



# Quarterly Macroeconomic Outlook Update

August 18, 2022

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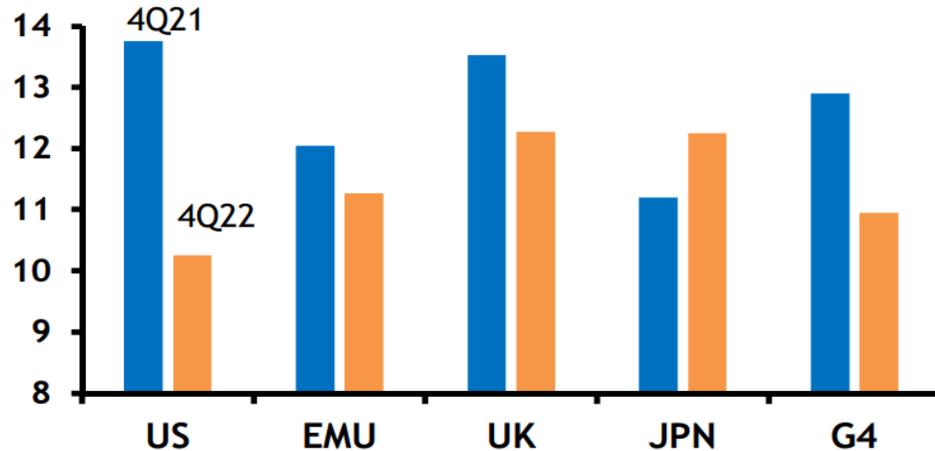
# Global Economic Expansion Moderating, Not Collapsing

- **Key Underpinnings of Global Expansion Discussed in April Still Largely in Place**
  - Strong consumer and business financial positions / robust employment
- **Inflation, However, More Persistent Than Expected**
  - Despite some welcomed easing in commodity prices...
  - Developed Market core inflation still elevated and wage pressures continuing to build
  - Inflationary concerns depressing consumer confidence and moderating PMIs
- **Major Developed Market Central Banks Have Become More Hawkish (ex. Japan & China)**
  - Markets seemingly confident that central banks will tame inflation
  - Financial conditions have eased in recent months
- **Key Questions Coming to the Fore**
  - Possible collateral, damage from central banks tightening...
    - Will it cause recessions and if so, how severe?
  - China's recent slowing; aberration or new regime?
  - Impact of rising geopolitical tensions on cyclical outlook?

# Representative Indicators of Expansion's Continuing Strong Underpinnings

## Excess Household Saving

% of HH income, cum. saving since 4Q19 less 2019 pace



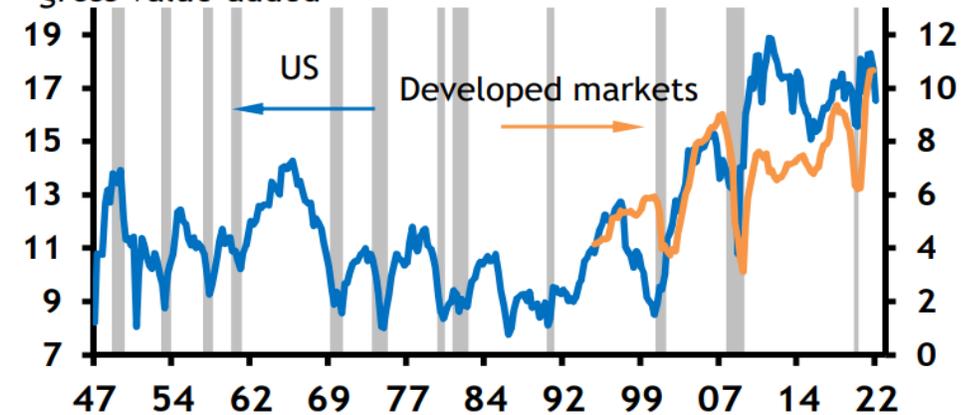
Source: JPM

- G4 consumers accumulated unprecedented saving during the pandemic
- Even though consumers have started to draw down their excess savings, their savings are still expected to be equivalent to ~111% of household income at year end

