Weekly Macro and Markets View

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Highlights and View

Japan's Nikkei 225 stock index finally breaks through its 1989 high

Although the broader TOPIX index still lags the bubble level set in the '80s, Japanese stocks are back in vogue amongst investors, with momentum strong.

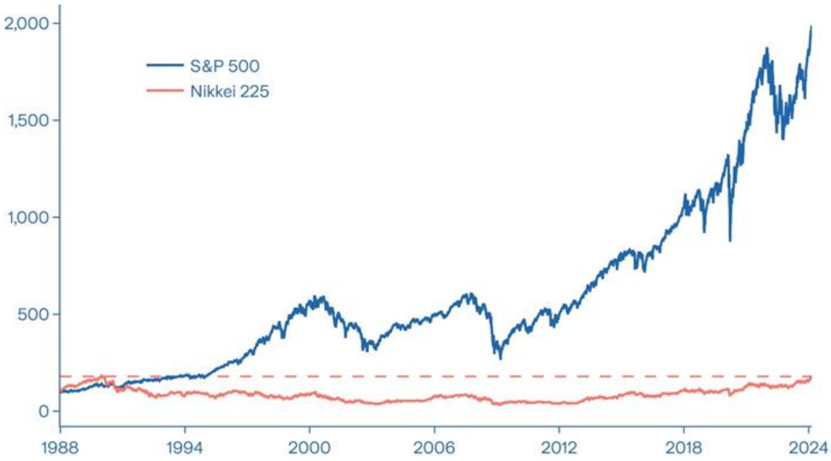
Benchmark European natural gas prices continue to fall sharply, trading at levels seen before the invasion of Ukraine

While structural pressures for higher energy prices are relevant, these falls are currently leading to lower electricity prices across the Eurozone, aiding disinflation.

UK business activity expands at the fastest pace since May 2023

The improving outlook suggests that the recession is already over. However, rising costs remain a concern, particularly in the service sector.

Japanese stocks hit new highs after 34 years in the wilderness



Source: Bloomberg

Equity momentum continued to be robust last week, as investors were encouraged by news from both sides of the Pacific. Following the bursting of Japan's asset bubble back in 1989, when stocks traded in excess of 60 times earnings, the Nikkei 225 index managed to break through to reach a record high. It has been a long wait for investors since then, with the move is even less impressive when inflation is adjusted for, and certainly in comparison to the US market over the same period. Time, however, has brought market multiples back to the mid-teens, and investors are reloading. The weak yen and more shareholder focus coming from corporate Japan is likely to support momentum for some time yet despite signs of short-term, over-bought conditions emerging. While Japan may no longer be home to the leading global technology companies, the US market continues to benefit from its technology behemoths. Last week it was Nvidia, the AI chip manufacturer, that showed that despite the high multiples, which reflected extremely bullish investor expectations, it was still able to surprise positively with a cracking set of Q4 numbers. The stock is up 59% YTD, hitting an intra-day market capitalisation of USD 2tn last Friday. Although the top US tech companies have reached rich multiples and are certainly not immune from chunky setbacks, as 2022 illustrated, outstanding business models, dominant market positioning and extremely large war chests of cash will likely maintain their leadership credentials for some time yet.

US

Service activity slows

The latest batch of PMIs shows slightly lower activity in February but continues to point at trend-like growth in the first quarter. The Manufacturing PMI ticked up from 50.7 to 51.5, the highest level since September 2022, indicating that the extended contraction in manufacturing may have come to an end. On the other hand, activity in the service sector has slowed from 52.5 to 51.3. It's worth noting that services firms highlighted caution with regards to hiring due to cost concerns and softer new order growth. The Conference Board's leading index also deteriorated to -0.4% MoM in January from -0.2% the month before. The latest Fed minutes do not provide much additional insights, but a number of FOMC members continued to urge caution regarding the path of expected Fed rate cuts as inflation rates remain significantly above the Fed's target. Investors have now almost fully priced out the possibility of a rate cut in March and are expecting less than 100bps of cuts in the coming twelve months.

