



# Global Markets Monthly Update

July 2022

## KEY INSIGHTS

- Stock and bond markets rallied in many developed markets as investors anticipated inflation would retreat from multi-decade highs.
- Chinese shares pulled back on worries over slowing growth and fears that Beijing would not respond with forceful stimulus measures.
- The assassination of Japan's former prime minister, Shinzo Abe, was followed by strong election gains for his party, seeming to indicate that Abe's economic reforms would gather momentum.

## HIGHLIGHTED REGIONS

- U.S.
- Europe
- Japan
- China
- Other Key Markets

## U.S.

Stocks rebounded in July on some signs that inflationary pressures were easing, along with hopes that negative sentiment had reached peak levels. The S&P 500 Index recorded its best monthly gain since late 2020, ending the month up nearly 13% from its June low. Consumer discretionary shares led the gains within the index, helped by strength in shares of Amazon.com and Tesla. Typically defensive sectors lagged, along with communication services stocks, which were weighed down by Facebook parent Meta Platforms and telecommunications shares.

Bonds also recorded solid returns, helped by a sharp decrease in longer-term bond yields, which fell to their lowest levels in nearly four months. The Federal Reserve raised its official short-term interest rate by another 75 basis points (0.75 percentage

point) late in the month, but evidence of a slowdown in many areas of the economy led many investors to lower their expectations for how high the Fed would have to push rates to squelch inflation. (Bond prices and yields move in opposite directions.)

### Growth Slows, Raising Hopes That Inflation Will Follow

The month's economic data generally—but not universally—indicated considerable slowing and surprised to the downside. S&P Global's Composite Index of private sector business activity fell into contraction territory for the first time in over two years, weighed down by a sharp decline in service sector activity. Manufacturing was relatively robust, though a sharp fall in new orders was concerning, while declines in housing starts and existing home sales reflected the steep rise in mortgage rates over the previous few months.

Payroll growth remained strong in June, but weekly jobless claims reached back to their highest levels in about eight months in mid-July. At the end of the month, the Commerce Department reported that the economy had shrunk at an annualized rate of 0.9% in the second quarter, marking the second consecutive quarterly contraction and meeting a common, if unofficial, definition of a recession.

The upside of slowing demand was some evidence of easing price pressures. Inflation data released early in the month were largely disappointing, underscored by headline consumer prices rising by 9.1% over the past 12 months—a four-decade high. But stocks rallied on July 15 after the University of Michigan's preliminary survey of consumer sentiment showed that Americans' expectations for inflation over the next five years declined to 2.8%, the lowest level in over a year. Producer price data and

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manufacturing surveys also indicated easing input inflation as supply chains continued to heal. Some prominent retailers announced plans to cut swollen inventories, suggesting that consumers would see price cuts in the months ahead.

### **Sentiment Due for a Turnaround?**

Investors may have also taken some comfort in the overall resilience of corporate earnings. According to FactSet, S&P 500 companies reporting in July generally defied tough year-over-year comparisons and beat analyst estimates for second-quarter earnings, if by a lower margin than in recent years. Many firms lowered guidance for the coming quarters, however, and investors kept a close eye on reports of tighter operating margins because of higher input and wage costs alongside more cautious and cash-strapped consumers.

Finally, a sense among many on Wall Street that sentiment had reached a bottom and was due for a turnaround may have supported the market's gains. On July 19, stocks rallied after Bank of America released its Monthly Fund Manager Survey, which showed that funds' cash holdings had reached their highest levels since 9/11, while their equity exposure was at the lowest levels since the recession and global financial crisis of 2007–2009. A record number of fund managers also reported taking on lower-than-normal risk.

## **Europe**

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Shares in Europe rebounded, lifted by solid quarterly earnings. Markets also appeared to temper their expectations for future interest rate hikes. In local currency terms, the pan-European STOXX Europe 600 Index ended higher. Major indexes in Germany, Italy, France, and the UK also gained ground.

