

Weekly Macro & Markets View

Highlights and View

- **US inflation rates pick up further, though much remains driven by transitory factors**

Used cars, airline fares and lodging continue to drive much of the acceleration, but some underlying trends are expected to be more sustainable.

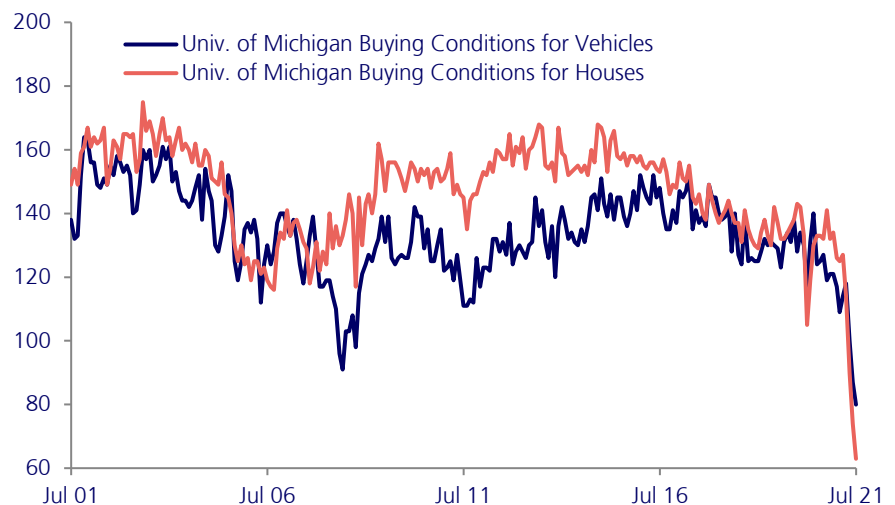
- **China's economic indicators for June and Q2 surprised to the upside**

We are sticking to our above consensus 8.8% GDP growth forecast for 2021, but are closely monitoring service-related segments and the property market for risks.

- **The European Commission unveiled its "Fit for 55" environmental plans last week**

The plans could transform the way economic activity is carried out in Europe and will have important sectoral implications if implemented in full.

Rising prices weigh on the mood of US households



Source: Bloomberg

The S&P 500 ended the week 1% lower, despite reaching a fresh all-time high on Wednesday, as investors took a step back to digest the latest batch of economic data as well as a number of mixed earnings reports from major banks. Inflation rates accelerated further in June with the headline CPI rate reaching 5.4% YoY. Core CPI rose at an annual rate of 4.5%, the highest in three decades. Transitory components such as used cars, airline fares and lodging continue to drive much of the acceleration, though as we have mentioned in prior publications there are some underlying trends that could prove more sustainable, particularly around shelter costs. Consumer-related data sent mixed messages last week. Retail sales recovered in June from the dip the month before, rising 0.6% MoM. However, the University of Michigan's consumer sentiment index fell back to the lowest level since February as both the perception of the current situation as well as expectations came under pressure. Rising prices for big ticket items are weighing on households' mood and could provide some headwinds for consumer spending in the months ahead. On a more positive note, small business optimism improved to the highest since last October as first signs of an easing in the labour market bottleneck are visible, probably helped by a marked pickup in compensation plans.

China: Economic activity better than expected, but risks linger

China reported Q2 GDP data as well as June activity data. Looking at YoY comparisons is misleading due to severe base effects, so we prefer to focus on sequential data. GDP growth recovered from an annualised rate of 1.6% in Q1 to 5.3% in Q2. Growth picked up steam in services related sectors and construction, remained stable in manufacturing and financial services industries, and slowed in the property sector. Most of the June activity indicators came in better than consensus had expected, particularly those for exports, industrial

production, public and manufacturing investment, as well as retail sales. Capacity utilisation in the manufacturing sector even hit a nine-year high. Infrastructure investment growth is slowing amid less fiscal support, while property investment remains brisk, though we anticipate a slowdown as the pipeline for new projects is getting shorter. Consumption is facing constraints due to lower auto sales amid supply bottlenecks, a setback in IT-services and flare ups of Covid cases here and there.

