UNITED STATES

ACCELERATED NORMALISATION OF MONETARY POLICY

Inflation's unexpected rebound in May forced the Federal Reserve (Fed) to accelerate the normalisation of its monetary policy. In mid-June, the Federal Open Market Committee (FOMC) decided to raise the fed funds rate by 75 basis points (bp). At the same time, the Fed began to shrink its balance sheet through Quantitative Tightening (QT). For the moment, the US economy is holding up well, supported by robust fundamentals such as employment. Yet activity is beginning to slow under the impact of tighter lending conditions and deteriorating global economic prospects. The US economy will come under fierce pressure as it navigates towards a hard or soft landing.

Inflation continues to surge with the consumer price index rising to an annualised rate of 8.6% in May, driven by the upturn in energy and food prices, which contributed 2.4 points and 1.3 points, respectively. Inversely, core inflation continued to ease on a year-on-year basis (to 6% from 6.2% in April and 6.5% in March). In contrast, core inflation was still high on a month-on-month basis (+0.6% m/m), buoyed by robust aggregate demand (illustrated by the increase in production capacity utilisation rates, to 78.9% in April, far above pre-crisis levels) as well as by pressures throughout the supply chain, which were much stronger and more persistent than expected. Looking at survey data, input prices have continued to rise since early 2022 (82 in May, up from 73 in January according to the ISM index) which could fuel more inflation in the months ahead.

Stimulated by a job market at full employment and an unemployment rate of 3.6% in May, wage increases, which tend to be inflationary, must be monitored closely. Labour shortages are also driving up average hourly earnings (AHE, up 5.2% y/y in May), notably in leisure and hotel services (+10.2%), business services (+6.5%) and health care (+5.7%). Higher labour costs combined with lower productivity (-0.6% in the year to Q1 2022) are beginning to squeeze corporate margins. Yet wage increases nonetheless encourage workers who had left the job market to return to work, notably newly retired workers, which should help ease somewhat job market pressures as well as the impact of the inflationary shock on purchasing power. The Biden administration also intends to review US immigration policy to increase the number of work visas to fight against labour shortages.

To achieve a soft landing of the economy, monetary policy would have to be conducted cautiously. However, inflation remains way too high and signs of a slowing economy are already feeding fears of recession, although its timing and extent are hard to estimate. Even so, key policy rates are being raised at a very fast pace. At its most recent mid-June meeting, the FOMC opted to raise the fed funds rate by 75 basis points (bp). Moreover, it could maintain this pace at the next FOMC meeting in July. All in all, we are looking for an additional 175bp increase in the Fed funds rate by the end of the year. This would bring the upper range to 3.5% at the end of this tightening cycle. As the Fed begins to reduce the size of its balance sheet, there is also some concern about its impact on the real economy and financial stability. Between June and August, the Fed will no longer reinvest USD 47.5 bn of assets that reach maturity each month. And starting in September, it plans to accelerate the reduction of its balance sheet by USD 95 bn a month. It remains to be seen how well the US economy can hold up in the face of such a rapid normalisation of monetary policy.

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GROWTH & INFLATION

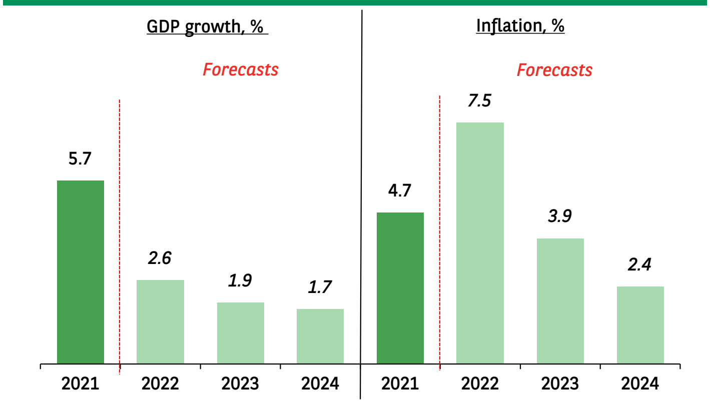

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

US: AVERAGE EARNINGS AND INFLATION

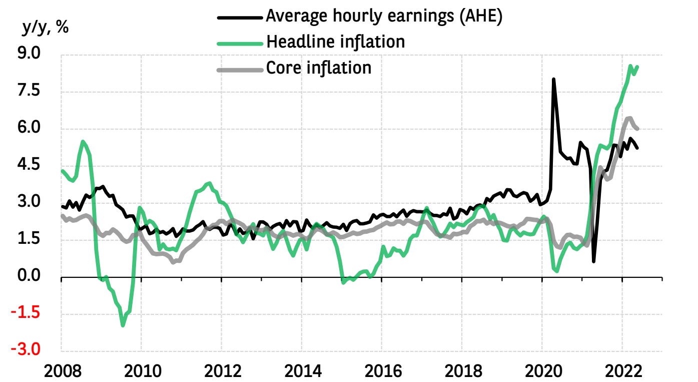

CHART 2 SOURCE: BLS, BNP PARIBAS