Monthly Macro Insights — July 2024

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Business confidence fell at the end of Q2-24, casting doubts on the positive momentum going into the second half of the year, while rising political uncertainty adds to an already complicated conduct of monetary policy.

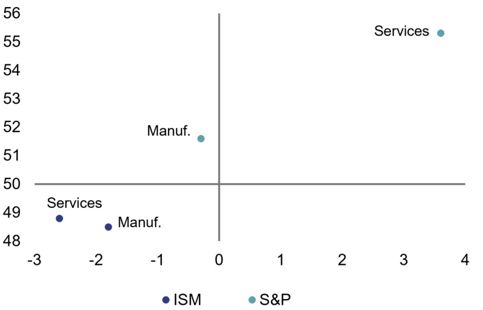
Ending the first semester on a weak note

Global growth looks to have lost momentum according to business confidence indicators. The S&P Global PMI[1] fell both in the manufacturing (-0.1pt) and services sectors (-0.9pt) despite rising confidence in the US (+0.3pt to 51.6 and +0.5 pt to 55.3, respectively)[2].

Yet, as noted previously, national indicators continue to paint an even weaker picture compared to the S&P Global indices. In China, the NBS manufacturing PMI remained in contraction territory (49.5) in June, whereas the Chinese S&P PMI increased 0.1pt to 51.8[2]. In the US, the ISM manufacturing index unexpectedly fell -0.2pt to 48.5 while the services index plunged -5pts to 48.8[3], a level last seen during the 2008-2009 recession (bar a momentary drop at the start of the pandemic), suggesting that economic activity has contracted at an accelerated pace in June. Looking ahead, it remains to be seen whether the national surveys depict a more accurate economic situation compared to the S&P Global PMIs, which would certainly upset investor’s sanguine economic outlook.

US - Business confidence

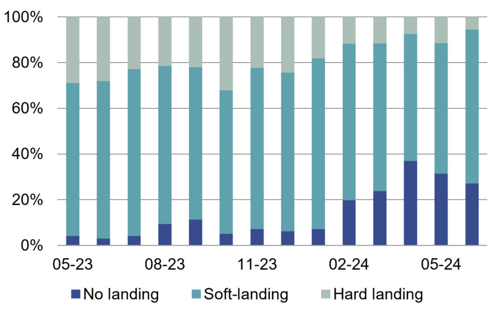
June vs. March 2024



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

World - Global fund manager survey

in %, global baseline scenario



Sources: Bank of America, Rothschild & Co Asset Management, July 2024.

Murky outlook in China

In China, headline inflation remained at a mere 0.3 per cent in May while core inflation unexpectedly fell to 0.6 per cent[4], fuelling concerns over persistently weak domestic demand amid a prolonged property sector slump. What's more, the US announced steep tariff hikes targeting a short list of strategic imports from China, covering namely semiconductors and electric vehicles, and Europe could follow.

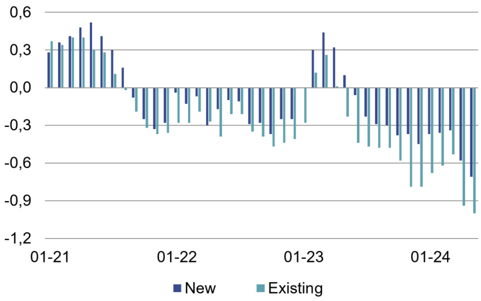
The only bright spot in May's economic activity data was growth in retail sales which picked up to 3.7 per cent y/y from 2.3 per cent in April[4], in part explained by a long holiday in the month. In contrast, industrial production rose 5.6 per cent y/y, down from 6.7 per cent in April, notably undershooting the consensus forecast for a 6.2 per cent rise. Fixed asset investment growth unexpectedly eased to 4 per cent y/y in the first five months of 2024[4].

New home prices fell -0.7 per cent m/m, the most since October 2014, and existing home prices tumbled -1 per cent, the sharpest decline since 2011 when China started using the current data collection method[4]. The authorities unveiled a broad real estate rescue package to address the biggest cloud over China's economy, but initial results in pilot cities and various other local initiatives show the challenges ahead, as local governments are worried about adding more debt, while developers and homeowners are reluctant to sell at a discount.

Overall, with China's two big traditional growth engines – property and trade – sputtering, it seems that more policy support is needed to solidify the economy. However, the People's Bank of China's focus on currency stability appears to have tied its hands on cutting interest rates – at least until the Fed moves.

China - Housing prices

in %, m/m



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

China - Exchange rate

USD/CNY

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

Inflation and politics

Most investors expect that the ECB and the Fed will cut their policy rates in September, although the decisions are highly dependent on incoming data.

