CHARTS OF THE WEEK

Credit Suisse, a slowing chip sector and adverse trends in China

OCTOBER 7, 2022
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This week's charts cover market stress related to Credit Suisse, the slowdown in global semiconductors, the prospect of a year-end US stock rally and the break from a historic correlation between falling equity markets and higher bond returns. We also examine demographic headwinds in Asian countries including China, whose GDP gap with the US is widening again. Finally, an anomalous gap between measures of the US economy has evaporated, while social research shows how a healthier, cleaner and more equal society is linked to national wealth.

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Credit Suisse is stressed but not the new Lehman

Speculation about the future of Credit Suisse was rampant over the past week. Swiss central bankers said they were monitoring the situation.

On Oct. 7, Credit Suisse responded with a debt buyback to reassure the markets while it plans a major overhaul.

As the chart below shows, this year, the bank's credit-default swaps (CDS) have spiked along with the European Central Bank's Composite Indicator of Systematic Stress (CISS). It's worth noting that the two stress measures moved more or less in tandem until about 2013, before and during the global financial crisis and the subsequent European debt crisis. Perceived risk for European banks generally stayed higher thereafter.

Capital requirements for banks are much higher than before the GFC, and policy makers are very unlikely to allow another "Lehman moment" where a financial institution gets into trouble and contagion spreads to the others. It's worth noting that banks were relatively unscathed by the pandemic as central banks provided markets with an enormous amount of liquidity.

To access this chart, you require a subscription to the GFI Company CDS database.

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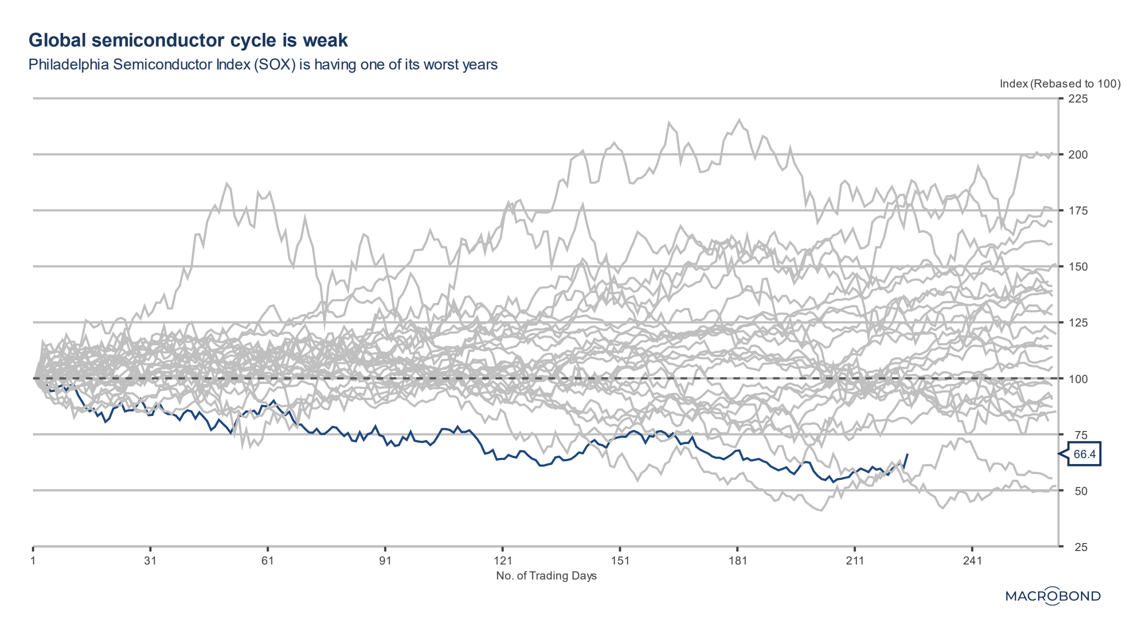
Semiconductor stocks have a rough 2022

The Philadelphia Semiconductor Index (SOX) includes the 30 largest US companies in the sector. It's closely watched because chipmakers are considered particularly sensitive to the economic cycle.

