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Wealth Management Chief Investment Office
16 June 2023

Weekly Market View

An epic battle brewing?

→ Markets seem to be building up for a tussle with central banks this summer. Risk assets have surged in recent weeks after overcoming several hurdles.

→ Meanwhile, core inflation across Developed Markets (DM) remains sticky, well above central bank targets. As a result, DM central banks have turned more hawkish lately. Investor positioning in parts of the equity market now looks stretched.

→ Our base case remains for an economic slowdown in the US and Euro area over the next 12 months bringing down price pressures, which suggests the Fed and the ECB are nearly done with policy tightening.

→ Nevertheless, if the ongoing Artificial Intelligence-led rally extends, which is possible given 'mania'-like characteristics, there is a risk of the central banks raising rates further. Thus, we would be cautious in chasing the ongoing rally and instead focus on maintaining a diversified foundation allocation.

Do you expect US equities to continue to outperform their Chinese peers?

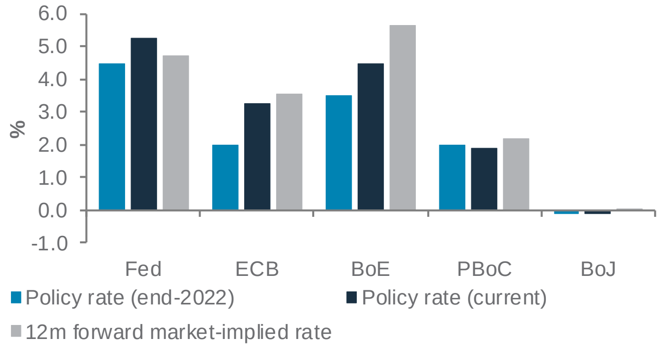
Do the Fed's hawkish pause and ECB's rate hike alter your near-term view on the USD and EUR?

How do the PBoC's surprise rate cuts impact this week impact the CNH and Chinese bond yields?

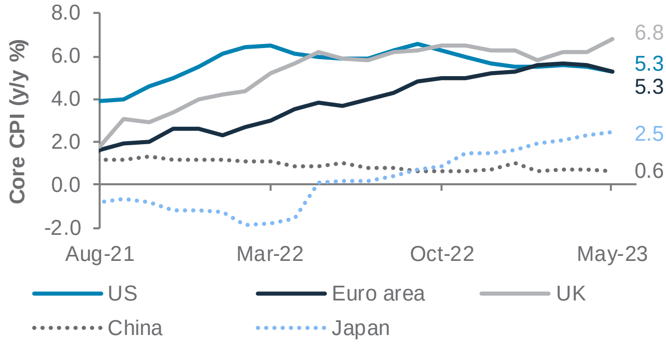
Charts of the week: Turning hawkish again?

Developed Market central banks have turned more hawkish lately amid elevated core inflation, while China cut rates

Major central bank rates and money market estimates



Core inflation across major economies



Source: Bloomberg, Standard Chartered

Editorial

An epic battle brewing?

Markets seem to be building up for a tussle with central banks this summer. Stocks and other risk assets have surged in recent weeks, breaking above key technical resistance levels, after overcoming several hurdles such as the US banking crisis, US debt ceiling drama and China's relapse in economic activity. Meanwhile, core inflation across Developed Markets (DM) remains sticky, well above central bank targets. As a result, DM central banks have turned more hawkish lately. Investor positioning in parts of the equity market now looks stretched.

Base case: Our base case remains for an economic slowdown in the US and Euro area over the next 12 months bringing down price pressures, which suggests the Fed and the ECB are nearly done with policy tightening. Nevertheless, if the ongoing Artificial Intelligence-led technology sector rally extends, which is possible given 'mania'-like characteristics, there is a risk of the central banks raising rates further. Thus, we would be cautious in chasing the ongoing rally and instead focus on maintaining a diversified foundation allocation.

