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JULY 7, 2023
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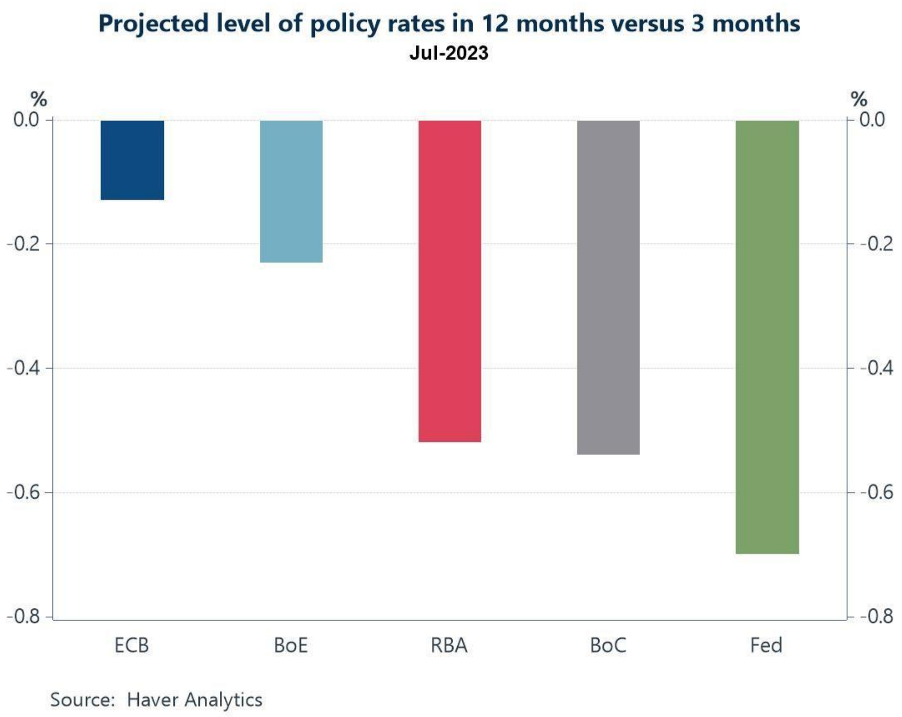
Summary

Communications from central banks together with firmer-than-expected US labour market data have continued to suggest that monetary policy could remain tighter for longer in the period ahead. This, coupled with disappointing survey evidence this week, has magnified growth concerns in recent days in financial markets. In this week's charts we focus on the expectations for central bank policy that can be derived from the July Blue Chip Financial Forecasts survey (in chart 1). We then delve into the specifics for Fed policy with a look at the shape of the US yield curve (in chart 2). Next, we shift our attention to inflation matters and specifically the negative surprises that characterise the incoming data from major developed and developing economies (in chart 3). That diminishing inflation threat finds an echo too in the underlying details of this week's June ISM survey (in chart 4). It finds an echo as well, albeit not as loud, in the latest consumer expectations survey from the ECB (in chart 5) as well as the latest Q2 Tankan survey from Japan (in chart 6).

The central bank policy consensus

The latest Blue Chip Financial Forecasts survey suggest a firm consensus that policy rates will continue to climb in the immediate months ahead. A key caveat to this, however, concerns the degree, which is not that marked. Moreover, an easing cycle is generally anticipated to have been initiated by most major central banks within the next 12 months. As chart 1 below suggests, the degree of policy rate easing that's anticipated beyond the next 3 months is relatively acute in the US, and not that acute in the euro area.

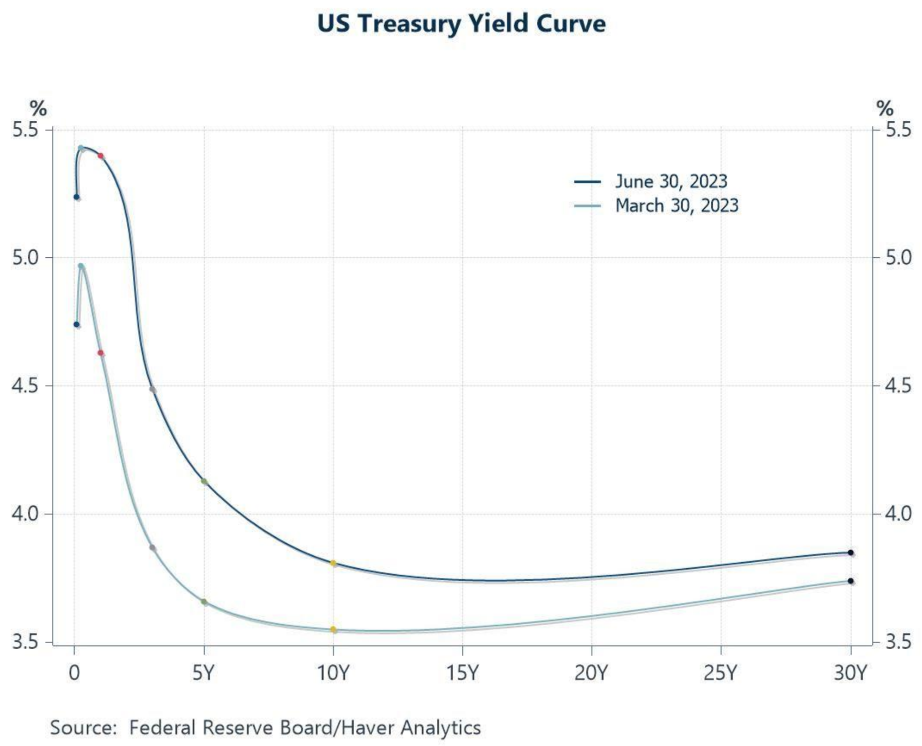
Chart 1: Blue Chip Financial Forecasts of policy rates, 12 months ahead versus 3 months ahead



