BNY MELLON

iFlow

WEEK AHEAD

May 26, 2024

Inflated

"I think democracies are prone to inflation because politicians will naturally spend – they have the power to print money and will use money to get votes." – Charlie Munger

"The first panacea for a misguided nation is inflation of the currency; the second is war. Both bring a permanent ruin. But both are the refuge of political and economic opportunists." – Ernest Hemingway

Summary:

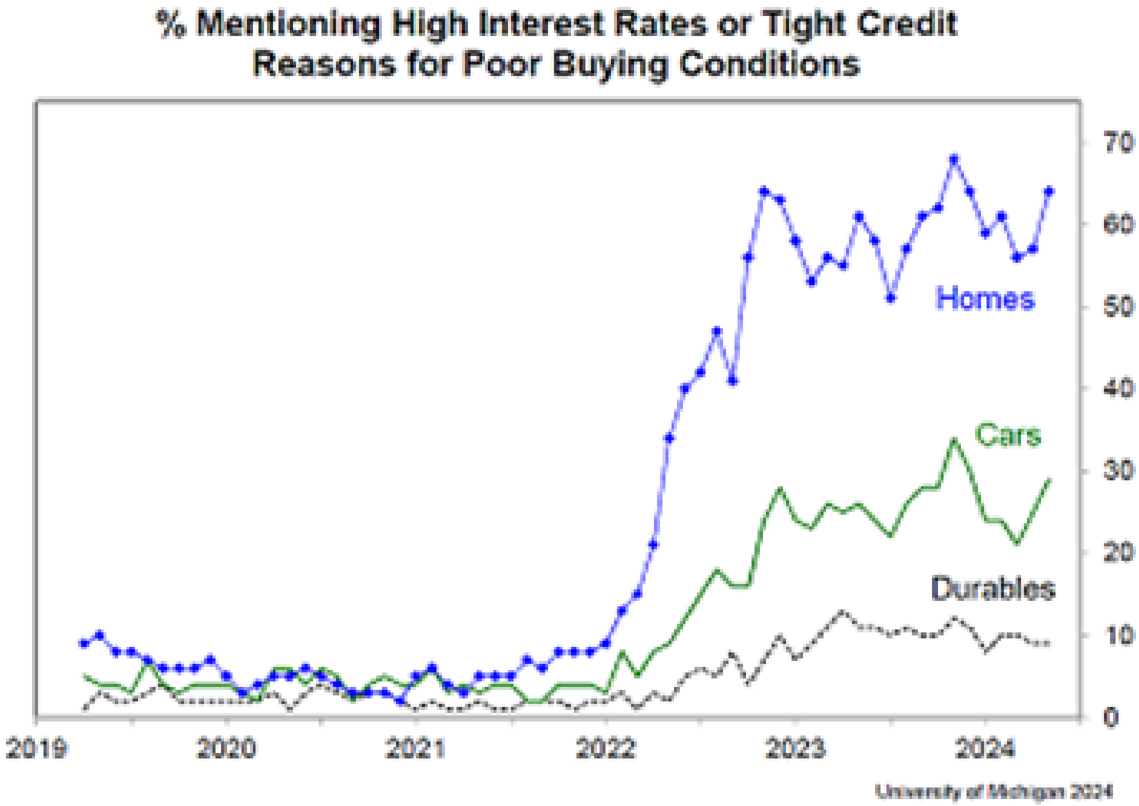
The end of May beckons and with it the end of fears about asset prices falling into their seasonal pattern of weakness and lethargy. The flows we have seen in May suggest more fear of missing out than of clear selling or buying trends. The push for returns rather than safety has put carry trades in play. Yet our flows highlight the ongoing FX value factor – with CHF, JPY and SEK and many emerging markets finding gains. The chasing of the stock ticker tape shows up most clearly in IT and the AI hype. The confusion over rates and policy ahead is obvious in bonds and the lack of certainty about inflation or growth keeps FX markets stuck in tight ranges. The S&P500 fear barometer – VIX trades below 12% back to 2019 lows - while the US bond volatility index MOVE is back to 2021 lows – both highlight the lack of concern about inflation, growth, elections and policy uncertainty. Whether this can stand the next week and the new month ahead will rest on the actual economic data on inflation, growth and the counting of votes. The Holiday shortened US week will be met with a settlement shortened plan – with T+1 dominating US markets on Tuesday, with the South African election and with the release of inflation reports in the US, Europe and Japan all key for easing or hiking risks ahead. While the US Memorial Day Holiday is the unofficial start of summer, the week ahead is expected to be anything but a vacation given the focus on growth and inflation and how politics really play out around the world.

Key Themes :

- **The natural rate and the fiscal risks** – Markets were half open Friday when Fed Governor Waller gave his R* speech. The bottom line of which was that he isn't sure that we have higher growth and higher rates after this cycle ends. The markets maybe surprised by the less hawkish result and finds some relief but for others its about the one risk he did highlight, fiscal sustainability in US debt. The ability for any nation to borrow money requires some credibility beyond its central bank.

- **Politics and Geopolitics vs. AI**- Focus on how markets have ignored risks in elections and wars in Europe and Israel – with the UK snap July 4th election announced last week and no notable reaction in bonds, stocks or GBP as an example. Risk is seen as "too calm" across markets but with no clear catalyst for larger break outs of recent ranges and with no clear trend chasing other than in equities AI where FactSet noted the 1Q earnings delivered a clear focus on the AI technology hype with 199 of 500 companies in the S&P500 mentioning the term – that is over the 10-year average of 50. The uncertainty of politics and wars has been offset by hopes for productivity and growth from technology with many seeing a larger shift in favor of the US over EU and others on the basis of AI rather than concerns about politics.

- **High for Longer – is it finally showing up in autos and housing?** The divergence of the US flash PMI for May at 25-month highs and the sharp drop in consumer sentiment to 6-month lowsv with rising job fears and ongoing inflation concerns battle for the mind of investors and policy makers. The role of politics in driving moods is also part of the picture for investors as they try to dissect risks and rewards. There is a corollary for high for longer – higher growth merits high real returns. How markets balance the risks of increased corporate profits and investments against a weaker consumer moods matters.



