



SECOR Asset Management

Macroeconomic Update with a Focus on Inflation

June 14, 2022

Global Macroeconomy: Cross Currents Reflected Latest Data/Reports

▪ **Elevated and Persistent Inflation Major Headwind**

- US May CPI report another upside surprise¹
- Central banks increasingly hawkish² / Global financial conditions tightening
- OECD and World Bank recently lowered their '22 global GDP forecasts to trend-like growth

▪ **Robust Fundamentals Potential Source of Continuing Support**

- Strong job gains, rising wages, and near-record excess savings continuing to buttress global consumer spending³
- Manufacturing output remains positive/ rebound in China's May PMIs somewhat reassuring
- New global Covid cases still close to last summer's lows

▪ **Key Questions Coming to Fore**

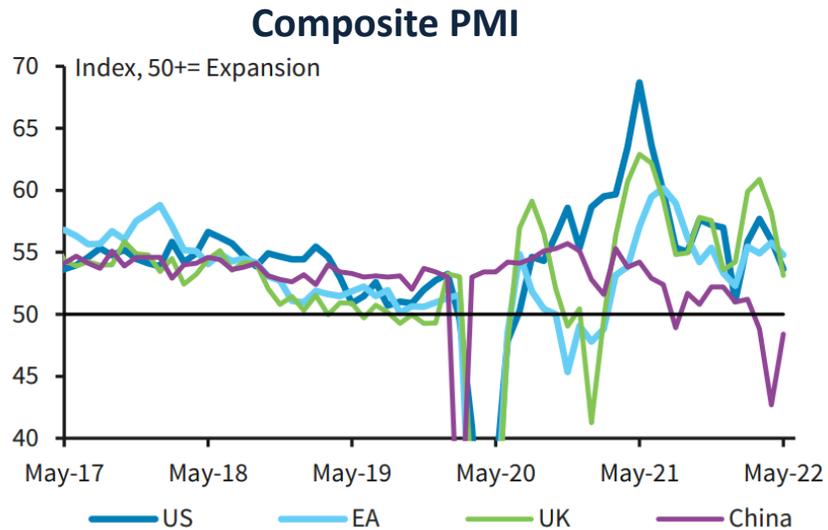
- Likelihood of '22-'23 recessions / severity of the recession, if one occurs
- Possible cyclical and longer-term implications of China's recent unprecedented weakness

1. Headline CPI rose 1% in May to 8.6% over a year ago, a 40-year high. Increase broad-based with indexes for shelter, gasoline, and food largest contributors. Core inflation was up 6% over a year ago in May. Increase was broad-based with particularly large increases for used cars (16.1%) and airfares (37.8%).

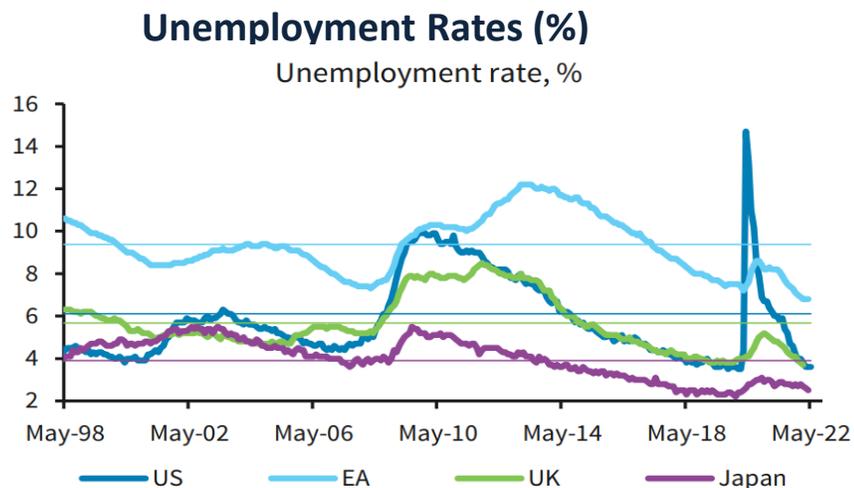
2. The ECB is now expected to raise its policy rate 75 bps by September. Fed had been signaling a 50 bps increase at this week's meeting but post May CPI 75 bps appears possible and perhaps likely.. The MPC is expected to raise UK bank rate 25 bps at its June meeting

3. OECD recently lowered its '22 global GDP outlook to 3% from 4.5% and the World Bank lowered its forecast for '22 GDP growth to 2.9% from 4.1% in January.

