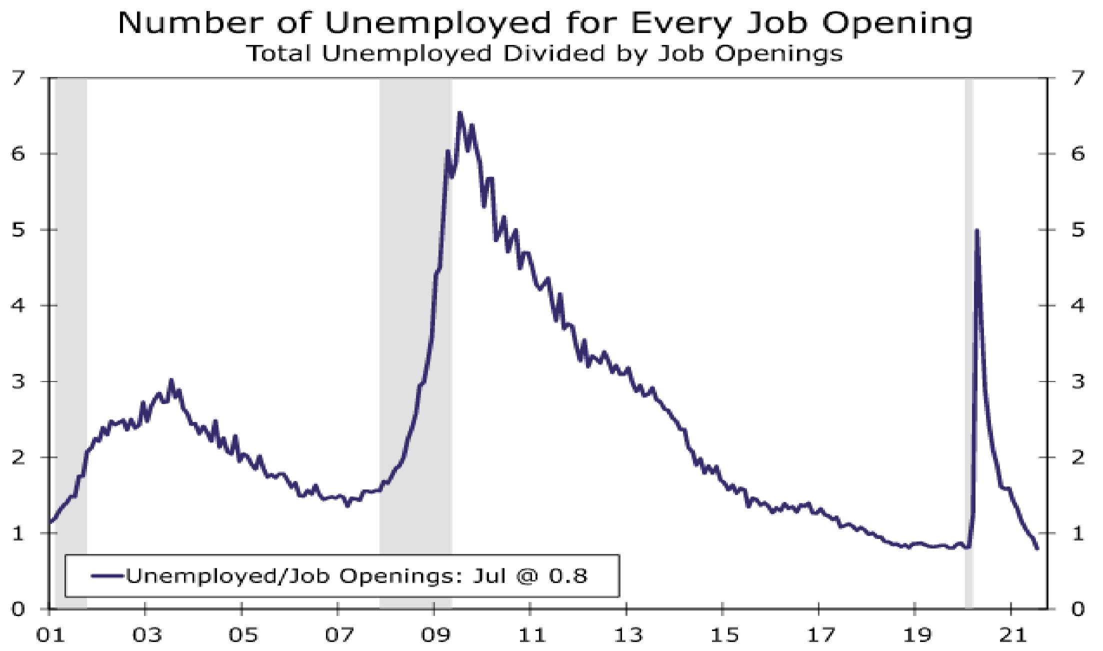
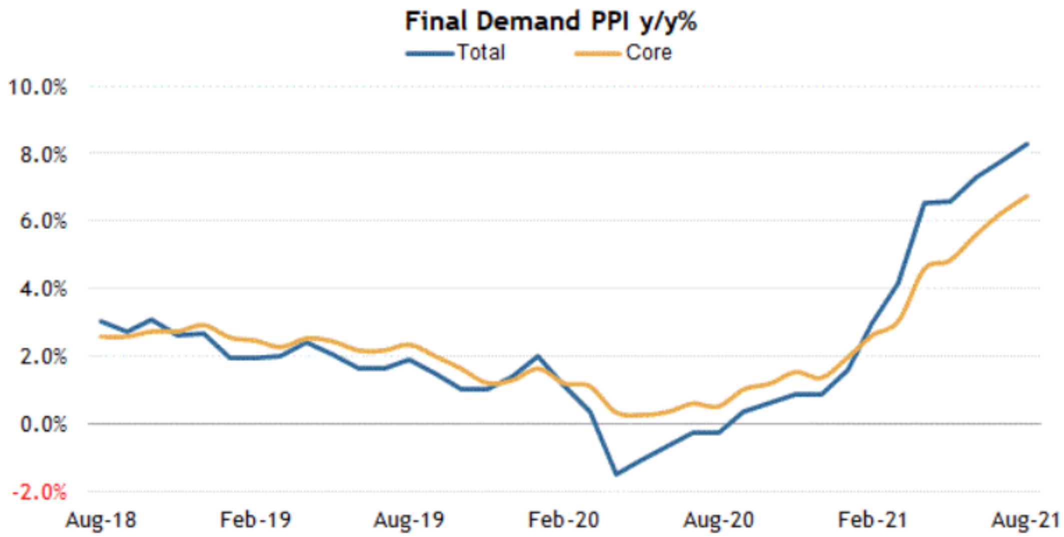
# Weekly Market Update

