November 15, 2021

Weekly Macro & Markets View

Highlights and View

- **China's economy continues to suffer from the property downturn and mobility restrictions following a new wave of Delta infections**

  We appreciate that the government is no longer fully opening the spigots as in previous downturns, but we expect more targeted measures to come through in the next few months.

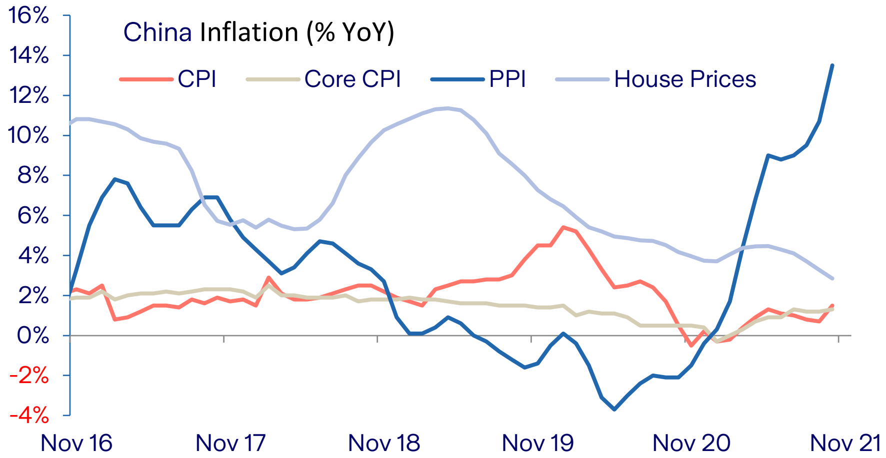
- **US inflation jumps yet again, with PPI and CPI readings hitting multi-decade highs**

  The surge is starting to prove disruptive, eating into wages and undermining confidence, and is unlikely to abate until well into the new year.

- **COP26 concludes with a deal that includes pledges to deliver more ambitious 2030 targets, reduce the use of fossil fuels, and ensure financing for emerging markets**

  The climate conference showed a greater and much needed sense of urgency in tackling climate change and focus should now be on taking actions to deliver on the 2030 targets.

China: Historic glory meets current economic challenges



Source: Bloomberg; House price: 70-city new commercial residential building prices

At its 6th Plenum meeting of more than 300 top leaders, the Central Committee of China's Communist Party released a resolution on its achievements and historical experiences since its founding 100 years ago. President Xi Jinping was lifted to the same level as Mao Zedong and Deng Xiaoping, consolidating his authority and enabling him to extend his presidency at the party congress later next year. Turning to the economy, our readthrough of all economic indicators for October, published today and last week, is that the economy continues to tackle huge hurdles amid renewed Delta related lockdowns, the property slowdown and surging producer price inflation. The broad picture reveals that the property downturn has intensified, with property sales, new housing starts and land sales contracting further. House prices fell again on a MoM basis, and the downward trend on a YoY basis, as shown in the chart, continues. (Please find a detailed analysis in our latest Topical Thoughts paper Evergrande: A canary in the coalmine?). The recovery in industrial production is mainly a reflection of the government's efforts to increase power and coal supplies following the prior power outages, but it also mirrors strong exports. The recovery in retail sales appears distorted. Producer price inflation surged to a record high of 13.5% YoY and is likely to pull consumer prices higher as the impact from tumbling pork prices is waning.

US: Inflation undermines confidence, if not the rise of risk assets

The key US data points last week were concerning, although equity and credit investors seemed unperturbed. Inflation readings surprised to the upside once more, with the headline PPI and CPI coming in at 8.6 and 6.2% YoY respectively. While some of the drives will indeed prove relatively short lived, there is evidence that rising prices are seeping into more persistent components, including shelter, health insurance, as well as wages. Rising prices are very evident in key areas of consumer spending such as cars, rents, and fuel bills. This may help explain why consumer confidence fell last week to below the lows of the pandemic, despite the fact that asset values are booming, unemployment has plunged and Covid infections, at least in most US states, have subsided. While we believe that it is too soon to raise interest rates, continued monthly asset purchases, albeit in a now tapered manner, seem unnecessary and potentially damaging to both the economy and the Fed's credibility.

