MORNING BRIEFING
July 21, 2022

Financials, China & Russian Gas

Check out the accompanying chart collection.

Executive Summary: Banks have been navigating rising interest-rate seas remarkably well, managing to keep low the interest rates they pay out on deposits and raise the rates they take in on loans. As a result, net interest margins have been improving nicely from last year's depressed levels. If banks can keep that up, the income upside would be substantial. … Also: China may regret not opposing Russia's war in Ukraine if emerging market nations, struggling under the burden of war-induced food and energy inflation, aren't able to make good on their debt payments to China. … And: A timely look at innovative ways to generate and store energy.

Financials: An Eye on Deposits. Going into the Q2 earnings season, it was fairly clear that banks with large capital markets businesses would face tough y/y comparisons. With the S&P 500 down 20.6% in the first half of 2022, the IPO market slowed to a crawl and even bond underwriting was down sharply y/y. Traditional banking businesses fared better, however, with demand for consumer and commercial loans growing briskly and credit quality remaining strong.

Banks' next challenge may be navigating the jump in interest rates. So far, consumer deposits largely have stayed put, even though the interest rates offered on bank deposits remain close to zero while the yield on the three-month Treasury bill has risen to 2.51%. Let's take a look at how higher interest rates are affecting banks' assets and liabilities:

(1) *Deposits rose during Covid.* When Covid struck in 2020, the federal government supported US citizens with a flood of free money. Some of that money was spent, but some of it wound up in bank accounts. More deposits came from people who continued to work but were unable to go out and spend because they feared catching the virus. So in 2020, total deposits at banks surged by $2.9 trillion y/y (21.8%), followed by a $1.8 trillion y/y increase in 2021 (11.4%) (*Fig. 1*).

This year, with Covid-related government financial support ended and consumers able to spend money more freely in a reopened world, the rate of deposit growth has slowed sharply. Only $166 billion of deposits has found its way into banks' coffers in the first half of this year, and total deposits appears to have plateaued around $18.0 trillion (*Fig. 2*).

(2) *Higher-yielding alternatives now.* During the Covid crisis, there were few good alternatives to low-yielding bank deposits because the Federal Reserve lowered interest rates sharply and rapidly when the economy was closed. The federal funds rate was cut to a low of 0.00%-0.25% on March 15, 2020 and stayed there until March 16, 2022 (*Fig. 3*). Interest rates on Treasuries and other bonds fell in tandem.

But faced with rising inflation, the Fed started raising interest rates this year. The federal funds rate stands now in a range of 1.50%-1.75%, and 12-month federal funds futures have jumped to 3.44% in anticipation of additional interest-rate hikes to come. Treasury bond yields have risen as well. The six-month Treasury bill now yields 3.04%, and the three-year Treasury note yields 2.51% (*Fig. 4*).

While Treasury yields have risen, the interest being offered on many bank deposits has barely budged. Bank of America (BofA) paid 0.02% on deposits in Q2, unchanged from a year ago, and JPMorgan's interest bearing deposits sport a 0.2% interest rate. This raises the following question: When will depositors start shifting out of deposits that pay next to nothing into higher-yielding alternatives? And: How high will banks need to raise rates to retain deposits?

(3) *Loans on the rise.* In 2020 and 2021, banks took funds from surging deposits and invested in Treasuries because there was tepid consumer and commercial loan demand. US Treasury and agency securities held by banks rose from $3.0 trillion at the start of 2020 to a peak of $4.7 trillion at the end of this February (*Fig. 5*). Since late May 2021, the yearly change in bank purchases of Treasury and agency securities has slowed sharply, from a peak of $982 billion to $401 billion in early July (*Fig. 6*).

Instead of buying Treasuries and agencies, banks are making more commercial and consumer loans. Commercial & industrial (C&I) loans spiked at the start of the pandemic as companies quickly borrowed funds as a precautionary measure. C&I loans then fell sharply for most of 2021, only to rise again this year. In an indication that the economy may be stronger than expected, C&I loans have risen $207 billion ytd to $2.7 trillion (*Fig. 7* and *Fig. 8*).

