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## Growth forecasts

The International Monetary Fund (IMF) upwardly revised its 2024 global growth forecast to 3.1% from 2.9%, largely because of a more resilient US economy and policy stimulus in China.

## Regional banks

New York Community Bank surprised markets by slashing its dividend due to troubled commercial real estate loans, but I believe this problem is largely contained rather than contagious.

## US jobs

The US jobs report was, simply put, red hot, including the area I am most focused on — wage growth — although that is likely an anomaly.

### Weekly Market Compass | February 5, 2024

Last week was a busy one for market watchers, featuring revised economic growth forecasts, regional bank surprises, some cold water from the Federal Reserve regarding a potential March rate cut, and a hot US jobs report, among other headlines. Following are my key takeaways from the week, and why they matter.

### Economic growth forecasts largely improve for 2024

The IMF released its updated World Economic Outlook with some tweaks to the forecasts it released in October.<sup>1</sup>

- **Global.** Its 2024 global growth forecast was upwardly revised to 3.1% from 2.9%, largely because of a more resilient US economy and policy stimulus in China. The IMF acknowledged a reduced likelihood of a hard landing and noted the potential for faster disinflation.
- **United States.** US growth for 2024 was upwardly revised to 2.1% from 1.5%. This would still be a slowing of growth from 2023, which we expected as the impact of past rate hikes continues to weigh down the economy.
- **Euro area and United Kingdom.** Euro area growth for 2024 was downwardly revised to 0.9% from 1.2%, but that would still be an improvement from an estimated 0.5% growth in 2023. The IMF expects the UK's growth in 2024 to be even more modest, at 0.6%.
- **Japan.** Japan's growth for 2024 was also downwardly adjusted from 1.0% to 0.9%, which is well below Japan's estimated 2023 growth of 1.9% but still above potential.
- **Emerging markets.** Emerging markets were revised upward from 4% to 4.1%. An area of particular interest is emerging and developing Asia, where growth for 2024 was upwardly revised from 4.8% to 5.2%. This can be attributed to an improved outlook for China. Its 2024 growth was upwardly revised from 4.2% to 4.6%, reflecting "carryover" from better-than-expected growth in 2023 and increased government spending.

### US regional bank concerns surprised investors

Last week, New York Community Bank surprised markets in its earnings report by slashing its dividend as a result of some troubled commercial real estate loans and the need to increase its reserves. Markets were rattled by the news, which caused fears that the regional bank mini-crisis of last year might not be over, sending the KBW Regional Bank Index down more than 7% last week.<sup>2</sup>

However, it appears that this problem is largely contained rather than contagious. NY Community Bank is rather unique in its high level of exposure to commercial real estate loans and its low commercial real

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estate reserve ratio. It's also important to note that the credit facility created last year, which was a critical factor in stabilizing the regional bank mini-crisis, is still in place and available for banks to utilize if needed.

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### **The Federal Reserve (Fed) tempers expectations for a March rate cut**

The Federal Open Market Committee (FOMC) met last week and decided to hold its benchmark funds rate unchanged at 5.25% to 5.50% — its fourth consecutive pause. Markets were primed to hear about a potential March rate cut thanks to good inflation data and the news about New York Community Bank's problems, but they came away disappointed because Fed Chair Jay Powell threw cold water on the notion that the Fed would start cutting in March.

However, I viewed the press conference positively. As I wrote last week, it's OK if the Fed does not cut in March — there isn't a big difference between March 20<sup>th</sup> and May 1<sup>st</sup>. And it's not about *when* the rate cuts start but *how much* is cut in 2024, and I expect it be higher than what the Fed anticipated in December.

I think it's also important to note that Powell acknowledged a shift in the Fed's thinking. A year ago, the Fed thought a softening of US economic data was required for inflation to adequately ease. But now the Fed is comfortable with the strength of the US economy, and it doesn't believe the economy needs to weaken to see inflation be tamed. A few other takeaways:

- Powell did admit that if the labor market unexpectedly weakens, that would speed up the start of rate cuts. But he maintained a hawkish tone, noting that more persistent inflation would move the timeline for cuts in the other direction.
- The Fed's balance sheet run-off so far has been going very well, Powell said, and he plans to begin in-depth discussions of the balance sheet in March.
- Powell added that the Fed could cut rates and make alterations to balance sheet run-off at the same meeting. He sees them as separate tools, which is good to hear. The more flexibility the Fed has, the better.

As a follow-up to the Fed meeting, Powell was interviewed on the TV show "60 Minutes" where he reiterated and expanded on his remarks at the FOMC press conference. Powell again stated the unlikeliness of a March rate cut, explaining that he doesn't need better data – he just needs more data: "It's not that the data aren't good enough. It's that there's really six months of data. We just want to see more good data along those lines. It doesn't need to be better than what we've seen, or even as good. It just needs to be good. And so, we do expect to see that."<sup>3</sup>

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### **US jobs jumped in January**

The US Employment Situation Report was, simply put, red hot. A whopping 353,000 non-farm payroll jobs were created in January, which was dramatically higher than consensus expectations.<sup>4</sup> In addition, December non-farm payrolls were revised upward from 216,000 to 333,000. The unemployment rate was unchanged at 3.7%.

My focus is on average hourly earnings and the impact they could have on inflation. I must admit, January's figures were too high for my taste, rising 0.6% month-over-month and 4.5% year-over-year.<sup>4</sup> I'm optimistic that this

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is an anomaly, perhaps driven by a surprisingly shorter average workweek. I anticipate we will see tamer earnings growth in future jobs reports, more in line with the Employment Cost Index released last week, which showed more modest overall compensation growth.

