Perspectives

Economics

SwissLife Asset Managers

April 2024

Key takeaways

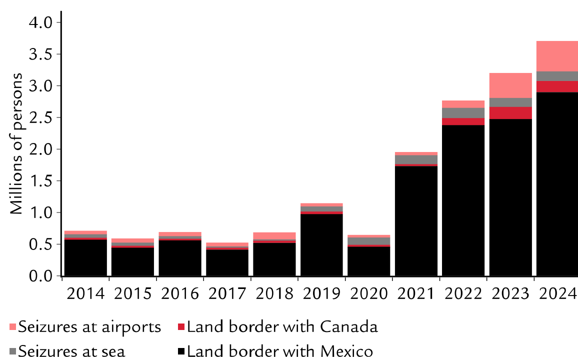
- USA: Slowdown in retail, improvement on the real estate market, mixed signals on the labour market
- Europe: Momentum remains weak, but initial glimpses of hope and a surprising interest rate cut
- China: Growth target of 5% unrealistic, and announced fiscal measures remain vague

Comparison of forecasts

	2024 GDP growth		2025 GDP growth		2024 inflation		2025 inflation	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	2.1%	2.2% ↑	1.7%	1.6% ↓	3.1% ↑	2.8% ↑	2.4%	2.2%
Eurozone	0.3%	0.5%	1.0%	1.3%	2.5% ↑	2.3%	2.0%	2.0%
Germany	-0.2%	0.1% ↓	1.0%	1.1%	2.2%	2.5%	1.9%	2.1%
France	0.7% ↑	0.7%	1.0%	1.3%	2.3% ↑	2.5% ↑	1.7% ↓	1.9%
Italy	0.6% ↑	0.6% ↑	0.8%	1.0%	1.7%	1.8% ↓	1.9%	1.9%
Spain	1.3%	1.6% ↑	1.6%	1.8%	2.9% ↑	3.0% ↑	2.1%	2.2% ↑
UK	0.1%	0.2% ↓	1.0%	1.1%	3.0%	2.5% ↓	2.4%	2.2% ↑
Switzerland	1.2% ↑	1.1%	0.9%	1.6%	1.2%	1.4% ↓	0.9%	1.1% ↓
Japan	0.4% ↑	0.6% ↓	0.7%	1.1% ↑	2.0% ↑	2.3%	1.5% ↑	1.6%
China	4.5%	4.7% ↑	4.4%	4.4% ↑	0.8% ↑	0.8% ↓	1.9%	1.6%

Arrows indicate change from previous month. Source: Consensus Economics Inc. London, 11 March 2024

Chart of the month



In the USA, immigration pressure has increased significantly during the Biden presidency, particularly from Latin America. Border guards apprehended six times more people without a residence permit in 2023 than in 2020. Many illegal border crossings are successful, however, and the independent Congressional Budget Office (CBO) estimates that illegal immigration amounted to 2.4 million people in 2023 alone, many times the pre-pandemic level. This immigration surge is likely to have contributed to the unexpectedly robust economic growth in 2023. Immigration will also be a key campaign issue, and could cost the Democrats votes.

USA
Quo vadis, labour market?

GDP growth

Swiss Life Asset Managers	Consensus
2024: 2.1%	2024: 2.2%
2025: 1.7%	2025: 1.6%

As expected, US private consumption lost momentum in the first quarter, with weak retail sales figures in January and February and a decline in the Purchasing Managers' Index for service providers in March. In our view, however, this is a normalisation of consumption growth from the previously unsustainable levels. Meanwhile, the easing of financial conditions is having a positive impact on the real estate sector. Sentiment has improved significantly in the sector according to the NAHB survey, and the transaction market for single-family homes has picked up again since the start of the year. Clear so far. In terms of labour market figures, however, the signals are contradictory. Job growth, which is based on the establishment survey, was well above expectations in January and February, and unemployment benefit claims are not sending any warning signals either. However, the household survey shows a sharp fall in employment and a higher unemployment rate over the same period. We usually pay more attention to the establishment survey, as the sample is larger, but this fact does not really explain the current record divergence. One possible explanation is the high level of illegal immigration (see chart of the month), which is reflected in job growth but is insufficiently covered in the household survey according to some labour market experts.

Inflation

Swiss Life Asset Managers	Consensus
2024: 3.1%	2024: 2.8%
2025: 2.4%	2025: 2.2%

Following the inflation shock in January, the data for February did not sound the all-clear: US headline inflation rose from 3.1% to 3.2%, driven by higher energy prices, while core inflation (excluding energy and food) fell less sharply than expected, from 3.9% to 3.8%. Higher rental cost growth once again made itself felt, which is at variance with easing price pressure in advertised new and asking rents.

