J. Safra Sarasin

# Cross-Asset Weekly

30 August 2024

## Don't underestimate the US consumer

Concerns about the US consumer's health have risen in recent months as the labour market has cooled. These fears may be overdone. Household net wealth has grown significantly, cash reserves are ample, and debt service ratios remain near historic lows. While poorer households face increasing financial strain, with high borrowing costs and rising delinquency rates on consumer loans, a resilient labour market and forthcoming interest rate cuts should offer some relief.

Over in the US rates space, we look at seasonal effects in the US treasury market. Over the past 20 years, 10-year yields have mostly risen in September and October in particular. However, rate cut cycles, most of which took place before 2004, eclipsed these seasonal effects. The Fed is about to start an easing cycle in September and although market expectations for policy easing look ambitious, actual Fed cuts tend to maintain downward pressure on policy rate expectations and bond yields. Therefore, the typical September/October effect for US yields should be less pronounced this time.

Finally, China's export prices have continued to fall this year, in line with our earlier expectation. There is evidence that Chinese government subsidies have led to lower export prices in metal, furniture and autos. These subsidized products have gained market share, particularly in emerging markets as they face more barriers in developed markets.

## This week's highlights



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# US macro

## Household sector – healthy but disparate

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**Concerns about the US consumer's health have risen in recent months as the labour market has cooled. These fears may be overdone. Household net wealth has grown significantly, cash reserves are ample and debt service ratios remain near historic lows. While poorer households face increasing financial strain, with high borrowing costs and rising delinquency rates on consumer loans, a resilient labour market and forthcoming interest rate cuts should offer some relief.**

**Concerns about the health of the US consumer have grown**

Concerns about the health of the American consumer, and by extension the economy, have grown in recent months. Indeed, delinquency rates on credit card debt and other consumer loans have risen further and the labour market is cooling.

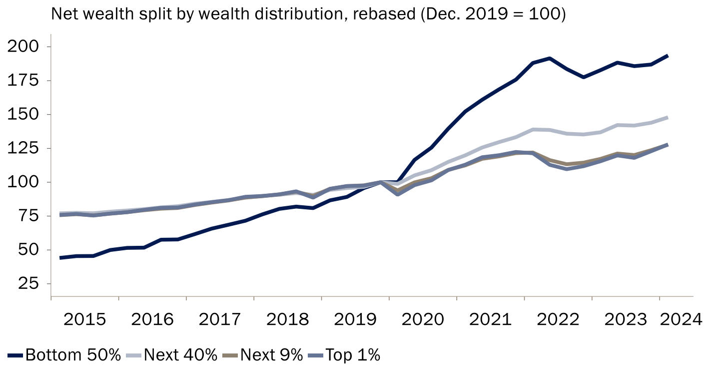
**We think those are likely overstated, for three reasons:**
**(1) Net wealth has risen over the past year**

We believe these worries are likely overstated, for three reasons. First, household net wealth has continued to increase as equity and house prices have climbed. By the end of the first quarter, net wealth had grown by 17 percentage points of GDP compared with the previous year. This typically correlates with growing, not shrinking, consumption. What's more, all wealth brackets have seen significant gains in net wealth over the past few years, with those in the bottom half of the wealth distribution nearly tripling their net wealth since 2019 (Exhibit 1).

**(2) The household sector still sits on ample cash balances**

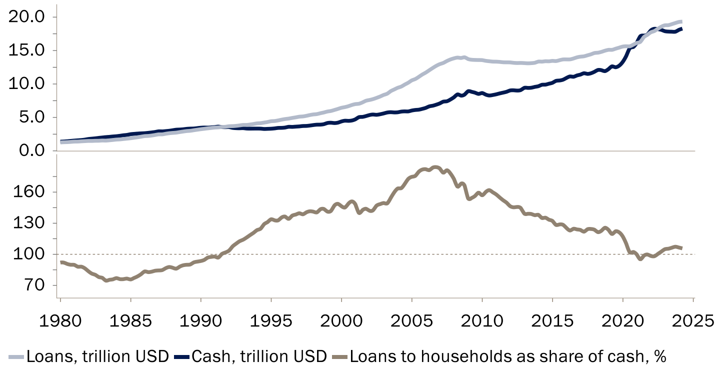
Second, households are still sitting on ample cash reserves, with cash holdings in bank accounts and mutual funds roughly matching their total debt. In a world where cash and debt were evenly distributed, households could almost pay off all their debts (Exhibit 2).

