

Gas pipelines, Germany's downturn, and Britain's pounding

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This week's charts cover the importance of Norwegian gas and LNG in a world with shrinking Russian shipments; Britain's currency and bond market shock after the Truss tax cut surprise; devalued equities and balance-of-payments alerts flashing red in emerging markets; Germany's spiraling business cycle; and predicting recessions through a more sophisticated reading of consumer sentiment.

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Norway and LNG boats are ever more crucial for European gas

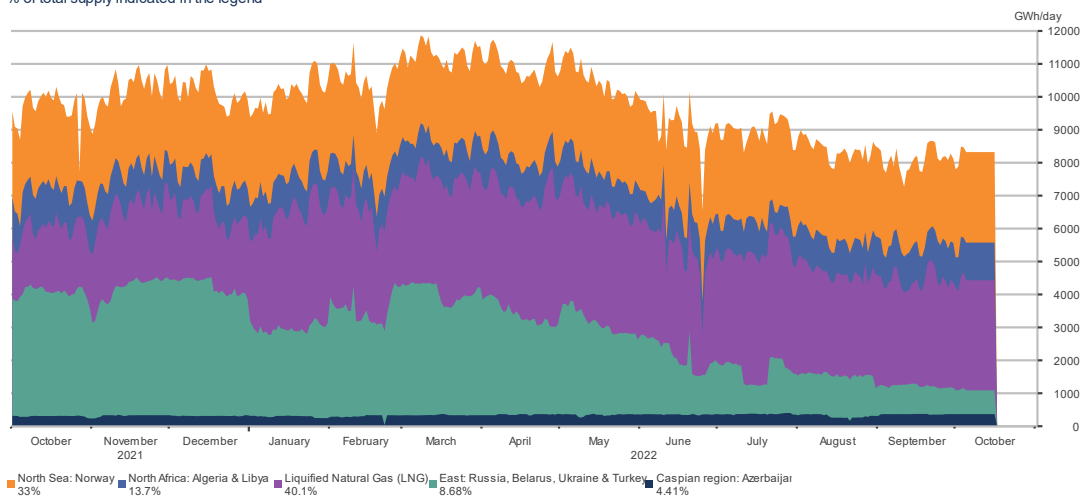
“Energy security” usually refers to the uninterrupted availability of energy sources at an affordable price. At least that’s the International Energy Agency’s definition.

However, the phrase can be defined more literally in the wake of suspected sabotage that damaged the Nord Stream gas pipelines between Russia and Germany. [Norway has deployed its military](#) to protect its gas installations in the incident’s wake. Lithuania has taken steps to bolster security around its own liquefied natural gas (LNG) terminal.

As our chart shows, Norway and LNG are ever more important to the European Union’s energy mix. The 12-month graph shows how gas shipments peak in the cold winter months. The steadily shrinking green section shows the gas supply that reaches the EU from Russia – including the now seriously damaged Nord Stream pipelines.

Gas supply corridors and flows to the EU

Source: European Network of Transmission System Operators for Gas (ENTSOG)
% of total supply indicated in the legend



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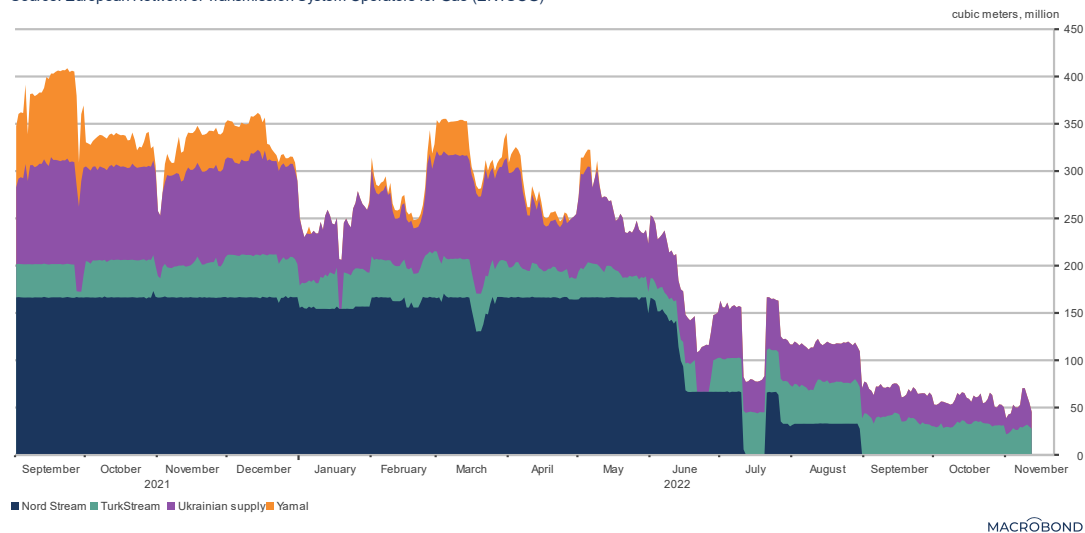
Shrinking Russian pipeline shipments

