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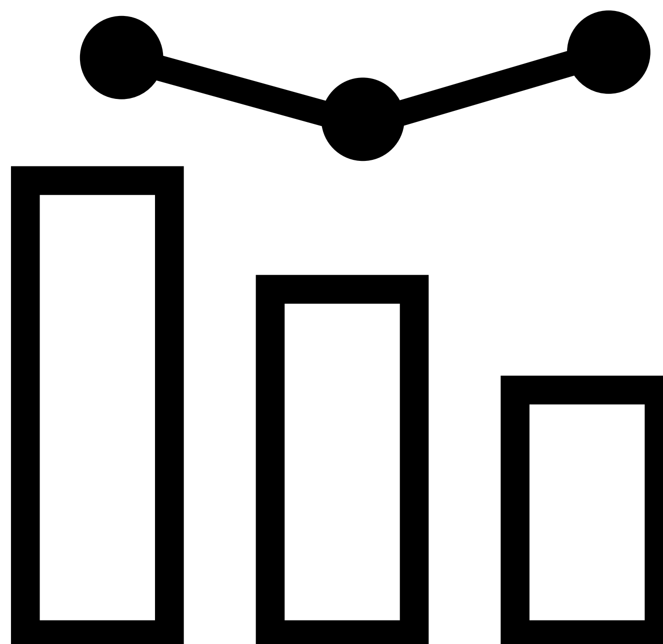


Market update

June 2023

June 2023: a good month for equity investors

June 2023 was a typical risk-on month, when equities performed well and bonds did not. The biggest loser was again listed real estate.

Most major stock markets experienced a good month in June, at least in Europe and the US. The US stock market remained ahead of European stock markets, with monthly returns in euros of 4.3% for the MSCI North America index and 2.4% for the MSCI Europe index. If we compare returns measured not in euros but in local currencies, the depreciation of the US dollar further increases the differences in favour of the US. In the case of US equity, it was also striking that technology equities continued to lead the way in June, but the yield differences with traditional sectors were less pronounced than earlier in the year.

In Asia, the Japanese stock market again performed above average, but due to the depreciation of the Japanese yen (-5% in June), little of that remained in euros. Other stock markets in the region, both developed (Singapore, Australia) and emerging (including China, Taiwan, South Korea), also experienced a difficult month. On balance, the MSCI Asia Pacific index delivered a 1.2% return in June. Emerging markets performed slightly better with a monthly return of 1.6% for the MSCI Emerging Markets index, helped by the stock markets of India and Brazil.

Bonds were clearly less popular than equities in June, with slightly negative yields for both European government bonds and investment grade corporate bonds. More risky high yield corporate bonds delivered marginally positive returns. Finally, listed real estate was again the worst performing asset class with a negative return of 1.7% in June, as it has been so far this year and for most of 2022.

Not only in June, but also in the first half of 2023, equities have clearly outperformed bonds. In that context, US tech and other equities were the most popular, with returns well above 10% on a six-month basis. Returns on Asian equities and emerging market equities were more in line with European bonds, at around 2-5% over the first half of the year.

The returns on the various asset classes were as follows:

Rendementen (total return, in euro's)	juni	Q2	2023	12 mnd
Bloomberg Barclays Eurozone Staatsobligaties	-0.3%	0.1%	2.5%	-4.7%
Bloomberg Barclays Euro Bedrijfsobligaties	-0.4%	0.4%	2.2%	0.1%
Bloomberg Barclays Euro High Yield Bedrijfsobligaties	0.5%	1.7%	4.4%	9.1%
FTSE/EPRA Europe Onroerend Goed	-1.7%	-5.1%	-10.2%	-22.3%
MSCI Europe Aandelen	2.4%	2.3%	11.1%	16.7%
MSCI North America Aandelen	4.3%	7.7%	14.3%	12.9%
MSCI Asia Pacific Aandelen	1.2%	0.7%	4.2%	1.1%
MSCI World Developed Markets Aandelen	3.7%	5.6%	11.9%	11.1%
MSCI Emerging Markets Aandelen	1.6%	0.2%	2.9%	-3.0%
EUR/USD	2.2%	0.6%	1.9%	4.9%

Source: Bloomberg

2023 economic start less good than expected, especially in Europe

While economic institutes such as the IMF were mildly optimistic about the state of the global economy in 2023 just a few months ago, the mood has deteriorated considerably in recent times. For the global economy, the IMF now expects growth of 2.8% for 2023 and 3% for 2024, lower than previous forecasts for both years. Given the latest macroeconomic figures, further downward revisions are to be expected.

