Market Monitor – United States

Inflation Pressure Eases Slower Than Expected

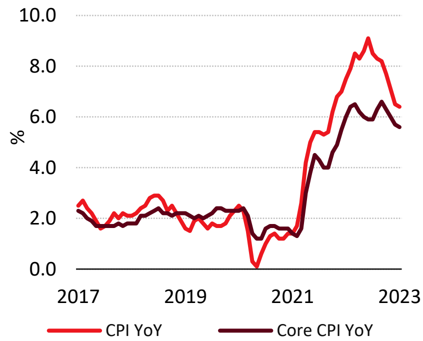
- US GDP expanded at a downwardly revised annualized rate of 2.7% QoQ in Q4 2022, chiefly due to a 0.7 ppts downward revision in private consumption to 1.4%.
- Inflation data was mixed in January 2023, with continued easing in YoY CPI growth while the PCE price index edged higher.
- US consumer sentiment continued to improve in February with the University of Michigan Consumer Sentiment Index rising to 67, a new high since January 2022.

The US economy posted a moderate expansion in 2022 but inflation and the job market eased slower than expected

The latest GDP reading indicated the US economy continued to expand in Q4 2022, despite a slower pace. The US GDP expanded at a downwardly revised annualized rate of 2.7% in Q4 2022, down 0.2 percentage point from the advance estimate. The downward revision in the second estimate was mainly attributable to the downward revision of private consumption 0.7 percentage points (ppts) to an annualized 1.4% in Q4 2022. At the same time, the annualized growth rate of non-residential investment was revised up by 2.6 ppts to 3.3% in Q4 2022, while the drop in residential investment narrowed by 0.8 ppts to 25.9%. The 2.1% real GDP growth for the whole year of 2022 was unrevised in the second estimate.

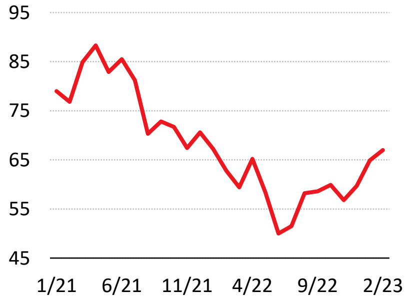
Inflation reading was mixed in January 2023, implying that price pressures may ease slower than previously expected. The year-on-year (YoY) increases of headline and core consumer price indices (CPIs) edged down by 0.1 ppt from previous month to 6.4% and 5.6% respectively, in January 2023. The preferred inflation gauge by the Federal Reserve (Fed), core price index of personal consumption expenditure (PCE), even accelerated by 0.1 ppt from the previous month to 4.7% YoY in January. Both the CPI and PCE price index showed the stickiness of US price pressures, indicating that inflationary pressure could stay above the 2% policy target for longer than previously expected.

US Inflation



Source: Bloomberg

University of Michigan Consumer Sentiment Index



Source: Bloomberg

Resilient labour market and improving consumer sentiment could lead to a slower pace of easing in inflation. The University of Michigan Consumer Sentiment Index rose to 67 in February, up from 64.9 in January and reaching a new high since January 2022, while the one-year inflation expectation rose by 0.2 percentage points from January to 4.1%. The five-year inflation expectation stayed at 2.9% in February. Meanwhile, despite the rapidly raising rates in 2022, January's labour market figures continued to record solid employment and earnings growth, together with the improving consumer sentiment, possibly resulting in the stickiness of inflationary pressure.

Fed Chair turns more hawkish after stronger than expected data

The minutes for the policy meeting concluded in early February showed most officials favoured 25-basis points (bp) hike, but a few still favoured a 50-bp hike. A number of participants reckoned that an insufficiently restrictive policy stance could halt the recent progress in moderating inflationary pressures, leading inflation to remain above the 2% target for a longer period, and poses a risk that inflation expectations could become unanchored. In the latest Testimony to the Senate, Fed Chairman Powell said the latest economic data have come in stronger than expected, which suggests that the ultimate level of interest rates is likely to be higher than previously anticipated. If the totality of the data were to indicate that faster tightening is warranted, they would be prepared to increase the pace of rate hikes. This implies that the upcoming employment and inflation data will be the key to determine the pace of rate hike in March and the summary of economic projections will also be closely watched.