As our next chart shows, Nord Stream 1's gas flows were halted at the start of this month, when Russia cited a need for repairs. This pipeline accounted for almost half of Russia's gas shipments to EU markets a year ago.

However, Russian gas travels along different export routes, including the Yamal pipeline from the Arctic to Poland via Belarus. Other pipelines arrive at the EU's eastern border via Ukraine, which still receives gas Russian transit fees despite the war. Only TurkStream, which heads to Bulgaria and Greece via the Black Sea and Turkey, is delivering a quantity of gas similar to a year earlier.

Russian gas routes to the European Union

Source: European Network of Transmission System Operators for Gas (ENTSO-G)



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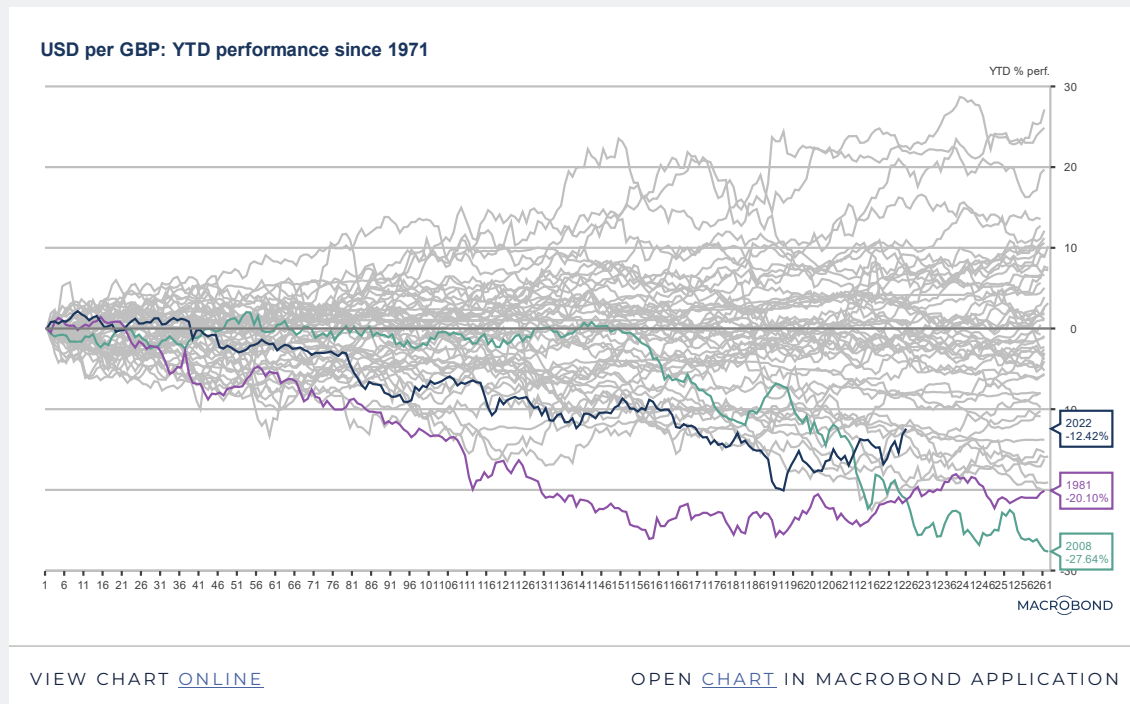
Sterling gets pounded

King Dollar is crushing currencies everywhere, but Britain presents a special case. Market turmoil in the wake of the UK's tax-cutting plan is pushing the pound towards parity with the greenback.