**Exhibit 1: Households have grown richer in all wealth cohorts**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 2: Households have enough cash to cover their loans**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

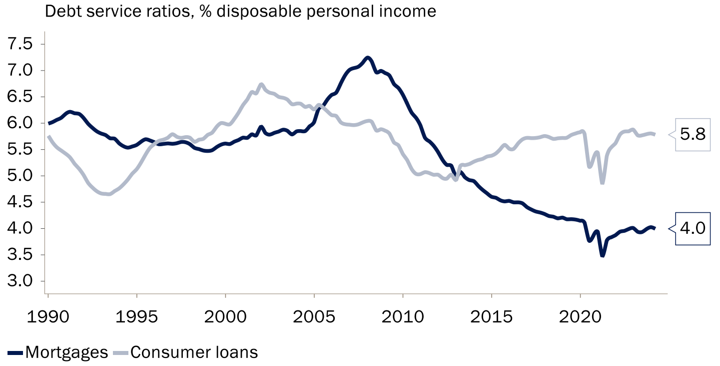
**(3) The debt service ratio remains near record lows**

Third, the debt service ratio remains near record lows, at under 10% of disposable income, despite elevated interest rates on credit cards and other consumer loans (Exhibit 3). This is because mortgages, which account for about 70% of household debt, are still being serviced at low effective rates –3.9% on average –thanks to households locking in fixed rates when interest rates were at historic lows (Exhibit 4).

**Still, less wealthy households have been increasingly struggling, with delinquency rates on consumer loans rising steadily**

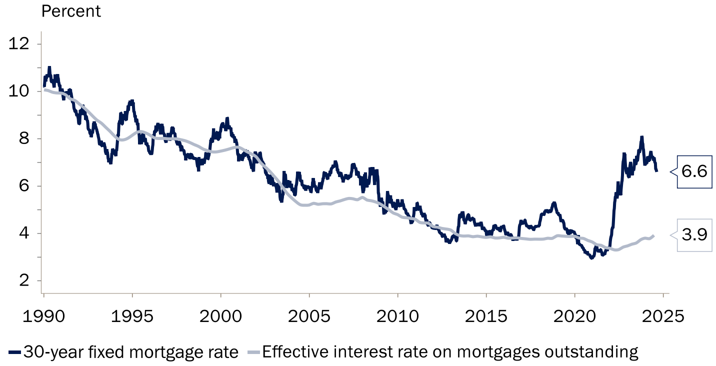
Beneath these healthy aggregate figures, however, the situation has worsened, especially for poorer households. Delinquency rates on credit cards, auto loans, and other consumer loans have risen markedly in recent years. Research by the St Louis Fed highlights that the rise in the share of people with delinquent credit card debt has been particularly pronounced in the poorest ZIP codes.

**Exhibit 3: Total debt service ratio remains very low ...**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 4: ... reflecting low effective mortgage rates**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**To some extent, delinquencies are reverting to more normal levels**

One likely explanation is that delinquency rates are reverting to more typical levels after falling to extraordinary lows during the pandemic, likely due to temporary assistance programs. Yet present levels of credit card and other consumer loans delinquencies are greater than pre-pandemic levels, suggesting that a trend which began prior to the pandemic has accelerated (Exhibit 5).

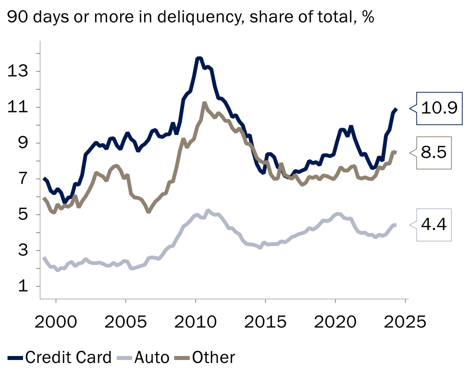
**But elevated interest rates and lower cash balances in the last two years have squeezed poorer households**

Tight monetary policy is clearly a factor. Interest rates on credit card debt have risen from around 15% in early 2022, before the Fed began raising rates, to nearly 22% by the end of the first quarter of this year. Over the same period, cash holdings among households in the bottom half of the wealth distribution fell by $60bn, while their consumer loans increased by $100bn. In other words, less wealthy households appear to have financed their consumption in recent years at increasingly higher costs (Exhibit 6).

