

# A whiff of reflation

- > Our cyclical roadmap remains that the Fed has eased monetary policy into a backdrop of elevated nominal GDP. Recession is unlikely if financial conditions are loose and savings rates are falling.
- > **US:** Today's mix of weak labor market data, resilient growth, and improving liquidity was last seen in 2002-03, when the US economy experienced a "jobless" recovery.
- > **China:** Our growth and inflation LEIs are still rebounding, while excess liquidity tailwinds remain. More stimulus is needed for housing/consumer.
- > **Eurozone:** We are taking profits on our SOFR vs Euribor Dec 25/26 convergence trade established last month.



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*This is our first Leading Indicator Watch (LIW) of the month and covers the US, China, and Eurozone. Our second LIW report for the month will dig into lesser followed country-specific themes in EM and DM.*

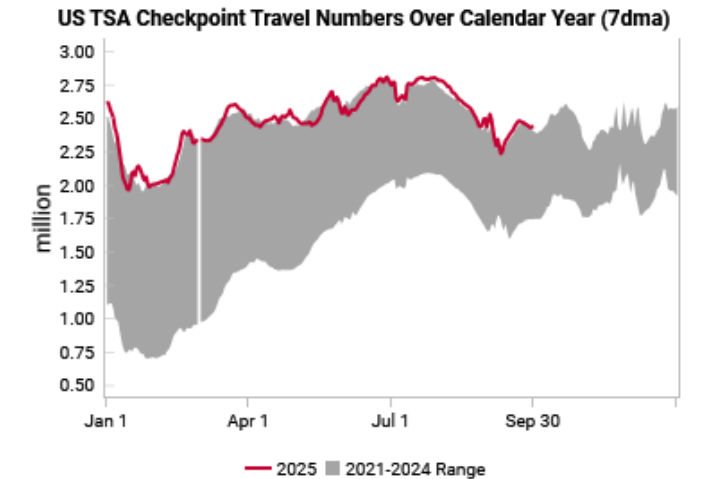
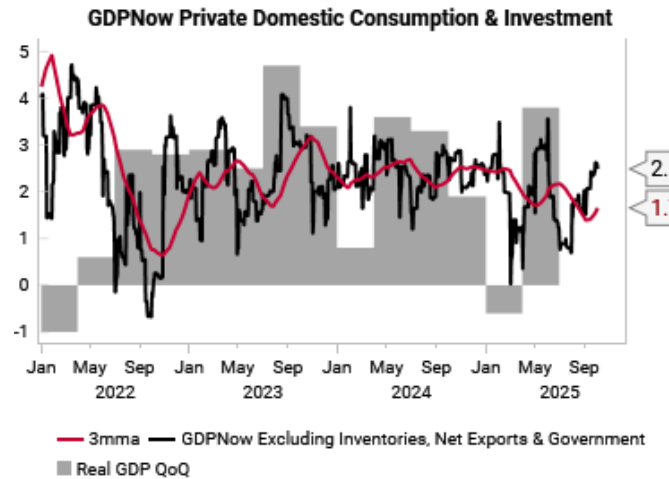
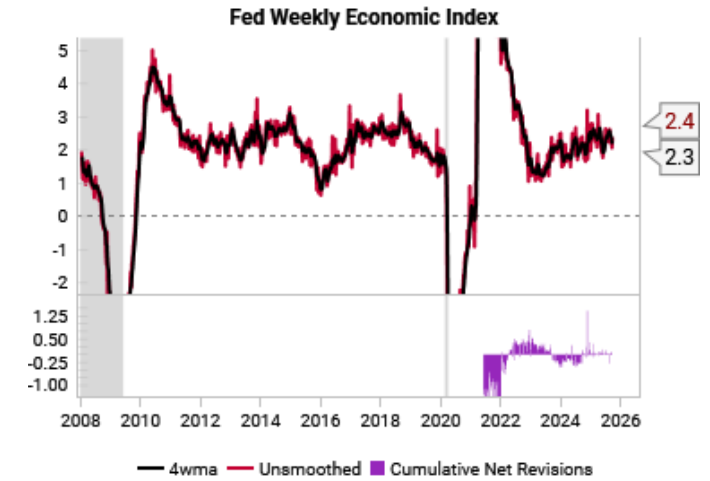
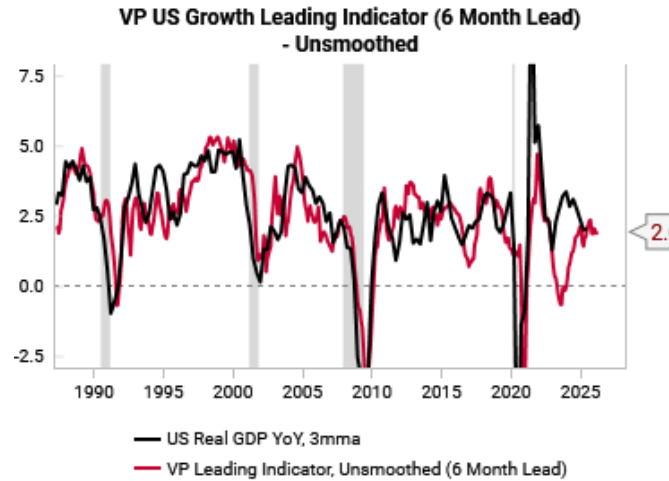
See also our [Asset Allocation](#) and [Top Global Macro Ideas](#) summaries.