As our chart shows, chip stocks are seeing a substantial drawdown. The SOX is down almost 40 percent this year, putting 2022 on track to be one of its three worst yearly performances.

With central banks continuing to hike and tech companies announcing hiring freezes, there might be more pain to come.



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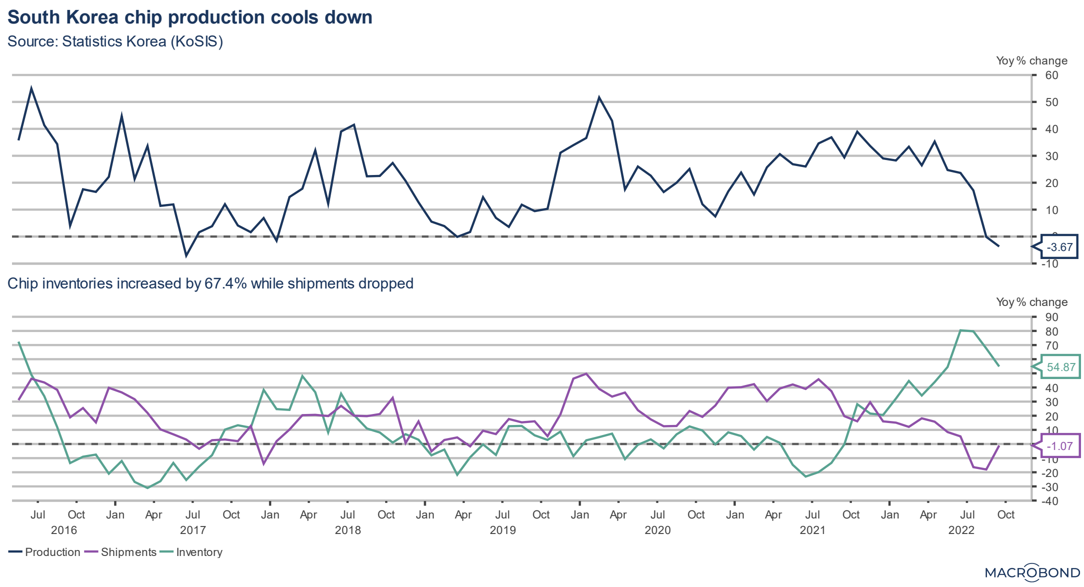
South Korean chip production cools

It's not just the US chip sector: the following chart shows how South Korean semiconductor production is slowing.

South Korean trade data is often regarded as a "canary in the coal mine" because the country exports so many high-tech products to the rest of the world. When Korean exports stall, this usually indicates a period of cooling global demand.

Domestic inventories of chips have increased significantly since the end of last year, while shipments have declined. That could well indicate bad news for the global tech sector.



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Autumn is the season for end of year rallies

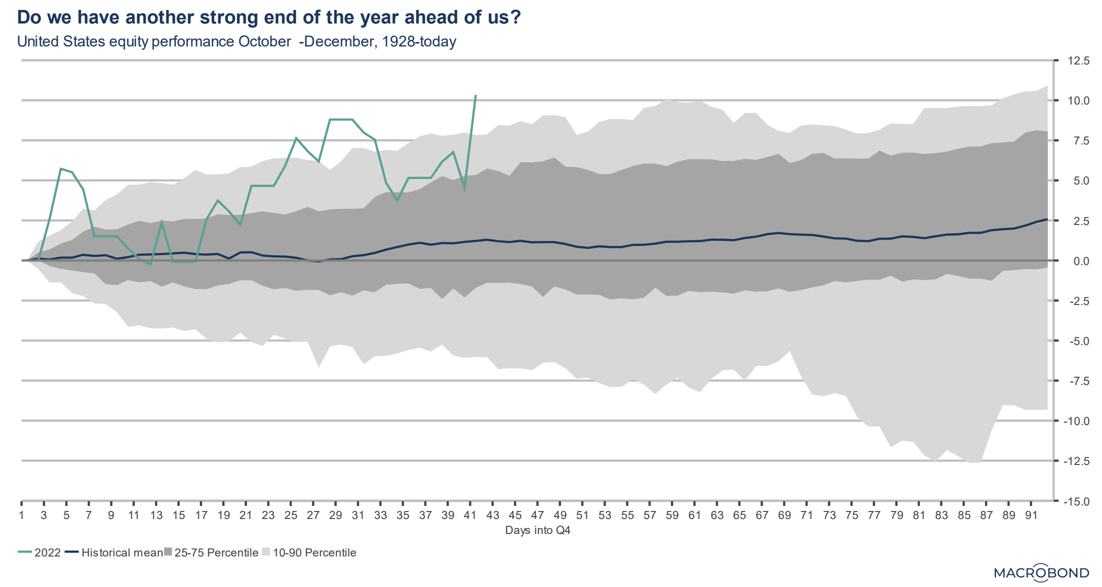
Data indicates that stock markets display seasonality, and we're heading into a historically bullish period.