Eurozone

A silent collapse in energy prices

Much ink has been spilled discussing the European energy crisis. Whisper it quietly, but there may yet be reasons to be optimistic on this front. Natural gas is trading back at 2021 prices, before Russia's invasion of Ukraine, having fallen a further 50% since December. Electricity prices are falling, even in Germany, and at current trends could soon be back to average levels. There are plenty of risks to this possibility, including the fact that these price falls may reflect weak global demand, volatility may re-assert itself, and the phasing in of carbon credits in 2026 could create longer-term upside price pressures. Nevertheless, current prices represent a key tailwind for the Eurozone economy, particularly the manufacturing sector, while also further reducing immediate inflationary pressures. But we are yet to see this come through in the data. Last week's PMIs showed a broad improvement in Eurozone countries with the exception of Germany. Services continue to lead the way, with manufacturing sentiment unexpectedly declining further in February.

North Asia

Japan celebrates a record high for the Nikkei 225 index

As mentioned on the front page, the Nikkei 225 Index managed to reach a new record high after a 34-year wait. However, economic data did not add to the festive mood as PMIs for February, including some of the most relevant sub-indices, contracted. We do not expect this downward trend to continue as special factors seem to have been the main drag. On the political front, Prime Minister Kishida's approval rating fell to a record low in the wake of the ruling LDP's funding scandal. In China, Lunar New Year travel and entertainment spending rose to a record high, although we note that the per capita figures were less convincing. House prices continued to fall. New home sales remained lacklustre, but second home sales rose sharply. The PBoC finally cut the 5yr LPR rate, which is the benchmark for mortgages and longer-term corporate loans, by 25bps to 3.95%. South Korea's exports contracted 7.8% YoY in the first twenty days of February, but we do not read too much into this statistic due to various distortions.

India

Still glowing

India's Flash PMIs continue to reflect a positive outlook for the economy, marked by the strength of the services sector. The Flash Services PMI climbed from 61.8 to 62, reaching a seven-month high. The manufacturing sector also experienced decent expansion, with a reading of 56.7. Other components of the Flash PMIs, such as new orders and new export orders, also indicate an expansionary trend. India remains a bright spot, with sustained growth driven by public capital expenditure, though private consumption has seen more modest growth. Despite the strong growth environment, inflation has steadily fallen since its peak in July 2023 to the upper limit of the Reserve Bank of India's (RBI) target range. Nevertheless, the RBI has adopted a prudent stance when it comes to rate cuts. That said, we anticipate mild rate cuts by the RBI later this year. Ahead of the inclusion of Indian sovereign bonds into the JPM Government Bond EM Index, foreign flows into the bond market have been robust. Equities, while maintaining positive momentum, have seen modest flows YTD.

Credit

Strong demand remains in flows and supply

US IG credit had another strong week of issuance with the largest weekly volume since March 2022, mostly driven by M&A related deals. After Cisco's USD 13.5bn deal on Wednesday, biopharmaceutical company AbbVie sold USD 15bn on Thursday to fund recent acquisitions. Investors' appetite remained healthy with USD 85bn in orders, allowing the issuer to pay flat to 5bps concessions across the various tranches. AbbVie is the third borrower to bring a jumbo acquisition financing transaction following Bristol Meyers the previous week. On Friday, 3M's healthcare unit Solventum sold USD 6.9bn to fund its spin-off. Despite these large deals, credit spreads continue to narrow, but at a slower pace compared to the end of last year, with the US underperforming Europe. Inflows to credit mutual funds were also strong as investors continued to bet on lower yields should central banks start to cut their rates. However, credit spreads are at historically expensive levels, which should limit further upside in credit performance, especially relative to stocks.

What to Watch

- In the US, consumer confidence will give important insights into the current state of households while personal spending is expected to have slowed in January.
- A key indicator, preliminary Eurozone inflation for February will be published on Friday and is expected to drop from 2.8% YoY to 2.5%. Prior to that, Thursday will bring the individual German, French, and Spanish inflation prints.
- In APAC, Japan will publish the usual set of monthly indicators for January, while China will release PMIs for February. In Hong Kong, the budget will be announced, as well as foreign trade and retail sales data for January. Australia's monthly CPI will reveal insights into inflation trends while home prices are expected to show slower growth. India's Q4 GDP growth is anticipated to decelerate from the previous quarter yet remain robust. Taiwan will report industrial production, export orders, and labour market data for January, while South Korea will release export data for February.

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