KeyValue

ASSET MANAGEMENT

MACRO RESEARCH

WEEKLY NEWS ANALYSIS

DATE :
2th June 2024

keyvalueam.com

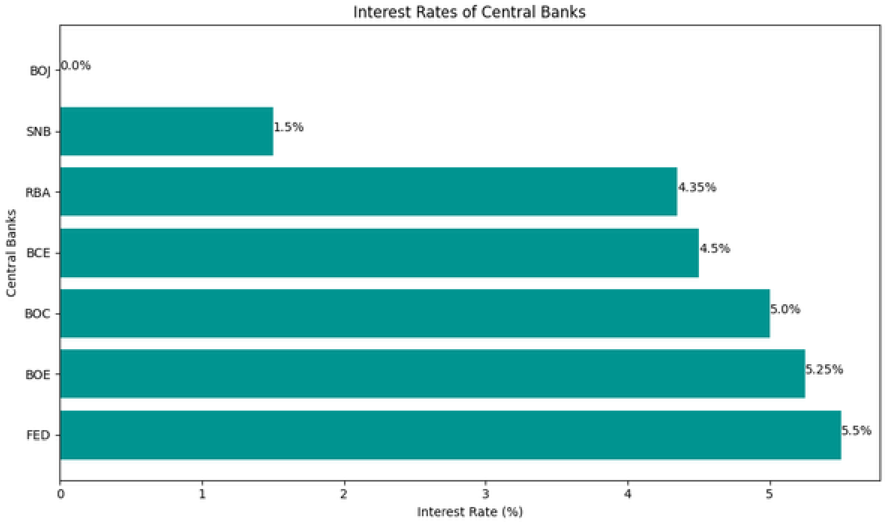
ECB's Monetary Policy and Economic Outlook in 2024

The European Central Bank (ECB) is anticipated to reduce interest rates in 2024 by a total of 100 basis points, according to projections from EY and Oxford Economics. This forecast was discussed at the recent conference "Central Bank Rates Declining: When and at What Pace?" held in Rome. In the Eurozone, GDP growth is expected to be modest, at 0.8% in 2024, rising to 1.8% in 2025. Inflation is projected to average 2.2% in 2024, dropping below the 2% target by the latter half of the year. For Italy, real GDP growth is predicted to be around 0.7%-0.8% in 2024, slightly exceeding 1% in 2025. Inflation is expected to decrease from 5.6% in 2023 to below 2% in both 2024 and 2025.

Nicola Nobile, Chief Italy Economist at Oxford Economics, emphasized the importance of inflation data in determining interest rate trends. He noted that the projected growth for 2025 should not disrupt the disinflation process, thus allowing the ECB to continue easing monetary policy.

In the United States, GDP growth is expected to reach 2.6% in 2024, driven by strong domestic demand. However, inflation is projected at 3.3%, still above the Federal Reserve's target, with anticipated rate cuts of 50 basis points by the end of the year. In China, GDP growth is estimated at 4.7% in 2024, slightly below the government's 5% target. Inflation is expected to be 0.5%, raising concerns about deflation.

The ECB is likely to begin reducing interest rates in June 2024, with further cuts possible throughout the year. The ECB Governing Council has indicated that monetary restrictions may be eased if new assessments confirm that inflation is returning to the 2% target. François Villeroy de Galhau, Governor of the Bank of France, asserted that the ECB should not delay rate cuts unless there are major surprises.



Mario Centeno, Governor of the Bank of Portugal, suggested that rate cuts could exceed 1% in 2024, as inflation might temporarily fall below 2%. The ECB's Bank Lending Survey (BLS) revealed a significant drop in corporate credit demand in the Eurozone during the first quarter of 2024, contrary to banks' expectations for a recovery.

