Weekly Macro and Markets View

15 August 2022

Highlights and View

Monthly inflation turns negative in the US as energy costs fall and distortions unwind

In line with our view, inflation fell more than consensus expected though some sticky components remain elevated for now.

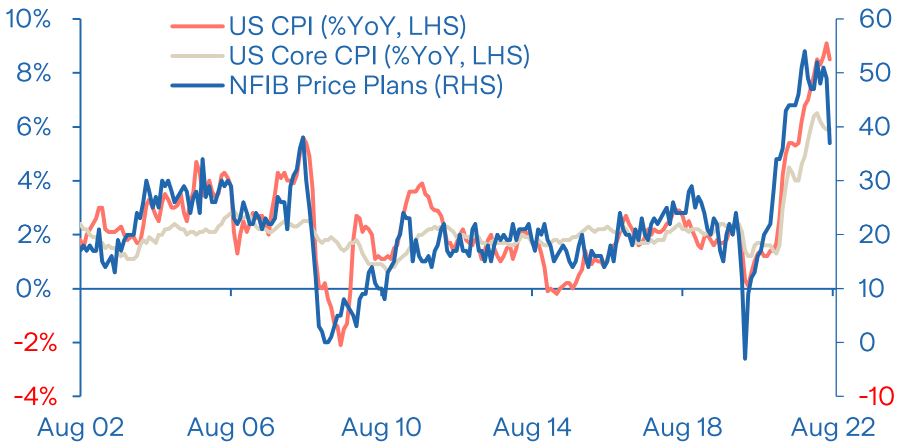
UK GDP fell by 0.1% in Q2, slightly less than consensus expected

While business investment had been holding up reasonably well, weaker spending by consumers and the government has led to the small decline in GDP.

In Australia, business confidence improves in July while consumer confidence has fallen 3% MoM in August

Despite current business conditions remaining solid, the increase in interest rates will likely lead to slowing economic growth for 2023.

US inflation peaks, but still has a long way to go



Source: Bloomberg

Inflation rates fell further in July than consensus had expected as pandemic-related distortions continue to unwind and lower energy costs, particularly lower gasoline prices, further reduced price pressure. The monthly headline rate dipped into negative territory for the first time since the pandemic, bringing the annual inflation rate down from 9.1% to 8.5% in June. Core inflation slowed from 0.7% MoM to 0.3% MoM, leaving the annual rate at 5.9%. In addition to the sharp fall in energy prices, cheaper airfares, as well as lower prices for car rental and lodging helped to reduce inflation amongst other things. The S&P 500 rose in the aftermath of the softer inflation data and gained 3.3% last week as fading price pressure will help the Fed to slow down its aggressive tightening path. Although these numbers are in line with our view that inflation has peaked, the FOMC is unlikely to move swiftly to a more dovish stance in the near term as some of the stickier components remain at very elevated levels. Meanwhile, the University of Michigan's consumer sentiment survey reveals that households' mood has improved in August, helped by the recent fall in gasoline prices and rising expectations. Small business optimism ticked up slightly in July though it remains close to the lowest level in a decade while plans to raise prices dropped significantly.

China

The PBoC cuts policy rates amid dreadful economic data for July

China's economic indicators for July disappointed across the board. Aggregate financing came in far below expectations, negatively impacted by the mortgage crisis. (See our Topical Thought Will China's mortgage crisis be contained?) Meanwhile, the reopening recovery seems to have stalled, with retail sales growth and service sector growth slowing again. Shallow improvements in manufacturing and infrastructure investments could not make up for a further contraction in property investments. New housing starts, home sales and house prices continue to fall. Industrial production growth retreated only slightly, supported by resilient exports. We believe, however, that exports will come to suffer as global demand for Chinese products is expected to stall. (A more detailed discussion thereof can be found in our Topical Thought China's *reasonable* growth prospects). While the overall labour market appears resilient, we are concerned by rising youth unemployment. In an unexpected move, the PBoC cut both the seven-day reverse repo rate and the MLF rate by 10bps.