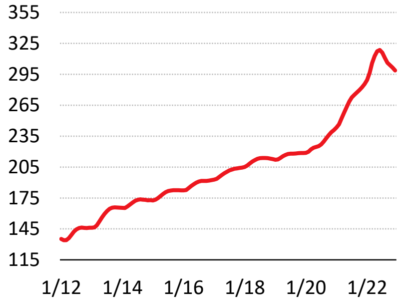
The US economy is expected to post modest growth in 2023 given an elevated inflation and tight monetary policy stance, etc. With the aggressive rate hikes by the Fed, the interest rate sensitive housing sector has continued to see a notable slowdown. The S&P 20-city Composite Home Price Index fell for six consecutive months, declining by another 0.5% month-on-month (MoM) in December 2022 after falling 0.5% MoM in November. The property price growth for the full year of 2022 moderated to 4.6% from the 18.5% in 2021. As inflation sets to stay elevated for longer than previously expected, the Fed may need to raise the terminal interest rate higher and maintain a contractionary stance for longer. US consumer spending, which accounts for more than two-third of its economy, may face headwinds from higher financing costs and asset market consolidation, weighing down on the overall performance of the US economy.

Benchmark equity indices consolidated in February amid renewed inflation and rate hike worries

US equity markets closed lower in February as the latest data suggests inflation may stay elevated for longer, prompting the Fed to continue raising interest rates. As of 28th February, the Dow Jones Industrial Average, S&P 500 and Nasdaq dropped by 4.2%, 2.6% and 1.1%, respectively as compared with the end of January. The benchmark 10-year treasury yield closed at 3.923% at the end of February, 41 basis points higher than the previous month.

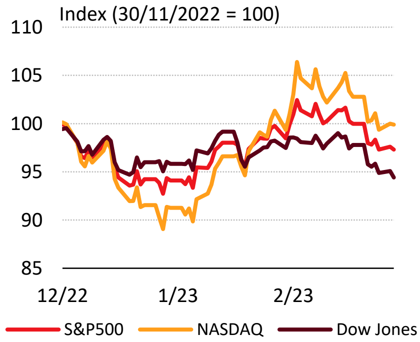
Meanwhile, the US dollar exchange rate strengthened amid renewed rate hike worries on the back of stronger-than-expected inflation data. As of 28th February, the dollar index stood at 104.87, about 2.7% higher than the level at the end of January.

S&P/Case-Shiller 20-City Composite Home Price Index



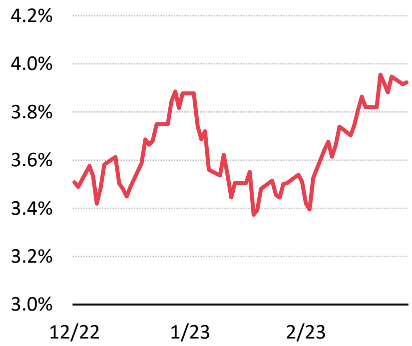
Source: Bloomberg

US Equity Indices



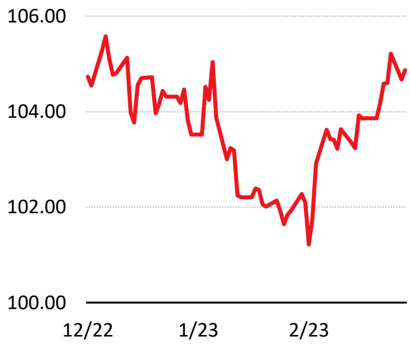
Source: Bloomberg, data as of 28/2/2023

US 10-year Treasury Yield



Source: Bloomberg, data as of 28/2/2023

Dollar Index



Source: Bloomberg, data as of 28/2/2023

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