12 Sept 2021

# US Economy : Whiff of Caution

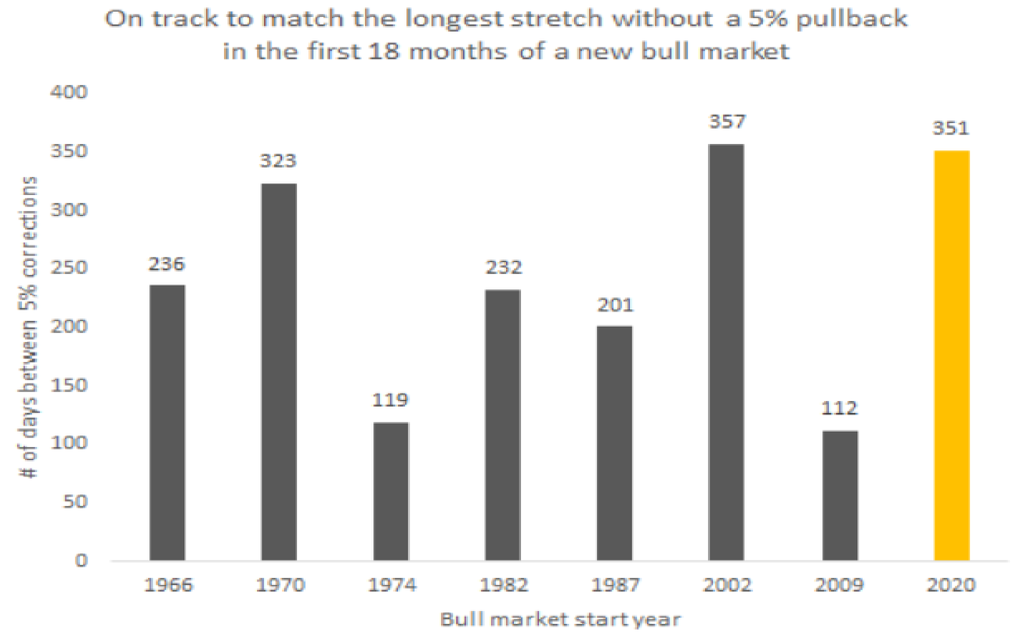
- In a slow week for economic data, the same themes that have hampered the re-opening boom have persisted.
- Supply-chain disruptions are proving to be more persistent -Wide spread labor and material shortages are restraining production, holding back the recovery, and driving prices higher.
- According to JOLTS data ,there were a record 10.93 million positions waiting to be filled in July, almost 1 million more than consensus estimates.
- initial jobless claims have continued to come down and reached a post-pandemic low of 310000 in the week of Sept 4.
- Consumer borrowing slowed in July after two record increases.
- Finally, inflation worries may have continued to weigh on sentiment. Beige book noted that inflation is “steady at an elevated pace,” with half the Fed’s 12 districts reporting “strong” pressure while the other half said it was “moderate.”
- August PPI showed that month-over-month growth in PPI for final demand came in a tick above expectations at 0.7%, bringing the year-over-year increase to 8.3%