Bonds: US CPI inflation surges, rates and yields snap higher; real yields close to all time lows

Global bond yields snapped higher last week on the strong US CPI print. Moves in the Treasury market were led by the belly, with the 5yr yield up 17bps on the week as the first expected Fed rate hike was brought forward from September to July, with 2.5 hikes now priced for 2022. The overall amount of tightening stayed roughly unchanged though, with six rate hikes fully priced by end 2024. This led to more benign moves at the longer end of the curve and further curve flattening, with the 10yr and 30yr yields, at 1.56%, and 1.93% respectively, well below their recent highs in October, despite soft demand at the 30yr auction. With elevated inflation and rising inflation expectations, US real yields are deeply negative and close to historical lows, indicating that financial conditions are still exceptionally favourable, with little tightening despite inflation surprising strongly on the upside. While European yields also snapped higher on the US inflation print, they failed to rise meaningfully on the week, potentially reflecting concerns around rising Covid infections.

Japan: Sharp GDP contraction in Q3, but conditions are swiftly improving

GDP contracted by 3% on a sequential annualised basis, more than consensus had expected, pulled down by a sharp drop in capex and durable goods consumption. Both are impacted by the supply chain issues auto companies were facing. The Bank of Japan Consumption Activity Indicator started to recover in September, though it shows that auto sales remained weak. The message is confirmed by the Eco Watchers Survey for October, a consumption-oriented poll, whose current conditions index surged more than 13 points to 55.5, a level last seen at the peaks in 2005 and 2013. Here as well, the corporate segment displays weakness in auto sales, though we believe that supply bottlenecks are waning as auto manufacturers ramp up production. Meanwhile, the manufacturing component of the Reuters Tankan for November softened again, but it is encouraging that the outlook component climbed higher. Producer prices experienced the steepest rise in more than 40 years, up 8% YoY, pushed up by petroleum and coal products as well as lumber and wood products.

ASEAN: The worst has now passed

As expected, Malaysia's GDP data showed a deep contraction in Q3 as the economy experienced the second most stringent lockdown since the start of the pandemic. Q3 output fell by 3.6% QoQ, driven by a considerable drop in exports related to factory closures and production disruptions. Business investment and private consumption were also lacklustre. Encouragingly, Malaysia has fully vaccinated more than 75% of its population, paving the way for a swift reopening of the economy. Malaysia's Manufacturing PMIs have risen noticeably since September, signalling the recovery is well underway while September industrial production also rose strongly by 2.5% YoY. Meanwhile, the Philippines' GDP came in much better than consensus expectations. Q3 output rose by 3.8% QoQ, bolstered by a 7% QoQ rise in consumption. This came as a surprise, given that the country's unemployment rates hit a record of 8.9% in September. The country's recovery should gain further traction in Q4, with Covid largely contained and still plenty of space for the Philippines to close its output gap.

LatAm: Already above expectations in most countries, inflation continues to accelerate

In Brazil, headline inflation surprises, accelerating 1.25% MoM, reaching 10.67% YoY. The surprise was widespread, with core inflation also coming in above expectations. In Chile, inflation similarly rose above expectations, reaching 6% YoY. Volatile components were the main drivers in October. In Mexico, core and headline inflation remain under pressure, while Banxico raised the policy rate by 25bps to 5%.

On the political front, Brazil's Lower House approved the constitutional amendment that includes the change in the rule for calculating the spending cap. The bill must now be voted on in the Senate. In Chile, the Senate rejected the bill for a fourth pension fund withdrawal. A mixed commission made up of deputies and senators will now discuss it, giving it a lower likelihood of being approved. In Argentina, midterm elections had more than 70% participation. Preliminary results show that the opposition is leading by ~9ppts over the governing coalition, which stands to lose its majority in the Senate.

What to Watch

- In APAC, Japan's PM Kishida will present his economic package on Friday. Export and CPI data for October as well as machinery orders for September will be reported. Both Bank Indonesia and the Philippine's BSP are expected to keep policy rates unchanged. Thailand will release Q3 GDP data while both Indonesia and Singapore will report October export data. In Australia, Q3 wage data will be released. Markets will be closed in India on Friday in celebration of Guru Nanak's birthday.
- The second estimate of Eurozone Q3 GDP will likely confirm a strong pace of growth, while the final estimate of Eurozone inflation in October will also be closely watched.
- We expect a solid Q3 GDP growth in Chile, while the focus will be on the presidential and parliamentary elections. In Brazil, monthly economic activity for September will be released.

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