

# ECONOMIC UPDATE

14<sup>th</sup> October 2022

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London  
&Capital

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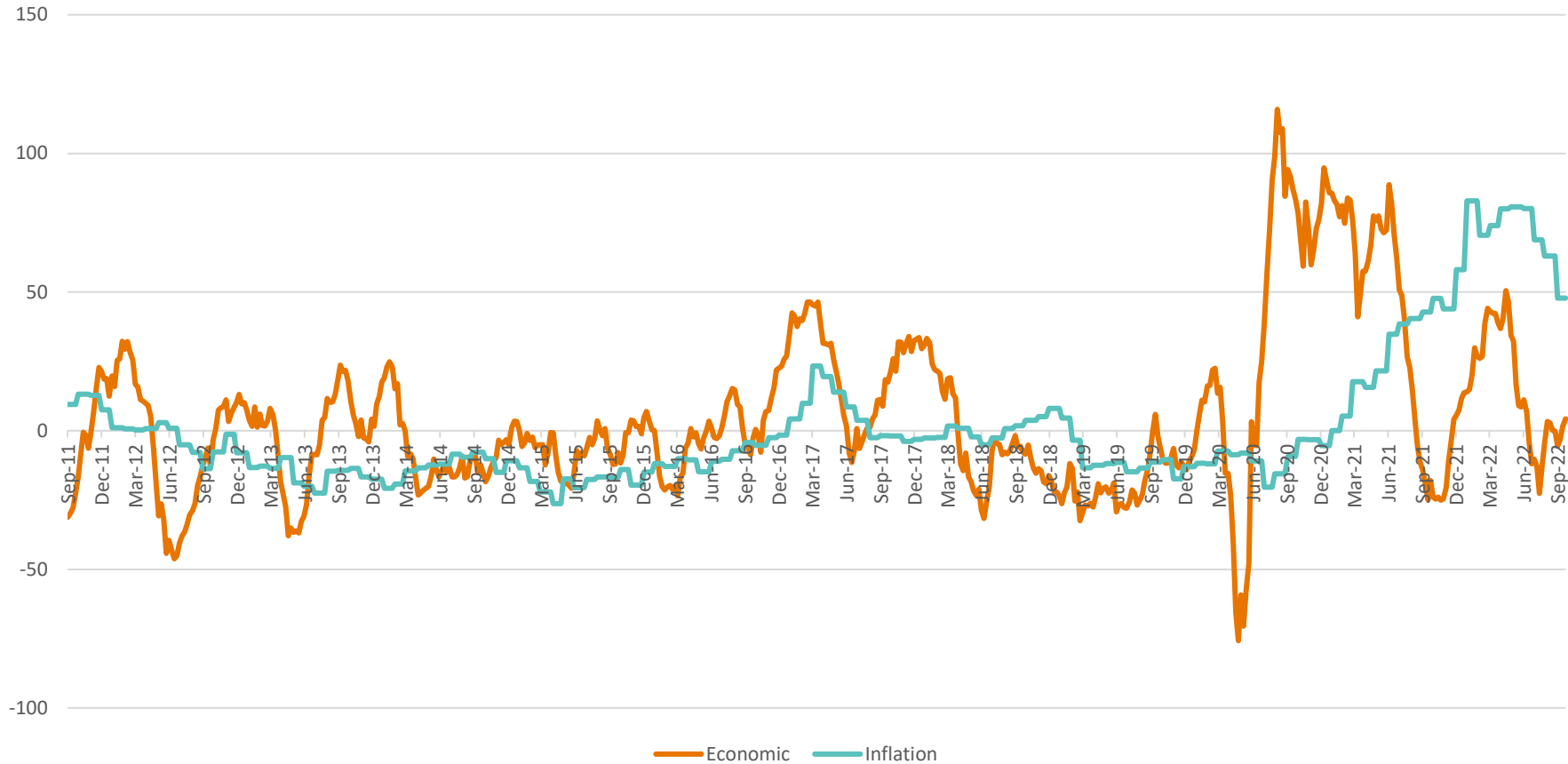
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## KEY QUESTIONS

- When will monetary policy risks recede?
  1. The shape of inflation
  2. Economic conditions
  3. Central Bank priorities
  
- How should we manage portfolios in uncertainty?

