PICTET

PICTET WEALTH MANAGEMENT

Macro update: growth scare vs. recession risks

Macro risks are building to the downside, but current data doesn't warrant a 50bps Fed rate cut in September, or an inter-meeting cut beforehand

05 AUGUST 2024, CIO OFFICE & MACRO RESEARCH

AUTHOR
XIAO CUI
xcui@pictet.com
MACRO RESEARCH
fducrozet@pictet.com

FLASH NOTE

SUMMARY

- The July employment report in the US showed softer-than-expected job gains and a further rise in unemployment that triggered the Sahm rule. **Recession concerns rose sharply** with markets quick to price in around 125bps of cuts by year-end, and high odds of an inter-meeting cut before the September FOMC.
- We were already expecting a slowdown to below-trend growth in the US in H2, with downside risks. **We now expect three 25bps rate cuts at the Sept, Nov, and Dec meetings**. Increased labour market slack and progress on disinflation suggest monetary policy could be overly restrictive, and **a quicker return to neutral is appropriate from a risk-management perspective**.
- **However, we don't think current data warrant a 50bps rate cut from the Fed in September, or an inter-meeting cut beforehand, nor do we see recession as the base case**. First, we expect a partial weather-related rebound in the August employment data. Second, hard data on spending and balance sheets suggest a labour market that is cooling in an orderly fashion. Survey data has been misleadingly soft for more than a year. Lastly, for an outsized/inter-meeting cut to happen, the FOMC would need to see more than one month of data to extract signals from the noise, or significant dislocation in the credit market.
- **We view the Fed easing cycle as policy normalisation, not labour market rescue**. However, the risk at full employment in an environment of low hiring and low firing is that unemployment rises nonlinearly, leading to a vicious cycle of job and income losses. **If evidence of layoffs increases further or financial conditions tighten unexpectedly with credit stress, then 50bps and an easing cycle resembling past recessions would become more likely**.
- **We still expect the ECB and the BoE to cut rates** twice more this year, to 3.25% and 4.5%, respectively, by year-end, with risks tilted towards more easing. We also expect the SNB to cut rates to 1% in September, with risks tilted towards a larger cut as well as FX interventions to mitigate CHF strength.

For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.

In this note, we address key questions for the economic and monetary policy outlook. Are we headed to a recession? Did weather play any role in the employment data? What kind of easing cycle does the outlook warrant?

THE SAHM RULE IS TRIGGERED – ARE WE HEADED TO A RECESSION?

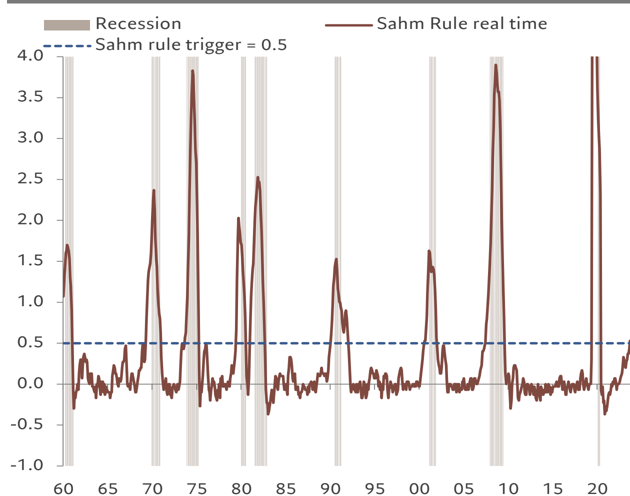
The rise in the unemployment rate in the past few months has triggered the Sahm rule, which states that if the 3-month moving average of the unemployment rate is 50bps or more above its minimum in the 12 months prior, then the economy is **in recession (chart 1)**. The Sahm rule has a very good, but not perfect, track record of indicating prior recessions. It captures **the nonlinear nature of unemployment** where the unemployment rate tends to rise slowly, then rapidly. On average there was a 2% increase after the rule has been triggered in the past.

However, we believe the Sahm rule is a “statistical regularity” (to borrow Chair Powell’s wording) and might not be helpful in predicting a wave of layoffs or recessions in the current cycle. That’s because it doesn’t differentiate the trigger for the jump in employment – whether it is driven by more layoffs or by more labor supply. In fact, the prime-age labour force participation rate made a new cycle high in July.