**Lower interest rates should provide some relief. But a further cooling of the labour market would likely lead to additional Fed cuts**

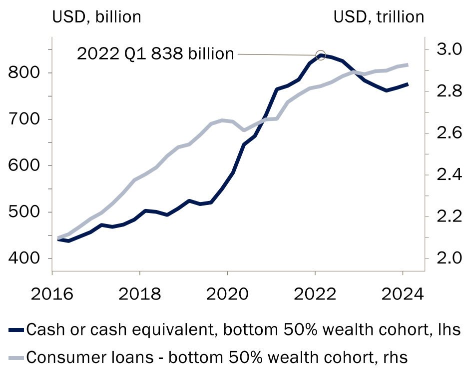
A resilient labour market and the prospect of lower interest rates in the coming months should provide some relief to struggling households. However, with some surveys indicating growing pessimism about personal finances among middle-income households, it is not surprising that Jay Powell has hinted at the possibility of 'insurance' cuts if the labour market were to cool down further (Exhibit 7).

**Exhibit 5: Delinquencies on consumer loans are rising**



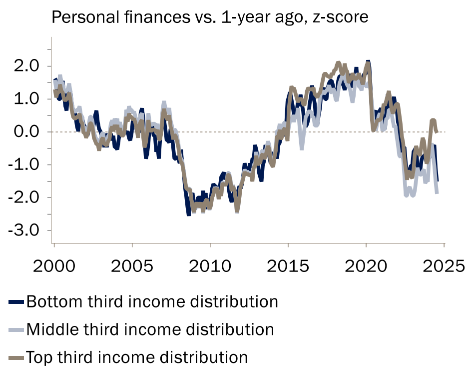

Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 6: Poorer households have been spending their cash balances and more**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 7: Growing pessimism about personal finances**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

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## US fixed income

# Fed cuts to counteract seasonal effect for US yields

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**We find distinct seasonal effects in the US treasury market over the past 20 years with 10-year yields more likely to go up in September and October in particular. However, if we extend the look-back window further to 1980, this distinct seasonality almost disappears. We find that eight of the ten easing cycles since 1980 took place before 2004, usually starting between June and October, and they completely reversed the usual seasonality. The Fed is about to start an easing cycle in September and although market expectations for policy easing look ambitious, actual Fed cuts tend to maintain downward pressure on policy rate expectations and bond yields. Therefore, the typical September/October effect for US yields should be less pronounced this time.**

**There is a distinct September/October effect in the US Treasury market over the past 20 years**

10-year US Treasury yields hit the lowest level for the year at the beginning of August as softer labour market data and ongoing disinflation opened the way to lower policy rate expectations. Over the past years, however, in the September to October period, 10-year Treasury yields have tended to go up, sometimes quite sharply. It so happened last year again when yields surged by 100bp from August to October. Therefore, we take a closer look at this apparent seasonal pattern for US 10-year Treasury yields and explore how relevant it is in the current environment.

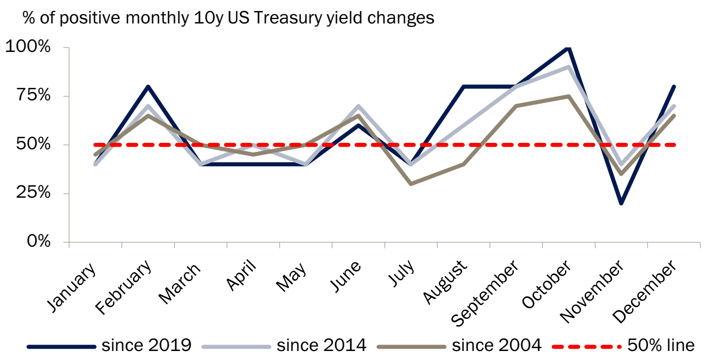
**Seasonality for 10y yields is likely caused by patterns in bond issuance and seasonal money flows between different asset classes**

The main reasons for seasonal effects likely come from bond supply patterns and behavioural patterns from the demand side:

(1) Bond issuance:
Corporate bond issuance at the beginning of the year and in September and October tends to put upward pressure on yields, while the lack of supply during the summer lull usually has the opposite effect. The month of January seems to be less affected since institutional investors have a lot of cash to absorb large issuance at the beginning of the year. US Treasury issuance is less seasonal, but the refunding announcements can be a driver for yield moves in the short term.

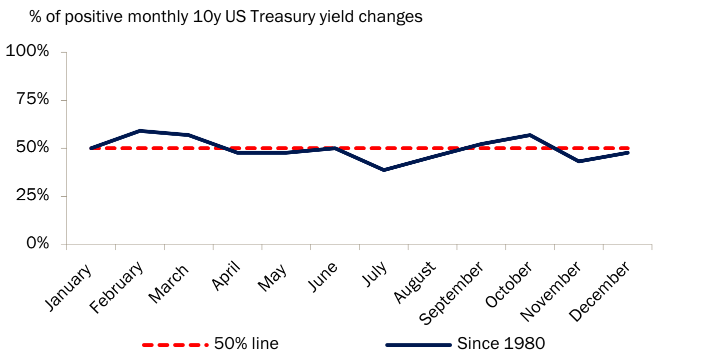
(2) Seasonal patterns from the demand side:
Equity markets tend to perform worse than average during the summer months as traders and investors de-risk before they head off to the beach. This usually benefits fixed income markets as money flows to safer fixed income markets or cash. The reverse usually happens after the summer as the risk-off flows are unwound causing yields to rise again.

