

Weekly Update of U.S. Economy

Junko Nishioka
Chief Economist
Sumitomo Mitsui Banking Corporation

(212) 224-4568
junko_nishioka@smbcgroup.com

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Softening Final Demand Would Motivate Fed to Keep Policy on Hold

Signs of Softening Final Demand

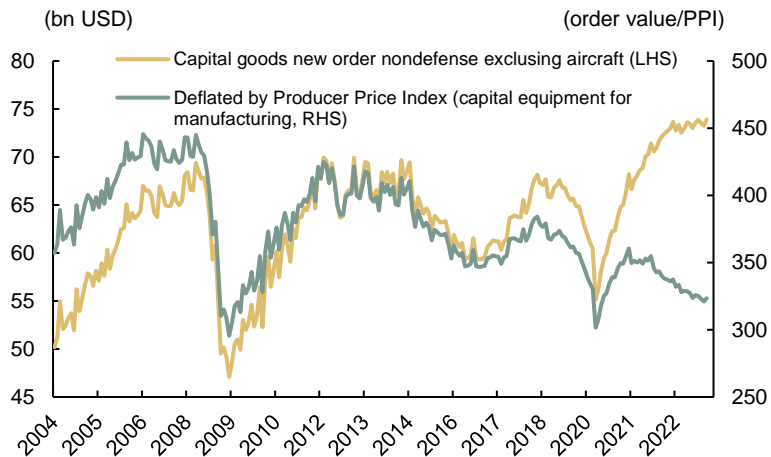
- If we look at economic data released this week, we notice some indicators that call for a cautious view, such as a decline in sales in the new housing market and a slow recovery in orders for durable goods. However, despite the high policy interest rate exceeding 5% and the corresponding rise in market interest rates, they do not point to a downturn significant enough to motivate the Federal Reserve Board (the “Fed”) to consider pivoting its policy stance.
- August capital goods new orders (nondefense, excluding aircraft) increased by 0.9% from the previous month. Smoothing out fluctuations shows the core order value has continued to increase at a moderate pace since September of last year. After deducting inflation, core capital goods orders have been declining since the end of 2021, but the pace of decline has moderated recently.
- Sales of new homes in August (annualized rate) fell to 675,000, after increasing for three consecutive months. Both the new housing and the existing home market bottomed out at the beginning of this year. However, sales are being put under pressure again with the home price increase and the rise in mortgage rates.
- Home prices have risen again as inventories have not yet recovered enough to meet the demand from potential buyers. The recent resumption of the rise in mortgage rates has clearly disappointed potential buyers.
- If the resurgence in home prices becomes entrenched, it will present a new challenge to the Fed’s monetary authorities, who so far seem to have been successful in tightening monetary policy and keeping the economy on track for a soft landing. If the acceleration in of house-price growth spills over into the rental market, it will inevitably lead to a reacceleration of the Consumer Price Index.

Fed Will Keep Policy on Hold

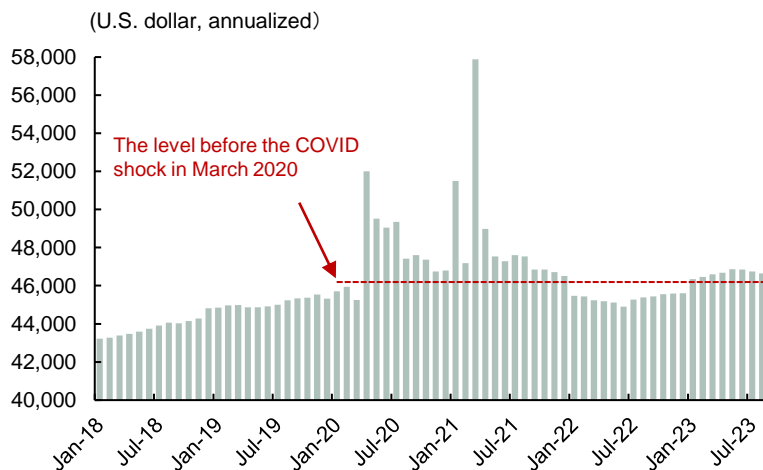
- As heard from senior Fed officials, the Fed is willing to raise interest rates further to curb inflation. However, this is a logical stance for a central bank whose top priority is to suppress inflation, and it is also intended to produce an “announcement effect”, i.e., one that can have an impact without any concrete action.
- In this sense, the fact that real income in the household sector has gradually peaked out is probably good news for the Fed, which wants to suppress final demand in the private sector.
- However, even raising interest rates has not had a clear effect on suppressing demand, except in interest rate-sensitive sectors such as the housing market and corporate capex. This is due to the fact that the U.S. private sector tends to have excess savings from a macro perspective.
- Excess savings in the household sector, boosted by fiscal measures since early 2020, are certainly returning to normal. However, we must account for the wealth effect of high-income earners who have not yet satisfied their consumer appetite.
- In the corporate sector, net interest payments are decreasing despite the rise in market interest rates. Corporate bond issuance has increased, and bank borrowing has accumulated, so interest payments have increased on a gross basis, but companies have lengthened the duration of their debt as interest rates declined in the wake of the 2020 COVID shock. Additionally, companies that have increased cash flow due to the recent economic expansion are enjoying returns by investing their surplus funds in the market.
- Under these circumstances, unless asset prices fall substantially or dollar-funding costs rise significantly, interest-rate cuts will be a long way off.

