August 9, 2021

# Weekly Macro & Markets View

## Highlights and View

- **The employment situation in the US shows further significant improvement**

  While still some way off pre-pandemic levels, strong labour market data will move the Fed closer to tapering its asset purchases.

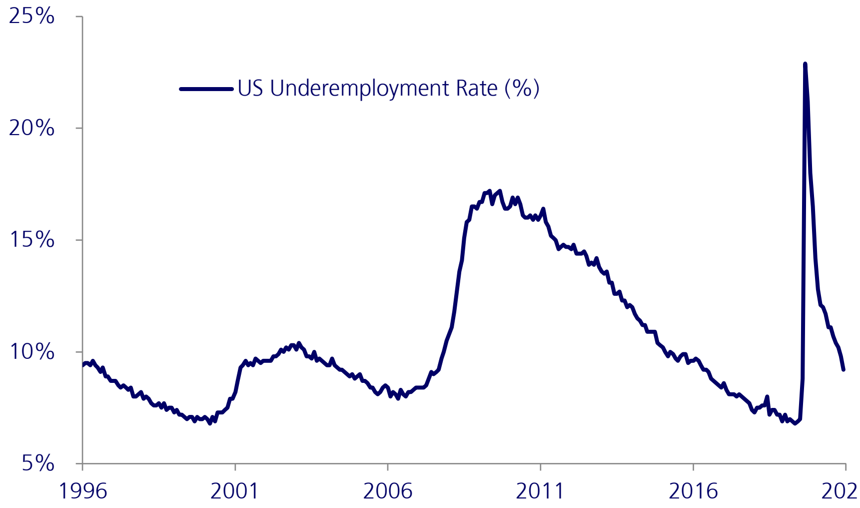
- **Industrial production in Germany fell a third consecutive month, by -1.3% MoM in June, disappointing expectations**

  Semiconductor shortages remain a persistent issue in the auto sector, but strong order data suggest that if these shortages can be overcome, industrial output will bounceback.

- **Central banks turn more hawkish globally as indicated last week by the central banks of the UK, Brazil and South Korea**

  The trend towards monetary tightening is likely to continue, which is expected to increase volatility in financial markets.

## A big step closer to Fed tapering




Source: Bloomberg

Given the Fed's recent emphasis on further progress in the labour market, investors focused on the latest set of employment data published last week. 943'000 new nonfarm payrolls were created in the US in July, and June's number was revised up to 938'000. Meanwhile, the unemployment rate fell sharply to 5.4% from 5.9% the month before while wage growth accelerated to 4% YoY. The broader underemployment rate, which includes those marginally attached to the labour market and those having to work part-time for economic reasons, has fallen even faster to 9.2% from 9.8% indicating strong improvements in the employment situation. Though still some way off pre-pandemic levels, almost two million new jobs in the last two months will move the Fed a big step closer to achieving its second mandate and is likely to ignite more discussions regarding the future path of monetary tightening. Bond yields rose in the aftermath of the strong labour market report with 10yr Treasury yields climbing back towards 1.30% from an intra-week low of 1.13%. Business activity remains very strong as indicated by the ISM surveys, with the services industry showing particular strength as new orders and employment both picked up in July while price pressure remains very high in both manufacturing and services.

## UK: The BoE provides more details on its path towards policy tightening

The final reading of the Services PMI for July was revised up by almost 2 points to 59.6, indicating less of a slowdown compared to the month before and reflecting a continuation of very strong activity in the service sector. Meanwhile, investors' focus was on the Bank of England (BoE) last week. As expected, the Monetary Policy Committee (MPC) made no changes to its current policy, but it did provide some details regarding the future policy path. It confirmed that reducing the balance sheet after the QE-induced gilt purchases will be a two-step process in which the Bank will first stop reinvesting maturing assets, followed by active sales at a later stage. The MPC revised down the level of the Bank Rate at which it intends to stop reinvestments from 1.5% to 0.5% and introduced a new threshold of at least 1% for the active sale of assets. While policy tightening is still some way off, the BoE could start to hike rates in the first half of 2022 if the economy keeps expanding as expected.

