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Written by Andy Cates

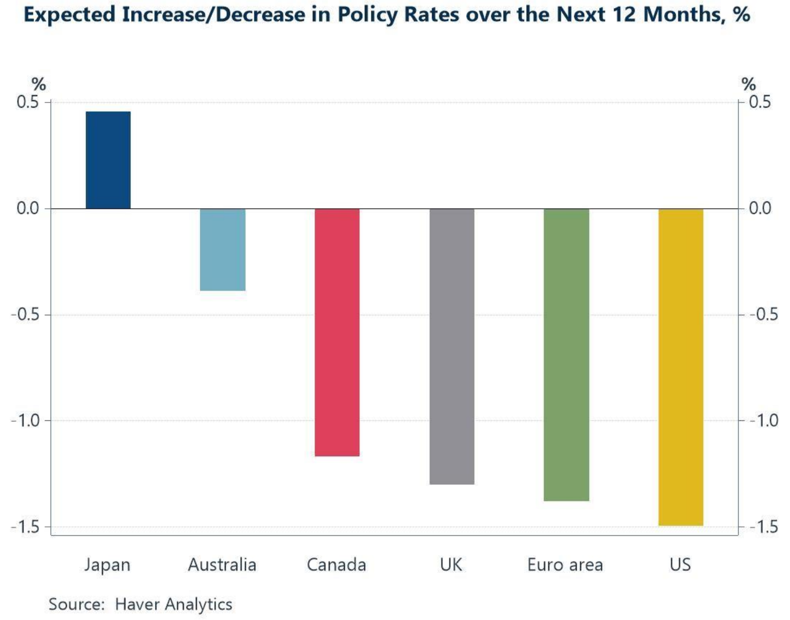
Back to School

With the summer vacation season now over in the Northern Hemisphere our charts this week shed light on recent and prospective developments in the world economy. Latest data have, on the whole, reinforced expectations that most central banks will loosen monetary policy in the immediate months ahead (chart 1). And that’s partly because incoming inflation data have been well-behaved (chart 2). In the meantime, forward-looking survey data have, with one or two exceptions, remained above the threshold that would typically generate recession alarms (chart 3). Soft landing narratives have, accordingly, remained in vogue. That being said, lingering imbalances—particularly in China (chart 4)—combined with growing concerns about an unwinding of Japan’s carry trade (chart 5), have left the risks to the global economic outlook skewed to the downside. Added to that, the potential profitability of technology companies and the broader health of the US economy are also now being more actively challenged (chart 6). Either way, central banks continue to face a complex mix of challenges in the period ahead, not least if political instability (e.g. in the US) were to hamper confidence in the final quarter of this year.

The policy rate consensus

Dovish comments from central bankers in recent weeks have amplified expectations for a global policy easing cycle over the past few weeks. Fed Chair Powell’s address at the Jackson Hole symposium, in which he noted that upside risks to inflation have diminished, and the downside risks to employment have increased, have certainly suggested the direction of travel for US policy rates is clear. This chimes too with the latest survey of Blue Chip Financial Forecasts. US policy rates, for example, are expected to decline from current levels by nearly 150bps over the next 12 months. That contrasts with the UK and euro area, where policy rates are expected to decline by 130 and 138 basis points respectively.

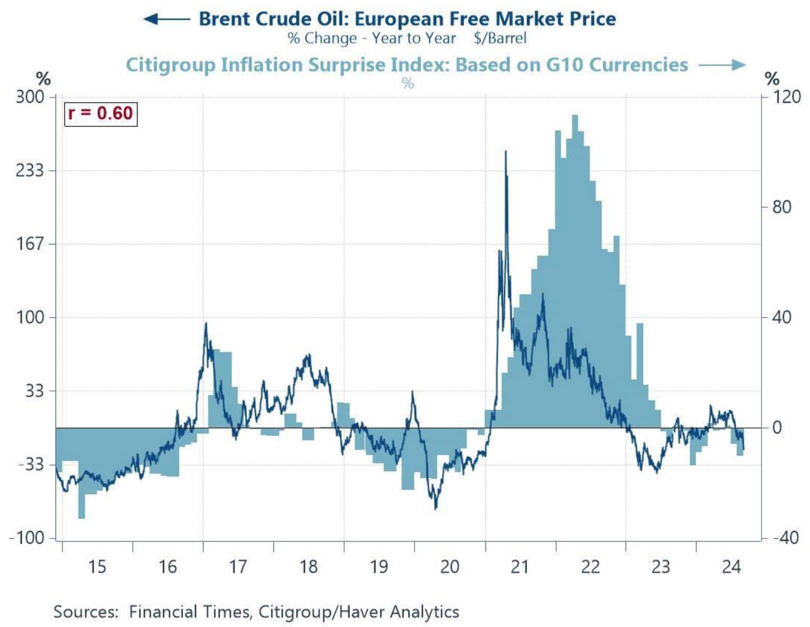
Chart 1: Blue Chip Financial Forecasts: Expected change in policy rate over the next 12 months



