

# Weekly Macro and Markets View

8 August 2022



## Highlights and View

### US service activity picks up in July while new nonfarm payrolls soar

The latest batch of economic data reflect the current strength of the US economy and help mitigate worries about an imminent recession.

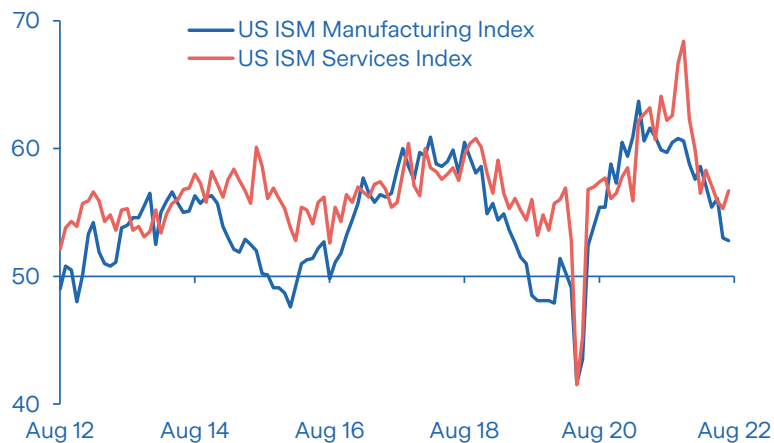
### The final Eurozone Composite PMI falls from 52.0 in June to 49.9 in July, while retail sales fall sharply in June

The data reinforce our view that the Eurozone will probably fall into recession later this year.

### The BoE lifts the Bank rate 50bps to 1.75% as inflation keeps rising

Given the expected increase in the energy price cap, the BoE has substantially revised up its forecast for the peak level in headline inflation.

## Solid business activity and payrolls mitigate US recession worries



Source: Bloomberg

Last week brought more evidence that near-term recession risks in the US are low despite a second consecutive drop in GDP published the week before. While the ISM Manufacturing Index ticked down slightly, the ISM Services Index rose to 56.7 in July against consensus expectations of a fall to 53.5. Service activity is holding up well with new orders picking up to the highest since March while prices paid fell to the lowest since February 2021, indicating that price pressure is fading further. Underlining the current strength of the economy 528'000 new nonfarm payrolls were created in July, more than double the number expected by consensus. The unemployment rate ticked down to 3.5%, a new post-pandemic low. Although the labour market remained tight in July there were more signs of a softening at the margin. The number of job openings fell by more than 600'000 in June, further narrowing the gap between open jobs and the number of unemployed people. Meanwhile, initial jobless claims ticked up to 260'000 last week while continuing claims rose to 1.416mn, the highest since April. Bond yields jumped on the stronger economic numbers while equity markets were caught between relief about reduced near-term growth risks and renewed worries regarding a continuation of aggressive monetary tightening by the Fed.

## Eurozone

Final PMIs confirm the economy is rapidly losing momentum

In contrast to the US, the final Eurozone PMIs showed that the region's economy is rapidly losing momentum and likely to fall into recession later this year in our view. Admittedly, both the Manufacturing and Services July PMIs were revised up slightly compared to their flash estimates. However, the upward revisions were minor compared to the decline from June to July. The Manufacturing PMIs for all four of the Eurozone's largest economies are now below 50. What's more, forward-looking indicators within the survey, such as new

orders, continue to deteriorate rapidly. Meanwhile, high inflation is also affecting retail sales and consumer spending. Eurozone retail sales fell 1.2% MoM in June (-3.7% YoY), with most categories of spending down on a MoM and YoY basis. Unfortunately, with headline inflation likely to move even higher and probably breach 10% YoY due to the recent spike in European natural gas prices (up around 250% since mid-June), the crunch on households' real spending power will only grow worse over the next few months.

