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The centre holds

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"Turning and turning in the widening gyre. The falcon cannot hear the falconer" – W.B. Yeats, The Second Coming

August usually delivers its fair share of news even as the attention of the many is diverted by the summer's seasonal delights and even in an unseasonably damp United Kingdom. Financial markets have wrestled with an increasingly lopsided-looking global economy, pricing adjustments reflecting, on the one hand, the "second coming" of the United States where, despite aggressive interest rate hikes, activity is proving more than resilient. On the other hand, a "fourth turning" of a stagnating Chinese economy the consequence of which has been record capital outflows, a slumping stock market and plunging currency. Whilst the stock and bond markets of the UK and Europe have moved to reflect developments on the international stage, domestic economic conditions are, for now, holding steady in the centre ground. The truth, as Oscar Wilde once quipped, is rarely pure and never simple, a fact not lost on the world's most important central banks as they obsess over how best to position monetary policy in this far-from-normal post-pandemic economic cycle.

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"We are navigating by the stars under cloudy skies". So said Mr Jerome Powell, Chairman of the Federal Reserve at the conclusion of his remarks at the US central bank's annual Jackson Hole symposium in Wyoming. Despite having raised US interest rates at the most aggressive pace in a generation, by 5 ¼% in little over a year in the battle to curb inflation, the US economy is proving remarkably resilient. While the aim of the Fed's rate hiking programme might be to suppress growth to the extent that price pressures subside to and sustainably hit the 2% medium term target, the reality is that so far activity has been well above trend throughout 2023. Not only that, but the surprising strength of recent data implies that not only could the US economy avoid a hard landing (recession), it might not experience any landing whatsoever. In the Treasury bond market pricing has adjusted to accommodate such a prospect, short-dated yields hitting and holding their highest levels since the 2008 financial crisis. The stock market has lost some ground, partially giving back gains earlier in the year, but not markedly so and the heavyweight technology sector has beaten expectations as the corporate reporting season has unfolded. Investor enthusiasm for the potential derived from the roll-out and deployment of artificial intelligence remains undimmed.

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It is often said that where the US economy leads, the UK economy will not be far behind. This might be too much to hope for despite the latter's better-than-expected growth recorded over the second quarter. Forward-looking business surveys in the US, UK and Euro Area paint a subdued picture regarding prospects, the lagged effect of earlier interest rate increases still fully to percolate through to the real economy, notwithstanding the fact that, in the UK, mortgage rates have hit their highest level in years and house prices are subsiding even as the broader economy holds steady.

More encouragingly, inflationary pressures are slowly abating. True, financial markets like dogs barking in the night fear a reacceleration, asset pricing reflecting this possibility, but the flip side of subdued economic activity is a loosening labour market (more subdued wage growth), an increase in idled productive capacity (increased slack) and less scope for companies to make product price increases stick. So, while markets may fear the consequences of El Nino weather conditions, including drought in South-East Asia, hurricanes in California and the Gulf of Mexico and a rise in natural gas prices the knock-on effect of industrial action at facilities in Australia, these are likely temporary and to nothing like the degree experienced last autumn when fears regarding Europe's energy security drove prices aggressively higher. Indeed, with storage tanks said to be 91% full (against just 77% in July 2022) a repeat of last year's price spike seems unlikely.

While Mr Powell may seek astral guidance under cloudy skies, this is as nothing to tumultuous events engulfing the world's second largest economy in the year of the rabbit. Having enjoyed a brief reopening bounce as the Chinese economy emerged from lockdown last December, conditions have deteriorated to the extent that at the conclusion of the ruling Politburo's quarterly meeting on economic affairs local conditions were described as "tortuous", a far cry from the "proceeding better than expected" message conveyed back in April. China on the world stage, this month overseeing the planned expansion of the so-called BRICS+ bloc from five to eleven members from 1st January, always makes headlines in the West, but cannot paper over structural shortcomings increasingly apparent in its domestic economy. In a far from ironic twist of fate, having presided over the evolution of hitherto unimaginable prosperity in the decades following the Cultural Revolution, China's leadership now faces both practical and philosophical challenges as it repositions for the future under a zodiac sign typically symbolising longevity, peace and prosperity.

China's leadership has been stung by the Politburo's conclusions and rattled by financial problems as the benignly named and conservatively managed property developer Country Garden has run into difficulty. This has brought concerns regarding the fragility of the country's giant property sector and interwoven non-banking financial institutions (so-called "shadow banks") bubbling back to the surface. In a month in which shares in the bankrupt Evergrande began trading again after an 18-month hiatus, and promptly fell almost 90%, investors are reminded that we have been here before. On three previous occasions Beijing has been forced to step aggressively into the fray, most recently in 2015 in response to a falling stock market and plunging currency. As efforts to deliver stability have failed to deliver lasting traction earlier this month, financial markets are now speculating about another "whatever it takes" moment, invoking Dr Mario Draghi at the European Central Bank, over a decade ago.

Investors are, of course, well versed in the slings and arrows of financial market fortune, a broadly diversified portfolio providing the armour to withstand periodic hostile fusillades. Even as markets respond to prevailing events, a dark hour precedes dawn and with it the falcon's return, once again, to the falconer's gauntlet.

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