What are we watching: T+1, US core PCE, China PMI, CPI from Tokyo, Australia, Europe, Brazil and the South African election

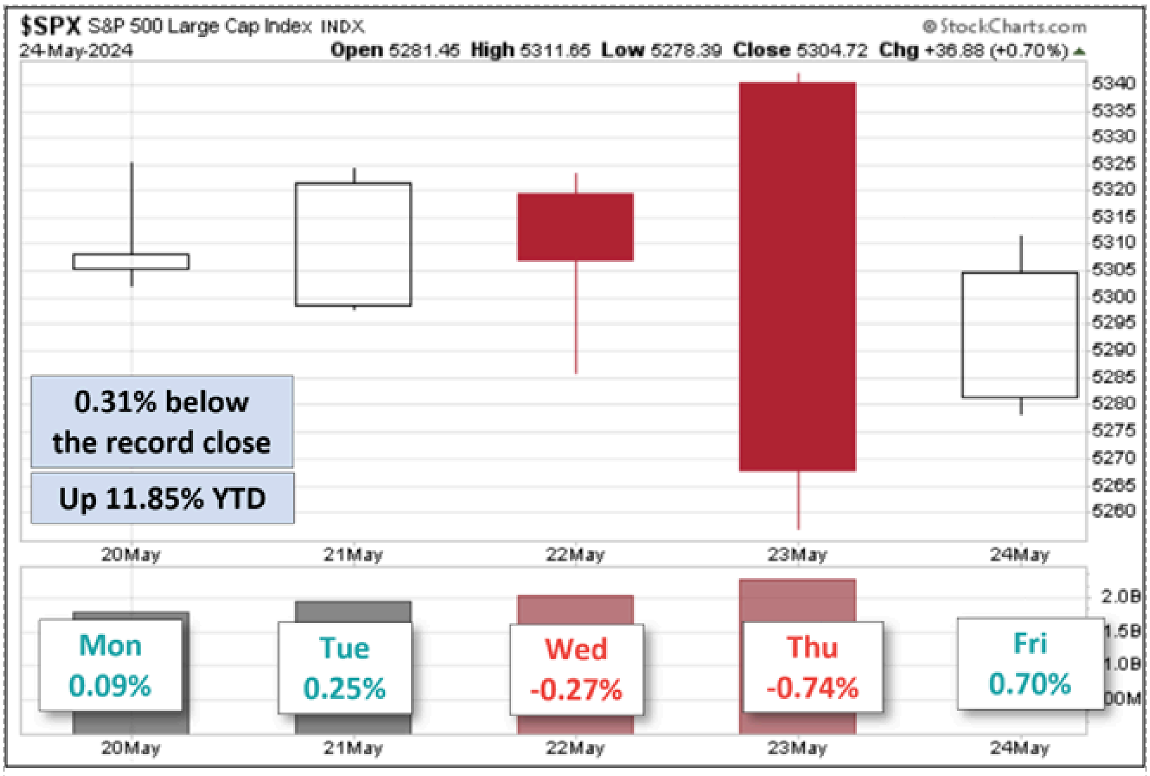
- **Economic Releases**: **Monday -** China Industrial Profits, German Ifo; **Tuesday** – Australia retail sales, ECB inflation expectations, Canada PPI, US house prices; **Wednesday** – South Africa election, German flash CPI, EU M3; **Thursday** – Sweden GDP, Swiss GDP, Taiwan GDP, EU economic barometer; Mexico jobs, US GDP; **Friday** – Japan jobs, Tokyo CPI, German retail sales, Eurozone flash CPI, US core PCE prices
- **Central Banks: Monday** – BOJ Ueda, ECB Lane, Israel BOI rate decision; **Tuesday** – Fed Cook, Kashkari; **Wednesday** – Sweden Riksbank FSR, Fed Beige Book, Fed Williams, ECB Villeroy, RBA Hunter; **Thursday** – South Africa SARB, Fed Logan, Riskbank Breman; **Friday** – Fed Bostic, ECB Vujcic
- **US Issuance**: US sells $183bn in coupons this week with cash flow negative by $191bn as $338bn is issues settle vs. $147bn in coupons and redemptions Friday. The 4-week cash flow is seen negative -$241bn. **Tuesday** - $69bn in 2Y notes, $70bn in 5Y notes; **Wednesday** - $44bn in new 7Y note and $28bn in 2Y FRN.
- **EU/UK Issuance**: EU nations expected to issue E26bn of debt with Belgium, Netherland, Italy, Germany and Finland. The cashflow is positive E66.4bn with E84.4bn of coupons and redemptions against the new issues. UK is cash flow neutral. **Monday** – EU sells 3Y E2.5bn and 19Y Green E2.5bn bonds, Belgium sells E3bn of 10Y and 30Y OLOs; **Tuesday** – Dutch sell 14Y E2bn DSL, Italy sells E4bn in 1Y and 2Y BTPs, Germany sell 5Y and 10Y E2bn Green Bunds; **Wednesday** – UK sells 15Y GBP1bn Linker, Germany sells E2bn of 14Y and

17Y Bunds; **Thursday** – Italy sells E7.3bn in 5-7Y BTPs and Finland sells E1bn in ORI

What changed last week:

- **In Equities, the US S&P500 rose for the 5th week but marginally** with just 0.03% gains while the DJIA fell 2.33% and the NASDAQ rose 1.41% to new record highs, led by NVIDA which beat expectations and led AI buying. There was a rotational focus in shares as utilities and energy fell and some IT rose but within IT there as clear divergence. Outside the US the Sweden OMX rose 0.86% given its tech focus and Canada TSE rose 0.09%. The rest of the world saw pullbacks with Hong Kong Hang Seng -4.83%, Italy MIB off 2.57%, China CSI 300 off 2.08% and in EM, Mexico Bolsa off 3.77%.

