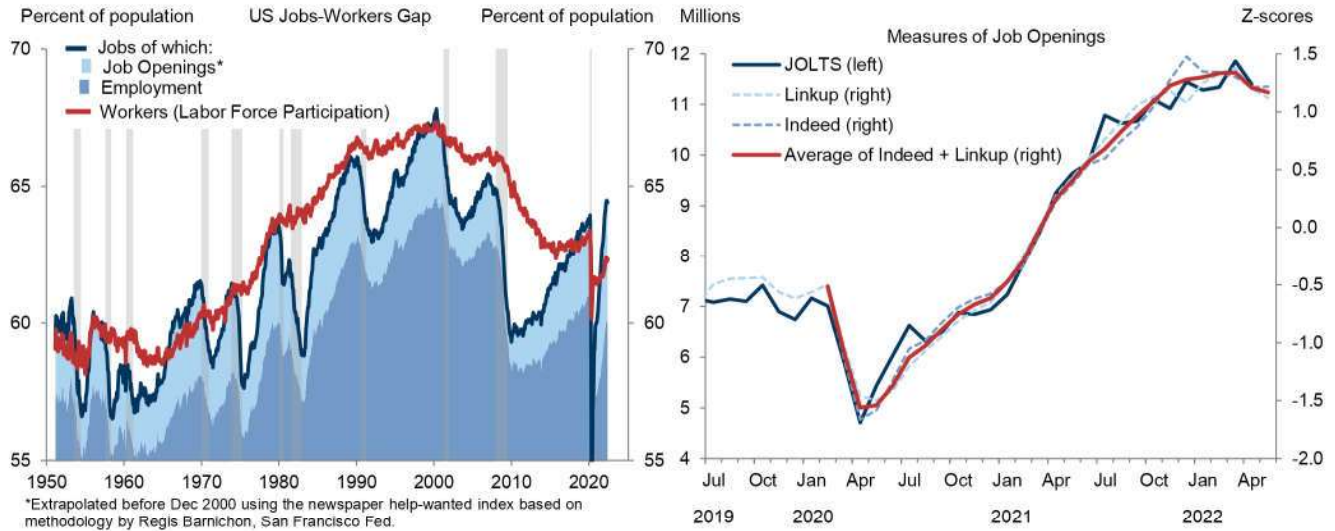


Global Views: Still on the Same Narrow Path

1. We continue to see the US economy on a narrow path to a soft landing. The 390k increase in nonfarm payrolls in May beat expectations, but the unemployment rate has now been flat at 3.6% for three months, the underemployment rate U6 edged up again, and average hourly earnings registered another benign 0.3% gain. Moreover, job openings have started to decline. The official JOLTS series dropped sharply in April and timelier private-sector measures suggest that this drop continued in May. More anecdotally, many technology firms seem to be cutting back on new hiring and job openings, although we note that the job openings index in the NFIB small business survey showed a surprising rise in May.

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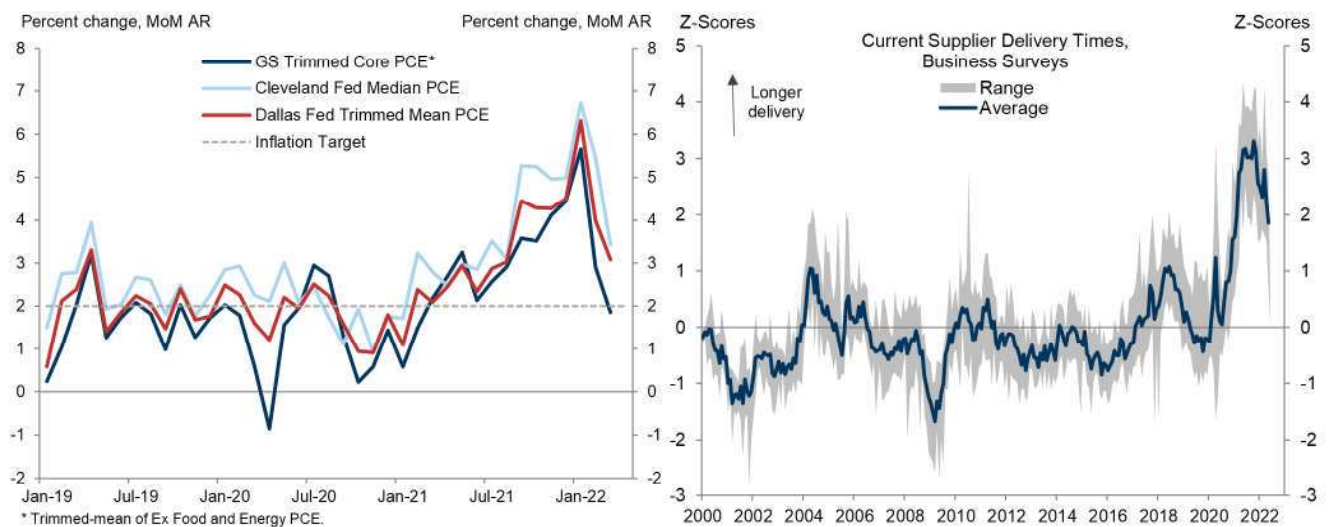
Exhibit 1: Jobs-Workers Gap Remains Large But Some Signs of Easing in Job Openings



