MORNING BRIEFING
November 1, 2023

Other Central Bankers & The MegaCap-8, Again

Check out the accompanying chart collection.

Executive Summary: Today, Melissa reviews how monetary policies are being conducted outside the US. Japan's BOJ has given itself more latitude in policy decisions, retracting a commitment to retain its long-standing ultra-easy stance and widening its target interest-rate range. … China's PBOC and central government have been working to stimulate its economy by numerous means. ... Europe's ECB finally paused its rate-hiking recently after a 10-hike streak and trimmed its balance-sheet assets; no more rate hikes or reductions are likely for a while. … Also: Joe updates data on the MegaCap-8 stocks' growing share of the S&P 500.

Global Central Banks I: BOJ Tweaks Accommodation. Since Bank of Japan (BOJ) Governor Kazuo Ueda assumed office in April, succeeding Governor Haruhiko Kuroda, Japan's central bank has gradually shifted toward a less accommodative monetary policy stance. Shortly after the change at the helm, the BOJ *removed* its commitment to maintaining interest rates at current or lower levels; that was on April 28.

Previously, in December 2022, the BOJ enhanced its flexibility by *widening* the range around its yield target. It did so again in July and once again at the two-day meeting that concluded yesterday.

The BOJ's October 31 *Statement on Monetary Policy* explains that the bank is retaining its long-standing super-accommodative monetary policy while making slight modifications to its yield curve control (YCC) bond purchasing plan. The YCC's objective has been to anchor 10-year Japanese government bond (JGB) yields around the zero mark through appropriate bond purchases. However, the YCC policy is increasingly questionable now that the yield is approaching 1.00%.

In recent months, inflation in Japan has consistently exceeded the BOJ's 2.0% target. As a result, investors are closely watching the BOJ for signs that they may abandon the YCC policy. This may involve reducing the pace of bond purchases or eliminating the program's long-term interest rate target altogether. Governor Ueda acknowledged this possibility during a July press conference, stating, "The risk of us being forced to abandon YCC against our will is not zero," *reported* CNBC.

The unexpected moves made by the BOJ in December and July surprised investors, whereas yesterday's subtle adjustment was more widely anticipated. Melissa and I are anticipating a more significant YCC adjustment at the BOJ's final *meeting* of the year, on December 18-19.

Let's dive into where the BOJ currently stands:

(1) *Policy tweaks.* The BOJ made slight adjustments to its ultra-easy monetary policy last month. While maintaining the short-term interest rate target at -0.1%, the bank altered its YCC policy. In the September *statement*, the BOJ announced that it would permit 10-year JGB yields to fluctuate within a range of around plus or minus 0.5ppt from the target level, offering to purchase 10-year JGBs at 1.0% daily.

However, the latest move by the bank eliminated the plus or minus 0.5ppt range and introduced a flexible "upper bound" of 1.0% for 10-year JGB yields. In the statement's footnotes, the bank clarified that it would "determine the offer rate for fixed-rate purchase operations each time, taking market rates and other factors into account." Essentially, the 1% offer on the bank's 10-year JGBs could rise without a specific limit.

As of Monday's close, the 10-year JGB yield was just slightly below the central bank's flexible reference cap (*Fig. 1*).

(2) *Stagnating purchases.* Despite the unprecedentedly high bank balance-sheet assets—which have risen from around 450 trillion yen in 2016 at the beginning of YCC to nearly 750 trillion yen today—purchases clearly have stalled since earlier this year (*Fig. 2*). Additional purchases could be a challenge, as the bank already owns a very large share of the Japanese bond market.

(3) *Inflation overshooting.* Japan's consumer price index, excluding fresh food, has exceeded the bank's 2.0% y/y target rate consistently since summer 2022, coming in at 2.8% this September (*Fig. 3*). The bank attributes the prolonged cost increases to a rise in import prices and recent crude oil price increases; it *anticipates* a 3.0% rate at year-end, up from a previous forecast of 2.8%.

(4) *BOJ lagging.* In stark contrast to the BOJ's unyielding ultra-easy policy stance, the Fed has been tightening over the past year—most recently keeping rates unchanged after an aggressive series of hikes—while the European Central Bank (ECB) has taken the bold step of raising its main rates to their loftiest levels in over two decades and is now pausing

in restrictive territory. It's likely that the BOJ won't be as aggressive as those two counterparts, but inevitably will be on a tightening path soon too.