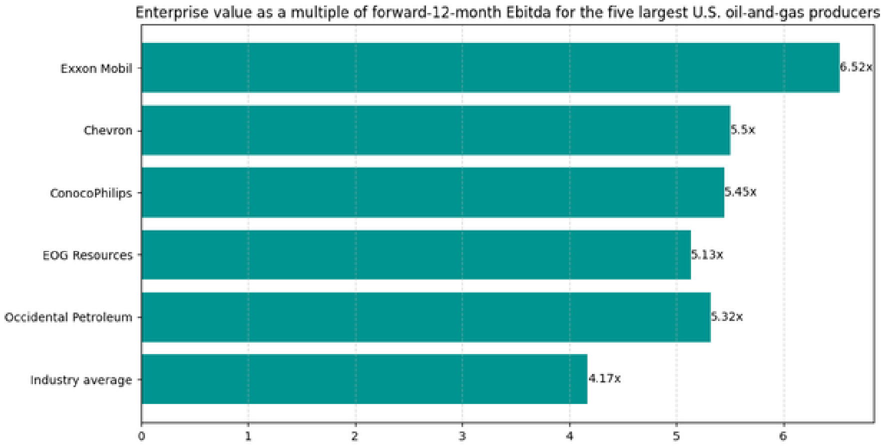
This decline indicates negative prospects for investments and economic growth, with corporate loan demand decreasing due to higher interest rates, reduced economic confidence, and lower fixed investments.

Weak loan demand suggests that investments will likely remain limited in the coming months, maintaining restrictive monetary policy. Easing interest rates will be crucial for investment recovery in the second half of the year. Mediobanca expects loan volumes to increase later in 2025.

In summary, the ECB is set to reduce interest rates in 2024 to support economic growth and control inflation, despite geopolitical uncertainties and differing trends from the Federal Reserve's monetary policy. The first rate cuts are expected in June, with further reductions likely throughout the year, allowing for additional monetary easing.

Commodities: Acquisitions and U.S. Crude Oil Dynamics

In a significant oil industry move, ConocoPhillips has acquired Marathon Oil for $22.5 billion. This deal, including a 15% premium on Marathon's pre-announcement stock price, is expected to greatly boost Conoco's cash flow. While not expanding inventory life or opening new frontiers, it fits well with Conoco's assets. Marathon's mature assets, needing less reinvestment, appeal to cash-focused investors and are likely to boost Conoco's earnings per share right away.ConocoPhillips plans ambitiously post-acquisition, aiming to up its dividend by a third and increase share repurchases by 40% to $7 billion in the first year after the deal. Despite possible antitrust scrutiny over their combined Eagle Ford basin presence, the deal should proceed smoothly, as both firms divested their refining arms a decade ago. This acquisition deals a blow to Devon Energy, losing key targets Marathon Oil and CrownRock to rivals. With most top U.S. oil firms already in deals, remaining buyers might consider higher-production-cost companies. This consolidation trend favors giants like ExxonMobil and Chevron, possibly eyeing more acquisitions. post their current deals. In other news, U.S. crude inventories fell by 4.2 million barrels to 454.7 million barrels for the week ending May 24, surpassing expectations of a 1.4 million barrel decline. Strategic Petroleum Reserve saw a modest 485,000 barrel rise to 369.3 million barrels, while Cushing, Oklahoma hub stocks dropped by 1.8 million barrels to 34.6 million barrels. Refinery capacity utilization rose by 2.6 percentage points to 94.3%, exceeding forecasts. U.S. crude production held steady at 13.1 million barrels per day, with imports up 106,000 barrels per day to 6.8 million barrels per day, and exports down 505,000 barrels per day to 4.2 million barrels per day. Contrary to expectations, gasoline stocks rose by 2 million barrels to 228.8 million barrels, 1% below the five-year average. Gasoline demand fell to 9.1 million barrels per day. Distillate fuel stocks also climbed by 2.5 million barrels to 119.3 million barrels, defying predictions and remaining below the five-year average. In a related sector, Eni's arbitration with the Nigerian government over the OPL 245 production license has been extended three months, to August 2024.



Eni aims to convert the exploratory permit into a production license and recover its €1.208 billion investment, covering initial acquisition and subsequent expenses.

