Weekly round up (Week 36)

Our weekly view of key developments in financial markets and economies examines whether a disappointing week in terms of economic data and risk asset performance is another short-term bump in the road or a harbinger of things to come.

The first Monday of every September in the United States is a federal holiday, Labor Day, in recognition of workers' contribution to the country's development. However, despite the shortened week, market sentiment was mediocre, with investors nervously awaiting August's Non-Farm Payrolls report, released on September 6 (142k - 23k below consensus). Total non-farm payrolls for June and July were revised down, 86k lower than previously reported.

This should help pave the way to understand whether the soft landing hoped for by "Goldilocks" is still intact after July's disappointing data, or whether the dreaded hard landing scenario is back on the table, requiring a more radical response from the Federal Reserve than previously anticipated.

A mixed assessment

All in all, the employment report is a mixed bag: new hires (142,000 workers) are well below expectations (165,000) and show that there has been no significant rebound from July. However, the slight improvement in the unemployment rate from 4.3% to 4.2% and the increases in average weekly earnings and hours worked suggest that the labor market is not in freefall.

The report was not enough to raise fears of an imminent recession, or to raise expectations of a 50 basis point (bp) cut by the Federal Reserve later this month. However, investors were concerned by the negative tone of the latest Beige Book (a summary of economic conditions by the Federal Reserve's 12 regional banks) and by other labor data reports, including the ADP National Employment Report and the Job Creation and Labor Turnover Survey.

In our view, the door remains open to a possible Fed rate cut in the short term, while the risk of a hard landing - or, perhaps more accurately, not a soft one - remains real. The overnight interest rate swap market currently indicates a 77% probability of a 50bp cut in November.

Data disappoint in China and Europe

Elsewhere, the loss of momentum in China after a weaker-than-expected stream of data since June, including the latest Purchasing Managers' Index report, has led economists to question the government's 5% growth target for 2024 and adjust their forecasts for 2025 downwards. The lack of economic impetus from the commodity-hungry sovereign state triggered a massive sell-off in energy and industrial metals.

Meanwhile, the eurozone economy is showing signs of a potential double dip in growth. PMI data for August was revised down by 0.2 points to 51.2, and second-quarter GDP growth was adjusted downwards to 0.2% quarter-on-quarter, compared with the 0.3% initially announced.

Growth was largely driven by public spending, while disappointing private investment and consumption continue to weigh on the region's economy. The failure of consumption to recover, despite rising real incomes and a resilient labour market, will be a cause for concern for policymakers and has unsettled investors, contributing to a massive sell-off in European equities last week.

In Japan, wage data exceeded expectations, indicating an upward trend in wages. Inflation-adjusted wage growth in July was positive for the second consecutive month, at 0.4% year-on-year, down on June (1.1%), but well above consensus (-0.6%). Meanwhile, average cash wages, which eliminate distortions caused by sample changes and are the Bank of Japan's (BoJ) preferred measure, rose by 4.8% year-on-year. This was slightly lower than the previous month, but well above the 3.2% expected.

The rise in wages has raised concerns about the possibility of a further rate hike at the BoJ's October meeting. Since the beginning of the month, the yen has gained 2% against the US dollar.

A risk-free week

Given the general gloom, it's perhaps unsurprising that the only asset class investors didn't shy away from last week was government bonds, with yields on 30-year US Treasuries and German Bunds falling by 20 and 15 basis points respectively.

Over the past decade, September has always been a month of underperformance for equities and corporate credit. Moreover, the three months preceding a US election have traditionally been headwinds for US equities.

Economists who argue that the inversion of the 2-year versus 10-year US Treasury yield curve is a reliable signal of an impending recession have noted that the curve has normalized (the 2-year yield is now lower than the 10-year). However, in each of the last four economic cycles, the curve has returned to normal before the onset of recession.

The fear of holding too much risk in September may have prompted investors to place sell orders during a disappointing week for risk assets.

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