Weekly Market Summary

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Time To Stop Beating Around The Bush? Recession Risks Higher
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It was another week of the growth scare/recession narrative as markets digested some bad economic data.

It's becoming much more obvious that central banks globally are willing to sacrifice economic growth to combat inflationary pressures. And even setting aside how fiercely (or not) central banks will react to inflation, the economic impact of price rises is starting to become a major worry. In an interview with Marketplace, the Federal Reserve chairman admitted that "a soft landing is really just getting back to 2% inflation while keeping the labor market strong. And it's quite challenging to accomplish that right now". He went on to say that "nonetheless, we think there are pathways … for us to get there." While the headline unemployment rate appears robust, both the labor participation and employment rate show a different picture, as they have been stagnant for almost a year. Both the labor force participation rate, at 62.2 percent, and the employment-population ratio, at 60.0 percent remain each 1.2 percentage points below their February 2020 values, as the April Jobs Report shows. Real wages are down, as inflation completely eats away the nominal wage increase. According to the Bureau of Labor Statistics, real average hourly earnings decreased 2.6 percent, seasonally adjusted, from April 2021 to April 2022. The change in real average hourly earnings combined with a decrease of 0.9 percent in the average workweek resulted in a 3.4-percent decrease in real average weekly earnings over this period.

Although US retail sales came in in line with market expectation, providing some belief that consumers are weathering the inflationary headwinds, disappointing quarterly numbers from retail giants Target and Lowe's are striking fear into the market. The retail data suggests that consumers are weathering the inflation hit for now. Retailers, however, are not doing so well at navigating through soaring input costs. Last Friday, US consumer sentiment data were the lowest since 2011. The University of Michigan's sentiment index fell to 59.1 from 65.2 in April. The figure was lower than all estimates in a Bloomberg survey of economists, which called for a median reading of 64. In a market economy like the US, consumer spending is critical. It is literally the lifeblood of economic health. When consumers feel bad about the state of the world, they do interesting things. They start to protect their next dollar and question how they should be spending their current dollar. Consumer sentiment usually only dips this low during a recession. This might hint that one is already here. This has hit markets at the opening of the week. On Wednesday, US stocks suffered their sharpest fall since the early months of the coronavirus pandemic. The benchmark S&P 500 share index fell 4 per cent, its biggest loss since June 2020, with 98 per cent of stocks in the index declining . The flight from risky assets prompted rallies in government bonds and other assets perceived as safe havens. The yield on the 10-year US Treasury dropped 0.09 percentage points to 2.89 per cent. The dollar index, which measures the buck against a basket of peers, also halted its recent slide to climb 0.5 per cent.

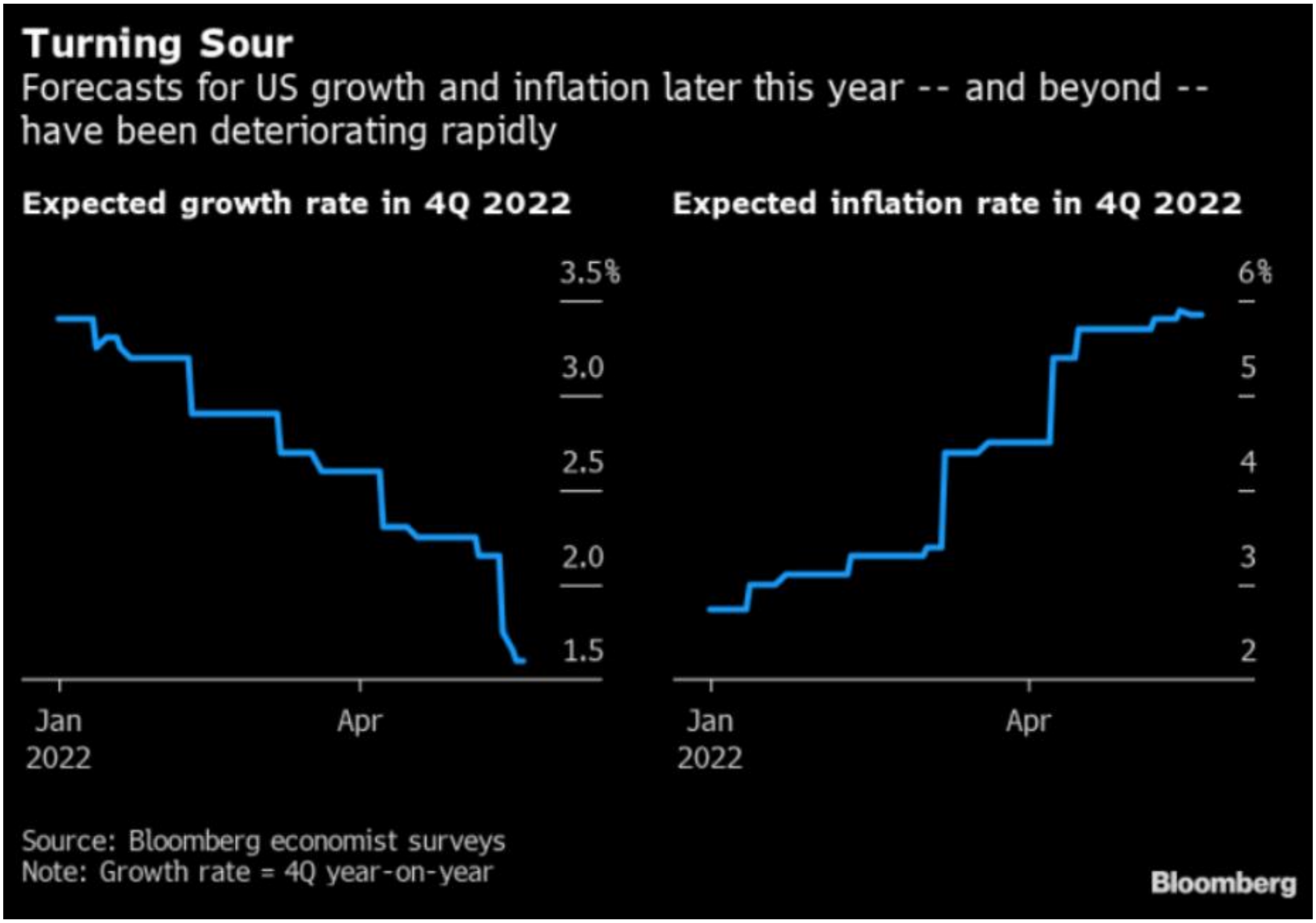
Goldman Sachs Senior Chairman Lloyd Blankfein urged companies and consumers to gird for a US recession, saying it's a "very, very high risk." Blankfein noted that while some of the inflation "will go away" as supply chains unsnarl and Covid-19 lockdowns in China ease, "some of these things are a little bit stickier, like energy prices." Equity Funds had $5.2 billion outflows in the week to May 18, led by redemption from mutual funds. Wall street economists are cutting their growth forecasts in response. Credit market risk premiums are soaring globally. The cost to insure investment-grade and high-yield US corporate bonds hit levels last seen in 2020. It was largely the same in Europe and Aisa. The Fed warned about the risk of low liquidity in its May Financial Stability Report noting that "the low level of depth means that liquidity provision remains fragile due to heavier reliance on sufficient rapid quote replenishment." That dependence "suggests that there is a higher-than-normal risk that a significant deterioration in liquidity provision could make prices even more volatile and lead to market dysfunction," the report said.

