Weekly Macro and Markets View

19 September 2022

Highlights and View

US headline inflation continues to fall though core CPI rose more than expected

The pickup in core inflation was relatively broad-based leaving no room for the Fed to deviate from its aggressive tightening path in the near term.

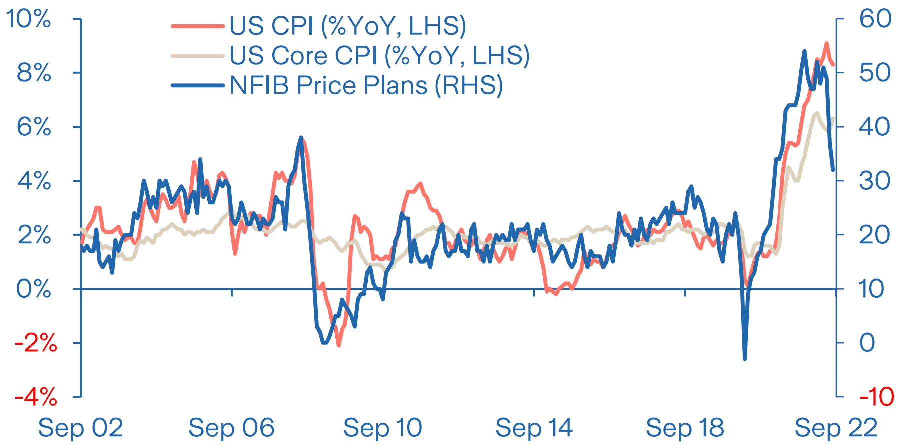
Most of China's economic data for August continue to be weak

For the rest of the year, we expect infrastructure investment to remain the bright spot, while the property market is likely to remain weak.

EU President Ursula Von der Leyen lays out proposals to reform energy markets

The proposals should help but will not prevent high energy prices from pushing the region into recession over the winter months.

Solid core inflation, but price plans point at fading price pressure



Source: Bloomberg

Headline inflation decelerated to an annual rate of 8.3% in August from 8.5% in July with falling energy prices again being a major driver of the slowdown in price pressure. However, investors were spooked by a substantial and relatively broad-based pickup in core inflation that lifted the annual rate to 6.3% from 5.9% the month before. With a monthly pickup in core CPI of 0.6% there is no room for the Fed to soften its rhetoric in the near term and the FOMC is expected to lift the target rate by another 75bps at its meeting this week. Nevertheless, there were also a number of reassuring signs on inflation last week. Small businesses' price plans saw another substantial fall in August, pointing to significantly lower inflation rates in the months ahead. Consumers' inflation expectations both for next year as well as for the longer term ticked down in September, mitigating fears of an uncontrolled wage-price spiral. Meanwhile, there are increasing signs of a further slowdown in economic activity. Retail sales fell over a two-month period while industrial production ticked down in August. The combination of rising core inflation, mixed economic data and a profit warning from FedEx triggered a marked sell-off in the S&P 500, which lost almost 5% over the course of the week, the biggest weekly drop since June.

Eurozone

ZEW falls further, Von der Leyen lays out energy reforms

Economic data in the Eurozone continue to be consistent with an economy gradually slipping into recession. The German ZEW expectations survey, a useful leading indicator, fell from -55.3 in August to -61.9 in September, a fresh multi-year low. Eurozone industrial production in July fell 2.3% MoM and is now down 2.4% on a YoY basis. Meanwhile, Eurozone HICP inflation was confirmed at a new record high of 9.1% YoY in August when the second estimate was released last week, which will only add to the squeeze on households' real incomes and spending power over the next few months and quarters. In her state of the union speech on Wednesday, European Commission President Ursula von der Leyen confirmed the likely form that energy markets interventions will take, which included a windfall tax on energy companies not using gas, reducing energy consumption, and easing collateral requirements for companies trading energy. While these measures should help, they will not be able to prevent a recession in the region over the winter months in our view.