## Corporate Profit Margins

%; NIPA after-tax profits gross value-added

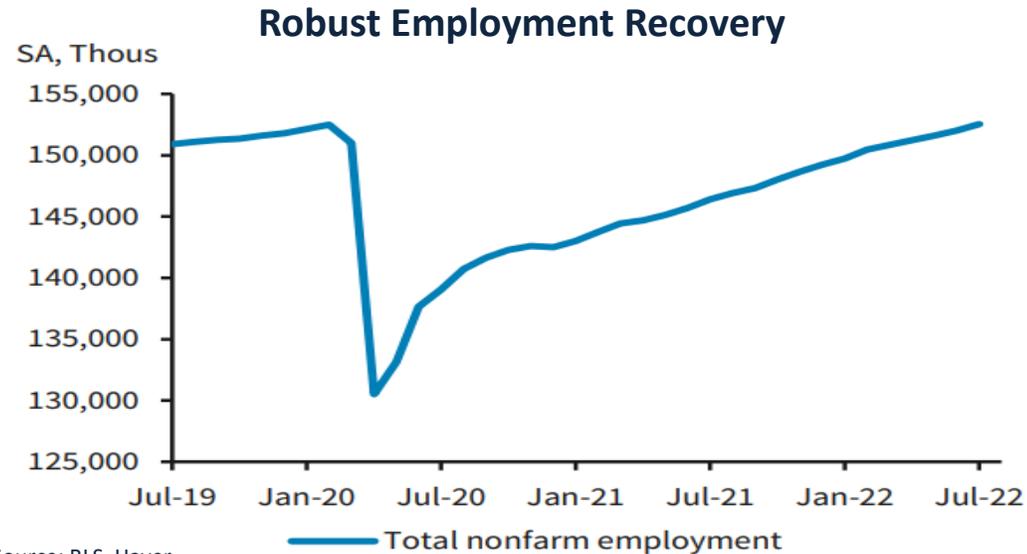
%, MSCI earnings/revenue



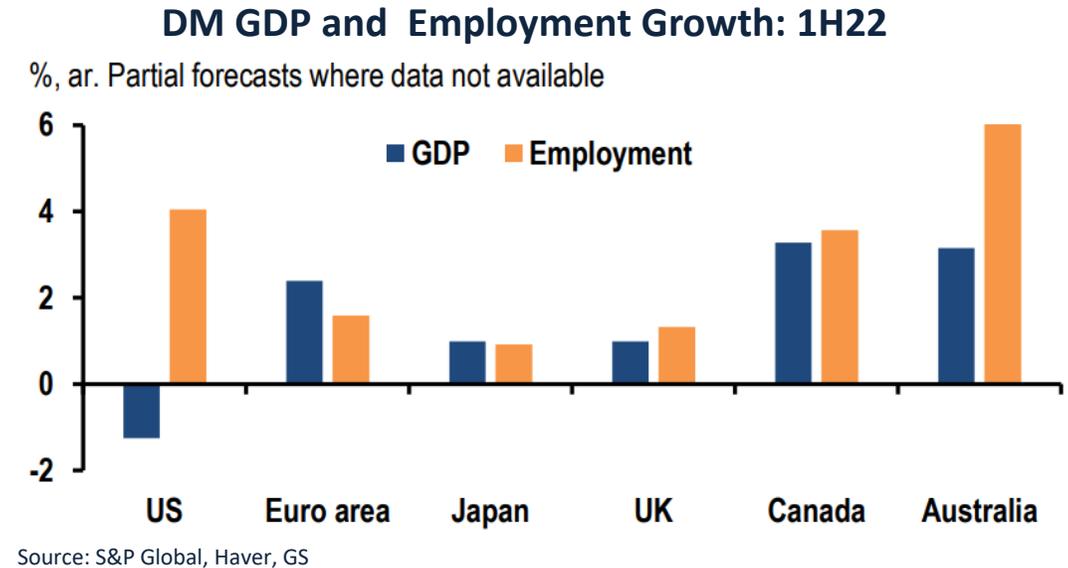
Source: MSCI, JPM

- DM profit margins at near-record levels
- Post-pandemic productivity rebound and more recently increasing pricing power have contributed to strength in profit margins

# Representative Indicators of Expansion's Continuing Strong Underpinnings



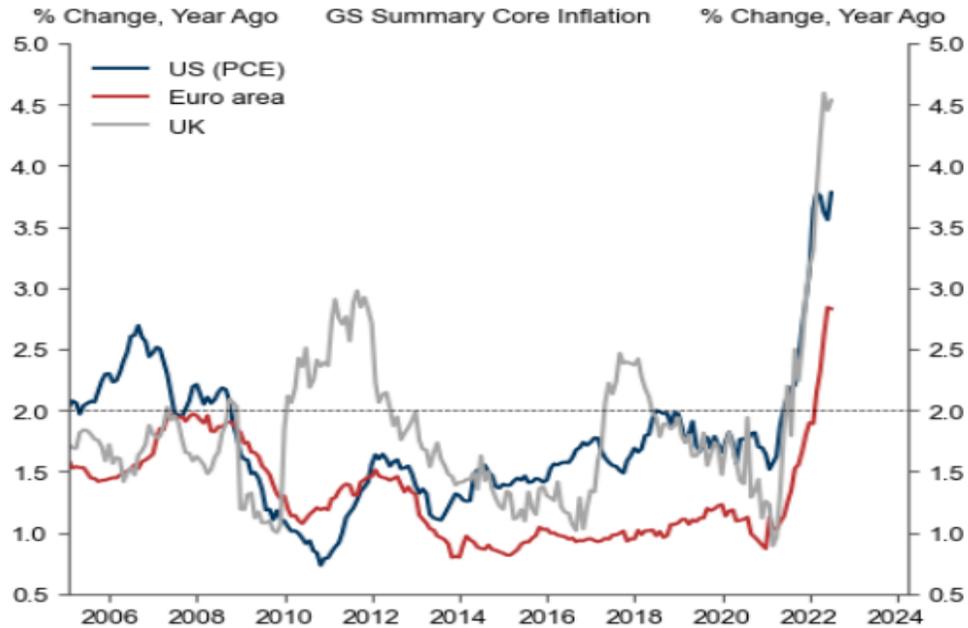
- US payroll employment soared to 153 million in July, surpassing pre-pandemic levels
- Unemployment rates at historical lows: 3.5% in US, 3.8% in the UK and 6.6% in Euro area



- Employment strong in major DMs in first half of year...
- Outstripping GDP growth in US, UK, and Australia
- Robust employment growth and tight labor markets potential source of resilience

# Elevated Core Inflation / Building Wage Pressures Concerns

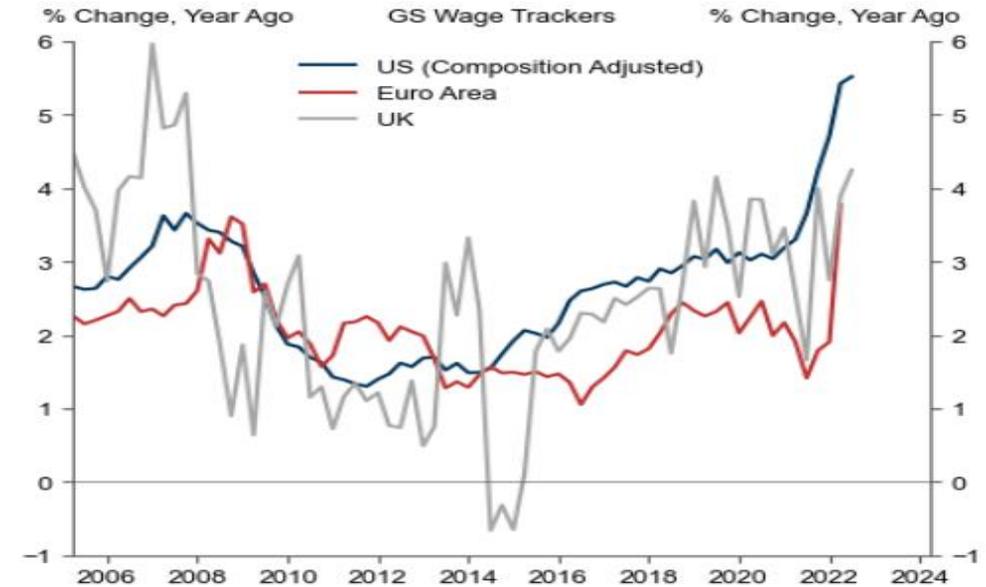
## Core Inflation



Source: GS

- Core inflation is still far above target in US, UK and Euro area
- Caveat re chart, core plots are trimmed estimates that eliminate 1/3<sup>rd</sup> of extreme changes for individual components. “Untrimmed” UK core inflation is currently 6.2% oya

