

Seven reasons to be optimistic about the global economy



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US disinflation continues

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Signs of improvement in the eurozone

Euro area business optimism about the coming year improved for a fourth consecutive month in January.

China stimulus draws closer

Last week brought several announcements from regulators that offer reasons for optimism for the Chinese economy and Chinese equities.

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The start of 2024 has been bleak. Two wars rage on, with disturbing casualties including the deaths of many civilians. Commercial ships in the Red Sea have been attacked by Houthi rebels, leading to US and UK strikes against Houthi targets and reports of missiles being launched at US military vessels. Three US service members were just tragically killed in an attack on a US outpost in Jordan, increasing the probability that more countries will become directly involved in the Israel-Hamas War. In addition, there are concerns that major elections around the world could result in more geopolitical uncertainty. I'm fielding a lot of questions about the state of the economy given these global events, so I thought it might be time to share a few reasons to be positive about the global economy.

US disinflation continues

The December reading of the core Personal Consumption Expenditures price index, the Federal Reserve's (Fed) preferred measure of US inflation, fell below 3% year over year — the lowest level since March 2021.¹ This underscores the very significant progress made in taming US inflation. The disinflationary process is sloppy and can include some disappointing data points, but the reality is that the march towards the Fed's 2% inflation target continues. We are still on the "D train."

US growth surprises to the upside

The initial report of US fourth-quarter gross domestic product was better than expected — an annualized rate of 3.3% versus expectations of 2% — although down from the third quarter print of 4.9% annualized.² In addition, the US S&P Global flash manufacturing Purchasing Managers' Index (PMI) reading moved into expansion territory for the first time since April 2023, reaching its highest level since October 2022. The services index also beat expectations.³ And durable goods orders excluding transportation comfortably exceeded expectations in December.

Some might not think this is good news because it throws some cold water on the view that the Fed will begin to cut rates in March. But I don't think there's anything wrong with assuming the Fed won't cut in March — I'm quite confident the Fed will begin cutting in the second quarter and I expect a substantial amount of cutting in 2024.

Some Fed watchers seem to have adopted a view that the Fed won't cut until later because the US economy is so resilient. But as I've said before, we don't need economic weakness for the Fed to start cutting — we just need satisfactory progress on disinflation. I must remind you of words from Fed Governor Chris Waller back in November: "I am increasingly confident that policy is currently well positioned to slow the economy and get inflation back to 2%..." Waller was clear that if the decline in inflation continues "for several more months...three months, four months, five months...we could start lowering the policy rate just

because inflation is lower. It has nothing to do with trying to save the economy. It is consistent with every policy rule. There is no reason to say we will keep it really high.”⁴

Signs of improvement in the eurozone

The most recent flash Eurozone PMI survey showed that manufacturing PMI has improved to 46.6, a 10-month high.⁵ While that just means the decline in manufacturing is softening, I will take it. In addition, German manufacturing PMI, while still weak, is at an eight-month high.⁵ Perhaps more importantly, the survey also showed that euro area business optimism about the coming year improved for a fourth consecutive month in January — and is at its highest level since last May.

As explained by Dr. Cyrus de la Rubia, Chief Economist at Hamburg Commercial Bank, which conducts the PMI survey, “The commencement of the year brings positive tidings for the eurozone as manufacturing experiences a widespread easing of the downward trajectory witnessed in the past year. This positive shift is evident across key indicators such as output, employment, and new orders. Notably, the export sector plays a pivotal role in driving the improvement of the latter, showing better conditions compared to the end of the preceding year.”⁶ This means the bumpy landing we anticipate in coming months should be a bit less bumpy.

Red Sea shipping disruptions have had a moderate economic impact

From an economic perspective, shipping disruptions in the Red Sea are not causing as much disruption as one might expect. Last week, European Central Bank (ECB) President Christine Lagarde noted that, while further conflict in the region would pose additional risks to shipping and energy/commodities prices, the inflationary impact of problems moving cargo in the Red Sea has been relatively modest thus far: “...we are observing very carefully because we are seeing what you are all observing, which is that shipping costs are increasing, delivery delays are increasing and, while we all know that there is more shipping capacity than there was in 2020 and 2021, we also know that costs and fees are increasing. Now, I think most observers agree to say that it has a moderate impact. The percentage of the water transport costs is a little north of 1.5% of total input costs.”⁷

Similarly, it was noted in the S&P Global/HCOB eurozone flash PMI survey that the impact to supply chains has certainly been negative — but not as negative as would be expected: “The persistent attacks by Houthi rebels on commercial vessels navigating the Red Sea are exerting discernible impacts on supply chains...Nevertheless, various industry reports indicate that businesses are not caught off guard like they have been previously, having learned from past disruptions. Many have proactively diversified their suppliers across geographical regions and enterprises, mitigating the potential fallout from such unforeseen challenges.”⁸

It appears we may be seeing something not that far off from the economic concept of “creative destruction.” The shifts and alterations that were made to supply chains in response to COVID-related vulnerabilities have made businesses better equipped to handle the current challenge created to supply chains from the Red Sea attacks.