As our chart shows, 2022 marks one of the most severe devaluations that sterling has ever experienced versus the US dollar. Only recessionary 1981 and the bank-bailout year of 2008 surpass it (for now).

Those years were also marked by tight US monetary policy, especially in 1981, which saw Federal Reserve Chairman Paul Volcker willingly engineer a downturn to tame inflation. In 2008, monetary policy was also extremely tight, but more by accident than anything else. As we have said previously, Fed chair Jerome Powell may be [channeling his inner Volcker](#) in 2022-23.

The following chart allows for the [change region](#) functionality.



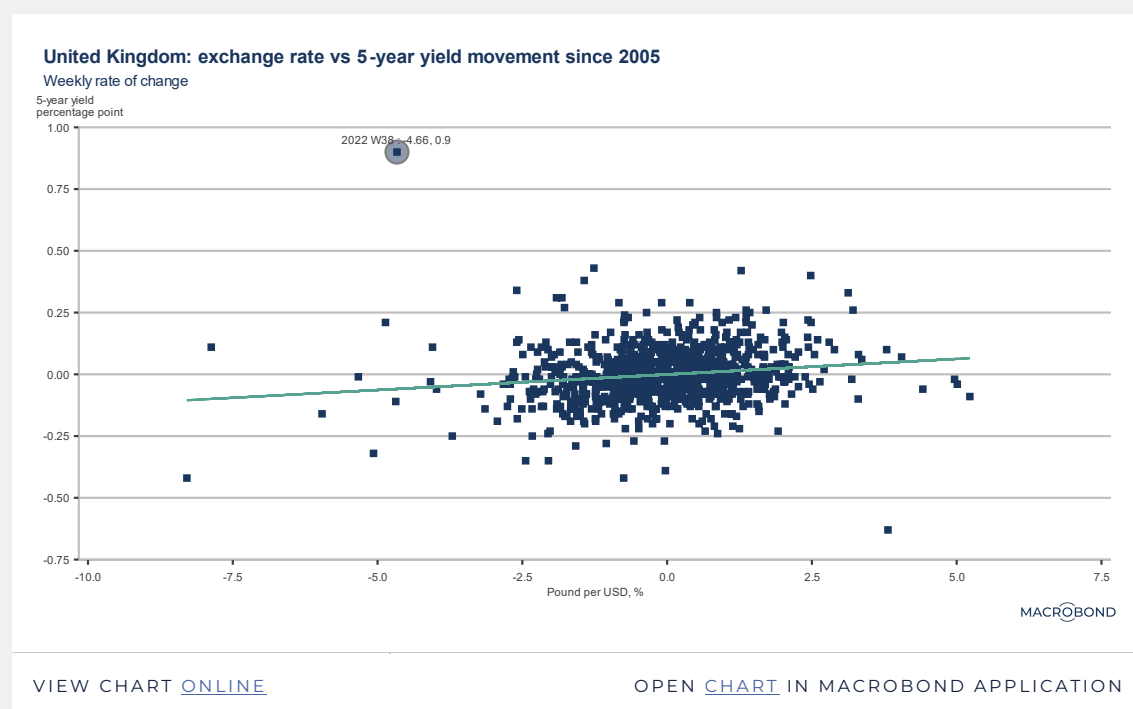
The unfunded Truss tax cuts shatter UK financial markets

Liz Truss's government shocked markets with a mini-budget that included increased borrowing to fund tax cuts (and the cancellation of tax increases planned by her predecessor). The measures, which will disproportionately benefit higher earners, come amid a macroeconomic environment of elevated inflation and low growth in the wake of the pandemic – which had already stretched public finances.

The pound and bond yields saw some of their most extreme movements in decades. Five-year yields moved 90 basis points higher in a matter of days. That's a 7-sigma event (translation for non-statisticians: an occurrence that's incredibly rare). Sterling slid about 5 percent against the dollar.

Our scatter chart plots the weekly movements of the exchange rate and five-year yields since 2005. The dot for last week doesn't have many neighbours. It's a data point showing moves usually associated with emerging markets, not developed economies.

The following chart allows for the [change region](#) functionality.