## Wage Pressures

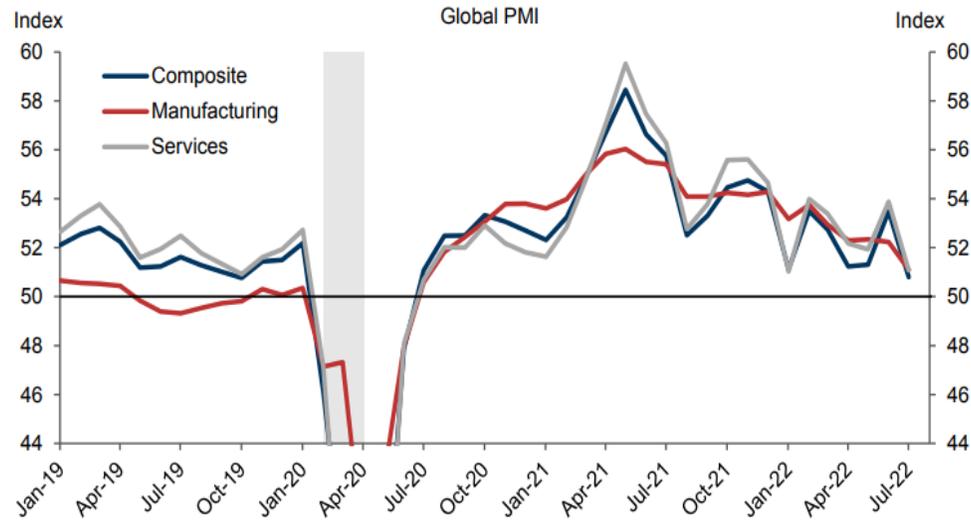


Source: GS

- Wage trackers indicate that wages are accelerating in the UK and Euro area but not as rapidly as in the US

# Inflation Global Headwind: PMIs Moderating / Consumer Confidence Weak

## Global PMIs

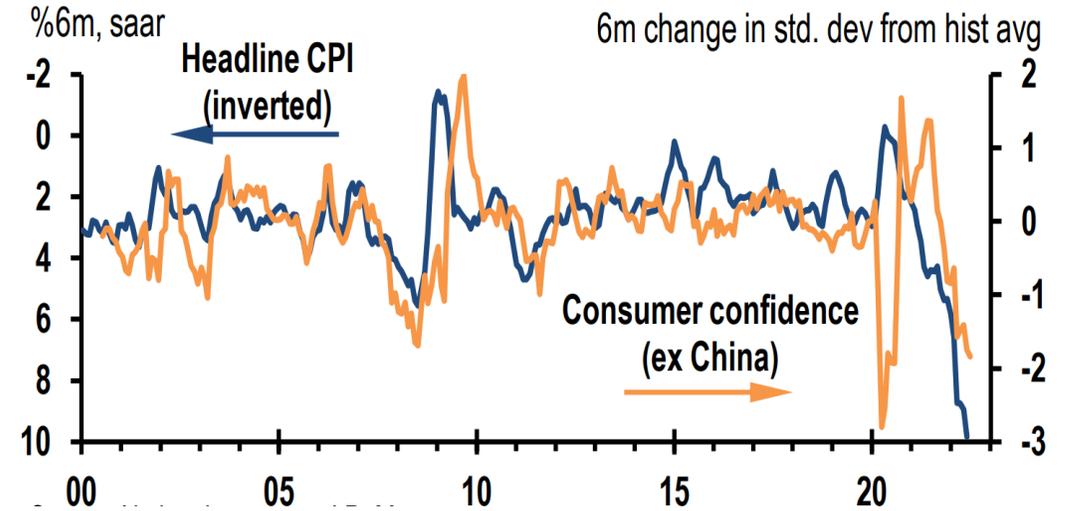


Note: grey bars denote US recession.

Source: S + P Global, Haver, GS  
As at August 2022

- Global composite PMI decreased nearly 3pts in July to 50.8
- Manufacturing and services both at 51
- New orders, a forward indicator, decreased in month to ~54, still consistent with expansion but lowest since May 2020

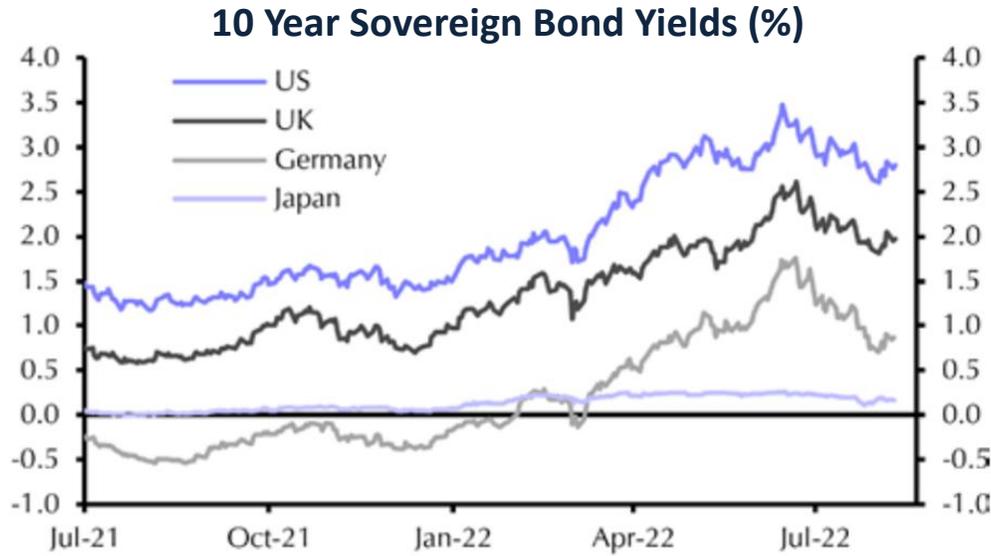
## Global Consumer Confidence & Inflation