No tolerance for inflation: The DM central banks' unease with the market rally easing financial conditions was evident from the Fed projecting another 50bps of rate hikes by end-2023 and the European Central Bank raising rates to a 23-year high and anticipating even higher rates. These followed surprise rate hikes from the central banks of Australia and Canada last week. Next week, the Bank of England is likely to signal higher rates after upside inflation surprises. This suggests major central banks are not yet giving up the fight against inflation. In the US, data this week showed core inflation remains well above target at 5.3% y/y and m/m price changes resilient at 0.4% for the third straight month, even as headline inflation continued to cool.

Two scenarios: Resilient DM core inflation so far raises doubts about Fed Chair Powell's "Immaculate disinflation" thesis, wherein inflation falls sharply without a significant deterioration in employment (watch Powell's Congress testimony next week for more on this). Instead, there is a greater chance of one of the two scenarios playing out: either DM inflation falls sharply on the back of a further downturn in growth, or the central banks continue to hike rates if growth and inflation remain resilient. Leading indicators continue to flag meaningful deterioration in DM growth (watch PMI data next week). Thus, both these scenarios point to the risk assets rally stalling over the 6-12-month period, despite any near-term upside.

East-West policy divergence: The divergence in monetary policies between the DM central banks and China/Japan also raises scope for market volatility during the summer. This week, China's central bank cut one of its key rates for the first time in 10 months as post-pandemic recovery flags and deflationary pressures build. The Bank of Japan separately held on to its ultra-dovish monetary policy despite rising inflation pressures.

Investment implications: A hawkish turn in DM monetary policy due to sticky core inflation is likely to challenge the ongoing risk asset rally at some point in the coming months. Near-term market diversity indicators (see page 7) are showing heightened risk of a reversal in global equities, particularly in US communications and technology sectors, Emerging Market Local Currency bonds and EM ex-Asia equities. Thus, we see better value in higher quality bond markets (DM government bonds and Asia USD corporate bonds) where we expect the best potential for generating returns over the next 12 months.

We also see opportunity to add to China equities. Sentiment towards this market appears to be excessively depressed and policymakers are starting to take coordinated measures to revive confidence. Meanwhile, policy divergence has led to a surge in USD/CNH. The resilience in the CNH in trade-weighted terms vs pre-pandemic levels suggests authorities are unlikely to stand in the way of a slightly weaker CNH (see page 5).

— Rajat Bhattacharya

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as neutral for risk assets in the near term

(+) factors: Softer US consumer inflation, China policy stimulus

(-) factors: Hawkish Fed & ECB; slower US industrial data, China activity

	Positive for risk assets	Negative for risk assets
Macro data	• US consumer inflation slowed more than expected to 4.0% y/y, the lowest since March 2021; core inflation moderated to 5.3% y/y, but remained resilient m/m at 0.4% • US producer prices rose less than expected • US core retail sales rose more than expected	• US industrial production unexpectedly contracted 0.2% m/m • US initial jobless claims rose more than expected • Euro area ZEW growth expectations fell further • China retail sales, fixed-asset and property investment rose less than expected; factory output rose as expected • China youth jobless rate rose to an all-time high • China credit growth slowed more than expected
	Our assessment: Neutral – Slower US consumer and producer inflation vs. weaker China activity, US industrial data	
Policy developments	• China cut 7-day reverse repo rate and 1-year medium-term lending facility rate by 10bps • The PBoC governor Yi Gang committed to more countercyclical adjustments and lower borrowing costs • China authorities are reportedly considering a broad stimulus package • BoJ maintained its ultra-dovish monetary policy	• The ECB hiked rates by 25bps as expected; President Lagarde signalled another hike in July • Fed pauses as expected but signalled another 50bps of hikes this year • Former US Treasury Secretary Summers said US economy is still "very, very hot"
	Our assessment: Neutral – Supportive China policies, dovish BoJ vs. hawkish Fed, ECB	
Other developments		• Beijing denied US claims that it has spy operations in Cuba
	Our assessment: Negative – Geopolitical tensions	

