Monthly Macro Insights — May 2024

STRATEGY — 13/05/2024

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Recent monthly indicators suggest that the slowdown in global growth around the turn of the year has bottomed out. However, inflation outlook remains murky and the latest data have shaken investors' confidence that significant monetary policy easing is in the offing.

Unpleasant surprises in the US…

Global economic growth has been moderating since the second half of 2023 and, until recently, was also greatly uneven among countries. It was robust in the US, driven by strong household consumption and unexpected expansionary fiscal policy. Activity was also buoyant in some large emerging economies, namely India, helped by strong public investment in an election year, and surprised on the upside in Brazil and Mexico. In sharp contrast, growth weakened in many other advanced economies, especially in Europe. In fact, a rising number of economies experienced a technical recession in 2023, with two or more consecutive quarterly GDP declines. Yet, the regional divergence has somewhat diminished in Q1-24 as the US lost steam while Europe rebounded.

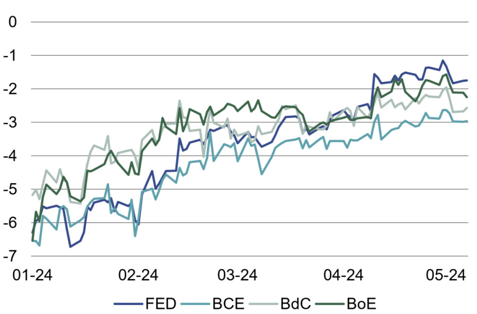
Amid higher borrowing costs, historically high delinquency rates in both credit cards and auto loans, and the rundown of accumulated excess household savings, US GDP growth came in below consensus estimates, at 1.6 per cent annualised – or 0.4 per cent q/q – down from the robust growth of 4.1 per cent in the second half of last year, making it the lowest reading since spring 2022[1]. Although volatile net exports and inventories categories partly explain the downward surprise, business confidence surveys tumbled in April, with the ISM[2] indexes for both manufacturing (49.2) and services (49.4) particularly disappointing. The latter was the lowest since 2009 bar the pandemic period, suggesting the loss of economic momentum accelerated entering the second quarter.

Simultaneously, the disinflation process has been stalling since January, with monthly consumer price increases that are not compatible with a swift return to target. Core goods price inflation has fallen steadily, but services price inflation has been stickier, especially the supercore measure (core services ex. housing) in part reflecting the greater weight of wages in the services sector.

Correspondingly, Fed Chair Powell has been forced to acknowledge at the May meeting that gaining confidence in inflation normalising will likely take longer than previously expected. However, unlike some of his colleagues, he steered clear of any suggestion that the next move could be a hike in the fed funds rate, insisting instead that any further persistence in inflation would lead him to hold off on rate cuts.

World – Change in policy rate

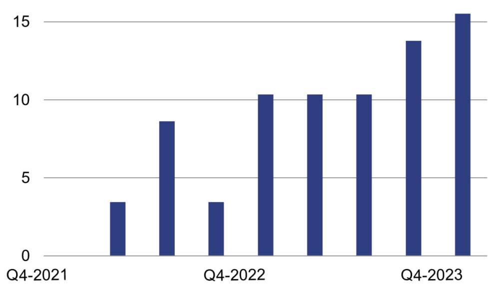
in number of rate cut of 25 bp for 2024



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

World - Countries in technical recession

in %, 2 successive quarterly GDP declines



Sources: OECD, Rothschild & Co Asset Management, May 2024.

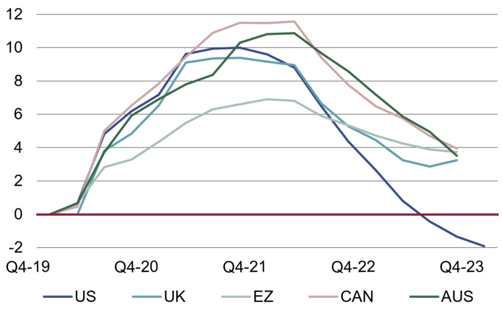
… yet investors remain sanguine

Overall, the US has been facing an ominous mix of slower growth, yet accelerating inflation in the first part of this year. Still, financial markets have so far proved resilient, and global financial conditions have eased in recent months amid strengthening equity prices, receding volatility and signs that the transmission of monetary policy tightening to credit conditions may be approaching its end. Indeed, in most advanced economies, bank lending rates to household mortgages have edged down recently, suggesting a completed pass-through of past policy rate increases, while the tightening in credit standards has moderated according to the central banks' lending surveys.

