

Weekly Update of U.S. Economy

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Higher Inflation Puts Demand and Supply Under Pressure

Inflation Stays High Longer

- The June Consumer Price Index (CPI) accelerated its pace of month-over-month increase to 1.3%, while the core CPI excluding food and energy also increased by 0.7% from the previous month.
- Where the spread of price increases among goods and service items has been pronounced in recent months, the price increases have gained further momentum. The pace of price increases in services, which are less volatile than goods, has also been accelerating.
- Once the upward trend in service prices takes hold, it will take time for the trend to turn downward. Owners' equivalent rent, which carries a particularly large weight, rose 0.7% month over month, well above the range of the past 30 years. Medical services also accelerated to 0.7% month over month. Price increases for dentists and ophthalmologists boosted the overall increase. In addition, the cost of services at nursing homes also accelerated, indicating a broadening in the rise in prices of services for daily necessities.
- Food prices also continue to soar, fueling consumer fears of persistent inflation. Food products as a whole showed a remarkable 12.2% growth over the previous year. Among fresh foods, eggs rose 33.1%, milk 16.4%, and flour 19.2%.
- People's anxiety about prolonged inflation is strong. The consumer survey conducted by the Federal Reserve Bank of New York indicates that people are expecting further price increases for food, rents, and healthcare costs.
- The University of Michigan's monthly survey revealed that inflation fears are putting further downward pressure on consumer confidence. Households' assessment for six months ahead is deteriorating rapidly and has fallen below the lows recorded during the global financial crisis.
- However, people's inflation expectation is rather adaptive. Households' one-year inflation expectation edged down to 5.2% from the previous month but nonetheless remains very high.

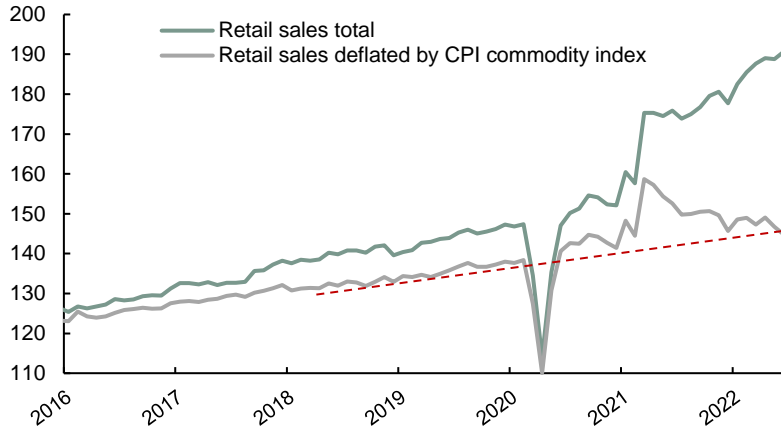
The Fed Will Likely Overlook the Economy's Sluggishness

- Economic data all point to the U.S. economy being under pressure from inflation.
- Deducting price inflation, retail sales in June declined by 1.3% from the previous month, the second consecutive month of decline and the beginning of a fall below the pre-pandemic trend line.
- Gasoline prices appear to have peaked in early June and have been declining ever since. However, in relation to past spending, the price adjustment is not sufficient to increase gasoline sales volume. The focus will be on the extent to which service consumption increases during the summer vacation period. Restaurant sales, which are included in services in retail sales, have increased in nominal terms for two consecutive months, but are unchanged when inflation is deducted. It cannot be said that the shift of spending from goods to services has begun.
- From the broader point of view, the pace of the adjustment seen in household spending is a small margin, with a steady increase of labor compensation. The high purchasing power of asset holders, benefiting from the existing rise in asset prices, also mitigates the downside risks to consumption. However, the slow convergence of inflation to a high rate, combined with the effects of sharp interest-rate hikes limiting borrowing and a deteriorating labor market, are expected to reduce consumption more sharply.
- The recovery of supply capacity also slowed down in May-June. There is also a growing sense of caution among manufacturers about a rapid deflation of demand in the process of continued rapid rate hikes. Particular attention should be paid to the production adjustment pressure on consumer durable goods.
- With inflation certain to remain high for a longer period of time, the Federal Reserve Board (the "Fed") is in a hurry to raise interest rates quickly and significantly. Fed officials seem determined to show that inflation cannot be controlled this time without going that far. Even if economic indicators show a more pronounced slowdown in the second half of this year, we do not expect the central bank to ease off on interest-rate hikes.

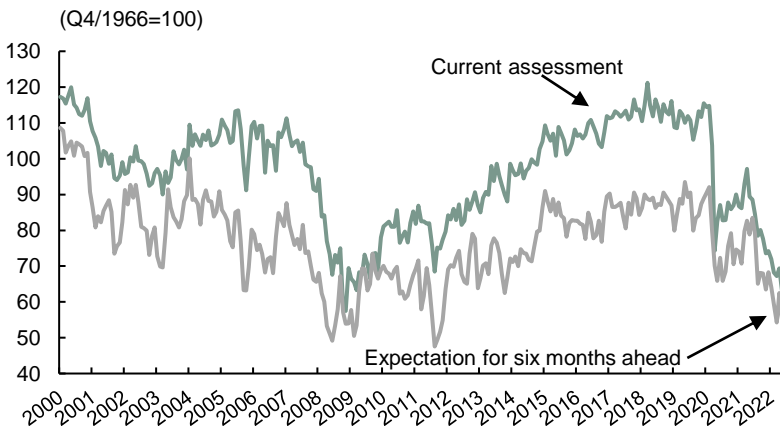
Higher Inflation Puts Demand and Supply Under Pressure (continued)

Retail sales in real terms continued to decline, falling below the trend line before the pandemic period.

