J. Safra Sarasin

Cross-Asset Weekly

08 March 2024

Monthly forecast update: recession called off

The biggest change to our macro view concerns our US growth forecast. We no longer expect the US to fall into recession this year. In Europe, the outlook remains largely unchanged, with growth only picking up slowly over the coming quarters. Inflation is set to decline gradually in the US and in Europe, but remain stickier than generally expected. Central banks are thus set to ease policy later this year, but only at a modest pace.

The shallower downward trajectory for policy rates also limits the scope for bond yields to fall, but remains large enough for us to remain constructive on fixed income. In credit, we are downgrading Investment Grade to neutral, in DM and EM, while upgrading High Yield from least preferred to neutral, driven by its low duration and the improved outlook for the US economy. In FX, the Japanese yen should benefit as we expect the BoJ to abandon its Negative Interest Rate Policy in Q2. In equities, we are upgrading our targets across the board, most notably in the US, with the S&P 500 expected to end the year at 5400.

Over in Switzerland, inflation is back to the SNB's target range. The inflation outlook is more balanced and there are no obvious signs of a wage-price spiral, suggesting that monetary conditions are probably too tight now. Consequently, we expect the SNB to deliver the first rate cut at its meeting on March 21. The ECB, on the other side, has indicated that it will likely wait until June before pulling the trigger.

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Monthly macro and strategy forecast update

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We no longer expect the US to fall into recession this year. The European economy should continue to perform as previously anticipated, with growth only picking up slowly as the year progresses. Inflation is likely to be stickier than generally expected. Major advanced economy central banks are set to ease policy later this year, though rate cuts will only come gradually in our view. The one central bank that is likely to hike is the Bank of Japan, with an end to Negative Interest Rate Policy in April. We have kept our 2024 China GDP growth forecast at 4.5%, though the risks are skewed to the upside. In line with the shallower downward trajectory for policy rates, we also see a bit less scope for bond yields to fall. That said, we are still looking for lower bond yields and steeper yield curves over the next 6 to 12 months. In DM and EM, we have downgraded Investment Grade corporates to neutral on valuation grounds. On the other side, we have upgraded High Yield from slight underweight to neutral, due to its low duration and our call for no recession. The US dollar will likely be supported near-term, but weaken somewhat in the second half as the Fed cuts rates. The Japanese yen should be supported by the likely BoJ exit from Negative Interest Rate Policy. In the equity space, we have upgraded our equity targets, most notably in the US. The main reason is the absence of a US recession and generally higher GDP growth estimates. We reiterate our positive stance on euro area equities and US small caps.

Global macro

We no longer expect the US economy to fall into recession this year

The biggest change to our macro view is on the US economy. As we indicated in last month's forecast update, January data posed a significant challenge to one of our major assumptions underpinning our more downbeat view of the US economy: that the impact of past monetary tightening had yet to be fully felt. Instead, the easing of financial conditions since October suggests that the bulk of the impact rather lies in the past (for a detailed analysis, please refer to last month's document).

Exhibit 1: We expect lower growth but stickier inflation than the Consensus

GDP in % yoy - BJSS forecasts	2023	2024	2025	Difference from BBG Consensus 2023	2024	2025
US	2.5	2.3	1.4	0.0	0.3	-0.3
Eurozone	0.4	0.5	1.1	-0.1	0.0	-0.3
Switzerland	0.7	0.9	1.0	-0.1	-0.3	-0.5
UK	0.1	0.1	1.0	-0.2	-0.3	-0.2
Japan	1.9	0.7	0.9	0.0	0.0	-0.2
China	5.2	4.5	4.5	0.0	-0.1	0.1

CPI in % yoy - BJSS forecasts	2023	2024	2025	Difference from BBG Consensus 2023	2024	2025
US	4.1	3.0	2.5	0.0	0.3	0.1
Eurozone	5.4	2.5	2.2	0.0	0.2	0.1
Switzerland	2.1	1.5	1.8	0.0	0.0	0.4
UK	7.3	2.3	2.2	0.0	-0.2	0.1
Japan	3.3	2.3	1.9	0.0	0.1	0.2
China	0.3	1.1	2.4	0.1	0.2	0.7

Blue = BJSS forecasts > Consensus

Source: Bloomberg, Bank J. Safra Sarasin, 06.03.2024

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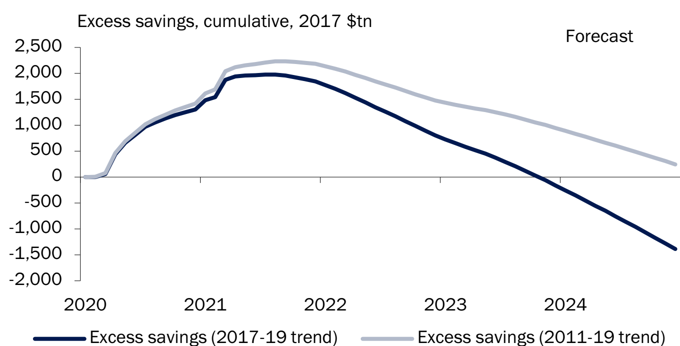
US GDP growth should slow later this year but inflation is likely to be stickier than generally assumed

Still, this doesn't mean that growth will not slow. We think that consumer spending cannot continue to grow at the same brisk pace as last year. In part because a lot of the 'excess savings' have probably been spent (Exhibit 2) ("Questions about US economic resilience remain" – *Cross-Asset Weekly*, 01.03.2024). But also, because the disinflationary impulse from the normalisation of the supply side of the economy, which acted as a tax cut, will not be repeated (Exhibit 3). We forecast US GDP growth on a quarterly sequential basis to slow from 2% in the first quarter to 1.2% in the other three quarters of the year. We then expect growth to move back to trend by the second half of 2025. Counterintuitively, our forecasts show that the economy will expand by 2.3% in 2024 due to large carry-over effects from 4Q23. We expect inflation to remain stickier than generally assumed, and have raised our CPI growth forecast for the year to 3%, from 2.7%. Inflation in 2025 should also be a bit higher than previously expected, with an average of 2.5% (vs 2.4%).

Risks around our central US scenario remain large

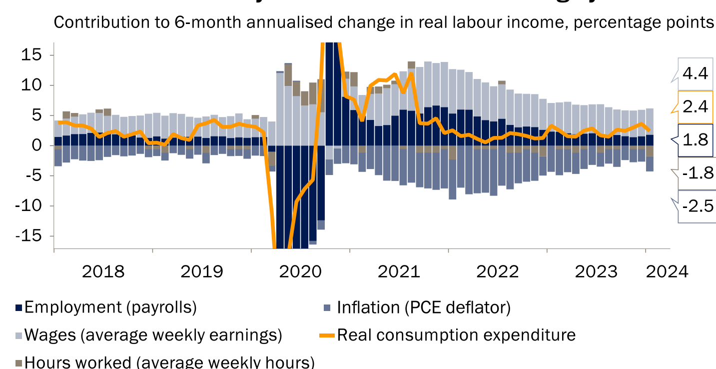
Still, the risks around our new central scenario, for which we assign a probability of 55%, remain large. The risks of a 'hard landing' (below-trend growth, below-target inflation) sits at 30%, and those of a 'no landing' (above-trend growth, above-target inflation) at 15%.

Exhibit 2: Excess savings might have been exhausted



Source: Macrobond, Bank J. Safra Sarasin, 06.03.2024

Exhibit 3: Disinflationary boost to real incomes is largely over



Source: Macrobond, Bank J. Safra Sarasin, 06.03.2024

The Fed should cut in June and twice more over the rest of the year. We expect four rate cuts in 2025

Changes to our growth and inflation forecasts have led us to revise our path for monetary policy. We now expect the Fed to start easing policy in June with a 25bp rate cut, and then proceed gradually with an additional one every quarter. This would leave the upper band of the Fed funds rate at 4.75% by year end and 3.75% in December 2025. We think that officials will not want to cut at the October FOMC meeting just ahead of the US Presidential election, but September should be a 'live' meeting, in our view. We continue to think that the Fed will start to scale back QT in 2H23.

