August 2, 2021

Weekly Macro & Markets View

Highlights and View

- **Latest FOMC comments slightly more hawkish than expected, but no clear indication regarding the start of tapering.**

  As the narrative has moved from inflation to employment, investors' focus will likely be on the next two job reports prior to the September FOMC.

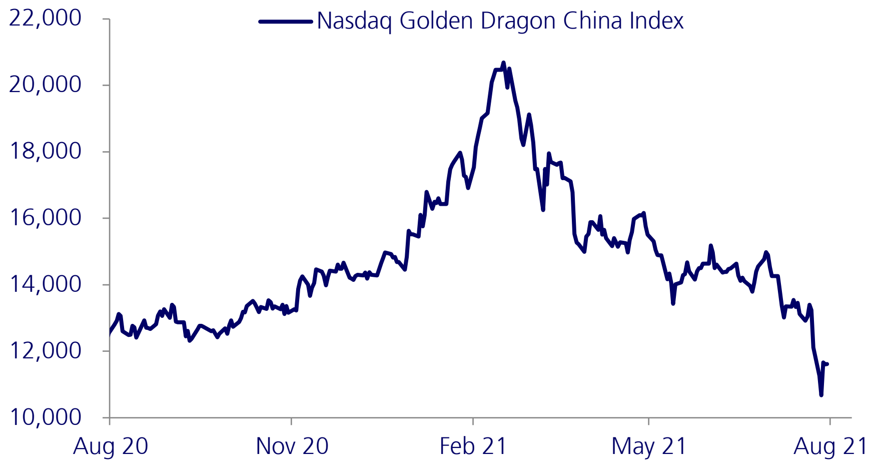
- **Measures taken by China's regulators against new economy companies with US listings hit global investor sentiment**

  We believe that China's government will continue to address domestic policy issues, but may act more carefully in the future to avoid severe capital market friction.

- **ASEAN becomes a Covid epicentre in Asia with the rapid spread of the Delta variant**

  Lockdowns and social restrictions have a significant drag on economic activity. We expect the region's output to contract noticeably in Q3.

China's crackdown on new economy companies is hitting investors



Source: Nasdaq, Bloomberg

China's regulators continue to tackle 'new economy' companies in an overarching move to show social responsibility. What started in an anti-monopolistic move against Alibaba's Ant Financial was followed by measures tackling internet giant Tencent to protect client data and continued in restricting Didi's passenger transportation platform on concerns that sensitive data might become visible to foreign investors. In the latest move, tutorial education companies were prohibited from generating profits, and plans for a foreign investor ban were announced. China's new economy stocks were hit by another selling wave that even affected global investor sentiment. Companies with common stock listed in the US were at the centre of the storm (see chart), while major Chinese equity indices like the HSCEI, comprised of Hong Kong listed 'H'-shares, as well as the MSCI China, tumbled more than 10% last week and were down about 30% from their February highs. Even the CSI300, the 'A'-share index driven by domestic retail investors, suffered a blow. As Chinese stocks comprise about one third of the MSCI Emerging Markets Index, EM underperformance versus the MSCI World accelerated. The 'buy-on-dip' mentality of retail investors as well as comforting remarks from China's regulators induced a knee-jerk reaction to the upside, while we suspect that institutional investors have room to further reduce previously accumulated positions in Chinese equities.

Credit: Chinese credit takes a hit, CCC rated bonds and energy lag in US high yield

Following China's escalating crackdown on new economy companies last week, Chinese corporate credit spreads widened as concerns about the A-rated tech sector added to the existing concerns about high yield (HY) defaults, epitomized by the ongoing saga of Evergrande. The property developer, Asia's biggest issuer of HY dollar bonds, saw its rating cut deeper into junk by S&P and Fitch last week, following a similar action by Moody's in June. Credit stress in China, the second-largest domicile of HY dollar debt, could test the nerves of the global HY market. Fund managers incurring losses in their Chinese portfolios could lower risk across all their portfolios, including US ones. Such a development would be an additional headwind to US HY, which has already shown signs of vulnerability in the past few weeks. Investors' growth concerns have resulted in a rising high yield/investment grade spread ratio and in underperformance of energy and CCC rated bonds versus the index, given fluctuating oil prices and lower rated companies' larger exposure towards reopening-sensitive sectors.

