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Multi-Asset - Data Science

Listen Up: Inflation, Recession, and FX

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1. Trending terms on US 2022-Q2 earnings calls



Source: HSBC, Refinitiv TRKD

This is an abridged version of a report with the same title published on 02-Sep-22. The full version of the note is available for clients of HSBC and contains further discussion of the work our data science team has undertaken to apply machine learning and NLP to corporate earnings calls. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

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Taking a dip into the data

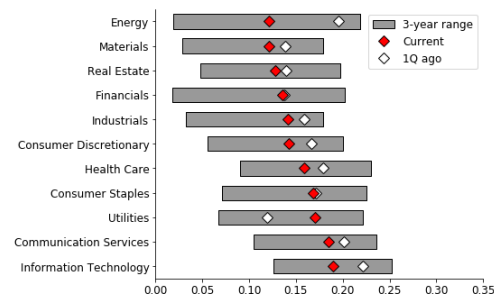
Listen Up: Inflation, Recession, and FX

Sentiment

In light of this gloomy set of trending topics, it is perhaps unsurprising that the sentiment of company management when discussing the future (a measure that we call Guidance Sentiment) has deteriorated in the last quarter.

In Chart 2 we can see that the only sector that has seen Guidance Sentiment increase over the past quarter is Utilities. In previous work we have found links between this guidance sentiment and the subsequent performance of companies and sectors so this negativity of companies when discussing the future suggests headwinds in the short term.

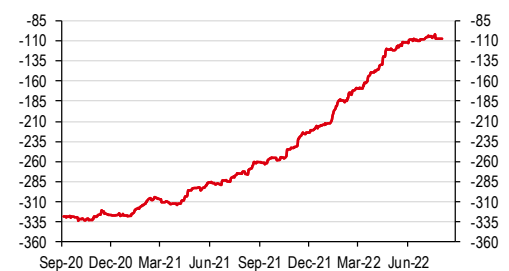
2. Company management are becoming more gloomy when discussing the future



Source: HSBC, Refinitiv TRKD

Note: Guidance Sentiment measures the aggregate sentiment from the sentences where company management discuss the future

3. Uptrend in CPI surprises appears to be coming to an end



Source HSBC, Bloomberg

Note: The HSBC Surprise Indices are calculated by aggregating standardised surprises. As such, it is the direction in which the index moves which is important, and not the index level

Inflation

This negativity lies in stark contrast to the price action seen over much of the summer. Risk assets saw a brief, but significant, rally in July and the first half of August. A significant driver of this rally had been the feeling that the market was no longer behind the curve on inflationary pressures.

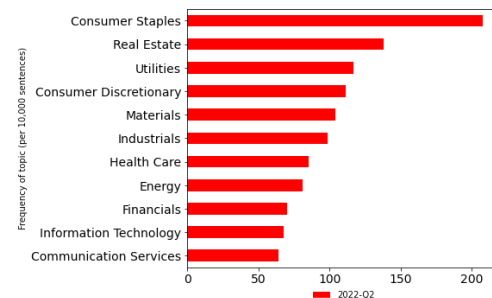
In Chart 3 we show the HSBC Global CPI Surprise Index. This index measures the surprise component of CPI data from around the world – i.e. not whether inflation is objectively high, but whether it is higher than the market expected.

This surprise index had been trending relentlessly higher in 2021 and 1H 2022 as the market continued to underestimate the true level of inflation. Since June 2022 there have been signs that this index has been moving sideways, suggesting that market expectations for inflation are now in line with reality.

This softening of inflation *surprises* has been interpreted by some as a sign that the level of inflation will fall over the coming months. By themselves, inflation surprise indices do not tell us about this. Instead they tell us that market expectations have caught up with reality.

Inflationary pressures are still a clear focus for company management. In Charts 4 and 5, we can see that all sectors are discussing inflation more frequently on earnings calls than one year or one quarter ago. The horizontal axes for both of these charts are on the same scale so it is a little encouraging that the numbers in Chart 5 are far smaller than in Chart 4.

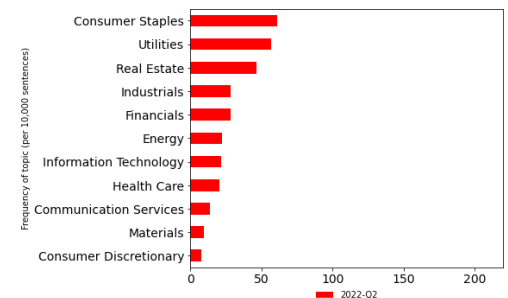
4. Inflation discussions are much more frequent than one year ago...



