LISTEN TO PODCAST HERE: [HTTPS://HAVERPRODUCTS.COM/CHARTS-OF-THE-WEEK-2023/](https://haverproducts.com/charts-of-the-week-2023/)
JUNE 16TH, 2023
ANDY CATES

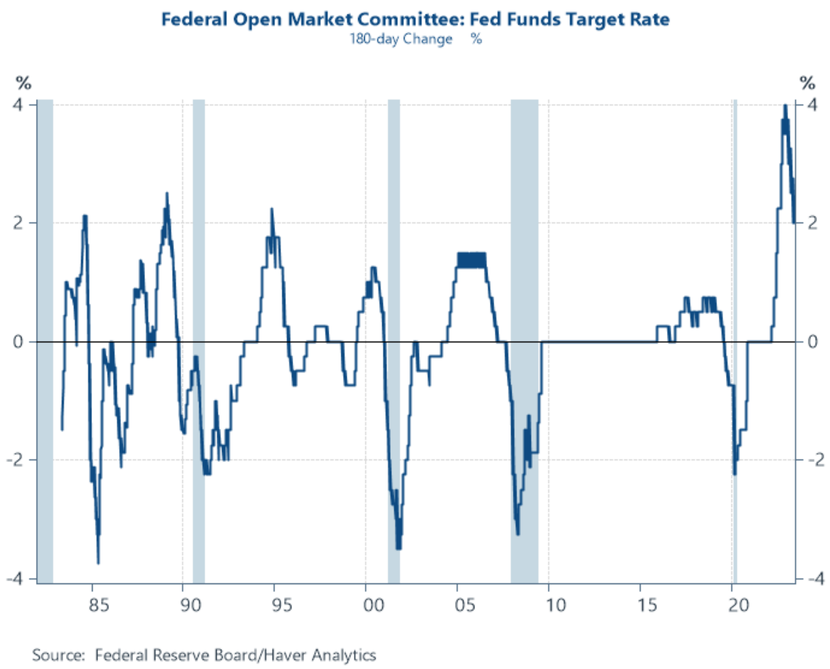
Summary

Central banks have stolen the limelight over the past few days but with policy shifts that reveal stark differences – and perhaps greater disagreement among policymakers - about the outlook for their respective economies. For example, the decision by the US Federal Reserve to pause its tightening campaign, while simultaneously hinting at future rate hikes in the coming months, undoubtedly raised a few eyebrows. Meanwhile, China's decision this week to reduce its 7-day reverse repo rate by 10bps, lowering it from 2% to 1.9%, was also noteworthy but not entirely surprising given a series of disappointing data releases. As for the ECB, this week’s decision to lift its key policy rates by a further 25bps came as no surprise even though the incoming growth data from the euro area have been equally underwhelming (compared with China). Against this backdrop, our charts this week focus on the Fed’s tightening campaign (in chart 1), the recent strength of global equity markets (in chart 2), and US and broader global inflation issues (in charts 3 and 4). We then turn to the growing inflexibility of the UK labour market (in chart 5) and finally focus on China’s disappointing reopening phase (in chart 6).

The Fed

By pausing its tightening campaign this week, the US Fed is acknowledging the long and variable lags that exist between changes in interest rates and their impact on the economy. These lags can be seen in chart 1 below which shows the 6 month (or 180-day) change in the Fed funds target rate. Recessionary phases (earmarked by the shaded areas in the chart) typically occur long after the Fed has initiated a tightening campaign and usually several months after that campaign has reached maturity as well.

