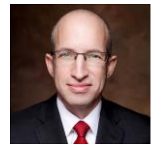
WEEKLY MARKET RECAP

11 March 2024

Summary for the week ending on Friday, 8 March 2024

MULTI-ASSET SOLUTIONS EMEA & LATAM



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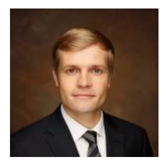

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ECONOMIC AND POLITICAL BACKDROP

The US

On Wednesday, the Federal Reserve (Fed) reported in its periodic Beige Book survey of regional economic conditions that consumers were showing more sensitivity to rising prices, while the Labor Department said that job openings fell in January to their lowest level in three months. The quits rate – the share of workers leaving jobs voluntarily, typically considered a good measure of workers' perception of the ease of finding a new job – also fell to its lowest level since August 2020, early in the rebound from the pandemic.

Friday's jobs report also seemed, at least initially, to reassure investors about the labour market. Employers added 275,000 jobs in February, more than consensus forecasts of around 200,000, but January's gain was revised significantly lower, from 353,000 to 229,000. Moreover, the unemployment rate rose unexpectedly from 3.7% to 3.9%, its highest level in over two years. In a positive sign for inflation, average hourly earnings rose 0.1%, below expectations and down sharply from January's 0.5% increase.

Fed Chair Jerome Powell testified before Congress at midweek. While the testimony was largely seen as reiterating previous Fed talking points, it did offer some less hawkish takeaways on the timing of the path of rate cuts. In particular, Powell stated that policymakers were "not far" from having the confidence that inflation's downtrend will be sustained, enabling them to begin cutting rates. As a result, futures markets ended the week pricing in a somewhat higher (71.0%, according to the CME FedWatch Tool) chance of a cut at the Fed's policy meeting by June.

Europe

The European Central Bank (ECB) left its key deposit rate unchanged at 4.0% but revised its inflation and economic growth forecasts lower and indicated that discussion on dialling back restrictive policy later in the year had begun. ECB President Christine Lagarde acknowledged that "good progress" had been made toward the 2.0% inflation target but also indicated that the Governing Council still needed to be more confident that inflation was falling sustainably. "We will know a lot more in June," she said, adding that there was broad agreement on that point.

The central bank now sees inflation falling to 2.0% in 2025, rather than 2026. Projections for core inflation, which excludes volatile food and energy prices, were also revised lower, with the latest update suggesting that it would hit the 2.0% target in 2026. The ECB's latest forecast cut economic growth to 0.6% in 2024, which was slightly lower. However, it expects growth to accelerate to 1.5% in 2025.

The UK

Chancellor of the Exchequer Jeremy Hunt, in his last Spring Budget before a general election, unveiled a reduction in national insurance rates that would amount to a GBP 10 billion payroll tax cut. The budget also included changes to child benefit rules that would make them more generous. Hunt partly funded these measures by making the tax status of non-domiciled foreign residents whose permanent homes are outside the UK less favourable and extending the windfall tax on oil and gas companies for another year. The Office for Budget Responsibility said that spending cuts of GBP 20 billion were still required to balance the budget. It also said that taxes would climb to 37.1% of GDP by 2028–2029, a figure that was lower than the 37.7% predicted in November.

Japan

Investor speculation continued about the likely monetary policy trajectory the Bank of Japan (BoJ) – with signs of increased conviction that the central bank could be closer to raising short-term interest rates out of negative territory than previously thought. Comments by a BoJ board member suggested that a virtuous cycle of prices rising in tandem with wages was in sight (a stated precondition for monetary policy tightening).

Against this backdrop, the yield on the 10-year Japanese government bond rose to 0.73% from 0.71% at the end of the previous week. The yen appreciated sharply to JPY 147.1 against the US dollar from 150.1 the prior week. The currency's strength weighed on Japan's exporters, as they derive a significant share of their revenues from overseas. Japanese stock markets have been significantly boosted by historic yen weakness over the past three years.

On the economic data front, household spending fell by -6.3% year on year (y/y) in January, the sharpest decline in nearly three years. Weakness was evident across most categories and notably in auto sales. Inflationary pressure has had the effect of weighing on domestic demand. Conversely, nominal wage growth came in higher than anticipated, with wages rising 2.0% y/y in January versus estimates of 1.2%. Japan's unions are demanding the highest wage rises in over three decades at this year's spring shunto negotiations. Finally, the consumer price index (CPI) for the Tokyo area rose 2.5% y/y in February, in line with expectations.

