

MNI Market Analysis: Not So Much A Soft Landing

26 May 2022, Yvan Berthoux

Executive summary

- Since the start of the year, we have seen that a rising number of leading and financial 'leading' indicators have been pricing in a significant deceleration in the economic activity in the coming 6 to 12 months.
- Even though the Ukraine war shock is going to accelerate the process, global growth has been slowing down even before the February breakout, leaving market visibility extremely poor in the short to medium term.
- Hence, preference for the 'safe' US Dollar could remain high in the medium term.

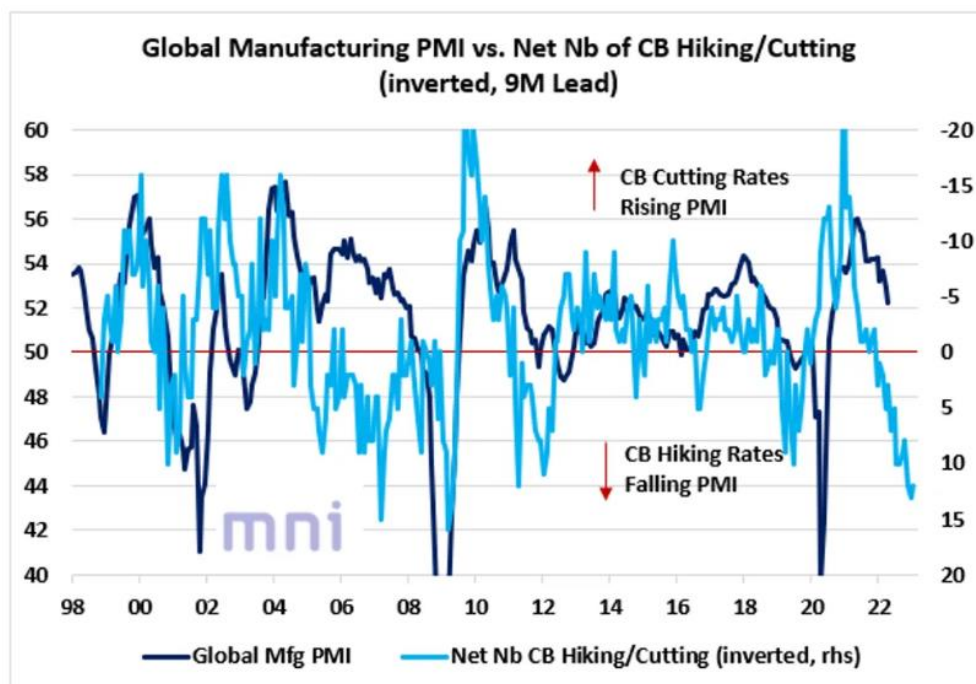
Economic Slowdown To Accelerate

Since the start of the year, we have seen that a rising number of economic and financial 'leading' indicators have been pricing in a significant deceleration in the economic activity in the coming 6 to 12 months. Even though the Ukraine war shock is going to accelerate the process, global growth has been slowing down even before the February breakout, leaving market visibility extremely poor in the short to medium term.

Figure 1 shows that the aggressive tightening run by central banks is pricing in a significant plunge in the global manufacturing PMI in the coming 9 months ('proxy' for real time growth). Out of the 38 central banks tracked by the BIS, 24 raised interest rates this month to tame inflation and support the domestic currency. CBR is the only major central bank that cut rates this month following the emergency meeting this morning, lowering its benchmark rate by 300bps to support the economy. Hence, the light blue line represents the net central bank hikes in May (23), which has historically acted as a strong 'leading' indicator of the global economic activity.