UK international investment position in focus

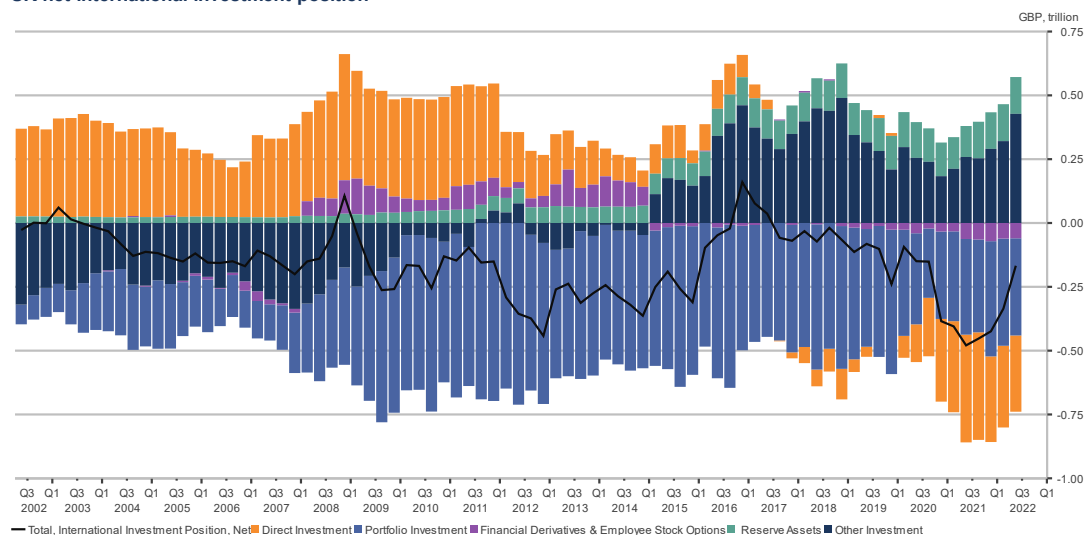
A country's net international investment position (IIP) is a key metric of national wealth. It also gives an idea of the risks a nation is running should international investors flee. That's the kind of incident associated with emerging markets, but the European debt crisis showed developed economies are not immune.

Most high-income countries have positive net IIP as their external assets exceed their liabilities. The US is the notable exception, but it generates net positive income because the return on its assets is higher than the return on its liabilities.

As our chart shows, this does not seem to be the case for the UK. A two-decade trend has resulted in negative IIP combined with net negative primary income on international investments. (Note the orange section, showing the deterioration in the net direct investment position from around the time of the Brexit vote.) This leaves the country more vulnerable to an external shock – such as an international loss of confidence in UK assets.

While the UK is not in a full currency crisis yet, it is clear that investors want a higher risk premium to hold UK assets following Truss's tax cuts. Sterling's safe-haven days are long in the past.

UK net international investment position



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Emerging market heat map shows signs of macro trouble

The US dollar is at its strongest level in decades. And dollar strength is usually accompanied by emerging-market weakness and stress elsewhere.

The following heatmap, which uses a variety of national and international sources, tracks key metrics of internal and external macroeconomic stability. They're commonly used to assess country risk in emerging markets.

Every single emerging market currency is down against the dollar, most by more than 10 percent. Interest rates have gone up, approaching or exceeding 10 percent in many countries. Most EMs are also simultaneously experiencing current account deficits and a negative fiscal balance. This twin deficit [is usually a harbinger](#) of a balance of payment crisis, especially when accompanied by large external debts in foreign currency.

