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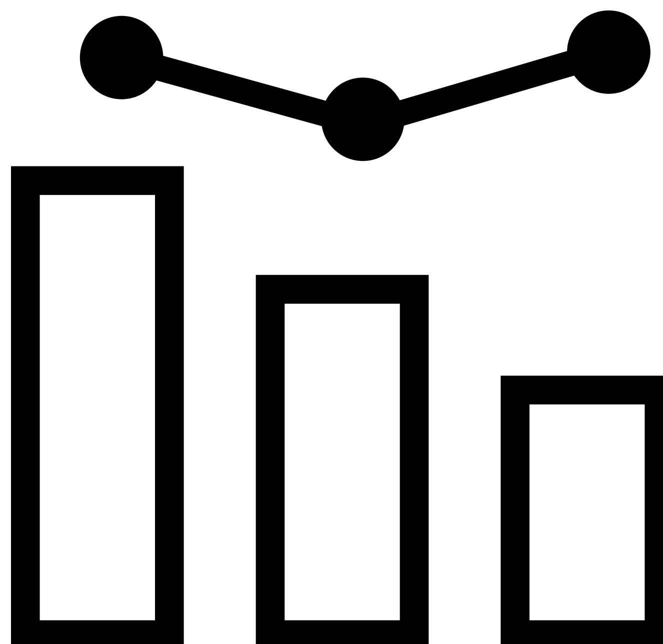


Marketupdate

June 2024

June 2024: We laugh, we cry

Financial markets changed direction again in June, at least in Europe. Shares and listed real estate fell out of favour, but European bonds were in demand. Outside Europe, the upward trend in equity markets continued unabated.

European equity markets had a volatile quarter. May was a good month for investors in European stocks, although there were declines in April and June. Despite a negative monthly return of 1.0% for the MSCI Europe index in June, returns for the second quarter as a whole were still positive at +1.3%. The picture for European listed real estate was similar, albeit more marked. Real estate delivered a positive return of 4.7% in May, but then surrendered 3.7% in June. Unlike European equities, real estate failed to deliver a positive return, with a quarterly return of -1.7%.

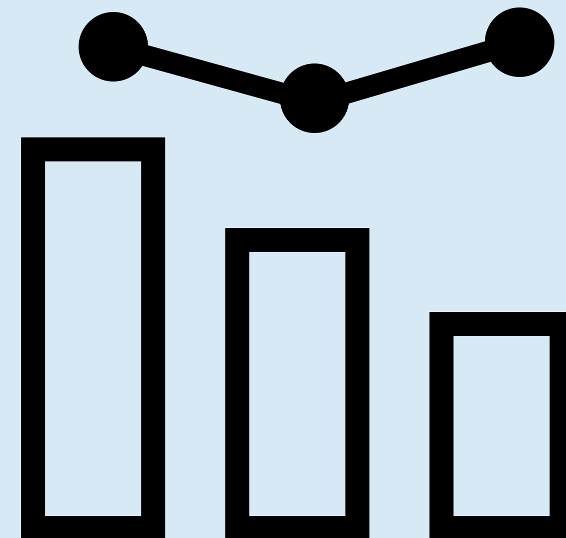
Whereas European stocks and real estate were out of favour in June, European bonds delivered positive monthly returns of 0.2% for government bonds, 0.7% for investment grade corporates and 0.3% for high yield corporates. The picture for European government bonds was however mixed: German capital market rates fell, but increased in France and, to a lesser extent, in Italy and Spain. Over the second quarter as a whole, European capital market rates rose slightly, with government bonds yielding a negative quarterly return of 1.3% on balance. Despite the rise in yields, European corporate bonds achieved positive quarterly returns of 0.1% for investment grade corporates and 1.3% for high yield corporates.

It was notable that the negative stock market sentiment was limited to Europe. Outside of Europe, equities had a very good month, led by returns of +4.6% for US equities and +5.3% for emerging markets. Despite a moderate start, stock markets outside Europe performed well, with quarterly returns ranging from 3.3% for the MSCI Asia Pacific index and 4.4% for the MSCI North America index to 5.8% for the MSCI Emerging Markets index.