Source: National Sources, JPM  
As at July 2022

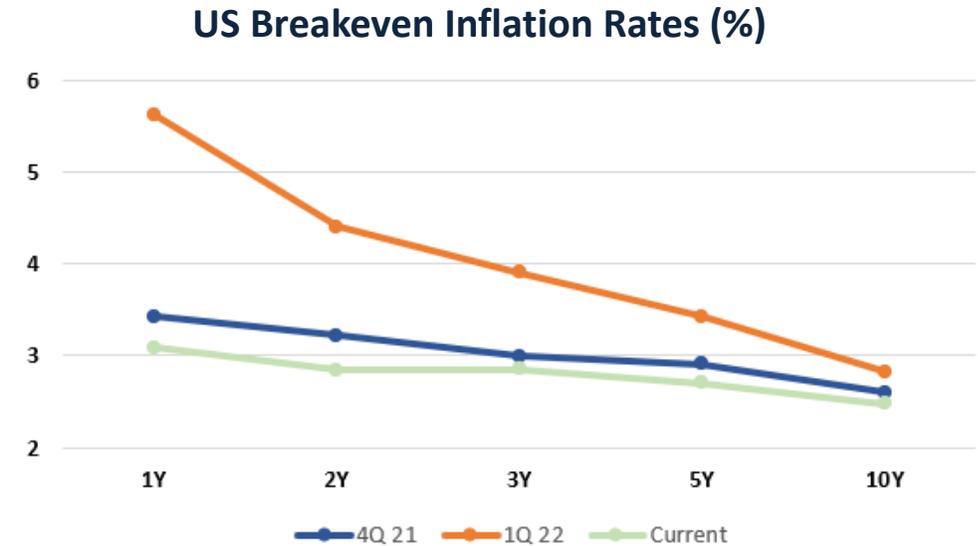
- Slump reflected in global-consumer confidence surveys closely tied to surging inflation
- Data plotted thru June. Perhaps slowing in commodity prices may help to rebuild confidence in coming months

# Financial Conditions Easing and Inflation Expectations Contained



Source: Refinitiv, CE

- Globally, rates remain above historic lows as central banks continue to tighten
- Over the past two months, however, 10Y rates have retreated from peaks reached in Q2
- In the US, the 10Y has fallen 65 basis points since mid June – leaving it 130 bps above 2021 year-end level



Source: Bloomberg

- Market implied inflation levels in the US rose rapidly during the first quarter, but have since fallen below where they began the year
- Short and long-term expectations have converged in the 2.5%-3% range, approaching the Federal Reserves long-term target

# Oil and Agricultural Prices Down from Recent Peaks

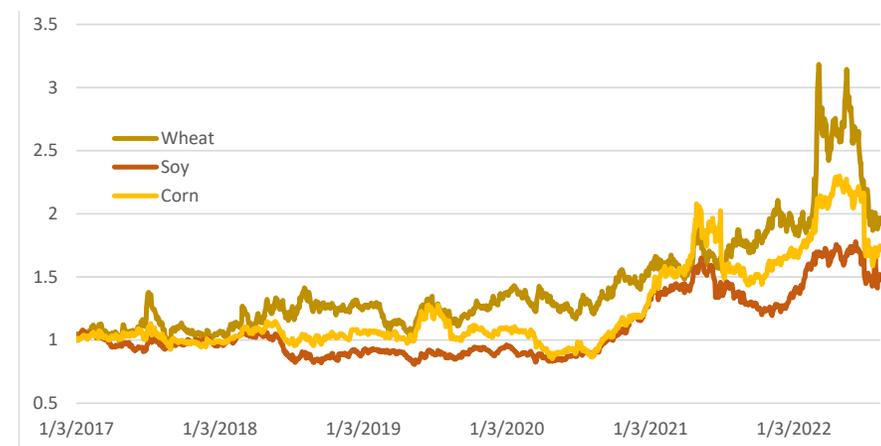
## Brent 1 Month Future Contract (\$)



Source: Bloomberg

- Brent prices have come down 25% this summer after peaking at just below \$130
- Price action largely driven by cyclical concerns and strong USD
- Underinvestment constraint on supply. But cyclical factors consistent with flat to soft oil prices
- Russian output being redirected, not reduced materially, demand soft, supply edging up, futures curve in significant backwardation

## Agricultural Prices



Source: Bloomberg

- Wheat and corn prices experienced significant pullback this summer due to a mix of macro and micro factors
- Fundamentals mixed but on balance point to stable / perhaps slightly lower prices
- Favorable factors include bumper Latin American harvest and Ukraine exports inching up. Principal negative: low US crop yields due to hot summer and drought conditions

# Inflation: Some Positive Signs — Goods Demand Slowing / Supply Improving

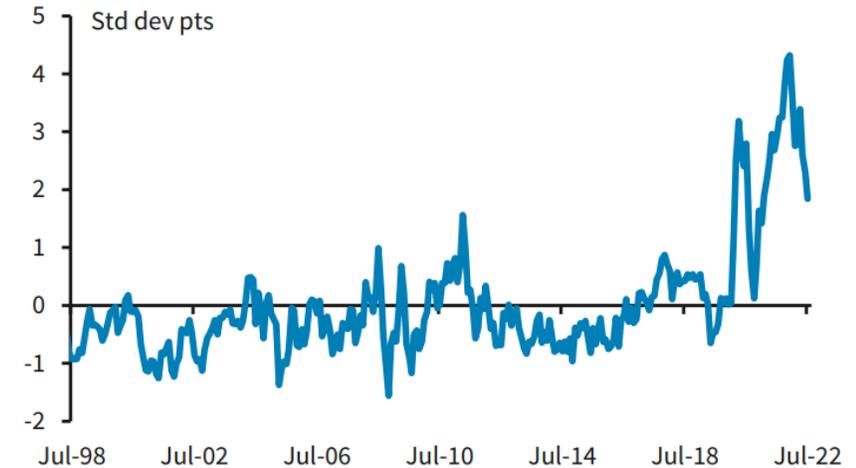
- **Some Factors Pointing to Moderation of Global Inflation**