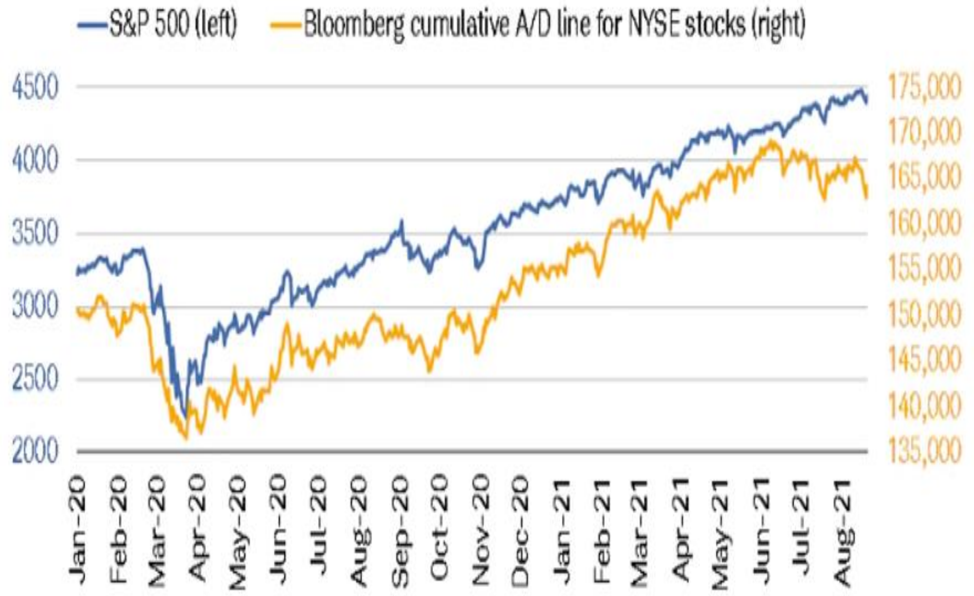


# US Equity : Sept 2020 Repeat ?

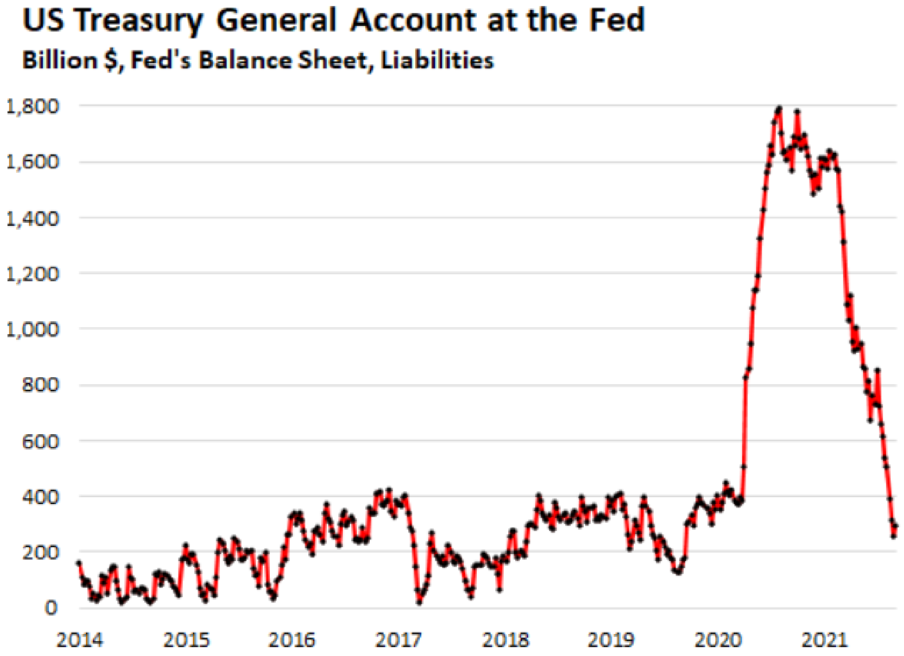
- Since the bear-market bottom last March (about 18 months ago) , there has been a bull market marked by lack of downside volatility. The last time the S&P 500 experienced a 5% or more pullback was about a year ago, in September 2020, when stocks declined 9.6% from the highs
- Absent a sharp decline in the next few days, the current stretch (number of days without a 5% pullback) will be the longest in the first 18 months of a new bull market since 1965.
- Generally, market breadth indicators highlight the percentage of stocks in an index trading above moving averages; or the number of stocks rising relative to the number that are falling—often incorporating volume statistics as well.
- An analogy often used to explain why breadth matters comes from the battlefield. When the generals are on the front line; but the soldiers are lagging behind, the force is less powerful than when the soldiers are on the front line alongside the generals.
- Although the S&P 500 traded at an all-time high as recently as last week, the cumulative advance/decline (A/D) line for the broader NYSE universe peaked on June 11 this year.
- The divergence between the two looks similar to early-September last year—the point at which it was mostly the “big 5” stocks within the S&P 500 (the “generals”) that had powered the S&P 500 to its September 2, 2020 high.