Composite PMI Consistent With Moderate Growth/ Employment Source of Support



- PMIs in advanced countries have declined from elevated levels but remain in expansion territory
- China's May PMI slightly below 50 but up notably from April lows. Similarly, weakness in retail sales and industrial production narrowed significantly in May

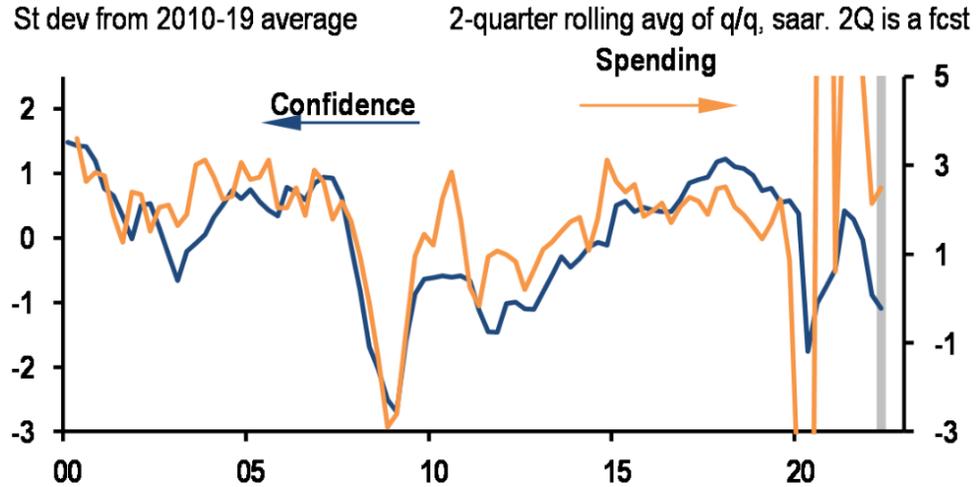


Note: Horizontal lines show Long-term average for respective countries

- Employment strength remains a sign of resilience for the global economy
- Unemployment rates in DMs near historic lows

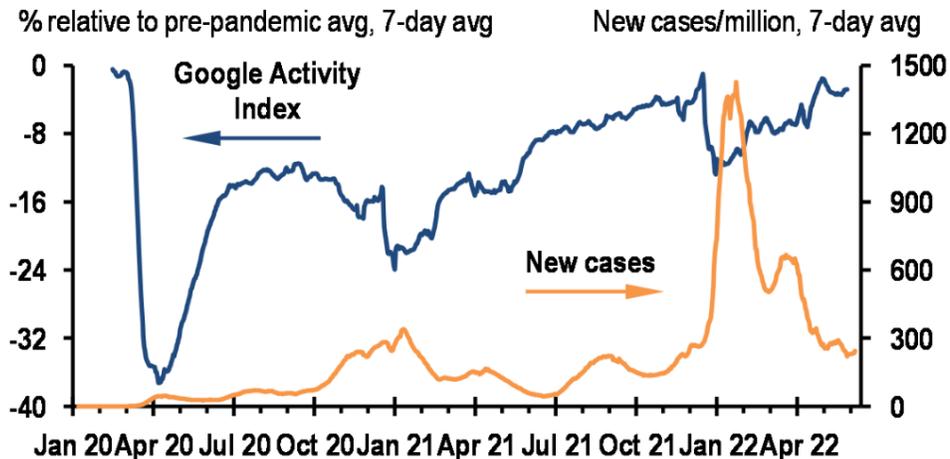
DM Consumers / Global Mobility New Covid Cases

Consumer Spending / Confidence, DM



- Despite inflationary concerns depressing confidence (blue line), consumer spending (gold line) is holding up thus far...
- Accumulated saving appear to be continuing to support spending