# Resilient leading indicators alongside resilient coincident growth

Our US growth leading indicator remains steady at around 2% annualized growth on a 6-month forward basis (top left chart). The indicator is being supported by tight credits spreads, low layoffs and resilient service PMIs, which are helping to offset the drag from other leading indicators like building permits.

Most high frequency growth indicators we track still show resilient coincident growth. The Fed Weekly Economic index is running at 2.4% annualized (top right chart), while GDPNow for the “core” private consumption and investment components is running at 2.5% annualized (bottom left chart). TSA travel numbers also remain at the upper end of the post-Covid range (bottom right chart).

As we laid out in our previous Note, *Lessons from previous “no recession” Fed cuts (1984, 1995, 2024)* ([link](#)), our roadmap remains that the Fed has eased monetary policy into a backdrop of elevated nominal GDP. This means the September Fed cut likely marks a tradeable low in yields and the USD while ultimately supporting further equity gains.



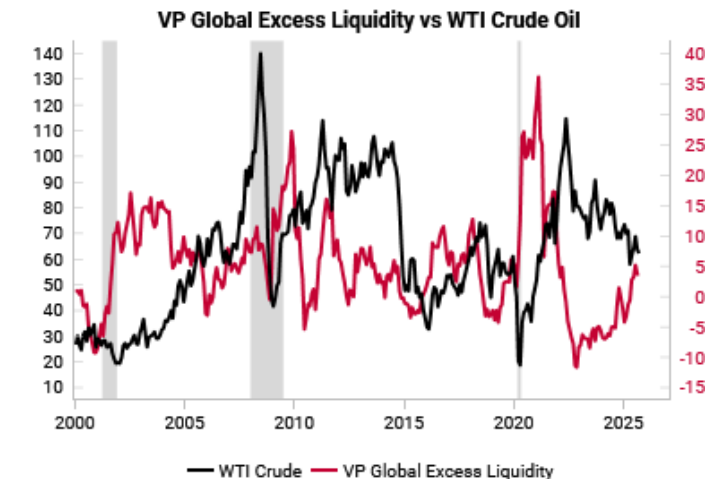
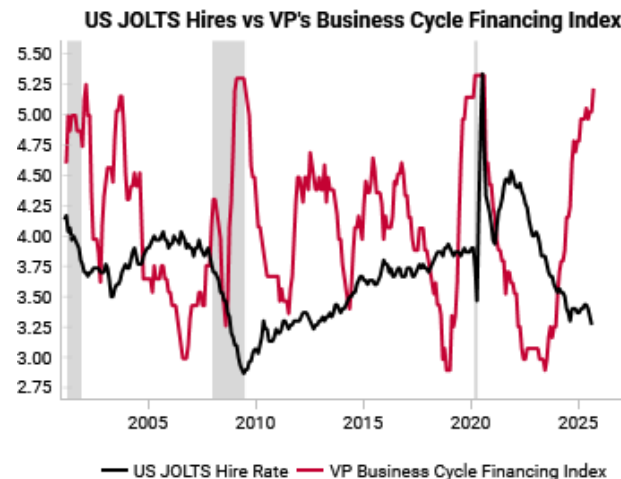
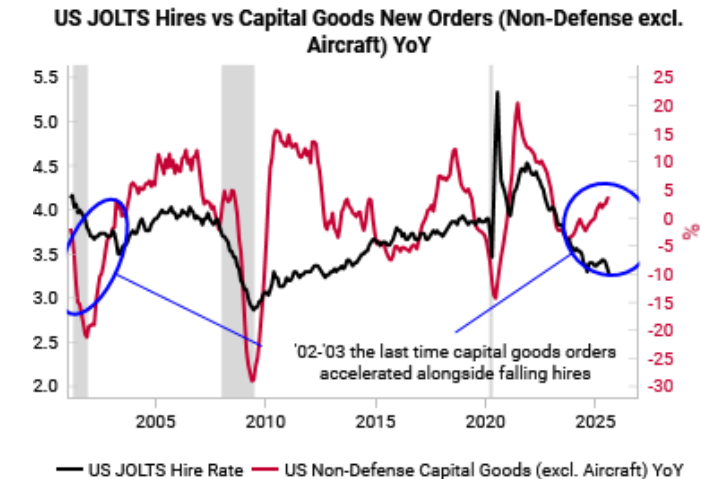
# 2002-03 analog: muted jobs market alongside resilient growth