Global Central Banks II: PBOC on Easing Street. An October 24 Bloomberg *article* explored the People's Bank of China's (PBOC) attempts to bolster short-term liquidity in China's financial system. Maintaining bank funding costs below the PBOC's preferred rate has been challenging owing to scarce liquidity, primarily a result of surging government debt and tax payments.

Consequently, the PBOC has increased its support to uphold low borrowing costs. Over three days last week, the central bank injected a record net amount of 1.96 trillion yuan (equivalent to $268 billion) in short-term cash into the financial system, according to Bloomberg's calculations. Simultaneously, outstanding one-year policy loans are on track to reach a historical high of 5.7 trillion yuan after a mid-October operation.

Throughout this year, Beijing's central planners have been working to bolster the fragile economy, with particular focus on the ailing property sector. Their measures have encompassed reductions in benchmark rates, bank reserve requirements, and various liquidity-boosting initiatives, *wrote* BNN Bloomberg.

In a report delivered to the Standing Committee during the weekend of October 21, Governor Pan Gongsheng of the PBOC *vowed* to implement more targeted and robust policy measures. Notably, Chinese President Xi Jinping recently *visited* the PBOC, the first such visit during his decade-long tenure. The purpose of the visit remains undisclosed, but it undoubtedly pertained to coordinating the nation's fiscal stimulus policies. A few days later, Chinese authorities *announced* one of the most substantial alterations to the national budget in years, along with a plan to issue 1 trillion yuan (equivalent to $137 billion) in government bonds.

Following a surge in interest rates yesterday, a source close to the central bank *indicated* that the PBOC is likely to inject additional liquidity into the money market.

Global Central Banks III: ECB Hunkers Down. On October 26, the ECB delivered a pivotal decision by ending its long streak of interest-rate increases. The interest rates on the main refinancing operations, marginal lending facility, and deposit facility all were maintained at 4.50%, 4.75%, and 4.00%, respectively. This pause came after an impressive run of 10 consecutive interest-rate hikes, starting in July 2022 and concluding in September 2023, which lifted the deposit facility rate out of negative territory.

Simultaneously, the ECB has actively trimmed the assets on its balance sheet, primarily by reducing its routine asset purchases and reinvestments while still retaining pandemic-related assets. The likelihood of further rate hikes appears remote, and we don't anticipate any rate reductions until the second half of 2024.

Here are more key insights:

(1) *Inflation easing*. Despite pausing the rate hikes, the ECB's *Monetary Press Release* underscores the persistence of inflation concerns, stating, "Inflation is still expected to stay too high for too long, and domestic price pressures remain strong." However, it acknowledges that inflation notably receded in September, partly due to robust base effects, and most indicators of underlying inflation continue to soften.

The Eurozone's headline CPI rate moderated to 2.9% y/y in October, while the core rate fell but remained elevated at 4.2% (*Fig. 4*).

(2) *Rates adequate*. The ECB believes that its previous interest-rate increases effectively have dampened demand, contributing to the moderation of inflation, and that current interest-rate levels are "sufficiently restrictive." It pledges to maintain them "as long as necessary."

(3) *Shrinking balance sheet*. The ECB's total assets have dropped significantly from their peak in late June 2022, driven by the reduction in asset purchases and reinvestments under the Asset Purchase Program (*Fig. 5*). On the other hand, the bank has committed to reinvesting principal payments from maturing securities purchased under the Pandemic Emergency Purchase Program through at least the end of 2024.

Strategy: MegaCap-8's Growing Share of S&P 500. In spite of the stock market's decline back to correction territory from its July 31 high, the MegaCap-8 group of stocks (Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, Nvidia, and Tesla) remains near its recent record-high shares of the S&P 500's market capitalization, forward revenues, and forward earnings (*Fig. 6*). It's helpful to remember how high these shares are when considering S&P 500 performance, valuation, and earnings data: A good chunk of that data is attributable to just eight stocks! (FYI: Forward revenues and earnings are the time-weighted average of analysts' consensus projections for the current and following years; forward profit margins we calculate from forward revenues and earnings.)

