

# Weekly Macro and Markets View

29 August 2022



## Highlights and View

### Fed Chair Powell reiterates a commitment to tame inflation at the Jackson Hole Symposium

A relatively short speech offered little new insights but affirmed the priority of bringing inflation back to target through further rate hikes and maintaining a restrictive monetary policy.

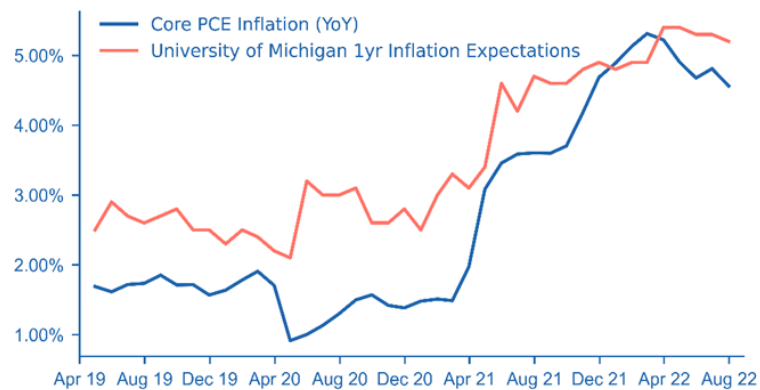
### The Flash PMIs signalled a further decline in global growth in August with both manufacturing and services weak

Recession risk is high with aggressive policy tightening and a European energy crisis weighing on both sentiment and activity.

### China's State Council announces a 19-point policy package worth RMB 1tn to counter the economic slowdown

We note that the stimulus measures appear to be targeted and prudent. Infrastructure investments remain the focus of policy stimulus.

## Investors proclaim a hawkish Fed at Jackson Hole as inflation eases



Source: Bloomberg

An action-packed week in the US saw a plethora of economic data combine with the much-anticipated speech by Fed Chair Powell in Jackson Hole to derail investor enthusiasm. The S&P 500 closed down 4% on the week, with the Nasdaq fairs slightly worse as investors put a hawkish interpretation on Powell's well prepared and, in our opinion, unsurprising remarks. Rightly, the Fed's determination to return inflation to target was re-emphasised with an acknowledgement that monetary policy would need to be restrictive for some time. The market reaction seems to be a case of over optimism prior to the speech. The bounce from June lows was becoming stretched as resistance levels were approached, which had led us to become more cautious on stocks recently. The economic data reported were somewhat mixed, with PCE inflation falling back, the core reading down from 4.8% YoY to 4.6% while the University of Michigan sentiment survey was robust, showing a decline in both one-year and five to 10-year inflation expectations. GDP was also revised higher to -0.6% for Q2, on better consumption and inventory data, but a sharp decline in the PMI Services reading to 44.1 was a surprise. While the latter series can be misleading, a further drop in both new and pending home sales, along with personal spending, is indicative of an economy that we will think is faltering and slowly moving towards recession.

## Bonds

A muted response to Powell's speech with the focus on surging gas prices instead

In contrast to the heavy sell-off in stocks, the initial response of Treasuries to Powell's speech was muted. The 10yr Treasury yield was flat on the day, closing at 3.04%, while the rate outlook was little changed with 150bps of Fed rate hikes priced over the coming year. Europe saw bigger moves in response to surging gas prices and hawkish central bank rhetoric, which caused the rate markets to price in an increasingly aggressive central bank response. In the UK, gilts continued to underperform following the stronger than expected CPI print in the

prior week given the backdrop of currency weakness and fiscal concerns. The 2yr gilt yield rose above 2.8%, the highest level since 2008, while the 10yr yield breached its recent June high. The curve remains inverted, in line with elevated recession risk. With growth slowing sharply, it is questionable as to whether European central banks will be able to deliver on the rate hikes that are now priced, implying a peak above 2% for the ECB rate and above 4% for the BoE rate.

