CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

September 2023

Goldilocks? Inflation remains too hot, economy not cold enough

The past month saw market expectations of a ‘Goldilocks’ scenario somewhat reduced as markets retreated over the first half of the month. This scenario is premised on inflation falling seamlessly to target range as a result of rising interest rates, with the economy avoiding economic hardship and continuing to progress – policy and the economy are ‘just right’. Market participants and spectators listened attentively to Fed Chair Jerome Powell’s speech at the Jackson Hole conference, whose stance on the fight with inflation was unwavering and on the hawkish side, stating that inflation remains “too high”. This, coupled with some weaker economic data such as the flash Purchasing Manager’s Index (‘PMI’, an indication of sentiment among manufacturers) and rising unemployment, added further evidence that Goldilocks may be too good to be true. Interestingly, softer economic data was absorbed well by markets which recovered ground at the end of the month - a strong indication that markets continue to be largely driven by inflation and interest rate dynamics.

UK inflation remains elevated compared to other regions, and the continued tightness in the labour market is undoubtedly giving the Bank of England Monetary Policy Committee some sleepless nights as they look to avoid a wage spiral that would leave inflation more entrenched. Figures released in August looked to be a step in the ‘right’ direction in terms of a cooling labour market, as the unemployment rate ticked up. Further progress here should be supportive of reducing inflation, albeit progress in this month’s UK inflation data may be blurred slightly by one-off wage settlements which have been paid out. As Labour Day is celebrated in the US, it feels apt to consider US labour markets, which have also been surprisingly resilient. Here too we have seen some signs of weakness as job openings dropped to their lowest level in more than two years – again, data that encouraged markets.

A common narrative at the start of the year was centred on the reopening of China following extensive lockdown restrictions and hopes of a consequent rebound in growth. This narrative has so far failed to play out, with weak demand, consumer confidence and the consumer price index moving to deflation. Concerns around the property sector have also weighed on the region, however recent news on the restructuring of a debt payment for one of the larger developers provides some reassurance. Other Asian countries seem to be picking up some of the slack, with Japan announcing further encouraging data over the month. We remain overall positive on Asian markets and maintain an overweight position to Japan.

A weakening Chinese economy is bound to have ramifications for global demand and inflation, which are already showing signs of cooling. We feel that a diversified approach with a focus on quality companies remains appropriate at the current juncture. Softer economic data releases point to pain in the real economy, however recent market movements highlight that this should be beneficial for markets. While the book may be almost shut on Goldilocks, we feel markets should continue to respond well to economic weakness and further reductions in inflation.

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