# Key issue : Debt Ceiling

- On August 1, 2021, the amount of the gross national debt outstanding, a monstrous $28.43 trillion, became the "debt ceiling" that cannot be breached until Congress raises it, suspends it, or changes the definition of what "debt" means, as it has done 78 times since 1960.
- The Government is now paying for the deficits, not by issuing new debt, but by drawing down the TGA and by using "extraordinary measures"
- At the rate of decline since August 1, the TGA balance will hit zero near mid-October. This out-of-money date could be extended by "extraordinary measures" into November, which is when US government would begin defaulting on its bills:
- Learning from Obama — who vowed not to negotiate over the debt ceiling after doing it once — Biden is essentially daring Republicans to vote down a debt limit suspension or increase.
- Since Republicans led by Senate Minority Leader Mitch McConnell announced publicly that his party members would not support an increase in the debt limit, Biden administration has not had any additional talks with him on the issue.

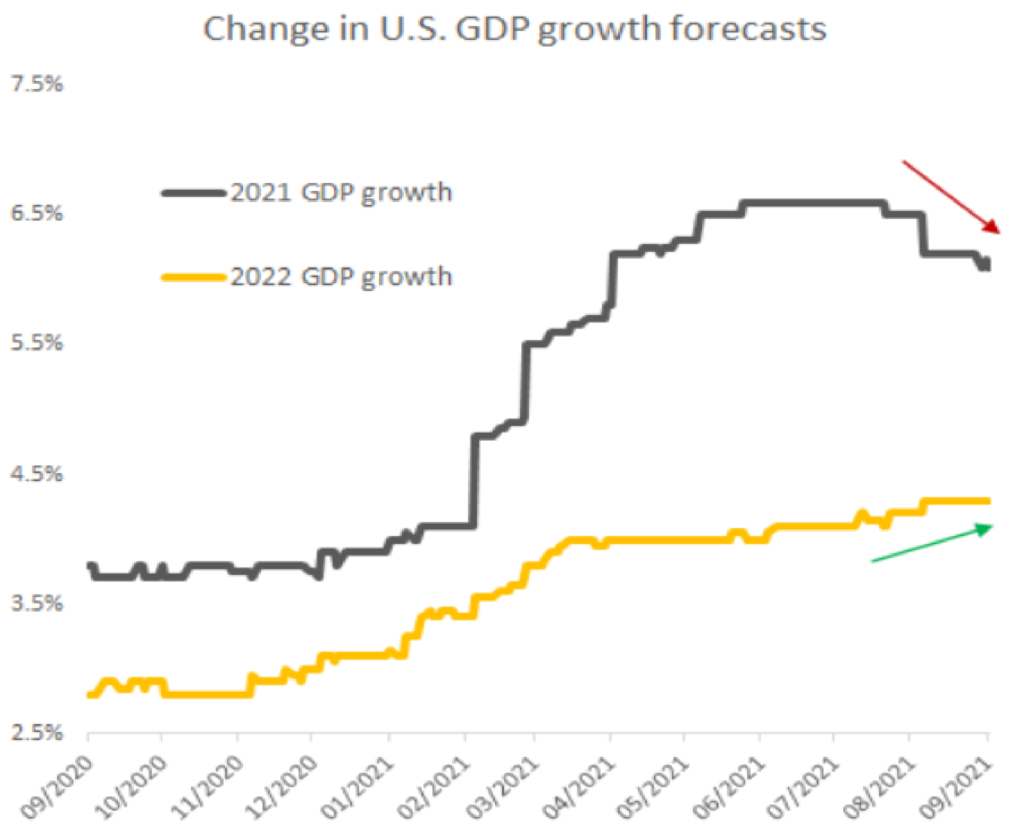



# Risk to Build back better…

- Biden said that the government should have two focuses in September.  The top priority, he said, is beating back the  pandemic. But he also pushed Congress to pass his two major spending plans  . However , the emerging risk is that  Build Back Better" agenda — and that many progressive priorities, from universal preschool to free community college, are in danger of dying this Congress.
- House Democrats are seeking to move quickly on the $3.5 trillion package, aiming to have all committees approve their portions of the legislation by Sept. 15; however, key challenges remain.
- Democrats want to push the package through using a fast-track process known as reconciliation that allows budget-related legislation to advance through the Senate by simple majority rather than the usual 60 votes
- The margin for error is minuscule. With the 50-50 Senate just a single defection will sink the reconciliation bill.
- It's not clear how Democratic congressional leaders will balance the demands of  Sen .Manchin for a smaller reconciliation bill with promises from party progressives to torpedo the infrastructure bill if they don't get what they want in reconciliation. Democratic Senator Joe Manchin backs as little as USD 1 trillion of Biden's USD 3.5 trillion spending plan, highlighting the wide gap between moderates and progressives, although there were reports later in the week that Manchin might be willing to go as high as USD 2 trillion.
- Manchin’s vote will be critical in passing the legislation in the evenly divided U.S. Senate (with Vice President able to break the deadlock).
- A fight over the cap on state and local tax deductions could prove Democrats’ another hurdle in passing their $3.5 trillion budget reconciliation package.

