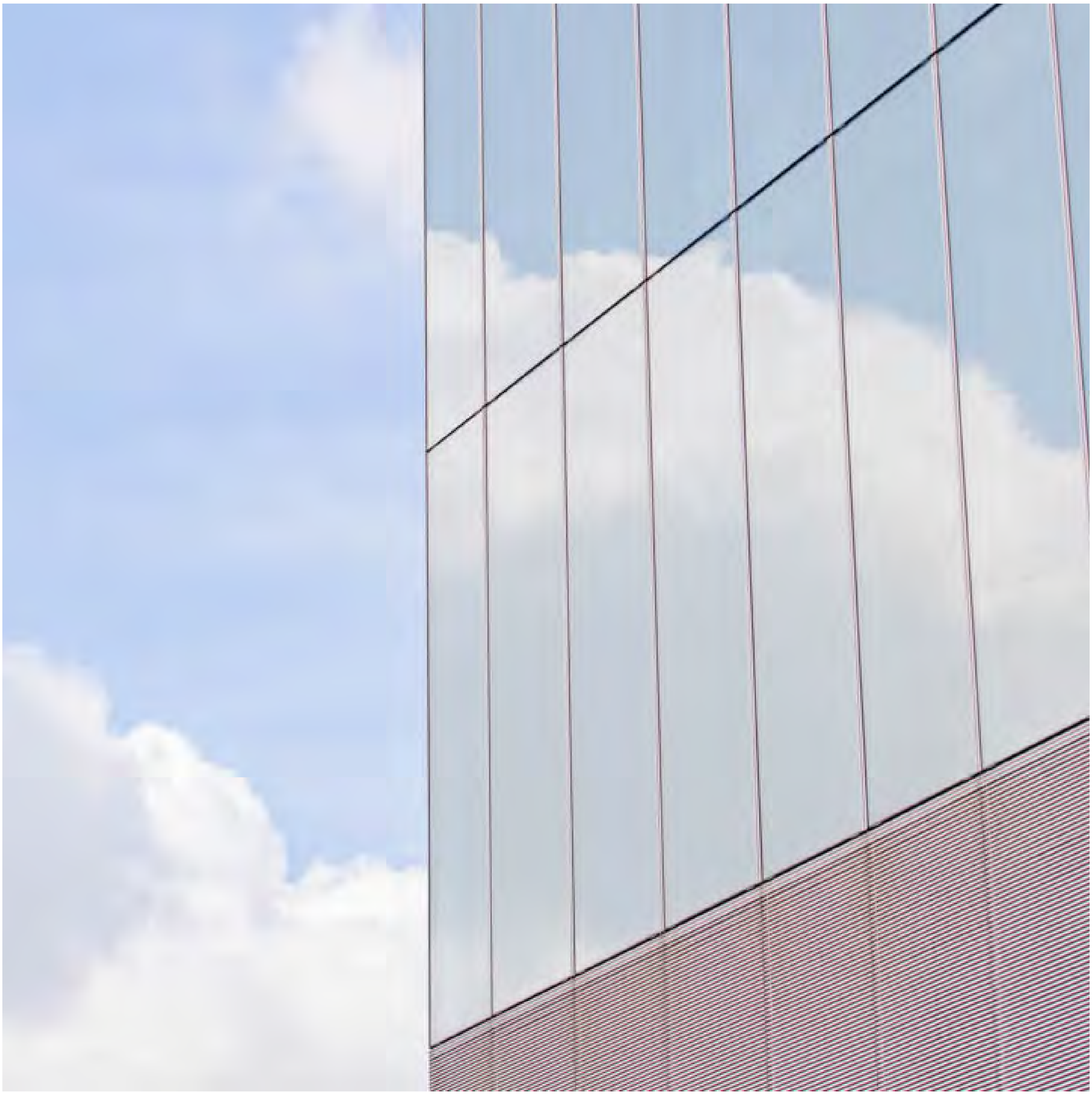
Monthly Macro Insights

January 2022



Rothschild & Co
Asset Management

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The past two years have been marked by disruptions and opportunities. Indeed, Covid-19 upended not only financial markets, but also our daily lives as the pandemic has been a catalyst for transformative change in a short period of time. However, households and businesses proved to be far more adaptable than expected amid extraordinary monetary and fiscal support, which has nevertheless reached a clear inflection point.

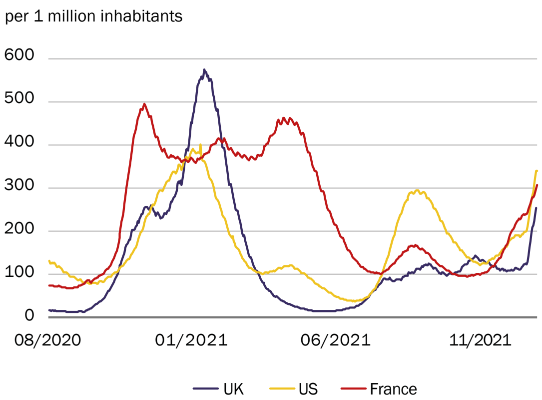
Delayed, but not derailed

In early January, reported global daily Covid-19 infections reached 2.5 million(1), more than twice the previous peak registered in April 2021, although distortions in testing and delays in reporting around the holidays might have somewhat inflated virus statistics. While hospitalisations are likely to continue to rise over the coming weeks given the recent surge in new cases, several studies suggest that the Omicron causes milder symptoms, which would result in a lower hospitalisation rate compared to the previous Delta variant wave.

