LINK TO PODCAST: [HTTPS://HAVERPRODUCTS.COM/CHARTS-OF-THE-WEEK-2023/](https://haverproducts.com/charts-of-the-week-2023/)
AUGUST 11TH, 2023
ANDY CATES

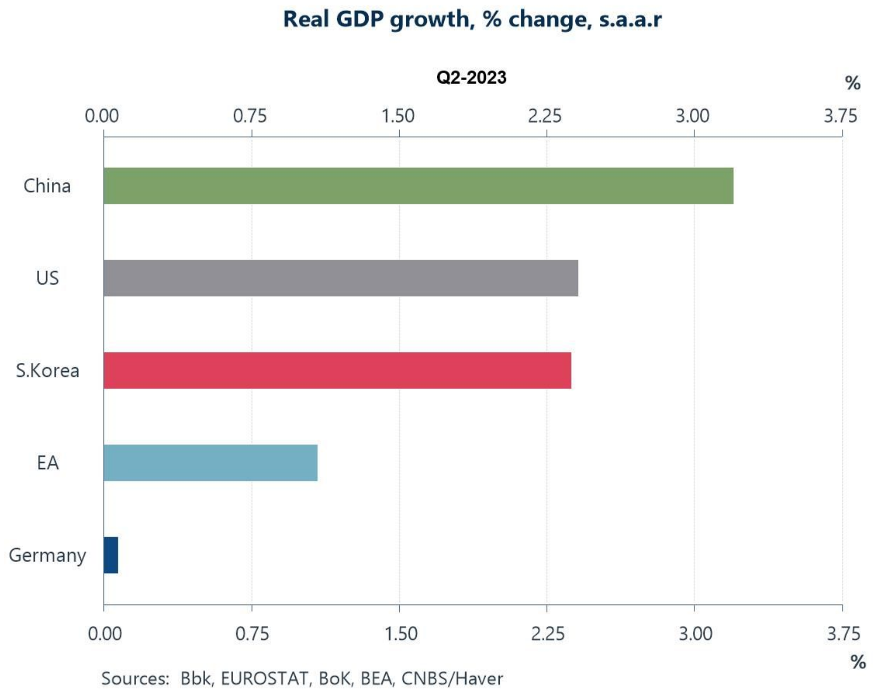
Summary

Financial markets have continued to gravitate toward the ‘Goldilocks’ scenario where economic growth is neither “too hot” nor “too cold” and where inflation gradually moderates to more target-friendly levels. Under that scenario central banks could take their proverbial foot off the brake, and sit back and wait for a few months, before gently re-applying the accelerator. But while that view may have appeared overly optimistic a few weeks ago, much of the incoming data more recently appears to support this narrative. GDP data, for example, for most major economies suggest that a recession was averted in Q2 (see chart 1). This is despite the high odds that had been assumed by many economists and financial market participants about that scenario (chart 2). In the meantime, ebbing US labour market activity, firmer productivity growth and more benign unit labour cost pressures (chart 3) have aligned quite convincingly with the Goldilocks narrative, not least given the importance of the latter for inflation outcomes. And this has found an echo in the headline CPI inflation outcomes for June (and July) not just for the US but for other major economies as well (chart 4). Not for the first time, however, the incoming data can still be cut both ways. Much of the good news on the inflation front, for example, can be traced to the weakness of energy prices in recent months. But with oil prices having strengthened again more recently – and core inflationary pressures less benign than the headlines suggest – market-based measures of inflation expectations are now somewhat un-friendly for most central banks (chart 5). Finally – and in the other direction – latest data from China are not all friendly for soft-landing enthusiasts either as downside risks to the growth and inflation outlook have been accumulating (chart 6).

GDP growth in Q2 2023

The messages from most of the GDP data for Q2 that have been released in recent weeks have been upbeat. Economic growth was stronger than consensus surveys had anticipated a few weeks ago and far-removed from the recessionary pace that equally dominated many economists’ expectations. The exception to this is China, whose economic performance has been weaker-than-expected but, even so, it still managed to eke out an annualised growth rate of around 3.2% in Q2. Larger economies within the euro area and most notably Germany have also been exhibiting some fragility (see chart 1).