We continue to expect euro area growth to pick up slowly as the year progresses

We have made fewer changes to our macro forecasts for Europe. Our view that the continent would see almost no growth over the winter months, but that it wouldn't see either a negative spiral between higher unemployment and lower spending is so far panning out. We still expect GDP to expand by around 0.5% this year and 1.1% in 2025. Somewhat stronger consumer spending, on the back of lower inflation and higher real disposable incomes, should drive growth later this year. The global manufacturing cycle appears to have troughed too and we see some green shoots. Corporates appear to have gotten rid of their excess inventories and the credit impulse is turning up (Exhibit 4). External demand should also strengthen as the Chinese government provides more support to the economy in order to meet its newly-set 5% growth target (though we have our doubts on whether it will be achieved).

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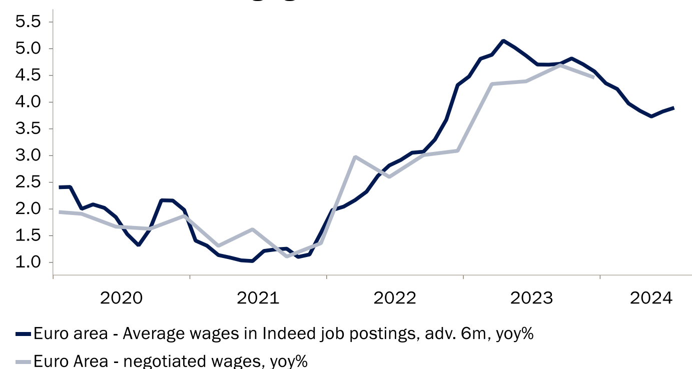
Sticky wage growth is a concern for the ECB. We see a first cut in June and three more over the rest of the year

Euro area inflation should continue to fall, largely on the back of lower energy and producer prices. Still, wage growth is likely to fall only slowly, as the ECB's latest update of its negotiated wage growth tracker shows (Exhibit 5). Despite almost a year of flat-lining economic activity, the labour market remains tight. We therefore expect the ECB to proceed carefully, with a first rate cut in June. The ECB's deposit rate is likely to fall to 3% by year end (instead of 2.75% previously) and 2% by end 2025.

Exhibit 4: ECB bank lending survey has improved

Source: Macrobond, Bank J. Safra Sarasin, 06.03.2024

Exhibit 5: Euro area wage growth remains elevated



Source: Macrobond, Bank J. Safra Sarasin, 06.03.2024

The UK economy is also slowly improving, and lower energy prices should push headline inflation below 2% this spring

The economic situation in the UK seems to be slowly improving, too. Credit surveys have turned more positive there as well, and leading indicators are pointing to a rebound in residential investment (Exhibit 6). Another piece of good news is the new Ofgem price cap, which is set to kick in from April, and should reduce energy bills by 12%. This alone should be enough to push headline inflation below the Bank of England's 2% target for a good chunk of the year, and support consumer spending (Exhibit 7).

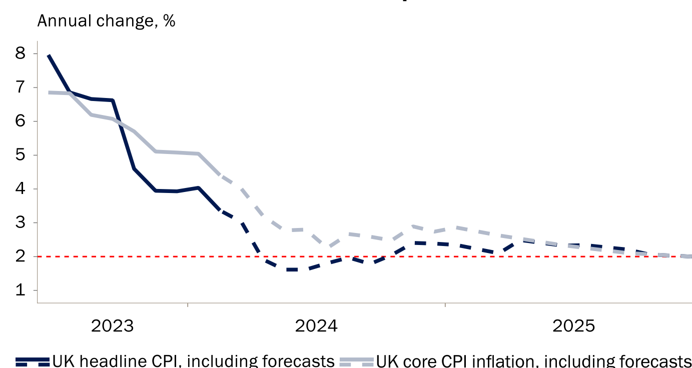
Underlying inflation remains elevated and the BoE will likely wait until August to deliver its first rate cut

Nonetheless, we think the Bank of England (BoE) is likely to wait somewhat longer than the Fed and the ECB to start easing policy. We expect the first cut to come in August only. The main reason for this delayed reaction is that so far, the fall of services inflation and wage growth has been very limited, suggesting that underlying inflation might be stickier than elsewhere. In addition, the BoE thinks that potential growth will average just 1% a year in the coming years, just over half its growth rate before the pandemic. That implies a low speed limit of the economy and a rebound in activity later this year might lead to more persistent inflation. We expect the MPC to cut rates by 75bp cumulatively this year, and another 125bp in 2025.

Exhibit 6: UK residential investment is set for a rebound

Source: Macrobond, Bank J. Safra Sarasin, 06.03.2024

Exhibit 7: UK headline inflation to drop below 2% over next 6 months



Source: Macrobond, Bank J. Safra Sarasin, 06.03.2024

Inflation in Switzerland should stay within the target range. We think the SNB will lower its policy rate in March already

The most important change that we have made to our forecasts for Switzerland is on the timing of the Swiss National Bank (SNB) first rate cut. In our view, the SNB will lower its policy rate in March. As such, it will be the first major advanced economy central bank to pivot to a less restrictive stance. We think the stars are aligned. The SNB is the first advanced economy central bank that has brought inflation back to its target, which ranges between 0 and 2%. And after two low inflation reports this year, the SNB can be more confident that inflation will stay there over its entire projection horizon. Inflation should average 1.5% in 2024 and 1.8% in 2025, below our previous forecasts (1.8% in 2024 and 1.9% in 2025). Indeed, inflationary pressures have declined further in the past months reflecting lower global goods prices, a high real exchange rate and rather weak domestic demand. As a result, risks to the inflation outlook are more balanced and the monetary policy stance doesn't have to be as tight as it was last summer, in our view (see our piece on page 14 for more details).

Shunto should lead to elevated pay gains. The BoJ is likely to end its Negative Interest Rate Policy at its April meeting. Any further rate increases will come only gradually

Finally, we think the Bank of Japan (BoJ) will end its Negative Interest Rate Policy and put a formal stop to Yield Curve Control at its April 25 meeting. Japan has entered a critical period for wage setting, with employers and unions conducting the annual pay round, or 'shunto'. On balance, macro factors suggest that this round of negotiations should lead to a second consecutive year of strong wage gains for employees (Exhibit 8). And the BoJ should have enough information by April 25 to pull the trigger. But we shouldn't conclude that this step will mark the beginning of a sustained series of rate hikes, as Deputy Governor Uchida recently warned. Further rate increases will probably require firm evidence of a shift in the inflation regime. We have therefore flattened out our rate hike profile for the BoJ, with the policy rate moving up to 0.1% (0.2% previously) by the end of this year and 0.2% (0.5% previously) by the end of 2025.

Exhibit 8: A virtuous cycle between wages and prices

Source: Macrobond, Bank J. Safra Sarasin, 06.03.2024

Uneven growth in China: Weak housing, but robust exports and consumption

We continue to see uneven growth in China. On the one hand, home sales have been very weak with January-February sales for the largest 30 cities running at 50% below the same period last year. Chinese property developers continue to make news headlines on doubts about their bond repayments. The housing weakness has kept related industries weak, as shown by the below-50 readings of the NBS manufacturing PMI (Figure 9). On the other hand, manufacturing exports are on an upswing with the Caixin PMI staying above 50 for the last 4 months. Export growth for the first two months of the year rose 7% yoy. Moreover, consumption got a boost from strong Lunar New Year holiday spending (Exhibit 10).

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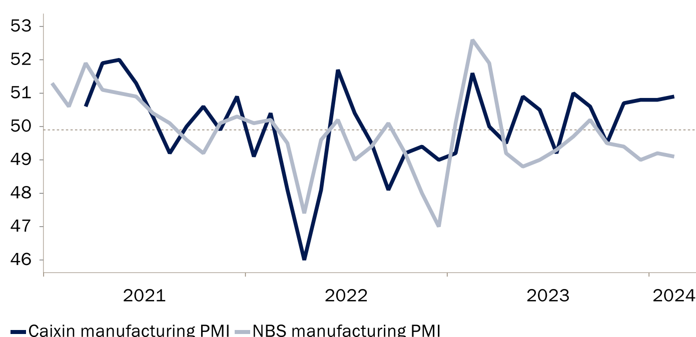
We keep our growth forecast for China at 4.5% despite the new growth target at around 5%

Despite the growth target of "around 5%" announced this week at the National People's Congress (NPC) meeting, we kept our forecast at 4.5% (see more details on the NPC readouts here). While we acknowledge that the modest fiscal expansion and credit support offer upside risks to our growth forecast, we are still worried about the downside risks from the housing market. The government work plan's emphasis has shifted from supporting high quality developers to defusing risks in the real estate sector. In our view, defusing risks may not be sufficient to stabilise the housing market and sentiment. If home sales do not stabilise, there is likely a need for more stimulus or a more aggressive support for property developers. While there is some progress on banks' financial support to unfinished projects (the so-called "white list"), developers' finances remain precarious.