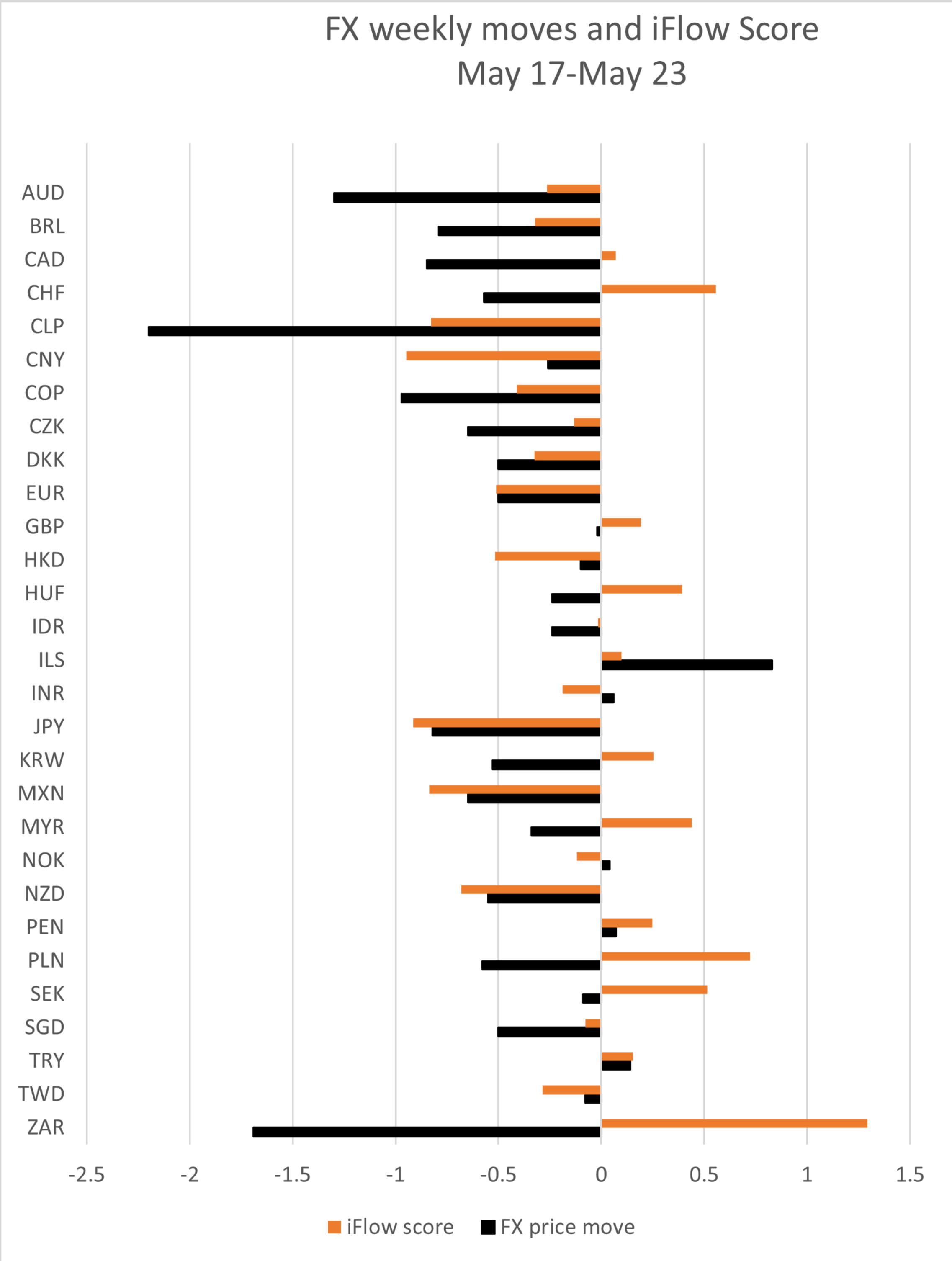
US markets rally again led by AI not the world



Source: Bloomberg, BNY Mellon

- **In Foreign Exchange**, the US dollar index gained 0.25% to 104.73, reflecting high for longer US rates and divergence of policy elsewhere. The week saw pullbacks in CLP due to copper, ZAR due to the election and Zuma ban, AUD due to commodities, China and data. The biggest winners were ILS even as war issues rise, TRY with TCMB on hold at 50%. The biggest iFlow divergence from price was in ZAR where our investors bought ZAR. Also notable was CHF, HUF, PLN and SEK – all saw inflow while prices fell. The Friday Colombia warnings on need for debt extension or default risk moved COP sharply -1.2%.

FX focus EM divergence



Source: Bloomberg, iFlow, BNY Mellon

- **In Fixed Income**, the US markets bear inverted the US rate curve further, to the widest of the year-to-date with 2/10Y -48bps. The market repriced Fed rate cuts to just 33bps to the end of the year with the odds of a September hike at 44% from 60%. The FOMC Minutes, higher flash PMI and better than expected jobless claims drove the shift in pricing from two cuts to just one in December.

The rest of the world also saw higher rates with New Zealand 10Y up 16bps on back of RBNZ hawkish hold, with the UK 10Y Gilts up 9.5bps to 4.26% on back of the PM Sunak surprise election call and with Japan 10Y JGBs up 3bps to 0.995% back to 2011 highs as weak JPY and high CPI drive BOJ hike expectations. In iFlow, the week saw notable selling in Ukraine bonds, while Philippines, Thailand, and Colombia all saw inflows. Carry themes were notable in Fixed Income broadly.

US Bond	High	Low	Current	% from Low	1W change
30Y	5.35	0.99	4.57	3.72	0.01
20Y	5.44	0.87	4.66	3.97	0.00
10Y	5.26	0.52	4.47	4.1	0.05
5Y	5.18	0.19	4.53	4.48	0.08
2Y	5.22	0.09	4.95	4.9	0.12
3M	5.63	0	5.27	5.37	0.00
FFR	5.41	0.04	5.32	5.28	-0.01
The Yields and Fed Funds Rate data from January 2007					

