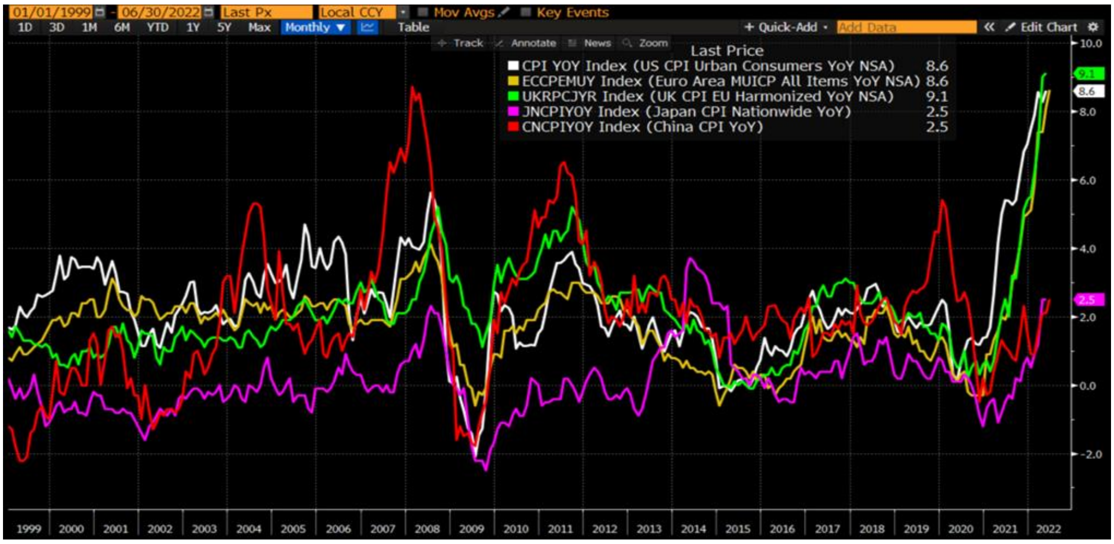
13 July, 2022

Surging in inflation as US faces recession risks

June inflation data comes out this week, the U.S. consumer price index is expected to show an 8.8% year over year increase and a 1.1% month over month increase, which would be accelerations from last month’s number. Gas prices and the cost of energy are expected to be the main drivers, as the average price of crude oil was 3.6% higher in June than May. Core CPI is expected to be 5.8% year over year, slightly down from May’s number. The new data arrives as the Federal Reserve pursues a series of rate hikes that aim to tackle inflation by slowing down the economy and slashing demand. The moves, however, risk tipping the economy into a recession.

In the western countries, such as US, EU and the UK, inflation has been climbing rapidly. France, Germany and Spain CPIs are all expected to stay at or near record high levels. Meanwhile, inflation has been rising at more moderate pace in China and Japan. Central banks are acting quickly and in lockstep. When the pandemic hit in 2020, countries all responded with rate cuts to support their economies. Now supply chain snarls caused by the pandemic and Russia's invasion of Ukraine are fueling price increases, again forcing the hands of central banks.

Consumer price index (nominal) among five industrial nations: US (white line), EU (yellow), UK (green line), China (red line) and Japan (magenta)



Sources: Bloomberg

Central banks across the world are picking up the pace of interest hikes, with developed nations raising rates to fight inflation and emerging economies following suit to defend their currencies. For many nations, the current inflationary environment is unseen for decades, most central banks shift tactic from ultra-loose monetary policy and to tighten up. Since March, the US Federal Reserve has hiked its Fed Funds Target Rate from 0.25% to the current 1.75%. It’s the most aggressive rate hike since the early-80s. Bank of England was the world’s first major central bank to raise interest rates in December 2021, and warned inflation was likely to hit inflation to hit 6% in April, three times of its target level. At its latest meeting on 15 June 2022, the Monetary Policy Committee (MPC) voted by a majority of 6-3 to increase Bank Rate by 0.25% to 1.25%. South Korea's central bank on Wednesday raised rates by 50 basis points, the biggest increase since the bank adopted the current policy system in 1999, and the New Zealand central bank also increased rates by the same amount. Bank of Canada also hiked its rate from 1.5% to 2.5% on 13 July, the largest increase since August 1998. The European Central Bank is expected to raise interest rates in July for the first time in 11 years.

Investors are worried about potential downside risk of the market and could push the global economy into recession. Investors pull out money from stocks and to other safer assets, because of the the economic outlook. Equity markets remain under pressure, notably among the high growth highly valued sectors such as technology. This is vividly demonstrated by the weakness in the tech-ladened Nasdaq Composite in the US, as well as the Taiwan and South Korean benchmark indexes, both markets are known for their technology prowess and corporate leaders in the tech sector. Compared to the peak in November 2021, the Nasdaq was down more than 30%.
Given the already sizable correction in equity prices since peaking, any occurrence of a mild-to-moderate recession may not prompt for further plunge of similar magnitude. The market increasingly believes that "the Fed and others central banks will try to contain inflation at the expense of the economy, The challenge for central banks is to keep inflation under control without causing the global economy to buckle

US GDP YoY Growth (yellow line) and S&P 500 in log scale (white line)

Sources: Bloomberg

Sources: Bloomberg, investing.com, wallstreet news, the Washington post, yahoo finance

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