China

Beijing set an economic growth target of around 5% this year at the National People Congress (NPC), China's parliament, which started 5 March and ends 11 March. The target was the same as last year, when China's economy officially rose 5.2%. However, analysts said it would be hard to match last year's growth pace, which benefited from a post-lockdown rebound in early 2023.

The government set the budget deficit at around 3% – the same target as early last year until it was subsequently raised to 3.8% to accommodate more borrowing – and said it would issue RMB 1 trillion in special ultra-long central government bonds to support growth.

At the NPC, Premier Li Qiang announced that China will refine housing policies and construct government-subsidised housing to support the property sector, which is mired in a prolonged downturn. Li also stated that the government will step up efforts in big data and quantum computing to enhance technological self-reliance at a time when the US is pushing several countries to further restrict their technology exports to China. However, analysts were underwhelmed by the lack of tangible measures to support Beijing's economic goals.

On the economic front, the private Caixin/S&P Global survey of services activity fell to a weaker-than-expected 52.5 in February from January 52.7. However, the gauge remained above the 50 threshold, separating expansion from contraction for the 14th consecutive month.

Chinese exports and imports rose in the first two months of the year. Exports grew an above-consensus 7.1% in January and February from the prior-year period, improving from December's 2.3% increase. Imports rose 3.5% over the two-month period, greater than the 0.2% gain in December. China combines trade data for the first two months of the year to smooth out distortions arising from the weeklong Chinese New Year holiday.

Australia

Australia's fourth quarter GDP came in unsurprisingly soft at 0.2% quarter on quarter (q/q) and 1.5% year on year, in line with consensus. Per capita GDP decreased -0.3% q/q, the third consecutive quarter of decline. While labour productivity improved 0.5% q/q thanks to a decline in hours worked, it is still down -5.4% from 2022. Looking under the hood, net trade and government spending were the biggest positive contributors, while private sector destocking and residential construction were the largest headwinds to economic activity. This print is consistent with February forecast of the Reserve Bank of Australia (RBA), so probably will not shift its outlook going into the March RBA meeting. The value of new housing loans in Australia fell a further -3.9% month on month in January.

EQUITY MARKETS

Last week, the MSCI All Country World Index (MSCI ACWI) rose 0.6% (6.4% YTD).

In the US, the S&P 500 Index moved -0.2% lower (7.7% YTD). Growing hopes that the Fed might begin cutting interest rates sooner rather than later appeared to help bring the S&P 500 to new record intraday highs, alongside the Nasdaq Composite Index before pulling back late Friday. The week began on a down note – on Tuesday, the S&P 500 fell by more than 1% for the first time since mid-February – which was attributed in part to disappointing policy news out of China. Stocks regained momentum at midweek, however, seemingly on the back of easing demand and inflation pressures domestically.

Growth stocks lagged value shares and small caps outperformed large caps, while mega-cap tech shares lagged due in part to a decline in Apple following reports about slowing iPhone sales in China. Notably, Danish pharmaceuticals company Novo Nordisk, which has seen robust demand for its diabetes and weight loss drugs, displaced Tesla on Thursday as the 12th biggest public company by market capitalisation. The Russell 1000 Growth Index returned -1.3% (9.2% YTD), the Russell 1000 Value Index 1.1% (5.4% YTD) and the Russell 2000 Index 0.3% (3.0% YTD). The technology-heavy Nasdaq Composite declined -1.1% (7.3% YTD).

In Europe, the MSCI Europe ex UK Index firmed 1.5% (6.6% YTD). Major stock indexes advanced. Germany’s DAX Index ticked up 0.4% (6.3% YTD), France’s CAC 40 Index increased 1.2% (6.6% YTD) and Italy’s FTSE MIB Index gained 1.4% (10.5% YTD). Switzerland’s SMI Index was up 1.9% (5.2% YTD). The euro appreciated versus the US dollar, ending the week at USD 1.09 for EUR, up from 1.08.

In the UK, the FTSE 100 Index rose 0.1% (-0.1% YTD) but the FTSE 250 Index put on 1.3% (flat YTD). The British pound strengthened versus the US dollar, ending the week at USD 1.29 for GBP, up from 1.27.

The performance of Japan’s stock markets was mixed over the week. While the Nikkei 225 Index was lower, the TOPIX Index firmed 0.6% (15.3% YTD) and the TOPIX Small Index added 1.1% (9.6% YTD). Exuberance around artificial intelligence and solid corporate earnings boosted sentiment.