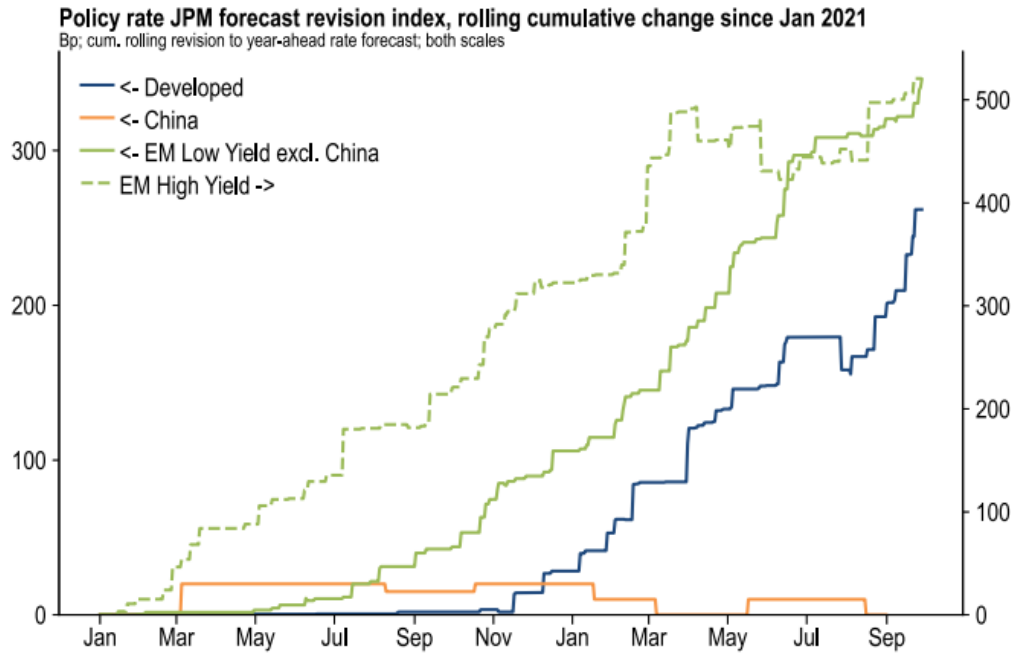
# UNFAVOURABLE MIX OF DATA

GLOBAL ECONOMIC AND INFLATION SURPRISE INDEX

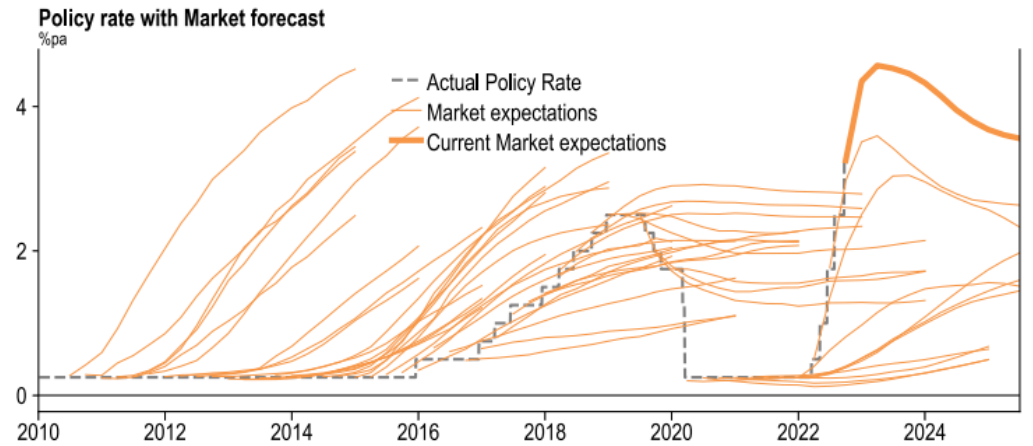


# POLICY EXPECTATIONS STILL EDGING HIGHER

POLICY FORECAST REVISION INDEX – CHANGE SINCE JAN-21

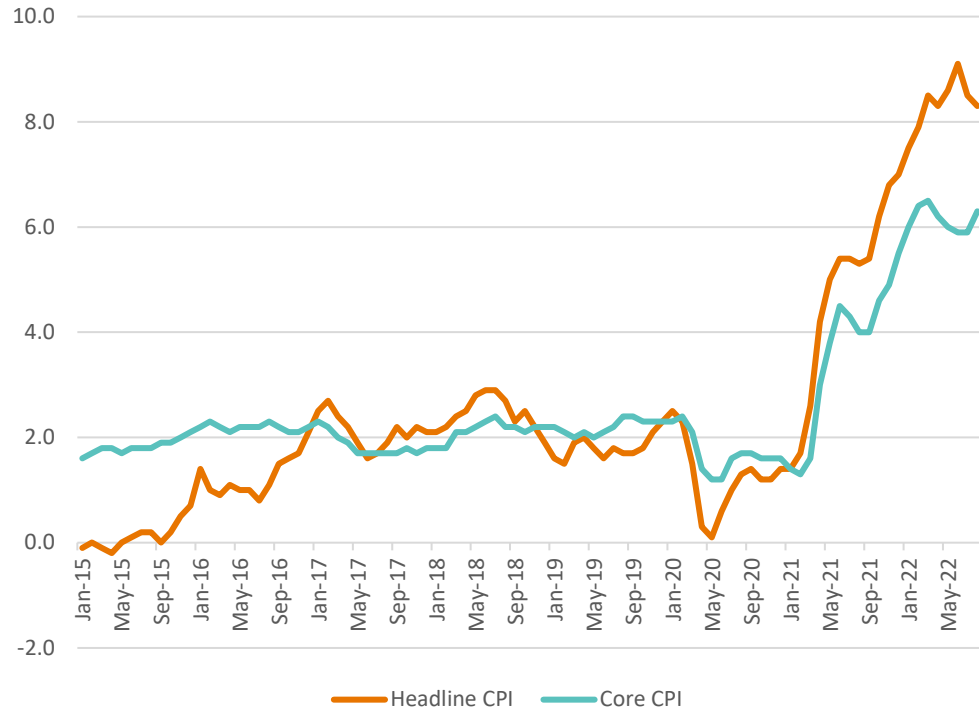


US POLICY RATE WITH MARKET FORECAST



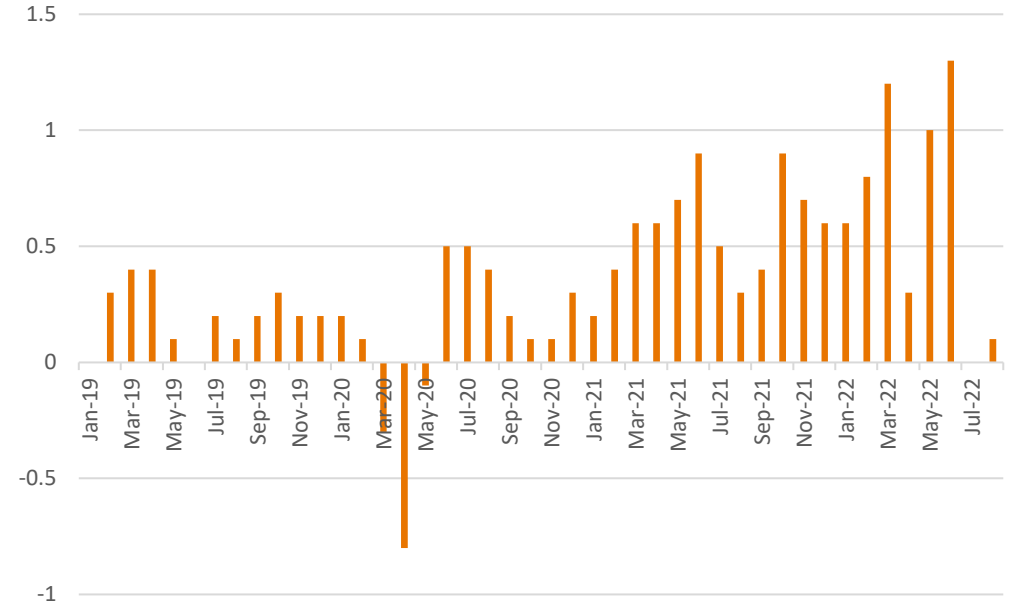
# INFLATION APPEARS TO HAVE PEAKED

US CONSUMER PRICE INFLATION – YOY %



Source: BLS

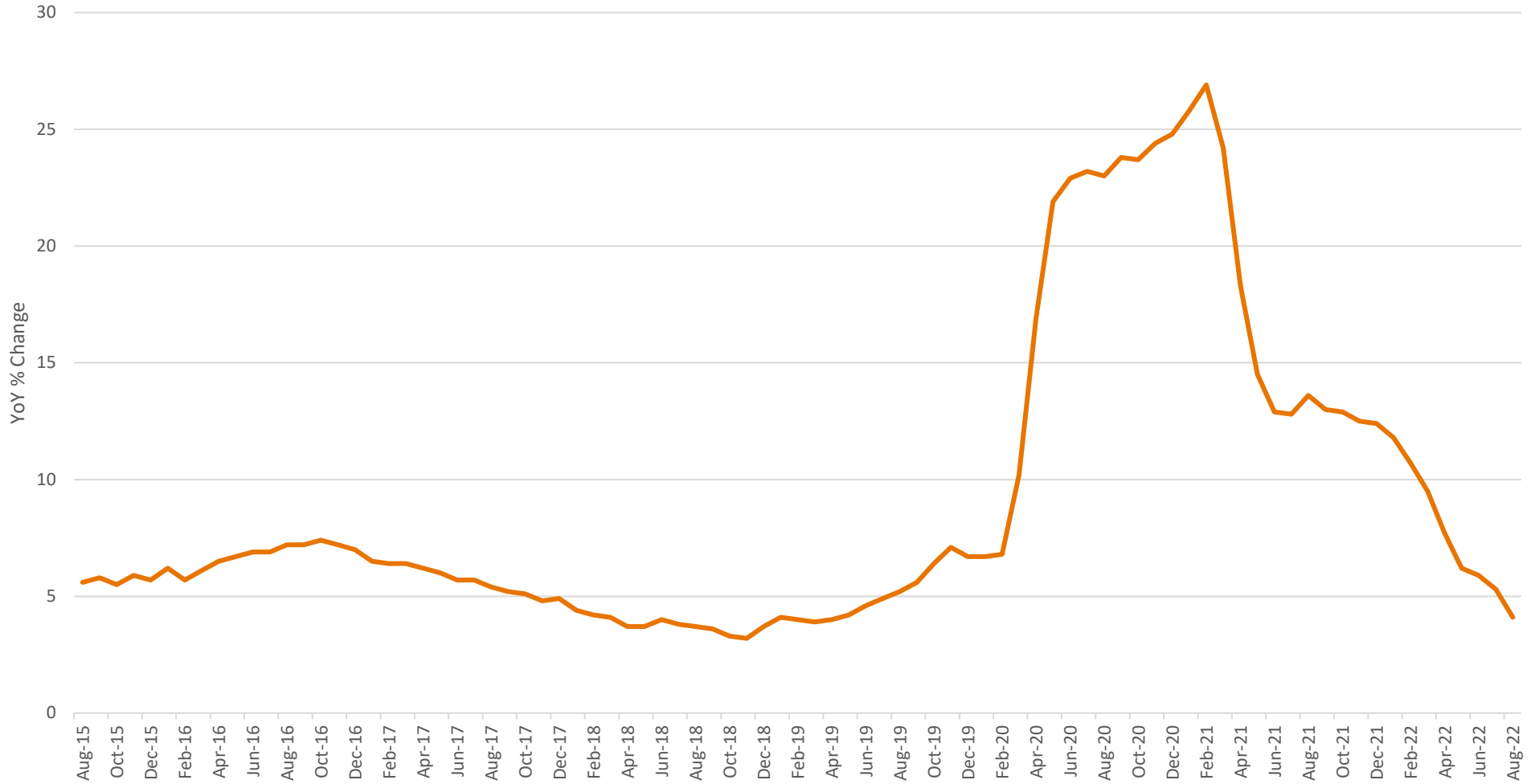
US CONSUMER PRICE INFLATION - MOM %



Source: BLS