Likewise, consumer borrowing has been strong. Consumer credit outstanding was $4.6 trillion as of May, up 7.3% y/y (*Fig. 9*). Car loans have risen sharply, as have student loans (*Fig. 10*). After bottoming in January 2021, consumer revolving credit has jumped 14.4% to $1.1 trillion (*Fig. 11*). And home mortgage debt has increased gradually but consistently

throughout the pandemic and this year (*Fig. 12*).

(4) *Improving NIM.* As interest rates on loans and Treasuries have increased and interest rates on deposit rates have remained low, banks' net interest margin (NIM) has improved from historically low levels. The average NIM fell to a low of 2.50% in Q2-2021, and it rose to 2.54% in Q1. A more "normal" NIM is north of 3.0% (*Fig. 13*).

If NIM continues to improve, the upside opportunity is substantial. At BofA, the net interest yield on loans rose to 1.86% during Q2, up from 1.69% in Q1 and 1.61% in Q2-2021, according to the bank's earnings *press release*. As a result, the bank's net interest income jumped by 22% y/y in Q2, or $2.2 billion, to $12.4 billion due to higher interest rates, lower premium amortization, and loan growth.

The bank calculated that a 100bps parallel shift in the interest-rate yield curve would boost net interest income by $5.0 billion over the next 12 months. The key word in that sentence is "parallel." It looks like banks may have to raise interest rates on their deposits if consumers ever wake up from their slumber. At BofA, total deposits at the end of Q2 were $1.98 trillion, down from $2.07 trillion in Q1 but up y/y from $1.91 trillion in Q2-2021. The bank attributed the q/q decline to customers paying their taxes, a normal seasonal event.

As the Fed continues to raise interest rates, we'll be watching to see how banks react and their depositors respond.

China: Ramifications of Siding with Russia. When the Ukraine war broke out, we thought China was more likely to stay neutral or side with its largest trading partners: the European Union (14.9% of Chinese exports) and the US (16.3%) (*Fig. 14*). While Russia is another authoritarian nation, it purchases only 1.5% of China's exports. However, China has used the Ukraine war as an opportunity to buy Russian oil on the cheap and encourage the construction of new gas pipelines between the two countries.

China may not have counted on the Ukraine war's impact on emerging markets. The war sent the prices of food and oil surging, and the Fed's tightening response to subdue the inflation boosted the dollar's value. The stronger dollar and higher food and oil prices have hurt overleveraged emerging market nations. Some of those nations have begun restructuring their debt, which is bad news for China and its banking institutions—collectively the world's largest creditor.

Here's a look at one of the Ukraine war's unintended consequences and an update on

Covid cases in China:

(1) *Debt & dollar headaches.* Since the Ukraine war intensified on February 24, the Fed has raised interest rates, and the US trade-weighted dollar has gained 7.4% (*Fig. 15*). Unfortunately, what benefits the dollar doesn't benefit emerging market countries that have struggled with rising food and oil prices and owe dollar-denominated debt.

Bonds in more than a dozen countries are trading at distressed levels, the weakest of which will likely default. China, as the biggest bilateral creditor in the world, will get dragged into these restructurings. "Poorest countries face $35 billion in debt-service payments to official and private sector creditors in 2022, with over 40% of the total due to China," according to the World Bank," a July 4 Reuters *article* stated. Due to its Belt and Road Initiative, China is owed $1.5 trillion in debt and trade credits by more than 150 countries, a February 26, 2020 *Harvard Business Review* (*HBR*) *article* estimated.

And the debt is growing quickly. The *HBR* article states: "For the 50 main developing country recipients, we estimate that the average stock of debt owed to China has increased from less than 1% of debtor country GDP in 2005 to more than 15% in 2017. A dozen of these countries owe debt of at least 20% of their nominal GDP to China (Djibouti, Tonga, Maldives, the Republic of the Congo, Kyrgyzstan, Cambodia, Niger, Laos, Zambia, Samoa, Vanuatu, and Mongolia)."

Chinese lending, which is done mostly by state-controlled agencies and policy banks, was described as "opaque" by Reuters. Countries may be required to keep the loans confidential and give them seniority, which means that other lenders may be providing loans based on inaccurate information. *HBR* notes that the Chinese loans are typically made at market rates, unlike the subsidized lending and grants provided by other large nations.