Wood Mackenzie named Eni the top upstream explorer for the fifth time, praising its ability to find significant resources. Other firms like Shell, Galp, and Petronas also received recognition. European natural gas prices hit €35.5 per megawatt-hour on supply concerns from Norway and Austria. Equinor's €1 billion investment in Norway's Troll gas field, Europe's largest, aims to meet 10% of the continent's gas needs. Despite Troll's maintenance delays, reducing flows, Norwegian gas exports to Europe have risen. OMV G warned of potential Russian gas supply disruptions, further pushing prices. Market volatility is driven by U.S. liquefied natural gas project delays and high Asian demand due to an Indian heatwave.

EU Consumer Confidance Indicator (CCI): **May 2024**

The Consumer Confidence Indicator (CCI) for the **European Union (EU)** saw a modest increase in May 2024, rising by **0.5 percentage points** to **-13.2**, while the **Euro Area's CCI** increased by **0.4 percentage points** to **-14.3**. This improvement, though modest, signals a cautiously optimistic shift in consumer sentiment across Europe.

Several key factors have contributed to this uptick:

1. Economic Sentiment Indicator (ESI) Improvement

The Economic Sentiment Indicator (ESI), which reflects the overall economic outlook based on business and consumer surveys, also saw a marginal increase. In May 2024, the **ESI** rose by **0.3 points** in the **EU** and by **0.4 points** in the **Euro Area**, indicating a general improvement in economic conditions and sentiment among businesses and consumers alike.

2. Stable Employment Rates

Employment stability has played a crucial role in bolstering consumer confidence. As of March 2024, the **unemployment rate in the EU** stood at **6.0%**, with the **Euro Area at 6.5%**. Youth unemployment rates also showed a slight decrease. This stability in the labor market has likely contributed to increased consumer confidence as people feel more secure in their employment and income prospects.

3. Retail Trade and Consumer Spending

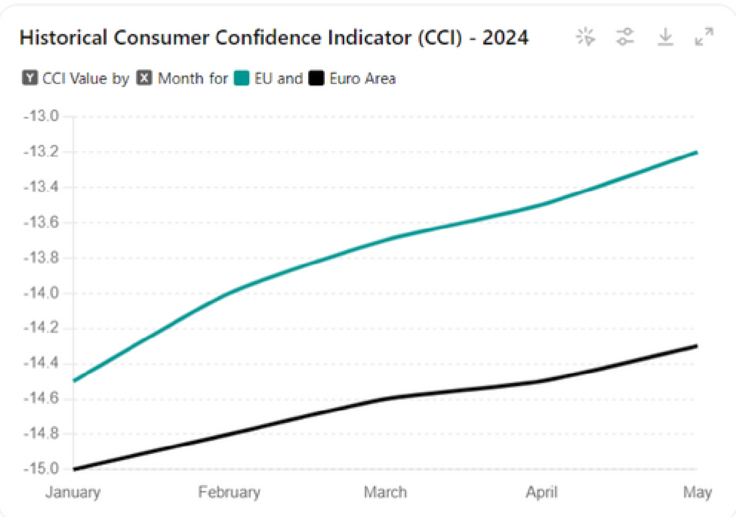
An increase in retail sales has further supported the improvement in consumer confidence. In March 2024, **retail sales** in the **EU increased by 1.2%**, while the **Euro Area saw a rise of 0.8%**. These increases suggest that consumers are spending more, reflecting greater confidence in their financial stability and the economy.

