



R&R Weekly Column  
By Brunello Rosa



## Investors Must Remember the Asynchronous Nature of Financial and Business Cycles

Last week, the US recorded a second consecutive quarter of negative growth (-0.9 q/q SAAR), after Q1 1.6% contraction. Traditional economic theory would suggest that the US has entered a technical recession, however [prominent economists](#) and policymakers suggest this may not necessarily be the case. Former US Secretary of the Treasury [Lawrence Summers said](#) that the US is not in a technical recession because the largest negative contribution to GDP growth came from a drawdown of inventories, which is partly a sign of the economy's strength. In effect, inventory decumulation provided a -2% contribution to Q2 growth, [while export and consumer spending provided positive contributions](#).

Previously, [Federal Reserve Chair Jay Powell said](#) that, even in the case of two consecutive quarters of negative growth, the US would not be in a technical recession because the first quarter's negative figure may be due to residual seasonality (and may be revised subsequently), and that the broad-based contraction in economic activity that is typical of a recession is not yet there, in spite of the clear weakening of growth observed by the central bank in Q2 2022.

So, the question remains: are the world's major economies entering a recession at some point this year? If inflationary pressures persist, if the energy crisis intensifies, and central banks continue to increase rates to combat rising prices, *it is almost inevitable that between Q4 2022 and Q1 2023 a recession will begin*. While a vast majority of economists expect that such a recession, if it does occur, will be shallow, Nouriel Roubini expects it to be sharp and prolonged, [given the stagflationary global debt crisis that is accompanying it](#). Even if those conditions mentioned above do not materialise all at once, it will still be very difficult to avoid some form of hard landing, in spite of central banks' best efforts.

Let us assume then that some form of recession will materialise between 2022 and 2023. What would the implications of this be for central banks and markets? Central banks would likely have to stop increasing rates, as the recession will cause the tightening of economic and financial conditions that central banks are pursuing with their current policy actions. Money market futures do predict that the Fed and the BOE, for example, will cut rates in 2023. We expect a deceleration in the pace of tightening from the Fed [and the ECB towards the end of 2022](#).

As far as markets are concerned, [investors celebrated Powell's words accompanying the Fed's second consecutive 75bps rate increase in July with a relief rally](#). Powell said that the Fed will decide its policy meeting by meeting, since it is data dependent; in the past, when central banks become "data dependent", this has generally been seen as anticipating a shift in stance, in this case towards a less aggressive posture. So, is it possible that, even as the economy is about to enter its worst phase, financial markets will hit bottom and start recovering?

Well, yes, it is entirely possible that this will occur, given the asynchronous nature of the financial and business cycle. Financial markets tend to anticipate what happens to the real economy (and even more so the labour market, which is a lagging indicator), as they are able to immediately reflect new information into prices (if one believes in the "efficient market hypothesis"). Over the years, empirical models have been developed to formalise this relationship. For example, an inversion of the yield curve (as is the case in the US currently) is considered to be a predictor of an upcoming recession. Equity markets tend to hit bottom a few quarters before a recession ends (as happened in March 2009 in the US, for example). But even Hyman Minsky's "financial instability hypothesis" suggests that the financial cycle turns well before business cycles do.

In coming months therefore we may observe financial markets bottoming out, while the economy tanks. There is one big *caveat* here, though. If the recession morphs into a systemic crisis, for example by triggering a stagflationary debt crisis – as Nouriel Roubini suggests may happen – then both equity and bond markets may experience another leg down, as commodity prices continue to increase given supply bottlenecks and the impact of the war in Ukraine.

### Our Recent Publications

📌 [Flash Preview: BoE To Increase Bank Rate by 50bps in August](#), by Brunello Rosa and Nato Balavadze, 29 July 2022

📌 [Flash Review: Fed Hikes Fed Funds by 75bps, But Ongoing Rate Increases Will be Data Dependent](#), by Brunello Rosa and Nato Balavadze, 27 July 2022

📌 [Preview: For Now The Fed to Continue Its Policy Tightening Undeterred by The Weakening Economy](#), by Nouriel Roubini, Brunello Rosa and Nato Balavadze, 25 July 2022

📌 [GEOPOLITICAL CORNER: A Man-Made Crisis: The International Technocracy Is Culpable in the Assisted Suicide of Sri Lanka](#), by John C. Hulsman, 19 July 2022

Looking Ahead

The Week Ahead: Unemployment To Be Unchanged In US And EZ; PMIs To Decrease In DMs, Even To Fall Below 50 In US And EZ

**In the US**, in July, the unemployment rate is expected to stay unchanged at 3.6% and NFPs are likely to slow down to 250K (*p*: 372K). In July, manufacturing and service PMIs are seen decreasing to 52.3 (*p*: 52.7) and 47 (*p*: 52.7) respectively. Composite PMI is expected to fall to 47.5 (*p*: 52.3).

**In the EZ**, in June, the unemployment rate is expected to stay unchanged at 6.6%. Also in June, retail sales are likely to shrink by -1.6% y-o-y (*p*: 0.2%). June's PPI is seen rising by 35.7% y-o-y (*p*: 36.3%). July's manufacturing and service PMIs are seen falling to 49.6 (*p*: 52.1) and 50.6 (*p*: 53) respectively. Composite PMI is expected to fall to 49.4 (*p*: 52).