Eurozone
Fear of November

GDP growth

Swiss Life Asset Managers	Consensus
2024: 0.3%	2024: 0.5%
2025: 1.0%	2025: 1.3%

The eurozone is struggling not only with a cyclical weakness in growth, which continued in the first quarter of 2024, but also with structural problems, particularly the ongoing loss of international competitiveness. At the same time, developments in the Ukraine war are worrying and show a clear need for more defence spending at EU level. A second Trump presidency would further exacerbate both trade and defence issues, even if Trump's threats of a 10% tariff on all goods imports and withdrawal from NATO are unlikely to be fully carried out. The eurozone would suffer much more than the US from a broad-based trade war: exports to the US account for around 3.4% of eurozone GDP, while exports from the US to the eurozone come to around 1.4% of US GDP. It is questionable whether the formulation of a non-binding intent to buy more US products would appease Trump this time. Moreover, such a "promise" would contradict the aim of the new EU defence strategy of securing 60% of procurement within the EU by 2035 – the EU currently procures 63% of its defence equipment from the US. Financing remains another weakness of the new strategy, especially at a time when fiscal consolidation is once again called for on a national level.

Inflation

Swiss Life Asset Managers	Consensus
2024: 2.5%	2024: 2.3%
2025: 2.0%	2025: 2.0%

A second Trump presidency would have a negative impact on growth in Europe, whereas the effect on inflation is unclear. More trade barriers and higher government spending on defence would increase inflation, at least temporarily, while generally weaker demand would have a dampening effect. However, we expect inflation to decline further in the run-up to the November elections, after a slight upside surprise was seen in February at 2.6%.

Germany
Weak activity in January

GDP growth	
Swiss Life Asset Managers	Consensus
2024: -0.2%	2024: 0.1%
2025: 1.0%	2025: 1.1%

In 2022, exports to the US accounted for 4% of Germany's GDP. Its share within Europe was only higher in Ireland (11.8%), Switzerland (8.0%) and Belgium (6.4%). Germany is thus much more exposed to the risk of a more protectionist US government than the three other major eurozone economies (Italy: 3.3%, France: 1.8%, Spain: 1.4%). In addition, car imports are a particular thorn in Trump's side, and a focus on new trade barriers in this sector would be painful for Germany. Even without Trump, Germany's economy is lagging behind other economies. Industrial production in January did not fully compensate for the slump in December, and remains 10.7% below the pre-pandemic level (eurozone: -2.5%). Retail sales fell further and are again 1.2% below the level of January 2020 (eurozone: +1.4%). The Purchasing Managers' Index for manufacturing also remains particularly weak in Germany. While most of the further decline in March was driven by a normalisation of delivery times, the employment index also continued to fall, whereas the production and new orders indices improved only slightly. One glimmer of hope was the significant improvement in sentiment across all main sectors according to the ifo survey, albeit mostly from low levels.

Inflation	
Swiss Life Asset Managers	Consensus
2024: 2.2%	2024: 2.5%
2025: 1.9%	2025: 2.1%

Headline inflation fell from 2.9% to 2.5% in February. However, core inflation remained at 3.4%, with persistently high inflation in services and surprisingly high core goods inflation. Annual growth in negotiated wages also remained constant in January at 2.4%, after having steadily declined from 3.5% since July 2023. We do not expect core inflation to fall below 2% until next year.

France
A sporting challenge

GDP growth	
Swiss Life Asset Managers	Consensus
2024: 0.7%	2024: 0.7%
2025: 1.0%	2025: 1.3%

The most recent corporate surveys offered something for everyone. Anyone who still considers the glass half-empty can point to the decline in the Purchasing Managers' Indices (PMI) for manufacturing and the services sector in March. With the exception of January 2023, the PMI for manufacturing has now been below the 50-point growth threshold for 19 months. The PMI for service providers has now also fallen below the above-mentioned threshold ten times in a row. Those who are more optimistic about the rest of the year can take pleasure in the results of the business surveys conducted by the statistical office INSEE, which showed a clear rise in March. According to this source, manufacturing companies' order books have been filling up since the beginning of the year. The corresponding indicator is currently at its highest level since December 2022, which could be an indication that the end of the purchasing power crisis is indeed imminent. The combination of real wages rising for the first time since 2021 and the expectation of lower finance charges gives us confidence that consumer and investment demand will recover in the course of the year. The quantitative forecast for GDP growth in 2024 is made more difficult by the fact that the net effects of hosting the Summer Olympics on gross domestic product cannot currently be estimated.

Inflation	
Swiss Life Asset Managers	Consensus
2024: 2.3%	2024: 2.5%
2025: 1.7%	2025: 1.9%

The inflation forecast is also being challenged by the summer Olympics. Service providers are likely to utilise their price-setting power on sports-loving tourists during the summer months. However, the general inflation trend is downward, especially for clothing, communications and household appliances. We are expecting the inflation rate to fall below 2% by the final quarter of 2024.

Italy
Risk spread decreases

The economic figures from Italy remain favourable. The March Purchasing Managers' Index (PMI) was not available at the time of writing, but developments up to and including February suggest accelerating momentum in the services sector while the manufacturing sector, like in the rest of Europe, is slowing. Our simple model, which regresses the PMI to economic growth, projects growth of 0.2% in the first quarter of 2024 compared to the previous quarter. Italy could thus maintain its momentum from the second half of 2023 and once again perform better than Germany. Italy also performed better in terms of government bonds. Yields on 10-year German government bonds have increased by 0.3 percentage points since the start of 2024, while those on Italian bonds with the same duration even fell marginally. "Lo spread," i.e. the risk spread on Italian government bonds over German government bonds, fell to its lowest level in two years – a "pledge of confidence" by the financial markets that could also have a positive impact on Italian growth in 2024 due to looser financial conditions.

