Weekly Macro and Markets View

28 August 2023

Highlights and View

Led by services weakness, the Flash PMIs surprised to the downside in August

Global growth is set to fall to a below trend pace as services resilience is fading while manufacturing activity remains downbeat.

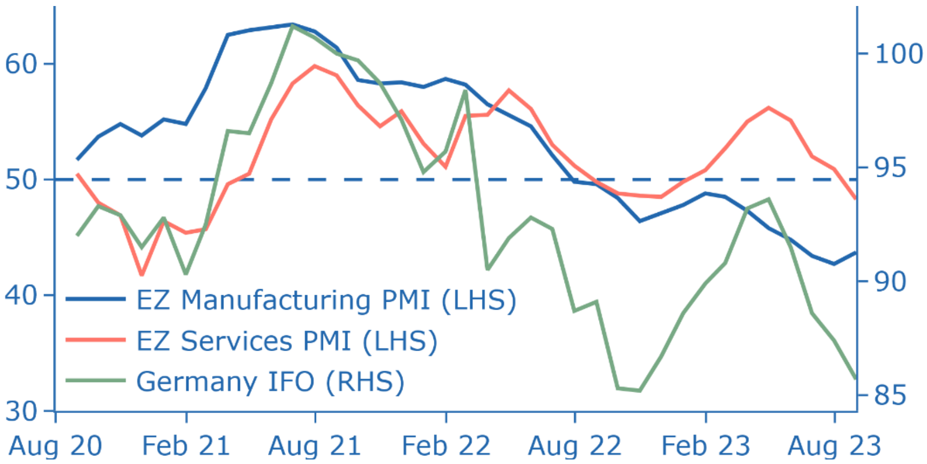
The US Flash PMI indicates that the economy almost stagnated in August

The Composite PMI fell to 50.4, driven by a slowdown in both manufacturing and services.

Private sector activity in the UK falls at the fastest rate since January 2021

The Composite Flash PMI dropped to only 47.9 with both manufacturing and services in contractionary territory at 42.5 and 48.7.

A deepening economic slowdown in the Eurozone



Source: Bloomberg

Eurozone macro data continue to disappoint, with weakness in manufacturing and construction broadening out to services at a faster pace than expected. The Flash PMIs showed a concerning slump in services activity while sentiment in manufacturing remained downbeat, with depressed new orders and rising business inventories. The Composite PMI, which tracks overall activity, fell further below the boom/bust line of 50, flagging downside risk to Q3 GDP. The downturn has been led by Germany, given its energy and export exposures, and the German ifo survey also surprised to the downside last week, falling to a level last seen in autumn 2022 when concerns over the energy crisis were acute. Demand weakness was also visible in German producer prices, which are tracking at a pace of -6% YoY, as disinflationary goods prices add to energy price declines. The upshot of the growth slowdown is that less tightening may be forthcoming from the ECB. Indeed, investors have become more sceptical that the ECB will hike rates further, with a September ECB rate hike no longer fully priced. We would agree with this outlook given our below consensus growth expectations for the region, though recognise that this week's CPI data will be key in assessing how pricing trends are developing, with services inflation remaining troubling.

US

PMIs signal near-stagnation in August

The latest Flash PMIs reflect a substantial growth slowdown and a near-stagnation in August as consumer demand falls. Manufacturing dipped further into contraction while service activity slowed to the weakest since February. The Composite PMI stood at only 50.4 with the manufacturing component falling from 49.0 to 47.0 and services slowing from 52.3 to 51.0. Durable goods orders dropped by -5.2% MoM in July though the core part picked up modestly. Data from the housing market were mixed with new home sales picking up 4.4% following last month's -2.8% fall while existing home sales fell for the fourth time in five months. In his highly anticipated speech in Jackson Hole Jerome Powell kept a hawkish tilt as expected, emphasizing that inflation remains too high despite recent success in taming price pressure and that the FOMC will keep rates at a restrictive level until inflation is moving sustainably down towards the target. Bond yields rose slightly in the aftermath of Powell's speech.

