Economic & Market review – August 2022

U-Turn from the Fed

In August Financial markets were well oriented until Federal Reserve Chairman Jerome Powell delivered a hawkish keynote speech at the Jackson Hole symposium. Central bankers doubled down on their bid to tame inflation through higher interest rates even this could result in lower economic growth for a sustained period and bring some pain to households and businesses. The argument for an early dovish pivot by the Federal Reserve and other major central banks is now "clearly out of the window". Markets are now confronted with slowing growth, rising recession risks and elevated inflation. We have seen some poor business surveys in the US over August with a composite PMI (service and manufacturing activity) hit its lowest level since early 2020 and sales of new homes in July fell for the sixth month so far this year.

Signs of slowing activity pushed the IMF and the World bank to lower their global growth forecast and express concerns about financial instability.

Over August, global equities showed significant volatility and finished lower with a negative performance for the S&P 500 of -4,2%, Nasdaq 100: -5,2% and Stoxx Europe 500: -5,2%. From a sectoral point of view, Consumer-exposed, Technology and rate-sensitive such as Real Estate suffered the most. On the other side defensive sector such as energy outperformed the indices.

On the Fixed Income side, markets will remain very volatile, caught between the fact that they are already incorporating a lot of bad news and that the economic outlook continues to deteriorate. Nominal rates have increased substantially. On the credit side, corporate fundamentals are still solid but should weaken in a context of tightening financials conditions. This context may continue causing further damage to EM local bonds market. Frontier countries may also suffer while commodity exporters will do better. Last the US Treasury yield curve remained inverted. US Treasury yields moved higher with the US two-year treasury yields reaching the highest level since 2007 at 3,46% and US ten-year yield at 3,19%.

The dollar index strengthened this month and EUR continued to struggle as the economic outlook worsens in Europe. The EUR/USD reached a 20-year low and fell below parity on August 22nd. The USD is a structural safe-haven currency. In addition, the superior profitability, and earnings of US companies relative to the rest of the world attract capital.