Exhibit 9: Robust export-related manufacturing sector

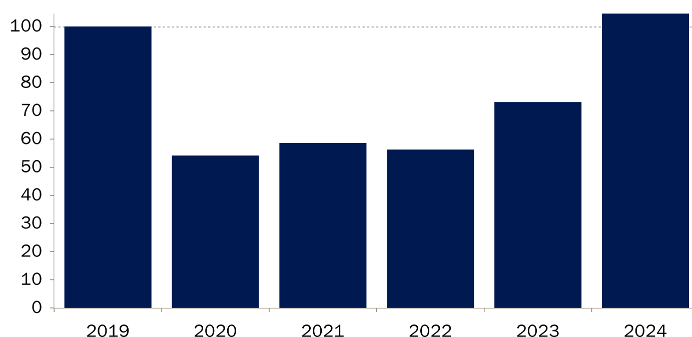
China, Manufacturing PMIs, SA, Index



Source: Macrobond, Bank J. Safra Sarasin, 07.03.2024

Exhibit 10: Strong holiday spending

China, Holiday Tourism Revenues, Spring Festival, Index 2019=100



Source: Macrobond, Bank J. Safra Sarasin, 07.03.2024

Commodity demand will likely slow somewhat this year

Infrastructure spending and manufacturing activity have kept China's demand for commodity imports strong throughout last year. On the metals front, copper demand has been supported by its needs for electricity grid infrastructure as well as electric vehicles (EV) production. While China's State Grid is poised to maintain its investment spending at over 500 billion yuan for another year, investment growth will likely be lower than in 2023. Demand for EVs is also expected to slow domestically after a strong 2023 (Exhibit 11). For iron ore, steelmaking activity seems to have slowed with raw material inventory building up (Exhibit 12). We therefore do not expect iron ore demand to be as buoyant as last year. On the energy side, a more ambitious goal for energy intensity reduction has been set at the NPC, partly to make up for the failure to reach last year's target. This could equate to a lower use of coal and a higher use of renewables (of which the capacity grew at double-digit rate last year).

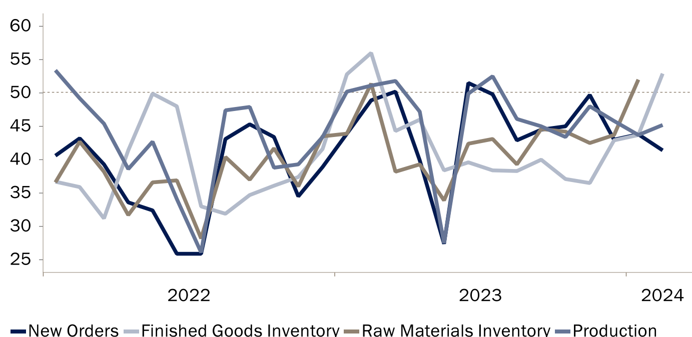
Exhibit 11: We expect EV sales to slow compared to 2023

China, Retail Passenger Cars sales, 2-week moving average, million

Source: Macrobond, Bank J. Safra Sarasin, 07.03.2024

Exhibit 12: Slowing steel manufacturing with weak new orders

China, NBS PMI, Steel Sector, SA, Index



Source: Macrobond, Bank J. Safra Sarasin, 07.03.2024

Fixed income

A shallower policy rate trajectory leads to a shallower bond yield trajectory

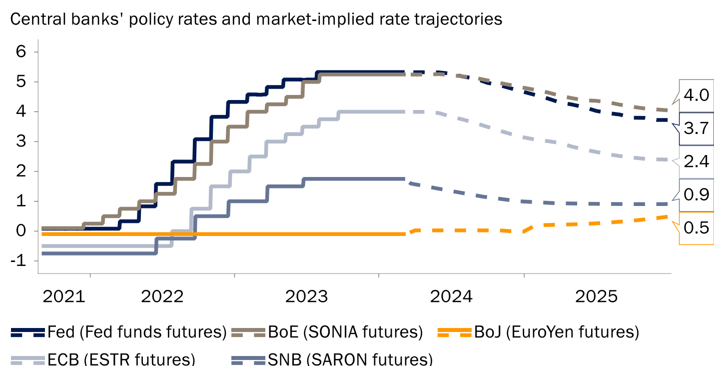
Our revised economic scenario does not incorporate a US recession, but an extended period of sub-par growth. Consequently, we have reduced the number of expected policy rate cuts in 2024 and 2025, mostly in the US and the UK. In line with the shallower downward trajectory for policy rates, we also see a bit less scope for bond yields to fall. That said, we are looking for lower bond yields and steeper yield curves over the next 6 to 12 months.

Market-implied average 10-year policy rates above neutral levels

The current pricing of policy rate trajectories already reflects expectations for a high degree of resilience of DM economies to sharply higher real interest rates. Average policy rates priced in markets are above the levels generally regarded as neutral, while even the market-implied cyclical lows for policy rates are priced to remain above neutral. In terms of numbers, markets price cycle lows of roughly 3.5% and an average policy rate of 3.75% in the US and in the UK. In the euro area, the cyclical low is priced at 2.2% and the average policy rate over the next 10 years at around 2.6% (Exhibit 13).

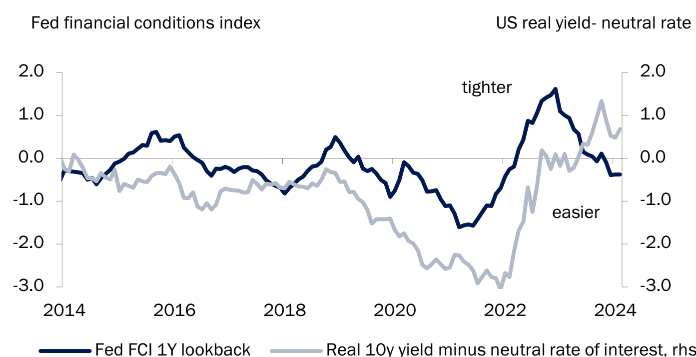
Exhibit 13: Cycle lows for rate expectations above neutral levels

Central banks' policy rates and market-implied rate trajectories



Source: Macrobond, Bank J. Safra Sarasin, 07.03.2024

Exhibit 14: Where policy rate expectations go, bond yields go



Source: Bloomberg, Bank J. Safra Sarasin, 07.03.2024

Markets are not priced for a no-landing scenario

What markets are not priced for is a scenario in which growth remains too strong for inflation to come sustainably down to target. In this case, central banks would not be able to deliver the expected number of rate cuts, hence markets would need to reprice their policy rate projections. 10-year government yields would likely be 50bp to 75bp higher from here at the end of the year, leaving 10-year US Treasury yields closer to 5%.

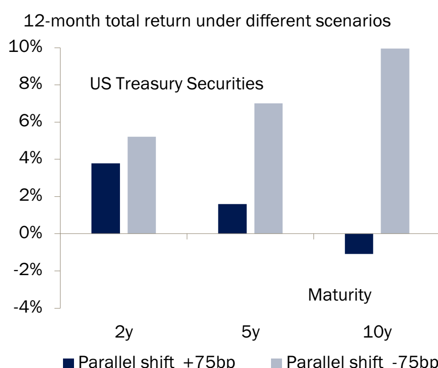
The resilience of DM economies to higher real interest rates, in particular the US, suggests that at least in the short term, monetary policy might not be as restrictive as generally thought. This is reflected by some financial conditions indices, which have loosened over the past few months (see here) (Exhibit 14). Although the odds of a no-landing scenario have risen, we expect economic growth and inflation to slow down enough to allow central banks to lower rates in 2024 and 2025.