- Commodity prices and shipping costs down from peaks
- Product shortages and bottlenecks easing
- Business activity moderating
- Rate hikes starting to weigh on DM consumer spending
- EM retail sales (ex China lockdown distortions) softening
- Global demand for traded goods slowing
- Expect energy inflation (ex. Europe) to moderate
- Long-run inflation expectations still largely contained

- **Key Questions Remain**

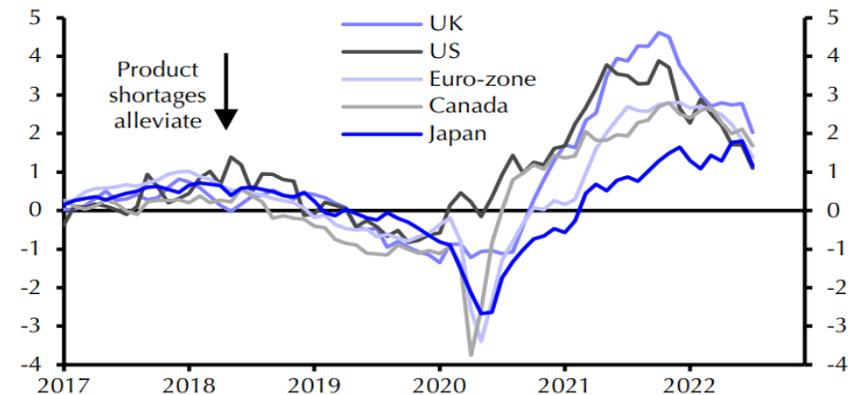
- Will central bank rate hikes tame wage pressure sufficiently?
- How long will it take for inflation to get to 2% targets?
- Might energy prices reaccelerate due to geopolitical events?

### Supply Chain Pressure Index



Source: NY Fed, Barclays

### Product Shortages



Source: Refinitiv, CE

# US / Euro area / UK: Overview of Cyclical Outlook

## Baseline Outlook

|                  | GDP (%Y) |     |     | CPI (%Y) |     |     |
|------------------|----------|-----|-----|----------|-----|-----|
|                  | '21      | '22 | '23 | '21      | '22 | '23 |
| <b>US</b>        | 5.7      | 1.8 | 1.2 | 4.7      | 7.8 | 3.0 |
| <b>Euro area</b> | 5.3      | 3.1 | 0.6 | 2.6      | 8.0 | 4.0 |
| <b>UK</b>        | 7.4      | 3.4 | 0.8 | 2.6      | 9.0 | 5.5 |

- GDP baseline outlook: year-over-year growth slowing in '22 –'23...
- CPI baseline outlook: peak in '22 but stay above target in '23

|                  | GDP: 4Q22 & 1Q23/ CPI 4Q22 (%Y) |      | Recession Prob. Next 12 Mos |
|------------------|---------------------------------|------|-----------------------------|
|                  | GDP <sup>1</sup>                | CPI  |                             |
| <b>US</b>        | 1.5                             | 7.0  | 30%                         |
| <b>Euro area</b> | (0.5)                           | 9.0  | 75%                         |
| <b>UK</b>        | (0.1)                           | 10.0 | 60%                         |

- 2<sup>nd</sup> half of '22 – US GDP picking up from first half, while Euro area and UK slowing...
- CPI decelerating in US, remaining elevated in Euro area and UK
- Recessions possible/ likely in next 12 months, particularly in Euro Area

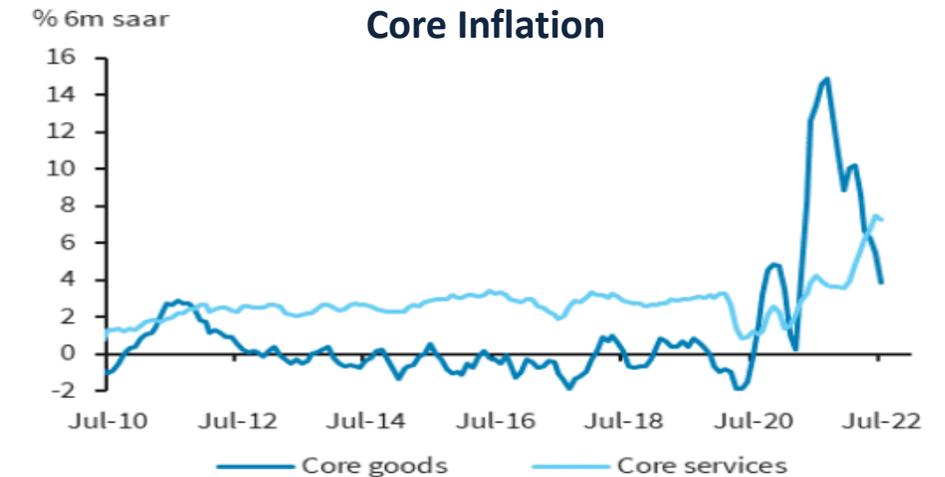
1. Forecast GDP % growth at annual rate in 4Q22 and 1Q23

# US Cyclical Outlook: Growth Slow but Positive / Inflation Continuing Concern

- **Despite Two Consecutive Quarters of Negative GDP Growth, US Is Not in Recession**
  - Strong employment growth / domestic final sales expanding at ~1.5% pace
- **Inflation Edging Down From Recent Peaks**
  - Energy and core goods prices easing but service prices, particularly rents and wages ongoing concerns
- **Path to Soft Landing Still Open, Albeit Narrow**
  - Key challenge to slow wage growth from 5.5% to 3.5% pace, while keeping unemployment relatively contained



