Weekly Update of U.S. Economy

Junko Nishioka
Chief Economist
Sumitomo Mitsui Banking Corporation

(212) 224-4568
junko_nishioka@smbcgroup.com

July 21, 2023

Disclaimer

This presentation is for discussion purposes only and is not intended to be an offer to sell or the solicitation of an offer to buy any securities, or any commitment to underwrite, subscribe for or place any securities, is not an offer or commitment to provide any financing or extension of credit or service, and does not contain any tax or legal advice. This presentation has been prepared by SMBC Group (which may include, collectively or individually, any of the following entities in the Americas Division: Sumitomo Mitsui Banking Corporation ("SMBC"), SMBC Nikko Securities America, Inc. ("SMBC Nikko"), SMBC Nikko Securities Canada, Ltd. ("Nikko Canada"), SMBC Capital Markets, Inc. ("SMBC-CM"), SMBC Leasing and Finance, Inc., JRI America, Inc., and SMBC Rail Services LLC) and is being furnished by SMBC Group solely for use by the client or potential client to whom such materials are directly addressed and delivered. This presentation is confidential, and is the property of SMBC Group subject to copyright. Any reproduction of this presentation, in whole or in part, is prohibited, and you may not release these materials to any person, except to your advisors and professionals to assist you in evaluating these materials, provided that they are obligated, by law or agreement, to keep the presentation confidential. These materials do not constitute research, a recommendation or an offer or solicitation to any person to enter into any transaction or adopt any hedging, trading or investment strategy. Prior to participating in any such transaction, you should consult your own independent, competent, legal, tax, accounting and other professional advisors.

In preparing this presentation, SMBC Group has relied upon information available from third parties, including public sources, and we have assumed, without independent verification, the accuracy and completeness of such information. Specific prices, indices or measures, including ranges, listed in this document were prepared at the time the document was prepared, and are subject to change without notice. SMBC Group makes no representations to and does not warrant this presentation's accuracy or completeness. SMBC Group expressly disclaims any liability for any use of the information set forth herein, including, without limitation, any use of the information set forth herein in the preparation of financial statements or accounting material.

These materials may contain forward looking statements, which may include projections, forecasts, income estimates, yield or return, future performance targets or similar analysis. These forward looking statements are based upon certain assumptions. All forward looking statements are based upon currently available information and SMBC Group is not obligated to provide an update. Actual events may differ from those assumptions. Opinions, projections, price/yield information and estimates are subject to change without notice. There can be no assurance that estimated returns or projections will be realized, that forward looking statements will materialize or that actual results will not be materially lower than those presented. Past performance is not necessarily indicative of future results. Any transactions or strategies addressed may not be suitable for all parties. The value, price or income from transactions or strategies may fall as well as rise. SMBC Group or an affiliate may have a position in any of the underlying instruments, assets, indices or rates mentioned in this document. You should make your own independent judgment or seek independent financial and tax advice with respect to any matter contained herein.

SMBC is subject to Japanese firewall regulations and therefore absent client consent, non-public client information may not be shared with SMBC Nikko Securities Inc.

SMBC Nikko is a US registered broker-dealer of SMBC Group. Nikko Canada is a U.S. and Canadian registered broker-dealer of SMBC Group. SMBC-CM is provisionally registered as a U.S. swap dealer with the CFTC. Capital markets and other investment banking activities for SMBC Group are performed by a combination of SMBC Nikko, Nikko Canada, SMBC Nikko Securities Inc. and SMBC-CM. Lending and other commercial banking activities are performed by SMBC and its banking affiliates. Derivative activities may be performed by SMBC-CM or SMBC. SMBC Group deal team members may also be employees of any of the foregoing entities. SMBC Group does not provide tax advice. Accordingly, any discussion of U.S. tax matters contained herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with the promotion, marketing or recommendation by anyone unaffiliated with SMBC Group or for the purpose of avoiding U.S. tax-related penalties.