Source: Bloomberg, iFlow, BNY Mellon

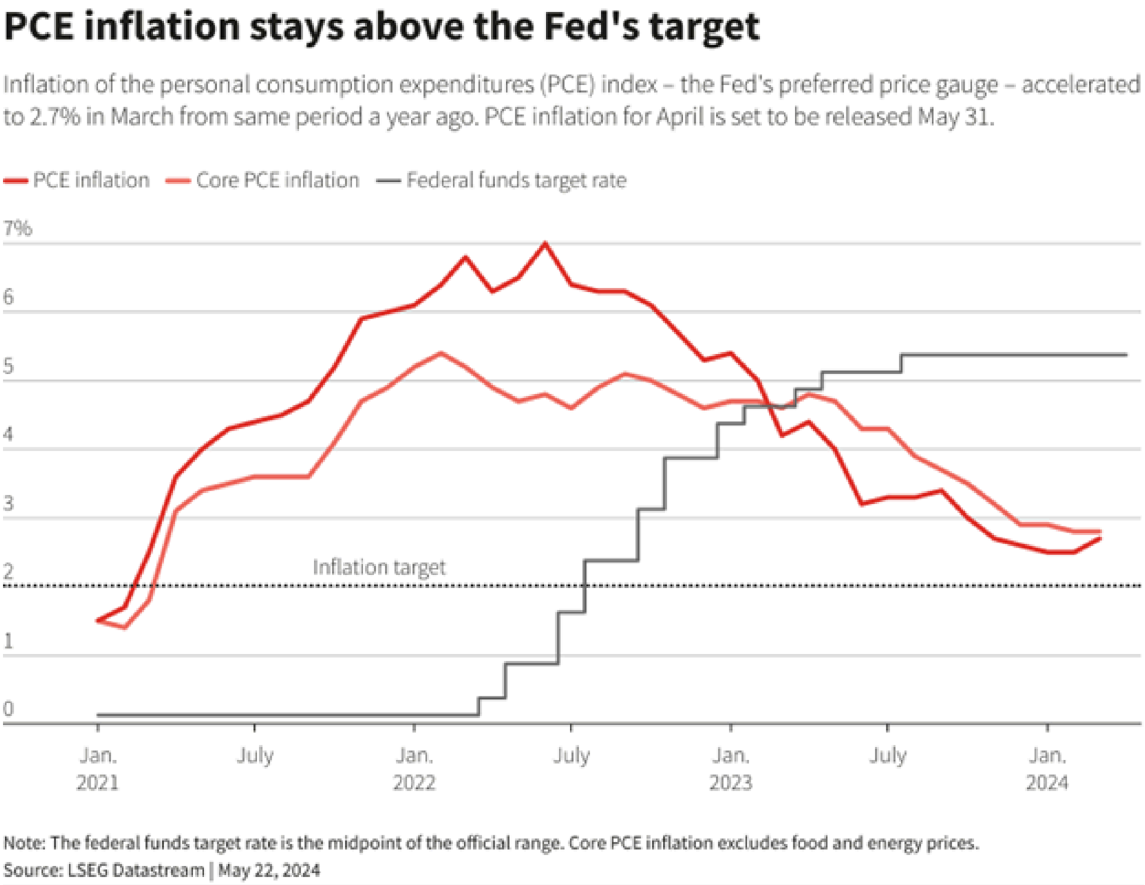
News Agenda and Weekly Themes – T+1, US core PCE, CPI from Tokyo, and Europe

In the US, investors will be closely monitoring PCE Price Index, personal income and spending and speeches by several Fed officials. Also, the focus will be on the 2nd estimate of Q1 GDP growth, corporate profits, the, CB consumer confidence, pending home sales, and the Case-Shiller Home Price Index. Globally, attention will be on inflation rates for Germany, the Euro Area, France, Italy, Spain, Poland, Australia, and the Netherlands. GDP growth rates will be released for Switzerland, Turkey, India, and Canada. Unemployment rates will be reported for the Euro Area, Italy, Brazil, and Mexico. Also, key indicators to watch include Germany’s GfK Consumer Climate Indicator, and China’s NBS Manufacturing and Services PMI. Finally, in Japan, the focus will be on Governor Ueda's opening remarks at a conference hosted by the Bank of Japan, alongside releases of data for consumer confidence, the Tokyo CPI, retail sales, unemployment rate, and industrial production.

1. US Pricing Power is this about the consumer or corporate margins – US core PCE comes on May 31 - It follows separate data earlier this month that showed monthly consumer prices increasing less than expected, which kept alive investors' hopes for rate cuts at some point this year, after hotter-than-expected inflation reports in the first quarter. The mood for FOMC rate cuts has waffled between 1-3 in

May and this report matters for setting up summer expectations. The FOMC sees the core PCE as its best indicator for inflation trend. Expectations are for the headline index to rise 0.3% m/m, 2.7% y/y while the core is expected 2.8% - both flat to March. Other US events that could matter to the debate over rates comes from GDP 1Q revisions, the Fed Beige Book and further Fed speakers including Williams, Cook and Logan. Focus on core-PCE revolves around whether the drivers of inflation are part of the consumer mood shift or if there is a risk for corporate pricing power in a sticky inflation environment. Both are being watched in the PCE report with keen focus on housing, services and how energy shifts.

Will core PCE surprise in the US?



