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Charts of the Week: Inflated Expectations

A HAVER ANALYTICS podcast and publication

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Written by [Andy Cates](#), Senior Economist

Inflated Expectations

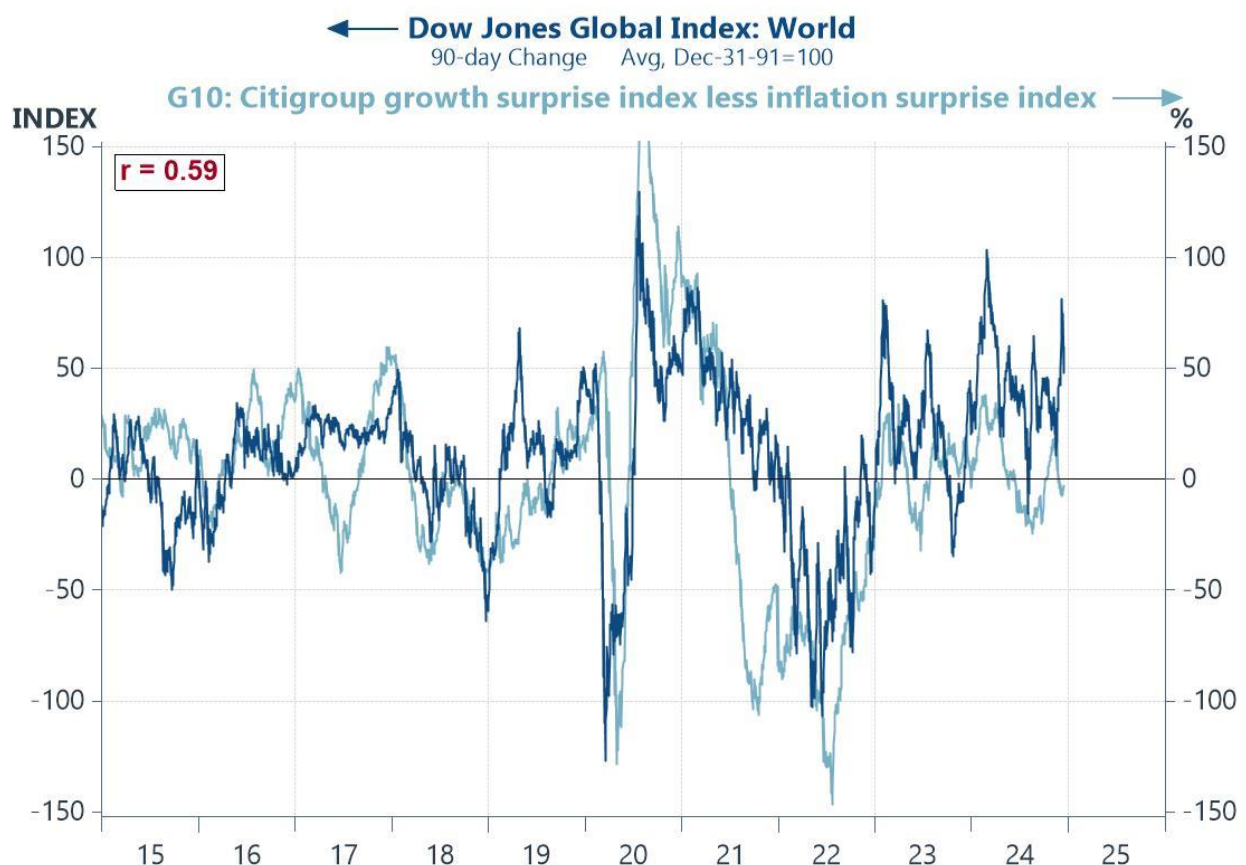
Investors have shifted their attention back to the economic data and monetary policy over the past few days, marking a shift from recent weeks when political developments took centre stage in shaping financial market sentiment (chart 1). While this week's decision by the US Fed to cut policy rates by 25 bps was widely anticipated, the accompanying commentary and forecasts have heightened concerns that US monetary policy will remain tighter for longer in the months ahead. Similarly, the BoE's decision to leave rates unchanged this week might stoke comparable concerns about the UK's policy trajectory. The key driver behind these concerns is inflation. Persistent inflation in the services sector (chart 2) and ongoing wage pressures are leaving policymakers in the US and UK reluctant to ease monetary policy further. This hesitancy has been amplified by financial conditions that have arguably been looser in recent months than central banks would prefer (chart 3). Additionally, a potential shift toward a more protectionist global trade environment next year could exacerbate price pressures in traded goods sectors, further complicating efforts to bring inflation back toward target levels (chart 4). Meanwhile, in Japan, the BoJ's decision to maintain its accommodative monetary policy highlights a contrasting challenge: low inflation and a fragile economy.