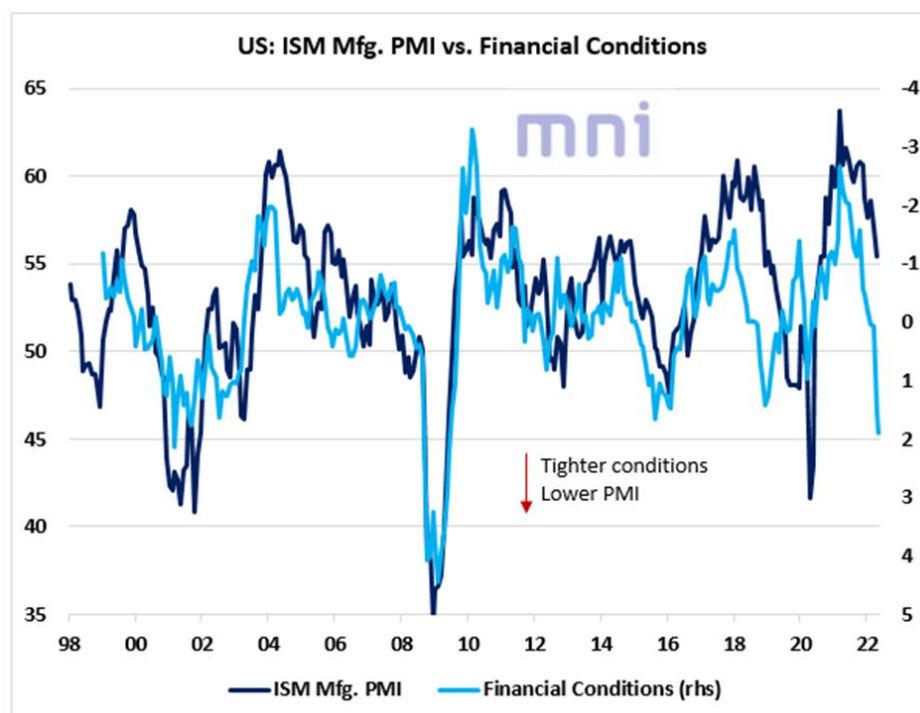
We see similar results when we look at the 2Y change in the 2Y yield; we have seen that periods of aggressive tightening are generally followed by a sharp economic slowdown. Figure 2 shows that financial conditions also prices in a significant deceleration in the economic activity (chart below), though the financial conditions index also includes equities, FX and credit.