The Fed raised end-2023 rate projections by 50bps, upgraded growth and core inflation forecasts and cut jobless rate estimates for 2023

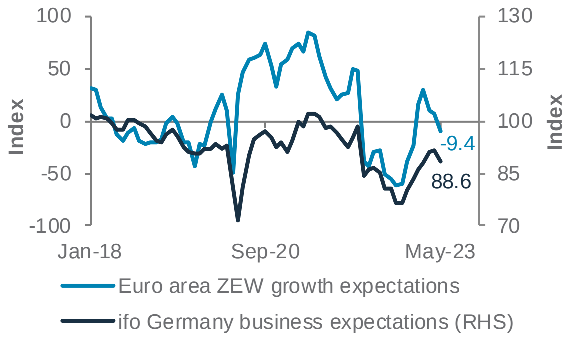
The Fed's latest projections vs. March estimates

	GDP		Unemploy-ment		Core PCE		Rates estimates	
Dates	Old	New	Old	New	Old	New	Old	New
2023	0.4	1.0	4.5	4.1	3.6	3.9	5.1	5.6
2024	1.2	1.1	4.6	4.5	2.6	2.6	4.3	4.6
2025	1.9	1.8	4.6	4.5	2.1	2.2	3.1	3.4
LR*	1.8	1.8	4.0	4.0			2.5	2.5

Old - Mar projections; **New** - Jun projections
*Longer Run
Source: Bloomberg; Standard Chartered

Euro area economic growth expectations continued to deteriorate

Euro area ZEW survey expectations of economic growth; German ifo expectations



Source: Bloomberg, Standard Chartered

China's retail sales and fixed asset investment rose less than expected in May, while factory output remained sluggish

China retail sales, fixed asset investment (YTD) and industrial output growth

Source: Bloomberg, Standard Chartered

Top client questions

Do you expect US equities to continue to outperform their Chinese peers?

Investors have been enjoying a "comfort zone" in US equities – high-valuation, interest rate-sensitive technology stocks have been rallying and US growth data has continued to beat expectations. In our opinion, though, the Fed's relatively hawkish message may moderate the tailwind for this rally. Further tightening by the Fed could lead to upward pressure on bond yields, which acts as a headwind for US technology sector valuations. This, together with potentially slowing US economic surprises, holds the potential for triggering a mild reallocation away from US equities.

Meanwhile, we see emerging green shoots in Chinese equities. While the market could arguably be past the 'sweet spot' in the reopening trade, we have seen monetary policy easing this week, illustrating authorities' determination to support Chinese growth. Moreover, US Secretary of State Blinken's visit to China may help alleviate the market's concerns over US-China relations, at least for now. MSCI China is now trading at 36% P/E discount vs. global equities, which is at one standard deviation below its 15-year average.

— **Daniel Lam,** *Head, Equity Strategy*

China equities trading at one standard deviation discount in terms of relative valuation vs. long-term average

Relative price-to-earnings ratio between MSCI China vs. MSCI All-Country World Index

Source: FactSet, Standard Chartered

Do the Fed's 'hawkish pause' and ECB's rate hike alter your near-term view on the USD and EUR?

While the Fed rate pause was in line with our expectations, the forward guidance of two more rate hikes was more hawkish than anticipated. Despite this, the USD index (DXY) has largely remained unchanged as markets are still expecting only one more rate hike this year.

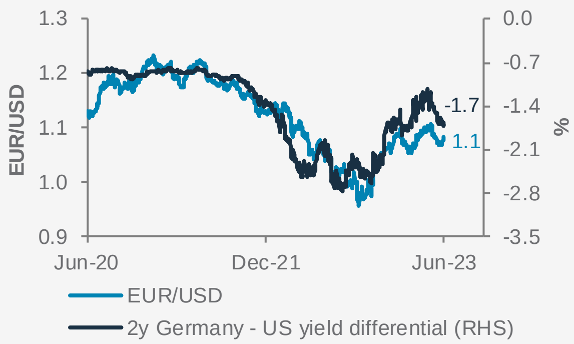
While this is likely to exert upward pressure on two-year US government bond yields, the interest rate differential (a key driver of currencies) is unlikely to change significantly given similarly hawkish guidance from the ECB, BoE and other G7 central banks. As a result, we expect DXY to trade in the 100.75-103.75 range over the next 1-3 months.