EM economies at risk

	Current Account % GDP	Fiscal Balance % GDP	Reserve assets % ARA (IMF)	External debt % Reserves	CPI YOY % change	FX YTD perf % against USD	10Y yield %
Brazil	-2.5	-4.42	147	162	7.17	5.72	13.3
Chile	-8.2	-7.49	104	466	13.7	-4.13	5.79
Colombia	-5.9	-6.84	133	298	11.4	-15.17	14.4
Mexico	-0.7	-3.80	134	225	8.7	4.79	9.22
Peru	-5.1	-2.55	275	101	8.79	3.27	5.86
Czech Republic	-5.8	-5.88	380	118	18	-7.09	4.9
Hungary	-8.1	-6.77	121	687	20.1	-17.27	10.5
Poland	-4.9	-1.87	138	239	17.3	-11.10	7.21
Turkey	-5.5	-3.86	64.9	627	83.5	-28.30	12.1
Egypt	-3.1	-6.96	56.5	422	15.1	-35.59	19.7
Israel	3.3	-3.81	288	76.1	4.59	-8.89	3.15
Pakistan	-3.0	-6.05	43	683	26.6	-20.36	13.3
Kazakhstan	4.5	-4.97	190	1510	6.97	-5.49	9.84
South Africa	0.2	-6.04	73	320	7.8	-7.60	9.91
China	2.2	-6.10	64.5	81.1	2.78	-10.62	2.84
Hong Kong	5.9	0.14	68.7	378	4.33	-0.52	3.77
India	-2.5	-9.98	175	104	7	-7.48	7.35
Indonesia	0.9	-4.62	136	297	5.95	-8.14	7.29
Malaysia	1.8	-5.46	114	226	4.65	-9.96	4.49
Philippines	-6.8	-6.46	199	107	6.86	-10.54	7.59
Singapore	19.1	-0.19	67.8	425	7.48	-1.86	3.34
South Korea	1.7	-0.02	94.8	138	5.58	-9.52	3.93
Sri Lanka	-3.8	-11.64	12.1	1072	66.7	-44.85	28.8
Thailand	-3.0	-7.03	242	91.2	5.98	-7.75	2.93

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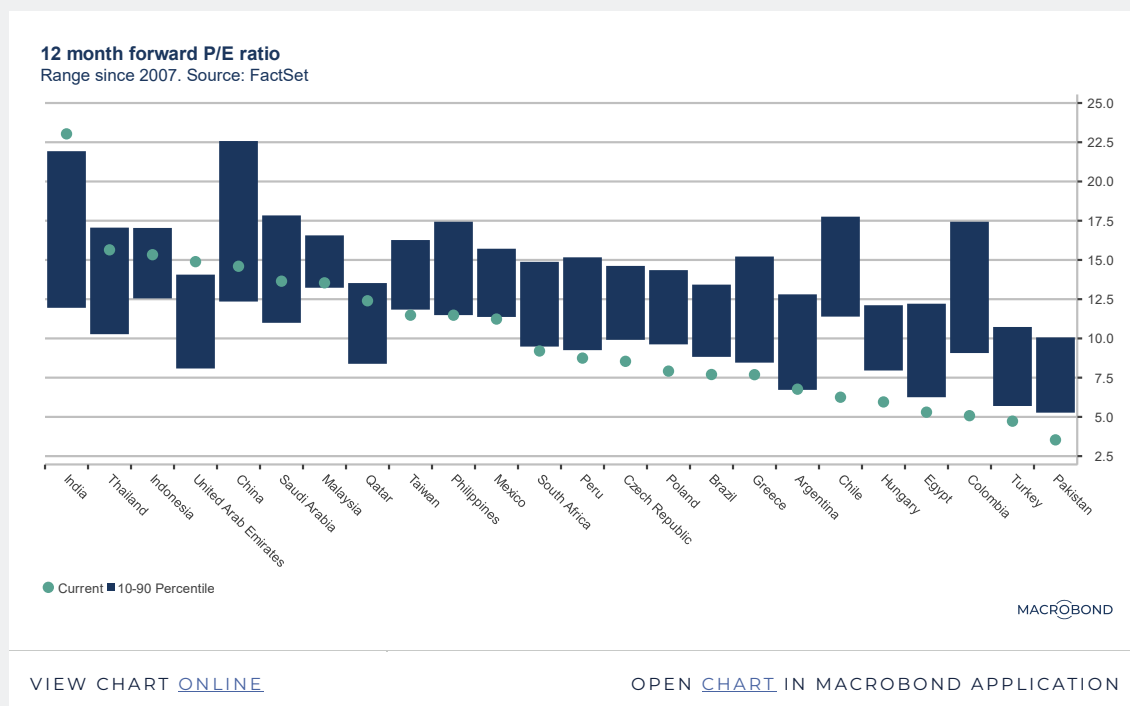
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Emerging market equity valuations are historically low

It's not just macroeconomic indicators: dollar strength and the Federal Reserve's rapid tightening cycle has weighed on emerging-market equities as well.