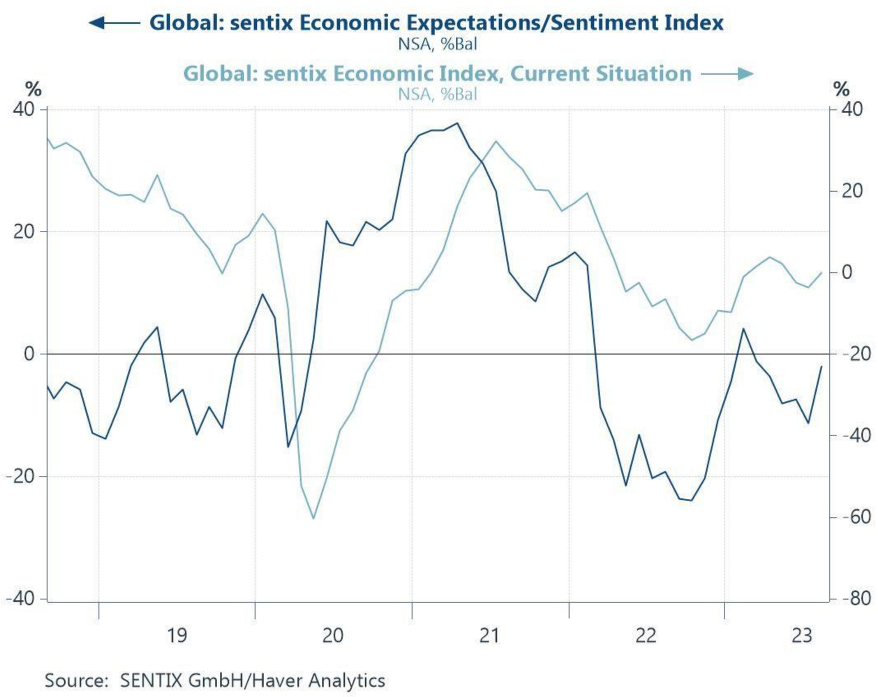
Chart 1: GDP growth in Q2 2023 in selected major economies



Global growth expectations

As noted above, the expectations of economists and financial market participants have not wholly aligned with the outcomes from economic data of late. This week's sentix survey of investor expectations, for example, revealed readings for the forward looking expectations components that remain mired in negative (i.e. recessionary) territory in most major regions (see chart 2). That said the August survey also revealed a small pick-up in both the expectations and the current situation components albeit from depressed levels.

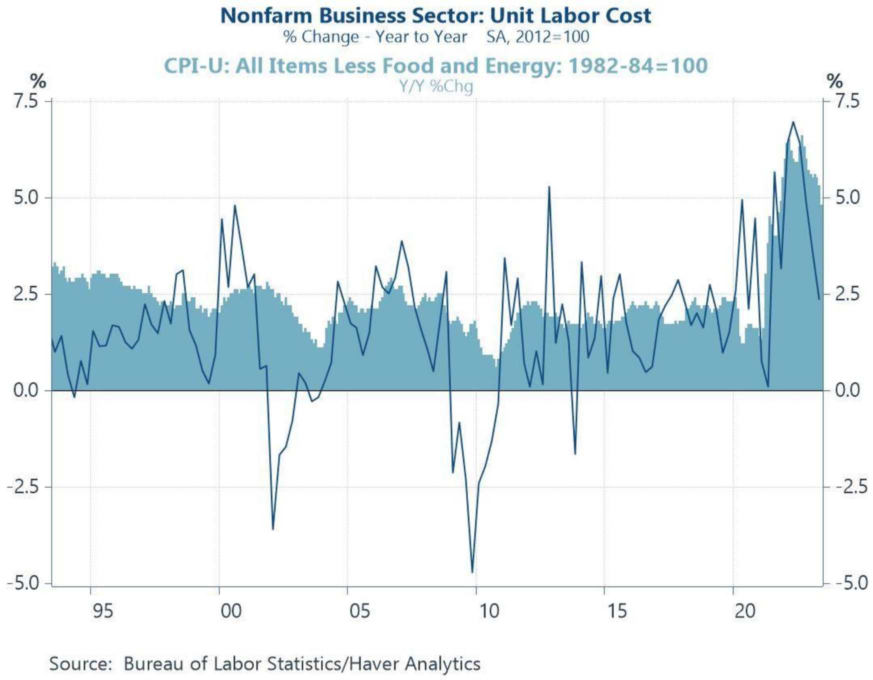
Chart 2: Global sentix survey: current situations and expectations components