The ECB hiked interest rates by 25bps, in line with our and the market's expectations, and guided towards further rate hikes, citing still-elevated inflation. This guidance supports our investment thesis that the ECB's tightening bias and Eurozone's declining inflation are likely to turn interest rate differentials in the EUR's favour over the medium term. However, given our view of a near-term USD resilience, we view 1.0785 as the near-term support for the EUR, with 1.1033 and 1.1100 likely to act as a resistances.

— **Abhilash Narayan,** *Senior Investment Strategist*

Hawkish Fed and ECB guidance means that US and German interest rate differentials are likely to remain steady in the near-term, leading to rangebound EUR/USD

EUR/USD and 2-year German and US interest rate differentials



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

How do the PBoC's surprise policy rate cuts this week impact the CNH and Chinese bond yields?

In our last week's Weekly Market View, we highlighted that the lowering of deposit rate would likely be a precursor to policy rate cuts in China. This indeed came to pass as policymakers sought to prop up economic growth. The PBoC trimmed its seven-day repurchase rate, 3 tranches of Standing Lending Facilities (SLF) rates and one-year Medium-term Lending Facility (MLF) rate by 10bps each and released CNY 37bn of additional liquidity via medium-term loans. Both the Chinese onshore government bonds and the CNH jumped following the cuts.

While the direct growth impact from a 10bps rate cut is likely to be modest, we believe the signalling effect is powerful, especially if more rate cuts are forthcoming. With PBoC governor Yi Gang signalling more counter-cyclical adjustments earlier this month, we may see a cut of Loan Prime Rate in next Tuesday's meeting. This week, there were also reports that policymakers are considering a broad package of stimulus proposals, on top of the property support package released last week. Together, it suggests greater policymaker willingness to add stimulus to lean against growth concerns.

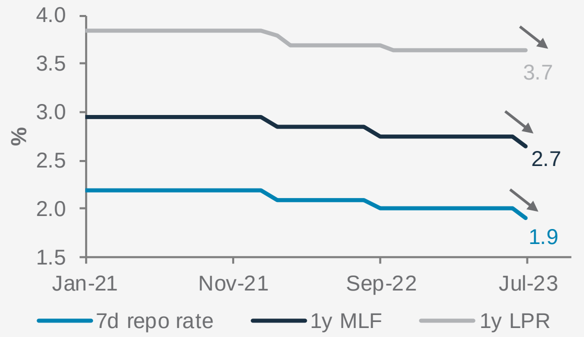
These measures are likely to maintain downward pressure on China government bond yields (ie, upward pressure on prices) in the near term. Within bonds, Asia USD remains a preferred route for us to gain exposure to the likely growth benefits of policy stimulus given the majority of the asset class comprises Chinese issuers. However, we continue to hold a strong preference for IG bonds within this.

However, falling bond yields is likely to mean further downward pressure on the CNH in the near term (ie, upward pressure on the USD/CNH pair) given a less supportive rate differential. Technical indicators argue that a move towards 7.2490 remains possible before any potential retreat. We note the CFETS policy basket (the basket of currencies against which Chinese authorities measure CNY/CNH strength) is still stronger relative to pre-COVID-19 levels; this means that while the CNH optically has weakened vs. the USD, it reduces the likelihood of more direct policy support for the currency.

