BNY

iFlow

WEEK AHEAD

July 7, 2024

Doubt

"Curiosity will conquer fear even more than bravery will." – James Stephens

"Faith and doubt go hand in hand, they are complementarians. One who never doubts will never truly believe." – Herman Hesse

Summary:

The week ahead will highlight the doubts about the summer and rest of year as investors climb a wall of worry about US growth slowing down and the FOMC policy to stay high for longer in their push to get inflation lower. The world risks of a recession revolve around geopolitical rifts, the payback from higher rate policies and the shift in trade, all of which suggest a world still learning post-Covid economics.

The voters in the UK gave a landslide victory to Labour and the voters in France surprised with a win for the left. The far-right RN and its allies failed to win a majority with the surprise New Popular Front – the leftist coalition - leading followed by Macron's centrists in the race for control of the 577 in parliament, however, according to early exit polls no one gets an absolute majority. This won't comfort markets given the swing to left wasn't priced, nor the likely minority coalition government that follows but the shift to higher fiscal will add to central bank inflation risks. The weekend also brought some relief to Japan PM Kishida as the Tokyo Governor Koiko wins her third term. This indirectly helps the struggling LDP with the cabinet suffering record low support at 25%.

Politics in the US fester with the doubts about both Presidential candidates in the US ongoing as democrats are still discussing President Biden replacements, while Trump is not clear of lawsuits. NATO meetings this in Washington DC will be important for all. The ongoing wars in Israel and Ukraine grind on with focus on Iran and Russia while fears of escalation in both continues. The week ahead brings US

CPI, more from FOMC Chair Powell, and the preliminary July consumer sentiment in the US. The economic data focus outside the US tracks UK GDP, trade and China CPI, trade and credit data. The central bank decisions from New Zealand, Korea and Malaysia make clear the role of USD and FOMC policy balancing against domestic growth concerns. The historic highs in US shares will be tested by the start of 2Q earnings with focus on banks, while energy markets contend with US refinery risks with Monday hurricane risks in Texas against hopes for a Gaza peace deal.

Themes:

- **Fed balancing between jobs and inflation** – The curse of the dual mandate returns to the FOMC as they see post Friday the unemployment rate at 4.1% and indicators point to a slowing labor market, balancing against the slowing CPI, but not yet at the goal. The risk for investors is that the Fed cuts rates without achieving the 2% CPI target. This will increase fears that we have lost central bank credibility, the USD will remain vulnerable, and the cost of debt will show a term risk premium again. There is a balancing act for investors beyond the FOMC decision as they bet on an extended decade for pick-up in productivity growth and the risk of higher and more volatile inflation. The FOMC Chair faces the Congress and will highlight the limits of forward guidance when data dependency dominates.
- **Political uncertainty - will fiscal doubts dominate bonds over policy easing?** In France the surprise outcome of the New Popular Front will make clear fiscal risks matter to markets. In the UK this wasn't so scary but the Autum Budget could matter. In the US, some investors are betting on higher inflation under Trump because of trade and economic policies such as higher tariffs on imports, and profligate government spending along with lower tax revenues, which would boost fiscal deficits and U.S. debt levels. Trump's team has said his pro-growth policies would bring down interest rates and shrink deficits. Investors had bet heavily early this year on a normalization of interest rates, but that has sharply changed with the Fed increasingly being seen as pushing rate cuts out further. Traders of futures contracts tied to the Fed's policy rate are betting on about two rate cuts for the rest of 2024, one-third of the policy easing investors were hoping for in January. Year-to-date total returns, which include bond payouts and price fluctuations, were minus 0.6% as of Friday, the ICE BofA US Treasury Index), returns have been negative since early February.
- **Oil, Israel and the Iranian Election** - The Reformist candidate Masoud Pezeshkian has won Iran's presidential election after pledging to re-engage with the west to secure sanctions relief and to relax social restrictions in the Islamic republic. The former health minister secured 16.3mn votes in Friday's

run-off, defeating hardliner Saeed Jalili who garnered 13.5mn votes, according to the interior ministry. Pezeshkian's success is a remarkable turnaround for the reformist camp, which has spent years in the political wilderness. It was bolstered by an increase in turnout which was officially put at 49.8%, compared with a record low of 40% in the first round. Throughout the campaign, Pezeshkian emphasized his religious beliefs and reiterated that he would follow Khamenei's guidelines. So just how much the domestic and foreign policy shift will remain a question – and one that matters to oil, the entire region and to the wars in Israel and Ukraine.

- **2Q Earnings and the 2Q GDP** - can profits rise even when growth stalls? The S&P 500 (.SPX), opens new tab has rallied 16% so far in 2024, driven by a handful of massive stocks poised to benefit from emerging artificial intelligence technology. Only 24% of stocks in the S&P 500 outperformed the index in the first half, the third-narrowest six-month period since 1986, Meanwhile, the equal-weight S&P 500 -- a proxy for the average stock -- is only up around 4% this year. As of Tuesday, about 40% of S&P 500 components were down for the year. Second-quarter earnings kick off next week with major banks including JPMorgan and Citigroup reporting on July 12. Investors will be watching whether profits from other companies are catching up with the "Magnificent 7": Nvidia, Microsoft, Apple, Alphabet, Meta Platforms and Tesla many of which rebounded from struggles in 2022. In particular, the loan loss provisions around CRE, consumer loans and the quality of fees vs. trading revenues will be a focus for the banks in the weeks ahead.