Figure 1



Source: Bloomberg/MNI/BIS

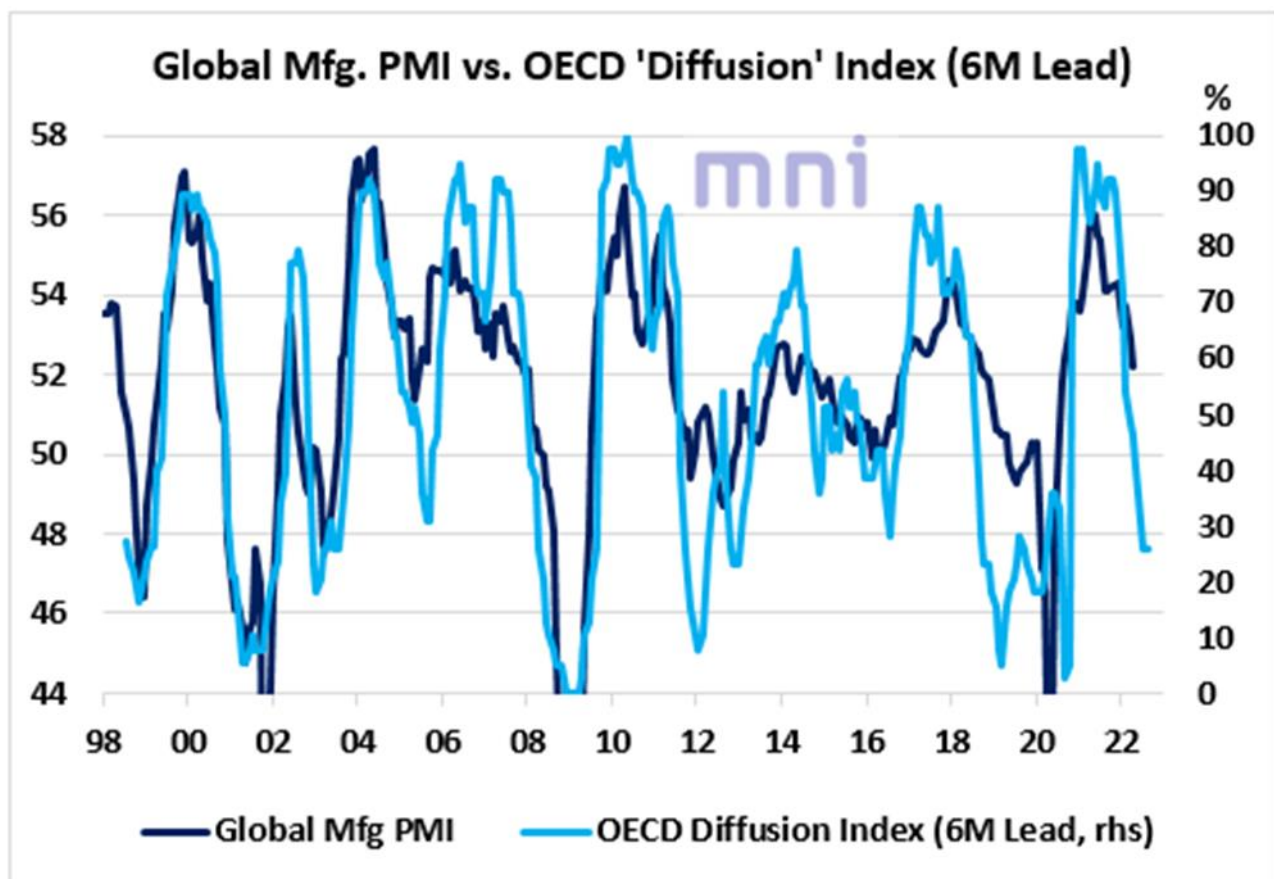
Figure 2



Source: Bloomberg/MNI

These charts adds to a series of charts that continue to point to a deterioration of economic conditions. This lengthening list includes the OECD 'diffusion' index, which looks at the percentage of countries with rising leading economic indicators (LEI). The number of economic countries with rising LEI fell from over 90% in November 2021 to 25% in February 2022 (total of 39 countries), and therefore is expecting a significant slowdown in economic activity (figure 3).

Figure 3



Source: Bloomberg/MNI

The sharp contraction in China 'liquidity' in 2021 has also been pricing in a significant drop in global Manufacturing PMI (figure 4).

Figure 4



Source: Bloomberg/MNI

China manufacturing PMI contracted to 47.4 in April, and has historically strongly led US manufacturing PMI by 6 months.

Figure 5



Source: Bloomberg/MNI

Could we expect the market to move on in the current environment with investors starting to buy the dip, particularly some sectors 'screaming' for value (i.e. banks)?

The short answer is no. The lack of visibility or convictions make it difficult to see a sustained bull market recovery in the near term. Every rally is considered a 'bear rally'. Investors would clearly need more support from CB to confirm their MT view on markets.

Bank of America FM survey shows that investors have been the most underweight on equities since May 2020, with a strong preference for cash. Other surveys show that market risk takers (i.e. traders, PMs) have switched their PA allocation to cash in recent months despite inflation rate nearing 10%.

Hence, USD preference could remain high in ST/MT

We have seen that the USD has been consolidating lower in the past two weeks, falling below the 102 level this week after reaching a local high at 105 on May 13. It is likely that the USD is experiencing a ST 'tactical' consolidation, but bull momentum could start to resume as economic data start to disappoint. First ST support zone stands at 101.2560 – 101.3540 (50DMA/ 23.6% Fibo), followed by the 100 key psychological level and then 99.0960 (38.2% Fibo of the 89.5350 – 105 range).

Figure 6



Source: Bloomberg

Unauthorized disclosure, publication, redistribution or further dissemination of this information may result in criminal prosecution or other severe penalties. Any such authorization requires the prior written consent of Market News International. Redistribution of this information, even at the instruction of your employer, may result in personal liability or criminal action unless such redistribution is expressly authorized in writing by Market News International. Violators will be prosecuted. This information has been obtained or derived from sources believed to be reliable, but we make no representation or warranty as to its accuracy or completeness. This is not an offer or solicitation of an offer to buy/sell. Copyright © 2021 Market News International, Inc. All rights reserved