The paradox is that, combined with past years' expansionary fiscal policies, this easing of financial conditions is feeding the resilience of the economy, and in turn is another reason why the speed of the final descent of inflation to targets is highly uncertain. Expectations that inflation will continue to decline steadily while growth remains robust – the immaculate disinflation[3] – could prove misplaced, especially since geopolitical tensions, namely in the Middle East, is a significant near-term adverse risk.

World – Excess accumulated savings

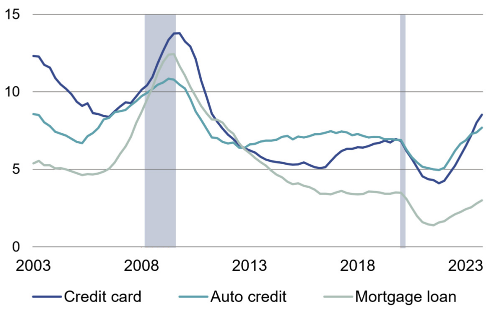
in % of GDP



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

US – Delinquencies rates

in %, 30 days



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

Diverging monetary policies

While the Fed has seemed on pause for some time, the ECB has signalled it is highly likely to start cutting interest rates at its next policy meeting on June 6, as long as price pressures are in line with its forecasts, and labour costs cool somewhat. However, the Governing Council is facing a complex equation.

On the one hand, financial market spillovers from monetary policy divergence can be significant, although the linkages are not necessarily straightforward and depend on the context. Expectations that the Fed will hold off cutting rates in part explain the rise in yields on governments bonds in Europe, making it more costly to borrow and buy a home or expand a business. All else equal, this is a headwind for the eurozone economy, which would tend to lower inflation.

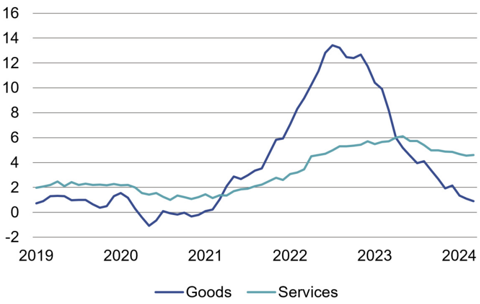
On the other hand, some ECB members have expressed concerns about committing to more easing after June because of the risk that this would cause the euro to depreciate, thereby increasing inflation by pushing up import prices.

What's more, the eurozone delivered upside surprises on growth and core inflation in the first part of 2024. The latter was higher than expected in April at 2.7 per cent and the details suggest firm domestic inflationary pressures[4]. The unemployment rate was unchanged at its historical low of 6.5 per cent in March[4] and has been stable over the past year despite mediocre GDP growth. The counterpart to this is weakness in productivity, and that looks to have continued despite the improvement in GDP growth. According to the Eurostat flash estimate, the economy grew 0.3 per cent q/q in Q1-2024, likely ending the shallow technical recession of H2-2023.

Overall, the eurozone's growth is somewhat recovering without clear signs of improving productivity growth. While services inflation remains sticky, a complicated equation could disappoint investors' outlook of ECB monetary easing beyond the well-telegraphed June rates cut.

OECD – Inflation rate

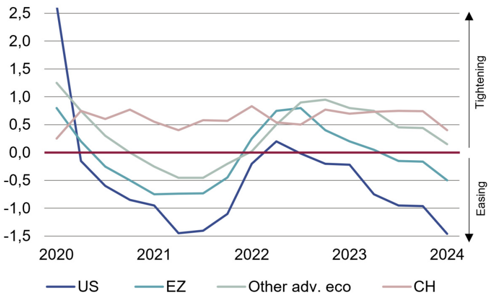
in %, median



Sources: OECD, Rothschild & Co Asset Management, May 2024.

World – Financial conditions

standard deviation over the long-term average



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

Performance of the indices and interest rate levels

	Price as of 30/04/2024	1 month % change	2024 % change
Equity markets			
CAC 40	7 985	-2.7%	5.9%
Euro Stoxx 50	4 921	-3.2%	8.8%
S&P 500	5 036	-4.2%	5.6%
Nikkei 225	38 406	-4.4%	14.8%
Currencies			
EUR/USD	1.07	-1.1%	-3.4%
EUR/JPY	168.22	3.0%	8.0%

Interest rates	Price as of 30/04/2024	1 month bp(1)	2024 bp(1)
3 month			
Eurozone	3.80%	-3	19
United States	5.39%	3	6
10 years			
Eurozone	2.58%	29	56
United States	4.68%	48	80

(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

Completed writing on May 10th, 2024.

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(1) Source: U.S. Bureau of Labor Statistics, May 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) Immaculate disinflation.
(4) Source: Eurostat, May 2024.

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