Weekly Macro and Markets View

22 August 2022

Highlights and View

The US housing market cools down significantly in July with housing starts falling by almost 10% MoM

The slowdown in housing activity will weigh on growth, and the latest home builder survey signals more weakness ahead

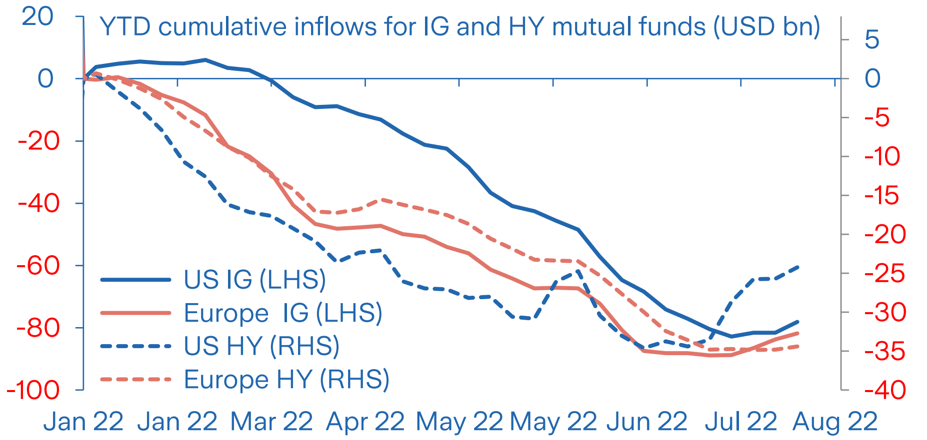
China's government appears to support SOE bond issuance for a few private developers with full credit protection, while the PBoC cuts the 1yr LPR by 5bps and the 5yr LPR by 15bps

The moves are expected to stabilise the confidence of potential home buyers and has supported the stock and bond prices of affected developers.

Natural gas prices in Europe hit the highest levels this year

The further spike in natural gas prices will add to inflation and probably tip the Eurozone into recession later this year.

Underlying demand improves in credit



Source: EPFR, Lipper-FMI

Despite broad spread widening that was driven by weaker sentiment in risk assets last week, underlying demand continues to improve in credit with inflows returning to credit funds. European IG funds again enjoyed strong inflows of close to USD 2bn, the fourth week in a row while US funds saw their third consecutive week of inflows. HY funds also saw inflows, confirming that the decline since the start of 2022 has now stabilised. Furthermore, US primary market activity also remains robust with another USD 22bn of new bonds sold last week, bringing the cumulative monthly volume to almost USD 110bn, well above the average usual volume for August. Investor appetite has been strong, as seen in decent order books, although issuers had to pay elevated double-digit concessions. Activity will likely reduce ahead of the Fed's Jackson Hole Symposium this week until American Labour Day on September 5. Issuance rebounded strongly in Europe too, led by banks, with the highest weekly volume since the end of June. As has been the case since the start of the year, covered bond issuance was strong. We think that banks will continue to favour secured funding to contain the rise in their funding cost. In the US, issuance of ABS has also had a busier than usual August. Despite tighter spreads, investor demand has improved and should remain strong, especially for the senior tranches.

Bonds

Sovereign yields rise on energy and inflation concerns

Sovereign bond yields snapped higher last week despite weak activity data and falling oil prices. The narrative that we may have seen peak inflation was undermined by surging European gas and electricity prices and a surprisingly strong UK inflation print. Yields on 2yr gilts surged by close to 50bps on a more aggressive BoE rate path while 10yr gilt yields were 'only' up 30bps on the week, leading the 2s/10s curve to invert for the first time since 2008. Hawkish ECB rhetoric, which expressed concerns around the persistence of the energy shock and the potential de-anchoring of inflation expectations, added to upward pressure on yields, leading to a 24bp rise in Bund yields. Treasury yields also gained, with the 10yr yield approaching 3%, despite a weak set of housing data. While near-term angst around inflation is likely to persist, the backdrop is one of rapidly slowing growth and elevated recession risk. We suspect this will weigh on yields over time, though this week's Jackson Hole meeting will be important to watch.

