

Weekly commentary

June 5, 2023

BlackRock

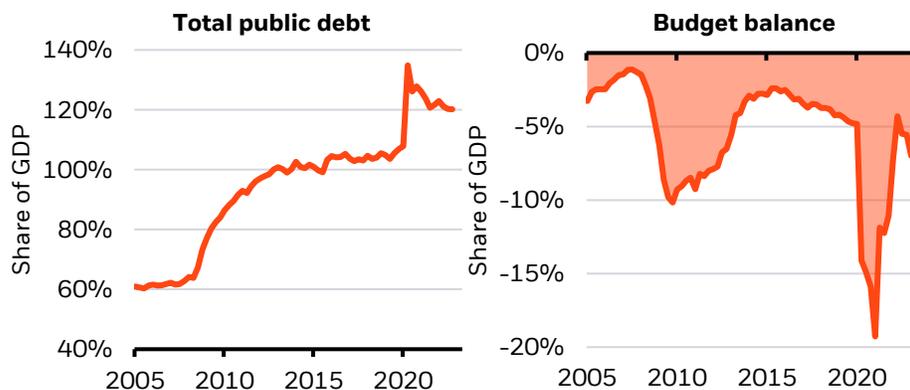
Macro outlook retakes spotlight

- We see the market’s focus returning to higher-for-longer rates and sticky inflation after a U.S. debt ceiling deal. We prefer an up-in-quality portfolio.
- U.S. stocks hit 2023 highs after the debt ceiling deal. Yields rose amid the specter of rate hikes after Friday’s payroll report showed a jump in new jobs.
- China macro data is in focus this week. We trim our growth view slightly as the economic restart loses steam and policy reactions remain uncertain.

Last week’s U.S. debt ceiling deal removes near-term uncertainty and thrusts the market’s focus back to the macro picture: sticky inflation due to tight labor markets. We see rates staying higher for longer as a result. We keep a quality tilt in portfolios and prefer income for now. Over time, we could see the attention shifting to the large U.S. debt load – and investors demanding more compensation for holding long-term government bonds.

Debt dilemma

U.S. total public debt and budget balance, 2005-2023



Source: BlackRock Investment Institute with data from Federal Reserve Bank of St. Louis, Bureau of the Fiscal Service and Refinitiv Datastream, June 2023. Notes: The left chart shows total public debt and the right chart shows the U.S. federal government budget balance, both as a share of GDP.

The U.S. debt ceiling deal has taken the near-term risk of default off the table. Yet the fiscal situation remains challenging, in our view. Total public debt as a share of GDP has jumped to around double the level in 2005 (left chart). The budget deficit is also already large (right chart) at a time when the economy is overheating. The debt deal doesn’t really change this picture, we think. The spending cuts are a fraction of what was cut in the last debt ceiling showdown in 2011: about 0.3% of GDP, according to the Congressional Budget Office, compared with 1% in 2011. We don’t see spending cuts dragging on growth in the same way as a result. But we do think higher-for-longer interest rates will raise debt servicing costs and could leave debt levels growing in this new macro regime. We have said the market focus would move back to the macro picture after the debt ceiling deal – now the Federal Reserve and stubborn inflation are retaking the spotlight.



Jean Boivin
Head – BlackRock Investment Institute



Wei Li
Global Chief Investment Strategist – BlackRock Investment Institute



Alex Brazier
Deputy Head – BlackRock Investment Institute



Nicholas Fawcett
Macro Research – BlackRock Investment Institute

Visit [BlackRock Investment Institute](#) for insights on the global economy, markets and geopolitics.

BlackRock Investment Institute

The pandemic shocked U.S. labor supply, creating worker shortages. The labor market remains extremely tight, as confirmed in the latest payrolls data, with workforce participation not having improved. That is keeping core inflation sticky. This has presented the Fed with a sharp trade-off: crush growth with even higher rates or live with some inflation. We think the Fed will have to keep policy tighter. Markets have already started to mull the possibility of another rate hike even after the Fed signaled a potential pause. Markets are no longer pricing in repeated Fed rate cuts, waking up to our long-held view that rates are likely to stay higher for longer to combat persistent inflation.