Part of the explanation for the downwardly revised growth forecasts is that 2023 started off less well than previously thought. This applies in any event to the European economy, which contracted by 0.1% in the first quarter of 2023 instead of the previously reported 0.1% growth. With negative growth of also 0.1% in the final quarter of 2022, this means the eurozone did not escape the winter recession feared beforehand. For the rest of 2023 and 2024, slightly positive growth is now expected for the eurozone, but not much needs to go wrong to sink back into recession in the quarters ahead. Confidence indicators for European manufacturing have already fallen to recession levels, but meanwhile producer confidence in services is also under pressure. Meanwhile, consumer confidence has still not recovered from the blows of the COVID-19 pandemic and the Ukraine war, and the subsequent wave of inflation. All in all, the ECB's growth forecast for the European economy of 0.9% this year does seem rather optimistic.

The US economy started 2023 better than the European, but it remains to be seen whether it will stay that way

In contrast to Europe, US economic growth figures for the first quarter actually turned out to be better than previously reported, and reasonable growth of 0.3-0.4% quarter-on-quarter is still expected for the second quarter too. However, the outlook for the second half of the year is considerably less favourable, with even an expected economic contraction towards the end of 2023. As in Europe, in the US manufacturing in particular is struggling, but the picture is now starting to deteriorate in services as well. Much will depend on whether consumer spending holds up in the months ahead. So far, it looks as if it will. The US labour market is still in good shape, even if the unemployment rate did creep up slightly to 3.7% in May from 3.4% (the lowest level since the summer of 1969). The US housing market also seems to be picking up recently. The main question now is to what extent consumers have now spent the savings accumulated during the COVID-19 pandemic. This is difficult to estimate, but the savings surplus seems to be depleting considerably. Besides a possible revival of the short-lived banking crisis of last spring, a possible slump in consumer spending is the main threat to the US economy in the months ahead.

Japan and China: 'a tale of two countries'

In Asia, the differences between the two economic powerhouses and neighbours, Japan and China, are striking. For a change, the Japanese economy surprised positively in this regard, while China lagged behind, at least in relative terms. In the first quarter of 2023, the Japanese economy grew by an altogether reasonable 0.7% quarter-on-quarter. For the period ahead, the outlook remains relatively good. Japanese manufacturing is struggling, as in many other countries, but services are in good shape, mainly thanks to high consumer spending, which in turn is partly due to low unemployment (2.6%). In addition, Japanese exporters are benefiting from the weak yen, which has depreciated more than 10% against the euro so far this year.

Also in the case of China, the currency has depreciated significantly recently, but Chinese exporters hardly seem to be benefiting from this. Judging by the official macro figures, the domestic economy does seem to be in reasonable shape, but the fact that China's central bank recently felt it necessary to cut interest rates suggests that achieving the 5% growth target for this year is going to be a challenge. Recent monetary easing seems mainly aimed at supporting the ailing real estate and manufacturing sectors via the banking sector.

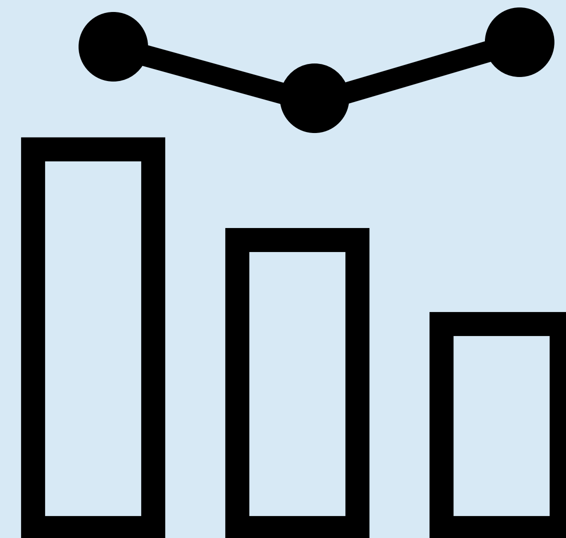
Emerging markets: Brazil unexpected positive outlier

The moderate development of the Chinese economy is also detrimental to emerging markets, both within the region (e.g. Taiwan and Vietnam) and beyond, such as commodity-exporting countries in Africa and Latin America. On the other hand, India's economy is performing above average, which in turn reflects positively on countries like Indonesia and Malaysia. In Latin America, Brazil's economy is in better shape than expected, which also favours other countries in the region such as Mexico and Chile. Elsewhere in emerging markets, the picture is divided, mostly because of country-specific developments, such as in Russia (political unrest), Turkey (hyperinflation) and South Africa (power outages).

