# Weekly Macro and Markets View

27 June 2022

## Highlights and View

**Flash PMIs in the Eurozone fall sharply in June**

The latest Eurozone business surveys suggest growth is slowing even before the full impact of Russia's 60% reduction in gas supply to Europe has been felt.

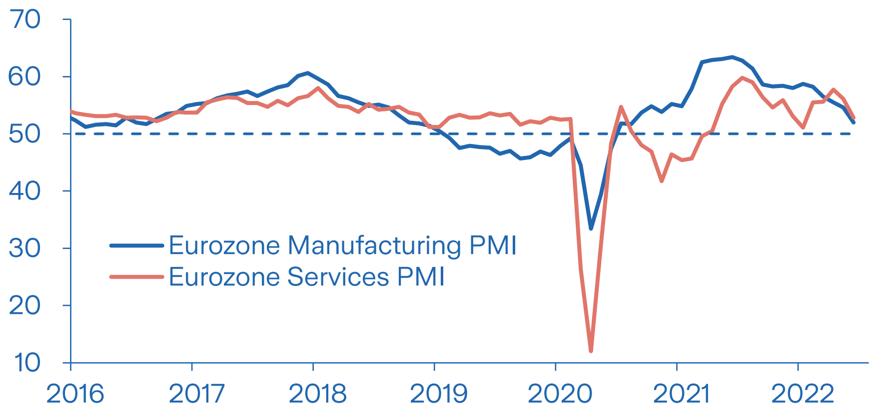
**June Flash PMI data indicate a significant slowdown in global growth, but supply conditions improved further and price pressures eased**

A sharp tightening in financial conditions and elevated energy and food prices are taking a toll on growth, but employment growth remains brisk and should provide near-term resilience for the global economy .

**The UK headline inflation rate ticked up to 9.1% YoY in May, the highest in four decades**

Rising living costs are weighing on consumers' minds, pushing sentiment to a record low in June.

### Eurozone recession risks increase as economy loses momentum




Source: Bloomberg

The Flash S&P June PMIs for the Eurozone were disappointing, with big declines in both manufacturing and services confidence. The overall Eurozone Composite PMI fell to 51.9 in June from 54.8 in May, and though that's still consistent with growth it's getting closer to the 50 mark that separates expansion from contraction. Forward-looking subindices in the manufacturing sector were particularly weak, with the new orders index falling to 44.7 from 48.7 and new export orders falling to 45.1 from 47.7. Admittedly, there was a glimmer of hope that supply-chain problems are waning, with supplier delivery times improving for the third consecutive month. In addition, national business confidence surveys released last week for Germany and France were not as weak as the Flash PMI. However, despite having been resilient in the first half of the year, the economy is now clearly losing momentum. The recent reduction in gas supplies from Russia to Europe and associated around 50% increase in European natural gas prices in the past two weeks unfortunately increases the chances that the Eurozone will fall into recession around the turn of the year. Last week, Germany moved to stage two of its three stage gas emergency plan. A move to stage three would mean that the government would decide which sectors would have to endure rationing, an increasing possibility over the winter months, unless there is a resolution to the crisis in the meantime.

## Global

### A growth downshift

Investors' focus has moved from inflation to growth as sentiment has slumped and financial conditions tightened. Economic activity has held up well so far, helped by strong services demand and a business drive to restock inventories. High savings have also cushioned households against rising prices. Last week's Flash PMIs showed that these tailwinds are waning, with a sharp decline in new orders and a slump in services activity, particularly in the US and Europe. The weak PMI data added to the recession narrative and contributed to a decline in government bond yields as expectations for central bank rate hikes came off a bit. While the slump in demand is concerning, supply conditions continued to improve, with decreasing delivery times and order backlogs, plus a tick lower in price pressures as China lockdowns are easing. Employment growth also remains brisk, with demand for labour still outpacing supply, providing resilience for households. We maintain our view that a recession is unlikely, though recession risk has risen materially, with geopolitical and policy risks at the fore.