(2) *China learns to restructure.* China is new to the world of restructuring sovereign debt, but it's going to have to learn the ropes on the fly. Zambia's debt restructuring is one of the first involving China, and it's taking longer than expected. It has been two years since Zambia defaulted on $17 billion of external debt, about a third of which is owed to China, a May 31 Reuters *article* reported. China's central bank reportedly was willing to move ahead with the restructuring, but the country's finance ministry was concerned that if it accepted losses on its loans the restructuring would set "a costly precedent" for China's other debtors.

A June 28 *FT* *article* noted that Chinese lenders often are willing to extend maturities or

grant payment holidays to debtors, but they don't like to reduce the amount of debt owed for fear of a "political backlash in Beijing"—which "puts them at odds with commercial creditors such as bondholders."

Sri Lanka defaulted earlier this year on $12 billion of overseas debt, of which China is owed $6.5 billion. Various Chinese lenders invested in the country's highways, a port, airport, and coal power plant, an April 28 Reuters *article* reported. Some critics are blaming the country's current crisis on the excessive debt that China made available. Treasury Secretary Janet Yellen has said she will push China to restructure loans to countries facing unsustainable debt burdens, a July 14 *WSJ* *article* reported.

(3) *Covid cases escalating.* On another note, China's Covid-19 cases surged past 1,000 on Wednesday for the first time since May 20, rising from 776 cases a day earlier, a July 20 Reuters *article* reported. With China's zero-Covid policy remaining in force, lockdowns are increasing. "About 264 million people in 41 cities are currently under full or partial lockdowns or living under other measures, analysts at Nomura, the Japanese bank, wrote in a note on Monday. Last week, the figure was about 247 million in 31 cities," a July 19 *NYT* *article* reported.

One dramatic situation involved 2,000 tourists visiting Weizhou Island who were caught up in a surprise lockdown after 700 cases were discovered over the past week. There are multiple areas where mass testing is being required, including Shanghai.

Disruptive Technologies: Replacing Russian Gas. Russia's game of cat and mouse continues, with the European Union's energy security and Ukraine's independence at stake. Russian President Vladimir Putin indicated yesterday that Russia would send natural gas through the Nord Stream pipeline to Europe, but he was cagey about the amount. Gazprom, the pipeline's Russian-controlled majority shareholder, will "fulfill all of its obligations," said Putin, but natural gas flows may be only 20% of the pipeline's capacity next week if a turbine being repaired in Canada isn't returned to Russia soon. The turbine is reportedly in transit back to the pipeline operator. Another turbine requires maintenance on July 26.

Also yesterday, Russia's foreign minister announced that Moscow's goals for the Ukraine invasion have moved beyond liberating the eastern Donbas border region. Moscow now also aims to control the provinces of Kherson and Zaporizhzhia in southern Ukraine and a number of other territories. He warned that Russia would go further if the West continues to supply Ukraine with advanced weapons, a July 20 *FT* article reported.

This is occurring as Europe swelters during a major heatwave that is causing fires across the continent. Yesterday, the EU called upon member nations to cut natural gas use by 15% from August 1 through March 2023 in anticipation of supply disruptions this winter. That's the equivalent of about 45 billion cubic meters of natural gas. Europe has looked overseas for additional sources of natural gas, and it has plans to increase its reliance on coal- and nuclear-fired power plants.

Meanwhile, entrepreneurs are working on new ways to approach this old problem. Here are some ideas being explored for generating and storing energy:

(1) *Solar on balconies.* Serial entrepreneurs Karolina Attspodina and Qian Qin have developed a way to put the charming balconies on European buildings to good use. Their company, WeDoSolar, has developed vertical solar panels that weigh 1kg each and plug into a standard power socket. "The WeDoSolar Microinverter then pushes the power into the home grid, allowing the panels to power home appliances ahead of using the normal grid," a July 18 *article* in *TechCrunch* reported. The company claims they will reduce electricity bills by up to 25% per year. An eight-panel set costs €1,299 or it can be rented by electric vehicle owners in exchange for CO2 certificates.