Attention could also eventually shift to the broader U.S. fiscal position with rates staying higher, in our view. The relatively smaller spending cuts in the U.S. debt ceiling deal aren't likely to put a dent in the debt load, in our view. They stand in stark contrast with the aftermath of the 2008 financial crisis when the focus swiftly shifted to fiscal austerity. Interest rates were near zero then and debt servicing costs were at record lows. But now rates have jumped in the fastest rate hiking cycle since the 1980s.

Higher rates mean higher debt servicing costs. We think persistent inflation and high debt levels could cause investors to demand more compensation for holding U.S. assets over time, especially long-term Treasuries.

We also expect a burst of Treasury-bill issuance as the government seeks to replenish the money drawn down since the debt ceiling was hit earlier in the year. We estimate bill issuance could balloon to as much as \$1 trillion in the next few months – well above normal issuance levels outside of past crises like the 2008 financial crisis and the pandemic. That could add to volatility in fixed income, in our view, especially in the very short-dated maturities. We tweak our preference for short-term Treasuries as a result, extending the preferred maturities beyond short-term paper to encompass two-year Treasury notes that have repriced in recent weeks.

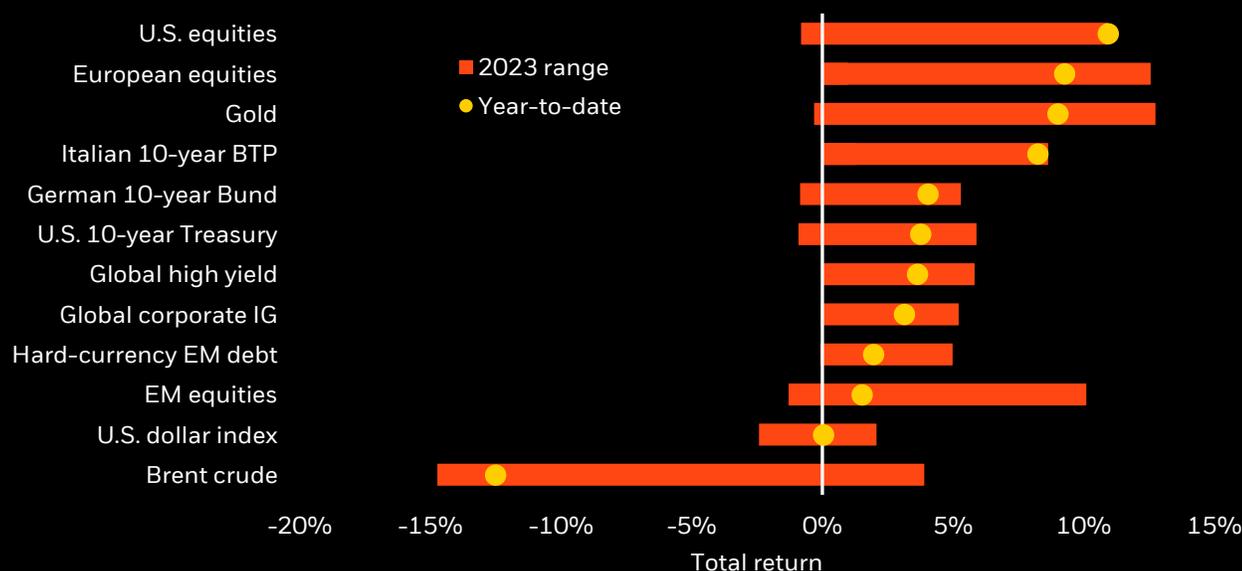
Bottom line: The U.S. debt ceiling deal removes near-term uncertainty – we now expect markets to focus on the macro picture. We see higher-for-longer rates, so we keep our quality tilt in equities and bonds and prefer income for now. We like short-term Treasuries, emerging-market local currency debt and inflation-linked bonds.

