Rothschild & Co
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Monthly Macro Insights

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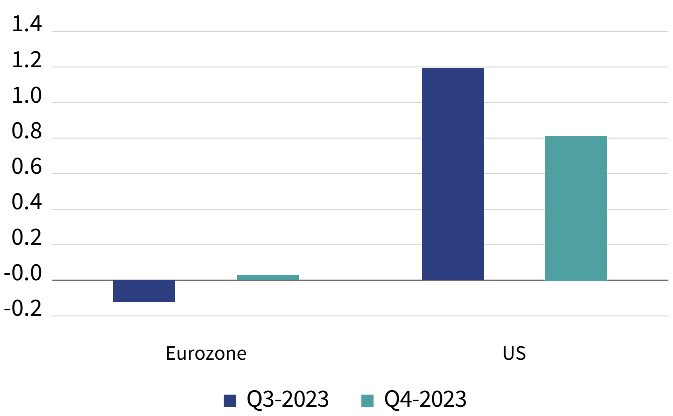
Regional divergence remained significant at the end of 2023. Although the impacts of high interest rates and the withdrawal of fiscal support amid debt sustainability concerns are expected to weigh on growth in 2024, investors are keeping their sanguine outlook as they foresee fast interest rate cuts. Yet, resilient labour markets and renewed pressures on supply chains could require a tighter monetary policy stance than expected, upsetting investors' high hopes.

The US mask a lacklustre H2-2023

The US exceptionalism continued in late 2023, with GDP up 0.8 per cent q/q after the 1.2 per cent surge in Q3-2023[1]. Once again, the main engines were household consumption and government expenditures. In fact, the contribution of the latter to the GDP in 2023 has been twice as strong compared to the 2015-2019 period average which, combined with the surge in the federal deficit, shows how the economy has been boosted by the help of the public sector. Falling savings rates and the surge in credit card growth were also important factors behind the resilience of household consumption, all of which seem unlikely to persist for long. What's more, the lagged effects of monetary policy tightening and gradual fiscal tightening are also causing headwinds.

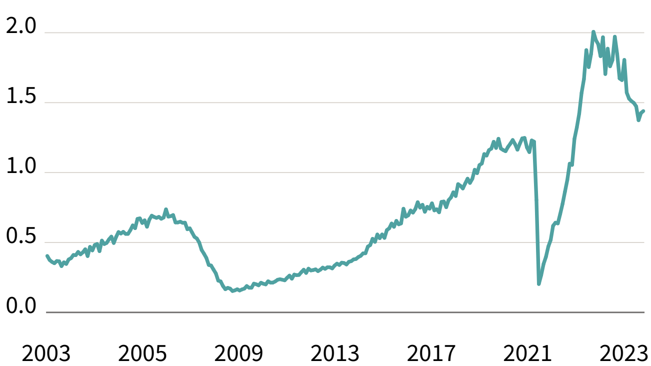
Conversely, the eurozone economy stagnated in Q4-2023 as GDP fell in Germany and marginally in France. The Spanish economy posted a surprisingly strong gain (0.6 per cent q/q[2]), but the headline reading probably overstates the strength of underlying demand as government spending and inventories made large contributions to growth. Overall, eurozone growth is no doubt lacklustre, especially compared to the US, although economic

Advanced economies – GDP
in %, q/q



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

US – Job vacancies per unemployed
ratio



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

(1) Source: U.S. Bureau of Labor Statistics, February 2024.
(2) Source: Eurostat, February 2024.

activity is not falling off a cliff either. Looking ahead, survey data suggest the start of 2024 was still relatively weak, especially in Germany where the Ifo business confidence index unexpectedly fell in January for a second month. The country continues to suffer from weak global demand and the aftermath of the energy crisis, while a rebound in consumer spending has not yet materialised.

In China, household consumption was clearly the main driver of the 2023 economic growth amid the short-lived activity surge in China early last year, following the reopening from pandemic restrictions. Conversely, investment was much weaker compared to the pre-pandemic period, accounting for less than a third of GDP growth. The first data for 2024 point at an economy still fragile as the manufacturing PMI was up marginally in January to 49.2 from 49 in December, remaining in contraction territory for a fourth straight month. The non-manufacturing PMI[3] reached 50.7 from 50.4 as the services PMI (50.1) suggests activity expanded for the first time since October, although confidence in the construction sector eased to a three-month low. The details showed the small improvement in business confidence was mostly driven by external demand, whereas domestic demand still appears to be struggling despite a range of stimulus measures that were rolled out since the second half of 2023. Overall, it seems that more support from Chinese authorities is needed especially as deflationary pressures are a key challenge for growth this year, with both consumer inflation and producer price having surprised to the downside in the past few months.

