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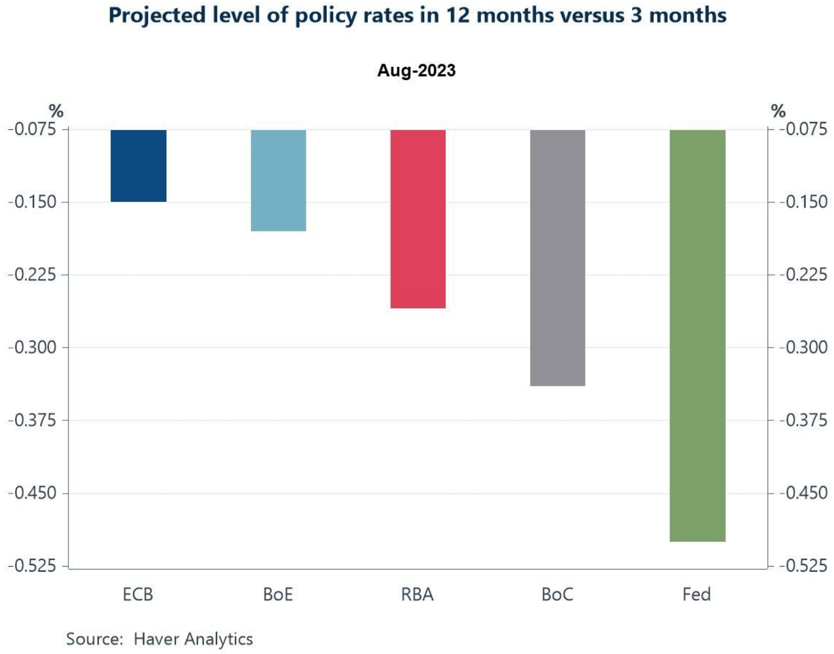
Summary

The downgrade of US government debt by a credit rating agency has been a big driver of this week's financial market gyrations. The decision by the Bank of England to lift policy rates by 25bps (with hints of more to follow) coupled with firmer-than-expected private sector payrolls data (from ADP) also served as a reminder that central banks may not yet have completed their tightening cycles. In our charts this week we look at the latest views on central bank policy that emerged from August's Blue Chip Financial Forecasts survey (chart 1). That those views remain consistent with the idea that tightening cycles are near completion is, in part, a reflection of tighter financial market conditions, which we offer some perspectives on in our next exhibit (chart 2). It is also, however, a function of inflation, and for many central banks, service sector inflation which we focus on next (in chart 3). The decline in global economic policy uncertainty that's unfolded in recent months is the takeaway from our next exhibit (chart 4). We then contrast this with the recent weakness of demand and of pricing power in the world's traded goods sector (in chart 5). Lastly, (in chart 6) we look at the escalation in global rice prices in recent weeks given the threats this is posing for economic, political and social stability in many emerging market economies.

Blue Chip Financial Forecasts

The latest Blue Chip Financial Forecasts survey reveals much disagreement about whether or not the world's major central banks have now completed their tightening cycles. What seems clearer, however, is that an easing cycle is expected to have commenced within the next 12 months even if further hikes are enacted before the end of this year. This is illustrated in chart 1 below showing the spread between forecasts for policy rates in a number of major economies in 12 months compared with forecasts for 3 months. As that chart further suggests, the degree of policy rate easing that's anticipated beyond the next 3 months is relatively acute in the US, but not that marked in the euro area.

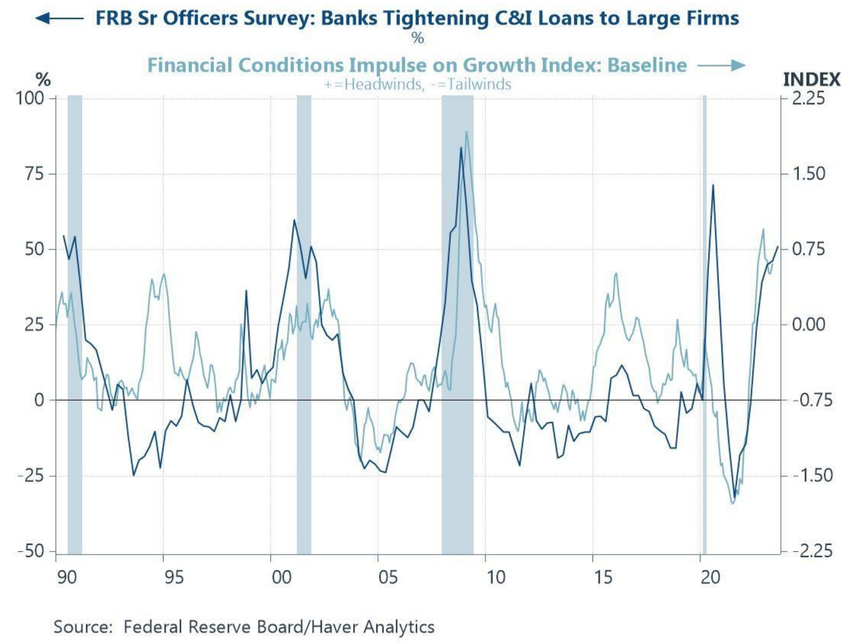
Chart 1: Blue Chip Financial Forecasts: Projected change in policy rates, 12 months versus 3 months



