Monthly Macro Insights

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Rothschild & Co
Asset Management

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Pandemic headwinds are once again strengthening as on-going Covid-19 outbreaks continue to restrict mobility and pockets of low regional vaccinations create breeding grounds for new strains of the virus. Meanwhile, in durable goods sectors, persistent logistical problems occur where supply bottlenecks are most concentrated and, with increasing food and energy costs, have led to higher and more enduring inflation than expected.

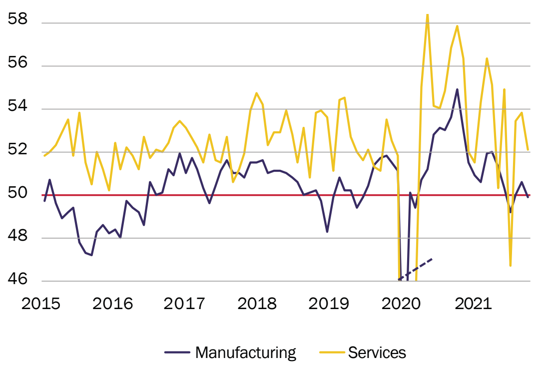
Global business confidence little changed… for now

China's Caixin/Markit business[1] confidence index fell from 50.6 to 49.9 in November as an improvement in the production sub-index – due to fading power supply issues – was more than offset by new orders dropping below the 50-threshold, in the contraction zone. In the services sector, confidence tumbled by almost two points to 52.1, as firms indicated that measures to curb the spread of Covid-19 had dampened new order inflows. In fact, the authorities have warned that the fast-spreading Omicron variant could cause challenges in hosting next February's Winter Olympics in Beijing amid a zero-Covid policy. Overall, these data suggest that China's economic activity softened in November after the small rebound in October.

In Europe, Germany now finds itself at the epicentre of rising virus infections. Confidence among both businesses and consumers may end the year at levels well below the peaks registered in the spring. The Bundesbank warned in its latest Monthly economic bulletin[2] that the German economy has probably hit a soft patch in Q4 2021 on the back of input and labour shortages, and because of new restrictions designed to fight the pandemic.

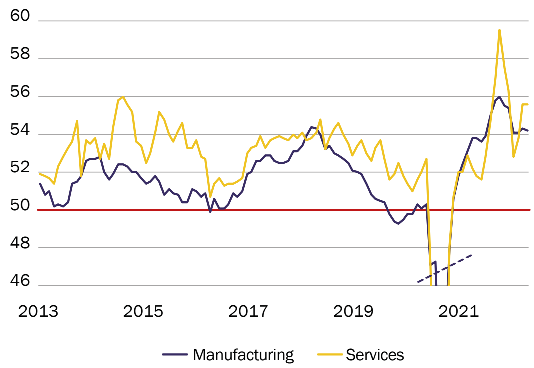
(1) Indicator reflecting the confidence of purchasing managers in a sector of activity. Above 50, it indicates an expansion of activity, below 50, a contraction.
(2) Source: Bundesbank, 22/11/2021.

China - Caixin/Markit business confidence



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

World - Markit business confidence



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

However, confidence improved in other countries, namely in Asia-ex-China, and according to the Markit business confidence index, global economic growth remained resilient in November despite the resurgence of the pandemic. The manufacturing index edged down slightly to 54.2[(3)], although overall confidence has not changed much over the past four months. Rates of increase in the input costs and output charges for sub-components eased, but they remained among the steepest in the survey's history, suggesting inflation pressures persist. In the services sector, the new wave of Covid cases has convinced many countries to tighten travel restrictions and inflation has hurt households' purchasing power, yet confidence remained – surprisingly – unchanged. Although Omicron might be the most infectious Covid variant so far, there is currently no clear evidence as to whether it will cause worse symptoms or if vaccines will become ineffective. In addition, a strong labour market and an elevated saving rate provided enough scope for the consumer to shrug off the pull from higher inflation.

