Weekly round up (Week 14)

Although it was only a four-day trading week in Europe, the price trend more than made up for the loss of one trading day. The VIX, our preferred volatility index, recorded its highest level for six months, although it remains cushioned in historical comparison.

Bond curves flattened, with the 10+ year part of the curve underperforming. Commodity prices rose, with metal and energy prices up by over 4%. After falling by 12% between April 2023 and February this year, commodity prices have recovered strongly in recent weeks, as shown in Figure 1. The effects of this development can be seen on the foreign exchange market, where the currencies of commodity-producing countries have outperformed those of emerging countries.

Credit markets showed contrasting trends, with euro-denominated securities outperforming, while many major US, Japanese and European equity markets retreated over the week. Asia (excluding Japan) bucked the trend, with indices in China, Hong Kong, India, Malaysia and Taiwan turning in positive performances.

From soft landing to standstill

Market movements did not follow the usual risk-off pattern. However, a strong dynamic was at work, which could explain the rise in volatility.

Take interest rates, for example. At present, the possibility of the Federal Reserve, the European Central Bank (ECB) or the People's Bank of China making a 180-degree turn and raising their key rates is seen by many as a "tail risk" that is being lost sight of.

A further delay in normalizing monetary policy to a neutral level is, however, a clear risk. This is particularly true in the US, where expectations of a "no-landing scenario" - in which inflation is slightly above the Fed's 2% target and economic growth remains robust - are gaining momentum.(2)

Manufacturing booming

Recent economic data support these expectations, with manufacturing purchasing managers' indices improving around the world, indicating that economic activity and trade are beginning to pick up.

In China, the Caixin General Manufacturing PMI, closely linked to the evolution of Chinese exports, rose to 51.1 in March, the fastest growth in over a year. China's official manufacturing PMI, more closely linked to domestic activity, returned to the growth zone for the first time since September 2023, rising from 49.1 to 50.8.(3)

In the USA, the manufacturing PMI rose for the first time since Q4 2022, reaching 50.3%. This was a big surprise, as the consensus for the manufacturing sector was 48.3%, suggesting a decline. In both China and the USA, the improvements were driven by production and demand, with both output and new orders rising.

By contrast, in the Eurozone, manufacturing activity continued to contract, falling to 46.1 in March from 46.5 the previous month, but at a slower pace than expected. The overall PMI index (which reflects activity in the manufacturing and services sectors) rose for the first time since May 2023, from 49.2 in February to 50.3 in March. This increase was mainly due to new orders, which rose from 48.6 to 50.3. In the UK, the manufacturing sector expanded for the first time since May 2022.

Conspiracy theorists suggest that this is a "Trump effect", with companies building up inventories in anticipation of an expected new round of tariff hikes if the former US president is re-elected later this year. However, the rebound in manufacturing purchasing managers' indices is broad-based, and the global aggregate is now growing (see graph 2). This explains the strong week for equities in Asia, the global hub of the manufacturing sector, and the rise in industrial metals prices in a week when risks were generally lower.

For central banks, the concern is that a broad-based recovery in manufacturing and robust conditions in the service sector could put further pressure on wages in an already tight labor market. The overnight swap market has postponed the Fed's first interest rate cut until July, with only two 25bp cuts fully priced in for 2024. Investors still expect the ECB to start easing monetary policy in June, and the Bank of England to follow suit in August.

Don't forget debt

Staying with the theme of hidden risks: Geopolitics was also on the agenda, with rising tensions in the Middle East driving up energy prices and dampening sentiment in many risk assets. The combined effect of improving economic activity, rising commodity prices and possible delays in monetary policy easing pushed bond yields higher.

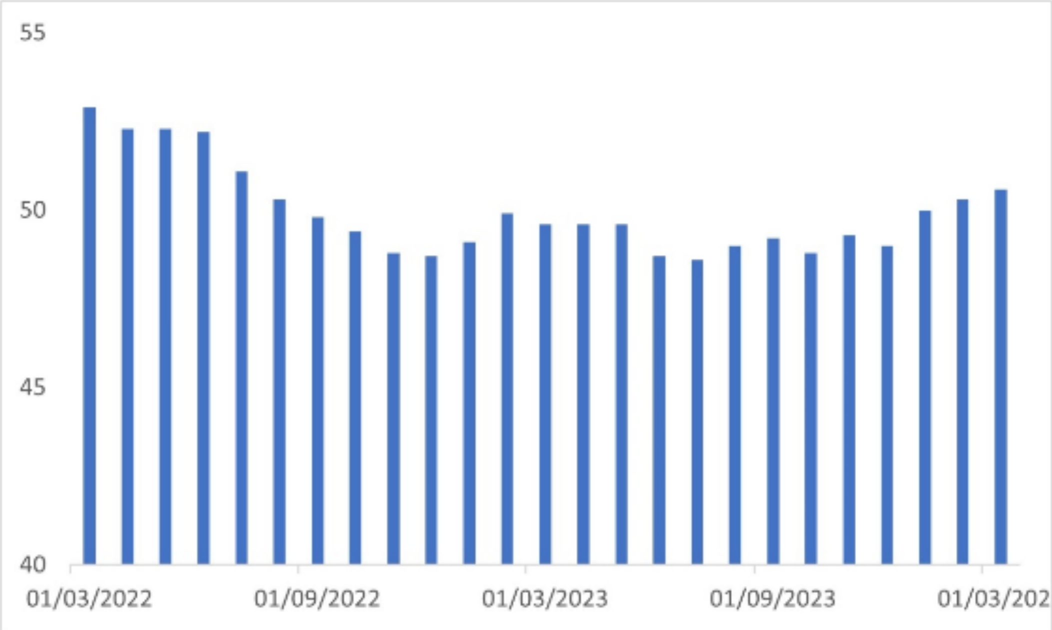
Other risks that didn't make the headlines last week, but which remain visible, include persistent tensions over Chinese real estate and commercial property in developed countries, as well as the steady increase in global debt. After an increase of $15,000 billion in the last quarter of 2023, the Institutional Institute of Finance recently announced that global debt had reached a record level of $313,000 billion by the end of 2023, and had risen by $100,000 billion over the last ten years.(4)

Charts of the week

Figure 1: Bloomberg Commodity Index

Source: Bloomberg, as of April 5, 2024. For illustrative purposes only.

Figure 2: JP Morgan Global Manufacturing PMI



Source: JP Morgan, S&P, as of April 5, 2024. For illustrative purposes only.

(1) Charles Schwab International, 'Top Global Risks of 2022', December 19, 2021

(2) Fortune, 'Nearly half of investors expect a "no landing scenario"', March 25, 2024

(3) Note: A PMI reading above 50 indicates output is expanding overall; below 50 means it is contracting.

(4) Reuters, 'Global debt hits record high', February 21, 2024