Today's mix of weak labor market data alongside resilient growth and improving liquidity was last seen in 2002-03, when the US economy experienced a "jobless" recovery after the dot com bust. The key takeaway was that the economy continued to recover and eventually created jobs again.

Today retail sales and capital goods new orders have returned to growth after a prolonged period of basing, alongside a very low hiring rate, which was last seen in 2002-03 (top two charts).

Today's liquidity context is also similar to 2002-03. Our Business Cycle Financing Index, which tracks the breadth of central bank policy easing globally, shows a very synchronized global easing cycle alongside the weak hiring rate (bottom left chart). We have also seen a similar surge in global excess liquidity and drawdown in oil prices (bottom right chart).

The notable difference between today and 2002-03 is the wider political context, with great power competition with China rather than the off-shoring of US manufacturing jobs. This suggests we may see a quicker recovery in the US jobs market vs 2002-03. US prime-age labor participation rates have already recovered ([chart link](#)).





## Recession unlikely if everyone dis-saves and financial conditions are loose

Given the slowdown in the US labor and housing data, many investors are understandably focused on downside growth risks. The weak US labor and housing data is preventing our US recession regime model from falling below 30% ([link](#)).

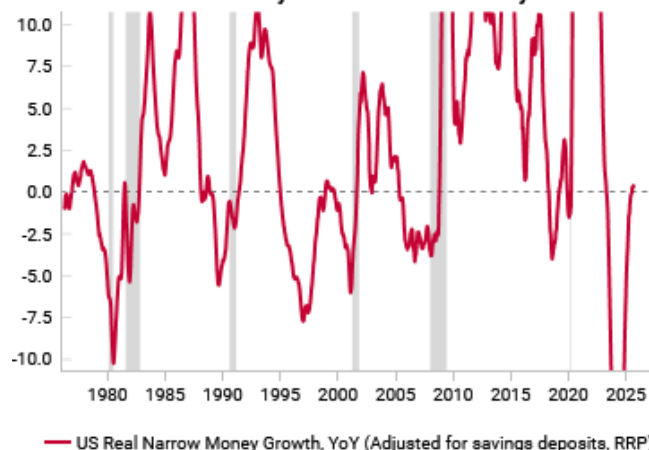
**However, the bigger picture is that many of the other typical signs you see heading into a recession are not present today.**

**US real narrow money has returned to growth** after a prolonged period of drawdown (top left chart). The economy tends to be most vulnerable to recessions when real money growth is contracting.

**US household savings rates are also falling again** (top right chart). Typically, recessions see households turn more cautious and increase their savings rate, not lower it. **US fiscal deficits also remain large** (bottom left chart), so **both the government and households are dis-saving right now**. This is a key part of the Kalecki-Levy framework we use to understand the economy ([link](#)).

**Recessions also do not tend to occur with equities at the highs.** You typically see an initial drawdown of 10%+ that creates cascading wealth effects and feedback loops between hard and soft data. The time to start worrying is the next time we get a 10% drawdown.