(2) *Solar from Africa.* Russian natural gas imports could theoretically be replaced by large solar farms in the Sahara desert, a March 22 *article* by the Institute for Security Studies suggested. Solar farms can be assembled more quickly than liquified natural gas terminals, and they are more environmentally sustainable. Undersea cables would need to be laid to transmit the electricity from Northern Africa to Southern Europe.

Already, Tunisia and Algeria are planning underwater links to Italy and Spain, and Greece and Egypt are in discussions to lay a cable between the two countries. Such a large solar farm would generate so much heat that local temperatures could rise by 1.5 degrees Celsius, the article states. The impact might be minimized by spacing out the solar panels and improving their efficiency. Electricity from such a large project might also be used to desalinize water in North Africa or power green hydrogen projects.

Africa also has hydroelectric power and oil and natural gas resources that Europe may want to consider tapping.

(3) *Energy storage in oil wells.* The intermittency of solar and wind energy remains a hurdle that has entrepreneurs looking for new ways to store excess energy. Hyperlight Energy plans to solve the problem by storing excess solar energy in existing oil wells. The goal is to

"store solar-produced heat in rock formations below the (earth's) surface, creating a solar-generated geothermal resource in which heat is stored for meaningful durations," Daniel Codd, a researcher at the University of California, San Diego said in a March 14 IEEE Spectrum *article*. The stored energy can be used as heat energy or harnessed to produce electricity.

Calendars

US: Thurs: Leading Indicators -0.5%; Initial & Continuous Jobless Claims 240k/1.34m; Philadelphia Fed Manufacturing Index; Natural Gas Storage. **Fri:** M-PMI & NM-PMI Flash Estimates 52.0/52.6. (Bloomberg estimates)

Global: Thurs: France Business Survey 106; Japan CPI; ECB Interest Rate Decision & Deposit Facility Rate 0.25%/-0.25%. **Fri:** Eurozone, Germany & France C-PMI Flash Estimates 51.0/51.2/51.8; Eurozone, Germany & France M-PMI Flash Estimates 51.0/50.6/50.8; Eurozone, Germany & France NM-PMI Flash Estimates 52.0/51.2/52.7; UK Headline & Core Retail Sales -0.3%m/m/-5.3%m/m & -0.4%m/m/-6.3%y/y; UK PMI C-PMI, M-PMI & NM-PMI Flash Estimates 52.5/52.0/53.0; Canada Headline & Core Retail Sales 1.6%/1.6%. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) climbed to 1.00 this week after 11 weeks below. The BBR advanced for the second week from 0.76 to 1.00 over the period; it was at 0.60 four weeks ago, which was the lowest since the week of March 10, 2009's 0.56. The BBR has been bouncing around 1.00 since late February. Bullish sentiment rose for the second week this week from 30.5% to 35.2%; It was at 26.5% four weeks ago—which was the fewest bulls since early 2016. Meanwhile, bearish sentiment fell for the third time in four weeks this week, from 44.1% to 35.2% over the period, while the correction count slipped to 29.6% this week after climbing from 27.1% to 31.0% the previous two weeks. In the meantime, the AAII Sentiment Survey (as of July 14) showed the percentage expecting stocks to fall over the next six months pulled back 6.3ppts to 46.5% after rebounding from 46.7% to 52.8% the prior week—holding above its historical average of 30.5% during 33 out of the past 34 weeks and at an "unusually high level 22 out of the

last 26 weeks," according to the report. The percentage expecting stock to rise over the next six months jumped from 19.4% to 26.9%, a six-week high. Bullish sentiment remained below its historical average of 38.0% for the 34th straight week, and at an unusually low level of 23 of the past 27 weeks.

