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Monthly Macro Insights

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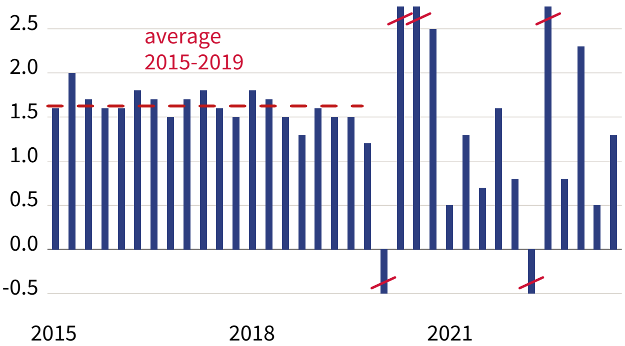
The last few months have seen global consumer confidence dip back to still-depressed levels, while business confidence has weakened in most countries. Still, investors remain somewhat optimistic as they foresee the resilience of the global economy amid the end of the monetary tightening.

More divergences in Q3-23…

In China, GDP grew 1.3 per cent quarter-on-quarter (q/q), an improvement from the weak 0.5 per cent in Q2(1), but still significantly lagging the pre-pandemic trend. Domestic demand improved somewhat, but the low level of inflation, hovering around 0 per cent in the past few months, suggests that the economic slack remains significant. The authorities recently decided to issue an additional 1 trillion yuan of treasury bonds to invest in the economy(2), trying to stabilise market expectations and boost activity. Still, the non-manufacturing PMI fell to 50.6(3) in October, the lowest level since the government announced the end of its Zero-Covid policy last year. In the manufacturing sector, the PMI dropped to 49.5(4) and the output and input price sub-indexes both fell, feeding into the debate of deflation risk. Overall, the very soft readings suggest weak momentum at the end of Q3-23 carried into early Q4, and further fiscal and monetary expansion is likely needed.

China – GDP

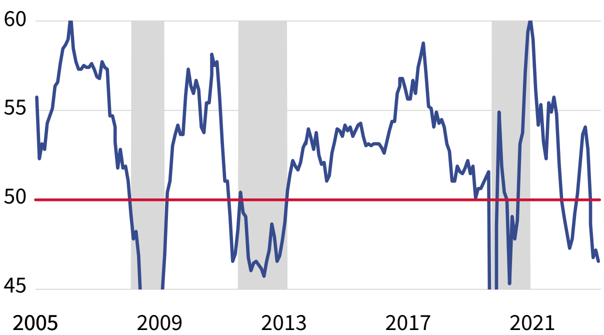
in %, q/q



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

Eurozone – Business confidence

S&P Global composite



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

(1) Source : Bloomberg, 31/10/2023.
(2) Source : Xinhua Agency, October 2023.
(3) 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.
(4) Source : National Bureau of Statistics of China, October 2023.

Although the economy is not falling off a cliff, Eurozone GDP nonetheless fell -0.1 per cent q/q amid higher interest rates[5], slowing external demand and the lingering impacts of the energy price shock. Growth in France (0.1 per cent), Spain (0.3 per cent) and Belgium (0.5 per cent) was more than offset by falling activity in Ireland (-1.8 per cent), Austria (-0.6 per cent), Portugal (-0.2 per cent) and Germany (-0.1 per cent), while Italy stalled after the Q2 contraction.

... but the US' outperformance will be tested

In sharp contrast, US GDP surged 1.2 per cent q/q – or 4.9 per cent q/q annualised – the fastest pace since 2021[6]. Business investment declined for the first time in two years on a drop in outlays for equipment, and net exports also fell. However, the strength of household demand remained surprisingly resilient. In addition, significant positive contributions to growth came from inventories and government.

Yet, the US' outperformance was driven in large part by temporary factors that are unlikely to be repeated. First, the contribution of government spending in the past few quarters has been twice as large as the pre-pandemic average. What's more, the budget deficit doubled up until recently, which also represented a significant tailwind. In that regard, the debt ceiling agreement earlier this year, combined with the incoming budget currently debated in Congress, will most likely reverse the recent trend in the government and fiscal contributions to GDP.

Secondly, residential investment made a small positive contribution to growth after decreasing over the previous nine quarters. With mortgage rates soaring to the highest level in almost 25 years[6], the sector is most likely to become a headwind once again.

Thirdly, Americans increasingly dipped into their savings to finance their current consumption, with the saving rate dropping to 3.8 per cent from 5.2 per cent in the prior quarter[6]. Some of the outperformance also reflects a temporary boost from events like the Taylor Swift and Beyoncé tours as well as the Barbie and Oppenheimer movies. Looking ahead, the strength of the consumer will be increasingly tested by elevated borrowing costs, tighter access to credit and the recent resumption of student-loan payments.

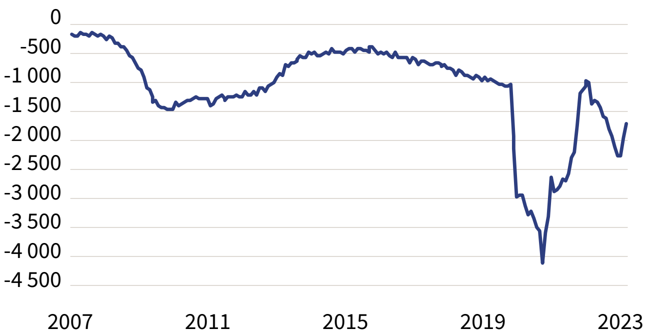
Higher bond yields spooked central banks...

