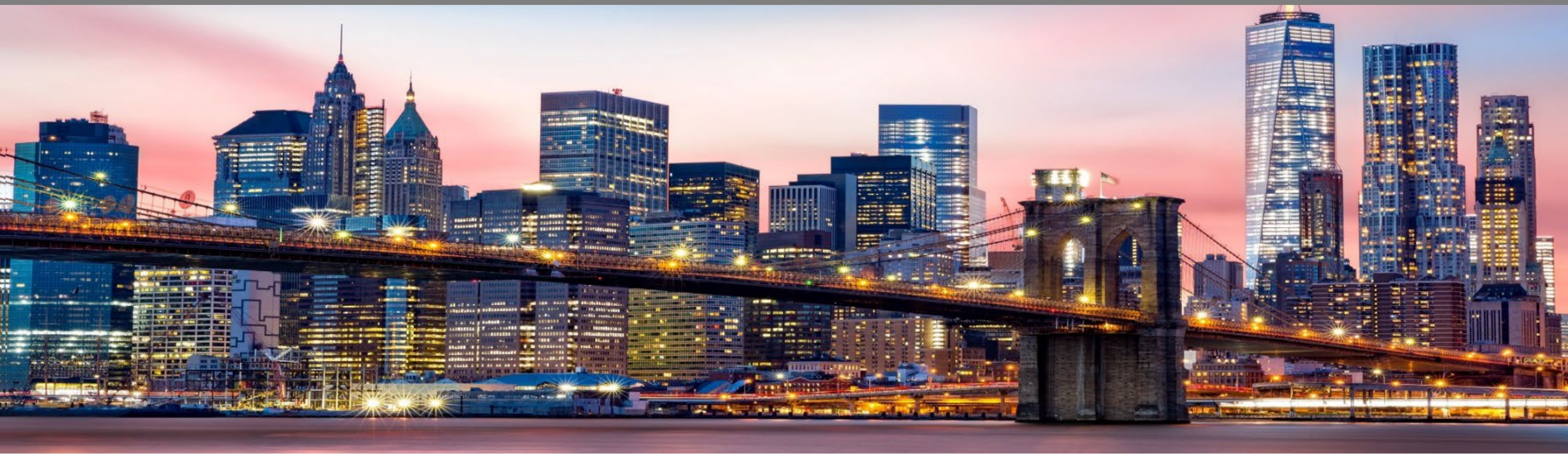
Economic Research

May 2022

Market Monitor – United States

Solid Labour Market Allows For More Aggressive Tightening



US GDP unexpectedly saw quarterly-on-quarter contraction in Q1 2022

The US economy unexpectedly saw quarter-on-quarter decline in the first quarter of 2022. GDP registered 1.4% annualized quarter-on-quarter drop in Q1 2022, worse than market expectation of 1% quarterly growth. The GDP in Q1 2022 was mainly dragged by a 5.9% drop in exports and a 17.7% surge in imports, which resulted in a subtraction of 3.2 percentage points in GDP growth during the quarter. Decelerated investment in business inventories also subtracted the GDP growth by about 0.8 percentage points in Q1 2022. However, consumer spending still saw solid performance in Q1 2022, with quarterly growth slightly accelerating to 2.7% during the quarter.

Fed continues to raise interest rate nevertheless, backed by higher inflation and a solid labour market

The US labour market continued to see jobs growth in March, albeit at a moderated pace. Nonfarm payrolls saw 431,000 added jobs during the month, building on an upward revision of 750,000 added jobs in the previous month. At the same time, the unemployment rate dropped to 3.6% in March, down from 3.8% in the previous month and close to the pre-pandemic level of 3.5%. Labour earnings saw further growth amid a tight labour market, with average hourly wages registering year-on-year growth of 5.6% in March. The solid wage growth has helped boost consumer confidence to some extent, with the final reading of the University of Michigan Consumer Sentiment Index rebounding to 65.2 in April from 59.4 in the previous month.

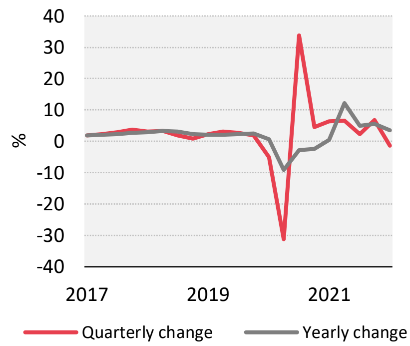
Meanwhile, as Russia's invasion of Ukraine pushed up oil and gasoline prices and with supply chain bottlenecks persisting, the headline US consumer price index (CPI) registered year-on-year growth of 8.5% in March, hitting a new four-decade high and up from 7.9% in February. The core CPI, which excludes the volatile categories of food and energy, registered a 6.5% annual growth during the month, the highest increase since August 1982. Nonetheless, there are some signs that inflation in the US may be close to its peak. Monthly growth of the core CPI slowed to 0.3% in March, mainly driven by a 3.8% drop in used car and truck prices.

US GDP unexpectedly saw quarterly contraction in Q1 2022, mainly due to larger trade deficit and decelerated investment in business inventories.