These dynamics stand in stark contrast to the issues confronting the US Fed (chart 5). Further complicating the global picture is China (chart 6), where recent data point to an economy weighed down by weak consumer demand, excess industrial capacity, and tepid inflation. This also underlines the increasingly divergent challenges faced by policymakers across the world's major economies as they navigate a highly complex and uncertain macroeconomic landscape.

Stock markets and economic data

In recent weeks, financial markets have been glued to political developments, with a particular focus on the policy implications of a new US administration. This political backdrop has buoyed US equity markets, which have responded positively to expectations of pro-growth policy shifts. However, beneath the surface, the economic data have told a more nuanced story. While inflation readings have consistently surprised to the upside, incoming growth data have fallen short of expectations (chart 1). Against this backdrop, the recent souring of sentiment in the US equity market seems less surprising, as investors reassess the balance between political optimism and the underlying economic reality.

Chart 1: Global equity markets versus G10 growth and inflation surprises

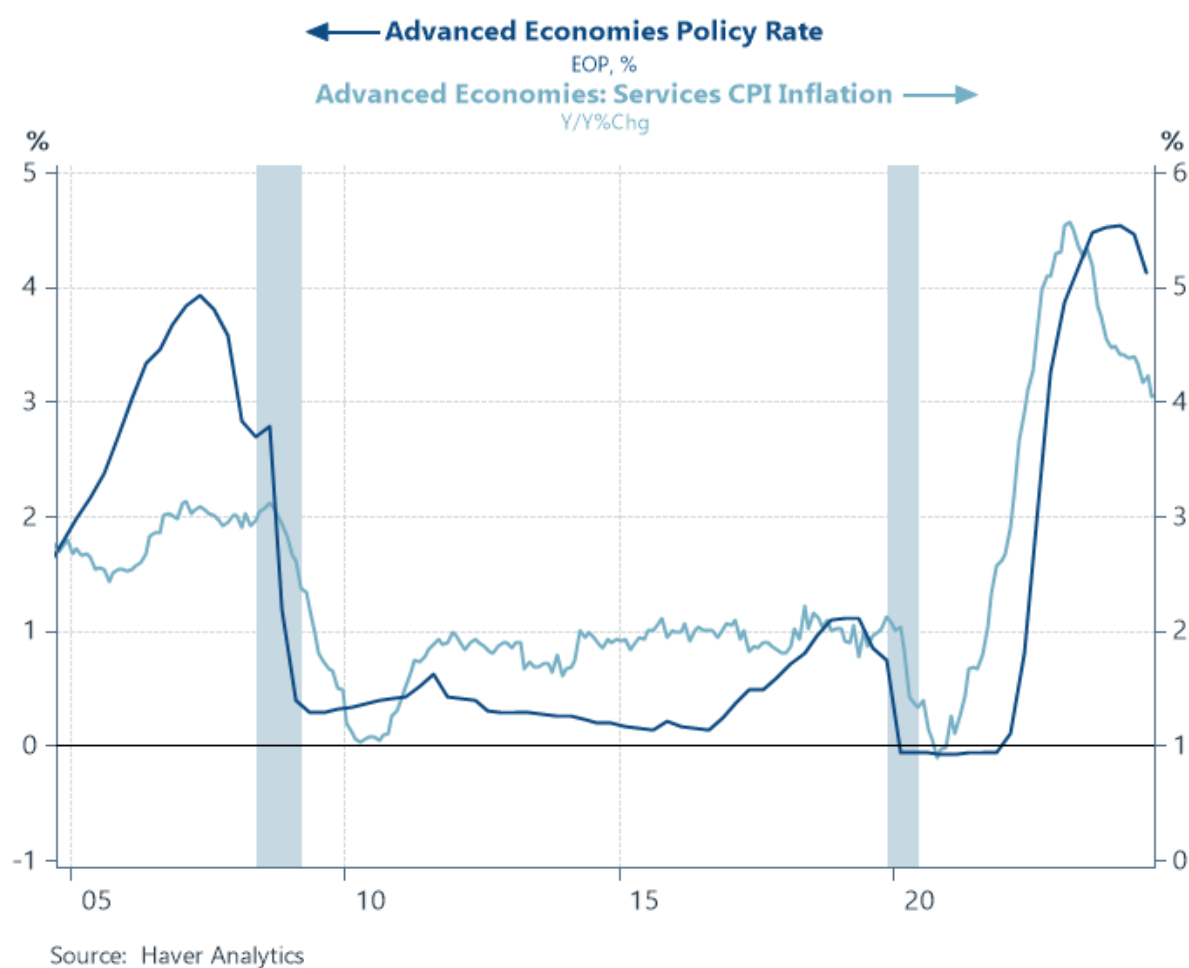


Source: Dow Jones/Haver Analytics

Services inflation and monetary policy

An additional reason, however, for that souring of sentiment concerns monetary policy. Although the US Fed cut interest rates by 25 bps this week, the commentary and forecasts left investors much more concerned about the scope for looser policy in 2025. These concerns have been amplified as well by incoming inflation data suggesting that service sector inflation has remained elevated (chart 2).

