

Asia Morning Bites

Expectations for a tweak to the Bank of Japan's (BoJ) yield curve control (YCC) policy rise as Tokyo inflation remains high in July



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Global Macro and Markets

- **Global markets:** The main market development yesterday stemmed from the more dovish commentary from the ECB, which in contrast to the attempt by Jay Powell the previous day to keep thoughts of tightening alive, seemed to suggest that this may be the peak in Europe. EURUSD dropped to 1.0978, and this pulled most other G-10 with it, helped also by stronger-than-expected GDP figures out of the US that dampened thoughts of rate cuts next year. The AUD dropped to 0.6709, Cable fell to 1.2794. But the JPY, bucked this trend, with possible tweaks to the yield curve control program at today's Bank of Japan (BoJ) meeting (see also below), the JPY has strengthened to 139.271. The MYR and THB also made some decent gains yesterday, but the CNY weakened 0.34% to 7.1675 as optimism about stimulus measures continued to fade. Bond markets saw the spread of US yields widen over European yields. Germany's 2Y govt yields fell 5.2bp yesterday to 3.033%, while US 2Y Treasury yields rose 7.7bp to 4.928%. And there was a large rise in US 10Y yields too, which pushed up 13.1bp to just under 4% and briefly traded above the 4% level. The equivalent German bond yield fell 1bp to 2.467%. Equities did not like the prospect that rates in the US may stay elevated thanks to rising prospects of a soft landing. Here, a bit of bad news might actually go down better than continued macro resilience. Both the S&P 500 and NASDAQ

dropped by 0.64% and 0.55% respectively. Chinese stocks were mixed. The Hang Seng made a decent gain of 1.41%, but the CSI 300 lost 0.13% on the day.

- **G-7 macro:** There was no shortage of macro excitement yesterday - first the ECB meeting [which is covered by our European team here](#). Europe's main policy rate is now 3.75%, which remains well below inflation, so on some measures, is barely even restrictive, and one of the reasons why our Eurozone economists don't believe the ECB is done with hikes just yet. Christine Lagarde may not have shut the door to further hikes, but she has undoubtedly opened one to possible pauses should that be deemed appropriate by the run of data. One other tweak to their policy was to reduce the remuneration of minimum reserves to zero.
- The 2.4% annualized GDP growth rate from the US was also a surprise yesterday. The consumer spending figures did slow from 1Q23, but at 1.6%, were better than had been forecast. And the continued signs of slowing inflation were evident in the decline in the PCE deflator's annualized growth rate to 3.8% from 4.9%. [James Knightley describes this "Goldilocks: release here](#).
- **Japan:** Tokyo inflation stayed at 3.2% YoY in July for a third month, which was higher than the market consensus of 2.9%. Even more surprising is that core inflation, excluding fresh food and energy, actually rose to 4.0% YoY (vs 3.8% in June, 3.7% market consensus). This shows that, unlike other major economies, Japan's inflation hasn't yet reached its peak. The only item to fall was utilities (-10.8%) thanks to the continued energy subsidy program. On a monthly comparison, inflation accelerated 0.3% MoM sa in July (vs 0.2% in June) and we saw a pickup in service prices of 0.4% while goods prices continued to rise 0.2%. Headline inflation will continue to go down slowly due to base effects and falling global commodity prices, but core inflation will remain high for a considerable time.
- The BoJ is set to announce its policy decision in a few hours later today following this inflation surprise. We expect the BoJ to leave its policy rates unchanged, but we think there is a good chance of a YCC policy change at today's meeting, which is a non-consensus view - the market believes that October is more likely. If the BoJ seeks to normalize its policy in the future, we think that delaying a YCC policy adjustment will create a larger burden for them. For a more detailed view of BoJ policy, [please see here](#).
- The BoJ will also release its quarterly macro outlook today, and the focus will be the inflation outlook for 2024. We think that this is how the BoJ will assess the sustainability of inflation in this cycle and will be a good indicator against which to estimate the timing of the BoJ's first rate hike move.
- **South Korea:** Industrial production fell -1.0% MoM sa in June (vs revised 3.0% in May and -0.9% market consensus). Semiconductor output has now increased for four months in a row which is quite different from the industry's reduction plan, and inventory data suggest that high-value chip output may have increased while general chip production slid. Also, shipments of semiconductors rose 41.1%. We believe that the chip cycle is bottoming out slowly. Meanwhile, vehicle output dropped quite sharply -12.9% but after having risen solidly for the previous three months, it seems likely that the auto sector is taking a breather for the time being. Forward-looking investment data were soft, which suggests that investment in the current quarter will continue to contract.

What to look out for: The BoJ and US core PCE

- Japan BoJ policy (28 July)

- Australia PPI (28 July)
- US personal spending, core PCE, University of Michigan sentiment (28 July)

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