Source: HSBC, Refinitiv TRKD

Note: we measure frequency in terms of the number of sentences discussing inflation per 100k sentences

5. ... and slightly more frequent than one quarter ago

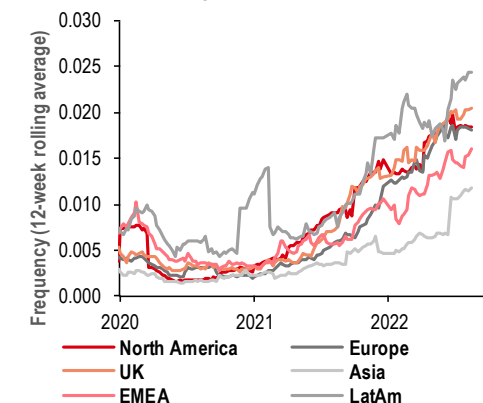


Source: HSBC, Refinitiv TRKD

Note: we measure frequency in terms of the number of sentences discussing inflation per 100k sentences

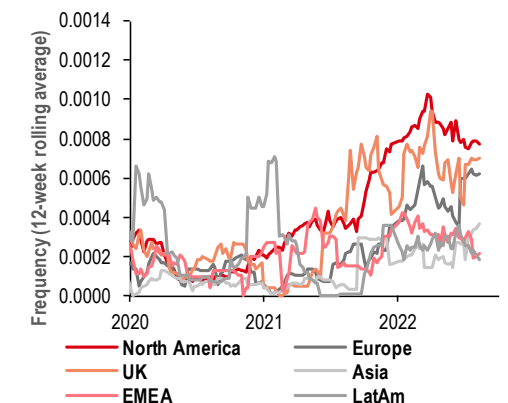
We can see that inflation is a trending topic not just at the sector level but also across regions. In Chart 6 we can see that in recent earnings call transcripts company managements have spoken about inflation more frequently than at any time in this inflationary cycle across all regions. Optimists will be pleased to see that the frequency with which companies are speaking about wage pressures appears to have peaked (Chart 7). This is notable since it is hard for an inflationary spiral to continue if wages do not continue to increase.

6. Company management continue to talk about inflationary pressures...



Source: HSBC, Refinitiv TRKD

7. ... But discussions of wage pressures appear to have peaked



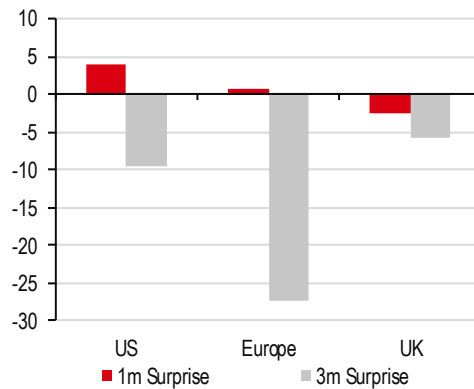
Source: HSBC, Refinitiv TRKD

Recession

Of course, the outlook for inflation should not be considered in isolation. Another key component is the outlook for growth. If we look at our Activity Surprise Indices we can see that, for developed markets, expectations for economic activity have been too positive over the past quarter with net downside activity surprises in the US, Eurozone, and UK (Chart 8).

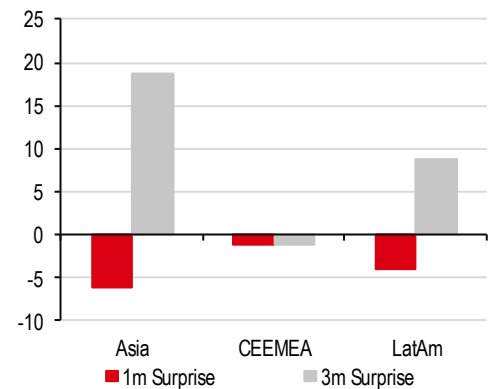
Within EM the story is more mixed. The activity surprise index for CEEMEA has moved basically sideways over the past 3-months suggesting that the market expectations for CEEMEA have been about right. In contrast, for Asia and LatAm, market expectations for economic activity were too negative with the surprise indices for both regions moving up over the past quarter (Chart 9). However, more recently both of these surprise indices have moved lower so expectations for these regions may now be too bullish.

