MONTPENSIER'S EYE

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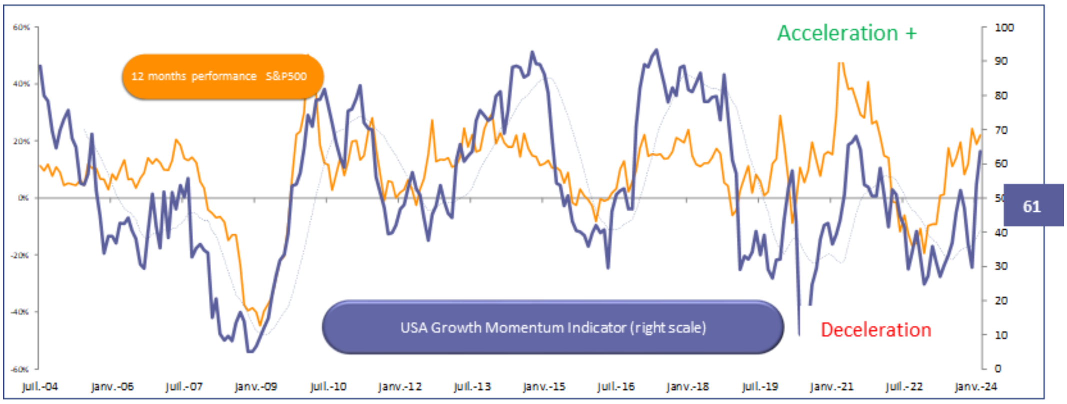
Back to the "Great Moderation"?

Despite the political, monetary, and economic uncertainties that make the context very different, the market seems to believe in the return of the 'Great Moderation,' an economy with growth and little inflation, similar to the pre-2008 years.

3.3%. Published on January 25th, the first estimate of the annualized US economic growth for the last quarter of 2023 surprised observers. After already more than 5% for the previous quarter, the performance of the world's leading economy continues to surprise with its strength.

The IMF did not make a mistake in its new growth estimates published on January 30, significantly revising upward its forecasts for the growth of economic activity in the United States from 1.6% to 2.1%. **Our Montpensier Economic Momentum Score (MMS) at 61 confirms this positive trend.**

Our Economic Growth Momentum Score (MMS) indicator for the United States is progressing around 61

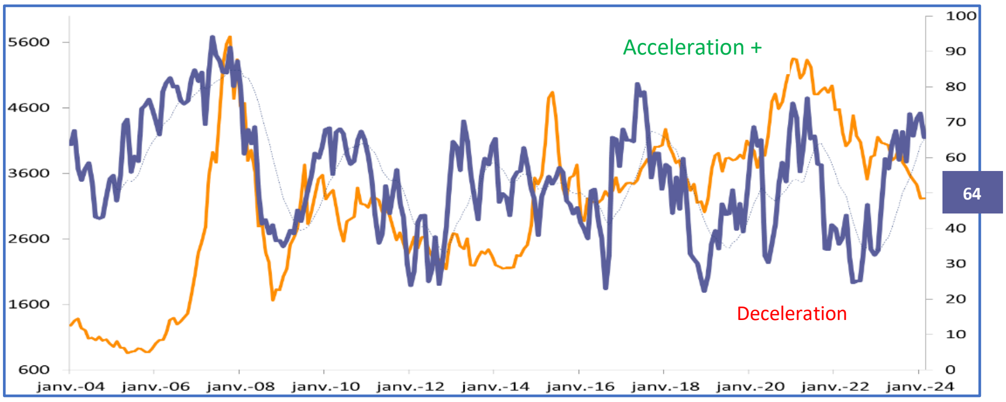


Source : Bloomberg / Montpensier Finance as of 1st February 2024

The robust health of the United States contrasts with the persistent sluggishness of Chinese growth. Continuously grappling with a real estate sector in serious trouble, as evidenced by the liquidation of the major developer Evergrande on Monday, January 29, by a Hong Kong court, authorities are struggling to restore confidence among households, private businesses, and investors.

