

Weekly Macro and Markets View

19 February 2024



Highlights and View

In the US, inflation rates remain elevated with Core CPI at 3.9% YoY in January

The above-consensus inflation numbers poured cold water on investors' expectations of future rate cuts.

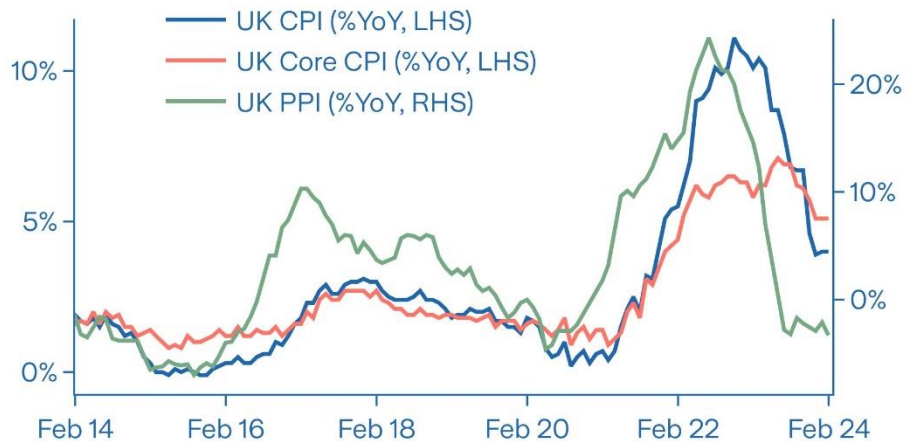
Japan's economy slid into recession in H2 2023

We believe the Bank of Japan will look through the current soft patch and abort its negative interest rate policy (NIRP) in its late April meeting amid a favourable wage increase outlook.

Initial voting tallies suggest that Prabowo Subianto has won Indonesia's presidential election with more than 58% of votes

Former president Jokowi's reform policies are likely to be continued when the new president takes over on October 20, while private capex plans are likely to be implemented quicker amid the election results.

UK producer prices signal fading price pressure



Source: Bloomberg

On a monthly basis, inflation rates have fallen just enough to keep the annual rate of both headline and core inflation steady, which was slightly better than consensus expected. While inflation rates remain significantly above the Bank of England's (BoE) target, producer prices keep signalling further relief ahead. Nevertheless, given the still tight labour market and high wage growth, the BoE is unlikely to cut rates in the near term. The unemployment rate ticked down from 3.9% in November to 3.8% in December while wage growth slowed from 6.7% YoY to 6.2%, still significantly above the levels that would be in line with the BoE's inflation target. Both employment and wages are expected to face further headwinds as growth remains modest. GDP fell by 0.3% QoQ in the final quarter of 2023 as both consumer and government spending receded, dragging the UK into a technical recession as growth had already been marginally negative in Q3 of 2023. The latest batch of data provides somewhat of a silver lining, though, with industrial production growing by 0.6% MoM in December and retail sales soaring by 3.4% MoM in January. The latter follows a dip of more than 3% in December, however. Falling inflation rates, solid employment and an improving growth outlook have helped to support UK equities and lift the FTSE 100 by 1.8% last week, outperforming many of its peers.

US

Inflation rates remain elevated

Inflation reaccelerated on a monthly basis leaving the annual rates of headline and core at 3.1% and 3.9% respectively, both higher than consensus had expected. Some of the pickup in prices reflects price increases at the beginning of the year that are not expected to be repeated in the coming months. Nevertheless, the reacceleration in both consumer and producer prices emphasises the Fed's dilemma and will strengthen their commitment not to cut rates too soon. Meanwhile, the solid growth picture showed some cracks last week, with

both retail sales and industrial production falling more than consensus had expected. Small business optimism ticked down to the lowest since May 2023, further underlining the potential growth headwinds. Housing starts fell by almost 15% MoM in January, the largest drop since April 2020, though part of the decline was likely driven by weather conditions. The equity market struggled with negative growth and inflation surprises dragging the S&P 500 down to end the week with a small loss of 0.4%.