Source: Reuters, BNY Mellon

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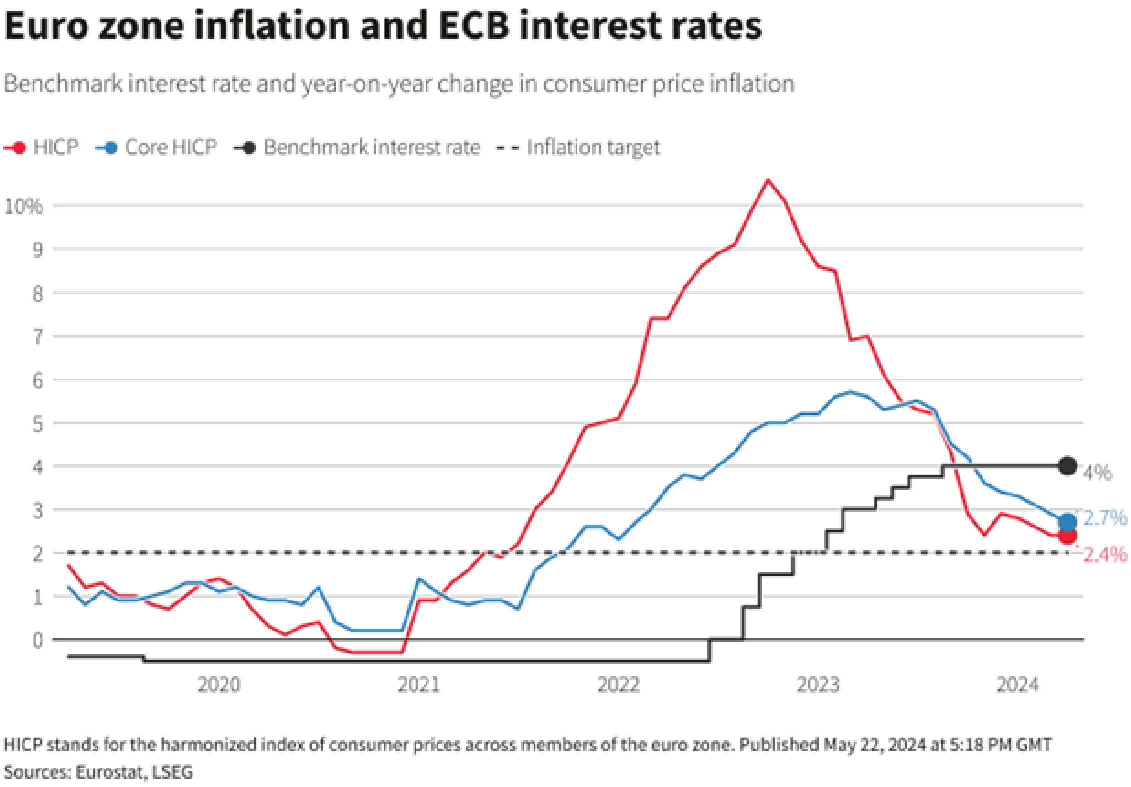
2. Eurozone flash May CPI – will this bring back beyond June easing? May 31 the flash CPI release is expected to have risen to 2.5% in May year-on-year, from 2.4% in April. The result may keep the June then September pricing intact. However, the May data is problematic as it is expected with core at 2.7% y/y - the first time the core CPI has stopped deflating since July 2023. The national CPI reports come through the week with focus on Germany on Wednesday expected higher at 2.7% y/y along with France also at 2.7% y/y and Spain at 3.7%. Italy is the only big economy expected to show disinflation rising just 0.7% y/y. The issue for markets is whether this data can shift the ECB talk of cutting in June and then waiting for September. Other reports that could matter to Europe and the ECB this week – the

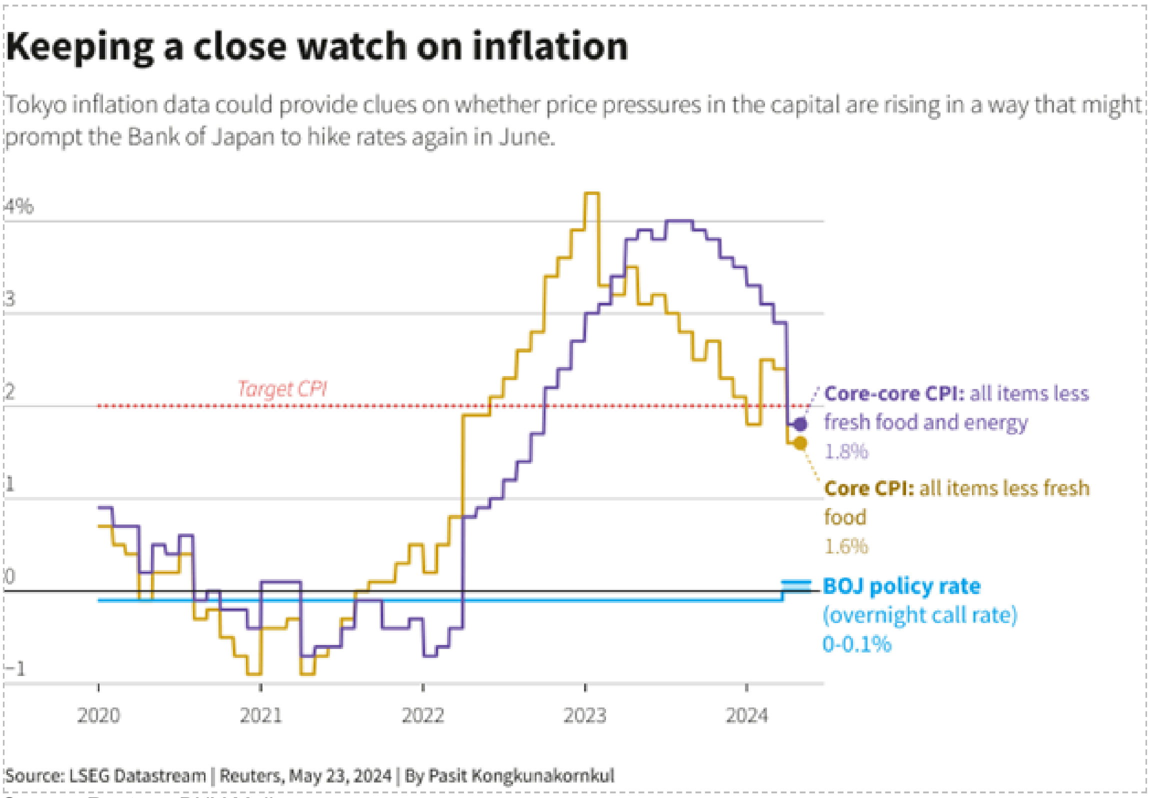
Monday German Ifo business confidence, the ECB survey of inflation expectations on Tuesday and the EU economic barometer on Thursday.



Source: Reuters, BNY Mellon

3. Japan Tokyo CPI – keeping July hike intact? The May 31 release for the Tokyo inflation report comes two weeks before the BOJ's next monetary policy meeting, where some are betting the central bank could deliver its second rate rise after March's historic move. Policymakers have thus far remained reticent on how soon further hikes could come, but they face increasing pressure to do so as a fragile yen continues to cripple weak consumption. May 31 will also see the periodic release of the Ministry of Finance's intervention data which covers the recent rounds of suspected intervention and the BOJ's bond buying schedule, where traders will look out for cuts in the amount of central bank purchasing. How BOJ Governor Ueda guides the markets into the meeting and how JPY trades are clearly key drivers for risk in the week ahead.

