Weekly Macro and Markets View

29 April 2024

Highlights and View

US GDP growth slowed to an annualised rate of 1.6% while core inflation remains elevated

PCE Core inflation was stuck at 2.8% YoY in March, which is line with the Fed's projections and keeps them on track for rate cuts later this year.

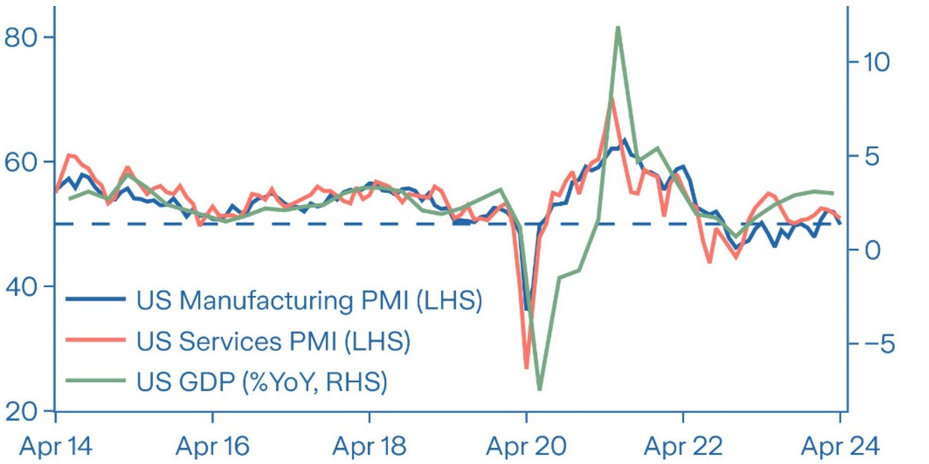
After a torrid prior week, equity markets rebound with the FTSE 100 hitting a record high

With no further escalation in the Middle East conflict and better earnings reports emerging investors again bought the dip, with stocks recovering around half of recent losses.

Bank Indonesia hikes its policy rate by 25bps to a record high 6.25%

Only a minority among consensus forecasters had projected the hike, which was made by the cental bank to stem the recent IDR currency devaluation.

The US economy is slowing



Source: Bloomberg

Growth in the US has slowed from an annualised rate of 3.4% in the final quarter of 2023 to a rate of 1.6% in the first quarter of this year, significantly below consensus expectations. While these numbers are often revised substantially they confirm a trend that was observable in recent months and the latest business surveys are pointing at further weakness ahead. Driven by both manufacturing and service activity the S&P Composite PMI for the US fell from 52.1 in March to 50.9 in April, showing a further loss of momentum in the economy. This is expected to have an impact on the labour market, too, as hiring plans are likely to come under pressure. The reduction in workforce numbers identified by the survey was centred around services, where employment decreased by the largest extent since mid-2020. This will likely have an impact on wage growth and should help to put a lid on service inflation in the coming quarters. On a more positive note, the survey also shows a slowdown in service price inflation. Price pressure remains high for now, however. PCE Core inflation rose by 0.3% MoM, in line with expectations, keeping the annual rate at 2.8%. This is in line with the Fed's projection and keeps them on track for rate cuts later this year. Stock markets shrugged of the inflation print and focused on solid earnings instead, rebounding strongly from their recent lows.

Equities

Better earnings renew investor confidence in the bull market

A rebound in equity markets last week saw investors' attention switch from geopolitical angst and interest rate fears to corporate earnings. US heavyweights dominated the announcements and though Meta disappointed, both Microsoft and Alphabet (Google) exceeded high expectations. Alphabet surged 12% to take the stock up 23% so far this year, helped by plans to initiate a dividend and repurchase stock. The miss from Tesla on both earnings and revenues didn't bode well for a stock that was already down 43% YTD, however, a shift in strategy renewed the faith and led the stock to close the week up over 14%. In aggregate, earnings have been strong with close to 80% of US stocks beating estimates, which is a bit better than usual and has encouraged investors to see the recent sell-off as temporary. We are also heartened and note the new high on the UK FTSE 100 as signs of broadening participation. That noted, higher bond yields and recurring concerns about interest rate policy suggest it is a tad early to fully embrace a back-to-the-races view.