US financial conditions

One reason why an easing cycle is expected to commence in the US concerns financial market and banking sector conditions. Federal Reserve Board staff have recently introduced a new index to gauge financial market conditions in the US and the extent to which they pose headwinds or tailwinds to economic activity. At present that index suggests big headwinds to US growth. The same message, incidentally, emerged from this week's Senior Loan Officer Survey for Q3. This showed that credit conditions were mostly tightening in key lending categories and that loan demand was mostly weakening (see chart 2).

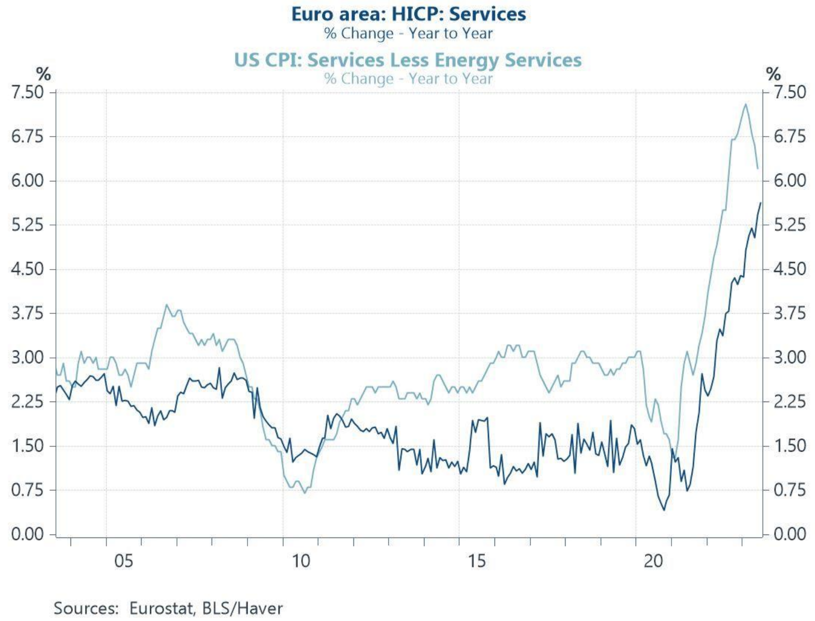
Chart 2: A US financial conditions impulse and bank lending standards for large companies



Service sector inflation in the US and euro area

A key reason in the meantime for why forecasters are not anticipating too much easing from the ECB in the months ahead concerns service sector inflation. Although this week's flash CPI data for July showed that euro area headline inflation has continued to fall, core CPI inflation remained at 5.5% y/y, the key reason for which was higher service sector inflation, which climbed to 5.6% from a prior 5.4%. This trend incidentally contrasts with the US, where service sector CPI inflation has been falling steadily since last January (see chart 3).

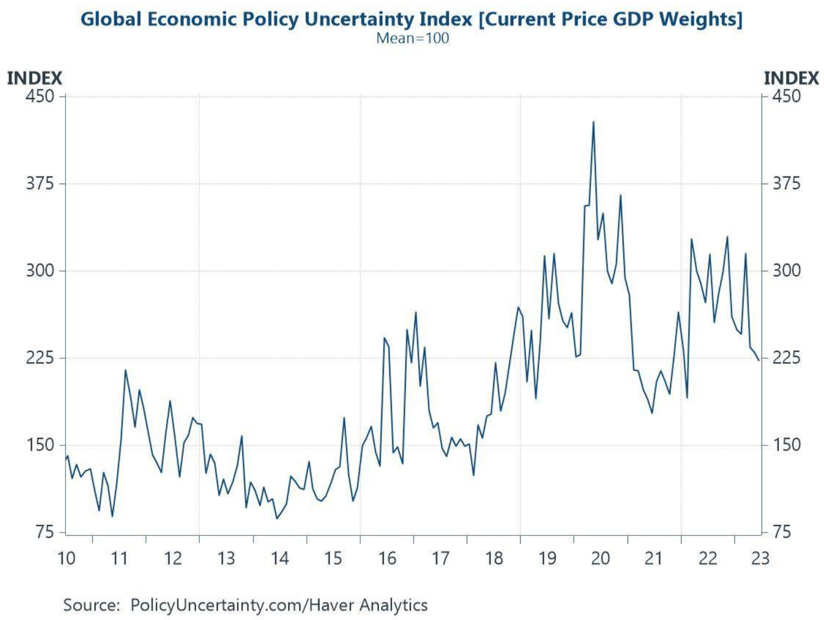
Chart 3: Services CPI inflation in the US and euro area



Global economic policy uncertainty

Uncertainty surrounding the outlook for inflation and interest rates has significantly impacted the world economy in recent months. However, there are indications that this impact may be starting to ease. Having peaked last October, an index of global economic policy uncertainty has steadily moved off its highs and stood at a 16-month low in June. That global energy prices (and generic inflation concerns) peaked around a year or so ago and have additionally moved steadily lower since then is arguably no coincidence.