Chart 2: Services inflation versus policy rates in advanced economies

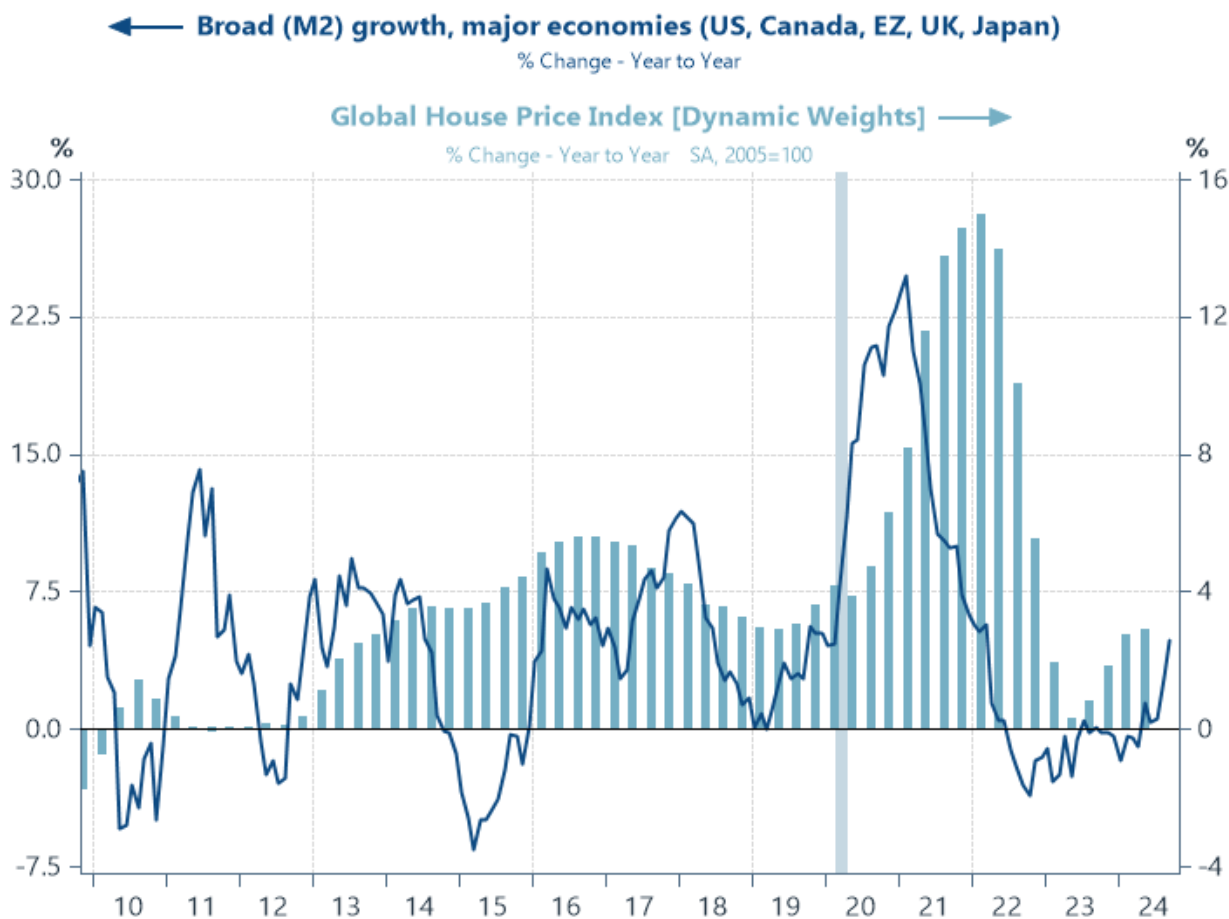


Broad money growth versus house price inflation

There are, in addition, some forward-looking indicators that suggest inflation could pick up in the coming months. The recent lowering of policy rates across most major economies has been mirrored by an uptick in growth of broader measures of the money supply. As shown in chart 3, M2 growth in several major economies has gained momentum. This, in turn, has begun to translate—albeit with a lag—into stronger

house price inflation. Against a backdrop where consumer price inflation has been above target and sticky this will potentially concern many policymakers.