Spain
Resilient labour market

Spain's Purchasing Managers' Index for manufacturing climbed above the 50-mark in February for the first time since March 2023, with improvements in the manufacturing, new orders and employment indices. The employment index rose to its highest level since May 2023. The labour market is generally resilient. The unemployment rate fell further to 11.6% in January, compared to 13.0% a year earlier. The decline was sharpest for female workers in the 15–24 age group, which came to 27.7%, while men in the same age group recorded an increase to 29.4%. The unemployment rate of 8.5% for men aged 25 and over is significantly lower than for women in the same age group, at 12.1%. In February, the number of employed people showed the strongest increase since April 2023, and fears of unemployment continued to decline according to the consumer survey. People aged between 30 and 49 are currently most worried. Year-on-year wages grew 2.6% in February. However, real wages fell slightly again with inflation at 2.8%.

Switzerland
Policy rate down, inflation too?

GDP growth	
Swiss Life Asset Managers	Consensus
2024: 1.2%	2024: 1.1%
2025: 0.9%	2025: 1.6%

The index of weekly economic activity published by the State Secretariat for Economic Affairs (SECO) and other high-frequency regional indicators stagnated throughout the first quarter. This confirms our finding of creeping economic development in recent weeks. Against this backdrop, the Swiss National Bank (SNB) came into play on 21 March with an interest rate cut that few analysts expected. The SNB justified the interest rate move in very clear terms by its standards, not only with the stabilisation of inflation achieved, but also by saying that the rate cut supports economic development. We also expect economic momentum to accelerate in the course of the year. For this to happen, the Purchasing Managers' Indices for all sectors need to rise above 50 points in the second quarter. We would also expect an increase in consumer confidence, which is now being surveyed monthly by the SECO. Rising real wages in Europe for the first time since 2021 and supportive monetary policy herald such a development.

Inflation	
Swiss Life Asset Managers	Consensus
2024: 1.2%	2024: 1.4%
2025: 0.9%	2025: 1.1%

As expected, the SNB's interest rate cut led to the depreciation of the Swiss franc, thus increasing the likelihood of higher import prices in the short term. However, the interest rate cut is also having a counterintuitive dampening effect on the further development of the Swiss Consumer Price Index (CPI) due to a peculiarity in Switzerland: It is now less likely that the mortgage reference interest rate used to determine existing rents will be increased further. If this does indeed not happen, the increase in rents in the CPI next year will be lower than previously expected.

UK
Tax cuts announced

GDP growth	
Swiss Life Asset Managers	Consensus
2024: 0.1%	2024: 0.2%
2025: 1.0%	2025: 1.1%

In March, the focus in the UK shifted from economic data to fiscal and monetary policy. Chancellor Jeremy Hunt presented his "spring budget," in which the main measure is to reduce National Insurance contributions by two percentage points. The fuel duty freeze is also being extended. These measures will cost around 0.5% of UK GDP. In return, the tax rules are to be tightened for (mostly wealthy) foreigners claiming their main residence outside the UK ("non-domiciled residents"). The further "counter-financing" measures, such as higher productivity assumptions, are questionable, which is why the budget could deliver a marginally positive fiscal impulse overall. First and foremost, however, the budget is also following electoral tactics. The general election will take place no later than 28 January 2025, and the Tories are lagging behind in the polls. The budget creates a "fait accompli" with measures that are popular with some Labour voters. However, monetary policy is even more important for the economic outlook. Statements by the Governor of the Bank of England (BoE), as well as the vote distribution in the March rate decision, have brought market expectations of interest rate cuts forward, with 20 June being seen as a possible date for a first rate move.

Inflation	
Swiss Life Asset Managers	Consensus
2024: 3.0%	2024: 2.5%
2025: 2.4%	2025: 2.2%

February's inflation figures also boosted hopes that the BoE would cut rates earlier than previously expected. Both headline and core inflation fell more sharply than expected by the market, the former from 4.0% to 3.4% and the latter from 5.1% to 4.5%. Recent labour market data has also been weak, leading to a further slowdown in wage growth.

China
Growth target will be missed

GDP growth	
Swiss Life Asset Managers	Consensus
2024: 4.5%	2024: 4.7%
2025: 4.4%	2025: 4.4%

China has announced a growth target of "around 5%" for 2024, which remains unchanged from the previous year. We consider this to be a very ambitious target, as substantial stimulus measures would be required to achieve such a growth target. However, the 2024 budget deficit target, including the issuance of "special government bonds", was only slightly increased to 4.1% of GDP (compared to 3.5% in the previous year). Support measures for the real estate sector – currently the biggest drag on China's economy – also remained vague. While the government stressed that it wants to support the real estate sector with public projects for affordable housing and urban redevelopment, which could lead to an increase in real estate investment, the announcement remained vague with no concrete figures. We therefore expect the government to take a cautious approach to these real estate investments. Given the moderate fiscal announcements and the unclear measures for the real estate sector, we are not revising our current growth forecast of 4.5%. This would mean that the announced growth target will be missed – a rare event, but one that has occurred in the past.

