Rothschild & Co
Asset Management

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# Monthly Macro Insights

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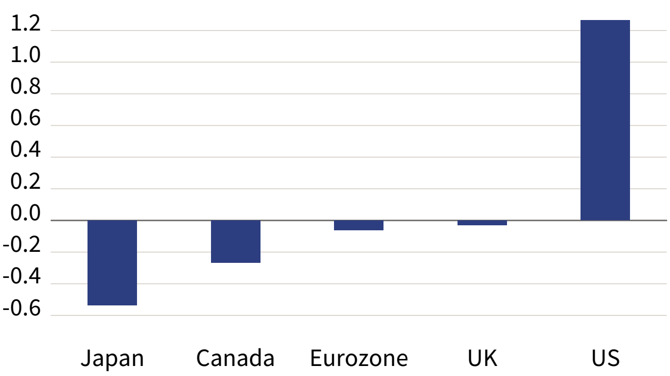
Economic growth in advanced economies has been very weak in Q3-23, but the US was the notable exception, giving the impression the global economy remained resilient. Are we on a path of 'immaculate disinflation', or is the fall in inflation increasingly the reflection of a deteriorating economy?

## Divergence unlikely to persist...

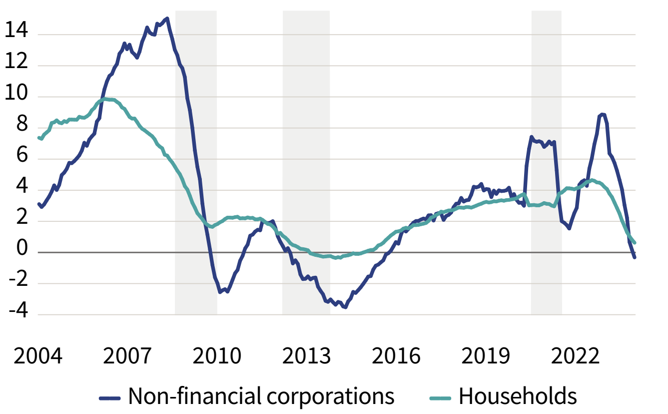
Growth in China has been volatile since the reopening of the economy at the start of 2023. According to the latest PMI[1], activity in manufacturing and services sectors shrank in November. The manufacturing business confidence index fell to 49.4, the second straight month of contraction. In services, the index fell to 49.3 as post-holiday cooling in travel and consumption-related businesses was a major drag. In fact, this is the first contraction in services since the end of the Zero-Covid policy, and the lowest level on record, barring the pandemic period. The only bright spot was the construction sector with the PMI rising to 55 from 53.5. While recent policy easing has increased investors' confidence in their outlook for an improved growth profile during 1H24, these data suggest that the momentum remains rather fragile.

### Advanced economies – GDP Q3-23
*in %, q/q*




Sources: Macrobond, Rothschild & Co Asset Management, December 2023.

### Eurozone – Credit to private sector
*in %, y/y*




Sources: Macrobond, Rothschild & Co Asset Management, December 2023.

(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.

Although not falling off a cliff, most advanced economies saw negative GDP in Q3-23 as the impact of tighter financial conditions, weak trade growth and lower consumer confidence is increasingly felt. Business confidence remains low amid higher debt-service burdens and tighter credit standards, with new lending to non-financial corporations in the Eurozone now contracting.

In sharp contrast, US GDP surged 1.3 per cent q/q[(2)]– or 5.2 per cent q/q[(2)] annualised – thus reassuring investors that the fastest monetary tightening in decades was not sufficient to derail the economy. Yet, the US' outperformance was driven in large part by temporary factors that are unlikely to be repeated. What's more, given the lags of monetary policy, GDP weakness likely lies ahead.

## … and so does fiscal largesse

In the wake of the invasion of Ukraine by Russia, many governments have provided sizeable help to households and businesses to face the ensuing energy shock. Defence spending has also been raised in several countries, particularly in Greece and some Central and Eastern European countries, but also in many economies in Western Europe, which partly reflects their military aid to Ukraine.  Furthermore, faster implementation of Next Generation EU plans has boosted expenditure in some European economies. In the US, higher spending on social security and healthcare, as well as lower-than-expected tax revenues, have generated an easing in the fiscal stance.

