Market Monitor – United States

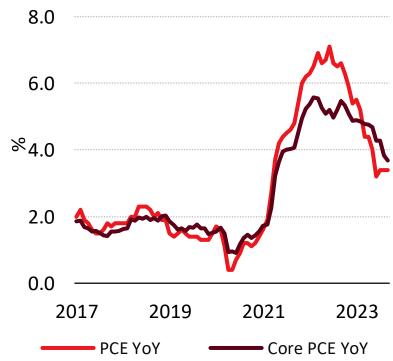
Tighter Financial Conditions Reduce the need for further rate hikes

- The US economy accelerated strongly in Q3 2023, bolstered by a robust labour market. But it is unlikely that the strong growth performance will be sustained.
- The Fed identified higher longer-term bond yields as contributing to a further tightening of financial conditions.
- US stocks regained ground in early November, supported by a lowered possibility of further rate hikes.

Growth sped up in Q3 2023, but momentum is unlikely to be sustained

The US economy accelerated strongly in Q3 2023, bolstered by a robust labour market. Real GDP growth accelerated from an annual rate of 2.1% quarter-on-quarter (SAAR) in Q2 2023 to 4.9% in Q3 2023, beating market expectations. Consumer spending, private investment, and government spending all registered faster growth. Consumer spending rose by 4.0% SAAR in Q3 2023, marking the fastest growth since Q4 2021. Private investment grew by 8.4% SAAR in Q3 2023, largely due to a build-up in inventories and a revival of residential investment (which rebounded from -2.2% in Q2 2023 to 3.9% SAAR in Q3 2023). Government spending increased by 4.6% SAAR in Q3 2023. In the first 3 quarters of 2023, the US economy grew by 2.4% year-on-year (YoY). However, faced with multiple headwinds such as aggressive monetary tightening by the Fed, dwindling personal savings, and the resumption of student debt repayment, it is unlikely that the strong growth performance seen in Q3 2023 will be sustained moving forward.

US PCE Inflation

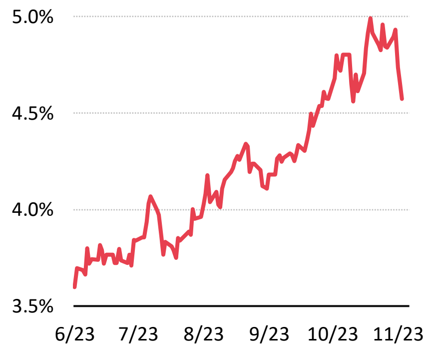


Source: Bloomberg

Inflation slowdown remained on a bumpy path. In September, headline PCE inflation held up at 0.4% month-on-month (MoM) and core PCE inflation increased from 0.1% in August to 0.3% MoM. The acceleration in core PCE inflation was fuelled by faster gains in service prices, which revealed that underlying inflationary pressure was still sticky. On an annual basis, headline PCE inflation stayed flat at 3.4%, and core PCE inflation slowed slightly to 3.7% in September. In fact, inflation has exceeded the Fed's 2% target for too long. The high persistence of inflation has called for a restrictive monetary stance to stay, despite some encouraging signs of a slowdown in recent months.

The labour market cooled with slowing wage growth. Nonfarm payrolls increased at a softer pace, with 150,000 jobs added in October, below market expectations. It came down from a downward-revised increase of 297,000 in September. While employment in most industries continued to expand, manufacturing employment declined sharply by 35,000 in October, largely due to strike activity. The transportation and warehousing industry also reported lower employment (-12,000 in October). The unemployment rate ticked up to 3.9% in October. During the month, employment levels went down by 348,000, the largest drop since April 2020. Average hourly earnings grew by 0.2% MoM in October, the slowest monthly growth since the Fed began the current rate hike cycle in March 2022. Furthermore, a strong rise in productivity helped slow the growth of unit labour costs to 1.9% YoY in Q3 2023, down from 3.7% in Q2 2023. This indicated positive evidence for easing the underlying inflationary pressure ahead.

US 10-year Treasury Yield

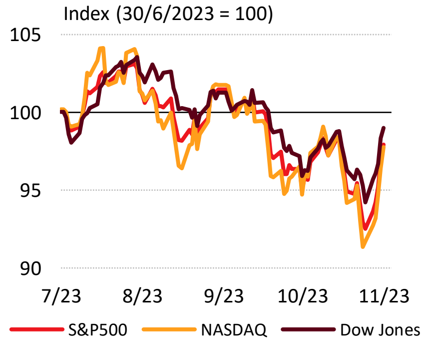


Source: Bloomberg, data as of 3/11/2023

The Fed stayed put but signaled that additional rate hikes are unlikely

The Fed identified higher longer-term bond yields as contributing to a further tightening of financial conditions. At the November meeting, the FOMC stayed put by maintaining the fed funds rate at 5.25-5.50%. With the rise of longer-term bond yields likely to weigh on the US economy, the Fed took a less hawkish turn by admitting that there has been a tightening of financial conditions since September's meeting. Besides, Chairman Powell downplayed the September dot plot, which pencilled down one more rate hike to 5.50-5.75% by the end of 2023, by stating that the efficacy of the dot plot will probably decay between the September meeting and the December meeting. While Chairman Powell did not explicitly rule out another rate hike, market participants generally viewed that the Fed is done with its rate hike cycle. That said, the Fed will keep a restrictive monetary stance until inflation is within reach of its 2% target.

US Equity Indices



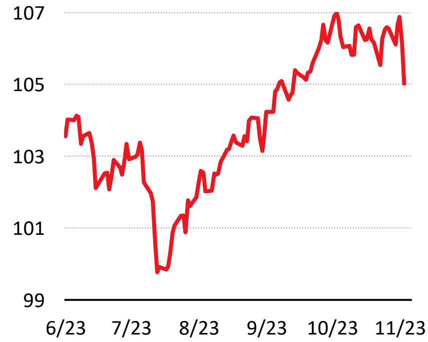
Source: Bloomberg, data as of 3/11/2023

Economic momentum in Q4 2023 looks set to moderate. Despite surprisingly strong growth in Q3 2023, a softening labour market report in October provided a first glimpse that economic activity is likely to start moderating in Q4 2023. Other leading measures were also weakened. Most notably, the ISM services Purchasing Managers' Index fell from 53.6 in September to 51.8 in October, suggesting that strong services spending in the summer is not likely to continue in Q4 2023. After the November FOMC meeting, bond yields retreated but remained elevated. It should be noted that the prevailing restrictive monetary environment will remain a restraining force on the economy. Overall, growth is poised to moderate in Q4 2023.

Stocks recovered as markets expected rates to peak

US equity indices regained ground in early November, supported by a lowered possibility of further rate hikes. As of the end of October, the S&P 500, Nasdaq, and Dow Jones Industrial Average dropped by 2.2%, 2.8%, and 1.4%, respectively, when compared to the end of September. The 10-year treasury yield stood at 4.932% at the end of October, about 36 basis points higher than that in September. The US dollar index hovered at 106.66 at the end of October, up by 0.5% in the month. In early November, the Fed's signal for a lowered need for further rate hikes lifted market sentiment rapidly, with US stocks surging to recoup most of the losses incurred in October.

Dollar Index



Source: Bloomberg, data as of 3/11/2023

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