How Likely Is a Soft Landing for the Economy?

Slower Economy Does Not Yet Signal a Recession

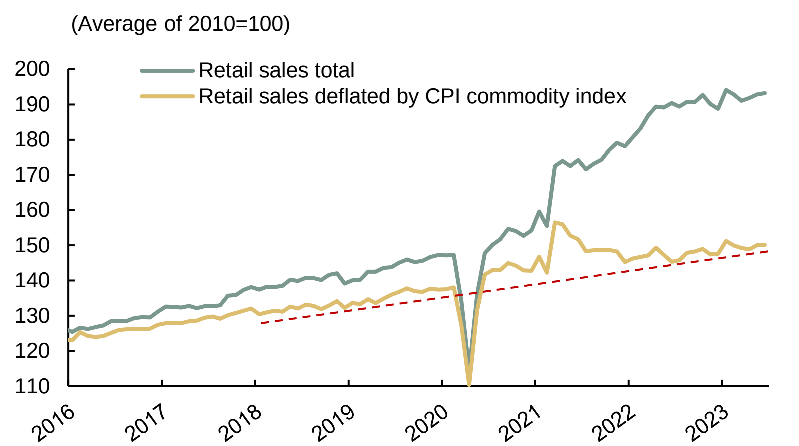
- A deeply inverted U.S. Treasury yield curve suggests increased odds of a recession in the near future, but we have not yet observed the fact based on the economic data.
- Retail sales in June rose 0.2% for the third straight month of growth. The pace of growth has slowed gradually but it is not enough to signal a recession. Based on the June inflation data and retail sales, consumer spending for goods is likely to be slightly negative in the April-June GDP numbers, which are due out next week on July 27. However, overall consumer spending will be able to avoid a decline, spurred by service spending. Meanwhile, continued inventory adjustments may put downward pressure on headline GDP growth to a level slightly below its potential—approximately 2% in real terms—but they do not signal a recession.
- It is estimated that excess savings by households based on the coronavirus budget will gradually decrease and return to a steady state in October-December of this year. If the job market escapes a sharp correction and asset prices remain high, however, a sharp decline in overall household consumption may be avoided, driven by higher consumption by high-income earners.
- Housing investment appears to have bottomed out late last year after falling sharply last year. Existing home sales have been exposed to inventory shortages, and sales have not recovered steadily. On the other hand, inventory recovery and falling prices have spurred demand from potential buyers in the new home market. The impact of the Federal Reserve Board's (the "Fed") interest-rate hikes appears to be fading in the housing market as the reduced-rate mortgages being offered by major home builders gain popularity.
- Meanwhile, manufacturing production has been on a downward trend, a different trend from the resilient growth of final demand. With supply constraints tightened starting in late 2021, many U.S. companies have significantly increased their inventory levels in preparation for unforeseen circumstances.

