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Seven reasons to be positive in this market environment

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Global supply chain pressures are easing

While still very elevated, global supply chain pressures have decreased, in part due to an improvement in China supply delivery times.

There are some bright spots in recent inflation data

While headline US inflation rose last month, I see a few positive takeaways in the recent data.

Positive economic signs have emerged in China

China’s second-quarter economic growth was disappointing, but June saw a solid rebound.

As I have mentioned before in this blog and in media interviews, I find the current global market environment to be overly pessimistic. After all, two years ago we were in the throes of a global pandemic and were unsure if there could be an effective vaccine developed against COVID ever, let alone in the near term. We are in a much different place today. Of course, it’s not ideal to have such a high level of inflation and such an aggressive tightening underway for many developed market central banks, but I’d argue we are in a far better place than we were two years ago.

However, that doesn’t seem to be how many feel. Pessimism is high for consumers, businesses, and financial markets in much of the world. I thought it might be helpful to provide a few reasons for optimism in this environment. Below are seven reasons to be positive in this environment.

1. Global supply chain pressures are easing

While still very elevated, global supply chain pressures have decreased over the last several months, as indicated by the Global Supply Chain Pressure Index. The decline in the last month was largely due to an improvement in China supply delivery times, which makes sense given that many cities have re-opened following COVID lockdowns. This indicates that at least one inflationary pressure is easing.

2. Commodity prices are on the decline

While still elevated, commodity prices are easing as well. The Goldman Sachs Commodity Index is down 19.92% from its peak this year, which was registered on March 8.[1] The Bloomberg Commodity Index is down 16.94% from its peak, which occurred on June 9.[1] This indicates that at least one other inflationary pressure is easing. By the way, this in turn should moderate the rate of increase in the goods portion of the US Producer Price Index (PPI) — with a lag, of course — which suggests that goods inflation is also likely to moderate sometime soon.

3. There are some bright spots in recent inflation data

While headline US Consumer Price Index (CPI) and Personal Consumption Expenditures (PCE) each rose in their last report, core CPI and PCE growth (which exclude food and energy prices) have very recently actually declined slightly.[2] And even though last week’s PPI print was higher than expected, there were a few positive takeaways to be found. Service PPI went up by only 0.4% month over month.[3] And the index for services for intermediate demand was unchanged in June, following seven consecutive advances.[3] These suggest that service sector inflation may moderate in the near future.

Longer-term US inflation expectations are becoming better anchored

We learned last week that five-year ahead inflation expectations, as measured by the University of Michigan survey, fell to 2.8% from 3.1% in the prior month.[4] The New York Fed Survey of Consumer Expectations, which was released early last week, showed similar results. Like the Michigan Survey, the New York Fed Survey showed an increase in one-year ahead inflation expectations and a decrease in five-year ahead inflation expectations. In addition, it also showed a material decrease in three-year ahead inflation expectations, from 3.9% in May to 3.6% in June.[5] These two surveys help confirm that longer-term inflation expectations are reasonably well-anchored and becoming slightly better anchored, which arguably could provide the Fed with the cover to not tighten policy so significantly that a recession ensues.

More specifically, it suggests the Fed is unlikely to hike rates by 100 basis points at its next meeting; 75 basis points seems more appropriate, in my view. This is in contrast to inflation expectations in Canada. A recent Bank of Canada Survey of Consumer Expectations showed five-year ahead inflation expectations rose from 3.23% in the first quarter to 4% in the second quarter,[6] which helps to explain why the Bank of Canada felt the need to increase rates by 100 basis points at its last meeting.

Positive economic signs have emerged in China

China's second-quarter economic growth was disappointing, but June saw a solid rebound. China reported a disappointing Q2 gross domestic product growth of 0.4% year-over-year due to Omicron-related lockdowns.[7] However, growth broadly rebounded in June as pandemic restrictions eased. We continue to expect an economic recovery in the second half, led by industrial production and infrastructure investments due to pro-growth policies.

The COVID situation in China has improved

Cities have reopened and economic activity is improving. However, there have been increases in infection rates reported recently in some areas, which has some worried that wide-scale lockdowns could occur again. To me, this seems very unlikely given that China's COVID policy has evolved and adapted in recent months — from a Zero COVID policy to a Dynamic Zero COVID policy to a Dynamic Social Zero COVID policy. That means smaller areas, such as neighborhoods, could be locked down in the event of a rise in infections rather than larger geographical areas. This policy is supported by daily COVID testing, which enables policymakers to react quickly to any increase in infections, before it can spread broadly.

When pessimism permeates markets, positive surprise can be more powerful

Stocks have been beaten down. That doesn't mean we won't see more downside for some stock markets around the world, especially given that earnings expectations are likely to be adjusted downward. But I believe we are far closer to the bottom than the top — and meaningful positive catalysts could present themselves in coming months.

With contributions from Tomo Kinoshita, Arnab Das, David Chao and Brian Levitt

Notes

[1]Source: Bloomberg, as of July 15, 2022

[2]Source: Bloomberg, Macrobond, Invesco. Data through June (headline) and May (core), as at 15 July 2022

[3]Source: US Bureau of Labor Statistics, as of 7/14/22

[4]Source: University of Michigan Survey of Consumers, as of July 15, 2022

[5]Source: Federal Reserve Bank of NY Survey of Consumers, as of July 11, 2022

[6]Source: Bank of Canada Survey of Consumer Expectations, Second Quarter 2022, July 4, 2022

[7]Source: China National Bureau of Statistics (NBS). Data as of June 2022

The New York Fed's Global Supply Chain Pressure Index (GSCPI) integrates a number of commonly used metrics with an aim to provide a more comprehensive summary of potential disruptions affecting global supply chains.

The S&P Goldman Sachs Commodity Index (S&P GSCI) is a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities.

The US Producer Price Index (PPI) is compiled by the US Bureau of Labor Statistics and measures the average change over time in the selling prices received by domestic producers for their output.

The US Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics. Core CPI excludes food and energy prices while headline CPI includes them.

The Core Personal Consumption Expenditures Price Index measures the price changes of consumer goods and services, excluding food and energy prices. It is reported by the US Department of Commerce's Bureau of Economic Analysis.

Intermediate demand includes goods, services, and maintenance and repair construction sold to businesses, excluding capital investment

The Survey of Consumers is a monthly telephone survey conducted by the University of Michigan designed to assess US consumer expectations for the economy and their personal spending.

The New York Fed's Survey of Consumer Expectations is a nationally representative, Internet-based survey of a rotating panel of approximately 1,300 household heads.

The Canadian Survey of Consumer Expectations (CSCE) is a quarterly survey aimed at measuring household views of inflation, the labor market and household finances, as well as topical issues of interest to the Bank of Canada.

A basis point is one hundredth of a percentage point.