As we’ve been highlighting the important role immigration plays in the current labour market, the rise in the unemployment rate has been partly driven by large increases in newly-arrived immigrants, as the absorption is losing momentum as the labour market cools (chart 3). Of course, even a supply-driven rise in the unemployment rate may not be quick to reverse. But this is different from the pre-recessionary dynamics of a vicious cycle of job loss leading to income loss, which leads to further job losses.

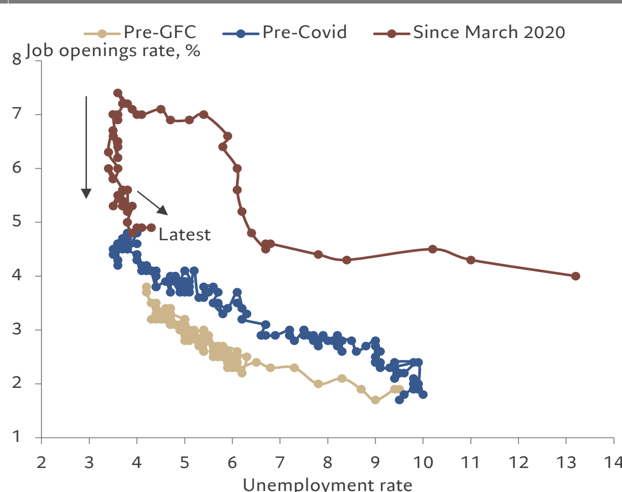
Last but not least, **a large share of the rise in recent rise in unemployment was driven by temporary layoffs**, people expected to be recalled to their jobs. This has not been a great predictor of recessions. It is an indicator worth watching especially if it continues its upward trend, particularly if there is no policy response.

Chart 1: Real time Sahm rule



Source: Pictet Wealth Management, BLS, Claudia Sahm, as of August 2024

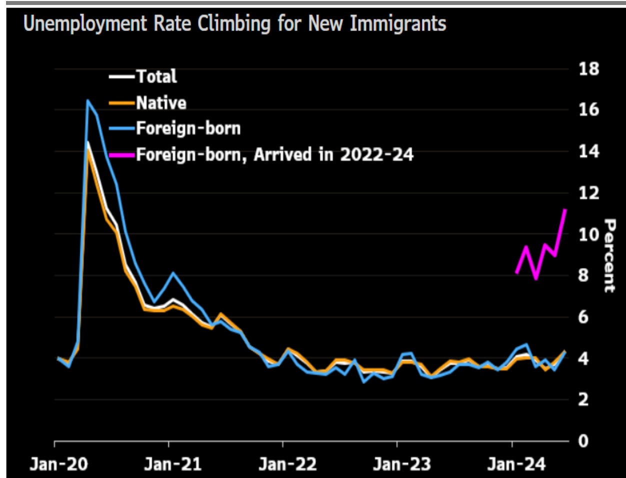
Chart 2: Labor market Beveridge curve



Source: Pictet Wealth Management, BLS, as of August 2024

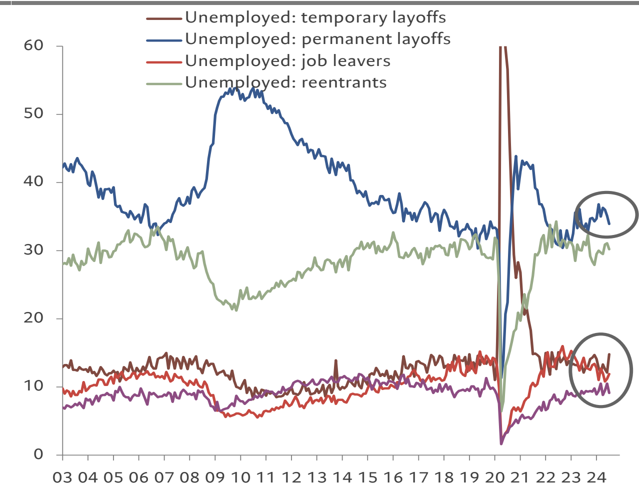
For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.

