THE DIFFICULTIES OF AUGUST

It was the rating agency Fitch, on the 1st of August, that brought attention back to debt. In particular, it focused on that of the United States, the most important and decisive in the world. Of course the rating went from AAA, the highest ability to repay its debts, to AA+, so apparently nothing serious, since the notation is still very good and the outlook rated 'stable'. But for the United States, which had already suffered the humiliation of being downgraded by S&P in 2011, it was a real shock that also quickly affected the markets. Fitch's decision "reflects the expected fiscal deterioration over the next three years, a high and rising public debt burden, and erosion of governance" compared to other major economies. But there is more. For the agency, 'repeated policy stalemates over the debt limit and last-minute resolutions have eroded confidence in fiscal management'. Moreover, Fitch reiterates, the US government 'lacks a medium-term fiscal framework' as there has been 'limited progress' in addressing the challenges of rising Social Security and Medicare costs, given the ageing population. The reaction of the US government was extremely testy. White House Press Secretary Karine Jean-Pierre was quick to say that the move 'defies reality' while Janet Yellen, Treasury Secretary and former Federal Reserve Chair, said she strongly disagreed with Fitch, calling the change 'arbitrary and based on outdated data'.

As August approached, the markets were less liquid: the impact of the news immediately turned into a correction in the indices. These, however, were in an overbought situation, galvanised by expectations of corporate profits that turned out to be far higher than expected in July and by inflation data that hinted at a pause in the rate hike. Fitch's note lifted the US ten-year yield to 4.2% in the week in which the Treasury was issuing 103 billion new bonds. With the quarterly earnings season over and in the absence of any new stimulus, the markets have been redoing their accounts with the rating agency's concerns in mind. Inflation is falling, in the US it is close to 3% (4.7% the core), but it is still sustained, with rare exceptions such as Switzerland where it is even back below 2% (1.6%). In Europe it is even stickier at 5.3%, in Germany at 6.2%. Technology stocks (NYSE FAANG), which have significant multiples, left 3.5% on the ground on the 2nd of August.

Inflation seems harder to eradicate in the last mile. Interest rates are likely to remain high for longer than expected. These are two major August concerns that have been given a further reminder: in China, exports fell for the third consecutive month in July. The economy of the world's second-largest power is struggling. Xi Jinping intends to reform his country's production structure by other means than those chosen by the US administration. At the heart of his interventions is the desire for absolute control of the country's production system, in particular by taming information technology companies. And there is also the choice to let the real estate bubble deflate through a Darwinian selection. Xi seems not to want to use monetary levers as happened with the US Quantitative Easing after the subprime crisis in 2008.

His design is essentially geopolitical and long-term. If China wants to become the alternative to the, in his view, decadent western civilisation centred on the United States and the dollar, the Yuan must prove to be a strong, trustworthy currency that can be used in international trade and as a central bank reserve instrument. With this approach, the country of Mao Tse Tung intends to place itself at the centre of an alternative coalition to the international order defined by Washington. The meeting of the Brics countries (Brazil, Russia, India, China, South Africa), which took place between 22 and 24 August in Johannesburg, to which 67 states were invited, including Egypt, the United Arab Emirates, Algeria and Iran, which had applied to join, had a planetary media echo: many Western news sources exaggerated the news and its consequences. In particular, their focus was on the downsizing of the United States and the imminent end of dollar hegemony. The reality is much more complex than the media's summer simplifications. The Brics, old and new, are different countries, economically and politically. They also do not seem ready to want to replace American hegemony with Chinese hegemony and do not yet have a real alternative to the dollar with the sophisticated financial structure it represents. Moreover, the world is too interconnected to think now of strict partitions between blocs of influence.

The US is probably also becoming convinced of this. As Larry Summers, an economist with great political influence, said months ago, a soft landing in the US is unlikely to hold without the vigour of the Chinese economy. There has been no shortage of trips to Beijing by senior US officials and Washington heavyweights in recent months. On June 19 there was Antony Blinken's less than encouraging trip. On July 9, Treasury Secretary Janet Yellen visited ('The world is big enough for China and the US'). On July 18 it was the turn of centenarian Henry Kissinger to bring new cordiality ('Let's avoid confrontation. We cannot treat each other as adversaries'). Lastly, more pragmatically, on 29 August, it was the turn of the Secretary of Commerce, Gina Raimondi, to sound out the scope for a new dialogue. But, in parallel, the United States is not letting up on its support for Ukraine and continues to restrict the export of technology vital to China's digital development. As if to say: diplomacy is still the expression of military and technological power.

In the first two weeks of August, markets reacted to a series of events and data interpreted as if the future was already today, in the midst of the troubled summer weather. In reality, the steps facing geopolitics and the world economy are still open. The risks are piling up, as Fitch has also pointed out, but the interdependencies are strong and Biden's United States has chosen the hard fist to remain at the centre of the system or at least to curb its transformation. American assertiveness is powerful and, in part, unexpected. Russia, by invading Crimea in 2014, without excessive international reaction, thought that the US would stand by and watch the invasion of Ukraine as a whole. China, thanks to Washington's weakness, would then bring Taiwan back.

The markets realised that they had gone too far. The second half of August saw a partial recovery. China has probably not chosen the path of monetary easing to the bitter end, but it has nevertheless been forced to intervene by cutting rates, moderately, in order to favour at least those property developments that already have buyers and that have been blocked by the crisis: social pressures mount, such as the growing percentage of unemployed young people, perhaps over 20% (the government now no longer communicates this data). The markets can still hope that the Chinese economy will give new important signals, contributing to the recovery of the world economy and allowing the soft landing of the American one. At Jackson Hole, the annual gathering of central bankers, Jerome Powell wanted to signal that inflation is not yet defeated. Not being able to figure out what the neutral rate is (the rate at which the economy neither grows nor declines) it is possible that there are pauses to assess the work done so far. In Europe, the services PMI index also fell below 50 in July, after the industrial one, anticipating a slowdown in the Gross Domestic Product. China's rose from 49.3 to 49.7, signalling an improvement but remaining in the recession zone. That of the United States slows down, but remains above 50. In addition, the Federal Reserve Bank of Atlanta's growth estimate, through its model (GDPNow), indicates growth of the US economy in the third quarter of 5.6%, driven mainly by private investment.

Biden's United States seems to be in the best position to get through this difficult time. Especially since developments in artificial intelligence will have a rapid impact on productivity across the Atlantic, given the flexibility of the system. In the coming months, the United States is the country to invest in. Europe, on the other hand, especially through the German economy, is a loser in this design and the discontents, under the ashes, are growing. It is politically difficult to raise rates further in such an environment. In the war climate, financial flows will struggle to return to China, but they will not abandon Europe. Fitch, however, has given an early warning signal, via the US, to the whole world. Sooner or later the problem of over-indebtedness will return to the centre of attention, but not in the very short term. For now, the August weather and Fitch's decisions have given a foretaste of temperatures to come.

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