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## APAC PMIs

A mixed bag

APAC July PMIs reveal a mixed picture both in terms of levels and directions. On the positive side, India stands out with its Manufacturing PMI increasing by 2½ points to 56.4, while PMIs in Indonesia and Thailand are advancing within expansionary territory. Meanwhile, Taiwan stands out on the negative side, with its Manufacturing PMI tumbling by 5.2 points to 44.6. We believe slower semiconductor production and exports are behind this remarkable contraction, which is also visible in South Korea (down 1½ points to 49.8), though not

to the same extent. In China, both the NBS and the Caixin Manufacturing PMIs dipped back again following last month's reopening boost. The NBS and Caixin Services PMIs showed contradictory messages, most likely due to the different survey periods in July. We note that China's Construction PMI rose 2.6 points to 59.2, probably due to surging infrastructure investment, despite a weak property market. One feature is common in APAC: New Export Order PMIs are falling nearly across the board, led by Taiwan.

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## Australia

The RBA increases rates by 50bps and raises inflation expectations for 2022

The RBA raised its policy rate by 50bps to 1.85% in August, and we expect the cash rate to increase by a further 50bps in September. In the quarterly Statement of Monetary Policy, the RBA lifted its inflation forecast for 2022 to 7.8% and to 4.3% for 2023, with both revisions higher than analyst expectations. The revision shows that the increase in underlying inflation pressures will take longer to resolve and that headline inflation is not expected to return to the target band until 2024. The RBA also revised its GDP growth forecast down for 2022 to

3.2% and to 1.8% for 2023 to account for the expected impact of higher interest rates. Housing data have started to soften on concerns of higher mortgage rates, with the CoreLogic house price index falling by 1.4% in July, and by 2.5% over the past three months. The value of Australian home loans also declined by 4.4% MoM in June. The correction in Australia's housing market will continue in the coming months as the impact of further rate hikes takes effect.

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## LatAm

The Central Bank of Brazil (BCB) hikes the policy rate to 13.75%, but the tightening cycle is coming close to its end

In Brazil, the BCB hiked the Selic rate by 50bps to 13.75%. The statement noted that the inflation forecasts for 2022 and 2023 were heavily impacted by temporary tax cut measures and therefore opted to change the relevant horizon of monetary policy to Q1 2024, downplaying the higher than target inflation estimate for 2023. The BCB mentioned it will evaluate the need for an adjustment of lower magnitude in its next meeting. Given the deflation print expected for the next couple of months and the global economic outlook, we believe the BCB will

likely pause the tightening cycle. In Argentina, the new economy minister announced measures to reduce the fiscal deficit and support FX reserves. Nevertheless, the details were sparse and the implementation will likely be challenging. We believe these measures are a step in the right direction but are insufficient to stabilise macroeconomic imbalances. Furthermore, no changes to the current FX regime were unveiled, while currency devaluation pressure and inflation expectations are increasing.

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## Credit

No summer break for US issuers yet

Credit spreads continue to benefit from better market conditions and lower volatility, tightening last week with HY outperforming IG both in Europe and the US. Activity in the US IG primary market surged unexpectedly with USD 56bn of new bond sales. Issuance volume was boosted by tech companies with an inaugural transaction from Meta, which sold USD 10 bn in bonds to investors, but also jumbo deals from Intel and Apple. Junk issuers took advantage of the better market conditions with two companies selling bonds on Thursday, the first multi-

deal session since the beginning of June. It was a strong contrast to Europe, where issuers sold a mere EUR 2.6bn, the second lowest weekly volume of 2022. Encouraging signs also materialised on the demand side. US IG funds experienced their first inflow since March, breaking a 18-week record streak of outflows. In Europe, IG funds recorded a strong inflow, the largest in 38 weeks and so far this year.

## What to Watch

- In the US, investors will focus on the latest set of inflation numbers, which are expected to show fading price pressure.
- In APAC, we will focus on Australia's latest consumer and business surveys, Japan's July producer prices and China's July inflation and credit data. We expect the Bank of Thailand to hike its policy rate by 25bps to 0.75%. Taiwan, Malaysia, and the Philippines will report Q2 GDP data. Markets will be closed on Tuesday in India and Singapore, on Thursday in Japan and on Friday in Thailand.
- In Mexico, we expect Banxico to raise the policy rate by 75bps and inflation will likely continue to increase. In Brazil, the tax cut measures will probably drive deflation in July, while in Argentina, inflation is expected to surpass 70% YoY.

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