MSCI World & Region Net Earnings Revisions (*link*): Analysts' recent earnings revisions through July suggest more pessimism about profits in the Americas and EM Eastern Europe, but more optimism about profits throughout the rest of the world. The US MSCI's NERI was negative in July for the first time in 24 months, falling to -2.6% from 0.5% in June. That compares to a post-pandemic high of 21.1% in July 2021 and an 11-year low of -36.9% in May 2020. The AC World ex-US MSCI's NERI was negative for a fifth month following 17 straight positive readings, but rose to -2.4% from -3.5% in June and is up from a 22-month low of -3.8% in May. NERI was negative again in July for EM Asia and Emerging Markets, but improved m/m. EM Latin America weakened m/m, but was positive for a fifth month. EM Eastern Europe turned negative m/m again in July. Here are July's scores among the regional MSCIs: EMU (4.3% in July, up from 3.7% in June), Europe ex-UK (3.8, 3.1), Europe (3.3, 3.0), EM Latin America (3.3, 5.0), EAFE (1.9, 1.8), EM Eastern Europe (-1.1, -0.6), US (0.5, 0.3), AC World ex-US (-2.4, -3.5), AC World (-2.4, -2.4), Emerging Markets (-5.4, -7.3 [23-month low]), and EM Asia (-6.1, -8.5 [24-month low]).

MSCI Countries Net Earnings Revisions (*link*): NERI was positive for 22/41 MSCI countries in July. That's down from 23/41 in June and compares to 20/41 in April, which was the lowest count since October 2020. It had peaked at 35/41 during May 2020, which nearly matched the record-high 36/41 from June 2004. That also compares to zero countries with positive NERI from April to June 2020. NERI improved m/m in July for 21/41 countries, down from 23/31 in May and June and up from 12/41 in April. These countries had relatively high NERIs in July: Indonesia (the highest since May 2010), Spain (11-month high), Denmark (10-month high), and Norway (10-month high). Canada and Norway have had positive NERI for 24 straight months, followed by the UK (23), Italy (21), and Turkey (21). New Zealand has the worst negative-NERI streak, at 22 months, followed by Hong Kong (14), China (11), and Malaysia (11). NERI flipped back into positive territory for Egypt, but turned negative for Australia and Korea. The highest NERI readings in July: Turkey (20.2%), Norway (16.0), Austria (15.5), Ireland (12.4), Mexico (10.3), Portugal (10.2), and Denmark (9.9). The weakest NERIs occurred this month in Hong Kong (-10.4), India (-9.9), New Zealand (-7.5), China (-7.2), Switzerland (-6.9), Taiwan (-6.3), and South Africa (-5.8).

AC World ex-US MSCI (*link*): This index is up 1.3% in local-currency terms so far in July to a 12.2% decline ytd. In US dollar terms, the index is up a lesser 0.3% so far in July, and has

declined a substantially greater 19.5% for 2022 to date. Local-currency forward revenues has risen 15.8% since it bottomed in January 2021, and rose 1.3% m/m to its first record high since May 2019. Local-currency forward earnings rose 0.9% m/m to a record high too and has soared 57.3% since it bottomed in July 2020. Revenues are expected to rise 11.3% in 2022 and 3.4% in 2023 following a 16.7% gain in 2021, and earnings are expected to increase 13.5% (2022) and 4.7% (2023) after soaring 57.2% (2021). The industry analysts' sales forecasts imply short-term 12-month forward revenue growth (STRG) of 6.8% and short-term 12-month forward earnings growth (STEG) of 7.1%, compared to 4.1% and 10.0% before Covid-19 hit the news. These measures bottomed at -0.1% and -0.3%, respectively, during May 2020. The profit margin implied by analysts' earnings and revenue estimates calls for 9.2% in 2022 and 9.3% in 2023, compared to 9.1% in 2021. The record-high forward profit margin forecast of 9.3% is up from a 10-year low of 6.6% at the end of May 2020 and first exceeded its prior 9.0% record high from September 2007 during August. The Net Earnings Revision Index (NERI) for the AC World ex-US MSCI was negative in July for a fourth straight month following 17 positive readings, but improved for a second month to -2.4% from -3.5% and is up from a 22-month low of -3.8% in May. That compares to a 12-year high of 6.4% in July and an 11-year low of -23.9% in May 2020. The forward P/E of 11.5 is up slightly from its 28-month low of 11.4 a week earlier. That compares to an 18-year high of 17.1 in February 2021 and its March 2020 low of 10.8. The index is at an 18% discount to the World MSCI P/E, up from a record-low 22% discount around the beginning of the year.