Eurozone

In an ironic turn of events, Spain bails out Eurozone Q4 growth

This week quarterly GDP growth for Q4 2023 was revealed to be 0%. Considering that a majority of individual national prints were known, this number was not a surprise. The makeup is interesting, with Spain's strong 0.6% offsetting Germany's poor -0.3% amid broader stagnation. Eurozone employment growth increased by a further 0.3% QoQ in Q4, highlighting the continued dichotomy between historically low unemployment and very weak growth. Amid the backward-looking gloom, we received some better news from Germany. The ZEW

investor expectations survey continued to improve and is now in firmly positive territory. We do not see improving sentiment as fundamentally changing Europe's weak growth potential, but it reduces imminent recessionary risk. Wholesale prices for January increased slightly by 0.1% MoM, but growth in these prices has been negative in year-on-year terms since April 2023. Although the ECB doesn't target wholesale prices, they will take comfort from falling upstream pricing reducing the likelihood of ultimate consumer price increases.

Switzerland

Inflation falls sharply in January

Inflation surprised to the downside in January with the annual rate at 1.3%, down from 1.7% in December. This was much weaker than market consensus and implies downside risk to the SNB's Q1 forecast of 1.8%. A January rebound in the monthly rate had been expected given rising electricity prices and VAT and, while these effects did come through, weakness elsewhere led the overall rate lower. The strong franc, in particular, is pulling inflation down, with prices on imported products down -0.9% YoY, compared to a 2% rate for those that

are domestically produced. While the likelihood of a March SNB rate cut has increased given recent soft inflation, the full impact of rent inflation is yet to come through and domestic price pressures are still running at a significantly higher rate compared to the pre-Covid level. We therefore maintain our view that rates will be left on hold in the next policy meeting, but the February inflation print will be important to watch as further weakness could bring forward the rate cutting cycle.

Japan

The Bank of Japan is expected to look through the recession

Japan's economy made headlines as it fell into recession following two quarters of negative sequential GDP growth. While real Q3 GDP growth data were revised down to -3.3% on a sequential annualised basis, the economy shrank by a further -0.4% in Q4, though it was up 1% YoY. However, we note that a small upside revision to inventory statistics may easily lift Q4 GDP back into positive territory and thus negate the recession mantra. Despite encouraging leading indicators, private consumption was the major drag as real income growth

remained negative while shrinking fixed asset investment and government expenditure also contributed negatively. Net export growth remained positive due to higher services exports, driven by intellectual property rights income. Even though we maintain our cautious outlook for growth in Q1 of this year, we still believe that the Bank of Japan will end its negative interest rate policy (NIRP) in its late April meeting as the board is taking a more forward looking stance amid the ongoing 'Shunto' spring wage negotiation round.

Credit

Strong demand meets robust supply

Credit spreads ended the week tighter with cash bonds outperforming CDS, despite weak and volatile equity markets after the higher than expected US inflation prints. Credit resilience seems to be driven mainly by higher government bond yields that are attracting inflows into IG funds and ETFs. Supply has also been robust, with a new record of USD 189bn set in the US IG credit market in January. Furthermore, USD 37bn of new bonds were sold last week alone, with the new deals being largely well received. Bristol Myers gathered orders exceeding

USD 85bn for its USD 13bn debt sale to finance recent acquisitions and paid single-digit to negative new issue concessions across the nine tranches of the deal. In Europe, Siemens sold the largest corporate bond offering in a year, raising EUR 5bn including a 20 year tranche. Issuance is expected to remain strong as most companies will exit blackout period after their earnings releases. Eventually, however, the strong supply, along with historically tight spreads is likely to limit the upside in credit, especially compared to stocks.

What to Watch

- The Flash PMIs for major regions will show whether the growth momentum in the manufacturing sector improved further in February.
- In addition to PMI data, next week will see Eurozone Consumer Confidence numbers as well as the German ifo survey. Germany will release the full details of its Q4 2023 GDP print. The ECB will release their January inflation expectation survey.
- In APAC, we expect both the Bank of Korea and Bank Indonesia to keep policy rates unchanged. Japan will release its PMIs and the Reuters Tankan for February, export data for January and machinery order statistics for December. In China, we will watch whether the PBoC will cut the LPR, as it left the MLF rate unchanged over the weekend. January home prices will be published on Friday. India will release its February PMIs, while Australia will report February PMIs and wage data for January. CPI data for January will be released in Hong Kong, Singapore and Malaysia. Japan's markets will be closed on Friday to celebrate the Emperor's birthday.

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