### **ECB Raises Interest Rates More Than Expected to Curb Inflation**

The European Central Bank (ECB) raised interest rates by 50 basis points

as part of its efforts to curtail rising inflation. This larger-than-expected adjustment was combined with the announcement of a new bond-buying tool called the Transmission Protection Instrument, which was introduced to help control the surge in borrowing costs. The tool may also be used against any unprecedented market activity that could pose a serious threat to the transmission of monetary policy across the euro area.

### **Eurozone Second-Quarter GDP Surprises; Inflation Hits New High**

Gross domestic product (GDP) in the euro area increased by a higher-than-expected 0.7% sequentially in the second quarter. However, the eurozone economy shrank in July, with output and new orders falling for the first time since the COVID-19 lockdowns, according to early readings from a purchasing managers' index (PMI). S&P Global's Flash Composite Purchasing Managers' Index fell to a 17-month low of 49.9 in July from 52.0 in June, which was below consensus forecasts. (A PMI reading below 50 indicates a contraction.) A downturn in manufacturing accelerated, while services almost stalled.

An early estimate of euro area inflation came in above expectations, hitting 8.9% in July—up from the 8.6% registered in June. The rise in headline inflation was driven by food and energy prices.

The Economic Sentiment Indicator for the European Union (EU) fell below its long-term average, with confidence declining the most in the industry, services, retail trade, and consumer categories. Consumer confidence has largely been impacted by the deteriorating outlook for personal finances.

Russia restarted Nord Stream gas flows to Europe following the pipeline's closure for a 10-day maintenance period but then cut shipments to 20% of previous capacity, citing the need for maintenance on another turbine. EU

energy ministers agreed that member states would cut their natural gas use by 15% over the winter.

### **UK Inflation Accelerates to 40-Year High**

UK consumer price inflation reached a 40-year high of 9.4% year on year in June—up from 9.1% in May. The main driver of inflation was an increase in fuel and energy costs and food prices. The UK labor market continued to tighten as the number of people employed continued to rise and unemployment fell.

### **Italian Prime Minister Draghi Resigns**

Italian Prime Minister Mario Draghi resigned after the Five Star Movement, Forza Italia, and League parties boycotted a confidence vote. President Sergio Mattarella announced that the next election will take place September 25. Draghi will remain as caretaker prime minister until then.

## **Japan**

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Japan mourned its former and longest-standing prime minister, Shinzo Abe, who was shot and killed on July 8 while campaigning for the parliamentary upper house election. After stepping down in 2020, Abe remained influential as a member of parliament and head of the ruling Liberal Democratic Party (LDP). On July 10, the LDP increased its seat count in the election, winning a majority with its coalition partner Komeito. The result signaled strong support for Prime Minister Fumio Kishida of the LDP and his government's policy priorities, with the focus on lifting growth likely to remain unchanged.

According to Daniel Hurley, T. Rowe Price's Japanese equity specialist, the election victory is likely to consolidate the LDP's power and ability to implement many of the reforms championed by Abe and the party that were designed to stimulate the economy after decades of deflation. With more political capital and popular support, Kishida's government should also be

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able to push forward in more politically sensitive areas, such as restarting nuclear power plants and continuing to open Japan's borders to tourism.

### Japan's Stock Market Rises, Yen Recovers From 24-Year Lows

Japanese stocks rose in July, with the MSCI Japan Index gaining 3.98% in yen terms and 5.70% in U.S. dollar terms. Global risk appetite was boosted by tentative expectations that the U.S. Federal Reserve may need to slow down the pace of its interest rate hikes, given that the U.S. economy contracted for the second straight quarter in the three months ended June 30. The yield on the 10-year Japanese government bond fell to 0.18%, from 0.22% at the end of June, on global recession fears. The yen strengthened to around JPY 133 against the U.S. dollar, from about JPY 135 the prior month, recovering somewhat from 24-year lows.

