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OCTOBER 26TH, 2023
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Heating up

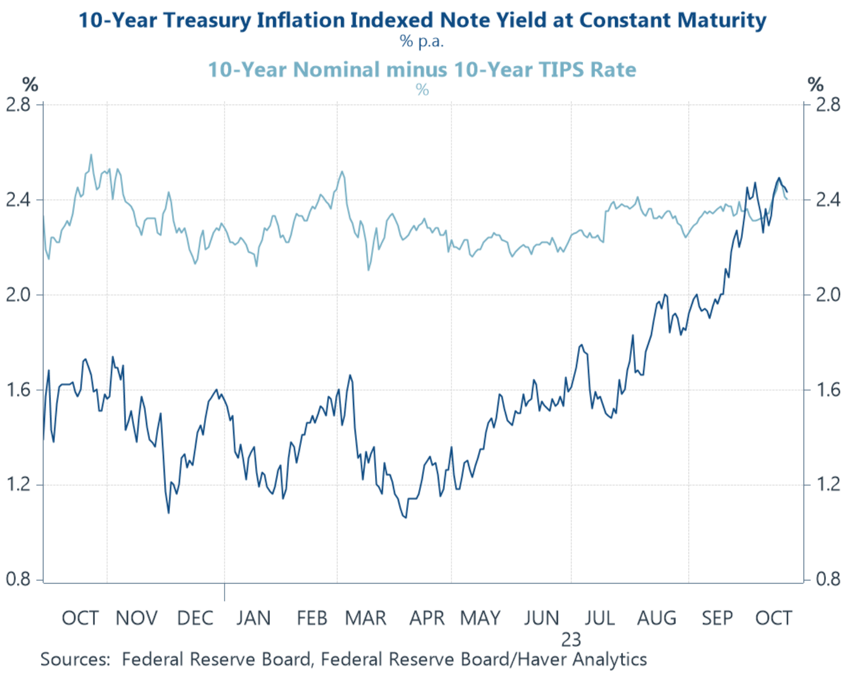
Summary

Financial markets have been more unsettled over the past few days partly because of an escalation of geopolitical tensions in the Middle East. This has been exacerbated by a mixed set of company earnings reports from the United States coupled with lingering concerns about the trajectory of bond yields. In our charts this week we offer some insights on these issues with some perspective on US Treasury yields (in chart 1) and financial market stress (in chart 2). Then, ahead of the ECB’s policy decision later this week, we look at the messages from its latest Q3 survey of bank lending conditions (chart 3). With one eye on this week’s UK labour market release we subsequently focus on how unemployment rates have shifted in the world’s major economies over the last 6 months (chart 4). We then pivot to Asia with some colour on the region’s portfolio flows (chart 5). We wrap up with an update on temperature anomalies and highlight evidence that suggests September marked another month of record-breaking temperatures throughout the globe (chart 6).

US bond yields

As noted, the surge in US (and global) bond yields in recent weeks has unnerved investors. Several factors potentially account for this trend including a tighter-for-longer Fed policy stance amidst stronger-than-expected US growth data, fiscal policy funding pressures, rising oil prices and mounting inflation concerns. However, as chart 1 below indicates, most of the increase in nominal yields over recent months can be traced to higher real yields. Inflation expectations, in contrast, have been relatively steady. This implies that robust economic growth alongside monetary and fiscal policy considerations have played a more significant role than inflation worries in pushing nominal yields higher. While difficult to estimate, there are strong suggestions too that the term premium –the additional return investors receive for holding longer-dated Treasuries - has also been climbing, a function of heightened uncertainty about the safe haven appeal of US government debt.

