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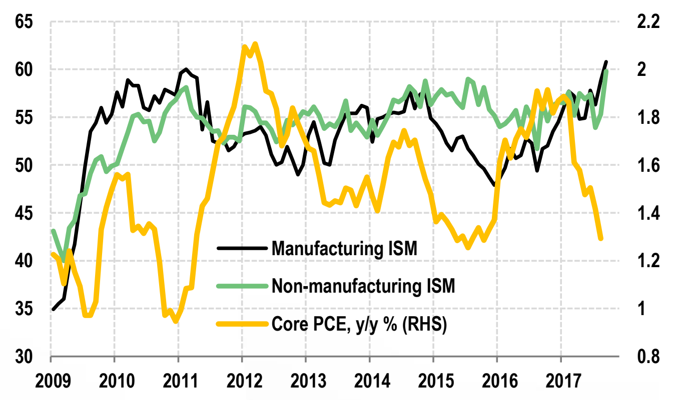
US: the better growth/lower inflation puzzle

■Survey data released this week point to stronger US growth in September ■This doesn't stop core inflation from declining ■Bond and currency markets expect the FOMC to focus on the growth indicators

How good can it get? Better than you think. That's the impression one gets from key survey data released at the start of this month and which show the economic pulse for September. Although the global manufacturing PMI was stable at 53.2, the PMI for the eurozone rose to 58.1 (from 57.4). This brings us close to the 17 year high of 60.5 reached in April 2000. In the US, the ISM index for the manufacturing sector increased to 60.8 (from 58.8) with a big increase of the new orders series. The non-manufacturing ISM reached 59.8 (from 55.3 in August). As expected, this caused a jump in the real-time growth estimate ('nowcast') produced by the Federal Reserve of Atlanta. Annualised quarterly real GDP growth for Q3 is now estimated at 2.8%. Yet the year over year change in the core personal consumption expenditures price index has been on a declining trend since the start of the year. Although the monthly change has been stable for four months in a row, it has been so at a very low level (0.1%). It implies that the puzzling mix of sustained good growth and subdued inflation continues, raising the question about what it entails for monetary policy. Ongoing low inflation numbers going forward would intensify the debate with some arguing that inflation is bound to accelerate quite soon (at some point the slope of the Phillips should steepen) and others defending the view that real factors like globalisation, technological change and price sensitivity of demand imply we're in a new era. Financial markets take the view that there are enough reasons available to justify a Fed rate hike and the probability of a December move has increased to 77%. The rise in treasury yields and the stronger dollar did not stop Wall Street from beating record after record, underpinned by the growth environment, low rates, a cautious central bank. Hopes about cuts in corporate taxes are an additional factor and they also support the corporate bond market: if companies were to repatriate earnings previously kept abroad this could lower bond issuance. Whereas Wall Street didn't bother about the dollar, Frankfurt will have welcomed the strengthening. With only three weeks to go to the crucial ECB meeting which should decide on QE in 2018, the numerous references to the euro in the September meeting account released this week show the importance of this factor in the thinking of the governing council members.

UNITED STATES: ISM VS INFLATION



Sources : ISM, BEA, BNP Paribas

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