Weekly Update of U.S. Economy

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The Effect of the Rise in Long-Term Interest Rates

The Economy Appears to Be in a Good Position

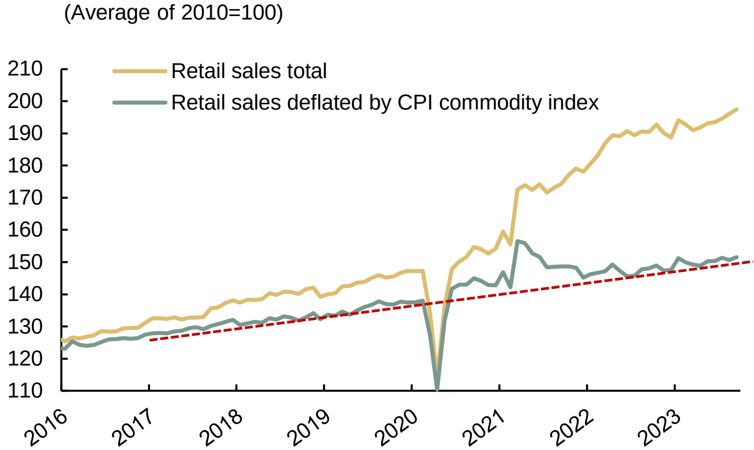
- Economic indicators are generally favorable, with the inflation rate appearing to be steadily slowing down, and the tightening of monetary policy thus far seems to be successfully guiding the economy to a soft landing.
- Retail sales in September grew by 0.7% from the previous month, increasing for the sixth consecutive month. The control group, which excludes volatile items such as automobiles, also increased by 0.6%. After deducting the price fluctuations from inflation figures, the overall index turned to an increase of 0.6% from the previous month. Contrary to the pessimistic view for household consumption that the consumption would decline if households used up the excess savings that had been boosted by government income transfers in a fiscal package after the COVID-19 shock, it appears to have gained growth momentum at a pace above the 2020 pre-pandemic period.
- The industrial production index for September increased by 0.3% compared to the previous month, and the manufacturing industry also registered a production increase of 0.4%.
- Production capacity has been gradually improving due to the increase in production equipment, the expansion of the number of employees, and the increase in working hours.
- In other words, while demand is strong as observed in better-than-expected retail sales, supply is improving at the same time, and the abnormal tightness in the macro supply-demand balance has eased. The Federal Reserve Board (the “Fed”) is concerned that aggressive interest-rate hikes could lead to a significant drop in demand, but in reality, the situation is more favorable for the Fed, with upward pressure on prices easing as both supply and demand improve.
- Against this backdrop, the focus this week was on the tone in which Fed Chair Jerome Powell would express the need for further interest-rate hikes.

Fed Chair Acknowledges Impact of Rise in Long-Term Yields

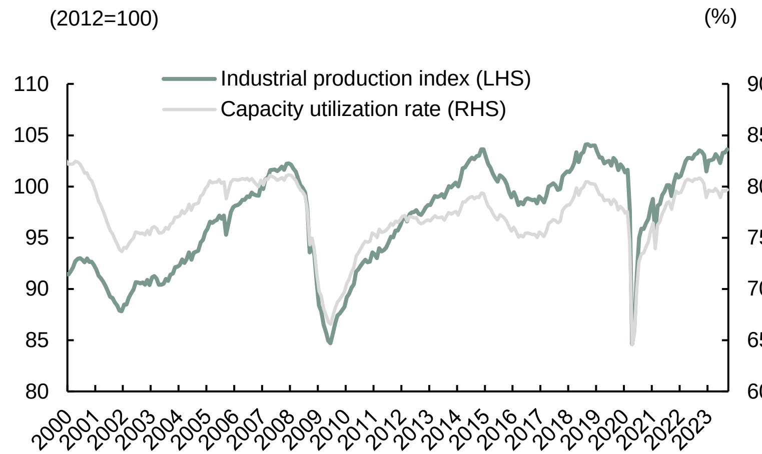
- In a speech on October 19, Chair Powell suggested that further interest-rate hikes are unlikely unless there is clear evidence that strong economic activity jeopardizes progress in controlling inflation. Although he emphasized that inflation risks still remain, he seems to have gained a certain level of confidence from the fact that the pace of price increases has been gradually moderating since last fall.
- It is important that the Fed chair mentioned the recent rise in market interest rates as one of the grounds for determining that there is not necessarily a clear need for additional interest-rate hikes. The 10-year Treasury yield briefly surpassed the 5% milestone this week, its highest level since 2007.
- Stock prices are also somewhat weak against the backdrop of rising market interest rates, driven by rising risk premiums. Maintaining stock prices is not the responsibility of the central bank, but given the fact that the current U.S. economy, and especially consumer spending, is strongly dependent on asset prices remaining high, the Fed may also be concerned about tightening confidence, which would put significant downward pressure on asset prices.
- Broken down by income group, the deficit in the annual balance of the low-income group is widening, while the surplus in the balance of income and expenditures of the high-income group is expanding at a rapid pace, making the fault line between them even clearer.
- Even if the policy interest rate reaches its current ceiling (terminal) of 5.25%-5.50%, it will take nearly two years for the quantitative easing policy to be reinstated. If the Fed also believes that the accumulation of excess liquidity during that period will ensure the stability of dollar liquidity and, as a result, will contribute in no small measure to the rise in asset prices, then it is assumed that the Fed will not reconsider its stance just because economic indicators are strong. Rather than raising interest rates, we believe the central bank will place emphasis on a strategy of maintaining a high-interest-rate policy for a long period of time, and prioritize avoiding large adjustments in asset prices.