Source: BLS, Haver

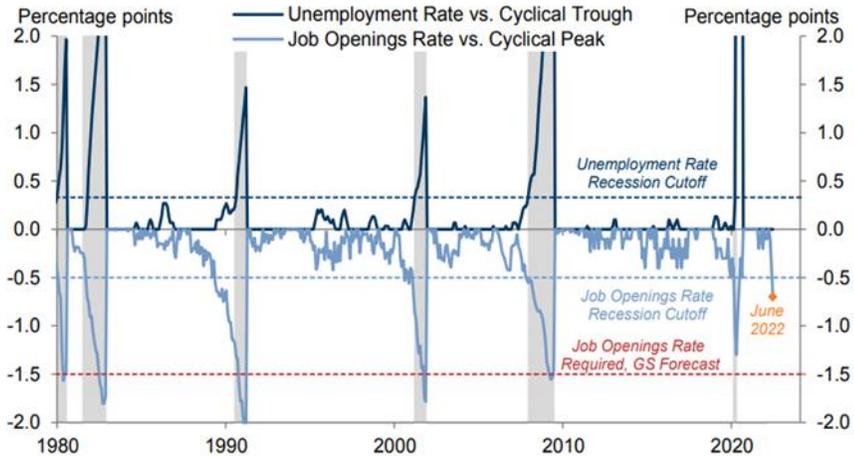


Source: BLS, Haver, Barclays

1. Energy prices down 4.5% in July. Rate of increase for core services decelerated 0.7pp in July to 0.3% / service prices still rising rapidly -- ex. energy services up 0.4% m/m in July with shelter up 0.6 m/m and 5.5% y/y As at July 2022

# US Recession / Soft Landing Debate / Key Challenge

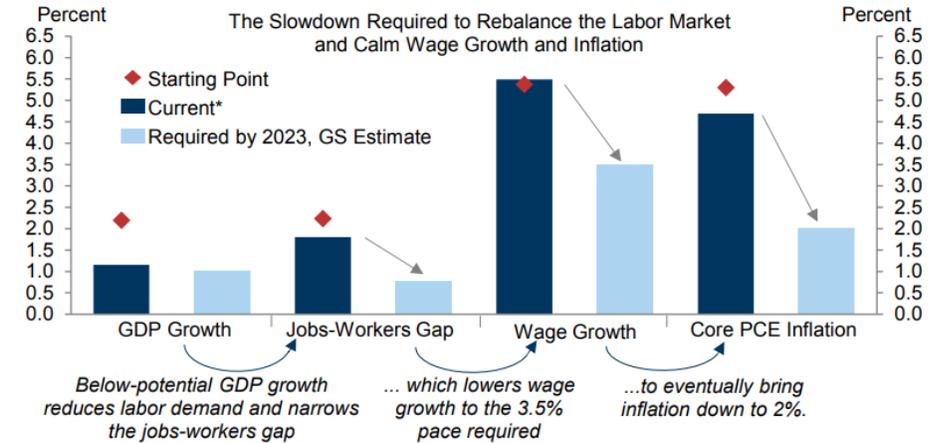
## Cyclical Relationship: Job Opening / Unemployment



Source: GS

- During recessions unemployment typically rises, while job openings plummet. Could unprecedented 5+ mil, openings alter this relationship?
- Job openings down 900k since March, while unemployment rate declined to 3.5%
- Fed model implies job openings could be key shock absorber in current cycle but some prominent economists disagree<sup>1</sup>

## GS Schematic of Path to Soft Landing



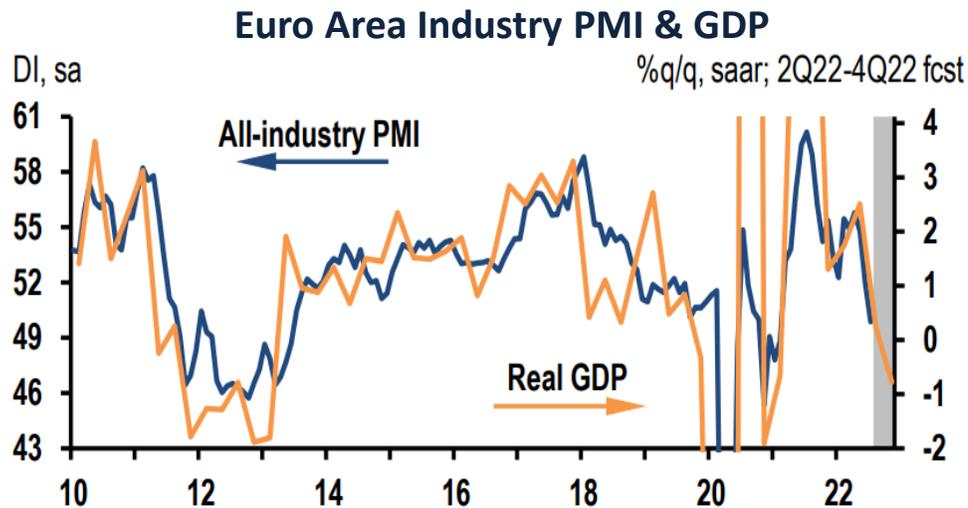
Source: BLS, GS

- GDP growth and possibly jobs-worker gap outlooks consistent with soft landing
- Whether wage growth will slow still open question...
- But macro backdrop should be conducive to some slowing if inflation moderates as expected

1. Goldman Sachs (GS) economists using a modified version of Fed governor Chris Walker's Beveridge Curve model estimate that the job openings rate will decline ~1.55pp to 5.25% and that the unemployment rate will only rise to 3.8% by the end of 2023.

