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Monthly Macro Insights



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Recent data suggest that inflation could prove persistently high for some time and limit the room for central bank easing. Despite this high-for-long path for policy stances, investors remain convinced it will not prove sufficient to derail global growth.

Goods disinflation taking a pause...

Last year, inflation has been falling quickly from its 2022 peak, with a smaller-than-expected toll on employment and activity. However, following a material downshift from 5 per cent annual rate in H1 2023 to 3 per cent in H2 2023, core CPI in advanced economies picked up in Q1 2024⁽¹⁾. Indeed, sliding core goods inflation contributed materially to the downtrend last year, but this disinflationary impulse has been fading in the past few months for several reasons.

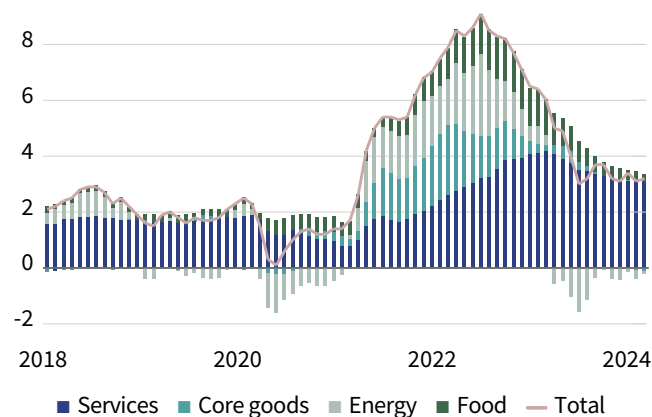
First, the weakened global manufacturing sector shows signs of recovering. The PMI⁽²⁾ posted 50.6 in March, up from 50.3 in February, being its highest reading since July 2022⁽³⁾. After 16 months in contraction territory, the index has now signalled some

improvements in overall operating conditions in each of the past two months. Signs of firmer pricing are evident in the survey, with the output prices sub-index higher compared to last year.

In addition, despite recent stabilisation, container shipping rates are still double their earlier December levels. Major shipping companies have stopped using the Red Sea (through which more than ten per cent of global trade flows) as the Houthis have attacked several commercial ships with drones, missiles and speed boats. These attacks have raised shipping costs sharply and lengthened delivery times, which could contribute to core goods inflation. The collapse of a bridge in Baltimore, a key US port for carmakers and other manufacturers, could also add to global supply chain disruptions.

US – CPI inflation rate

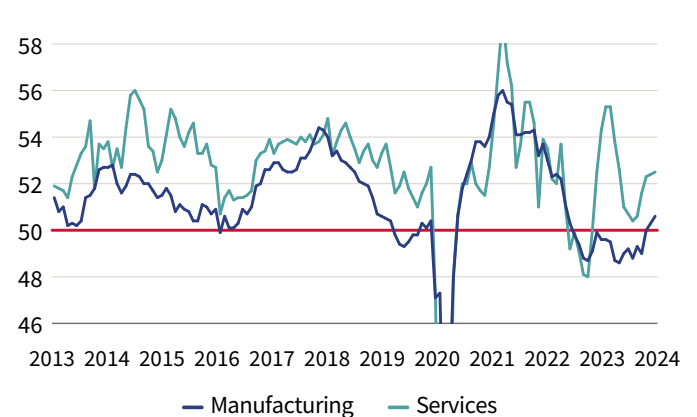
in %



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

World – Business confidence

S&P Global PMI



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

(1) Source: Bloomberg, 03/31/2024.

(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) Source: U.S. Bureau of Labor Statistics, March 2024.

Compounding the rebound in core goods, energy prices are also turning higher after being a significant drag on headline inflation in 2023. Crude has pushed higher this year, with Ukrainian attacks on Russian energy infrastructure, OPEC's supply policy and Middle East tensions impacting prices. There have also been patches of disruption elsewhere, including an early-year deep freeze in the US, and a recent curb to exports by Mexico. If the price of Brent were to stay around US\$87 per barrel⁽⁴⁾, the impact on inflation next summer could be notable and contribute to upside surprises.