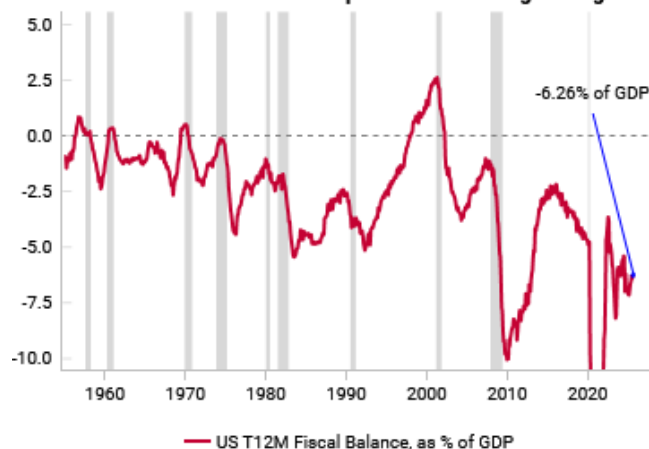
Recessions are more likely when real narrow money is contracting



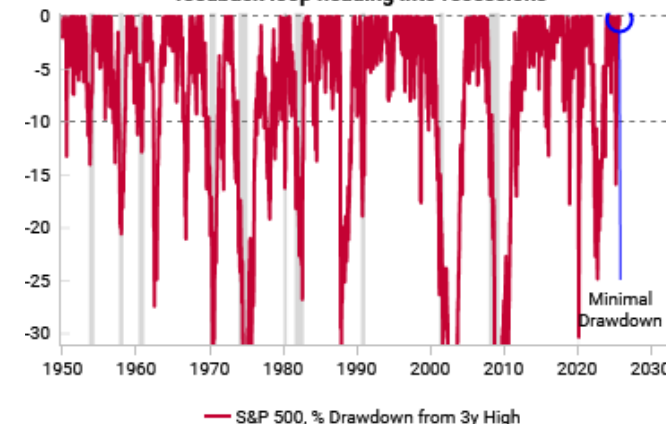
A jump in household savings is usually fuel for a recession



Recessions tend to follow periods of fiscal tightening



Deteriorating financial conditions are a necessary part of the feedback loop heading into recessions



# Signs of relief + potential for an inventory re-build cycle

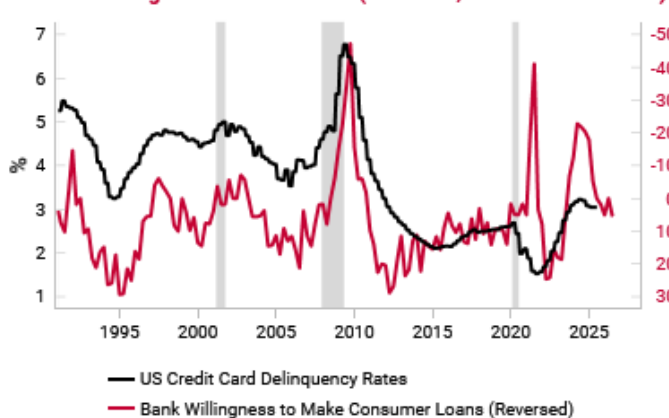
The bi-furcated US consumer with the lower income cohorts suffering and higher income cohorts propping up consumption remains the big picture context. However, there has been some notable improvements shifts in the underlying data.

**Lending standards are easing for consumer loans**, which leads delinquency rates and suggests we are past peak delinquencies (top left chart). **Retail sales for more discretionary items like furniture, electronics, and clothing** are also starting to grow again after a prolonged period of stagnation in 2023-24 (top right chart).

**Wholesale durable goods sales are starting to accelerate, while inventories growth remains muted** (bottom left chart). This is something that is typically seen coming out of downturns.

**The ISM manufacturing survey also continues to report low and falling customer inventories** (bottom right chart), which bodes well for future customer orders.

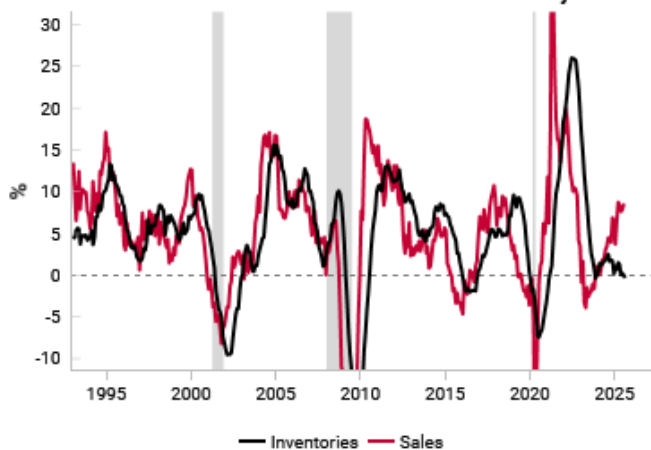
US Credit Card Delinquency Rate vs Bank Willingness to Make Loans (Reversed, Advanced 9 Months)



