24 June 2022

Global Markets Research

Research Alert

PMI data warned of weakening activity

- **Manufacturing expansion slowed in the US, Eurozone, UK and Japan**
- **Surveys showed softer new orders, higher cost pressures & poorer sentiments**
- **Japan's services PMI boosted by tourism revival**

The latest set of PMI readings are stacking up the evidence of an impending global downturn. The stubbornly high inflation and deteriorating consumer sentiment in western developed economies are shaping up to be a most tricky summer to manoeuvre with central banks vowing to contain price pressure at all cost.

Manufacturing sector experiencing weaker demand

The preliminary S&P Global PMI (formerly known as IHS Markit PMI) data showed that manufacturing sectors in the US, Eurozone, UK and Japan are experiencing some form of weakening demand conditions heading into the third quarter. The surveys reported new orders contracting in the US and Japan, slowed substantially in the UK and stagnated in Europe. Factories also struggled with slower new export orders, indicating softer external conditions. Words of supply chain constraints and high inflation continued to show up numerous times in these surveys, highlighting the persistent supply chain issues and higher raw material costs stemming from the Ukraine-Russia war and Covid-19 restrictions in China. In the US, manufacturing production posted its first decline (albeit a modest one) in May after sustaining a near-1% average growth rate for three months. The first batch of regional Fed manufacturing gauges (NY, Philly, Kansas City Fed) all come in at negative levels.

Services sector gripped by poorer sentiment in the West:

The services PMI readings were more mixed across these economies. Whereas the US and Eurozone recorded lower PMI readings, the UK PMI managed to sustain the same level from the previous month while Japan saw an uptick, thanks to international border reopening. Nonetheless, key themes identified remain similar namely weakening demand, higher cost pressures, supply chain related issues and retreating sentiment. Accordingly, in the Eurozone, the record growth in tourism and recreation activity in the Apr-May period "faltered to a near stand-still" in June. This is in line with the most recent drop in the Eurozone Commission's consumer sentiment gauge past the series' pandemic low point.

Similarly in the UK, despite slightly better services PMI reading, many surveyed respondents pointed out headwinds from the cost-of-living crisis and mounting economic uncertainty. The GfK Consumer Confidence plunged to a new record low this month of which the sub-index that gauges the climate for major purchases was buried deep in the negative territory, a precursor to what may be a large pullback in household spending. UK inflation has surged to 9.1% y/y in May, consistent with the BOE's prediction

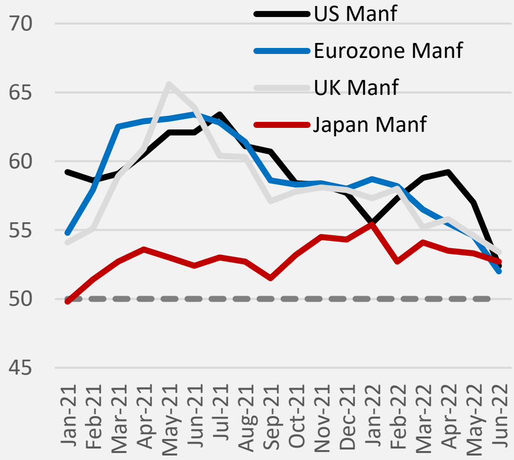
Figure 1: Preliminary S&P Global PMI for key economies in June

	Manufacturing	Services
US	52.4 (57.0)	51.6 (53.4)
EU	52.0 (54.6)	52.8 (56.1)
UK	53.4 (54.6)	53.4 (53.4)
Japan	52.7 (53.3)	54.2 (52.6)

Numbers in () are May readings

Source: Bloomberg, S&P Global

Figure 2: Manufacturing PMIs converging to low 50s



Source: Bloomberg

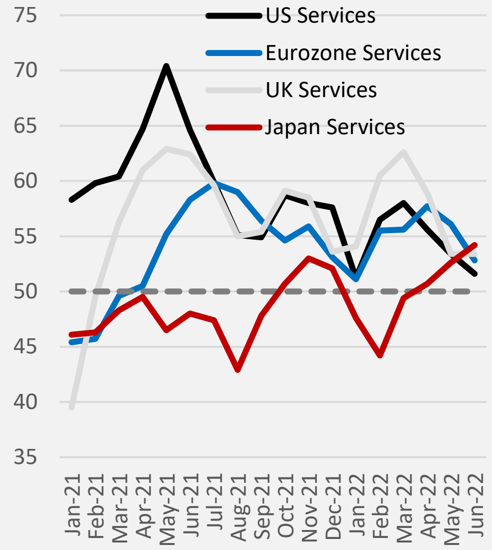
that CPI will be above 9.0% for a few months before heading up to 11.0% in October when the country's energy regulator raises the electricity price cap.

Japan's services PMI outperformed temporarily:
On the other hand, Japan's services PMI was boosted by the revival of tourism activity following the easing of international border restrictions starting from 01 June. Retail sales had managed to sustain two months of 1.0% m/m increase in March-April, in line with the broader measure of household spending in the same period. The private sector did report a further robust increase in prices in June as the higher costs of material and staff were passed to customers. Even so, we think that the extent of cost passing likely remains limited as seen in the sharp difference in PPI inflation vs CPI inflation as output gap remained negative and the Japanese economy and employment has yet to return to pre-pandemic levels.

In fact, inflation readings stabilised instead of accelerating in May; the all-item CPI inflation remained unchanged at the more-than-seven-year high of 2.5%, which is comparatively lower compared to its western counterparts' 8.0-9.0% rates. Inflation remained very much supply driven, boosted in part by the surge in prices of global energy of which Japan is a net importer. The BOJ's preferred measure of CPI-ex-fresh-food remained at above 2.0% for the second month but still well below the nearest peak of 3.4% in 2015. The narrowest gauge- CPI excluding food and energy turned higher at 0.8% for the past two months, in part driven by the low corresponding bases.

However, the negative real wage growth in April (-1.2% y/y) suggests that the growth in spending may be short-lived as pent-up demand will fade while short-term inflation expectations rise. Having said that, the services resumption will likely to help boost headline wage growth given Japan's currently tight labour market, thus offering some mitigation.

Figure 3: Services PMIs slightly mixed



Source: Bloomberg

Hong Leong Bank Berhad
Fixed Income & Economic Research, Global Markets
Level 8, Hong Leong Tower
6, Jalan Damanlela
Bukit Damansara
50490 Kuala Lumpur
Tel: 603-2081 1221
Fax: 603-2081 8936
Email: HLMarkets@hlbb.hongleong.com.my