Rothschild & Co
Asset Management

Monthly Macro Insights — August 2024

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Weakening business confidence indices continue to cast doubts on the global economy's resilience. Although core inflation remains above central banks' targets, the cooling of labour markets has not gone unnoticed, prompting a major shift in policy rates projections.

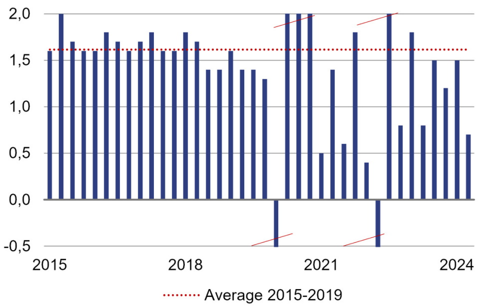
China's economy disappoints

Chinese GDP grew a mere 0.7 per cent q/q in Q2-2024, the weakest since early 2022[1], showing activity is struggling to maintain a tepid recovery. What's more, weak July PMIs [2] signalled a poor start to Q3 — a worrying development given the undershoot in the previous quarter. Manufacturing confidence edged down to 49.4 and remained in contraction territory for a third month straight. The non-manufacturing gauge inched lower to 50.2, marginally above the 50-threshold, thanks solely to the construction sector (51.2) [1] that has been supported by government measures.

A concerted policy push, including the surprise 20bp reduction in the one-year medium term lending facility rate from the People's Bank of China, may help battle the mid-year softness. However, effectiveness will depend in large on how much the measures boost confidence, as poor sentiment is keeping households and businesses from spending and investing. Despite a support package in May where the central government planned to buy unsold homes, ongoing adjustments in the property sector continue to weigh on private demand due to the measure being held back by a lack of matching funds at a local level, and limited appetite from banks. Furthermore, exports have been a significant engine for the economy, but are now under increasing pressure from intensifying trade frictions and looming tariffs from the US and European Union.

China - GDP growth

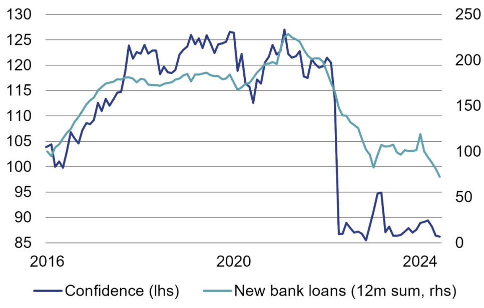
in %, q/q



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

China - Confidence and credit

NBS index and index jan. 2016 = 100



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

Fed policy swift shift…

The US economy has greatly surprised to the upside last year and outperformed most other advanced economies. The government largesse, visible through the worsening budget deficit, boosted domestic demand amid high accumulated excess savings. In addition, monetary policy tightness was not only offset by loose fiscal policy, but the transmission mechanisms were likely suffering longer lags than usual.

For instance, in the housing sector, mortgage payments for variable-rate borrowers have risen alongside increases in policy rates, whereas fixed-rate borrowers face a large and delayed jump in their mortgage payments, depending on the term of their fixed-rate loan. Therefore, the high share of fixed-rate loans has added an extra delay to the pass-through to outstanding mortgage rates.

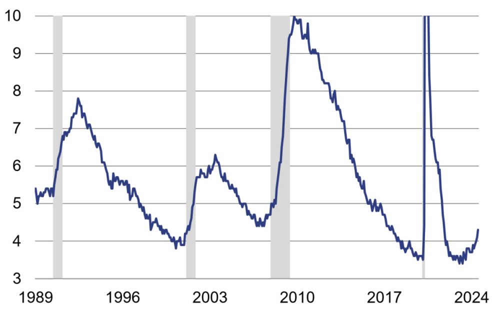
Yet, latest data suggest that the effects of the US monetary policy tightening are increasingly visible. The delinquency rates for credit cards and auto loans have hit multi-year highs. After some improvement in the housing sector late last year and early 2024, home sales have tumbled in the past months to reach an almost 30-year low and housing starts have been particularly weak[1]. More importantly, the labour market seems to have deteriorated much more swiftly than anticipated.