Monetary Policy Going Forward

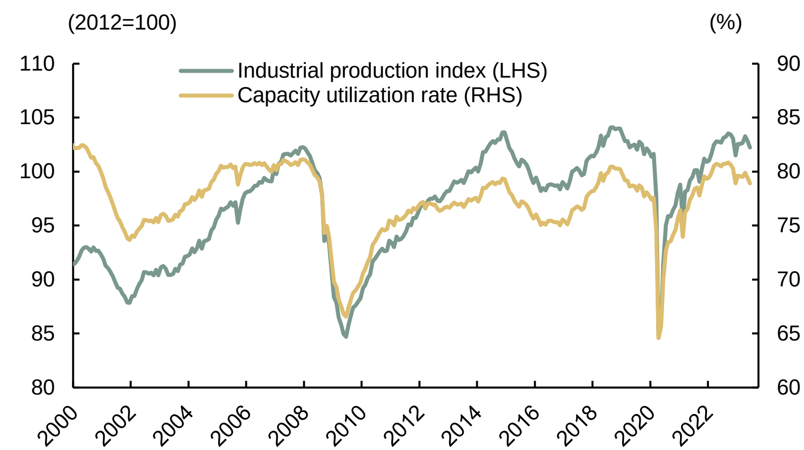
- Under a scenario of the gradual slowing of inflation, a high policy rate would lead to higher real interest rates. A 0.25% rate hike by the Fed at next week's Federal Open Market Committee meeting is fully priced in by the market, further pushing short-term real interest rates higher.
- Since the beginning of this year, there has been a clear upward trend in real interest rates, and the real interest rate obtained by subtracting the Personal Consumption Expenditures deflator from the federal funds policy rate has already returned to positive territory.
- Historically, the economy slows when real interest rates rise. But this doesn't always come with a recession—that is, two or more consecutive periods of negative growth.
- During the inflationary phases of the 1970s and 1980s, massive monetary tightening took its toll on the economy and led to recessions. However, during the period of interest-rate hikes from 1988, the economy remained firm, just as it is now. It is true that the economy slowed down in the early 1990s, but what actually pushed the economy into negative growth was the outbreak of the Gulf War and the reacceleration of prices.
- At that time in early 1990, there was balance-sheet adjustment pressure in the U.S. corporate sector, which delayed the recovery of capital investment. However, the fact that the non-performing loan issue did not greatly weaken the strength of the banks is also similar to the current situation. The policy interest rate was cut in step with the steady slowdown in inflation, and the economy achieved a soft landing, leading to stable growth thereafter.
- If the current policy can be fine-tuned step by step in a way that matches the inflation slowdown in the future, the U.S. economy may not necessarily fall into a recession and may experience a soft landing.
- It should be noted that these scenarios can vary depending on the reaction of asset prices.

How Likely Is a Soft Landing for the Economy? (continued)

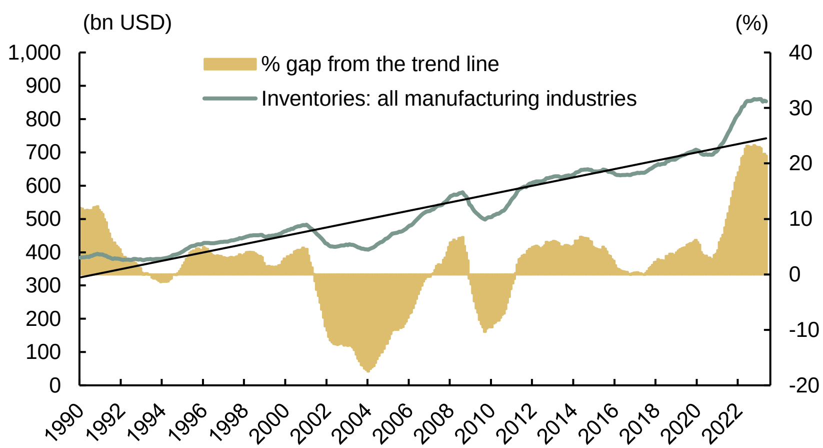
Retail sales in real terms suggest that consumer spending on goods is increasing at a mild pace.



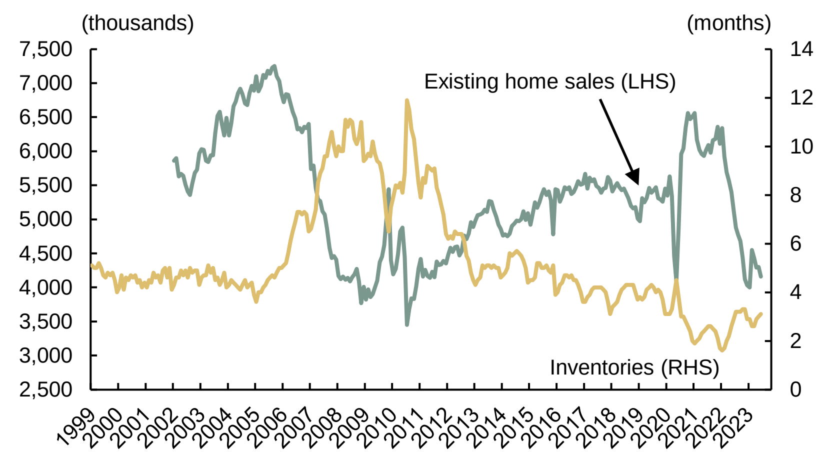
While final demand remains resilient, the manufacturing industry faces inventory adjustment pressure and production is on a downward trend.