### BoJ Maintains Ultra-Loose Monetary Policy

At its July monetary policy meeting, the Bank of Japan (BoJ) left its short-term policy interest rate unchanged at -0.1%, while maintaining its long-term yield target and asset purchase program, with a view to achieving its inflation target of 2%. It had been widely anticipated that Japan's central bank would maintain its accommodative stance, which is in stark contrast to the tighter monetary policy being pursued by other major central banks.

The BoJ downgraded its forecast for economic growth while revising upward its outlook for inflation. In June, Japan's core consumer price index rose 2.2% year on year, remaining above the BoJ's target for the third month, as higher global raw materials costs pushed up domestic prices. Inflation in Japan remained low compared with other developed economies.

Japan's daily COVID-19 cases rose to record highs in the month, but the government ruled out the possibility

of imposing movement restrictions. Vaccination rates in Japan are among the highest in the world.

### Inaugural Government Meeting for "Green Transformation"

At an inaugural meeting for green transformation, or GX—a critical component of Kishida's new capitalism policy agenda—the government and business leaders debated Japan's transition to a greener economy. Topics included how Japan can achieve carbon neutrality by 2050 and the ways in which to ensure a stable energy supply, with a focus on the restarting of nuclear plants. The government is aiming to restart nine nuclear reactors that have passed stringent safety standards implemented after the 2011 Fukushima nuclear disaster.

## China

Chinese stocks fell in July as Beijing tempered expectations of large-scale stimulus and signaled flexibility on meeting its official growth target after the economy slowed sharply in the second quarter due to coronavirus restrictions. A growing movement among homebuyers to stop paying their mortgages on unfinished projects weighed on property and banking sector shares. The broad, capitalization-weighted Shanghai Composite Index eased 4.3% and the blue chip CSI 300 Index, which tracks the largest listed companies in Shanghai and Shenzhen, fell 7%, according to Thomson Reuters. The MSCI China Index sank 9.44%.

At a meeting of global business leaders hosted by the World Economic Forum, Premier Li Keqiang said that lower growth might be acceptable as long as employment is sufficient, household income grows, and prices are stable. China announced a 2022 growth target of about 5.5% earlier this year. China's economy grew a weaker-than-expected 0.4% in the June quarter from a year ago, down from 4.8% in the first quarter, as the government shut down Shanghai

for two months and imposed pandemic curbs in other cities.

A growing number of homebuyers across China have refused to make mortgage payments on unfinished homes, raising concerns about financial contagion spreading throughout the financial system. In response, regulators asked lenders to provide credit to certain developers so that they could complete their projects.

In corporate news, UK bank HSBC became the first foreign bank to set up a Chinese Communist Party committee in its investment banking subsidiary in China, the *Financial Times* reported, a move that could pressure other foreign banks to follow suit. In a statement, HSBC called its Communist Party branch "common" and said that as few as three employees could set one up but that such groups would have no influence on its business or any formal role in its day-to-day activities.

On the regulatory front, China's cybersecurity regulator fined Didi Global CNY 8 billion (USD 1.2 billion), potentially signaling an end to the government's crackdown on the ride-hailing app and clearing a path for a public listing in Hong Kong. Didi was among the most high-profile targets of Beijing's clampdown on the country's internet industry that began in 2020, when regulators unexpectedly canceled the initial public offering of Ant Group.

The yuan eased 0.64% versus the U.S. dollar for July, according to MSCI. The 10-year Chinese government bond yield fell to 2.775% from 2.837%, according to Dow Jones.

## Other Key Markets

### Chilean Stocks Outperform Broader Emerging Markets

Stocks in Chile, as measured by MSCI, returned 12.35% in July versus -0.16% for the MSCI Emerging Markets Index.

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Selling pressure on the peso, which dropped 16% versus the dollar in the second quarter, intensified in the first half of July. Early in the month, Chile's central bank sent out a communication shedding some light on the situation. However, the statement failed to stabilize the peso.

