MACRO THOUGHTS

RESEARCH / MARKET COMMENTARY / CONSULTANCY

The week ahead October 9 - 14, 2022
Key market data and events Macro Thoughts will be focused on

- *With elections in Lower Saxony, and following the damage done to Nord Stream pipelines, an act of sabotage was said to be blamed for a major disruption to the North German railway network*
- *EU Ministers met in Prague to show unity against Russia; ironic, as Oban has not been so outspoken against Putin and EU payments for Russian fuel since the war began now exceed €100bn*
- *Petrol pumps are running dry in France, because of energy-worker strikes disrupting deliveries*
- *It is being reported that China was stockpiling PPE months before the official outbreak of COVID…Macro Thoughts warned of a SARs-type outbreak in Wuhan in the first 'The Week Ahead' of January 2020, and months before the WHO warned of the crisis. We also warned of the economic and market risks in February, before the March equity market sell off*
- *China has announced further easing of foreign investment rules, to include Service sectors, including tourism and elderly care, in some of China's largest cities*
- *India plans a phased launch of e-rupee this year, aiming to follow China*
- *The RBA slowed their rate of hiking - their economy is closer to the Chinese economy - warning of economic risks to households*
- *For the first time since 1998, the BOJ is intervening to support the Yen; Forex Reserves have fallen by $54bn*
- *HSBC cuts fixed rate mortgages for existing customers*

CHINA

Ahead of the 20th National Congress of the Chinese Communist Party (held twice every 10 years) which starts next weekend and will give Xi Jinping his third term, Xi is holding a meeting of his inner circle. Amid speculation about who will be appointed to China's top governing roles, PM Li Keqiang and other prominent leaders over the past 10 years are expected to step down.

Focus will be on the seven-member Politburo Standing Committee (PSC), where Beijing's most important directives, decisions, and deals are made, and the seven up, eight down rule, the age of 68 being recognised as the cut off for top jobs. Along with this rule, Xi will also break the 2006 directive that officials should stay no longer than two five-year terms in a single position. Hu Chunhua (59) and Chen Min'er (62) are amongst those expected to take senior roles, given their seniority, support of Xi, age and the prerequisite vice-premier experience, though there may be a place for Wang Yang, but his age is against, and Xi may fear his support from the Tuanpai or Youth League Faction. Given the importance of the meetings and the significance to Xi, recent data may be regarded as being on the optimistic side, therefore, Caixin Services and Composite PMI surveys being negative is extremely concerning, as they may have been a lot worse.

ECB

Bloomberg and Reuters headlined that the ECB said inflation continues to be driven by demand. We find it hard to believe consumers are actively spending, when there is such an aggressive rise in the basic cost of living. Given so many governments are bailing out energy companies and needing to subsidise energy bills, consumers cannot be the force that is driving up inflation. Perhaps these media outlets are fixated on inflation, but when a Bloomberg journalist says, 'in all my 11 years commenting on markets I have not seen interest rates this high', it is a surprise markets are so driven by articles, rather than data. Lane said in the ECB minutes: 'After the unusually high economic growth rates recorded at the start of the year as sectors reopened, global activity had slowed to the average growth rates observed before the pandemic.'

The deceleration in trade, coupled with a fall in new export orders, pointed to a continued loss of momentum. Lane did say of inflation that there was a 'strong contribution from the consumption of services, while the consumption of durable goods had continued to be weak over the period,' but also commented on, 'weakening of demand for goods from already low levels'. ***German Factory Orders have been positive for just one month since January, and domestic orders fell by -3.4% in August.***

ECB staff macroeconomic projections featured a significant upward revision to inflation in the period to the third quarter of 2023. This was mostly due to higher energy and food commodity prices, but core inflation also accounted for an upward revision of about 1% - but let's take into account the second derivative effect, as any item being sold will also be impacted by the increase in energy and transportation costs, and if those items are being hit by 9% increases, then a rise of 1% may actually highlight tighter margins, and therefore it is the importance of the trend in producer prices that the ECB should be keeping an eye on.