Specifically, the MegaCap-8's collective market-cap share of the S&P 500 was 27.1%

during the October 27 week, little changed from its record high 27.4% during the October 6 week. The group's forward revenue and forward earnings shares likewise have dropped by just a hair in recent weeks: forward revenues to 2.18% from 2.19% (October 6 week) and forward earnings to 17.25% from 17.34% (September 1 week).

With the Q3-2023 earnings season now more than half finished, I asked Joe to give us an update on the MegaCap-8's surprise metrics to date and discuss just how much they've contributed to the S&P 500's "REMs" (revenues, earnings, and margins). Here's his report:

(1) *MegaCap-8 Q3 surprise review*. Six of the MegaCap-8 stocks have reported Q3 results so far (all but Apple and Nvidia). Among the reporters, all but Tesla beat the analysts' consensus forecast for revenues and earnings. Collectively, these six have beaten the aggregate revenue forecast by 1.3% and the aggregate earnings forecast by 16.2%. They've recorded y/y growth in revenues of 12.8% and in earnings of 58.7%. Their aggregate profit margin of 17.8% well exceeded the 15.5% forecast.

Here's how each of the six MegaCap-8's fared in Q3. Their revenue and earnings surprises were mostly positive: Alphabet (1.0% revenues surprise, 6.8% earnings surprise), Amazon (1.2, 60.9), Meta (1.7, 20.9), Microsoft (3.7, 12.7), Netflix (0.1, 6.9), and Tesla (-3.1, -8.2). Their y/y revenue and earnings growth rates were mostly positive too, topped off with a sprinkling of triple-digit percentage earnings growth rates: Alphabet (11.0% y/y revenues growth, 46.2% y/y earnings growth), Amazon (12.6, 452.9), Meta (23.2, 167.7), Microsoft (12.8, 27.2), Netflix (7.8, 20.3), and Tesla (8.8, -37.1)

(2) *S&P 500 Q3 results with and without the MegaCap-8.* The S&P 500 companies that have reported so far have a revenue surprise of 0.9% and have beaten earnings forecasts by 7.9%. Revenues are up 2.0% y/y and earnings up 6.8% y/y. The S&P 500's profit margin of 13.2% for companies that have reported so far exceeds the 12.4% forecast and compares favorably to the 12.6% recorded a year earlier in Q3-2022.

The S&P 500 results without the MegaCap-8 reporters to date are mostly weaker. The revenue surprise remains unchanged at 0.9%, but the earnings surprise drops to 6.1% from 7.9%. The y/y growth rates are weaker too, dropping to just 0.3% from 2.0% for revenues and falling to a y/y decline of -1.2% from 6.8% for earnings. The S&P 500 ex-MegaCap-8 profit margin for Q3-2023 drops to 12.5% from 13.2% but still exceeds the forecasted 11.1% and is up from 11.9% a year earlier in Q3-2022.

(3) *MegaCap-8's share of results rose in Q3 and is expected to remain high*. On a blended

actual/estimate basis, the MegaCap-8's share of S&P 500 revenues rose to a three-quarter high of 10.7% in Q3-2023 from 10.4% in Q2-2023. The group's earnings share rose to an 11-quarter high of 19.0% from 17.5%.

Looking ahead to Q4-2023, the group's shares of the S&P 500's revenue and earnings are expected to rise to new record highs of 12.2% for revenues and 21.2% for earnings. They're expected to remain high at least through Q3-2024. Analysts are estimating the MegaCap-8's revenues share of the S&P 500 to be between 11%-12% with an earnings share of 18%-21%. Revenues are expected to grow at a 12%-13% y/y rate from Q4-2023 to Q4-2024. Earnings growth is expected to decelerate, though, as Nvidia's y/y growth slows from its torrid triple-digit percentage pace in 2023. Analysts expect the peak y/y earnings growth of 52.8% in Q3-2023 to drop to 43.4% in Q4-2023 before slowing to 10.3% in Q3-2024.

(4) *MegaCap-8 on a blended basis.* Our earlier analysis primarily focused on the companies that have reported so far. Investors are still waiting on results for the last two MegaCap-8 companies, Apple and Nvidia. Apple's fiscal Q4 results are due out on Thursday, and Nvidia's October-quarter results on November 21.