In fact, despite one of the fastest monetary tightenings in almost 40 years, the global economy's resilience in the first half of the year has surprised most economists. Some investors might have even concluded that monetary policy may have become ineffective. However, the easing of fiscal policy played a central role in offsetting the negative impact of the monetary tightening.

This policy mix divergence is now turning with remaining energy support measures being phased out, and fiscal consolidation being deployed at a mild pace in the vast majority of countries, to mitigate the debt sustainability risks. Indeed, public debt levels are higher than before the pandemic, and interest payments are set to rise further as low-yielding debt matures and is replaced by new higher-yielding issuance, while central banks' bond holdings are reduced through the ongoing quantitative tightening.

## Are rate cuts' expectations to be upset?

Headline inflation has come down quickly in most economies over the past year, but generally remains some distance from target, and positive base effects from the reduction in energy prices are now fading. Still, recent central bank communications suggest that the risk of further tightening has significantly receded, and the rates market now incorporates relatively high probabilitiesof easing by both the ECB and FED in early 2024. For instance, futures[(3)] point to close to five 25pbs cuts by the end of next year in the feds fund rate[(4)].

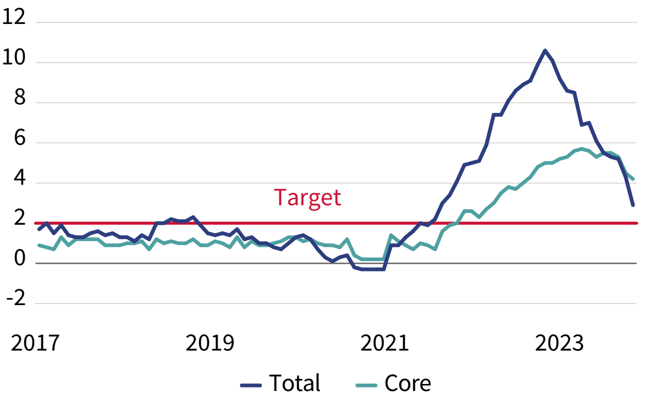
While core inflation has indeed moderated in recent months thanks to downward pressure on goods prices, service price gains remain sticky as wages are generally the main production cost in that sector.

In that regard, signs of labour market easing have started to appear in many economies, including a slowdown in employment growth, lower vacancies, and in some cases a mild upturn in unemployment rates. In addition, nominal wage growth has begun to moderate in many economies.

However, unit labour cost (ULC) growth remains high due to weak productivity growth, with again the exception of the US. Although

### Eurozone – Inflation rate

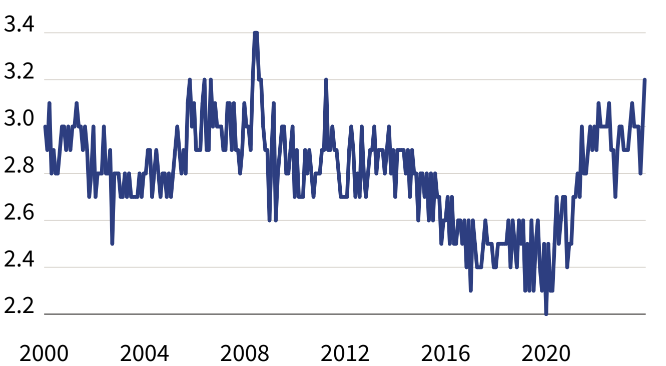
*in %*




Sources: Macrobond, Rothschild & Co Asset Management, December 2023.

### US – Inflation expectations

*in %, U. of Michigan index, households, 5 years*




Sources: Macrobond, Rothschild & Co Asset Management, December 2023.

(2) Source: U.S. Bureau of Labour statistics, 30/11/2023.
(3) Firm commitment to buy or sell an agreed quantity of an asset at an agreed price on an agreed future date.
(4) Source: Bloomberg, 30/11/2023.