Inflation	
Swiss Life Asset Managers	Consensus
2024: 0.8%	2024: 0.8%
2025: 1.9%	2025: 1.6%

China's headline inflation rate rose to 0.7% in February, exceeding our expectations. This increase was attributable to New Year factors that led to higher prices for food and travel activities. We are expecting moderate inflation rates for the remainder of 2024 due to overcapacity and subdued demand.

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Perspectives
Financial Markets

Swiss Life
Asset Managers

April 2024

Interest rates & bonds

Central bank easing cycle is commencing

Overview of bond yields and investment grade credit spreads

	10-year government bond yield			Investment grade credit spread		
	Current	March 2024*	Year-to-date*	Current	March 2024*	Year-to-date*
US	4.2%	-6 bps	31 bps	90 bps	-6 bps	-9 bps
Eurozone	2.3%	-12 bps	27 bps	114 bps	-7 bps	-24 bps
UK	3.9%	-19 bps	40 bps	118 bps	-7 bps	-21 bps
CH	0.6%	-13 bps	-3 bps	79 bps	2 bps	-3 bps

10-year government bond yield eurozone = DE. * Change as at 27 March.
Source: Bloomberg

USA

- The 10y-2y government bond yield curve remained inverted at -35 basis points (bps) in March. Credit spreads tightened despite high new issue volumes.
- The Federal Reserve kept rates unchanged, adhering to its guidance of three rate cuts this year, despite raising its own forecasts for growth and inflation, with the latter expected to stay above its 2% target.

Eurozone

- The German 10y-2y yield curve inverted further to -52 bps, extending its inversion of over 500 days.
- The European Central Bank kept interest rates unchanged, but hinted at a potential cut in June, with the market anticipating three more cuts by year-end.

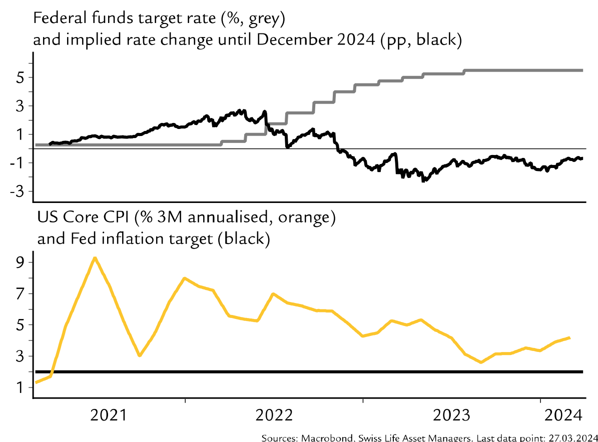
UK

- The market now expects the Bank of England to make the first rate cut in June, given the declining inflation and dovish communication.
- Uncertainty remains high, as inflation is at 3.4% and economic data is improving, with Purchasing Managers' Indices back in expansionary territory.

Switzerland

- The Swiss 10y-2y government bond yield curve remained inverted at -20 bps.
- The Swiss National Bank unexpectedly cut rates under the assumption that the currently sustained low inflationary pressure will persist in the future, leading to the CHF weakening against major currencies.

Markets expect rate cuts despite rising inflation



"Transitory inflation" served as the primary justification for the late start of rate hikes by developed market central banks, despite witnessing the fastest price increases in decades. Two years on, the central banks, particularly the Federal Reserve (Fed), appear overly keen to lower rates again, despite not having reached their 2% inflation target. The US core inflation on a three-month annualised basis has risen back to 4.2% since the previous summer without ever touching the 2% target. With the US unemployment rate hovering near historic lows, wage growth remaining at around 5%, and GDP growth projected to surpass potential, even the Fed's forecasts do not anticipate inflation hitting the target anytime soon. The market, aligning with the Fed's guidance, anticipates three rate cuts this year. Equities and speculative assets such as cryptocurrencies have experienced a surge, and the decline in long-term yields has significantly eased financial conditions. For the time being, the central banks' readiness to ease financial conditions is beneficial for risk assets, but we recommend exercising caution due to the current high valuations. In terms of government bonds we have a long duration stance but see potential in a steepening position, given the increased risk of headwinds for long-term interest rates should inflationary pressures persist.

Equities

Strong markets in March

Overview of equity market performance

	March 2024*	Year-to-date*
USA	3.0%	10.2%
Eurozone	4.4%	10.2%
UK	4.3%	3.8%
Switzerland	3.3%	5.4%
Emerging Markets	1.8%	1.7%

MSCI net total return indices in local currency.
* Performance as at 27 March. Source: Bloomberg

US

- The Magnificent 7 stocks were again the primary contributors to the positive market performance in March (+17.8% since the start of the year).
- The dovish tone from the Fed at its recent meeting supported the market, as three to four rate cuts this year have become more likely.
- The US market valuation still remains far above historical averages and that of other markets. Technical indicators are stretched, but not extreme.

Eurozone

- Earnings growth has been zero so far this year, meaning that the market increase since January can be entirely attributed to higher valuations.
- The valuation of the European market is now roughly neutral.

