Signs of recovery in the global manufacturing sector

5 February 2024

Dear Clients and Partners,

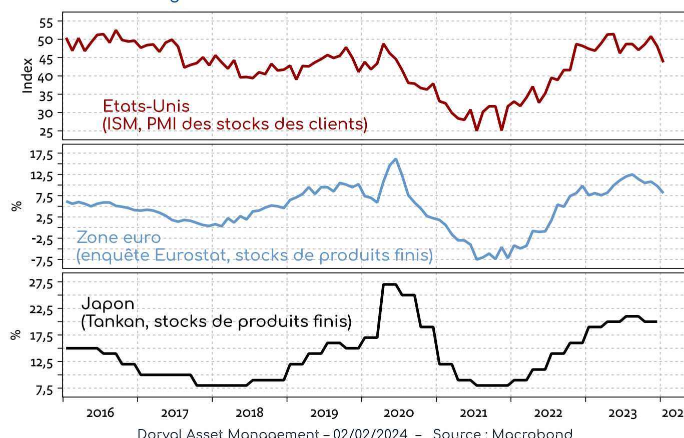
The need to decrease inventory levels has been producing a negative dynamic in the manufacturing sector worldwide since 2022 – a dynamic that seems to be coming to an end, making the scenario of a recovery in the manufacturing sector in 2024 more likely.

In 1923, economist Joseph Kitchin published a study showing that, on average, economics could be viewed as short cycles of about 40 months (or just over 3 years). He attributed the reason for this to successive inventory accumulation and clearance phases by manufacturers. When inventory is low and demand is strong, companies are encouraged to produce more. After a given length of time, which varies depending on the cycle, this production eventually raises inventory levels. As a result, the incentive to produce decreases – especially if demand decreases at the same time – and inventory levels ultimately drop until the conditions are ripe for a new cycle to begin. It is in this last phase that the global manufacturing sector seems to find itself today. Companies surveyed around the world report that inventory levels are still too high, but less so than in recent months (see chart 1).

Is there excess inventory in the manufacturing sector?
Yes – but maybe not for long

Manufacturers' verdict on inventory levels

Excès de stocks dans l'industrie ?
Oui, mais peut-être plus pour longtemps
Jugement des industriels sur le niveau des stocks



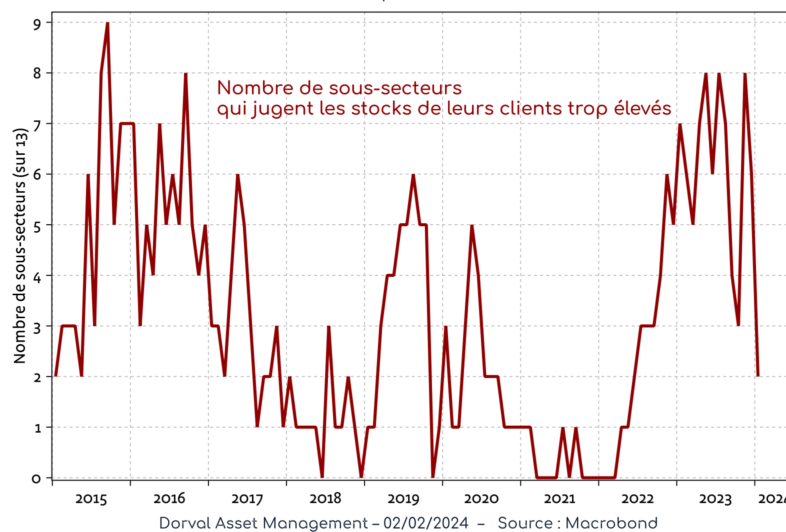
Dorval Asset Management – 02/02/2024 – Source : Macrobond

- *United States (ISM, PMI Customers' Inventories)*
- *Eurozone (Eurostat survey, stocks of finished goods)*
- *Japan (Tankan, Inventory Level of Finished Goods & Merchandise)*

While this recent improvement seems to be worldwide – as may be expected for this highly globalised sector – it is, as often, in the United States that things are picking up the fastest. According to the ISM survey on the manufacturing sector, out of 13 sub-sectors only two (Fabricated Metal Products and Plastics & Rubber Products) reported customers' inventories as being too high in January, compared to 8 out of 13 sectors last November (see chart 2).

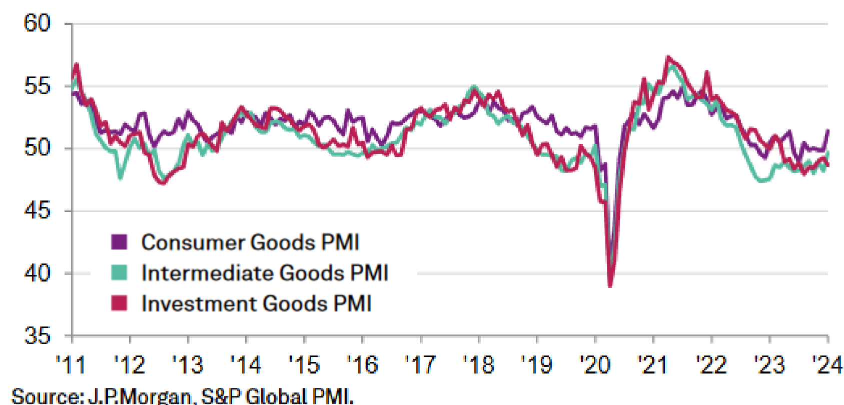
Marked decrease in manufacturing inventories in the United States

ISM survey



- *Number of sub-sectors reporting customers' inventories as too high*

Inventory levels therefore seem to be normalising, which – barring any negative shocks affecting demand – could usher in a new bullish phase in industrial production. The Global Manufacturing PMI for January 2024 rose to 50 for the first time since 2022, mainly thanks to the consumer goods sector (see chart 3). Time will tell, but a rise in purchasing power combined with healthier manufacturing inventory levels seems to be bearing fruit.



For the financial markets, a global recovery in the manufacturing sector in 2024 could have several significant impacts. On the downside, it would reduce the potential for central banks to lower interest rates. As Jerome Powell mentioned during his last press conference, recent deflation in the goods sector – driven by industrial destocking – could dwindle, making it somewhat more difficult to bring annual inflation back to 2%. At this stage, we do not believe this risk to be of major concern, especially in light of the other disinflationary forces at play (such as rent in the United States). Conversely, it is clear that a recovery in the manufacturing sector would reduce the need for a sharp fall in real rates to sustain economic growth. It is worth noting that this could be a problem for bond markets, but not necessarily for equity markets – not as long as the rise in long-term rates remains modest.

As for the positives, potential earnings for global manufacturers would of course be strengthened. It would above all buoy hopes of the European manufacturing sector, still heavily impacted by the energy crisis of 2022, breaking out of its current rut.

In our global diversified funds, our positioning remains as follows: overweighting of equities, a moderate bond duration (for hedging in the event of a more pronounced economic slowdown than expected), and returns on money market instruments in euro. In anticipation of an ECB rate cut and a gradual recovery in activity, we are maintaining a high exposure to equities in our flexible European funds. In these funds, in addition to a core basket close to Euro Stoxx 50, we are investing in a diversified basket of small and medium-sized stocks, banking stocks and companies benefiting from the themes of productivity and the energy transition.

Our exposure rates are as follows:

- **Dorval Convictions:** The equity exposure rate is 70%.

Dorval Asset Management

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