August and September are notoriously difficult months for US equities. Those "autumn blues" are often followed by a recovery.

The following chart tracks the historic October-December performance by the S&P 500. On average, stocks go up about 2.5 percent in the fourth quarter. The distribution of outcomes is extremely wide, however. (A couple of famous October stock-market crashes come to mind.)

October of 2022 has already been particularly striking. The S&P 500 is up 5 percent, though it's still more than 20 percent down for the year.

This chart allows for the change region function.



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Simultaneous stock and bond slump bucks the historic correlation

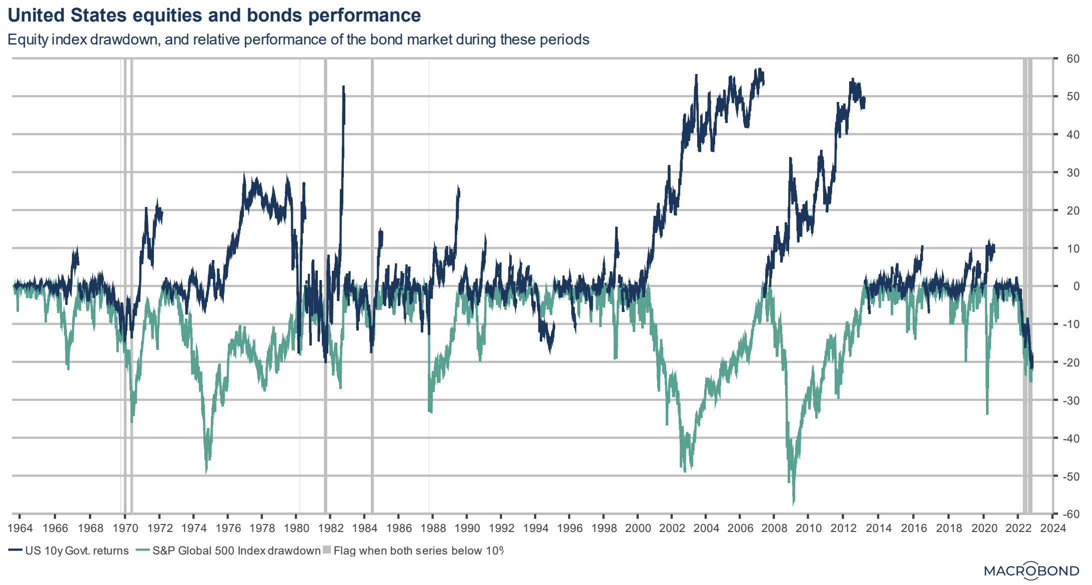
Most of the time, equities and bonds are negatively correlated: stocks slump, investors move to relative safety in fixed income. Risk-off days. However, it's well-known that this correlation shifts over time and is dependent on the macroeconomic regime.

The chart below shows S&P 500 drawdowns are often accompanied by substantial returns in the bond market. (Most notably in this chart, at the outbreak of the pandemic.)