(Average of 2010=100)

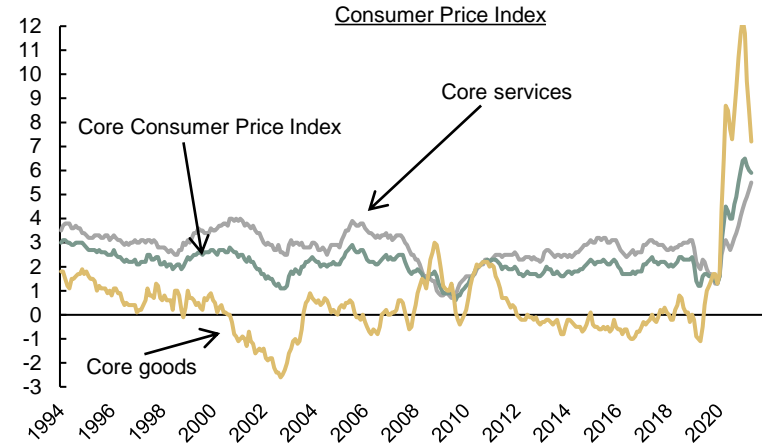


Consumers' future assessment is now lower than during the global financial crisis period.

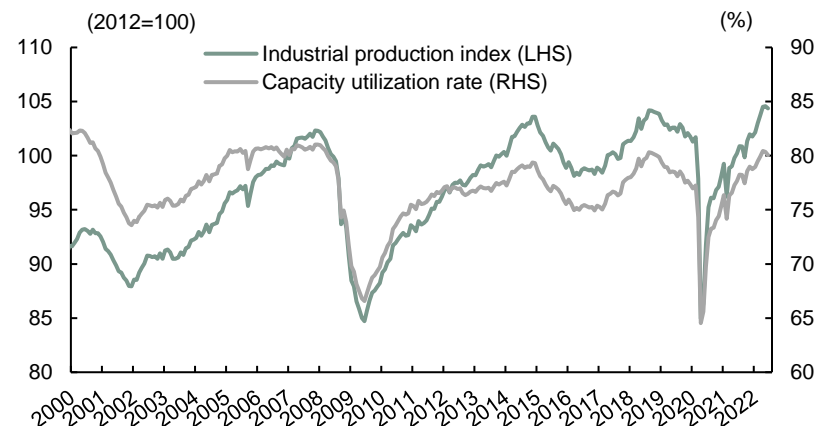


The rise in the Consumer Price Index has been transmitted from commodity goods to service items.

(YoY, %)



Industrial production fell by 0.2% from the previous month. Manufacturers have become cautious against further rate increases.



SMBC Economy and Rates Forecast

		2021			2022				2023				2020	2021	2022	2023
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
U.S.	Real GDP (saar)	6.7	2.3	6.9	-1.5	1.1	2.1	1.6	1.3	1.5	1.4	1.5	-3.4	5.7	2.1	1.6
	Inflation rate (YoY)	3.2	3.6	4.6	5.1	4.9	4.8	4.5	4.2	3.9	3.5	3.0	1.4	3.3	4.8	3.7
	Jobless rate	5.9	5.1	4.2	3.8	3.6	3.7	3.7	3.8	3.9	4.0	4.0	8.1	5.4	3.7	3.9
Euro area	Real GDP (qoq)	2.2	2.3	0.3	0.6	0.4	0.5	0.4	0.4	0.5	0.5	0.5	-6.5	5.3	3.0	1.8
	Inflation rate (YoY)	1.8	2.9	4.7	6.2	7.5	6.3	5.2	3.0	2.5	2.0	2.0	0.3	2.6	6.3	2.4
	Jobless rate	8.0	7.5	7.1	6.8	6.7	6.6	6.6	6.6	6.5	6.5	6.5	7.9	7.7	6.7	6.5
Japan	Real GDP (saar)	2.6	-3.2	4.0	-0.5	6.3	4.4	3.0	1.6	0.9	0.9	1.0	-4.5	1.6	2.2	2.3
	Inflation rate (YoY)	-0.6	0.0	0.4	0.5	2.0	1.9	1.9	1.6	0.9	0.7	0.6	-0.2	-0.2	1.6	1.0
	Jobless rate	2.9	2.8	2.7	2.7	2.6	2.6	2.5	2.5	2.4	2.4	2.4	2.8	2.8	2.6	2.4
China	Real GDP (YoY)	7.9	4.9	3.5	4.8	1.0	5.6	5.9	5.9	9.5	5.2	5.2	2.2	8.0	5.2	5.4
	Inflation rate (YoY)	1.1	0.8	1.8	1.1	1.8	1.7	1.9	2.0	1.6	1.5	1.5	2.7	0.8	1.6	1.7
	Jobless rate	5.0	5.0	5.0	5.5	5.3	5.2	5.0	5.0	5.1	5.2	5.0	5.0	5.1	5.1	5.1