**Exhibit 1: Clear seasonality in US 10y yields over the past 20 years**




Source: Bloomberg, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 2: Seasonality hardly visible if we extend window to 1980**

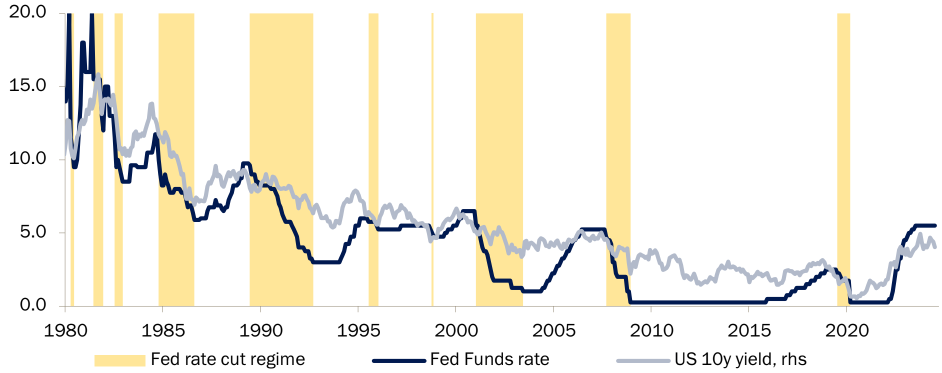



Source: Bloomberg, Bank J. Safra Sarasin, 29.08.2024

**Distinct seasonal patterns over shorter look-back periods, but they vanish over longer windows**

To get a better sense of what is going on, we compare monthly yield changes for 10-year US Treasury bonds back to 1980. Over the past 5, 10 or even 20 years, we find distinct seasonal effects: Yields are much more likely to go up in September/October as well as in February, June and December. In all other months, yields have a higher probability of moving lower. However, if we extend the lookback window to 1980, the distinct seasonality observable over shorter periods almost completely disappears (Exhibits 1, 2).

**Exhibit 3: Ten periods of policy easing since 1980, eight of which took place before 2004**

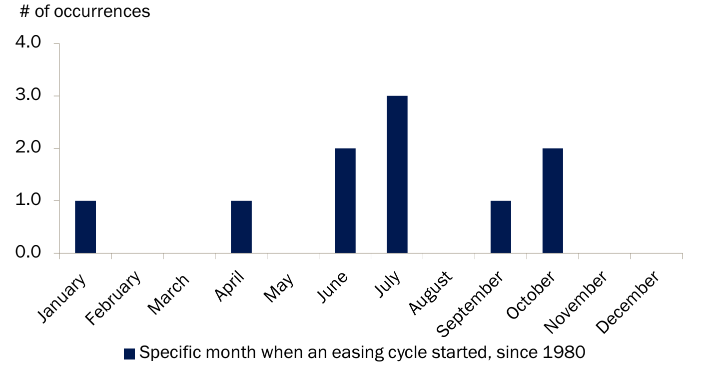



Source: Bloomberg, Bank J. Safra Sarasin, 29.08.2024

**Policy easing cycles eclipse seasonality**

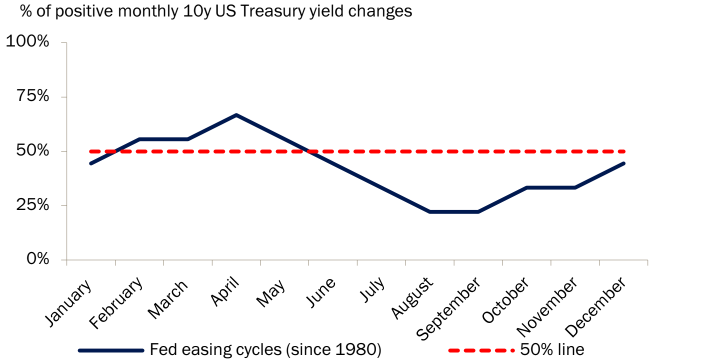
Changes in policy rate expectations are the main driver for bond yields. The fact that seasonal effects disappear when we extend the window to 1980 strongly suggests that policy rate expectations must have eclipsed the seasonal patterns that we have observed over shorter windows, in particular in past August to October windows. In fact, there have been ten periods of policy easing since 1980, eight of which took place before 2004 (Exhibit 3). In eight out of the ten periods, cuts started between June and October (Exhibit 4). Therefore, it should come as no surprise that during these easing cycles yields fell between June and October, a mirror image from the seasonality observed since 2004 (Exhibit 5).