## UK

Consumer sentiment hits a record low as inflation remains high

Headline CPI inflation ticked up to 9.1% YoY in May, the highest in more than four decades with the monthly rate slowing from 2.5% to 0.7%. On a more positive note, core inflation decelerated to an annual rate of 5.9% from 6.2% in April. Producer prices also increased less on a monthly basis than in April. Nevertheless, price pressure remains high in the near term though the recent fall in energy prices should help to mitigate the rise in input costs. Rising living costs and a deteriorating economic outlook keep weighing on households' minds with consumer sentiment falling to a new record low in June. While the deteriorating sentiment is likely to have an impact on future purchasing decisions, household unemployment fears have decreased and are still far away from recessionary levels. Retail sales reflect households' downbeat mood, falling by 0.5% MoM in May. Meanwhile, business activity is expanding at a decent pace according to the latest set of PMIs with both manufacturing and service sentiment holding up relatively well.

## ASEAN

Malaysia's inflation intensified, Indonesia is in no rush to hike

Malaysia headline inflation accelerated to 2.8%, while core inflation rose to a five-year high of 2.4% and food inflation reached a decade high of 5.4% in May. These were mainly driven by rising food and energy costs, a weaker ringgit, a persistent labour shortage, seasonal demand, and an increase in the minimum wage. We expect inflationary pressures to intensify following the government's decision to adjust the ceiling on price control for chicken and remove subsidies for selected cooking oils. While electricity tariffs will be maintained for H2 2022 despite rising fuel costs, we are closely watching upside risk from potential adjustments to the fuel price subsidy. Against market expectations, Bank Indonesia (BI) maintained its policy rate at 3.5% in June. We still expect inflation to breach BI's 2-4% target in H2 as domestic demand continues to recover and accelerated rate hikes by the Fed and the ECB may drag the rupiah down further in the coming months. We continue to expect a 75bp hike in 2022, with the first hike likely in July.

## LatAm

Banxico accelerated its tightening, while the BCB signalled higher rates for longer

In Mexico, the Central Bank accelerated its tightening, raising the policy rate by 75bps to 7.75%, the largest increase since adopting the inflation target in 2008. The statement considers that the balance of risk for inflation remains biased to the upside, mentioning that they will continue to hike in the coming meetings. Banxico revised its year-end inflation forecast from 6.4% to 7.5%. We believe that the higher, more persistent inflation, combined with a more aggressive stance from the Fed, will cement Banxico's hawkish tone and that we will see another 75bp hike in August. Monthly economic activity surprised to the upside, growing 1.1% MoM. In Brazil, the most recent monetary policy meeting minutes were hawkish, signalling higher interest rates for a longer period. The Chilean peso remains under pressure, reaching its lowest historical level. The Treasury is trying to contain the depreciation, announcing a sale of USD 5bn during the next two months. We think this FX intervention will have a short-lived impact and will not change the current currency trend.

## Credit

Credit spreads underperformed despite the rebound in equity markets

Cash credit markets underperformed last week, and spreads were wider despite better momentum and a decent rebound in equity markets. European Investment Grade corporate spreads rose above 200bps, reaching levels only observed during Covid-19 and the previous major crises in financial markets. Credit markets have been impacted by high volatility in government bond yields and amid growing concerns that the economy is headed toward a recession. Outflows from mutual funds have also picked up in the last two weeks and US IG funds experienced their longest losing streak on record, with 13 consecutive weeks of outflows. Activity in primary markets rebounded but issuers had to increase the new issue premium to attract any bids. In Europe, financial issuance was largely driven by covered bonds as banks took advantage of net asset purchases by the ECB. Given the surge in credit spreads, we think that a lot of bad news has already been priced in and that the credit markets should stabilize, especially if volatility in equity market starts to abate.

## What to Watch

- In the US, PCE core inflation is expected to have ticked down in May while the latest ISM manufacturing survey will give important insights into the current state of the US economy.
- The first estimate of Eurozone inflation in June will be closely watched and is expected to show a further increase to the latest record high.
- In China, the focus will be on June's Manufacturing and Non-Manufacturing PMI. With the decline in Covid cases and restriction easing it is expected that both PMIs will print above 50 for the first time since February.

**Disclaimer and cautionary statement**



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