There was Call buying in German Schatz 2 year bonds this week; however, we are watching for stresses in Repo markets. The Fed is playing a dangerous game under the guise of fighting inflation. The warning signs are evident…. Walmart, FedEx, Ford, Credit Suisse, *Real Estate, central bank activity and Forex Reserves continuing to fall.* ***Italian yields are at the highest since 2012, 4.70%, while the spread to Germany remains at 2.50%.***

Global Instability - OPEC lowering oil production goes beyond economics

OPEC cutting oil production by 2 million barrels a day is a direct challenge to Biden and the US, especially coming so soon after Biden had taken a large and much publicised step in going to Saudi Arabia, to meet Saudi Crown Prince Mohammed bin Salman in Jeddah. This also comes just as Putin is being pushed back in Ukraine, Xi Jinping leads the most controversial NCCP meeting in Beijing and ***ahead of mid-term elections in November****. Days prior to the OPEC announcement, a delegation from the White House was in Saudi Arabia on a mission to prevent any large cuts. Oil prices for the US have been raised, and lowered for Europe.* ***Average gasoline prices in the US bottomed in mid-September and have started to move higher.***

Meetings between Saudi energy minister, half-brother to Prince Mohammed, and the Russian PM, while under US sanctions, also highlights the geopolitical gap that is widening between both nations, which could have ramifications throughout the Middle East. Until now, Saudi's aggression in Yemen had been tolerated by US Presidents - even to the point of providing military support as part of an energy-for-security alliance that has endured through two wars in the Gulf and the 9/11 attacks - but this could change. Russia has already weaponised its gas exports to Europe, while Saudi is clearly set on pursuing its own commercial and diplomatic interests.

Beyond the politics, the limited rise in the price of oil highlights how much speculative shorts and inflation hedging had boosted the price of oil during the first half of the year, and why the Fed should be doing more in its analysis of why and where inflation is a problem; ***or in Tom & Jerry, Homer Simpson, Mr Bean style, are they blowing up the house to find the inflation mouse?***

The IEA will release its Oil market report this week. In its September report, it said: 'Growth in global oil demand continues to decelerate, weighed down by renewed Chinese lockdowns and an ongoing slowdown in the OECD.' Global production rose 790 kb/d in August, to 101.3 mb/d, with a strong recovery in Libya. Russian total oil exports rose by 220 kb/d in August, to 7.6 mb/d, down 390 kb/d from pre-war levels. Estimated export revenues fell by $1.2bn, to $17.7bn.

US Consumer Saving Rate is at record lows and Consumer Credit is at a 20 year record high

The higher they go, the harder they fall!! *We initially cautioned to expect a sharp rise in post-COVID inflation over two years ago, saying Producer prices would be as important as Consumer prices and as the spread between them widened, margins would be squeezed. A survey in the UK suggests 50% of producers are not able to fully pass on rising costs and this is likely to be indicative, globally. Equity markets have fallen close to 30% from their highs, yet credit spreads have remained relatively calm, but for how long can this last? We saw the value in investing in Investment grade bonds some weeks ago, but remain cautious over high yield.*

So far this year, over 20 CEOs at large US retailers have left their positions, including Gap, Home Depot and Reebok. As consumers continue to tighten spending, 18 retailers are said to be at risk of bankruptcy (including GameStop, Wayfair and Bed, Bath and Beyond, which are at significant risk, while Land's End and Abercrombie & Fitch are among those that are under pressure). While this number may be relatively small compared with 2018 and 2019, there should be no complacency and, as we have highlighted, small businesses are in a much more precarious position. In March, it was clear from the warnings retailers were giving out, along with deteriorating Earnings results, that the US consumer had come out of lockdowns with a sense of relief, even if the spending spree wasn't to last, and now as the cost of living hits, they are suffering the same slowdown as they did following the GFC. As mortgage rates move above the level of 2007 (7%, compared with 6½%), this week, mortgage applications collapsed, falling -14.2%, the lowest since 2007. The Median rent in New York for a one bed apartment is now said to cost just under $48k pa, while a two bed is around $53k ($4,410pm), a rise of 33% yoy and 40% yoy, respectively.

In August, we highlighted the problem: 'Over optimism, even as lead times were extended, meant anyone buying warehouse space bought 50% more than they needed as demand grew. Over supply and rising inventories have now created a recessionary problem, which may already be pushing unemployment levels higher. Disproving those who believed inflation was being demand driven, the largest warehouse in the US at San Bernardino is running out of space, and it will get worse. This storage space is nearly 44 times larger than New York's Central Park….'

We never bought into the idea that the US consumer was about to go on a multi-year spending spree and warned that high inflation, falling demand and bloated inventories would put pressure on margins and profits, and that is exactly what has been happening over the past six months and will continue well into 2023. Markets should be very aware of the amount of liquidity being drained by central banks, globally, while government debt continues to rise and fiscal discipline has been virtually abandoned. A recession worse than the GFC is practically inevitable (has there ever been a real recovery since?) Global debt is today more than a fifth higher than then and is now 250% of GDP, according to the IMF - OK when rates are low. COVID pushed combined central bank balance sheets close to $10tn, but they are now contracting at the fastest rate ever.