# MONEY SUPPLY HAS NORMALISED

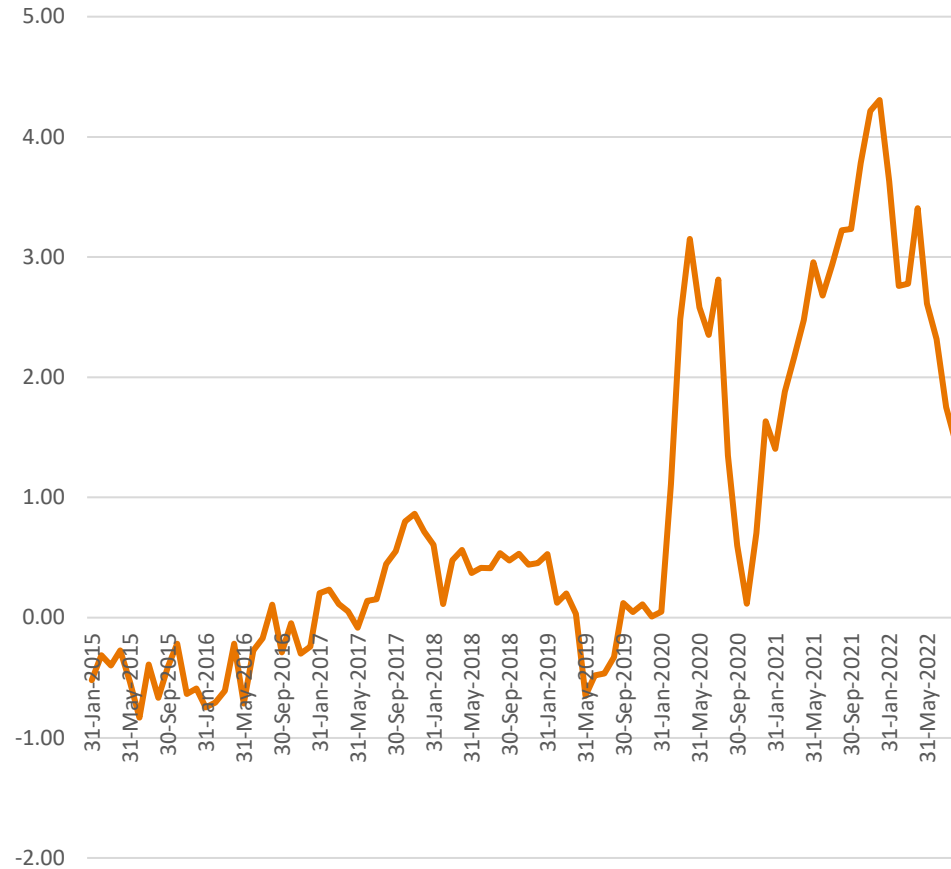
FEDERAL RESERVE M2 MONEY SUPPLY



Source: Bloomberg

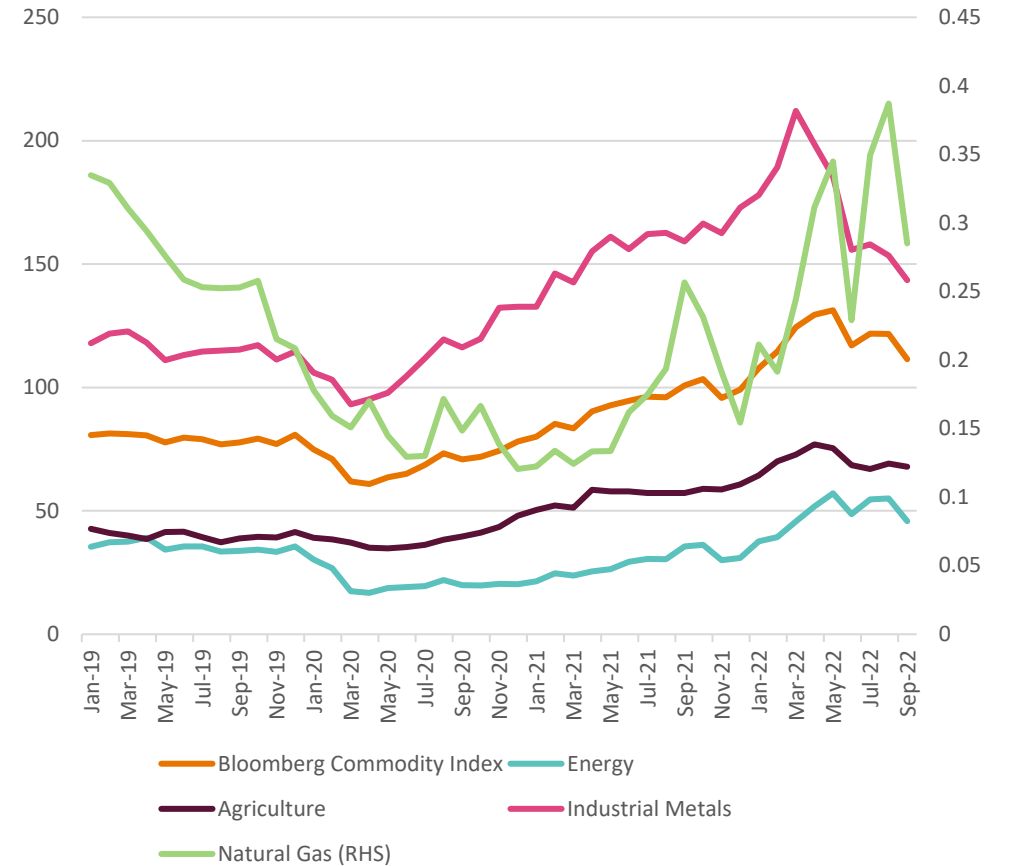
# PANDEMIC DISLOCATIONS & COMMODITY PRESSURES EASING

GLOBAL SUPPLY CHAIN PRESSURE INDEX (GSCPI)



Source: Federal Reserve of New York

COMMODITIES

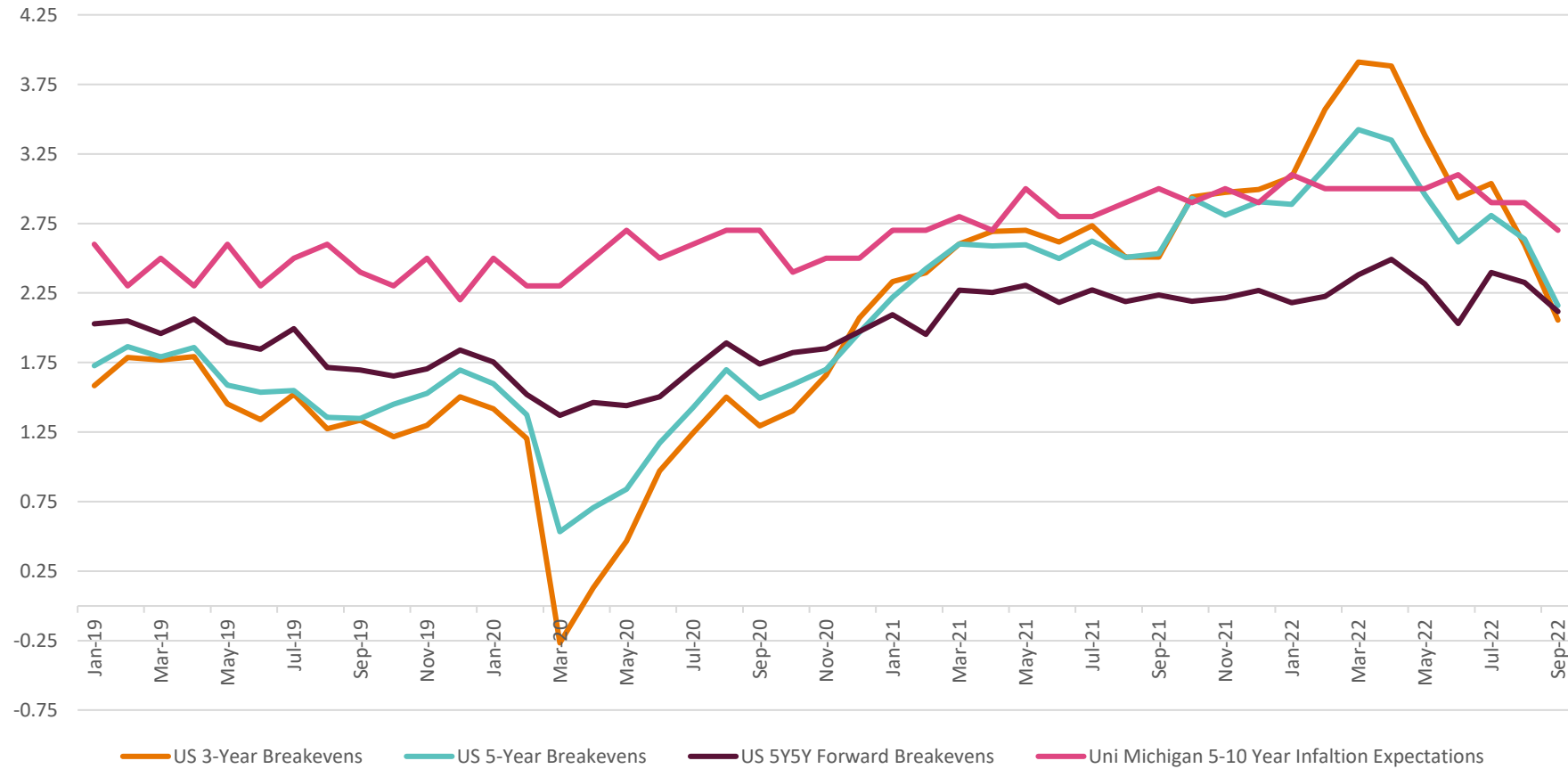


Source: Bloomberg



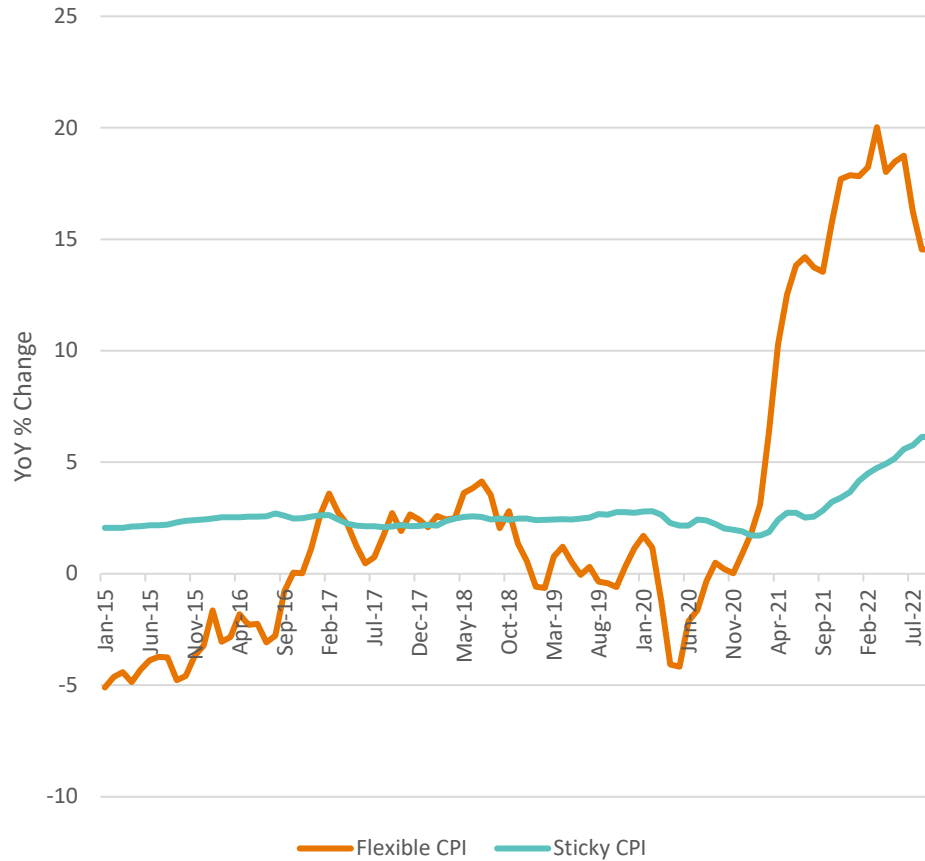
# INFLATION EXPECTATIONS MODERATING

MARKET IMPLIED & SURVEY BASED INFLATION EXPECTATIONS



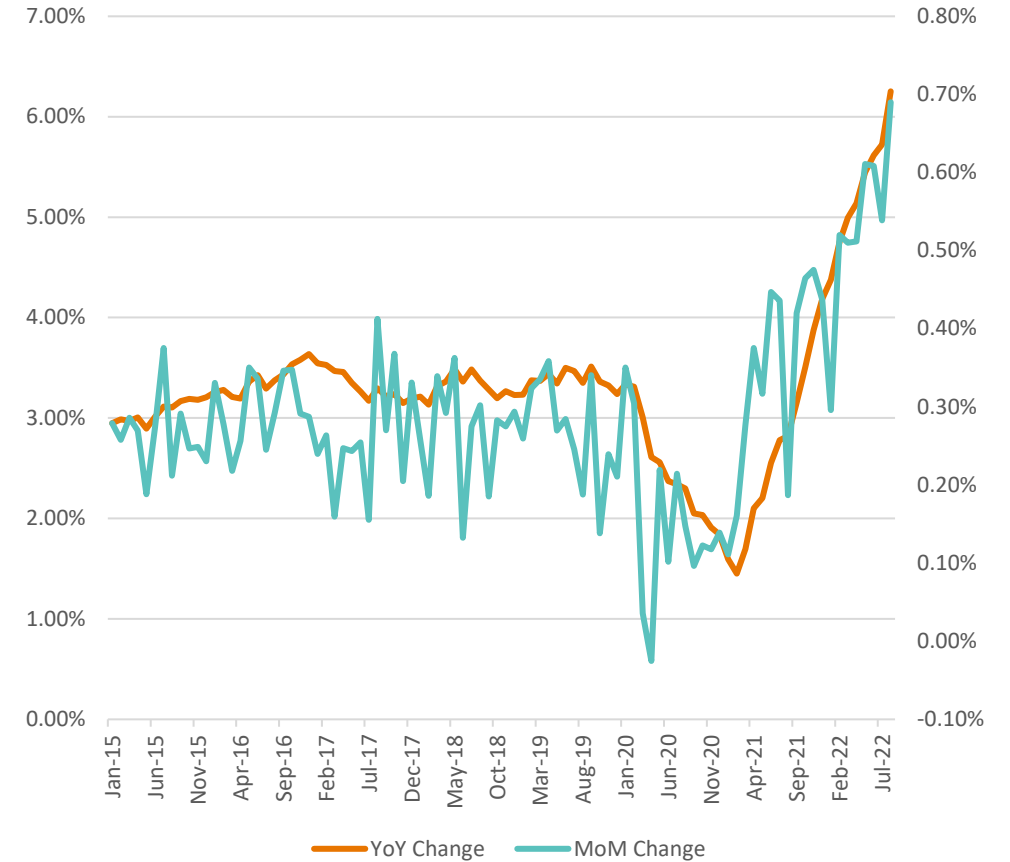
# BROADER INFLATION PRESSURE MAY TAKE LONGER TO CURB

