Monthly Macro Insights

September 2021

Rothschild & Co
Asset Management

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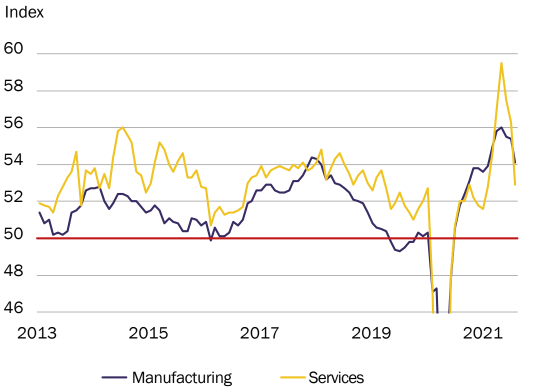
Despite clear weakening activity and survey measures, investors remain optimistic that downward revisions to current-quarter growth will be offset by a symmetrical rebound later this year. Indeed, part of the recent disappointing data is attributed to supply bottlenecks and resurgent pandemic fears that are judged transitory, especially in the face of rising vaccination rates.

Slumping confidence and widening divergence

According to the latest Markit business confidence index, the rate of global economic expansion slumped to a seven-month low in August, as growth eased across the manufacturing and service industries, with a deepening divergence between regions. Governments of economies with high vaccination rates are able to resist another round of shutdowns, opting instead for targeted measures. However, the slowdown is particularly acute in some regions, notably in Asia where in Japan (45.5) and China (47.2) confidence fell below the 50-threshold, in contraction territory.

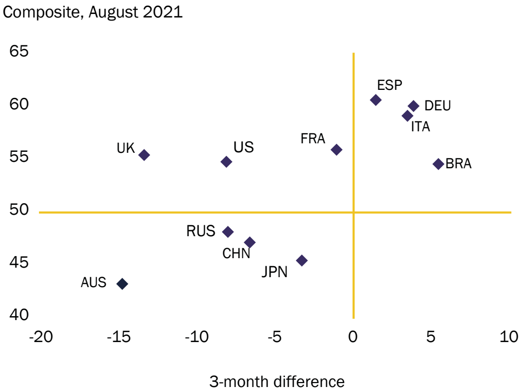
Uncertainty introduced by recent regulatory changes, flooding and efforts to contain the recent resurgence of COVID-19 cases impacted Chinese economic activity, especially in the service sector. Indeed, mobility restrictions held back consumer spending and domestic tourism activity during the peak summer travel season. That said, services companies remain somewhat upbeat as they anticipate activity could rebound quickly when restrictions are lifted. While the Chinese economy's growth momentum slowed notably in Q3, investors expect the authorities will address the deteriorating environment by ramping up monetary and fiscal stimulus.

World - Markit business confidence



Source: Macrobond, Rothschild & Co Asset Management Europe, September 2021.

World - Markit business confidence



Source: Macrobond, Rothschild & Co Asset Management Europe, September 2021.

In addition to the Chinese slowdown, emerging countries (EM) are facing several headwinds, from poor access to vaccines to a fragile health care system. Manufacturing and tourism-led economies like Vietnam and Thailand have been forced to close factories and turn away visitors. In turn, troubles in the Asian industrial and shipping sectors are causing complex and interlinked supply shortages globally. For instance, the auto industry is signaling that supply constraints will generate additional production cutbacks through September, while auto sales are plunging globally.

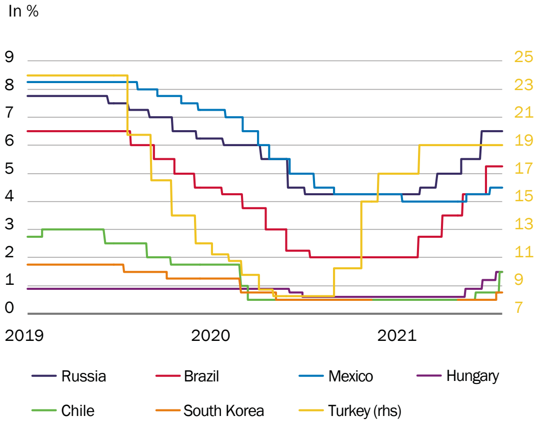
What's more, monetary policies are being tightened in many EM. In Chile, the central bank surprised investors and raised its policy rate by 75bp to 1.50%, as it is facing challenges to its credibility from rising inflation. The Bank of Korea also surprised market expectations and hiked its rate by 25bp to 0.75%, after maintaining a record-low rate since May 2020, becoming the first major Asian economy to raise interest rates since the pandemic began. The move was aimed at helping curb the country's household debt and home prices, which soared in recent months. As such, Chile and South Korea followed the path of several other EM central banks this year that hiked pre-emptively. In fact, policy makers are attempting to balance the need to support the economy against the risks of surging debt and rising inflation, yet the tightening cycle will impact economic activity.

Tapering uncertainty

In the US, consumer confidence dropped as concerns about the Delta variant – and also the rise in inflation – were a clear drag. The improvement in the labour market continued in August, but at a much slower pace as only 235,000 jobs were created, missing expectations (725,000) and breaking the string of robust job gains of the prior two months. The leisure and hospitality sector saw no job gains in August, having increased by an average of 350,000 positions per month over the previous six months. That said, the weakness might be a bump in the road as robust wage growth suggest that labour supply – not demand – drove the weakness. The expiration of the augmented unemployment benefits (US$300 per week) in early September and the availability of vaccine booster shots could brighten the prospects for improvement in September. On the other hand, persistent fears about catching Covid, as well as childcare issues, could weigh on the labour market for some time.