What are we watching:

- **Economic Releases**: **Monday** – Japan wages, US consumer credit; **Tuesday** – Australia, Business Confidence, Mexico CPI; **Wednesday** – China CPI/PPI, Norway CPI; **Thursday** – UK GDP May, Industrial Production, trade, US CPI, weekly jobless claims; **Friday** –China trade, M2 and CNY loans, Japan industrial production, Sweden CPI, India CPI, US PPI, Michigan consumer sentiment.
- **Central Banks/Events**: **Monday** – India Modi/ Russia Putin meetings; Singapore MAS, Israel BOI; **Tuesday** – NATO Summit, FOMC Powell testimony, ECB Cipollone; **Wednesday** – New Zealand RBNZ, FOMC Powell continues; Fed Bowman, Goolsbee, ECB Nagel, BOE Pill; **Thursday** – Malaysia BNM, Korea BOK, Fed Bostic, Musalem; Peru BCRP; **Friday** -
- **US Issuance:** The US Treasury sells $119bn in notes this week with cash flow expected zero, but over the next four weeks -$106.2bn with $315bn in issues

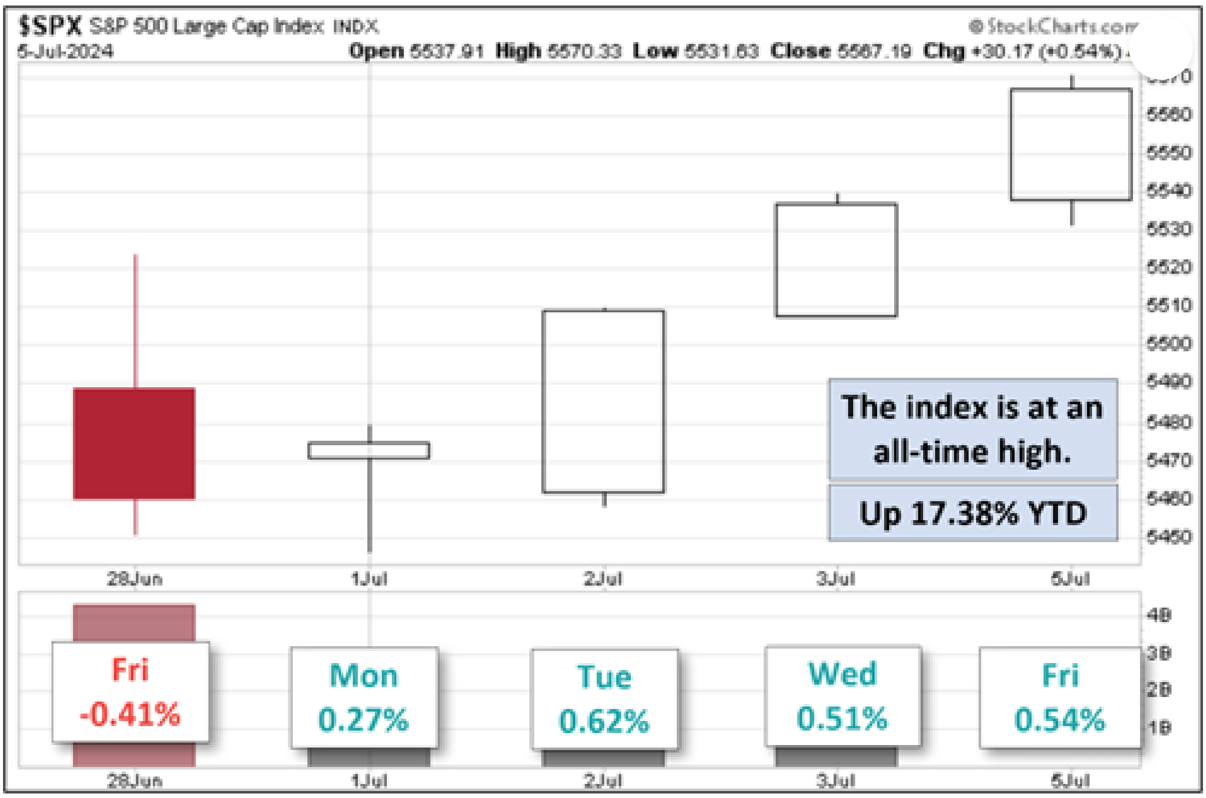
against $208.8bn in redemptions and coupons. Tuesday - $58bn in 3Y notes, Wednesday -$39bn in 10Y notes and Thursday -$22bn in 30Y bonds.

- **EU Issuance:** Austria, Germany, Netherlands and Italy are expected to issue E13bn in bonds, with cash flow negative E22bn as E22.2bn of issues are offset by just E0.2bn in coupons from Italy; with Tuesday -E2bn from Netherlands in 20Y Green DSL, Austria E1.5bn in 5Y Green RAGB and 20Y RAGB; Wednesday Germany sells E0.5bn in 12Y Bunds and E1.5bn in 14Y Bunds; Thursday Italy sells E7.3bn of BTPs.

What changed this week:

- **The S&P 500 starts 2H2024 with a new record high**. The index is currently up 17.38% year to date and has recorded a new all-time high 34 times this year – that is second to 70 in 2021 but above the 33 in 2020. The DJIA rose 0.54% on the week, up 4.47% on the year, while the NASDAQ jumped 2.77% on the week and up 22.26% ytd. The Biggest winner last week was Japan Nikkei up 3.36%, then the French CAC 40 up 2.62% while the worst was China CSI 300 off 0.88% and Swedish OMX off 0.5%. Our Mood Indicator for iFlow was significantly positive much of the week and 4 regions saw inflows.