Global Mobility/ New Covid Cases



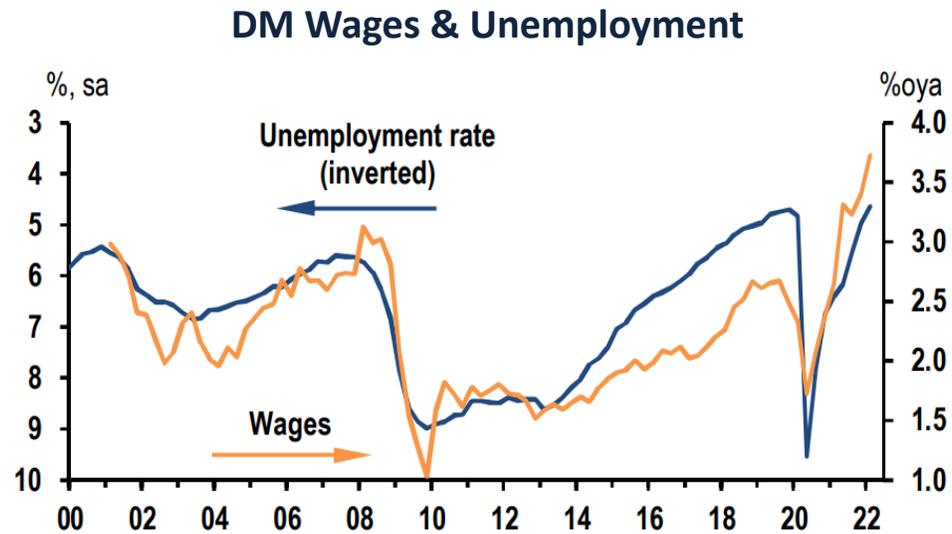
- New global COVID-19 cases have declined from peaks earlier in year and are approaching year ago lows
- Correspondingly, global mobility is edging toward pre-pandemic level

Source: National Sources, Google, OWID, JPM

Global Inflation: Surging and Evolving / DM Wages Rising



- Global headline inflation tracking a 10% annual rate this quarter reflecting surging energy and persistent strength in core prices
- Some moderation reflected in latest core goods prices but service prices rising sharply



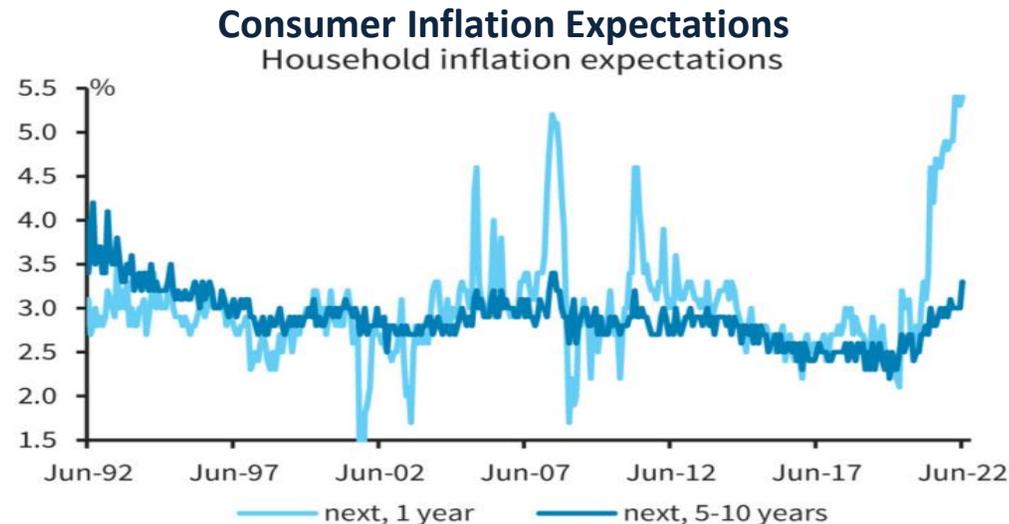
- Strong DM wage growth accompanying robust labor-market recovery
- Rapidly rising wages significant challenge for businesses trying to maintain margins and for central banks trying to engineer soft landings