**Exhibit 4: In eight out of the ten easing cycles since 1980, cuts started between June and October ....**




Source: Bloomberg, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 5: ... leading to lower yields between June and October, a mirror image from the seasonality since 2004**




Source: Bloomberg, Bank J. Safra Sarasin, 29.08.2024

**The current easing cycle will likely counteract seasonal effects for US yields**

The Fed is about to start an easing cycle in September and although market expectations for policy easing look somewhat ambitious, actual Fed cuts tend to maintain downward pressure on policy rate expectations and bond yields. Therefore, the typical September/October effect for US treasury yields should be less pronounced this time.

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## Emerging markets macro

# Is China exporting deflation to EMs?

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**China's export prices have continued to fall this year, in line with our earlier expectation. There is evidence that Chinese government subsidies have led to lower export prices in metal, furniture and the auto industry. These subsidised products have particularly gained market share in emerging markets (EMs) as they face more barriers in developed markets. We find evidence of China exporting deflation to two EMs: Brazil and Thailand. Cheaper imports from China have contributed directly to the disinflation process, while increased competition from Chinese imports could continue to exert downward pressure on consumer prices.**

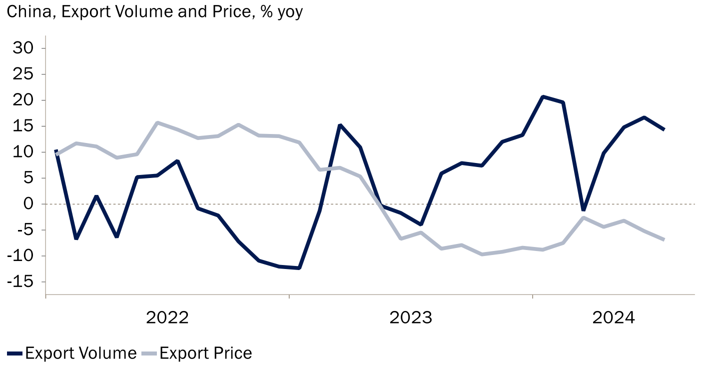
**China's export prices continue to fall**

China's export prices have continued to fall this year, in line with our expectation from last December (Exhibit 1). Weak domestic demand has driven Chinese companies to expand abroad. Indeed, the share of imports from China has risen across major EMs since 2018 (Exhibit 2). In the sectors that are related to the housing industry, large overcapacity due to the housing correction has driven down prices. The steel sector is a prime example of this. A change in technology (that has been aided by government incentives) and fierce competition among producers have driven down prices in the auto industry.

**Empirical evidence shows that state subsidies have lowered export prices only in some sectors such as metal, furniture and auto**

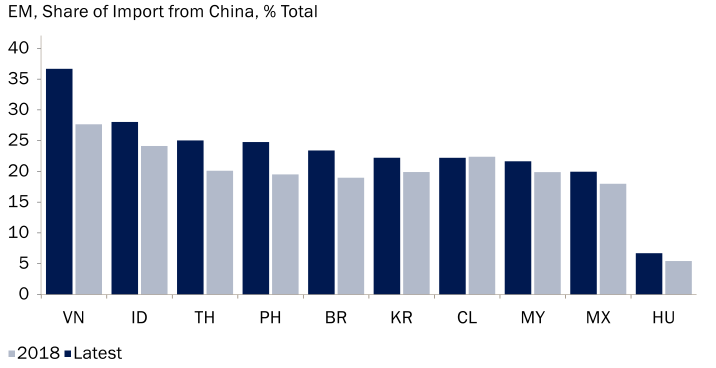
One popular notion is that China's falling export prices have been a direct result of state subsidies. A recent IMF study, however, shows that there is only weak evidence that China's state subsidies have lowered export prices on average. But at the sectoral level, they find evidence of subsidies leading to lower export prices and higher export quantities in metal products, furniture and the auto industry. For other industries, such as electrical machinery, the subsidies seem to have promoted quality upgrading and not led to lower export prices.