Chart 3: Labor force participation rate



Source: Pictet Wealth Management, BLS, Bloomberg Economics analysis, as of August 2024

Chart 4: Unemployment rate by immigration status



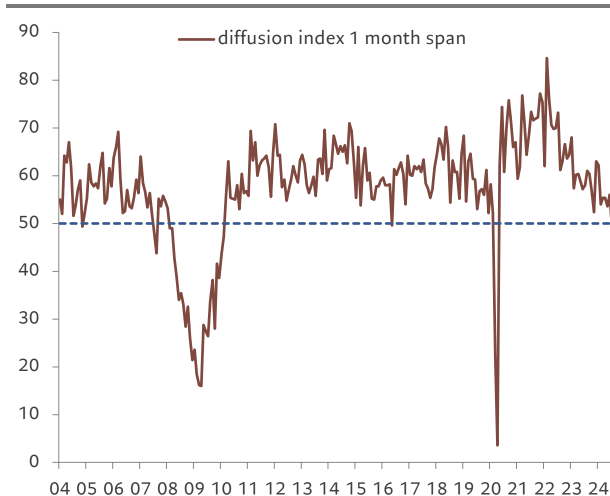
Source: Pictet Wealth Management, BLS, as of August 2024

DID WEATHER PLAY ANY ROLE IN THE EMPLOYMENT DATA?

At face value, July's employment report was quite soft, with job gains falling to 114k, below estimates of the long-term sustainable pace of job creation. **The breadth of job gains narrowed**, with slightly more industries reducing employment (chart 5).

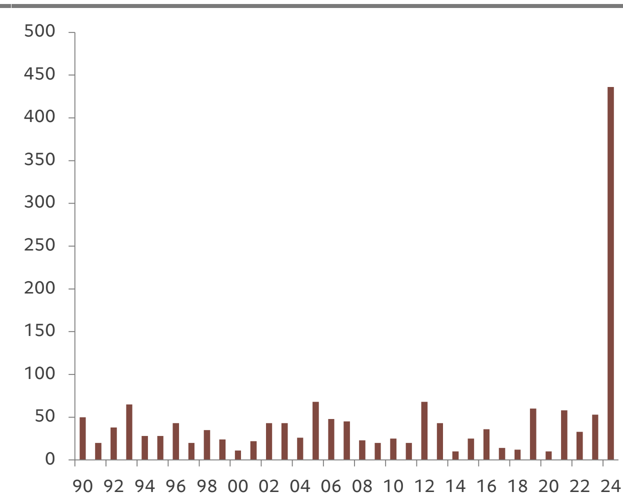
Given disruptions to the Texas economy (second largest state economy) as Hurricane Beryl made landfall during the survey week for the employment report, there are reasons to think it negatively impacted employment readings or at least clouded the reading on underlying labour market conditions.

Chart 5: NFP diffusion index (*)



Source: Pictet Wealth Management, BLS, as of August 2024 (*50 percent indicates an equal balance between industries with increasing and decreasing employment)

Chart 6: Not at work due to bad weather in July



Source: Pictet Wealth Management, BLS, as of Aug 2024

For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.

The Bureau of Labor Statistics mentioned there was no discernable impact from the hurricane, but the report showed some typical patterns of weather disruption. The household survey showed **a surge in the number of persons reported as employed, but not at work, due to bad weather**, which was the highest ever recorded for the month of July (chart 6). There was a drop in hours worked for production and nonsupervisory workers and a response rate at the low-end of the range.

WHAT KIND OF EASING CYCLE DOES THE OUTLOOK WARRANT?

The July employment report highlights the downside risks to the labour market now that it has normalised to its pre-pandemic level. The risk at full employment in an environment of low hiring and low firing is that unemployment rises nonlinearly, leading to a vicious cycle of job and income losses. From a risk management perspective, building downside risks, increased labour market slack and progress on disinflation suggest monetary policy could be overly restrictive, and a quicker return to neutral is appropriate. We therefore expect three 25bps rate cuts – one each at the September, November, and December meetings.

We continue to view the Fed easing cycle as policy normalisation, not labour market rescue. What would make us change our view?

Our forecast hinges on data and credit markets not becoming super stressed. We think it is more likely than not that we see a rebound of payroll gains and hours in August. But if next month's data prove us wrong, if evidence of layoffs increases further or financial conditions tighten unexpectedly with credit stress, then 50bps and an easing cycle resembling past recessions would be likely.

We will be following the weekly initial jobless claims closely (note the numbers are currently being distorted by seasonal adjustment issues around the summer and Hurricane Beryl), **credit markets spreads**, and **regional employment data** which show a state-level breakdown and could shed color on any weather disruption.