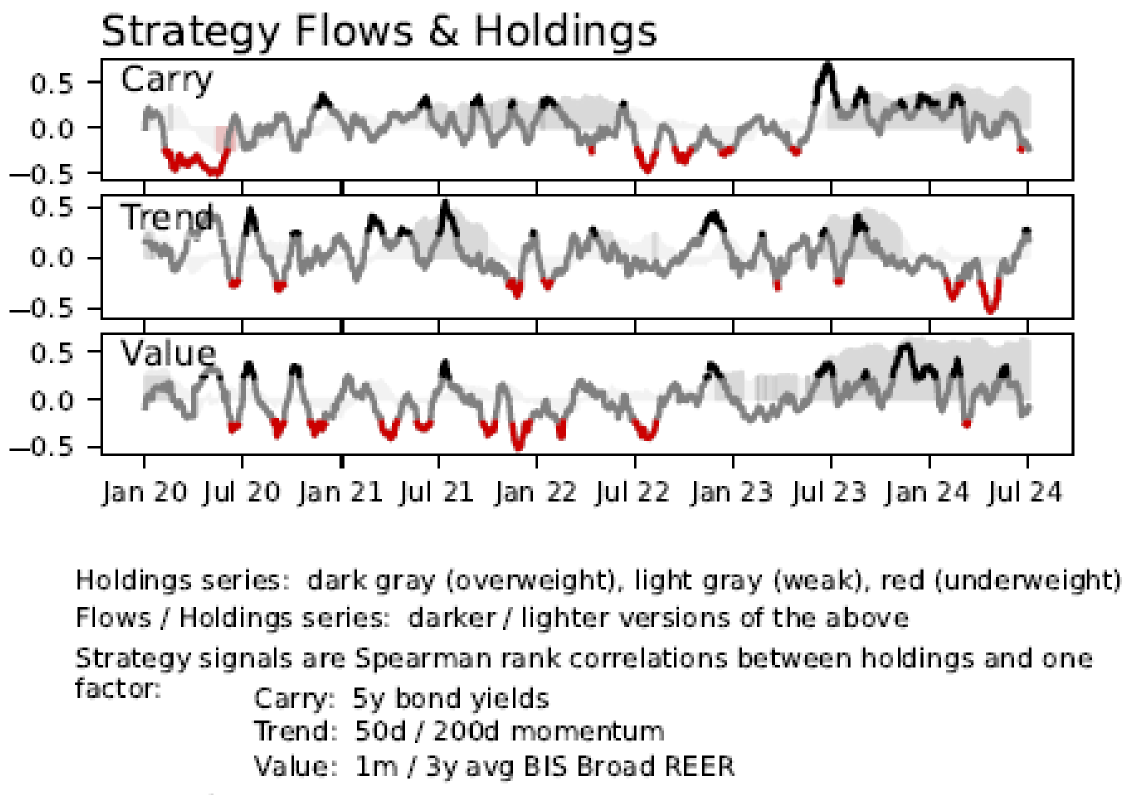
Exhibit #1: New Records in US S&P500



Source: Bloomberg, BNY Mellon

- The **FX markets saw the US dollar drop 0.95% - the first decline in 7 weeks**. The biggest gainer was BRL up 2.5% as efforts to cap the currency dominated the central bank efforts despite ongoing political issues. The ILS rose 2.3% while HUF gained 1.9%. The losers were INR off 0.1%, TWD off 0.15% and KRW off 0.2% even as the tech and AI equity story held. The week had carry factors negative but just shy of significant correlation while the trend factor was positive albeit ending outside of significance over July 4th holiday. The most overheld currencies in iFlow were PLN, MXN and CAD while JPY, THB and CZK led the shorts. USD short positioning started to accelerate again reversing from the smallest short since May 2023.

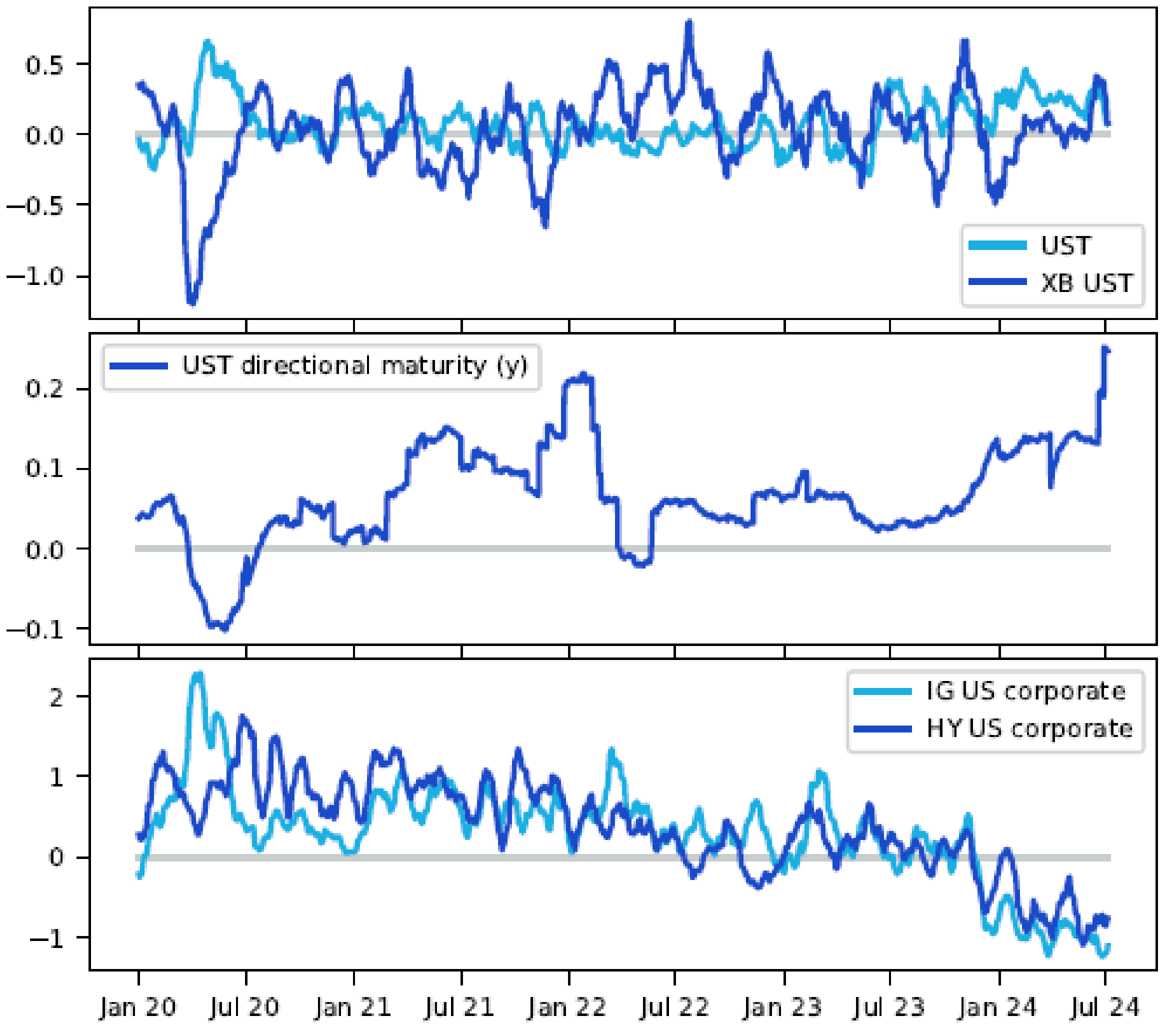
Exhibit #2: Carry still negative, Trend still positive



Source: iFlow, BNY Mellon

- **In Fixed Income, the US curve bull steepened** with term risk premium returning early in the week followed by investors pricing in 2 rate cuts from the FOMC after further weaker US Service ISM and higher unemployment. The US 2/10Y curve ends -32.5bps with 2Y at 4.605% and 10Y at 4.28% with the auctions next week a focus on curve and demand. The 10Y US move was notable in the moves Wednesday and Friday off 18bps on the week. The biggest movers outside the US were Italy off 17bps to 3.932%, Gilts off 16bps to 4.125%, while the worst were China where PBOC put in a floor lifting 10Y up 3.5bps to 2.26% while Japan 10Y rsoe 1.5bps to 1.06% and New Zealand rose 6bps to 3.19%.