8. Activity data has underperformed expectations in developed markets...



Source: HSBC, Bloomberg

9. ... But has been more mixed in EM

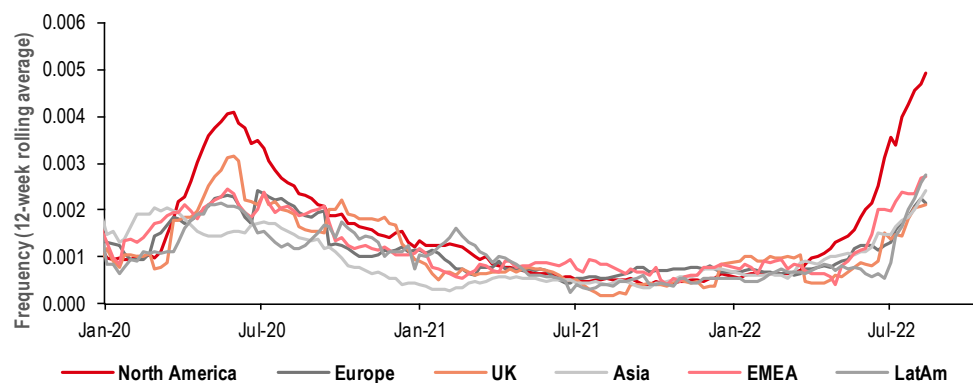


Source: HSBC, Bloomberg

The market has developed an instinctive reaction that a more accommodative Fed will lead to strong returns from risk assets. This is because there have been many periods of moderately weak activity since the financial crisis but not such weak activity that we risked falling into recession. At such times, the stimulus from more accommodative central bank policy outweighs the weakness in growth.

However, recessionary risks are clearly high now. For example, our European economics team are forecasting a recession in both Europe and the UK. It is not just economists who are worried about recessions: company management are discussing recessions very frequently now. Notably, in the most recent reporting season North American companies discussed recession with a higher frequency than during the depths of the COVID shutdown in 2020 (Chart 10).

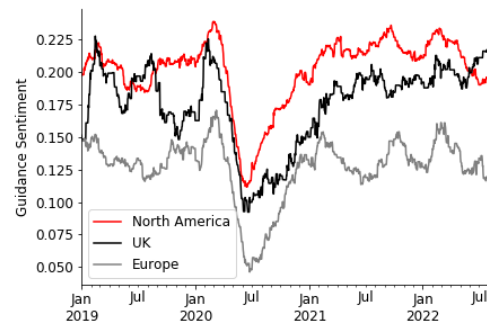
10. Company management are now frequently discussing recession



Source: HSBC, Refinitiv TRKD

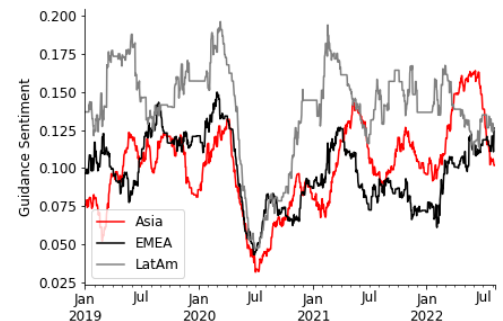
It is a little surprising to see company management in North America discussing recessionary pressures more frequently than in other regions given that macro-economic challenges appear to be manifesting themselves more strongly elsewhere. It also seems somewhat at odds with the relatively resilient Guidance Sentiment for North American companies compared with other regions (Charts 11 and 12).

11. Guidance Sentiment in DM



Source: HSBC, Refinitiv TRKD

12. Guidance Sentiment in EM



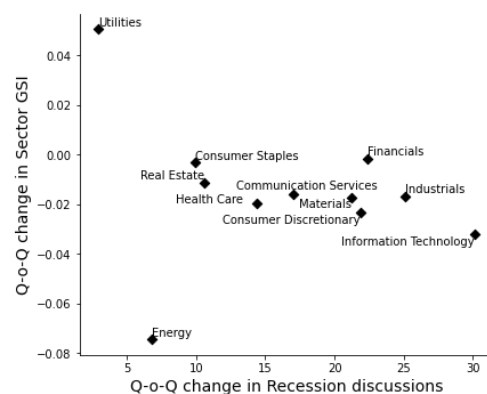
Source: HSBC, Refinitiv TRKD

When we look more closely at what US companies are saying when they have recently spoken about recessions, this apparent tension between the frequent discussion of recession alongside resilient sentiment when discussing the future is more understandable.

