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Investment Institute Macroeconomics

Monthly Op-ed

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If you are bored by central banks, Tech remains interesting

Key points

- The recent dataflow makes it more plausible the Fed will start easing in September, three months after the ECB
- We do not think it will take a hard landing to get inflation back to target in the US, which of course would be good news for the markets
- Macro backdrop supports risk assets
- Technology theme remains strong after Q1 earnings
- Understanding social change is important for stock picking

It may not take that much

Since the Federal Reserve (Fed) is explicitly in "data dependent mode", it is not surprising to see the market pricing of the monetary policy trajectory move a lot from one day to the next. Over the course of this month, the market has gone from pricing the Fed at close to a 50% chance of the first cut in September to almost fully pricing it (on the 15th) and now back to effectively 50% again.

Several developments have shaped thinking. The core Consumer Price Index (CPI) came out on 15 May in April in line with market expectations – for once – and decelerated in year-on-year terms (3.6% against 3.8% in March), resuming the slowdown which had come to a halt in February, and back to the lowest reading since April 2021. Now, it would of course be wrong to shed all the concerns about the pace of inflation landing in the US just because we have just had a piece of good news on a single month. There was already a pause in the re-acceleration in the core CPI momentum in December which proved short-lived. Calls for prudence from some Fed speakers, together with the release of fairly hawkish minutes, clearly dampened the market's enthusiasm.

Yet, it is tempting to read the improved CPI reading in April in the context of an accumulation of signals of a general softening in the US real economy. Retail sales disappointed in April. The "control group" – the retail sales version which is closest to the aggregate personal consumption concept of the national accounts – declined in April by 0.1% against a consensus expectation of +0.2%. This seems to confirm the growing uneasiness of households reflected in the very weak reading in consumer confidence released on 10 May. Even residential investment – a counter-intuitively powerful element of support to the broader US economy of late – is showing signs of weakness. Building permits fell 3% on the month in April after already shedding 5% in March, and housebuilder confidence declined in May for the first time in 6 months. So far, the lack of turnover on the existing houses market, as households are reluctant to lose the benefit of low-interest rate mortgages contracted several years ago, has been driving those forced to move to the new-build market, but even on this segment mortgage rates above 7% may have finally taken their toll.

This does not mean that the US is on the verge of dramatic downturn. Non-residential investment continues to be very resilient – as substantiated again by a strong reading in durable goods orders in April – as industrial policy, notably the Creating Helpful Incentives to Produce Semiconductors (CHIPS act and the Inflation Reduction Act (IRA) continue to boost capex programmes by US businesses, but a softer growth pace, which would help cover the "last mile" of disinflation.

We have developed a simple model-based framework, using the augmented Phillips Curve to explore by how much the labour market would have to deteriorate from now to bring inflation back to 2%. We find that a rise of 3% in the "under-employment rate", which adds to the unemployment rate people only loosely attached to the labour market, would suffice. This would be in line with what was observed during the very shallow downturn of 2001, when US GDP did not even fall for two quarters in a row (the bar to call a recession in Europe). Moreover, we think this model would overstate the magnitude of the required softening of the economy. Indeed, consumers' price expectations would probably decline as the labour market deteriorates. Moreover, there are still some idiosyncratic factors pushing inflation up – e.g., car insurance and rents – which should fade irrespective of the state of the real economy this year. We are thus confident the Fed will be in a position to cut by September, event without a "hard landing" materialising.

While the Fed continues to refuse to embark on a precise conversation on the timeline, the European Central Bank (ECB)'s rate cut in June is increasingly presented as a "done deal" by Governing Council members, even by the hawks. The debate has shifted to the pace of easing beyond June. Even if the Euro area economy has stabilised, three 25bp cuts this year remain our baseline.

More of the same

Evolving monetary policy expectations have largely determined the performance of highly interest-rate-sensitive assets in 2024. Fewer interest rate cuts are priced in today than at the start of the year which has meant longer duration – more rate sensitive – assets have underperformed. Meanwhile, resilient growth and corporate profits have allowed earnings sensitive assets to perform better. Looking at the performance of fixed income markets, the leading asset classes – those that have managed to deliver cash-beating returns – include Asian high yield bonds, leveraged loans and emerging market debt. Within equity markets, growth and higher beta has topped the performance rankings.