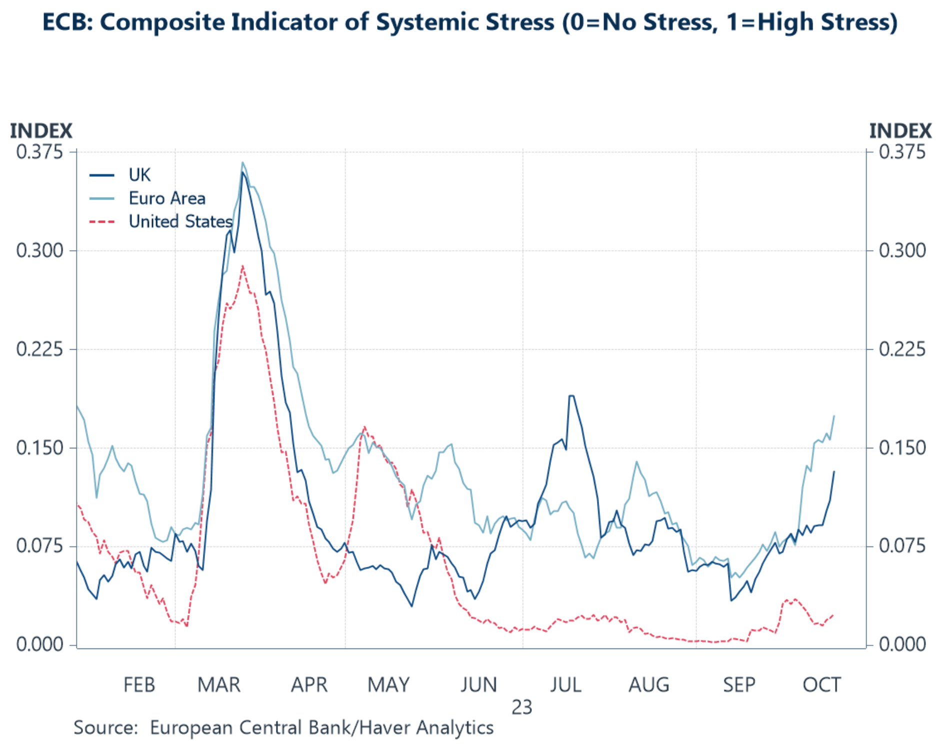
Chart 1: US 10-year bond yields – real yields and inflation expectations



Financial stress

The ECB's composite indicators indicate a notable rise in financial stress across Europe in recent weeks. After reaching multi-month lows in mid-September, these indicators—for both the euro area and the UK—point to levels of financial stress not seen since mid-April. During that period, escalating financial instability was driven by profound worries about the health of both the US and European banking sectors. It seems notable, nevertheless, that US stress, while off its lows, has climbed only modestly over the last few weeks.

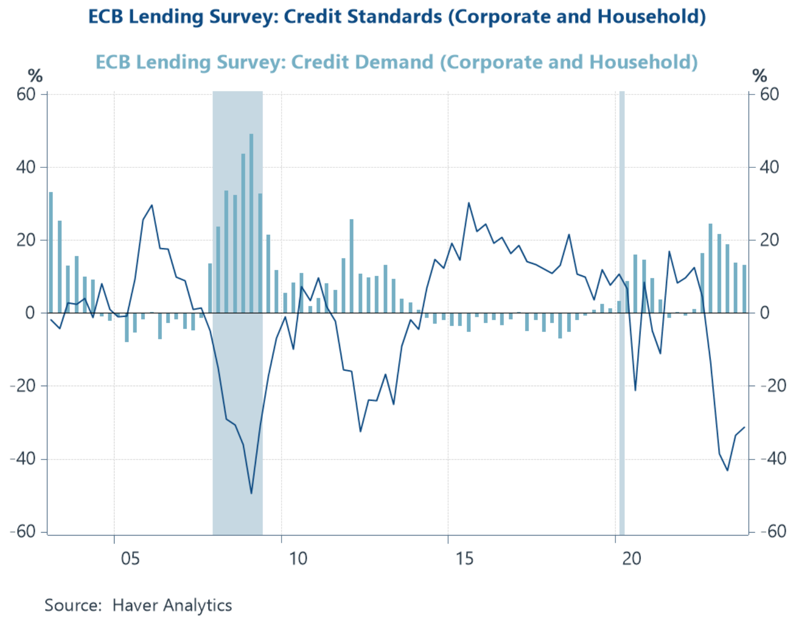
Chart 2: The ECB's composite indicators of financial stress in the US and Europe