The returns on the various asset classes were as follows:

Rendementen (total return, in euro's)	June	Q2	2024	12 mths
Rendementen (total return, in euro's)	0,2%	-1,3%	-2,0%	2,4%
Bloomberg Barclays Euro Bedrijfsobligaties	0,7%	0,1%	0,5%	6,4%
Bloomberg Barclays Euro High Yield Bedrijfsobligaties	0,3%	1,3%	2,8%	10,4%
FTSE/EPRA Europe Onroerend Goed	-3,7%	-1,7%	-5,2%	18,9%
MSCI Europe Aandelen	-1,0%	1,3%	9,1%	13,7%
MSCI North America Aandelen	4,6%	4,4%	17,5%	25,7%
MSCI Asia Pacific Aandelen	3,6%	3,3%	11,1%	15,2%
MSCI World Developed Markets Aandelen	3,2%	2,9%	14,2%	20,5%
MSCI Emerging Markets Aandelen	5,3%	5,8%	10,8%	14,6%
EUR/USD	-1,2%	-0,7%	-3,0%	-1,8%

Source: Bloomberg



Trend towards convergence of economic growth in the US and the eurozone

After the global economy started strongly against expectations in 2024, this positive trend has now softened to some extent. The US economy, in particular, has been growing less strongly since the first quarter, but is still nevertheless a long way from a possible recession. The eurozone, which was still close to a recession in the two quarters before the turn of the year, seems to be gradually emerging from a period of economic stagnation. In China, expectations were low, leaving room for positive surprises. In the first quarter, the Chinese economy managed to grow faster than the 5% target, thanks in part to an accommodative fiscal government policy.

For the time to come, the most plausible scenario appears to be that the US economy will continue to outperform the European economy in absolute terms. For example, the IMF expects economic growth of around 0.9% for the eurozone and 2.1% for the US for the whole of 2024. For 2025, however, the IMF expects a further convergence of both regions towards economic growth of 1.7%. This suggests that the US will see slower growth compared to 2023. So far, the US economy has proved to be more robust than expected, but the lagged effects of tighter monetary policy, the gradual weakening of fiscal policy, and a weakening of the labour market are still expected to weigh on overall demand. This normalisation is also visible in what are known as the sentiment indicators, all of which are now around an average level.

The presidential election in November is a risk factor for the US economy. Without anticipating the outcome, this could lead to short-sighted and inefficient public investment to win votes, potentially affecting the confidence of American consumers and businesses in the run-up to the election.

Is the European economy catching up, or is Macron's kamikaze campaign throwing a spanner in the works?

Economic growth in the eurozone is lower than in the US, partly because Europeans have spent less of their savings and have continued to save a larger proportion of their disposable income. In addition, the eurozone is still struggling with the consequences of the war in Ukraine. As a result, the eurozone now has relatively more recovery potential. Investments in the energy transition and the defence industry by both governments and companies could stimulate this growth. The labour market in the eurozone continues to tighten, with unemployment now at 6.5%, the lowest level since 1999. As a result, employees in the eurozone have a strong negotiating position, resulting in higher collective labour agreement wage growth and an improvement in European purchasing power, at least in the short term.

On the other hand, interest rates here are significantly higher than they were a couple of years ago and the scope for additional government spending is limited. It should be noted that economic growth in France and Germany is lagging behind the southern eurozone countries. Production-intensive Germany in particular is struggling to export capital-intensive products to countries such as China.

Moreover, the fact that it is the southern euro countries that are achieving excellent growth and thus can to some extent grow out of debt is 'beneficial' for the eurozone. As a result, the eurozone is avoiding the risk of fiscal fragmentation, with southern countries having to pay significantly more to raise capital than the western countries. At the beginning of June, France unfortunately rekindled the debate on the sustainability of European sovereign debt, after President Emmanuel Macron decided to announce new parliamentary elections in response to the outcome of the European elections. The political uncertainty in France and the potential gains of extremist political parties may have financial consequences. Following Macron's announcement, the spread between French and German ten-year yields widened by around 30 basis points, showing the increased uncertainty that investors are currently pricing in.

US inflation is still heading in the right direction, but this is (temporarily or otherwise) no longer the case for inflation in Europe

US inflation figures have been consistently higher than expected since the beginning of this year until April, when inflation was in line with market expectations. This changed in May, when inflation figures were slightly below market expectations. Headline inflation stood at 3.3% year-on-year in May, while core inflation (excluding volatile components such as food and energy) was 3.4%. Inflation rates have thus stabilised around 3.0%-3.5%, still well above the Fed's 2.0% target. Looking a little further, it is striking that core inflation is now driven entirely by labour-intensive services inflation, and that core goods have in the meantime even become deflationary. This is due to the relatively tight labour market in the US, which has allowed wages to rise faster than prices for some time.

