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Monthly Macro Insights



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Global slowdown has intensified amid a combination of surging inflation, tightening financial conditions and sliding sentiment. In fact, it is likely that world GDP shrunk in Q2 2022 – for the first time since the 2020 pandemic related decrease – owing to economic downturns in China, Russia and the US. Is bad news truly good news?

Downside risks are materialising

Interpreting the recent signals from global macroeconomic data is complicated as a rebound in China from its Covid-related slump – GDP contracted significantly by -2.6% on a sequential basis (q/q) in Q2⁽¹⁾ – is taking hold while economic activity is slowing markedly in most countries. What's more, China's growth momentum seems to have already softened as the NBS manufacturing business confidence⁽²⁾ index fell to 49.0 in July – back to contractionary territory – and the non-manufacturing index dipped down to 53.8 as activity in services slowed amid sporadic Covid outbreaks⁽¹⁾. In addition, the worsening crisis in the property sector is dragging

down sales and real estate investment. Home buyers have threatened to halt mortgage payments over concerns that ailing property developers would not be able to deliver still-unfinished apartments. Overall, the Chinese recovery remains on shaky ground and might need more policy stimulus to revive confidence and support economic growth in H2, although the authorities have suggested that no massive measures would be forthcoming.

In the US, GDP fell in Q2 (-0.2% q/q, or at a -0.9% annual rate⁽³⁾) for the second consecutive quarter, disappointing expectations and reinforcing speculation that the economy is in recession. Although the labour market is not yet compatible with the concept

China – Real estate sector

stock market index



Source: Bloomberg, Rothschild & Co Asset Management Europe, August 2022.

Germany – Confidence and growth

Index and in %



Source : Macrobond, Rothschild & Co Asset Management Europe, August 2022.

(1) Source: National Bureau of Statistics of China, August 2022.

(2) Purchasing Managers' Index, an indicator reflecting the confidence of purchasing managers in a sector of activity. Above 50, it expresses an expansion of activity, below 50, a contraction.

(3) Source : Bureau of Economic Analysis, August 2022.

of a recession, most interest-sensitive categories of final demand – housing, consumer durables and business spending on equipment and structures – contracted last quarter, confirming the economy is clearly losing momentum.

By contrast, economic growth (0.7% q/q⁽⁴⁾) surprised on the upside in the eurozone according to the flash estimate. The country split hints at a positive contribution from the holiday season in the South (namely Italy and Spain) with robust Covid tourism rebound reopening effects, while gas supply issues seem to have negatively impacted Germany more forcefully. However, the Ukrainian war's effects on major European economies will likely hit hard in H2, owing to crumbling consumer confidence, slower momentum in manufacturing resulting from persistent supply chain disruptions and rising input costs, and spiking energy prices and possible rationing as the threat of a full Russian natural gas shutoff still looms on the horizon. Furthermore, the ECB hiked rates by a larger-than-signalled 50 bps at the July meeting and hinted more tightening is coming, while Italian political uncertainty has been brought again to the fore. Accordingly, despite the continuation of a vigorous labour market, a sharp slowdown is expected.

Is normalisation almost over?

Somewhat stable long-term inflation expectations in most advanced countries and a rapidly slowing global economy have cooled expectations for the scale of central banks' interest-rate hikes needed to tame inflation, spurring a July rebound in both stocks and bonds.

Since 2021, consumer prices have consistently risen faster than widely expected. Last June, prices rose by 9.1% and 9.4% in the US⁽⁵⁾ and the UK⁽⁶⁾, respectively – the highest inflation rates in these two countries in 40 years. In the eurozone, inflation reached

8.9% in July⁽⁷⁾, its highest level since the inception of the monetary union, while in emerging economies, Q2 inflation is estimated to have been almost 10%⁽⁸⁾.

Although higher commodity prices, especially food and energy, has driven up consumer prices, underlying price pressures have also increased, as reflected in different gauges of core inflation due to the pass-through of cost pressures by way of supply chains and tight labour markets. With the current surge in inflation having resulted in a sharp and unanticipated decline in real wages, attempts to recoup these losses can be expected in wage bargains, with the risk of triggering a typical wage-price spiral. In that context, central banks might well be forced to keep hiking interest rates in order to preserve their credibility and prevent inflation becoming entrenched at high levels, particularly in the US.

As expected, the Fed delivered another unusually large 75 bps rate hike in July to combat persistent inflationary pressures. Although Fed Chair Jerome Powell provided little in terms of forward guidance during his press conference, he indicated that the FOMC is looking for compelling evidence that inflation is moderating, meaning another 75 bps hike may be appropriate in September. That said, he also underscored that it will be appropriate to slow hikes eventually as interest rates reach restrictive territory, which was seen as a dovish signal and has fuelled speculation of a pivot in monetary policy.

Yet, some measures of compensation have reached record levels. The employment cost index – one of the best measures as it adjusts for composition and job-quality changes – rose 5.1% y/y in Q2, a record for a data series that goes back to Q1 2002⁽⁹⁾, while the Atlanta Fed wage tracker jumped to 6.7% y/y in June. These wage gains would require implausible rapid productivity growth to be consistent with the Fed's inflation target in the medium-term.

Italy – Sovereign spread

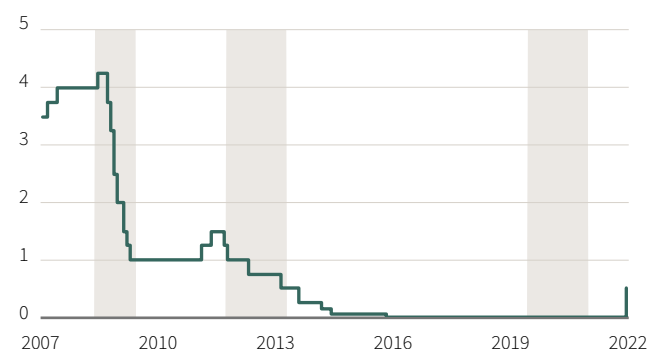
in %, 10Y, vs Germany



Source : Macrobond, Rothschild & Co Asset Management Europe, August 2022.