US unit labour cost inflation

While much of the focus of US economy watchers has been on labour market and CPI data over the past few days, last week's weaker-than-expected numbers for unit labour cost inflation were arguably as, if not more, important. A slightly firmer-than-expected rebound in productivity growth in Q2 (aided by signs of softening in the labour market) coupled with compensation gains that were not as threatening as they were in the previous year helped squeeze unit labour cost pressures down to far more inflation-friendly levels. Unit labour costs specifically climbed by just 2.4% in the year to Q2 2023 which compares with 3.6% in Q1 and 6.1% in 2022 as a whole.

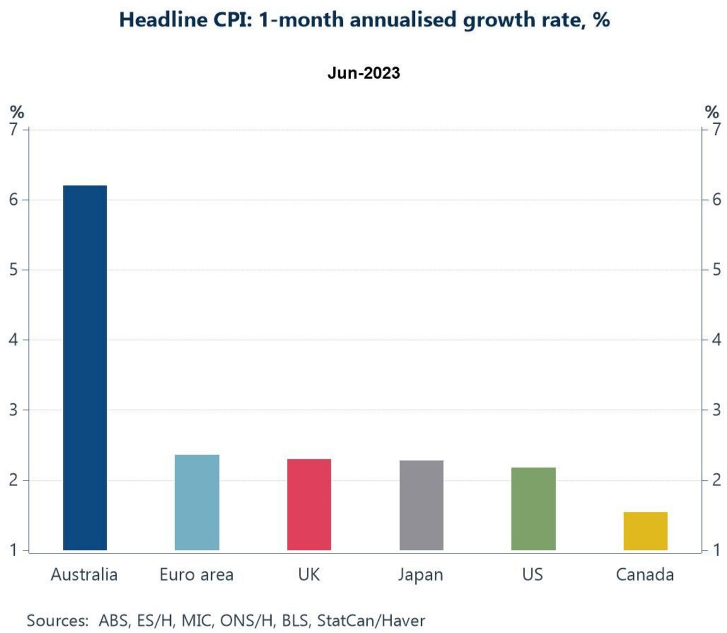
Chart 3: US unit labour cost inflation and core CPI inflation



Headline CPI inflation in advanced economies

Central banks that are targeting headline inflation rates ought to have been a little happier with the messaging from June's CPI releases. That's because the 1-month annualised increase in their respective headline CPI index was little more than 2% while for Canada it was little more than 1.5%. The exception to this was Australia, whose CPI index climbed by 6.2% in June though that followed an unchanged reading in May (chart 4).