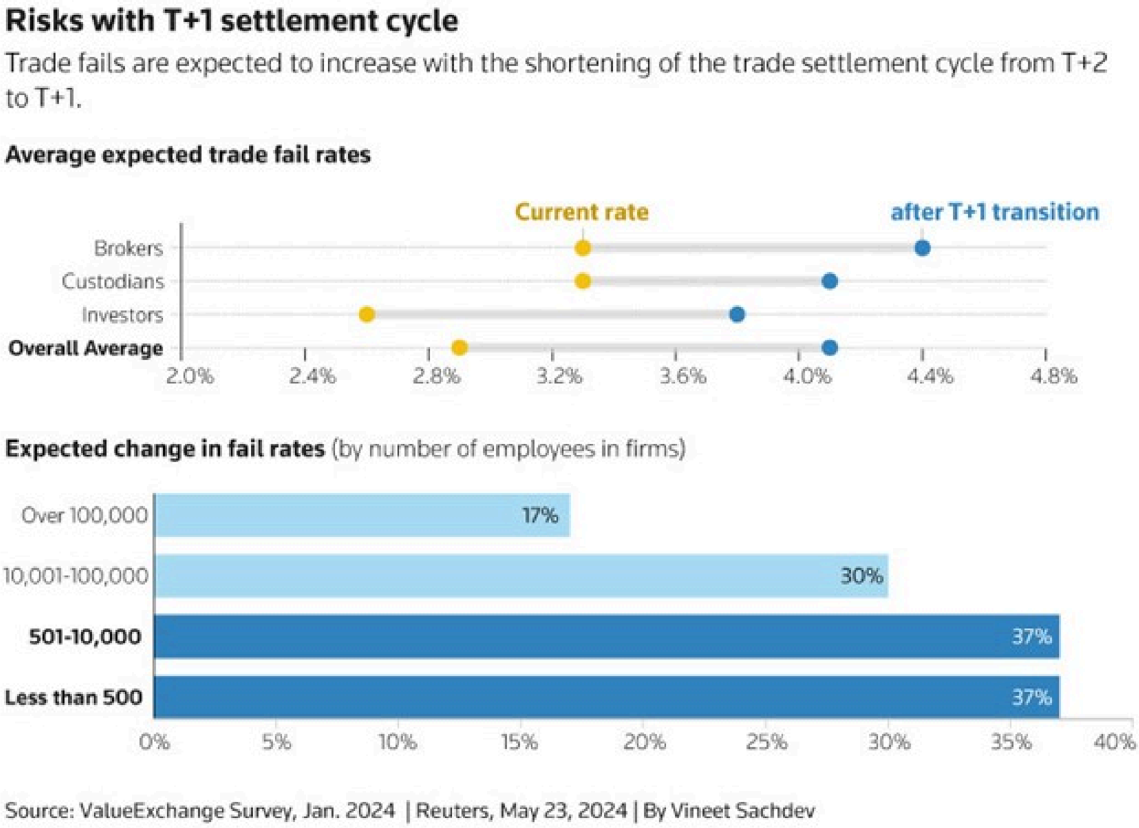
Is Tokyo CPI going to matter to BOJ?



Source: Reuters, BNY Mellon

4. T+1 and the risk of settlement. Smooth settlement May 28 will be the expectation as the US moves from 2-days to 1-day for bonds, stocks and other securities. As trading activity climbs, so too do the risks of so-called trade "fails" - when intermediaries don't have necessary instructions to settle on behalf of clients within the tighter time frame. This might trigger a rush for dollars among non-U.S. investors who need to borrow at short notice to cover any temporary mismatch in inflows and outgoings. Any disruption is expected to be temporary, and the move to T+1 is broadly considered a crucial step towards more liquid and efficient financial markets. But given time zones, the move to T+1 trade settlement is effectively T+0 for many in Asia, where preparations are seen lagging other regions.

Will settlements matter next week?



Source: Reuters, BNY Mellon

Economic Data and Events Calendar May 27-31:

Central Bank Decisions

- **Israel BoI (Monday, May 27)** – The BoI is expected to maintain rates at 4.50%, keeping a comfortable real rate buffer as inflation remains relatively robust at 2.8% and current expectations remain elevated as the national inflation forecast survey is at +3% over the next 12 months. The BoI will be cognizant that unlike most peers, capacity for fiscal restraint is limited while labour markets will remain supply-challenges under current circumstances. Continued strong vigilance is the result, even though external from the Fed has softened slightly.
- **South Africa SARB (Thursday, May 30)** – No change is expected in South African rates and given the election is the day before, we doubt the SARB decision will be the main driver of price action in ZAR. However, depending on the election result and the impact on the ZAR, any material volatility could require a policy response. This is asymmetric and largely hinge on whether ZAR moves materially lower if the next administration is not seen as particularly market friendly. If this is the case then precautionary moves will be needed.

Key data/releases

Date	BST	EDT	Country	Event	Period	Cons.	Prior
05/27/24	09:00	04:00	GE	IFO Business Climate	May	90.3	89.4
05/27/24	*14:00*	*09:00*	*IS*	*Base Rate*	*May-27*	*4.50%*	*4.50%*
05/28/24	02:30	*21:30	AU	Retail Sales MoM	Apr	0.20%	-0.40%
05/28/24	13:00	08:00	BZ	IBGE Inflation IPCA-15 MoM	May	0.47%	0.21%
05/28/24	15:00	10:00	US	Conf. Board Consumer Confidence	May	96	97
05/29/24	12:00	07:00	US	MBA Mortgage Applications	May-24	--	1.90%
05/29/24	13:00	08:00	GE	CPI YoY	May P	2.40%	2.20%
05/29/24	13:00	08:00	GE	CPI MoM	May P	0.20%	0.50%
05/30/24	02:30	*21:30	AU	Building Approvals MoM	Apr	1.80%	1.90%
05/30/24	07:00	02:00	SW	GDP QoQ	1Q	--	-0.10%
05/30/24	08:00	03:00	TU	Trade Balance	Apr	--	-7.34b
05/30/24	13:30	08:30	US	GDP Annualized QoQ	1Q S	1.20%	1.60%
05/30/24	13:30	08:30	US	Initial Jobless Claims	May-25	--	215k
05/30/24			*SA*	*SARB Announce Interest Rate*	*May-30*	*8.25%*	*8.25%*
5/30-6/5			UK	Nationwide House PX MoM	May	--	-0.40%
5/30-6/5			UK	Nationwide House Px NSA YoY	May	--	0.60%
05/31/24	00:30	*19:30	JN	Jobless Rate	Apr	2.60%	2.60%
05/31/24	00:30	*19:30	JN	Job-To-Applicant Ratio	Apr	1.28	1.28
05/31/24	00:30	*19:30	JN	Tokyo CPI Ex-Fresh Food YoY	May	1.90%	1.60%
05/31/24	00:50	*19:50	JN	Industrial Production MoM	Apr P	1.50%	4.40%
05/31/24	02:30	*21:30	CH	Manufacturing PMI	May	50.4	50.4
05/31/24	08:00	03:00	CZ	GDP YoY	1Q P	0.40%	0.40%
05/31/24	09:00	04:00	PD	CPI YoY	May P	--	2.40%
05/31/24	10:00	05:00	EC	CPI MoM	May P	0.20%	0.60%
05/31/24	13:00	08:00	SA	Trade Balance Rand	Apr	12.8b	7.3b
05/31/24	13:30	08:30	CA	Quarterly GDP Annualized	1Q	2.00%	1.00%
05/31/24	13:30	08:30	US	Personal Income	Apr	0.30%	0.50%
05/31/24	13:30	08:30	US	Personal Spending	Apr	0.30%	0.80%