The macroeconomic outlook for the rest of 2024 suggests more of the same. Our core view is we are at the peak of the interest rate cycle and some easing should be seen in the second half of the year. Growth is moderate but signs of recession are hard to find in developed economies. There are inflation risks, but market pricing of inflation is currently calm. Of course, in the details of price reports we can detect unwelcome trends in parts of the services sector, wage growth is still buoyant and commodity prices have the scope to provide inflationary shocks. But a resurgence of 2022-2023 like inflation would likely need a supply-side shock and a major miscalibration of aggregate demand management by central banks and fiscal policy makers. Bond vigilantes are one counter to that scenario.

Technology is a genuine theme, generating earnings and shaping capex

The macro view is supportive of decent returns in financial markets with a bias towards equities, and credit – especially short-duration. US technology firms first quarter earnings' reports (Q1) highlighted that artificial intelligence (AI) remaining a strong capital-spending driver of research and development. And it should continue to be a driver of equity strategies for some time. Of course, what is less transparent are the use-cases for AI applications across sectors outside of technology. However, anyone close to any corporate would have had to live a sheltered life over the last year not to notice how operational efficiencies are being sought by introducing AI techniques across a range of activities. The long-term view is that AI is productivity enhancing. Where the fruits of that are enjoyed remains to be seen.

Owners of capital and high-income cohorts are doing very well. They have strong balance sheets, real income growth and less interest rate sensitivity. There are numerous examples of inflated economic activity – real estate prices in the Mediterranean, eye-watering restaurant bills in New York City, the price of a Taylor Swift concert ticket. Airline passenger capacity is at a high level. Meanwhile, those with lower incomes, having to pay rent for accommodation and likely to be net debtors are suffering. Real incomes have been squeezed, delinquencies on revolving debt are increasing with higher interest rates, and when jobs start to be cut, marginal workers will suffer first. We would note the recent decline in full-time employment in the US jobs data. So far, credit issues have not infected the core of the credit markets, but this is something to watch, especially given how tight public credit market spreads are today.

Delve into the micro for long-term themes

The pandemic spurred economists to pay more attention to corporate supply chains and the network effects on macro-aggregates like inflation. Perhaps attention also needs to be paid to employment networks, particularly with growth in immigration and the so-called gig economy. A key concern is growing income inequality. Corporates can benefit from automating tasks previously done by workers, but businesses can also be hurt by the rise in activities such as shoplifting and, on a more advanced level, cyberfraud. Growing income inequality and how this manifests itself in public attitudes to business should be a major concern for environmental, social and governance (ESG) focussed investors because it can impact the top-line in some cases – for example, in retail.

The interaction of changing social structures and business extends to generational considerations. Young people are less likely to be homeowners and have mortgages. If homeownership is perceived as unattainable, life-cycle spending patterns might be different to the received wisdom. This means more disposable income and perhaps more experienced-based spending than material. Businesses which observe and adapt to more digitalisation, more social and environmental influences on spending and a marginally more migratory consumer base will be able to benefit from these trends. For core technology providers, the young will tend to be a loyal customer base but for other goods and services, small and mid-cap businesses could be the ones that are adaptable and innovative enough to meet demand from a generation that has very different spending patterns to those of forerunners.

Income inequality should be viewed as an economic negative. At extremes it requires policy decisions to be made and with elections upcoming in the UK, Europe and the US, social factors will be central to the political debate. The temptation is to use big macro levers to address them – taxes, spending and trade policies, which are often suboptimal to economic welfare and hurt the people they are actually trying to help the most. There may well be investment implications from such policy choices – higher government borrowing will impact on real interest rates, changes in marginal taxes will produce winners and losers, trade policy can shift the economics of businesses engaged in export and import activities. Not to mention that the polemic can impact on investors sentiment.

The generation question has more positive economic and investment implications. Social media has already spawned business opportunities and wealth creation; digital natives among the younger generations will consume and be entertained through online channels as much as physical. Of course, this has been happening for years, but we are still not likely to have seen the full impact of changing consumer patterns on businesses like banking, asset management, health provision and transport.