## STICKY PRICES STILL RISING



Source: Federal Reserve of Atlanta

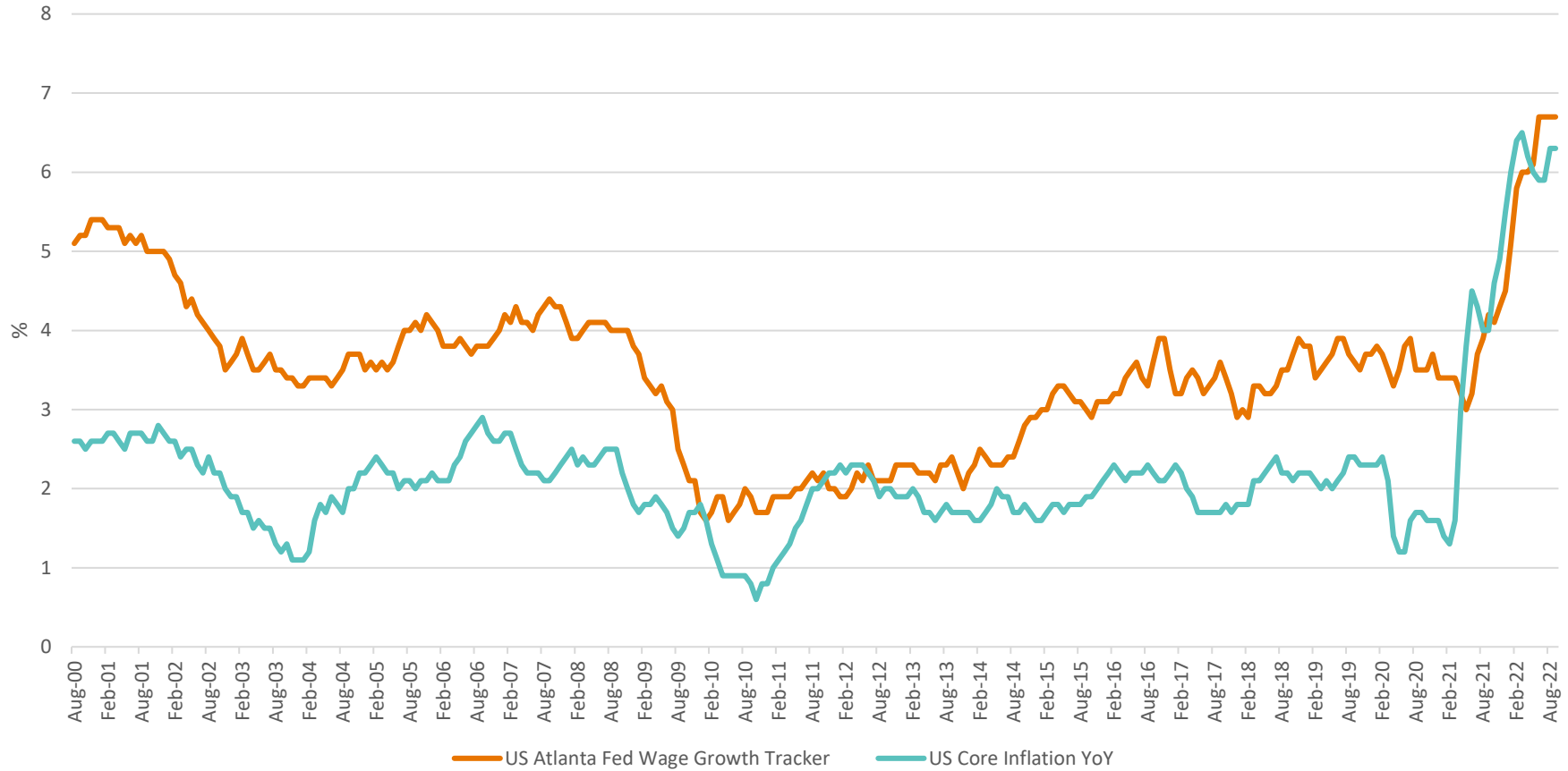
## COST OF SHELTER



Source: US Bureau of Labour Statistics

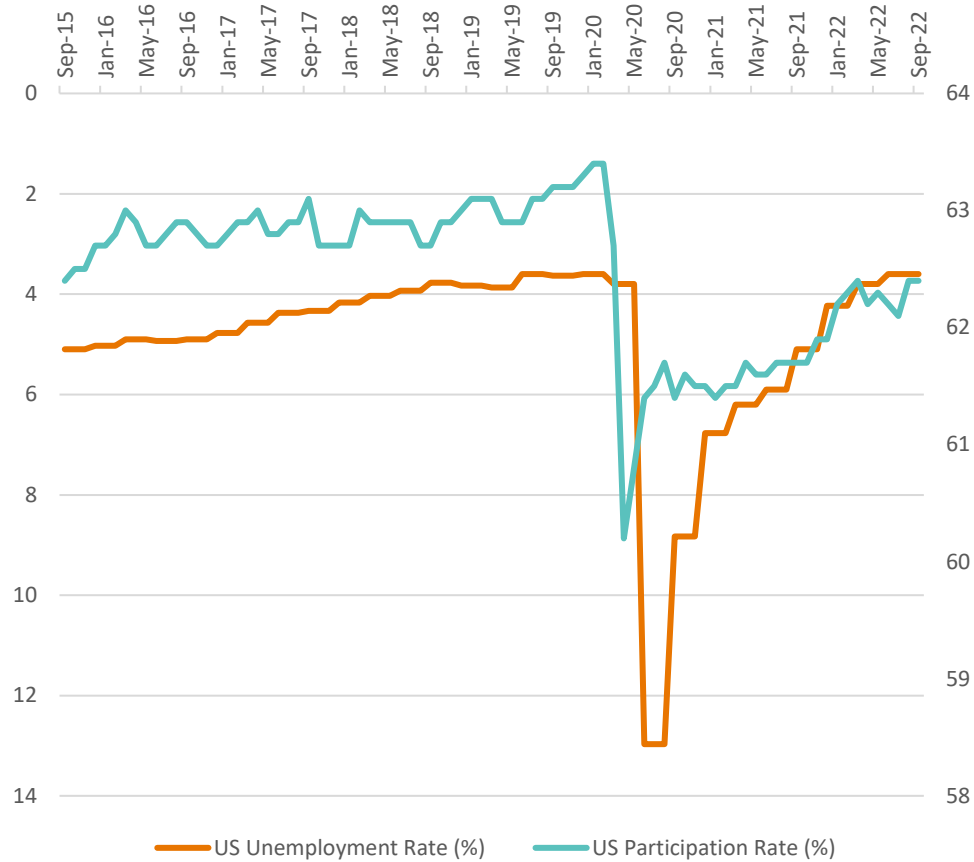
# THE LABOUR MARKET NEEDS TO PLAY TO SCRIPT

## WAGE GROWTH VS. CORE INFLATION



# MOMENTUM IN LABOUR MARKET STILL RESILIENT

## UNEMPLOYMENT VS. PARTICIPATION RATE RATE



Source: Bloomberg

## NON-FARM PAYROLLS



Source: Bloomberg

## LONG-TERM INFLATION INFLUENCES

### DISINFLATIONARY

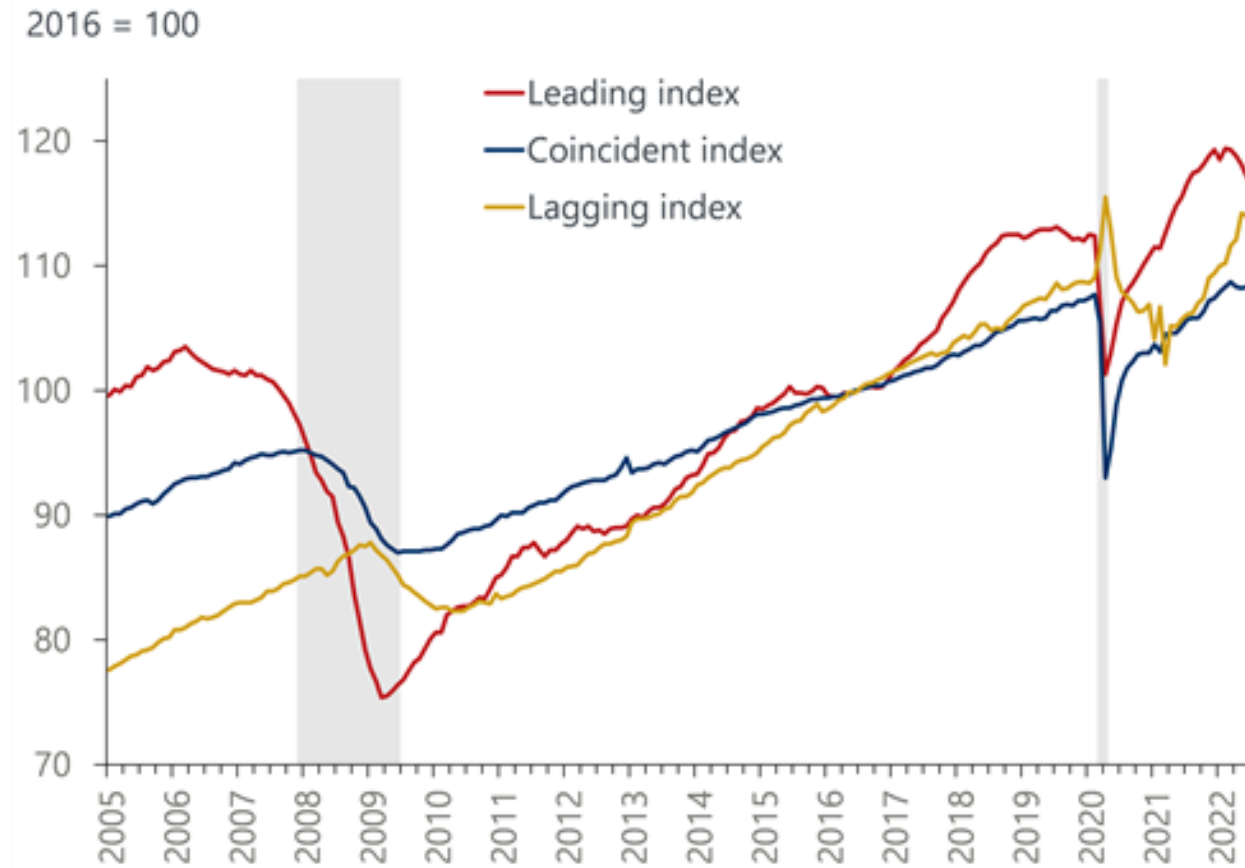
- Weak demographics
- High levels of debt
- Financialization
- Technology disruption
- Globalisation?

