Monthly Macro

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Jim Leaviss
CIO of Public Fixed Income

Stuart Canning
Fund Manager, Multi Asset

What were the biggest drivers of markets in July?

- In July, central banks continued to raise interest rates, but with inflation continuing to decline there was a growing expectation that we could be approaching the end of the current hiking cycle. US annual inflation slowed to 3% in June, while UK inflation also moved in the right direction, falling to 7.9% year-on-year. With economic data remaining resilient, there was increased optimism that an economic slowdown might be avoided. In the second quarter, the US economy grew at a better-than-expected annual rate of 2.4%.
- After a pause in June, the Federal Reserve hiked rates again in July, to 22-year highs. The European Central Bank also announced a 25-basis point hike. In a surprise move the Bank of Japan tweaked its yield curve control (YCC) policy, allowing bond yields to rise flexibly to 1%.
- Against this background, US Treasuries and German bunds both fell, although gilts rose. Credit performed well in the positive environment, with spreads tightening further. Global high yield bonds continued to advance, taking their year-to date gains to 6.1%. It was another positive month for emerging market bonds.
- Market sentiment improved in July. Equity markets were generally strong, particularly in China and related markets, which benefited from supportive language and stimulative measures from the Chinese authorities. European equity markets lagged other regions.
- The Bank of Japan's policy move was followed by yen weakness. This was a surprise to consensus expectations, potentially indicating the market was expecting more pronounced action. Ultimately, the currency was little moved over the month as a whole.
- Bond yields in the developed world were relatively unchanged as markets continue to grapple with signs of easing inflation pressures alongside resilient growth and labour markets. In the main, July's data signalled ongoing disinflation. Emerging market bonds and currencies generally appreciated.
- Growth data in the US have been encouraging and labour markets remain robust in most major economies. However, economic activity data were more disappointing in Europe, and there continues to be notable softness in global manufacturing.

What will you be looking out for in August?

- Ahead of the next Federal Reserve meeting in September, there will be plenty of time to assess the effect of recent rate hikes. Policymakers have said decisions will be data-dependent. If higher rates are making life tough for consumers, could we have reached the peak?
- Meanwhile, in Japan, bond yields have risen to the highest level in 10 years after the Bank of Japan widened its YCC band -- a move that could be an initial step towards policy normalisation. The yield curve remains inverted, a phenomenon which has historically predicted a recession, but it has not yet materialised. For the time being, the economy appears resilient but a 'higher for longer' rate environment could create difficulties and trigger the economic downturn.
- Developments in July appeared to bring even greater confidence among market participants that there will be benign disinflation in the western world. Fear that policymakers will have to materially damage growth and employment to bring inflation to target has notably decreased.
- This shift in sentiment is somewhat at odds with the language of policymakers themselves, the history of previous economic cycles, and with what we know about the lags between policy tightening and its impact on the real economy.

Key dates for the month ahead:

10 August: US inflation **16 August:** US FOMC meeting minutes **16 August:** UK inflation data **31 August**: Eurozone inflation

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