BEA 東亞銀行

Economic Research

August 2022

Market Monitor – United States

US Economy Slips into Technical Recession in Q2 2022

US economy contracts by 0.9% in annualised terms in Q2 2022, dragged down by inventory adjustment and investment

In Q2 2022, US GDP contracted at an annualised rate of 0.9%, following a 1.6% decline in Q1. This fulfilled the definition of a technical recession, marking two consecutive quarters of negative growth. The biggest drop in the Q2 GDP figures was in private inventory accumulation, which saw 2.0 percentage points subtracted from the headline figure, particularly among general merchandise stores and motor vehicle dealers. Slower inventory accumulation may be a sign of increased business caution, as high inflation squeezes household budgets. Meanwhile, personal consumer expenditures still saw a 1% annualised growth in Q2, though slowing from 1.8% growth in the previous quarter. Other interest rate-sensitive components like residential investment and business investment in equipment and structures also recorded negative growth in Q2, resulting in a 13.5% annualised drop in gross private investment during the quarter.

Inflation remains the key focus for the US economy, with the headline consumer price index (CPI) registering a 9.1% year-on-year (YoY) growth in June, a new four-decade high. At the same time, the core CPI, which excludes food and energy prices, rose by 5.9% YoY in June, down only 0.1 percentage point from the previous month. The price increase was broad-based, with energy prices recording 41.6% growth from a year earlier and food prices rising by 10.4%. At the same time, the booming property market also pushed up rents, with the yearly rise in shelter costs at 5.6% in June, up 0.1 percentage point from the previous month. With broad-based inflationary pressure, it is believed that inflation will stay high at least in Q3, before easing gradually going into 2023.

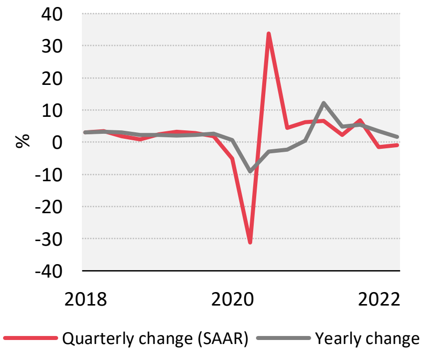
Meanwhile, the US labour market stayed solid in July, with no clear sign of cooling. Both unemployment rate and total nonfarm employment have returned to their pre-pandemic level. The unemployment rate further edged down to 3.5%, and another 528,000 jobs were added to nonfarm payrolls during the month. The average monthly increase in nonfarm stayed at 471,000 jobs in the first seven months of 2022, slightly lower than the

US economy enters technical recession, with GDP declining by annualised rate of 0.9% QoQ in Q2 2022.

Headline inflation hits another four-decade high, with YoY growth of 9.1% in June.

Fed raises the fed funds rate by another 75 basis points at its July meeting and leaves the door open for another 75-basis point hike at its next meeting.

US GDP



Source: Bloomberg, data as of 28/7/2022

2021 average of 562,000. Labour income recorded another solid growth, with average hourly earnings increasing by 5.2% YoY in July. Nonetheless, elevated inflation and a rapidly tightened monetary policy stance has continued to weigh on consumer sentiment, with the final reading of the University of Michigan Consumer Sentiment Index up just slightly to 51.5 in July from the historical low of 50 in June.

Fed shows determination to fight inflation with another 75-basis point hike

As labour market is close to full employment and inflationary pressure persists, the Federal Reserve (Fed) is continuing its aggressive plan to quickly raise interest rates back to a neutral level to curb inflation. At its July meeting, the Fed raised the fed funds rate target by another 75 basis points to 2.25%-2.5%. Fed chairman Jerome Powell said another unusually large hike could be appropriate at the next meeting, but the decision will still depend on incoming data. Powell also said the Federal Open Market Committee (FOMC) can no longer provide the kind of clear guidance that it did while the Fed Funds Rate was returning to neutral and pointed to the quarterly Summary of Economic Projections (SEP) as the best indicator of where he sees policy rates going this year, i.e. 3.25%-3.50% at year-end. With the Fed Funds Rate now at the FOMC's neutral level, Powell mentioned that at some point it will be appropriate to slow down the pace of rate hikes.