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### **The Bank of England removes its bias for hiking**

The Bank of England (BOE), like the Federal Reserve and the European Central Bank, kept its main interest rate stable at its meeting last week. It also removed its hiking bias. BOE Governor Andrew Bailey explained, “For me, the key question has moved from: how restrictive do we need to be? to, how long do we need to maintain this position for?”<sup>5</sup>

The answer to that question may be “not very long” given the BOE’s update to growth and inflation forecasts. It revised its UK Consumer Price Index forecast for 2024 to 2.75% from 3.25%, and its forecast for 2025 from 2.5% to 2.0%.<sup>6</sup> It’s important to note that its previous forecast was only released in November.

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### **Earnings season continues with mixed results**

Some of the big tech companies reported their earnings last week, and they were generally very positive with a few exceptions. Artificial intelligence continued to be an important theme for some of them, European earnings thus far have been more disappointing. (No surprise given the challenging growth environment; Europe has been under pressure.)

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### **Pessimism leads to a sell-off of Chinese equities**

I would be remiss if I didn’t mention that Chinese stocks sold off last week. This leaves Chinese equities at the very low end of their historical valuation range. Needless to say, conditions feel oversold – it’s as if investors are ignoring everything positive, including better-than-expected economic growth last year and recent improvement in Purchasing Managers Index readings.

In our view, valuations are rarely predictive in the short term; there needs to be a catalyst for stocks to move higher. And that catalyst, in my opinion, will be policy support. We already got a pledge from Beijing regulators over the weekend to provide additional measures to support capital markets.

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### **Bond markets ride a roller coaster**

Bond yields went on a wild ride last week. Early in the week, the US Treasury positively surprised markets, reducing its estimate for Treasury issuance for the current quarter — it now expects net borrowing of \$760 billion for January through March, down from a previous estimate of more than \$800 billion.<sup>7</sup> With supply expected to be lower, bonds rallied. The 10-year US Treasury yield fell to 3.86% on Thursday, only to rebound above 4% on Friday on the hotter-than-expected jobs report.<sup>8</sup>

Finally, we continue to see stocks impacted by bond yields. I would expect to see more of the same with heightened stock volatility driven by heightened bond volatility, which in turn is being driven by some uncertainty around Fed policy.

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## The week ahead

This week will likely be slower, with fewer important data releases and market events. Here's what's on the docket:

### Dates to watch

Date	Report	What it tells us
Feb. 5	German Composite PMI	An index of the prevailing direction of economic trends in the manufacturing and service sectors.
	Eurozone Composite PMI	An index of the prevailing direction of economic trends in the manufacturing and service sectors.
	US ISM Non-Manufacturing PMI	An economic index based on surveys of more than 400 non-manufacturing (or services) firms' purchasing and supply executives.
	Reserve Bank of Australia Decision	Reveals the latest decision on the path of interest rates.
Feb. 7	Bank of Canada Summary of Deliberations	Reveals the latest decision on the path of interest rates.
	US Consumer Credit	Reports outstanding credit extended to individuals.
	China CPI	Tracks the path of inflation.
Feb. 9	Canada Jobs Report	Indicates the health of the job market.
	German CPI	Tracks the path of inflation.

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### Notes

<sup>1</sup>Source: Moderating Inflation and Steady Growth Open Path to Soft Landing, World Economic Outlook Update, Jan 2024

<sup>2</sup>Source: Bloomberg, as of Feb. 2, 2024

<sup>3</sup>Source: Jerome Powell: Full 2024 60 Minutes interview transcript, CBS News, Feb. 4, 2024

<sup>4</sup>Source: US Bureau of Labor Statistics, Feb. 2, 2024

<sup>5</sup>Source: Bailey speaks after Bank of England holds rates at 5.25%, Reuters, Feb. 1, 2024

<sup>6</sup>Source: Monetary Policy Report – February 2024, Bank of England, Feb. 1, 2024

<sup>7</sup>Source: Treasury Announces Marketable Borrowing Estimates, US Department of the Treasury, Jan. 29, 2024

<sup>8</sup>Source: Bloomberg, as of Feb. 2, 2024

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### Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

Should this contain any forward looking statements, understand they are not guarantees of future results. They involve risks, uncertainties, and assumptions. There can be no assurance that actual results will not differ materially from expectations.

Diversification does not guarantee a profit or eliminate the risk of loss.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Many products and services offered in technology-related industries are subject to rapid obsolescence, which may lower the value of the issuers.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

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.

The International Monetary Fund is a global organization of 190 member countries that supports economic policies that promote financial stability and monetary cooperation.

The KBW Regional Banking Index seeks to reflect the performance of U.S. companies that do business as regional banks or thrifts.

The Employment Cost Index measures the change in the cost of labor, free from the influence of employment shifts among occupations and industries.

The European Central Bank (ECB) is responsible for the monetary policy of the European Union.

Yield is the income return on an investment.

Inflation is the rate at which the general price level for goods and services is increasing.

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

The federal funds rate is the rate at which banks lend balances to each other overnight.

The Federal Open Market Committee (FOMC) is a 12-member committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

Balance sheet run-off refers to the Federal Reserve reducing its balance sheet by electing not to reinvest some or all of the principal repaid when securities mature.

Purchasing Managers' Index (PMI) looks at economic trends in the manufacturing and service sectors.

The UK Consumer Price Index (CPI) measures change in consumer prices as determined by the UK Office of Statistics.

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

The opinions referenced above are those of the author as of **Feb. 5, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.