Banking conditions in the euro area

The ECB's latest bank lending survey underscored that the ECB's tightening campaign is accentuating a broader slowdown in the euro area economy. Credit standards in Q3 were tightened again for households and companies, albeit not as aggressively as they were in Q2. More significantly, however, demand for loans by both households and firms declined by more than banks had expected. Overall levels of demand, moreover, remain very weak and at levels that have previously been associated with a recession (chart 3).

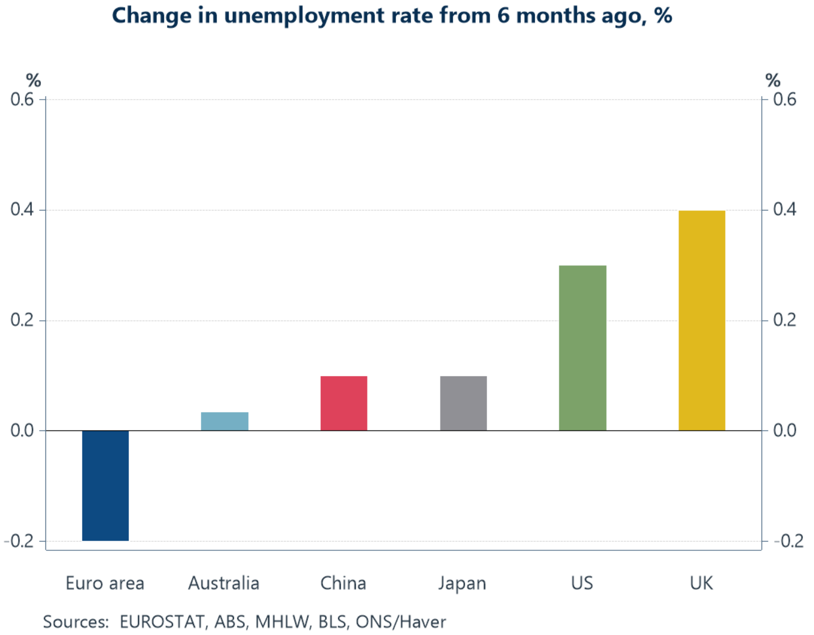
Chart 3: ECB Bank Lending Survey: Credit standards and credit demand



Unemployment comparisons

The UK's Office for National Statistics (ONS) created new "experimental adjusted" series for unemployment, employment, activity and inactivity in this week's delayed labour market release. They revealed a modest downward revision to the UK's unemployment rate during the May-July period (now 4.2% from 4.3%). Still, the bulk of the increase in unemployment that had already been recorded by the ONS, based on the previous methodology over the past year, remained intact. As chart 4 below suggests, looking at changes in the unemployment rate in a selection of major economies, that continues to place the UK in a relatively unfavourable light.

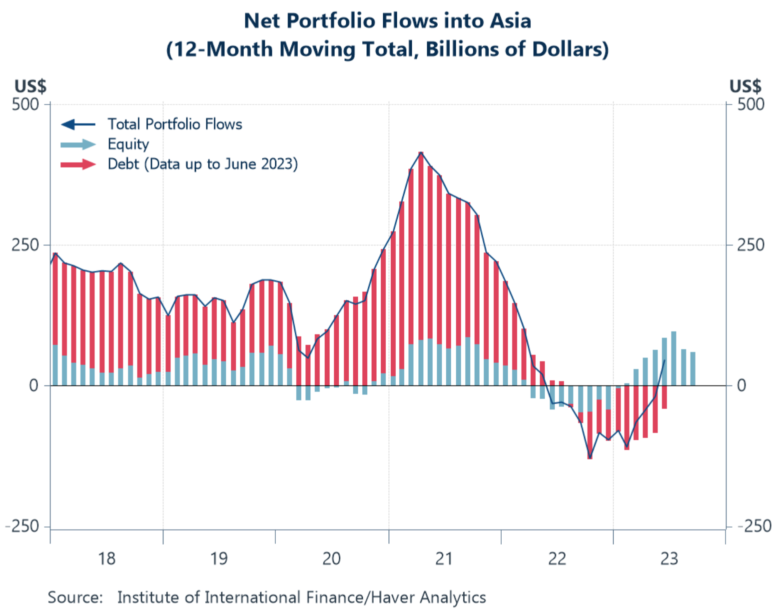
Chart 4: Unemployment rates in selected major economies: 6 month changes