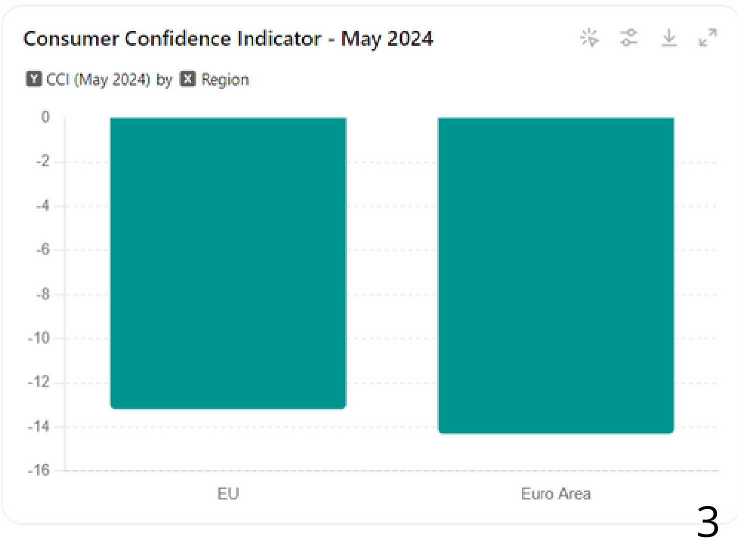
4. Inflation and Interest Rate Management

Effective management of inflation and interest rates by the European Central Bank (ECB) has also been a critical factor. The ECB maintained key interest rates in April 2024, providing a stable financial environment that supports consumer spending and borrowing. Additionally, controlled inflation helps maintain the purchasing power of consumers, contributing to a more positive outlook.

5. Macroeconomic Stability

Overall macroeconomic stability, including investment growth and steady economic policies, has reinforced consumer sentiment. The EU saw a 0.9% increase in gross fixed capital formation (investment) in the first quarter of 2024, further underpinning economic stability and consumer confidence.





A brief look at how the AI revolution is proceeding

One year ago, generative AI burst onto the scene, fundamentally altering how people interact with technology. As AI becomes widely spread in the workplace, both employees and businesses are under extreme pressure. The accelerated pace of work, intensified by the pandemic, has not eased, compelling employees to bring their own AI tools to work, and they won't wait for companies to catch up. While leaders acknowledge AI as a business imperative and feel pressured to show immediate ROI, many lack a coherent plan and vision to transition from individual impacts to organizational transformation.

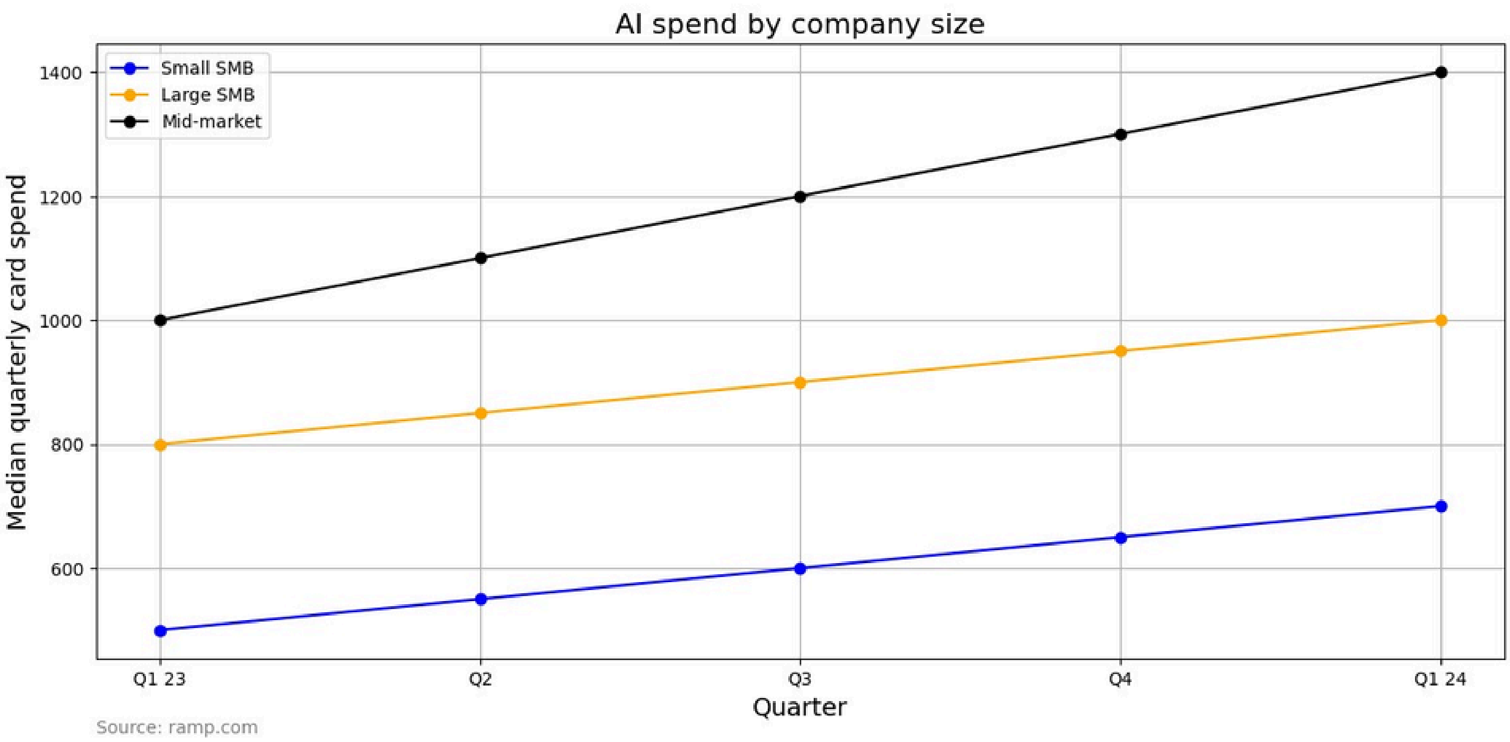
Despite the widespread enthusiasm, significant challenges lie ahead and some worrying signals also. The rapid improvements in AI technology are slowing down, and there are fewer applications for even the most advanced systems than initially imagined. Building and running AI remains prohibitively expensive.