Chart 3: Broad money growth in major economies and global house price inflation

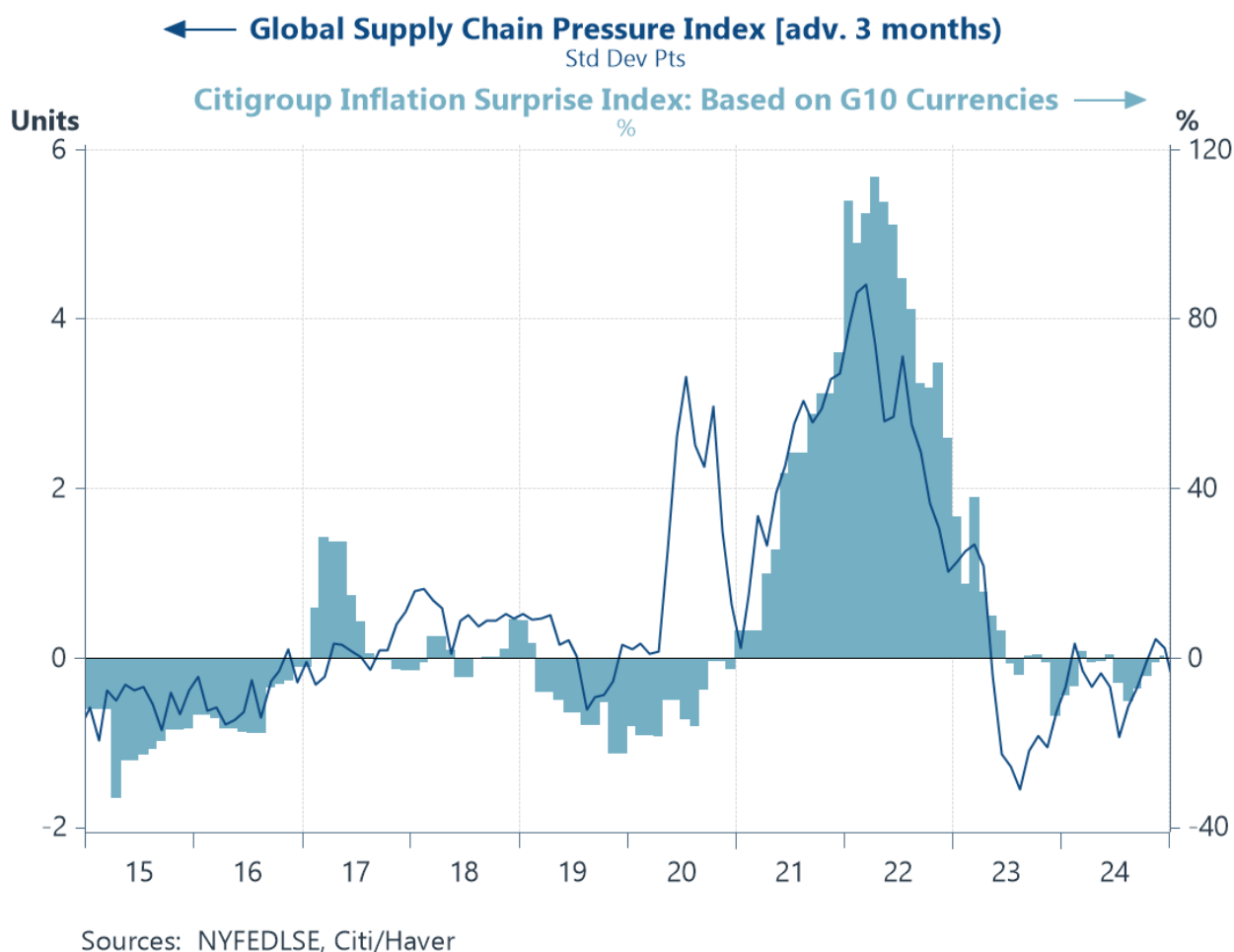


Source: Federal Reserve Bank of Dallas/Haver Analytics

Supply chain pressures and inflation surprises

These inflation concerns could be further amplified in the coming months by a potential shift in US policy toward greater trade protectionism. As chart 4 illustrates, global supply chain pressures have played a pivotal role in shaping inflation dynamics—first by driving inflation higher during the pandemic and