EUROPE: GRADUAL RECOVERY SCENARIO STILL HOLDS, RISKS TILTED TOWARDS FURTHER EASING

In the euro area, the main drivers of a gradual recovery in activity this year remain intact at this stage. However, with the recent weakness in the US labour market, the **risks to this scenario have shifted from being tilted to the upside to being balanced.** First, a sharper-than-expected slowdown in the US economy could weigh on euro area external trade and also make a recovery in European manufacturing more uncertain. Second, a continuation of the market correction could lead to a tightening of financial conditions and hamper the recovery in bank lending. Against this backdrop, although our inflation outlook remains unchanged and **we still expect two rate cuts by the ECB, in September and December, the risk is now tilted towards an additional cut in October**.

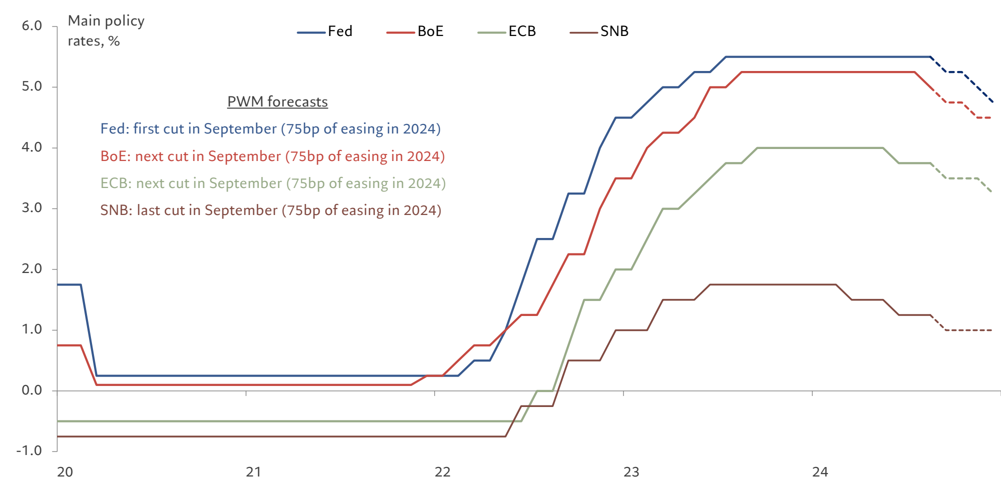
In the UK, we also continue to expect a moderate recovery in 2024, with the balance of risks remaining skewed to the upside. This is underpinned by recent improvements in economic activity, and the start of an easing cycle. In this context, **we**

For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.

maintain our expectation that the Bank of England (BoE) will cut interest rates three times in 2024, including the first cut in August, totalling 75 basis points.

In Switzerland, our central scenario is for a final 25bp cut in September, bringing the policy rate to 1%, in line with the SNB's view of a broadly neutral rate. **However, risks are tilted towards a larger cut in September or an additional cut in December**, given the recent appreciation of the CHF, moderate inflationary pressures and weakening growth momentum as indicated by recent surveys (PMI, KOF). Furthermore, potential policy decisions by other central banks, in particular the Fed and the ECB, could influence the SNB's actions. **Given the importance of the exchange rate for the inflation outlook, the SNB could also intervene in the FX market to counteract an unwarranted appreciation of the CHF, even though interest rates are its primary policy instrument.** In particular, recent data suggest that the SNB did not intervene in the FX market in June amid the uncertainty surrounding the French elections.

Chart 7: major central bank policy rates, including PWM forecasts



Source: Pictet Wealth Management, BLS, as of August 2024

WHAT'S NEXT IN ASIA?

The Bank of Japan (BoJ) hiked again in July, in line with our expectation. **We expect the BoJ to normalise monetary policy gradually further**, with policy rate gradually approaching the nominal neutral rate, including the next rate hike in January next year with a chance of an earlier hike if markets stabilise and/or if inflation overshoots. However, if the US entered a recession, the cycle could be shallower.

Chinese growth slowed notably in Q2, but we expect sequential momentum to pick up in H2 with the government strong determination to achieve annual growth target, supported by more policy easing in H2 as suggested by the pro-growth politburo meeting. But the housing sector, which has not shown visible signs of stabilisation, could continue to be the largest downside risk for Chinese growth.

For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.

DISCLAIMERS

Distributors: Banque Pictet & Cie SA, Route des Acacias 60, 1211 Geneva 73, Switzerland and Bank Pictet & Cie (Europe) AG, Neue Mainzer Str. 1 60311 Frankfurt am Main Germany.