# US Growth : Toned down Optimism

- The last couple of weeks have seen a flurry of downgrades to third-quarter and 2021 GDP growth forecasts.
- A survey of 71 investment firms shows that the economy is now expected to grow about 6% this year, which would still be the fastest pace since 1984 but below the almost 7% rate that was projected at the end of July
- The main culprits for the downbeat narrative are
    - 1) softening consumer demand impacted by the delta variant
    - 2) lingering supply-chain disruptions.
- The silver lining is that growth and economic output are possibly shifting from the third quarter to the fourth (best-case scenario) and next year, instead of being completely lost
- With increased vaccinations and COVID-19 cases appearing to crest, the reopening process is likely delayed, not derailed.

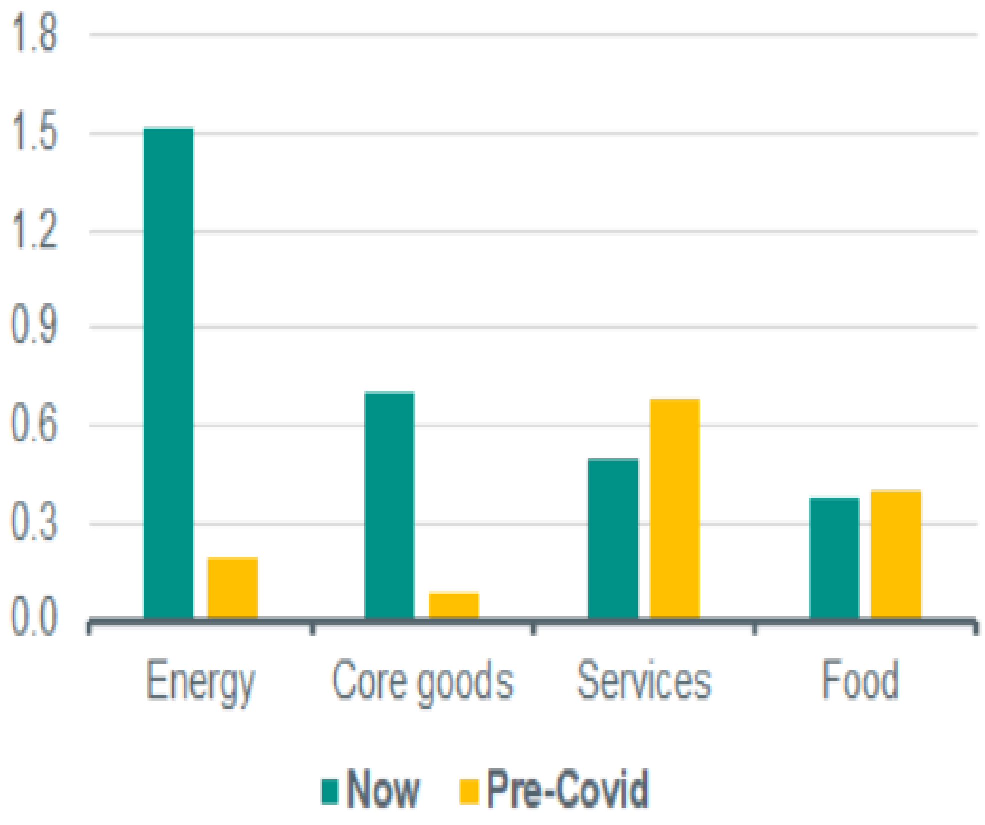



- Schools reopen and the expiration of the enhanced unemployment benefits could push more workers to rejoin the labor force, alleviating some of the labor shortages.
- And inventories, which are extremely lean because of the supply-chain disruptions, will need to be rebuilt, adding to growth.