**Exhibit 1: China's export prices have been falling since May 2023**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 2: Share of imports from China has increased in most EMs**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**China's subsidised products have particularly gained market share in EMs as they face more barriers in DMs**

The same IMF study also finds that these subsidised products have gained more market share in emerging markets (EM) than in developed markets (DMs). One possible explanation is that China's subsidised products may face more scrutiny and higher barriers in DMs through retaliation policies and countervailing duties. The steel sector, again, is a good example (Exhibit 3). Chinese steel has been subject to tariffs in the US since 2018 and to anti-dumping duties in the EU. EM governments have reacted much more slowly to the increased steel imports from China. In Vietnam, an anti-dumping investigation started in

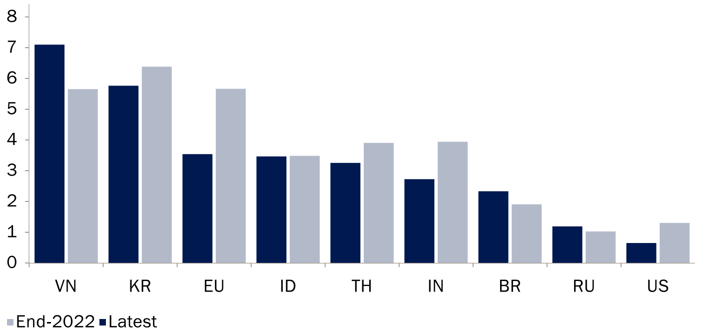
June, but has not yet resulted in a policy action. The Korean government has been mulling over the same issue without any decision yet.

**The increase in imports from China reflects both China's supply chains and the penetration of some consumer goods such as passenger cars**

Parts of the increase in imports from China reflect supply chain lengthening and trade diversion following the US-China trade tensions that started in 2018. But the rise in import penetration is not only in the raw materials and intermediate products. Imports of consumer goods from China have also risen. The case in point is passenger cars. The rest of the world has imported more Internal Combustion Engine (ICE) cars from China as producers have large spare capacity resulting from slowing demand. But imports of New Energy Vehicles (NEVs) have also increased rapidly from a low base. Again, the US and the EU have raised tariffs on NEVs from China, while most EMs have not (Exhibit 4).

**Exhibit 3: China's steel exports mostly end up in EMs**

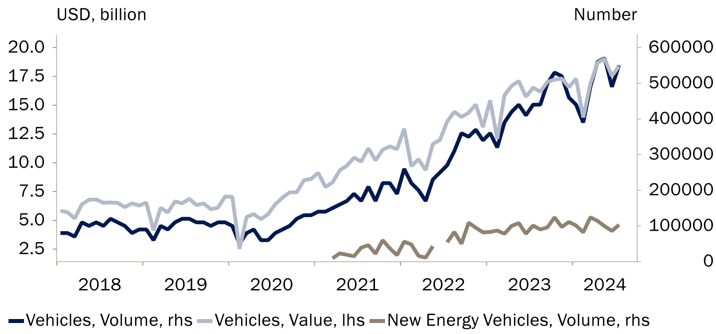
China, Export of Iron and Steel by Country, USD Billion




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 4: China's passenger car exports have increased since 2020**

China, Export of Vehicles, Value and Volume



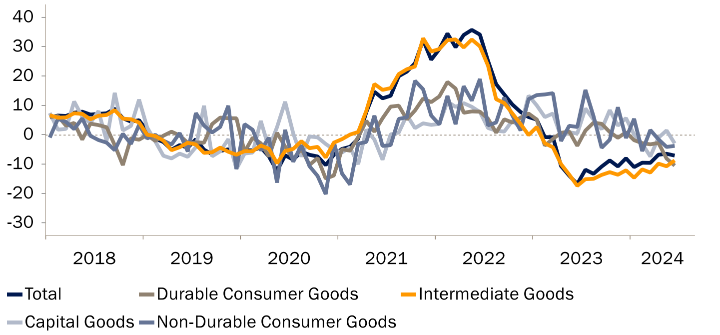

Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**In Brazil, cheaper consumer durable imports contributed to disinflation in 2023**

Have we seen any clear evidence of China exporting deflation to EMs? We look at two EMs that have been in the top five EM destinations for Chinese passenger cars (especially NEVs) exports: Brazil and Thailand. We assume that a large part of Brazil's durable consumer goods is passenger vehicles. Brazil has experienced falling *import prices* for durable consumer goods, while *consumer prices* for durable goods have been flat since 2023 (Exhibit 5). While Brazil is a rather closed economy, competition from imports may have put pressure on overall consumer prices for durable goods. The flatlining of durable goods prices has contributed to the disinflation process from the second half of 2023. Consumer price inflation of durable goods has not fallen as much as its import price counterpart in the latest period, however (Exhibit 6). This could be a result of weaker Brazilian real.

