ZURICH

Weekly Macro and Markets View

15 April 2024

Highlights and View

Iran attacks Israel with missiles and drones, neglecting strong warnings by the US

As 99% of the barrage was shot down and global efforts for de-escalation are intensifying, the reaction of Asian equity markets has been muted while US equity futures are up and oil futures down.

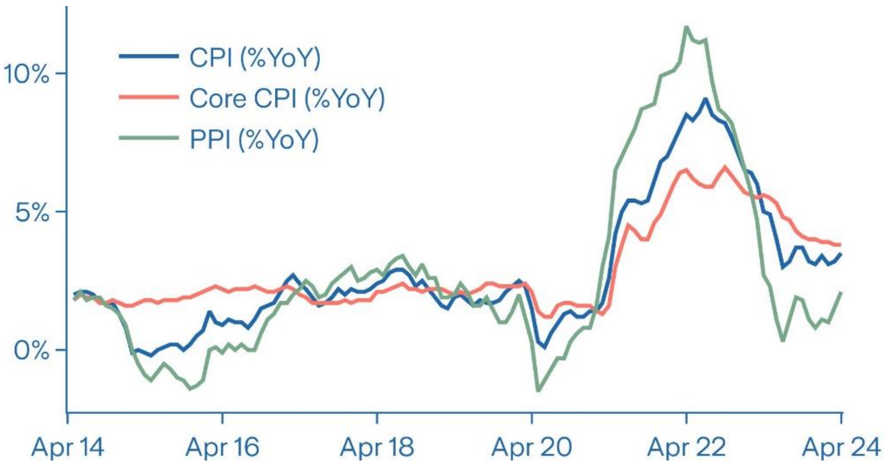
US headline inflation reaccelerates to 3.5% YoY while core CPI remains at 3.8%

Price pressure remains high, making near-term rate cuts less likely, but some components look more promising.

The ECB keeps policy unchanged, but emphasises slowing inflation and independence from the US Fed

We continue to see a June rate cut as consistent with both falling inflation and the Eurozone's low growth environment. We do not think the ECB's will be deterred by stickier US inflation.

US inflation is not vanquished yet



Source: Bloomberg

The latest batch of price data shows that inflation rates in the US remain elevated. Headline CPI accelerated from 3.2% to 3.5% YoY in March while Core CPI remained at 3.8% YoY, both above consensus expectations. While the Fed shrugged off the stronger CPI prints in January and February it will be harder to so this time. A rate cut in June is still possible if inflation or growth slow substantially in the weeks ahead, but it becomes increasingly unlikely as the Fed will have to acknowledge continuously elevated price pressure.

Within CPI, services remain the major driver of inflation while prices for core goods actually fell again after the small uptick in February. Shelter costs are still a big driver of service inflation though the rise was marginally lower than in February with other indicators like the Zillow rent index pointing at further moderation ahead. Not surprisingly given the recent pickup in oil and gasoline prices, energy and transportation were another major factor that pushed up prices in March. Producer prices also accelerated in March, but some of the components that feed into core PCE inflation, the Fed's favourite measure, like airfares and healthcare services came in on the weaker side.

Treasury yields rose to the highest since November 2023 providing some headwinds for equities. The S&P 500 fell by 1.6%, the largest weekly drop since October last year.

Global Inflation

Trends are diverging, but services inflation remains brisk

While US inflation was surprisingly strong in March, data for other regions have been more encouraging. In Europe, news on inflation over the past weeks has generally been good, with downside surprises on both CPI and producer price (PPI) releases, and last week's LatAm data showed similar trends. Despite expectations of the contrary, global goods prices remained disinflationary in Q1, with further price declines in components such as autos and household goods. China PPI, which is a key driver of global goods prices, fell again in March as excess capacity persists. In contrast, services inflation remains elevated in most regions, reflecting tight labour markets and brisk rent growth. Going forward, oil prices have rebounded while manufacturing activity is picking up after a protracted contraction. While the economic outlook for China remains challenging, conditions are improving on the margin as support measures are extended. We suspect this will mean less disinflation from the goods components, with services now having to step up to drive further declines in inflation.