Inflation progress

Well-behaved inflation data have been another key driver of these interest rate expectations. Headline inflation rates in most major economies have continued to decline over the past few weeks and, at least as far as the US, the euro area and the UK are concerned, were not that far above central banks' target levels. Incoming inflation data have, on the whole, also been surprising forecasters' expectations on the downside in recent weeks with some underlying stability in the price of oil a key factor assisting that trend (chart 2).

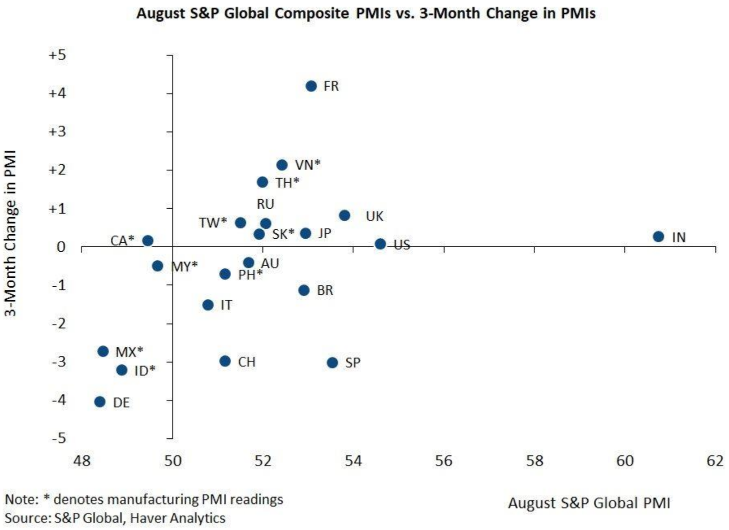
Chart 2: Citigroup's G10 inflation surprise index versus oil prices



The global business cycle

While forward-looking PMI readings for many economies have remained relatively stable in recent months, several have experienced some significant swings. For instance, France has seen a notable improvement, though it is worth noting that the August figures were significantly bolstered by activity from the Olympic Games. Conversely, Germany has struggled, with its PMI falling further into contraction territory due to ongoing weaknesses in the manufacturing sector. Meanwhile, India continues to stand out relative to its peers with consistently strong PMI readings over recent months (see chart 3).

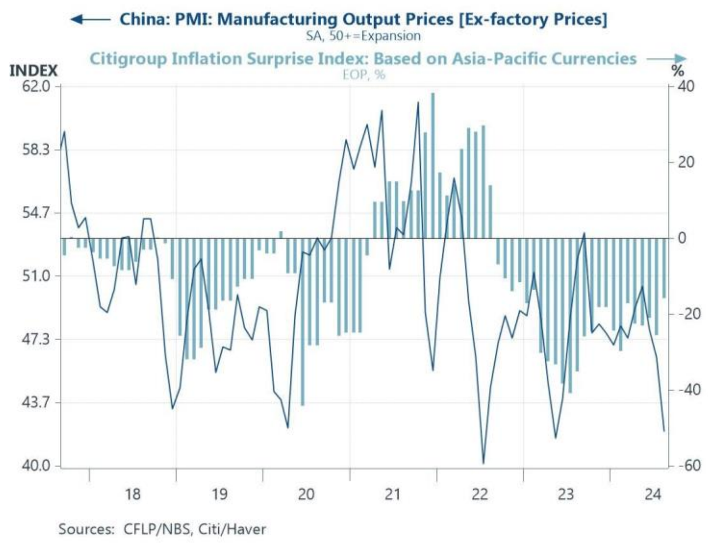
Chart 3: Composite PMIs: August levels versus 3-month changes (US data to be updated at 3pm Lon time)



China's excess capacity

China's economy stands out too as its latest PMI survey suggest its economy has lost much momentum over the past 3 months, largely because of some further weakening in the manufacturing sector. Digging into some of the underlying details of the manufacturing survey also reveals persistent downward pressure on that sector's output prices (chart 4). Given the importance of China's manufacturing sector for world trade, which might herald broader disinflationary pressures in the traded goods sector in the period ahead as well.