We remain constructive on fixed income over the medium term

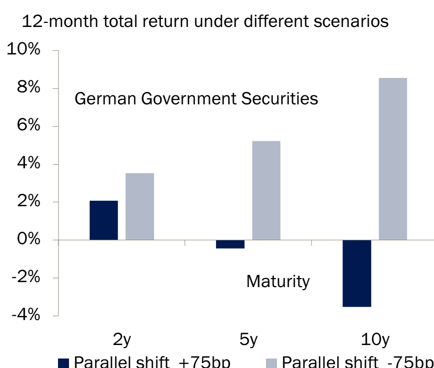
We therefore remain constructive on high-quality fixed income over the medium term, for the following reasons: (1) We are most likely at the end of a global tightening cycle, where the odds for weaker growth surprises and lower inflation are increasing, and where bonds usually do well, (2) forward markets already price DM policy rates to remain above most estimates of the neutral rate in this current cycle and (3) even under a no-landing scenario, most of the rise in yields has already happened over the past 24 months. It is important to note that the current rates structure in developed markets provides a positive asymmetric pay off for bond holders. For example, if US 10-year Treasury yields were to move

up by 75bp, to 5%, over 12 months, the total return for an investor is -1%. Conversely, if yields fall by 75bp, the total return for an investor stands at +10%. A similar logic applies to bonds in other currency spaces (Exhibits 15-17). Hence, high quality fixed income instruments continue to provide a relatively cheap hedge against a more negative economic environment than currently expected.

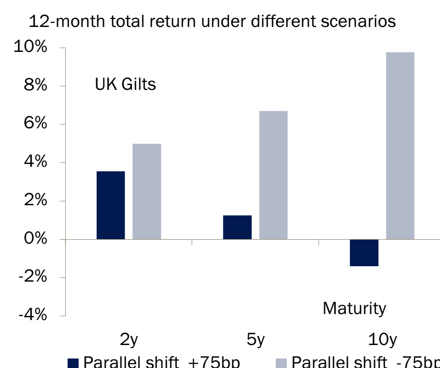
Exhibits 15 to 17: A positive asymmetric 12-month total return pay-off for developed market rates markets



Source: Bloomberg, Bank J. Safra Sarasin, 07.03.2024



Source: Bloomberg, Bank J. Safra Sarasin, 07.03.2024



Source: Bloomberg, Bank J. Safra Sarasin, 07.03.2024

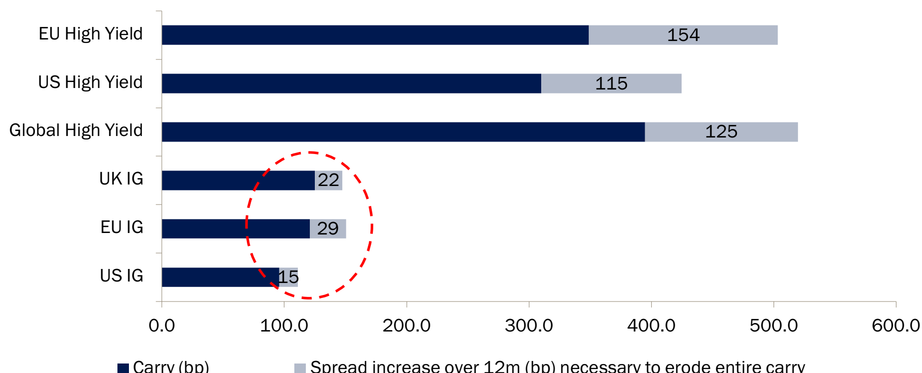
Intermediate maturities should still do well over the next 6 to 12 months

We still expect yields to be somewhat lower in 6 to 12 months, with steeper yield curves. Intermediate maturities (5 to 10 years) should still be preferred: (1) They benefit from steeper yield curves; (2) They have sufficient duration to profit from lower yields, and (3) current intermediate yields provide significant downside protection in an adverse yield scenario.

We remove our preference for IG over HY

Credit spreads of Investment Grade (IG) and High Yield (HY) bonds both trade below their historical medians. We note that valuations in Investment Grade bonds look stretched, providing little cushion against spread widening, in particular for longer-dated bonds (Exhibit 18). This is true for both Developed Market IG and Emerging Markets (EM) sovereign and corporate IG. We therefore downgrade IG to neutral. On the other side, we have upgraded High Yield from slight underweight to neutral. This is not a bullish call on credit, in fact, there is a high probability that credit spreads will rise over the next 6 to 12 months. But in the absence of a US recession, the impact from the widening for this low duration High Yield segment will likely be contained, and a neutral positioned is therefore warranted. We therefore rate both segments now at neutral.

Exhibit 18: IG valuations leave little cushion against spread widening



Source: Bloomberg, Bank J. Safra Sarasin, 07.03.2024

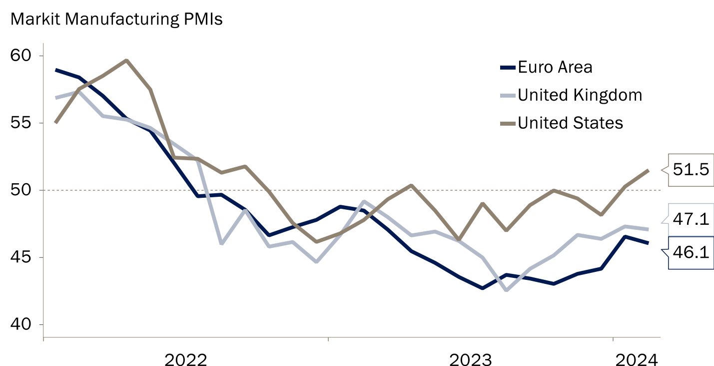
FX

US dollar is supported around current levels, but it should weaken at the margin

Moves in G10 FX have been moderate in past weeks and we expect this to remain the case over the coming months (see our March FX Atlas). Given the recent convergence of central bank policies, we expect little impetus from the monetary front, while the cyclical outperformance of the US justifies a dollar valuation around current levels in the near term. Yet we expect the cyclical strength of the US to fade at some point as the labour market normalises and the savings rate increases. Recent prints suggest that global PMIs have troughed around the end of last year (Exhibit 19), which is particularly visible on the manufacturing side, and should turn relative macro surprises in favour of non-US data. As a result, cyclical currencies now look better supported than just a few months ago.

Exhibit 19: Manufacturing PMIs have likely troughed in 2H23

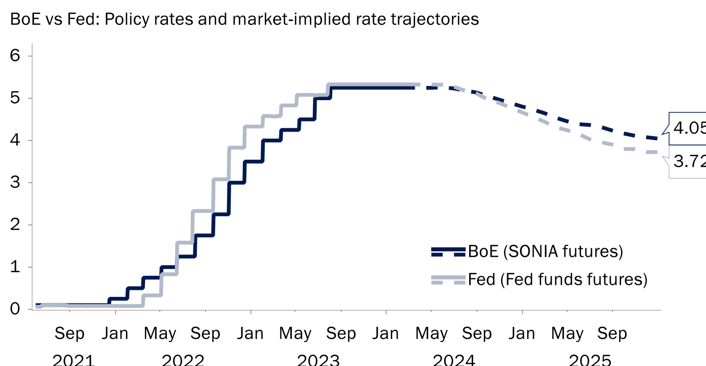
Markit Manufacturing PMIs



Source: Macrobond, Bank J. Safra Sarasin, 07.03.2024

Exhibit 20: Markets are buying into the BoE's hawkish bias

BoE vs Fed: Policy rates and market-implied rate trajectories



Source: Macrobond, Bank J. Safra Sarasin, 07.03.2024

We left our EUR-USD YE target unchanged but revised our GBP-USD profile upwards

This means that the euro should make moderate gains versus the dollar. For EUR-USD, we stick to our year-end target at 1.10, but note the possibility of temporary overshooting. Near term, we have turned constructive on pound sterling as markets are buying into the BoE's hawkish bias (Exhibit 20) on the back of positive real wage growth and a pronounced rebound in services activity. Hence we revised our GBP-USD year-end forecast from 1.22 to 1.28, even if the currency continues to be expensive from a valuation standpoint and should devalue in the longer term. We maintain our constructive stance on the Swiss franc. But we think that the currency is poised to remain weak in the near term, given the elevated possibility that the SNB delivers its first rate cut at its March meeting. Still, EUR-CHF should revert to its January lows later this year.

