August 16, 2021

Weekly Macro & Markets View

Highlights and View

- **The spread of the Covid Delta variant is adding to China's growth slowdown in Q3**

  We expect monetary and fiscal policy to help stimulate growth into Q4.

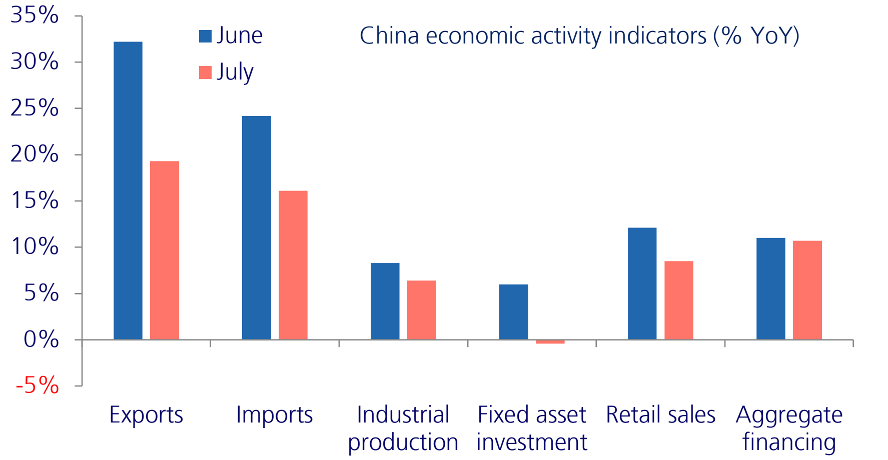
- **The University of Michigan's consumer sentiment index falls to the lowest since 2011**

  Elevated price levels weigh on households' mood as buying conditions for houses and vehicles are the worst in decades.

- **Eurozone companies saw very strong earnings growth in Q2, led by the energy sector**

  The strong economic rebound supported corporate earnings and should continue in Q3.

China's economic activity is slowing, while the Delta variant spreads



Source: NBS, CGA, PBoC, Capital, Bloomberg

The Covid Delta variant is spreading quickly from the Eastern city of Nanjing to other provinces and cities. As of today, China has defined 27 high-risk and 129 medium-risk areas, most of them in the provinces of Jiangsu, Henan and Hunan. Severe lockdown measures have been triggered, including closing highways and metros, mobility controls and tourist and entertainment sites to avoid accelerating infections. So far, both new and active infections remain miniscule in an international comparison. To put this into perspective, on a per-capita basis, Switzerland, for example, has about 2,500 times more active infections than China, while new Swiss infections on Friday alone exceeded China's total active cases. However, lockdown measures will slow private consumption in China in Q3, particularly in services, and may even impact foreign trade as one of the busiest harbours on the Eastern coast has been partially closed. Activity data for July, published today and last week, reveal deteriorating economic conditions. Export growth has retreated particularly for home appliances and furniture, with slowing demand in the US, the EU and ASEAN. Import volumes are shrinking, particularly for commodities. Retail sales, industrial activity and investment spending slowed markedly, while credit growth moderated on tighter housing market and shadow banking policies. We expect monetary and fiscal policy will help to alleviate pressures.

US: Consumer sentiment suffers as buying conditions deteriorate further

The S&P 500 kept grinding higher to reach yet another record high last week. Investors focussed on the latest set of inflation data, which was in line with expectations and thus had only a minor impact on both bonds and equities. Headline CPI remained at 5.4% YoY in July while Core CPI receded slightly to 4.3% YoY from 4.5% the month before. As expected, some of the recent distortions in areas like used cars or airfares show signs of easing, confirming our view that most of the recent spike in inflation is likely to prove transitory. Meanwhile, elevated price levels continue to weigh on households' mood with the University of Michigan's consumer sentiment index falling to the lowest since 2011. Buying conditions for houses and vehicles are the worst in decades. Small business optimism also deteriorated in July with difficulty filling job openings surging to a new record high, reflecting ongoing bottlenecks in the labour market. Highlighting the distortions, the number of job openings reached more than 10 million in June – the highest number ever.