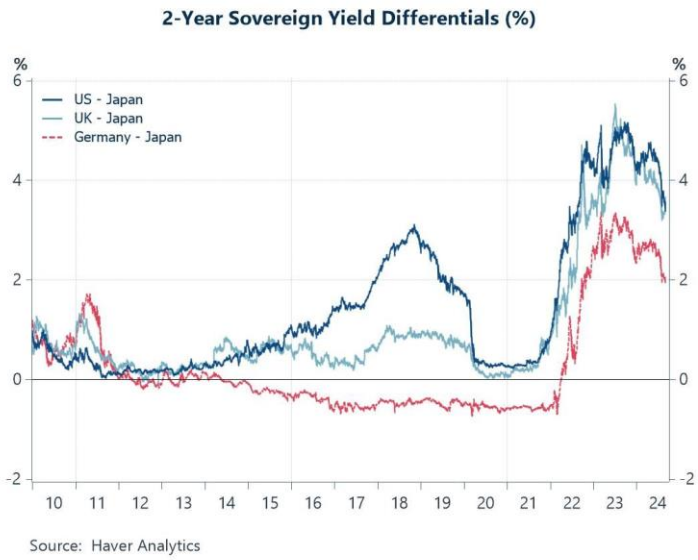
Chart 4: China's manufacturing PMI output price balance versus EM inflation surprises



Japan’s carry trade

While some of the initial volatility in Japan’s currency markets has stabilized since the decision by the BoJ to lifts its policy rate, fundamental drivers are turning increasingly unfavourable for the carry trade. Specifically, Japan’s yield differentials with other major economies are becoming less advantageous, as evidenced in chart 5 below. As chart 1 above additionally underscores, this shift is being further compounded by the BoJ’s ongoing – and expected - tightening measures, which stand in vivid contrast to the easing cycles now underway from other major central banks.

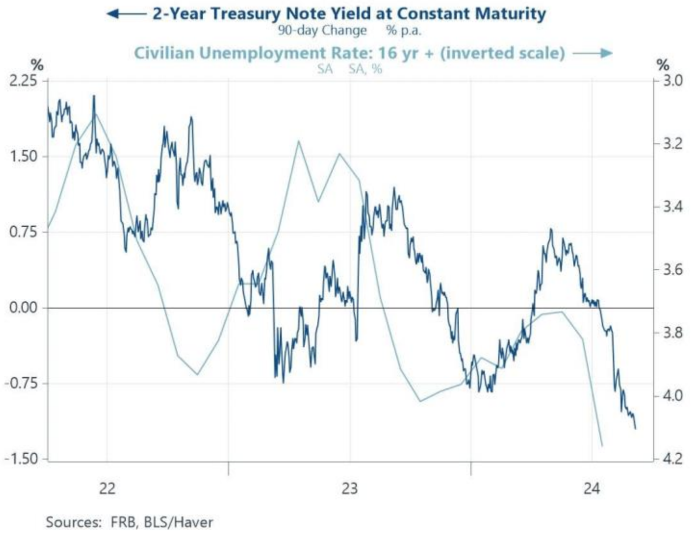
Chart 5: 2-year yield differentials between Japan and selected major economies



US monetary policy and labour markets

With central banks arguably now slowly switching their attention away from inflation, the prospective dataflow on economic growth – and perhaps more significantly, labour market activity - is taking on more importance. On that score (and writing ahead of the publication of August’s US employment report on Friday September 6th) it has certainly been notable that much of the incoming US labour market data have disappointed expectations in recent weeks and that financial markets have responded to this by pricing in more easing from the US Fed (see chart 6).

Chart 6: US 2-year Treasury yield versus ISM manufacturing employment index



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.

