Rothschild & Co
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Monthly Macro Insights

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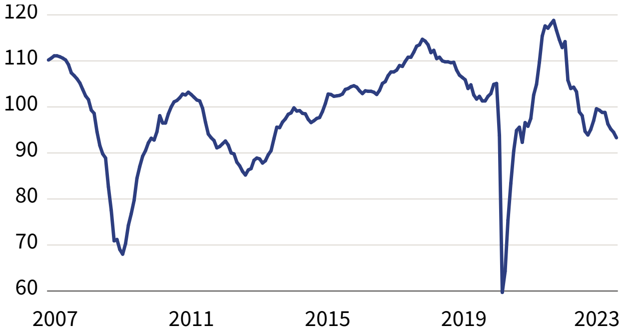
Over the past months, narratives dominated by central bank tightening producing an inevitable recession have faded from the scene. In fact, investors continue to wager that the resilience of the US and global expansions will persist. However, the economic outlook remains particularly uncertain amid further deterioration in business confidence.

China and Europe raise concerns – again…

The message from Europe's August surveys is clear: the expansion is at risk. In the UK, the PMI[1] tumbled to 48.6 after a modest recovery over the past six months as the cooling economic effects of higher interest rates started to impact on spending and confidence. Several businesses stressed that faltering UK economic growth and sticky inflation were weighing on the outlook, especially since the backlogs of work sub-index fell to the weakest level for over three years.

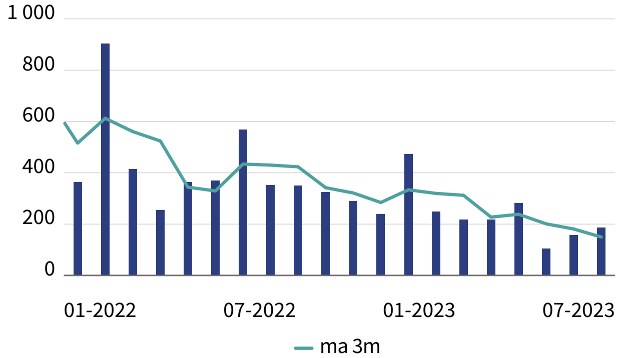
In the Eurozone, the EC economic sentiment survey[2] fell to 93.3[3], a level last seen in Q3-22 when an energy crunch was feared after Russia's invasion of Ukraine, and during the Eurozone debt crisis in early 2010s. This downturn echoes the sharp fall in the composite PMI, down to 47 amid a sharp fall in services' business confidence. Several factors can explain the significant decline in the surveys, including China's disappointing economic activity and building monetary policy drags. On the latter, lending to households in July showed a quickening fall in growth as higher mortgage rates are at play, while loans to businesses were also decelerating. In fact, the latest ECB Bank lending survey showed that credit standards to

Eurozone – Economic sentiment
European Comission index



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

US – Non farm payroll
in thousand, m/m



Sources: Macrobond, Rothschild & Co Asset Management, September 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
(2) The Economic Sentiment Indicator (ESI) is a composite indicator produced by the European Commission's Directorate-General for Economic and Financial Affairs (DG ECFIN).
(3) Eurostat, September 2023.

corporates tightened further, while a record percentage of financial institutions reported declining demand for loans from businesses[4].

In China, recent developments increased concerns around potential spillover from housing weakness to the rest of the economy, although the signals from August's PMIs were modestly constructive. Business confidence in the non-manufacturing sectors unexpectedly slowed in August to 51.8 from 54.1 in July according to the S&P Global index, the lowest level in eight months. Optimism in the services sector cooled markedly, as expectations about future activity recorded the lowest reading since November. However, the manufacturing index jumped to 51 from 49.2, sparkling optimism that the authorities' stimulus measures announced in the past few weeks will inject confidence and dynamism into the Chinese economy[5]. For instance, the People's Bank of China decided to cut rates for existing mortgages and lower down-payment requirements, as policy continues to aim at steadying the slowdown in the real estate sector.

... and divergences could soon fade

In contrast, the latest macroeconomic data in the US suggest the economy is robust. Consumption remained robust in July, and labour demand stayed solid last month, as employment increased by another 187,000, an acceleration from the 157,000 gain the prior month, which would have been even larger were it not for the Hollywood strike and trucking bankruptcy[6].

However, business confidence fell in August to the lower range of the post-GFC period, suggesting that risks to the downside have increased. What's more, the Fed's Senior loan officer opinion survey on lending showed a significant net share of banks reported having tightened standards for credit card and other consumer loans. Yet, credit has played a determining role to support consumption as households' savings rate has dropped to an almost all time low. Furthermore, for the past three years, student loan borrowers in the US have enjoyed a suspension of interest accumulation on their loans, providing some financial breathing room for millions of individuals. However, on Friday 1 September, interest started accruing and payments are expected to commence on Sunday 1 October, impacting 43 million borrowers who owe more than US$1.7 trillion[7].