Eurozone: Q2 GDP better than expected, while EC survey at highest level ever

As expected, the Eurozone officially exited recession in Q2. Indeed, the first estimate of second quarter GDP growth was even higher than expected, at 2.0% QoQ versus consensus expectations of 1.5% QoQ. Individual Eurozone countries reported that domestic demand, especially household consumption, was the main driver of growth. What's more, the strong pace of growth seems likely to continue in Q3, given continued strong business surveys. For example, last week the European Commission's economic sentiment indicator increased to its highest level ever, reaching 119.0 in July from 117.9 in June, which was itself a 21-year high. While the second and third quarters are likely to represent the peak in growth for the region as it bounces back sharply from the Covid crisis, we expect the expansion to continue into next year supported by the NextGenEU spending initiative as well as continued recovery from the Covid crisis. Eurozone equity markets were broadly flat over the week as investor concerns over the Delta variant appeared to diminish somewhat.

Japan: Counting both Olympic medals and new Covid cases

Social media trackers are confirming that the mood has changed from a strong anti-Olympics attitude towards a more favourable assessment, with the remarkable success of Japan's Olympic athletes (17 gold medals so far) certainly contributing. On the other hand, the surge in new Covid infections during the current fifth wave of the pandemic to a record high is dampening sentiment. In addition to Tokyo, the state-of-emergency has been expanded to three neighbouring prefectures within the Greater Tokyo area and Osaka. However, we note that the number of fatalities is stabilising at a low level, as about two thirds of the elderly are already fully vaccinated. Turning to economic indicators for June, there is evidence that our more optimistic view of the economy is being confirmed. Industrial production bounced back, driven by a 'V'-shaped recovery in the auto sector, while retail sales were stronger than consensus had expected, driven by strong sales of apparel and general merchandise. Meanwhile, the labour market is stabilising as the jobs-to-applicants ratio continues to bottom out.

ASEAN: Covid-19 doom and gloom

ASEAN faces considerable setbacks due to the rapid spread of the Delta variant. The region has become an epicentre in Asia, with Indonesia reporting more than 40k cases a day, followed by Thailand and Malaysia with the number of daily cases at around 15k. Hospitals are operating with tight capacity, leaving many patients with severe symptoms untreated, notably in Indonesia. The vaccination rates in most countries are still low, except for Malaysia and Singapore. Singapore is the first Asian economy with 70% of its population having received at least one dose. Malaysia has also ramped up vaccine administration drastically. For the time being, lockdowns and tightened social restrictions remain the key measure for most countries in combating the pandemic. As lockdowns weigh heavily on economic activity, the region is likely to experience a sharp contraction in output in Q3. One of the brighter areas of the economy is probably exports. The latest export data for June and July in Malaysia, Thailand and Vietnam held up well, supported by strong global demand for commodities and electronics.

LatAm: The IMF expects a robust economic recovery, but still below pre-crisis level

The IMF upgraded LatAm growth expectations from 4.6% to 5.8% in 2021 and from 3% to 3.2% in 2022, mainly driven by a better economic outlook for Brazil and Mexico. The IMF expects Brazil and Mexico will grow 5.3% and 6.3%, respectively, in 2021 and 1.9% and 4.2%, respectively, in 2022. In Mexico, the flash GDP for Q2 showed an acceleration in economic activity, but it was below market expectations. GDP grew by 1.5% QoQ in the Q2, driven mainly by the services sector due to the reopening of the economy. Despite the increase in the number of new Covid cases and rate of positivity, vaccination in Mexico lags the region. Brazil and Chile continue to make progress in reducing restrictions associated with the pandemic. In Brazil, unemployment remains high at 14.6%, but with solid employment growth, compensated by a higher participation rate. Market expectations for inflation for this year continue to rise, reaching 6.3%, while the figure for 2022 remains relatively stable at 3.8%. We expect a 100bp increase in the Selic rate this week.

What to Watch

- In the US, the ISM Manufacturing PMI will show how companies are faring in meeting demand amid bottlenecks. The ISM Services PMI will show whether services activity is in line with Q3 growth expectations. Labour market data will be particularly scrutinized to infer when the Fed will signal the start of tapering.
- In APAC, we expect Australia's RBA, India's RBI and the Bank of Thailand to keep policy rates unchanged. Most APAC countries will release or revise July PMIs, while several countries will publish CPI data for July. Japan will release July consumer confidence and Tokyo CPI data for July as well as wages and the household survey for June. China will report July export data next Saturday. Australia will release house price data for July, building permits for June as well as retail sales data for June and Q2. Note that several markets will be closed due to country specific holidays.
- Higher inflation expectations should push BCB to raise the Selic rate by 100bps to 5.25% in Brazil. In Chile, we expect monthly economic activity to continue to recover and an acceleration in inflation.

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

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