualised drop in Q3 GDP was a blip and that a technical recession is highly likely to be avoided.

Government bonds rally sharply on a surprisingly dovish Fed with significant policy loosening priced for 2024

While there is further downside to yields in the coming year, bond markets are set to remain volatile near term with inflation data remaining critical.

The Fed turns more dovish



Source: Bloomberg

In a surprising twist away from its recent hawkish statements, the Fed is preparing the ground for looser monetary policy. Not only has the FOMC removed the additional rate hike from its dot plot, the committee is now signalling three rate cuts in 2024. Chair Powell further fuelled investors' rate cut expectations by not directly pushing back when asked about recent market pricing. Accordingly, the S&P 500 rose by 2.5% last week, reaching the highest level in almost two years. While the projected looser policy strengthens our long-held view that the Fed will cut rates aggressively in 2024, the timing of the announcement is somewhat surprising as recent data have not been significantly weaker than expected. Headline CPI inflation ticked down to 3.1% YoY in November from 3.2% in October while Core CPI remained at 4% YoY. Meanwhile, producer prices are signalling that price pressure keeps fading with the annual rate receding to 0.9% from 1.2%. The latest set of PMIs show overall modest growth at the end of the year with the Composite PMI ticking up to 51.0 from 50.7. The pickup was entirely driven by services as manufacturing activity has moved deeper into contraction in December. Industrial production recovered slightly less than consensus expected, up from a revised down dip the month before, while retail sales rebounded from their drop in October.

UK

The Bank of England keeps rates on hold

As expected, the Bank of England left the Bank Rate unchanged at 5.25% at its meeting last week. Similar to the November meeting, the decision to keep the policy rate on hold was not unanimous as three members voted for another 25bp hike. Unlike the surprisingly dovish Fed, the BoE kept its hawkish tone, emphasising that policy will likely have to be restrictive for an extended period of time. The door has been kept open for further rate hikes, although we think this is unlikely given the recent trends in growth and inflation. Wage growth slowed from 7.8% YoY to 7.3% in October but remains elevated and above levels that the BoE is comfortable with. However, a pickup in jobless claims and a weaker growth environment are likely to slow wage growth further in the coming months. Industrial production disappointed with a 0.8% MoM drop in October, which was even more exacerbated in the manufacturing sector. The latest PMIs show a modest pickup in activity, entirely driven by services while manufacturing falls deeper into contraction.

Eurozone

Not so fast

The most important event in the Eurozone last week for markets was Thursday's ECB meeting. With the US Fed signalling a clear pivot to rate cuts in 2024, it was going to be hard for the ECB to appear more dovish. They stuck firmly to a risk-averse and balanced view, and pushed back on the market's aggressive pricing for cuts in 2024. The main policy rates were left unchanged, as expected, while new guidance was introduced on balance sheet reduction throughout 2024. Christine Lagarde made it clear that rate cuts were not being 'discussed' by the governing council, at least not yet. We forecast ECB policy easing via rate cuts in 2024, but see the current market pricing of six cuts as too aggressive and too front-loaded, with the key risk being temporarily higher inflation into the beginning of the year. The early release of the Eurozone December PMIs showed an unexpected fall from November levels, and the overall Eurozone Composite PMI fell to 47 from 47.6, confirming our forecast that we are already in a mild recession.

China

PBoC liquidity injections cheer up the mood at the end of a disappointing week

During its Central Economic Work Conference, China's government pledged to 'seek progress in a bid to maintain stabilisation', focusing on economic growth without promising large-scale stimulus. 'Tech innovations' ranked first among nine key economic work tasks for 2024. Though investors were disappointed by the outcome, they applauded the PBoC's record-high cash injection to lenders worth USD 112bn on Friday and the relaxation of home buying restrictions in Beijing and Shanghai. 'H'-shares rallied 2.3% following three weeks of losses. In terms of economic indicators for November, most property related statistics, including home sales, home prices and property investment, remained weak. Retail sales growth, though up 10.1% YoY, was softer than expected, while fixed asset investment growth and labour market data were in line with expectations. Industrial production growth, up 6.6% YoY, surprised to the upside. Following deflationary CPI/PPI data and contracting imports, credit data disappointed as well, even though the credit impulse is marginally positive.

Brazil

The Central Bank of Brazil (BCB) cuts its reference interest rate by 50bps, in line with market expectations

In a unanimous decision, the monetary policy committee of the BCB decided to cut the Selic rate by 50bps, leaving it at 11.75%, accumulating 200bps since the beginning of the easing cycle in August of this year. Regarding its forward guidance, there were no major changes, with the board unanimously seeing 50bp cuts as appropriate for upcoming meetings. In the statement the central bank acknowledged a less adverse global environment and saw domestic underlying inflation moving closer to the inflation target. Nevertheless, long-term inflation expectations are the main risk for the central bank, which could constrain rate cuts soon, amid doubts regarding the government's fiscal targets and concerns about the BCB profile after 2025 when the membership of the monetary policy committee will change. With those issues unlikely to be settled before midyear, we find it unlikely that inflation expectations will decline enough to accelerate the easing cycle.

Bonds

Government bonds enjoy a Santa rally on a surprisingly dovish Fed

Government bonds rallied further last week on the back of a surprisingly dovish Fed. The 2yr Treasury yield fell by 28bps as the probability of a March rate cut rose sharply, with close to 150bps of cuts priced in for 2024. The 10yr yield slumped by 31bps and fell below 4% for the first time since July. Despite the ECB and the BoE pushing back against the dovish narrative, market pricing took little notice, with the 10yr gilt yield falling below 4% for the first time since May, down 36bps, while the 10yr Bund yield fell 26bps to 2.01%. Although we see further downside to yields in the coming year, we suspect bond markets will remain volatile near term, with inflation data still critical. Elsewhere, Eurozone peripheral yields tightened slightly vs. Germany following a succession of good news on slowing inflation and market excitement about policy easing. However, considering recent positive moves in other risky assets, Italian bond spreads stick out as still high. While clear negative risk remains around Italian debt, the market outlook is now more balanced.

What to Watch

- In the US, the latest batch of housing data is expected to show that the housing market is still struggling while consumer confidence will give insights into the current state of households.
- In the Eurozone we will receive the ifo survey for Germany, along with GfK consumer confidence measures. Similar confidence data will also be released for France and Italy. November Producer Price Inflation will also be published with disinflation likely less evident.
- In APAC, Japan will release foreign trade and CPI data for November. The Bank of Japan is expected to maintain its current monetary policy settings at its MPM next week. Taiwan, Malaysia and Singapore will report November export data. Hong Kong and Malaysia will publish November CPI data, while Hong Kong and Taiwan will report November labour market statistics.
- *Wishing everyone a very happy festive season and a healthy and profitable New Year. The Weekly will return on January 8th.*

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