ZURICH

Weekly Macro and Markets View

22 April 2024

Highlights and View

Global equity markets fall sharply, with the S&P 500 off 3% and Japan's Topix down nearly 5% on the week

The combination of aggressions between Israel and Iran and growing fears that interest rates will stay high for even longer led to profit taking in stocks.

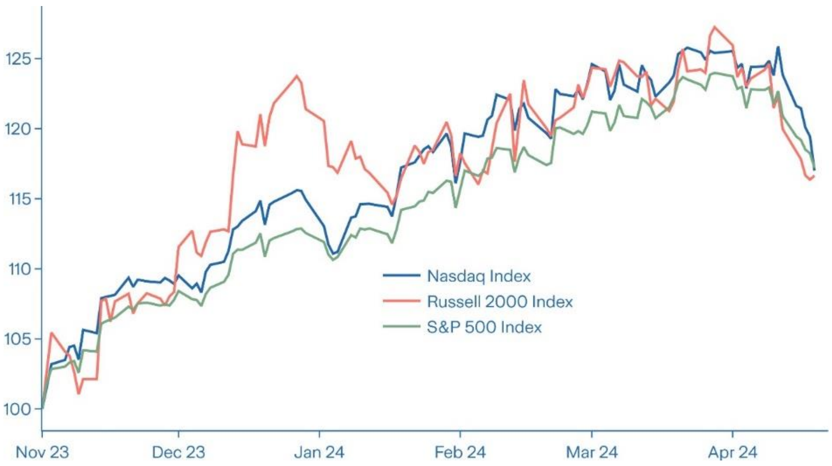
Most of China's economic activity data for March were weak

However, we're sticking to our 4.9% real GDP growth forecast for this year mainly due to statistical calculation reasons.

UK inflation slows but remains elevated while unemployment picks up

The BoE is unlikely to change its stance based on last week's data but will want to see a further deceleration in price and wage pressure in the months ahead.

Equity markets falter on geopolitics and policy-rate expectations



Source: Bloomberg (Note: Indexed to 100, November 2023)

A volatile week in financial markets saw losses in both equity and government bond markets, though oil prices actually fell modestly in spite of the escalation of the crisis in the Middle East. The first direct attacks on each other's territory by Israel and Iran marked a disturbing turn of events, but were deemed by many to be a show of strength rather than the start of outright war between the two long-standing adversaries. Certainly the response in the oil markets was encouraging, though the risk of mistakes being made in such an environment are high. Global equity investors appeared to price-in a higher risk premium, but this was only part of the story last week. US data and comments from policy makers once again pushed back expectations of when the Fed's first rate cut would be made, lifting global bond yields, despite the rising geopolitical risks. US stocks fell sharply over the week, with the interest-rate-sensitive Nasdaq index off 5.5%, and some key names such as Tesla and Nvidia both down 14%. While Nvidia is still up more than 50% this year, the 40% decline in Tesla shows that investors have become more discerning, a theme we think will continue as the earnings season gets underway. So far we see the falls in equity markets as an overdue correction within a bull market trend, but acknowledge that given interest rate and geopolitical uncertainty, buying the dip requires a degree of caution.

Credit

Wider but still vulnerable

During another volatile week for markets, credit outperformed equities but was not insulated from the risk-off sentiment. So far this month, CDS has underperformed cash credit and HY has underperformed IG, causing HY/IG decompression. Similar movements played out in European credit. Jitters were also visible in fund flows according to LSEG Lipper and EPFR data. While US IG funds saw modest inflows after strong inflows the week prior to last, US HY funds saw the biggest outflows of 2024. In Europe both IG and HY funds suffered outflows, in contrast to almost continuous inflows since last October/November. On a positive note, HY issuance was resilient last week, picking up from the week prior. Meanwhile, IG issuance, excluding financials coming out of blackout period, was modest, providing technical support. Despite the recent widening, we believe that credit spreads are still tight and would be vulnerable if sticky inflation were to lead to higher rates or were a recession to become likely. Although recession is not our base case, it is still a major risk.