The US added 114,000 jobs in July, down from 206,000 in June [3] and well short of expectations. The unemployment rate rose to 4.3 per cent [3], triggering the Sahm rule, i.e. whenever the three-month moving average of the unemployment rate rises 0.5 percentage points or more above its low in the preceding 12 months. Although this indicator has correctly predicted all the post-World War II US recessions, the July increase was in part driven by temporary layoffs, and Hurricane Beryl and summer auto plant shutdowns were the likely culprits behind this sharp uptick. Correspondingly, the number of unemployed due to temporary layoffs may retrace its steps in the next months as these are individuals that anticipate being recalled to their job. What’s more, some of the recent rise in unemployment is explained by weakening demand, but it has also been supply-driven, as evidenced by growth in the labour force.

Still, the upward trajectory bears a close watch during the coming months, given its nonlinear nature. A 25bp rate cut at the September Fed meeting is basically a done deal, and from a risk-management perspective, 50bp cannot be ruled out. With Fed Chair Powell stressing in his July press conference that he is carefully watching for signs that the labour market could be more than just cooling, attention will be keenly focused on his remarks at the Jackson Hole Symposium later this month, if not sooner.

US - Unemployment rate

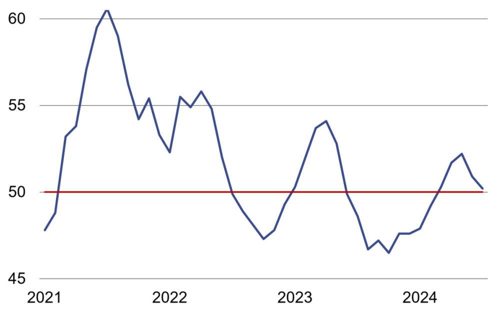
In %



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

Eurozone - Business confidence

S&P Global



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

… likely affecting the ECB

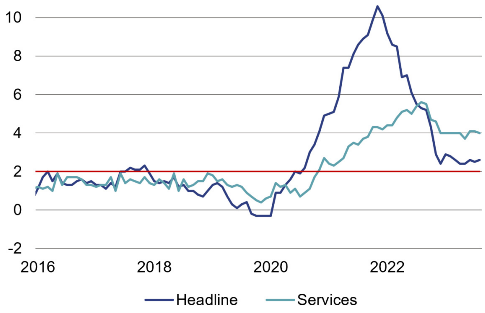
Eurozone inflation once again surprised to the upside in July, unexpectedly rising to 2.6 per cent, while core inflation held at 2.9 per cent [4] as services inflation is sticky. The report is one of the two crucial monthly inflation readings that will inform the ECB Governing Council before the meeting on 12 September, not to mention the Q2-2024 negotiated wages data to be published later this month.

Although wages and inflation dynamics are likely to worry the hawks, the sharp deterioration of business confidence in June and July, combined with high uncertainty regarding the US business cycle, could well convince the ECB to deliver more rate cuts this year. In addition, the unemployment rate unexpectedly increased 0.1 percentage points in June, albeit from a record-low 6.4 per cent [4].

In short, the fall in global sovereign yields reflects investors' expectations of a major and coordinated easing of central banks, against the backdrop of growing fears that economic growth is weakening at a faster pace than expected just a few weeks ago.

Eurozone - Inflation rate

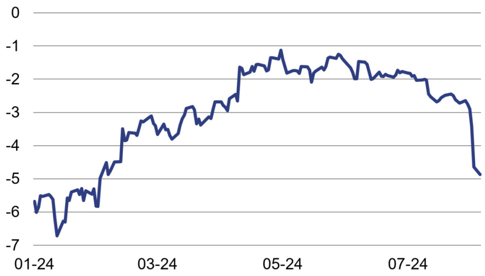
In %



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

US - Market expectations in 2024

number of -25bps decreases of the key interest rate



Sources: Bloomberg, Rothschild & Co Asset Management, August 2024.

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(1) Source : National Bureau of Statistics of China, August 2024.
(2) Purchasing Managers' Index, an indicator reflecting the confidence of purchasing managers in a sector of activity. Above 50, it indicates an expansion in activity, below 50, a contraction.
(3) S&P Global, August 2024.
(4) Source : Eurostat, August 2024.

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