Exhibit #3: US bonds cross border bid erodes, duration demand acceleration



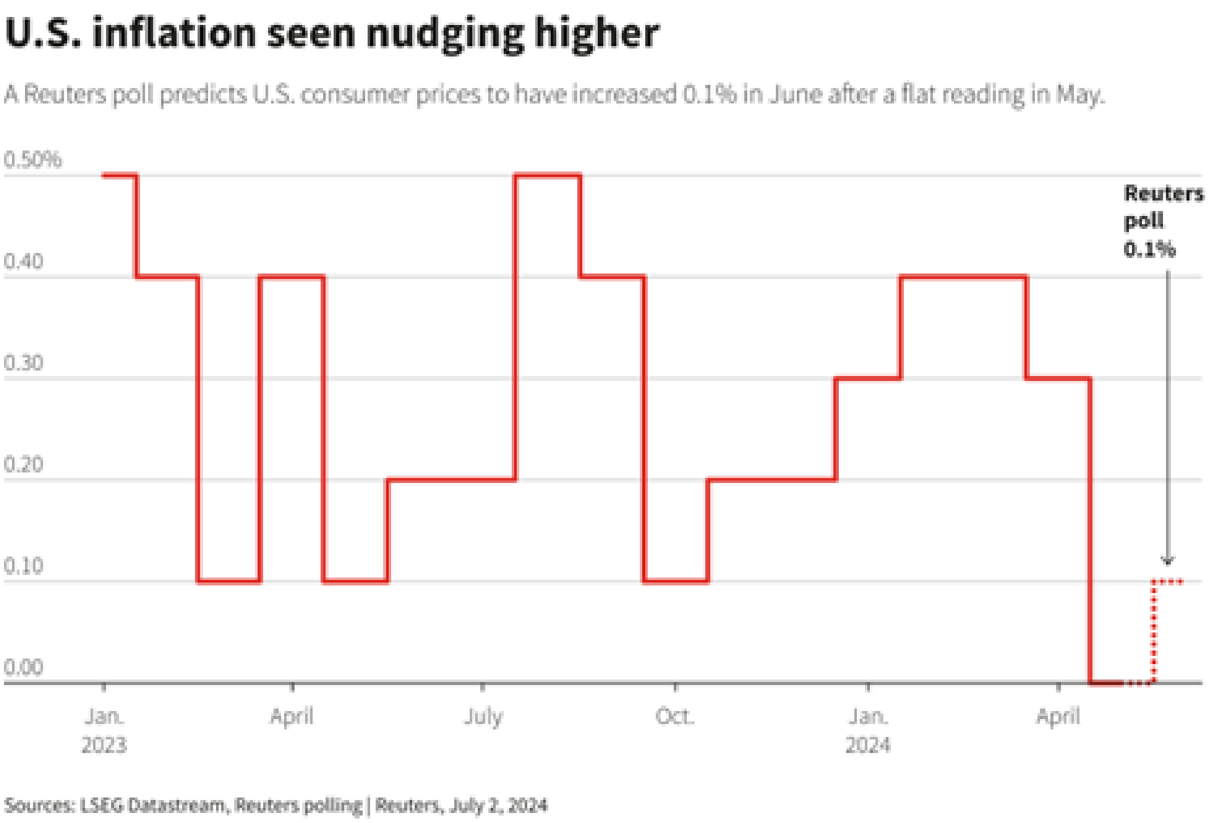
Source: iFlow, BNY Mellon

News Agenda and Weekly Themes – US CPI, China CPI, FOMC Powell, RBNZ, BOK

In the United States, attention will be paid to the release of CPI and PPI data for June, followed by Federal Reserve Chair Powell’s semiannual testimony on monetary policy at the Senate Banking Committee. Additionally, investors will closely follow the Michigan consumer confidence report. In Europe, the spotlight will be on the second round of parliamentary elections on Sunday. Elsewhere, interest rate decisions will be announced in New Zealand, South Korea, and Malaysia, accompanied by inflation data releases in Mexico, China, Brazil, India, and Russia. In the UK, key data points include GDP for May, goods trade balance, industrial production, and the BRC retail sales monitor. China will release its inflation rate, PPI, new yuan loans, and trade balance data. Australia will report on NAB business confidence and Westpac consumer confidence, while India will release its industrial production figures. Germany's trade balance will also be closely monitored.

1. US CPI and FOMC Powell - what level matters for an easing in September?
Thursday's monthly U.S. consumer price index reading will shape views on whether the Fed could cut interest rates in the coming months. The June reading is expected to have climbed 0.1%, according to a Reuters poll, after being unexpectedly unchanged in May.. Data late last month showed another inflation measure, the personal consumption expenditures price index, rose 2.6% on an annual basis - suggesting inflation is cooling, but the measure was above the Fed's target of 2%.
That comes of course after Powell's testimony before Congress on Tuesday. He told a conference in Portugal this week that the U.S. is back on a "disinflationary path," but policymakers need more data before cutting interest rates.

