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Economic Research

June 2023

Market Monitor – United States

Mounting Uncertainties Surrounding the Fed's Terminal Rate

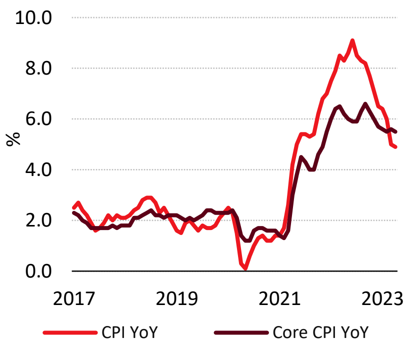
- The US economy expanded steadily in Q1 2023, with the annualized quarter-on-quarter (QoQ) GDP growth revised upward to 1.3%.
- Inflation remained sticky, with the headline and core consumer price indices (CPI) rising by 4.9% and 5.5% year-on-year (YoY) in April, respectively.
- Despite the debt ceiling deal, the US economic outlook remains uncertain as the Fed may continue to raise interest rates amid persistent inflation risks and a tight labour market.

The US economy and job market proved resilient, while inflationary pressure remained sticky

The US economy expanded steadily in Q1 2023, with the GDP growth rate revised upwards to an annualized rate of 1.3% quarter-on-quarter (SAAR), up by 0.2 percentage points (ppts) from the advanced estimate. Upward revisions were seen in major components: the growth of personal consumption expenditures was revised up by 0.1 ppts to 3.8% (SAAR); the growth in non-residential investment was revised up by 0.7 ppts to 1.4% (SAAR); and the growth in exports was revised up by 0.4 ppts to 5.2% (SAAR).

The US job market continued to ease gradually but saw a mixed picture in details. The US employment market remained largely resilient, despite small up-tick in unemployment rate and some moderation in wage growth as the effects of monetary policy tightening emerged. In May, nonfarm payroll added 339,000, up from the upwardly revised 294,000 in April and largely in line with the prior 12-month average of 341,000. Nonetheless, household survey data indicated that overall employment contracted by 310,000 in May when compared to April. As a result, the unemployment rate edged up by 0.3 ppts from April to 3.7% in May, but still close to the multi-decade low. The YoY increase of average hourly wage edged down by 0.1 ppt from April to 4.3% in May, 1.2 ppts lower than the same month last year.

US Inflation



Source: Bloomberg

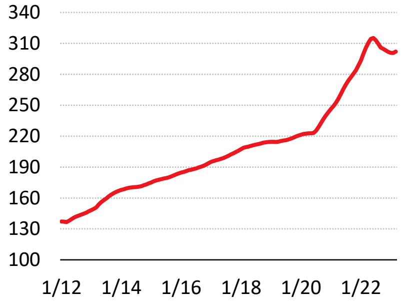
Driven by lower energy prices and a slower rise in food prices, the headline CPI dropped by 0.1 ppts to 4.9% YoY in April. Core inflation stayed firm and edged down slightly by 0.1 ppts from March to 5.5% YoY in April. The growth of core goods prices recovered from 1.5% YoY in March to 2.0% YoY in April, while core services inflation eased from 7.1% YoY in March to 6.8% YoY in April. Shelter costs increased by 8.1% YoY in April, down slightly by 0.1 ppts from March. Meanwhile, the personal consumption expenditure (PCE) price inflation, the Federal Reserve's (Fed) preferred the inflation gauge, accelerated again in April, with the headline and core PCE price inflation rising by 4.4% and 4.7% YoY, respectively, up from 4.2% and 4.6% YoY in March.

Despite the debt ceiling deal, downside risks continue to build under a highly restrictive monetary environment

President Biden signed the debt ceiling deal into law in early June, avoiding a potential default of the US. Under the deal, the US debt limit is expected to be suspend through 1st January 2025. Non-defense spending will be kept flat in the 2024 fiscal year 2024 but see a 1% rise in the 2025 fiscal year. The agreement will also claw back the unused funds from Covid-19 relief packages. This implies that the growth of government expenditures and investment may be constrained, potentially posing a drag on the economic growth beyond 2023. Consumer confidence deteriorated significantly in May amid debt ceiling uncertainties and concerns over a potential economic slowdown. The University of Michigan Consumer Sentiment Index dropped by 4.3 points from April to 59.2 in May, with the index for the year-ahead economic outlook plummeting by 17% from last month.

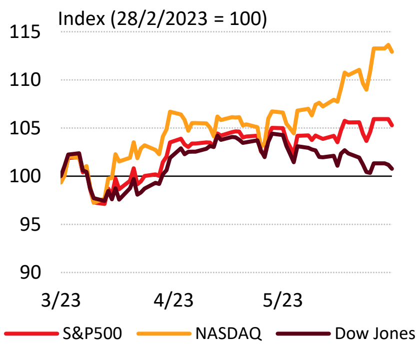
Even though the debt ceiling issue has temporarily settled, downside risks continue to build as the Fed is likely to maintain a highly restrictive monetary environment for longer. With inflation remaining high, market participants have increasingly priced in an elevated interest rate environment for an extended period, and further interest rate hikes could not be ruled out. With a further rise of interest rates, the US property market would see heightened pressures for further correction, as higher borrowing costs and tighter lending conditions for households and businesses would dampen both demand and sentiment. Despite registering a 1.1% YoY decline, the S&P/Case-Shiller 20-City Composite Home Price Index stabilized on a month-on-month (MoM) basis, rising 0.5% in March. It is no doubt too early to conclude that the property market correction is over, and its future performance will still hinge on the monetary policy stance as well as the pace of economic slowdown. A continued property market correction could also pose downside risks to consumption and the economic outlook and the stability of US commercial banks could be challenged amid a potential deterioration in the quality of collateral.

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



Source: Bloomberg

US Equity Indices



Source: Bloomberg, data as of 31/5/2023

US 10-year Treasury Yield

Source: Bloomberg, data as of 31/5/2023

US stock markets diverged in performance, while the dollar strengthened and US treasury yields edged higher

US equity indices showed divergent performance under the debt ceiling uncertainties in May. As of the end of May, the S&P 500 Index and Nasdaq rose by 0.2% and 5.8% respectively, when compared to the end of April. The outperformance in Nasdaq was mainly due to investors' optimism in the outlook of artificial intelligence (AI) development. Nonetheless, the Dow Jones dropped by 3.5% over the same horizon.

As investors increasingly priced in the possibility of further rate hikes by the Fed amid elevated inflation, US treasury yields edged higher and the dollar strengthened. As of the end of May, the 10-year treasury yield stood at 3.646%, about 22 basis points higher than the level at the end of April. Meanwhile, the US dollar index rose by 2.6% to 104.326 over the same horizon.

Dollar Index

Source: Bloomberg, data as of 31/5/2023

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