July 29, 2022

Recession Fears Rise As US Growth Slumps

A review of the week's top global economic and capital markets news.

Investment Solutions Group

For the week ending 29 July 2022

As of noon on Friday, global equities were higher on the week while the yield on the US 10-year Treasury note fell from last week's 2.75% reading. The price of a barrel of West Texas Intermediate crude oil rose to $100 from $94 last week. Volatility, as measured by the Cboe Volatility Index (VIX), fell to 21.4 from 23.1 last Friday.

US economy shrank again in Q2

Gross domestic product in the United States declined at a 0.9% annual rate in the second quarter, which follows a Q1 fall of 1.6%. Personal consumption rose 1% in June, down from Q1's 1.8% pace, with demand for goods particularly weak. One bright spot in the data is that the core PCE price index rose 4.4%, a decline from the 5.2% pace in Q1.

Fed delivers three-quarter point hike

On Wednesday, as widely expected, the US Federal Reserve raised the federal funds target by 0.75% to a range between 2.25% and 2.5%. While acknowledging that spending and production have softened, job gains have remained robust, the FOMC said, while indicating further increases in rates would be appropriate. Markets took comfort in comments from Chair Jerome Powell, who said that following the rate hike, "we are now at levels broadly in line with our estimates of neutral interest rates, and after front-loading our hiking cycle until now we will be much more data-dependent going forward." Smaller rate hikes are anticipated ahead, though lots of data that could sway expectations will be released ahead of the Fed's next meeting on 21 September.

German consumer, business sentiment plunged in July

A survey from Germany's Ifo Institute suggests that the country is on the cusp of a recession, said Clemens Fuest, the institute's president. The Ifo Business Climate Index plunged to a two-year low of 88.6 in July from 92.2 in June amid continuing energy shortages stemming from Germany's reliance on Russian energy supplies. While Russian natural gas supplier Gazprom resumed shipments via the Nord Stream 1 pipeline last week, it has already cut those flows by half, meaning the pipeline is now operating at just 20% capacity. At that rate, it will be difficult for Germany to store enough gas to make it through the winter without shortages. In an effort to avoid shortfalls, European Union members agreed this week to target 15% cuts in gas demand and that voluntary cuts would become binding in an emergency. On

Thursday, the GfK consumer confidence reading slumped to a record low of -30.6.

IMF cuts GDP outlook again

This week, the International Monetary Fund cut its global growth forecast for the third time this year. The IMF expects the global economy to expand 3.2% in 2022, down from its 3.6% forecast in April and from 4.4% in January. Growth is expected to slow further in 2023, to 2.9%. The risks to the global outlook are "overwhelmingly tilted to the downside," the fund said. Inflation is expected to reach 8.3% this year and 5.7% next year.

High prices, rising rates crimp US home sales

Sales of new homes in the United States fell 8.1% in in June from May to their lowest levels since the early months of the pandemic as high prices and rising mortgage rates hurt affordability. Pending home sales declined as well, falling 8.6% in June from May. Also in May, the Case-Shiller US home price index rose 19.75% from a year earlier. This week, the Mortgage Bankers Association reported that the number of weekly mortgage applications fell to its lowest level since 2000.

QUICK HITS

Friday saw the release of the US employment cost index, an indicator Fed Chair Powell said is important for the central bank as it seeks to get inflation under control. The index rose 1.3% in Q2.

US consumers have had to pay more for goods and services as inflation has surged. Household spending in June rose more rapidly than expected, at a 1.1% pace compared with 0.3% in May.

On Wednesday, the US Senate approved a bill that would provide more than $52 billion in subsidies to semiconductor

manufacturers that produce in the US along with billions more in research and development funding. The bill now moves to the House of Representatives, where it is expected to pass.

China's population is growing more slowly and is expected to start shrinking no later than 2024, the country's state media reported on Sunday.

The Conference Board's consumer confidence index declined to 95.7 in July from 98.4 in June, its third straight monthly drop.

Inflation in Australia rose to a 21-year high last quarter as consumer prices jumped 6.1% compared with the same quarter a year ago and core prices rose 4.9%. The Reserve Bank of Australia is expected to hike its policy rate by 0.5% next Tuesday.

The *Financial Times* reported that to avoid the delisting of many Chinese companies from US exchanges for failing to comply with audit requirements, China is planning to place Chinese companies with US stock listings into three broad categories, those with secret data, those with sensitive data and those with non-sensitive data. However, US regulators said they will not accept any restriction of their access to Chinese audit papers, putting the listings of 270 firms at risk.

The eurozone's economic growth grew 0.7% in Q2 despite surging prices and declining household and business confidence. The general reopening of economies helped the economy in the first half of the year, but economic growth is expected to slow in coming months amid elevated inflationary pressures and continued supply constraints.

Germany's harmonized consumer price index rose to a preliminary 8.5% in July from 8.2% in June.

A preliminary spending agreement was reached this week between US Senate Majority Leader Chuck Schumer (D-NY)

and Senator Joe Manchin (D-WV) addressing energy, health care and tax hikes. The package faces a number of legislative hurdles before it can be put to a vote in the evenly divided Senate under so-called budget reconciliation rules.

256,000 initial jobless claims were filed in the most recent week, a decline of 5,000 from an upwardly revised 261,000 last week. Claims have been trending higher since bottoming at 166,000 in March.

EARNINGS NEWS

With 56% of the constituents of the S&P 500 Index having reported for Q2 2022, blended earnings per share (which combines reported data with estimates for those that have yet to report) shows that earnings growth is running at around 6% while sales rose about 12.3% compared with the same quarter a year ago, according to data from FactSet Research. Among the key themes this week was better-than-feared technology sector earnings.

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