There are several instances of US company management acknowledging the risk of a recession but highlighting that they believe their performance will be resilient (either on an absolute or a relative basis) if a recession transpires. Such confidence is admirable; however, we believe that the intense focus of company management on the risk of recession is probably a significant indicator of upcoming negativity.

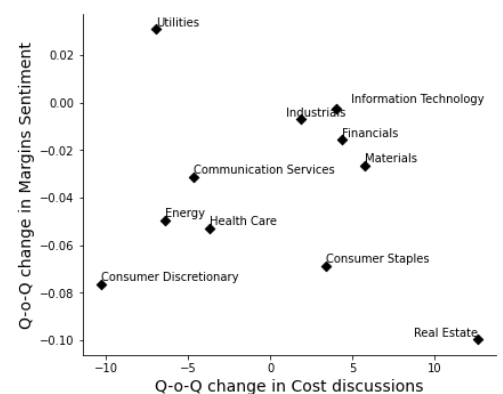
Notwithstanding the attempts by company management to put a positive spin on the prospect of recession, we can see a clear relationship between the degree to which a sector has increasingly discussed recession and the deterioration in Guidance Sentiment (Chart 13). The outlier from this very intuitive relationship is Energy, which has seen a sharp deterioration in Guidance Sentiment but have not seen a notable increase in the frequency with which company management discuss recessions.

13. Sectors which talk about recessions more frequently have seen deterioration in Guidance Sentiment



Source: HSBC, Refinitiv TRKD

14. Increased discussion of cost pressures have been associated with worsening sentiment towards margins



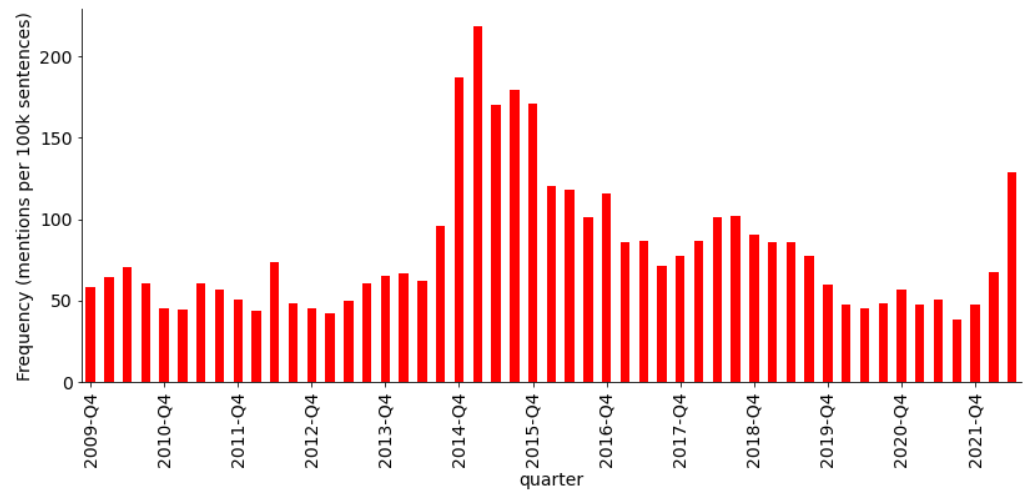
Source: HSBC, Refinitiv TRKD

In addition to seeing a broad-based deterioration of Guidance Sentiment, most sectors have seen a deterioration of sentiment when company management discuss margins (Chart 14). There is a clear relationship between this worsening sentiment towards margins and the increased frequency with which companies are discussing cost pressures.

The impact of FX

We saw in Chart 1 that a key trending concern for US company management during this reporting season has been the strength of the US dollar. Indeed, developments in the FX market have not just been a concern for US companies. In Chart 15 we show the frequency with which global companies have warned of the impact which FX is having on their results.

15. Frequency with which global companies have warned of FX impact



Source: HSBC, Refinitiv TRKD

We highlighted in our previous edition of Data Matters that there is the risk of a 'circle of strife' in which a strong US dollar causes headwinds for important large-cap companies, which leads to risk-off sentiment, which itself leads to further USD strength.

Disclosure appendix

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