The People's Bank of China (PBOC) announced that the reserve ratio requirements (RRR) for banks will be cut by 50 basis points in an effort to increase the capacity for lenders to extend loans and spur spending in the broader economy. This is the first reduction in RRR this year after two cuts last year, and so far, the impact on the economy seems to have been rather limited since the real estate sector remains in a process of deleveraging, with some of its largest property developers facing serious debt problems. Furthermore, the real estate troubles are closely intertwined with local government finances since they have typically relied on land sales to developers for a significant portion of revenue.

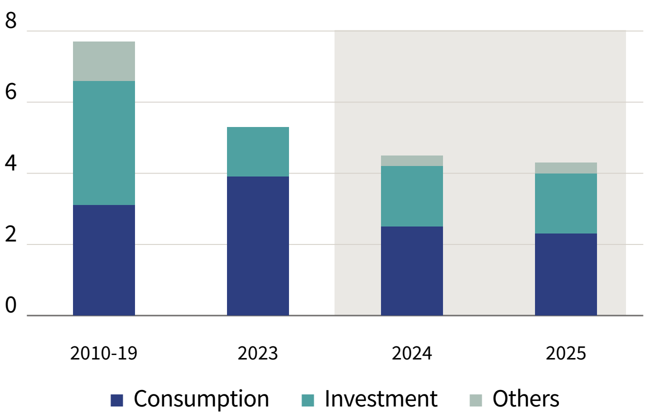
Strong labour market could derail the disinflation trend

Amid favourable global supply chain improvements, lower commodity prices and a tight monetary policy, inflation has been falling for the past few quarters. According to the latest IMF projections, inflation in advanced economies is expected to fall from 4.6 per cent in 2023 to 2.6 per cent this year, thus remaining above most central banks' targets for the fourth year in a row[4].

In fact, the risk of persistent core inflation, requiring a tighter monetary policy stance, seems to be highly underappreciated by investors. 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, disrupting production schedules and raising price pressures. Combined with the ongoing war in Ukraine, it risks generating fresh adverse supply shocks, with spikes in food, energy, and transportation costs. In addition, the conflict in Gaza and Israel could escalate further into the wider region, which produces about 35 per cent of the world's oil exports.

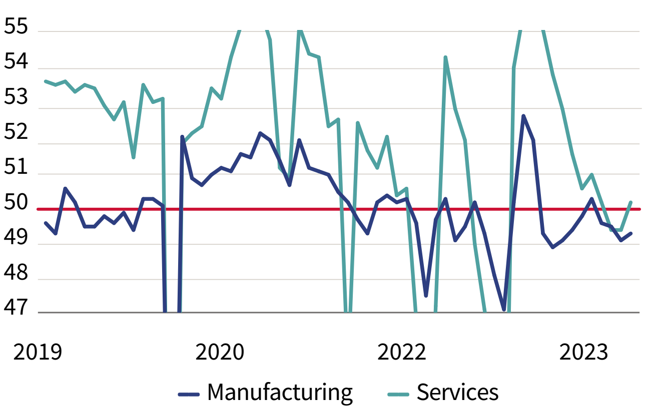
The tightness of most labour markets is also a cause for concern. In the eurozone, the unemployment rate stayed at a record 6.4 per cent in December[5]. Many companies have been hoarding labour, retaining more staff than they need in the hope that they will be

China – Contributions to growth
in %



Sources: World Bank, Rothschild & Co Asset Management, February 2024.

China – Business Surveys
NBS index



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

(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: FMI, World Economic Outlook, January 2024.
(5) Source: Eurostats, February 2024.

able to operate at increased capacity when demand rebounds. Accordingly, risks of elevated wage pressures and hence above target medium-term inflation remain high. Most ECB members have tried to push back against investor expectations of imminent rate cuts, and President Lagarde has recently insisted data regarding wages are critically important in deciding when to begin monetary easing. Yet, those figures aren't due until after the 11 April ECB meeting, suggesting a first-rate cut is unlikely before mid-2024 – later than what is priced in by investors.