Source: National Sources, JPM

Longer-Run Inflation Expectations Near Higher End of Multi-Decade Range



- Longer-run inflation expectations are rising but arguably still anchored
- GBP 5y/5y forward-swap break-evens are near 15-year highs, whereas US and Euro 5y/5y break-evens are up from recent lows but still below 15-year peaks



- US consumers are understandably very concerned about near-term inflation, but their longer-run expectations are still below early-'90s levels

Source: Bloomberg, U of M, Haver, Barclays

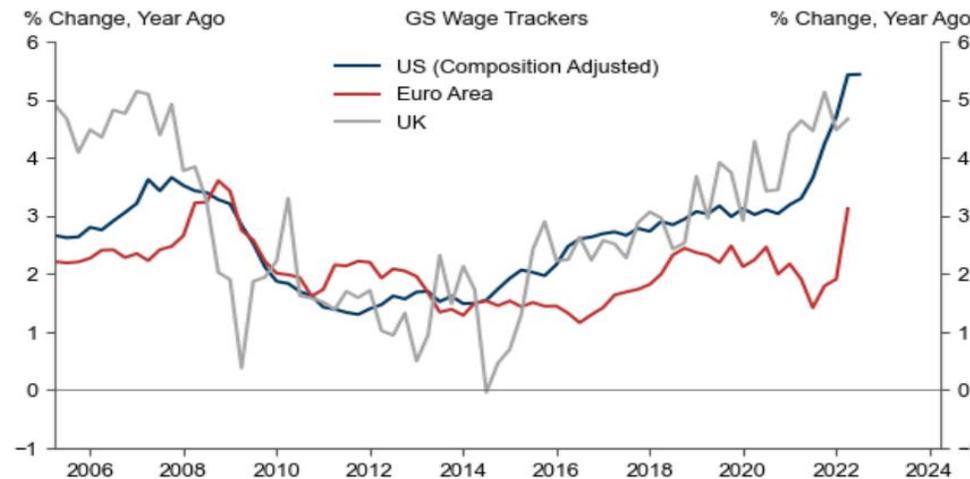
US, UK, Euro Area Inflation & Wage Pressures Similarities/Differences

Core Inflation



- Widely monitored US & UK *core* inflation barometers currently well above Fed & BoE's targets but still only 0.5%-pt. above ECB's target (red line)

Wage Trackers



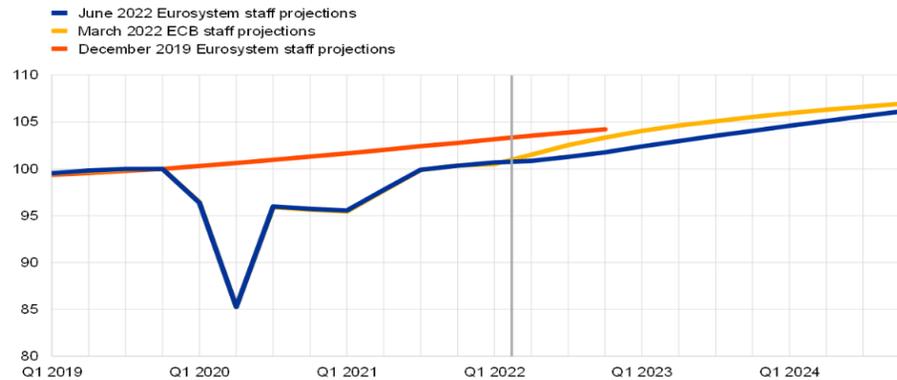
- Correspondingly, wages are currently tracking 4.5% - 5.5.% rates of increase in the US and UK versus ~3% in Europe
- Overall, Europe appears to be more exposed to risks from Russia curtailing energy exports further, whereas the US and UK appear to be more exposed to inflation risks

Source: Natural Sources, GS

ECB's Revised Euro area Economic Outlook: June 2022

Baseline Real GDP Outlook

(chain-linked volumes, Q4 2019 = 100)



Euro area HICP

(annual percentage changes)



Note: The vertical line indicates the start of the projection horizon.

