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December Overview

Key points:

- Economic activity and inflation continued to fall in the euro area.
- Persistently high wage growth has kept services inflation high in the UK.
- A mixed picture in China includes an acceleration in retail sales and a slowdown in manufacturing activity.
- The US remains an anomaly among developed markets with robust economic growth alongside falling inflation, whereas growth in the euro area and the UK has weakened.

United Kingdom - Restrictive monetary policy appears to be working through the UK economy but persistently high wage growth has kept services inflation high.

The Bank of England (BoE) maintained its Bank Rate at 5.25% for a second consecutive meeting on 2 November. After two years of rate hikes totalling more than five percentage points, we believe the BoE has reached its peak rate. Like the ECB, the UK central bank suggested rates would need to remain in restrictive territory "for an extended period" given inflationary pressures. We don't see policy rate cuts until mid-2024 at the earliest.

The pace of CPI headline inflation slowed considerably in the 12 months to October to 4.6%, significantly lower than the 6.7% recorded in the 12 months to September. Core CPI, which excludes volatile food, alcohol and tobacco prices, rose by 5.7% in the 12 months to October, down from 6.1% in the 12 months to September. Goods prices fell sharply to 2.9% in the 12 months to October compared with 6.2% in the 12 months to September. Stickier prices for services moderated from 6.9% to 6.6%. Annual growth in regular pay (excluding bonuses) remained high for the three months to September, at 7.7%.

The first estimate of Q3 UK GDP showed growth slowing to a standstill compared with the second quarter. On a monthly basis, GDP increased in both August and September, following a sharp 0.6% decline in July.

The unemployment rate was largely unchanged at 4.2% in the July-to-September period, according to the Office for National Statistics (ONS). Citing "increased uncertainty" around its traditional surveys, the ONS used a new methodology that relies on real-time payroll and unemployment benefits data. There are recent signs of loosening in the labour market. Employment growth declined and vacancies fell in 16 of the 18 industry sectors

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United States - The Federal Reserve (Fed), the US central bank, maintained its target for the federal funds rate in a range of 5.25%–5.5% at its November meeting. It is expect that the Fed will proceed cautiously given competing economic and market forces and that the it won't be in a position to cut rates until the second half of 2024.

Growth in personal consumption reaccelerated to 4% (on a seasonally-adjusted basis) in the third quarter (Q3), which was far stronger than the 0.8% growth rate recorded in the second quarter. Services accounted for 60% of the consumption growth, while goods accounted for 40%. An advanced estimate of Q3 growth by the Bureau of Economic Analysis put Q3 US GDP growth at 4.9%.

Core inflation, which excludes volatile food and energy prices and is measured by the Personal Consumption Expenditures (PCE) Index, fell to 3.7% in the 12 months to September, down from the 3.8% recorded in the 12 months to August. Headline inflation, as

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measured by the Consumer Price Index (CPI), fell to 3.2% in the 12 months to October, down from the 3.7% recorded in the 12 months to September.

The US labour market showed further signs of slowing. A survey of US households found that 348,000 jobs were lost in October—the greatest decline since April 2020, just after the start of the Covid-19 pandemic. The latest jobs report suggests the US labour market may be approaching a turning point with increased part-time employment, long-term unemployment and discouraged job seekers pointing towards a 0.5 percentage point rise in the unemployment rate over the next six months. Such a rise is inconsistent with a 'soft landing' scenario, i.e., the avoidance of recession, but the unemployment rate is unlikely to reach recession levels due to structural labour supply factors.

Euro area - Subdued economic activity and falling inflation suggest the European Central Bank's (ECB) monetary policy tightening programme is taking effect.

The ECB held its deposit facility rate unchanged at 4% in October following 10 consecutive rate increases. The central bank said it would "ensure that its policy rates will be set at sufficiently restrictive levels for as long as necessary.

Headline inflation decelerated significantly in the 12 months to October to 2.9%, according to a flash estimate. That compares with 4.3% in the 12 months to September and 5.2% in the 12 months to August. The primary driver of the deceleration in headline inflation was an 11.1% decrease in energy price rises over the period.

Core inflation, which excludes food and energy prices, slowed to 4.2% in the 12 months to October, down from 4.5% in the 12 months to September.

The euro area economy contracted by 0.1% (on a seasonally-adjusted basis) in Q3 relative to Q2. Economic activity indicators point towards a further contraction in the fourth quarter, which would signify an economy in recession. The unemployment rate edged up to 6.5% in September, from 6.4% in August.

China - A mixed picture of economic data released in mid-November suggests China's economy is gaining momentum after recent government stimulus.

Retail sales increased by 7.6% in the 12 months to October, the National Bureau of Statistics reported, far stronger than the 5.5% growth in the 12 months to September and above consensus estimates. Industrial production remained resilient, rising by 4.6% in the 12 months to October, up slightly from September's 4.5% year-over-year growth.

China's economy grew by 1.3% on a seasonally-adjusted basis in Q3 relative to Q2, which puts the country on track to meet the government's 2023 full-year growth target of "around 5%".

Other recent data suggest the economy isn't yet on its front foot. Purchasing managers' index data released in November revealed slowdowns in manufacturing, construction and services activity in October compared with September.

Recent inflation data suggest tepid consumer demand amid strained household balance sheets. Consumer prices fell by 0.2% in the 12 months to October; food prices declined for a fourth straight month and by the greatest amount—4%—in more than two years. Core inflation, which excludes volatile food and energy prices, rose by just 0.6% in the 12 months to October.

Source: Vanguard

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