Mizuho Chart Speak: Global Demand

Economics & Strategy | Asia ex-Japan

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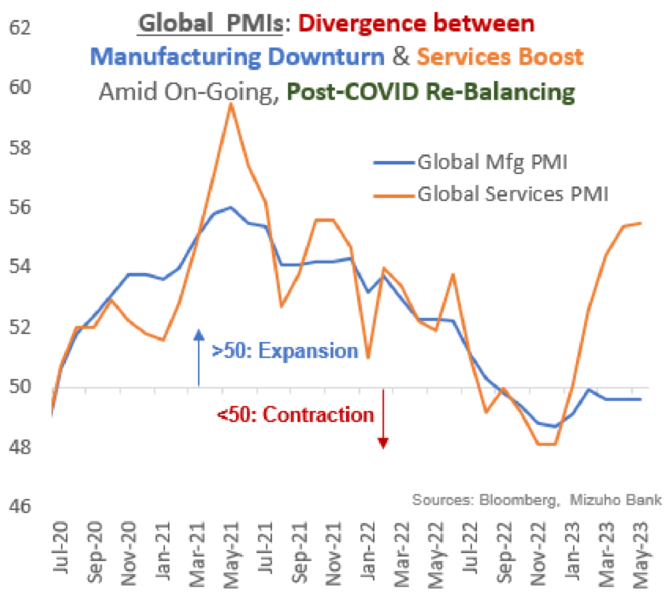
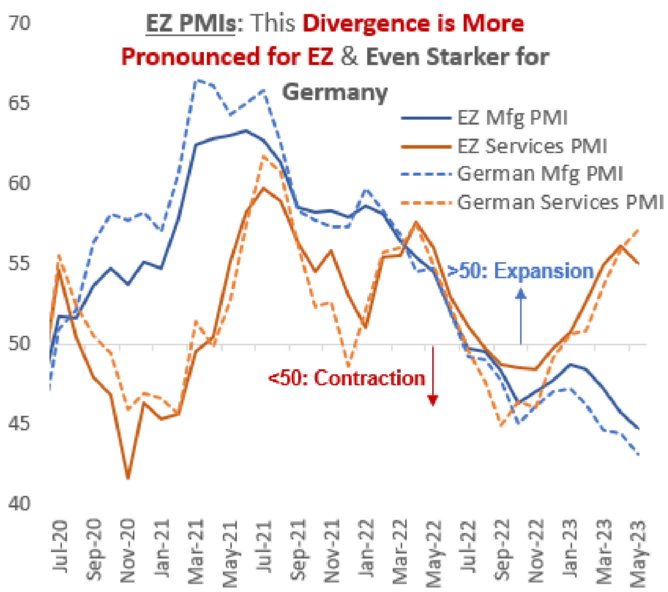
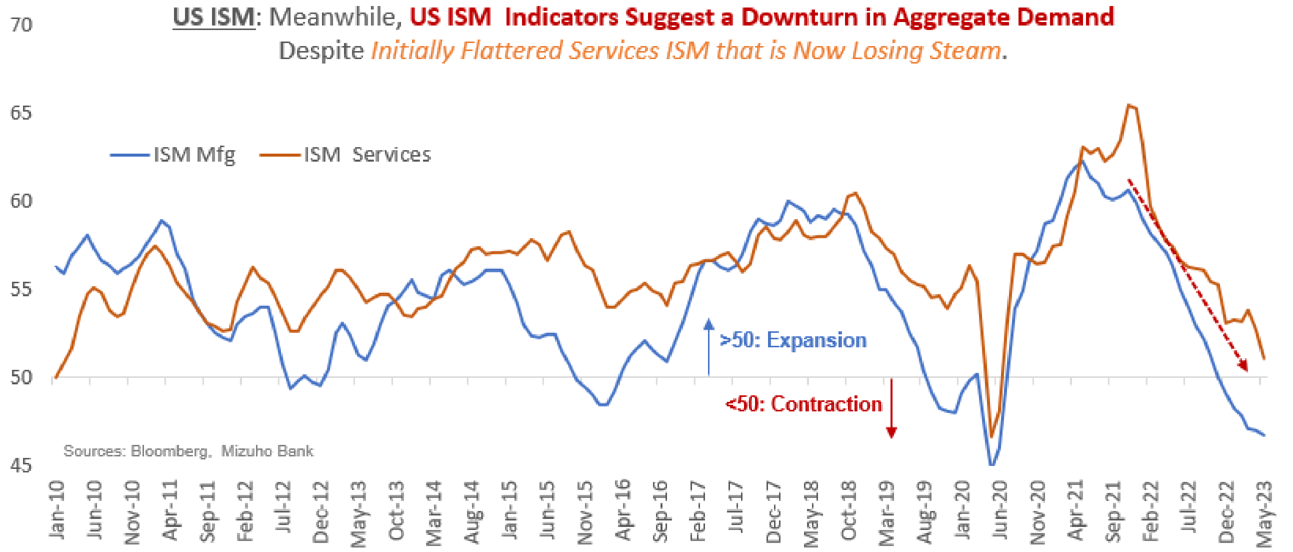
Silver-Lining or Red Herring?