1. ECB forecast also includes downside GDP scenario. Severe disruptions in energy supplies could cause recession in late –'22-23 — e.g., baseline '23 GDP + 2.1% vs. -1.7% in downside scenario

Source: ECB

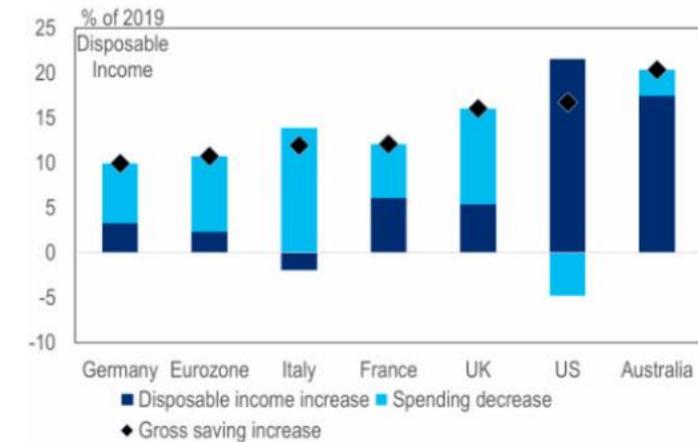
- Rising inflation and supply bottlenecks largely related to invasion of Ukraine are dampening Europe's cyclical outlook (blue line)
- At the same time, phasing out of pandemic restrictions and excess saving are continuing to support moderate growth¹
- Energy prices are expected to be the prime driver of continuing ~ 7.5% headline inflation in the Euro area over the balance of the year
- Inflation is expected to decline to 3.5% in '23 and 2.1% in '24 due to base effects, unwinding of pandemic-related distortions, and improved terms of trade

Likelihood /Severity of '22-'23 Recession

Can Inflation be Tamed Without Precipitating Recession?

- Central bank's job "take punch bowl away when party ... warming up" (1)
 - Taming inflation has usually but not always led to a recession
- Credible case for arguing "this time would be different" until recently
 - Supply shocks /pandemic distortions underpinned '21 inflation
 - Now rising wages & bond yields have retired "transitory" label

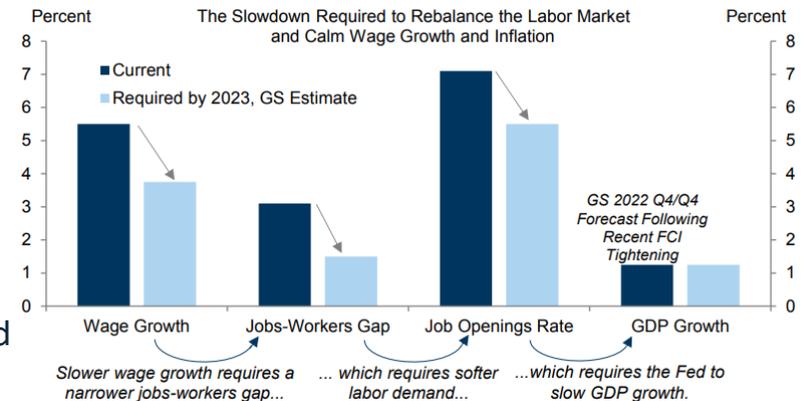
Selected Economies – Cumulative Excess Saving Q1 2020 to Q4 2021 (% of disposable income)



Soft Landing / Recession Probability / Mild Recession, if One Occurs

- *Soft Landing Case*² — Limited pandemic scarring & unwinding of distortions, record saving
 - Should allow tightening conditions & demand destruction from high inflation to ...
 - Gradually slow economic activity and inflation without precipitating a recession
- *Near-Term Recession Probabilities Problematic*
 - GS forecast: 15% recession probability over next 12 months / 35% next 24-months
 - Recent FT poll: nearly 70% of academic economists expect US recession next year
- *Mild Recession if One Occurs*³ — Strong fundamentals, 2022 isn't 1973-74 redux..
 - Today's policy makers in better position /current inflationary episode barely year old

GS Framework for Soft Landing



Data as of 5 June 2022.