# Eurozone Inflation : Transitory

- The jump in headline inflation to 3% yoy in August has seen the transitory vs permanent debate on consumer prices in Europe.
- Looking at the details of the rise of consumer prices as well as the underlying drivers suggest that this rise will indeed prove transitory.
- The rise in inflation is driven entirely by energy and to a lesser extent core goods inflation. Services inflation is on balance modestly lower, while the contribution of food prices has been stable, though both items have displayed volatility in between.
- Another transitory factor that has been putting upward pressure on consumer price inflation more broadly is taxes.
- Most importantly, Germany cut its value added tax in the second half of last year and subsequently returned it to its previous level at the start of this year. This has led to a significant base effect, pushing up inflation, from July onwards.
- For instance, the ex-tax HICP inflation rate is currently 0.6 percentage points lower than the headline. This effect should fade in January

Contribution to HICP inflation, ppts to % yoy rate



# ECB : the lady is not tapering

- ECB decided to slow its PEPP bond purchases to a 'moderately lower pace of net asset purchases under the pandemic emergency purchase programme (PEPP) than in the previous two quarters. This slowdown was widely expected and probably as close to the market consensus as there could be. The entire press conference unfolded in a quite predictable fashion.
- Lagarde quipped that ‘the lady isn’t tapering’, apparently drawing on the spirit of Margaret Thatcher.
- The decision was based on the view that favourable financing conditions can be maintained at a lower pace of purchases and indeed likely reflects the fall in weighted sovereign yields over the summer.
- ECB gave further guidance of the next re-calibration to take place at the December meeting, which was widely as expected. The 'calibrate, not taper' narrative gave us deja-vu of the December 2016 press conference. Further TLTRO operations will be discussed alongside the general stance at the December meeting, but will be data dependent.
- ECB ‘s forecast for GDP growth in 2021 was revised higher (to 5.0%, up from 4.6% in its June forecasts), which mainly results from higher than expected growth in Q2 and upward revisions of earlier quarterly growth numbers. As a result of the 2021 growth number, the level of GDP will return to its pre-pandemic level (i.e. 2019Q4) in the final quarter of this year.
- ECB’s inflation forecast for 2021 was revised higher to 2.2%, up from 1.9%, that for 2022 to 1.7% from 1.5% and that for 2023 to 1.5% from 1.4 %
- Fiscal rather than monetary policy will increasingly determine how the euro area recovery continues in 2022 and in that respect the outcome of Germany’s upcoming parliamentary election will play a crucial role.

# German Election : Shift to the Left ?

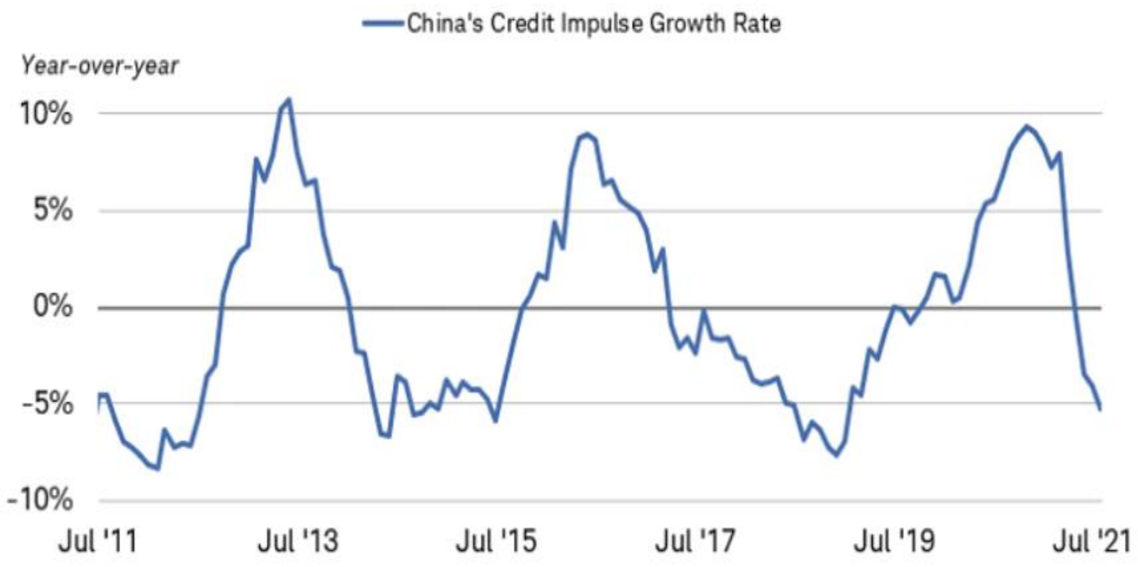
- In line with a broader trend of changes in European politics, Germany's political landscape has become more fragmented in recent years.
- This has resulted in a move away from the traditional parties around the centre of the political spectrum, towards Green parties and extreme left and right. Polls have seen a dramatic shift to the left over the last couple of weeks. While last-minute changes remain a possibility, it now looks very likely that the next coalition government will be dominated by parties from the left.
- If the SPD were indeed to win the election, its leader Olaf Scholz would become the next Chancellor and the SPD would also take the lead in the formation of the next coalition, which will have different political priorities than the previous coalition. For instance, Germany's traditional fiscal austerity might shift towards a more expansionary policy stance with less stringent debt restrictions, which would give the government more fiscal leeway.
- Polls have been relatively accurate in the past to predict German election outcomes. However, an added element of uncertainty this time stems from the increased share of mail voting. In 2017 nearly one third of voters voted via mail, this time it is expected that the share will rise to 40-50%
- A union between SPD and the Greens will have to be joined either by the centre-right liberal FDP or the left-wing Die Linke. Market impact is expected to be EUR negative in both cases - more pronounced if Die Linke joins the coalition.
- Entering a coalition with the Die Linke will probably not be the SPD's first choice, as Olaf Scholz has stated that he considers Die Linke too radical and hard-left. However, a potential coalition with Die Linke has also not been completely ruled out by neither the SPD nor the Greens.
- If the liberal FDP rejects a coalition with the SPD and the Greens (which seems very likely), a left-wing coalition will be the only option left for the SPD. This type of coalition (SPD, Greens, Die Linke) has already governed Germany's state Berlin since 2016