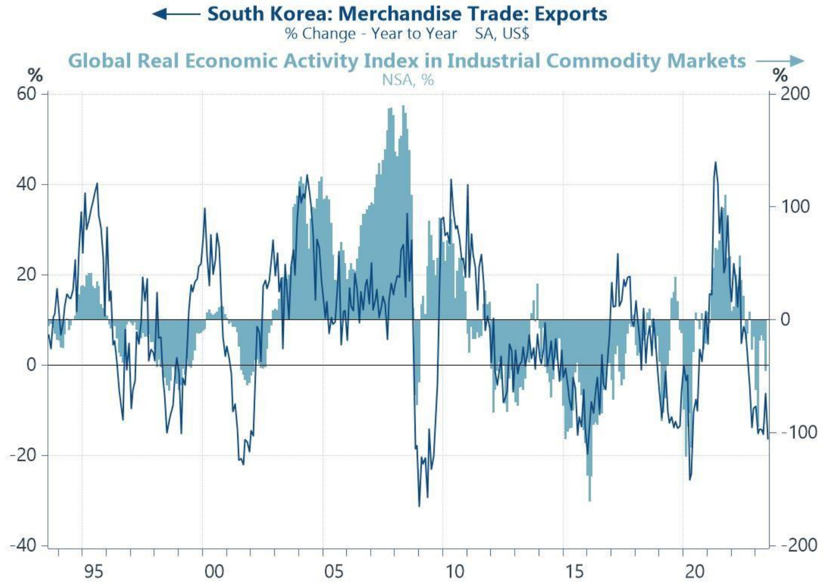
Chart 4: Global economic policy uncertainty index



South Korea’s export growth and activity in industrial commodity markets

Notwithstanding this favourable trend, key bellwethers of global trade conditions have remained weak. For example South Korea's exports declined on a year-on-year basis for the 10th consecutive month in July and were specifically down by 16.5%. Some of this reflects the rotation in global demand away from goods and toward services that has unfolded since the pandemic. But it is rooted too in a more generic interest-rate driven deceleration in global growth and the spillovers from this into commodity markets (see chart 5).

Chart 5: South Korea's export growth and economic activity in commodity markets

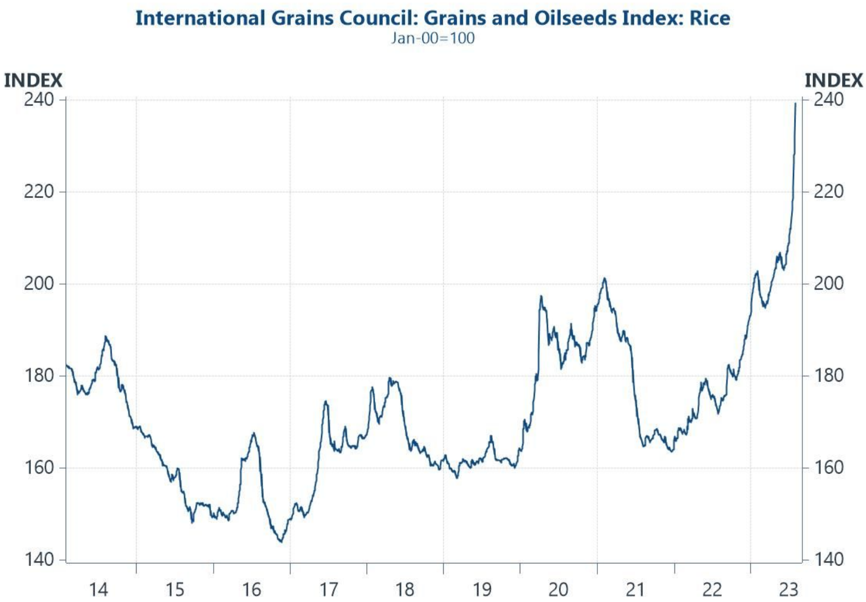


Sources: KCS/H, FRBDAL/Haver

Rice prices

Rice prices are currently hovering at decade highs thanks to the impact of unusual weather patterns (spawned by El Nino) and their impact on global rice production. This supply-side squeeze moreover threatens to be further exacerbated by India's recent announcement that it will ban rice exports in the period ahead. This could be significant given the weight of rice in the dietary make-up of many emerging economies' populations and the knock-on reverberations for economic, political and social stability.

Chart 6: Rice prices



Source: International Grains Council/Haver Analytics

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.