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Weekly Macro and Markets View

29 January 2024

Highlights and View

The ECB emphasises data as markets jostle between rate cuts beginning in April or June

The ECB is publicly divided on the timing of cuts. We favour June as the meeting at which policymakers coalesce, but the outcome is sensitive to inflation and wage data.

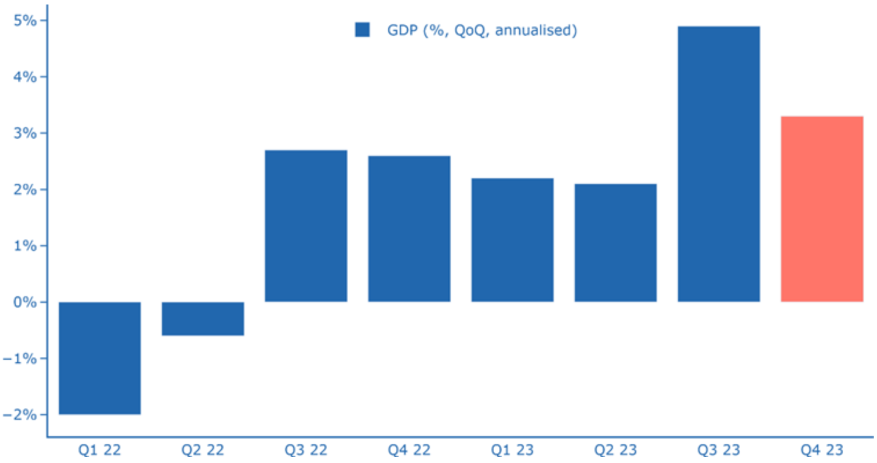
China's authorities release a stock rescue package; the PBoC cuts the RRR by 50bps

While 'H'-shares rallied 11%, continued support measures are needed to stabilise market and consumer confidence.

US Investment Grade (IG) markets seem to be on track to set a record in January for supply

Demand in credit markets has been strong due to high overall yields with some deals being priced at a premium to old bonds. However, spread levels remain tight and are lagging the move in stocks.

US GDP surprises positively for Q4, with consumption robust



Source: Bloomberg

Another week of encouraging US data portrayed an economy still very much in growth mode, with inflation moderating. Q4 GDP came in at a much stronger than expected 3.3% QoQ annualised, following the dramatic 4.9% reading in Q3. Consumption remained strong at 2.8%, down only marginally on last quarter's reading, and inventories and capital spending were higher. While backward looking, the data suggest that momentum in the economy is good, which was borne out by preliminary PMI readings for January. Both services and manufacturing measures moved higher, the latter back into expansionary territory. Weekly initial jobless claims, at 214k, gave up some ground on last week, but the four-week average fell further to 202k. It was also good news on the inflation front, with the Fed's favoured core PCE measure slowing to 2.9% YoY from 3.2%, and the headline unchanged at 2.6% YoY. While we believe it is too early for the Fed to relax, members at this week's FOMC meeting will be pleased that the three-month annualised reading is down to 1.5%. Certainly, investors remain in good spirits. Despite Tesla's disappointing earnings and forward guidance, with the stock off 14% on the week, the S&P 500 tacked on another 1%, with the small cap Russell 2000 up 1.8%. While the Fed may push back a little on market expectations of a March rate cut, equity momentum is compelling.

Eurozone

The ECB's very public debate

The ECB left policy unchanged, while moving emphatically from time-based to data-dependent guidance. President Lagarde delivered a balanced message as concerns around declaring premature victory over inflation remain despite good progress. Subsequent messaging by various policymakers sent contradictory signals on the timing of cuts, and discord is evidently high. We favour June vs April for the first cut as those policymakers more concerned about persistent inflation will likely have received sufficient data to legitimise easing.

The decision is highly sensitive to data such as inflation, wage and activity, with risks to both scenarios. Economic data were mixed last week. While the Eurozone Composite PMI increased to 47.9, German and French PMIs were disappointing, with improvements in manufacturing offset by disappointments in services. The rest of the Eurozone contributed positively to the overall PMI. German data were broadly disappointing as the ifo unexpectedly fell both for the current assessment and expectation surveys. Consumer confidence fell back as well.