# Chinese Grey Rhino

- Stress is mounting for the most obvious grey rhino in China, namely the real estate sector. From a general perspective, the sentiment for real estate has worsened towards the level of Q1 2020, the peak of Covid-19 pandemic in China.
- Evergrande's business model is representative of "China's highly debt-dependent growth model". In 2020, Chinese companies' debt represented 160 % of GDP, compared to just 85 % in US and 115 % in Eurozone
- Markets are bracing for the increasing risk that Chinese real estate colossus Evergrande will collapse under the weight of more than $300 billion of debt-roughly equivalent to the entire public debt of Portugal . But it is common knowledge that China will have no choice but to save a company that is so emblematic of its economic growth model – and whose collapse would send shockwaves across the global economy.
- Evergrande got its fingers into so many pies because it wanted a presence in a sufficient number of priority sectors so that the state would be more inclined to support it financially when the weight of its debt became too heavy to bear. Evergrande find themselves in a tricky situation now that Beijing has pushed heavily indebted countries to deleverage over the past year.
- For Evergrande, the chain of credit events, such as delayed interest payments and legal cases from creditors, has damaged investors' confidence and led to plummeting market view since early 2021..
- If Evergrande went bankrupt, the markets expect at least one bank to go under - That may well push other banks to be more reluctant to end to highly leveraged countries – and that would herald the end of China's debt-fuelled growth model
- From the demand side, home loan growth is slower and mortgage rates have trended higher, such as the changes in Shanghai. For real estate firms, the focus has switched from rapid expansion to debt control.
- Cleaning up a mess as big as a $300 billion debt pile will be a tough proposition and risk is a global contagion where markets choose to dislike leverage

# China : Cost of Common Prosperity

- China's regulatory and credit policies have been rippling through the Asian and EM economies.
- The market has been responding to uncertainty about what this heightened regulation means for the private sector. The pace of the regulatory crackdown is such that no sector is safe.
- China's new emphasis on "getting rich together," or "common prosperity," would likely mean further regulatory headwinds
- The decline in credit growth has led to slower economic growth and contributed to a drop in commodity prices.
- China's credit impulse tracks the growth rate of credit in China—as of July, the year-over-year growth rate in credit was -5.29%.
- The decline is likely to weigh on the Chinese yuan relative to U.S. dollar.
- Given that China is a top trading partner of the U.S., it is the second-highest currency weight in the Fed's trade-weighted dollar index.
- This means a weaker CNY translates to a stronger trade-weighted dollar.

