Weekly Macro and Markets View

5 September 2022

Highlights and View

Gazprom announces that gas supply via Nord Stream 1 will be cut off indefinitely

The announcement will weigh on growth in Europe and boost inflation, but also force the EU to accelerate the transition to energy independence from Russia.

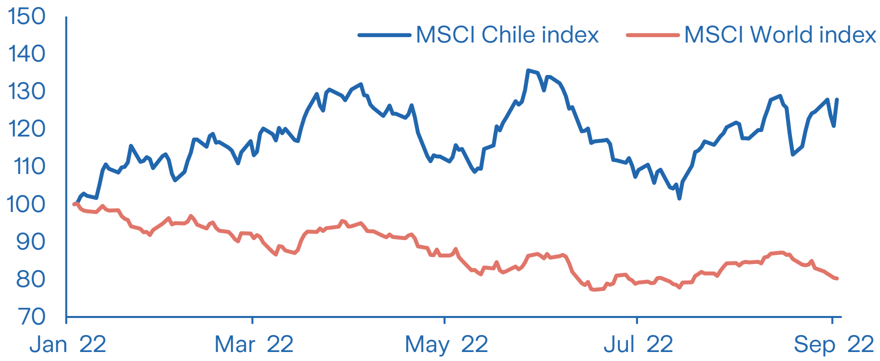
Chile rejects the proposed new constitution and will initiate a second redrafting

Although the constitutional discussion will continue, we expect a positive impact on the financial markets and a more balanced new constitution proposal.

The US unemployment rate rises to 3.7%, driven by a pickup in participation

The labour market remains tight, though continues to show signs of softening with a lower quits rate and slowing wage growth.

The equity market in Chile decouples from global markets



Source: Bloomberg, re-based 31 Dec 2021=100

With a historically high participation rate of 85%, Chile rejected the proposed new constitution with 61.9% of the votes and will now embark on a second redrafting process. The government will try to establish a second constitutional convention, elected by popular vote. The mechanism to redraft the constitution must first be approved by four sevenths of Congress, and any further proposed new drafts of the constitution must be ratified in a new referendum. The government will likely have more challenges in advancing in its reform agenda this time around as Congress will focus on designing a new path to rewrite constitution. Considering Boric's administration does not hold a majority in Congress, we believe that they will modify some of their reforms so that they will gain approval, reducing the impact on economic activity. Also, a cabinet reshuffle expanding the government coalition by bringing the traditional centre-left parties on board is expected, improving the likelihood of legislative success.

The equity market and the Chilean peso were already reflecting the referendum's outcome, decoupling from global markets and rising by 2.6% and 1.8% last week, respectively. Although the constitutional process will continue for at least another twelve months, the new constitution proposal will have to moderate, which will be well received by the market.

US

A steep fall in business prices points at significantly lower inflation

Manufacturing activity is holding up reasonably well according to the latest ISM Manufacturing survey. The headline level remained at 52.8 in August while new orders accelerated slightly following two months of decline. Crucially, another steep fall in business prices to the lowest since June 2020 is pointing at a significant drop in inflation rates. Meanwhile, though still tight, the latest batch of labour market data shows further softening at the margin. 315'000 new nonfarm payrolls were added in August while the unemployment rate rose from 3.5% to 3.7% thanks to a rise in the participation rate to 62.4%, matching the post-pandemic high reached in March. The Fed will also take some comfort in wage growth slowing to 0.3% MoM from 0.5% the month before. Similarly, the fall in the quits rate to the lowest level in more than a year is indicative of reduced wage pressure. Finally, consumer confidence improved for the first time in four months in August, helped by a significant drop in gasoline prices.