The Effect of the Rise in Long-Term Interest Rates (continued)

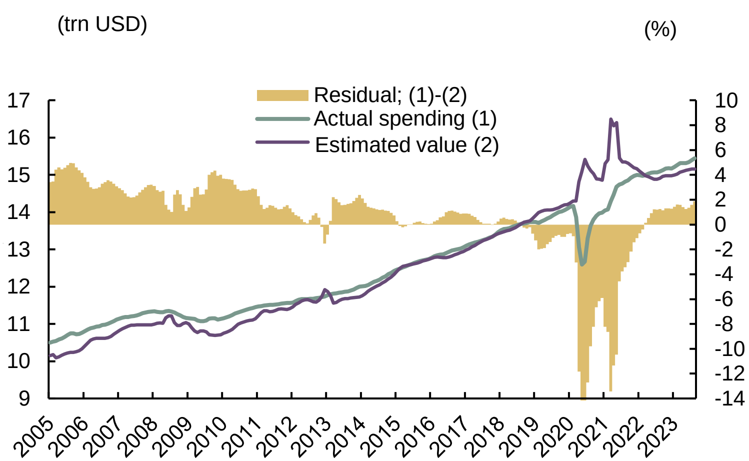
Retail sales continued to grow at a steady pace, in contrast to the market's fears that a lack of excess savings would have depressed household consumption.



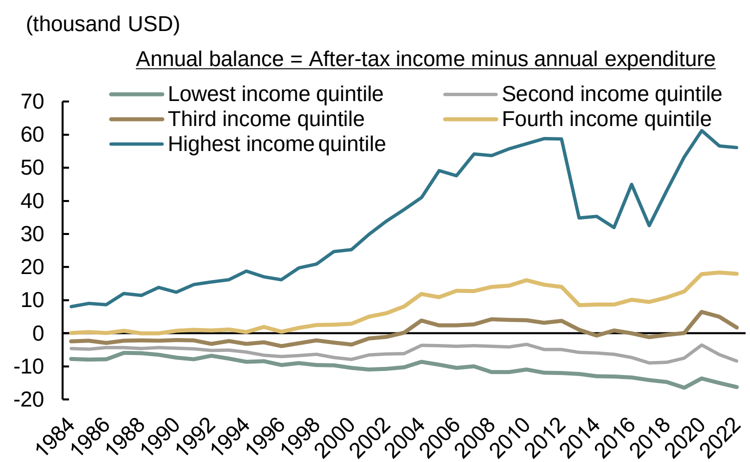
Inventory adjustments have come to an end, and production is on a gradual recovery trend.



Although personal consumption continues to exceed the theoretical value, it has not yet recovered even half of the decline following the pandemic.



The annual balance of low-income people is in deep deficit. The U.S. economy depends on the expansion of consumption by high-income groups who benefit from the wealth effect.