... while services inflation is sticky

Meanwhile, services inflation remains elevated, both relative to pre-pandemic norms and relative to goods inflation amid elevated unit labour costs and tight labour markets. Regarding the latter, recent data are sending a mixed message on how supply and demand are evolving, but most indicators of labour demand are still high in OECD countries. For instance, the unemployment rate in the Eurozone is at its lowest since the start of the euro. In the US, the vacancies-to-unemployed ratio is down to 1.4 from 2022's peak⁽⁵⁾ of around 2.0, indicating a better balance between supply and demand. However, the ratio is still higher than before the pandemic and has held steady at around 1.4 for several months, which suggests that the labour market remains tight and wage growth elevated.

Productivity is a wild card

Combined with weak productivity, strong wage growth will most likely sustain price pressures in services, where labour has an outsized impact on final costs. Yet, the awakening of the US' productivity entails that output and income could grow quickly without putting upward pressure on inflation.

Over the final three quarters of 2023, it grew at a pace of around 4 per cent in the US⁽⁶⁾, much faster than the average since the 1970s. But how can we explain this performance?

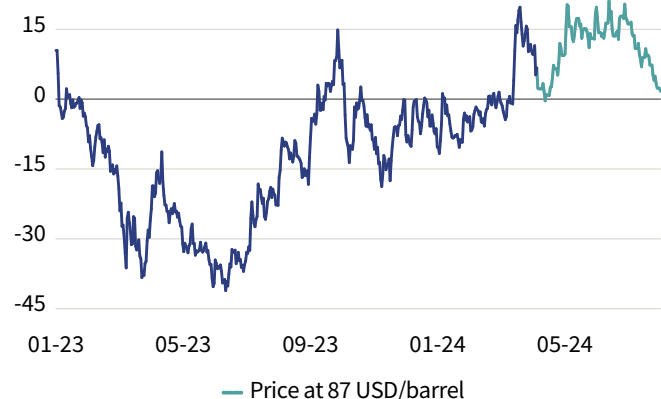
First, productivity is volatile. It actually fell in 2022 and early 2023, so the rebound could be an adjustment from earlier mediocre data. Historically, periods of fast growth that last more than a few years are unusual, and identifying the causes are notoriously very complex.

Some investors have pointed to recent large investment projects, such as those associated with the Inflation Reduction Act or Artificial Intelligence, as boosters of productivity. While they could increase longer-run productivity growth, these investments will take place over many years and are thus unlikely to have had a meaningful impact in the short term.

Another factor is the resolution of supply chain problems. While this factor might be compelling, this boost would only be temporary once supply chain issues are resolved. As such, this is probably a one-off factor that has raised the level, but not the long-run growth rate of productivity.

World – Brent

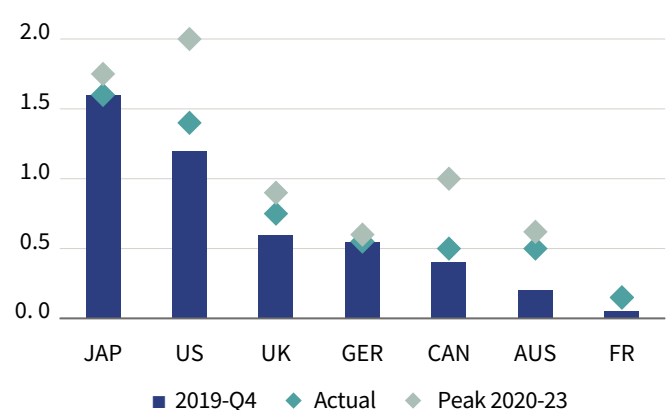
in %, y/y



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

World – Vacancy and unemployment ratio

ratio



Sources: IMF, Rothschild & Co Asset Management, April 2024.

(4) Source: Bloomberg, 28/03/2024.

(5) Source: S&P Global, March 2024.

(6) Source: Bloomberg, 31/03/2024.

Others have argued that the recent productivity growth is linked to changes in work organisation and the use of technology in the post-pandemic period. While these changes could indeed have affected the level of productivity and short-run growth, this is also an unlikely driver of sustained productivity growth.

The complicated last mile

The monetary policy tightening in 2022-23 did weigh on economic activity, but was offset by the fiscal policy, especially in the US where the public deficit widened significantly. Furthermore, the transmission mechanism appears to have been countered by the significant easing of financial conditions since the early Q4-23 peak.

