September 6, 2021

Weekly Macro & Markets View

Highlights and View

- **PM Suga will leave the LDP leadership race and step down by the end of October**

  Chances for the LDP to win Lower House elections are likely to improve, which should support consumer and investor confidence.

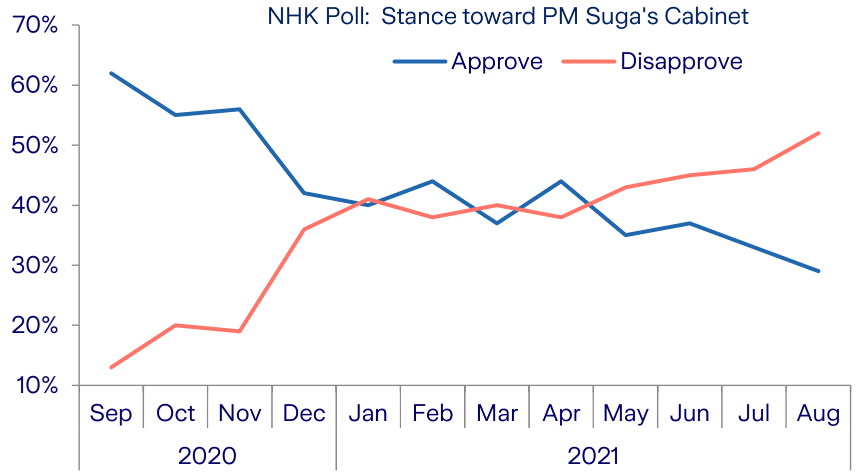
- **In the US, growth in new nonfarm payrolls slowed significantly in August**

  Although the modest number underestimates the current tightness of the labour market it will allow the Fed to keep its dovish stance for now.

- **Headline inflation in the Eurozone jumped to a ten-year high of 3.0% in August**

  The jump probably exaggerates the size of the increase, but underlying inflation is gradually moving higher in the region.

Japanese equities rally as PM Suga steps down



Source: NHK Japan

Surprisingly, PM Suga declared on Friday that he will no longer stand as a candidate for the LDP leadership election. His de facto resignation as PM by the end of this month ends a difficult term for him as successor to PM Abe, plagued by continuously falling public support. Indeed, the Cabinet's approval rating has fallen to a nine-year low amidst criticism from the public for not handling the Covid crisis properly. Several LDP politicians are expected to stand as candidates. We believe this will improve the chances that the LDP win the Lower House elections scheduled for October or November. Investors seem to share our view, with the Topix up 3% in two days, outperforming global equities. Turning to the economy, most of Japan's economic indicators for July, which were released last week, were encouraging. The MoF corporate survey for Q2 was solid. Principally, Japan's manufacturing sector is in good shape, with the operating profit margin even reaching the highest level in more than forty years. Industrial production in July was nearly back at its pre-Covid level and is expected to climb higher, even though the auto sector may experience a setback. July's employment data were stronger than expected, with the exception of services directly impacted by stricter Delta related mobility restrictions. Consumer confidence retreated in August, but less so than in previous state-of-emergency situations. Housing starts surged, driven by some large-scale projects.

US: The number of new payrolls grows less than expected

A relatively modest number of new nonfarm payrolls in August will allow the Fed to keep its dovish tilt for the time being. Meanwhile, most of the other labour market data show continued improvement. The broad underemployment rate dropped to 8.8% from 9.2% in July while wage growth accelerated to 4.3% YoY, supported by a strong pickup in the leisure and hospitality sector. Consumer confidence, as measured by the Conference Board, slipped back markedly to the lowest level since February. Both current perception as well as expectations deteriorated, weighed down by increasing worries around rising infection rates. Weaker sentiment has already translated into reduced consumer spending, reflected in last week's fall in vehicle sales, which are now significantly below pre-crisis levels. While business sentiment in the manufacturing sector held up well in August, with the ISM Manufacturing index ticking up to 59.9, the ISM Services index fell back to 61.7 from 64.1. In both cases, strong new orders signal a continuation of solid momentum in business activity.

