UNITED STATES

STRESS TEST

With inflation soaring, the US Federal Reserve announced that it would accelerate the process of normalising its monetary policy. Held near the lower zero bound until March, the key policy rate should rise to roughly 2% or even higher by the end of the year. The Fed will also reduce the size of its balance sheet. Operating at full employment, the US economy seems to have recovered sufficiently from the health crisis to pass muster. Yet it is still sensitive to credit conditions and is not immunised against the impact of the war in Ukraine.

The most recent economic surveys were not as good for the United States, which shows that the world's number one economy is not immunised against the consequences of the Russian war in Ukraine. It also proves that the Covid-19 pandemic, which has just triggered new lockdown measures in China, has not finished causing supply chain disruptions. Although it is still too early to talk about recession, industrial orders were hard hit in March, and the regional business climate indexes, like the New York and Philadelphia indexes (for the future expectations component), are poor.

FIGHTING INFLATION: THE TOP PRIORITY

The surge in input costs – energy, metals, agricultural commodities, etc. – has not ended yet and will continue to drive up inflation in the short term. February's record of 7.9% y/y is likely to be broken soon, especially since the housing market is also overheating, which in turn is pushing up rent, which accounts for a third of the price index.

With the unemployment rate dropping to 3.6% of the active population in March, and with the participation rate in the 20-64 age group near pre-pandemic records, the job market has reached full employment. Wage pressures are growing, especially in the sectors where most of the post-crisis hiring difficulties can be found: hotel & restaurant services, transport & storage, and retailing, among others. Wage growth is also higher than average in professional business services, which account for nearly a quarter of employment in the private tertiary sector, and are at the heart of the digital transformation.

On the whole, wage growth is counterbalanced by major productivity gains, which is a break from the pre-pandemic trend (chart 2). Unit labour costs (wages and benefits as a share of production volumes) are not exploding (+3.7% y/y in Q4 2021) and are nowhere near the double-digit figures of the early 1980s. In the breakdown provided by the Bureau of Economic Analysis (BEA), they do not even appear as a key motor of the rebound in the prices of value added in 2021, which was due more to taxes on production and imports (which in turn were driven up by higher commodity prices) as well as to higher corporate margins.

For the US Federal Reserve, however, wage growth seemed to be "incompatible with its price stability target", and the monetary tightening phase launched on 16 March is bound to continue. Assuming the Fed raises its key rates by a quarter point at each of the Open Market Committee meetings, the Fed funds target rate would reach 1.75% to 2% by the end of the year. Starting in May, the Fed will also begin to reduce the size of its balance sheet, at a peace that could reach USD 95 billion per month. This leaves us with a big unknown: the aptitude of the US economy – whose recovery has been largely debt-financed – to pull off this policy change.

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GROWTH & INFLATION

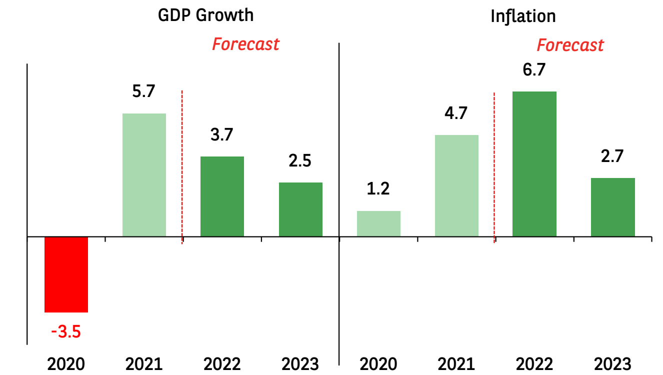

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

HOURLY LABOR PRODUCTIVITY

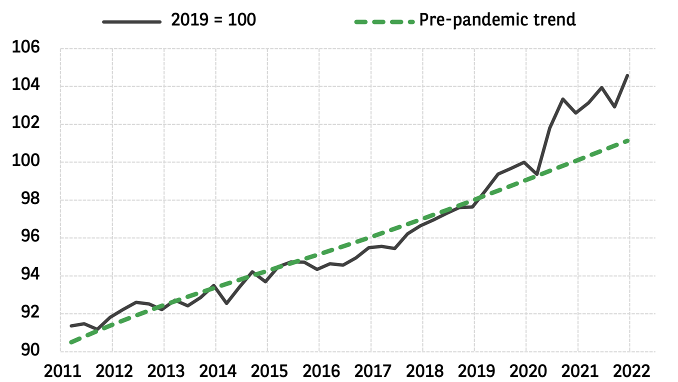

CHART 2 SOURCE: BLS