Rothschild & Co
Asset Management

Monthly Macro Insights — December 2024

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While global growth has proved resilient to policy tightening, significant divergences have emerged across countries, and the outcome of the US election has increased the risks for that trend to amplify. Furthermore, by choosing not to act on any assumptions about what the incoming US administration might enact, combined with the long and variable lags of monetary policy, the Fed will struggle to contain the economic consequences of Donald Trump's priorities.

Regional divergence to widen further

The US experienced the fastest GDP growth of all G7 countries in the past two years [1], and this exceptionalism has generally been positive for growth elsewhere, as US demand boosted global trade flows and asset prices.

Amid promises of loose fiscal policy and stimulated by businesses' animal spirits, the US economy should stay robust in the short term. In addition, the introduction of tariffs on all imports could foster economic activity, as demand shifts from foreign to domestic goods, enabling the country's trade deficit to improve.

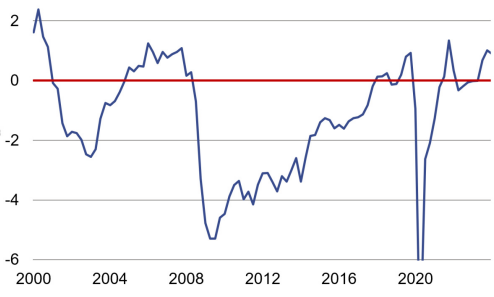
However, the initial positive effects could fizzle out and possibly reverse, and the hit to business sentiment outside the US from the threat of a widening trade war may be the

most important channel of transmission. China is expected to be the country most significantly impacted by the new US administration and consequently, China's trading partners in the region will likely face spillover effects from its weaker demand. Although European growth will be boosted from the initial buoyant US demand, these benefits are expected to be offset by weaker growth in Asia and gloomy business confidence, especially if tariffs are also imposed on the region.

In the US, the initial higher demand in an economy that is already at full employment and with a positive output gap will put upward pressure on prices, whereas inflation is already above target. In addition, Chinese and European retaliation would hurt exporters, and after the initial improvement, the US trade balance will thus deteriorate.

US - Output Gap

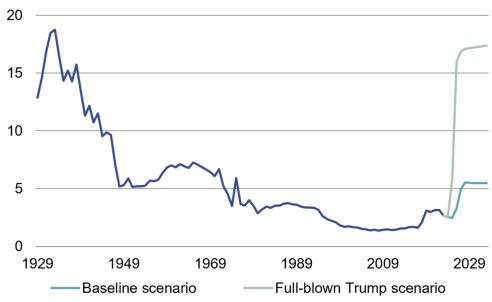
in %, CBO



Sources : Macrobond, Rothschild & Co Asset Management, November 2024.

US - Effective tariff rate

in %



Sources : Oxford Economics, Rothschild & Co AM, November 2024.

US inflation risk on the rise

After the temporary initial positive impact, lower imports and exports may lead to reduced economic activity. This, combined with higher interest rates due to rising inflation, could leave the incoming administration with little to show for the tariff increase. That obviously assumes the Fed's monetary policy response will be consistent with its employment and inflation objectives, which seems a highly likely hypothesis. Indeed, at the first Fed monetary policy conference since the US election, Chair Powell emphasised that Trump lacks the legal authority to fire him before the end of his term in May 2026, which he plans to serve out.

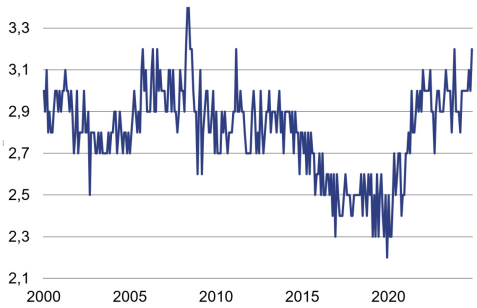
The Fed is avoiding speculation about how Trump's promises of higher tariffs, mass deportations and lower taxes might influence monetary policy. While an analysis on the effects of such measures is carried out, the Fed will not consider them in its policy-making until they become law. Although wise in the current politically polarised environment, this approach is not without risks.

Indeed, if the new Administration decides to abruptly implement some of its policies –such as those related to tariffs or deportations – the Fed's response would most likely occur too late to fully mitigate the economic impact. In that regard, higher import prices, as well as labour shortages caused by a much stricter immigration policy, would raise

inflation and push up inflation expectations that have already reached levels rarely seen in the past few decades, according to household surveys. In turn, this would increase uncertainty and necessitate more aggressive monetary adjustments, hence leading to higher interest rates, especially if the fiscal outlook worsens.

US - Inflation expectations

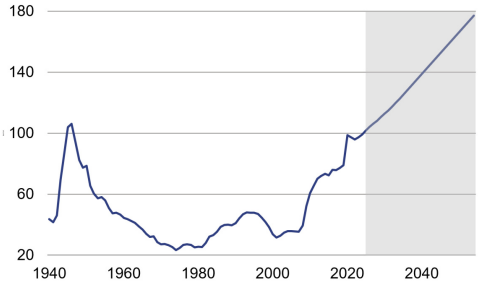
in %, U. of Michigan



Sources : Macrobond, Rothschild & Co Asset Management, November 2024.

US - Debt

in % of GDP



Sources : CBO, CRFB, Rothschild & Co Asset Management, November 2024.