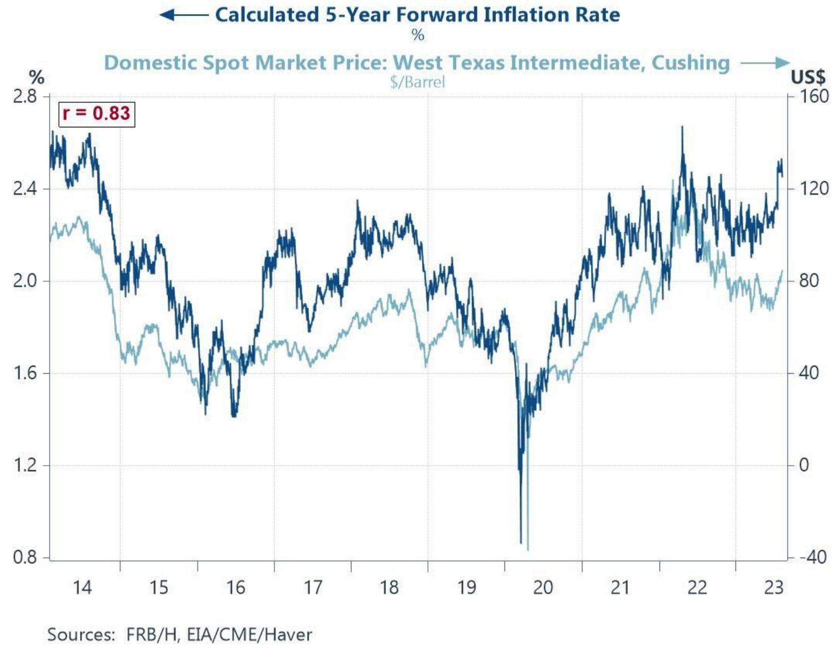
Chart 4: Headline CPI inflation: 1-month annualised growth rates in selected major economies



US inflation expectations and oil prices

While that inflation data may have been comforting, the latest news about investors' inflation expectations almost certainly is not. The market implied 5-year forward inflation rate in the US, for example, has climbed sharply in recent days and presently hovers just shy of 2.5%. That shift can be partly traced to the increase in oil prices that has unfolded in recent weeks. But as chart 5 equally suggests there also hints that inflation expectations have become un-moored relative to those oil price-related fundamentals.

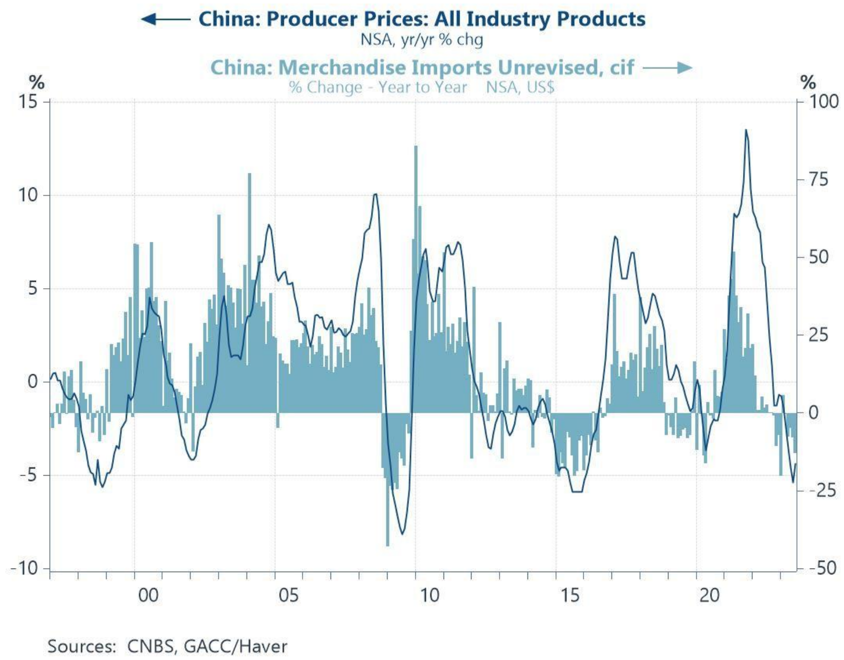
Chart 5: Market-based inflation expectations and oil prices



China's PPI inflation and import growth

As noted already, China's economy is on the other side of this debate. Incoming trade and inflation data for July this week paint a picture of a weakening economy that's saddled with excess capacity and intensifying deflation. In chart 6 below we highlight two of these data points: firstly, PPI inflation which fell by 4.4% y/y in July and secondly, import growth which fell by 13.8% y/y. Both figures attest to the weakness of China's domestic economy. More significantly they attest to a big weakening of the impulse from China to traded goods price inflation and global growth.

Chart 6: China's PPI inflation and import growth



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.