September 20, 2021

ZURICH®

Weekly Macro & Markets View

Highlights and View

- **China's latest activity data came in weaker than expected**

  Targeted public stimulus measures should support households and SMEs in Q4 and into next year, while both the property and internet sector will continue to be tightly regulated.

- **US and European credit markets were unaffected by news flow around Chinese property developer Evergrande**

  A credit event seems likely and is in the price of Evergrande bonds, but calmer developed credit markets suggest a global systemic event seems unlikely, despite jitteriness seen in broader risk assets.

- **US CPI inflation measures come in below market expectations**

  The modest decline in both headline and core readings for August is encouraging and aligns with our view. However, bottlenecks and base effects will keep readings elevated into 2022.

Investor confidence suffers as China's economic growth slows

Source: Bloomberg

China has moved into the limelight of global observers again. Investors are concerned about slower economic growth, the impact of continuous regulatory measures against major internet companies, and credit issues in the slowing property market. Economic activity data for August were weaker than consensus had expected. Retail sales, particularly in the services segments of domestic travel, dining, and entertainment, suffered from strict lockdown measures in various provinces affected by the spread of the Covid Delta variant. While this could be interpreted as a one-off slowdown, we are concerned that the latest wave of infections in the province of Fujian, an important industrial base on the Eastern coast, will continue to hamper trade and consumption. Though weaker than expected industrial production and manufacturing investment activity fared better, benefitting from strong exports in August. Meanwhile, property investments and home sales are suffering from the tightening in developers' financing. Home prices are rising at a slower pace, with some major cities like Beijing and Guangzhou experiencing a rapid slowdown in house price inflation. Concerns about the ailing real estate developer and digital technology group Evergrande are reflected in the more than 90% drop of its stock price since its July 2020 high. On a positive note, we believe that the government will alleviate the pressure on the economy with targeted fiscal and monetary measures in Q4.

Credit: Evergrande jitters don't spill into developed credit

Despite a broader risk-off mood last week driven by news flow around the Chinese property developer Evergrande, spreads tightened in the US and European credit markets. While investor angst centres around whether the saga at Evergrande represents a 'Lehman moment' for China and the world, the sanguineness of developed credit markets implies that systemic risks to global credit seem limited in probability and impact. The US high yield market was more jittery during late summer around concerns related to Huarong. Evergrande bonds trade at distressed values with prices trading in the range of 25% to 30%, implying a credit event is in the price. A restructuring appears more likely than liquidation with a coupon payment on 23rd September being closely watched by investors. That said, a systemic spillover into the property sector and exposed financial institutions, such as banks and insurance companies, should largely depend on the policy response. Longer term, it should be healthy if credit investors price in appropriate risk premiums for Chinese credit not contingent on government bailouts.

US: Stocks falter despite good economic releases and easing inflation

US stocks slipped for a second week, though the S&P 500 was only down 0.6%. While the index is still less than 3% off its all-time high at the start of the month, it is now testing the bottom end of its smooth uptrend. To keep the upward momentum intact it will be important that the 'buy-on-dip' investor mentality holds. Despite the move in stocks, it was a good week for US economic data, with industrial production back at pre-pandemic levels and regional manufacturing indicators strong. More importantly, retail sales rebound in August. Online sales were particularly robust, jumping 5.3% MoM, while auto sales softened in part due to ongoing supply restrictions. Inflation data were the focus of the week, however, with some relief that both headline and core CPI readings moderated, coming in below expectations at 0.3% and 0.1% MoM, respectively. While a welcome relief from the recent surge, readings are still up 5.3% and 4.0% from the depressed levels of a year ago. We maintain that base effects and better supply/demand dynamics will increasingly help but acknowledge that elevated readings will remain into next year.

Eurozone: Final release confirms August inflation spike

Eurostat's final release confirmed the flash estimate, with headline Eurozone inflation hitting a ten-year high of 3.0% in August from 2.2% in July, and core inflation jumping to 1.6% from 0.9%. Inflation statistics have been extremely volatile this year due to changes in the HICP weightings, the different timing of summer sales due to Covid, the lapsing of a temporary cut to German VAT, and higher oil prices. The base effect from higher oil prices should start to wane in the next few months. However, gas and electricity prices have now recently spiked and this will add another source of upward pressure on inflation. The upshot is that headline inflation is likely to rise even further over the next few months though we still expect the ECB to look through this and concentrate on evidence of second-round impacts on wage growth, which so far remain modest. However, higher gas and electricity prices could weigh on consumer spending in the region, especially if they spike further over the winter months.

