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Weekly Macro and Markets View

18 July 2022

Highlights and View

China's economy is recovering from a slump in April/May, but remains vulnerable

Although consumption is recovering, supply bottlenecks are easing and infrastructure spending is gaining speed, we remain concerned about China's property market.

US headline inflation accelerates to 9.1% YoY while core inflation recedes to 5.9% YoY

Rising energy prices lifted headline inflation in June, though the recent fall in oil and gasoline prices will help to mitigate the price pressure.

The central banks of South Korea, New Zealand, Singapore, and the Philippines tightened monetary policy last week

We expect further tightening into next year, although the Bank of Japan and the People's Bank of China are expected to stand pat for the time being.

China's economic data reveal a mixed picture

Source: NBS, PBoC, Nomura, Barclays, Bloomberg

China's economy was up a meagre 0.4% YoY in Q2, avoiding a negative figure by a slim margin. However, in sequential terms, China's economy contracted by 10.8% in annualised terms versus Q1 following the severe Omicron related lockdowns and supply chain disruptions in many regions and cities in April and May. Looking at the economic indicators for June, the picture is mixed. On the positive side, retail sales bounced back following re-opening measures and services consumption improved, though not yet to the level a year ago. The surveyed jobless rate improved from 5.9% to 5.5%. Both infrastructure and manufacturing investment growth was solid, but the property market keeps ailing, with property investment contracting further by 9.4% YoY and floor space under construction tumbling 48%. Easier mortgage conditions helped home sales contraction to relent from -32% to -18% YoY, but the latest issues around rural banks with home buyers protesting and suspending their mortgage payments as housing completion has been delayed appear to be dampening the appetite for new homes, particularly as house prices keep falling. With economic growth up only 2.5% YoY in H1, the government's growth target of 'about 5½%' for this year remains unrealistic. Our 4½% forecast rests on the cautious side, but above the more cautiously tilted consensus.

US

Headline inflation rises further though inflation expectations fall back

Driven by the recent surge in energy prices headline inflation accelerated further to 9.1% YoY in June while core inflation receded for the third month in a row to 5.9% YoY. Given that the oil price has dropped more than 20% from its recent peak the headline inflation rate is likely to slow substantially in the coming months. Producer prices show a similar pattern with headline rates accelerating in June while core measures have slowed down both on a monthly as well as on an annual basis. Helped by lower oil and gasoline prices, US consumers' long-term inflation expectations have dropped from 3.1% to 2.8% in July, the lowest in a year. This is reassuring as a potential de-anchoring of inflation expectations was one reason for the Fed's recent acceleration of its tightening path. Consumer sentiment has slightly improved in July driven by better current conditions while expectations remain downbeat. Finally, initial jobless claims continue to rise, reaching 244'000 last week, the highest number since last November, indicating that the labour market tightness continues to unwind.

Eurozone

The ZEW falls further, Italian politics heat up

Industrial production grew 0.8% MoM, 1.6% YoY in May, with broad-based output gains across sectors, suggesting that supply chain problems are diminishing. Unfortunately, this was of little comfort to analysts as the prospect of the Russian gas supply being cut-off of is weighing heavily on sentiment. The German ZEW expectations index fell to its lowest level since 2011 in July. However, with sentiment so negative a bounce back is possible should the worst case scenario not materialize. Meanwhile, the Italian political situation has become more volatile. The Five Star Movement refused to vote in favour of Prime Minister Mario Draghi's government in a confidence vote in parliament, despite being part of the governing coalition. This prompted Prime Minister Draghi to tender his resignation to Italian President, Sergio Mattarella. Mattarella refused his resignation and instead has given Draghi a few days to from another coalition government. Should he not be able to do this, then early elections within the next few months are likely, which could add to upward pressure on Italian bond spreads.

APAC

Central banks in hawkish mode

Various APAC central banks are tightening monetary policy more aggressively, given that inflation figures are breaching target ranges. Following policy rate hikes in Australia, New Zealand and Malaysia, South Korea announced its biggest hike since 1999, up 50bps, on the back of inflation hitting a 24-year high of 6% in June. This was followed by unscheduled monetary tightening by central banks in Singapore and the Philippines. Singapore's MAS expects core inflation to rise above 4% in the near term before easing into the fourth quarter though there is still a considerable amount of uncertainty over the extent of the decline. The Philippine's BSP initiated its biggest hike since 2002, up 75bps, and expects inflation to potentially hit 7.2% in Q4, well above its target range of 2-4%. Indonesia remains the only outlier in Southeast Asia, keeping policy rates at record lows of 3%. We believe that its high June trade surplus, thanks to the removal of export restrictions on palm oil, and core inflation below 3% are giving Bank Indonesia breathing space to hold back hiking rates for now.

Australia

Strong employment growth drives unemployment to a historic low of 3.5%

In Australia, the labour market continued to tighten, with employment increasing by 88k for June. The Australian unemployment rate fell from 3.9% to 3.5%, reaching the lowest level on record, and with the vacancy rate elevated the unemployment rate could fall even further in the following months. The employment data will likely cause the RBA to increase the cash rate by a further 50bps in August to 1.85% as the central bank attempts to moderate inflationary pressures. The increase in interest rates has most directly impacted consumer confidence, with the Westpac consumer confidence index falling to the lowest level since August 2020. The NAB business sentiment survey was more mixed, and while business conditions remained elevated, business confidence fell to the lowest level in six months. The Australian economy remains in a transition phase where higher interest rates will moderate pent-up demand in the economy, leading to a slower pace of economic growth in Q4.

LatAm

The Central Bank of Chile hikes the policy rate, announces an FX intervention program

In response to the abrupt depreciation of the peso and to stabilize and reduce currency volatility, the Chilean Central Bank announced an FX intervention program to sell up to USD 20bn. The intervention program will start today and end on September 30. Market reaction was positive, with the CLP appreciating ~7% after the announcement. The statement comes just one day after the central bank hiked the policy rate by 75bps to 9.75%, signalling that additional rate hikes are required to ensure the convergence of inflation to its 3% target. We believe the currency intervention will normalize FX market conditions, but upward inflation pressures will remain in the short term. In Brazil, economic activity fell 0.1% MoM in May. The service sector remains robust, increasing by 0.9% MoM and avoiding a sharper deceleration in economic growth. Congress approved a bill increasing the cash transfer program until year end, implying an additional 0.4% of GDP fiscal easing in 2022.

What to Watch

- In the US, the focus will be on the latest batch of housing data while the Markit PMIs will show whether business activity held up at the beginning of Q3.
- In the Eurozone, the ECB is expected to unveil details of its Transmission Protection Mechanism, designed to contain periphery spreads. All eyes will also be on whether Russia reopens the Nord Stream 1 pipeline.
- In APAC, we expect the Bank of Japan, China's PBoC and Bank Indonesia to keep monetary policy unchanged. The BoJ is likely to revise its inflation forecast higher and growth prospects lower. Japan, Taiwan, Malaysia, and Thailand will report export data for June, while Japan, Hong Kong, and Malaysia will release June CPI data.

Disclaimer and cautionary statement

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