US UNEMPLOYMENT

Employment over the next few months may give the illusion that the economy is withstanding the rise in the cost of living and interest rate hikes, but as retailers, manufacturers and producers react to the slowdown in consumer activity, inventory risks are increasing. Most notably, surveys are showing inventories are increasing, while new orders are decelerating…a clear warning of a considerable economic slowdown already in the pipeline. ISM Manufacturing New Orders has already fallen into contraction (47.1), while New Orders *for ISM Services declined from 61.8 to 60.6, with prices falling in both surveys. Therefore, while seasonal employment has started early, the fire sale is beginning to heat up, and a sharp rise in unemployment in the new year may surprise markets and the Fed.*

Earlier in the year, we discussed the Quits rate and the Fed's failure to differentiate between unemployment data and actual unemployment that is not being picked up in official data...Companies ranging from 500 to 1,500 employees, depending on the industry, are responsible for 2/3rds of employment in the US and, in June, the US National Federation of Independent Businesses measured its lowest level of economic expectation on record. We have constantly highlighted the vagaries of official unemployment data, which at times are hard to fathom and this cannot always be a coincidence for a large economy such as the US.

The ratio of job openings to jobs came down to 1.7, rather than the 'over 2' which Chairman Powell has been keen to highlight, and this week FOMC member Daly said, from her contacts she learnt that, 'A company posts job openings on a given platform, usually with a three month or six month contract. The job may get filled or may not really still be available, but the posting stays up for the term of the contract, just like that pinned clipping on the student union bulletin board.' ***Shouldn't this have been investigated before raising rates aggressively, based on such data, and is this why the Fed is still six months behind the economy?***

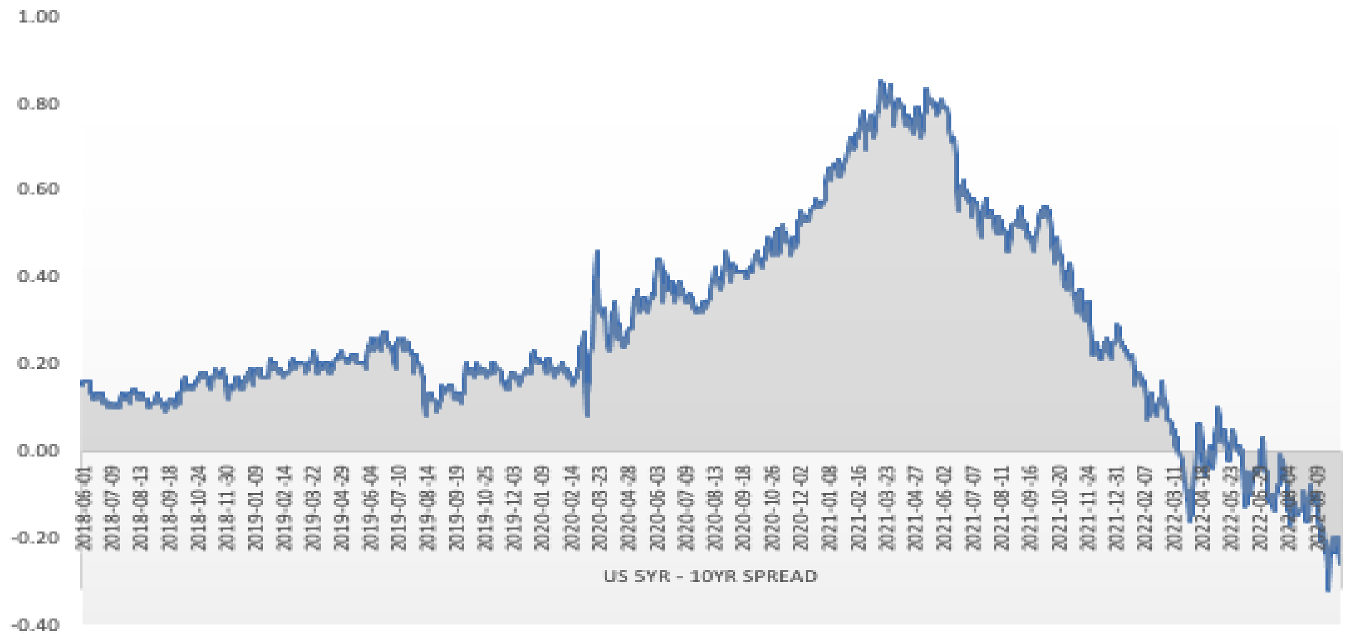
She added that her business contacts are NOT recruiting aggressively and said the wage narrative has changed: 'Firms are planning for a lower rate of wage increases.' While Daly may remain in the line for further rate hikes to quell inflation, clearly there are doubts beginning to impact on her thinking.