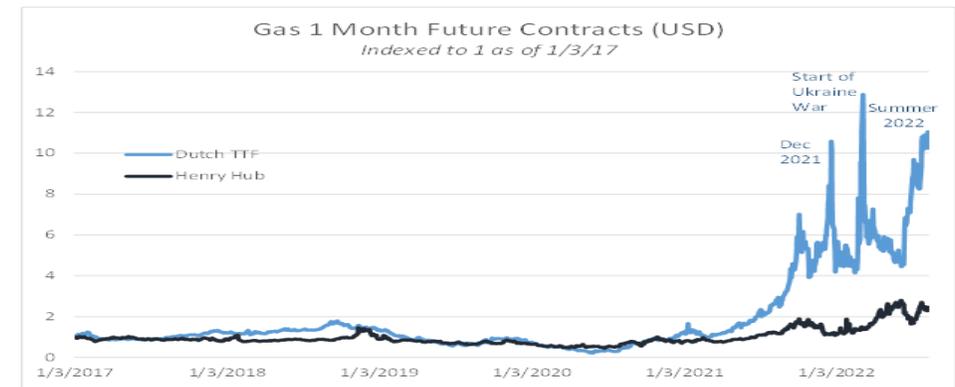
# Euro Area: Cyclical Outlook Deteriorating

- **Economy Poised to Weaken Following Particularly Strong 2Q<sup>1</sup>**
  - Principal headwind energy shock but Rhine's low water level and Italy's political instability also concerns
    - Baseline outlook assumes gas flows from Nord Stream pipeline remain at 20% of capacity
    - Severe weather or complete shutdown potential downside picks
  - Persistent ~9% inflation in 2<sup>nd</sup> H year squeezing purchasing power
    - Expected to precipitate mild recession in late '22 – early '23
    - Fiscal supports expected to only provide partial relief for consumers



Source: S&PM Global, JPM  
As at July 2022

## Euro Area & US Natural Gas Prices



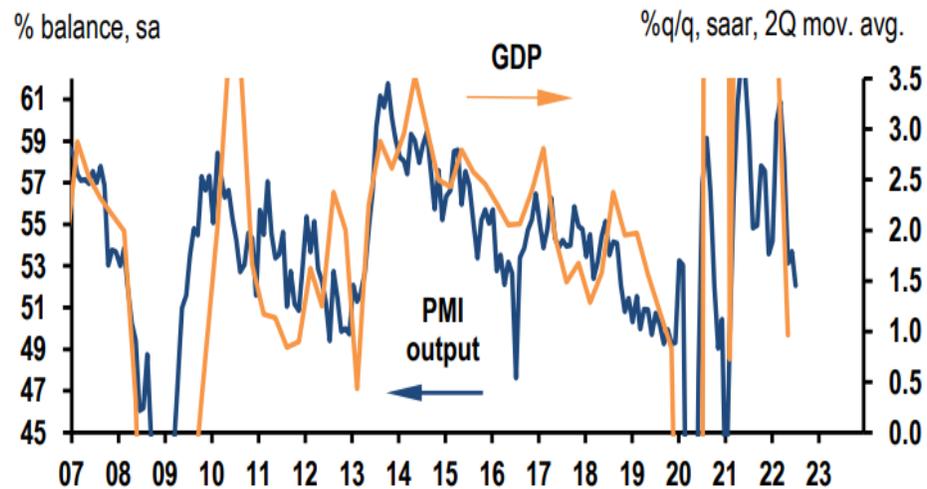
Source: Bloomberg, Reuters, GS  
As at August 2022

1. 2Q GDP rose at 2.8% annual rate in 2Q, while the unemployment rate dropped to a historically low 6.6%

# UK: Cyclical Outlook Similar to EA with Some Important Differences

- **Recession Possible Later in Year / Early '23 but Not Assured**
  - Elevated inflation has depressed confidence, but PMIs point to slow growth
  - At minimum, recession likely to be less severe than forecast by BoE<sup>1</sup>
  - Significant expected fiscal package will limit recession risk/severity<sup>2</sup>
  - UK's exposure to Russian natural gas not significant<sup>3</sup>

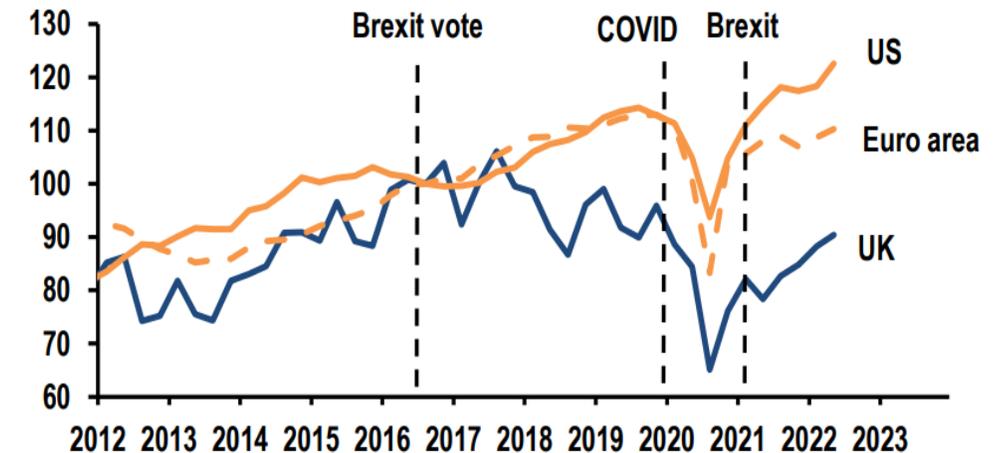
### Composite PMI & GDP



Source: Markit, ONS, JPM  
As at July 2022

### Investment Long-Term Concern

2Q16=100, sa, business machinery and equipment spending



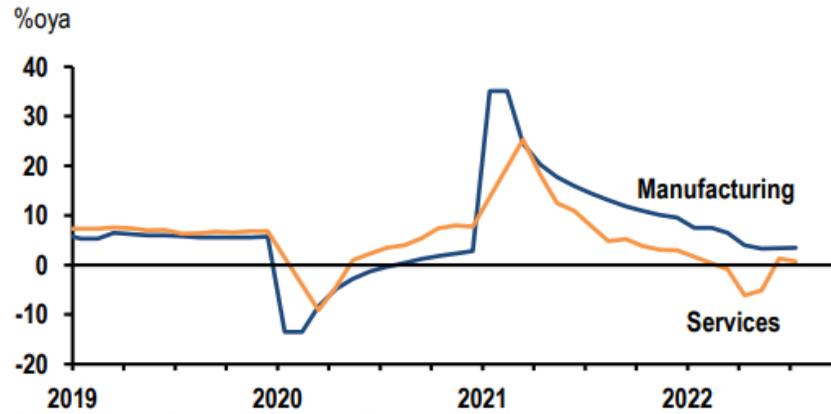
Source: ONS, Haver, JPM  
As at July 2022

