Market Commentary

A repeat of early month blues….

And a trip to the Middle East

Key points:

- With the labour market a particular focus for Powell, employment indices in ISM surveys show little reason to fear a weakening job market.
- Equity markets have been rocked by a drop in Nvidia's stock price, and a more pronounced drop in stocks could attract attention from policymakers.
- Across Europe, there is mounting concern in the political establishment concerning parties on the political extremes.
- Looking ahead, there is an abundance of important data out soon, but we continue to hold the view that a US recession narrative is being overstated in the near term.

06 September 2024 (London) – Yields rallied and risk assets have come under pressure at the start of September, with price action having some parallels to the moves at the start of August. Although many are eager to cite a weaker trend in economic data, we think there is a risk of overstating this narrative.

With respect to the labour market this week, the Jolts survey on jobs openings dipped. Yet it needs to be remembered that this data pertains to the month of July, when other labour market indicators were also soft, in part due to a hurricane-related impact.

Meanwhile, employment indices in ISM surveys this week, which are more forward looking, give little reason to fear a more rapid slowing in labour market demand and weekly claims data has also remained relatively healthy.

However, with the labour market a particular focus for Powell, we head towards today's labour market report, with this taking on particular importance. But unless we see a downside surprise in these data, we continue to see short dated interest rate expectations inferring too much monetary easing in the near term. In this context, a 25bps easing remains expected at this month's FOMC.

Meanwhile, equity markets have been rocked by a drop in Nvidia's stock price, with an anti-trust probe pushing valuations lower from highly elevated levels. A more pronounced drop in stocks could attract attention from policymakers.

However, at this point, it strikes us that there will be more contentment than concern, inasmuch as risks of a bubble being inflated in AI appear to have receded. This will be seen in a beneficial context, from the standpoint of financial stability.

In Europe over the past week, attention has moved back towards politics with the AfD making strong gains in German regional elections and parties on the political extremes winning votes across the board, at the expense of the centre. With these trends mirrored across Europe, there is mounting concern in the political establishment and maybe a growing sense that past policies have been failing voters.

With Germany paying six times as much for its energy compared to its industrial competitors, it is no small wonder that the economy continues to struggle. VW's move to shutter German production highlights policy failure, in the pursuit of an environmental agenda which feels poorly conceived. It remains ironic to observe how German dependency on dirty coal has resulted from a national rejection of nuclear, and there is a sense that an institutional rethink may be required.

Indeed, it is also interesting to note that six times as many young German voters under the age of 24 recently voted for the AfD compared to the Green party. In past generations, it has been the young who have been more inclined to lean to the left and also to embrace a green, environmentalist mindset.

This shift to the right amongst the young is even more prevalent amongst young males. It would appear this group in society are expressing frustration with establishment policies that have tolerated rapid levels of immigration, which have impacted quality of life for the existing population. This cohort also appears unhappy at the prospect of national interests seemingly sacrificed in the name of an ESG agenda. It is, arguably, also resentful of the limited opportunities for those who are unfortunate enough to be born 'male and pale' within that particular age group.

For the time being, the construct of German politics will continue to keep the AfD away from power. However, it feels that the political centre needs to adjust its stance and reclaim the narrative, if populist trends are to be contained. There may also seem a need to reclaim a sense of optimism and opportunity in terms of medium to long-term future prospects for countries across the region, in contrast to what is being painted as a pretty lost and depressing future to our young in society, at the current point in time.

Over in France, political veteran (and ex-EU Brexit negotiator) Michel Barnier was instated by president Macron to the Matignon after sounding out a number of potential candidates. This was a surprise move and most likely had the blessing from the far right. However, the far right need Barnier to fail – otherwise he becomes a threat as a Presidential candidate to stop Le Pen in 2027.

Moreover, we are not sure how Barnier (who is more of a conservative) can get support from parties on the left. So, it seems Macron is over-reaching just ahead of budget negotiations, which will likely be fractious. We continue to see risks skewed to higher OAT spreads over the medium term, all else being equal.

Elsewhere, economic data from Japan paints a picture of an economy performing relatively well. Labour earnings were ahead of expectations, and there is growing evidence that the rise in prices and wages are becoming more established. From this point of view, comments from Ueda in the past week have highlighted that the BoJ remains on track to continue to normalise policy, as long as incoming data is in line with the Board's expectations.

During the past week, risk assets have come under some pressure, with cross market correlations also picking up. Credit spreads have widened, though market moves have been much more modest than was the case in August, when low liquidity and a stop out of positions led to much more extreme price action.

We continue to believe that the general economic backdrop is benign and therefore any weakness in credit will be relatively short lived. However, if we see more common spikes in volatility, we would note that this may serve to limit the scope for much further spread tightening to occur.

Looking ahead

It is all about the US labour market data today, then CPI and the FOMC meetings which are soon to follow. This marks a couple of important weeks. Although we will always be open minded to different scenarios and will seek to adjust views based on incoming information, at the time being, we continue to hold the view that a US recession narrative is being overstated in the near term.

Looking further ahead, political trends can and will help shape the financial market landscape and so staying close to what is happening around the themes of policy and politics will continue to be important. In light of that, the US election remains one of the key events just ahead of us in the coming quarter, and for now, it remains difficult to call the outcome with any certainty.

In meetings in the Middle East this week, it has been interesting to contrast regional prospects with what we see elsewhere. Buoyed by enormous oil wealth, ambitious leaders have helped promote an economic boom, which shows little sign of being tempered any time soon.

In some respects, it may seem that benevolent dictatorships are outperforming liberal democracies and one might hope for a more visionary cohort of politicians to emerge closer to home, in order to re-energise the democratic ideal. As for the Middle East, away from the sad situation in Gaza, blue doesn't look like such a bad colour in this part of the world….

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