Banque Pictet & Cie SA is established in Switzerland, exclusively licensed under Swiss Law and therefore subject to the supervision of the Swiss Financial Market Supervisory Authority (FINMA).

Bank Pictet & Cie (Europe) AG is established in Germany, authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht, the German Federal Financial Supervisory Authority (Bafin).

This marketing communication is not intended for persons who are citizens of, domiciled or resident in, or entities registered in a country or a jurisdiction in which its distribution, publication, provision or use would violate current laws and regulations.

The information, data and analysis furnished in this document are disclosed for information purposes only. They do not amount to any type of recommendation, either general or tailored to the personal circumstances of any person. Unless specifically stated otherwise, all price information is indicative only. No entity of the Pictet Group may be held liable for them, nor do they constitute an offer or an invitation to buy, sell or subscribe to securities or other financial instruments. The information contained herein is the result neither of financial analysis within the meaning of the Swiss Bankers Association's Directives on the Independence of Financial Research, nor of investment research for the purposes of the relevant EU MiFID provisions. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness.

Except for any obligations that any entity of the Pictet Group might have towards the addressee, the addressee should consider the suitability of the transaction to individual objectives and independently assess, with a professional advisor, the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences.

Furthermore, the information, opinions and estimates in this document reflect an evaluation as of the date of initial publication and may be changed without notice. The Pictet Group is not under any obligation to update or keep current the information contained herein. In case this document refers to the value and income of one or more securities or financial instruments, it is based on rates from the customary sources of financial information that may fluctuate. The market value of financial instruments may vary on the basis of economic, financial or political changes, currency fluctuations, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Some investments may not be readily realizable since the market in the securities can be illiquid. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. When investing in emerging countries, please note that the political and economic situation in those countries is significantly less stable than in industrialized countries. They are much more exposed to the risks of rapid political change and economic setbacks.

Past performance must not be considered an indicator or guarantee of future performance, and the addressees of this document are fully responsible for any investments they make. No express or implied warranty is given as to future performance. Moreover, forecasts are not a reliable indicator of future performance. The content of this document can only be read and/or used by its addressee. The Pictet Group is not liable for the use, transmission or exploitation of the content of this document. Therefore, any form of reproduction, copying, disclosure, modification and/or publication of the content is under the sole liability of the addressee of this document, and no liability whatsoever will be incurred by the Pictet Group. The addressee of this document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information reproduced in this document.

This marketing publication is issued by Banque Pictet & Cie SA. This marketing publication and its content may be cited provided that the source is indicated. All rights reserved. Copyright 2023.

Distributor: Bank Pictet & Cie (Europe) AG, London branch ("Pictet London Branch")

This is a marketing communication distributed by Pictet London Branch.

This document sets forth neither a personal recommendation tailored to the needs, objectives and financial situation of any individual or company (investment advice as defined in the Financial Conduct Authority's Handbook of rules and guidance (the "FCA Handbook")), nor the results of investment research within the meaning of the FCA Handbook. Moreover, it does not constitute an offer, or an invitation to buy, sell or subscribe to securities or other financial instruments, nor is it meant as a proposal for the conclusion of any type of agreement. Furthermore, this document should not be considered a suitability report as Pictet London Branch has not received all the necessary information on the recipient to complete its suitability assessment that covers the recipient's knowledge and experience, tolerance to risk, sustainability preferences, if any, investment needs and the recipient's ability to absorb financial risk. Should its addressee decide to proceed to any transaction in relation to a financial product referred to herein, this will be in his sole responsibility, and the suitability/appropriateness of the transaction and other financial, legal and tax aspects should be assessed by an expert.

Any information contained in this document is disclosed for information purposes only, and neither the producer nor the distributor can be held liable for any fluctuation of the price of the securities. No express or implied warranty is given as to future performance. The opinions expressed reflect an objective evaluation of information available to the general public, such as rates from customary sources of financial information. The market value of securities mentioned may vary on the basis of economic, financial or political changes, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. It is also expressly noted that forecasts are not a reliable indicator of future performance, while past performance is not a reliable indicator of future results.