In the US, job openings unexpectedly rose in the last two months of 2023, suggesting that demand for workers remains solid, despite the fact that the number of people voluntarily quitting their jobs was the lowest in nearly three years. In addition, 353,000 jobs were created in January, almost twice as many as forecast, and the three-month average reached almost 290,000, the highest level since March 2023. This could lead to persistently high core services inflation. Indeed, wage increases remain significant as the tight labour market give workers strong bargaining power while businesses have high pricing power thanks to a buoyant economy.

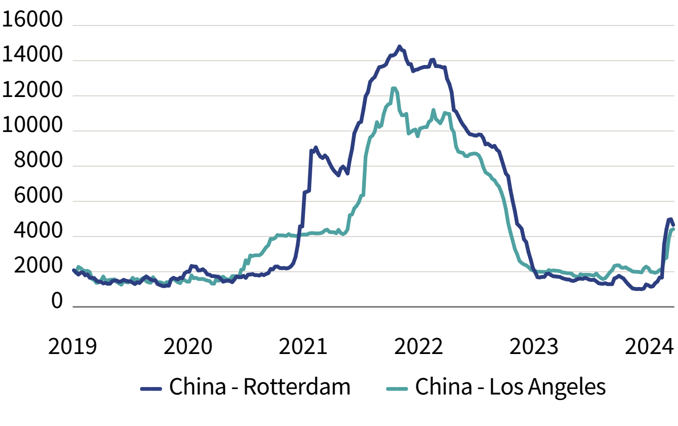
In this context, Fed Chair Powell reframed his message by adopting a much less accommodating tone compared to the December meeting where he surprised market participants by suggesting that rate cuts were clearly on the agenda. So it appears the Fed will not act as a lone ranger.

In sum, core inflation is still above target in most countries and unit labour cost growth generally remains above levels compatible with medium-term inflation objectives. Correspondingly, it is highly uncertain that the inflationary episode that began in 2021 will end soon, and the significant monetary easing that is expected by investors might well be misplaced.

Completed writing on 6 February 2024

World – Maritime freight rates

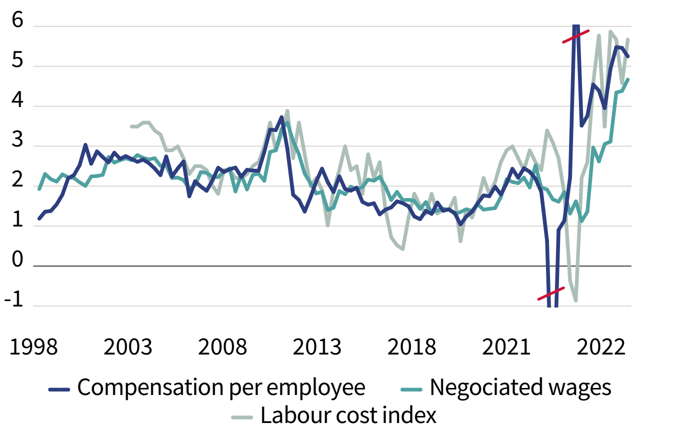
USD per container



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

Eurozone – Wages indexes

in %, y/y



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

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

Performance of the indices and interest rate levels

	Price as of 31/01/2024	1 month % change	2023 % change
Equity markets			
CAC 40	7 657	1.5%	1.5%
Euro Stoxx 50	4 648	2.8%	2.8%
S&P 500	4 846	1.6%	1.6%
Nikkei 225	36 287	8.4%	8.4%
Currencies			
EUR/USD	1.08	-2.0%	-2.0%
EUR/JPY	158.95	2.1%	2.1%

Interest rates	Price as of 31/01/2024	1 month bp(1)	2023 bp(1)
3 month			
Eurozone	3.80%	19	19
United States	5.36%	3	3
10 years			
Eurozone	2.27%	24	24
United States	3.91%	3	3

(1) Basis point.

Source: Bloomberg. data as of 31/01/2024. 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.

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 31 billion euros and employ nearly 160 people. More information at: www.am.eu.rothschildandco.com

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