Labour market remains solid, with unemployment rate dropping to 3.6% in March, closer still to the pre-pandemic level of 3.5%.

Fed raises fed funds rate target to 0.75% – 1% at May's meeting and starts reducing its balance sheet in June.

US GDP



Source: Bloomberg, data as of 28/4/2022

As the labour market remains solid and inflation continues to accelerate, the Federal Reserve (Fed) has raised the fed funds rate target by 50 basis points to 0.75%-1% as expected at May's meeting. At the same time, the Fed also announced it will start reducing the size of its balance sheet on 1st June, at a pace of USD 47.5 billion per month. The pace of balance sheet reduction will be doubled to USD 95 billion starting from September. At the press conference, Fed chair Jerome Powell said that the additional 50 basis point hikes should be on the table at the next couple of meetings, despite ruling out consideration of 75 basis point hikes.

Going forward, the trajectory of inflation will play an important role in determining the pace of monetary tightening and the continued economic recovery of the US from the pandemic. As Secretary of State Antony Blinken warned that the Russian war in Ukraine could last through the end of 2022, commodity production is likely to be disrupted. In addition, China's zero Covid-19 policy may create additional uncertainties for international supply chains. These two factors have been also mentioned in Fed's meeting statement in May. If the inflation pressure in the US remains for longer than expected, the Fed may need to tighten monetary policy faster than previously projected. Although US households' financial position improved in the past year, with net worth rising by 14.4% year-on-year to about USD 150 trillion in Q4 2021, faster monetary tightening will result in corrections for asset prices, negatively impacting household net worth and hence consumption. This may drag on the country's ongoing economic recovery from the pandemic.

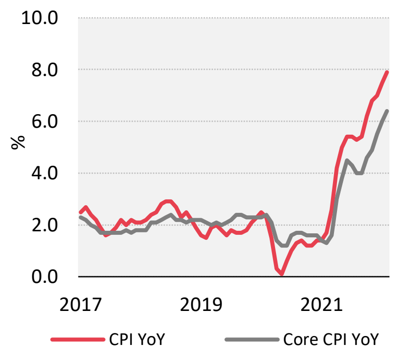
Equity market dips amid rising treasury yields

US benchmark equity indices experienced a correction in April as treasury yields climbed, denting the attractiveness of stocks relative to the return on Treasuries. As of 29th April, the S&P 500 Index had dropped by 8.8% when compared to the level at the end of March, while the Nasdaq Composite Index was down 13.3% and the Dow Jones Industrial Average had declined by 4.9%.

Yields rise and dollar strengthens as investors price in more rate hikes in the upcoming months

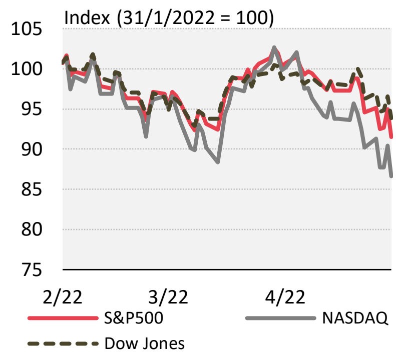
As inflationary pressure is expected to remain high for longer, markets expect that the Fed will need to raise interest rates again at its upcoming meetings, pushing up treasury yields and the US dollar. On 19th April, the 10-year Treasury yield closed at 2.939%, reaching the highest since late 2018. As of 29th April, the 10-year Treasury yield still stood at 2.937%, about 60 basis points higher than the level at the end of March. Meanwhile, the dollar index also rose to the highest level since March 2020. As of 29th April, the dollar index stood at 102.959, about 4.7% higher than the level at the end of March. Looking ahead, as assets that previously benefited from low interest rates will see a mounting risk of value correction, US financial markets may see increased volatility in the months ahead.

US Inflation



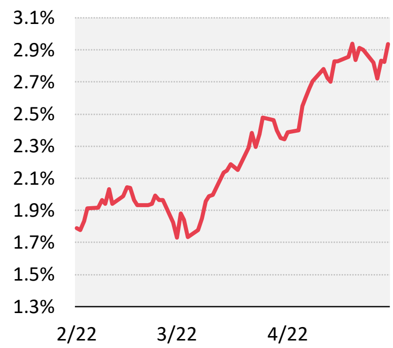
Source: Bloomberg, data as of 19/4/2022

US Equity Indices



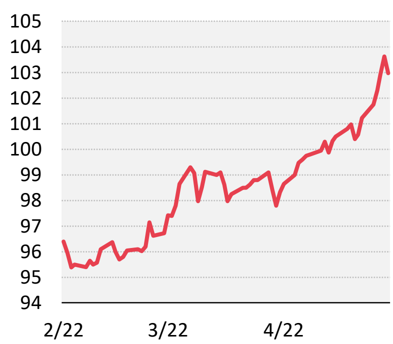
Source: Bloomberg, data as of 29/4/2022

US 10-year Treasury Yield



Source: Bloomberg, data as of 29/4/2022

Dollar Index



Source: Bloomberg, data as of 29/4/2022

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