You shall only take investment decisions when you fully understand the relevant financial product and the involved risks. In particular, the relevant product documentation (such as the issuance program, final terms, prospectus, simplified prospectus and key (investor) information document), as well as Appendix 4: Risk Warnings Relating to Trading in Financial Instruments of the Terms and Conditions of Pictet London Branch, shall be read. Structured products are complex financial products and involve a high degree of risk. The value of structured products depends not only on the performance of the underlying asset(s), but also on the credit rating of the issuer. Furthermore, the investor is exposed to the risk of default of the issuer/guarantor.

In respect of any product documentation, including key information documents of

Packaged Retail and Insurance-based Investment Products ("KIDs"), please note that these may change without notice. You should therefore ensure that you review the latest version of them prior to confirming to Pictet London your decision to invest. If you have been provided with a link to access the respective KID/other product document, you should therefore click on the link immediately before confirming to Pictet London Branch your decision to invest, in order to review the most recent version of the respective KID/other product document. If you have not been provided with a link to access the relevant document, or if you are in any doubt as to what the latest version of the respective KID/other product document is, or where it can be found, please ask your usual Pictet London Branch contact.

Pictet London Branch is not the manufacturer of the product(s) and the KID/other product document is provided by a third party. The KID/other product document is obtained from sources believed to be reliable. Pictet London Branch does not make any guarantee or warranty as to the correctness and accuracy of the data contained in the KID/other product document. Pictet London Branch may not be held liable for an investment decision or other transaction made based on reliance on, or use of, the data contained in the KID/other product document.

By subscribing to the product(s) proposed herein, you acknowledge that you have (i) received, in good time, read and understood any relevant documentation linked to the product(s), including, as the case may be, the respective KID/other product document; (ii) taken note of the product(s) restrictions; and (iii) meet the applicable subjective and objective eligibility conditions to invest in the product(s).

Pictet London Branch may, if necessary, rely on these acknowledgements and receive your orders, to transmit them to another professional, or to execute them, according to the relevant clauses of your mandate, as well as the Terms and Conditions of Pictet London Branch.

The content of this document shall only be read and/or used by its addressee. Any form of reproduction, copying, disclosure, modification and/or publication in any form or by any means whatsoever is not permitted without the prior written consent of Pictet London Branch and no liability whatsoever will be incurred by Pictet London Branch. The addressee of this document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information provided in this document.

Pictet London Branch is a branch of Bank Pictet & Cie (Europe) AG. Bank Pictet & Cie (Europe) AG is a credit institution incorporated in Germany and registered with the Handelsregister, the German Commercial Register under the no. HRB 131080. Its head office is at Neue Mainzer Str. 1, 60311 Frankfurt am Main, Germany. Bank Pictet & Cie (Europe) AG is authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht, the German Federal Financial Supervisory Authority (BaFIN)

Pictet London Branch is registered as a UK establishment with Companies House (establishment number BR016925) and its UK establishment office address is Stratton House, 6th Floor, 5 Stratton Street, London W1J 8LA. Authorised by the Prudential Regulation Authority (PRA) and subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Distributors: Bank Pictet & Cie (Asia) Ltd ("BPCAL") in Singapore and/or Banque Pictet & Cie SA, Hong Kong Branch ("Pictet HK Branch") in Hong Kong.

The information, tools and material presented in this document are provided for information purposes only and are not to be used or considered as an offer, an invitation to offer or solicitation to buy, sell or subscribe for any securities, commodities, derivatives, (in respect of Singapore only) futures, or other financial instruments (collectively referred to as "Investments") or to enter into any legal relations, nor as advice or recommendation with respect to any Investments. This document is intended for general circulation and it is not directed at any particular person. This document does not have regard to the specific investment objectives, financial situation and/or the particular needs of any recipient of this document. Investors should seek independent financial advice regarding the appropriateness of investing in any Investments or adopting any strategies discussed in this document, taking into account the specific investment objectives, financial situation or particular needs of the investor, before making a commitment to invest.

BPCAL/Pictet HK Branch has not taken any steps to ensure that the Investments referred to in this document are suitable for any particular investor, and accepts no fiduciary duties to any investor in this regard, except as required by applicable laws and regulations. Furthermore, BPCAL/Pictet HK Branch makes no representations and gives no advice concerning the appropriate accounting treatment or possible tax consequences of any Investment. Any investor interested in buying or making any Investment should conduct its own investigation and analysis of the Investment and consult with its own professional adviser(s) as to any Investment including the risks involved.

