

April 15, 2024

# Weekly Investment Insights



With US inflation proving sticky and tensions in the Middle East flaring up, US equities retreated, and US Treasury yields shot up last week. While the ECB signalled that it could be ready to cut rates in June, the likelihood of a Fed rate cut in the first half of the year is considered increasingly remote.

The Q1 earnings season got off to a reasonably good start, that is until Friday when big banks disappointed, at least in terms of forward guidance.

Over the weekend, Iran's attack on Israel led to stress, however, this morning, global markets showed signs of stability. Oil prices declined, with traders betting that the events would not escalate into a regional crisis. It was reported that Iran said, "the matter can be deemed concluded", while, according to Bloomberg, US President Biden reportedly told Israeli Prime Minister Netanyahu that the US would not support a counterattack...

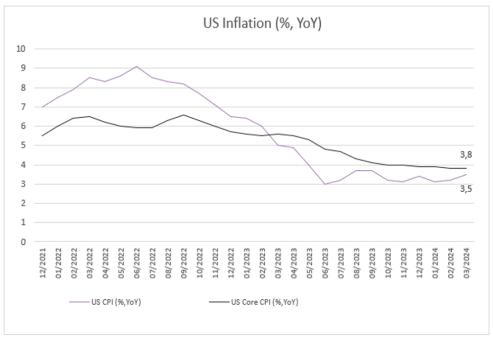
#### US inflation data rocks the market

US inflation rose for a second straight month to 3.5% YoY in March, up from 3.2% the month before and above forecasts of 3.4%. This marks the highest level since last September. On a

monthly basis, as in the two previous months, it rose 0.4%, with over 50% of the increase coming from shelter and gasoline prices.

Energy costs rose 2.1% (vs -1.9% prior), with gasoline increasing 1.3% (vs -3.9%). There was also an increase in transport (10.7% vs 9.9%) and apparel (0.4% vs 0%). On the other hand, prices declined for new vehicles (-0.1% vs 0.4%) and used cars and trucks (-2.2% vs -1.8%). The services component is still running quite hot at 5.4% YoY. Motor vehicle insurance was a key contributor (+22.2%), as was shelter, which remained stuck at 5.7% YoY.

Core inflation, which excludes food and energy, was unchanged at 3.8% YoY and slightly above forecasts of 3.7%.

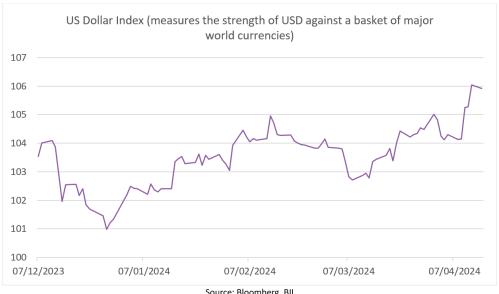


Source: Bloomberg, BIL

The new data catalysed a relatively strong market reaction: expectations for Fed rate moves fell to just 1 to 2 quarter-point cuts this year (down from 6 at the beginning of 2024), the market-implied probability of a first-rate cut in July fell to around just 50%, bond yields jumped, and stocks softened.

The US dollar dominated, swallowing other major currencies in its wake, as rate expectations moved higher.

On Wednesday, the Japanese **yen** broke through 152 to the dollar, its weakest level since 1990, piling pressure on Japanese officials to support their ailing currency. Tokyo is ready to act against the currency's recent sharp falls; The last time the Tokyo authorities intervened to support the yen was in 2022.



Source: Bloomberg, BIL

Turning back to the inflation prints, one point to keep in mind is that the official figure that the Fed is looking at to gauge inflation is the PCE index which is due on April 26th. The PCE report is derived in part from the producer price index (PPI), which was released last week. While it came in below expectations (rising 2.1% YoY in March, versus 2.2% expected), it was nevertheless the biggest increase since April 2023.

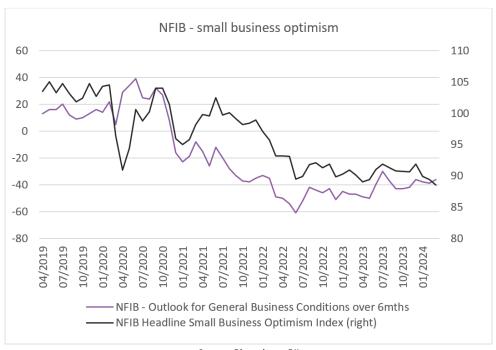
#### Less optimistic sentiment among small US businesses

Sticky inflation does not bode well for increasingly pessimistic small businesses. The NFIB Small Business Optimism Index, fell for a third consecutive month to 88.5 in March, reaching the lowest level since 2012. This was 0.9 down on the previous month and below the market expectation of 90.2.

Business owners continue to cite inflation as the top business problem on Main Street; for 25% of owners, it is their single most important problem due to higher input and labour costs. This component is up two points from February.

In terms of sales, fewer and fewer owners are expecting an increase in real sales, down eight points in February to -18%.

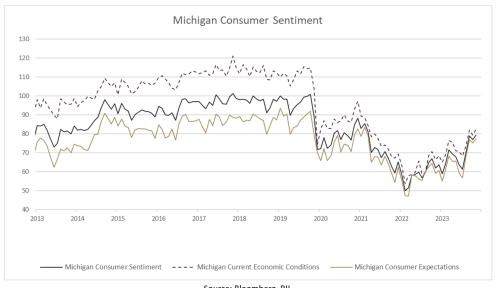
On the job front, businesses continue to be less likely to open positions. Only 11% expect to create new jobs in the next three months, down one point in February and the lowest level since May 2020.



