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A more circumspect market

Overview

Last week marked the end of the uptrend that had held sway for several weeks. Blame top brass at the Fed, who spoke up to remind us that their battle with inflation was far from over. Their remarks left investors in doubt as to whether the Fed would be more hawkish than expected at its next meeting in September. Additionally, the global economic backdrop has become increasingly troubling. The war in Ukraine is showing no signs of abating while electricity shortages are looming for Europe and hurting an already weakened Chinese economy. The climate is therefore fuelling increased distrust.

Fed might be more hawkish than originally expected at next meeting

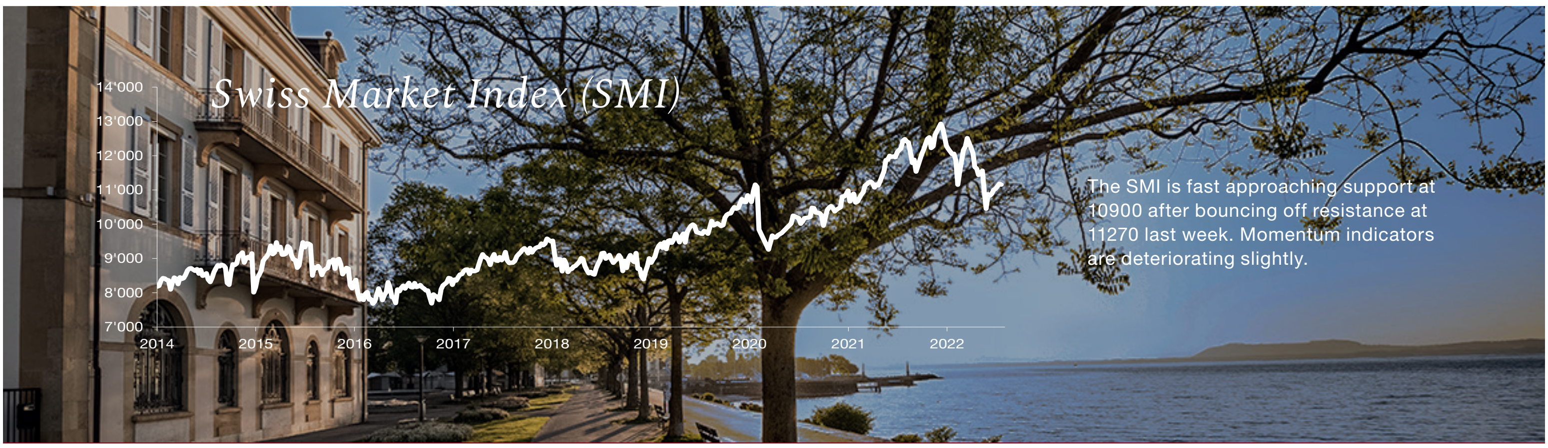
German producer prices were 37.2% higher year-on-year in July, stoking fears of a recession and runaway inflation in Europe as natural gas prices continued to rise (EUR 247 per megawatt hour). Eurozone inflation set a new record high of 8.9%. In the UK, it was 10.1%.

The US labour market remains strong and is substantiating the Fed's restrictive stance. Unemployment lies at its lowest mark (3.5%) since February 2020, before the pandemic hit, while the market added 528,000 jobs in July – well above the 398,000 in June.

China lowered its benchmark policy rates, as expected, while strengthening support for the property market. The government reduced the five-year loan prime rate – the benchmark rate for mortgages – by 15 basis points to 4.3% as it sought to alleviate the worsening housing crisis and strengthen demand for borrowing. But these easing moves are seen as too modest to provide significant stimulus to the economy. China's economy is facing mobility restrictions amid rising Covid cases and persistent difficulties in the real estate sector in addition to the energy shortage in Szechuan province – a key manufacturing hub. Although the Chinese authorities have pledged to step up support in response to the debilitated economy, their actions are capped by the risks of inflation and capital outflows.

China lowers benchmark policy rates

Attention this week will be focused on the major annual meeting of central bankers in Jackson Hole, Wyoming. The symposium is taking place against a backdrop of tightening monetary policies around the globe as central banks try to combat persistent inflation, which risks undermining the post-pandemic economic recovery. This dilemma – faced by the various rate setters – will lie at the heart of the discussions, while Powell's speech on Friday will set the tone for the Fed's next meeting.



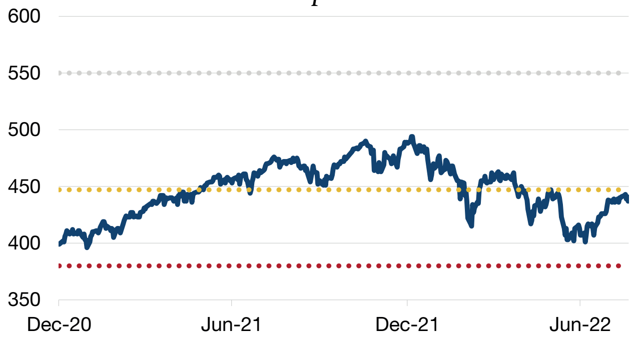
Key data

	USD/CHF	EUR/CHF	SMI	EURO STOXX 50	DAX 30	CAC 40	FTSE 100	S&P 500	NASDAQ	NIKKEI	MSCI Emerging Markets
Latest	0.96	0.96	11'156.72	3'730.32	13'544.52	6'495.83	7'550.37	4'228.48	12'705.21	28'930.33	1'001.46
Trend	→	→	→	→	→	→	↑	↑	↑	↑	→
YTD	5.16%	-7.18%	-13.35%	-13.22%	-14.73%	-9.19%	2.25%	-11.28%	-18.79%	0.48%	-18.71%

(values from the Friday preceding publication)

European stocks

Stoxx Europe 600 Index



Stocks and bonds both enjoyed propitious summer rallies, helped by resilient earnings and a bet on peak inflation. European equities have gained 9% since their early July low while corporate bonds are up 4.4% from their mid-June low.

But the lingering war in Ukraine, the energy crisis and runaway inflation are together reigniting fears of recession, and this is weighing on future corporate earnings. The appeal of equities could wane as an economic slowdown potentially triggers a flight to safety, which would benefit government and investment-grade corporate bonds.

The second quarter earnings season restored confidence in the European market as corporates showed that demand was robust enough for them to pass on higher costs to consumers. However, an economic slowdown is threatening the next few quarters and likely to undermine their profits.

European investment funds have seen outflows of USD 2.2bn over the past week, bringing the European market rally to a halt. The regional marketplace is largely made up of cyclical stocks and is therefore more sensitive to an economic slowdown that is becoming more and more evident across the Continent.

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