UK

- The UK remains a weak performer, despite its outperformance of other developed markets in March.
- The UK market still benefits from the lowest valuation and the highest dividend yield (3.9%) of all the major developed markets.

Switzerland

- Measured in CHF, the Swiss market has significantly underperformed the eurozone and US markets in March, as the CHF has depreciated against the EUR and USD.
- The Swiss equity market is the second most expensive after the US market.

Emerging markets

- The relatively weak performance of the equity markets in the emerging world is broad-based.
- The Indian stock market has only gained 4.9% for the year to date in local currency, while the Chinese market is down 1.8% as measured in HKD.

What is going on in Japan?

The Japanese equity market reached a new all-time high in 34 (!) years a few weeks ago. In 2023 and so far this year, it has outperformed all major markets when measured in local currency. This begs the question: Is this merely another short-term rally, or are there structural changes underway that could enhance the mid- and long-term performance of the Japanese market?

Equity Market Total Returns & Profitability

	In local currency			In CHF			Return on equity
	2023	Year-to-date*	10 Years	2023	Year-to-date*	10 Years	
JP	29%	20%	168%	9%	19%	83%	9%
US	26%	10%	210%	15%	18%	212%	18%
Eurozone	19%	9%	91%	12%	15%	50%	11%
CH	5%	5%	65%	5%	5%	65%	23%

* Performance as at 26 March. Sources: Bloomberg, Swiss Life Asset Managers

Several recent developments have contributed to the strong performance of the Japanese stock market. First, a weak yen has provided a dual benefit to Japanese exporters: their products become more competitive from the perspective of foreigners, and global sales are worth more in yen terms. Second, persistently low and negative interest rates have given Japan a relative advantage. Unlike other central banks, the Bank of Japan did not raise rates until its most recent meeting in March. Third, the Japanese stock market organisation has implemented several structural reforms aimed at improving corporate governance and focusing more on profitability. It is worth noting that about half of Japanese stocks are still trading below book value. Fourth, anecdotal evidence suggests that Chinese investor have discovered Japan for speculative investments. In the short term, the momentum of the Japanese market may continue. Valuations remain within the fair value range, the yen is still weak, and the positive effects of the structural reforms may continue to bolster the profitability of Japanese companies. However, risks loom in the longer term. The yen is significantly undervalued and may appreciate at some point. The return on equity, a measure of profitability, is still much lower than in other markets. Competition from China is also intensifying, and Japan's long-term structural issues — unfavourable demographics, insufficient immigration, and low potential growth — persist. Japan needs to do more to address these challenges.

Currencies

We expect the Swiss franc depreciation to be temporary

Overview of major currencies

	March 2024*	Year-to-date*	1-month view
EUR/USD	0.2%	-1.9%	↘
EUR/CHF	2.4%	5.4%	↘
GBP/USD	0.1%	-0.7%	↘
USD/JPY	0.9%	7.3%	↗

* Performance as at 27 March. Source: Bloomberg

USA

- March was an uneventful month for the USD. Monetary policy expectations remained stable and the trade-weighted USD ended the month at almost the same level as at the beginning.
- Financial markets are now firmly expecting a first rate cut in June, and these expectations should remain well-anchored in April as well. Other factors such as the US interest rate advantage, the prospect of a second Trump presidency, or a less-friendly risk environment could thus reignite USD appreciation.

Eurozone

- The EUR had another strong month in March, as the ECB retained its wait-and-see attitude.
- We still believe that the markets are somewhat underappreciating the potential for rate cuts this year, as economic dynamics remain weak and progress on the inflation front should continue. We thus have a negative view of the EUR vs. USD and CHF.

UK

- In March, sterling was unmoved by the prospect of earlier rate cuts by the Bank of England, but we expect some weakness in April, notably against the USD.

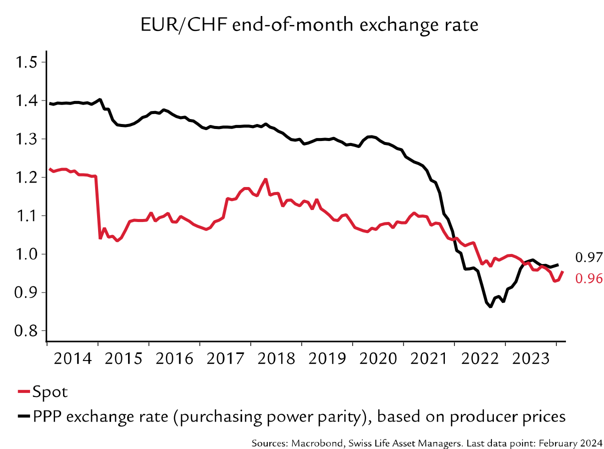
Switzerland

- The CHF was among the worst-performing currencies in March, although we caution against extrapolating this weakness (see text in the right-hand column).

Japan

- Despite the first interest rate hike by the Bank of Japan, JPY remained weak in March.
- The markets are not expecting a "proper" rate hike cycle by the Bank of Japan, but merely an exit from its ultra-expansionary monetary policy. We thus expect JPY to continue to suffer from its significant carry disadvantage.

