6th August 2022

Global Market – Bank of England warns of long recession

Last week we have discussed, will US Fed will manage soft landing? US GDP data for Q2 for 2022 came at -0.90%, 2nd successive quarter of negative growth. US Fed chair Jerome Powell in post FOMC meeting press conference said that full impact of interest rate hike not seen yet and now it's the time to go to meeting-to-meeting basis.

This week we will discuss rate hike by Bank of England and BOE guided for long recession. In our 16th July 2022 article, we have discussed is Europe epicenter of next financial & economic crisis? We will continue to focus on Europe in today's article.

BOE increase rate by 50 bps to 1.75%

- Biggest interest rate hike in 27 years.
- BOE also boosted the peak inflation forecast to 13.3% in October 2022 on surge in gas prices.
- BOE forecast GDP decline equivalent to seen during 1990 recession. The pace of tightening will probably drop back to 25 bps points.
- Traders see 80% probability of another 50-bps rate hike.
- BOE forecast economy contracting by 1.25% in 2023 and 0.25% in following year 2024.
- UK GDP to contract from Q4 2022 to Q4 2023, growth thereafter will be very weak by historical standards.

Bank of England is much behind the curve and inflation is expected to peak around 13% by October and yearly inflation could stable around 9% to 9.5%. BOE would continue to raise interest rate at higher rate to control inflation. BOE have projected economic contraction for Q4 2022.

EURO zone economies face similar problem such as UK. European Central Bank have raised rate by 50 bps in July 2022 meeting for the first time. EDB guided for aggressive rate hike in September 2022 meeting.

US Economic data released on 5-Aug-22

- Average hourly earnings grew by 0.50% Vs expectation of 0.30% rise.
- Unemployment rate @ 3.5% Vs expectation of 3.6%
- Non-farm Employment change @ 528k Vs expectation of 250k.

US strong economic data means more aggressive rate hike by US Fed. Next US FOMC meeting on 21-Sep-22, which is more than 7-weeks away. As comment by Jerome Powell to go by meeting-to-meeting, so near-term economic data would not have concluded impact.

Why crisis in Europe could be the next epicenter?

After Russia-Ukraine crisis in February 2022, which was followed by sanctions on Russia by US & European nations. It triggered prices sky rocketed for food and energy where Russia & Ukraine was key supplier.

Europe was heavily dependent on cheap gas & oil from Russia. Russia & Ukraine together supplies 1/3 of the total wheat supplied to the world. Russia, Belarus and Ukraine are key supplier for fertilizers and even US is dependent on Russia for its fertilizers supply to an extent.

Sanctions had negative economic implications on European nations more than US or Russia. Sanctions were designed with an objective to hurt Russia's economic interest but it had worst economic impact on Europe itself.

Russia's currency RUBLE is trading stronger compared to pre-crisis level where as EURO traded at parity with US Dollar.

What are the key challenges for ECB & BOE?

- Inflation is mainly led by high Natural gas prices; it is political problem as Russia have restricted supply to Europe.
- Crude oil & Food prices have declined and near to pre-Russia-Ukraine crisis.
- ECB & BOE are much behind the curve on interest rate.
- Economic crisis in Europe have started having political implication and its current government in office.

Equichain Wealth Advisors: Opinion & View

In near term market will continue to focus on corporate earnings as we are in the middle of earnings season. Corporate earnings so far have not been disappointing and market reaction in last 3 weeks was surprisingly positive.

Interest rate, inflation and recession are the factors which will sooner or later impact corporate earnings, economic impact on individual as high inflation will impact purchasing power going ahead. US Fed's objective to bring long term inflation to 2% for sustainable economic growth.

We are still not out of the woods as far as global financial market is concern, but short-term trend can be different from long term recovery path. Its time to go by month-by-month and quarter-by-quarter to review market view and corporate earnings.