Market backdrop

U.S. stocks climbed to 2023 highs after the debt ceiling deal. Yields rose as markets eyed more rate hikes after Friday's payroll report showed a jump in new jobs. The number of jobs added in May was well above market expectations. But the unemployment rate rose with no improvement in labor force participation. We don't think the labor shortage is easing, so wage growth remains elevated. We think that will keep core inflation sticky – and makes rate cuts this year unlikely.

Assets in review

Selected asset performance, 2023 year-to-date return and range



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, with data from Refinitiv Datastream as of June 1, 2023. Notes: The two ends of the bars show the lowest and highest returns at any point in the last 12-months, and the dots represent current year-to-date returns. Emerging market (EM), high yield and global corporate investment grade (IG) returns are denominated in U.S. dollars, and the rest in local currencies. Indexes or prices used are: spot Brent crude, ICE U.S. Dollar Index (DXY), spot gold, MSCI Emerging Markets Index, MSCI Europe Index, Refinitiv Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI Index, Bank of America Merrill Lynch Global Broad Corporate Index and MSCI USA Index.

Macro take

Last week's U.S. jobs report showed 339,000 new jobs were created in May, way above expectations of 195,000. Unemployment rose to 3.7% from 3.4% but the employment-to-population ratio – the share of the total population in work – was little changed. See the chart. That means labor supply hasn't increased. The worker shortage doesn't appear to be easing.

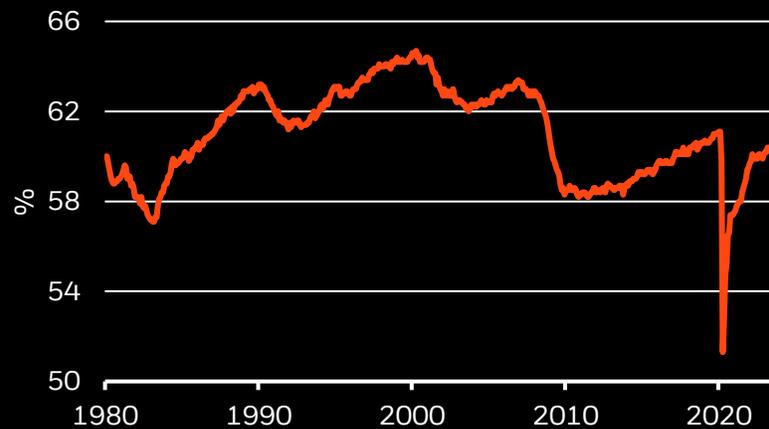
The labor shortage persisting means pay growth isn't slowing down either. Average hourly earnings grew by around 4% in May, still too high to see inflation come back down to the Fed's 2% target. But this measure doesn't adjust for the pandemic's impact on the services sector. The employment cost index (ECI) measure does, and it shows wages rising even more quickly.

This is still a very tight labor market, beset by shortages, and this report leaves the possibility of further Fed hikes firmly on the table, in our view.

Explore our recent Macro take blog posts [here](#).

Sustained labor supply shortage

Employment-to-population ratio, 1980-2023



Source: BlackRock Investment Institute, with data from Refinitiv Datastream, June 2023. Notes: The chart shows the U.S. employment-to-population ratio – the proportion of a country's working age population that is employed.