As new, competing AI models emerge, their practical impact on work processes takes time to materialize, raising questions about AI's potential to generate revenue and profits. This situation bears resemblance to the fiber-optic boom of the late 1990s, which led to major crashes during the first dot-com bubble.

A brief look at how the AI revolution is proceeding

A big problem seems to be the slowing pace of AI improvements, which is related to the increasing difficulty in their training. Most enhancements in today's large language models, like OpenAI's ChatGPT and Google's Gemini, have resulted from feeding them increasing amounts of data. However, companies have nearly exhausted the available data from the internet, and the efficacy of synthetic data generated by other AIs remains questionable. According to Gary Marcus, a cognitive scientist, AI capabilities have either plateaued or are improving at a much slower rate. Evidence shows that the performance gaps between various AI models are narrowing, with even free, open-source models catching up to the best proprietary ones.

An interesting theme is the commoditization of artificial intelligence. As AI technology matures, breakthroughs become rare, leading to incremental commoditization. This shift from innovation to cost-efficiency diminishes the edge of performance, making it harder for startups to compete with well-funded giants like Microsoft and Google. Anshu Sharma, CEO of Skyflow, notes that while large companies may entice enough users to justify their AI investments, AI startups might struggle to keep up due to limited financial resources. Already, some AI startups are experiencing turmoil, with key personnel moving to larger firms and others considering selling themselves.