Softening Final Demand Would Motivate Fed to Keep Policy on Hold (cont.)

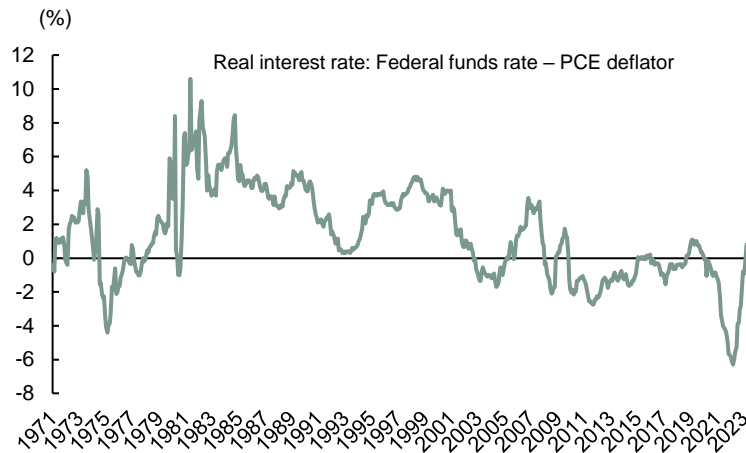
Capital goods orders have leveled off.



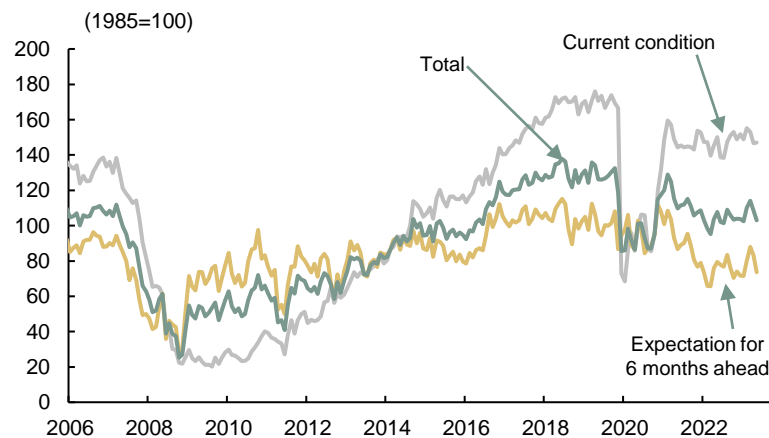
Households' real disposable income per capita appears to have peaked out.



The real interest rate is now as high as in September 2007.



The consumer confidence index slid due to pessimism over the future.



Sources: U.S. Census Bureau, Bureau of Economic Analysis, Conference Board

SMBC Economy and Rates Forecast

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
U.S.	Real GDP (saar)	-0.6	3.2	2.6	2.0	2.1	2.5	1.2	0.6	1.0	1.2	1.7	6.0	2.1	2.1	1.2
	Inflation rate (YoY)	5.0	5.0	4.8	4.7	4.4	4.0	3.6	3.0	2.7	2.6	2.5	3.3	5.0	4.2	2.7
	Jobless rate	3.6	3.6	3.6	3.5	3.6	3.4	3.6	3.9	4.1	4.2	4.3	5.4	3.7	3.7	4.4
Euro area	Real GDP (qoq)	0.8	0.4	-0.1	0.0	0.3	0.2	0.1	0.2	0.3	0.3	0.2	5.3	3.3	0.6	0.9
	Inflation rate (YoY)	8.0	9.3	10.0	8.0	6.2	4.8	3.2	3.1	2.9	2.7	2.5	2.6	8.4	5.6	2.8
	Jobless rate	6.7	6.7	6.7	6.6	6.6	6.6	6.7	6.8	6.8	6.9	6.9	7.7	6.7	6.6	6.9
Japan	Real GDP (saar)	5.6	-1.5	0.2	3.7	6.0	0.9	0.9	0.9	0.9	1.1	0.7	2.3	1.0	1.5	1.0
	Inflation rate (YoY)	2.1	2.7	3.8	3.5	3.2	3.0	2.5	3.0	2.8	2.5	2.1	-0.2	2.3	3.0	2.6
	Jobless rate	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP (YoY)	0.4	3.9	2.9	4.5	6.3	4.8	5.5	4.5	5.0	5.1	5.1	8.4	3.0	5.3	4.9
	Inflation rate (YoY)	2.2	2.8	1.8	1.3	0.2	0.0	0.6	1.1	1.5	1.8	2.0	0.8	1.7	0.5	1.6
	Jobless rate	5.8	5.4	5.6	5.5	5.2	5.3	5.2	5.1	5.0	5.0	5.0	5.1	5.1	5.3	5.0

