Weekly Macro & Markets View

Highlights and View

- **Risk assets wobble as Chinese regulation, further lockdowns, and the prospect of tighter policy shake sentiment**

  Last week's moves are a reminder that risks persist, though we suspect the direction of travel for stocks and credit is still higher

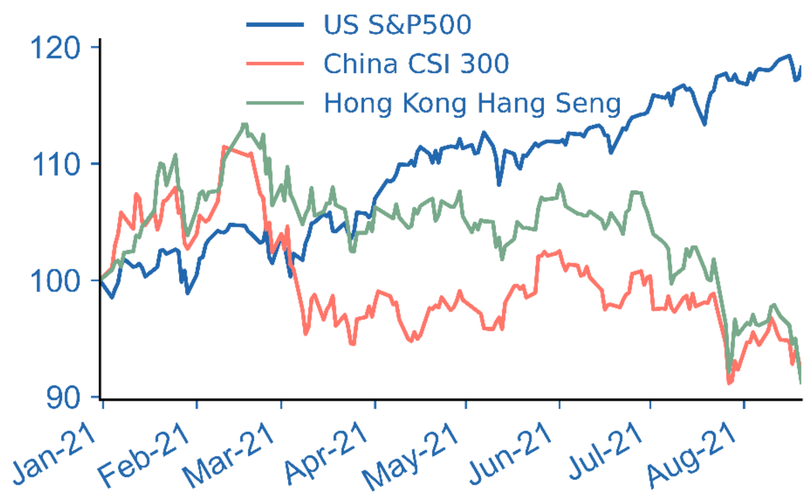
- **China's 'common prosperity' policies have been reiterated by the government**

  The topic will continue to have wide ranging consequences for equity and credit investors

- **US retail sales slide, while manufacturing activity ramps up**

  Data suggest that some of the supply/demand bottlenecks are starting to ease, with car demand abating while production is rising

Financial markets are prodded from their summer slumber



Source: Bloomberg

Investors received a small taste of volatility last week, as a diverse mix of concerns disrupted quiet summer trading. Although the S&P500 was off a very modest 0.6% on the week and the Euro Stoxx 600 1.5%, Asian markets took the brunt of a downdraft. Japan's Topix index fell close to 4% along with Chinese stocks, while the Hang Seng in Hong Kong dropped 5.8%. Credit markets sold off modestly, not helped by strong supply in the US, but safe haven government bonds were only marginally stronger. Weaker data out of China and further regulatory tightening around data privacy undermined investor confidence, while the spread of the Delta Covid variant, particularly in Asia, forced further lockdowns in Australia and New Zealand. Concerning as this is, the timing of US tapering took the spotlight, as Fed minutes indicate a more hawkish tilt. Fed members acknowledge that the goal of full employment could be achievable this year and with inflation above target, tapering is becoming appropriate. This implies that a formal announcement will be forthcoming at the September FOMC meeting, with regular cuts to the USD 120 monthly purchase of Treasuries and MBS starting as soon as November. This is a little earlier than we had assumed, but it is good that this is being openly signalled at a time when equites are close to record highs and bond yields are again depressed. The containment of the risk asset sell-off last week suggests upside ahead.

US: Data show moderating growth, while bottlenecks are being addressed

Economic conditions remain very strong in the US, but data last week supported our thesis of a lower growth trajectory and moderating inflation. In a broad-based move, retail sales declined 1.1% in July, though they are still 15% higher than last year. Interestingly, sales of motor vehicles and parts dropped by 3.9%, in July, following the remarkable demand that has pushed prices sharply higher for new and used cars. While demand may be starting to ebb, the other side of the equation – supply – showed a marked increase. Industrial production numbers were stronger than expected for July and have managed to return to pre-pandemic levels. Motor vehicles and parts were particularly strong, jumping 11.2% MoM, with a number of producers delaying the annual retooling of plants to keep production going. As supply and demand begin to normalise, some of the inflationary pressures should abate. While Fed minutes point to tapering ahead, with Covid again rampant in many southern states and economic growth slowing, we trust that a considered and flexible approach will be applied.