UK: Inflation spikes and retail sales disappoint but the labour market improves

The UK saw a mixed set of data last week that will keep rate hikes in play in 2022. Similar to the Eurozone, inflation spiked in August due to a mix of factors. Headline CPI saw its highest jump on record to 3.2% in August from 2.0% in July. Core CPI inflation hit a ten-year high of 3.1% from 1.8% in July. A large part of the increase was due to base effects with discounts from restaurants and hotels last year due to Covid and the Eat Out to Help Out scheme. However, inflation could increase further in the coming months due to the recent spike in gas and electricity prices.

Meanwhile, retail sales disappointed in August, falling a fourth consecutive month, down -0.9% MoM. This may partly reflect a return to more normal levels of household consumption, however, with service sector spending picking up as lockdown restrictions ease. Indeed, the labour market continues to improve with net jobs created up 183,000 in the three months to July. Overall, the data are still consistent with an ongoing recovery and the Bank of England hiking interest rates in 2022.

Australia: Employment drops amid lockdowns

The current round of lockdowns started to show some damage to the labour market in August. There were around 146k job losses, driven by both the full-time and part-time segments. New South Wales experienced a 4.2% MoM fall in employment. As during the first lockdowns in Q2 2020, the participation rate dropped considerably from 66% to 65.2%. Thus, the unemployment rate is artificially lower, down from 4.6% to 4.5%. The underemployment rate moved up from 8.3% to 9.3% in August, better reflecting the deteriorating state of the labour market. We suspect that data will continue to be weak in September given that lockdowns are largely still in place. However, a potential reopening in October would likely lift employment swiftly. In his recent speech, Governor Lowe appeared quite bullish regarding a recovery in Q4. The RBA also views fiscal stimulus as a more effective measure to respond to short-term Covid and lockdown shocks. Therefore, the RBA decided to go ahead with its QE tapering in September. However, the RBA also extended the timing of the next tapering talk until mid-2022.

What to Watch

- In a relatively quiet week for US data, other than home sales, all eyes will be on the FOMC meeting. No change in rates is expected, but the press conference may give indications on the tapering of QE.
- In the Eurozone, outside of various economic data (mainly business surveys), the German federal election on Sunday is the main event, with a variety of coalition government scenarios possible.
- In APAC, we expect the central banks of Taiwan, Indonesia, and the Philippines to leave policy rates unchanged. Australia's September PMIs will be in focus, while CPI data for August will be released in Japan, Hong Kong, Singapore, and Malaysia. Industrial production data for August will be published in Thailand and Singapore, while export statistics will be released in Taiwan and Thailand. Financial markets will be closed on Monday and Thursday in Japan and on Wednesday in Hong Kong due to local holidays.
- The G3 PMIs will reveal if the deceleration in global growth in August has continued into September.

Disclaimer and cautionary statement

This publication has been prepared by Zurich Insurance Group Ltd and the opinions expressed therein are those of Zurich Insurance Group Ltd as of the date of writing and are subject to change without notice.

This publication has been produced solely for informational purposes. The analysis contained and opinions expressed herein are based on numerous assumptions concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies. Different assumptions could result in materially different conclusions. All information contained in this publication have been compiled and obtained from sources believed to be reliable and credible but no representation or warranty, express or implied, is made by Zurich Insurance Group Ltd or any of its subsidiaries (the 'Group') as to their accuracy or completeness.

Opinions expressed and analyses contained herein might differ from or be contrary to those expressed by other Group functions or contained in other documents of the Group, as a result of using different assumptions and/or criteria.

The Group may buy, sell, cover or otherwise change the nature, form or amount of its investments, including any investments identified in this publication, without further notice for any reason.

This publication is not intended to be legal, underwriting, financial investment or any other type of professional advice. No content in this publication constitutes a recommendation that any particular investment, security, transaction or investment strategy is suitable for any specific person. The content in this publication is not designed to meet any one's personal situation. The Group hereby disclaims any duty to update any information in this publication.

Persons requiring advice should consult an independent adviser (the Group does not provide investment or personalized advice).

The Group disclaims any and all liability whatsoever resulting from the use of or reliance upon publication. Certain statements in this publication are forward-looking statements, including, but not limited to, statements that are predictions of or indicate future events, trends, plans, developments or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties and can be affected by other factors that could cause actual results, developments and plans and objectives to differ materially from those expressed or implied in the forward-looking statements.

The subject matter of this publication is also not tied to any specific insurance product nor will it ensure coverage under any insurance policy.

This publication may not be reproduced either in whole, or in part, without prior written permission of Zurich Insurance Group Ltd, Mythenquai 2, 8002 Zurich, Switzerland. Neither Zurich Insurance Group Ltd nor any of its subsidiaries accept liability for any loss arising from the use or distribution of publication. This publication is for distribution only under such circumstances as may be permitted by applicable law and regulations. This publication does not constitute an offer or an invitation for the sale or purchase of securities in any jurisdiction.

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL

ZURICH®