Source: US Bureau of Labor Statistics, Haver Analytics, Linkup, JOLTS, Indeed, Goldman Sachs Global Investment Research

2. The price news also looks more encouraging. Most notably, statistical measures of sequential PCE inflation—especially our trimmed core index—have eased over the past few months. Broad supply chain measures have improved, with the supplier delivery components of the monthly business surveys declining from high levels. However, one area where the news has been more mixed is the auto sector, as semiconductor supply is improving but shortages of auto parts from Ukraine and China are putting upward pressure on prices. This is one reason why we expect a 0.5% increase in the May core CPI.

Exhibit 2: Signs of Slowing in Sequential Core Inflation



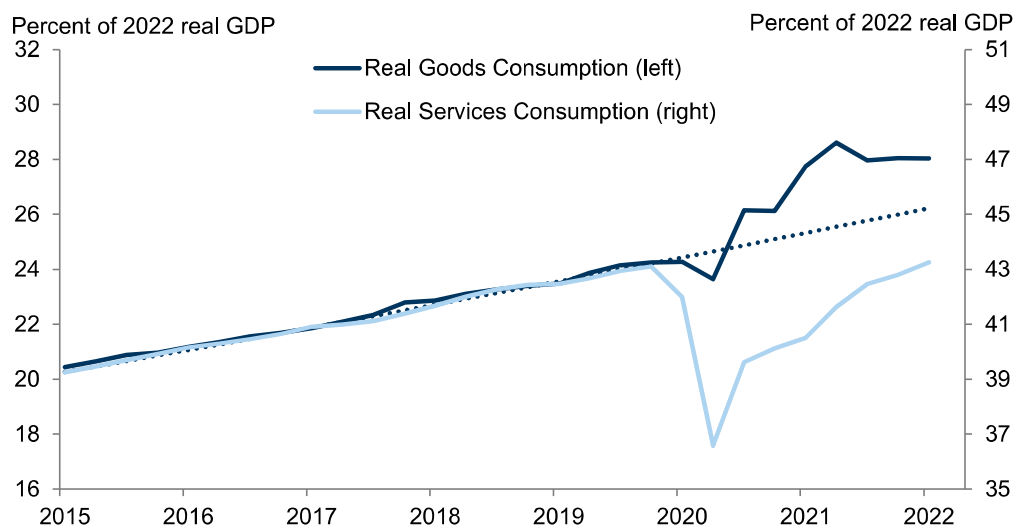
Source: Haver Analytics, Goldman Sachs Global Investment Research

3. We have not changed our estimated 35% risk that the US economy will enter a recession within the next two years. Although the deterioration in some growth indicators (most notably the 1.5% decline in Q1 GDP) suggests that near-term recession risk has increased in a mechanical sense, other broad activity measures (including the

2% increase in the income-side equivalent of Q1 GDP) imply that output is still expanding. Moreover, the net 200bp tightening of financial conditions since late 2021, increased signs of labor market adjustment, and better inflation numbers have reduced the risk that Fed officials will need to tighten monetary policy to a degree that will force a recession in 2023-24.

4. We fielded a number of questions about an imminent recession following the Q1 earnings reports from WalMart and Target. But the macroeconomic significance of these disappointments is limited, in our view. Part of the problem was a large increase in shipping costs, consistent with what we see in the economic data but not really new information. Then there was the spending shift away from discretionary items in April noted in the Target earnings call. Since that call, however, we have learned that real personal consumption in April was actually quite solid; in any case, we should expect goods consumption to underperform service consumption as the economy emerges more fully from the pandemic.