Source: ramp.com

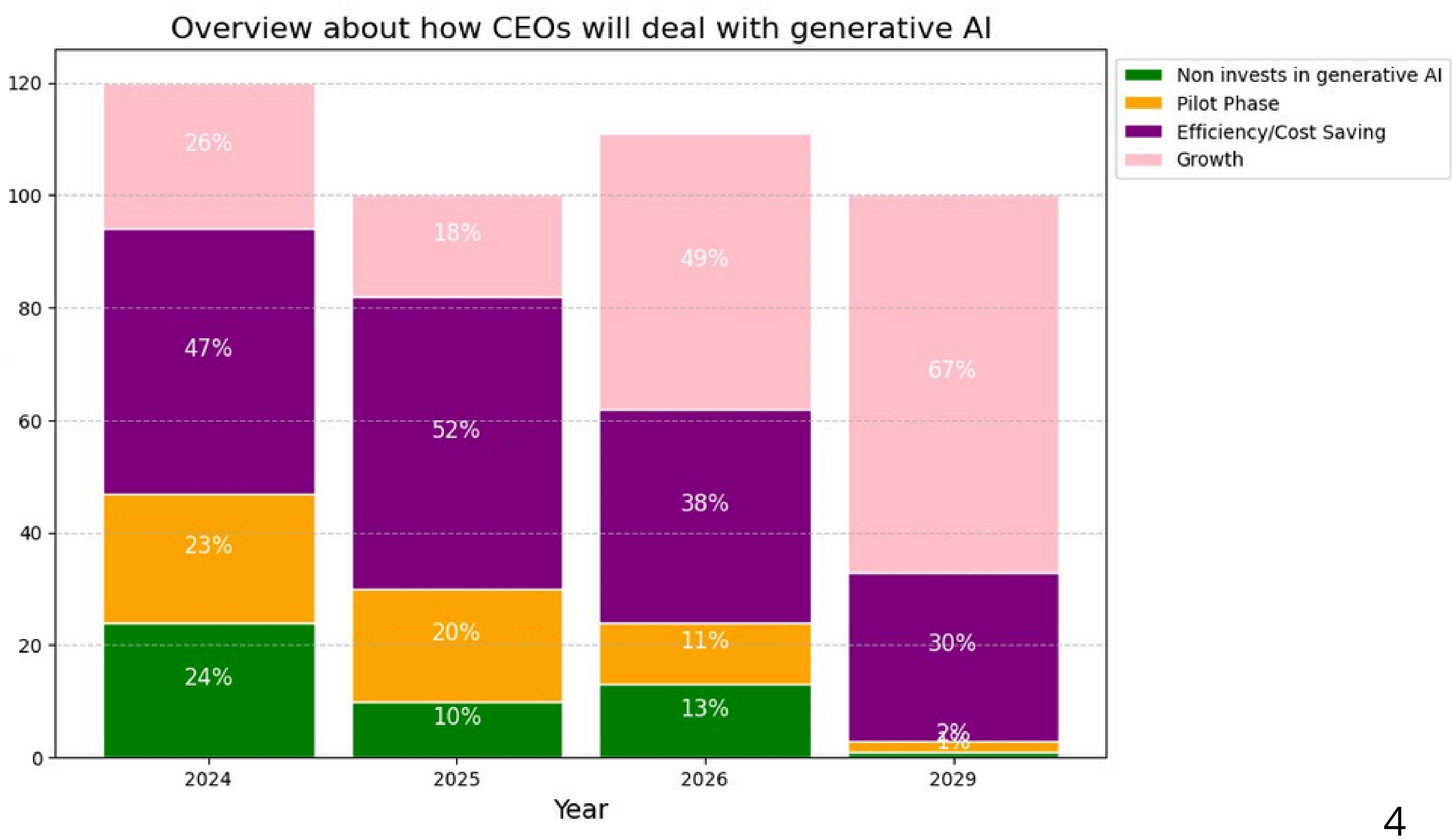
In fact, as mentioned before, running AI models is extremely costly. The resources required for generating AI responses far exceed those needed for traditional computing tasks because AI has to process anew every time a request is made. A calculation by Sequoia Capital highlighted that while the industry spent $50 billion on Nvidia chips to train AI in 2023, it only generated $3 billion in revenue. This disparity underscores the high operational costs that could hinder the long-term sustainability of AI services.

AI adoption in the workplace is significant but varies widely. According to a survey by Microsoft and LinkedIn, 75% of knowledge workers use AI at work, primarily to save time and boost creativity. However, while 79% of leaders agree on AI's critical importance, 59% are concerned about quantifying productivity gains, and 60% believe their companies lack a clear vision for AI implementation.

There is a notable gap between the number of workers experimenting with AI and those relying on it for their daily tasks.

AI is also beginning to reshape the job market. Although there are concerns about job displacement, data shows a growing interest in career changes and a demand for AI skills. Leaders in various sectors are worried about talent shortages, particularly in cybersecurity, engineering, and creative design. While professionals are increasingly acquiring AI skills independently, companies must invest in AI training to attract and retain top talent.