1. William McChesney Martin, Fed Chairman 1951 – 1970
 2. Soft landing case: JPM US economist JPM European economist also argue low probability of recession in Europe.
 3. Alan Blinder, "If We Get a Recession Soon, It'll Be a Mild One" WSJ, April 2022

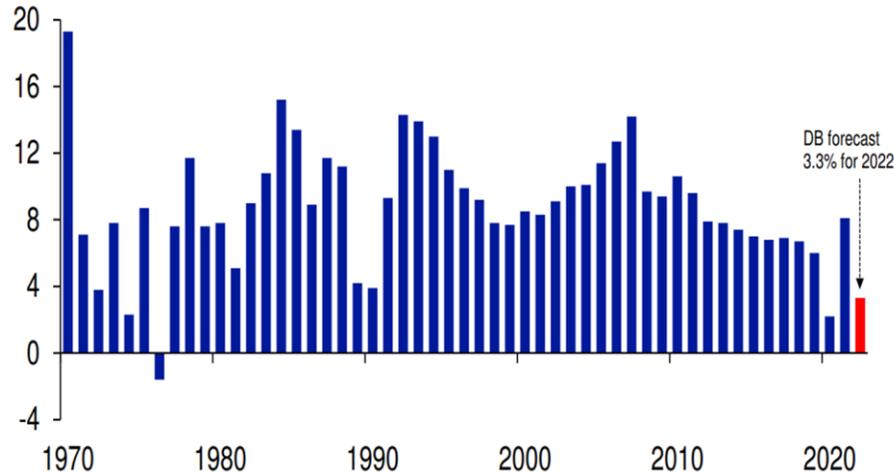
China: Questions Re Near & Longer-Term Policies and Outlook

- **China's Zero-Covid Tolerance Policy Arguably Unique Global Success at Least Until Recently**
 - Soon after Covid-19 outbreak emerged in Wuhan and Hubei province in January 2020
 - China imposed lockdowns and electronic surveillance on ~ 60 million citizens
 - Able to relax initial lockdowns within few months and then ...
 - Sporadic lockdowns, mass testing, and limiting access to country enabled China...
 - To maintain relatively strong growth and minimize Covid outbreaks and fatalities
 - China only major country to achieve positive GDP growth in 2020
- **Efficacy of Zero-Tolerance Covid Policy, However, Being Questioned Currently**
 - China, however, was seemingly not well prepared to cope with Omicron variant
 - Low vaccination rates -- particularly among elderly, mRNA vaccines not available, low antibody protection
 - 2022 lockdowns more pervasive than prior counterparts
 - ~373 million people in 45 cities representing 40% of economic output in some form of lockdown in late April/ May
 - Shanghai's 26 million residents were locked-down and strict measures were imposed on Beijing's residents
 - Re-openings now in progress as new case levels have fallen far below recent peaks
 - Baring another significant resurgence, mobility, construction, and ports should fully recover in month
 - But V-shaped growth recovery similar to the spring of 2020 unlikely¹