## North Asia: Covid is hitting back in Japan and China

New Covid cases have surged in Japan and China. Following record-high new infections in Japan, more prefectures have been put under stricter restrictions and hospitals are facing constraints in accepting new patients, even though fatalities remain low. In China, Delta cases have quickly spread from the city of Nanjing to other provinces, with new mobility restrictions imposed. Following the recent rebound, services consumption is expected to suffer again in both countries. In Japan, wage income fell in June, pulled down by a sharp drop in the summer bonus. Household spending fell accordingly, though we believe consumption will pick up this autumn once new Covid infections have peaked. In South Korea, statements by several Bank of Korea policy board members suggest that a policy rate hike is imminent, even though we believe the latest spike in inflation is a temporary phenomenon. Export growth seems to be stalling but exports remain brisk, far above pre-Covid levels, while Taiwan's electronics sector remains in excellent shape. Covid cases have peaked in Taiwan and vaccinations keep rising steadily.

## APAC: July PMIs paint a mixed picture

ASEAN Manufacturing PMIs deteriorated markedly from 49 to 44.6 in July, with Indonesia's PMI tumbling 13.4 points to only 40.1 amid the severe impact of the latest Covid infection wave. Indonesia's new export order index has nearly halved to an alarming level of 26.6. Within ASEAN, Singapore remains the bright spot, benefitting from its brisk export driven electronics sector, similar to Japan, South Korea and particularly Taiwan, where the Manufacturing PMI recovered close to the 60 mark. Australia's PMI is leading within APAC, though economic conditions have started to falter again mainly due to Covid. China's Manufacturing PMIs have deteriorated further but remain just above the boom/bust line of 50. In Asia ex Japan, we note that the manufacturing new order-to-inventory index has not only rolled over but has fallen more steeply than the respective global index, which we interpret as a warning signal. Services PMIs tend to reflect Covid waves and suggest that the latest recoveries in China and Japan do not yet indicate a sustainable turn for the better.

## Australia: The economic impact of lockdowns becomes more evident

The latest economic indicators show the negative impact of lockdowns on economic activity. Payroll jobs for the two weeks ending July 17 declined by 2.4% compared to the previous fortnight. Retail sales fell by 1.8% MoM or 2.9% YoY but remained 10% above the pre-pandemic level. Lockdowns led to consumers shifting from in-store purchases to online shopping, with online sales surging. Australia remains a beneficiary of the commodity upswing. The trade balance hit a record high in June, bolstered by iron ore exports. Despite lockdowns, house prices were up by 1.6% MoM or 16.1% YoY. However, both home loans and building approvals fell. We think the rise in house prices will slow as housing affordability declines. While the RBA maintained its narrative of no rate hikes until 2024, it confirmed that it intends to taper QE from September. Due to the new Covid wave, Australia has deviated from the recovery trend seen in other developed markets. However, we think the rebound will be swift once the vaccination program reaches a significant milestone in Q4.

## LatAm: Inflation turns the central banks more hawkish

The Central Bank of Brazil accelerated the normalisation process, hiking the Selic rate by 100bps to 5.25% as expected but with a more hawkish tone, signalling a further increase of the same magnitude for the September meeting. The committee justified the decision due to the recent deterioration of the inertial components of inflation, which could further increase inflation expectations. In addition, inflation has been persistent with new price pressures from electricity and food and some core inflation components. Against this backdrop, the monetary policy committee (COPOM) considers it appropriate to move the Selic above neutral. In Chile, monthly economic activity surprised to the upside, growing 2.1% MoM, with all sectors contributing positively. Economic activity rose 20.1% YoY, reaching 2.2% above the pre-pandemic level, with consumption as the main driver boosted by the pension fund withdrawals and the fiscal stimulus. Inflation was also above market expectation, accelerating from 3.8% to 4.5% YoY. Although energy prices contributed the most to the surprise, the rise in prices was broad.

## What to Watch

- In the US, investors will focus on the latest set of inflation data while the NFIB small business survey and the University of Michigan's consumer confidence index will provide important insights into the current state of the economy.
- In APAC, we expect the BSP, the central bank of the Philippines, to keep policy rates unchanged. Q2 GDP data will be reported in Hong Kong, Singapore, Malaysia, and the Philippines. In China, money supply and credit data for July will be released, while in Japan our focus is on the Eco Watchers July survey. Consumer and business confidence data will be reported in Australia. Markets will be closed on individual days in Japan and several ASEAN countries due to local holidays.
- We expect the Central Bank of Mexico to hike the monetary policy rate by 25bps, and inflation data for July will be released. In Brazil, the focus will be on inflation, retail sales, economic activity, and the minutes of the last policy meeting.

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