**In the UK**, in July, manufacturing and service PMIs are seen falling to 52.2 (*p*: 52.8) and 53.3 (*p*: 54.3) respectively. Composite PMI is expected to fall to 52.8 (*p*: 53.7).

**Still in the UK**, the BoE is expected to increase its Bank Rate by 50bps 1.75%.

The Quarter Ahead: EU-wide Plan on Gas Rationing Is Reached; The US Imposes Sanctions; IMF Cuts Global Growth Outlook

**EU Energy ministers reach a deal on a 15% gas reduction plan.** Voluntary savings of 15% from now until next spring could amount to 45 ml cubic meters of gas. The European Council noted that there could be 'some exemptions' from a mandatory reduction target in the event of an emergency. Meanwhile, Russian Gazprom suspended gas supplies to Latvia.

**The US announced a new package of sanctions against Russia.** The US unveiled new sanctions on two Russians individuals and four Russian entities accusing them of supporting Moscow's global malign influence and election interference operations. According to US authorities, the sanctioned individuals and entities raised funds and spread false information to derange the American electoral process. As reported, the measures need to be taken separately from war-related sanctions.

**In its updated World Economic Outlook, the IMF slashed economic forecasts again.** The IMF warned of 'an increasingly gloomy and uncertain outlook'. Higher-than-expected inflation, China's lockdown, and negative spillovers from the war weigh on the global economy and could push it to the brink of recession. World growth is seen slowing from 3.2% in 2022 to 2.9% in 2023.

Last Week's Review

Real Economy: QoQ GDP Shrank In US And Rose In EZ; EZ Inflation Accelerated; US PCE Increased; Fed Hiked Rates

**In the US**, in Q2, according to advance estimates, GDP shrank by -0.9% q-o-q (*c*: 0.5%; *p*: -1.6%). PCE and Core PCE rose to 6.8% y-o-y (*p*: 6.3%) and 4.8% y-o-y (*p*: 4.7%). July's Michigan Consumer Sentiment increased to 51.5 (*c*: 51.1; *p*: 50).

**Also in the US**, the Fed increased its target Fed funds range by 75 bps to 2.25% - 2.5%.

**In the EZ**, in Q2, according to flash estimates, the economy expanded by 0.7% q-o-q (*c*: 0.2%; *p*: 0.5%) and slowed down to 4.0% y-o-y (*c*: 3.4%; *p*: 5.4%). In July, headline and core inflation rose to 8.9% y-o-y (*c*: 8.6%; *p*: 8.6%) and 4.0% y-o-y (*c*: 3.8%; *p*: 3.7%). July's economic sentiment decreased to 99 (*c*: 102; *p*: 103.5) and consumer confidence deteriorated further to -27 (*p*: -23.8) as expected.

**Among the largest EZ economies**, in Q2, *i*) France's GDP advanced by 0.5% q-o-q (*c*: 0.2%; *p*: -0.2%) and grew by 4.2% y-o-y (*p*: 4.8%) *ii*) German economy reports 0% q-o-q growth (*c*: 0.1%; *p*: 0.2%) and 1.4% y-o-y (*c*: 1.7%; *p*: 3.8%); and *iii*) In Italy, GDP rose by 1.0% q-o-q (*c*: 0.3%; *p*: 0.1%), whereas it slowed down to 4.6% (*c*: 3.7%; *p*: 6.2%). July's annual harmonized inflation rate: *i*) rose in France to 6.8% (*c*: 6.7%; *p*: 6.5%); *ii*) surged in Germany to 8.5% (*c*: 8.1%; *p*: 8.2%); and *iii*) decreased in Italy to 7.9% (*c*: 8.1%; *p*: 8.0%).

Financial Markets: US And EZ Stocks Post Gains; Yields Fell; Dollar Slides, While Oil And Gold Prices Rose

**Market Drivers:** Investors worry more about the recession than inflation, even though the U.S. annual PCE inflation posts the largest increase since 1982. It is believed that the economic downturn would cause the Fed to soften its aggressive hiking campaign. As a result, the dollar weakened versus the EUR and equities rallied.

**Global Equities:** Increased w-o-w (MSCI ACWI, +3.3%, to 637.7). The US S&P 500 index increased (+4.3% w-o-w, to 4,130.3). In the EZ, share prices were up (Eurostoxx 50, +3.1% w-o-w, to 3,708.1). In EMs, equity prices increased (MSCI EMs, +0.7%, to 993.8). Volatility fell to 23.4 (VIX S&P 500, 52w avg.: 23.4; 10y avg.: 18.1).

**Fixed Income:** w-o-w, 10-year US treasury yields fell (-9.6 bps to 2.66%). The 2-year US Treasury yields decreased too (-8.2 bps to 2.89%). The German 10-year bund yield also fell (-20 bps to 0.83%).

**FX:** w-o-w, the US Dollar Index was down (DXY, -0.9%, to 105.7; EUR/USD +0.1%, to 1.02). In EMs, currencies strengthened (MSCI EM Currency Index, +0.7% w-o-w, to 1,661.11).

**Commodities:** w-o-w, oil prices rose (Brent, +5.7% to 104 USD/b). Gold prices also increased w-o-w (+2.1% to 1,764 USD/Oz).



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## Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year

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