The rise of AI power users, who extensively use AI and reimagine business processes, indicates a potential for significant productivity improvements. However, these users typically work in environments that prioritize AI adoption and provide tailored training.



Source: IBM - CEO Survey 2024

Bibliography

ECB's Monetary Policy and Economic Outlook in 2024

https://www.wsj.com/economy/global/eurozone-rebound-continues-apace-as-germany-leads-recovery-surveys-show-fb9438ff?mod=economy_feat2_global_pos1

https://www.milanofinanza.it/news/ey-oxford-economics-atteso-taglio-dei-tassi-da-parte-della-bce-di-100-punti-base-entro-fine-anno-202405141111172265

https://www.milanofinanza.it/news/la-bce-puo-anticipare-la-fed-sui-tagli-dei-tassi-ecco-le-attese-dei-mercati-e-i-motivi-del-divario-tra-202404122011304986?refresh_cens

https://www.milanofinanza.it/news/tassi-bce-taglio-prima-della-fed-ecb-rate-cuts-certa-riduzione-giugno-non-escluso-luglio-202404112054254432?refresh_cens

https://www.milanofinanza.it/news/tassi-bce-tagli-ecb-rate-cuts-ecco-perche-forte-aumento-salari-germania-puo-essere-un-problema-202404101959103542

https://www.milanofinanza.it/news/ecb-rate-cuts-imprese-calo-inatteso-domanda-prestiti-bce-taglio-dei-tassi-2024040
https://www.milanofinanza.it/mercati/spread-e-tassi

Commodities: Acquisitions and U.S. Crude Oil Dynamics

https://www.wsj.com/business/energy-oil/big-oil-companies-will-just-keep-getting-bigger-ac194ae7?mod=energy-oil_news_article_pos5

https://www.wsj.com/finance/commodities-futures/u-s-crude-oil-stocks-fall-more-than-expected-a505fb95?mod=energy-oil_news_article_pos4

https://www.wsj.com/business/energy-oil/saudi-arabia-aims-to-raise-up-to-12-billion-in-fresh-aramco-stock-sale-8a2387c3?mod=energy-oil_news_article_pos3

https://www.wsj.com/business/energy-oil/new-zealands-biggest-energy-user-commits-to-long-term-e9ec1742?mod=energy-oil_news_article_pos2

https://www.wsj.com/business/energy-oil/saudi-arabia-to-kick-off-aramco-stock-sale-of-up-to-12-billion-6e1936bc?mod=energy-oil_news_article_pos1

EU Consumer Confidance Indicator (CCI): May 2024

https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/business-and-consumer-surveys_en

https://ec.europa.eu/eurostat/web/microdata/household-budget-survey

https://www.ecb.europa.eu/stats/ecb_surveys/hfcs/html/index.en.html

A brief look at how the AI revolution is proceeding

https://www.wsj.com/tech/ai/the-ai-revolution-is-already-losing-steam-a93478b1?mod=wknd_pos1

https://blogs.microsoft.com/blog/2024/05/08/microsoft-and-linkedin-release-the-2024-work-trend-index-on-the-state-of-ai-at-work/

https://ramp.com/blog/q1-2024-spending-insights

https://www.milanofinanza.it/news/intelligenza-artificiale-1-ceo-su-4-non-prevede-di-investire-nel-2024-secondo-ibm-ecco-cosa-temono-e-202405302130014282?refresh_cens

Bibliography

https://www.ibm.com/thought-leadership/institute-business-value/en-us/c-suite-study/ceo

By Google - https://gemini.google.com, Public Domain, https://commons.wikimedia.org/w/index.php?curid=145660492

By OpenAI - OpenAI, Public Domain, https://commons.wikimedia.org/w/index.php?curid=98220235

Analyst

- Gianmarco Gabbiani - gabbianigianmarco5@gmail.com
- Giorgio bonetta - giorgio.bonetta@studbocconi.it
- Michele della Rossa - micheledellarossa94@gmail.com