US

The housing market is still feeling the impact of higher rates

The latest batch of housing data shows renewed weakness in many areas of the real estate market. Building permits fell by 4.3% MoM in March to the lowest since last July. Housing starts dropped by almost 15% MoM, though that followed a strong rebound the month before and reflects the recent volatility in the data. Finally, existing home sales fell by 4.3% MoM, which was roughly in line with expectations. The National Association of Home Builders' survey was unchanged in April, indicating a stabilisation at recent levels that is still significantly below pre-Covid levels. Meanwhile, a solid rebound in retail sales underlines the continuing strength of consumer spending, which is supported by a healthy labour market. Both factors make any near-term rate cuts less likely. Initial jobless claims remain at low levels while continuing claims have ticked up marginally. Overall, the Conference Board's leading index dropped by 0.3% MoM in March, reflecting potential headwinds to growth in the coming months.

UK

Unemployment picks up while price pressure remains high

The data offered mixed messages last week. Headline CPI inflation slowed from an annual rate of 3.4% in February to 3.2% in March, but at 0.6% the monthly rate remains uncomfortably high, particularly driven by service inflation. Meanwhile, the labour market is weakening, with the unemployment rate picking up to 4.2% from 4.0% in February and the number of employed people falling at an accelerating pace. However, despite the softening employment situation, wage growth has slowed only marginally from 6.1% YoY the month before to 6.0% and is therefore still not in line with the Bank of England's inflation target. Finally, retail sales did not grow at all in March as consumers held back spending, although this may have been distorted by the Easter holiday. Despite only moderate growth in March, retail sales are still 0.8% higher than a year ago, the biggest rise in two years. Gilt yields rose modestly over the course of the week while the FTSE 100 lost some ground as global stock market sentiment turned more cautious, once again outperforming the S&P 500, however.

China

A second glance at strong Q1 GDP statistics

At first glance, China's GDP statistics for the first quarter came in strong at a seasonally adjusted annualised rate of 6.6% QoQ, up from 4.9% in the prior quarter, and firm at 5.3% in YoY terms. However, we see two caveats to this rosy picture. Firstly, Chinas Q1 GDP grew only 4.2% YoY in nominal terms, and, secondly, growth weakened sequentially in March from January/February. Both industrial production and retail sales growth has started to soften from earlier this year, while infrastructure investment growth slowed in March, and property investment continued to contract, down 10% YoY. The housing sector remains in the doldrums, as official data confirm, but even these data may not fully reflect the dire reality, with both property sales volume and property prices down about one quarter from the 2021 highs, according to private data sources. Secondary home prices contracted at a record pace in March, down nearly 6% YoY. Finally, labour market conditions remain soft, particularly in the services and construction sector.

LatAm

Currencies are depreciating and interest rates rising due to expected changes in central banks' policies

Despite solid economic activity in Brazil, Mexico, and Chile, inflation has slowed but remains above the midpoint of the inflation target ranges in these countries. Additionally, the US Federal Reserve is now expected to make only one to two rate cuts this year. Geopolitical tensions in the Middle East have contributed to currency depreciation in the region as well as interest rate increases.

In Brazil, the economic activity indicator for February showed growth of 0.4% MoM (compared to 0.52% in January), above market expectations of 0.35%, resulting in an increase of 2.59% YoY (compared to 3.32% in January) and was slightly above market expectations of 2.55%. Retail sales volume (0.96% MoM and 8.2% YoY) was the primary driver of the expansion in economic activity at the sector level. Furthermore, the tight labour market has increased wage growth and real income in turn, effectively offsetting still high interest rates and contributing to higher demand.

What to Watch

- The Flash PMIs for major economies will show whether global growth momentum continued to improve in April.
- In the US, investors will focus on PCE core inflation for any clues as to what the Fed's stance will be in the coming months while GDP numbers are likely to reflect solid growth in Q1.
- In the Eurozone, we will receive the European Commission's consumer confidence survey on Monday. Wednesday brings German ifo data along with both French and Italian national sentiment measures. All of these are expected to show a further improvement.
- We expect both the Bank of Japan and Bank Indonesia to keep policy rates unchanged. April PMIs will be published in Japan, India and Australia. Japan will release Tokyo's CPI for April, while Australia will publish Q1 inflation data. South Korea will report Q1 GDP data, Taiwan March industrial production data, and Singapore March CPI and industrial production data. Markets will be closed in Australia on Thursday.

Disclaimer and cautionary statement

Zurich Insurance Group Ltd

Investment Management
Mythenquai 2
8002 Zurich

173008049 01/22) TCL