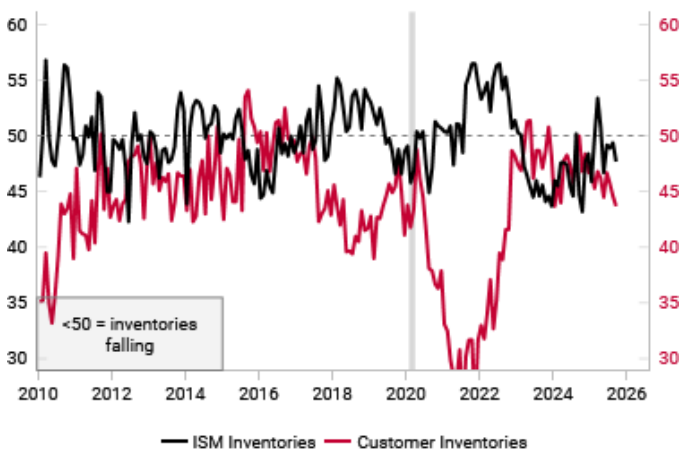
US Retail Sales - Overall vs Discretionary (Furniture, Home Furnishings, Electronics, Clothing, Accessories)



US Wholesale Trade - Durable Goods Sales vs Inventory Growth



ISM Customer Inventories vs Manufacturer Inventories



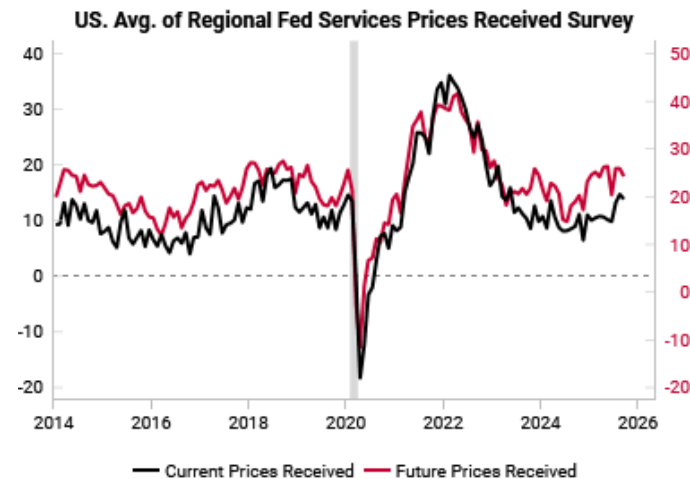
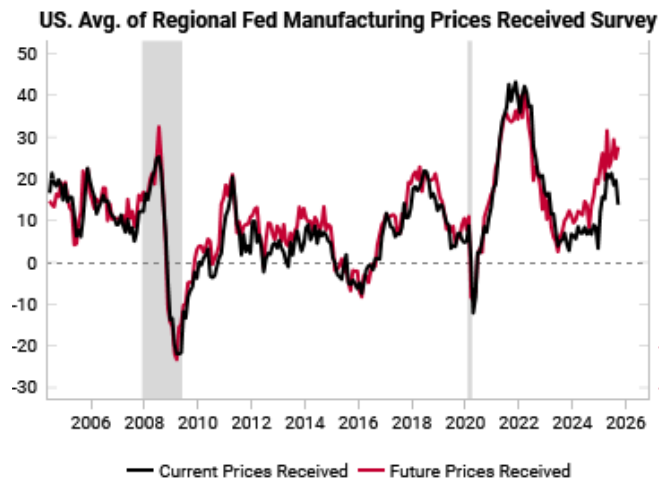
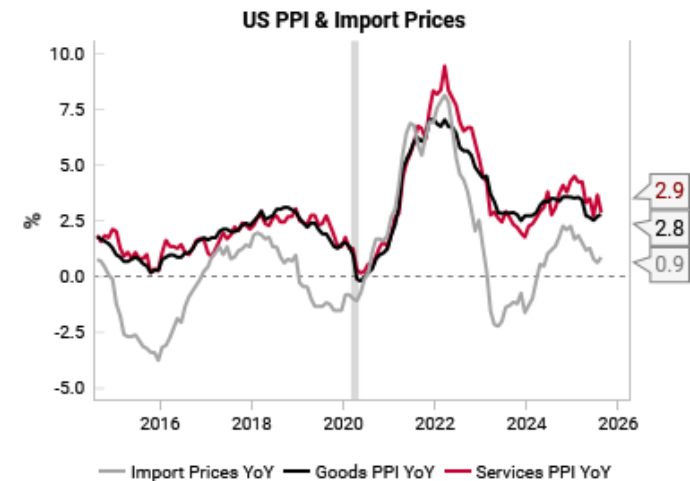
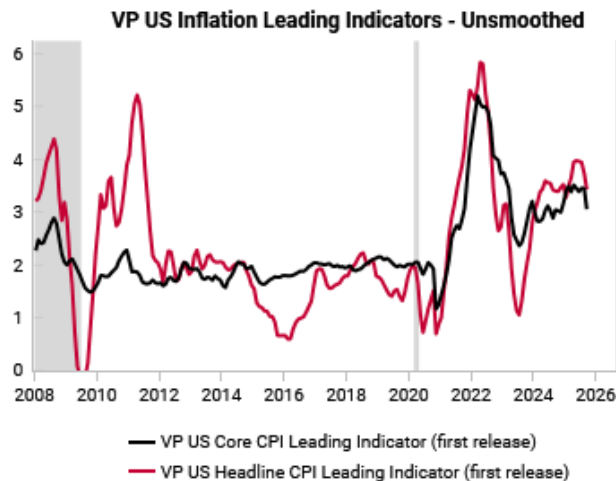
# Moderate inflation pressures