the war in Ukraine, and more recently by easing inflation as those pressures subsided. However, a resurgence of supply-side disruptions driven by renewed protectionist measures could trigger another inflationary spike. Such a scenario would likely force central banks to maintain a more restrictive monetary stance for longer, delaying anticipated interest rate cuts and adding to the challenges facing the global economy.

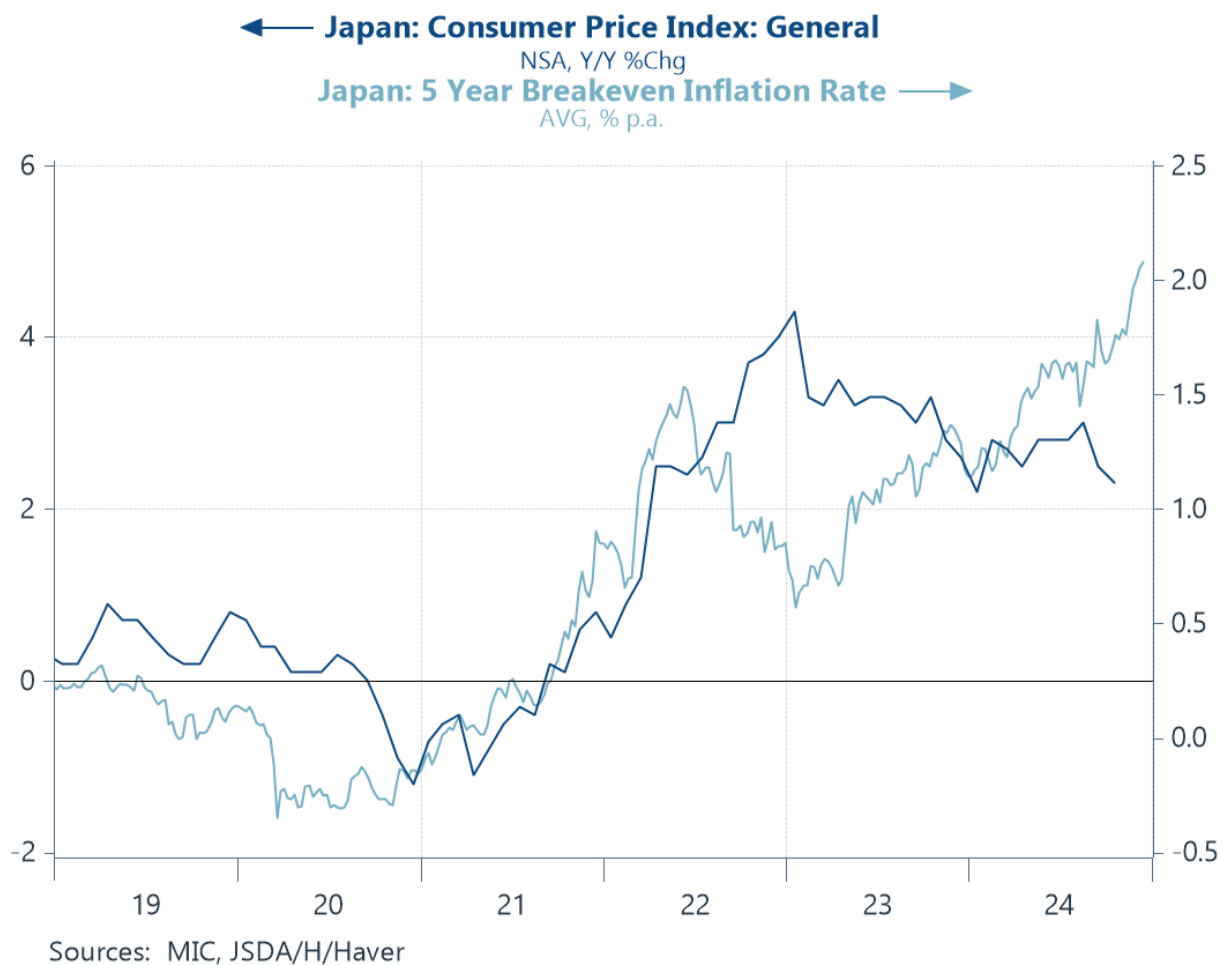
Chart 4: Global supply chain pressures versus G10 inflation surprises