Key speeches/events

Date	BST	EDT	Country	Event
05/26/24	08:30	03:30	EC	ECB's Cipollone Speaks
05/27/24	01:05	*20:05	JN	BOJ Governor Ueda Opening Remarks at the BOJ-IMES Conference
05/27/24	03:05	*22:05	JN	BOJ Deputy Governor Uchida Speech at the BOJ-IMES Conference
05/27/24	04:40	23:40	EC	ECB's Vujcic Speaks
05/27/24	12:00	07:00	EC	ECB's Lane Speaks
05/28/24	05:55	00:55	US	Fed's Mester Speaks at Bank of Japan Event
05/28/24	14:15	09:15	EC	ECB's Knot Speaks
05/28/24	14:55	09:55	US	Fed's Kashkari Gives Panel Remarks
05/28/24	18:00	13:00	UK	BOE's Haskel speaks
05/28/24	18:05	13:05	US	Fed's Cook Speaks on AI
05/29/24	02:30	*21:30	JN	BOJ Board Adachi Speech in Kumamoto
05/29/24			*SA*	*National and Provincial Election*
05/29/24	08:00	03:00	EC	ECB's Villeroy speaks
05/29/24	08:30	03:30	SW	Riksbank Financial Stability Report 2024:1
05/29/24	18:45	13:45	US	Fed's Williams Joins Watertown Community Services Roundtable
05/29/24	19:00	14:00	US	Federal Reserve Releases Beige Book
05/29/24	23:50	18:50	AU	RBA's Hunter-Fireside Chat
05/30/24	00:00	*19:00	US	Fed's Bostic Speaks on Economy
05/30/24	01:00	*20:00	SZ	SNB's Jordan Speaks in Seoul
05/30/24	12:00	07:00	SW	Riksbank First Deputy Governor Breman speech in Lund
05/30/24	17:00	12:00	UK	BOE's Breeden speaks
05/30/24	17:05	12:05	US	Fed's Williams Speaks at Economic Club of New York
05/30/24	22:00	17:00	US	Fed's Logan Speaks in Moderated Q&A
05/31/24	07:00	02:00	EC	ECB's Vujcic Speaks
05/31/24	08:30	03:30	EC	ECB's Vujcic Speaks
05/31/24	23:15	18:15	US	Fed's Bostic Gives Commencement Speech

Conclusions: EM elections and the pressure for diversification

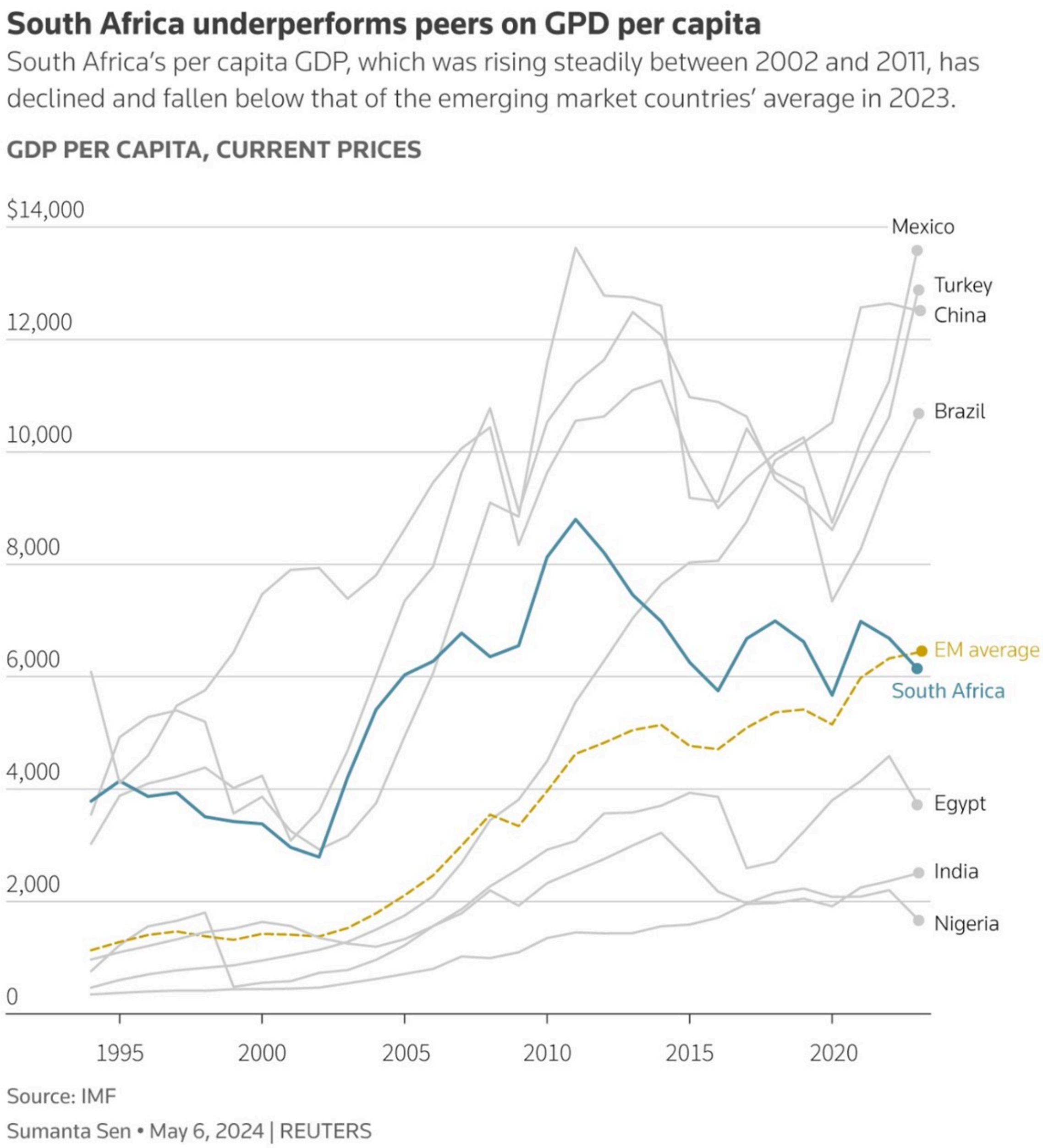
The next week is going to matter to markets beyond the G10 rate debates about the FOMC easing in December or September, about the ECB or BOC cutting in June or about how Japan deals with a weak JPY. The work of politics on markets shows up most directly in South Africa, India and Mexico in the coming two weeks and markets are likely to price in some uncertainty and risk premiums into these events. The outcome for Mexico we discussed last week, but for South Africa and India, the risks are similarly important. The ability for investors to find high rates and high growth outside of the US and for it to be diverse makes India and South Africa logical destinations, but for the politics.