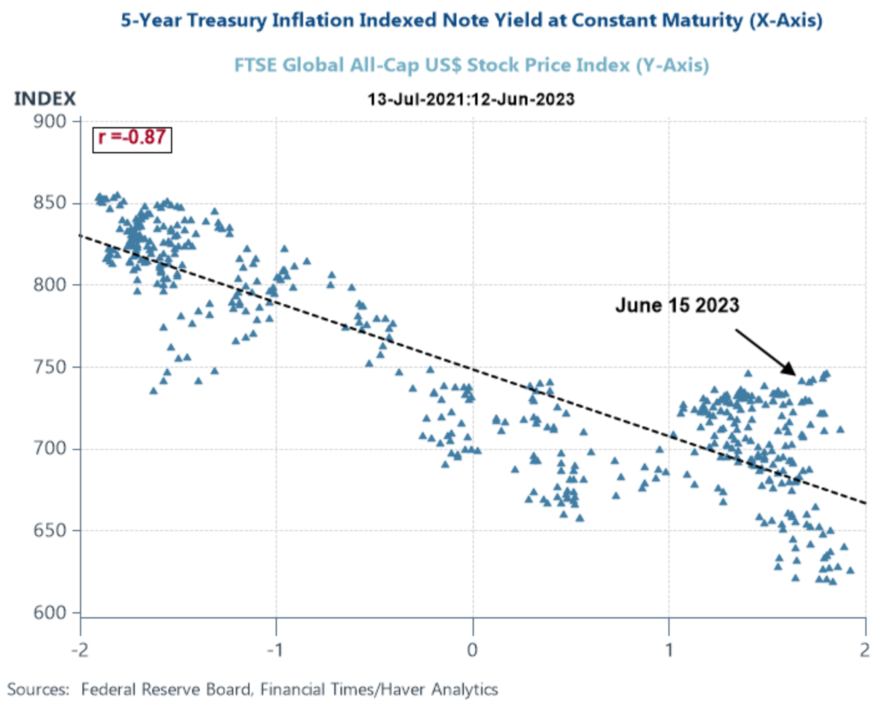
Chart 1: The US Fed Funds Target Rate, 6 month-changes versus recessionary phases



Financial markets

Financial market sentiment has recently improved despite a wave of disappointing economic data. Additionally, and notwithstanding the Fed's pause, there is a growing view that central banks in advanced economies will maintain tighter monetary policies for an extended period. The latter has pushed longer-term real yields in the US to higher levels in recent weeks. As chart 2 below suggests, equity market valuations certainly appear quite rich at present compared with that level of real yields.

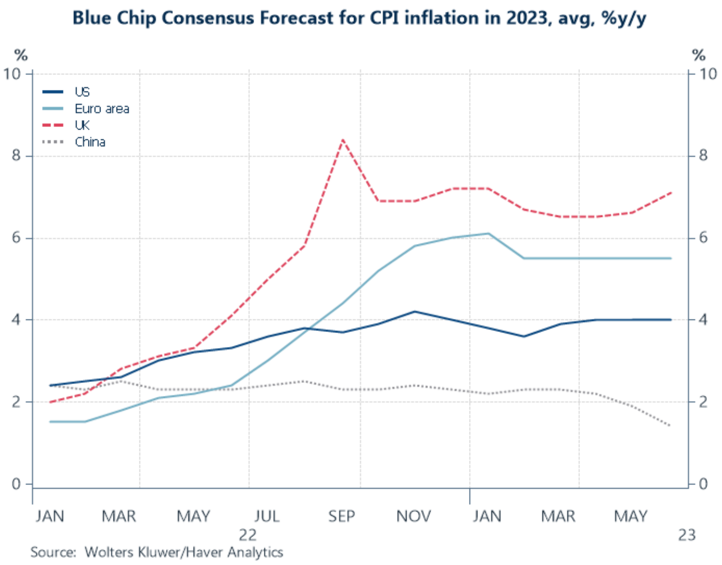
Chart 2: 5-year US real yields versus global equity markets



Inflation expectations

One of the reasons, of course, for these concerns about the stance of monetary policy relates to inflation. Stubborn levels of core CPI inflation, still-tight labour markets and lingering wage pressures have made central banks nervous about the calibration of monetary policy. These pressures have been particularly acute in the UK recently, following a series of firmer-than-expected inflation and labour market data. It was certainly noteworthy that UK economists lifted their forecasts for CPI inflation in 2023 in June's Blue Chip survey of economic forecasters. That stood in stark contrast to the downward revisions to inflation forecasts for China, and the stability in those forecasts for the US and euro area (see chart 3).

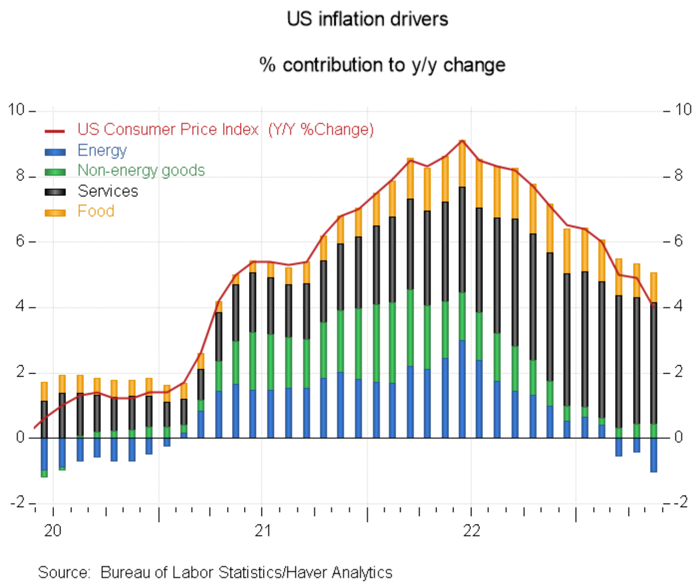
Chart 3: The evolution of Blue Chip consensus forecasts for inflation in 2023