— **Zhong Liang Han, CFA,** *Investment Strategist*
— **Abhilash Narayan,** *Senior Investment Strategist*

The PBoC cut a key rate this week as the post-pandemic recovery faded

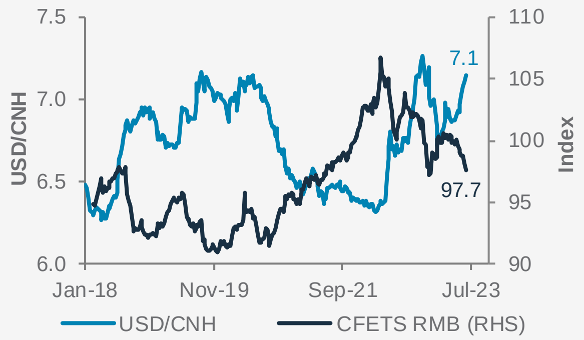
PBoC's 7-day repo rate, 1-year Medium-term Lending Facility rate and 1-year Loan Prime Rate



Source: Bloomberg, Standard Chartered

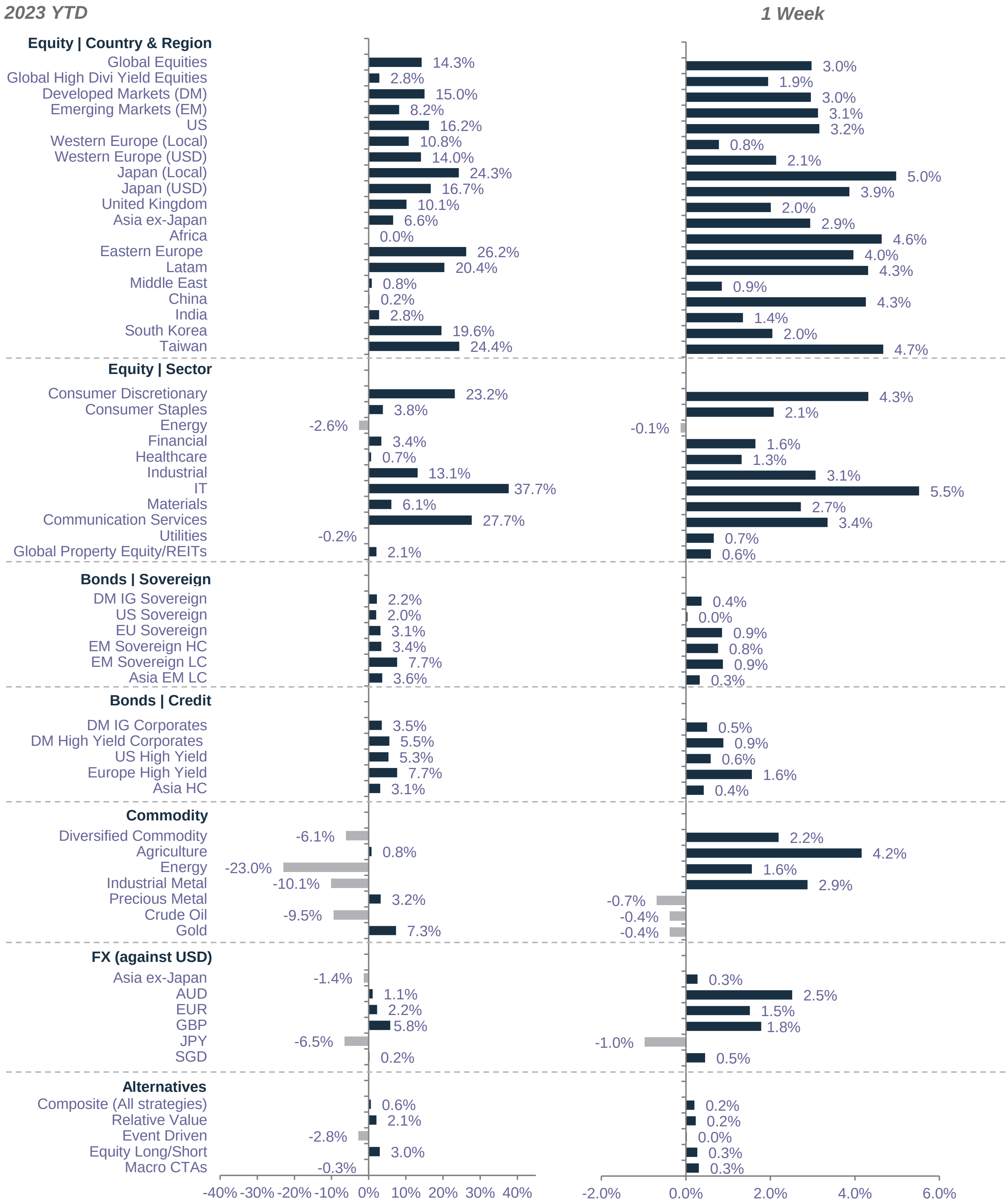
Despite the recent rise in USD/CNH, the policy CFETS basket indicates that the CNY is stronger at an aggregate level than pre-Covid levels; this limits the need for policy intervention