As our chart shows, the forward price-earnings ratios for most emerging markets are severely depressed compared to recent historical ranges.

The following chart requires a subscription to the Macrobond/FactSet add-on database.

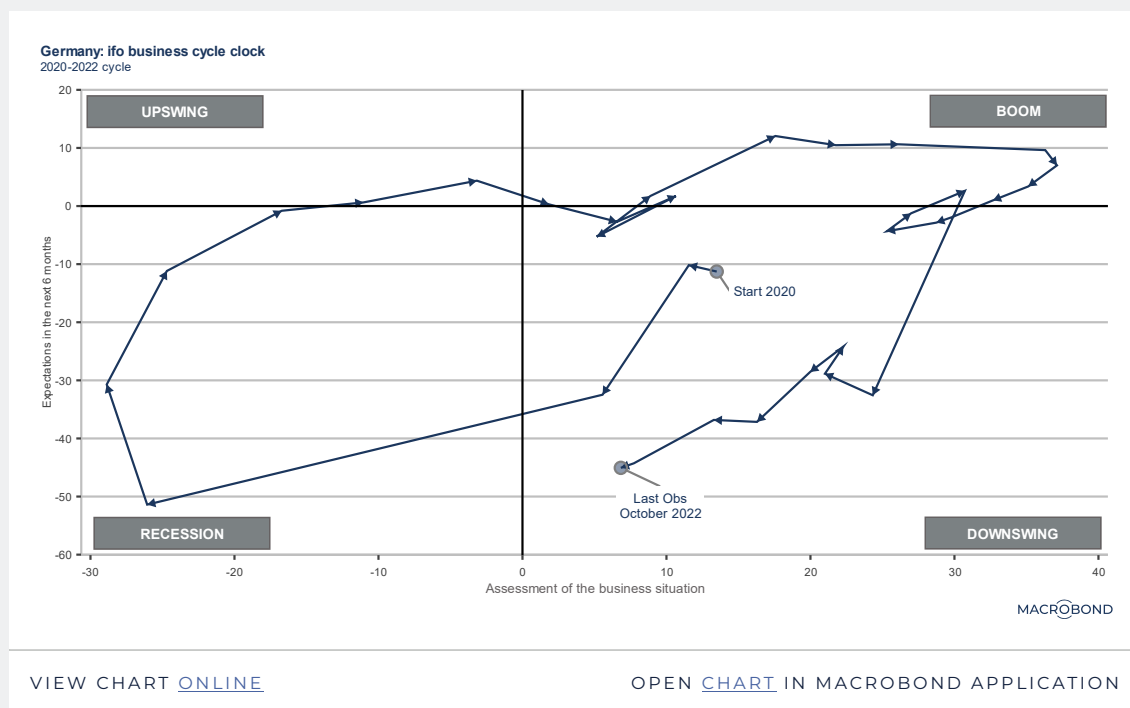


Moving like clockwork towards a German recession

Many economists are expecting a recession for Germany in early 2023 as rising commodity prices and surging inflation hurt the country's industries.

Our chart shows the famous “clock” created by Munich's Ifo Institute for Economic Research. It surveys companies, asking them about their view of the current situation (x axis) and their sentiment about the near future (y axis). The monthly data points have done an entire circle since the start of 2020, going through all four stages of the business cycle.

Germany exited the boom phase last year. The direction of travel is to the “recession” quadrant -- last entered when the pandemic went global.



Consumer sentiment as a recession indicator

[Macroeconomic research](#) suggests that downturns can be predicted by changes in consumer sentiment.

The following chart is a variation on the usual way of measuring that sentiment. It uses the spread between consumers' assessment of their current situation versus future expectations.

When the spread is in positive territory, it indicates consumers believe their current good times won't last. The same applies in reverse: a negative value indicates that consumers see a light at the end of a dark tunnel, so to speak.

The chart illustrates that when enjoyment of the present was combined with pessimism about the future, the economy entered a recession shortly thereafter. When that recession occurred, the spread rapidly reversed, with consumers believing things could only get better.

This spread rarely exceeds positive 75, which happens to be where we are today. That's a recession signal flashing bright red. Caveats apply: the post-pandemic economy has been quite different from anything we have seen in recent decades, and historic correlations may not hold.





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