It will take some time for private inventories, which have increased significantly in the face of supply-chain restrictions, to return to normal.



Existing home sales fell in June, weighed down by inventory shortages and persistently high home prices.



Sources: Bureau of Labor Statistics, Federal Reserve Board, U.S. Census Bureau, National Association of Realtors

SMBC Economy and Rates Forecast

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
U.S.	Real GDP (saar)	-0.6	3.2	2.6	1.3	1.5	-0.8	0.6	0.9	1.4	1.8	2.2	5.9	2.2	1.4	1.0
	Inflation rate (YoY)	5.0	4.9	4.8	4.8	4.6	4.2	3.9	3.2	2.8	2.5	2.2	3.3	5.0	4.4	2.7
	Jobless rate	3.6	3.6	3.6	3.5	3.5	3.7	4.3	4.6	4.7	4.7	4.6	5.4	3.7	3.7	4.7
Euro area	Real GDP (qoq)	0.8	0.4	-0.1	-0.1	0.3	0.2	0.1	0.1	0.4	0.3	0.3	5.4	3.5	0.6	0.9
	Inflation rate (YoY)	8.0	9.3	10.0	8.0	6.2	4.8	3.2	3.1	2.9	2.7	2.5	2.6	8.4	5.6	2.8
	Jobless rate	6.7	6.7	6.7	6.6	6.6	6.6	6.7	6.8	6.8	6.9	6.9	7.7	6.7	6.6	6.9
Japan	Real GDP (saar)	5.6	-1.5	0.4	2.7	1.7	1.0	0.9	0.9	0.8	0.8	0.7	2.3	1.1	1.0	0.9
	Inflation rate (YoY)	2.1	2.7	3.8	3.5	3.3	2.8	2.3	2.9	2.7	2.6	2.2	-0.2	2.6	3.0	2.6
	Jobless rate	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP(YoY)	0.4	3.9	2.9	4.5	8.4	5.7	6.3	5.4	5.2	5.1	5.0	8.4	3.0	6.3	5.2
	Inflation rate (YoY)	2.2	2.8	1.8	1.3	1.6	1.4	1.5	1.6	1.9	2.0	2.0	0.8	1.7	1.5	1.9
	Jobless rate	5.8	5.4	5.6	5.5	5.4	5.1	4.9	4.9	4.9	5.0	5.0	5.1	5.1	5.2	5.0

Rates		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
U.S.	FF target range	4.25 ~ 4.50	4.75 ~ 5.00	5.00 ~ 5.25	5.25 ~ 5.50	5.25 ~ 5.50	5.00 ~ 5.25	4.75 ~ 5.00	4.50 ~ 4.75	4.25 ~ 4.50	4.25 ~ 4.50	5.25 ~ 5.50	4.25 ~ 4.50
	2yr UST	3.43	4.03	4.90	4.20	4.00	3.80	3.60	3.40	3.20	4.20	4.00	3.20
	10yr UST	3.87	3.47	3.84	3.60	3.60	3.60	3.60	3.50	3.50	3.60	3.60	3.50
Germany	ECB refi rate	2.50	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	2.50	4.25	3.75
	ECB depo rate	2.00	3.00	3.50	3.75	3.75	3.75	3.75	3.50	3.25	2.00	3.50	3.25
	2yr Schatz	2.50	2.68	3.20	3.20	3.00	2.80	2.50	2.40	2.30	2.50	3.00	2.30
	10yr Bunds	2.20	2.29	2.39	2.30	2.30	2.30	2.20	2.10	2.10	2.20	2.30	2.10
Japan	IOER	-0.10	-0.10	-0.10	-0.10	-0.10	0.10	0.10	0.10	0.10	-0.10	-0.10	0.10
	2yr JGB	0.04	-0.06	-0.07	0.10	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr JGB	0.42	0.35	0.40	0.75	0.75	0.75	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.65	2.55	2.55	2.55	2.55	2.55	2.55	2.75	2.55	2.55
	2yr gov bond	2.40	2.41	2.11	2.16	2.24	2.32	2.39	2.49	2.59	2.40	2.24	2.59
	10yr gov bond	2.83	2.85	2.64	2.64	2.69	2.74	2.79	2.84	2.89	2.83	2.69	2.89

