



# Monthly economic outlook for Private Equity

14 October 2024

## Central bank whiplash

Monetary policymakers have been busy recently. In September, the Federal Reserve Bank (FED) made a jumbo rate cut of 50 basis points, and the People's Bank of China made the biggest rate cut to its medium-term lending facility since it began using it in 2016. Central banks for the Eurozone, Canada, Denmark, Mexico, Sweden, and Switzerland all cut rates in September as well<sup>i</sup>. Meanwhile, Japan has raised rates twice so far this year. Monetary policy normalization is expected to continue. This means additional rate cuts in China and most developed economies, and additional rate hikes in Japan. However, the pace of normalization might not be quite as fast as previously anticipated.

The Fed projects another 50 basis points of cuts this year and another 100 basis points next year<sup>ii</sup>. This relatively dovish outlook was formed before two critical data surveys were released. The first is the comprehensive data revisions for national income and spending. Prior to revisions, after-tax income was growing at a slower rate than consumer spending, suggesting that there would be a notable comedown in spending growth. The newly revised data now show that after-tax income is growing faster than spending<sup>iii</sup>, which suggests the comedown in spending should be more gradual. The second release was the United States payroll report, which showed that the unemployment rate fell in September, and that wage growth accelerated<sup>iv</sup>. The new data suggest a slower pace of interest rate cuts may be necessary.

Headwinds to additional monetary easing are not limited to the United States. Although the Eurozone's headline inflation was just 2.2% on a year ago basis in August, core inflation was stuck at 3.0%<sup>v</sup>. At the same time, Europe's wage growth remains too strong and productivity too weak for inflation to sustainably converge to 2%. For example, nominal wage growth for the Eurozone was 4.5% in the second quarter, while productivity growth was negative<sup>vi</sup>. This suggests that businesses may not be able to absorb much of the strong wage gains and will have to pass the cost onto consumers. A similar dynamic has emerged in the United Kingdom.

China's more dovish monetary policy stance has coincided with weak inflation and weak economic growth. As a result, more monetary easing is likely in the cards. However, after the government announced a surprise fiscal stimulus package<sup>vii</sup>, the People's Bank of China may be able to take a pause from its spate of rate cutting. Plus, higher global oil prices could provide inflationary pressure to consumer prices. Oil markets had previously been sanguine about the ongoing conflict between Israel and its neighbors. However, an intensification of the conflict on 1 October in the Middle East has caused oil prices to rise<sup>viii</sup>.

Although higher oil prices could force a more hawkish monetary policy stance across much of the world, the Bank of Japan is likely to take a more cautious approach to its tightening. Japan's western core inflation, which excludes food and energy, has been below 2% for five consecutive months on a year-ago basis<sup>ix</sup>. In addition, wage growth has eased, and the unemployment rate has drifted modestly higher.<sup>x</sup> Although wage growth is still likely too strong to be consistent with 2% inflation, the labor market is loosening rather than tightening. After advocating for

tighter monetary policy, Japan's new prime minister recently said that more rate hikes are unnecessary<sup>xi</sup>. The factors combined suggest that Japan will only see slightly more tightening.

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## Endnotes

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<sup>i</sup> Central Banks via Haver Analytics

<sup>ii</sup> Federal Reserve Board via Haver Analytics

<sup>iii</sup> US Bureau of Economic Analysis via Haver Analytics

<sup>iv</sup> US Bureau of Labor Statistics via Haver Analytics

<sup>v</sup> Eurostat via Haver Analytics

<sup>vi</sup> Ibid

<sup>vii</sup> <https://www.economist.com/finance-and-economics/2024/09/27/at-last-china-pulls-the-trigger-on-a-bold-stimulus-package>

<sup>viii</sup> Financial Times via Haver Analytics

<sup>ix</sup> Japan Ministry of Internal Affairs and Communication via Haver Analytics

<sup>x</sup> Ibid

<sup>xi</sup> <https://www.japantimes.co.jp/business/2024/10/06/markets/ishiba-interest-rate-remark-surprise/>

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