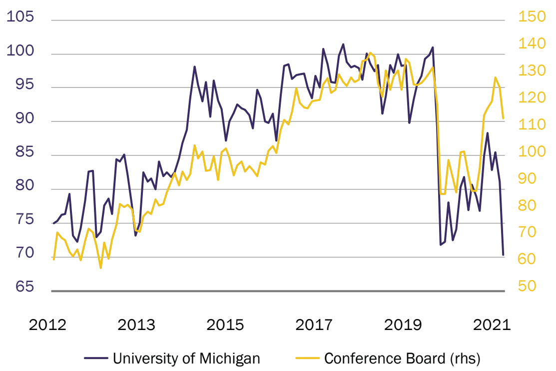
Overall, the employment data will likely amplify the debate among Fed members regarding tapering. Fed Chair Powell's speech at the annual Jackson Hole Symposium was consistent with his gradual and measured approach to policy changes. He seemed comfortable with the idea that adjustments could be implemented by the end of the year, although he also indicated further improvement needed to be made on the labour market front before tapering stimulus.

Emerging Markets



Source: Macrobond, Rothschild & Co Asset Management Europe, September 2021.

US - Household confidence



Source: Macrobond, Rothschild & Co Asset Management Europe, September 2021.

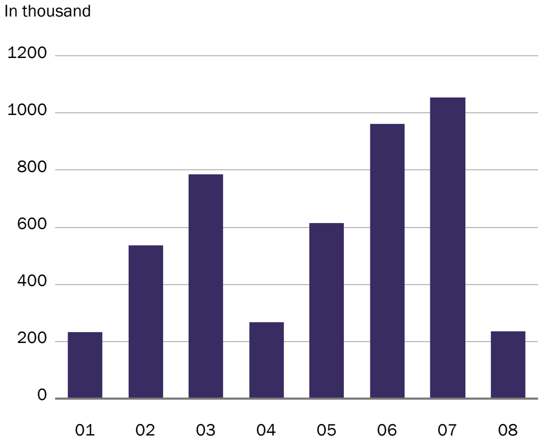
Indeed, pulling back policy support prematurely could be harmful with substantial slack remaining as, despite recent strides in the labour market, 5.3m more Americans remain out of work compared to February 2020, before the onset of the global pandemic.

However, his economic outlook was criticised for not reflecting sufficient appreciation of bottom-up, cost push pressures that several businesses are experiencing, which represent an inflation risk. Correspondingly, some officials have called for the Fed to announce plans at its September meeting to begin scaling back its US$120bn asset purchase programme, arguing that the economy is now on a sustainable growth path, particularly with rising inflation and a tightening labour market. Furthermore, some argue that the Fed's purchases now run the risk of creating bubbles in financial and housing markets. The S&P CoreLogic Case-Shiller home price index rose 19.1% y/y in June, the strongest growth in more than 30 years of data, and the third consecutive month of record gains. Strong demand, coupled with rising lumber costs and labour and material shortages, combined to push home prices to new highs.

Overall, service-sector activity is slowing sharply amidst resurgent pandemic fears while supply bottlenecks are disrupting goods production and adding to inflationary pressures globally, thus generating downside risks to the economic outlook. This might well explain why sovereign rates have remained very low despite the surge in global growth in Q2 2021 and higher inflation. In addition, the debate regarding the lasting impacts of the pandemic on potential GDP growth is far from settled, which might put a ceiling on long term interest rates. ■

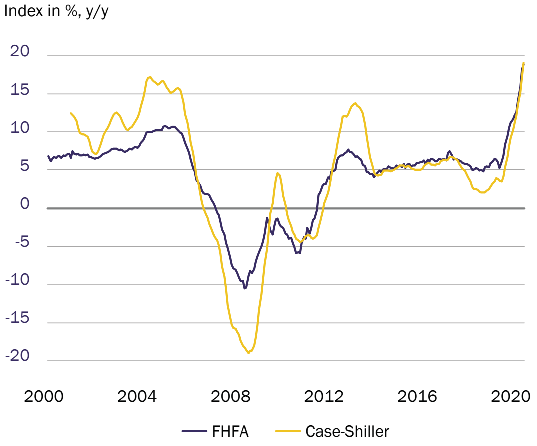
Completed writing on 7 September 2021

US - 2021 job creation



Source: Macrobond, Rothschild & Co Asset Management Europe, September 2021.

US - Housing prices



Source: Macrobond, Rothschild & Co Asset Management Europe, September 2021.

Performance of the indices and interest rate levels

	Price as of 31/08/2021	1 month % change	2021 % change
Equity markets			
CAC 40	6 680	1.0%	20.3%
Euro Stoxx 50	4 196	2.6%	18.1%
S&P 500	4 523	2.9%	20.4%
Nikkei 225	28 090	3.0%	2.4%
Currencies			
EUR/USD	1.18	-0.5%	-3.3%
EUR/JPY	129.92	-0.2%	3.0%

		Price as of 31/08/2021	1 month bp(1)	2021 bp(1)
Interest rates				
3 months	Eurozone	-0.63%	0	14
	United States	0.00%	0	-6
10 years	Eurozone	-0.19%	2	38
	United States	1.59%	-3	68

(1) Basis point.
Source: Bloomberg, data as of 31/08/2021. 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 Europe
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