China: Equities continue to tumble, while credit investors confront mixed news

'Common prosperity' and tackling inequality were core themes when the Communist Party's Central Committee, led by President Xi Jinping, convened last week. We believe that these topics will be very much in focus on China's political agenda not only in the short term, but over the next few years. Driven by major internet related companies, who are the main victims of the latest government policies, the MSCI China index fell another 7.7% last week, bringing the losses since its high six months ago to 34%. Meanwhile, credit investors focussed on the state-led bailout of Huarong, the distressed debt manager, that received a capital injection from various SOEs led by the CITIC Group, following its delayed announcement of a major loss for 2020. Huarong's dollar bonds spiked, as investors applauded the action by the authorities. Perhaps in order to show market participants that not all ailing debtors can expect a bailout, Evergrande, the major property developer, has been warned by the regulator to intensify its restructuring process in order to tackle its debt problem.

Japan: Yokohama mayoral election outcome a blow to PM Suga, while August PMIs deteriorate

PM Suga had to face another blow on Sunday, as his close aide Okonogi lost mayoral elections in Japan's second biggest city, Yokohama, to a candidate backed by major opposition parties. Suga may lose backing within the ruling LDP weeks before LDP presidential elections and Lower House elections are due. Meanwhile Covid infections are rising to new record highs and the number of patients in a critical condition is increasing further. July export volumes remained stable for the fourth month in a row, while June machinery orders retreated only slightly following a strong performance during the prior three months. Japan's biggest car producer, Toyota Motor, announced productions cuts of 500,000 units for August and September due to supply chain issues impacted by the Covid crisis in ASEAN. The upbeat Reuters Tankan survey for August and the weaker August PMIs published today give contractionary signals about the state of the economy. Obviously prevailing supply chain issues and the spreading of the Covid Delta variant will delay, but not invalidate our expected economic recovery scenario.

UK: CPI inflation fell sharply in July, but is likely to rebound

UK CPI inflation fell sharply in July, to 2.0% on the headline measure from 2.5% in June, and to 1.8% from 2.3% on the core measure. However, this was largely due to seasonal distortions to prices last year related to Covid. As the economy re-opened in July 2020, prices rose more than usual for a number of goods and services. This has now brought down the annual inflation rate when comparing prices this July to last year. Inflation is likely to bounce back later this year as some of these base effects reverse and others kick in. Meanwhile, consumer confidence fell back on the Gfk measure for August, as did retail sales in July (-2.5% MoM), possibly as a result of increased concerns around the Delta variant. However, consumer confidence has risen sharply in recent months and UK retail sales in July may also have been impacted negatively by England reaching the final of the Euro football tournament keeping people at home watching and away from the shops. Overall, despite some volatile data last week, the UK economic recovery seems intact.

Credit: US consumer ABS: Delinquencies keep declining

Data released this week by the Mortgage Banker Association showed another quarterly decline for mortgage loan delinquencies along with the lowest inventory of foreclosed homes since 1981. That is consistent with good credit performance seen in other segments such as US consumer, auto and credit card ABS. While it is quite unusual to see such a lack of correlation between levels of unemployment and household delinquencies, this is largely explained by the significant support provided to US consumers during the pandemic. Notably, around a third of US households used the stimulus cheques to pay down debt, while the weakest borrowers were eligible for moratorium and payment relief programs, offered by both state owned and private lenders. As most of these direct stimulus programs targeted at households are now coming to an end, we expect the trend in delinquencies to reverse somewhat. However, we think that any deterioration will be capped, given the robust economic recovery and better labour market prospects.

What to Watch

- US inflation and home sales will be closely watched this week, but it will be comments from the Jackson Hole Symposium at the end of the week that will be scrutinised for policy guidance.
- In APAC, following the release of softer August PMIs in Japan and Australia earlier today, Tokyo's August CPI as well Australia's Q2 capex and July retail sales data will be in focus. July export data will be reported in Hong Kong, Malaysia, and Singapore. We expect the Bank of Korea to hike its policy rate by 25bps to 0.75%.

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