1. BoE recently forecast a five-quarter recession starting in Q4 involving a cumulative drop in GDP of ~2%
2. Conservative candidates for PM propose significant fiscal packages. Liz Truss > 1% of GDP and Rishi Sunak ~ 0.7% of GDP
3. Russia supplies ~ 4% of UK's natural gas versus ~40% for Euro area's

# China: Latest Data Disappointing / '22 GDP Forecast Reduced

- **Rebound From Lock-Down Suppressed Q2 Off to Slow Start**
  - July data highlight domestic softness (ex. exports)<sup>1</sup> amid weak housing sector
  - PBOC reduced policy rate 10 bps / modest fiscal support expected<sup>2</sup>
  - Fund expected to be launched to stabilize housing sector<sup>3</sup>
  - GDP growth for '22 reduced 1% pt. to 3.2%
- **Baseline '23 Outlook: Cyclical Rebound ~5% Growth/Longer-term Outlook Problematic**
  - Seeming shift away from private sector bears watching<sup>4</sup>

### Economic Activity



Source: Natural Bureau of Statistics, JPM  
As at July 2022

### Credit Growth



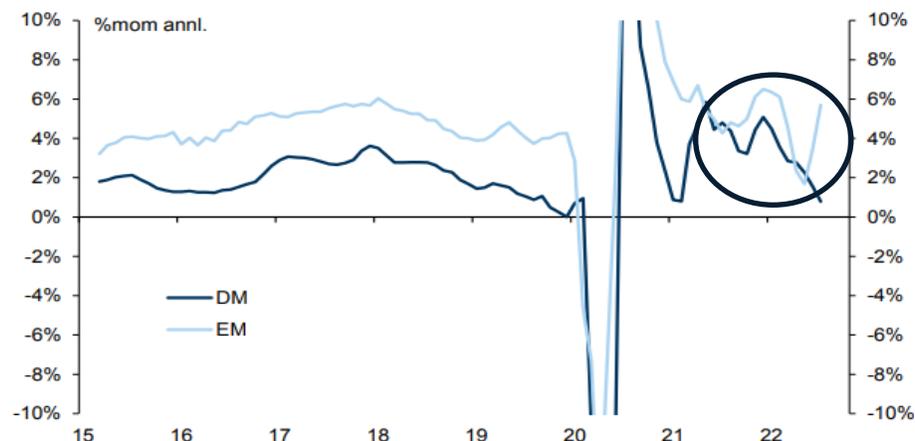
Source: PBOC, JPM  
As at July 2022

1. Disappointments in July data include industrial production (3.9% oya vs. 4.5% expected), retail sales (2.7% oya vs. 5% expected), unemployment eased to 5.4% vs. 5.5% in June, while youth unemployment rose  
2. Premier Li Keqiang ruled out massive stimulus package  
3. Goaded by increasing mortgage boycotts across China due to construction delays, policymakers expected to launch fund to stabilize markets  
4. Composition of Xi Jinping's post-election cabinet potentially important indicator of future direction

# EM and DM Growth and Inflation

## Current Activity Indicators

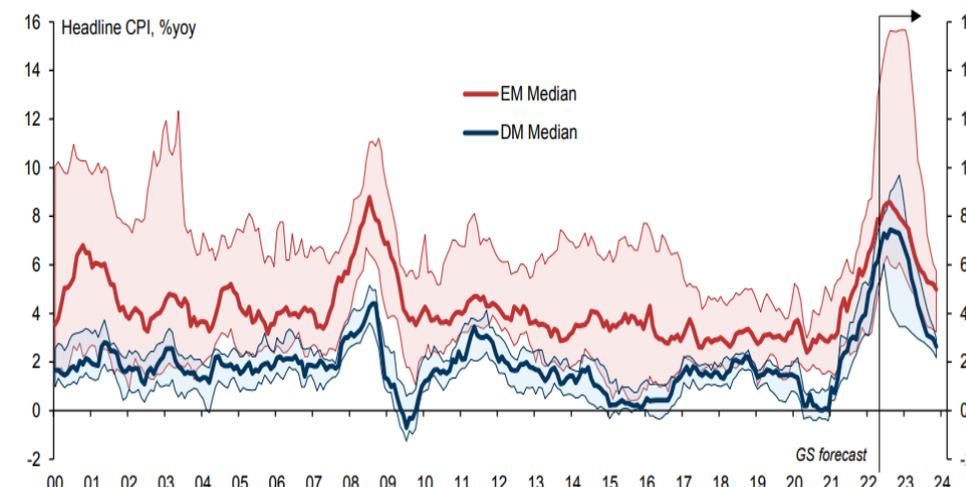
GS Current Activity Indicators (CAI), 3-month moving average



Source: GS  
As at 12 August 2022

- GDP growth was relatively strong across most Emerging Markets (light blue line) in first half '22. China and Russia exceptions.
- Emerging Market growth relatively robust at start of second half, while Developed Markets are slowing

## Headline CPI Inflation<sup>1</sup>



Source: GS  
As at July 2022

- Emerging Market and Developed Market inflation has moved up largely in tandem in '21 and thus far in '22
- GS economists forecast disinflation in '23 and '24, with median rates declining to ~2% in Developed Markets and ~5% in Emerging Markets by YE '24

1. Headline CPI Inflation: Median and 25-75% quantiles for 26 EM and 15 DM economies included in GS' forecast coverage.

- **Global Economy Slowing But Not Collapsing**
  - Key supportive factors cited in April, particularly employment, still in place
  - Inflation higher and more persistent than previously expected
  - Central banks, particularly in DMs, will have to tighten further
  - Markets seemingly confident that central-bank policies will be successful
  - Sovereign bond yields lower and long-run inflation expectations contained
- **Higher-Than-Expected Inflation Squeezing Purchasing Power/ Dampening Confidence**
  - Interest sensitive sectors such as housing, particularly vulnerable
  - Recent goods and commodity-price trends suggest inflation near peak
- **Global Growth Outlook Reduced 0.5% pt. to 2.9% for '22 and '23**
  - Downward revision largely reflects regional and national considerations ...
    - Natural gas shortages and energy price inflation in Europe / COVID policies in China
- **Geopolitical Uncertainties Principal Identifiable Risk**

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