EUR/CHF fairly valued according to producer prices



The main event on the foreign exchange markets in March was the rate cut by the Swiss National Bank (SNB). This policy action came as a surprise to financial market participants, and thus led to another leg of CHF depreciation. Among the major currencies, only the Turkish lira (-7.7% year-to-date) and JPY (-5.7%) performed worse than CHF (-5.3%) on a trade-weighted basis. Interestingly, the SNB not only justified the move with reduced inflationary pressure. It also explicitly stated "the appreciation of the Swiss franc in real terms over the past year" as a reason in its press release. This argument is somewhat surprising, as part of the appreciation of the real effective CHF exchange rate in 2023 was reversed by the depreciation in February and March 2024. While it is true that opinions in the Swiss export-oriented sector have become more alarming regarding the exchange rate, the CHF is still not overvalued according to some models. If producer prices are used for comparison, Bloomberg estimates that the CHF is now fairly valued against the EUR (see chart). The narrowing inflation differential and the appreciation of the CHF in 2023 have thus not led to an overvaluation, but have merely removed a temporary undervaluation of the CHF. This model also suggests that the CHF remains undervalued against the USD. In any case, we would caution against extrapolating the current CHF weakness. While the SNB has acted early, we do not expect it to deliver more rate cuts than previously expected, and see 1.25% as the terminal rate in this "easing cycle", which will be reached by the end of the year. We also expect the SNB to tolerate moderate CHF appreciation again after the recent sell-off.

Asset allocation

Strong equity market rally after a slow start

Review

- After a slow start, the equity markets gained momentum in the latter half of the month. However, they experienced increased volatility in the wake of the US Federal Reserve meeting, yet concluded the month on a robustly positive note. The credit markets also had a favourable month, albeit more modest in comparison. Meanwhile, government bonds were able to yield only slighty positive returns.
- The US central bank's relatively dovish communication, which hinted at the potential easing of its monetary policy in the coming months despite the persistently solid economic data, had a minimal impact on the market.
- The Swiss National Bank (SNB) surprised the markets with an early policy rate cut. The timing can probably be explained by the less frequent meetings of the SNB, wanting to reduce the risk of lower interest rates in the US and the eurozone leading to the strong appreciation of the Swiss franc. The cut supported the Swiss Franc bond market, which performed well. The Swiss equity market's reaction was more muted, although the return in March was relatively strong. However, due to the significant depreciation of the Swiss franc after the cut, the Swiss equity market ended up being one of the weaker markets once returns were converted into Swiss francs.

Current asset allocation views

Asset class	Active weight
Global Government Bonds	overweight
Global Investment Grade Credit	underweight
Emerging Market Bonds	neutral
Global Equities	neutral

Source: Swiss Life Asset Managers

- The strong equity market returns, still dominated by a fairly narrow group of sectors and companies, has pushed equity markets even further away from the fundamentals, rendering them even more expensive. However, momentum continues to be very strong, despite signs of weakness.
- While bond yields declined slightly, their levels continue to be attractive, whereas credit spreads, especially in USD, are at historically low levels.
- We remain (nervously) neutral on equities and are underweighting corporate bonds in favour of government debt.

Why are we underweighting corporate bonds?

In short, we find them unappealing. However, we also believe that equities are overpriced, so why only underweight credit? The primary reason is that bonds have a capped appreciation potential, unlike equities. If investors chose to entirely disregard risks and interest rate levels remained constant, the appreciation of a corporate bond would be limited by how much its spread, i.e., the additional yield paid to compensate investors for the risk of default, could decrease.

Currently, spreads are at historically low levels, indicating that there is minimal appreciation potential left in such bonds, even if market sentiment remains positive or becomes even more optimistic. On the contrary, equities, in theory, can continue to appreciate indefinitely, although their prices would increasingly deviate from their fundamental value and become more prone to correction. The following table outlines the probable responses of corporate bonds and equity markets under various market sentiment scenarios.

Market sentiment scenario	Corporate bonds	Equity markets
Strong positive	Small upside potential	Significant postive potential
Neutral	Stable return (yield)	Small positive return, volatility
Strong negative	Significant negative potential	Strong negative potential

Source: Swiss Life Asset Managers

If our assumptions are incorrect and the financial markets are indeed justified in their optimism, the cost in terms of return for underweighting equities will be significantly higher than for underweighting corporate bonds. Conversely, if our predictions are accurate and the market eventually adjusts, an underweight position in corporate bonds will offer less portfolio protection than an underweight position in equities. However, even in such a scenario, we could still reduce the weight of equities, albeit with some delay.

The risks, therefore, are asymmetric and slightly skewed in favour of equities, despite the unfavourable fundamental backdrop. But let's not deceive ourselves: If the financial markets undergo a significant correction, the current strategy will initially provide limited downside protection.