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Eurozone: As the economy recovers, companies report strong earnings growth in Q2

With nearly all companies due to report having now done so, we can see that the second quarter experienced very strong corporate earnings growth in the Eurozone. Overall earnings growth was around 68% YoY in Q2, which was a positive surprise of 17 percentage points higher compared to consensus estimates. The sector with the fastest earnings growth was energy, due to higher oil and gas prices, but all sectors reported positive earnings growth. Revenue growth was also strong, showing the positive impact of the economic rebound. We expect this effect to support earnings in Q3 as well. Admittedly, the forward-looking German ZEW expectations index and Eurozone Sentix investor confidence survey both fell last week. Germany's ZEW Expectations index fell from 63.3 in July to 40.4 in August, versus consensus expectations of a more modest fall to 55.0. These surveys are still at decent levels by historical standards, but they may be pointing to somewhat of a deceleration in the pace of growth in the Eurozone later in the year.

Switzerland: Hiring plans pick up, helping to sustain a strong recovery

The recovery remains in place, continuing to be led by the industrial sector. The Manufacturing PMI rebounded to a new high in July, with 73% of businesses reporting stronger activity vs June. Accelerating employment plans are encouraging as they show that businesses are adjusting capacity to meet demand, which will help to prolong the expansion. While the Services PMI and the KOF leading indicator edged lower, they are still elevated, with solid employment plans in services and some improvements for more vulnerable sectors, including accommodation and food services. Despite firm data, we suspect that a peak in growth is close, with conditions likely to moderate somewhat in the coming months. Given the strong recovery and the negative rates backdrop, it is not surprising that housing market imbalances rose again in Q2, as shown by the UBS bubble index. Higher prices in the residential housing market and rising mortgage volumes, along with sluggish rents, tilted risk to the upside. We do not rule out measures to contain risk, including a reactivation of the countercyclical capital buffer.

Japan: Political topics are moving into focus

Olympic joy was reflected in the Eco Watchers Survey for July, which rose further despite an expansion of Covid related restrictions, driven by its stronger household component. The business component backed off from June's four-year high. Meanwhile, Q2 GDP growth was stronger than expected, up 1.3% on a sequential annualised basis, recovering from the 3.7% drop in Q1, mainly driven by solid private demand. However, Covid infections surged to a record high over the weekend, far exceeding the peaks of the two prior waves, though mortality remains low as most elderly have been vaccinated. Public hospitals have reached capacity constraints and are often unable to even accept new patients with more serious symptoms. These circumstances are backfiring on PM Suga and the ruling LDP is deteriorating in public poll ratings. This may may force him to call for early Lower House snap elections just after the Paralympics in order to avoid a defeat in the LDP presidential elections as his term ends at the end of September. Tactical political options will be in focus in the weeks ahead.

LatAm: Core inflation continues under pressure

In Brazil, headline inflation was in line with market expectations, rising 0.96% in July and accelerating to 8.99% YoY. Core inflation accelerated to 5.5% YoY, the highest level since 2017. The reopening of the service sector and fiscal risk continue to imply an upward bias for inflation. Fiscal policy remained in the spotlight as the government sent two bills to Congress. One of these creates a new cash transfer program to replace the current 'Bolsa Familia'. The other proposal allows deferring part of the court-ordered payments scheduled for 2022. The latter's objective would be to create fiscal space under the spending cap for the new social program. In Mexico, headline inflation reached 5.81% YoY, and core inflation accelerated to 4.66%. In a split decision, Banxico raised the monetary policy rate by 25bps to 4.5% as expected. Although they maintain their view that inflation shocks are transitory, the variety, magnitude, and extended horizon may imply a risk for the price formation process.

What to Watch

- In the US, retail sales are expected to have softened from recent levels in July, while various housing data will provide insight into the current status of the real estate market.
- In APAC, July export data will be released in Japan, Taiwan, Singapore, and Indonesia. We will also focus on Japan's machinery orders for June and CPI for July, as well as Australia's labour statistics for July. We expect Bank Indonesia to keep policy rates unchanged. Indonesia's financial markets will be closed on Tuesday due to their Independence Day.

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