The current macro environment is very different: we've seen equities and bonds slump simultaneously. That's due to a combination of high inflation and rapidly rising interest rates.

Insofar as central banks are trying to cool demand with their rate hikes, they are probably succeeding by creating a huge negative wealth effect, i.e. slumping asset prices.

This chart allows for the change region function.



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China seems less likely to catch up with US gross domestic product

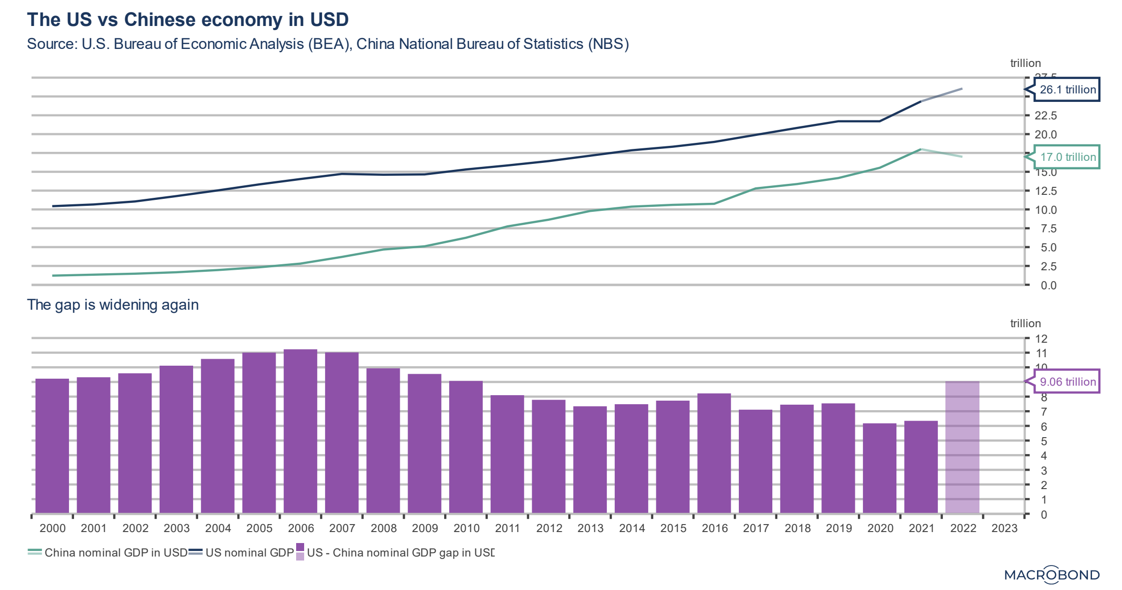
The China-US GDP gap is widening again – in fact, reaching its widest in 12 years.

China watchers have long speculated about when the Asian nation will overtake the US to become the world's biggest economy. Indeed, when adjusting for purchasing power parity, the Chinese economy is already larger given the nation's much lower consumer prices.

Of course, to truly measure an economy -- by its share of global GDP -- one must look at total output in nominal terms.

While China had been catching up for decades, the gap started to widen rather than narrow this year, as our charts show. US nominal GDP is forecast to grow more than 7 percent this year, almost double China's 4 percent pace. Meanwhile, the dollar is strengthening against almost all currencies, including the Chinese yuan.

That means China's GDP is actually contracting in dollar terms. Given the nation's severe slowdown, driven by the real-estate crash, and its very adverse long-term demographics, China might never overtake the US economy in dollar terms.



