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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Inflation Pressures Persist

Rising Service Prices Impede a Return to the Inflation Target

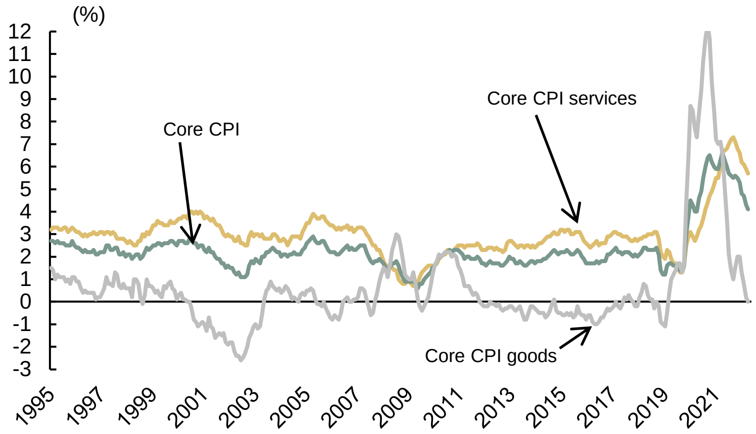
- The Consumer Price Index (CPI) for September, released this week, was slightly higher than expected, and did not meet the Federal Reserve Board's (the "Fed") expectations for a stabilization of inflation. Core CPI, which excludes energy and food, increased by 0.32%, which accelerated from 0.28% in the previous month. Although inflation has slowed moderately after the peak in the middle of last year, it has not yet reached a level that gives the central bank confidence in achieving its inflation target in a stable manner.
- The CPI of goods excluding energy (core goods) decreased by 0.4% from the previous month for the third consecutive month. As for automobiles, while prices for new cars rose for the second consecutive month, prices for used cars fell by 2.5%, accelerating the pace of decline. In general, core goods are becoming more disinflationary.
- Historically, the price change of core goods is close to zero when the fluctuations are smoothed out, and the overall situation is disinflationary. The reason prices in the United States continue to rise is because service prices continue to increase. If we overlook past economic recessions, core services, excluding electricity charges, etc., would have stabilized at around 3% growth.
- Core services grew 5.9% year over year in September, continuing to grow at nearly double the pace of the previous economic expansionary period. The acceleration of the rent price increase accounts for a large part of overall inflation.
- The housing market has not seen a full-scale recovery in construction due to the impact of high interest rates. If inventory shortages continue, real estate prices will rise, and lenders who want to maintain yields will remain motivated to raise rents. The Fed had believed that rent growth would eventually slow down in the process of renewal of the rent negotiations, but the current pace of slowdown in rent increases is clearly slower than the Fed had expected.

Opinions Divided on the Need for Additional Rate Hike

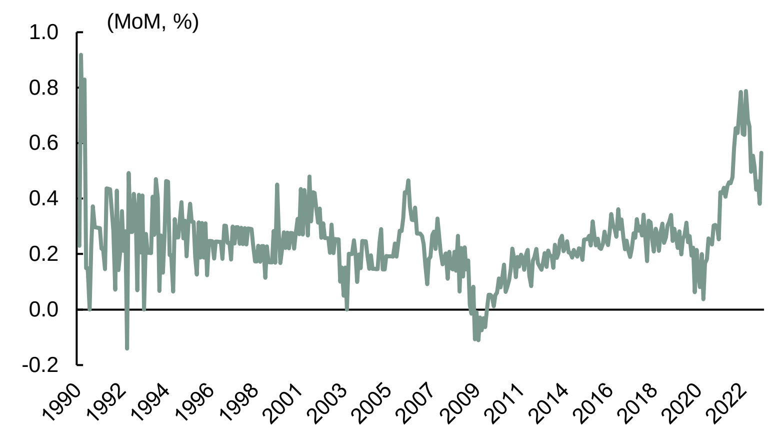
- Although inflation pressures are diminishing at a slower pace than expected, it is still plausible to argue that they are on the way to easing and that there is no need for further rate hikes unless this trend is reversed. Concerns that the tense situation in the Middle East will increase the risk of a recession also add to the argument that further interest-rate hikes are unnecessary. There is also speculation that the rise in market interest rates would finally suppress domestic demand.
- In the middle of last year, some market participants believed that the U.S. economy would be in recession in 2023. However, the economy remained stable despite the rapid pace of interest-rate hikes and continued high inflation as the economy's sensitivity to interest rates has been low on the back of ample excess savings.
- However, when this buffer against interest costs runs out, negative pressure appears on the economy. What we should be paying attention to now is at what point will consumers' evaluations of their financial situation suddenly deteriorate. According to a report conducted by the Federal Reserve Bank of New York, the number of consumers who are more cautious about their future cash flow forecasts is increasing.
- In fact, the policy stances of senior Fed officials seem to be divided into two groups: those who support making a full commitment to suppress inflation through one final rate hike, and those who hope for the cumulative effect of continuing the current monetary tightening for a long time.
- If economic indicators continue to be strong, there is a high possibility that the Federal Open Market Committee (FOMC) will raise interest rates again on November 1. However, if market interest rates rise further during that time or asset prices decline due to concerns over monetary policy tightening or geopolitical risks, the effects of cumulative monetary tightening will become stronger even if the FOMC does not raise interest rates further.