Exhibit #4: US CPI and FOMC Powell key

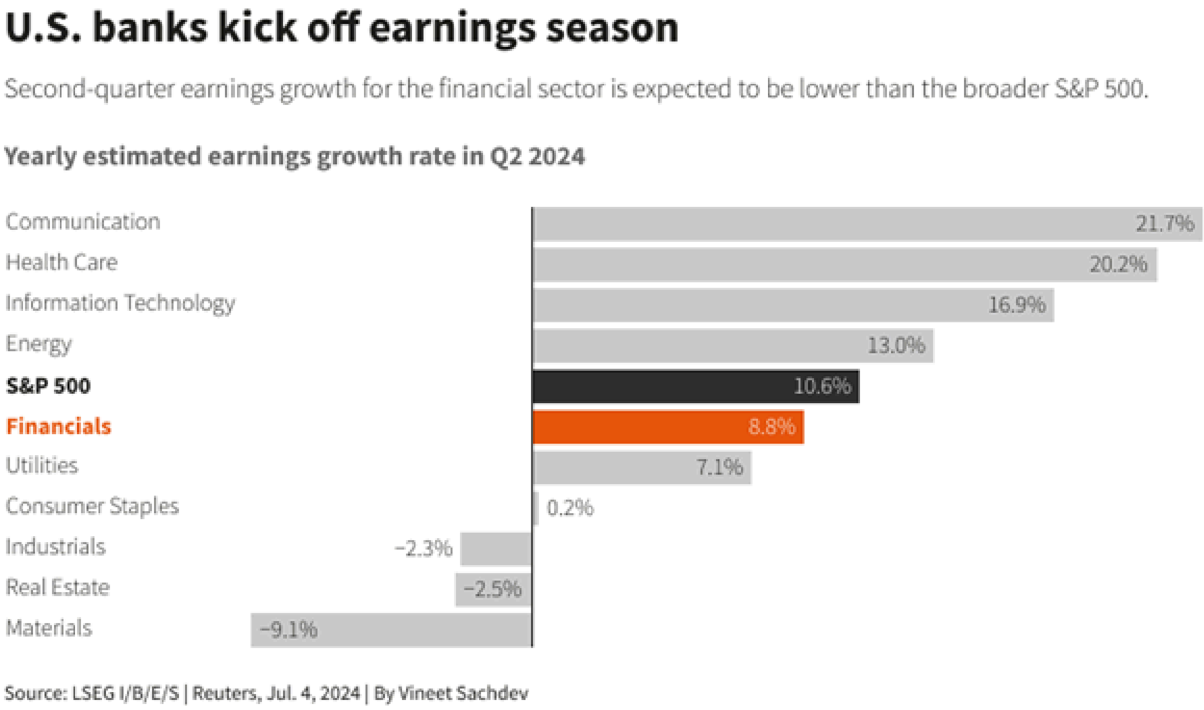


Source: Reuters, BNY Mellon

2Q Earnings and the banks - Higher interest rates and an uncertain economic environment are casting a cloud over U.S. bank earnings, with the second-quarter reporting season kicking off. JPMorgan Chase (JPM.N), opens new tab, Citigroup

(C.N), opens new tab and Wells Fargo (WFC.N), opens new tab will report second-quarter earnings on July 12. Bank of America (BAC.N), opens new tab will release its results on July 16.. The largest U.S. lender, JPMorgan, is expected to report earnings per share (EPS) of $4.69, according to LSEG estimates - below $4.75 a year earlier. Bank of America's EPS is forecast to slide to 79 cents from 88 cents a year earlier, though EPS at Citi and Wells Fargo are projected to climb. Executives' commentary on the path of interest rates will remain a key focus, especially after industry leaders cited improving conditions for investment banking, analysts said.

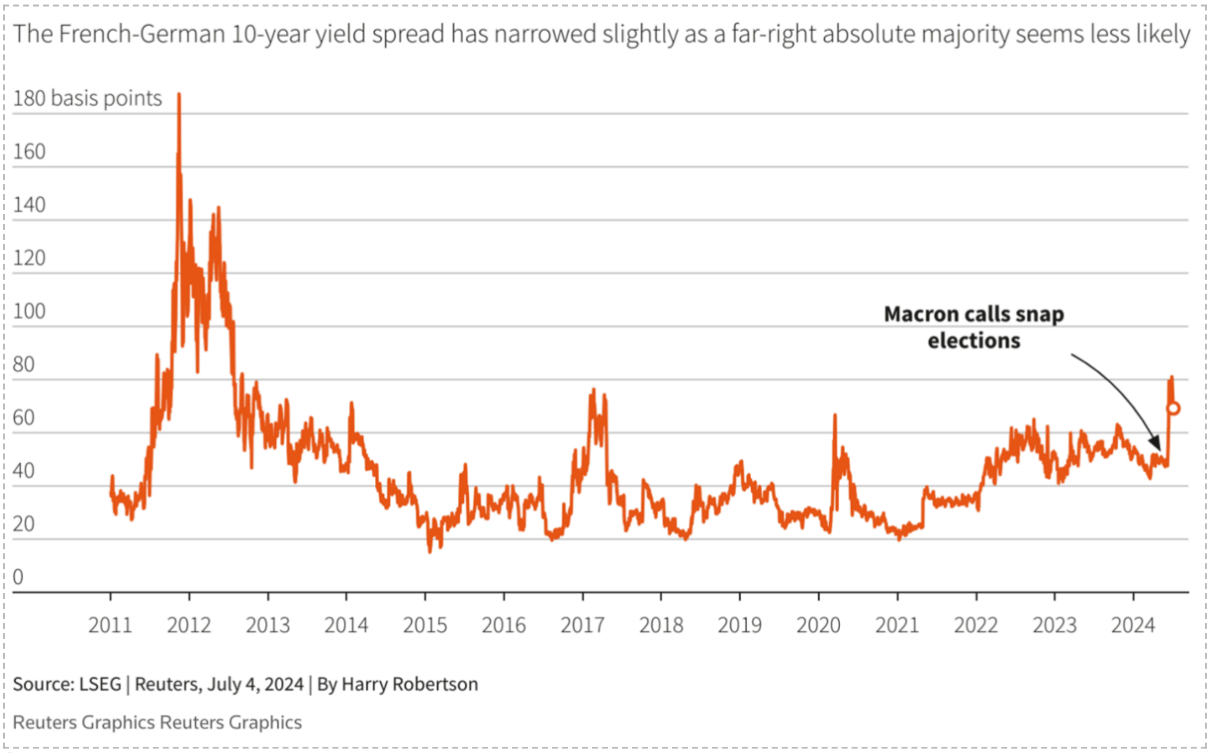
Exhibit #5: US Bank Earnings set tone for 2Q



Source: Reuters, BNY Mellon

French Elections and the Risk Premium - Prospects for higher spending under a left government, was not priced into markets in June. Instead, the fear of Le Pen dominated. But investors were more optimistic this week, with the RN posting a smaller win than some polls expected. What is the central question is how Macron deals with a minority left government. The cross-party bid to keep RN away from power worked but the unintended outcome may also spook markets. The risk premium on France's debt over Germany's has dropped to around 65 basis points, after hitting its highest since 2012 last week at 85 bps. But a hung parliament is no comfort for investors, as it risks a policy paralysis that could make it even harder to improve France's stretched finances that have left it facing European Union's disciplinary measures.