Asia's portfolio flows

Those headwinds for China's growth potential are one factor that explains the IMF's heightened pessimism toward the longer-term outlook for the world economy. In Chart 5 below, we compare the IMF's most recent October forecasts for global growth from 2023 to 2028, firstly with its longer-term projections made in April 2022 (and up to 2027), and secondly with the 40-year historical trend. In summary, the October forecasts have been revised downward and now fall well below the long-term average. There are a number of perhaps familiar reasons for this heightened pessimism but they underscore nevertheless some of the challenges that confront policymakers in the period ahead.

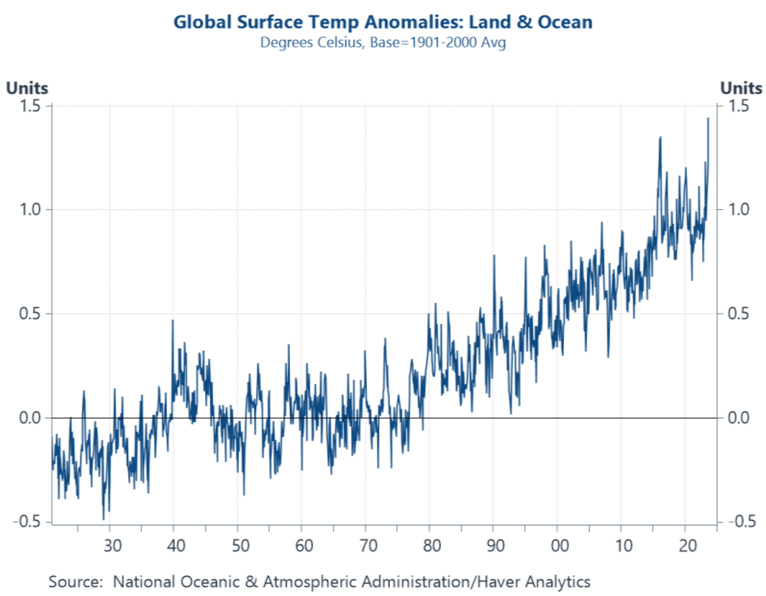
Chart 5: Net portfolio flows into the Asian region



Global temperature anomalies

According to the National Oceanic & Atmospheric Administration the average global temperature in September 2023 was 1.44 degrees Celsius above the 20th-century average of 15.0 degrees. That ranked as the warmest September on record. September 2023 also marked the 49th-consecutive September and the 535th-consecutive month with temperatures above the 20th-century average. Africa, Europe, North America and South America each had their warmest September on record. Asia had its second-warmest September, while September in Oceania ranked third warmest.

Chart 6: Global surface Temperature Anomalies



ABOUT THE AUTHOR

Haver Analytics is pleased to bring Andrew Cates's commentaries on the state of the global economy to its clients.

Andy Cates has more than 25 years of experience forecasting the global economic outlook and in assessing the implications for policy settings and financial markets. He has held various senior positions in London in a number of Investment Banks including as Head of Developed Markets Economics at Nomura and as Chief Eurozone Economist at RBS. These followed a spell of 21 years as Senior International Economist at UBS, 5 of which were spent in Singapore. Prior to his time in financial services Andy was a UK economist at HM Treasury in London holding positions in the domestic forecasting and macroeconomic modelling units.

He has a BA in Economics from the University of York and an MSc in Economics and Econometrics from the University of Southampton.