In the eurozone, political uncertainty in France is likely to weigh on economic activity. The far-right and Eurosceptic Rassemblement National (RN) is unlikely to win an absolute majority, thus creating little clarity about how a government can be formed and how the 2025 budget will be passed. Although the RN has dropped many costly measures from its platform and pledged to broadly respect the EU's fiscal rule, the risk of fiscal slippage remains. More broadly, weaker eurozone June PMI and national surveys increased near-term growth nervousness, which would favour a rate cut in September.

However, the ECB is simultaneously facing a very tight labour market and rising wage costs that are feeding services inflation. The June flash inflation estimate showed that prices in the services sector were up 0.6 per cent m/m and 4.1 per cent y/y, again surprising to the upside[5]. Correspondingly, despite falling goods and energy prices, core inflation remained at 2.9 per cent, a level still uncomfortably high for several ECB members[5].

Meanwhile, after four months of strong price increases, May US inflation data were more modest. While the Fed acknowledged this was good news, it will likely need consistently low readings in the three CPI reports leading to the September meeting to gain greater confidence that inflation is moving sustainably towards the 2 per cent target before embarking on monetary easing, unless the labour market shows clear evidence of deterioration.

What's more, the political outlook will also play a role in the Fed's reaction function. After a disastrous presidential debate, President Biden's odds of re-election have receded. At the top of Donald Trump's agenda, three items – raising trade tariffs, curbing immigration and prolonging expiring tax cuts – would all be inflationary, and their implementation could make it difficult for the Fed to ease. While the Biden Administration hasn't been a vocal advocate of free trade, a second Trump term could pave the way to two possible policies: a 60 per cent tariff on all Chinese imports, and a 10 per cent universal tariff on all imports. Although a complete pass-through to consumer prices is unlikely, the impact on inflation could nonetheless be significant.

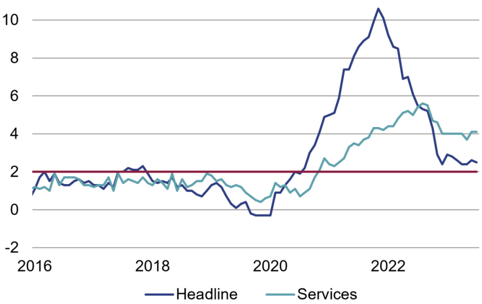
The inflationary impact of immigration is heavily debated as immigrants add to both labour supply and consumer demand, although some of the latter is crowded out via remittances to home countries. Still, most research shows that the rise in immigration in the post-pandemic period helped the US labour market not overheat, thus helping the Fed in its fight to tackle inflation. Incidentally, inflationary pressures could re-accelerate as Trump has vowed to shut the southwest border and begin large-scale deportations of unauthorised immigrants already in the country.

Regarding the fiscal outlook, the next Administration will immediately face the expiration of the corporate and personal tax cuts of the 2017 Tax Cut and Jobs Act (TCJA) at the end of 2025. President Biden has stated his intention to effectively extend the TCJA provisions for those making under US$400,000, but to revert to the older, higher rates for those with incomes above that limit. On the business side, Biden has proposed raising the corporate rate from 21 per cent to 28 per cent. However, Trump would presumably extend all provisions of the TCJA, thus exerting an even higher pressure on the fiscal deficit, once again complicating the Fed's objective.

Overall, central banks remain compelled to keep interest rates high amid persistent services inflation, and rising political uncertainty add to an already complicated conduct of monetary policy.

Eurozone - Inflation rate

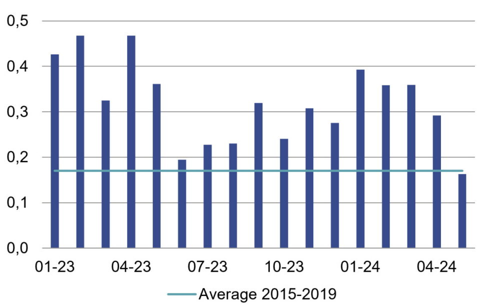
in %



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

US - CPI index

in %, m/m, core



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

Performance of the indices and interest rate levels

	Price as of 28/06/2024	1 month % change	2024 % change
Equity markets			
CAC 40	7 479	-6.4%	-0.8%
Euro Stoxx 50	4 894	-1.8%	8.2%
S&P 500	5 460	3.5%	14.5%
Nikkei 225	39 631	3.0%	18.4%
Currencies			
EUR/USD	1.07%	-1.2%	-3.0%
EUR/JPY	172.39	1.0%	10.7%

Interest rates	Price as of 28/06/2024	1 month bp(1)	2024 bp(1)
3 month			
Eurozone	3.71%	0	9
United States	5.35%	-5	2
10 years			
Eurozone	2.50%	-16	48
United States	4.40%	-10	52

(1) Basis point.
Source: Bloomberg. data as of 28/06/2024. 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 5 July 2024.

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(1) 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.
(2) Source: S&P Global, July 2024.
(3) Source: ifo Institut, July 2024.
(4) Source : National Bureau of Statistics of China, July 2024.
(5) Source : Eurostat, July 2024.

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