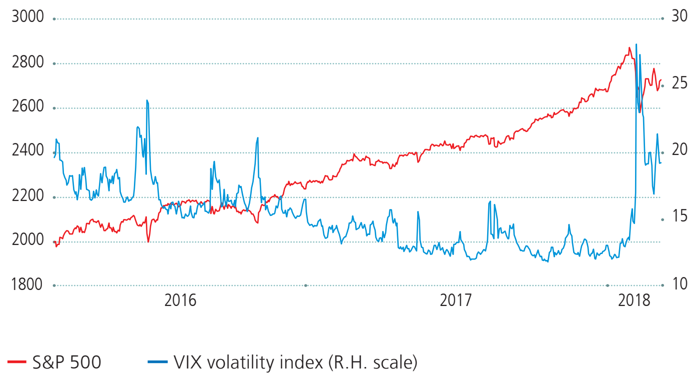
Economic overview

March 2018

The peak of volatility recorded on 5 February came as a thunderbolt for the markets. After having touched currencies, volatility spread to the bond markets before hitting shares. In this context, the main stock market indices fell back, driving the global equity average down by more than 4%. Although American equities resisted better thanks to the technology sector, the performance of large-caps in the United States took a negative swing nonetheless. In Europe, the fall in prices was often more substantial, exceeding 4% on average in Switzerland and Germany. As regards bonds, American T-bonds underwent the adjustment of inflation expectations while European yields trended more laterally, except on maturities above 30 years which rose moderately. Generally speaking, bonds failed to generate any real yields in this jittery outburst. Commodity prices also mirrored this volatility, with gold being impacted by the upturn of the dollar. Oil prices followed the same downward trend, under pressure from the still massive stock levels, therefore dropping back to around the 60 dollars a barrel mark.

S&P 500 and share volatility index in the United States



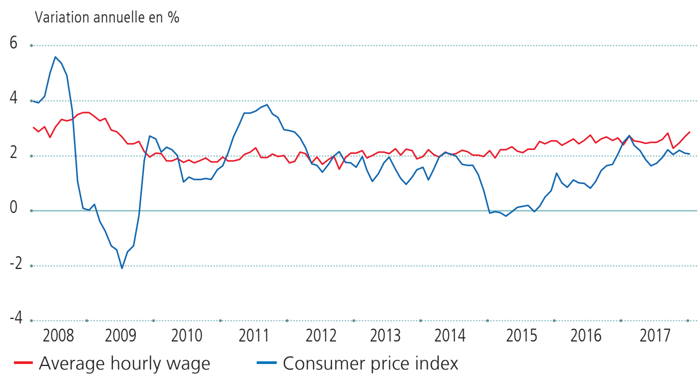
Source : Thomson Reuters Datastream

Wage statistics in the United States, published on 2 February, were what lit the touch paper for the peak of volatility on the stock markets. The annual rise in the average hourly wage in January remained at a moderate 2.9%, but such a marked rate of acceleration over the month had not been seen since 2008! This drive fuelled fears about what would happen to inflation in the context of an economy enjoying full employment and of the introduction of the tax reform, potentially capable of creating overheating. A number of anecdotal announcements about exceptional bonus payments, in response to the tax breaks, only added to the stress. It has been a brutal wake-up call for those who had forgotten that, after so many years with the risk of deflation remaining unchallenged, inflation could again form part of the economic landscape in a return to normality.

Meanwhile, US inflation remains moderate at 2.1%, and 1.9% excluding the volatile components (energy and food), and its excess-free trend is part of the normalisation process. The breakdown of the aggregate figure shows that at this stage, it is the service sectors that are at the origin of the increase observed in this early part of the year. The finance, IT and leisure sectors have pushed the average upwards; conversely, wage inflation has remained below 2% in the manufacturing sector. In Europe, with inflation contained at 1.2%, the recent wage agreements reached at IG Metall do not point to any worrisome pressure yet.

Nevertheless, inflation expectations on the bond markets continue to edge upwards and, in the United States, stand at between 2 and 2.5% depending on the measurements used; nothing alarming, especially as the statements made by Jerome Powell, the Fed's new governor, have remained in line with the ongoing policy of a gradual monetary normalisation process. Lastly, it is essentially a change of sentiment towards the inflationary context with specific catalysts such as dollar volatility that triggered February's jolt.

Inflation and average hourly wage in the United States



Source : Thomson Reuters Datastream

As regards the activity picture, February's statistics again provided confirmation that the growth momentum is well established, with no signs of fragility coming from the business sector. The results season is confirming the financial solidity of companies in the different regions. On the basis of these fundamentals, asset allocation in favour of equities remains valid regardless of volatility movements which are interpreted as being temporary events and, in particular, underlined by the fall in the sentiment indicators of the financial markets (surprise indicators).