**Exhibit 5: Falling import prices for durable consumer goods in Brazil**

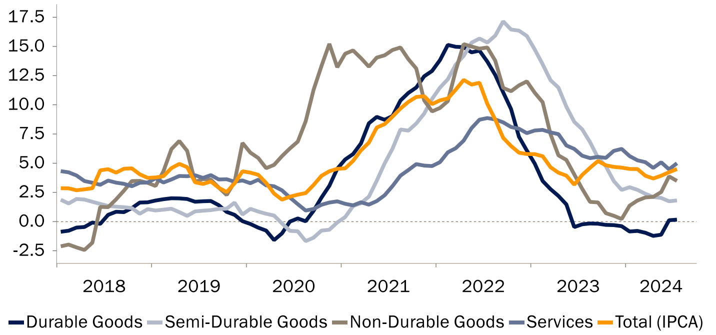
Brazil, Import Prices, % yoy




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 6: Falling consumer prices for durable goods**

Brazil, CPI Inflation, % yoy

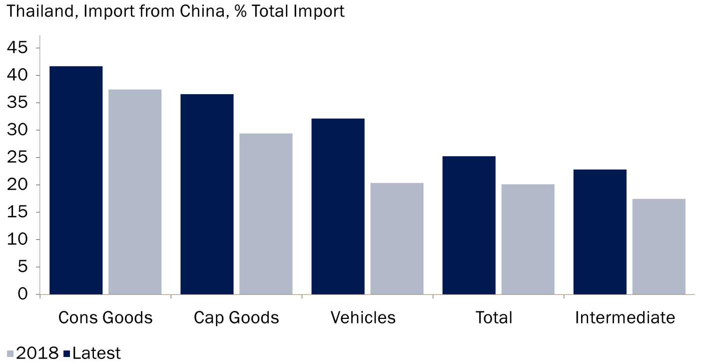



Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Increased competition from Chinese imports has exerted downward pressure on Thai inflation**

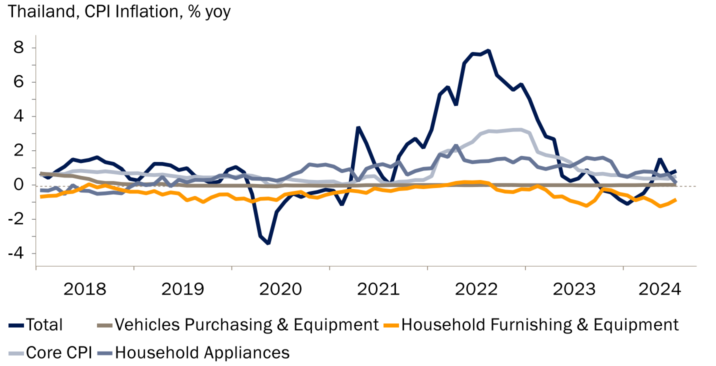
In Thailand, the Bank of Thailand (BOT) said at its latest Monetary Policy Committee's press conference that increased competition from imported goods from China has exerted downward pressure on Thai inflation. The BOT's study finds that import prices of consumer durables from China have fallen by around 10% from the beginning of 2023 to mid-2024. A big part of this is likely passenger cars (Exhibit 7). Prices of non-durable imports from China have also fallen slightly over the same period. The large fall in consumer durable import prices from China has contributed to a flat overall durable import price index in 2023. In the consumer price index, prices of vehicles have been flat for many years, but prices of household durable items have been falling. This has contributed to very low core inflation at close to zero for quite some time (Exhibit 8).

**Exhibit 7: Vehicle import from China grew significantly in Thailand**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Exhibit 8: CPI inflation is at the low end of the BOT's target**




Source: Macrobond, Bank J. Safra Sarasin, 29.08.2024

**Cheaper imports from China have contributed to disinflation in both countries**

Our main conclusion is that there is enough evidence that China has exported deflation to EMs. Interestingly, Brazil has recently hiked its tariffs against Chinese NEVs and anti-dumping duties against Chinese steel. While other imported household goods could still contribute to lower inflation, China's support to Brazil's disinflation process will likely decline going forward.