Source: SMBC

SMBC FX Forecast

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58 ~ 151.95	127.23 ~ 137.91	130.64 ~ 145.07	128.00 ~ 147.00	125.00 ~ 138.00	121.00 ~ 135.00	119.00 ~ 133.00	116.00 ~ 130.00	116.00 ~ 130.00	113.47 ~ 151.95	125.00 ~ 147.00	116.00 ~ 135.00
	End of period	133.00	132.86	144.31	137.00	133.00	130.00	128.00	126.00	123.00	131.12	133.00	123.00
EUR/USD	Range	0.9633 ~ 1.0735	1.0484 ~ 1.1033	1.0635 ~ 1.1095	1.0300 ~ 1.1300	1.0200 ~ 1.1200	1.0100 ~ 1.1100	1.0000 ~ 1.1000	1.0100 ~ 1.1100	1.0100 ~ 1.1100	0.9536 ~ 1.1495	1.0200 ~ 1.1300	1.0000 ~ 1.1100
	End of period	1.0705	1.0839	1.0909	1.0700	1.0600	1.0500	1.0500	1.0600	1.0600	1.0705	1.0600	1.0600
USD/CAD	Range	1.3275 ~ 1.3885	1.3291 ~ 1.3832	1.3151 ~ 1.3642	1.3000 ~ 1.4200	1.3000 ~ 1.4200	1.3000 ~ 1.4200	1.3000 ~ 1.4200	1.2800 ~ 1.4000	1.2700 ~ 1.3800	1.2477 ~ 1.3885	1.3000 ~ 1.4200	1.2700 ~ 1.4200
	End of period	1.3554	1.3516	1.3242	1.3500	1.3600	1.3500	1.3500	1.3400	1.3300	1.3554	1.3600	1.3300
CAD/JPY	Range	96.76 ~ 109.11	95.13 ~ 100.59	97.54 ~ 109.21	95.00 ~ 108.00	91.00 ~ 103.00	90.00 ~ 102.00	88.00 ~ 100.00	88.00 ~ 100.00	85.00 ~ 98.00	89.77 ~ 110.06	91.00 ~ 109.21	85.00 ~ 102.00
	End of period	96.76	98.28	109.04	101.48	97.80	96.30	94.81	94.03	92.48	96.76	97.80	92.48
EUR/JPY	Range	138.81 ~ 148.40	138.19 ~ 145.67	143.12 ~ 157.92	144.00 ~ 158.00	136.00 ~ 150.00	131.00 ~ 145.00	128.00 ~ 142.00	126.00 ~ 140.00	123.00 ~ 137.00	124.40 ~ 148.40	136.00 ~ 158.00	123.00 ~ 145.00
	End of period	140.41	144.01	157.44	146.59	140.98	136.50	134.40	133.56	130.38	140.41	140.98	130.38
Oil price (WTI futures)		82.64	75.99	73.58	75.00	80.00	80.00	75.00	77.00	78.00	98.74	76.37	77.50

Source: SMBC

SMBC