RATHBONES

PAINTING A PICTURE

REVIEW OF THE WEEK
16 SEPTEMBER 2024

THE WAIT FOR US INTEREST RATE CUTS IS OVER. EVERYONE EXPECTS THE US FEDERAL RESERVE TO MOVE THIS WEEK, THE QUESTION IS HOW FAR WILL IT GO?

Almost half of all private-sector workers in America are employed by small businesses. Now, that can be a bit of a misnomer: many of these 'small' firms would be big fish in any other nation, yet it's a helpful area of the economy to keep an eye on. And at the moment, these businesses' view of the world is a little at odds with the economic picture we're all confronted with.

After months of wondering whether the US Federal Reserve (Fed) will finally cut interest rates, the discussion is over. A cut is now nailed on for this week, according to interest rate markets. Instead, Investors are discussing whether the Fed's first reduction in more than four years will be a quarter of a percentage point (25 basis points) or half (50bps). **We covered last week** the reasons for the sudden shift of attention from a possible resurgence in inflation to the potential for the economy to tank. Job openings are falling swiftly, fewer people are taking new jobs in recent months, and inflation is back below 3%. Fed Chair Jay Powell underscored these points while speaking last month at the annual monetary policy conference in Jackson Hole, Wyoming.

A first rate cut from the Fed has been clearly telegraphed, and a couple more are likely later this year. But investors are confidently forecasting a rapid rate cutting cycle all the way through 2025. It's hard to be so confident given how much noise and uncertainty surrounds the data in this unusual economic cycle. The latest survey of NFIB US small businesses illustrates the point. The single most important problem highlighted by most members was inflation, despite the decline in the headline rate. A full 60% of respondents didn't want a loan and only 10% couldn't get one or found the last refinancing more difficult. This at a time when the Fed is planning to make loans cheaper, at the risk of letting inflation resurge (remember, inflation hasn't hit the 2% target since February 2021).

One concern cited from the NFIB report is a drop in hiring intentions over the coming months. This can herald a recession as businesses start laying off staff, creating a downward spiral in household spending and business employment. Yet the second most popular 'important problem' cited by small businesses that's very close behind 'inflation' and a country mile ahead of all the rest? Quality of labour. Are companies failing to hire because they are worried about their bottom lines or are they struggling to find staff with the skills they require?

This is just one survey out of a sea of data, so we're not saying it's gospel or that it proves the popular narrative wrong. The broad sweep of evidence shows that underlying inflationary pressure has subsided and that the economy looks more fragile than it has in some time. The Fed will cut this week – and we expect 25bps rather than 50bps because it will be wary of spooking markets with an 'emergency move'.

Yet it's always helpful to face contradictory data and take a dose of doubt. People are fallible and therefore so is the data that flows from them. Exactly which bits are wrong is difficult to know. Since the pandemic especially, surveys and economic data have become less reliable, muddier and more confusing. Sometimes political leanings overly influence responses. Other times, changed lifestyles and routines have made it harder to get people to answer at all. And survey responses are only as good as the questions that prompt them. How many times have you struggled to answer a survey because you can't convey what you mean in the boxes provided? **When the world changes, it can make redundant economic tools crafted for the past**.

Walking a tightrope

The Bank of England (BoE) meets on Thursday to talk policy. Unlike their counterparts across the Atlantic, the monetary policy committee is expected to keep rates at 5.0%.

According to job postings website Indeed, UK annual wage growth was 6.7% in the three months to 31 July. The official figure from the Office for National Statistics is a more staid 4%, yet even that amount of growth keeps up the pressure on labour-heavy services inflation (prices in cafes, cinemas, garages, law firms and the like), which is still above 5%. How quickly it comes down will influence how much further the Bank of England is willing to cut interest rates. The next update is on Wednesday, the day before the BoE meets, and headline inflation is forecast to remain at 2.2%. Best to watch the services component closely.

Last week the European Central Bank (ECB) cut its rate for the second time, from 3.75% to 3.50% in a unanimous decision (the first decrease had one dissenter). Recent data increased the committee's confidence that inflationary pressures are under control, with Eurozone inflation for August falling from 2.6% to 2.2%. However, the core measure (which strips out volatile food and energy costs) is a little more stubborn at 2.8%. And services inflation actually ticked up from 4.0% to 4.2%. The ECB was convinced to cut rates because of the economic side of the ledger. Falling industrial production has led the central bank to trim its GDP growth forecast from 0.9% to 0.8% for 2024 and from 1.4% to 1.3% for 2025.

Speaking of more downbeat expectations, a report from the **UK's Office for Budget Responsibility (OBR) painted a grim long-term picture of the public purse**. The OBR projects that under current tax plans, unless productivity growth improves, the ratio of public debt to GDP will almost treble over the next 50 years. From 98% today – already the highest level in 60 years – it is slated to hit 274% by 2071. The main culprits for ballooning government spending are social care costs for the elderly, health spending, pensions and higher borrowing costs.

Global warming is expected to have an impact as well, with climate-related damage projected to increase debt by 23% of GDP in a two-degree warming scenario by the mid-2070s, or by a third of GDP in a three-degree scenario.

This has only added fuel to concerns that the Budget on 30 October will deliver higher taxes. This came as an investigation into the state of NHS services called for investment, alongside reform to boost productivity and have more services provided in the community. Cutting your way to growth isn't a strong strategy, yet neither is spooking the bond market by spending with abandon. The government is walking a difficult path. Itneeds to encourage investment in the UK and work to improve the health and skills of its people. That won't happen overnight and it costs money today. We await the Budget with interest.

If you have any questions or comments, or if there's anything you would like to see covered here, please get in touch by emailing ***review@rathbones.com.*** *We'd love to hear from you.*

The content contained in this document is for information purposes only and does not constitute as a recommendation to purchase any product or service, you should always take appropriate advice from a professional, who has made an evaluation at the point of investing. The value of investments and the income from them may go down as well as up and you may not get back what you originally invested. Tax treatments depend on the individual circumstances of each client and may be subject to change in the future. Cashflow planning is based on assumptions and can only give an indication as to what may happen. They are not guarantees.

Important information. Rathbones Group Plc, through its subsidiaries, is a leading provider of high-quality, personalised investment and wealth management services for private clients, charities and trustees. Our services include discretionary investment management, fund management, banking and loan services, financial planning, unitised portfolio services and UK trust, legal, estate and tax advice.

Rathbones and Rathbones Financial Planning are trading names of Rathbones Investment Management Limited, which is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered office: Port of Liverpool Building, Pier Head, Liverpool L3 1NW. Registered in England No. 01448919.

Rathbones Asset Management Limited is authorised and regulated by the Financial Conduct Authority and is a member of the Investment Association. Registered office: 30 Gresham Street, London E2V 7QN. Registered in England: 02376568.

Rathbones Investment Management International Limited is regulated by the Jersey Financial Services Commission. Registered office: 25-26 Esplanade, St. Helier, Jersey JE1 2RB. Company Registration No. 50503.

Rathbones Trust Company Limited is authorised and regulated by the Solicitors Regulation Authority. It should be noted that any services provided by Rathbones Trust Company, Rathbones Investment Management International and some services from Rathbones Financial Planning are not regulated by either the Financial Conduct Authority nor the Prudential Regulation Authority. Registered office: 30 Gresham Street, London E2V 7QN. Registered in England No. 01688454.

Copyright ©2024 Rathbones Group Plc.