For the group as a whole (using current estimates for Apple and Nvidia), y/y revenue growth picked up to a six-quarter high of 12.1% in Q3-2023 from 10.2% in Q2-2023, and y/y earnings growth is expected to accelerate sharply to a nine-quarter high of 52.8% from 29.4%. The profit margin is expected to rise to a nine-quarter high of 22.2% in Q3-2023 from 20.1%.

However, a third-straight blowout quarter by Nvidia—which has an expected profit margin of 52.0% for Q3-2023—could carry the group over and above its prior record-high profit margin of 23.0%, recorded during Q1-2021. Analysts expect a 24.6% profit margin for Apple.

Calendars

US: Wed: Fed Interest Rate Decision 5.50%; ADP Employment 150k; Job Openings 9.27m; ISM M-PMI & Price Index 49.0/44.5; Construction Spending 0.4%; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. **Thurs:** Nonfarm Productivity & Unit Labor Costs 4.0%/0.8%; Factory Orders 1.9%; Motor Vehicle Sales 15.3mu; Initial & Continuous Jobless Claims 210k/1.795m; Natural Gas Storage. (FXStreet estimates)

Global: **Wed:** UK-PMI 45.2; UK Nationwide HPI -0.3%; Rogers. **Thurs:** Eurozone, Germany, France, Italy, and Spain M-PMI 43.0/40.7/42.6/46.4/47.3; Germany Unemployment Rate 5.8%; BoE Interest Rate Decision 5.35%; Lane; Bailey; Fernandez-Bollo; Schnabel. (FXStreet estimates)

Strategy Indicators

S&P 500 Q3 Earnings Season Monitor (*link*): With the Q3-2023 earnings season over 53% complete, the indications from the companies that have reported so far suggest a stronger earnings surprise compared to Q2-2023 but a weaker revenues surprise. During Q4-2022, the earnings surprise was the lowest since Q4-2008, and the revenue surprise the smallest since Q1-2020. Furthermore, the earnings surprise failed to outpace the revenue surprise in Q4-2022 for the first time since we began tracking that data in Q1-2009. With 267 of the S&P 500 companies finished reporting for Q3-2023, revenues are ahead of the consensus forecast by 0.9% and earnings have exceeded estimates by 8.4%. At the same point during the Q2 season, revenues were 1.5% above forecast and earnings had beaten estimates by 7.3%. Just 60% of the 267 Q3 reporters through mid-day Tuesday has reported a positive revenues surprise, while 77% has reported an earnings beat. That's on pace for the weakest revenues surprise reading since Q1-2020; but the percentage with positive earnings surprises would be near the highest since Q3-2021 if it holds to the end of the season. The early reporters' aggregate y/y growth rates have ticked up for revenues from their Q2-2023 readings and improved for earnings: to 1.6% from 0.9% for revenues growth and to 3.1% from -6.2% for earnings growth. Over the past 58 quarters through Q2-2023, y/y earnings growth has trailed y/y revenues growth in only 16 quarters and for six straight quarters, but earnings growth is ultimately likely to outpace revenue growth in Q3-2023 as the Energy sector becomes less of a drag on overall results. Fewer companies have been reporting positive y/y earnings growth in Q3 (61%) than positive y/y revenues growth (65%). With three-quarters of the MegaCap-8's results complete, they have been a net positive contributor to the S&P 500's revenue and earnings surprise and the y/y growth rates. While the surprise metrics remain positive without the MegaCap-8 reporters, the y/y growth rates are flat or negative without them. Looking at the S&P 500 excluding the MegaCap-8 reporters to date, the revenue surprise remains steady at 0.9%, the earnings surprise falls to 6.6% from 8.4%, revenue growth drops to 0.0% from 1.6%, and earnings growth falls to -5.0% from 3.1%. These figures will continue to change as more Q3-2023 results are reported in the coming weeks. While we expect y/y revenues growth rates to remain positive yet again in Q3, earnings growth will be positive on a y/y basis for the first time in four quarters.

