Weekly Macro and Markets View

21 August 2023

Highlights and View

China's downward economic spiral continues, with the property market at its core

We have cut our 2023 GDP forecast further to 5% and expect government support to gain speed this autumn.

North Asian export data can be characterised as a 'mixed bag'

While Taiwan's electronic export orders for July gained steam, Korean exports in the first twenty days of August and Japan's July exports remained patchy.

Equity markets fall once again, with the MSCI World Index now down over 5% from its recent high

Markets appear to be heading towards a test of critical support levels as rising bond yields and expectations of more hawkish policy lead to profit taking and faltering momentum in light summer trading.

More policy support needed for China's economic and property unease

Source: NBS, Bloomberg

Negative news from China's economy and property market continue to make headlines. Economic activity data for July disappointed the already downbeat consensus across the board, with nominal retail sales growth tumbling to a meagre 2.5% YoY. Wage cuts, deteriorating employment conditions and private balance sheets problems amid falling home prices are hitting consumer confidence. Industrial production growth slowed further to 3.7% YoY while fixed asset investment growth moderated to only 1.3% YoY. Manufacturing and infrastructure investment growth continues to slow, while property investment contracted by 12.2% YoY, falling for 17 consecutive months. The property market downturn continues as July new housing starts contracted 26%, floor space under construction by 23% and property sales by 15½% YoY. The latter deteriorated further, falling 32% YoY in the first half of August. News about China's major property developer Evergrande filing for bankruptcy in the US and the delayed payment of some maturing wealth management products by Zhongrong Trust hit investor sentiment further. Today's 1yr loan prime rate cut of only 10bps and no change to the 5yr LPR is disappointing, while fiscal support and measures to spur consumption appear rather piecemeal. We see an urgent need for more convincing, proactive government support to tackle the vicious cycle.

Bonds

Government bonds not in favour by investors

Government bonds sold off last week, for the fifth consecutive week. Critical levels were breached, with the 10yr and 30yr US Treasury yields closing above their October highs and yields also marking cycle highs in the UK and Japan. Negative momentum was initially triggered a few weeks ago by rising US short-term borrowing needs and the US ratings downgrade, along with a shift in BoJ policy. Since then, resilient US data and expectations that rates may stay high for longer have underpinned negative sentiment.

Strong UK wage data added to the sell-off last week, with the 10yr gilt continuing to underperform its peers. By contrast, Bund and Swiss yields have outperformed amid weak macro data. Looking forward, we maintain our view that government bonds will be favoured once growth slows more materially. This week's focus among bond investors will, however, be on the Jackson Hole symposium, where central banks are expected to maintain a hawkish positioning.

US

Households keep spending

Consumer spending remains resilient with retail sales growing by 0.7% MoM in July after 0.3% the month before. Record sales on Amazon's Prime Day may have brought forward some spending but are also a reflection of the ongoing strength of the consumer sector. Meanwhile, the housing market continues to show signs of stabilisation with building permits flat in July following the decline in June and housing starts picking up by 3.9% MoM following a substantial fall of 11.7% the month before. The National Association of Home Builders' survey points at some further weakness in August, however. Industrial production picked up steam in July, though a large part of the growth was caused by electricity production given the heatwave in many parts of the country. The Conference Board's leading index fell by another 0.4% MoM in July, keeping the annual rate at a recessionary level for the fifth month in a row. Finally, the Fed minutes brought no surprises and emphasized that future decisions will depend on incoming data.

UK

Inflation falls substantially

Driven by the expected fall in energy prices, headline inflation dropped by 0.4% on a monthly basis in July. The annual rate slowed substantially to 6.8% from 7.9% the month before while core inflation remained at 6.9% YoY. Although the slowdown in price pressure is promising, inflation is still far too high and a number of service components remain sticky. Meanwhile, wage growth keeps accelerating despite a pickup in unemployment. The unemployment rate rose from 4% in May to 4.2% in June, but wage growth ticked up to 7.8% YoY from 7.5% YoY. Both inflation and wage growth will keep the Bank of England on its toes, making it likely that the MPC will keep its hiking bias for now. On a positive note, from the BoE's point of view some indicators, like jobless claims, point at further weakness in the labour market which should eventually lead to falling wage pressure. In addition, a substantial fall in retail sales in July indicates that growth is slowing as consumer spending weakens.

Japan

A positive Reuters Tankan outlook and strong nominal growth contribute to a favourable earnings outlook

Japan's real GDP growth accelerated from an upward revised 3.7% in Q1 to 6% in Q2 in sequential annualised terms and was up 2% YoY in both quarters. However, the impressive growth statistics for Q2 need to be treated carefully as net exports, particularly falling imports, contributed the most, while private consumption and inventory were a drag, with capex neither adding nor subtracting to growth. Nominal GDP growth accelerated to 12% in sequential annualised terms, which bodes well for the wages and corporate profits outlook. Exports for July turned slightly negative for the first time in 29 months, particularly those to China. Looking forward, we are impressed by the solid Reuters Tankan survey for August, which showed an improvement in both the manufacturing as well as non-manufacturing sectors, with the diffusion index for the retail sector even surging to a record high. Moving to the equity market, better than expected corporate earnings in Q2 certainly contributed to the renewed outperformance of Japanese versus global stocks since mid-July.

Brazil

New inflationary pressures and the end of earnings season

This past week, aiming to better align with international prices, SoE Petrobras announced price increases for gasoline and diesel of 16% and 26% respectively, effective August 16. According to the Central Bank, this measure should translate into upwards revisions to inflation estimates of up to an additional 40bps between August and September, potentially pushing inflation to 5% for 2023, above the Bank's upper bound target of 4.75%. Q2 earnings season is now over and 57% of companies reported earnings in line with or above estimates. Overall, results were roughly in line with expectations, but it is worth highlighting that domestic-related names drove performance while commodity-related firms came in below expectations and posted strong declines on an annual basis, in line with the relevant commodities. On the domestic side, retail, industrials and utilities were the main outperformers while banks lagged somewhat as large banks entered into a risk-off mode based on higher NPLs and lower credit growth.

What to Watch

- Investors will scrutinise this year's Jackson Hole meeting for clues as to central banks' intentions and their willingness to keep interest rates higher for longer.
- The flash PMIs for major economies will show whether global growth momentum continued to weaken in August.
- In APAC, we expect the Bank of Korea and Bank Indonesia to keep policy rates unchanged. Japan will release PMIs and Tokyo's CPI for August. Australia will report August PMIs. Hong Kong and Thailand will publish foreign trade data for July; Taiwan and Singapore July industrial production data; and Hong Kong, Singapore and Malaysia July CPI data.

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