### INFLATIONARY

- Fiscal Policy
- Populist demands
- Labour mobility
- Geopolitical instability – China/Russia
- Climate transition

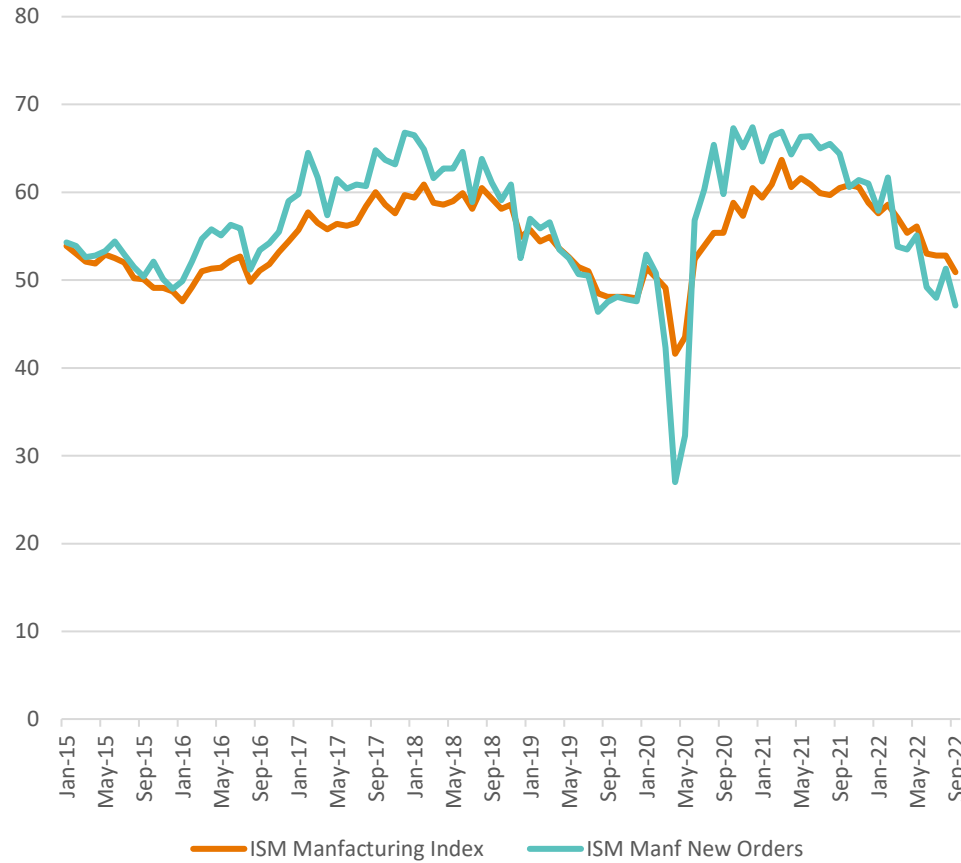
## LEADING INDICATORS CONFIRM ACTIVITY IS SLOWING