China

Stimulus measures lift market sentiment

The week began with disappointment that China's central bank did not cut its LPR benchmark lending rate. Two days later, however, the PBoC cut the reserve requirement ratio (RRR) by 50 bps to 10% for large banks (and 7% for all financial institutions) as of Monday next week, which amounts to a CNY 1bn liquidity injection. The move was preceded by measures to support the stock market by using overseas funds from state-owned enterprises (SOEs) to buy domestic shares, while tightening rules on share sales by insurance companies. The market welcomed these measures, sending the MSCI China up 9% and 'H' shares up 11% in three days, after having lost nearly 30% over the past six months. Nonetheless, we will need to see continued public support to boost consumer and investor sentiment as the economy and the market continue to struggle. After a surge in sales by developers before the end of the year, home sales softened again, falling by 30% year to date. Property developer Evergrande was suspended from trading following a liquidation order from a Hong Kong court.

Japan

Our view of a change to the BoJ's 'NIRP' in April remains intact

Although no changes to monetary policy were announced at the Bank of Japan meeting, comments made by BoJ Governor Ueda at his press conference confirm our view that the 'negative interest rate policy' (NIRP) is likely to be abolished at the BoJ's April meeting. The BoJ seems more optimistic that a virtuous cycle between wages and prices will take hold, noting today that '…the likelihood of realising this outlook has continued to increase gradually'. Further evidence of a wage-price inflation loop and the emphasis on monitoring the outcome of the 'Shunto' spring wage negotiations show some signs that the BoJ's policy action is on the horizon. Our view remains unaffected by the surprisingly large decline in core CPI from 2.1% to 1.6% YoY in January, as it is mainly influenced by a special base effect of hotel charges. Meanwhile, we take note of the strong Services PMI in January, up 1.2 points to 52.7, driven by strong inbound travel demand.

Credit

Performance lags that of stocks, but a record monthly supply of US IG is in view

US and European credit index spreads closed the week tighter, reaching YTD lows in both IG and HY. Primary markets in US IG slowed down compared to the previous weeks, but the monthly tally is still on track to be a January record. New deals continued to be well received, with low, and on several days even negative, new issue concessions and healthy oversubscription levels. Positive sentiment was also visible in continued inflows into US and European funds. In Europe, HY issuance picked up notably in January. As we expected, the approaching maturity wall and diminished cash balances have forced companies to issue. Normally we would view this as a fundamentally positive development as it signals that the market is open. However, the issuance pickup is likely to notably weaken the technical support that bolstered the market in 2023, when HY supply was dismal. Finally, the latest ECB Lending Survey showed that credit standards in the Eurozone tightened further during Q4, but the increment was smaller than in Q3, suggesting that the worst of the tightening cycle is behind us.

Covered Bonds

Strong supply weighs on spreads

Covered bond spreads underperformed broader credit last week. Activity surprised to the upside in the primary market with ten issuers selling new bonds for a total deal volume that was slightly above EUR 10bn. YTD cumulative covered bond issuance has now reached EUR 40bn, only marginally below what was seen at the same time last year. Investor reception remained good, enabling issuers to print with tight new issue concessions. The French bank Société Générale was able to sell a 12-year tranche, the longest tenor issued in a year, highlighting the demand for duration from investors who want to position themselves ahead of future central banks' rate cuts. We expect that this robust issuance pace will start to abate amid weak loan growth in Europe. The latest euro area bank lending survey confirmed a substantial decline in demand for loans to households, which should limit banks' need for funding. The lower issuance volume should help spreads to stabilise and we expect covered bonds to outperform corporate credit should the risk of an economic recession gain momentum.

What to Watch

- Global attention will be firmly on the US FOMC meeting on Wednesday, and while no move in rates is expected, commentary at the press conference will be key. Otherwise, it will be the payroll data, with 180k new jobs expected, and the unemployment rate, anticipated to tick up to 3.8%, that will be in focus.
- The Bank of England meets on Thursday, and policy is likely to be unchanged. The vote split will be closely watched for any dovish dissents, but the overall message is likely to be wary given still-high inflation. We will also watch January house price data.
- In APAC, Japan will release a series of economic data for December and January as well as the 'Summary of Opinions' from last week's BoJ MPC. China will publish its January PMIs. Australia will report Q4 inflation data and December retail sales, building approvals and lending data. India will announce its interim budget. Q4 GDP data will be released in Hong Kong, Taiwan and the Philippines. Malaysia's markets will be closed on Thursday.
- In LatAm, we expect 50bp cut to the Selic rate in Brazil, bringing it to 11.25%, and a 75bp cut to the MPR, to 7.5%, in Chile.

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