Weekly Macro and Markets View

11 March 2024

Highlights and View

US unemployment rises to 3.9%, the highest in more than two years

There are increasing signs of a softer labour market with substantial negative revisions in payrolls and the quits rate ticking down further.

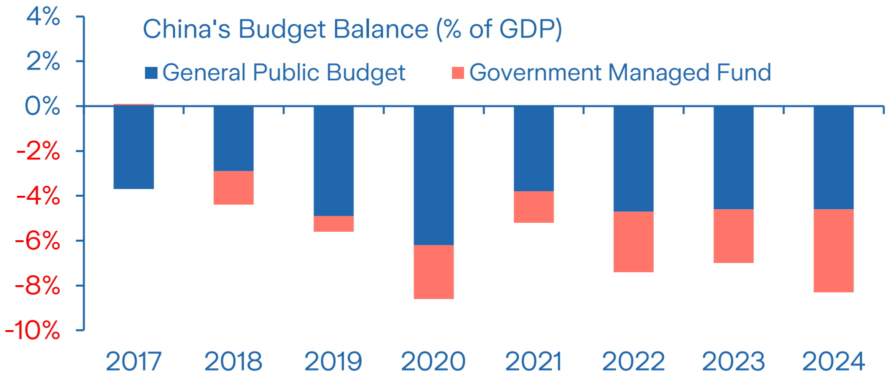
The ECB kept policy unchanged, but signalled increased conviction that the first rate cut is likely this summer.

We maintain our view that the ECB will first cut in June and gradually ease policy thereafter, although incoming inflation prints present significant two-sided risks to this forecast.

UK Chancellor Hunt announces a two percentage point cut in national insurance contributions

The tax cut will support the economy at the margin, but leaves the estimated fiscal headroom close to the lowest level in decades.

China's NPC 2024 growth target appears challenging, but achievable



Sources: NPC, MoF, CEIC, HSBC

China's National People's Congress (NPC), the world's largest legislative body comprised of about 3,000 members, convened last week in the Great Hall of the People in Beijing under the leadership of the Communist Party. Our focus is on the economic aspects, reflected in the 'Government Work Report' as presented by Premier Li Qiang, the report by the National Development & Reform Commission (NDRC), and the Budget Report. Overall, targets and policy measures can best be described by the word 'modest', and we regard the real GDP growth target of about 5% as challenging. Though unchanged from last year, when growth exceeded the 5% target slightly at 5.2%, the low base effect induced by the earlier Covid-related drag made it easy to achieve the target. This year, however, it will require more effort.

Though challenging, we are confident that our above-consensus growth forecast of 4.9% can be achieved as the fiscal impulse is stronger than last year. We are taking into account that public 'shadow' funds will be used in addition to the regular general public budget. As shown in the chart above, the overall budget adds up to 8.3% of GDP, 1.3 percentage points more than in the prior year. We also expect the monetary impulse to be helpful. However, support for the ailing housing sector is insufficient in our view, which leaves scope for more support measures throughout the year.

US

More cracks in the labour market

Last week brought further evidence of a softening labour market. While 275'000 new nonfarm payrolls were created in February, the prior two months have been revised down substantially by a combined 167'000. The unemployment rate rose from 3.7% to 3.9%, the highest level in more than two years, while broader underemployment ticked up to 7.3%. Further on, the quits rate dropped to 2.1% indicating that people are getting increasingly reluctant to leave their current employer, which should help to further reduce wage pressure. Growth in average hourly earnings slowed to only 0.1% MoM from 0.5% the month before. Meanwhile, service activity was still expanding modestly in February, with the ISM Services survey at 52.6, although the employment component fell back into contraction. A weaker growth environment and lower bond yields initially supported equities, but stock markets could not hold onto earlier gains by the end of the week. The S&P 500 ticked down by 0.3% while the Nasdaq lost 1.2%.