When a central bank governor switches from being prepared to 'let the economy run hot', to being prepared to run the economy into recession, alarm bells need to be ringing…we fear 2023 could develop into a worse economic slowdown than even the GFC…China is already dragging the global economy down and government borrowing is at unprecedented levels.

- *Challenger Job cuts of 29,989 was the highest in three months (to August) and 67.6% higher than the 17,898 cuts announced a year earlier, with retailers cutting the most jobs*
- *JOLTs Job Openings fell to the lowest since April 2021, 10.1mio in August, and July was revised down to 11.2mio*

Non-Farm Payrolls came in line with our and market projections, as we anticipated that the three month moving average to September would realign to the three month ma to August; however, while adding 263k jobs, this was the least since April 2021. Leisure and hospitality (83k) and Healthcare (60k) led the gains.

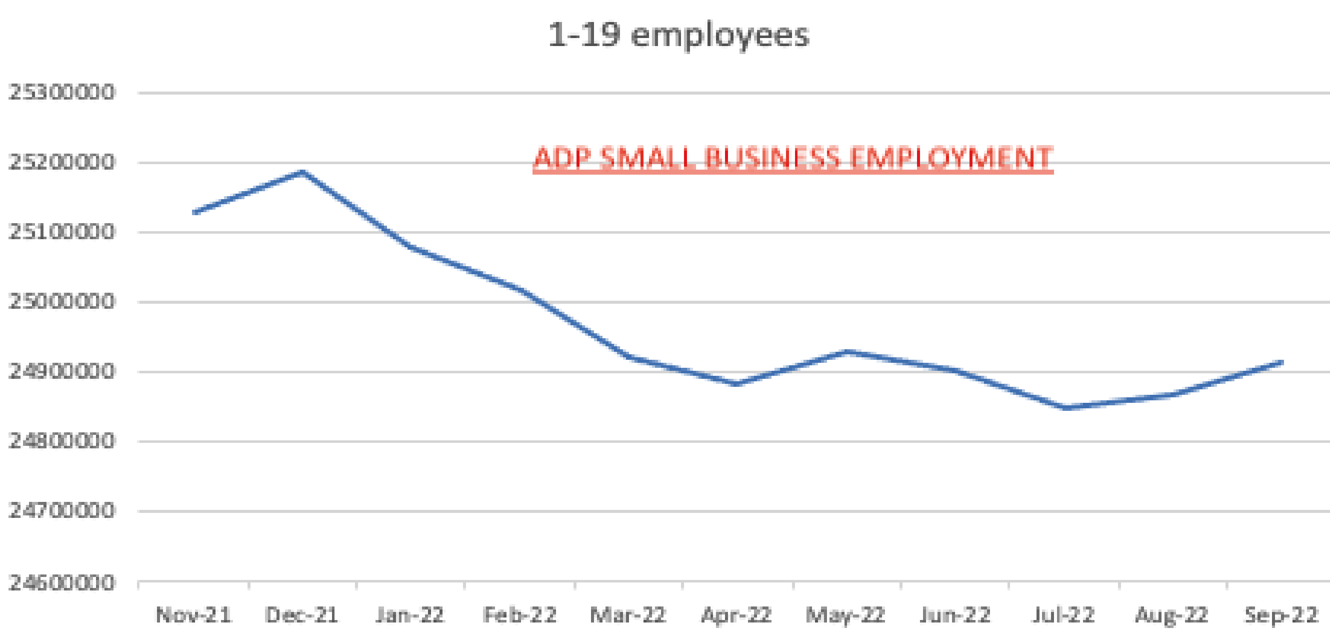
Although the previous average of 439k in the first eight months of the year is now lower, the average for the past three months from July to September of 371k is in line with the 361k average from April to June, therefore despite all the monthly excitement and volatility overreach of the past six months, in effect, there has been little change. *Nevertheless, the Unemployment rate is now 3.5%, the Participation Rate edged up to 62.3%, and the number of unemployed is now 5.8 million, as the number of permanent job losses fell by 173k. The Participation Rate and the Employment to Population Ratio are both still 1.1% lower than before the pandemic and the number of discouraged workers marginally attached who believed that no jobs were available for them increased by 119k, to 485k. There were 1.4mio that reported they had been unable to work because their employer closed or lost business due to the pandemic, down from 1.9mio.*