US: LEADING, COINCIDENT AND LAGGING INDEXES



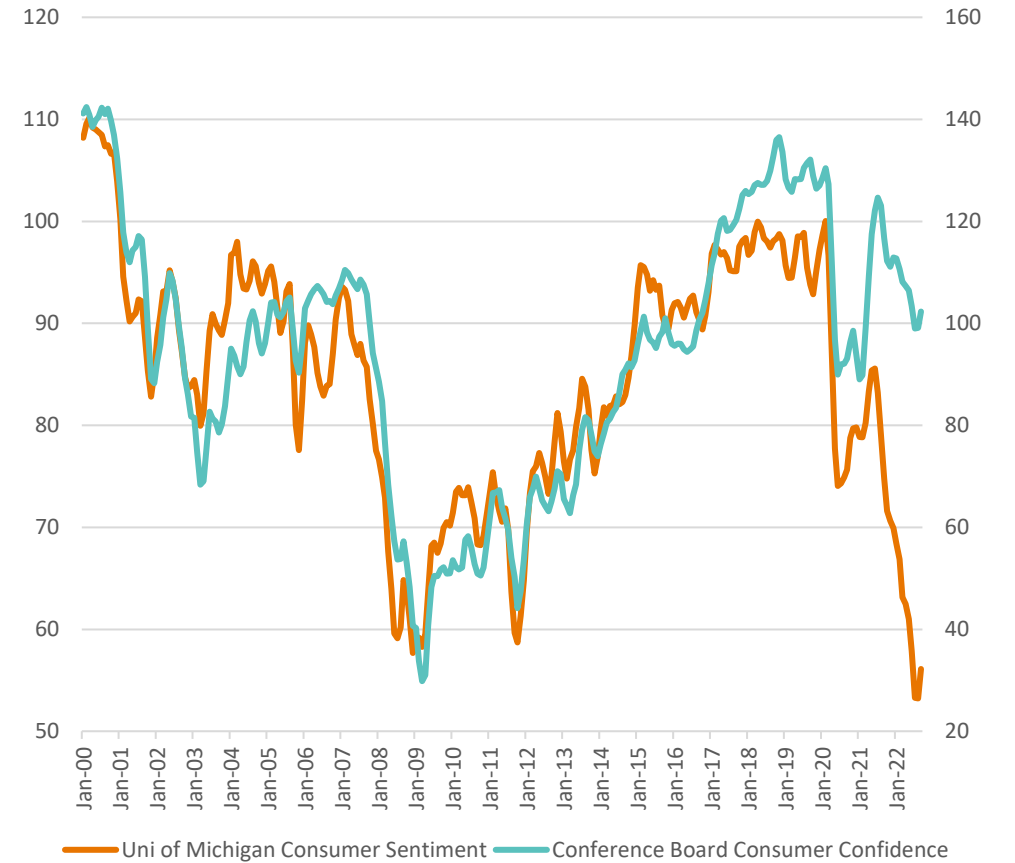
# LEADING INDICATORS

## ISM MANUFACTURING SURVEY & NEW ORDERS COMPONENT



Source: Bloomberg

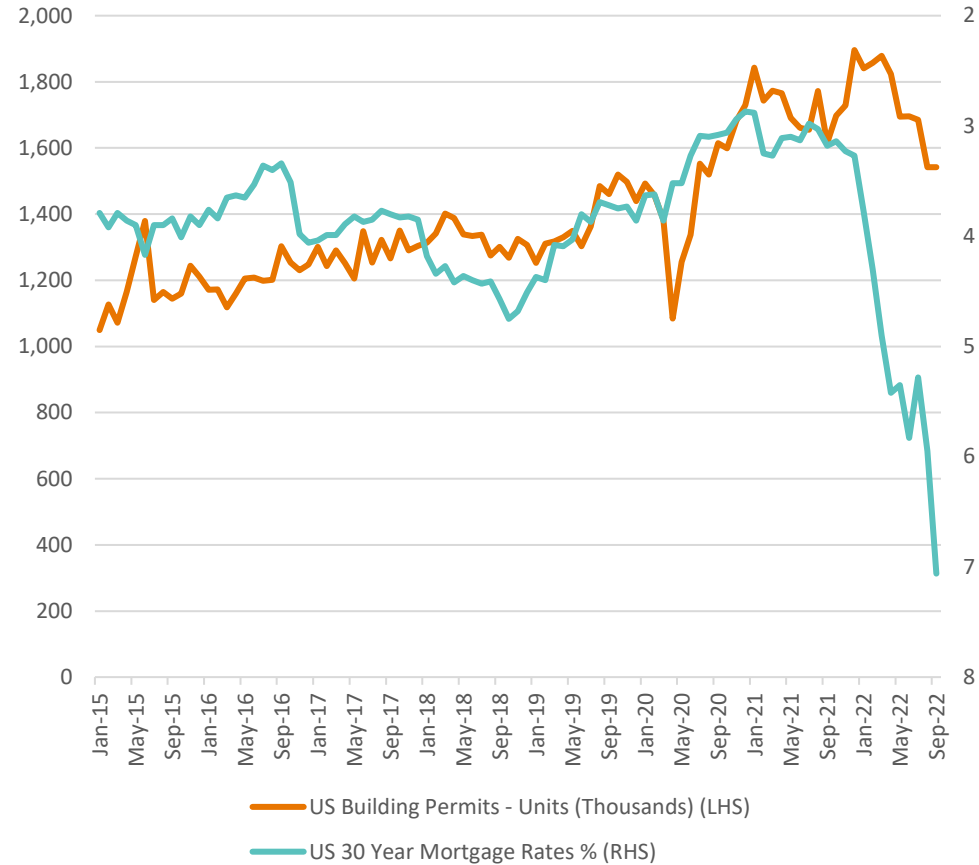
## US CONSUMER SENTIMENT & EXPECTATIONS



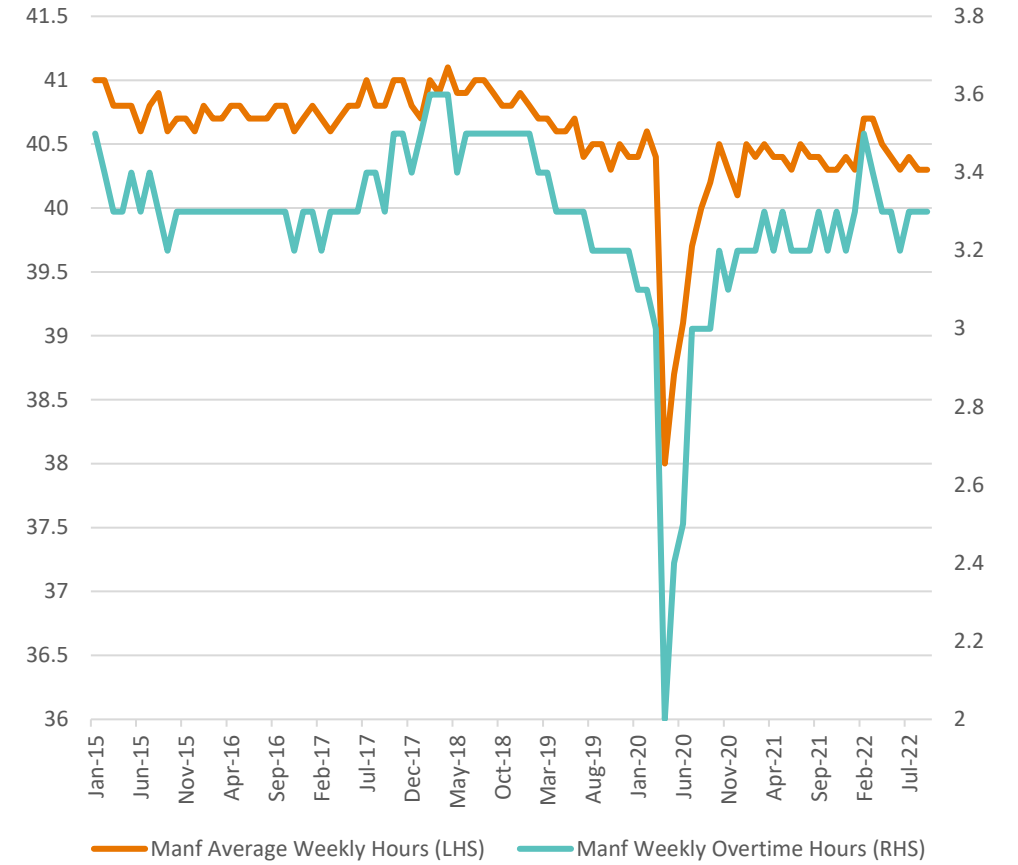
Source: Oxford Economics

# LEADING INDICATORS

## PROPERTY



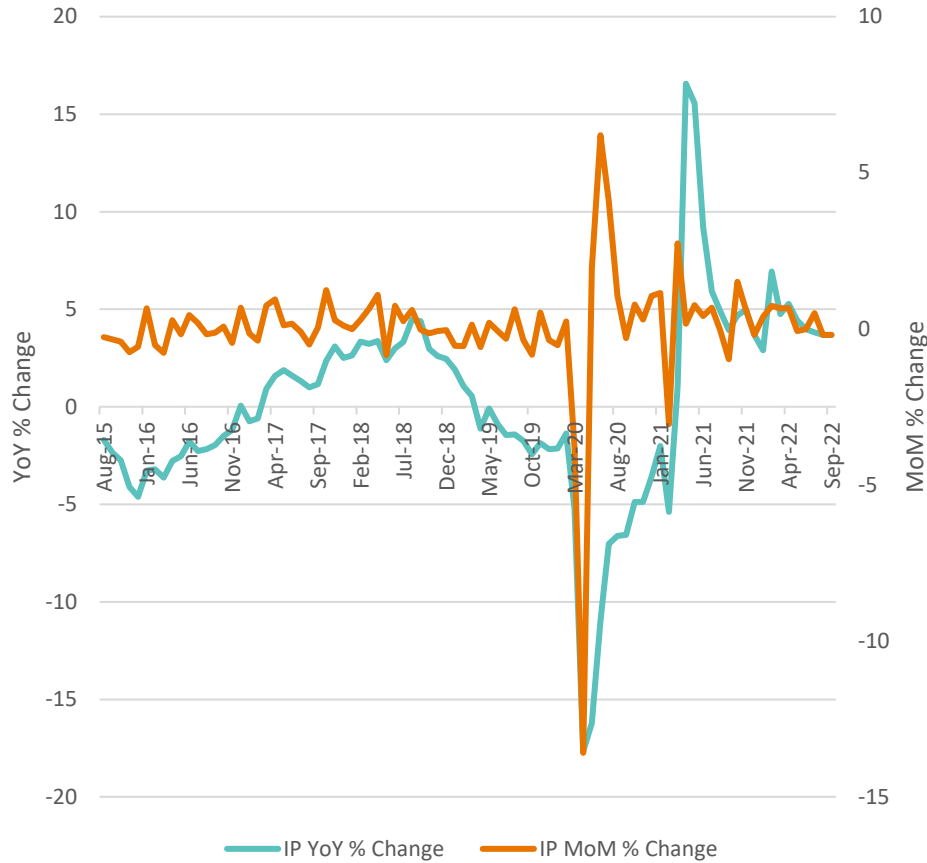
## MANUFACTURING – WEEKLY HOURS





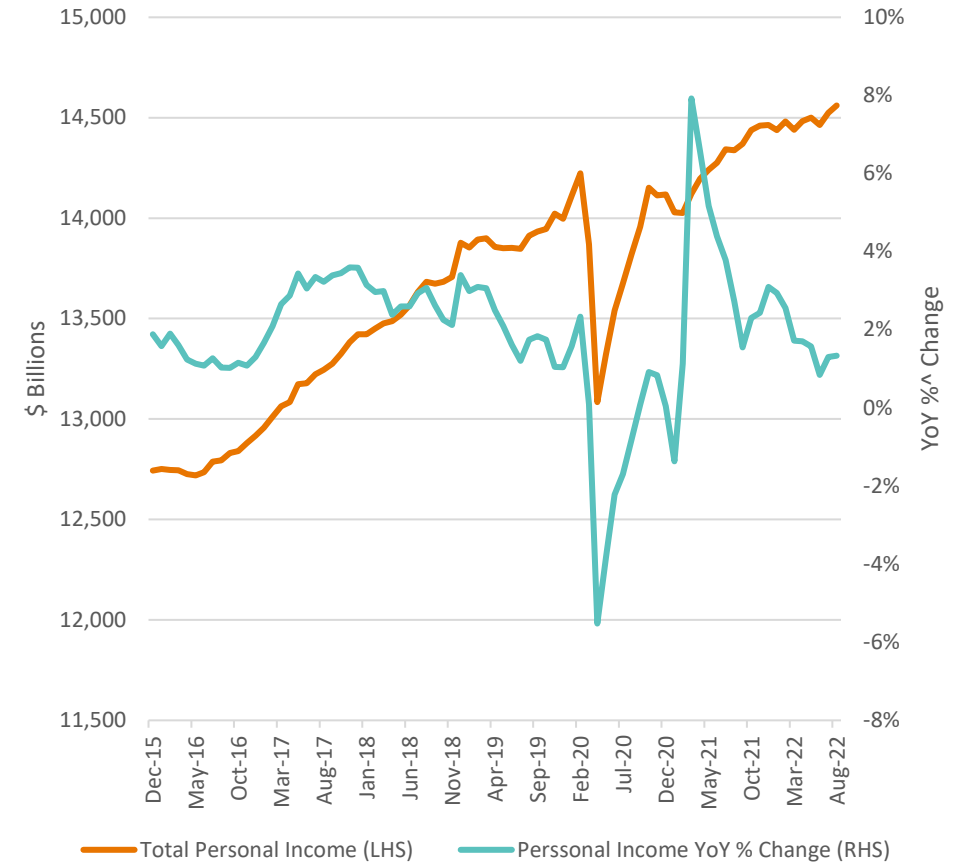
# COINCIDENT INDICATORS

## US INDUSTRIAL PRODUCTION



Source: Bloomberg

## PERSONAL INCOME LESS TRANSFERS



Source: Bloomberg

# REAL INCOMES UNDER PRESSURE

US REAL AVERAGE WEEKLY EARNINGS YOY



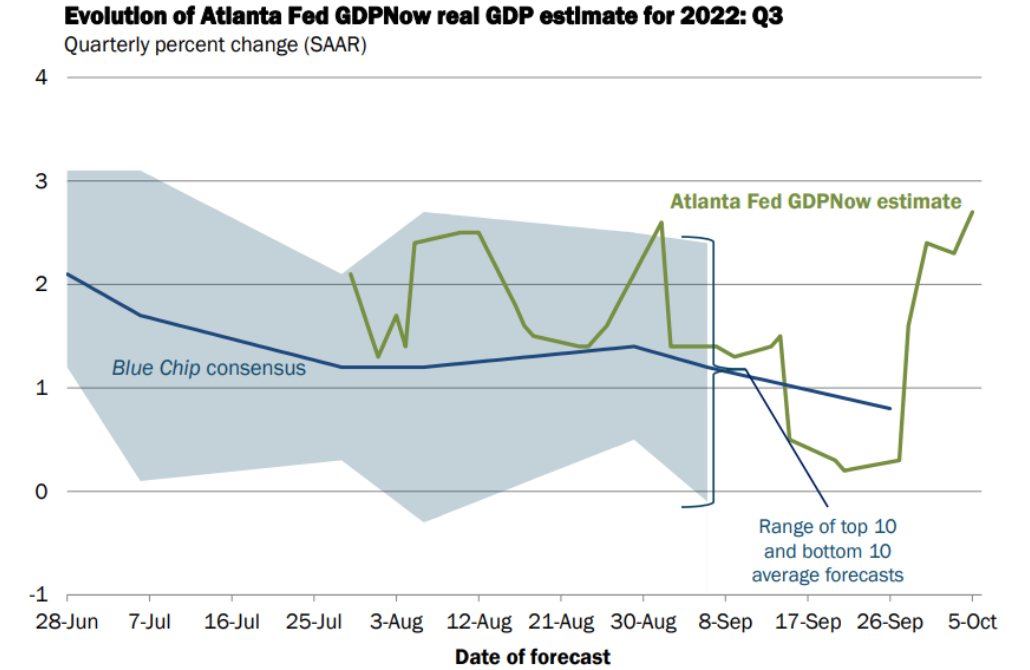
# LAGGING: H1 CONTRACTION OVERSTATES CURRENT WEAKNESS