US Economic Indicators

Consumer Confidence (*link*): Consumer confidence in October fell for the third successive month, with expectations exceptionally weak. “Write-in responses showed that consumers continued to be preoccupied with rising prices in general, and grocery and gasoline prices in particular. Consumers also expressed concerns about the political situation and higher interest rates. Worries around war/conflict also rose, amid the recent turmoil in the Middle East,” observed Dana Peterson, chief economist at The Conference Board. She added, “The decline in consumer confidence was evident across all householder ages 35 and up, and not limited to any one income group.” *Headline* consumer confidence slumped 11.4 points during the three months through October to 102.6. Through the first 10 months of this year, it has decreased seven times and increased three times for a ytd loss of 6.4 points. *Expectations* plunged 12.4 points over the past three months to 75.6 after jumping 16.5 points over the two months through July to an 18-month high of 88.0. The report notes that the expectations component remained below 80.0—the level that historically signals a recession within the next year—bouncing around that level in recent months. The *present situation* remains in a volatile flat trend, though has slipped 12.2 points the past four months to 143.1, falling 4.3 points ytd. *Current business conditions* were more pessimistic in October, with the percentage of consumers saying business conditions were good at 19.1%, down from 21.0% in September, and those saying conditions were bad rising to 18.3%, up from 15.9% in September. Meanwhile, consumers’ assessment of the *current labor market* held steady in October, with 39.4% of consumers saying jobs are plentiful, down slightly from 39.7% in September, and 13.1% saying jobs are hard to get, down from 14.2% in September. *Short-term business conditions* (six-month outlook) on balance were more pessimistic in October: The percentage expecting conditions to worsen climbed to 20.2% from 18.7% in September, while those expecting business conditions to improve increased only slightly to 16.5% from 15.3% in September. Consumers’ assessment of the *short-term labor market* was only slightly less favorable, with the percentage of consumers expecting more jobs to be available six months from now dipping to 16.0% from 16.2% in September and the percentage anticipating fewer jobs rising to 19.0% from 18.9%. Consumers’ *short-term financial prospects* deteriorated in October, with 15.6% expecting their incomes to improve, down from 17.9% in September; it’s steadily been declining since May’s 18.9%. Meanwhile, 13.0% expect their incomes will decrease, just below September’s 14.1%.

Employment Cost Index (*link*): The *overall ECI* for private industry workers increased 1.0% (saar) during Q3, matching Q2’s gain—which was the slowest quarterly pace in two years. *Wages & salaries* (to 1.1% from 1.0%, saar) during Q3 was slightly faster than Q2's increase, while *benefits* (0.8 to 0.9) showed a slightly smaller gain. On a yearly percent change basis, *overall labor costs* for the private sector slowed for the fifth consecutive quarter since peaking at a recent high of 5.5% during Q2-2022 (the highest since mid-1984) to a two-year low of 4.3% last quarter, with the rates for wages and salaries (from 5.7% to 4.5%) and benefits (5.3 to 3.9) both easing over the comparable periods. Meanwhile, the *Atlanta Fed's median wage growth tracker*, which tracks the ECI wages & salaries component closely, fell in September to a 20-month low of 5.2% based on the three-month average, down from 5.6% in June and 6.4% y/y in March; prior to that, it had fallen from 6.7% last summer to 6.1% at year-end 2022. Inflation adjusted (constant dollar) compensation costs for private industry were up 0.6% y/y, with wages up 0.8% and benefits up 0.2%.

Global Economic Indicators

Eurozone CPI Flash Estimate (*link*): The CPI rate for October is expected to slow measurably from 4.3% in September to 2.9% in October—the lowest since July 2021 (2.2%); it peaked last October at a record-high 10.6%. Looking at the main components, *energy* is predicted to plunge -11.1% y/y, its seventh negative reading in eight months and the sharpest drop since May 2020 (-12.0%). It posted double-digit yearly gains from April 2021 through February of this year. It peaked at a record high of 44.3% last March. The rate for *food, alcohol & tobacco* is forecast to ease for the seventh month to 7.5% y/y after accelerating steadily from June 2021's 0.5% to a record high of 15.5% this March. The rate for *non-energy* industrial goods is expected to ease month to 3.5% y/y from February's record-high 6.8%. Meanwhile, the *services* rate is predicted to slow for the third month, to 4.6% y/y, from 5.6% in July—which was the highest since fall 1992. Of the *top four Eurozone economies*, only Italy's (1.9% y/y) rate was below the Eurozone's CPI rate of 2.9%, while rates in France (4.5), Spain (3.5), and Germany (3.0) were above. Here are the record-high inflation rates and months they were achieved for the four countries: Germany (11.6%, October 2022), Italy (12.6%, October & November 2022), France (7.3%, February 2023), and Spain (10.7%, July 2022).

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