The US yield curve

Financial market participants on the whole agree with that assessment concerning the direction of US policy rates. Indeed the steep inversion of the curve beyond the next 3 months suggests that investors are still placing a fairly high probability on a US recession in the period immediately ahead. The steep inversion beyond 3 months equally suggests that Fed policy will be calibrated much more loosely in the coming months in response.

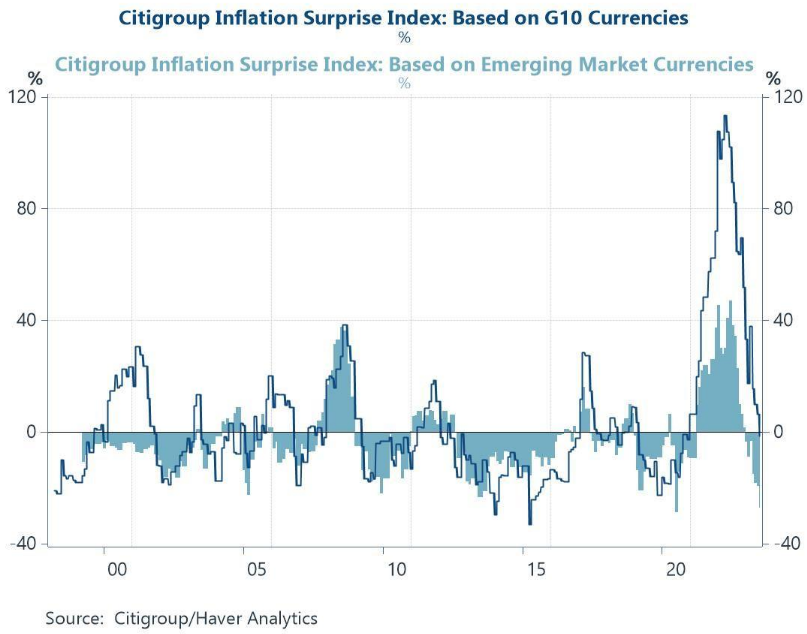
Chart 2: The US Treasury Market yield curve, end-June versus end-March



Inflation surprises

A further reason for why economists and investors are discounting easier policy relates to inflation. Incoming inflation data have been surprising forecasters' expectations to the downside far more frequently and far more broadly in the last few months. That's the message from the steep downward trend in Citigroup's inflation surprise index – and their now-negative values - for the G10 and emerging economies (see chart 3 below).

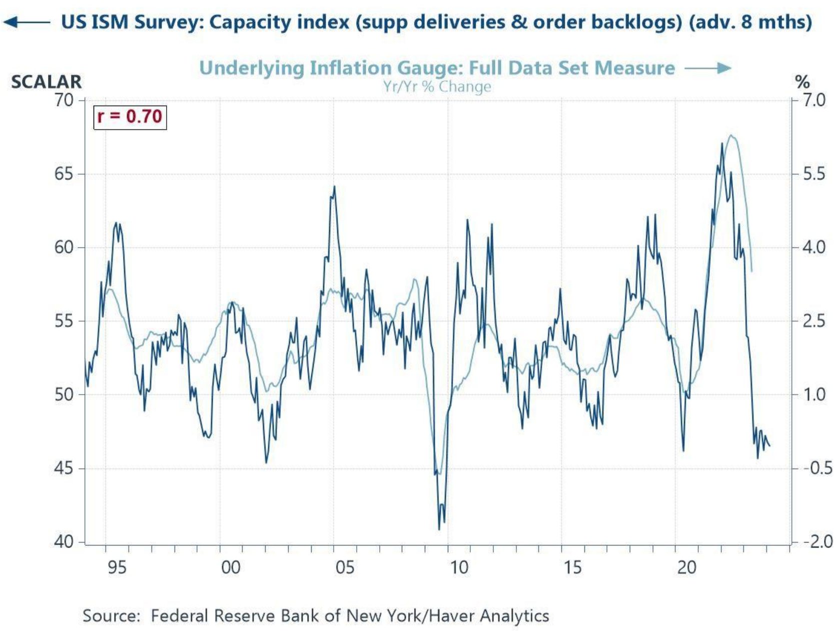
Chart 3: Citigroup's inflation surprise index for G10 and Emerging Market economies



Capacity pressures in US manufacturing and underlying inflation

The message conveyed by chart 4 below is that inflationary pressures in the US ought to continue easing in the coming months. The chart illustrates two capacity gauges from the US ISM survey: the supplier delivery times index and the order backlogs index. These gauges have been combined and advanced by 8 months, and then plotted against the New York Fed's underlying inflation gauge. The implication of the chart is that supply-side pressures have eased significantly over the last few months, suggesting that underlying inflation is likely to slow down rapidly in the near future.