Source: Bloomberg, BIL

### Michigan index falls slightly

Michigan's preliminary index of consumer sentiment fell from 79.4 to 77.9, below the forecast of 79, a slight decrease, but the index remains high. This deterioration is explained by the rise in petrol prices and heightened fears of job losses.



Source: Bloomberg, BIL

# Industrial metal prices pushed up

Industrial metal prices are rising. Notable increases include:

• Copper prices up by more than 10% YTD

- Zinc has rallied by almost 20% this month alone
- Iron ore is up by over 10% this month

This is partially driven by a recovery in manufacturing activity. Over the past few weeks, we have had several indicators confirming this: The US manufacturing PMI marked its first expansion after 16 months of contraction, China's manufacturing activity expanded for the first time in six months in March and UK Manufacturing also jumped 1.2% last month, a much stronger than expected print.

Even Germany's ailing manufacturing sector managed to surprise positively last week. **Industrial production** rose to 2.1% MoM, from an upwardly revised 1.3% gain in January. It was boosted by construction activity, automotive and the chemicals industry. At the same time, production grew for all components: intermediate goods (2.5%), consumer (1.9%), and capital ones (1.5%).

These green shoots in the data tie in with the latest **World Trade Report** from the WTO, also released last week. After a contraction in 2023 (-1.2%) due to the persistent effects of high energy prices and inflation, world merchandise trade is expected to recover this year, with 2.6% growth.

This is good news for Europe's manufacturing-oriented economy which, in 2022, accounted for a significant share of global trade in goods (37% of both exports and imports).

#### Oil falls but remains high

As mentioned before, oil is well supported by rising tensions in the Middle East, and the last speculation that the conflict will remain contained has pushed oil prices slightly down.

While geopolitics are driving short-term market movements, demand is still a key overarching consideration in the oil market. The International Energy Agency (IEA) lowered its **oil demand growth forecast** for 2024, following weaker-than-expected consumption in OECD countries and a slowdown in industrial activity.

Nonetheless, the IEA revised upwards the forecast price of **Brent crude oil**. The agency now expects the price of Brent to average \$88.55 a barrel this year, compared with the previous forecast of \$87.

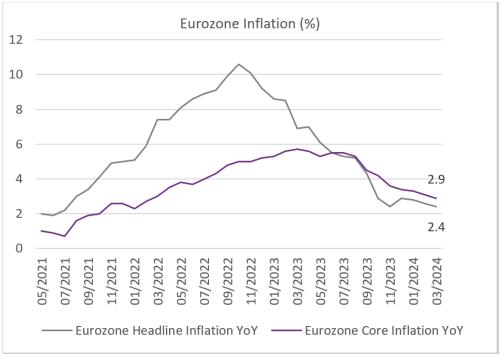
## In the Eurozone, a rate cut is not for this time

At the last monetary policy meeting, the **European Central Bank** kept its key interest rate at a record high.

The interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 4.50%, 4.75% and 4.00%, respectively.

The ECB signaled that it is still considering a cut at its next meeting in June, and in the aftermath of the meeting, the market has upgraded the probability of a June cut to approximately 90%.

Inflation in the bloc has continued to converge towards the 2% target, led by lower food and goods prices. Energy prices are lower than a year ago, while prices for services keep increasing a lot. At the same time, growth is fragile, with only a meagre expansion expected this year.



Source: Bloomberg, BIL

Nonetheless, the ECB wants more certainty before cutting rates, and in particular, it wants to see further progress regarding cooling wage growth. Of particular interest is negotiated wage growth - this statistic is reported quarterly, and we will not have another print until May 23rd.

The ECB protests that it is not Fed-dependent, but it must nevertheless take account of what is happening across the Atlantic. While it could front-run the Fed with a first cut in June, it will be difficult for it to continue cutting if the Fed remains on hold. This could lead to a depreciation of the EUR and thus rekindle inflation (especially considering the Eurozone's dependence on international energy markets, where prices are denominated in USD).

#### China's trade balance below market forecasts

The latest economic data from China calls into question its 5% growth target.

Exports fell by 7.5% YoY, more than the 3% decline expected by the market and the sharpest drop since August last year. On top of this, China is suffering from intense price competition in high-tech sectors such as solar panels, wind turbines and electric vehicles, which is driving down prices and leading to disinflation in Chinese exports.

Imports failed to meet the market expectations of a 1.2% rise falling by 1.9% YoY after 3.5% growth recorded in the first two months. This decline underlines the weakness in domestic demand, which was also highlighted by Thursday's data showing that consumer inflation slowed more than expected last month, to 0.1% from 0.7%.

China's GDP for the first quarter will be published on Tuesday, giving an idea of the progress towards the target.

#### Economic calendar for the week ahead

**Monday** – Eurozone Industrial Production (February). US Retail Sales (March).

Tuesday – Eurozone Balance of Trade (February). Germany ZEW Economic Sentiment Index (April). UK Unemployment Rate (February). US Building Permits (Preliminary, March). China GDP Growth Rate (Q1), Industrial Production and Retail Sales (March).

Wednesday – UK Inflation Rate (March). Japan Balance of Trade (March).

Thursday – Eurozone Current Account (February).

**Friday** – Germany PPI (March). France Business Confidence (April). UK Retail Sales (March). Japan Inflation Rate (March).

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