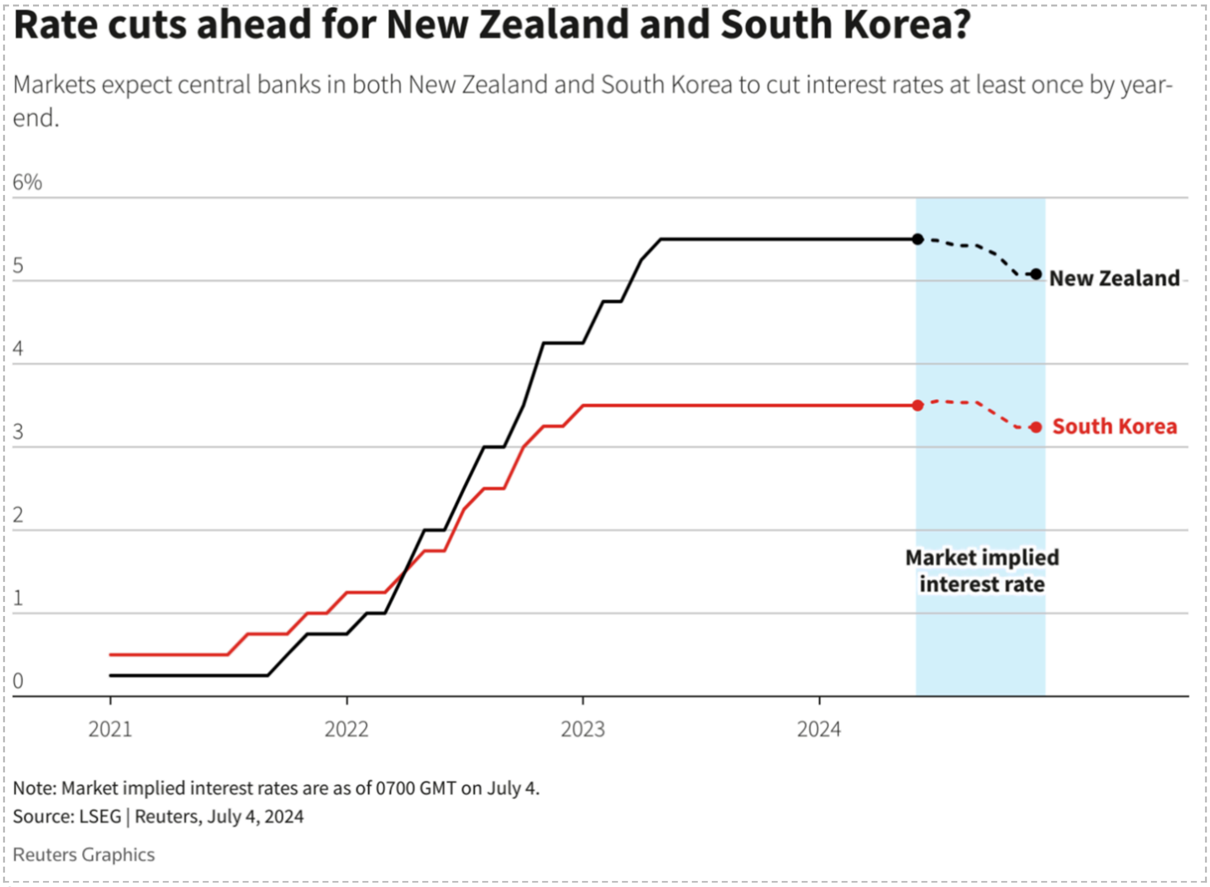
Exhibit #6: French bonds are a barometer for EU politics



Source: Reuters, BNY Mellon

Will the RBNZ or BOK guide to a cut and add to the divergence trade? Investors are hungry for clues on whether rate cuts are coming this year at the Reserve Bank of New Zealand and the Bank of Korea. Both central banks have taken a cautious stance amid stubbornly high inflation, are widely expected to keep rates steady at 15-year highs at their meetings on Wednesday and Thursday, respectively. In New Zealand in particular, policymakers even flagged the risk of another hike this year, with a cut not projected until late 2025. Markets are more optimistic, pricing for a single cut this year to come as early as October, as inflation cools, business sentiment deteriorates, and domestic demand weakens. South Korea has had even more pronounced indications of prices coming under control, but the market consensus is still for no cut until the fourth quarter. Political pressure is mounting though, with President Yoon Suk Yeol calling cuts to keep in step with the U.S. Federal Reserve "unavoidable."

Exhibit #7: BOK and RBNZ could shift tone



Source: Reuters, BNY Mellon

Calendar July 8-12

Central Bank Decisions

- **Singapore MAS (Monday, July 8th) –** We expect MAS to keep policy unchanged at July's meeting. Looking ahead, further lowering CPI trajectory ahead could see MAS to ease by flattening the SGD NEER slope, BUT we don't think there is sufficient data swing to shift MAS in either direction. Growth momentum has eased a touch in Q2 2024, especially on consumer spending, but more important and relevant to MAS is the evolution of CPI. Singapore headline and core CPI are converging around 3%. MAS is likely to maintain view that CPI to step down more discernibly in Q4 2024. We will be playing close attention for any changes in CPI forecast (unlikely in our opinion).
- **Israel BoI (Monday, July 8th) –** The surprisingly soft inflation print in May could point to some scope for easing expectations by the BoI to come through but inflation continues to push against the 3% headline level on a realised and forecast basis, and we expect the central bank to continue pushing back against such prospects. The supply constraints in the economy and fiscal pressures continue to point to upside risk on prices so we expect ongoing caution by the BoE. We doubt there will be much change in the guidance compared to the May release but circumstances are largely beyond the BoI's control.