USD/CNH and CFETS basket



Source: Bloomberg, Standard Chartered

Market performance summary *



Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

*Performance in USD terms unless otherwise stated, 2023 YTD performance from 31 December 2022 to 15 June 2023; 1-week period: 08 June 2023 to 15 June 2023

Our 12-month asset class views at a glance

Asset class			
Equities	▼	**Preferred Sectors**	
Euro area	◆	US Healthcare	▲
US	▼	US Staples	▲
UK	▼	US Communications	▲
Asia ex-Japan	▲	Europe Healthcare	▲
Japan	▲	China Discretionary	▲
Other EM	◆	China Comm. Services	▲
Bonds (Credit)	◆	**Alternatives**	◆
Asia USD	▲		
Corp DM HY	▼	**Gold**	▲
Govt EM USD	◆		
Corp DM IG	◆		
Bonds (Govt)	▲		
Govt EM Local	◆		
Govt DM IG	▲		

Source: Standard Chartered Global Investment Committee

Legend: ▲ Most preferred | ▼ Less preferred | ◆ Core holding

Economic and market calendar

		Event Next week	Period	Expected	Prior
MON					
TUE	US	Building Permits	May	1435k	1416k
	US	Housing Starts	May	1400k	1401k
WED	UK	CPI Core y/y	May	–	6.8%
	US	Fed Chair Powell's Congress testimony	21-Jun	–	–
THU	UK	BoE Bank Rate	22-Jun-23	–	4.5%
	US	Existing Home Sales	May	4.25m	4.28m
	US	Leading Index	May	-0.8%	-0.6%
	EC	Consumer Confidence	Jun P	–	-17.4
FRI/SAT	EC	HCOB Eurozone Manufacturing PMI	Jun P	–	44.8
	EC	HCOB Eurozone Services PMI	Jun P	–	55.1
	UK	S&P Global/CIPS UK Manufacturing PMI	Jun P	–	47.1
	UK	S&P Global/CIPS UK Services PMI	Jun P	–	55.2
	US	S&P Global US Manufacturing PMI	Jun P	48.5	48.4
	US	S&P Global US Services PMI	Jun P	–	54.9

Source: Bloomberg, Standard Chartered
Prior data are for the preceding period unless otherwise indicated. Data are % change on previous period unless otherwise indicated
P - preliminary data, F - final data, sa - seasonally adjusted, y/y - year-on-year, m/m - month-on-month

The US S&P500 index's next resistance is at 4,468

Technical indicators for key markets as of 15 June close

Index	Spot	1st support	1st resistance
S&P 500	4,426	4,341	4,468
STOXX 50	4,365	4,311	4,397
FTSE 100	7,628	7,584	7,650
Nikkei 225	2,294	2,247	2,318
Shanghai Comp	3,253	3,237	3,261
Hang Seng	19,829	19,536	19,975
MSCI Asia ex-Japan	648	643	652
MSCI EM	1,024	1,009	1,031
WTI (Spot)	75.7	73.1	76.9
Gold	1,958	1,947	1,965
UST 10y Yield	3.72	3.68	3.78