The Bank of Japan

Standing in contrast to these broad global concerns was the Bank of Japan's decision this week to signal patience regarding further interest rate hikes. Policymakers specifically opted to keep the policy rate unchanged. This decision appears justified, as inflation in Japan is currently holding just above the 2% target, with no significant upward pressure on prices to warrant additional tightening. Moreover, Japan's economic growth remains relatively weak, although nominal wage growth continues to be positive. Looking ahead, market-based inflation expectations have steadily risen in recent years, specifically with the 5-year breakeven inflation rate recently surpassing the 2% threshold (see chart below). If these expectations materialize, a more stable inflationary environment could provide the BoJ with a stronger case for further increases in its policy interest rate next year.

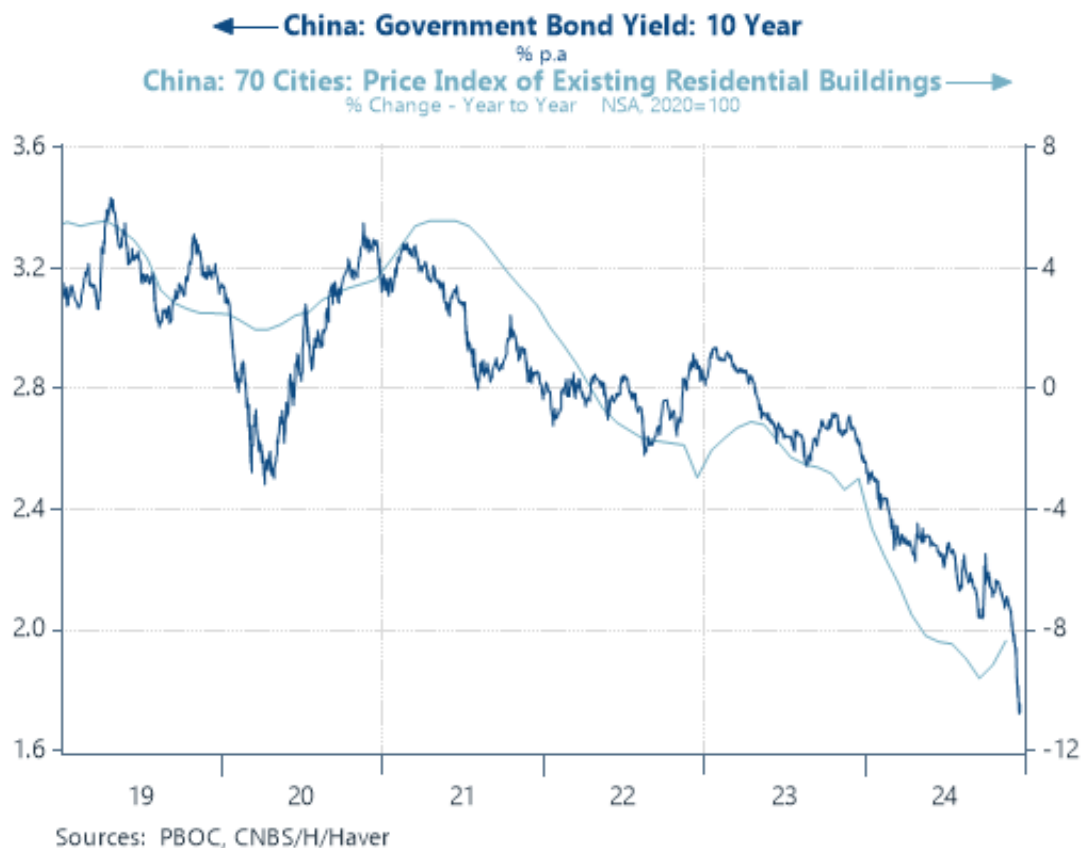
Chart 5: Japan's CPI inflation versus the 5-year breakeven inflation rate



