Economic Research

October 2023

Market Monitor – United States

Economic outperformance Caused a Hawkish Fed

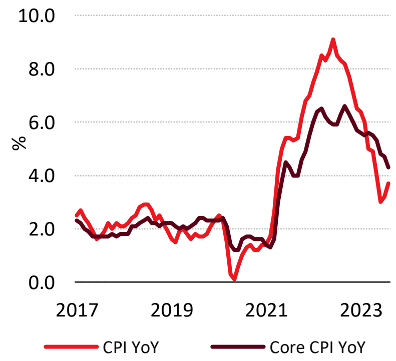
- Consumer spending and business investment exhibited resilience, suggesting a likely acceleration in GDP growth for Q3 2023.
- Rising oil prices pushed up headline inflation while core inflation eased further.
- The Fed kept rates unchanged at their September meeting but retained a hawkish stance.

Consumer spending and business investment exhibited resilience

The US economy continued to expand at a solid pace. Growth momentum has been underpinned by strong consumer spending, and a further uptick in business investment. Summer spending performed better than consensus, with real personal consumption expenditures (PCE) growing 0.1% month-on-month (MoM) in August, following a strong growth of 0.3% and 0.6% in June and July, respectively. The surge was mainly fuelled by services spending, as US consumers opened their wallets for travel and leisure. Equipment investment also increased notably, with new orders and shipments for capital goods, excluding defense & aircraft, rising by 0.9% MoM and 0.7% in August. These indicators suggested that an acceleration in GDP growth for Q3 2023 would likely be seen.

Core inflation eased further. In August, headline CPI accelerated by 0.6% MoM, mainly due to a surge in gasoline prices. The annual growth of headline CPI also climbed from 3.2% in July to 3.7% in August. Core CPI increased at a steady pace of 0.3% MoM in August, with its annual growth slowing from 4.7% YoY in July to 4.3% in August. Some inflation drivers, such as shelters and used cars, continued to show signs of cooling. PCE inflation also indicated a similar divergent trend between the headline and core measures. Headline PCE and core PCE inflation were at 0.4% MoM and 0.1% in August (in YoY terms in August, headline PCE: 3.5% and core PCE: 3.9%).

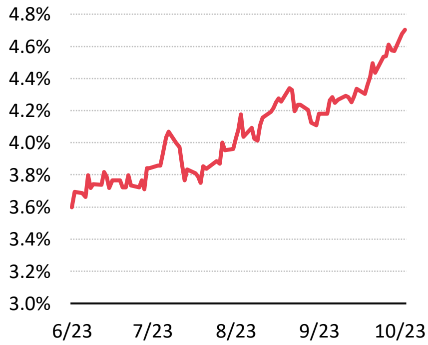
US Inflation



Source: Bloomberg

The labour market remained tight. In September, US employers added 336,000 nonfarm payrolls, with robust job gains in various sectors, from leisure & hospitality, government, to health care, etc. The gains in nonfarm payrolls in July and August were both revised up by 79,000 and 40,000, respectively. However, the unemployment rate remained unchanged at 3.8% in September, pointing to a stable employment situation in the household survey. Besides, average hourly earnings grew by 0.3% MoM (4.2% YoY) in September, indicating a further moderation in wage pressure. This offered some relief for concerns about a potential wage-price spiral in the US economy. Overall, these indicate a still-resilient labour market, which can provide support for private consumption.

US 10-year Treasury Yield



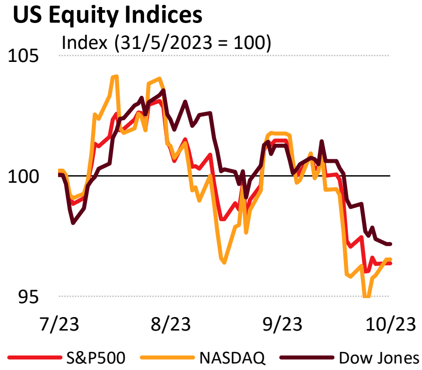
Source: Bloomberg, data as of 3/10/2023

The Fed retained a hawkish bias

The Fed held interest rates steady but maintained a hawkish stance. At the September meeting, the FOMC voted to keep the fed funds rate unchanged at 5.25-5.50%. The decision was widely expected. However, the Fed's forward guidance retained a hawkish bias, with FOMC members' forecasts pencilling in one more hike by the end of 2023 and revising up the medium fed funds rate projection for 2024 from 4.6% to 5.1%. Meanwhile, Fed Chairman Powell highlighted that a restrictive monetary environment is needed to bring inflation down towards the Fed's 2% target. These messages indicated the Fed's preference to keep interest rates at high levels for longer and caused US treasury yields to soar further in September.

Despite its near-term resilience, some headwinds are emerging to weigh on the US economy. While the US avoided a government shutdown with a last-minute deal to extend funding until mid-November, the issue appears to be postponed instead of completely resolved. And several forces are intensifying to slow the US economy. First, excess savings accumulated during the pandemic are anticipated to drop rapidly. The San Francisco Fed estimated that households held less than US$ 190 billion of excess savings by June 2023, down from the peak of US$ 2.1 trillion in August 2021. Second, around 43 million student loan borrowers resumed their repayments in October after a three-year pause. It will create a non-negligible drag on consumer spending. Third, the effects of monetary tightening will continue to be felt by both households and corporations, especially when their debts are due for refinancing. Fourth, a renewed rally in oil prices will increase the squeeze on household incomes, dampening consumer confidence. With these headwinds, it is very possible that the US economy will slow, notably in Q4 2023.

US Equity Indices

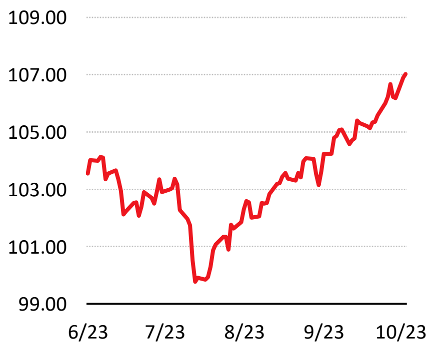


Source: Bloomberg, data as of 3/10/2023

Stocks dropped further amid surging treasury yields

US equity indices registered the second consecutive month of declines as investor sentiment weakened following a sell-off in bond markets. As of the end of September, the S&P 500, Nasdaq, and Dow Jones Industrial Average dropped by 4.9%, 5.8%, and 3.5%, respectively, when compared to the end of August. Given a tight labour market, along with bouncing oil prices, a hawkish Fed sparked a further surge in US treasury yields. The 10-year treasury yield stood at 4.572% at the end of September, about 46 basis points higher than that in August. The US dollar index rose by 2.5% to 106.17 over the same horizon, driven by higher yields and prevailing risk-off sentiment.

Dollar Index



Source: Bloomberg, data as of 3/10/2023

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