Source: Bloomberg, Standard Chartered
Note: These short-term technical levels are based on models and may differ from a more qualitative analysis provided in other pages

Investor diversity narrowed in equities, EM local bonds

Our proprietary market diversity indicators as of 15 June

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↓	2.27
Global Equities	◐	↓	1.27
Gold	●	↓	1.83
Equity			
MSCI US	◐	↓	1.28
MSCI Europe	◐	↑	1.35
MSCI AC AXJ	◐	→	1.49
Fixed Income			
DM Corp Bond	●	↓	1.70
DM High Yield	◐	↓	1.42
EM USD	◐	↓	1.49
EM Local	○	↓	1.25
Asia USD	●	↓	2.01
Currencies			
EUR/USD	●	→	1.53

Source: Bloomberg, Standard Chartered; **Fractal dimensions below 1.25 indicate extremely low market diversity/high risk of a reversal**

Legend: ● High | ◐ Low to mid | ○ Critically low

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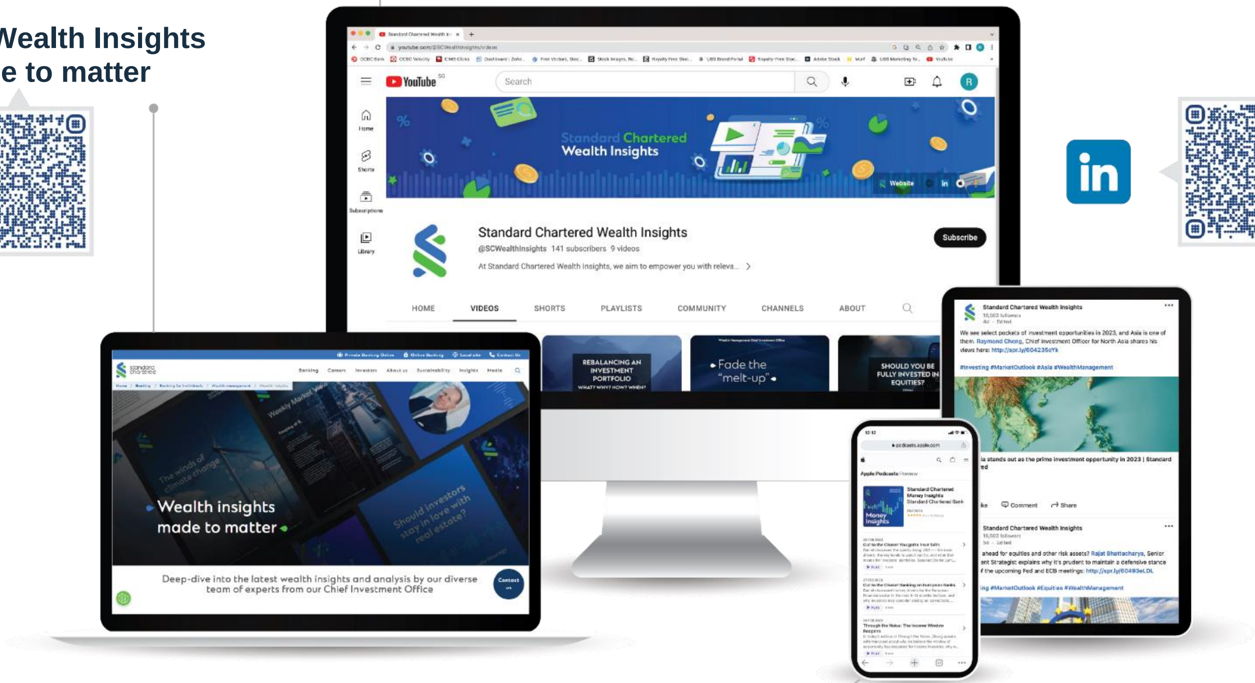

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