"How embarrassing … a house full of condiments and no food." - Fight Club

<u>In a Nutshell</u>:

- The stark divergence in manufacturing and services PMI reflecting global **goods-to-services consumption re-balancing may be framed as a "silver lining"**;
- with services expected to backstop aggregate demand and buy time for manufacturing recovery.
- *<u>But</u>* the **risk is that stellar services is a red herring hides recession risks in plain sight**.
- Especially as *eroding savings*, *high inflation*, *fiscal consolidation*, *tighter monetary policy* and *heightened geo-economic uncertainties* flag significant likelihood of **fading consumption boost**
- <u>Critically</u>, the dangers of **potential confidence-sapping dynamics** with far more pernicious demand shocks render unchecked optimism" as the hollow "*house full of condiment and no food*".
- Despite partial tourism offset, **EM Asia's goods exports reliance hobble unchecked bullishness**.

Re-balancing Divergence: The **on-going global macro dynamic** of **goods-to-services consumption rebalancing** of the work is easy enough to recognise. And to be sure, the **growing divergence between resilient**, *if not resplendent*, **services starkly at odds with sputtering manufacturing** is **hard to ignore**.

Not a Guaranteed Silver-Lining: *But* what's **harder**, is **to correctly decipher** if this current state of divergence is **a silver lining of insulation for the global economy** (as services provide the buffer and time for manufacturing to recover) *or;* this is **merely a red herring that distracts from** growing **recession risks** (muted by a conspiracy of pent-up demand and savings drawdown overstating underlying demand)

Optimism is Qualified: The answer is unclear. On one hand, **higher household savings** and **a strong job market** understandably suggest **prima facie reasons for optimism t**hat buys into resilience of the global economy based on the compensatory buffer from services. *Yet*, this is an **untested conjecture, not a guarantee of sustained spending propensity**.

Amid Heightened Uncertainty: Certainly not in the context of all the **uncertainties associated** with an unprecedented *transition from pandemic distortions* to spending against a backdrop of heightened *geo-political risks from Russia-Ukraine* and *mounting US-China geo-economic frictions.*

Flattered by Pent-Up Demand: Crucially, **unprecedented** (and *unfamiliar*), **post-COVID good-to-services demand re-balancing** may be **flattered by** (fleeting) **pent-up demand that overstates aggregate demand**. In turn, suggesting **over-estimated global economic resilience**; *both in degree and durability.*

Compromised by Spending "Fade": Notably, the **shift away from durable goods to services**/experiential **consumption might entail diminished "multiplier"** and/or **durability**.

More so, **as COVID-era excess savings are depleted quickly and unevenly**, hitting middle-/lower-income consumers (with typically higher propensity to spend) more acutely.

Furthermore, **spending power eroded by high and elevated inflation** conspiring with **post-COVID fiscal fade**. Point being, a **litany of risks flag impending spending fade** that may **undermine silver-lining optimism and expose red herring realities**.

& Policy Pain: What's more, **sharply higher global interest rates**, led by the Fed's fastest pace and greatest amplitude of post-Volcker hikes rate hikes, could **also hollow out perceived consumer resilience** that is **exaggerated by** *China's re-opening* and the *goods-to-services migration* of demand. And even **more acutely so if lagged credit tightening starts to bite** more emphatically into aggregate demand.

Divergence, Dilemmas & Dampeners: At the very least, this **risks persistent, uneven economic activity**, with lagged services rebound out-running the manufacturing downturn, **exacerbating pre-existing policy complexity and conundrums**.

In a worse case, **perceptions of consumer resilience prove illusory** and *demand is rapidly hollowed out as post-COVID boost fizzle* on tighter conditions; including a **confidence-sapping conspiracy of banking sector risks** and binding geo-political friction.

Confidence Cracks: If *an unfortunate series of risks* conspire, more **binding dent on confidence** (and consequent economic pain) *could decimate any notion of "silver lining" and give way to the "red herring" proposition of masked recession risks*.

Instead, more extreme iterations of **confidence cracks** will reveal the "*house full of* (temporary service out-run) *condiments and no* (durable demand) *food*" **fallacy of mis-judging the temporary trappings of stellar service sector up-swing from re-opening for a durable, virtuous growth dynamics**.

US Canary: **US aggregate demand conditions**, which we can assume lead the global goods-to-services rebalancing, **appear to be softening rapidly** – regardless of relative service sector out-performance – may be seen as the *proverbial canary in the coal mine*. Specifically **warning of** initially **over-stated re-opening service sector ebullience** (led by travel) **merely papering over cracks temporarily than saving the day**.

Global Red Herring: Upshot being, **elevated global uncertainty** requires that **cheer about "silver linings"** of global services buffering the global economy **be tempered by more brutal realities of red herrings** from **fleeting distortions that understate risks in plain sight**.

& EM Asia's Hobbled Bulls: To be sure, such a **broader demand pullback may prove even more emphatic for EM Asia** given *far greater reliance on external demand*. Consequently, **EM Asia susceptible to distinctly K-shaped outcomes** for now as *manufacturing overhang may be juxtaposed with, not necessarily turned around by, tourism resumption*.

Admittedly, tourism-to-manufacturing emphasis may differentiate near-term relative growth prospects within EM Asia. Regardless, **EM Asia bulls may be hobbled** *so long as global aggregate demand does not stage a more unimpeded and balanced rebound*.