South Africans vote in a national election on Wednesday and, for the first time since the end of apartheid 30 years ago, polls suggest the ruling African National Congress party (ANC) is at risk of losing its parliamentary majority. If the ANC gets less than 50%, or even 45%, support it would have to seek one or more coalition partners to govern. Just which partner joins the ANC matters - get the more business friendly Democratic Alliance (DA) on board and the ZAR and other South African assets are likely to gain. But any hint that it might be the far-left Marxist Economic Freedom Fighters (EFF) or recently-formed MK, led by ex-President Jacob Zuma, then assets and ZAR gains that started in May could reverse sharply. The election drama might not end there either. President Cyril Ramaphosa could face an internal leadership challenge if the ANC is perceived to have performed poorly adding to the uncertainty about the nation and how it will deal with its numerous problems. Back in 2019, the ANC won 57.5% of the national vote. Earlier this week, one local poll published results showing the ANC at 46.34%, the DA at 20.11%, and the EFF at 10.49%. It put the new Zuma backed MKP at 8.67% with the IFP at 4.05%. Other parties were cumulatively put at 10.34%. This poll also assumed a ~60% (+/- 4%) turnout – which will likely be crucial to polls being accurate given up to a third of the electorate claims to be undecided.

The India June 4th election results are also putting investors on edge with Modi's lead looking slimmer. Focus is on the ability for the government to overhaul land and labor laws. Only a substantial victory from the ruling Bharatiya Janata Party will suffice. The goal of moving India from emerging to developed nation status, something Korea and China has already done rests on the election results. Modi had said the BJP and its allies would win 400 seats in the election, up from about 350 seats in 2019. While Modi himself told The Economic Times in an interview published Thursday that the party would win a "historic mandate", low voter turnout and reports of close contests in some areas have raised concerns about the breadth of public support. The key for investors rests with the BJB seats – a strong majority is seen leading to a 1-2% INR gain, lower rates and stronger equities, while a smaller majority would hit the INR keep rates high and for stock market volatility. Other worse outcomes, such as a coalition government are seen as unlikely but more difficult for INR stability, RBI policy and equities with fears about fiscal policy and policy directions.

Bottom Line: The hunt for diversity will inevitably lead to emerging market money flows. The ability to determine what is safe and what isn't starts with the economics but finds its resting place in the rule of law and continuity of policies both monetary and fiscal. The week ahead is going to have a keen focus on South Africa but also on APAC overall as Japan, China and India all have significant policy and economic data points to consider. The value push we see in FX iFlow is worth watching and respecting in this week ahead with the chart below on EM value a useful tool for understanding the difficult balancing act of central bankers as they see FX weakness and inflation strength.

Does South Africa get fixed with a new government?



Evaluating fair value of Asian EM currencies against the USD

Purchasing power parity (PPP): differences of ln(CPI), 10y lookback; rate differentials: 3y lookback

	23-May-24	PPP	%dev.	r2	2y rate differential	%dev.	r2	5y rate differential	%dev.	r2	10y rate differential	%dev.	r2
CNY	7.3	7.0	-4.1	0.15	7.2	-0.9	0.86	7.3	-0.7	0.86	7.3	-0.4	0.90
INR	83.2	77.4	-6.9	0.79	83.8	0.8	0.77	84.3	1.4	0.85	84.3	1.3	0.89
KRW	1373.2	1300.9	-5.3	0.61	1363.5	-0.7	0.62	1367.9	-0.4	0.55	1363.2	-0.7	0.45
TWD	32.2	29.9	-7.0	0.03	31.5	-2.0	0.91	31.5	-2.1	0.91	31.5	-2.3	0.89
IDR	16208.3	13820.6	-14.7	0.08	15374.5	-5.1	0.45	15462.3	-4.6	0.60	15606.5	-3.7	0.72
THB	36.8	34.1	-7.1	0.04	35.7	-3.0	0.46	35.9	-2.4	0.43	36.0	-2.1	0.40
MYR	4.8	4.5	-5.8	0.20	4.7	-2.0	0.76	4.7	-1.4	0.82	4.7	-0.9	0.84
PHP	58.9	51.9	-11.9	0.30	54.9	-6.8	0.16	55.0	-6.6	0.16	55.1	-6.4	0.13
VND	25463.0	22914.3	-10.0	0.00	24421.3	-4.1	0.55	24303.7	-4.6	0.44	24227.5	-4.9	0.51

Green: undervalued v USD, red: overvalued v USD

MACROBOND

Source: Reuters, Macrobond, BNY Mellon

Disclaimers and Disclosures

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

Bob Savage

HEAD OF MARKETS STRATEGY AND INSIGHTS

CONTACT BOB