Eurozone

The allure of forward guidance

Last week the ECB kept all of its major policy rates unchanged, a move widely anticipated by the market. The key message, however, was one further cementing the ECB's intention to cut rates in upcoming meetings. Despite a commitment to restrictive policy and 'data-dependence' in the official statement, three factors point towards cuts starting soon, most likely in June. Firstly, ECB President Christine Lagarde was explicit about the good progress on inflation, and holistic data being available in advance of the June meeting. Secondly, we also saw significant downward revisions to the ECB growth and inflation forecasts, with inflation now expected at 2% in 2025 and below target in 2026. Lastly, public comments from ECB members have been fixated around specific dates on which to cut rates, with a clear majority now favouring June given the most recent data releases. We also continue to see June as most likely and expect the ECB to begin a gradual easing cycle given the high uncertainty around the inflation outlook and the ECB's risk aversion having considerably overshot inflation previously.

Japan

Positive news from the wage negotiation front

As we had expected, real GDP growth for the fourth quarter was revised up from a contraction to positive growth rates as investment was more solid than in the first release. As a result, Japan appears not to have fallen into recession. In fact, capital investment grew by 8% QoQ, the strongest increase since 2018. More good news came from the wage front. Wages rose 2% YoY in January, largely boosted by 'special wages' as half-yearly bonuses were paid. Real wages fell 0.6% YoY, less than the previous reading of 2.1%. Meanwhile, 'shunto' wage negotiations continue, with Rengo, the trade union confederation, announcing that its members are demanding a 5.85% wage increase, 1.36 percentage points higher than last year. It is encouraging to see that some employers have already accepted the demands in full, as confirmed by Japan's largest union. We expect more positive news on this front this week. We maintain our view that the Bank of Japan will end its negative interest rate policy (NIRP) at its April meeting while market expectations are starting to shift towards the March meeting.

Australia

Household income headwinds may begin to ease

The ASX200 Index reached record highs last week, reflecting global equity optimism after key central banks, including the Fed and the ECB, appeared dovish in their latest remarks. So far, the Reserve Bank of Australia (RBA) has maintained a cautious approach, refraining from discussing rate cuts. With Q4 GDP figures showing continued lacklustre growth amid stagnating household consumption, there is evidence that tighter monetary policy has effectively curbed demand. However, as inflation steadily declines and income tax cuts are forthcoming, pressures on households are expected to ease. Recent data indicate a slight rebound in real household disposable income after a -4% QoQ drop in Q3. This recovery in household real income, however, might lead to a rebound in spending and make inflation stickier. This will likely keep the RBA on a hawkish path a bit longer than other central banks. We expect the RBA to start cutting its cash rate only in Q4.

Credit

Healthy demand spurs heavy supply

Credit spreads tightened modestly last week after widening the week prior. During the last two weeks US HY has outperformed US IG on a beta-adjusted basis, which appears to be driven by issuance. Indeed, US IG supply has been exceptionally strong, with a third straight week of over USD 50bn in issuance, which has weighed on spreads. Demand was also strong, with positive fund inflows and low new issue concessions. IG issuance was also brisk in Europe last week, with financials making up the largest share of issuance, boosted by covered bonds sales. Notably, while US HY issuance continued at a sustained pace, EUR HY issuance saw a significant slowdown compared to the start of the year. Despite the latest slowdown, a pickup is expected in 2024 given issuers' impending maturity wall and dwindling cash balances. In the weeks ahead, we expect demand driven by yield-focused investors to remain strong and supply to eventually slow down into the Easter period, which would translate into positive technicals. However, we see limited room for upside from current levels given tight spreads.

What to Watch

- In the US, investors will focus on the latest set of inflation data while retail sales are expected to have rebounded from their dip in January.
- IPCA inflation data for February will be released in Brazil. Market expectations are 0.8% MoM and 4.4% YoY, which would place annual inflation within the central bank's target range of 3% ± 1.5%.
- In APAC, the first round of wage agreements will be announced in Japan. China will release February credit and money supply data as well as home price statistics. Australia will publish consumer and business confidence data. Indonesia and India will report February export data, and we will also watch January industrial production statistics in India and Malaysia. Markets will be closed in Indonesia on Monday and Tuesday.

Disclaimer and cautionary statement

Zurich Insurance Group Ltd

Investment Management
Mythenquai 2
8002 Zurich

173008049 01/22) TCL