The housing market is on the front line of the Fed's drive to slow growth by raising the cost of credit. Since the end of last year, mortgage rates have risen by more than two percentage points, the fastest run-up in roughly four decades. Housing leads the business cycle and housing is slowing. Permits for future U.S. homebuilding tumbled to a five-month low in April. Building permits dropped 3.2% to a seasonally adjusted annual rate of 1.819 million units in April, the lowest level since last November. A survey on Tuesday showed the National Association of Home Builders/Wells Fargo Housing Market Index dropped to the lowest level in nearly two years in May. Builders blamed the fifth straight monthly decline in sentiment on soaring prices for building materials as well as rapidly rising mortgage rates. Cooling housing demand was reinforced by a separate report from the Mortgage Bankers Association on Wednesday showing applications for loans to buy a home dropped 12% last week from the prior week. They were down 15% on a year-on-year basis. Airbnb co-founder and CEO Brian Chesky warned: "this moment feels similar to late 2008 when we started" the online marketplace for lodging.

It also appears the 'strongest labor market ever' is showing signs of stress as the number of Americans seeking first time jobless benefits surged to 218k last week - its highest since mid-January. The reading was above the consensus estimate and projections of 200k. Though stocks and the economy don't always have a tight correlation, the rise in jobless claims coupled with recently weak earnings reports and a "fierce" stock-market sell-off, suggest that questions about the durability of the economy are leading to an uptick in layoffs. While the Fed won't say it, incremental joblessness is an inevitable outcome of current policy.

Finally, the cost-of-living crises continued to pound the British economy. Official figures released showed a jump in inflation to 9 per cent, the highest level the country has seen in more than 40 years. Stagflation is on the cards for several countries this year, but the UK is especially exposed to the toxic combination of high inflation and low growth. Huw Pill, the Bank of England's chief economist said that prices rising at more than four times the central bank's 2 per cent target made for "obviously a very uncomfortable situation" and pledged to bring inflation down. But he added that the BoE was still grappling with the difficult question of how much inflation would fall on its own, since household finances are being hit hard by the cost of living crisis. "The UK labour market is tight, wages are growing at stronger rates than would normally be deemed consistent with the inflation target, and business confidence is resilient, in part in anticipation of being able to re-establish profit margins. In short, inflationary momentum in the UK is currently strong," Pill said.

Next week, the World Economic Forum returns and the minutes of the most recent Federal Reserve rate-setting meeting will give markets insight into the US central bank's tightening path. The "Fed Put" could well be the theme.


Turning Sour
Forecasts for US growth and inflation later this year -- and beyond -- have been deteriorating rapidly
Expected growth rate in 4Q 2022
3.5%
3.0
2.5
2.0
1.5
Jan 2022
Apr
Expected inflation rate in 4Q 2022
6%
5
4
3
2
Jan 2022
Apr
Source: Bloomberg economist surveys
Note: Growth rate = 4Q year-on-year
Bloomberg

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