We continue to suspect we will see persistent but moderate pass-through of higher input costs to US consumers by US corporates, which will keep inflation above target.

Our US inflation leading indicators for both core and headline CPI have rolled over but remain above the Fed's inflation target at >3% annualized (top left chart). PPI in both goods and services is also still running at close to 3% annualized (top right chart).

Regional Fed surveys in manufacturing continue to show higher expectations for future prices (bottom left chart), while services future price expectations remain in a normal range (bottom right chart).

Alongside our US growth LEI running at 2% annualized, this implies >5% nominal GDP. This is a healthy rate of growth that would normally NOT warrant the market to price in another 4 Fed cuts over the next year and a terminal rate of 3% by 4Q26.



# Rebound continues for growth and inflation leading indicators

Our leading indicators for the Chinese growth impulse and inflation both continued to recover over the past month (top two charts). The improvement in our PPI leading indicator is particularly notable in the context of China’s anti-involution efforts. It remains to be seen how quickly it will turn positive.

Chinese assets are also corroborating the constructive outlook. **Chinese small caps have outperformed large caps, while 10y yields have bottomed** (bottom left chart).

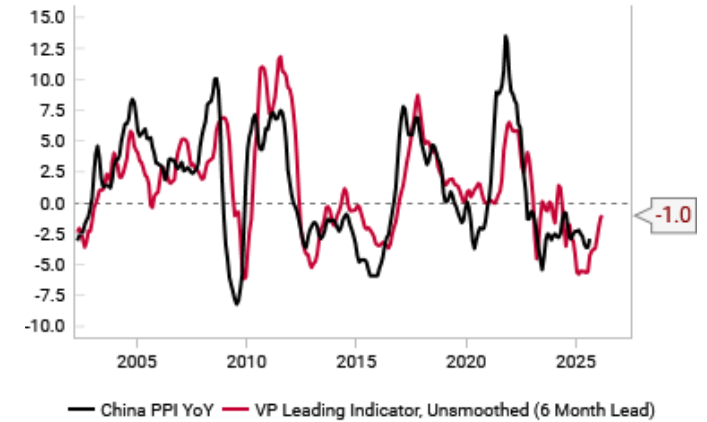
The labor market is also going from terrible to slightly less terrible, with the CKGSB recruitment index starting to recover from multi-year lows (bottom right chart).

On the political front, the US and Chinese have continued to take steps to de-escalate and reduce tail risks. Chinese Premier Li Qiang described US-China relations as like a married couple who bicker but ultimately need each other ([link](#)).

China Growth Leading Indicator Leads GDP Impulse by 6 Months - Unsmoothed



China PPI Inflation Leading Indicator (6 Month Lead) - Unsmoothed



China Small Cap vs Large Cap & 10y Yields



China Unemployment Rate vs CKGSB Recruitment Index (Inv.)