UK

Headline inflation decelerates in August

The monthly inflation rate ticked down slightly to 0.5% in August, which was just enough to push the annual rate back below 10%. Core inflation on the other hand accelerated to an annual rate of 6.3%, lifted by service prices. While inflation will remain elevated in the near-term, producer prices fell significantly more than consensus expected in August pointing to fading price pressure in the pipeline, although from still extraordinarily high levels. Meanwhile, the labour market remains very tight with the unemployment rate falling to 3.6% in July, the lowest since 1974. Accordingly, wage growth picked up to 5.2% YoY from 4.7% the month before. Given the ongoing headwinds it is not surprising that economic activity shows further signs of slowing. Industrial production fell by 0.3% MoM in July after -0.9% in June while retail sales dropped by 1.6% MoM from a pickup of 0.4% the month before. Overall, the monthly estimate of the rolling three-month GDP growth rate ground to a halt in July, summarizing the headwinds that the UK economy is facing in the months ahead.

China

August data reveal a gloomy picture despite some glimmers of hope

Following weak export and credit data, retail sales and property related indicators for August remained soft. At a first glance, retail sales data appeared to be strong, but they were distorted by the base effect. Lockdowns due to renewed outbreaks of Omicron infections are taking their toll, and while the lockdown in Sichuan's capital Chengdu is ending today, we expect restrictions to remain in many provinces until the 20th Communist Party Congress has concluded in late October. Industrial production remained stable at a low level, impacted by power shortages due to the severe heatwave. The contractions in property investment, new housing starts, home sales, land purchases and home prices accelerated, which we regard as worrisome. Only floor-space completions recovered as efforts to deliver houses and apartments on time intensified following the mortgage protests. On a positive note, infrastructure and manufacturing investment growth continued to rise, the former supported by frontloaded local government special bond issuance.

Japan

Surveys show mixed signals, while the MoF prepares to support the yen

Japan's quarterly Business Sentiment Survey paints a mixed picture. The BSI for large manufacturers recovered to positive territory in Q3 and is set to bounce further in Q4, before slowing again in Q1 next year. Small manufacturers show the same path of improvement, but remain in negative territory, while the BSI for large non-manufacturers dipped in Q3 but will rise again thereafter. The latest Omicron wave explains the pattern. The employment DI suggests that worker shortages are expected to intensify. Meanwhile, the Reuters Tankan indicated a setback of conditions in September for both manufacturers and non-manufacturers. Encouragingly, the auto sector is showing improvement following supply chain disruptions. The trade deficit moved to a record high in August as import prices surged nearly 50% YoY. Auto exports, up nearly 40% YoY, have recovered significantly. Finally, we want to highlight some indications that the Ministry of Finance (MoF) may instruct the Bank of Japan (BoJ) to intervene in currency markets to halt yen depreciation.

Credit

Strong outperformance vs stocks

Credit strongly outperformed equities last week. While the S&P 500 suffered its largest one-day drop since June 2020 on Tuesday after the CPI release, US IG spreads widened by just 1bp on the day. The 15bp widening in US HY spreads was also negligible in relative terms. The primary market was also resilient last week. Despite the issuance slowdown after the CPI release and the Fed's next interest rate decision already in sight, September issuance has been strong. Moreover, supply has been well received so far. Notably, US IG new issue concessions, after repeatedly touching levels above 25bps in the summer, have eased since US Labor Day and remained closer in line with the YTD average of 12bps. Another positive development last week was the stabilisation of flows, with outflows from US and European IG funds decelerating, according to Lipper and EPFR respectively, and US HY funds seeing inflows after three consecutive weeks of outflows. All in all, credit's performance last week confirms our view that more near-term downside seems priced into credit, especially in Europe.

What to Watch

- All eyes will be on the Fed which is expected to lift the target rate by 75bps for the third time in a row this week.
- In addition to various economic data releases, the focus in the Eurozone will be on the elections being held in Italy on Sunday, September 25, where the right-wing coalition is leading in the opinion polls.
- The SNB is expected to deliver another steep rate hike in this week's policy meeting.
- In APAC, we expect the Bank of Japan, Taiwan's CBS and the People's Bank of China to keep policy rates unchanged, Bank Indonesia to hike 25bps, and Bangko Sentral ng Pilipinas to lift by 50bps. Japan's headline and core CPI measures for August are expected to rise by 20bps. August export data will be released in Taiwan, Malaysia, and Thailand. August CPI data will be published in Hong Kong, Malaysia, and Singapore. Japan's markets will be closed today and on Friday, Australia's on Friday.

Disclaimer and cautionary statement

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