Inflation Pressures Persist (continued)

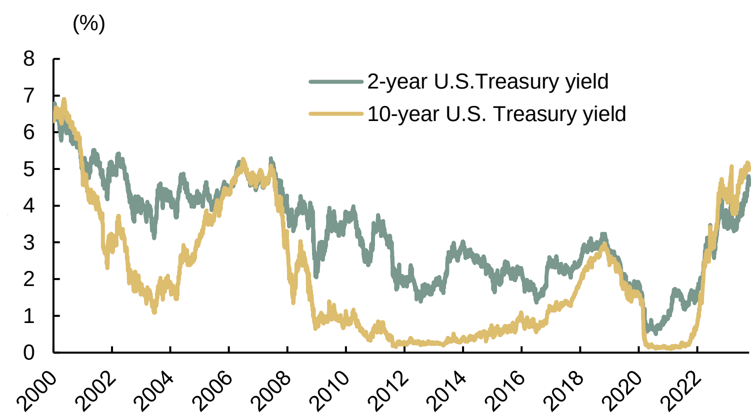
Inflation is on a path of stabilization. But the pace is slower than initially expected, driven by higher core service inflation.



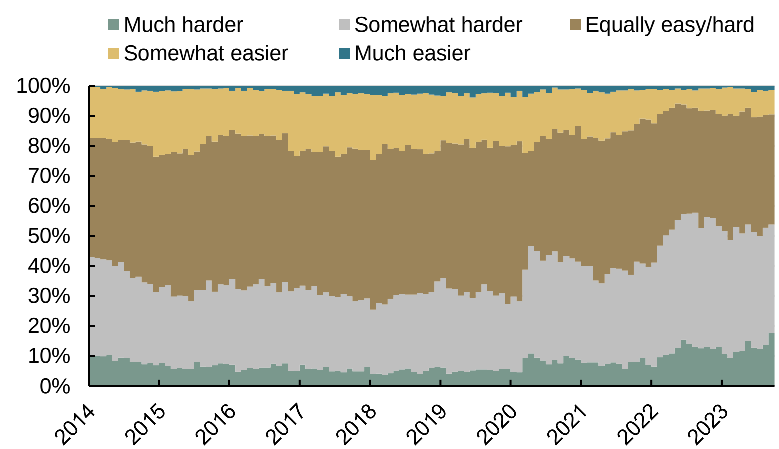
Rent prices are still far from their normal range.



Better-than-expected economic data have led interest rates higher across the curve.



Consumers' credit ability has been gradually trending tighter as interest rates increase.



Sources: Bureau of Labor Statistics, Institute for Supply Management, Bloomberg, Federal Reserve Bank of New York

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	2.30	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	0.05	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	2.40	2.40	2.40	2.40	2.40	2.75	2.40	2.40
	2yr gov bond	2.39	2.41	2.11	2.20	2.10	2.18	2.25	2.35	2.45	2.39	2.10	2.45
	10yr gov bond	2.83	2.85	2.64	2.60	2.55	2.60	2.65	2.70	2.75	2.83	2.55	2.75

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

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