Economic Research

August 2024

Market Monitor – United States

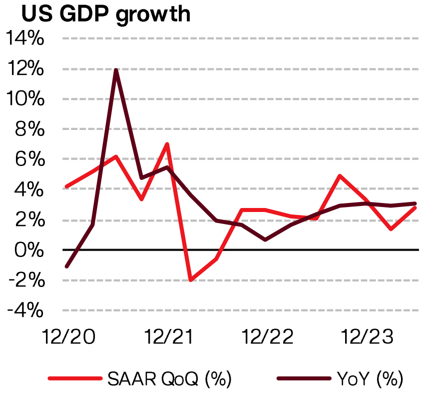
The Fed becomes more attentive to its dual mandate

- US economic growth surprised to the upside with an acceleration in Q2, propped up by strong consumer spending and non-residential investment.
- The Fed leaves the door open for a rate cut in September, given recent disinflation progress and as it becomes more attentive to its dual mandate.
- Soft labour market figures have raised the risk of a hard landing as well as the call for a sharper rate cut.

The US economy posted solid growth in Q2

The US economy beat expectations with a notable acceleration. In Q2 2024, advance estimates indicated that the US real GDP grew at a seasonally adjusted annual rate (SAAR) of 2.8%, up from the 1.4% rise in Q1 and above the market consensus of 2.0%. Growth was mainly driven by strong consumer spending, solid government spending, and increases in investment. Meanwhile, net exports were subtracted from growth. On a year-on-year (YoY) basis, US real GDP growth remained solid, growing by 3.1% in Q2 after growing by 2.8% in Q1.

US GDP growth



Source: Bloomberg

Among the major components of GDP, private consumption expenditures (PCE) grew solidly by 2.3% SAAR in Q2, up from 1.5% in Q1, and contributed 1.57 percentage points (ppts) to headline GDP growth. Strong consumer spending was backed by a pickup in goods spending, particularly in motor vehicles and energy products. Services spending remained resilient, especially for healthcare and housing & utilities. Non-residential fixed investment grew by 5.2% SAAR, and a rise in private inventories also boosted growth, reflecting increases in business spending. However, residential fixed investment contracted by 1.4% SAAR. Net exports were a drag on growth, as the growth in imports (+6.9% SAAR) outpaced that of exports (+2.0%) in Q2. Government spending also picked up, rising by 3.1% SAAR in Q2 compared to 1.8% in Q1. Looking ahead, the US economy is expected to expand further, albeit at a slowing pace. Leading indicators have already shown weakening momentum in recent months, driven by a tight monetary environment, dwindling personal savings and rising delinquency rates on credit cards and auto loans. On balance, solid household and corporate balance sheets should support the US economy to alleviate the potential downside risks, paving the way for a soft landing.

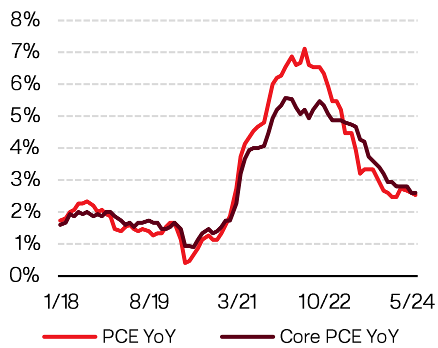
PCE inflation remained stable in June. Headline and core (which excludes food and energy) PCE inflation rose by 2.5% YoY and 2.6% in June, edging down from 2.6% and remaining unchanged in May, respectively. On a monthly basis, headline and core PCE inflation slightly accelerated to 0.1% month-on-month (MoM) and 0.2% in June, after remaining flat and rising 0.1% in May, respectively. The soft headline PCE inflation was attributed to lower energy prices (-2.1% MoM), and the trend of inflation slowdown in Q2 has enhanced market optimism for an eventual easing by the Fed.

Fed Chairman Powell puts a September rate cut on the table. During its July meeting, the FOMC voted unanimously to maintain the federal funds rate unchanged at 5.25-5.50% and to continue to reduce its holdings of treasuries and mortgage-backed securities. The meeting highlighted a shift in policy stance for the FOMC, from a previous focus solely on inflation to both inflation and the labour market. This more balanced approach can be attributed to recent trends of easing inflation and moderating labour market conditions. In the post-meeting press conference, Fed Chairman Powell said that the FOMC generally welcomed the disinflation progress made in recent months and mentioned that a rate cut could come as soon as its next meeting in September if disinflation continues.