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## Eurozone

### Business surveys slip further

The Eurozone PMI survey fell further in August, though perhaps not as much as could have been feared given the news flow recently. The German Ifo Business Climate indicator also fell in August, but by less than expected. There was some good news within the PMI survey as previous supply-chain pressures showed signs of easing. Nevertheless, the bigger picture remains that the Eurozone is heading into recession later this year as the shock from higher natural gas prices hits the economy. The S&P Eurozone Composite PMI fell from 49.9

in July to 49.2 in August, driven by declines in both manufacturing and services confidence. At this level it is consistent with growth declining to a snail's pace. Within the detail of the survey there was some encouraging news. Both input and output price growth fell, while supplier delivery times improved. However, the continued surge in natural gas prices will weigh on the Eurozone economy going forward, and we expect to see the PMI survey fall further over the coming months.

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## UK

### Household energy bills to almost double in October

In the UK, the S&P Services PMI held up well, declining just one-tenth of a point from 52.6 in July to 52.5 in August, but the Manufacturing PMI declined sharply from 52.1 in July to 46.0 in August. Forward-looking indicators within the manufacturing survey, such as new orders, were particularly weak. Indeed, the Manufacturing PMI New Orders Index fell from 46.9 in July to 42.2 in August. Meanwhile, Ofgem, the UK's energy regulator, has increased the price cap for electricity and gas bills for the average household from the current GBP 1'971 to

GBP 3'549 in October. Household gas and electricity bills will likely rise by around 80% as a result, with further increases in the price cap and bills possible next year. The government is likely to announce further support measures for households, but it will not be able to offset the full impact. Headline inflation will likely rise well into double digits, adding to the squeeze on households real spending power and eventually denting service sector activity despite the current apparent resilience.

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## Japan

### PMIs keep falling

New Covid infections and mortality remain at a record high in Japan, while new infections currently mark a global high on a per capita basis together with South Korea. To no surprise, the Services PMI fell further into contractionary territory to 49.2 in August, indicating weaker domestic demand. The manufacturing sector is suffering as well, with the Manufacturing PMI falling for a fifth month in a row, down 1.1 points to 51. All five subcomponents contributed negatively, and we want to highlight that the New Export Orders Index fell to 47, reflecting weaker

global demand in line with what we earmarked last week in our Asian Exports section. Meanwhile, Tokyo's headline and core CPI for August came in higher than consensus had expected. The core CPI (excluding fresh food) rose 0.3pps to 2.6%, climbing to a 30-year high (excluding the consumption tax hike). Finally, as BoJ Governor Kuroda repeated his dovish monetary policy stance versus Fed Chair Powell's hawkish remarks, the yen weakened further to 139 versus the US dollar today.

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## Mexico

### Economic activity is expected to decelerate in H2

Economic activity remains solid, mainly driven by the expansion of trade and consumption. GDP grew 0.9% QoQ in Q2, with all sectors increasing, but showing a deceleration in industrial production and services compared with the preliminary figures. Nevertheless, monthly economic activity decreased by 0.3% in July for a second consecutive month, driven by a drop of 6% in the primary sector. The current account deficit reached 0.2% of GDP in Q2, mainly driven by an increase in the oil balance deficit. The minutes for the last

monetary policy meeting confirm the tightening cycle will continue. However, there is some disagreement among the board member about continuing with the same magnitude of rate hikes. We expect slower growth in H2 as external demand should slow down due to the impact of elevated inflation and higher interest rates, while domestic demand will also be more muted due to the unfavourable environment for investment, despite the support provided by remittances and the recovery of bank credit.

## What to Watch

- In a heavy week for US data, close attention will be paid to the ISM readings given last week's poor PMI data, while payroll on Friday is expected to show further robust job gains and an unchanged unemployment rate of 3.5%
- In the Eurozone, inflation data for August will be closely watched, though it may be too early for the full impact of the recent surge in natural gas prices to be seen.
- In APAC, Japan will release July economic indicators. China will publish NBS and Caixin PMIs for August. Australia will report Q2 private capex data and housing related data. India will publish Q2 GDP data. South Korea will release Q2 GDP, July industrial production, and export and CPI data for August. Hong Kong will release July retail sales statistics.
- In Chile, unemployment and monthly economic activity data will be released, while all eyes will be on the constitutional referendum on the September 4. In Brazil, solid GDP growth for Q2 is expected. In Mexico, the focus will be on the central bank's inflation report.

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