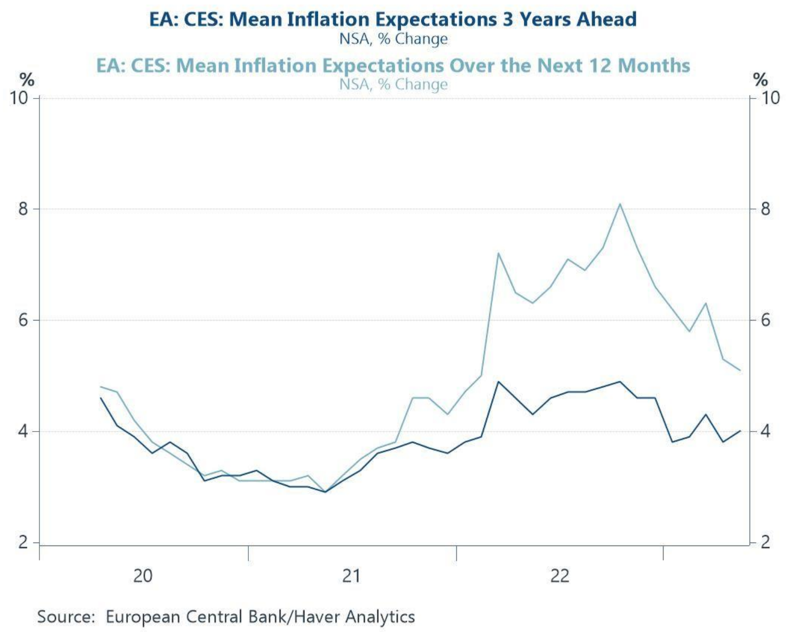
Chart 4: Capacity gauges in the US ISM Survey versus the NRBNY's gauge of underlying inflation



Inflation expectations in the euro area

Inflation concerns in the euro area have also been subsiding in recent months but not as much as in the US. This week's ECB consumer expectations survey for May, for example, showed that near-term inflation expectations have continued to moderate. Longer-term expectations, have also edged down, but are still arguably elevated compared with the ECB's 2% inflation objectives.

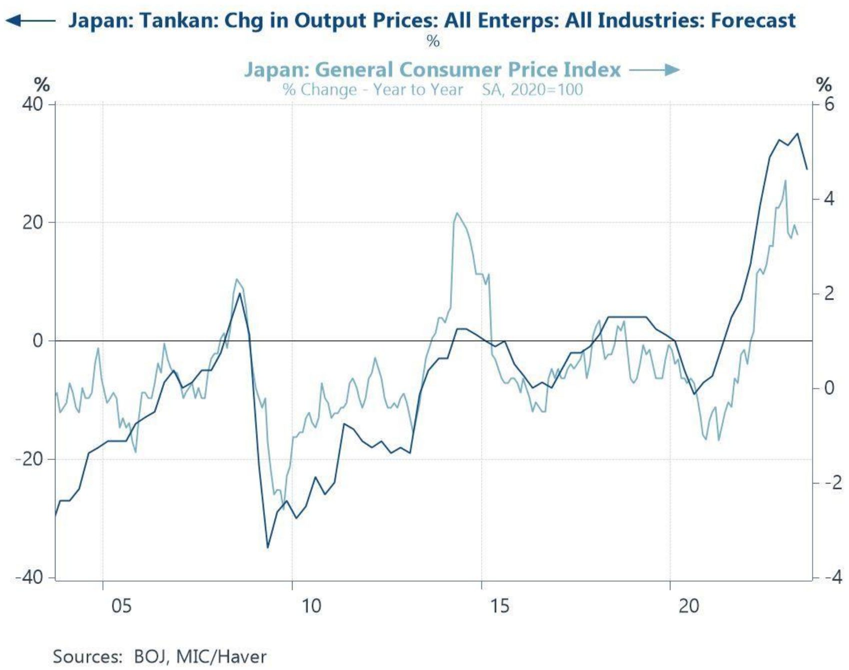
Chart 5: US ISM surveys suggest growing inventory imbalances



Japan's upstream price pressures and consumer price inflation

Finally, survey evidence from this week's Q2 Tankan survey from Japan may additionally quell inflation concerns at the BoJ. The output price expectations balance, for example, within the details of that survey, has moved off its highs. That chimes with the evidence for moderating inflationary pressures from Japan's recent CPI inflation data as well (see chart 6).

Chart 6: A comparison of energy generation costs in developing Asia



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.