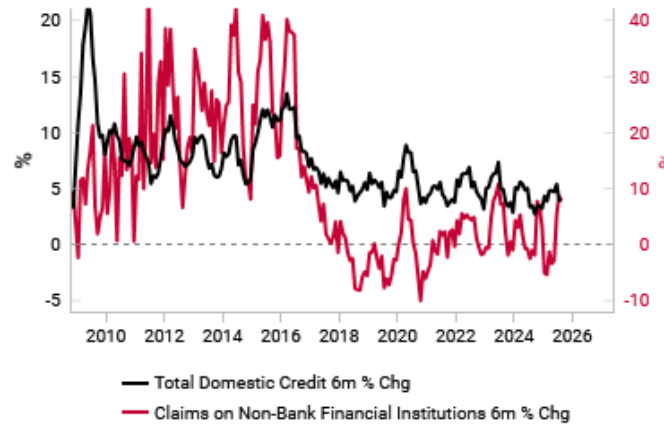
# Excess liquidity tailwinds, waiting for more housing/consumer stimulus

**Chinese assets continue to benefit from liquidity tailwinds.** Claims on non-bank financial institutions – our proxy for shadow banking – is still growing (top left chart). Meanwhile, M2 growth is also starting to pick up relative to nominal GDP growth, showing that the previous cuts to the reserve requirement ratio are starting to feed through (top right chart)

**The next catalyst for China will be the Fourth Plenum to be held between October 20-23.** The key remains to see how policymakers’ attitudes towards domestic consumption is shifting.

**It will be very hard to get a sustained reflation in the Chinese economy without addressing the weakness in housing and consumer sentiment.** House prices have been falling since 2021 and are still falling (bottom left chart). Alongside the weak jobs market, this has weighed heavily on consumer sentiment. Consumers are still heavily biased towards more saving than consumption (bottom right chart).

China Total Domestic Credits Growth vs China Claims on Non-Bank Financial Institutions



China M2 minus GDP YoY vs RRR



China New and Secondary Home Prices MoM (70 cities)



China PBOC Consumer Surveys



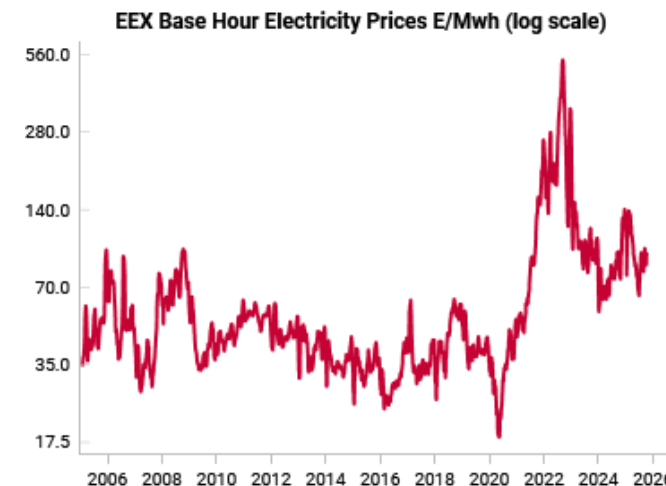
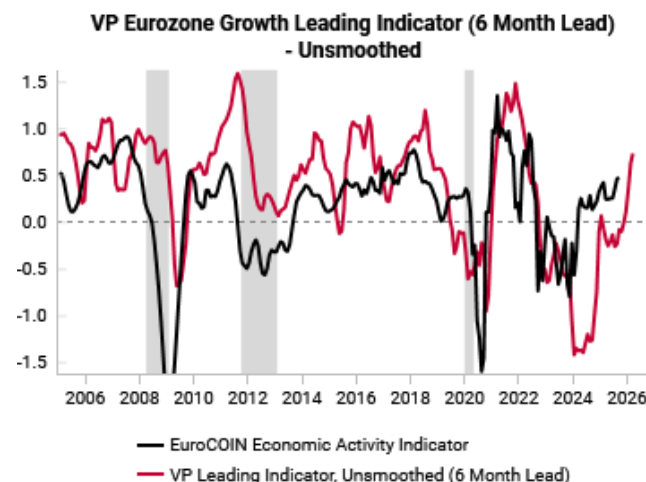
# Leading indicator improvement broadening, but structural issues remain

**Our Eurozone growth leading indicator (top left chart) has continued to recover with more corroborating evidence across other German leading indicators.**

The German IFO expectations vs current conditions spread has turned more positive (top right chart), while a majority of German manufacturing industries are seeing an improvement in their production expectations (bottom left chart).

That said, structural challenges remain for the European economy, which is likely to contain the magnitude of a European recovery.

Electricity prices are down materially from the 2022 shock but are still well above pre-Covid levels (bottom right chart). The trade weighted euro also remains a drag on export competitiveness ([chart link](#)). These factors are likely to continue to act as a structural drag amid the cyclical recovery.