We expect USD-JPY to drop meaningfully on the back of a likely end to NIRP; the odds of a near-term correction have risen for gold

We stick to our expectation that the yen should post substantial gains on the back of the likely end to the Japanese Negative Interest Rate Policy (NIRP) that we expect the BoJ to announce at its April Meeting. Yet disappointing Q4 growth has flattened the BoJ's prospective rate hiking path, leading us to moderate our projections for yen appreciation. As a result, we have revised our USD-JPY year-end target up from 130 to 138. We leave our year-end target for gold unchanged at $2'100 per troy ounce, in spite of the stellar performance the metal has delivered in the past days. While recent gains are partially backed by lower real yields and a moderately weaker US dollar, the moves look somewhat outsized and hence we think that the odds of a near-term correction have risen.

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Equities

We are upgrading our end-year target for the S&P 500 to 5400

We have upgraded our equity market end-year targets across the board. Most notably, we have revised our S&P 500 target to 5400, from 5100 previously. The main reason for this upgrade is our expectations for higher GDP growth. Indeed, our US growth forecast no longer foresees a recession this year. As a result, earnings should see more pronounced gains than previously assumed. We expect S&P 500 12-month forward EPS to rise by around 13% by the end of the year, to USD278, while valuations are set to slip only slightly from current levels (Exhibit 21). Given the fundamental strength of the US corporate sector, underpinned by tech, structurally higher valuations seem to be justified.

Exhibit 21: Stronger GDP growth translates into higher earnings expectations for S&P 500

S&P 500 end-2024		PE	US GDP growth 2024										
			-0.5%	0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	3.0%	3.5%
2025 EPS			232	242	251	260	269	278	288	297	306	297	306
Real	0	20.9	4853	5045	5238	5431	5624	5817	6009	6202	6395	6202	6395
Fed	10	20.6	4796	4986	5177	5367	5558	5748	5939	6130	6320	6130	6320
Funds	20	20.4	4739	4927	5116	5304	5492	5680	5869	6057	6245	6057	6245
future	30	20.2	4682	4868	5054	5240	5426	5612	5798	5984	6170	5984	6170
(bps)	40	19.9	4625	4809	4993	5177	5360	5544	5728	5912	6095	5912	6095
	50	19.7	4568	4750	4932	5113	5295	5476	5658	5839	6021	5839	6021
	60	19.4	4512	4691	4870	5049	5229	5408	5587	5766	5946	5766	5946
	70	19.2	4455	4632	4809	4986	5163	5340	5517	5694	5871	5694	5871
	80	18.9	4398	4573	4747	4922	5097	5272	5446	5621	5796	5621	5796
	90	18.7	4341	4514	4686	4859	5031	5204	5376	5549	5721	5549	5721
	100	18.4	4284	4455	4625	4795	4965	5135	5306	5476	5646	5476	5646
	110	18.2	4228	4396	4563	4731	4899	5067	5235	5403	5571	5403	5571
				Downside scenario			New base case			Upside scenario			

January base

Source: Refinitiv, Bank J. Safra Sarasin, 06.03.2024

Recent macro data has improved, with ISM momentum turning positive again

Tactically, the macro backdrop has also brightened over recent months. The best lead indicator for the market, ISM momentum, has continued to trend higher, and risk assets have followed. Interestingly, ISM momentum actually troughed at typical non-recession lows, in November 2022, close to the equity market's low in the month before (Exhibit 22). Had one known at the time that a recession could be avoided, the trough in ISM momentum would have provided a reliable indication that equity markets were entering a sustained move higher. However, back then, our expectations, as well as the broad consensus perceived this cycle to be different.

Improving financial conditions should translate into further improving macro momentum

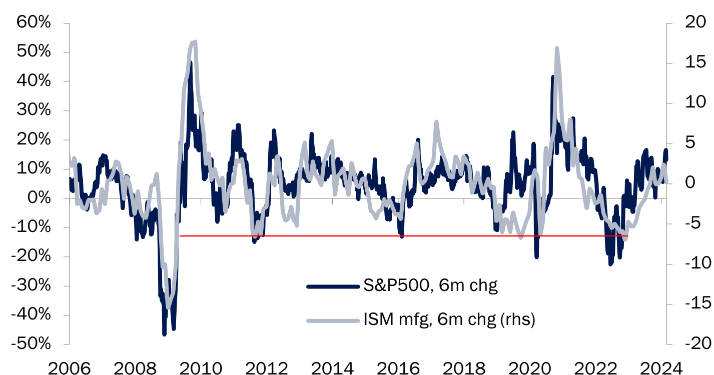
Fast forward to today, ISM momentum should remain in positive territory over the coming months. One reason for this assumption is that the manufacturing ISM itself remains at fairly depressed levels, with the February reading below 48. In a normal cycle, the ISM would typically rise above 55, before rolling over again. This would suggest that there's plenty of room for it to rise before another cycle peak is reached. Recent bank lending surveys further support the view that ISM momentum should continue to move higher from here. The Senior Loan Officer Opinion Survey (SLOOS), which points towards easing financing conditions in the US, suggests that ISM momentum should rise in the months ahead (Exhibit 23). These data would support tactical upside for equities until year-end.

The recent rally appears stretched, with better entry points likely in the coming weeks

A reason to be cautious, at least in the short term, is the extent and duration of the recent rally. After an almost uninterrupted increase over the past four months, risks of a temporary setback have risen. This would (i) follow the typical pattern of equity market rallies since 2021 and (ii) not come as a major surprise, given that valuations have surged back to levels last seen in January 2022 (Exhibit 24). We would thus caution against adding too

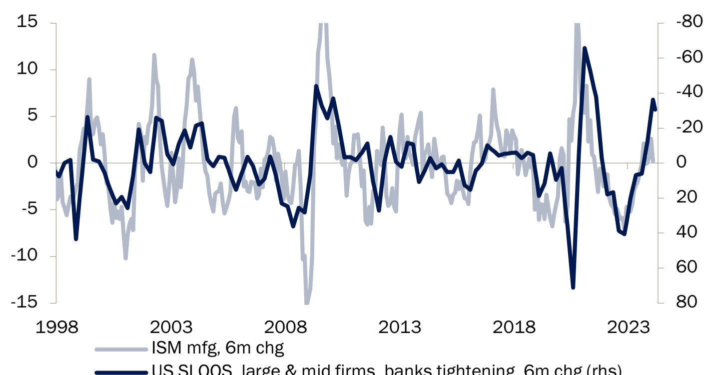
much risk in the coming weeks, but feel confident that market upside should materialise by the end of the year.

Exhibit 22: ISM momentum troughed Nov 22, a month after the S&P



Source: Refinitiv, Bank J. Safra Sarasin, 06.03.2024

Exhibit 23: ISM momentum should continue to improve

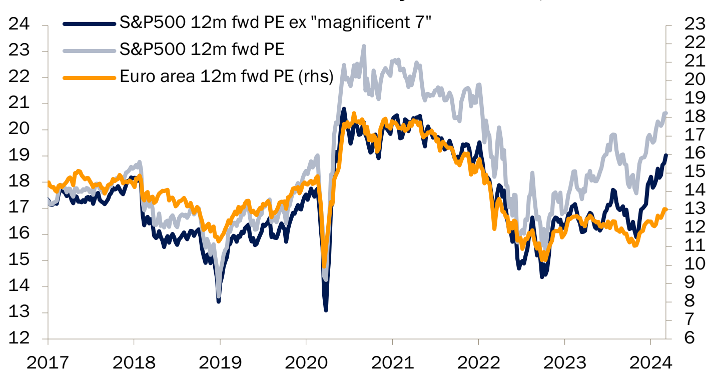


Source: Refinitiv, Bank J. Safra Sarasin, 06.03.2024

We reiterate our preference for euro area equities

Less stretched than US valuations are euro area multiples, which have only recovered back to levels last seen in 2023. Combined with a macro environment that has brightened significantly over recent months, we expect euro area equities to outperform tactically and reiterate our positive view on the region (Exhibit 25). This may at some point also start to provide more support to euro area small caps, which have not participated in the recent rally. Typically, these are more domestically-exposed. Once global dynamics start to feed through to euro area domestic demand, euro area small caps should benefit.