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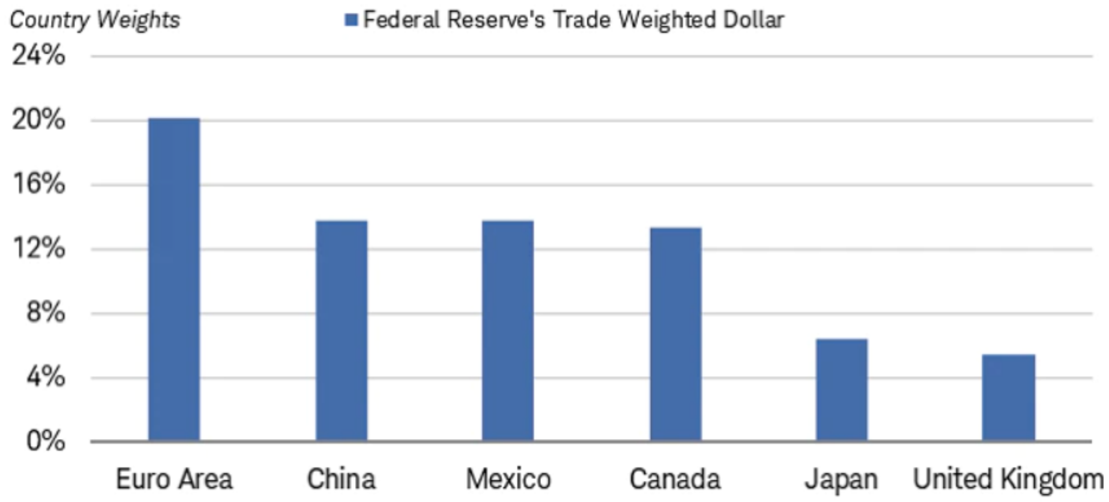

# India : Liquidity sustains

- In an extraordinary disclosure, RBI Governor said MPC was currently not looking at its legal mandate of keeping CPI inflation at 4%. Commenting on any possible link between the highly accommodative financial conditions and inflation, he said there was no evidence of surplus liquidity stoking inflation. And while the excess liquidity may be influencing asset prices in India and globally, there is no evidence that high asset prices were feeding into inflation.
- As such, the argument is that inflation had not become generalized.
- Liquidity in the banking system, which is estimated to be at near all-time highs, has been driving demand for gilts, especially the shorter-maturity papers, as banks prefer to park their surplus money in these gilts.
- Result of the auction showed strong demand - Greenshoe for a newly issued gilt is a very rare case and it indicates very firm demand - Centre borrowed Rs .328.60 bln against Rs 310 bln it had notified, by exercising greenshoe option in the 5.63%, 2026 gilt, the floating rate bond 2034 and the new 14-year 6.67%, 2035 gilt.
- Despite the exercise of the greenshoe option, the coupon set on the new 14-year gilt was largely in line with estimates, while, the cutoff price for the 5.63%, 2026 gilt was higher than expected.
- **WPI inflation** is expected to have edged down to 10.8% in August from 11.16% the previous month. A favourable base effect in August, for the third consecutive month, will likely pull wholesale inflation lower. Lower food prices for cereals and pulses in particular should also aid in the easing of WPI .
- **Retail inflation** is seen little changed in August from 5.59% in July. Monsoon shortfall, fuel price rigidity, service sector reopening gains, and pass-through of higher input price pressures continue to underpin the sequential pace.

# Nifty : Contrarian call

- There are generally two ways of looking at extended market cycles:
  - We are in the midst of a paradigm shift. It is different this time. Markets have fundamentally changed. The top performers are going to continue outperforming.
  - Everything is cyclical so it’s time to be a contrarian. It’s not different this time. We’ve seen this before. Nothing works forever and always.
- Hence it is not prudent to be guided by the price action in a given week for extrapolating the future direction as the sentiment wildly swings believing either of the two notions
- While the markets remained relatively pessimistic in the beginning , the current optimism is at times irrational .
- The price action in key indices this week was extremely thin in one of the narrowest weekly trading ranges for a long time now. The domestic optimism continue to outweigh the global caution.
- Although Nifty looked uncomfortable around key 100 % retracement level of 17350 -17400 throughout this week, there was no discernible weakness.
- Break of 17230 on the downside to see 16660