Emerging Markets MSCI (*link*): The EM MSCI price index is down 2.1% in US dollar terms so far this month to a 20.5% decline ytd. In local-currency terms, EM is down a lesser 1.2% month-to-date to a smaller ytd loss of 15.9%. Local-currency forward revenues has risen 12.0% since its bottom in January 2021, and rose 1.0% m/m to 3.9% below its record high in May 2019. Local-currency forward earnings is up 33.4% since its bottom in June 2020, but dropped 0.6% m/m and is now 6.7% below its record high in early March. Revenues are expected to rise 12.1% in 2022 and 5.9% in 2023 after jumping 21.0% in 2021. That's expected to lead to an earnings gain of 9.8% in 2022 and 7.8% in 2023, following a 52.0% recovery gain in 2021. Forecasted STRG of 8.4% is down from April 2021's 11-year high of 12.6%, which compares to a five-year low of 3.6% at the end of April 2020. STEG has dropped to 8.7% from a record high of 33.7% in December 2020, but that's up from a 12-year low of 5.3% in December 2021. The implied profit margin is expected to drop to 7.4% in 2022 from 7.6% in 2021 and improve to 7.6% in 2023. The forward profit margin of 7.5% is up from a four-year low of 6.1% at the end of May 2020 and compares to its 10.3% record high in December 2007. NERI was negative in July for a ninth straight month, but improved to -5.4% from a 23-month low of -7.3% in June. That compares to an 11-year high of 6.0%

in February 2021 and an 11-year low of -18.7% in May 2020. Emerging Markets' forward P/E of 10.7 is at a 28-month low, which compares to a record high of 16.3 in February 2021 and its March 2020 low of 10.1. The index is trading at a 24% discount to the World MSCI P/E. That's up from a 33% at the start of the year, which was its biggest discount since 2005.

EMU MSCI (*link*): The EMU MSCI price index is the best-performing regions so far in July with a gain of 3.9% in local-currency terms, but remains down 17.2% ytd. In US dollar terms, EMU is up a lesser 1.8% so far in July to a bigger ytd drop of 25.3%. Local-currency forward revenues gained 0.9% m/m and has risen 19.2% since its bottom in January 2021, but is still 1.2% below its record high in September 2008. Local-currency forward earnings gained 1.5% m/m and is up 72.9% since its bottom in July 2020, but remains 1.4% below its record high from January 2008. Revenues are expected to rise 9.5% in 2022 and 2.0% in 2023 after gaining 15.8% in 2021. That's expected to lead to an earnings gain of 13.9% in 2022 and 4.8% in 2023, following a recovery gain of 76.3% in 2021. Forecasted STRG of 4.9% is down from a record-high 8.3% during April 2020, but that's up from an 11-year low of -0.9% during April 2020. STEG has dropped to 8.3% from a record high of 47.4% in December 2020, but that's up from a record low of -6.7% in April 2020. The implied profit margin is expected to rise from 8.4% in 2021 to 8.7% in 2022 and 9.0% in 2023. The forward profit margin has risen to a 13-year high of 8.9% from a 12-year low of 6.0% at the end of July 2020, but remains below its 9.1% record high in October 2007. NERI was positive in July for a 19th month after 27 straight negative readings, and improved to 4.3% from 3.7% in June. That compares to a record low of -35.9% in May 2020 and is down from a record high of 15.2% in September. EMU's forward P/E of 11.1 is up from a 28-month low of 10.8 a week earlier, which compares to a record high of 18.3 in July 2020 and a low of 10.2 in March 2020. The index is trading at a 21% discount to the World MSCI P/E, which is among its worst readings since 2001.