Data featured in this commentary:

Chart 1: Blue Chip Financial Forecasts: Expected change in policy rate over the next 12 months
Series 1: (AAYW@BLUECFIN - N158RTAR@G10)
AAYW@BLUECFIN [BCFF: Japan: Policy-Rate Balance Rate 12-Mo Forecast: Consensus (%)]
N158RTAR@G10 [Japan: Bank of Japan Policy Rate (EOP, %)]
Series 2: (AAZI@BLUECFIN - N193RTAR@G10)
AAZI@BLUECFIN [BCFF: Australia: Official Cash Rate 12-Mo Forecast: Consensus (%)]
N193RTAR@G10 [Australia: Official Cash Rate (EOP, %)]
Series 3: (AAZF@BLUECFIN - N156RTAR@G10)
AAZF@BLUECFIN [BCFF: Canada: O/N Money Mkt Financing Rate 12-Mo Forecast: Consensus (%)]
N156RTAR@G10 [Canada: Overnight Money Market Financing Rate [Target] (EOP, %)]
Series 4: (AAYZ@BLUECFIN - N112RTAR@G10)
AAYZ@BLUECFIN [BCFF: UK: Official Bank Rate 12-Mo Forecast: Consensus (%)]
N112RTAR@G10 [U.K.: Official Bank Rate (EOP, %)]
Series 5: (AAZL@BLUECFIN - I023MR@EUDATA)
AAZL@BLUECFIN [BCFF: Euro area: Main Refinancing Rate 12-Mo Forecast: Consensus (%)]
I023MR@EUDATA [Euro Area 11-20: Main Refinancing Rate (EOP, %)]
Series 6: (AAYQ@BLUECFIN - N111RTAR@G10)
AAYQ@BLUECFIN [BCFF: US: Fed Funds Target Rate 12-Mo Forecast: Consensus (%)]
N111RTAR@G10 [U.S.: Federal Open Market Committee: Fed Funds Target Rate (EOP, %)]

Chart 2: Citigroup's G10 inflation surprise index versus oil prices
Series 1: yryr%(P112BRT@INTDAILY)
P112BRT@INTDAILY [Brent Crude Oil: European Free Market Price($/Barrel)]
Series 2: V110CIS@INTDAILY
V110CIS@INTDAILY [Citigroup Inflation Surprise Index: Based on G10 Currencies (%)]

Chart 3: Composite PMIs: August levels versus 3-month changes (US data to be updated at 3pm Lon time)
*Please see Excel file included in downloads folder

Chart 4: China's manufacturing PMI output price balance versus EM inflation surprises
Series 1: S924VMPF@EMERGEPR
S924VMPF@EMERGEPR [China: PMI: Manufacturing Output Prices [Ex-factory Prices] (SA, 50+=Expansion)]
Series 2: N505VCIS@G10
N505VCIS@G10 [Citigroup Inflation Surprise Index: Based on Asia-Pacific Currencies (EOP, %)]

Chart 5: 2-year yield differentials between Japan and selected major economies
Series 1: (R111M2Y@INTDAILY - R158M2Y@INTDAILY)
R111M2Y@INTDAILY [United States: 2 Year Treasury Bond Mid Yield (% p.a.)][I]
R158M2Y@INTDAILY [Japan: 2 Year Treasury Bond Mid Yield (% p.a.)][I]
Series 2: (R112M2Y@INTDAILY - R158M2Y@INTDAILY)
R112M2Y@INTDAILY [United Kingdom: 2 Year Treasury Bond Mid Yield (% p.a.)][I]
R158M2Y@INTDAILY [Japan: 2 Year Treasury Bond Mid Yield (% p.a.)][I]
Series 3: (R134M2Y@INTDAILY - R158M2Y@INTDAILY)
R134M2Y@INTDAILY [Germany: 2 Year Treasury Bond Mid Yield (% p.a.)][I]
R158M2Y@INTDAILY [Japan: 2 Year Treasury Bond Mid Yield (% p.a.)][I]

Chart 6: US 2-year Treasury yield versus ISM manufacturing employment index
Series 1: diff(FCM2@DAILY,90)
FCM2@DAILY [2-Year Treasury Note Yield at Constant Maturity (% p.a.)]
Series 2: sa(LR@USECON)
LR@USECON [Civilian Unemployment Rate: 16 yr + (SA, %)]

For more info on our data offerings please email sales@haver.com