HANG IN THERE...

An earlier and shorter note than usual, ahead of the Labor Day weekend.

As summer draws to a close, news on the US economy is encouraging. But the balancing act between curbing inflation and avoiding recession is set to continue a while longer.

The odds of a soft landing for the US economy are rising. This week's data reinforced a picture of slowing consumer price inflation and gradually easing pressures in the labor market. The Fed's preferred measure of inflation – core PCE – came in as expected in July at 4.2%. The underlying data show a gradual slowdown, with an annualized inflation rate of just 2.6% in the month.

But investors hoping for a definitive end to rate hikes need to wait a while longer. Major central banks are not yet ready to call a halt to the tightening they embarked on almost 18 months ago. That time is approaching. But even when interest rate hikes are over, policy in the US will stay restrictive until inflation goes down another notch.

Markets this week seemed to get comfortable with that prospect. Bond prices took an initial dive after Federal Reserve Chair Jerome Powell warned at Jackson Hole that the Fed might not yet be done. The prospect that rates would also be held up "higher for longer" by a changing global economy with higher government deficits hit equity markets at the beginning of the week. After a tricky few days, August looks set to end with equities just a bit below where they began the month.

The three themes that RockCreek outlined for Q3 – peaking interest rates, inflation, and a hard or soft landing for the economy – are still key for investors to watch this fall.

At the late August gathering of central bankers in the shadow of the Grand Tetons, it must have been tempting for Chair Powell to take credit for how much the US economy has improved since his downbeat speech at Jackson Hole a year ago. Inflation is now under better control than in most other developed countries. In Europe, the price data released Thursday show August headline inflation unchanged from July at 5.3% over a year ago. The European

Central Bank (ECB) and other observers had been hoping for a slowdown, but rising energy and food prices pushed up inflation in major economies including Germany and France. At the same time, prospects for growth are not good, especially in Germany and the UK.

In the US, this week's data show that the slowdown in inflation has come in a way that seemed quite unlikely until recently. Rather than being accompanied by economic contraction and a sharp rise in unemployment, as many predicted, disinflation has come alongside continued growth in output and jobs. Revised GDP data show growth at a still robust 2.1% in Q2, buoyed by consumer and government spending. Early data for Q3 show robust consumer spending continued in July, despite a drop in real disposable income as government transfers declined.

Despite the good news on inflation, the Fed was wise to avoid taking a victory lap. There is still further to go to secure price stability, which Chair Powell again defined as inflation of just 2%. And keeping money tight in the meantime, even without further rate rises, will continue to gradually squeeze the economy.

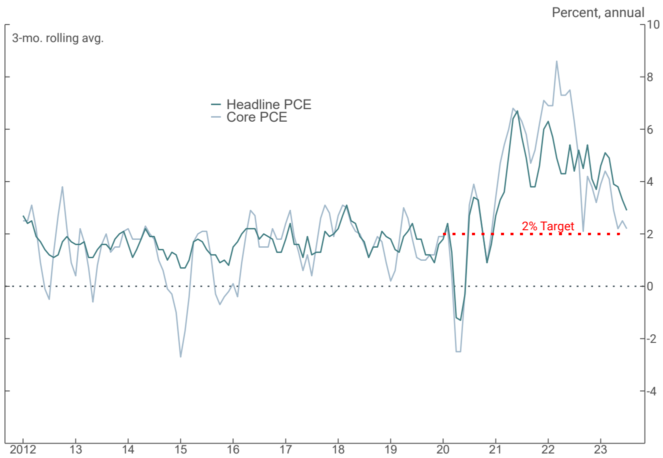
INTEREST RATES: A STEALTH PEAK?

Some observers believe that the soft landing is a mirage. On this view, inflation is not yet beaten. Higher wages and future disappointments on prices will force the Fed to tighten further, until jobs dry up and unemployment rises. This seems unduly pessimistic. In just three weeks, the Fed will release its latest economic forecasts, together with the "dot plot" projections of where the central bankers expect interest rates to go over the period ahead. Investors should not expect a declaration from the Fed that it has finished tightening, even if it pauses rate hikes in September. Indeed, the peak for rates may be clear only in retrospect, once the data dependent central bank is satisfied that the chance of a resurgence in inflation has dwindled away.

STEALTH INFLATION

This morning's inflation news confirms the summer improvement in consumer prices. On the Federal Reserve's preferred measure of inflation – core PCE– July inflation stayed at the June rate of 0.22% month on month, for an annualized rise over the past three months of just under 3%. Earlier in the week, the JOLTS report that Chair Powell has pointed to as a measure of tightness in the labor market showed pressures easing. Vacancies are still high, with 1.5 jobs available for every American seeking work. But this is well below the peak levels reached during the heat of the pandemic recovery. The rate at which workers are deciding to leave their jobs has also come down, to a more normal 2.3%. The August payroll report, due out Friday morning, is expected to confirm the pattern.

Another step towards the end of the hiking cycle



Source: Bureau of Economic Analysis

DIAMETRICALLY OPPOSED... FRIENDS?

Last week, the five-member bloc known as the BRICS – Brazil, Russia, India, China and South Africa – convened for their annual summit in Johannesburg. Despite initially uniting to enhance economic cohesion, the bloc has, in recent years, shifted its goals towards more geopolitical aspirations that challenge existing institutions. The decision to add six new countries with little in common other than grievances against the West illustrated this point.

One feature stood out among the new group of countries, which include Argentina, Ethiopia, Iran, Saudi Arabia, Egypt, and the United Arab Emirates: a number are heavyweights in fossil fuel production aspiring to be major economic or political players. The BRICS face an uphill battle if they want to become a formidable counterweight to their developed market peers in the G7, as some have suggested. For President Xi Jinping, who threw his country's economic weight behind adding new members, this win was particularly important to not only grow the bloc's symbolic power but to maintain China's sphere of influence amid an anemic economic recovery.

The members are often at odds with one another – even the decision to expand membership was drawn out until the eleventh hour – and many are struggling with economic, security and political woes. It seems unlikely a coherent alliance will form any time soon, although the intent of the expansion should give the US and G7 partners pause.

***Read the full article here*.**

CHINA, AGAIN

One of the most experienced US cabinet members visited China this week, as the two economic giants circle one another, wondering how best to reconcile their mutual economic dependence with growing national security and diplomatic competition on the global stage. Commerce Secretary Gina Raimondo's visit this week was deemed as very successful and critical as she sounded a conciliatory note when she declared that the US supported a strong China economy. But she also said that national security concerns were non-negotiable.

China's economic data continued to disappoint. In the latest attempt to stimulate the economy and moribund capital markets, Chinese authorities announced this week a 50% cut in the stamp duty for onshore equity transactions and eased margin requirements. The stock market reacted positively, but China's woes have less to do with market flows and valuations and more to do with a lack of consumer confidence. Further weakness in the all-important property sector was shown this week when Country Garden, China's largest private property developer posted a $7 billion loss for the first half of the year. One piece of good news was a strong rally in Pinduoduo, one of China's largest online discount retailers, perhaps reflecting a switch in spending from luxury to discount by stretched Chinese consumers.