Although the negative impact on GDP will likely be more muted compared to previous Covid-19 waves, the fast spreading Omicron variant will nonetheless hurt economic activity. Firms have been trying to adjust for the rise in new Covid-19 cases, including the pressure on staffing levels, and thousands of flight cancellations have been telling examples of the challenges firms are facing. The fall in business confidence in the services sector was mostly evident in the Eurozone and the UK as the Markit index(2) fell to 53.1 and 53.6 respectively in December, the lowest reading since early 2021, yet still firmly in expansion territory.

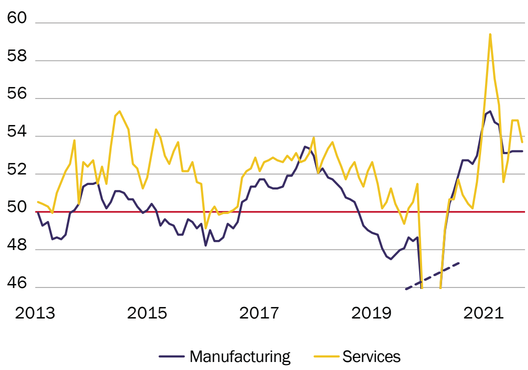
(1) Source: One World in Data, January 2022.
(2) Indicator reflecting the confidence of purchasing managers in a sector of activity. Above 50, it indicates an expansion of activity, below 50, a contraction.

World - Covid-19 hospitalisations



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

World - Business confidence



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

Governments are now weighing up how to keep critical services functioning amid a wave of staff absences. Countries including the US and the UK have shortened isolation periods for people who test positive for Covid-19, without showing symptoms, to prevent the shortage of workers in several areas, such as hospitals. In contrast, China is maintaining its zero-Covid policy of eradicating transmission of the virus ahead of the Winter Olympics, which will continue to weigh on the economy.

Admittedly, the recovery is likely to be delayed due to impact of the virus, but not derailed. Global manufacturers closed 2021 with favourable operating conditions, as the sector continues to reap the benefits of strong domestic and international demand. The Markit business confidence index remains robust, but continued to track sideways in December, hovering around 54 for the past five months.

Will supply chain constraints peak soon?

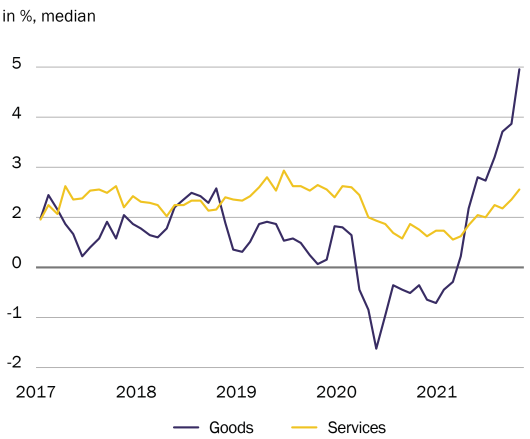
Whilst most forecasters remain optimistic regarding the 2022 economic outlook, it is difficult to ignore the impact of the pandemic. For instance, material shortages and supply chain disruptions have hampered growth and caused significant price pressures. Inflation has risen in most economies as disruptions in energy, food and commodity markets have pushed up prices. What's more, high energy prices are limiting the manufacturing of key materials and intermediate goods, and bottlenecks in production chains are leading to more generalised shortages of goods.

Furthermore, the labour market is imbalanced. For instance, in the US, a record 4.5 million Americans resigned from their jobs in November and pushed the quits rate up to 3%, the highest level since the data were first published in 2000. This unprecedented level suggests a lingering struggle for employers to retain talent, adding to concerns over wage inflation. Globally, unemployment rates in most countries remain above their pre-pandemic levels and hours worked have only partially recovered. Yet businesses in a number of sectors have difficulty recruiting workers, in part explained by a skills mismatch. A shortage of workers in different sectors also reflects a decline in labour force participation rates in several countries as some people decided to retire while childcare or health problems have led others to exit the labour market. In fact, whether or not the balance of power between capital and labour has changed for good, the pandemic will have sparked many changes.

