

OBSERVATIONS

- US Q2 earnings reports are off to a decent start, but thus far the number of companies beating estimates is lower than normal, while corporate guidance for the coming months is cautious ahead of a potential economic slowdown.¹
- US Housing saw a significant slowdown in June as both housing starts and sales of existing homes saw steep declines from May—starts were down -2% from May while existing home sales fell by -5.4%.²
- Europe suffered from a record-breaking heat wave last week that was blamed for hundreds of deaths in Spain, Portugal and other portions of Central and Southern Europe and further strained European utilities struggling with high energy prices and disruptions to Russian natural gas.³
- The European Central Bank (ECB) raised its policy interest rate by 50bps, bringing the deposit rate to 0.0%. The move marks the first rate rise in 11 years amidst surging energy prices. Including food and energy, inflation readings in the region reached 8.6%, while excluding food and energy was a more modest 3.7%.⁴
- Russian gas supplies began flowing again through the Nord Stream I pipeline but at reduced levels. The pipeline had been shut down for routine annual maintenance, but Moscow warned West European customers that Western sanctions were causing technical difficulties in maintaining the pipeline and may preclude it from resuming normal gas deliveries going forward.⁵
- Italian Prime Minister—and former ECB Central Bank President—Mario Draghi resigned last week triggering snap elections to take place within 70 days as his cross-party coalition fell apart due to his ambitious reform agenda. As a result, the 10-year Italian Eurobond hit 3.7% and Italian stocks sold off marginally.⁶
- PMIs weakened substantially, as Europe’s manufacturing PMI fell to 49.6—any reading below 50 denotes contracting activity—while the US manufacturing PMI fell to only 52.3, but the US services PMI hit 47.0.¹

EXPECTATIONS

- President Biden announced last week that he was likely to hold call with China’s President Xi in the coming weeks to discuss a host of bilateral issues including the removal of some of the Trump-era tariffs placed on Chinese steel and other manufactured goods that could help reduce prices on select items.⁷
- The US Senate passed, in a procedural vote last week, a slimmed down version of a bill passed last year to help boost semiconductor manufacturing with the US. The bill will provide at least \$52 billion in support of the US semiconductor industry, but last week’s vote suggests that is likely to also include additional support to broader US R&D efforts once the final bill is drafted in the coming weeks.⁸

ONE MORE THOUGHT: Chinese Authorities Grapple with Housing Woes⁹

In 2021, Chinese authorities introduced a so called “three red lines” policy that restricted the ability of Chinese property developers to borrow endlessly and become overly leveraged. As a result, several developers, including Evergrande the second largest developer in China, were pushed to the edge of bankruptcy as current revenues

¹ Bloomberg LP 22-Jul-2022; Factset 22-Jul-2022

² <https://www.wsj.com/articles/u-s-home-sales-fell-again-in-june-economists-estimate-11658309401>

³ <https://www.ft.com/content/a3386b16-ea9f-413b-bfb6-b1f4284d45a9>

⁴ https://www.wsj.com/articles/ecb-raises-rates-by-half-a-percentage-point-11658406446?mod=hp_lead_pos1

⁵ https://www.wsj.com/articles/russia-resumes-nord-stream-natural-gas-supply-to-europe-11658380074?mod=hp_lead_pos2