Eurozone

Hope springs eternal

Eurozone watchers were inundated with sentiment data last week, and the overarching theme was one of growing optimism about economic activity. The most important indicators were the PMI surveys for April, where the Eurozone composite moved further into expansionary territory to 51.4. Figures for Germany and France also beat consensus expectations, with the services side of both economies showing notable improvement. We also had ifo as well as GfK consumer confidence data for Germany that showed a similar picture. The outlook for Germany is quickly converging towards other Eurozone economies, although the starting base was extremely low. There continues to be a notable divergence in sentiment between services and manufacturing. The outlook for manufacturing actually deteriorated across the Eurozone in April, with the PMI in contractionary territory at 45.6. While we continue to see structural issues for European manufacturing, we are expecting a bounce from these levels given the improvement in the energy situation.

Japan

Currency capers as USDJPY spikes above 160

As widely expected, the Bank of Japan kept policy settings unchanged at its Monetary Policy Meeting last week. We are interpreting the BoJ's Outlook Report as showing confidence that its 2% inflation target can be met not only this year, but also in the medium to long term. The median CPI ex fresh food and energy forecast for FY 2026 at 2.1% is 20bps higher than for FY 2025. Overall, the tone seems to point to further monetary tightening. The drop in Tokyo's April CPI from 2.6% to 1.8% YoY doesn't seem to match the BoJ's inflation outlook. However, it is unlikely to be fully reflected on a nationwide basis as the broadening of high school tuition fee exemptions will not be reflected on a nationwide basis. Currency markets reacted with a further weakening of the yen, with the USDJPY rising to a 38-year high of 160.17 today, but fears of currency intervention by the Ministry of Finance led to a quick reversal back below 155. On a separate note, there appears to be an economic recovery taking place in Q2 as the Composite PMI for April recovered nearly one point to 52.6.

Bonds

Inflation is driving market volatility

The bond market sell-off persisted last week, initially fuelled by the US GDP report that showed PCE core inflation accelerating in Q1. Friday's monthly core PCE number was in line with expectations, easing concerns somewhat. There was also a moderate rally in Treasuries on Friday, leaving the 10yr at 4.66% at the end of the week, up compared to 4.2% at the end of March but still below the 5% level reached in October. Expectations for Fed rate cuts were pushed out further, with only one cut now fully priced by the end of 2024 as opposed to the six which had been priced at the beginning of the year. Other markets faced similar headwinds. Bund yields snapped higher as investors dialled back rate cut expectations for the ECB, though the first cut is still anticipated for July, and gilts performed similarly. After the sharp repricing of Fed policy easing, and with real yields also on the rise, we believe that bond yields are now becoming stretched to the upside. That said, bond markets are expected to remain volatile for the time being given still sticky services inflation and resilient economic activity.

Credit

Spreads tighter but flight to quality seen

Credit cash spreads closed the week tighter, reversing the widening seen the week prior, and now stand approximately midway between April lows and highs. Performance has not been uniform, however, and there has been a flight to quality within credit. In HY, Bs widened versus BBs, and CCCs widened versus Bs, markedly so in European credit. The HY/IG spread decompressed, especially in CDS. Sentiment dented by the latest bout of volatility was visible in corporate bond fund flows. US IG saw its first weekly outflows of 2024, and inflows into US HY were insufficient to reverse the large outflows of the prior week. European IG saw inflows, but HY experienced further outflows. Primary market activity in the US and Europe also diverged. US IG issuance was not only below estimates, it was the slowest of 2024, while European issuance was extremely brisk and marked the fifth most active week in 2024. Thanks to attractive all-in yields and manageable supply, strong technicals appear to have helped credit, but it remains vulnerable as long as rates are still unpredictable.

What to Watch

- ISM surveys and the latest batch of labour market data will give crucial insights into the current state of the US economy.
- Eurozone inflation figures will be released on Thursday. Headline is expected to be remain unchanged at 2.4% YoY while the core measures should tick down from 2.9%. Q1 GDP will also be released. A very minor economic expansion on the quarter is expected.
- Swiss CPI, PMI and KOF data will show how inflation and activity held up in April.
- Japan will release important economic indicators for March as well as April consumer confidence data. China will report April PMIs. Australia is scheduled to publish foreign trade, retail sales and private credit data for March as well as April house price data. Various countries will release April PMIs. Q1 GDP data will be published in Hong Kong and Taiwan. Japan's 'Golden Week' will start on Monday and last until May 6. Most markets will be closed on Labour Day, May 1, with China's markets closed from Wednesday to Friday.

Disclaimer and cautionary statement

Zurich Insurance Group Ltd

Investment Management
Mythenquai 2
8002 Zurich

173008049 01/22) TCL