- **New Zealand RBNZ (Wednesday, July 10th) –** The market will need to avoid pricing in an excessively hawkish RBNZ only to be disappointed thereafter, which has been the tendency in recent meetings. No change is expected in the cash rates and RBNZ will likely consolidate its position as having the highest yields in G10 markets. Current demand levels are mixed as consumer confidence is declining but realised national account figures continue to indicate expansion where terms of trade recover. There are clear signs of weakness in house prices but prior dips have not proven sustainable and we believe the RBNZ will need far more evidence of sustained declines in non-tradable inflation before acting.
- **Korea BoK (Thursday, July 11th) –** Bank of Korea is expected to keep rate unchanged at 3.5%. All eyes will be on BoK's take on the latest inflation declines and their confidence on inflation considering BoK upped its rhetoric on inflation at May meeting, commented that "upside risk to inflation forecasts have increased". In light of the resurgence of household debt, tensions within corporate re-financing with 3m CP-CD elevated at 53bp and the risk of further currency weakness, our view is for BoK to stay on the hawkish side and at risk to disappoint market's dovish expectation. Markets have been carried away somewhat with easing expectations, considering the moves in FRAs, indicating around 40bp in easing priced based on the 9x12m FRA relative to current CD rates.
- **Malaysia BNM (Thursday, July 11th) –** We see BNM to maintain a neutral stance, and to continue to hint of intervention or smoothing activities to safeguard FX stability. More recently, BNM recently noted that "a pilot program to repatriate foreign-currency balances will be expanded in the future". Since the previous meeting on in May, domestic data have been strong with higher-than-expected final reading of Q1 GDP at 4.2% y/y. Headline CPI ticked higher at 2.0% in May but overall business confidence remains sluggish. We see no convincing argument for BNM to shift in either direction. Inflation or growth momentum is neither too hot (high) or too cold (low) to warrant changes. If anything, evolution of the currency market remains a top concern even though USDMYR has been hovering around 4.69/4.72 since June.
- **Peru BCRP (Thursday, July 11th-)** - We see Peru maintaining a neutral stance with rates on hold at 5.75%. The CPI in June edged up to 2.3% from 2.0% and disappoints investors after the June hawkish hold stand. The persistent wage pressures are key for the central bank to continue to ease, while growth and unemployment have improved in 2Q along with sticky inflation.

Key data/releases

Date	BST	EDT	Country	Event	Period	Cons.	Prior
07/08-07/12	***01:00***	****20:00***	***SI***	***MAS Review***	***Jul-08***	***unch.***	***N/A***
07/08/24	00:50	*19:50	JN	BoP Current Account Balance	May	¥2350.2b	¥2050.5b
07/08/24	***14:00***	***09:00***	***IS***	***Base Rate***	***Jul-08***	***4.50%***	***4.50%***
07/09/24	07:30	02:30	HU	CPI YoY	Jun	3.90%	4.00%
07/10/24	00:50	*19:50	JN	PPI YoY	Jun	2.90%	2.40%
07/10/24	02:30	*21:30	CH	PPI YoY	Jun	-0.80%	-1.40%
07/10/24	02:30	*21:30	CH	CPI YoY	Jun	0.40%	0.30%
07/10/24	***03:00***	****22:00***	***NZ***	***RBNZ Official Cash Rate***	***Jul-10***	***5.50%***	***5.50%***
07/10/24	07:00	02:00	NO	CPI MoM	Jun	--	-0.10%
07/10/24	07:00	02:00	NO	CPI YoY	Jun	2.90%	3.00%
07/10/24	08:00	03:00	CZ	CPI MoM	Jun	0.20%	0.00%
07/10/24	08:00	03:00	CZ	CPI YoY	Jun	2.40%	2.60%
07/10/24	12:00	07:00	US	MBA Mortgage Applications	Jul-05	--	-2.60%
07/10/24	13:00	08:00	BZ	IBGE Inflation IPCA YoY	Jun	4.34%	3.93%
07/10/24	13:00	08:00	BZ	IBGE Inflation IPCA MoM	Jun	0.32%	0.46%
07/10/24	23:45	18:45	NZ	Food Prices MoM	Jun	--	-0.20%
07/11/24			***SK***	***BOK Base Rate***	***Jul-11***	***3.50%***	***3.50%***
07/11/24	00:50	*19:50	JN	Core Machine Orders MoM	May	0.90%	-2.90%
07/11/24	07:00	02:00	GE	CPI YoY	Jun F	2.20%	2.20%
07/11/24	07:00	02:00	GE	CPI MoM	Jun F	0.10%	0.10%
07/11/24	07:00	02:00	UK	Industrial Production MoM	May	0.20%	-0.90%
07/11/24	07:00	02:00	UK	Manufacturing Production MoM	May	0.40%	-1.40%
07/11/24	***08:00***	***03:00***	***MA***	***BNM Overnight Policy Rate***	***Jul-11***	***3.00%***	***3.00%***
07/11/24	12:00	07:00	SA	Manufacturing Prod NSA YoY	May	0.80%	5.30%
07/11/24	13:00	08:00	BZ	Retail Sales YoY	May	--	2.20%
07/11/24	13:30	08:30	US	CPI MoM	Jun	0.10%	0.00%
07/11/24	13:30	08:30	US	CPI YoY	Jun	3.10%	3.30%
07/11/24	13:30	08:30	US	Initial Jobless Claims	Jul-06	--	238k
07/12/24	05:30	00:30	JN	Industrial Production MoM	May F	--	2.80%
07/12/24	07:00	02:00	SW	CPI MoM	Jun	0.10%	0.20%
07/12/24	07:00	02:00	SW	CPI YoY	Jun	2.80%	3.70%
07/12/24	07:00	02:00	SW	CPI Level	Jun	416.7	416.18
07/12/24	08:00	03:00	TU	Current Account Balance	May	-1.50b	-5.29b
07/12/24	13:30	08:30	US	PPI Final Demand MoM	Jun	0.10%	-0.20%
07/12/24	15:00	10:00	US	U. of Mich. Sentiment	Jul P	67	68.2