Japan

PM Kishida reshuffles the Cabinet and top LDP positions

PM Kishida reshuffled his Cabinet and key ruling LDP posts following the win of the Upper House election. Cabinet ministers had to clarify that they do not support the Unification Church, which has been under strict public scrutiny following former PM Abe's assassination. The murderer argued that his family had been ruined due to the large donations by his mother, which had focused public attention on political support for the controversial church. In the new Cabinet, the focus will be on Sanae Takaichi, the economic security minister and one of only two women in the Cabinet, as well as digitalisation minister Taro Kono. Both had been Kishida's contenders for the race to become prime minister. Meanwhile, on the economic front the household component of the Eco Watchers Survey for July plunged by more than ten points to 42.6 amid the surge in new Omicron infections. Q2 GDP was up 2.2% in sequential annualised terms, driven by private consumption as well as private and public investment, but distorted by changes in inventory.

Switzerland

Price pressures are easing on a strong currency and slowing global growth

The combined producer and import price index fell in July for the first time this year, with the annual rate of inflation edging down from a 40-year high. Consumer prices were unchanged on the month, helped by a sharp decline in imported inflation and benign domestic inflation, with annual core CPI now at 2%. The PMI survey for July showed a similar pattern. While overall conditions for economic activity remain favourable, the data indicate a swift return to more normal pricing and supply conditions in both services and manufacturing. The share of companies that reported rising input prices slumped from a historical high, order backlogs and delivery time declined further, and goods inventories surged. Hiring plans also continued to retreat, taking some pressure off the tight labour market. We expect price pressures to continue to ease, though the outlook for gas and energy prices remains a key risk. The SNB sent a strong signal that it is not done tightening, and further rate hikes are likely over coming months.

LatAm

Argentina's monthly inflation jumps to 7.4% in July, the highest in twenty years

In Argentina, inflation jumped to 7.4% MoM in July, rising to 71% YoY. The monthly print was driven by the strong widening of the gap between the market and the official FX, which was triggered by the resignation of Economy Minister Martin Guzman. The central bank hiked the policy rate by 950bps, reaching 69.5%. In Brazil, inflation fell 0.68% MoM in July, driven by the impact of recent tax cuts on fuel and electricity and the gasoline price cuts by Petrobras. On an annual basis, inflation decelerated from 11.9% to 10.1%, with service prices under pressure.

In Mexico, inflation is still not showing signs of abating and continues to be driven mainly by the prices of processed food and services. Headline inflation reached 0.74% MoM in July, accelerating from 8.0% to 8.15% YoY. Banxico hiked the policy rate by 75bps to 8.5%, increasing its short-term inflation forecast and expecting inflation to converge to the target by Q1 2024. The statement also adjusted the forward guidance, suggesting a reduction in the pace of rate increases in future meetings.

Credit

Credit spreads grind tighter amid better inflows

Better than expected US inflation data and lower volatility helped corporate bond spreads to resume their tightening move. High Yield bond spreads had another strong week and tightened for the sixth consecutive week. The US primary market continues to surprise to the upside in terms of activity with the weekly volume of USD 30bn surpassing broker forecasts. Issuance volume of the past two weeks has already exceeded that of the full month of August 2021. In contrast, European primary activity remained subdued due to the holiday season, with only three issuers and the second lowest weekly volume of the year. Inflows remained positive for a second straight week for US Investment Grade and for the fourth week in the US High Yield space. In Europe, the good performance during July benefited IG funds, which recorded their best inflow for the year so far. We think spreads should remain supported in the near term with better supply/demand technicals due to a seasonal decline in supply and improving inflows.

What to Watch

- In the US, the focus will be on housing data that are expected to show further weakness following last month's steep fall in the home builder index.
- In the Eurozone, the ZEW survey and various macroeconomic data will give more insight into the state of the economy.
- In APAC, we expect the Philippine central bank BSP to hike policy rates by 25bps following its surprising 75bp hike in July. July export statistics will be reported in Japan, Malaysia, Indonesia, and Singapore. In Australia, we will focus on the RBA minutes, wage data for Q2 and the July labour survey. Japan will report CPI data for July. Markets will be closed on Monday in South Korea and India, on Wednesday in Indonesia and on Friday in India.

Disclaimer and cautionary statement

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