Rates		2021	2022				2023				2021	2022	2023
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
U.S.	FF target range	0.00	0.25	1.50	2.75	3.25	3.25	3.25	3.00	3.00	0.00	3.25	3.00
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	2yr UST	0.25	0.50	1.75	3.00	3.50	3.50	3.50	3.25	3.25	0.25	3.50	3.25
	10yr UST	0.73	2.33	3.25	3.60	3.60	3.60	3.40	3.20	3.00	0.73	3.35	3.50
Germany	ECB refi rate	1.51	2.34	3.30	3.60	3.50	3.40	3.25	3.00	3.00	1.51	3.50	3.20
	ECB depo rate	0.00	0.00	0.00	0.50	1.25	1.50	1.50	1.50	1.50	0.00	1.25	1.50
	2yr Schatz	-0.50	-0.50	-0.50	0.25	1.00	1.25	1.25	1.25	1.25	-0.50	1.00	1.25
	10yr Bunds	-0.64	-0.07	1.20	1.25	1.30	1.35	1.35	1.35	1.35	-0.64	1.30	1.35
Japan	IOER	-0.18	0.55	1.70	1.90	1.75	1.60	1.50	1.40	1.35	-0.18	1.75	1.35
	IOER	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
	2yr JGB	-0.09	-0.03	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.05	-0.09	-0.10	-0.05
China	10yr JGB	0.07	0.22	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.07	0.20	0.20
	Policy rate	3.80	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.80	3.70	3.70
	2yr gov bond	2.39	2.31	2.50	2.60	2.75	2.90	2.95	3.00	3.05	2.39	2.75	3.05
	10yr gov bond	2.77	2.79	2.95	3.00	3.10	3.20	3.25	3.30	3.35	2.77	3.10	3.35

SMBC FX Forecast

		2021	2022				2023				2021	2022	2023
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	110.82 ~ 111.52	113.47 ~ 125.09	121.67 ~ 140.00	125.00 ~ 147.00	125.00 ~ 143.00	120.00 ~ 138.00	120.00 ~ 135.00	120.00 ~ 133.00	117.00 ~ 130.00	102.59 ~ 115.52	113.47 ~ 140.00	117.00 ~ 130.00
		End of period	115.08	121.70	135.00	137.00	132.00	128.00	125.00	123.00	120.00	115.08	132.00
EUR/USD	Range	1.1186 ~ 1.1692	1.0806 ~ 1.1495	1.0200 ~ 1.1076	1.0000 ~ 1.1100	1.0100 ~ 1.1200	1.0200 ~ 1.1300	1.0400 ~ 1.1500	1.0500 ~ 1.1600	1.0700 ~ 1.1800	1.1186 ~ 1.2349	1.0000 ~ 1.1495	1.0200 ~ 1.1800
		End of period	1.1370	1.0670	1.0500	1.0600	1.0700	1.0800	1.1100	1.1100	1.1300	1.11370	1.0700
USD/CAD	Range	1.2321 ~ 1.2940	1.2477 ~ 1.2885	1.2400 ~ 1.3300	1.2400 ~ 1.3300	1.2200 ~ 1.3100	1.2100 ~ 1.3000	1.2100 ~ 1.3000	1.2000 ~ 1.2900	1.1900 ~ 1.2800	1.2035 ~ 1.2940	1.2200 ~ 1.3300	1.1900 ~ 1.3000
		End of period	1.2637	1.2505	1.2900	1.2800	1.2600	1.2500	1.2500	1.2400	1.2300	1.2637	1.2600
CAD/JPY	Range	87.77 ~ 92.75	89.77 ~ 98.60	97.87 ~ 106.87	102.00 ~ 111.00	100.00 ~ 111.00	98.00 ~ 109.00	95.00 ~ 106.00	95.00 ~ 106.00	93.00 ~ 104.00	80.69 ~ 92.75	89.77 ~ 111.00	93.00 ~ 109.00
		End of period	91.08	97.35	104.65	107.03	104.76	102.40	100.00	99.19	97.56	91.08	104.76
EUR/JPY	Range	127.39 ~ 133.48	124.40 ~ 137.53	132.66 ~ 146.00	136.00 ~ 151.00	134.00 ~ 149.00	131.00 ~ 146.00	130.00 ~ 145.00	129.00 ~ 144.00	128.00 ~ 143.00	125.09 ~ 134.13	124.40 ~ 151.00	128.00 ~ 146.00
		End of period	130.90	134.67	141.75	145.22	141.24	138.24	137.50	136.50	135.60	130.90	141.24
Oil price (WTI futures)		77.10	95.01	110.00	112.50	103.50	100.00	90.00	93.00	95.00	68.08	105.25	94.50