Average hourly earnings rose by a modest 10cents (0.3%), 5% over September 2021, ***which continues to show negative real earnings when compared with CPI and considering 20% increases in rents, mortgage rates tripling and official food inflation being 11.4%. Next month should show an increase in AHE and AWE as seasonal employment continues and Utility workers are in demand, following the floods in Florida. According to ADP, the median annual pay in the US is $56k.***

Other employment data and surveys are less optimistic. ISM Manufacturing Employment fell into contraction (48.7) and while retailers are starting their seasonal employment, the numbers are down on last year and small businesses are fearing for their future. In our comments for August's unemployment report we highlighted, ***'A report suggests that nearly half of small business owners in the US, including 59% of retailers, say they are at risk of closure by autumn, an increase of 12% over last year. Half of small retailers have cut back on orders for the all-important holiday sales season quarter, with 38% saying they're reducing orders by more than 20% compared to last year.'***

As expected, ADP employment had a small rebound (208k) following August's NFP and the previous month was upwardly revised to 185k, as schools reopened; however, overall, there has been a deterioration from Q2 and this is in line with the warnings Walmart, Home Depot and Target were giving in March. There was a 29k reduction in Goods Sector employment.



Sunday GER Lower Saxony Election, CHN Central Committee meeting
Monday Nagel
Tuesday IMF Meetings, Bailey, SNB Jordan
Wednesday S KOR CB, Lagarde, UK FPC Mins
Thursday IEA Oil Market Report, Nagel
Saturday Bailey, Nagel
Sunday NCCP

US

Tuesday: NFIB Business Optimism, Redbook, **CPI Expectations**
Wednesday: **MBA Mort Apps, PPI**
Thursday: **CPI, Jobless Claims**
Friday: **Retail Sales, Trade Prices, Michigan Sentiment, Inventories,** Baker Hughes, **CAD Manuf & Wholesale Sales**

Events and speakers: Monday CAD Holiday, Evans, Brainard, Tuesday Mester, Harker, Wednesday **FOMC Mins, WASDE Report,** Barr, Bowman, Friday Cook
Auction: Tuesday ***Treas 3yr ($40bn),*** *Wednesday* ***Treas 10yr ($32bn),*** *Thursday* ***Treas 30yr (18bn), CAD 2yr***

UK

Monday: **BRC Retail Sales**
Tuesday: **Unemploy, Earnings, RICS HPI**
Wednesday: **GDP, Manuf & Ind Prod, Trade, Construction Output, NIESR GDP Tracker**

Events and speakers: Tuesday **Bailey,** Cunliffe, Wednesday FPC Mins, Pill, Haskel, Mann, Thursday **BOE Credit Survey**, Breeden, Saturday **Bailey**
Auction: Tuesday ***Gilt Linker 0.125% 2051 (£900m),*** *Wednesday* ***G 4.125% 2027 (£3.5bn)***

EUROPE

Monday: **NOK CPI, PORT Trade**
Tuesday: **ITL Ind Prod**
Wednesday: **EA Ind Prod, SEK Unemploy**
Thursday: **GER, SEK, Various CPI**, GER Current Acct, **CHF Prod & Import Prices**
Friday: **EA Trade, GER Wholesale Prices, FRA, ESP, Various CPI**

Events and speakers: Sunday **GER Local Election**, Monday **Nagel**, Lane, Tuesday **SNB Jordan**, Lane, Enria, Wednesday **Lagarde**, Thursday **Nagel**
Auction: Tuesday ***GER 2yr,*** *Wednesday* ***GER 10yr,*** *Thursday* ***ITL 3yr – 30yr***

CHINA

Thursday: **New & Outstanding Loans, Total Social Financing, M2**
Friday: **CPI, PPI, Trade**

Events and speakers: Sunday **China Central Committee meeting,** Sunday (Oct16) **NCCP**

OTHER

Monday: NZ Retail Card Sales
Tuesday: JAP Current Acct, Econ Surveys, **AUD, Building Permits, Private House Approvals**, Consumer Conf, **BRL CPI**
Wednesday: JAP Machinery Orders, Reuters Tankan, **NZ Food Inflation, INDIA CPI, Manuf & Ind Prod**
Thursday: **JAP Bank Lending, PPI, AUD CPI Expectations**, NZ Business PMI
Friday: **INDIA WPI, Trade, Forex Reserves, S KOR Unemploy, SGD GDP**

Events and speakers: Monday JAP Holiday, Tuesday RBA Elis, Wednesday **S KOR CB**, Friday **RBI Mins**
Auction: Wednesday ***JAP 30yr,*** *Friday* ***JAP 5yr***

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