This document is not to be relied upon in substitution for the exercise of independent judgment. The value and income of any Investment mentioned in this document may fall as well rise. The market value may be affected by, amongst other things, changes in economic, financial, political factors, time to maturity, market conditions and volatility, and the credit quality of any issuer or reference issuer. Furthermore, foreign currency rates of exchange may have a positive or adverse effect on the value, price or income of any Investment mentioned in this document. Accordingly, investors must be willing and able to assume all risks and may receive back less than originally invested.

Past performance should not be taken as an indication or guarantee of future performance and no representation or warranty, expressed or implied, is made by BPCAL/Pictet HK Branch regarding future performance.

This document does not constitute the investment policy of BPCAL/Pictet HK Branch, or an investment recommendation, and merely contains the different assumptions, views and analytical methods of the analysts who prepared them. Furthermore, the information, opinions and estimates expressed herein reflect a judgment at its original date of publication and are subject to change without notice and without any obligation on BPCAL/Pictet HK Branch to update any of them. BPCAL/Pictet HK Branch may have issued or distributed other reports or documents that are inconsistent with, and reach different conclusions from, the information presented in this document.

While the information and opinions presented herein are from sources believed to be reliable, BPCAL/Pictet HK Branch is not able to, and do not make any representation or warranty as to its accuracy or completeness. Accordingly, BPCAL/Pictet HK Branch accepts no liability for loss arising from the use of or reliance on this document presented for information purposes only. BPCAL/Pictet HK Branch reserves the right to act upon or use any of the information in this document at any time, including before its publication herein.

BPCAL/Pictet HK Branch and its affiliates (or employees thereof) may or may not have long or short positions in, and buy or sell, or otherwise have

interest in, any of the Investments mentioned herein, and may or may not have relationships with the issuers of or entities connected with Investments mentioned in this document. BPCAL/Pictet HK Branch and their affiliates (or employees thereof) may act inconsistently with the information and/or opinions presented in this document.

The information used to prepare this document and/or any part of such information, may have been provided or circulated to employees and/or one or more clients of BPCAL/Pictet HK Branch before this document was received by you and such information may have been acted upon by such recipients or by BPCAL/Pictet HK Branch.

This document is provided solely for the information of the intended recipient only and should not be reproduced, published, circulated or disclosed in whole or in part to any other person without the prior written consent of BPCAL/Pictet HK Branch.

Singapore

This document is not directed to, or intended for distribution, publication to or use by, persons who are not accredited investors, expert investors or institutional investors as defined in section 4A of the Securities and Futures Act 2001 ("SFA") or any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject BPCAL and any of its affiliates or related corporations to any prospectus or registration requirements.

BPCAL is a wholesale bank regulated by the Monetary Authority of Singapore ("MAS") under the Banking Act 1970 of Singapore, an exempt financial adviser under the Financial Advisers Act 2001 of Singapore ("FAA") and an exempt capital markets licence holder under the SFA. Please contact BPCAL in Singapore in respect of any matters arising from, or in connection with this document.

Hong Kong

This document is not directed to, or intended for distribution, publication to or use by, persons who are not "professional investors" within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and any rules made thereunder (the "SFO") or any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject Pictet HK Branch and any of its affiliates or related corporations to any prospectus or registration requirements. If you do not want Pictet HK Branch to use your personal information for marketing purposes, you can request Pictet HK Branch to stop doing so without incurring any charge to you.

In distributing an investment product as agent for a third party service provider, Pictet HK Branch distributes the product for the third party service provider and the product is a product of the third party service provider but not Pictet HK Branch. In respect of an eligible dispute (as defined in the Terms of Reference for the Financial Dispute Resolution Centre in relation to the Financial Dispute Resolution Scheme) arising between Pictet HK Branch and you out of the selling process or processing of the related transaction, Pictet HK Branch is required to enter into a Financial Dispute Resolution Scheme process with you; however any dispute over the contractual terms of the product should be resolved directly between the third party service provider and you.

Banque Pictet & Cie SA is a limited liability company incorporated in Switzerland. It is an authorized institution within the meaning of the Banking Ordinance and a registered institution (CE No.: BMG891) under the SFO carrying on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities. The registered address of Pictet HK Branch is 9/F., Chater House, 8 Connaught Road Central, Hong Kong.

Warning: The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice. Please contact Pictet HK Branch in Hong Kong in respect of any matters arising from, or in connection with this document.