Asia Morning Bites

US GDP miss causes rate hike expectations to fall

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Macro outlook

- **Global Markets**: Equity tnvestors didn't react much to the news that the US is now technically in recession after it posted a second consecutive quarter of negative growth in 2Q22. GDP fell 0.9% (saar) after a 1.6%QoQ decline in 1Q22. Some have argued that this isn't really a true recession, with a decline in inventories accounting for about 2pp of the GDP decline. But as James Knightley notes in his piece yesterday after the GDP release, there was notable weakness elsewhere, not least in housing construction, and business investment, and in his view, a more meaningful recession is only a matter of time. Stocks gained again, with both the S&P500 and NASDAQ rising more than a percentage point and equity futures still look positive as we head into the weekend. EURUSD dropped sharply ahead of the GDP release but recovered thereafter. The AUD remains just below 70 cents to the USD this morning and Cable is also little changed from yesterday at 1.2174 while the JPY seems to be benefiting from a softer outlook for US rates, dropping to 134.33. The Asia pack made solid gains against the USD yesterday. The KRW and SGD led the charge, though the IDR also made decent gains and has pushed back convincingly below 15,000. US Treasury yields have fallen sharply. 2Y yields fell more than 13bp to 2.921% and 10Y Treasury yields fell 10.9bp to 2.676%. If you accept our house forecasts for Fed funds at end-2023 and end-2024 (3% and 2%) then this is currently consistent with a 10Y bond yield of 2.5%, so there may be a bit more of this move lower to come.

- **G-7 Macro**: Following yesterday's US GDP figures, 2QGDP data is out in Europe today too. The consensus is for a 0.2%QoQ increase – a slowdown from 0.6% in 1Q22. Like the US figure, this looks close enough to zero to consider zero or a small negative result a plausible downside risk. The median forecast actually looks closer to 0.1 QoQ than 0.2%, for what it is worth. Preliminary July CPI inflation is also set for release in Europe today. The consensus has the harmonised index inflation rate rising to 8.8% YoY from 8.5% in May despite a likely decline in the price index. This note from Carsten Brzeski highlights that European inflation problems may not yet be over. US data includes the personal spending and income data, together with PCE deflators (headline should rise in line with CPI gains) and the University of Michigan consumer confidence figures, which are already extremely weak so probably won't do too much.
- **Japan**: June industrial production jumped 8.9% MoM sa (vs 4.9% market consensus), recovering from losses in the previous two months. But retail sales declined unexpectedly (-1.4% vs 0.2% market consensus). Inflation and the resurgence of Covid appear to be putting pressure on consumer spending. July Tokyo CPI rose to 2.5% (vs 2.4% market consensus, 2.3% in June) mainly due to a hike in utility prices. Labour conditions remained relatively healthy. The unemployment rate stayed at 2.6% (vs 2.5% market consensus) but the job-to-applicants ratio made progress. In sum, today's data suggest that 2QGDP should rebound from the first quarter's contraction, but only marginally. Higher than expected inflation won't change the BoJ's policy stance as it was mainly cost-push driven.
- **China**: The Biden-Xi call turned out to be mainly a call about the "One-China" policy. President Biden confirmed the One-China policy of the US had not changed, and did not support Taiwan's independence. In terms of economic competition, President Xi emphasised that the US should not view China as primarily a rival. Our view is that this is not enough to deter the US and its allies from adding more export controls on technology parts and products to China. Overall, the call was something of a non-event for the market but could be negative for China's manufacturers of high-tech goods.
- The politburo meeting in China mentioned growing the economy with "best effort", and did not refer to the 5.5% GDP target any more. This hints that the government is not going to overly spend on infrastructure projects to achieve that target. Our view is that this is not such a bad thing. Local government bond issuance for infrastructure projects should not increase further. This would give more room for the central government to solve the problem of uncompleted construction projects. We do not expect gross government debt to increase rapidly from last year. Our GDP forecast for 2022 is 4.4%.
- **Korea**: June manufacturing production rose firmly 1.9%MoM sa (vs revised 0.2% in May), which was higher than the market expectation of -0.8%, and led by production increases in memory chips and autos. Retail sales fell -0.9% (-0.2% in May) for the fourth consecutive month while facility investment grew 4.1% (vs 12.8% in May) due to the expansion of semiconductor production facilities. More importantly, forward-looking orders data are positive with both machinery orders and construction orders gaining. We expect the current quarter's GDP to decelerate from the previous quarter, but investment spending will likely improve, partially offsetting the softening of private consumption.

What to look out for: US Michigan sentiment report

- South Korea industrial production (29 July)
- Tokyo CPI inflation (29 July)
- Japan retail sales and labor data (29 July)

- Taiwan GDP (29 July)
- US personal spending, core PCE, Univ of Michigan sentiment (29 July)

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