



Weekly round up

Last week, investors shied away from risk, driven by rising long-term US government bond yields; 30-year US bond yields rose by 30 basis points over the week.

Corporate credit spreads widened, equity and commodity prices fell, and the US dollar and Japanese yen appreciated. Volatility also increased - our preferred benchmark, the VIX, traded above 20 during the week.

We believe that economic data from the first week of each month is essential for assessing current activity and future momentum. Last week, investors continued to adjust their expectations and positioning in light of the "higher for longer" message given by Western central banks, carefully scrutinising the data for any signs of economic slowdown.

The Chinese National Bureau of Statistics' PMIs (purchasing managers' indices) confirmed that economic activity had bottomed out, exceeding expectations, and was now expanding again. The view of China remains pessimistic - no one expects a V-shaped recovery, as underlying weakness in fixed-asset investment persists. However, consensus now expects the economy to grow by 5% in 2023, in line with official targets.

For the Eurozone, the composite PMI came in at 47.2, in line with expectations, with contractions in the manufacturing and services sub-components. With the composite index now below the neutral level of 50 for the fourth consecutive month, we believe it is increasingly likely that the eurozone contracted in the third quarter and that there are few signs of recovery as we approach the fourth quarter, with new orders suffering further declines. Germany remains at the heart of the bloc's weakness. However, the repercussions on the labor market are less obvious, as the region's Eurostat unemployment rate fell to 6.4%, the lowest level ever recorded. In the U.S., the manufacturing PMI exceeded expectations, coming in at 49.0 versus 47.6 for consensus, thanks to a recovery in new orders and employment, which rose to 51.2, returning to expansionary territory. The trade balance also confirmed the recovery in the manufacturing sector, narrowing more than expected to -58.3 billion US dollars, supported by strong exports. Meanwhile, the services sector report was in line with expectations, with all its sub-components expanding. On the employment front, the data continues to show strong resilience. The JOLT (Job Openings and Labor Turnover) report surprised investors with a strong increase in job openings; 9.61 million versus expectations of 8.815 million. At the same time, the NFP (Nonfarm Payroll) report surprised on the upside with the creation of 336,000 jobs in September against 170,000 expected. Many economists now expect the US economy to grow at an annualized rate of over 3% in the third quarter.

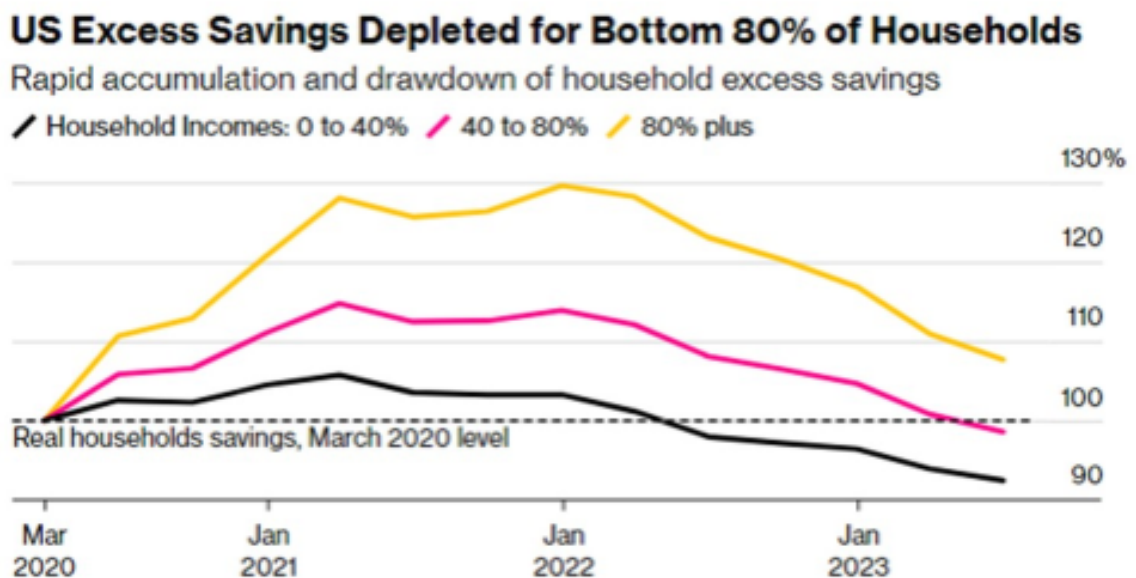
For the fourth quarter, growth is likely to slow compared with the third quarter, due to the "known" effects of the current tightening of financial conditions and rising costs linked to oil prices. However, in our view, it is the "known unknowns" that are likely to determine the level of weakness. These include the effects of the UAW (United Auto Workers) strike (now in its fourth week) and the end of the moratorium on student



loan repayments - 15% of the US population have outstanding student loans, representing the second largest consumer debt in the US at US\$1.6 billion. We note that 80% of households have exhausted their excess savings (see this week's chart). In addition, while the House vote to impeach Chairman Kevin MCarthy has no immediate impact on government funding (which has been extended until November 17), the leadership vacancy could increase the chances of a government shutdown when the current extension expires.

Overall, the FOMC (Federal Open Market Committee) should be satisfied with the current market reaction; it has been able to tighten financial conditions without raising key rates. Over the past 18 months, the FOMC has concluded that the reduced effectiveness of monetary policy calls for longer tightening, and that overnight interest rates do not control most economic decisions - these are determined by long-term rates, credit spreads and equity prices. The danger of this policy is that some parts of the economy are more sensitive to interest rates than others, as demonstrated by the stress in the US regional banking market earlier this year. We hope to avoid reaching a critical level that triggers a collapse in the economy or asset prices, as happened on "Black Monday" in 1987, with the collapse in stock prices explained by their overvaluation, a persistent budget deficit and rising interest rates.

For the FOMC to change course, it would need to see a clear liquidity problem, widespread financial turbulence or signs that the real economy is slowing more than desired. None of these are currently on the agenda.



Source: Federal Reserve, Bloomberg calculations, as of 26th September 2023



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