Japan: Our economic recovery scenario is confirmed by solid economic indicators

The Bank of Japan left its monetary settings unchanged, while continuing its tapering process by reducing JGB purchases. ETF purchases have come to a standstill, and we assume that they will only be used as a policy tool in case of turmoil in the equity market. The growth forecast for this fiscal year has been slightly lowered, but lifted higher for next fiscal year, while the higher CPI forecast is based on energy price inflation. The BoJ also elaborated on its Strategy for Climate Change. Turning to economic indicator releases, we feel encouraged in our positive

view about the economic recovery. Machinery orders for May were particularly strong for electric machinery, while machine tool orders for June surged both in terms of domestic and overseas orders. The Reuters Tankan survey for July painted a positive picture as well. The diffusion index for the manufacturing sector climbed another three points to 25, the 13th increase in a row, to levels last seen in late 2018. The non-manufacturing index fell back to negative territory, but the outlook component remains in positive territory.

Eurozone: European Commission unveils its ambitious "Fit for 55" environmental plans

The "Fit for 55" initiative aims to reduce greenhouse gas emissions by 55% or more from 1990 levels by 2030. The plans are extremely ambitious and if implemented in full would transform the way economic activity is carried out. They include: 1) an aim of zero emissions by 2035 for passenger cars and light trucks, which would imply the complete phasing out of diesel and petrol cars in favour of electric vehicles and mean having a network of electric charging stations, 2) expansion of the Emission Trading System for carbon to the road transport, building, airline

and shipping sectors, 3) the imposition of a carbon border tax by 2026 that would tax polluting imports, 4) a target of at least 40% of power generation from clean/renewable sources by 2030, and 5) a EUR 70bn fund to help lower income households deal with higher energy costs. The final plans may be changed and watered down somewhat as some countries have already voiced objections, but we expect legislation similar to the current plans to eventually be passed in the European parliament, with important sectoral implications.

UK: Strong job gains in June

Inflation rates accelerated further in June with the headline CPI rate reaching 2.5% YoY, the highest level since 2018, up from 2.1% in May. Core inflation rose to a slightly more modest 2.3% YoY, up from 2.0% the month before. Similar to the months before, price rises linked to the reopening of the economy were responsible for a major part of the overall increase. While these effects are expected to be transitory, inflation rates will remain above the Bank of England's (BoE) target for the foreseeable future. Nevertheless, the Monetary Policy Committee

(MPC) is likely to tolerate the overshoot in inflation. Andrew Bailey, the BoE's governor, has recently warned against prematurely tightening monetary policy. The latest labour market report shows substantial job gains in June, according to the Office for National Statistics (ONS). That is the second consecutive robust pickup, though total employment remains 206,000 below pre-pandemic levels. Wage growth (ex-bonuses) accelerated to 6.6% YoY from 5.7% the month before.

LatAm: Improvements in the Covid situation would continue to support economic activity

In recent weeks, the health situation has improved in Brazil and Chile, with significant drops in new Covid cases and lower hospitalisation rates and occupancy of ICU beds. Chile continues to lead in vaccination in the region, while in Brazil, the process is accelerating with 1.5mn doses on average per day. In Chile, the central bank started a gradual normalisation process, raising the policy rate by 25bps to 0.75%. However, the policy rate would remain below its neutral value over the two-year policy horizon. The results of the presidential primary elections

surprised both the centre-right and left coalitions. In the former, an independent candidate won, while the communist candidate was defeated in the latter. We believe that these results could be well received by the market. In Brazil, the service sector is showing improvement, growing 1.2% MoM in May. The highlights were services to families and tourism, which grew ~18% MoM. The economic activity index disappointed, falling 0.4% MoM in May, though the April result was revised up.

What to Watch

- The G3 flash PMIs are expected to show that growth remains well above trend, but it will be important to remain observant for signs that growth may be peaking
- In the Eurozone, the ECB meets to decide monetary policy for the first time since its strategic review and is likely to enhance forward guidance and make other changes to its communication
- In Japan, the Olympics will start on Friday. Thursday and Friday will be closed due to national holidays. Before that, June CPI and export data will be reported. We expect Bank Indonesia to keep policy rates unchanged. Taiwan will report export order, industrial production, and labour data for June. Australia will release its July PMIs as well as NAB business confidence for Q2 and Westpac leading indicators for June. CPI data for June will be reported in Malaysia, Hong Kong, and Singapore. Markets will be closed on Tuesday due to a Muslim national holiday in several ASEAN countries.

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Investment Management
Mythenquai 2
8002 Zurich

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