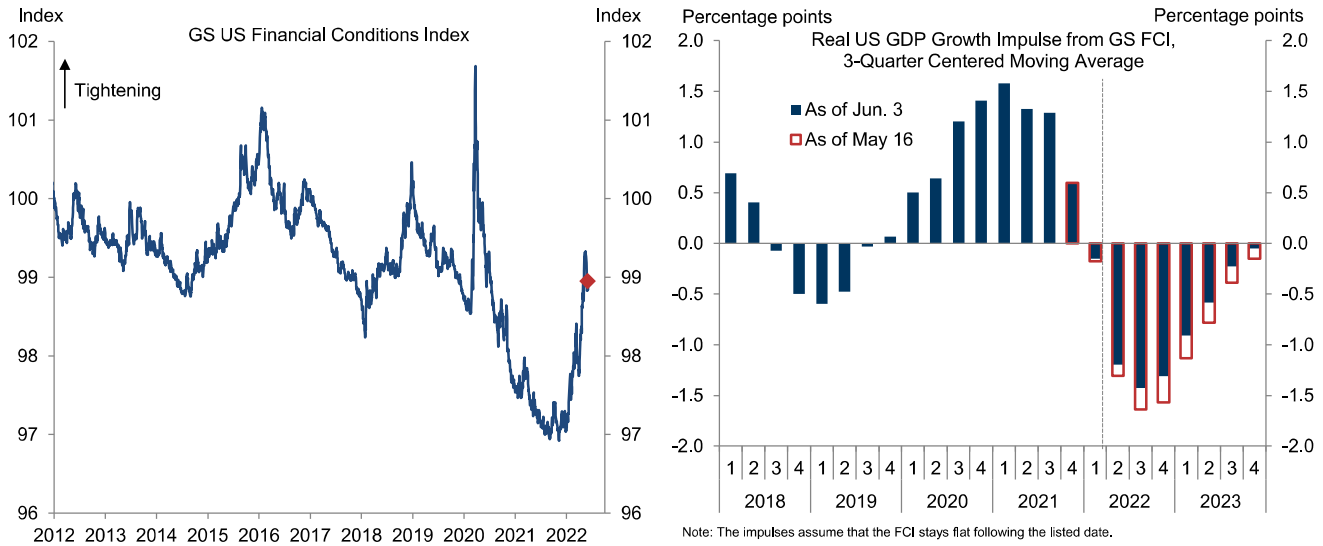
Exhibit 3: Goods-to-Services Rebalancing Still Underway



Source: Haver Analytics, Goldman Sachs Global Investment Research

5. We have also made no changes to our modal 3-3¼% forecast for the terminal funds rate. 50bp hikes at the next two FOMC meetings are almost certain, the September meeting is a close call between 25bp and 50bp (we are still at 25), and at least a few more 25bp hikes thereafter seem likely under our growth and inflation forecast. In terms of near-term communication, there is little incentive for Fed officials to deviate from their relatively hawkish framing of the last few months. After all, a significant further retracement of the earlier FCI tightening, on top of the 25bp easing seen in the past three weeks, would be counterproductive from the perspective of a central bank that is anxious to get inflation back down toward 2%. This could well mean signaling a fourth 50bp hike in September at the June 14-15 FOMC meeting. We will finalize our forecast for the dot plot in our FOMC preview next week.

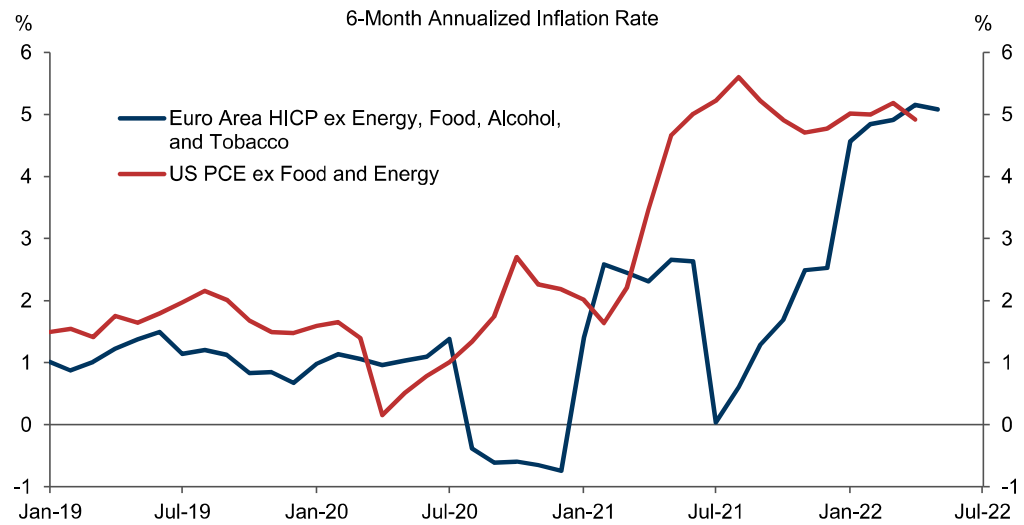
Exhibit 4: A Significant Further Retracement of the Earlier FCI Tightening Would Be Counterproductive



Source: Goldman Sachs Global Investment Research

6. Euro area inflation is converging toward US levels. In fact, over the past six months, the EA core HICP has risen a touch faster than the US core PCE. And while nominal wage growth remains much lower in Europe than in the US, it does seem to be accelerating meaningfully in 2022 as far as we can tell from the (unfortunately very lagged) data. We therefore expect next week's ECB meeting to set the stage for eight consecutive 25bp hikes starting in July and extending until the deposit rate reaches 1.5% in mid-2023. Risks around this forecast are two-sided; a sharper upturn in inflation expectations could trigger 50bp steps, while either a full shutoff of Russian gas or significant sovereign stress could prompt the Governing Council to pause. We also think the Bank of England will need to hike to 2½% by early 2023, a more aggressive path than the MPC seems to have in mind judging from its last press conference.