Early December marked a tug-of-war between markets and central banks, as pricing indicated greater investor conviction in earlier and deeper rate cuts. Yet, from early January onwards, central bank communication increasingly pushed back to dispel excessive market optimism. Still, government bond yields have declined since last October, on balance, even though they underwent substantial gyrations, while equity markets posted substantial gains. What's more, the compression of equity market volatility (VIX) persisted, and credit spreads continued to compress, especially in the high-yield segment.

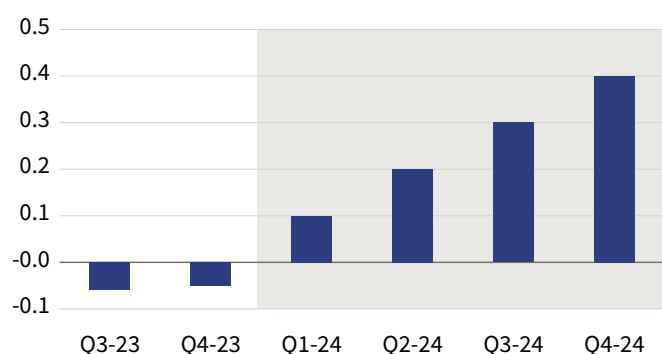
In fact, the loosening in financial conditions in the past five months coincides with the improvement of business confidence surveys in both the manufacturing and services sectors. This points to a gradual recovery in most advanced economies over the course of 2024, while growth is expected to remain robust in the US. Investors foresee that as inflation falls and wages remain buoyant, real incomes will rebound, supporting economic activity even though the stock of excess savings accumulated during the pandemic has largely been depleted, or invested in non-financial assets, such as housing, and in relatively illiquid financial assets, such as stocks and bonds. In addition, the dampening impact of past interest rate increases will gradually fade, and global trade is expected to pick up.

Correspondingly, the resilience of the economy is another reason why the speed of the final descent of inflation to target is highly uncertain. Central bankers may thus decide to be patient and hold their policy rate at the current restrictive stance for longer than previously thought, to help keep inflation on a sustainable trajectory toward targets. After all, the risk of waiting a little longer to ease policy seems small and significantly lower than acting too soon and possibly squandering the progress on inflation..

Completed writing on 5 April 2024

Eurozone – GDP growth

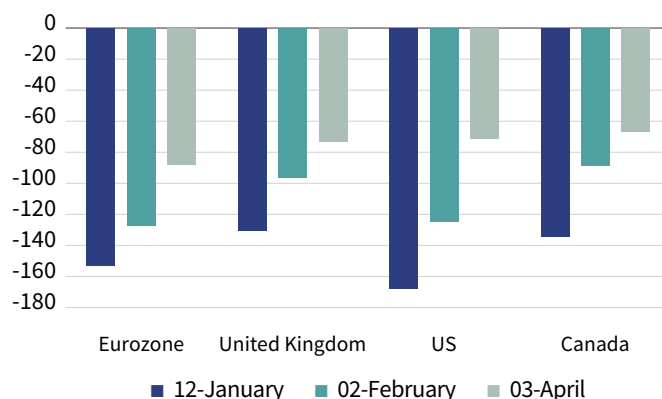
in %, q/q



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

World – Change in policy

in bp, year 2024



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

Performance of the indices and interest rate levels

	Price as of 28/03/2024	1 month % change	2024 % change
Equity markets			
CAC 40	8 206	3.5%	8.8%
Euro Stoxx 50	5 083	4.2%	12.4%
S&P 500	5 254	3.1%	10.2%
Nikkei 225	40 168	7.9%	20.0%
Currencies			
EUR/USD	1.08	-0.1%	-2.3%
EUR/JPY	162.06	0.7%	4.8%

Interest rates	Price as of 28/03/2024	1 month bp ⁽¹⁾	2024 bp ⁽¹⁾
3 month			
Eurozone	3.83%	-1	22
United States	5.36%	-2	3
10 years			
Eurozone	2.30%	-11	27
United States	4.20%	-5	32

(1) Basis point.

Source: Bloomberg, data as of 28/03/2024. 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.

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