Exhibit 24: US PEs are back to January 2022 levels, EMU PEs not



Source: Refinitiv, Bank J. Safra Sarasin, 06.03.2024

Exhibit 25: Euro area macro surprises have risen sharply vs global

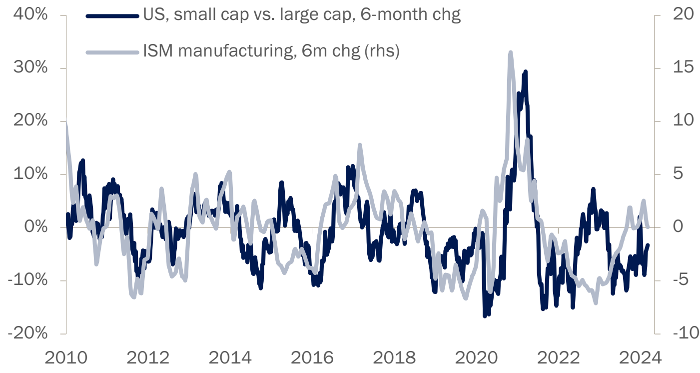
Source: Refinitiv, Bank J. Safra Sarasin, 06.03.2024

Improving manufacturing data and falling rates are a perfect environment for small caps

While it may take somewhat longer for euro area small caps to perform, we reiterate our preference for US small caps. As flagged earlier, the combination of a strengthening manufacturing cycle and moderating rates is a boon for US small caps, which have suffered disproportionately from the macro backdrop since the beginning of 2021 (Exhibit 26). The starting point also looks a lot more attractive than for large caps, with valuations well below their long-term averages (Exhibit 27).

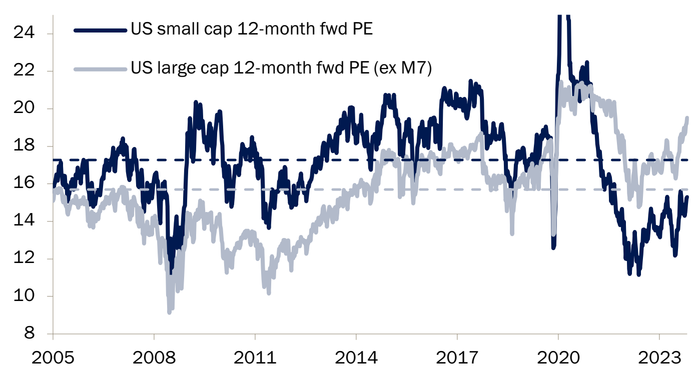
Bottom-line, we are turning more optimistic on equities with 5% to 10% upside until the end of the year, but caution against adding too much risk after the recent rally. A better entry point may be reached in coming weeks. Tactically, we reiterate our preference for euro area equities and US small caps.

Exhibit 26: US small caps have room to catch up with ISM momentum



Source: Macrobond, Bank J. Safra Sarasin, 06.03.2024

Exhibit 27: Moderate small-cap multiples compared to large caps'



Source: Macrobond, Bank J. Safra Sarasin, 06.03.2024

Exhibit 28: JSS Forecast overview

Breakdown per Asset Class

Equities Countries / Regions	
USA	→
Eurozone	↑
Switzerland	↑
United Kingdom	↓
Japan	↓
Emerging Markets	→
China	→

Equity Sectors	
Energy	→
Materials	↓
Industrials	↓
Consumer Discretionary	→
Consumer Staples	↑
Health Care	↑
Banks	↓
Insurance	→
Information Technology	→
Communication Services	→
Real Estate	→
Utilities	↑

Fixed Income Performance	
US Treasuries	↑
German Bunds	↑
UK Gilts	↑
Swiss Eidgenossen	→
IG Credit	→
HY Credit	→
EM USD Government Bonds	→

↑ **Overweight** → **Neutral** ↓ **Underweight**

Asset class views (overweight, neutral, underweight) express a tactical recommendation with a 3-month horizon. Tactical views might diverge from year-end stock index targets, which are based on our long-term economic and interest rate forecasts.

Stock Index Price Targets

	06.03.	2Q24	4Q24	4Q25
S&P 500	5'105	5'100	5'400	5'800
MSCI UK	2'204	2'150	2'300	2'450
DJ Euro Stoxx 50	4'915	5'000	5'200	5'500
DAX	17'717	18'000	18'900	20'000
SMI	11'546	11'800	12'200	12'800
MSCI Japan	1'691	1'500	1'650	1'750
MSCI EM	1'028	1'050	1'100	1'150
MSCI China	54	57	59	62

Key Policy Rates in %

	06.03.	2Q24	4Q24	4Q25
US Fed Funds	5.50	5.25	4.75	3.75
EUR Depo Rate	4.00	3.75	3.00	2.00
SNB Target Rate	1.75	1.25	1.00	0.75
BoE Base Rate	5.25	5.25	4.50	3.25
BOJ Policy Balance Rate	-0.10	0.00	0.10	0.20

Bond Yields (10yr Benchmark)

	06.03.	2Q24	4Q24	4Q25
USA	4.14	3.90	3.80	4.30
Germany	2.31	2.10	2.05	2.35
Switzerland	0.77	0.80	0.80	1.15
United Kingdom	3.99	4.00	3.80	3.45
Japan	0.71	0.75	0.90	1.10

FX-Forecasts

	06.03.	2Q24	4Q24	4Q25
EUR-CHF	0.96	0.97	0.93	0.93
EUR-USD	1.09	1.10	1.10	1.12
EUR-GBP	0.86	0.86	0.86	0.90
GBP-USD	1.27	1.28	1.28	1.24
USD-JPY	149	142	138	130
USD-CHF	0.88	0.88	0.85	0.83
USD-CNY	7.20	7.20	7.10	7.05
Gold, USD per ounce	2'146	2'050	2'100	2'100

Macro Forecasts

		2023	2024	2025
US	GDP	2.5	2.3	1.4
	CPI	4.1	3.0	2.5
Euroland	GDP	0.4	0.5	1.1
	CPI	5.4	2.6	2.3
Switzerland	GDP	0.7	0.9	1.0
	CPI	2.1	1.5	1.6
UK	GDP	0.1	0.1	1.0
	CPI	7.3	2.3	2.2
Japan	GDP	1.9	0.7	0.9
	CPI	3.3	2.3	1.9
China	GDP	5.2	4.5	4.5
	CPI	0.3	1.1	2.4

Swiss Macro

The SNB should cut its policy rate in March

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The Swiss National Bank (SNB) is the first big central bank that has brought back inflation to its target range of 0–2%. After two low inflation prints this year, the SNB can be more confident that inflation will remain within the band over the entire projection horizon than it was in December. Inflationary pressures have declined further in the past months reflecting lower global goods prices, a strong exchange rate and a slowly growing domestic economy that is limiting wage pressures. As a result, risks to the inflation outlook are more balanced, meaning they could be on both sides of the target range. In such a situation, monetary conditions don't have to be as tight as they were last summer. Therefore, we expect a rate cut by 25bp to 1.5% on March 21 and a reduction of the inflation forecast for 2026 to 1.5% from 1.6% so far.

Inflation surprised on the downside

Low February inflation data have shown that the big downside surprise in January was not a one-off. Headline inflation fell to 1.2% yoy in February. The core rate (1.1%) and the inflation rate ex partly regulated rents (0.8%) are even lower. Even if inflation is picking up slightly in March as a result of the early timing of Easter this year, average inflation in the first quarter will be around half a percentage point lower than the 1.8% the SNB projected in December. Will it stay that low?

A negative output gap should reduce corporate margins

Let's start by looking at the Swiss economy as a whole. GDP growth in Q4 was slightly below potential such that the output gap should be closed by now. Weak growth prospects for Switzerland's main trading partners and forward-looking indicators for Switzerland indicate that GDP growth is likely to remain below potential in the first half of this year, such that the output gap will turn negative soon. Capacity utilization of the industry is already far below its long-term average. As a consequence, corporate margins are more likely to shrink and are unlikely to be a source of increasing inflationary pressures.

No second-round effects from the inflationary shock: wages are no risk to the inflation outlook

Similar arguments can be made for the labour market. Unfilled vacancies have fallen and the unemployment rate has increased, admittedly from a very low level. And even if job losses are concentrated in the export-oriented manufacturing sector that is suffering from the low global goods demand and the real appreciation of the Swiss franc, labour demand has cooled off in other sectors as well. Fewer companies in the services sector are reporting that labour scarcity is their main concern. Therefore, it should be no surprise that wage expectations for this year have fallen to 1.8%. With Hotels & Catering being the only exception, wage expectations are within the inflation target range for all other sectors. Taking some productivity growth into account, it is safe to conclude that the risk of second round effects through higher wages is minimal by now.