Eurozone

Russia cuts off gas supply, ECB hawks become more vocal

Eurozone headline inflation hit 9.1% YoY in August, up from 8.9% in July, and core inflation also picked up. Gazprom's announcement on Friday that gas supplies to Europe will be cut off indefinitely will push up energy prices and make the inflation situation even worse. Although there is not yet much evidence of long-term inflation expectations becoming de-anchored, the ECB will be concerned about a further spike in headline inflation. Some notable hawks on the ECB governing council have already been calling for a 75bp rate increase at this Thursday's coming meeting, rather than the 50bp increase that Chief Economist Philip Lane has indicated he favours. Meanwhile, European Commission (EC) President Ursula von der Leyen has indicated that the EC is looking at options to potentially cap energy prices as well as cut the link between gas and electricity prices. Germany has also announced a fiscal package to offset the impact of higher energy prices. However, it will not be possible to offset the impact completely and the short-term hit to economic activity will still be substantial.

North Asia

Strong capex, sales, and earnings in Japan, while China's PMIs disappoint

Japan's MoF Corporate Survey revealed three quarters of solid earnings growth, a record high since the survey was released for the first time in 1954, while capex growth accelerated in Q3, mainly driven by the manufacturing sector. Industrial production grew another 1% in July, following the 'V'-shaped recovery with a record-high surge of 9.2% MoM in June, which was mainly driven by a strong pickup in auto production following prior supply chain bottlenecks due to China's lockdown. However, the corporate outlook for the next two months is more cautious. We also note that consumer confidence is stabilising, while housing starts remained anaemic in July. Meanwhile, China's PMI data for August remain disappointing, with the Caixin Manufacturing PMI slipping back below the critical 50 mark, while the Services and Construction PMIs deteriorated as well. Due to the resurgence of Covid cases, 34 cities are affected by full or partial lockdowns, with the more than 20 million inhabitants of Chengdu most affected, while Covid cases in Shenzhen and Hong Kong are increasing as well.

Australia

House prices and demand decline while retail sales remain positive

The recent increase in cash rates has led to weaker housing data in Australia. The volume of new building approvals fell by 17.2% MoM in July, and the Australia Corelogic house price index declined by 1.6% MoM in August, having dropped by 4.1% over the past four months. The value of Australia home loans for July has fallen by 8.5% MoM, driven by an 11.2% fall in investor loans as the high-interest rate has negatively impacted borrower demand. Sentiment toward the housing market is likely to remain negative as the RBA is expected to continue hiking interest rates into Q1 2023, with a 50bp rate hike expected for September. Non-housing data in Australia remain solid, with retail sales increasing by 1.3% MoM in July, well ahead of market expectations of 0.3%. The impact of higher interest rates has so far not impacted the spending pattern of the two thirds of Australian households who do not have a mortgage.

Markets

In the midst of a whirlpool

Another tough week for investors saw most financial assets under pressure. Market conditions are volatile as investors struggle to interpret incoming economic data as good or bad for market prospects. Certainly, with central banks in a race to hike rates ever higher, any sign of easing growth or inflation is being latched upon. Unfortunately, last week offered little on that front and continued the trend of higher global inflation prints and further hawkish policy tones. UK gilts experienced a further steepening of curve inversion as monetary policy and fiscal fears dominate, with 2yr yields rising to levels last seen during the financial crisis some fourteen years ago. Stocks and credit also lost ground, with the MSCI global stock index off more than 3% on the week and the US Nasdaq down 4.2%. While we see further downside for stocks, with equity markets likely to retest the lows of June, bond yields are becoming more appealing given our recessionary outlook for Europe and the US, while global inflationary forces are expected to ease.

What to Watch

- In the Eurozone, the ECB meets to decide interest rates with the choice between a 50bp or 75bp rate increase.
- In APAC, we expect Japan's Eco Watchers for August to pick up some steam while Q2 GDP is likely to be slightly revised upwards following the MoF Q2 Corporate Survey. A higher summer bonus is expected to have lifted nominal wage growth in July. In Australia, we expect the RBA to lift its policy rate by 50bps, while Q2 GDP and July foreign trade data will be released. Mainland China and Taiwan will announce inflation and foreign trade data for August. Malaysia's BNM is expected to lift its policy rate by 25bps to 2.5%. Taiwan's and South Korea's markets will be closed on Friday.
- Inflation data will be released in several countries in LatAm, with another negative print expected in Brazil. We also expect the Central Bank of Chile to hike the policy rate by 50bps to 10.25%.

Disclaimer and cautionary statement

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