The US labour market cooled notably in July, signalling downside risk and raising the call for a sharper rate cut. The July jobs report was concerning. The unemployment rate ticked up to 4.3% in July from 4.1% in June, up 0.9 ppts from the cycle low. Total nonfarm payroll employment increased by 114,000 in July, a sharp decline from the 179,000 increase in June, with a net downward revision of 29,000 in May and June. The average workweek also fell a tick to 34.2 hours. In terms of wage growth, average hourly earnings slowed in July, increasing by 3.6% YoY and 0.2% MoM in July, compared to 3.8% YoY and 0.3% MoM in June. The slowdown in the labour market has alleviated the inflationary concern, raised the risk of a hard landing, and increased the call for a sharper rate cut soon.

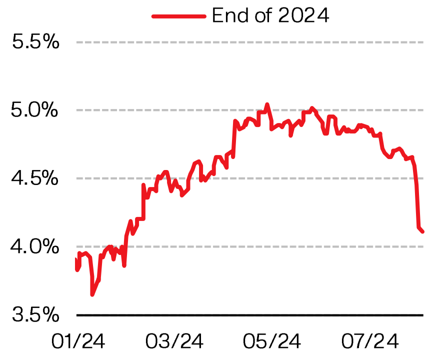
July was a tumultuous month for the US presidential elections. July saw significant developments in the US presidential elections. First, former President Trump became the official Republican Party's candidate, and chose Ohio Senator J.D. Vance as his running mate. Second, Trump survived an assassination attempt at a campaign speech en route to accepting the Republican nomination. Thirdly, President Biden stepped down as the Democratic Party's candidate and backed Vice President Harris as the candidate to succeed him. These events highlighted the political uncertainties in the upcoming US presidential elections. Recent polls suggest that the race will be tight. Looking ahead, it is worth monitoring the policy details in economic development and foreign relations of the two leading

US PCE Inflation



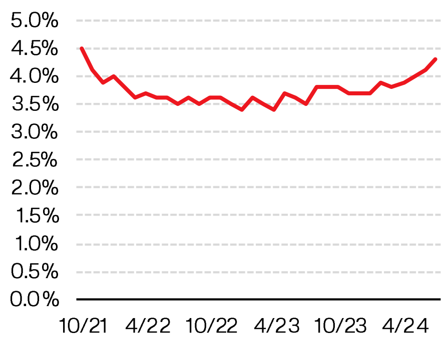
Source: Bloomberg, data as of 31/07/2024

US Rate Expectations



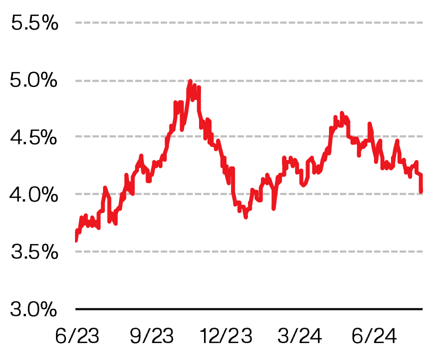
Source: Bloomberg, data as of 03/08/2024

US Unemployment rate



Source: CEIC, data as of 05/08/2024

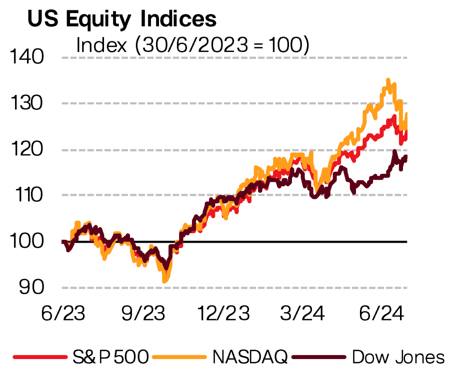
US 10-year Treasury Yield



Source: Bloomberg, data as of 31/07/2024 candidates, as they would have profound impacts on the US and other economies in the medium term.

Major US equity indices diverged in July

The performance of major US equity indices diverged in July. The S&P 500 and the Dow Jones rose 1.1% MoM and 4.4%, respectively, while the Nasdaq fell 0.8% in July. Strong GDP growth, prudent earnings guidance from major corporations, sectoral rotation and expectations of the post-election policy outlook once led to rapid changes in market pricing during the month, resulting in notably varied performance among the major US equity indices. A broader risk-on mood was once again seen after the July FOMC meeting, but reversed quickly after the jobs report, which raised investors' concerns over a hard landing.



Source: Bloomberg, data as of 31/07/2024

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