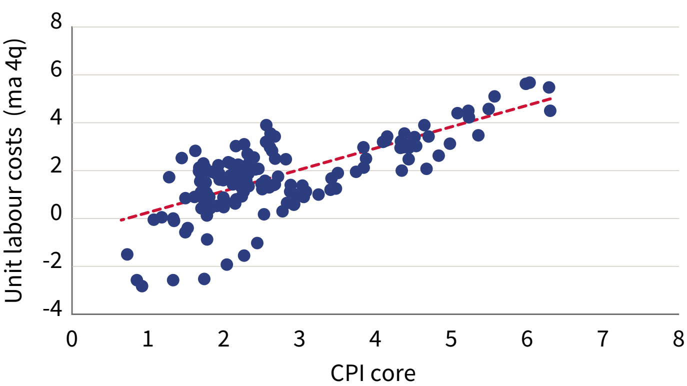
the link between ULC and price inflation varies across time, countries and also sectors, the recent trend represents a significant hurdle for central bankers, which are also facing somewhat higher inflation expectations. As a result, monetary policy likely needs to remain restrictive until there are clear signs that underlying inflationary pressures are durably lowered, with inflation expectations moderating.

Yet, inflation trends will take time to discern, and it is still far from certain that immaculate disinflation is even possible, i.e. to reach the inflation target without a significant weakening of economic activity. Some additional rate rises could still be needed if inflationary pressures prove persistent, or if financial conditions continue to ease.

Indeed, in order to have an effect on growth, and ultimately on inflation, tighter financial conditions have to be persistent. The latest surge in equity markets and the fall in sovereign yields, which are associated with investors' greater soft-landing optimism, could ironically force central bankers to adopt a more hawkish[5] tone as unwarranted easing in conditions jeopardizes their efforts to cool off the economy. Overall, investors' rate cuts expectations might prove to be ill-advised… unless their resilience scenario turns out to be too optimistic.

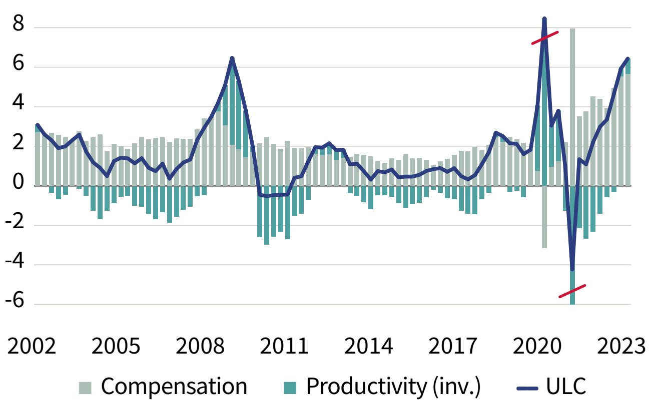
**Completed writing on 5 December 2023**

## US – Unit labour costs & CPI core
*in %, y/y, 1986-2023*




Sources: Macrobond, Rothschild & Co Asset Management, December 2023.

## Eurozone – Unit labour Costs (ULC)
*in %, y/y*




Sources: Macrobond, Rothschild & Co Asset Management, December 2023.

(5) Position in favor of a less accommodating monetary policy to combat inflation.

## Performance of the indices and interest rate levels

| | Price as of 30/11/2023 | 1 month % change | 2023 % change |
|---|---|---|---|
| **Equity markets** | | | |
| CAC 40 | 7 311 | 6.2% | 12.9% |
| Euro Stoxx 50 | 4 382 | 7.9% | 15.5% |
| S&P 500 | 4 568 | 8.9% | 19.6% |
| Nikkei 225 | 33 487 | 8.5% | 28.3% |
| **Currencies** | | | |
| EUR/USD | 1.09 | 3.0% | 1.8% |
| EUR/JPY | 161.37 | 0.6% | 14.9% |

| Interest rates | Price as of 30/11/2023 | 1 month bp(1) | 2023 bp(1) |
|---|---|---|---|
| **3 month** | | | |
| Eurozone | 3.78% | -2 | 202 |
| United States | 5.39% | -7 | 104 |
| **10 years** | | | |
| Eurozone | 2.45% | -36 | -12 |
| United States | 4.33% | -60 | 45 |

(1) Basis point.

Source: Bloomberg. data as of 30/11/2023. 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.



About Rothschild & Co Asset Management
As the specialised asset management division of the Rothschild & Co group, we offer personalised asset management services to a broad client base of institutional investors, financial intermediaries and distributors. Our development is focused on a range of open-ended funds, marketed under four strong brands: Conviction, Valor, Thematic and 4Change, and leveraging our long-term expertise in active management with conviction as well as in delegated management. Based in Paris and established in 9 European countries, we manage more than 27 billion euros and employ nearly 160 people. More information at: www.am.eu.rothschildandco.com

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