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Perspectives
Emerging Markets

Swiss Life
Asset Managers

Second quarter 2024

Key takeaways

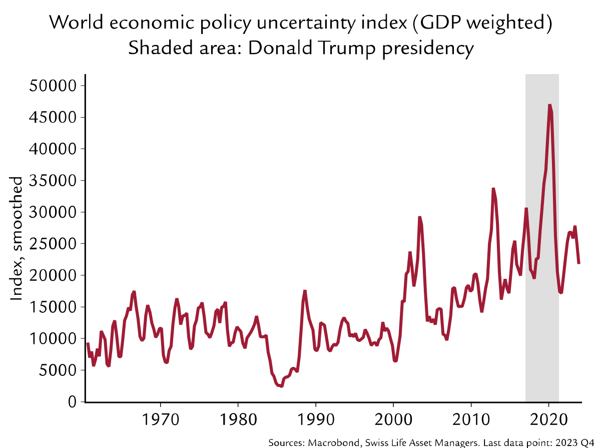
- Emerging markets saw a strong start to 2024, supported by falling inflation and lower interest rates
- China's economic measures are insufficient to meet its ambitious growth target
- Economic policy uncertainty would increase under President Trump and particularly affect emerging markets

Number in focus

60

Elections are due to be held in more than 60 countries in 2024. In Russia, President Putin has already secured another six-year term – this comes as no surprise, as no significant opponents were permitted. One of the most important upcoming elections in the emerging markets is in India, where the polls are predicting a victory for incumbent Prime Minister Narendra Modi. Elections are also scheduled for the second quarter of this year in South Korea and South Africa.

Chart in focus



The possibility of Donald Trump returning to power in the US presidential election on 5 November raises questions about the potential global economic impact. During his first term as President, Trump's foreign policy was confrontational and unpredictable, leading to significant economic policy uncertainties. For the emerging markets, the main concerns are renewed trade tensions with China, the impact on the war in Ukraine, Trump's influence on the ongoing war in Gaza, and the already announced crackdown on immigration.

Emerging markets saw a strong start to 2024

The emerging markets started 2024 with robust economic momentum. The Purchasing Managers' Indices for manufacturing surprised to the upside in both January and February, and the overall index for emerging markets is well above the 50-point mark that separates expansion from contraction (see Chart 1). There are a number of reasons for the acceleration of economic activity in emerging markets: First, private households in emerging markets have accumulated a sizeable surplus of savings, which they continue to spend. Second, lower inflation is having a positive impact on sentiment and disposable income. And third, central banks in Latin America and Eastern Europe have already started to lower their key interest rates, which is boosting investments. This means that the GDP growth figures for the first quarter of 2024, which are still to be published, may provide a positive surprise. Despite robust economic activity, the disinflation process is ongoing. While headline inflation has recently risen again slightly in some Asian economies due to higher food prices, the core component, which excludes the volatile food and energy items, is still on a downward trajectory, giving central banks room to cut interest rates further. In Latin America especially, the cycle of interest rate cuts is proceeding rapidly: Brazil, Mexico, Chile, Colombia and Peru have all lowered their interest rates this year. Most Asian countries are cautious of acting before the US Federal Reserve (Fed) due to potential currency depreciation risks. However, as soon as the Fed does ease its monetary policy, the Asian economies will follow suit.

China is likely to miss its growth target of "around 5%"

China has announced a growth target of "around 5%" for 2024, which remains unchanged from the previous year. We consider this to be a very ambitious target, as it will be more difficult to achieve 5% growth this year. This is due to the base number being higher. In 2023, growth of around 5% was comparatively easy to achieve, as it started from a very low baseline in 2022 when the Covid restrictions had a severe impact on the economy. We are particularly sceptical, as substantial stimulus measures are necessary to achieve such a growth target. There are two possible ways to ensure this support: On the one hand, fiscal policy measures. However, the budget deficit target, including the issuance of "special government bonds," was raised only marginally from 3.5% to 4.1% of GDP year-on-year. On the other hand, substantial support for the real estate sector, which is currently the biggest challenge facing the Chinese economy. This year, the government is no longer focusing on preventing an uncontrolled real estate expansion, but rather on slowing down the real estate slump. Support measures were therefore announced with the promotion of public projects for affordable housing and urban renovations, which could lead to an increase in real estate investments. However, this announcement remained vague with no concrete figures. We therefore expect the government to take a cautious approach to these real estate investments. Given the moderate fiscal announcements and the unclear measures for the real estate sector, we are not revising our current growth forecast of 4.5%.

Chart 1: The Purchasing Managers' Index for emerging markets continues to rise sharply