China

Turning to the situation in China, the week's economic data releases were underwhelming, as the economy's regular monthly data failed to meet expectations. This is reflected in the Citigroup Economic Surprise Index, which reversed from a period of positive surprises and took a downturn. Specifically, retail sales growth slowed to 3% y/y in November, down from the 4.8% seen in October. Furthermore, China's property sector remained in a dire state, with existing house prices falling by an additional 8.4% y/y (chart 6). These disappointing figures have reinforced expectations of further monetary easing by Chinese authorities and continued weakness in demand-driven consumer inflation. Additionally, producer prices have continued to decline, partly driven by excess capacity issues. This outlook has also solidified expectations of a prolonged period of low interest rates in China, contributing to a rally in the country's bond markets and pushing yields to record lows.

Chart 6: China house price inflation and 10-year bond yields



About the author



Haver Analytics is pleased to bring [Andy Cates's](#) commentaries on the state of the global economy to its clients.

Andy 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: Global equity markets versus G10 growth and inflation surprises

Series 1: [diff\(S001DJW@INTDAILY,90\)](#)

S001DJW@INTDAILY [Dow Jones Global Index: World (Avg, Dec-31-91=100)]

Series 2: [\(V110CSI@INTDAILY - V110CIS@INTDAILY\)](#)

V110CSI@INTDAILY [Citigroup Economic Surprise Index: Based on G10 Currencies (%)]

V110CIS@INTDAILY [Citigroup Inflation Surprise Index: Based on G10 Currencies (%)]

Chart 2: Services inflation versus policy rates in advanced economies

Series 1: [N110RTAR@G10](#)

N110RTAR@G10 [Advanced Economies Policy Rate (EOP, %)]

Series 2: [N110SIC@G10](#)

N110SIC@G10 [Advanced Economies: Services CPI Inflation (Y/Y%Chg)]

Chart 3: Broad money growth in major economies and global house price inflation

Series 1: [yryr%\(\(1000 * S111FM2@G10\) + \(FX\(S112FM2@G10,111\) + \(FX\(S158FM2@G10,111\) + \(\(1000](#)

S111FM2@G10 [U.S.: Money Supply: M2 (SA, Bil.\$)]

S112FM2@G10 [U.K.: Money Supply: M2 (SA, EOP, Mil.Pounds)]

S158FM2@G10 [Japan: Money Supply: M2 (SA, 100 Mil.Yen)]

1000

S023FM2@G10 [EA 11-20: Money Supply: M2 (SWDA, EOP, Bil.Euros)]

H128FM2@G10 [Denmark: Money Supply: M2 (EOP, SA, Mil.DKK)]

S156FM2@G10 [Canada: Money Supply: M2+ (SA, Avg, Mil.C\$)]

Series 2: [yryr%\(S001XHDN@G10\)](#)

S001XHDN@G10 [Global House Price Index [Dynamic Weights] (SA, 2005=100)]

Chart 4: Global supply chain pressures versus G10 inflation surprises

Series 1: [W1NGSCPI@TRANSPRT \[-3\]](#)

W1NGSCPI@TRANSPRT [Global Supply Chain Pressure Index (Std Dev Pts)]

Series 2: [V110CIS@INTDAILY](#)

V110CIS@INTDAILY [Citigroup Inflation Surprise Index: Based on G10 Currencies (%)]

Chart 5: Japan's CPI inflation versus the 5-year breakeven inflation rate

Series 1: [JYCIJ@JAPAN](#)

JYCIJ@JAPAN [Japan: Consumer Price Index: General (NSA, Y/Y %Chg)]

Series 2: [R158F5V@INTWKLY](#)

R158F5V@INTWKLY [Japan: 5 Year Breakeven Inflation Rate (AVG, % p.a.)]

Chart 6: China house price inflation and 10-year bond yields

Series 1: [R924VA@INTDAILY](#)

R924VA@INTDAILY [China: Government Bond Yield: 10 Year(% p.a.)]

Series 2: [yryr%\(N924HK@EMERGEPR\)](#)

N924HK@EMERGEPR [China: 70 Cities: Price Index of Existing Residential Buildings (NSA, 2020=100)]

Want to discuss your data needs?

Please email sales@haver.com and someone from our team will connect with you.