That said, the December Markit manufacturing survey has sent tentative signs that supply constraints might have started to abate. After reaching an all-time high in October, the global delivery times sub-index indicated a reduction in delays, and it is now back

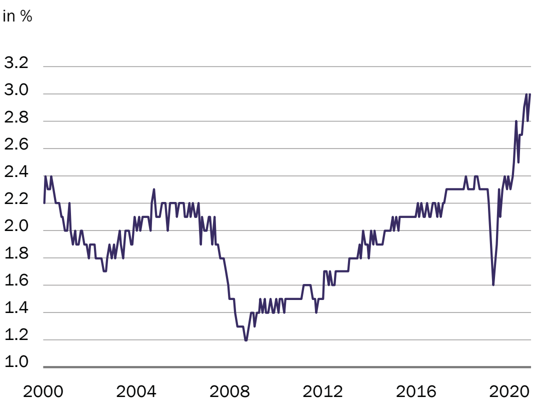
(3) Bureau of Labor Statistics, January 2022.

Advanced economies - Sectoral inflation



Source: OECD, Rothschild & Co Asset Management Europe, January 2022.

US - Quits rate



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

to the levels seen last May. What's more, the improvement aligns with fading price pressures, as the output price sub-index fell for a second month and, although still elevated, is now back to its lowest level since April.

Risks rising from less accommodative policies

Overall, the impacts of Omicron – and the possibility of new variants – are still unknown, but investors are optimistic policymakers will remain committed to containing any negative repercussions on the economy. However, the inflation outlook is uncertain and central bankers have been forced to tighten monetary policies in the face of rampant price pressures. The risk is that the global economy is hit by a 'rates shock' in 2022, following the 'inflation shock' of 2021 and the 'growth shock' of 2020.

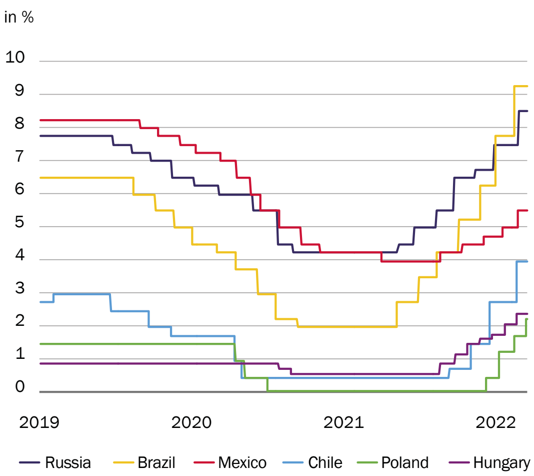
Indeed, most central banks in the emerging world, but also in some advanced economies such as Norway and the UK, have embarked on interest rate hiking cycles at a time when fiscal policy is on the verge of being less stimulative.

In the US, rates have remained at the zero lower bound, but the Fed delivered a hawkish message at its December meeting, doubling the pace of asset purchase tapering, which will bring forward the end of the programme to mid-March. Moreover, the median forecast for the fed funds rate now calls for three rate hikes in 2022 and some members went as far as arguing balance sheet reduction could start soon after the rate liftoff, adding a significant shrinkage might be appropriate. These adjustments reflect changes to the Fed's economic expectations, with notably core PCE inflation revised up to 2.7% in 2022. This is a change from the prior estimate of 2.3% and after 4.4% in 2021[4]. Furthermore, a falling unemployment rate was seen as evidence that the job market is rapidly approaching the maximum employment target and, accordingly, market participants expect the Fed could possibly start hiking rates as early as March if inflation move meaningfully higher. ■

Completed writing on 6 January 2022

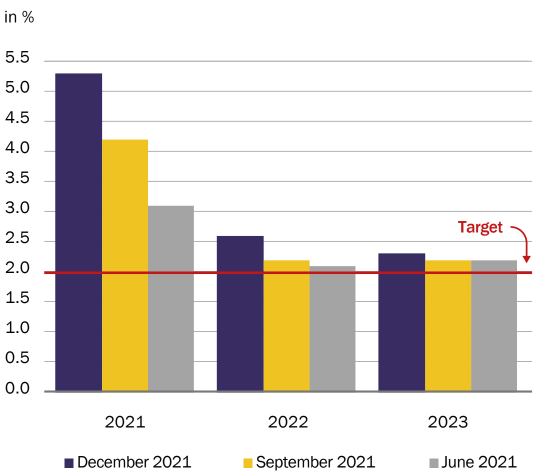
(4) Source: FOMC, December 2021.

EM - Policy rate



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

US - PCE inflation projections



Source: FOMC, Rothschild & Co Asset Management Europe, January 2022.

Performance of the indices and interest rate levels

	Price as of 31/12/2021	1 month % change	2021 % change
Equity markets			
CAC 40	7 153	6.4%	28.9%
Euro Stoxx 50	4 298	5.8%	21.0%
S&P 500	4 766	4.4%	26.9%
Nikkei 225	28 792	3.5%	4.9%

Currencies			
EUR/USD	1.14	0.3%	-6.9%
EUR/JPY	130.9	2.0%	3.7%

		Price as of 31/12/2021	1 month bp(1)	2021 bp(1)
Interest rates				
3 months	**Eurozone**	-0.82%	13	-5
3 months	**United States**	0.03%	-2	-3
10 years	**Eurozone**	-0.18%	17	39
10 years	**United States**	1.51%	7	60

(1) Basis point.
Source: Bloomberg. data as of 31/12/2021. 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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