Low goods prices are the main reason why inflation fell that quickly

Let's continue by looking at different components of the inflation basket. The main source of lower inflation has been the goods sector where prices are barely above last year's level (0.1%). We may have seen the most sizeable adjustments of goods prices already as pandemic related bottlenecks and impaired supply chains are no topic anymore and energy prices have also normalized. Yet producer prices for the domestic market are still negative (-2.3% yoy in January). With a certain lag, "upstream" producer prices are feeding into "downstream" consumer prices. Given that producer prices have fallen even more strongly in the euro area (-8.6% yoy in January) and the strong appreciation of the Swiss franc (6.9% yoy in January), imported deflation will reinforce the disinflationary trend in the goods sector in the coming months as well.

Services sector inflation is elevated only due to increasing rents

We acknowledge that the Swiss franc's real exchange rate is around 4% above its long trend already. This makes another strong appreciation unlikely, such that its disinflationary effect may fade in the coming months. Therefore, it is important to look at potentially more stable domestic prices separately. Prices of domestically produced goods and services have increased by 1.9% yoy, mainly reflecting elevated prices for private services (2.2% yoy). In most countries and at most times, this would be a warning sign that the underlying inflationary pressures remain elevated. In Switzerland, this is currently more a reflection of higher housing rents increasingly due to regulatory reasons. In February, rents contributed half a percentage point to the inflation rate. In other words, headline inflation ex rents amounted to 0.8% yoy only. This is the underlying inflation rate that the SNB should focus on as rent adjustments are one-offs by nature.

Box 1: Swiss rent inflation and regulation

We expect a final adjustment of the reference rate in September

In Switzerland, rents may be adjusted if mortgage rates increase. In turn, tenants may demand lower rents if mortgage rates fall. The idea is that landlords' costs also fluctuate with the interest level of their mortgages. For that reason, a mortgage reference interest rate is published quarterly. This reference rate has been raised in June and December 2023 by 25bp and allowed rent increases by 3% each. As rents are adjusted with a delay, the December adjustment should be visible in May and lead to slightly higher average inflation in Q2. Current rates for new mortgages exceed the average of existing mortgages of 1.7% by round 30bp. The average rate of existing mortgages has never changed by more than 15bp in a quarter since the financial crisis. For this reason, we expect the next and final adjustment of the reference interest rate to 2% only in September instead of June as we did so far. This would allow landlords to increase rents from next January onwards.

The policy rate can be lowered as financial conditions are quite restrictive now

We conclude that inflation is unlikely to exceed the upper band of the target range of the SNB until end 2026. In our view, this outlook is not compatible with current financial conditions. These might be even tighter than last summer as the real effective exchange rate (4.3% yoy in January) is showing the most sizable deviation from its long-term trend since the SNB abandoned its exchange rate floor versus the euro in January 2015. Hence, it is only a question of time before the SNB can lower its policy rate.

Tactical considerations also speak for an early rate cut

Tactical considerations come into play with respect to the timing of a first rate cut. In order to reinforce their inflation fighting credentials, central banks usually have an asymmetric pay-off from changing policy rates in a 'high inflation' environment. Lowering rates too late seems to be better than lowering rates too early. Doing so together with other central banks seems to be less risky. Given that markets are pricing the ECB and the Fed to cut rates only on June 6 and 12 respectively, it might seem to be safer for the SNB to wait until their meeting on June 20 as well. We believe this would be a mistake for six reasons:

Waiting until the Fed and the ECB may cut in June would be a mistake

1. The SNB should not wait for the Fed or ECB simply because its inflation outlook is different. Switzerland is back to target; the US and the euro area are not.
2. In general, it doesn't seem to be a great idea to base its policy on the rather slow-moving ECB.
3. Market developments may force the ECB and the Fed to cut already in April and May. In that case, it would look odd if the SNB waited until June.
4. It is not true that waiting for another quarter comes with negligible costs. Investment spending for equipment and software as well as for construction declined in the last quarter already. Credit volumes outside real estate are falling sharply. Keeping monetary conditions unnecessarily tight will be a burden for the economy.
5. Waiting until June and cutting more or less in tandem with the ECB by 25bp will not weaken the exchange rate as desired by the SNB. On the contrary, it may lead to upward pressure on the Swiss franc in the coming months as markets are pricing a probability of around 50% for a cut in March. Furthermore, the SNB should consider that

the ECB has more room to cut rates in the coming quarters, simply because its current policy rate is further above the neutral rate than is the case in Switzerland. This would lead to a shrinking interest rate advantage of the euro area versus Switzerland and could lead to upward pressure on the Swiss franc. As the SNB has less “ammunition” to cut than the ECB, it should appear more decisive early on. Being the first big central bank to cut would deliver such a widely recognized effect.

6. Last and by no means least, the SNB as well as we might be underestimating the deflationary trend on the goods side as much as we underestimated the strength and persistence when goods prices increased during the pandemic and the Russian invasion of Ukraine. Imported deflation from China that may try to boost its economy through export-driven growth could reinforce low goods inflation. In other words, risks around the inflation profile are not only to the upside as they were last year. The SNB should consider that there are again downside risks to its inflation target and that it may have underestimated these risks in their last two inflation projections already. With risks to the inflation outlook being more balanced, it would be appropriate to become gradually less restrictive as well. In our view, the risk that a rate cut in March turns out to be a mistake and inflation picks up again is low because even at 1.5% monetary policy would still be in restrictive territory.

Key charts for the Swiss economy

Exhibit 1: Inflation with and without rents

Switzerland, Consumer Price Index in % yoy

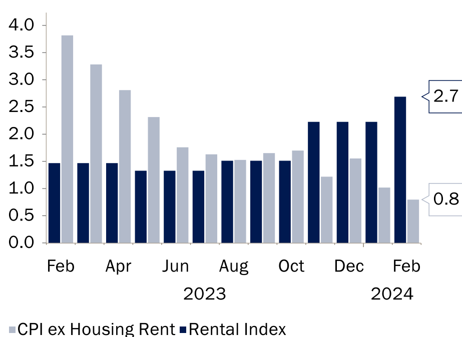


Exhibit 2: Output gap and capacity utilization

Switzerland, Output Gap in %, last SNB data: 2023 Q3

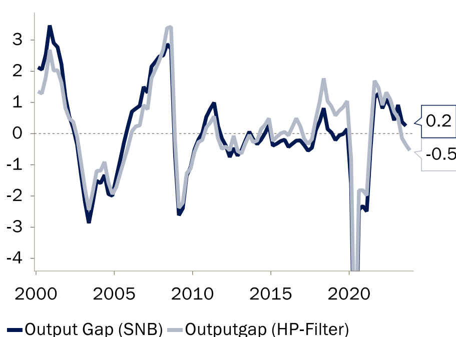


Exhibit 3: Sectoral wage developments

KOF Business Surveys, Gross Wages on Employees, Expected Change in % Next Year, latest data: 2024 Q1

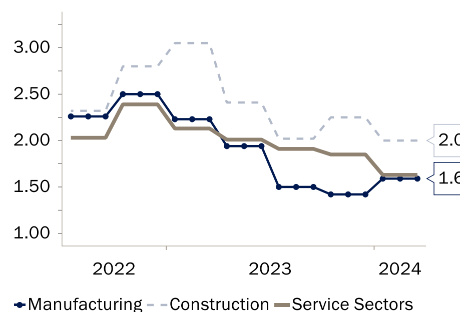


Exhibit 4: Effective exchange rates

Switzerland, SNB, CHF-FX Indices

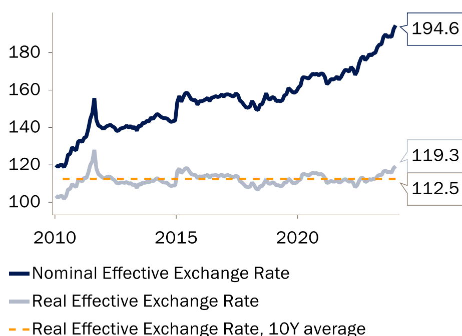


Exhibit 5: Producer and import prices

Switzerland, Producer Prices in % yoy, latest data: 01/2024

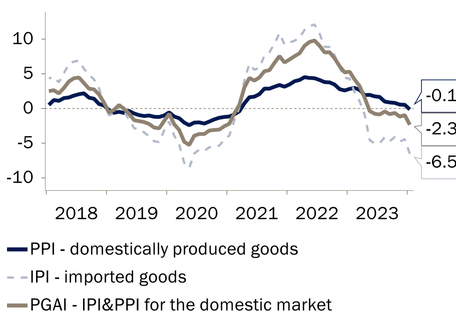
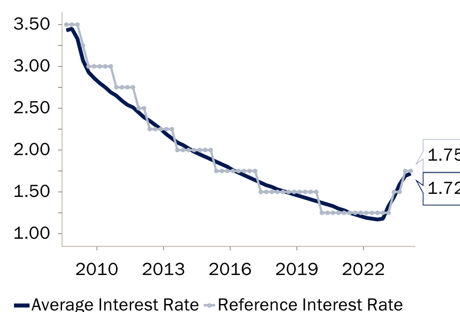