Nevertheless, the latest leading indicators are somewhat better than expected. Thus, the manufacturing PMI for January, published on the last day of the month, at 49.2, shows a slight improvement both compared to the previous reading (49.0) and compared to expectations (49.1). The same observation applies to the composite PMI, slightly above 50. **Our Montpensier Economic Momentum Score (MMS) for the country, at 64, is also in expansion territory thanks to the strength of exports and positive base effects.**

Our Economic Growth Momentum Score (MMS) indicator for Chinese economic growth is in positive territory around 64



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The IMF supports this positive view in its latest forecasts by also revising upward its activity projections for China in 2024 to 4.6%, compared to 4.2% in its October publication. Indeed, we are far from the stratospheric pace of the years 2009-2015, but the risk of a rapid deceleration seems to be receding for now.

Despite the lack of persistent momentum in Europe, still burdened by a stalled German industrial engine and the lack of dynamism in the French economy, the overall outlook for the coming year has improved in recent weeks. Global growth, while not dazzling, could therefore be maintained at a pace slightly above the symbolic 3% threshold.

At the same time, inflationary dynamics seem to be normalizing very quickly, although it is necessary to remain vigilant in the face of the sharp rise in maritime freight prices since the beginning of the year due to strong tensions in the Red Sea.

In the United States, the figures are spectacular: the PCE excluding energy and food, the most closely watched by the Fed, stood at 2.9% year-on-year for the month of December, but at an annualized 1.9% over the last six months and at 1.5% for the October-December 2023 period, well below the Fed's official target of a 2% pace year-on-year.

Even in Europe, which is supposedly further behind in the economic cycle, prices are slowing significantly: On January 31, inflation in France was measured at 3.4% on a year-on-year basis in harmonized European Union data, compared to 4.1% the previous month and an expected 3.6%. Prices even showed a decline on a month-to-month basis.

If we add, to complete this encouraging picture, a gradual erosion of consumer prices in China and producer prices that are also tending to decline in major manufacturing countries, the conclusion is clear: the scenario of persistently high inflation is gradually giving way to the return of a very moderate price dynamics.

Even with this surprising paradox: **massive investments in energy transition, far from contributing to accelerating inflation, have rather so far led to overproduction** in wind turbines or electric cars, generating fierce competition and a decrease in prices, as seen with battery-powered vehicles in China.

The economic scenario that could emerge this year is based on robust global economic growth thanks to the strength of U.S. consumption and the resilience of activity in China, and a sharply slowing inflation, quickly heading towards 2% on an annual basis, or even below by the end of the year.

Modest but resilient growth, low but anchored inflation close to 2%, this configuration is not unprecedented. It resembles the period known as the 'Great Moderation' from the early 2000s until the 2008 great financial crisis. Of course, growth was a bit higher, especially in the United States, although the average level of long-term interest rates over this period - between 3.8% and 4.5% from mid-2002 to mid-2008 for the U.S. 10-year - as well as inflation indicators, were comparable to those of today.

The attentive observer may object that comparison is not reason and that the political, economic, and monetary context today is very different from that of the early 2000s.

This is indisputably the case on the monetary front. Even though the rates, as we have seen, were on levels similar to those we know today, unlike the great stability we see today in the euro-dollar pair, the years 2002-2008 are characterized by a continuous erosion of the greenback in favor of the single currency, which reached its historical peak in July 2008 at almost 1.6 dollars for one euro.

On the political front, the diagnosis is less obvious. The global geopolitical context, beyond obvious divergences – Taiwan was not, during the times of Jiang Zemin and Hu Jintao, as sensitive an issue for China as it is for Xi Jinping, and Donald Trump's antics were limited to his real estate adventures – presents certain points of similarity: the Middle East, through the U.S. focus on Iraq, was already a cause for concern, and the strong character of George W. Bush disturbed the Republican establishment.

From an economic perspective, the slowdown in productivity growth in the United States worried and intrigued until recent months. The financial lever allowed the continuation of the American dynamic, while China began its irresistible ascent, and the use of the credit weapon to boost growth there would have to wait until after the financial crisis.

On the markets, it was the exuberance of finance and its limitless creativity that attracted the attention of investors and the vigilance of observers. Banks seemed irresistible, combining growth and high dividends. The reversal in 2008 would mark a change of era.

In the end, and despite the differences, a new formula for the 'Great Moderation' would be, as for the years 2002-2007, very good news for the markets. This scenario, even though it has gained consistency in recent weeks, is anything but certain. But in these sometimes dark times, it is not forbidden to hope and maintain a reasonable optimism.

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