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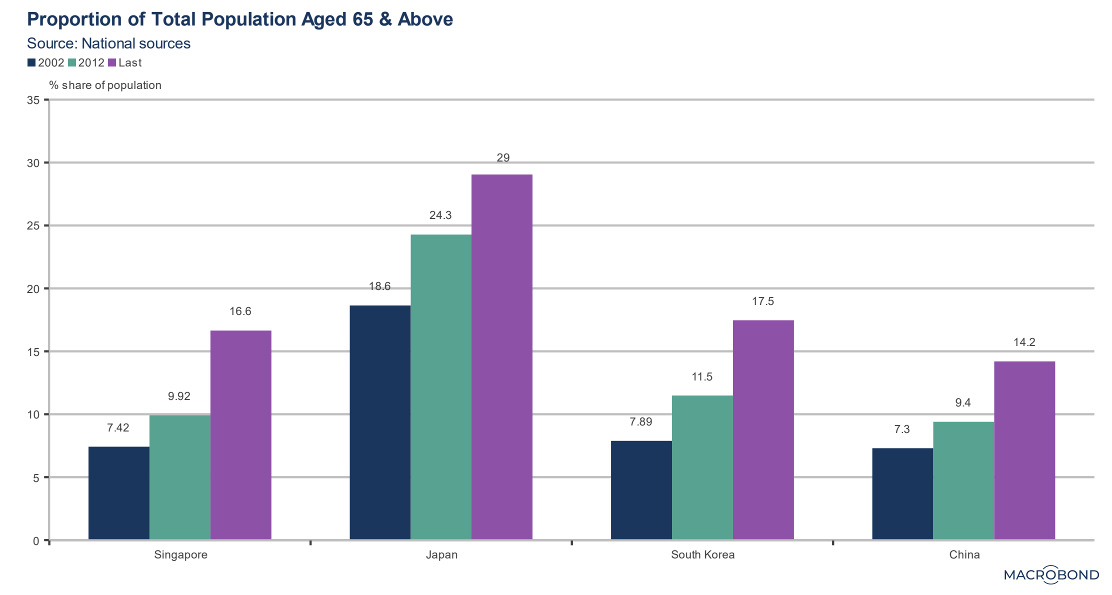
Asia is aging

Asian economies are seeing their population age rapidly, most famously in Japan, where the share of people aged 65 and over is approaching 30 percent. That's up from 20 percent in 2002.

South Korea and Singapore are experiencing a very similar albeit less extreme trend. The share of people aged 65-plus now exceeds 15 percent of the population in both economies.

Even though China's GDP per capita is significantly lower than these countries, it now has an age profile very similar to that of South Korea as a result of the strict one-child policy implemented decades ago.

China watchers are concerned that the aging population will strain the pension system to its limit well before the nation becomes an advanced economy.



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The importance of watching data revisions

Economic data is often revised, and when it is, historic anomalies can evaporate.

Earlier this year, we examined the perplexing gap between US GDP and GDI (gross domestic income), which reached a record 4 percent. We published a chart showing the record divergence between the two measures, and argued that the US was very unlikely to be in a recession even as GDP declined for two consecutive quarters. GDI growth was significantly healthier at the time.

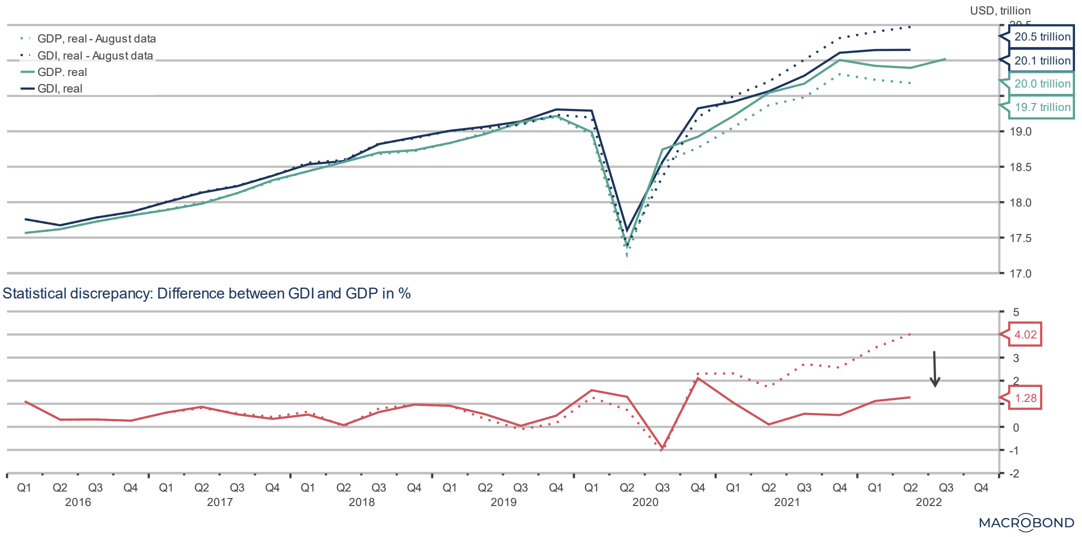
The Bureau of Economic Analysis released revised data on Sept. 29. As our chart shows, this revealed that the GDI-GDP gap has narrowed significantly to its usual pre-pandemic level of about 1 percent.