Eurozone – ECB refinancing rate

in %



Source : Macrobond, Rothschild & Co Asset Management Europe, August 2022.

(4) Source : Eurostat, August 2022.

(5) Source : U.S. Bureau of Labor Statistics, August 2022.

(6) Source : Office for National Statistics, August 2022.

(7) Source : Eurostat, August 2022.

(8) Source : FMI, August 2022.

(9) Source : U.S. Bureau of Labor Statistics, August 2022.

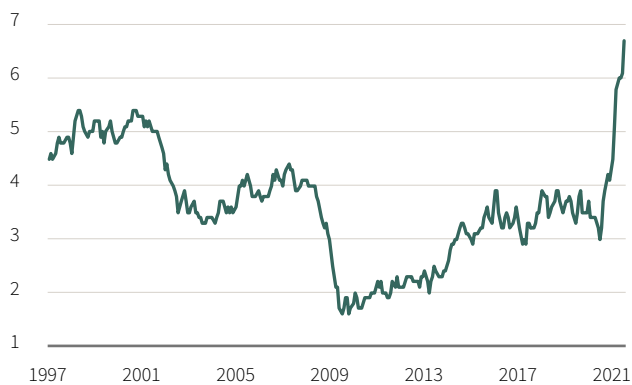
Overall, the US unemployment rate is very low, and vacancies are exceptionally high. This suggests that not only is the labour market overheating, but also the natural unemployment rate might be higher than estimated. On the assumption that the labour market needs to cool off to avert a wage-price spiral, investors hope this could happen through a decrease in vacancies and higher participation rate, thus preventing the unemployment rate to rise and avoiding the recession. However, theory suggests that this would require a strong improvement in matching labour supply and demand on which the Fed has no control. In fact, the length and depth of the slowdown – or recession –

will be determined by how long the Fed needs to maintain a restrictive policy to reduce core PCE inflation to near its 2% target. In that regard, the labour market dynamics imply that the growth sacrifice might be higher than what is expected by equity investors while the yield curve, which historically has been a rather efficient indicator of US recessions, is flashing warning signals.

Completed writing on 3 August 2022

US – Wage growth index

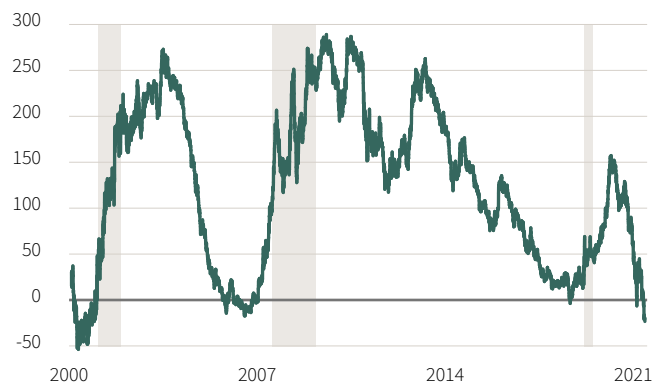
in %, y/y



Source: Fed Atlanta, Rothschild & Co Asset Management Europe, August 2022.

US – Yield curve slope

in bp, 10y - 2y



Source: Bloomberg, Rothschild & Co Asset Management Europe, August 2022.

Performance of the indices and interest rate levels

	Price as of 29/07/2022	1 month % change	2022 % change
Equity markets			
CAC 40	6 449	8.9%	-9.8%
Euro Stoxx 50	3 708	7.3%	-13.7%
S&P 500	4 130	9.1%	-13.3%
Nikkei 225	27 802	5.3%	1.3%
Currencies			
EUR/USD	1.05	-2.5%	-10.1%
EUR/JPY	137.0	-4.3%	4.0%

Interest rates	Price as of 29/07/2022	1 month bp ⁽¹⁾	2022 bp ⁽¹⁾
3 month			
Eurozone	0,01%	41	83
United States	2.32%	69	229
10 years			
Eurozone	0.82%	-52	99
United States	2.65%	-36	114

(1) Basis point.

Source: Bloomberg, data as of 29/07/2022. 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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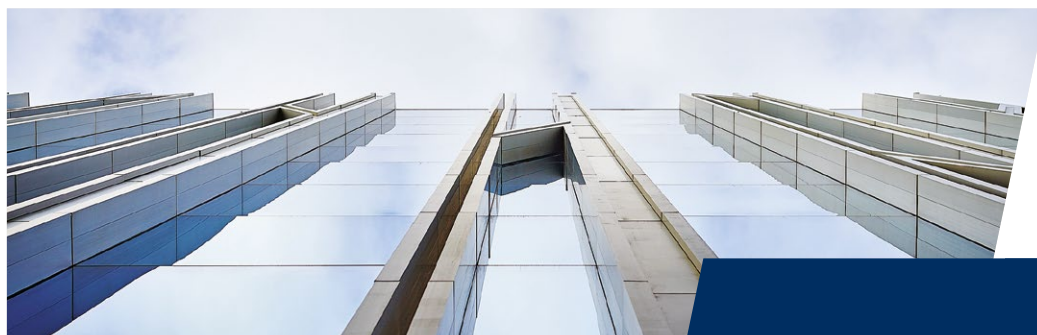
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