The macro might be boring for a while, with income from bonds and equity growth being the simple mantra for investors. Cash returns will slowly erode but not quickly enough to generate a wall of investment flows from money market and bank accounts into bond and equity funds. Steady returns as a result. But at the micro level, investors should try and understand network effects and corporate and social supply chains, as that is where future economic themes are gestating.

Download the full slide deck of our May Investment Strategy

30 May 2024

Macro forecast summary

Real GDP growth (%)	2023	2024*		2025*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
World	3.2	3.2		3.2	
Advanced economies	1.7	1.5		1.4	
US	2.5	2.4	2.3	1.6	1.8
Euro area	0.5	0.6	0.5	1.1	1.5
Germany	0.0	0.0	0.1	0.9	1.5
France	0.9	0.8	0.7	1.0	1.3
Italy	1.0	0.7	0.7	0.7	1.2
Spain	2.5	2.4	1.7	2.1	1.9
Japan	1.9	1.2	0.6	1.0	1.0
UK	0.3	0.7	0.3	1.2	1.2
Switzerland	0.8	0.8	1.2	1.3	1.5
Canada	1.1	1.2	0.9	1.7	1.9
Emerging economies	4.2	4.1		4.2	
Asia	5.3	5.2	4.0	4.7	
China	5.2	5.0	4.7	4.2	4.4
South Korea	1.3	2.3	2.1	2.3	2.2
Rest of EM Asia	5.9	5.6		5.6	
LatAm	2.3	1.8		2.6	
Brazil	2.9	1.6	1.8	2.0	2.0
Mexico	3.3	2.2	2.2	2.1	2.2
EM Europe	3.0	3.0		2.9	
Russia	3.6	3.2	2.3	1.8	1.1
Poland	0.2	2.8	2.9	3.5	3.4
Turkey	4.3	3.0	2.5	3.6	3.2
Other EMs	2.2	2.9		4.2	

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 30 May 2024
**Forecast*

CPI Inflation (%)	2023	2024*		2025*	
	AXA IM	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	4.7	2.8		2.3	
US	4.1	3.3	2.9	2.5	2.3
Euro area	5.5	2.5	2.3	2.2	2.1
China	0.2	0.6	0.8	1.6	1.9
Japan	3.3	2.2	2.4	1.6	1.5
UK	7.3	2.4	2.5	1.8	2.0
Switzerland	2.1	1.6	1.3	1.3	1.3
Canada	3.9	2.6	2.5	2.6	2.0

Source: Datastream, IMF, Bloomberg and AXA IM Macro Research – As of 30 May 2024
**Forecast*

These projections are not necessarily reliable indicators of future results

Forecast summary

Central bank policy Meeting dates and expected changes (Rates in bp / QE in bn)		Current	Q2-24	Q3-24	Q4-24
United States - Fed	Dates	5.50	12 June	30-31 Jul 17-18 Sep	6-7 Nov 17-18 Dec
	Rates		unch (5.50)	-0.25 (5.25)	-0.25 (5.00)
Euro area - ECB	Dates	4.00	6 June	18 Jul 12 Sep	17 Oct 12 Dec
	Rates		-0.25 (3.75)	-0.25 (3.50)	-0.25 (3.25)
Japan - BoJ	Dates	0 - 0.1	13-14 June	30-31 Jul 19-20 Sep	30-31 Oct 18-19 Dec
	Rates		unch (0-0.1)	+0.10 (0.1-0.2)	+0.10 (0.2-0.3)
UK - BoE	Dates	5.25	20 June	1 Aug 19 Sep	7 Nov 19 Dec
	Rates		unch (5.25)	-0.25 (5.00)	-0.25 (4.75)
Canada - BoC	Dates	5.00	5 June	24 Jul 4 Sep	23 Oct 11 Dec
	Rates		unch (5.00)	-0.25 (4.75)	-0.50 (4.25)

Source: AXA IM Macro Research - As of 30 May 2024

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Investment Managers

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Our Research is available on line: www.axa-im.com/investment-institute

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