US inflation

It is possible, moreover, that CPI inflation forecasts for the US will be revised a little lower in the coming months. The headline CPI and PPI inflation data for May, released this week, certainly surprised US forecasters on the downside. And that extends a trend toward negative surprises that's unfolded in recent months. As chart 4 below arguably suggests, a key reason for this relates to the restraining influence on inflation from falling energy prices. Given that energy prices have remained relatively low in recent weeks, this could be beneficial for the US economy's inflation arithmetic in the period ahead.

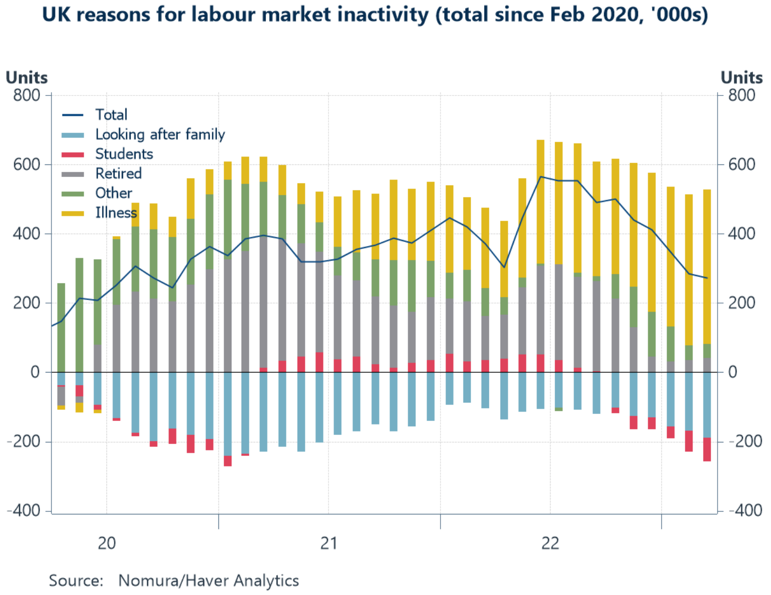
Chart 4: US inflation drivers



The UK labour market

As noted above, notwithstanding diminishing headline inflationary pressures, labour markets remain tight. One contributing factor is the significant number of people who have exited the workforce in recent years. This has resulted in a more limited pool of potential workers for employers to draw from, consequently driving up labour costs. This is particularly severe in the UK at present for several reasons that are shown in chart 5 below. Since the onset of the pandemic in early 2020, for instance, a considerable number of UK workers have left the labour force because of long-term illness and many have opted to retire early. Not only has the former strained the labour market, it has exerted heightened pressure on the UK healthcare system as well.

Chart 5: Reasons for UK labour market inactivity



China's economy

The boost to China's economy that had been anticipated from its re-opening phase has not been as strong as expected. The highly indebted property sector, in the meantime, continues to exert downward pressure on investment activity, causing ripple effects for the domestic – and broader global – economy. Those are some of the key takeaways from China's recent dataflow, including this week's fixed asset investment data, as shown in our final chart below.

Chart 6: China's fixed asset investment versus real estate investment

ABOUT THE AUTHOR

Haver Analytics is pleased to bring Andrew Cates's commentaries on the state of the global economy to its clients.

Andy Cates has more than 25 years of experience forecasting the global economic outlook and in assessing the implications for policy settings and financial markets. He has held various senior positions in London in a number of Investment Banks including as Head of Developed Markets Economics at Nomura and as Chief Eurozone Economist at RBS. These followed a spell of 21 years as Senior International Economist at UBS, 5 of which were spent in Singapore. Prior to his time in financial services Andy was a UK economist at HM Treasury in London holding positions in the domestic forecasting and macroeconomic modelling units.

He has a BA in Economics from the University of York and an MSc in Economics and Econometrics from the University of Southampton.