Between a rock and a hard place

Large increases in commodity prices, supply shortages, and higher transportation costs are key factors that have pushed up prices around the world. Headline consumer price inflation is projected to peak by the first quarter of 2022 in most advanced and emerging-market economies, before moderating gradually. Indeed, aggregate wage pressures remain limited despite a rise in some sectors, while bottlenecks and supply chain disruptions are expected to ease as capacity expands and consumers' goods demand moderates. However, although monetary policy has been tightened in most emerging countries, uncertainty has increased about reactions from central banks in advanced economies.

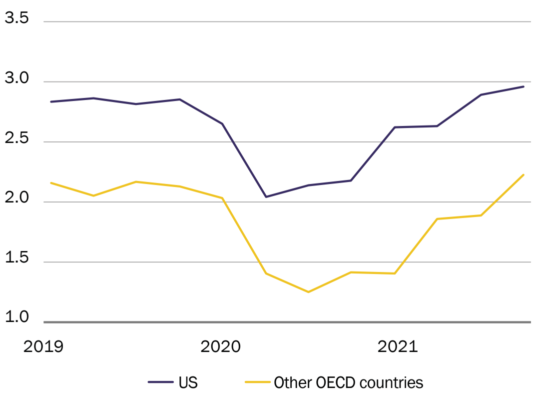
In the Eurozone, inflation surged to a record high for the era of the single currency, reaching 4.9%[(4)] in November, with core inflation rising to 2.6%. The ECB has redoubled efforts to reassure investors that the rise was mainly driven by energy costs and a series of one-time factors. That said, price pressures might take longer to subside, stoking speculation about the future course of monetary policy. At the December 16 meeting, the ECB is set to announce the end of the PEPP[(5)] and outline how regular purchases – currently at €20bn per month – will develop, and some Governing Council members might strive for a swifter exit due to recent inflation data.

Surging energy prices pushed UK inflation to 4.2% in October[(6)], the highest level in a decade. The Bank of England (BoE) expects inflation to rise, further to around 5% in the spring of 2022, before falling back toward its 2% target by late 2023, as the impact of higher oil and gas prices fades and demand for goods moderates. Yet, the jump in prices increased the likelihood that the BoE will have to raise interest rates at its December meeting, especially as the labour market continued to improve, with the unemployment rate falling to 4.3%[(7)],

(3) Source: Markit Index, 30/11/2021.
(4) Source: Eurostat, 30/11/2021.
(5) The Pandemic emergency purchase programme (PEPP) is a temporary asset purchase plan initiated during the 2020 health crisis.
(6) Source: ONS, 30/11/2021.
(7)Source: ONS, 30/11/2021.

OECD - Wage growth

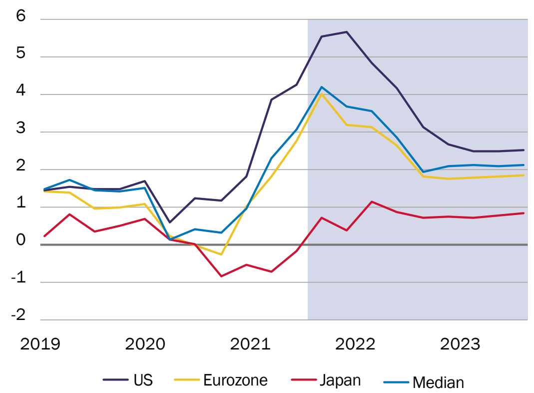
in %, year ahead expectations



Source: OECD, Rothschild & Co Asset Management Europe, December 2021.

Advanced economies - Inflation rate

in %



Source: OECD, Rothschild & Co Asset Management Europe, December 2021.

not far from the 3.8% pre-pandemic level. That said, while the BoE looks set to raise rates earlier than most central banks in advanced economies, the pace of normalisation is nevertheless expected to be fairly modest, with rates rising just 65bps to 0.75% by the end of 2022 according to financial markets.