Fragile US fiscal outlook

Public debt levels are elevated around the world, and the US is no exception. Its debt is at record levels and the long-term trajectory is unsustainable, although a precise tipping point is unknown. The Congressional Budget Office (CBO) predicts gross federal debt will reach more than 122 per cent of GDP by 2034[2], a level greater than at any point in the US history. The federal budget deficit is projected to widen to -6.3 per cent of GDP in the 2025-2034[2] period, way above the -3.8 per cent averaged over the past 50 years[2].

Yet, these are conservative estimates, as they assume corporate and personal tax cuts of the 2017 Tax Cut and Jobs Act (TCJA) – which are supposed to expire at the end of 2025 – will not be extended, which is an unlikely outcome since the Republicans control Congress and the White House. This is an unlikely outcome, given that the Republicans control Congress and the White House. In fact, if all tax provisions were to be extended, the deficit would be deeper, and debt would be expected to climb above 136 per cent of GDP by 2034[2]. What's more, the CBO's baseline projections assume that no US recession occurs in the next ten years, inflation falls back to normal levels and stays there, and, correspondingly, debt financing costs remain low. Higher-for-longer interest rates are obviously posing a challenge to serviceability.

Yet, some investors seem confident that the deficit could be reduced by slashing spending, especially since Tesla's CEO Elon Musk has been appointed as co-head of the new Department of Government Efficiency, and suggested it would be possible to drastically cut spending by eradicating waste. How realistic is that proposal?

Around 43.5 per cent of the USD6.7 trillion federal budget is mandatory[3], meaning it must be spent by law on those eligible. That includes Social Security, which primarily means pensions for Americans over the retirement age, and Medicare, a government-funded

health insurance program primarily serving Americans aged over 65. Not only has Trump never mentioned deep cuts in those very popular programmes, but he campaigned on a platform of making Social Security more financially generous, not less, by removing the income tax payable on it. Meanwhile, 14 per cent of the budget goes on interest payments on the national debt[2], which means that line of expenditure cannot be reduced without putting the US government in default.

In contrast, the so-called discretionary government spending is an outlay that is not permanently enshrined in law, and has to be voted on annually by lawmakers. It represents 42.5 per cent of total spending[2] and, while these agencies could be more easily targeted, it also includes defence (12 per cent)[2] which is rather incompressible.

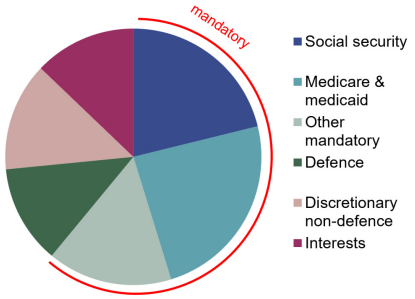
In summary, only 30 per cent of the federal budget could realistically experience significant spending cuts[4], and it still includes agencies such as transport, education, agriculture and Homeland Security, which deliver important government functions, especially as the US already spends a considerably smaller share than other advanced economies.

Overall, high debt reduces fiscal space and the governments' ability to respond to economic downturns. It also crowds out growth-enhancing investments, and raises the risk of sovereign distress. If Trump enacted all the measures he has suggested, one may question how many years it will take for investors to question the risk-free status of US Treasuries, thus markedly increasing US bond market volatility.

Trump's decision to pick Scott Bessent to serve as his next Treasury secretary has been read as a Wall Street-friendly choice to safeguard market stability. Yet, Bessent has signalled his backing for tariffs to serve twin purposes: raising government revenue to offset tax cuts, and addressing global economic imbalances. He believes that trade wars are not negative for growth nor positive for inflation - an unorthodox view among economists, to say the least.

US - Public spending

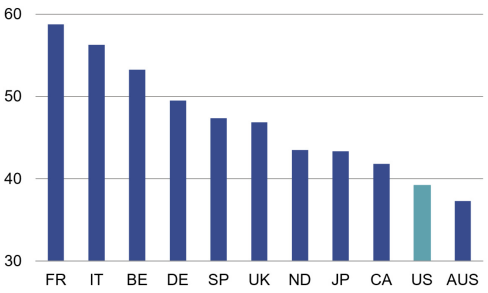
in % of total



Sources : CBO, Rothschild & Co Asset Management, November 2024.

World - Public spending

in % of GDP



Sources : Macrobond, Rothschild & Co Asset Management, November 2024.

Performance of the indices and interest rate levels

	Price as of 29/11/2024	1 month % change	2024 % change
Equity markets			
CAC 40	7 235	-1.6%	-4.1%
Euro Stoxx 50	4 804	-0.5%	6.3%
S&P 500	6 032	5.7%	26.5%
Nikkei 225	38 208	-2.2%	14.2%
Currencies			
EUR/USD	1.06	-2.8%	-4.2%
EUR/JPY	158.41	-4.3%	1.7%

Interest rates	Price as of 29/11/2024	1 month bp(1)	2024 bp(1)
3 month			
Eurozone	2.87%	-20	-74
United States	4.49%	-6	-85
10 years			
Eurozone	2.09%	-30	6
United States	4.17%	-12	29

(1) Basis point.
Source: Bloomberg. data as of 29/11/2024. Performances in local currency.
Past performance is not a reliable indicator of future performance and is not constant over time. Index's performance is calculated on the basis of net dividend reinvested

Completed writing on 4 December 2024.

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(1) Source: OECD, OECD GDP growth, August 2024.
(2) Source: Congressional Budget Office, December 2024.
(3) Source: US Bureau of Labor Statistics, December 2024.
(4) Source: Rothschild & Co Asset Management, December 2024.

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Für weitere Informationen: www.am.eu.rothschildandco.com

(1) Quelle: Rothschild & Co Asset Management, 31/07/2026.

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