Sharp decline in inflationary pressures, but core inflation in particular still remains high

In both the eurozone and the US, inflationary pressures have eased sharply recently to 5.5% year-on-year in the eurozone in June (from 10.6% in October 2022) and to 4.0% in May in the US (from 9% in June 2022). However, this is mainly due to the fall in energy prices over the past year. If we focus solely on core inflation, with volatile food and energy prices being excluded, a markedly different picture emerges. In the US, core inflation hovered at around 6-6.5% for most of 2022 and has decreased only slightly since then, now standing at 5.3% year-on-year. In the eurozone, core inflation still stood at around 3.5-4% in the summer of 2022, but then continued its rise, moving towards 6% in March 2023. It has now fallen back slightly and, at 5.4% year-on-year, is now at exactly the same level as in the US.

Outside the eurozone and the US, the inflation picture is highly volatile. In the UK, for example, inflation remains stubbornly high at 8.7% year-on-year. On the other hand, China, with inflation as low as 0.2% year-on-year, is now balancing on the brink of deflation. For many other emerging markets too, the post-COVID-19 pandemic inflation wave emerged earlier than in developed markets, but also now seems to be largely over. On the other hand, Japan seems to have finally emerged from the decades-long deflationary trend with inflation above 3%, although the question remains for how long.



Wage increases are finally keeping up with price rises, but a wage-price spiral is still a long way off

For the period ahead, in any event as regards the eurozone and the US, it is clear which way inflation will go: further down. The current consensus expectation is for eurozone inflation to fall to 3-4% by the end of this year and further to 2.5% or lower by 2024. The US has a fairly similar forecast: inflation of 3-3.5% by the end of this year and 2-2.5% by the end of 2024. A more uncertain factor is how core inflation will evolve. This partly depends on whether the recent slowdown in services will continue, and correspondingly how the labour market will evolve. Even though the tightness in the labour market has persisted for some time, there has so far been no sign of a feared wage-price spiral. Only now are real hourly wages in the US rising above 0% for the first time since the COVID-19 pandemic, i.e. wages are rising faster than prices. In Europe, too, this tipping point is only now coming into view.

More interest rate hikes are expected in the summer months and interest rate cuts are not yet in sight

Despite warnings from the likes of DNB and the ECB, the risk of a wage-price spiral does not seem particularly high. The economic growth outlook is moderate at best, inflationary pressures are easing and wages have so far risen less than might have been expected given the long-standing tightness on the labour market. Moreover, it is likely that the impact of central bank measures on the real economy and inflation is only now beginning to be felt. Over the past year, the Fed has raised the US base rate from 0% to 5.25%, while the ECB's European base rate has gone from -0.5% to 3.5% in less than a year. For the coming months, the interest rate market is anticipating further rate hikes that would bring the base rate to 5.5% in the US and 4% in the eurozone by the end of the summer. The current pace of interest rate hikes is unprecedented, and partly for this reason it is difficult to estimate what the impact on the real economy and inflation will be.

The main issue now is what will happen after the summer. The most plausible scenario seems to be that of a period of at least 3-6 months of stable high interest rates. This will give central banks the opportunity to better assess the impact of previous interest rate hikes on economic growth and inflation. If inflationary pressures were to remain unexpectedly high, or even if a wage-price spiral were to emerge, further interest rate hikes might be in the offing. In an alternative scenario, where economic growth declines further than is currently thought, the next plausible step would instead be one or more interest rate cuts. This is the scenario that interest rate markets are now counting on, but in any case it does not seem very likely that such a move would be made this year.

Financial markets: given the uncertain macroeconomic environment, is cash king?

After a good first quarter, stock markets performed unevenly in the second quarter of 2023, and so did bonds. Despite the different risk profiles, equities, bonds and cash are delivering similar direct returns for the first time in a long period of approximately 3% in the eurozone. Looking ahead, the major issue at present is what impact the series of interest rate hikes by central banks in recent times will have on the economy and financial markets. One risk scenario is that higher interest rates push the eurozone (and/or US) economy into a deeper recession than is currently thought. Another risk scenario is that despite higher interest rates, inflationary pressures do not come under control, and central banks will still have to raise interest rates further than now imagined. In principle, both scenarios seem unfavourable to more risky asset classes, especially equities.

Central banks are expected to raise interest rates further rather than cut them, at least in the period ahead. This will favour cash and, to a slightly lesser extent, short-term government bonds. In the longer term, it is plausible that yield curves will steepen again with lower short-term interest rates and/or higher long-term interest rates, but for the foreseeable future it seems likely that yield curves will remain flat, or even inverse.

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