

Jul 29, 2022

A second consecutive quarter of negative US real GDP growth

- **USD:** US quarterly real GDP releases are usually backward looking as the partials are pretty much discounted into market pricing. **But not so it seems, the preliminary estimate of US Q2 real GDP released overnight, that falls sharply following the contraction in Q1**, declining -0.9% (QoQ SAAR) and **contrary to Citi analysts' expectations** for a +0.6% increase and consensus looking for +0.4%. **Details of the print are also notably weaker than expected and potentially signal a possible peak in US activity by mid-2022.** In particular, **elements of domestic demand are softer than expected**, with final private domestic demand flat on the quarter after a 3% increase in Q1. **Consumption is up 1.0%** but surprisingly, **business investment is flat and residential investment declines a massive 14%**, undoubtedly impacted by higher rates weighing on housing demand. Meanwhile, **inventories also weigh on growth by 2pp but net exports boost GDP by 1.4pp.** The **data also shows core PCE inflation up 4.4%**, modestly stronger than expectations for 4.3%
- **USD:** The US Q2 GDP data highlights weakening elements of domestic demand and residential investment that are more concerning for underlying growth trends. Whether the 2 quarters of negative US GDP growth constitutes an official NBER-defined recession against the backdrop of still significant employment growth is a matter for debate, **but details of the Q2 GDP data suggest mid-2022 could be the peak in activity this cycle.** Housing seems to be the first area experiencing the impact of tighter Fed policy as mortgage rates respond to expectations for the entire Fed hiking cycle. **But with core PCE inflation also modestly stronger, this is likely to keep the Fed pursuing still-higher policy rates at least up until the September meeting.**

US initial jobless claims continue to trend higher

- **USD:** With US real GDP growth contracting, the hope is that the still solid US labor market will allow the Fed to engineer a soft landing. However, **while the seasonally adjusted initial jobless claims for the week of July 23rd drop to 256k** compared to an upwardly revised 261k the prior week, **this is slightly higher than consensus** looking for 250k. **Seasonally adjusted continuing jobless claims for July 16th also drop to 1359k** from an unchanged 1384k the prior week.
- **USD:** More interestingly however, while total continuing jobless claims decline, over 30 states in the US report an increase on the week – implying that in a broader sense, continuing jobless claims are heading higher, likely suggesting that labor markets should gradually loosen as US economic activity slows further. Overall, on a four-week moving average, there appears to be an unmistakable shift up in initial jobless claims albeit from a still low base.

Euro area gas supply worries and cost of living crisis deal strong blows to confidence

- **EUR:** The euro area Economic Sentiment Indicator (ESI) falls from a 103.5 in June to 99.0 in July, reaching its lowest level since Mar-21, well below consensus forecasts for a 1.5 point drop to 102.0. July's 4.5pt drop is the largest since March following Russia's invasion of Ukraine in late February, likely reflecting the combined negative impact of record high inflation and mounting fears of natural gas shortages due to the severe reduction in supplies from Russia. The headline sentiment index is now below its historical average of 100 in the euro area and also in the EU-27 (-4.2pt in July to 97.6). Citi analysts expect a euro area recession to become more likely by autumn if sentiment continues to soften at the same pace throughout summer.

Key data/ events for the remainder of this week

- **USD: US June Personal Income – Citi: 0.5%, median: 0.5%, prior: 0.5%; Personal Spending – Citi: 1.0%, median: 0.8%, prior: 0.2%; Core PCE MoM – Citi: 0.5%, median: 0.5%, prior: 0.3%; Core PCE YoY – Citi: 4.7%, median: 4.8%, prior: 4.7% - Citi analysts expect a 0.52%MoM rise in core PCE inflation and for the Y/Y reading to remain at 4.7%. Citi analysts expect core PCE to end the year higher than the Fed's latest forecast of 4.3%.**
- **USD: US Q2 Employment Cost Index (ECI – Citi: 1.3%, median: 1.1%, prior: 1.4% - ECI may be one of the most important data releases this week, especially as one recent narrative around a slowing inflation outlook is premised on labor costs moderating in recent months. Citi analysts though expect a strong 1.3%QoQ rise in ECI in Q2..**
- **EUR: Euro area inflation stable but still very high – Citi analysts look for signs that core goods price dynamics, on a MM basis, starts easing, following somewhat softer upstream pipeline pressures. Euro Area HICP Inflation, July – Citi Forecast 8.6% YY, Consensus 8.7% YY, Prior 8.6% YY; Euro area Core Inflation, July – Citi Forecast 3.7% YY, Prior 3.7% YY (temporary downward effect on core).**
- **CNY: China Manufacturing PMI July – Citi Forecast 50, Previous 50.2 – Citi analysts expect China's manufacturing PMI to notch down slightly to 50 in July.** High-frequency trackers show COVID-19 resurgence has led to limited mobility of the people in the impacted areas, while industrial production and supply chains appear largely intact. Property market sentiment might have been hit by the mortgage non-repayment event and the auto sales have been lackluster so far in July amid fading reopening momentum and purchase tax cut effect.

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