China MSCI (*link*): The China MSCI price index is the worst performer of the 49 MSCI countries so far in July, with a decline of 6.2% in local currency terms. Its 16.6% ytd decline ranks 32/49. Local-currency forward revenues has risen 5.9% since its five-year low in June 2021, but was unchanged m/m and 33.7% below its record high in October 2014. Local-currency forward earnings fell 0.4% m/m and is up only 1.3% since its bottom in June 2020 to 16.7% below its record high in June 2018. Revenues are expected to rise 11.6% in 2022 and 7.2% in 2023 after surging 19.3% in 2021. That's expected to lead to earnings gains of 11.2% in 2022 and 15.3% in 2023, following a 9.3% increase in 2021. Forecasted STRG of 8.8% is down from an 11-year high of 13.5% in April 2020, but that's up from a five-year low of 5.0% at the end of April 2020. STEG has dropped to 13.7% from a 10-year high of 18.6%

during December 2020, which compares to a four-year low of 8.0% in April 2020. The implied profit margin ranks as one of the lowest in the world; it's expected to remain unchanged y/y at 4.4% in 2022 and to rise to 4.7% in 2023. The forward profit margin of 4.5% is down from a record high of 5.2% in July 2021, and back down to its pandemic low of 4.5% in May 2020. NERI was negative for an 11th straight month in July, but improved to -7.2% from -11.3% in June and from a 23-month low of -11.7% in May. Still, that ranks as fourth worst among the 41 MSCI countries that we follow. China's forward P/E has jumped to 11.1 from an eight-year low of 8.7 in mid-March. That compares to its March 2020 low of 10.5. The index is trading at a 21% discount to the World MSCI P/E, up from a 22-year low discount of 46% in mid-March.

US Economic Indicators

Housing Starts & Building Permits (*link*): Both housing starts and building permits are heading south, along with homebuilders' optimism—which dropped sharply in July. Housing starts have plummeted 13.6% since peaking in April, falling to 1.559mu (saar) in June, the lowest since September 2021. (Revisions show that May starts were revised higher to 1.591mu from the 1.540mu previously reported.) Single-family starts contracted for the fifth time this year, by 8.1% in June and 19.0% ytd to 982,000 units (saar)—the lowest since June 2020—while volatile multi-family starts rebounded 10.3% in June to 577,000 units (saar) after plunging 17.3% in May and rebounding 20.4% in April. June's level is 8.7% below its recent peak of 632,000 units in April. Building permits dropped for the third straight month in June, down 0.6% m/m and 10.3% over the period to a nine-month low of 1.685mu (saar). Single-family permits have plummeted 19.7% during the four months through June to 967,000 units (saar)—the lowest since mid-2020. Meanwhile, multi-family permits rebounded 11.5% in June to 718,000 units (saar) after sliding 10.1% the prior two months. In June, total housing starts fell 6.3% y/y, while building permits were up 1.4%. In June, housing under construction reached another new record high at 1.680mu, while completions dipped 4.6% to 1.365mu. Homebuilders' confidence plummeted a near-record 12 points July and 28 points ytd to 55—the lowest since May 2020. July's 12-point drop is the biggest on record excluding April 2020's Covid-related 42-point plunge. All components were hit hard this month, with current sales (-12 points to 64), future sales (-11 to 50) and traffic of prospective buyers (-11 to 37) all posting double-digit declines, to their lowest readings since June 2020 for current sales and since May 2020 for the future sales and traffic components.

Existing Home Sales (*link*): "Falling housing affordability continues to take a toll on potential home buyers," said Lawrence Yun, NAR's chief economist. "Both mortgage rates and home prices have risen too sharply in a short span of time." Existing home sales contracted for the fifth consecutive month, by 5.4% in June and 21.1% over the period to 5.12mu (saar), with single-family home sales down 4.8% and 20.5% over the comparable periods to 4.57mu (saar) and multi-family down 9.8% and 25.7% to 550,000 units (saar). All are at their lowest levels since mid-2020. Regionally, sales in June fell in three of the four regions, with Northeast sales flat, while all were down versus a year ago: Northeast (0.0% m/m & -11.8% y/y), Midwest (-1.6 & -9.6), South (-6.2 & -14.1), and the West (-11.1 & -21.3). At the end of June, there were 1.260mu on the market, up 9.6% m/m and 2.4% y/y—with unsold inventory at a 3.0 months' supply at the current sales rate, up from 1.6 months at the start of this year. The median existing home price (13.4% y/y) increased for the 124th month, on a year-over-year basis, the longest streak on record. According to Yun, "Finally, there are more homes on the market. Interestingly though, the record-low pace of days on the market implies a fuzzier picture on home prices. Homes priced right are selling very quickly, but home prices too high are deterring prospective buyers."

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