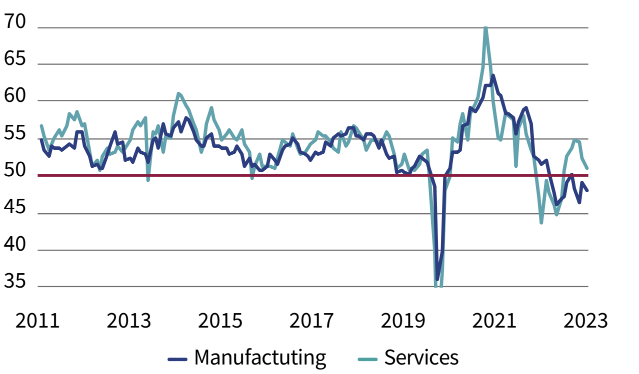
Meanwhile, until recently, global economic activity has been marked by unusually large sectoral divergence with a weak manufacturing sector, yet robust activity in the services sector, supporting investors' expectation for global growth to remain resilient. This divergence has somewhat receded in August, but for a mixed reason.

The services sector is unfortunately showing signs of turning down to match the poor performance of manufacturing. The downturn in the latter continued with the index below the 50-threshold for a year, although data from August provided signs that the contraction was easing. That said, the slight improvement on the month owes almost entirely to China. In fact, excluding the latter, the global manufacturing PMI declined once again and is stuck at a level that does not point to much, if any, momentum lift in the sector, as future output sub-index and the new orders-to-inventory ratio remain at a level consistent with output declines[8].

Overall, while investors remain sanguine regarding the economic outlook, the latest business confidence surveys do not corroborate this view.

US – Business confidence

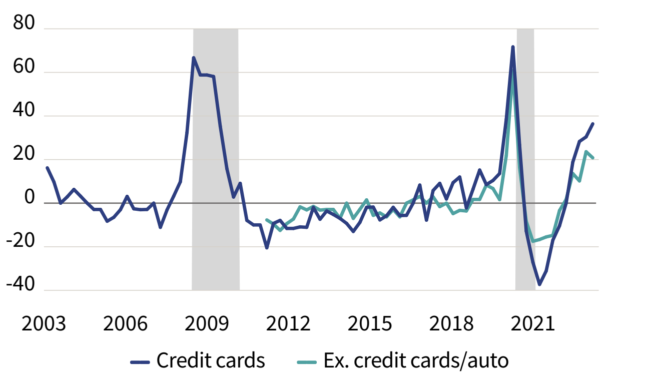
S&P Global



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

US – Bank lending conditions

in ppt, net tightening for households



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

(4) Banque de France, Press release of 25 July 2023

(5) National Bureau of Statistics of China, September 2023

(6) U.S. BLS, August 2023.

(7) Bloomberg, September 2023.

(8) National Bureau of Statistics of China, September 2023

Inflation likely to remain a constraint

Were downside risks to materialise and upset investors' scenario of a resilient global economy, how quickly would central banks react to support the economy?

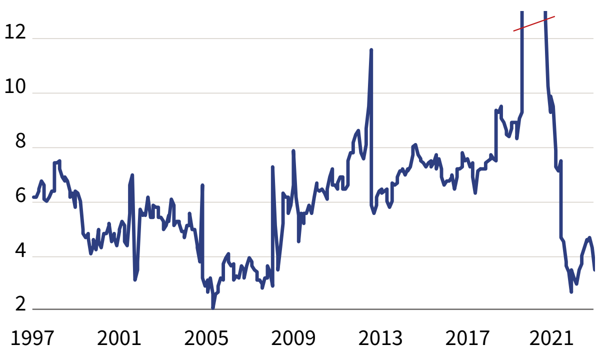
The recent decline in inflation has been encouraging, mainly due to lower base effects in commodities. However, services price and wage inflation remain elevated and sticky. Central banks are thus likely to respond more slowly to an upturn in unemployment rates compared to recent history in order to preserve their credibility.

Investors' view of a relatively painless return of inflation rates to targets could prove highly uncertain. In that regard, history shows that in the early 1980s, Fed Chairman Paul Volcker was forced to deteriorate the labour market to curb inflation. Short-term pain, but long-term gain.

Completed writing on 6 September 2023

US – Household saving rate

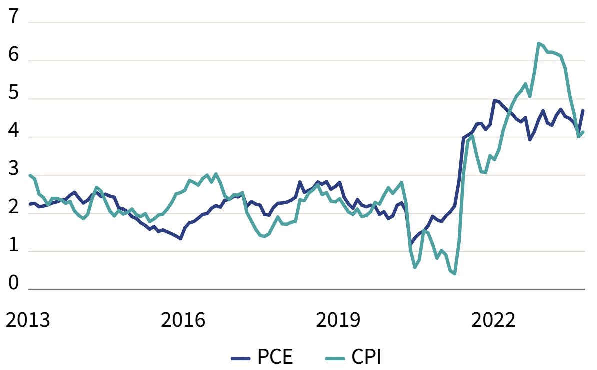
in % of disposable income



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

US – Core inflation services less shelter

in %



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

Performance of the indices and interest rate levels

	Price as of 31/08/2023	1 month % change	2023 % change
Equity markets			
CAC 40	7 317	-2.4%	13.0%
Euro Stoxx 50	4 297	-3.9%	13.2%
S&P 500	4 508	-1.8%	18.1%
Nikkei 225	32 619	-1.7%	25.0%
Currencies			
EUR/USD	1.08	-1.4%	1.4%
EUR/JPY	157.82	0.9%	12.4%

Interest rates	Price as of 31/08/2023	1 month bp(1)	2023 bp(1)
3 month			
Eurozone	3.65%	5	189
United States	5.44%	4	109
10 years			
Eurozone	2.47%	-3	-11
United States	4.11%	15	23

(1) Basis point.

Source: Bloomberg. data as of 31/08/2023. 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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