North Asia

A bird's eye-view across the regional economies

Amid rolling over global PMIs, Japan's August PMIs remained outstanding with the Composite PMI rising 0.4 points to 52.6 on strong services activity. Tokyo's core CPI fell slightly to 2.8% YoY in August amid lower electricity and gas charges. Meanwhile, China will be recognising existing homes rather than past mortgages in determining whether homebuyers can enjoy first-home preferential terms, which we consider to be another piecemeal stimulus measure to spur the economy and the property market. The Bank of Korea kept its policy rate at 3.5%, keeping the door open for another hike, though press conference comments sounded rather dovish. In Taiwan, elevated inventory levels and weak chip production remain a drag on industrial activity with production down 15.2% YoY in July. Hong Kong's rising exports to the US and Japan could not compensate for weak demand from Mainland China with overall exports down 9.1% YoY in July. At 1.8% YoY, Hong Kong's CPI remained moderate.

Brazil

A new fiscal framework is finally approved

The lower house approved a new fiscal framework with 379 in favour and 64 against in a final vote last week. The law is now headed for presidential approval. The new fiscal anchor allows the government to increase spending between 0.6-2.5% above inflation to a limit of 70% of revenue growth. The government is expected to submit their 2024 budget proposal by August 31 and comply with the new rules accordingly. The focus should turn to tax collection measures with the aim of closing next year's budget gap. The government needs extra revenues of close to BRL 140bn (USD 29bn) to deliver a zero primary result in 2024, and the market believes Congress should be supportive of this agenda. Mid-August CPI data of 0.28% MoM came in above expectations of 0.16% on the back of higher food prices, airfares, and hygiene goods. With this release, August expectations should correct upwards, but less favourable base effects were expected so annual forecasts should not deviate significantly from the current 4.9%. +6bps after Petrobras' announcement of fuel price increases.

Credit

Firm but warning signs emerge from US retailers

Credit markets were firm last week, reversing some of the losses suffered during prior weeks. However, returns in August are still mostly negative, especially for US IG. During the summer, credit spreads have benefitted from supportive technicals, which have kept them mostly rangebound. Such resilience is likely to be tested in September as primary activity is expected to pick up, especially in IG. Notably, some retailers gave warnings around consumer spending and consumer credit last week, such as Macy's reporting a sharp drop in its Q2 credit card sales due to delinquencies on its store credit cards rising faster than expected since Q1. Higher delinquencies could lead retailers to reign in the credit they provide to shoppers going forward, exacerbating already tight consumer credit conditions. The backdrop also confirms that some consumers are beginning to suffer, as are corporates, from the dramatic rise in interest rates. We continue to believe that credit markets remain vulnerable in an environment where firms and consumers face tight credit conditions.

Covered Bonds

A strong issuance rebound follows the summer lull

With the cost of funding having risen strongly over the past two years, banks continue to rely on covered bonds to raise cash. After a record first half in terms of supply, the summer pause lasted four weeks as last week ended the lull with supply close to EUR 10bn, more than half of the entire supply in European credit market. New issue concessions remained tight and good investor demand was seen despite the large deal sizes. However, it is worth noting that maturities of recent deals haven't exceeded five years and that the average maturity of this year's supply is at the lowest level since 2008. We think that investors remain cautious around duration given the recent spikes in interest rate volatility and the pending risk of an economic recession. Despite the record issuance levels seen so far, we still expect the primary market to remain active as also confirmed by the recent European Banking Authority's (EBA) report on banks' funding plans that showed European banks plan to issue more bonds in secured formats in the coming years.

What to Watch

- In the US, investors will mostly focus on the latest batch of labour market data where a continuation of the recent slowdown is expected while the ISM Manufacturing Index will give more insights into the current state of the economy.
- Eurozone CPI will be closely watched, along with consumer confidence and lending data.
- In Switzerland, the KOF, PMI and CPI data releases will show how growth and inflation held up in August.
- In APAC, several countries will report August PMIs. Japan will release July data for industrial production, retail sales and employment, August consumer confidence and the MoF Corporate Survey for Q2. Various housing related statistics, July retail sales and July CPI will be published in Australia. South Korea will release July industrial production and August foreign trade data. India will report Q2 GDP data while Hong Kong will publish July retail sales data.

Disclaimer and cautionary statement

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