1. Policy stimulus less expansionary and rebounds in exports and property expected to be less robust

China: GDP: Post-Mao Era Growth History / Q1 2022 Growth vs Target

Real GDP Growth History¹

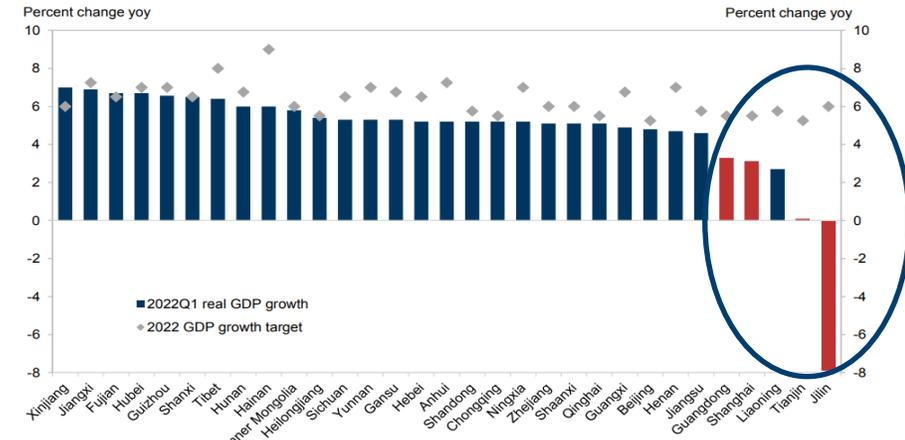


Source: CNBS, Haver, DB

- Aside from the pandemic-constrained 2020, this year is on track to be China's lowest year for growth...
- Since 1976 which was at the eve of liberation that launched a 40+ year extraordinary growth trajectory

1. Deutsche Bank forecast 2022 of 3.3% is ~ 1%-point below consensus
 2. Other Covid-impacted provinces in Q1 included Shanghai, Guangdong and Tianjin

Q1 2022 GDP Growth vs. Target



Note: For provinces that set the growth target above a level, we display the target as +0.25% of that level. Red denotes provinces with the highest Covid cases or Covid case to population ratios in Q1

Source: Wind, GS

- Provinces impacted by lockdowns in Q1 experienced significant growth shortfalls
- Jilin's GDP, which was largely fully locked down in March, fell 7.9% in Q1 vs. 6% growth target

China: Questions Re Near & Longer-Term Policies and Outlook

- **Key Question: What, If Any, Will Be Longer-Term Effects of Recent Growth Shortfall & Lockdowns**
 - Might there be a “reset of the reset”?
 - Based on recent discussion with a PM for large Asian real estate portfolio¹...
 - Answer depends importantly on composition of new Politburo Standing Committee
- **Premier Li Keqiang’s Views Seem to be Gaining Some Traction²**
 - Li seemingly committed to working within party but open to more market-friendly and pragmatic policies than Xi
 - Credited with achieving some push back on recent technology crackdown
- **Interesting Contrast Between Xi’s and Li’s Presumed Favored Candidates for Next Premier**
 - Xi reportedly favors Shanghai’s party secretary...
 - Who led that city’s long and oppressive lockdown
 - Li favors candidates such as Wang Yang who heads China’s top government advisory body and was...
 - Known for entrepreneurship and technology development when he ran southern province of Guangdong

1. Discussion with manager of large Asian real estate portfolio referenced in April 29, 2022, quarterly outlook presentation