Key events/speeches

Date	BST	EDT	Country	Event
07/06/24	08:15	03:15	EC	ECB's Muller
07/06/24	13:30	08:30	EC	ECB's Villeroy Speaks in Aix
07/08/24	08:00	03:00	CZ	CNB minutes
07/08/24	17:15	12:15	UK	BOE's Haskel speaks
07/09/24	10:00	05:00	EC	ECB's Cipollone Speaks
07/09/24	15:00	10:00	US	Fed's Powell Testifies to Senate Banking
07/10/24	03:00	*22:00	NZ	RBNZ Monetary Policy Review
07/10/24	09:00	04:00	EC	ECB's Nagel Speaks
07/10/24	10:00	05:00	IT	Istat Releases the Note on Italian Economy
07/10/24	14:30	09:30	UK	BOE's Huw Pill speaks
07/10/24	15:00	10:00	US	Fed's Powell Testifies to House Financial Services
07/10/24	19:30	14:30	US	Fed's Goolsbee, Bowman Give Opening Remarks at Childcare Event
07/11/24	16:00	11:00	MX	Central Bank Monetary Policy Minutes
07/11/24	16:30	11:30	US	Fed's Bostic Speaks in Moderated Q&A
07/11/24	18:00	13:00	US	Fed's Musalem Speaks in Q&A on Economy

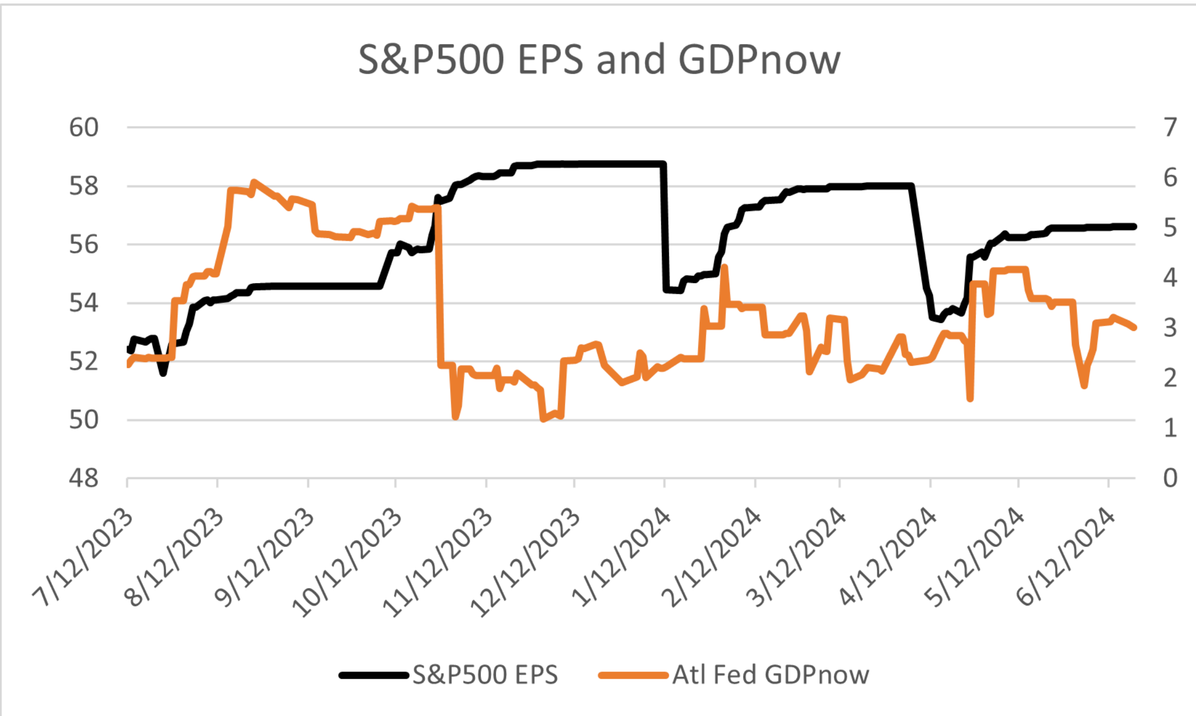
Conclusions: Is the split between stocks and bonds widening?

The questions about asset allocation in 3Q matter significantly given the positioning we see and the risks for surprises. The biggest surprises for the last week were in the US data weakening and the split between market expectations for FOMC easing rising while the comments from Fed officials remained steadfast in supporting just one cut ahead for 2024. The risks of less than a US soft-landing story is in play and that matters most to stocks which for 2Q are expecting a robust earnings season ahead. The correlation of US growth to US corporate earnings matters here. Overall, analysts have made smaller cuts to EPS estimates than average according to FactSet setting up the next 3 weeks of July for volatility around earnings.

For Bonds, the slowdown in US growth is seen as less important to Fed policy than the rise in unemployment over 4.0% - as the dual mandate of the Fed makes full employment a counterbalance to stable prices. The risk of US inflation not reaching the 2% goal when job markets are slowing is a key question for investors in the weeks ahead. Some of this will come from the Earnings reports and CEO outlooks from 2Q. The risk reward of bonds also has a notable return in political expectations wrapped around fiscal outlook.

Bottom Line: The US CPI and FOMC Powell will dominate the week ahead, as their outcomes will set the baseline for bond yields and stocks into rest of the month. The USD weakness may also be a key focus given the French election surprise and the risk of EUR staying in a range rather than breaking out. While many see US dollar weakness as a natural and needed outcome of US growth slowing, the alternatives aren't so obvious still – with the EUR stuck with political doubts overlayed with growth troubles, with the UK new government waiting for its fiscal test, with the JPY short notable and the doubt about the speed of Fed rate cuts essential to the logical for all hopes across most of the world. The power of the July seasonality that stocks just go up in summer seems likely to be tested by the events ahead.

Exhibit #8: Growth and EPS link



Source: Bloomberg, BNY Mellon

Disclaimer & Disclosures

Please direct questions or comments to: iFlow@BNYMellon.com

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