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Eurozone: Inflation hits highest rate in a decade

The flash estimate for Eurozone headline inflation came in at 3.0% YoY in August, a ten-year high, up from 2.2% in July and well above consensus expectations of 2.7%. Core inflation also jumped to 1.6% from 0.9% in July. Inflation statistics this year have been and are likely to continue to be extremely volatile due to various base effects, changes in the HICP weightings, different timing of summer sales this year and last due to Covid, as well as the lapsing of a temporary cut to German VAT last year, which had been introduced to support the economy. For example, core goods inflation jumped to 2.7% in August, from 0.7% in July. While the jump in August probably exaggerates the size of the increase in underlying inflation in the Eurozone, we do think that underlying inflation has gradually been moving higher this year and will continue to do so next year as well, driven by well-above trend regional growth and some pass-through of higher producer price inflation due to supply chain constraints and higher energy prices. Nevertheless, we expect the ECB to maintain a dovish stance at its monetary policy meeting this week.

Switzerland: A resilient recovery continues

GDP grew by 1.8% QoQ in Q2 after a contraction of 0.4% in Q1. Growth was boosted by services, with the subsector accommodation and food as well as the subsector arts, entertainment, and recreation both up by close to 50% QoQ respectively. Despite this, the level of output in these sectors is still well below pre-Covid levels and vulnerabilities persist. Domestic demand was the main growth driver, with strong private and public consumption, reflecting large-scale support measures and improving sentiment as vaccinations were rolled out. The Q2 data alongside the latest forward-looking indicators confirm our view of an ongoing and resilient recovery. The Manufacturing PMI stayed elevated in August, boosted by a further pickup in employment, which should help to relieve supply bottlenecks and maintain positive dynamics around sentiment and consumption. The KOF leading indicator slipped back but to a still healthy level. Taken together, this suggests that growth is easing but conditions are likely to remain favourable as this is part of a healthy normalisation.

Asia PMIs: Tilted to the downside

August PMIs painted a fragile picture for economic activity in Asia. As a result of the pickup in Covid cases and targeted measures to curb the renewed outbreak, China's services sector was hit harder than its manufacturing sector, with the Caixin Services PMI falling from 54.9 to 45.7, the lowest level since the lockdown in 2020. The Caixin PMIs for both services and manufacturing slipped more than the NBS PMIs, signalling that SMEs experienced a sharper drop than state-owned companies. ASEAN's Manufacturing PMIs remained in contractionary territory, except for Singapore. Malaysia's and Indonesia's indices remain weak, but improved slightly, while Vietnam's contracted further from 45.1 to 40.2, intensifying supply disruptions in the region. Some brighter spots include India, Taiwan, Hong Kong, and South Korea. After the severe Covid crisis in Q2, India's services activity rebounded swiftly from 45.4 to 56.7. Overall, the ability to contain the virus spread and to open economies safely remains key to the activity outlook in the region.

LatAm: The Central Bank of Chile accelerates tightening, warns of macroeconomic imbalances

In Chile, the Central Bank surprised, raising the monetary policy rate by 75bps versus expectations of 50bps, while emphasising the risk of an overheating economy and indicating that the MPR would reach its neutral level during the H1 of 2022. The statement argued that it is necessary to intensify the withdrawal of the monetary stimulus to avoid the accumulation of macroeconomic imbalances that could cause a more persistent increase in inflation. The monetary authority significantly raised the GDP and inflation projection for this year. Monthly economic activity remained solid in July. In Brazil, Q2 GDP remained practically flat with a contraction of 0.1% QoQ, below market expectations of 0.2% QoQ. Consumption and investment were a negative surprise while the services sector rebounded. The increase in electricity tariffs because of the drought continues to pressure inflation this year. The Lower House approved income tax reforms, implementing a dividend tax of 15% and reducing corporate taxes. The bill has been passed to the Senate.

What to Watch

- The ECB will meet to decide monetary policy this week and in particular the pace of the monthly PEPP going forward. We expect the ECB to remain dovish, with only a modest change in the size of monthly purchases likely at most.
- In Japan, we will focus on the August Eco Watchers Survey, wage data for July and machine tool orders for August. Q2 GDP is likely to be revised up slightly. In both Mainland China and Taiwan, August export and inflation data are worth watching. It is a close call for the RBA regarding its decision as to whether to taper QE given the sharp slowdown of activity due to current lockdowns in Australia. Malaysia's central bank is likely to keep its policy rate unchanged. July industrial production in India and Malaysia is also worth watching.
- In LatAm, we expect the publication of August inflation data for Brazil, Chile, and Mexico, which are relevant for upcoming monetary policy decisions. In Mexico, industrial production will be published, while in Brazil, retail sales will be released.

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