

Recession or resiliency? For the US economy, it's complicated.

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The US economy

It might not feel like a recession, but it feels like a slowdown. There is definitely real consumer pain.

UK inflation

The Bank of England is in a delicate balancing act, trying to tame inflation without snuffing out its economy.

China's housing market

China's economy is still recovering from COVID lockdowns but is now facing headwinds from the property sector.

My 16-year-old daughter plays club basketball and so, as we have done for the last several years, we spent time in July traveling to different tournaments in multiple states (with a stop at the beach along the way). From Louisville, Kentucky, to Michigan City, Indiana, to Chicago, Illinois, to Uncasville, Connecticut (and a few other stops on the road in between), we saw a US economy that was quite strong. There were many consumers out dining and shopping and a number of "help wanted" signs were out — despite high gas prices, increased costs for food, and reports of very negative consumer sentiment.

We saw this economic strength on full display with July's US jobs report. Far more non-farm payrolls were created than expected. Wages rose an unexpectedly high 0.5% for the month and are up 5.2% for the year — after appearing to be cooling last month.¹ The Twitterverse lit up after the jobs report was released, with many economists, strategists and plain old pundits heralding what they viewed as an economy on fire that refused to be hindered by the Federal Reserve's aggressive tightening. I felt like I was living in a Queen mini rock opera, with the lyrics from "Don't Stop Me Now" swirling in my head.

Maybe not a US recession, but a slowdown

But the reality is far more nuanced. A deeper dive into the US employment situation report shows that the number of part-time jobs held by people who wanted full-time employment increased by 303,000.¹ Not an ideal jobs picture — but not terrible either. After all, the Institute for Supply Management's Purchasing Managers' Index (PMI) survey figures for July showed an economy that is still in expansion — July manufacturing PMI was 52.8 while non-manufacturing PMI was 56.7.² However, the US economy is most definitely not on fire.

And that's the key takeaway. It might not feel like a recession, but it feels like a slowdown. There is definitely real consumer pain; it has been reported that more Americans are skipping meals because of higher food prices. And households are racking up credit card debt, likely because they can't afford living expenses. All that shouldn't be a surprise given that real incomes have fallen significantly this year. This situation — a US economy that has both significant strengths and weaknesses — was one of the disconnects I wrote about in a recent blog.

And so yes, despite the Fed's very rapid and substantial tightening, the US economy seems to be rather resilient and certainly doesn't feel like it's in recession — at least not yet. The reality is, as Fed Chair Jay Powell recently acknowledged, that much of the Fed's tightening has yet to turn up in economic data — there is a lag, of course. So it's only a matter of time before we see more signs of a slowdown in the jobs reports and elsewhere. At the risk of sounding like a broken record, the Fed's actions will largely dictate just how significant the slowdown is.

Despite those areas of weakness — and the two consecutive quarters of contraction for US gross domestic product — I think it's likely that the Fed will raise rates by 75 basis points in September given the robust jobs report. However, more data will be coming in before that decision has to be made — namely the Consumer Price Index (CPI), which comes out on Wednesday, Aug. 10. I'll be giving my takeaways on that CPI report and answering live questions in a LinkedIn Live event Wednesday morning — you can register for that event [here](#).

For Bank of Canada, rates hikes may continue

Canada's central bank seems to be a bit better at slowing its economy. Job losses in July's jobs report were more than expected, albeit still modest. And average hourly wages, while still high, rose less in July than in June. But I suspect it will still be too high for the Bank of Canada, which is likely to continue raising rates despite its mega rate hike of 100 basis points just a few weeks ago. The Bank of Canada doesn't appear poised to stop.

The Bank of England forecasts red-hot inflation

The chorus is singing "Don't Stop Me Now" in the UK, but there, the song is about inflation. The Bank of England (BoE) surprised and dismayed some with its latest inflation forecasts. The BoE is now anticipating that inflation will peak at 13.3% in October — and that it will remain in double-digits into the second half of 2023.³ Yes, the BoE expects inflation to remain red-hot even as the UK economy is in recession.

That's why the BoE had to bring out its jumbo-sized sledgehammer — hiking rates 50 basis points last week — which it hasn't used in more than a quarter of a century. It seems reasonable to expect the Bank of England to hike another 50 basis points in September, although the demand outlook may restrict further hikes to 25 basis points.

As with other central banks such as the Fed and the European Central Bank, the BoE is in a delicate balancing act, trying to tame inflation without snuffing out its economy. And it could be attempting to perform this balancing act under great scrutiny if UK Foreign Minister Liz Truss, who is in the running, becomes the next Prime Minister, given her recent criticisms of the central bank.

The eurozone economy is under pressure

Inflation is also hot and doesn't want to be stopped in the eurozone, although the eurozone economy is coming under very substantial pressure. It is going to be harder to stop eurozone inflation because most of it is not demand-driven, and so the ECB might "stop" the economy before it "stops" inflation.

The most recent manufacturing PMI was slightly in contraction territory, although the service sector PMI remains in expansion territory. However, Chris Williamson of S&P Global explained, "The eurozone economic outlook has darkened at the start of the third quarter with the latest survey data signaling a contraction of GDP in July. Soaring inflation, rising interest rates and supply worries — notably for energy — have led to the biggest drops in output and

demand seen for almost a decade, barring pandemic lockdown months.”⁴

China seeks to calm its housing market

The lyrics of Queen’s mini rock opera would need to be edited for the property situation in China. The chorus could be: “Don’t stop paying your mortgage,” with the response being: “Then don’t stop construction.”

A significant portion of Chinese households have stopped paying the mortgage on their properties under construction because developers have stopped building the projects. China’s economy is still recovering from COVID lockdowns but is now facing headwinds from the property sector, so this will hopefully be resolved quickly. Policymakers are likely to strongly encourage consumers to pay their mortgages on time, lest they risk legal action from the banks, while also providing more liquidity to developers to restart dormant projects. We believe the government has the tools to ensure these risks don’t spread to the financial system.

Conclusion: Maintaining a long-term perspective

In conclusion, many central banks are on the move, and economic data can be quite concerning depending on the country. There will likely be more market volatility, especially given heightened geopolitical tensions and the potential for downward earnings revisions. I believe the best we can do as investors is maintain a long-term perspective. That means being well diversified across equities, fixed income and alternatives — and being tactically opportunistic if comfortable.

With contributions from Emma McHugh and David Chao

Notes

¹Source: US Bureau of Labor Statistics, Aug. 5, 2022

²Source: Institute for Supply Management, July 2022

³Source: Bank of England, August 2022

⁴Source: S&P Global, Aug. 3, 2022

Important information

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions. All investing involves risk, including the risk of loss.

Diversification doesn’t guarantee a profit or eliminate the risk of loss.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer’s credit rating.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Purchasing Managers’ Indexes are based on monthly surveys of companies worldwide, and gauge business conditions within the manufacturing and services sectors.

Gross domestic product is a broad indicator of a region’s economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

A basis point is one hundredth of a percentage point.

The Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics. Core CPI excludes food and energy prices while headline CPI includes them.

The opinions referenced above are those of the author as of Aug. 8, 2022. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.