US: GDP



Source: Oxford Economics

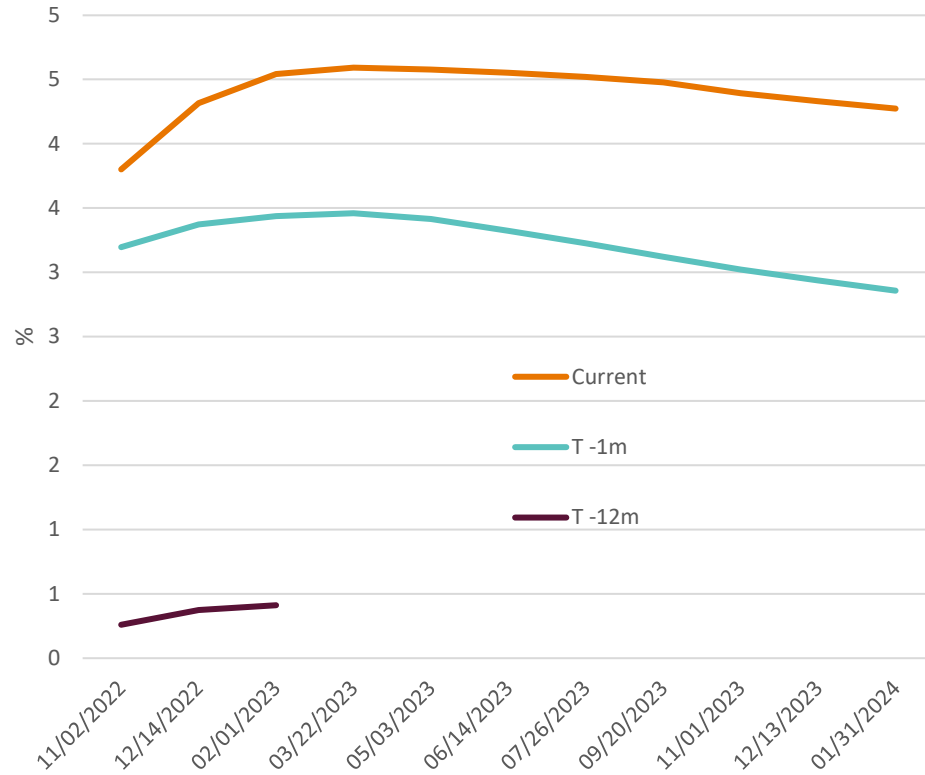
US GDP – Q3 2022



Source: Federal Reserve Bank of Atlanta

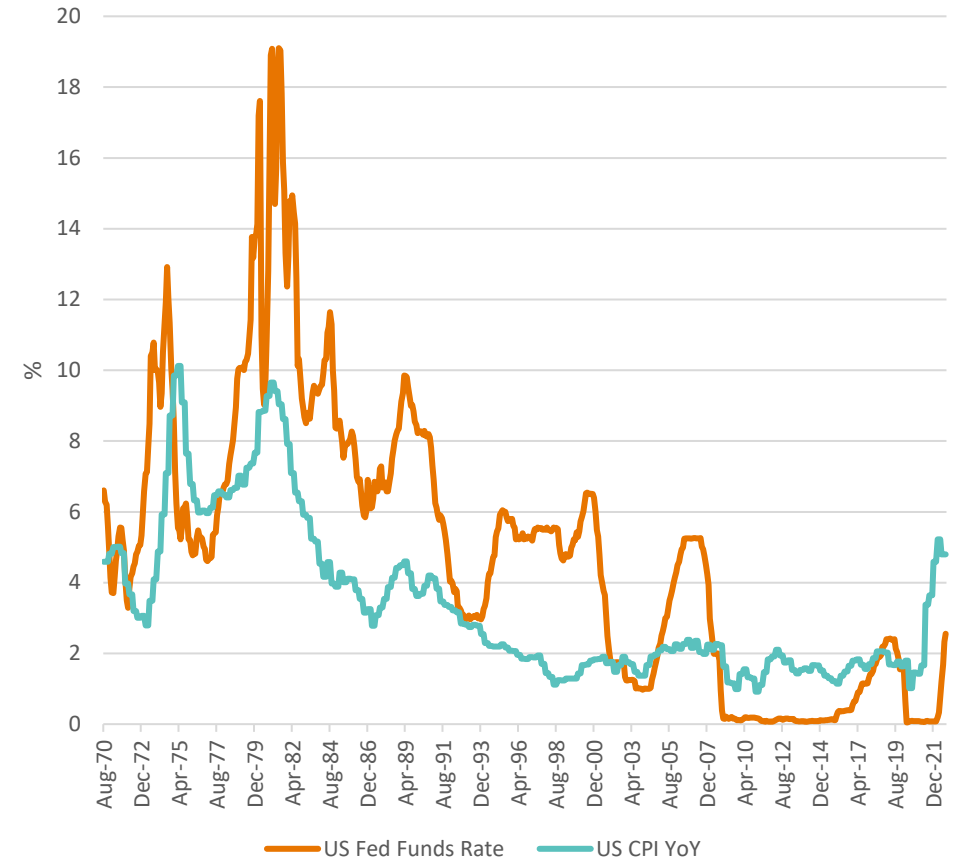
# POLICY EXPECTATIONS: FURTHER TO GO?

### MARKET IMPLIED FUTURE US RATES



Source: Bloomberg

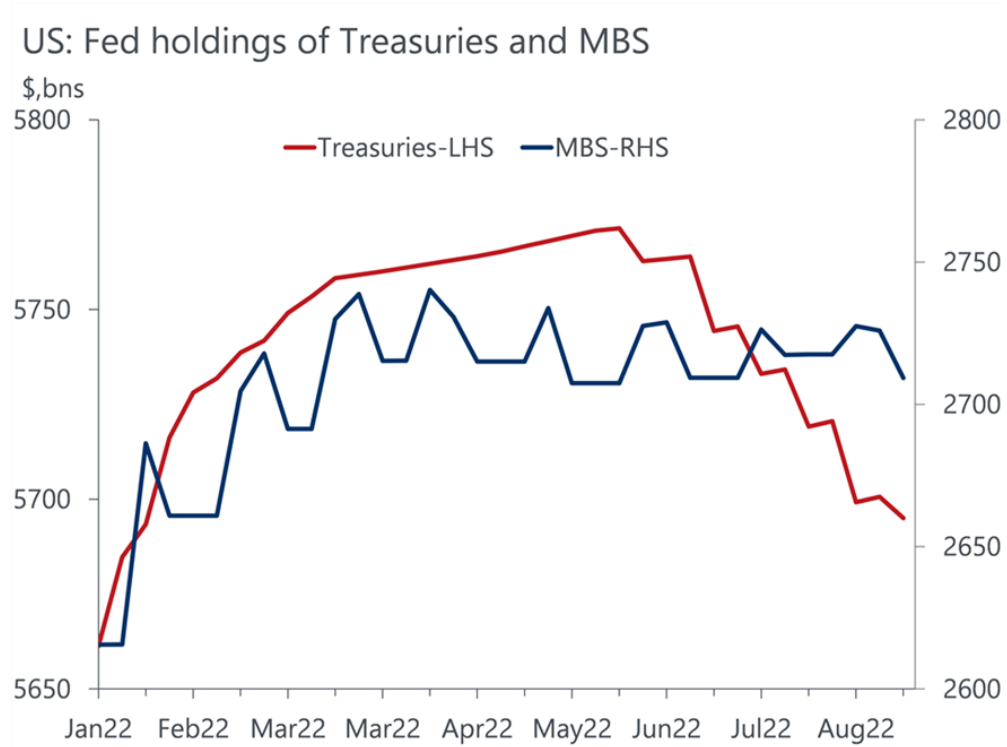
### CURRENT FED FUNDS VS. HEADLINE INFLATION