This does not necessarily mean that we have a wage-price spiral, but it does mean that inflationary pressures may stay at these too high levels for longer.

In the eurozone, headline inflation declined further towards the target in April, falling by 2.4% year on year. But the decline came to an end in May, when inflation accelerated to 2.6%. Core inflation also increased further to 2.9%. As in America, much of the upward price pressure in the eurozone is due to services inflation. This was partly due to a base effect in April: the low-cost public transport ticket in Germany was introduced in May last year and has now dropped out of the year-on-year comparison.

ECB interest-rate cut in June despite inflation increase in May

Despite the pick-up in inflation, the ECB did manage to cut its policy rate by 25 basis points in June, two years after the start of a series of rate hikes. In the run-up to this decision, the ECB had ensured that the market had little doubt about the decision to cut interest rates, so there were no surprises at the meeting. However, by pre-committing to an interest-rate cut, the ECB also denied itself the possibility of leaving rates unchanged, which could have been a desirable option given the acceleration in inflation.

Although the rate cut has made policy less restrictive, it is still restrictive, even in real terms. In doing so, the ECB's Governing Council anticipates a further normalisation of inflation in the future, in the knowledge that changes in interest rates due to monetary policy lags will take time to have their full effect on the economy. However, this entails a risk. If May's inflation rate continues, the ECB faces a difficult dilemma: raising interest rates again could damage the central bank's (already fragile) reputation, while doing nothing is not an option.

ECB cuts interest rates but intensifies QT; Fed will reduce QT and is keeping interest-rates unchanged

In addition to cutting policy rates, the ECB has also announced that it will continue not to reinvest in maturing bonds from the Asset Purchase Programme (APP), and that it will not reinvest €7.5 billion in maturing bonds from the Pandemic Emergency Purchase Programme (PEPP) from the second half of 2024. The ECB is thus slightly intensifying its quantitative tightening (QT) policy, which is at odds with the Fed's recent decision to reduce its balance sheet somewhat less rapidly.

Unlike the ECB, the FOMC decided in June to leave its policy rate unchanged at 5.25-5.5%, as was also expected by the market. At the beginning of this year, however, interest-rate markets were still counting on two to three rate cuts at the June meeting. These have clearly not materialised. Throughout the year, interest-rate markets have continually shifted their expectations further into the future. And even now, with two cuts, interest-rate markets seem to be expecting more rate cuts than the single cut expected by the Fed's central bankers at the end of this year. But the market's and central bankers' expectations are now much closer than they were at the beginning of the year. That does not mean that expectations will not change again in the coming months, but that will depend heavily on the development of economic data and, of course, on inflation.

A further decline in inflation will strengthen the argument for lower interest rates, but setbacks loom

Outside the eurozone and the US, central banks have taken little or no action. The Bank of England (BoE) decided that it is too early to implement a policy rate cut and the Bank of Japan also left its policy rate unchanged, regardless of the strong devaluation of the Japanese yen since the beginning of the year. In Switzerland, where inflation is now at 1.4%, the central bank cut its policy rate by 25 basis points a second time to 1.25% in June.

At this point, a gradual easing of inflationary pressures towards the central banks' 2% inflation target over the coming period looks to be the most likely scenario. Current interest-rate expectations appear to be reasonably in line. At present, the greater risk would seem to be that macroeconomic data will continue to be better and inflation data will continue to be higher than expected, rather than the reverse. There is thus a greater risk that central banks will keep interest rates higher for longer than they will cut interest rates earlier than expected. Of course, the latter scenario could occur in an unexpected crisis situation, such as the corona crisis of 2020 or the credit crisis of 2008, but that is difficult to prepare for.

Geopolitical uncertainty and thin summer markets call for restraint

The second quarter of 2024 was initially characterised in the financial markets by geopolitical unrest in the Middle East. After some of this turmoil subsided, there was room for a slight preference for 'risk-on' sentiment, which then returned to a 'risk-off' sentiment later in the quarter, particularly in Europe. In the end, the second quarter was dominated by rising stock prices, rising interest rates and narrower credit spreads.

For the coming months, we foresee an environment for financial markets characterised by heightened uncertainty, both geopolitically (after-effects of the French parliamentary elections and the upcoming US presidential election) and in the macroeconomic and monetary outlook. In addition, traditionally low liquidity in the summer months may cause an additional rise in volatility in the financial markets. In this environment, we prefer not to take a strong tactical position with respect to the different asset classes.

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