Quarterly Outlook

Is the inflation genie back in the bottle?

July 2024

Market developments and other events

Despite moderate GDP growth for most regions, long rates increased amid continued inflation concerns prompting major central banks to remain cautious. Headline inflation declined as food and goods inflation moderated, while services inflation remained elevated suggesting core inflation remains sticky and above central bank target in the short term. The ECB cut interest rates but revised their inflation forecast upwards citing high labor costs, while the US Federal reserve and the Bank of England maintained rates at current levels.

The US economy grew less than anticipated in the first quarter and economic indicators pointed towards further slowdown as retail spending cooled, unemployment edged up slightly and real wage growth slowed. First quarter data showed that the EU and UK returned to growth, showing some positive momentum. Overall, global economic prospects seem to be converging towards moderate growth.

Most developed market equities performed well, buoyed by continued AI enthusiasm. United States equities reached record highs, but European equites underperformed due to increased political uncertainty associated with the snap elections in France. Emerging market equities outperformed, owing to improving growth prospects in China and India. Oil prices surged in June after OPEC+ announced production cuts in response to earlier concerns about slowing oil demand.

Outlook for growth, inflation, and interest rates

Some signs point towards a soft-landing scenario as inflation gradually declines and growth in developed economies converges to moderate levels. Global labor markets are showing signs of cooling from historically tight levels but remain relatively robust, suggesting that the damage from the extraordinary spike in global inflation remains contained.

Short-term growth prospects in developed economies remain moderate amid cooling labor markets and above-trend interest rates. In the medium term, growth prospects are expected to slightly improve as the global economy moves on past the peak of monetary tightening.

Tight financial conditions and moderate growth prospects suggest that core inflation will decline in the coming years. Nevertheless, in the medium term (core) inflation is expected to slowly converge towards target against the background of upward fiscal spending pressures associated with the energy transition and elevated geopolitical risks.

Long-term interest rates are expected to move around their recent levels or somewhat decline for most developed markets in the medium term. This reflects higher for longer dynamics as inflation is anticipated to slowly converge to target.

Outlook for financial assets

Slightly higher global unemployment, along with negative market sentiment surrounding political uncertainty in Europe, weigh on the economic cycle. Nevertheless, the economic outlook remains stable as economic conditions are normalizing with inflation slowly trending down.

Equity returns remain positive over the next twelve months, despite somewhat stretched equity valuations. Compared to the first quarter, the short-term equity outlook slightly deteriorates, due to already positive realized equity returns. European and UK equities are an exception as they are anticipated to rebound on June's weak performance.

The medium-term government bond return outlook for developed markets improves on higher expected yields. The HY and IG corporate credits return outlook also improves for most countries, following higher expected government bond yields.

The outlook for financial assets remains clouded by elevated volatility and downside risk due to tight financial conditions, political uncertainty and elevated geopolitical tensions as signified by the ongoing wars in the Middle East and Ukraine.

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