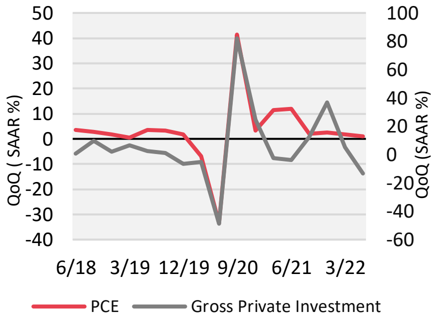
Looking ahead, as financial conditions continue to tighten, consumer activity will remain subdued, and the markets have already downgraded the US economic outlook. The latest Bloomberg survey in July reveals that the markets expect US GDP growth to be 2.1% in 2022, down by 0.5 percentage points from the June survey. It is expected to slow further to 1.3% in 2023, which is down 0.7 percentage points from the June survey. The IMF's latest forecast shows a similar downward revision, projecting that US GDP will grow by 2.3% in 2022 (down 1.4 percentage points from its April projection) and by 1.0% in 2023 (down 1.3 points from April). The IMF's projections imply that there is still room for further downgrades by the markets.

Equity markets rebound despite continued strength of US dollar, while bond yields decline from the recent peak

US equity markets saw a mild rebound in July after months of corrections, mainly because better than expected earnings from numerous large corporations and advanced GDP figures led to optimism that the Fed might start to slow its pace of rate hikes. As of 29th July, the S&P 500 Index had risen by 9.1% since the end of June, and the Nasdaq by 12.3%. The Dow Jones Industrial Average rose by 6.7% over the same horizon.

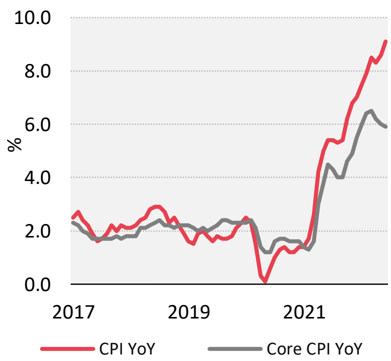
In the bond market, the benchmark 10-year treasury yield declined from the peak seen in June, mainly due to concerns about the US economic outlook. As of 29th July, the 10-year treasury yield stood at 2.651%, about 37 basis points lower than at the end of June.

Personal Consumer Expenditures & Gross Private Investment



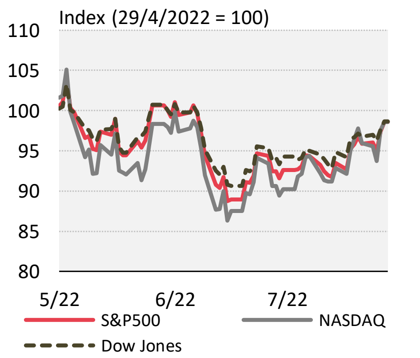
Sources: Bloomberg, Data as at 28/7/2022

US Inflation



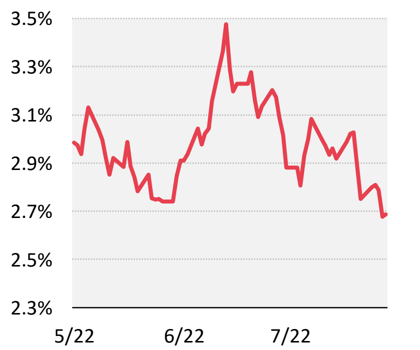
Source: Bloomberg, data as of 15/7/2022

US Equity Indices



Source: Bloomberg, data as of 29/7/2022

US 10-year Treasury Yield

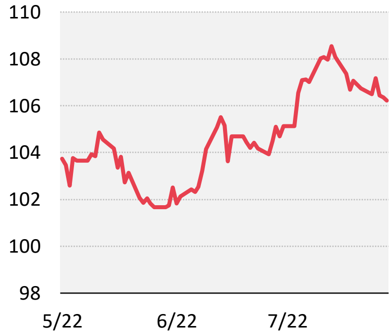


Source: Bloomberg, data as of 29/7/2022

In the foreign exchange market, the US dollar strengthened further, amid a divergence of monetary policy stances between the US and other major economies and rising geopolitical tensions. The dollar index once rose to 108.5 in July, a level that was last seen in 2002, although the dollar's rise eased towards the end of July amid concerns about the US economic outlook. As of 29th July, the dollar index stood at 105.903, about 1.6% higher than at the end of June.

Going forward, the US financial markets will continue to be driven by market expectations of how the US economy and inflation outlook will evolve as well as uncertainties related to heightened geopolitical tensions and the evolving pandemic situation.

Dollar Index



Source: Bloomberg, data as of 29/7/2022

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