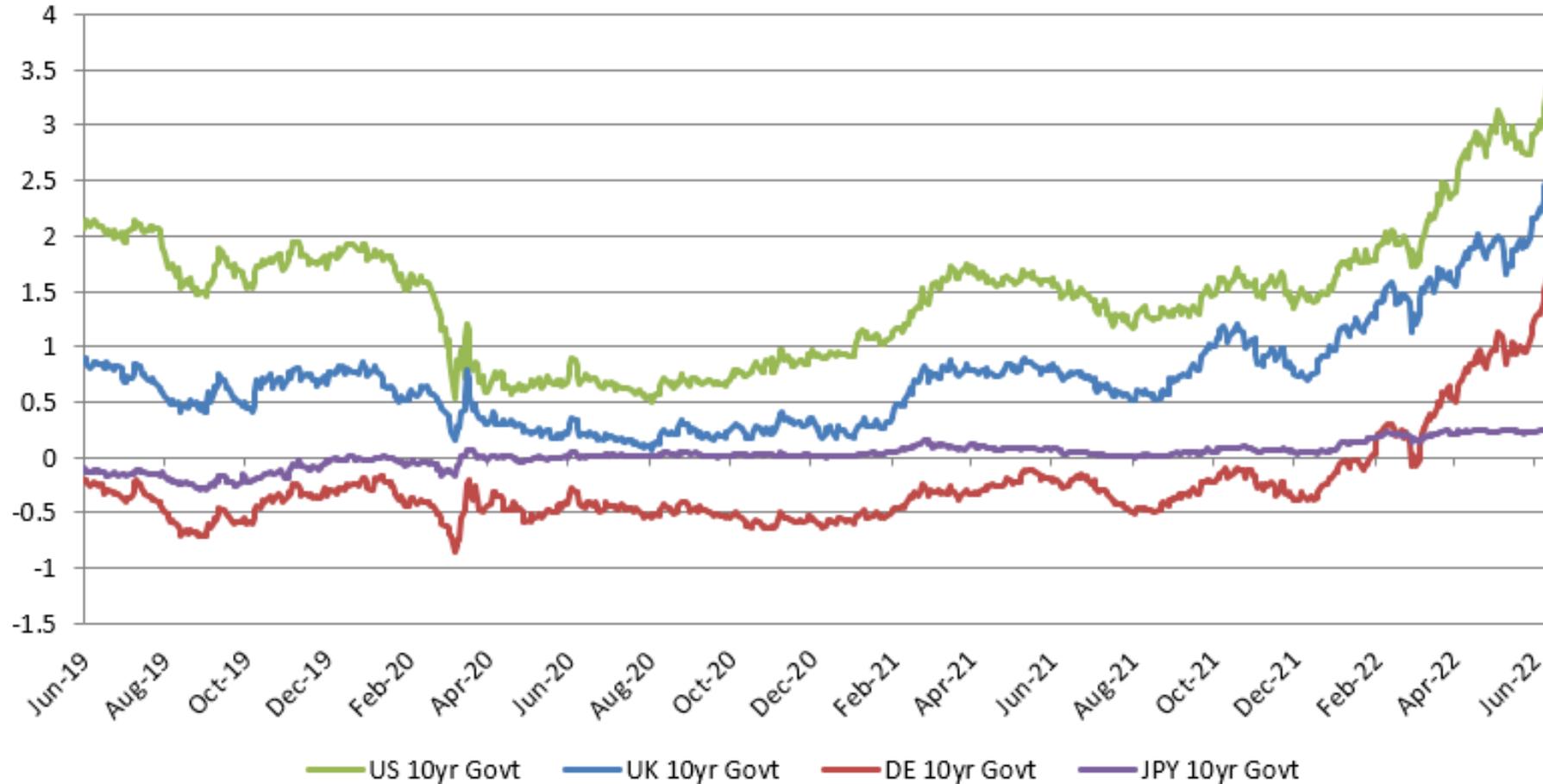
2. Mr. Li appeared in newspaper headlines 15 more in '21 than in prior year and is on track to double than in '22. (“China’s No.2 Emerges From Shadow of Xi”; WSJ, May 12, 2022)

Market Performance through Monday June 13, 2022

(USD)	Since 2/23	YTD	2021	2020	2019
Equities					
MSCI ACWI	-5.77%	-14.22%	18.54%	16.26%	26.60%
MSCI EAFE	-9.31%	-14.49%	11.26%	7.82%	22.01%
MSCI EM	-14.10%	-15.77%	-2.54%	18.31%	18.42%
MSCI US	-2.78%	-14.30%	26.45%	20.73%	30.88%
Fixed Income					
BarCap Global Agg Total Return (Hedged)	-5.29%	-8.45%	-1.39%	5.58%	8.22%
Citi US 10+ Govt Bond Index	-16.11%	-22.23%	-4.63%	17.72%	14.89%
BarCap US High Yield Total Return (Unhedged)	-5.25%	-9.29%	5.26%	7.05%	14.32%
Oil					
WTI Crude	23.23%	49.61%	56.87%	-10.23%	1.56%
Brent Crude	23.76%	48.19%	51.32%	-12.44%	-1.72%
Currency					
USD/EUR	7.02%	7.47%	7.57%	-8.25%	1.86%
USD/GBP	9.76%	9.66%	0.86%	-3.07%	-3.76%
USD/JPY	13.36%	13.29%	11.52%	-4.99%	-1.00%
USD/CNH	6.17%	5.40%	-2.11%	-6.73%	1.38%
USD/TRY	8.28%	12.42%	78.97%	24.88%	11.93%
USD/ARS	8.38%	13.20%	22.11%	40.55%	58.95%
USD/RUB	-16.20%	-9.65%	1.35%	19.10%	-10.48%

Source: Bloomberg

Sovereign Bond Yields



Source: Bloomberg

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