Sources: Bureau of Labor Statistics, Federal Reserve Board, U.S. Census Bureau

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	2.7	2.6	2.2	2.1	2.5	1.2	0.6	1.0	1.2	1.7	5.9	2.1	2.1	1.2
	Inflation rate (YoY)	5.2	5.2	5.1	4.8	4.6	4.0	3.6	3.0	2.7	2.6	2.5	3.6	5.2	4.2	2.7
	Jobless rate	3.6	3.6	3.6	3.5	3.6	3.7	3.9	4.2	4.4	4.4	4.5	5.4	3.7	3.7	4.4
Euro area	Real GDP (qoq)	0.8	0.3	-0.1	0.1	0.1	0.0	0.1	0.2	0.3	0.3	0.4	5.6	3.4	0.5	0.8
	Inflation rate (YoY)	8.0	9.3	10.0	8.0	6.2	5.1	3.2	3.3	3.2	3.0	2.8	2.6	8.4	5.6	3.1
	Jobless rate	6.7	6.7	6.7	6.6	6.4	6.5	6.6	6.7	6.8	6.8	6.8	7.7	6.7	6.5	6.8
Japan	Real GDP (saar)	5.6	-1.2	0.2	3.2	4.8	0.9	0.8	0.9	0.9	1.1	0.1	2.2	1.0	1.5	1.0
	Inflation rate (YoY)	2.1	2.7	3.8	3.5	3.2	2.9	2.5	2.9	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	4.4	4.8	3.7	4.1	4.6	5.0	8.4	3.0	5.0	4.4
	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 ~ 4.50	4.75 ~ 5.00	5.00 ~ 5.25	5.25 ~ 5.50	5.25 ~ 5.50	5.25 ~ 5.50	5.00 ~ 5.25	5.00 ~ 5.25	4.75 ~ 5.00	4.25 ~ 4.50	5.25 ~ 5.50	4.75 ~ 5.00
	2yr UST	3.43	4.03	4.90	5.04	5.00	5.00	4.75	4.75	4.75	3.43	5.00	4.75
	10yr UST	3.87	3.47	3.84	4.57	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	4.50	4.50	4.50	4.50	4.25	4.00	2.50	4.50	4.00
	ECB depo rate	2.00	3.00	3.50	4.00	4.00	4.00	4.00	3.75	3.50	2.00	4.00	3.50
	2yr Schatz	2.50	2.68	3.20	3.20	3.00	2.80	2.60	2.40	2.30	2.50	3.00	2.30
	10yr Bunds	2.20	2.29	2.39	2.84	2.50	2.30	2.20	2.10	2.10	2.20	2.50	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	0.05	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr JGB	0.42	0.35	0.40	0.77	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	2.50	2.50	2.50	2.50	2.50	2.75	2.50	2.50
	2yr gov bond	2.39	2.41	2.11	2.26	2.27	2.32	2.37	2.47	2.52	2.39	2.27	2.52
	10yr gov bond	2.83	2.85	2.64	2.67	2.62	2.67	2.72	2.77	2.82	2.83	2.62	2.82

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	138.00 ~ 152.00	133.00 ~ 147.00	126.00 ~ 140.00	128.00 ~ 142.00	128.00 ~ 130.00	113.47 ~ 151.95	127.23 ~ 152.00	126.00 ~ 147.00
	End of period	133.00	132.86	144.31	149.37	145.00	140.00	133.00	135.00	135.00	131.12	145.00	135.00
EUR/USD	Range	0.9633 ~ 1.0735	1.0484 ~ 1.1033	1.0635 ~ 1.1095	1.0488 ~ 1.1276	1.0100 ~ 1.1100	1.0000 ~ 1.1000	1.0100 ~ 1.1100	1.0100 ~ 1.1100	1.0200 ~ 1.1200	0.9536 ~ 1.1495	1.0100 ~ 1.1276	1.0000 ~ 1.1200
	End of period	1.0705	1.0839	1.0909	1.0573	1.0500	1.0400	1.0500	1.0600	1.0600	1.0705	1.0500	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	1.3577	1.3600	1.3500	1.3500	1.3400	1.3300	1.3554	1.3600	1.3300
CAD/JPY	Range	96.76 ~ 109.11	95.13 ~ 100.59	97.54 ~ 109.21	105.02 ~ 110.86	100.00 ~ 115.00	99.00 ~ 113.00	92.00 ~ 104.00	94.00 ~ 107.00	94.00 ~ 107.00	89.77 ~ 110.06	95.13 ~ 115.00	92.00 ~ 113.00
	End of period	96.76	98.28	109.04	110.01	106.60	103.70	98.50	100.75	101.50	96.76	106.60	101.50
EUR/JPY	Range	138.81 ~ 148.40	138.19 ~ 145.67	143.12 ~ 157.92	151.42 ~ 159.76	148.00 ~ 162.00	141.00 ~ 155.00	135.00 ~ 149.00	135.00 ~ 149.00	136.00 ~ 150.00	124.40 ~ 148.40	137.39 ~ 162.00	135.00 ~ 155.00
	End of period	140.41	144.01	157.43	157.93	152.25	145.60	139.65	143.10	143.10	140.41	152.25	143.10
Oil price (WTI futures)		82.64	75.99	73.67	82.23	89.50	85.50	79.50	79.50	80.00	98.74	80.35	81.38

Source: SMBC