J. Safra Sarasin

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30 August 2024

## Economic Calendar

### Week of 02/09 – 06/09/2024

| Country | Time | Item | Date | Unit | Consensus Forecast | Prev. |
|---|---|---|---|---|---|---|
| **Monday, 02.09.2024** | | | | | | |
| IT | 09:45 | Italy Manufacturing PMI | Aug | Index | -- | 47.40 |
| **Tuesday, 03.09.2024** | | | | | | |
| US | 14:30 | ISM Manufacturing Index | Aug | Index | 47.80 | 46.80 |
| | 14:30 | ISM New Orders | Aug | Index | -- | 47.40 |
| | 14:30 | ISM Employment | Aug | Index | -- | 43.40 |
| **Wednesday, 04.09.2024** | | | | | | |
| US | 13:00 | MBA Mortgage Applications | Au23 | wow | -- | -- |
| CA | 15:45 | Bank of Canada Rate Decision | Sep04 | % | 4.25% | 4.50% |
| US | 16:00 | Factory Orders Ex Transport | Jul | mom | -- | 0.10% |
| | 16:00 | JOLTS Job Openings | Jul | 1'000 | -- | 8184k |
| | 20:00 | Federal Reserve Beige Book | | | | |
| **Thursday, 05.09.2024** | | | | | | |
| EU | 11:00 | Retail Sales MoM | Aug | mom | 0.10% | -0.30% |
| | 11:00 | Retail Sales YoY | Aug | yoy | -- | -0.30% |
| US | 14:15 | ADP Employment Change | Aug | 1'000 | 145k | 122k |
| | 14:30 | Initial Jobless Claims | Aug31 | 1'000 | | -- |
| | 14:30 | Continuing Claims | Aug24 | 1'000 | -- | -- |
| | 16:00 | ISM Services Index | Aug | Index | 50.90 | 51.40 |
| **Friday, 06.09.2024** | | | | | | |
| JN | 07:00 | Leading Index CI | Jul | Index | -- | 109.00 |
| US | 14:30 | Change in Nonfarm Payrolls | Aug | Index | 160k | 114k |
| | 14:30 | Unemployment Rate | Aug | Index | 4.20% | 4.30% |

Source: Bloomberg, J. Safra Sarasin as of 29.08.2024

# Market Performance

## Global Markets in Local Currencies

| Government Bonds | Current value | Δ 1W (bp) | Δ YTD (bp) | TR YTD in % |
|---|---|---|---|---|
| Swiss Eidgenosse 10 year (%) | 0.47 | 5 | -23 | 2.5 |
| German Bund 10 year (%) | 2.27 | 5 | 25 | -0.2 |
| UK Gilt 10 year (%) | 4.02 | 13 | 48 | -0.6 |
| US Treasury 10 year (%) | 3.87 | 7 | -1 | 3.2 |
| French OAT - Bund, spread (bp) | 72 | 1 | 18 | |
| Italian BTP - Bund, spread (bp) | 138 | 4 | -30 | |

| Stock Markets | Level | P/E ratio | 1W TR in % | TR YTD in % |
|---|---|---|---|---|
| SMI - Switzerland | 12'418 | 19.2 | 0.9 | 15.0 |
| DAX - Germany | 18'913 | 13.9 | 2.3 | 12.9 |
| MSCI Italy | 1'104 | 9.4 | 2.8 | 15.1 |
| IBEX - Spain | 11'359 | 10.9 | 1.8 | 16.1 |
| DJ Euro Stoxx 50 - Eurozone | 4'966 | 14.0 | 1.7 | 13.0 |
| MSCI UK | 2'397 | 12.5 | 1.2 | 11.6 |
| S&P 500 - USA | 5'592 | 23.4 | 0.4 | 18.3 |
| Nasdaq 100 - USA | 19'325 | 29.9 | -0.9 | 15.5 |
| MSCI Emerging Markets | 1'095 | 13.0 | -0.5 | 9.3 |

| Forex - Crossrates | Level | 3M implied volatility | 1W in % | YTD in % |
|---|---|---|---|---|
| USD-CHF | 0.85 | 8.4 | 0.0 | 0.7 |
| EUR-CHF | 0.94 | 6.6 | -1.1 | 1.1 |
| GBP-CHF | 1.12 | 7.7 | -0.4 | 4.2 |
| EUR-USD | 1.11 | 6.7 | -1.0 | 0.3 |
| GBP-USD | 1.32 | 7.5 | -0.4 | 3.4 |
| USD-JPY | 144.8 | 11.5 | 0.3 | 2.7 |
| EUR-GBP | 0.84 | 4.8 | -0.7 | -3.0 |
| EUR-SEK | 11.32 | 6.7 | -0.6 | 1.7 |
| EUR-NOK | 11.62 | 8.7 | -0.7 | 3.6 |

| Commodities | Level | 3M realised volatility | 1W in % | YTD in % |
|---|---|---|---|---|
| Bloomberg Commodity Index | 97 | 11.4 | 1.3 | -1.5 |
| Brent crude oil - USD / barrel | 82 | 31.1 | 3.5 | 6.2 |
| Gold bullion - USD / Troy ounce | 2'514 | 14.9 | 1.2 | 21.8 |

Source: J. Safra Sarasin, Bloomberg as of 29.08.2024

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