Investment themes

1 Pricing in the damage

- Recession is foretold as central banks try to bring inflation back down to policy targets. It's the opposite of past recessions: Rate cuts are not on the way to help support risk assets, in our view.
- That's why the old playbook of simply "buying the dip" doesn't apply in this regime of sharper trade-offs and greater macro volatility. The new playbook calls for a continuous reassessment of how much of the economic damage being generated by central banks is in the price.
- In the U.S., it's now evident in the financial cracks emerging from higher interest rates on top of rate-sensitive sectors. Higher mortgage rates have hurt sales of new homes. We also see other warning signs, such as deteriorating CEO confidence, delayed capital spending plans and consumers depleting savings.
- The ultimate economic damage depends on how far central banks go to get inflation down. The Federal Reserve signaled a pause after hiking rates in May. But it also reiterated that persistent inflation means no rate cuts this year. We see the European Central Bank going full steam ahead with rate hikes to get inflation to target – regardless of the damage that entails.
- **Investment implication:** We're tactically underweight DM equities. They're not pricing the recession we see ahead.

2 Rethinking bonds

- Fixed income finally offers "income" after yields surged globally. This has boosted the allure of bonds after investors were starved for yield for years. We take a granular investment approach to capitalize on this, rather than taking broad, aggregate exposures.
- Very short-term government paper looks more attractive for income at current yields, and we like their ability to preserve capital. Tighter credit and financial conditions reduce the appeal of credit.
- In the old playbook, long-term government bonds would be part of the package as they historically have shielded portfolios from recession. Not this time, we think. The negative correlation between stock and bond returns has already flipped, meaning they can both go down at the same time. Why? Central banks are unlikely to come to the rescue with rapid rate cuts in recessions they engineered to bring down inflation to policy targets. If anything, policy rates may stay higher for longer than the market is expecting. Investors also will increasingly ask for more compensation to hold long-term government bonds – or term premium – amid high debt levels, rising supply and higher inflation.
- **Investment implication:** We prefer short-term government bonds over long-term government bonds.

3 Living with inflation

- High inflation has sparked cost-of-living crises, putting pressure on central banks to tame inflation with whatever it takes. Yet there has been little debate about the damage to growth and jobs. We think the "politics of inflation" narrative is on the cusp of changing. The Fed's rapid rate hikes will stop without inflation being back on track to return fully to 2% targets, in our view. We think we are going to be living with inflation. We do see inflation cooling as spending patterns normalize and energy prices relent – but we see it persisting above policy targets in coming years.
- Beyond Covid-related supply disruptions, we see three long-term constraints keeping the new regime in place and inflation above pre-pandemic levels: aging populations, geopolitical fragmentation and the transition to a lower-carbon world.
- **Investment implication:** We're overweight inflation-linked bonds on a tactical and strategic horizon.

Week ahead

June 5

China services PMI; U.S. ISM services PMI

June 9

China CPI and PPI

June 7

China trade data

June 9-16

China total social financing

China macro data is in focus this week as the restart loses steam. We now expect GDP growth to be a bit below 6% this year rather than slightly above as momentum slows and policy reactions remain uncertain. Deflationary pressures and weaker growth increase the odds of potential policy easing, but we think targeted support for sectors like real estate is more likely.

Directional views

Strategic (long-term) and tactical (6-12 month) views on broad asset classes, June 2023