Eurozone

Go your own way

On Thursday, the ECB left its deposit facility rate at 4%. As unexciting as the actual decision was, markets were focussing on the likelihood that easing will begin in June. The ECB left the door wide open for a June cut, which we think they will deliver. They emphasised good news on inflation, which continues to slow, amid below trend economic growth. While data from the US have been stronger, the ECB sets policy for the Eurozone where data continue to be much more conducive for an easing of the monetary policy stance. While the FX rate and possible depreciation of the EUR will factor into its thinking, we see this as being a secondary or even tertiary concern. Service inflation and wage growth both remain uncomfortably high, which we think will encourage slow and gradual easing. Otherwise, German industrial production for February was stronger than expected as production in energy-intensive areas rebounded somewhat. The quarterly Bank Lending Survey showed disappointing demand for loans from businesses and households amid high rates.

North Asia

The focus is on politics in Japan and Korea, while China's economic data disappoint

The Japanese yen depreciated to another 34-year high above 153 versus the US dollar, followed by renewed intervention warnings by the Ministry of Finance. Meanwhile, PM Kishida strengthened the defence cooperation in the South China Sea with the US and the Philippines during his US visit. In South Korea, both the prime minister and the leader of the conservative People Power Party stepped down after losing more seats to the Democratic Party and its allies, who won 192 out of 300 parliamentary seats. However, President Yoon will still be able to veto decisions by the DP as the opposition camp failed to reach the decisive 200 seat target. We expect the corporate governance 'Value-Up' reform program to proceed. In China, the drop in CPI inflation to 0.1% YoY in March and worsening PPI deflation as well as the big miss in March foreign trade data and easing credit growth suggest that a sustained rebound in growth momentum appears vulnerable. We are eagerly waiting for Lunar New Year statistical distortions to get out of the way once April data are released.

LatAm

General inflation is slowing, although services and core inflation remain high

March inflation moderated to 0.16% MoM from 0.83% in February, and was below market expectations. Year-on-year inflation slowed to 3.93% from 4.5% in February. Services continue to exert inflationary pressures, a concern for the Brazilian Central Bank (BCB). Despite this deceleration in inflation, we anticipate that the BCB will maintain its forward guidance, moderating the rate-cutting cycle. In Mexico, inflation accelerated from 0.09% MoM in February to 0.29% in March, but remained stable on an year-on-year basis, moving from 4.40% in February to only 4.42% in March. Services and core prices remain elevated, and robust economic activity makes it unlikely that Banxico (Mexico's central bank) will implement rate cuts in the near term. In Chile, inflation moderated from to 0.6% MoM in February to 0.4% in March and from 4.5% YoY in February to 3.7% in March. While this slowdown provides some relief for the central bank, it may not be sufficient to accelerate the rate cutting cycle. We expect a 50bp cut in May.

Credit

Markets are tested by rate volatility and geopolitics

The reaction of credit markets to renewed volatility in US rates following last Wednesday's inflation data was muted compared to the moves in equities. However, the tone appeared to shift on Friday as geopolitical risks flared up. The week closed with cash credit spreads flat in US IG and modestly wider in US HY and European IG and HY. CDS spreads moved wider across the board, especially so in HY. We see two main drivers behind the resilience in cash credit, especially in US IG. First, demand has remained robust due to attractive, high all-in yields, with the latest move higher in rates keeping that trend in place. Second, credit resilience suggests that the repricing of Fed rate cut expectations, which unsettled rates and equity markets last week, is not enough to upset credit investors as long as the growth outlook does not worsen. While growth has indeed surprised on the upside so far in 2024, we still think that credit investors are not provided with much of premium at current valuations, not only vis-à-vis the still uncertain growth outlook, but also elevated geopolitical risks.

What to Watch

- In the UK, inflation data will provide clues as to the BoE's future rate path while retail sales and labour market data offer important insights into the current state of the economy.
- India's elections will start on Friday and will take place in seven phases until June 1. Japan will release foreign trade and CPI data for March. China will publish Q1 GDP and March activity data. Australia will report March labour market data and Q1 business confidence. Malaysia will report Q1 GDP data. March foreign trade data will be released in India, Singapore and Malaysia. Markets will be closed in Indonesia and Thailand on Monday, in Thailand on Tuesday, in India on Wednesday and in Vietnam on Thursday.
- In Brazil, economic activity data for March is scheduled to be published. Expectations are that it will remain robust, with 0.7% MoM growth, accumulating 3.2% YoY. This growth is primarily driven by the services and retail sales sectors.

Disclaimer and cautionary statement

Zurich Insurance Group Ltd

Investment Management
Mythenquai 2
8002 Zurich

173008049 01/22) TCL