Firstly, GDI was significantly revised downward. Secondly, GDP was significantly revised upward – mostly for pre-2022 data, as the first half of this year still shows two quarters of negative growth.

This chart can only be accessed with the Data+ license as it uses revision history data.

Record gap between US GDP and GDI evaporates after data revisions

Source: U.S. Bureau of Economic Analysis (BEA)



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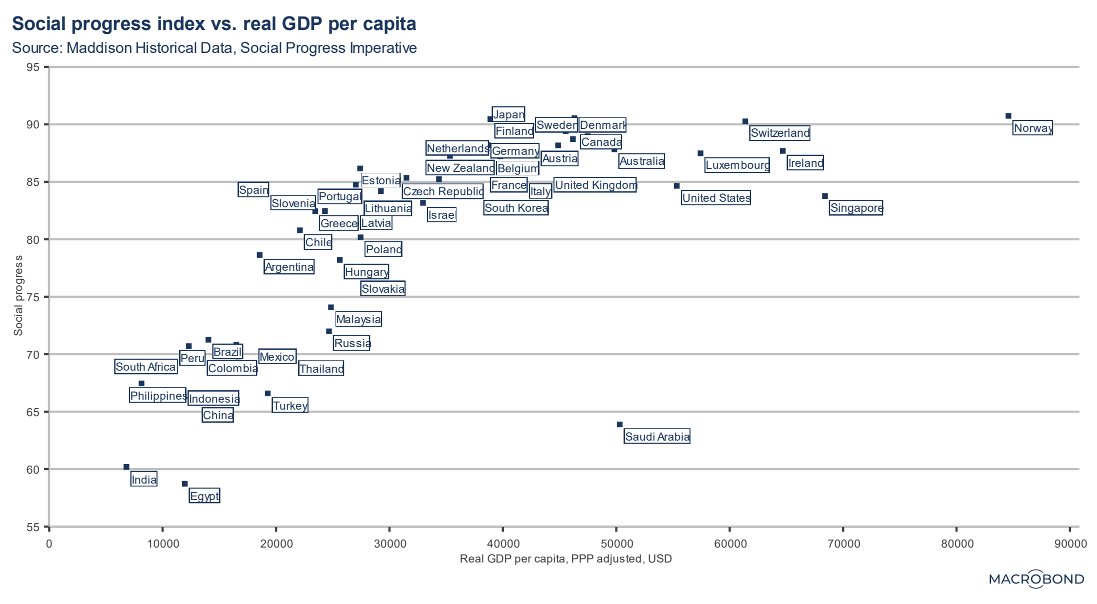
Social progress versus GDP per capita

We recently posted a chart showing the strong correlation between corruption and GDP per capita. There is a similar correlation between income per head and broader measures of social progress.

Our final chart tracks an index from Social Progress Imperative. It comprises 50 measures related to basic human needs (shelter and nutrition), the foundations of wellbeing (health and environment), and inclusiveness (equality and access to education).

It's easy to explain why a positive correlation emerges over time. Rich countries have the capacity to invest in a cleaner environment and better education and healthcare, while striving for a more equal and progressive society in general. Poorer countries often lack the means to achieve progress in any of these areas.

Progress on education, inclusiveness, and the environment also pays off in terms of higher long-run economic growth rates. The causality relationship between GDP per capita and social progress likely works both ways.



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