⁶ <https://www.ft.com/content/800d1dc1-7d26-41d2-b5ca-3a4850e95b98>

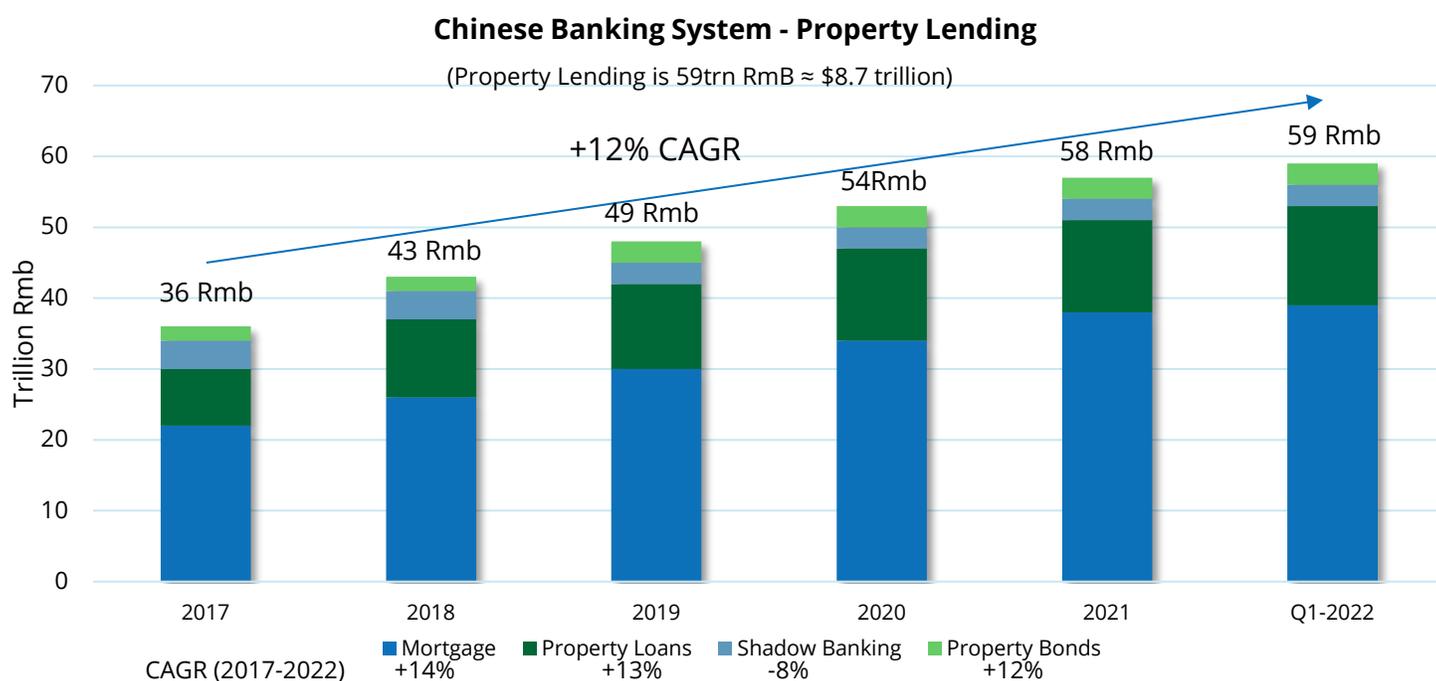
⁷ <https://www.bloomberg.com/news/articles/2022-07-20/biden-says-he-expects-to-talk-to-china-s-xi-within-next-10-daus#xj4y7vzkg>

⁸ <https://www.wsj.com/articles/senate-vote-to-test-appetite-for-expanded-chips-bill-11658265660>

⁹ <https://www.ft.com/content/dc738b2f-5a5f-4ff8-b165-c464a0578aa4>

proved unable to fully offset their cash needs. As these developers struggled with liquidity they temporarily abandoned or delayed the completion of several housing projects. However, in China it is common for most housing projects to be pre-sold so that mortgage payers have to begin making payments on the property before the property is fully finished and able to be inhabited. The result is that many Chinese are paying on mortgages despite the fact the housing project has not been completed and construction has stalled. Recently, Chinese borrowers revolted and began to withhold payments exacerbating the insolvency in the Chinese property. Beijing has since stepped in and helped to facilitate the creation of bailout funds that will provide funding to developers to finish the projects that have been pre-sold and avert that any further local banks or property developers get pushed further towards bankruptcy. As China grapples with an economic slowdown related to its Covid-shutdowns it also needs to stabilize its real estate sector—the single largest asset class in the world—that by some measures represents close to 20% of the entire Chinese economy. Expect more bailout funds to be created in the months to come.

CHART OF THE WEEK



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