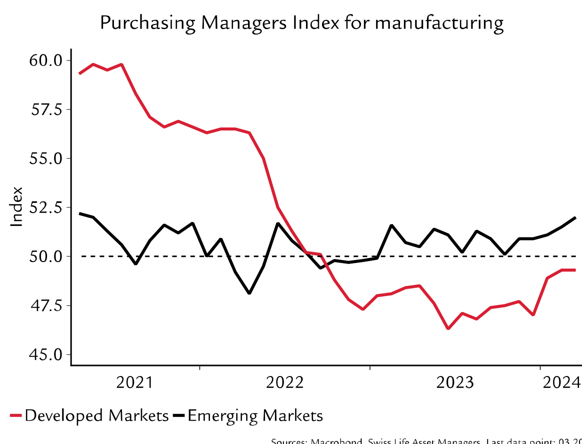
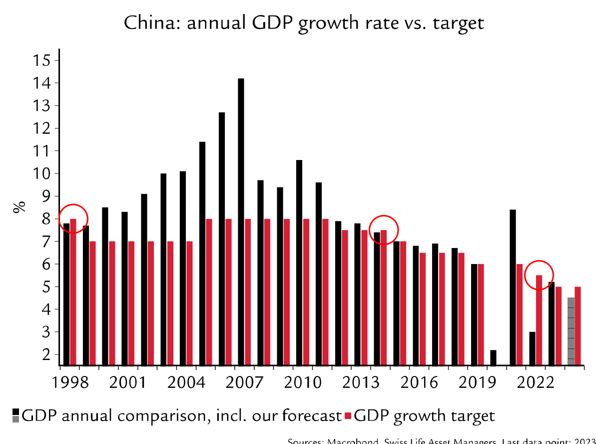


Chart 2: China has not always met its growth target in the past

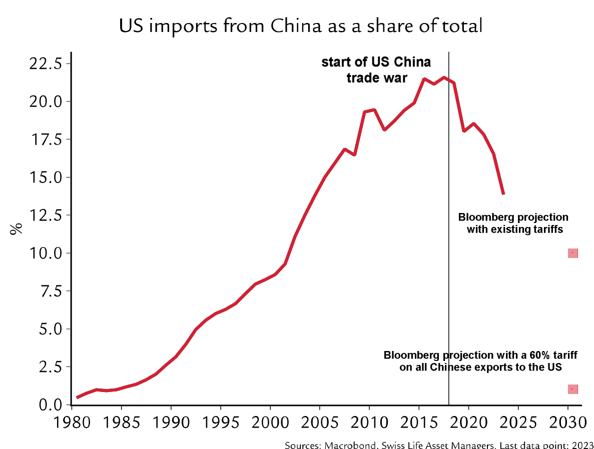


In view of the sluggish growth dynamics in China companies' pricing options are limited. In addition, overcapacity is emerging in a number of sectors as demand fails to keep pace with the abundant supply of goods. As a result, producer prices and export prices remain in deflationary territory. China will therefore continue to contribute to the general disinflationary trend in global goods prices, with a welcomed impact on inflation prospects in other major economies. At the same time, discussions about trade practices could become heated, as the intensified price competition from China will not please western competitors.

Trump 2 and the consequences for China

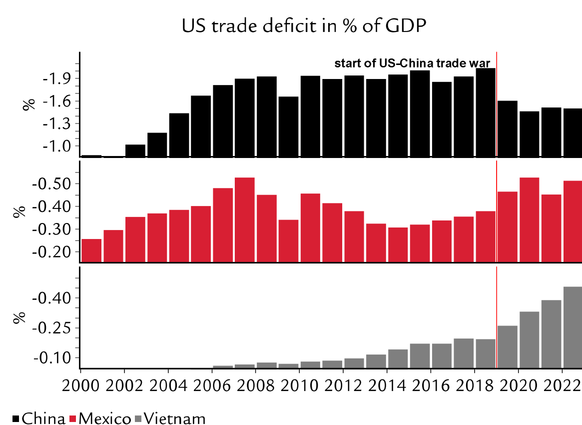
If Donald Trump is re-elected as US President in November, political uncertainty would increase significantly due to his unpredictable and confrontational foreign policy. Of particular concern would be his attitude towards China, and the resulting impact on the Chinese economy and the global economy in general. Compared to the Biden government, there are three main differences: Firstly, Trump would continue to use trade tariffs as his instrument of choice. He has already caused a stir with the threat of 60% tariffs on all Chinese goods. Secondly, broader export restrictions would be introduced as a large number of goods would be considered a threat to national security. And thirdly, as in his first term, Donald Trump is likely to adopt a unilateral and more confrontational approach that could put a strain on the US's long-standing partnerships. Biden, on the other hand, is focusing on working with allies and striving for "anti-China coalitions". Regardless of the outcome of the election, China can thus expect some negative effects. The threat of tariffs in particular is likely to lead to significant market volatility. The proposed 60% tariffs on all Chinese goods could lead to the almost complete disappearance of US imports from China. With their low profit margins, sectors such as the textile and electronics industries could not withstand such a drastic tariff increase. Although we consider an escalation on this scale unlikely, the Trump administration will continue to use the instrument of tariffs, not only against China, but also other countries. While the US trade deficit with China has declined since the start of the trade war in 2018, its deficits with other countries such as Mexico and Vietnam have reached new highs (see Chart 4). This shift reflects both the substitution of Chinese goods by those from other countries as well as the efforts of Chinese companies to circumvent tariffs via intermediate countries. Ultimately, world trade is becoming increasingly complex, and the US remains intertwined with China despite trade barriers.

Chart 3: US imports from China would almost completely disappear in the event of a 60% tariff



Sources: Macrobond, Swiss Life Asset Managers. Last data point: 2023

Chart 4: While the US trade deficit with China is falling, its deficit with Mexico and Vietnam is increasing



Sources: Macrobond, Swiss Life Asset Managers. Last data point: 2023

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