Source: Bloomberg

# CONDITIONS SET TO TIGHTEN FURTHER

QT: FED BALANCE SHEET



Source: Oxford Economics

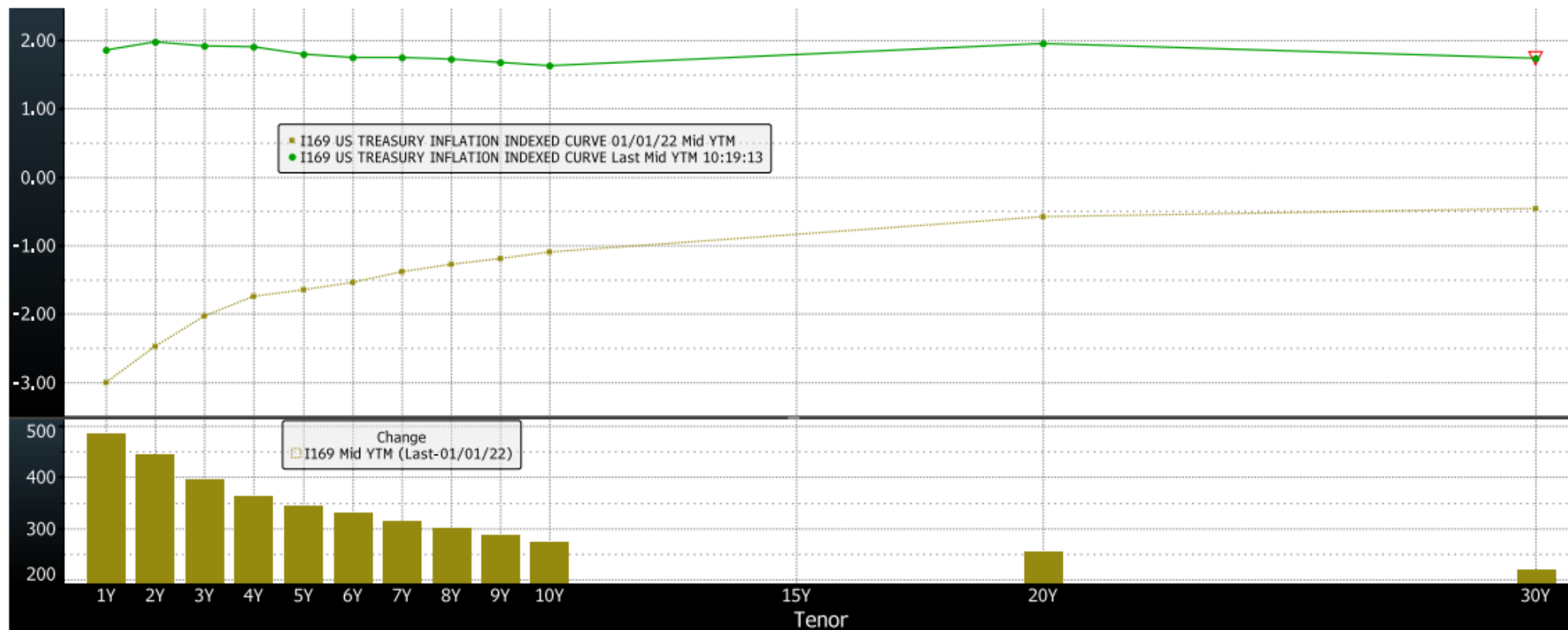
GS FINANCIAL CONDITION INDEX



Source: Bloomberg/Goldman Sachs

# US POLICY PUT ON A RESTRICTIVE PATH

REAL US YIELDS



## “SOME PAIN”: MORE REALISTIC EXPECTATIONS

FED ECONOMIC PROJECTIONS AND APPROPRIATE MONETARY POLICY – SEPT 2022

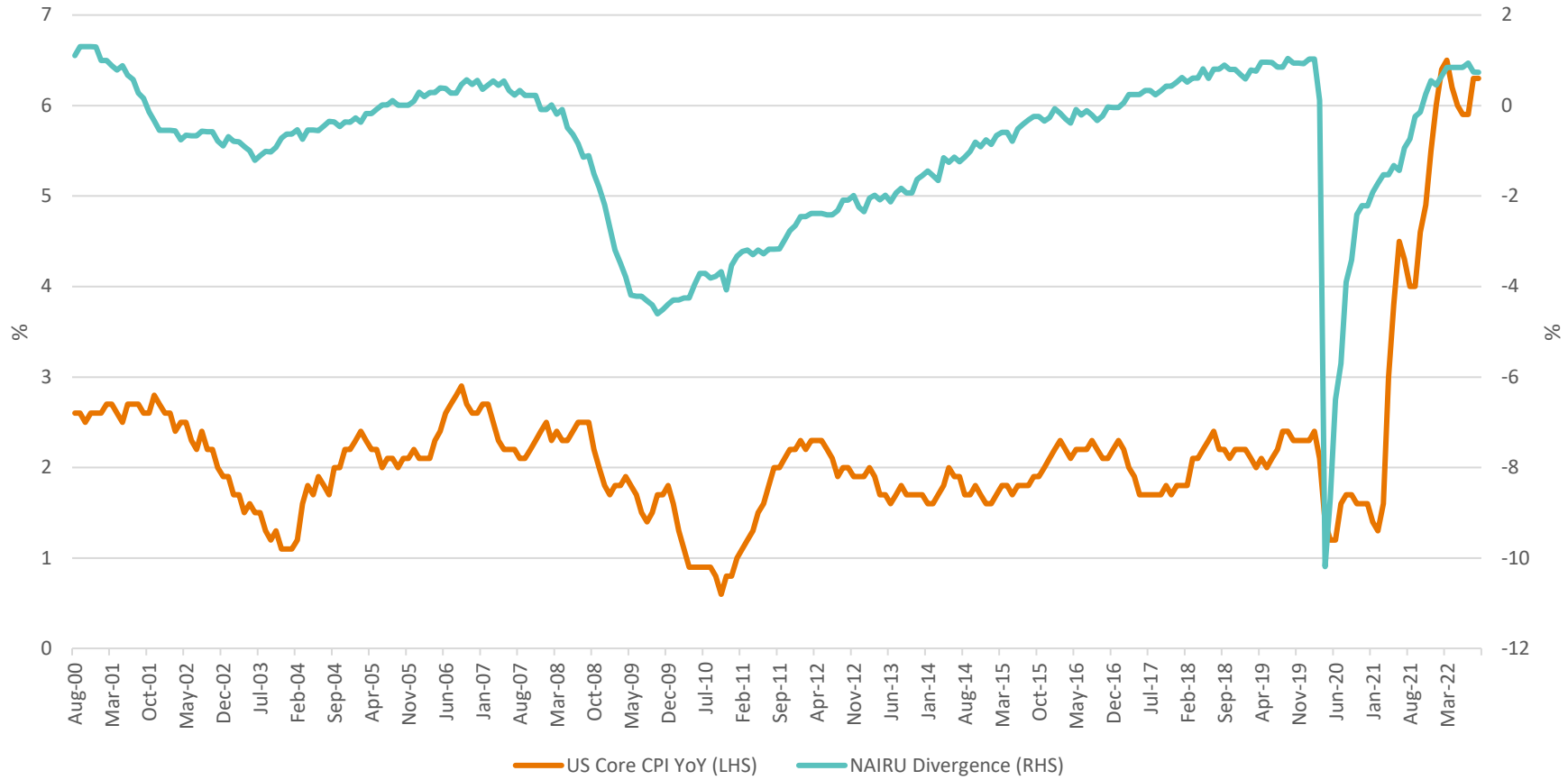
**Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, September 2022**

Percent

Variable	Median <sup>1</sup>					Central Tendency <sup>2</sup>					Range <sup>3</sup>				
	2022	2023	2024	2025	Longer run	2022	2023	2024	2025	Longer run	2022	2023	2024	2025	Longer run
Change in real GDP	0.2	1.2	1.7	1.8	1.8	0.1–0.3	0.5–1.5	1.4–2.0	1.6–2.0	1.7–2.0	0.0–0.5	-0.3–1.9	1.0–2.6	1.4–2.4	1.6–2.2
June projection	1.7	1.7	1.9		1.8	1.5–1.9	1.3–2.0	1.5–2.0		1.8–2.0	1.0–2.0	0.8–2.5	1.0–2.2		1.6–2.2
Unemployment rate	3.8	4.4	4.4	4.3	4.0	3.8–3.9	4.1–4.5	4.0–4.6	4.0–4.5	3.8–4.3	3.7–4.0	3.7–5.0	3.7–4.7	3.7–4.6	3.5–4.5
June projection	3.7	3.9	4.1		4.0	3.6–3.8	3.8–4.1	3.9–4.1		3.5–4.2	3.2–4.0	3.2–4.5	3.2–4.3		3.5–4.3
PCE inflation	5.4	2.8	2.3	2.0	2.0	5.3–5.7	2.6–3.5	2.1–2.6	2.0–2.2	2.0	5.0–6.2	2.4–4.1	2.0–3.0	2.0–2.5	2.0
June projection	5.2	2.6	2.2		2.0	5.0–5.3	2.4–3.0	2.0–2.5		2.0	4.8–6.2	2.3–4.0	2.0–3.0		2.0
Core PCE inflation <sup>4</sup>	4.5	3.1	2.3	2.1		4.4–4.6	3.0–3.4	2.2–2.5	2.0–2.2		4.3–4.8	2.8–3.5	2.0–2.8	2.0–2.5	
June projection	4.3	2.7	2.3			4.2–4.5	2.5–3.2	2.1–2.5			4.1–5.0	2.5–3.5	2.0–2.8		
Memo: Projected appropriate policy path															
Federal funds rate	4.4	4.6	3.9	2.9	2.5	4.1–4.4	4.4–4.9	3.4–4.4	2.4–3.4	2.3–2.5	3.9–4.6	3.9–4.9	2.6–4.6	2.4–4.6	2.3–3.0
June projection	3.4	3.8	3.4		2.5	3.1–3.6	3.6–4.1	2.9–3.6		2.3–2.5	3.1–3.9	2.9–4.4	2.1–4.1		2.0–3.0

# HOW MUCH SACRIFICE IS NEEDED?

US CORE INFLATION VS. NAIRU DIVERGENCE





## US FED POLICY SCENARIOS FROM HERE

When will the policy risks recede? Has the Fed mapped out a policy course that is ..... ?

### TOO LITTLE

- Economy resilient and little immediate slack
- Inflation expectations remain stubborn
- Oil price remains elevated
- Financial conditions ease
- More economic sacrifice required
  
- **Policy:** Further upward revisions, higher and for longer

### ENOUGH

- Economy cools and slack gradually opens up
- Inflation expectations moderate
- Oil price softens
- Financial conditions remain tight
- Sufficient economic pressure applied
  
- **Policy:** No course correction. Policy makers remain patient

### TOO MUCH

- Economy proves fragile and deeper recession risks apparent
- Inflation falls faster than expected
- Oil price falls
- Financial conditions tighten quickly
- Signs of financial market dysfunction
  
- **Policy:** Earlier dial back of policy or pivot

## SUMMARY

- Inflation may have peaked in the US, but the trajectory from here is critical
- Pandemic dislocations and some cyclical factors are easing, other inflation influences could be more stubborn
- The US economy is decelerating (recession risks are higher) but its unclear how quickly economic slack will open up
- Fed policy has been set on a course to sacrifice growth and jobs to curb inflation, but it is difficult to calibrate
- Significant policy uncertainty remains

## INVESTING IN UNCERTAIN TIMES

- Risk or uncertainty?
- Work to reduce the knowledge gap, but remain humble
- Scenarios are helpful in framing problems, ordering thinking and planning
- Avoid being precise, do not be afraid to use judgment and imagination
- Zoom out – Do not stray from objectives and a portfolio's definition of risk
- Build resilience and adaptability, despite the perceived inefficiency

**“It is not the strongest of the species that survives, nor the most intelligent, but the one most adaptable to change.”**

Charles Darwin

THANK YOU