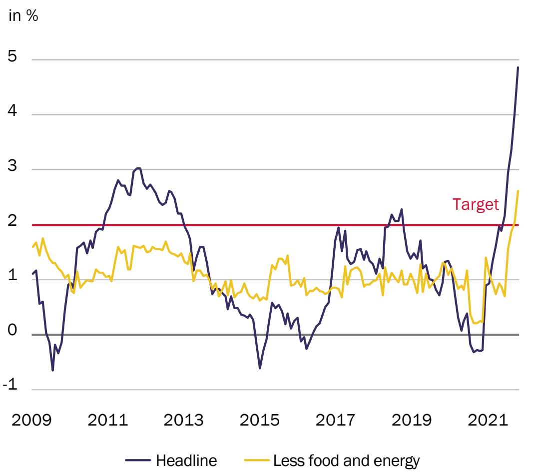
In the US, Congress has once again avoided a government shutdown, with an agreement to fund the government through mid-February. However, the debt ceiling negotiations remain challenging. Meanwhile, the payroll survey(8) showed the economy added only 210,000 jobs in November, less than half of estimates. On the other hand, the unemployment rate plunged to 4.2%, which is explained by the fact that it is calculated using the household survey(8) and 1.1 million jobs were created. There are conflicting signals from these two surveys, which will add uncertainty regarding monetary policy. What's more, while global supply shocks affecting trade and manufacturing should ease over time, it is less clear that the problems linked to reduced labour supply will disappear soon. The participation rate has not recovered from its lockdown lows and, combined with a mismatch between labour demand and supply, has resulted in a large number of unfilled vacancies and recruitment challenges. In fact, the average working week ticked up to an elevated 34.8 hours in November(8), indicating that firms are using their existing workforce more intensively, likely because of difficulties finding more workers.

The Fed still foresee that inflation may recede next year, yet Chair Powell recently acknowledged that it is proving to be more powerful and persistent than expected. Accordingly, the Fed might end its asset purchases earlier than planned – maybe in March 2022 – which will create some space to raise rates well before the end of next year if needed. In turn, the yield curve is flattening as investors scrutinise whether the pandemic recovery can weather diminishing monetary policy support and potential risks from the Omicron variant. Indeed, as the trajectory of Covid infections in the US have lagged that of Europe, it remains to be seen whether evidence of a winter wave of infections will emerge in America at the turn of the new year. ■

Completed writing on 6 December 2021

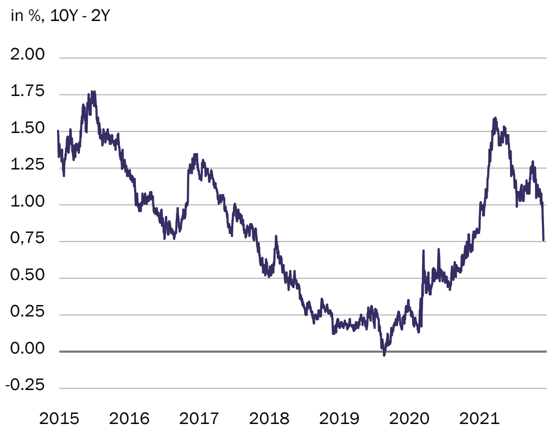
(8) Source: BLS, 30/11/2021.

Eurozone - Inflation rate



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

US - Yield curve



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

Performance of the indices and interest rate levels

	Price as of 30/11/2021	1 month % change	2021 % change
Equity markets			
CAC 40	6 721	-1.6%	21.1%
Euro Stoxx 50	4 063	-4.4%	14.4%
S&P 500	4 567	-0.8%	21.6%
Nikkei 225	27 822	-3.7%	1.4%
Currencies			
EUR/USD	1.13	-1.9%	-7.2%
EUR/JPY	128.32	-2.6%	1.7%

		Price as of 30/11/2021	1 month bp(1)	2021 bp(1)
Interest rates				
3 months	Eurozone	-0.94%	-11	-18
3 months	United States	0.05%	0	-1
10 years	Eurozone	-0.35%	-24	22
10 years	United States	1.44%	-11	53

(1) Basis point.
Source: Bloomberg. data as of 30/11/2021. 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

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 10 European countries, we manage more than 23 billion euros and employ nearly 160 people. More information at: www.am.eu.rothschildandco.com

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