The recent rise in global sovereign yields can be explained in part by the "higher for longer", as central banks have insisted monetary policy would remain tight for some time. It can also be explained by risks regarding public finances and debt sustainability as interest payments, as well as uncertainty regarding inflation volatility, are expected to surge in the next few years. Correspondingly, investors are demanding a higher term premium.

This trend has several repercussions, especially in the US. Indeed, Treasury yields serve as benchmarks for the pricing of a whole range of borrowing and lending by households, businesses and governments. They influence mortgage rates and the functioning of the housing market. They impact the stability of financial institutions and the system as a whole as their moves spill over to other countries' financial markets and economies.

The Fed acknowledged rates might not be sufficiently restrictive for inflation to move back to target, especially as a surprisingly strong employment cost index, higher job openings and rising house prices are all factors susceptible to feed inflationary pressures. That said, while it left the door open to another increase after pausing for the second meeting in a row, Fed Chair Powell

US – Budget deficit
in billion USD



Sources: Macrobond, Bloomberg, Rothschild & Co Asset Management, November 2023.

US – Mortgage rates
in %

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

(5) Source : Eurostat, October 2023.
(6) Source : U.S. Bureau of Economic Analysis, October 2023.

hinted that tighter financial conditions in general, and a run-up in Treasury yields in particular, reduced the impetus to tighten policy further as it will likely weigh on economic activity. Consequently, yields dropped significantly, and equity markets rallied amid investors' optimism that the Fed would pivot to rate cuts, which in turn loosened financial conditions.

Yet, in order to have an effect on growth, and ultimately on inflation, tighter financial condition has to be persistent. Ironically, the move following Powell's remarks might force the Fed to go back to its hiking campaign as the fight against inflation is far from over.

… but inflation still requires vigilance

In most countries, there has been a continued decline in inflation, even if timing has differed somewhat. Consensus forecasts and market pricing seem to indicate that inflation dynamics are expected to converge seamlessly towards the respective central bank targets.

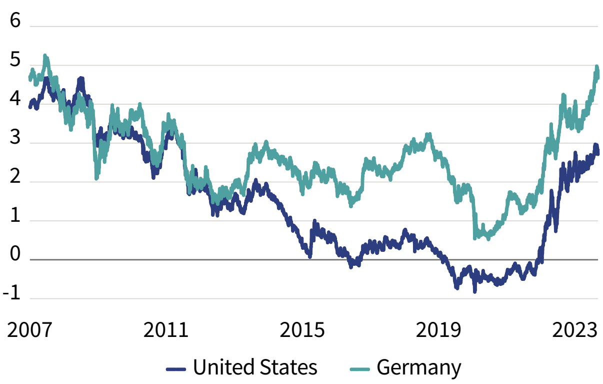
A large part of the disinflation was driven by the decline in commodity prices in the later part of 2022, especially energy, and by the significant improvement in supply chain disruptions. In contrast, core inflation has been more stubborn as services inflation has tended to move lower only gradually.

Furthermore, rising geopolitical tensions since the onset of the the crisis in the Middle East, including heightened risks of a regional conflict, should remind investors about how challenging the disinflationary process is. A potential regional escalation poses significant upside risks to energy prices, and commodities more broadly. What's more, weather events, including El Niño[7], are another important risk, especially for food prices.

Admittedly, commodity price shocks mainly affect relative prices rather than overall inflation, explaining why central banks usually look through them. But at a time when inflation has been high for long, some central banks may need to proceed with greater caution to prevent inflation from getting entrenched.

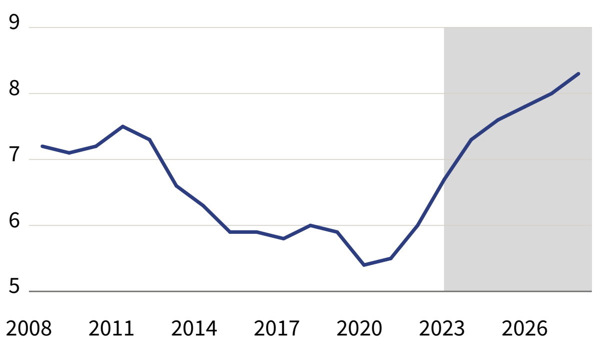
Completed writing on 3 November 2023

World – Sovereign yield
in %, 10-year



Sources: Macrobond, Bloomberg, Rothschild & Co Asset Management, November 2023.

Advanced economies – Interest payments
in % of gov. revenues



Sources: FMI, Rothschild & Co Asset Management, November 2023.

(7) El Niño is the result of an atmospheric disturbance in the Pacific Ocean, between the coasts of Peru and Oceania. It occurs every two to seven years in response to the build-up of excess heat in the waters of the tropics, and lasts from seven to twelve months.

Performance of the indices and interest rate levels

	Price as of 31/10/2023	1 month % change	2023 % change
Equity markets			
CAC 40	6 886	-3.5%	6.4%
Euro Stoxx 50	4 061	-2.7%	7.0%
S&P 500	4 194	-2.2%	9.8%
Nikkei 225	30 859	-3.1%	18.3%
Currencies			
EUR/USD	1.06	0.0%	-1.1%
EUR/JPY	160.41	1.6%	14.2%

Interest rates	Price as of 31/10/2023	1 month bp(1)	2023 bp(1)
3 month			
Eurozone	3.80%	-2	204
United States	5.46%	2	112
10 years			
Eurozone	2.81%	-3	24
United States	4.93%	36	106

(1) Basis point.

Source: Bloomberg. data as of 31/10/2023. 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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