Pyrford

Monthly Commentary

February 2024

Real wage growth positive but unemployment ticking up

For wholesale or professional investors only

Household consumption is the main driver of economic activity across the developed world with a consumption share of GDP ranging from around 50% in Australia and Germany to 60% in the UK and 70% in the US. The diverging trajectories of advanced economies post-Covid has much to do with the varied impacts of fiscal policy during and after the pandemic, followed by the sharp interest rate increases, on household finances.

Starting with the labour market, we're beginning to see early signs of a pick-up in unemployment off record lows. Canada most evidently has seen unemployment rise off its lows of 4.8% in July 2022 to 5.7% in January 2024. Similarly, Australia has seen unemployment rise from 3.4% to 4.1%. The UK and the US have had very slight increases whilst Japan and the Eurozone continue to record declining unemployment.

Moving on to consumption, only the US and Australia have continued real goods spending above their pre-pandemic trend. The UK has had the weakest growth in spending with real goods consumption more than -15% below pre-pandemic trend, followed by Germany -9%, Italy and France -5%.

When it comes to wages, the US saw another increase in average hourly earnings, which grew at an annual rate of 4.48% in January. Nominal wages continue to grow at uncomfortably high levels in the UK (5.52%) and Euro Area (5.7%), with Australia also elevated at 4.2%. Japan has seen a steady increase in nominal wages, now growing above 1.5% per year. The decline in inflation has meant that real wage growth has now been positive across the major economies for several months now.

What about the excess savings that were built up during and after the pandemic? The US had amassed the largest buffer at around 12% of GDP by the end of 2021. American consumerism has rattled that down to 8% of GDP now the lowest level among the G7. Whilst excess savings have declined slightly in Australia and Japan, they continue to increase across the Euro Area, Canada and the UK.

Mexico the clear winner from nearshoring

US-China trade relations have been declining since the Trump tariffs of 2018. After a brief surge following the pandemic, annual US imports from China have fallen from a peak in September 2022 of $563 billion to $427 billion in December 2023. We now have at least a year of data to confirm the winners of the 'reshoring' or 'friendshoring' dynamic resulting from the breakdown in trade between the world's two largest economies.

Where has the US gone to replace Chinese imports? Vietnam has seen the biggest increase in its share in US imports than any other country since 2018. Exports to the US have gone up by 13% of GDP in that time, although imports from China have also increased by 7% of GDP, suggesting a lot rerouting of Chinese trade has gone through Vietnam to the US.

Mexico has been the clear winner of 'nearshoring' and is now the US' largest trading partner. The government has stated that more than 400 firms are investing in Mexico supposedly related to nearshoring. According to BofA research, this includes the likes of Tesla ($5bn), BMW ($870mn), Nissan ($700mn), Volkswagen ($763.5mn) and Lego ($500mn). At its peak, exports from Mexico to the US reached 33% of GDP in Q3 2022. It has since come down to 26%. After Mexico, notable increases in their share of US imports were experienced by Taiwan, Korea, India and Thailand.

To the moon!

February saw several equity markets climb to record highs with bond markets selling off as investors recalibrated expectations for rate cuts with fewer cuts priced further down the line. The US 10 Year Treasury Yield climbed from 3.88% to 4.33% over the course of the month. US data throughout the month came in hot, except for retail sales which contracted by -0.8% in January.

The US, Japan, Europe and India all hit record highs over the month as investors optimism on future rate cuts remains in place despite pushing back the magnitude and timing of central bank rate cuts. The S&P 500 was first to reach the milestone led by the strength of the tech sector although momentum has been weaker of late as mixed economic data caused the market to reassess when the Fed will start cutting rates.

Europe's Stoxx 600 has taken just over two years to climb back to all-time highs, a mere blink of an eye compared to the Nikkei 225 in Japan which last hit its peak back in December 1989. Whilst both markets now sit at record highs, Japanese equities have been attracting flows whilst European equities have seen outflows since the turn of the year. Of course, valuations need to be considered. Japan is trading at a P/E multiple 16.9x, broadly in line with its 10-year average. Europe is trading on a P/E multiple of 14.6x, close to 20% discount to its 10-year average. Not all record highs are loved equally.

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