Eurozone

Natural gas price spike adds to the region's woes

Natural gas prices in Europe continued to move higher last week. The benchmark Dutch natural gas futures contract ended the week at around EUR 250 /Mwh, about triple its price in mid-June, just before Russia reduced the flow of gas to Europe to around 20% of normal levels. European governments are adopting various measures to help offset some of the impact on households, but it is still likely that energy bills will rise further over the winter months, and that some form of rationing of gas usage in the industrial sector will be needed as well, especially in Germany. Eurozone inflation was confirmed last week to have been at 8.9% YoY in July, and the latest rise in natural gas prices could push inflation even higher over the winter months. However, the ECB is still likely to continue with rate hikes this year. ECB executive board member, Isabel Schnabel, said that even a mild recession would not stop the ECB from raising rates. The next ECB meeting is on September 8, and we expect a 50bp rate increase to be announced at that meeting.

Asian Exports

Japan registers record high trade deficit while Korea's tech exports tumble

Japan registered a record-high trade deficit amid soaring import prices. However, exports of autos and machinery recovered following improving supply chain conditions as China's lockdown measures have eased. South Korea's tech exports in the first 20 days of August contracted significantly, while petro-product, auto and ship exports remained brisk. Indonesia's July exports and imports grew more than expected. The stronger domestic economy induced a higher import bill. We expect a record-high trade surplus for this year. Malaysia's July exports were up 38% YoY but softened versus June as tech export momentum rolled over. The same is true for Singapore, where both electronics and petrochemical exports retreated in July on a sequential basis, while pharmaceutical exports, particularly to the EU, rebounded strongly following a change in the product mix. Apart from exports, we want to highlight the 50bp policy rate hike by the BSP in the Philippines and the slump in visitors entering Macau in July following a Covid-related closure of casinos.

Australia

A solid earnings season while the unemployment rate falls to 3.4%

Australia's FY22 (ending June 30) earnings results have been slightly better than market expectations. Companies have benefitted from solid revenue growth and have so far been able to pass on higher input costs to consumers, though there is a risk that this trend will change if economic growth slows in the second half of this year. Australian banks have started to see a net interest margin increase, and while bad debt will increase with higher rates, it is coming off from a low level. Commodity companies like BHP are benefitting from strong demand from China. As for economic data, Australia's total employment unexpectedly declined by 41k in July due to seasonal factors, mainly driven by lower full-time employment, but the unemployment rate fell slightly to 3.4%, driven by a lower participation rate. Meanwhile, Q2 wages were up 0.7% QoQ and 2.6% YoY. The RBA minutes for August indicated that the central bank remains concerned about inflation, with a stronger focus on domestic factors. We believe the RBA will hike another 50bps in September and 25bps in October.

LatAm

Chile's current account deficit reached its highest level in 20 years

In Chile, Q2 GDP grew 0.0% QoQ, a weaker performance than the monthly economic indicator suggested. Private consumption contracted 2.4% QoQ, signalling some normalisation from 2021's unsustainably high levels. We expect consumption to adjust lower in the coming quarters as it is still significantly above the pre-Covid level. Fixed investment declined 1% QoQ, mainly explained by machinery and equipment, which slumped 3.2% QoQ. The current account deficit widened, reaching 8.5% of GDP in Q2. The result was explained by income earned through foreign investments in Chile and the services trade balance deficit. This vast deficit partly explains the sharp depreciation of the real exchange rate in recent months. We expect the current account deficit to decline gradually as private consumption falls to a more sustainable level. In Brazil, the election race has formally begun. Polls show that the gap between Lula and Bolsonaro is slowly narrowing, with Lula's support stable at around 44% while Bolsonaro's voter support has reached 34.5%.

What to Watch

- This week's Flash PMI data will show if the global economy lost further momentum in August.
- In the Eurozone, various economic data and business surveys are likely to confirm that the economy is rapidly losing momentum.
- In APAC, we expect both the Bank of Korea and Bank Indonesia to hike their policy rates by 25bps. Australia and Japan will release August PMI data. Japan will publish Tokyo CPI data for August and department store sales for July. Taiwan, Singapore, and Thailand will report industrial production data for July, Hong Kong and Thailand July export statistics, and Malaysia and Singapore CPI data for July.

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Investment Management
Mythenquai 2
8002 Zurich

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