At that time, policymakers did not commit to any foreign exchange (FX) intervention, but they acknowledged the large dislocation in the exchange rate and committed to monitoring the situation. They highlighted external pressures and noted that Chile is in a vulnerable position given its wide current account deficit, high inflation, and elevated domestic uncertainty. Policymakers also noted that the current FX weakness is particularly worrisome, as it could put stress on other sectors of the financial markets.

At the central bank's July 13 meeting, policymakers raised the key interest rate to 9.75% from 9.00% in a unanimous decision. The rate hike was slightly larger than expected, but it also failed to stabilize the peso. Although central bank officials warned that further currency weakness could lead to more upside pressure on domestic prices in the near term, they gave no hint of imminent FX intervention, claiming that recent peso depreciation had been absorbed by

markets and that the financial system continued to operate with an adequate level of liquidity.

On July 15, however, the Chilean central bank unexpectedly announced that it would implement an FX intervention program and a precautionary U.S. dollar liquidity provision for up to USD 25 billion to facilitate the adjustment of the Chilean economy to uncertain and changing external and domestic conditions. The program started on July 18 and is expected to last through September 30. While this has provided some short-term relief to the peso, T. Rowe Price emerging markets sovereign analyst Aaron Gifford believes that the longer-term global backdrop could produce headwinds.

#### **Contraction in Manufacturing Weighs on Stocks in Poland**

Stocks in Poland, as measured by MSCI, returned -0.08% versus -0.16% for the MSCI Emerging Markets Index. Returns to U.S. investors were hurt by the zloty's 3% decline versus the U.S. dollar.

During the month, Polish President Andrzej Duda signed into law a bill that enables mortgage borrowers to take a "mortgage holiday." Specifically, the new law—which was passed with wide legislative support—will allow homeowners to suspend their mortgage

payments for up to four months this year and up to four months in 2023.

While the intention of the new law is to give mortgage holders some financial relief, T. Rowe Price credit analyst Ivan Morozov believes that its stimulative impact could reduce the effectiveness of the central bank's interest rate increases as it attempts to bring inflation under control. In early July the central bank raised its key interest rate, although the 50-basis-point increase in the benchmark rate, from 6.00% to 6.50% was smaller than expected. Morozov notes that the magnitude of the increase may have been disappointing to investors considering that year-over-year consumer inflation remained above 15% in July.

In addition, Morozov believes it is a sign that the central bank intends to slow the pace of rate increases. Recent PMI data indicate that Poland's manufacturing sector has been contracting. Strong domestic consumption and investments related to European Union funds could ultimately keep the Polish economy out of a full-blown recession, but Morozov believes that the decline in manufacturing activity cannot be ignored, as PMI data are an important indicator of an economy's health.

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## Major Index Returns

Total returns unless noted

<b>As of 7/31/2022</b> Returns are in U.S. dollars	<b>July</b>	<b>Year-to-Date</b>
<b>U.S. Equity Indexes</b>		
S&P 500	9.22%	-12.58%
Dow Jones Industrial Average	6.82	-8.60
Nasdaq Composite (Principal Return)	12.35	-20.80
Russell Midcap	9.87	-13.83
Russell 2000	10.44	-15.43
<b>Global/International Equity Indexes</b>		
MSCI Europe	4.96	-16.42
MSCI Japan	5.70	-15.55
MSCI China	-9.44	-19.58
MSCI Emerging Markets	-0.16	-17.61
MSCI All Country World	7.02	-14.35
<b>Bond Indexes</b>		
Bloomberg U.S. Aggregate Bond	2.44	-8.16
Bloomberg Global Aggregate Ex-USD	1.92	-14.88
Credit Suisse High Yield	5.94	-8.28
J.P. Morgan Emerging Markets Bond Global	3.20	-16.23

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Note: Returns are for the periods ended July 31, 2022. The returns include dividends and interest income based on data supplied by third-party provider RIMES and compiled by T. Rowe Price, except for the Nasdaq Composite Index, whose return is principal only.

Sources: Standard & Poor's, LSE Group, Bloomberg Index Services Limited, MSCI, Credit Suisse, Dow Jones, and J.P. Morgan (see Additional Disclosures).

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