Rates		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
U.S.	FF target range	4.25	4.75	5.00	5.25	5.25	5.25	5.00	5.00	4.75	4.25	5.25	4.75
		~	~	~	~	~	~	~	~	~	~	~	~
	2yr UST	4.50	5.00	5.25	5.50	5.50	5.50	5.25	5.25	5.00	4.50	5.50	5.00
	10yr UST	3.87	3.47	3.84	4.50	4.20	4.00	3.90	4.00	4.00	3.87	4.20	4.00
Germany	ECB refi rate	2.50	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	2.50	4.25	3.75
	ECB depo rate	2.00	3.00	3.50	3.75	3.75	3.75	3.75	3.50	3.25	2.00	3.50	3.25
	2yr Schatz	2.50	2.68	3.20	3.20	3.00	2.80	2.50	2.40	2.30	2.50	3.00	2.30
	10yr Bunds	2.20	2.29	2.39	2.30	2.30	2.30	2.20	2.10	2.10	2.20	2.30	2.10
Japan	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	0.04	-0.06	-0.07	0.10	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr JGB	0.42	0.35	0.40	0.65	0.75	0.80	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.65	2.50	2.40	2.40	2.40	2.40	2.40	2.75	2.40	2.40
	2yr gov bond	2.39	2.41	2.11	2.05	2.05	2.08	2.15	2.25	2.35	2.39	2.05	2.35
	10yr gov bond	2.83	2.85	2.64	2.64	2.45	2.50	2.55	2.60	2.65	2.83	2.45	2.65

Source: SMBC

SMBC FX Forecast

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58 ~ 151.95	127.23 ~ 137.91	130.64 ~ 145.07	137.25 ~ 149.71	133.00 ~ 147.00	131.00 ~ 145.00	126.00 ~ 140.00	128.00 ~ 142.00	128.00 ~ 130.00	113.47 ~ 151.95	127.23 ~ 149.71	126.00 ~ 145.00
		End of period	133.00	132.86	144.31	149.00	140.00	138.00	133.00	135.00	135.00	131.12	140.00
EUR/USD	Range	0.9633 ~ 1.0735	1.0484 ~ 1.1033	1.0635 ~ 1.1095	1.0488 ~ 1.1276	1.0200 ~ 1.1200	1.0100 ~ 1.1100	1.0000 ~ 1.1000	1.0100 ~ 1.1100	1.0100 ~ 1.1100	0.9536 ~ 1.1495	1.0200 ~ 1.1276	1.0000 ~ 1.1100
		End of period	1.0705	1.0839	1.0909	1.0550	1.0600	1.0500	1.0500	1.0600	1.0600	1.0705	1.0600
USD/CAD	Range	1.3275 ~ 1.3885	1.3291 ~ 1.3832	1.3151 ~ 1.3642	1.3110 ~ 1.3685	1.3000 ~ 1.4200	1.3000 ~ 1.4200	1.3000 ~ 1.4200	1.2800 ~ 1.4000	1.2700 ~ 1.3800	1.2477 ~ 1.3885	1.3000 ~ 1.4200	1.2700 ~ 1.4200
		End of period	1.3554	1.3516	1.3242	1.3500	1.3600	1.3500	1.3500	1.3400	1.3300	1.3554	1.3600
CAD/JPY	Range	96.76 ~ 109.11	95.13 ~ 100.59	97.54 ~ 109.21	105.02 ~ 110.86	97.00 ~ 109.00	96.00 ~ 108.00	92.00 ~ 104.00	94.00 ~ 107.00	94.00 ~ 107.00	89.77 ~ 110.06	95.13 ~ 110.86	92.00 ~ 108.00
		End of period	96.76	98.28	109.04	110.37	103.00	102.20	98.50	100.75	101.50	96.76	103.00
EUR/JPY	Range	138.81 ~ 148.40	138.19 ~ 145.67	143.12 ~ 157.92	151.42 ~ 159.76	144.00 ~ 158.00	138.00 ~ 152.00	133.00 ~ 147.00	136.00 ~ 150.00	136.00 ~ 150.00	124.40 ~ 148.40	137.39 ~ 159.76	133.00 ~ 152.00
		End of period	140.41	144.01	157.43	157.20	148.40	144.90	139.65	143.10	143.10	140.41	148.40
Oil price (WTI futures)		82.64	75.99	73.67	82.23	82.00	82.00	76.00	77.00	78.00	98.74	77.92	78.25

Source: SMBC