	Underweight	Neutral	Overweight	● Previous view
Asset	Strategic view		Tactical view	
Equities	<p>+1</p>		<p>-1</p> <p>We are overweight equities in our strategic views as we estimate the overall return of stocks will be greater than fixed-income assets over the coming decade. Valuations on a long horizon do not appear stretched to us. Tactically, we're underweight DM stocks as central banks' rate hikes cause financial cracks and economic damage. Corporate earnings expectations have yet to fully reflect even a modest recession. We are overweight EM stocks and have a relative preference due to China's restart, peaking EM rate cycles and a broadly weaker U.S. dollar.</p>	
Credit	<p>Neutral</p>		<p>Neutral</p> <p>Strategically, we are neutral global investment grade. We don't think yields compensate investors for tightening credit conditions. We are neutral high yield as we see the asset class as more vulnerable to recession risks. Tactically, we're neutral investment grade due to tightening credit and financial conditions. We're underweight high yield as we see a recession coming and prefer to be up in quality. We're overweight local-currency EM debt – we see it as more resilient with monetary policy tightening further along than in DMs.</p>	
Govt bonds	<p>Neutral</p>		<p>-1</p> <p>We are neutral in our strategic view on government bonds. This reflects an overweight to short-term government bonds and max overweight to inflation-linked bonds. We stay underweight nominal long-term bonds: Markets are underappreciating the persistence of high inflation and investors likely demanding a higher term premium, in our view. Tactically, we're underweight long-dated DM government bonds for the same reason. We favor short-dated government bonds – higher yields now offer attractive income with limited risk from interest rate swings.</p>	
Private markets	<p>Neutral</p>		<p>—</p> <p>We're underweight private growth assets and overweight on private credit from a starting allocation that is much larger than what most qualified investors hold. We find private credit yields more attractive than in public credit, and we like its floating-rate nature given our view that policy rates will remain higher for longer than markets expect. We think private credit can help fill a lending gap left by banks after sector turmoil. Overall, private assets are not immune to higher macro and market volatility or higher rates, and public market selloffs have reduced their relative appeal. Private allocations are long-term commitments, however, and we see opportunities as assets reprice over time. Private markets are a complex asset class not suitable for all investors.</p>	

Note: Views are from a U.S. dollar perspective. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any particular funds, strategy or security.

Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, June 2023

Underweight
Neutral
Overweight
● Previous view

Asset	View	Commentary	
Equities	Developed markets	<p style="text-align: center;">-1</p>	We are underweight. Earnings expectations and valuations don't fully reflect recession risk. We prefer a sectoral approach: energy and healthcare.
	United States	<p style="text-align: center;">-1</p>	We are underweight. Financial cracks are emerging from Fed rate hikes. We don't think earnings expectations reflect the recession we see ahead.
	Europe	<p style="text-align: center;">-1</p>	We are underweight. The impact of higher interest rates and elevated inflation pose a challenge for earnings, even as the energy shock fades.
	UK	<p style="text-align: center;">-1</p>	We are underweight. Earnings expectations don't fully reflect the economic damage we see ahead.
	Japan	<p style="text-align: center;">-1</p>	We are underweight. The Bank of Japan looks set to wind down its ultra-loose policy. Japan is exposed to the weaker activity we see in other DM economies.
	Emerging markets	<p style="text-align: center;">+1</p>	We are overweight and have a relative preference over DM stocks due to China's powerful restart, peaking EM rate cycles and a broadly weaker U.S. dollar.
	China	<p style="text-align: center;">+1</p>	We see short-term opportunities from China's restart. But geopolitical risks have risen, and we still see long-term, structural challenges and risks.
Fixed Income	Asia ex-Japan	<p style="text-align: center;">Neutral</p>	We are neutral. China's restart is a positive yet we don't see valuations compelling enough to turn overweight.
	Long U.S. Treasuries	<p style="text-align: center;">-1</p>	We are underweight. We see long-term yields moving up further as investors demand a greater term premium.
	Short U.S. Treasuries	<p style="text-align: center;">+2</p>	We are overweight. We prefer short-term government bonds for income as interest rates stay higher for longer.
	Global inflation-linked bonds	<p style="text-align: center;">+2</p>	We are overweight. We see market pricing underestimating the risk of persistently higher inflation.
	Euro area govt bonds	<p style="text-align: center;">-1</p>	We are underweight. We see investors demanding greater term premium, with peripheral bonds at risk from tighter financial conditions.
	UK gilts	<p style="text-align: center;">Neutral</p>	We are neutral. We find gilt yields attractive as they have risen back near levels reached during 2022's budget turmoil. We prefer short-dated gilts for income.
	China govt bonds	<p style="text-align: center;">Neutral</p>	We are neutral. Yields are less attractive relative to those on short-term DM government bonds.
	Global IG credit	<p style="text-align: center;">Neutral</p>	We are neutral. We see tighter credit and financial conditions. We prefer European investment grade over the U.S. given more attractive valuations.
	U.S. agency MBS	<p style="text-align: center;">Neutral</p>	We're neutral. We see agency MBS as a high-quality exposure within diversified bond allocations. But spreads near long-term averages look less compelling.
	Global high yield	<p style="text-align: center;">-1</p>	We are underweight. We think spreads are still too tight, given our expectation for tighter credit and financial conditions – and an eventual recession.
	Emerging hard currency	<p style="text-align: center;">Neutral</p>	We are neutral. We see support from higher commodities prices, yet it is vulnerable to rising U.S. yields.
	Emerging local currency	<p style="text-align: center;">+1</p>	We are overweight due to China's restart, and we see EM debt as more resilient to tightening financial conditions than DM as EM hiking cycles near peaks.
	Asia fixed income	<p style="text-align: center;">Neutral</p>	We are neutral. We don't find valuations compelling enough yet to turn more positive.

Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Note: Views are from a U.S. dollar perspective. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. This information should not be relied upon as investment advice regarding any particular fund, strategy or security.

BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research to provide insights on macroeconomics, sustainable investing, geopolitics and portfolio construction to help BlackRock's portfolio managers and clients navigate financial markets. BII offers strategic and tactical market views, publications and digital tools that are underpinned by proprietary research.

General disclosure: This material is intended for information purposes only, and does not constitute investment advice, a recommendation or an offer or solicitation to purchase or sell any securities to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. This material may contain estimates and forward-looking statements, which may include forecasts and do not represent a guarantee of future performance. This information is not intended to be complete or exhaustive and no representations or warranties, either express or implied, are made regarding the accuracy or completeness of the information contained herein. The opinions expressed are as of June 5, 2023 and are subject to change without notice. Reliance upon information in this material is at the sole discretion of the reader. Investing involves risks.

In the **U.S. and Canada**, this material is intended for public distribution. **In the European Economic Area (EEA):** this is Issued by BlackRock (Netherlands) B.V. is authorised and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311 For your protection telephone calls are usually recorded. **In the UK and Non-European Economic Area (EEA) countries:** this is Issued by BlackRock Advisors (UK) Limited, which is authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL, Tel: +44 (0)20 7743 3000. Registered in England and Wales No. 00796793. For your protection, calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock. **In Italy**, for information on investor rights and how to raise complaints please go to <https://www.blackrock.com/corporate/compliance/investor-right> available in Italian. **For qualified investors in Switzerland:** This document is marketing material. This document shall be exclusively made available to, and directed at, qualified investors as defined in Article 10 (3) of the CISA of 23 June 2006, as amended, at the exclusion of qualified investors with an opting-out pursuant to Art. 5 (1) of the Swiss Federal Act on Financial Services ("FinSA"). For information on art. 8 / 9 Financial Services Act (FinSA) and on your client segmentation under art. 4 FinSA, please see the following website: www.blackrock.com/finsa. **For investors in Israel:** BlackRock Investment Management (UK) Limited is not licensed under Israel's Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 5755-1995 (the "Advice Law"), nor does it carry insurance thereunder. **In South Africa**, please be advised that BlackRock Investment Management (UK) Limited is an authorized financial services provider with the South African Financial Services Board, FSP No. 43288. **In the DIFC** this material can be distributed in and from the Dubai International Financial Centre (DIFC) by BlackRock Advisors (UK) Limited – Dubai Branch which is regulated by the Dubai Financial Services Authority (DFSA). This material is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. BlackRock Advisors (UK) Limited - Dubai Branch is a DIFC Foreign Recognised Company registered with the DIFC Registrar of Companies (DIFC Registered Number 546), with its office at Unit 06/07, Level 1, Al Fattan Currency House, DIFC, PO Box 506661, Dubai, UAE, and is regulated by the DFSA to engage in the regulated activities of 'Advising on Financial Products' and 'Arranging Deals in Investments' in or from the DIFC, both of which are limited to units in a collective investment fund (DFSA Reference Number F000738) **In the Kingdom of Saudi Arabia**, issued in the Kingdom of Saudi Arabia (KSA) by BlackRock Saudi Arabia (BSA), authorised and regulated by the Capital Market Authority (CMA), License No. 18-192-30. Registered under the laws of KSA. Registered office: 29th floor, Olaya Towers – Tower B, 3074 Prince Mohammed bin Abdulaziz St., Olaya District, Riyadh 12213 – 8022, KSA, Tel: +966 11 838 3600. The information contained within is intended strictly for Sophisticated Investors as defined in the CMA Implementing Regulations. Neither the CMA or any other authority or regulator located in KSA has approved this information. The information contained within, does not constitute and should not be construed as an offer of, invitation or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. Any distribution, by whatever means, of the information within and related material to persons other than those referred to above is strictly prohibited. **In the United Arab Emirates** is only intended for - natural Qualified Investor as defined by the Securities and Commodities Authority (SCA) Chairman Decision No. 3/R.M. of 2017 concerning Promoting and Introducing Regulations. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. **In the State of Kuwait**, those who meet the description of a Professional Client as defined under the Kuwait Capital Markets Law and its Executive Bylaws. **In the Sultanate of Oman**, to sophisticated institutions who have experience in investing in local and international securities, are financially solvent and have knowledge of the risks associated with investing in securities. **In Qatar**, for distribution with pre-selected institutional investors or high net worth investors. **In the Kingdom of Bahrain**, to Central Bank of Bahrain (CBB) Category 1 or Category 2 licensed investment firms, CBB licensed banks or those who would meet the description of an Expert Investor or Accredited Investors as defined in the CBB Rulebook. The information contained in this document, does not constitute and should not be construed as an offer of, invitation, inducement or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. **In Singapore**, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). This advertisement or publication has not been reviewed by the Monetary Authority of Singapore. **In Hong Kong**, this material is issued by BlackRock Asset Management North Asia Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong. **In South Korea**, this material is for distribution to the Qualified Professional Investors (as defined in the Financial Investment Services and Capital Market Act and its sub-regulations). **In Taiwan**, independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28F., No. 100, Songren Rd., Xinyi Dist., Taipei City 110, Taiwan. Tel: (02)23261600. **In Japan**, this is issued by BlackRock Japan Co., Ltd. (Financial Instruments Business Operator: The Kanto Regional Financial Bureau. License No375, Association Memberships: Japan Investment Advisers Association, the Investment Trusts Association, Japan, Japan Securities Dealers Association, Type II Financial Instruments Firms Association.) For Professional Investors only (Professional Investor is defined in Financial Instruments and Exchange Act). **In Australia**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975 AFSL 230 523 (BIMAL). The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. **In China**, this material may not be distributed to individuals resident in the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macau and Taiwan) or entities registered in the PRC unless such parties have received all the required PRC government approvals to participate in any investment or receive any investment advisory or investment management services. **For Other APAC Countries**, this material is issued for Institutional Investors only (or professional/sophisticated /qualified investors, as such term may apply in local jurisdictions). **In Latin America**, no securities regulator within Latin America has confirmed the accuracy of any information contained herein. The provision of investment management and investment advisory services is a regulated activity in Mexico thus is subject to strict rules. For more information on the Investment Advisory Services offered by BlackRock Mexico please refer to the Investment Services Guide available at www.blackrock.com/mx

©2023 BlackRock, Inc. All Rights Reserved. **BLACKROCK** is a trademark of BlackRock, Inc., or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.

BlackRock

Not FDIC Insured • May Lose Value • No Bank Guarantee