In Australia, the S&P ASX 200 Index surged 2.0% (5.0% YTD) as US equities hit all-time highs and Fed Chair Powell said the Fed was “not far” from confidence to ease policy. Australian government bond yields abated, with the curve modestly flattening. The Australian dollar appreciated against the US dollar by 1.6% as the Fed turned marginally more dovish.

Emerging markets and other markets

MSCI Emerging Markets Index closed 1.2% higher (1.5% YTD), with a positive contribution to performance from the stock markets of China, Taiwan, India and South Korea and a negative contribution from that of Brazil.

Chinese equities gained as the government’s recent market stabilisation measures lifted investor confidence despite an uncertain economic outlook. The Shanghai Composite Index gained 0.6% (2.4% YTD) and the blue-chip CSI 300 Index advanced 0.2% (3.3% YTD). In Hong Kong, the benchmark Hang Seng Index gave up -1.0% (-3.7% YTD).

In Türkiye, the government reported early in the week that CPI inflation in February was measured at a month-over-month rate of 4.5%. This was higher than expected, and it lifted the annualised CPI from 64% in January to 67% in February.

According to T. Rowe Price sovereign analyst Peter Botoucharov, the main driver of Turkish inflation remains services costs, particularly rent and transportation, but he notes that core goods inflation is stabilising. He believes that headline inflation could continue climbing toward 70% in the months ahead, then he anticipates a downtrend in the second half of the year.

As for monetary policy, he expects tight monetary conditions to persist, with the potential for the central bank to raise its key interest rate, the one-week repo auction rate – currently at 45.0% – one more time as inflation begins to crest in the spring.

In Poland, the central bank concluded on Wednesday its scheduled two-day monetary policy meeting and, as expected, decided to keep its key interest rate, the reference rate, at 5.75%. Other interest rates controlled by the central bank were also unchanged.

According to the post-meeting statement, policymakers acknowledged that "the process of disinflation" in the Polish economy is continuing, with inflation being "driven down by the reduction of cost pressures reflected in falling producer prices, and by the weak growth in economic activity." They also noted that fourth-quarter GDP growth, measured at 1.0%, was "relatively low" but that incoming data "indicate an increase in economic activity growth" in the first quarter of 2024. While policymakers projected that annual CPI growth "will run at the level consistent with" the central bank's inflation target, they anticipate that "the decline in core inflation will be slower and core inflation will remain above CPI inflation." As a result, policymakers decided to keep interest rates unchanged.

Central bank officials justified their decision by noting that inflation developments in future quarters are "associated with substantial uncertainty, related in particular to the impact of fiscal and regulatory policies on price developments, as well as the pace of economic recovery…and labour market conditions." They also cited other factors, such as the potential for higher value-added taxes (VAT) on food products, higher energy costs and "medium term demand pressure in the economy…stimulated by wage growth."

FIXED INCOME MARKETS

Last week, the Bloomberg Global Aggregate Index (hedged to USD) returned 0.7% (flat YTD), Bloomberg Global High Yield Index (hedged to USD) 0.6% (1.9% YTD) and Bloomberg Emerging Markets Hard Currency Aggregate Index 0.8% (0.8% YTD).

Powell's comments and the downside economic surprises helped push the yield on the benchmark 10-year US Treasury note to its lowest intraday level (4.03%) since 2 February. Over the week, the 10-year Treasury yield decreased -10 basis points (bp) to 4.08% from 4.18% (up 20bp YTD). The 2-year Treasury yield decreased -5bp to 4.48% from 4.53% (up 23bp YTD).

Ten-year government bond yields for Germany, Italy and France declined after the ECB left its monetary policy unchanged and signalled that interest rates could be cut in June. Over the week, the 10-year German bund yield decreased -14bp, ending the week at 2.27% from 2.41% (up 25bp YTD).

In the UK, the 10-year gilt yield decreased -14bp, ending the week at 3.97% from 4.11% (up 44bp YTD).

It was another week of heavy issuance in the US investment-grade corporate bond market, with USD 51 billion in total supply surpassing expectations of USD 30 billion to USD 35 billion. Technical conditions were supportive for high yield bonds, with coupon payments and tenders adding significant cash to the market, while net new issuance remained modest.

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YTD is year to date. GDP is gross domestic product.

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