Exhibit 6: Reference interest rate for rents

Switzerland, Mortgage Lending Rates, Swiss Federal Office for Housing, in %



Sources: Macrobond, Bank J. Safra Sarasin, 06.03.2024

Euro area macro

ECB cuts inflation and growth forecasts

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At its meeting on Thursday, the ECB decided to hold all key policy rates constant. The decision was unanimous and rate cuts were not discussed. No decision has been made on the new monetary framework that is now due to be presented on March 13. The inflation projection was reduced for 2024 and 2025, but not for 2026. Accordingly, President Lagarde confirmed that there was more progress on disinflation, though not enough to have full confidence in it. She was particularly unhappy about the elevated level of domestic inflation, reflecting profit margins and wage developments. President Lagarde frequently mentioned that the Governing Council will know a little more in April and a lot more in June, and that it continues with a data dependent approach. This does not close the door to an April cut completely, but makes a cut in June much more likely. However, the data have to go in the right direction. We expect a first rate cut in June, followed by three further cuts until the year end.

Lower inflation projections, but 2026 forecast remains unchanged

The ECB has revised its inflation projections down from 2.7% to 2.3% for this year and from 2.1% to 2.0% for next year. Importantly, though, the 2026 forecast was kept at 1.9%. A downward revision of this medium forecast could have been interpreted as a strong signal for an immediate rate cut. The forecast for core inflation has also been revised down to 2.6% for 2024, 2.1% for 2025 and 2.0% for 2026. They were 0.2 and 0.1 percentage points higher for 2024 and 2025 previously. In particular, the ECB mentioned the elevated level of domestic price pressures as a warning sign for inflation, reflecting high wages and profits. President Lagarde mentioned that labour shortages were less of a problem, which would justify the assumption of waning wage pressures.

Financing conditions are expected to have a dampening impact on economic growth

The ECB expects economic activity to remain subdued in the near term. A loss of competitiveness is part of the reason for the weak growth environment. However, the Red Sea shipping disruptions are not seen as a new major source of supply chain disruptions. Consumption and also investment should lead to somewhat stronger growth later in 2024. Consumption is expected to pick up as real household incomes grow more strongly, reflecting higher wages and lower inflation rates. Staff projections for GDP growth were revised down to 0.6% from 0.8% for 2024. They were left unchanged for 2025 and revised up to 1.6% for 2026 from 1.5% in December. Importantly, the ECB does not expect an increase in unemployment rates during its whole forecast horizon and even forecasts higher employment levels. Risks to growth in general remain to the downside, in particular due to a weaker global economy and geopolitical risks.

First rate cut likely in June

President Lagarde confirmed that the Governing Council was more confident to reach the inflation target, but that rate cuts have not yet been discussed at this meeting. Instead, she mentioned that the ECB would begin discussing the dialling back of restrictive monetary policies presently. While some further information would be available in April, there would be significantly more data published until June, in particular about the inflationary pressures originating from higher wages. As a result, the bar is very high for a rate cut in April. It is equally high for not cutting in June. Therefore, we expect a first rate cut in June, followed by three further cuts until the end of the year.

Economic Calendar

Week of 11/03 – 15/03/2024

Country	Time	Item	Date	Unit	Consensus Forecast	Prev.
Monday, 11.03.2024						
US	16:00	NY Fed 1-Yr Inflation Expectations	Mar	Feb	--	3.00%
Tuesday, 12.03.2024						
UK	08:00	Payrolled Employees Monthly Ch.	Jan	1'000	--	48k
	08:00	Average Weekly Earnings 3M/YoY	Jan	yoy	--	5.80%
US	13:30	CPI Ex Food and Energy MoM	Feb	mom	0.30%	0.40%
EU	13:30	CPI Ex Food and Energy YoY	Feb	yoy	3.70%	3.90%
Wednesday, 13.03.2024						
UK	08:00	Manufacturing Production MoM	Jan	mom	--	0.80%
	08:00	Manufacturing Production YoY	Jan	yoy	--	2.30%
	08:00	Index of Services MoM	Jan	mom	--	-0.10%
	08:00	Index of Services 3M/3M	Jan	3M/3M	--	-0.20%
US	13:00	MBA Mortgage Applications	Mar08	wow	--	9.70%
Thursday, 14.03.2024						
US	13:30	Retail Sales Control Group	Feb	mom	--	-0.40%
	13:30	PPI Ex Food and Energy MoM	Feb	mom	0.20%	0.50%
	13:30	PPI Ex Food and Energy YoY	Feb	yoy	--	2.00%
	13:30	Initial Jobless Claims	Mar9	1'000		--
Friday, 15.03.2024						
US	13:30	Empire Manufacturing	Mar	Index	-8.00	-2.40
	13:30	Industrial Production MoM	Feb	mom	0.00%	-0.10%
	15:00	U. of Mich. Expectations	Mar	Index	--	75.20
	15:00	U. of Mich. 5-10 Yr Inflation	Mar	%	--	2.90%

Source: Bloomberg, J. Safra Sarasin as of 07.03.2024

Market Performance

Global Markets in Local Currencies

Government Bonds	Current value	Δ 1W (bp)	Δ YTD (bp)	TR YTD in %
Swiss Eidgenosse 10 year (%)	0.72	-7	2	0.1
German Bund 10 year (%)	2.31	-11	28	-1.8
UK Gilt 10 year (%)	4.00	-19	46	-2.7
US Treasury 10 year (%)	4.07	-10	20	-0.8
French OAT - Bund, spread (bp)	45	-4	-9	
Italian BTP - Bund, spread (bp)	132	-16	-36	

Stock Markets	Level	P/E ratio	1W TR in %	TR YTD in %
SMI - Switzerland	11'575	18.4	1.8	4.5
DAX - Germany	17'843	12.7	0.9	6.5
MSCI Italy	1'062	9.1	2.4	10.5
IBEX - Spain	10'320	10.6	3.2	2.6
DJ Euro Stoxx 50 - Eurozone	4'974	14.1	2.0	10.3
MSCI UK	2'207	11.3	1.1	0.6
S&P 500 - USA	5'157	21.4	1.2	8.4
Nasdaq 100 - USA	18'298	33.8	1.4	8.9
MSCI Emerging Markets	1'030	14.4	0.9	0.9

Forex - Crossrates	Level	3M implied volatility	1W in %	YTD in %
USD-CHF	0.88	6.5	-0.7	4.3
EUR-CHF	0.96	4.8	0.3	3.4
GBP-CHF	1.12	5.6	0.5	4.9
EUR-USD	1.09	5.8	1.0	-0.8
GBP-USD	1.28	6.2	1.2	0.6
USD-JPY	147.9	8.6	-1.5	4.8
EUR-GBP	0.85	4.0	-0.2	-1.4
EUR-SEK	11.19	5.9	0.1	0.5
EUR-NOK	11.40	7.1	0.0	1.5

Commodities	Level	3M realised volatility	1W in %	YTD in %
Bloomberg Commodity Index	99	9.4	1.9	-0.1
Brent crude oil - USD / barrel	85	28.0	0.3	9.3
Gold bullion - USD / Troy ounce	2'161	10.3	5.7	4.8

Source: J. Safra Sarasin, Bloomberg as of 07.03.2024

J. Safra Sarasin
Cross-Asset Weekly

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