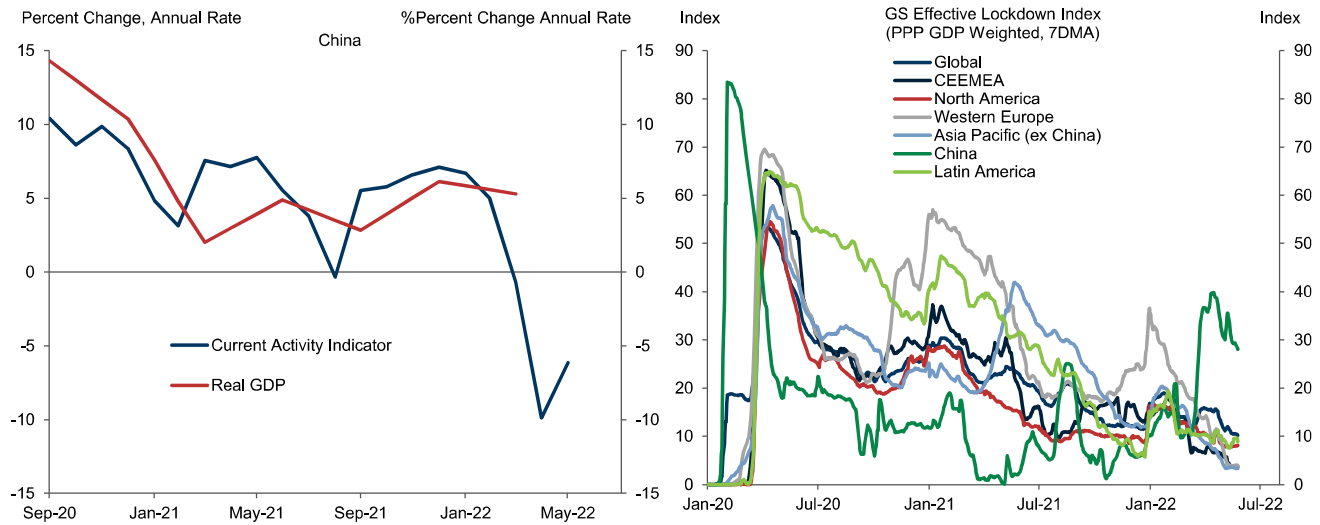
Exhibit 5: Euro Area Inflation Converging Towards US Levels



Source: Haver Analytics, Goldman Sachs Global Investment Research

7. The lockdowns in Shanghai and elsewhere had a dramatic negative impact on activity in China, with our current activity indicator declining at a 10% annual rate in April. And while May was not much better, we expect a strong rebound in June/July, consistent with the experience after other major lockdowns around the world though not quite as dramatic as the V-shaped Chinese recovery of March/April 2020. The Chinese economy's longer-term issues remain unchanged, however. First, the virus will remain a threat until policymakers feel comfortable moving away from the covid zero policy, which is likely to require more widespread vaccination of the elderly population, better vaccines, and greater availability of effective therapeutics. Second, China remains an export-oriented economy, and that model is under pressure as globalization slows or reverses. And third, we think Chinese property investment is in the early stages of a multi-decade decline as urban population growth slows and speculative activity diminishes.

Exhibit 6: Lockdowns Weigh on Growth in China



Source: Haver Analytics, Goldman Sachs Global Investment Research

8. To say that markets are likely to remain rangebound is often a cliché, but we think it currently has more content than normal because Chair Powell is so intently focused on the role of financial conditions in delivering a soft landing. Although financial conditions still look broadly compatible with the Fed’s goals, under our central economic forecast we don’t think the recent easing can go much further without triggering a fresh leg higher in terminal funds rate pricing, which would probably weigh on equities and credit. Conversely, a large renewed risk selloff could prompt Fed officials to switch to 25bp steps or cut the hikes short relatively soon, which could then provide renewed support to equities and credit. For risk assets to break out of the range, we may need genuinely new information about the economy relative to our forecast. An optimistic scenario is that CPI and PCE inflation fall faster than we are currently forecasting, as suggested by the sharp decline in our trimmed core PCE. A pessimistic scenario is a bigger energy shock that drives oil prices well beyond our commodity strategy team’s modal \$125/barrel forecast.

Jan Hatzius

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Reg AC

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