Source: S&P Global, Refinitiv, Macrobond, and Variant Perception

See disclosure at the end of this report

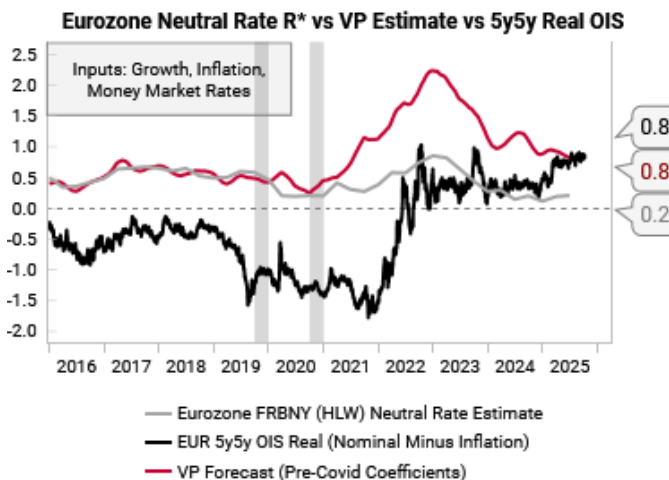
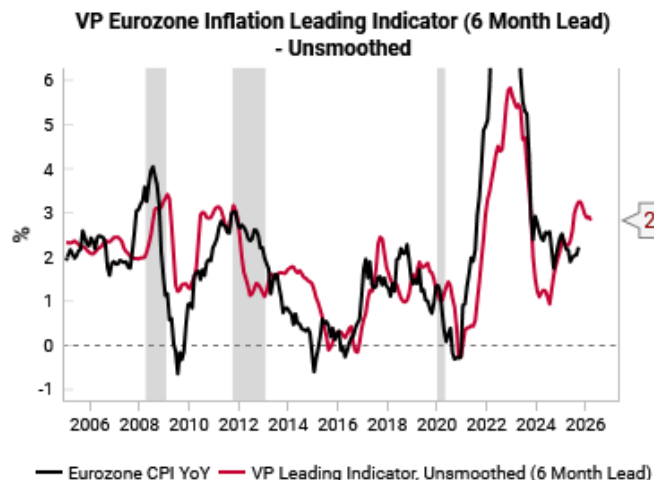
# Consensus too optimistic on disinflation

Current consensus expectations see eurozone headline CPI at 1.8% and core CPI at 2% in 2026. We suspect inflation risks are tilted to the upside from here given the recovery in our eurozone growth leading indicators and the ECB rate cuts so far this year.

Our main eurozone inflation leading indicator is rolling over from a high level, but the point estimate remains elevated at 2.8% (top left chart). Core and supercore CPI have also been slower to fall, still at 2.3 to 2.5% YoY (top right chart).

Our estimate of the real neutral rate ( $R^*$ ) for the eurozone is at 0.8%, which is also where the 5y5y EUR real OIS is trading, a proxy for market-implied  $R^*$  (bottom left chart). This is near the higher end of the ECB's estimated range of -0.5% to 1% ([link](#)).

With headline CPI at 2%, there is good chance that ECB policy is already stimulatory, potentially creating inflation upside in 2026. We are taking profits on our SOFR vs Euribor Dec 25/26 convergence trade established last month.





# Key View Summaries & Chart Collections

Clients can access our summaries of key view in the VP Portal:

- [Asset Allocation](#): A summary of views across asset classes and time horizons
- [Top Global Macro Ideas](#): Highest conviction current and historical trade ideas by asset class

| Region   | Key Chart Collections  |
|----------|--|
| > Global | <a href="#">G3 Recession Overview</a><br><a href="#">VP Macro Regime</a><br><a href="#">VP Growth Leading Indicators</a><br><a href="#">VP Inflation Leading Indicators</a>  |
| > US     | <a href="#">Growth</a><br><a href="#">Inflation</a><br><a href="#">Consumer</a><br><a href="#">Labor Market</a><br><a href="#">Manufacturing</a><br><a href="#">Housing</a><br><a href="#">Credit</a><br><a href="#">Fiscal</a><br><a href="#">US Dollar</a> |

| Region     | Key Chart Collections  |
|------------|--|
| > China    | <a href="#">Economy</a><br><a href="#">Assets – Equities, FX, Fixed Income</a> |
| > Eurozone | <a href="#">Economy</a><br><a href="#">Assets – Equities, FX, Fixed Income</a> |



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