Eurozone inflation has declined

Some came away from last week's ECB meeting disappointed by what felt like more hawkish "central bank speak." However, I'm not worried given the ECB's assessment of inflation: "Almost all measures of underlying inflation declined further in December. The elevated rate of wage increases and falling labour productivity are keeping domestic price pressures high, although these too have started to ease. At the same time, lower unit profits have started to moderate the inflationary effect of rising unit labour costs. Measures of shorter-term inflation expectations have come down markedly, while those of longer-term inflation expectations mostly stand around 2%."⁹

To me, it looks like the ECB is checking all its most important boxes. Now, I don't expect the ECB to cut rates before the Fed, but I do expect the ECB to start cutting soon thereafter, and that should be enough to ensure rates aren't higher for longer.

Eagerly awaited China stimulus draws closer

We've long expected that more China stimulus could play a decisive role in market performance in 2024. Well, last week brought several reasons to be more optimistic about Chinese equities in 2024.

- The People's Bank of China announced it would reduce the amount of money that the country's lenders are required to hold in reserve, which goes into effect Feb. 5. This is in response to sluggish credit growth, but it could have "knock on effects" in terms of improving market sentiment.
- Chinese regulators announced restrictions on short selling Chinese stocks — a sign that policymakers are very focused on ending equity market weakness. It seems that, with valuations at historically low levels, such measures could be a significant positive catalyst.
- In addition, Bloomberg reported that Chinese policymakers are considering implementing a stock-buying program valued at \$278 billion, in a move similar to its 2015 stock buying support program.

Inflation efforts in Japan

While Western developed economies are focused on taming inflation, Japan is interested in sustaining moderately higher levels of inflation after being stuck in a stagnant low growth/low inflation/low rate environment for decades. The annual spring wage negotiations, referred to as "shunto," are seen as critical to achieving that goal. There are high hopes that this year's negotiations, which have just gotten underway, will result in the biggest increases in pay in decades. Such an achievement would be positive for the Japanese economy.

Looking ahead

The seven points listed above may be at least part of the reason why we've seen risk assets perform well in recent weeks despite the wall of worry. And as we look ahead, there are some events ahead this week that promise to be important for markets: Some major tech companies — Microsoft, Meta, Apple, Alphabet and Amazon — will announce fourth-quarter earnings, and we'll get a look at the new US jobs report, a flash estimate of eurozone inflation, and the Bank of England decision.

And of course the Federal Open Market Committee meeting this week will be “must-see TV” in my book, as we look for guidance on what the Fed is thinking and when it could begin cutting. (Follow me @kristinahoop on X, formerly known as Twitter, for my immediate reactions to the Fed meeting.)

Dates to watch

Date	Report	What it tells us
Jan. 30	Flash estimate of euro area GDP	Measures a region’s economic activity.
Jan. 30	Euro area economic sentiment indicator	Indicates how consumers and businesses feel about the eurozone economy.
Jan. 31	FOMC decision and press conference	Reveals the latest decision on the path of interest rates.
Feb. 1	Euro flash estimate of inflation	Tracks the path of prices paid for goods and services.
Feb. 1	Bank of England decision and press conference	Reveals the latest decision on the path of interest rates.
Feb. 1	China Caixin manufacturing PMI	Indicates the economic health of the manufacturing sector.
Feb. 2	US Employment Situation Report	Tracks the health of the US job market.
Feb. 2	University of Michigan Survey of Consumers (final)	Measures US consumer sentiment and inflation expectations.

Notes

¹Source: US Bureau of Economic Analysis, Jan. 26, 2024

²Source: US Bureau of Economic Analysis, Jan. 25, 2024

³Source: S&P Global, Jan. 25, 2024

⁴Source: Reuters, “With Fed likely done hiking rates, Waller flags pivot ahead,” Nov. 28, 2024

⁵Source: Standard & Poor’s, S&P Global / HCOB Flash Eurozone PMI, Jan. 24, 2024

⁶Source: S&P Global, Jan. 24, 2024

⁷Source: European Central Bank press conference, Jan. 25, 2024

⁸Source: S&P Global, Jan. 24, 2024

⁹Source: European Central Bank press conference, Jan. 25, 2024

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Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

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Hawkish is to favor relatively higher interest rates if they are needed to keep inflation in check.

Disinflation, a slowing in the rate of price inflation, describes instances when the inflation rate has reduced marginally over the short term.

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Purchasing Managers' Indexes are based on monthly surveys of companies worldwide, and gauge business conditions within the manufacturing and services sectors.

Personal consumption expenditures (PCE), or the PCE Index, measures price changes in consumer goods and services. Expenditures included in the index are actual U.S. household expenditures.

Gross domestic product is a broad indicator of a region's economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

Tightening monetary policy includes actions by a central bank to curb inflation.

Flash reports give a early estimate of inflation and other economic data before the final report is announced.

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