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UOB Investment Insights
Thinking Ahead

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Stay nimble amid recession risks and rate hikes

- With the United States economy slipping into a technical recession and the US Federal Reserve (Fed) cautioning that another "unusually large" interest rate hike could be on the cards at its next meeting, it is critical that investors stay nimble in this uncertain market landscape.

- Learn more about the outlook for interest rates and economic growth in the months ahead.

Key Takeaways from July's Federal Reserve Meeting

- At the 26/27 July Federal Open Market Committee (FOMC) meeting, as widely expected, the Fed raised interest rates by another 0.75% to a range of 2.25 - 2.50%.

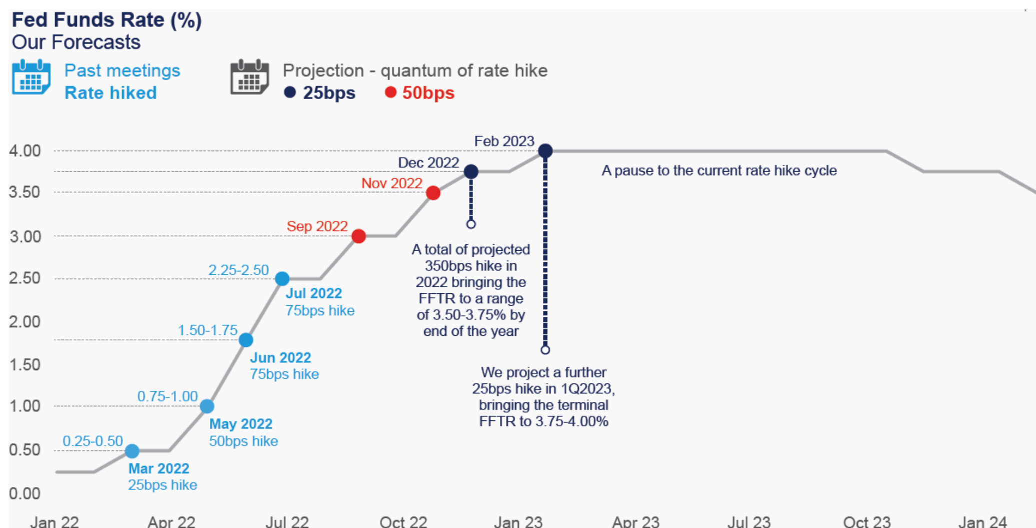
- Fed Chairman Jerome Powell reiterated the need for further rate hikes to curb 40-year high inflation and said another "unusually large" increase could be appropriate at the September meeting. However, the pace of increase is likely to slow while policymakers assess the impact of tighter policy measures on the economy and inflation.

- No explicit forward guidance for September's FOMC meeting was provided and any rate increase will depend on economic data moving forward.

- Powell rejected speculation that the US economy is in recession, as employment levels remain strong.

- UOB's latest forecast is shown in the chart below.
  - Our economists now expect another two 0.50% rate hikes in September and November, before ending the year with a 0.25% hike in December. This is expected to be followed by a final 0.25% hike in 2023.
  - This will bring the Fed Funds Target Rate to the range of 3.50% - 3.75% by end-2022 and to a range of 3.75% - 4.00% by the end of 1Q 2023.

Figure 1: UOB's forecast for upcoming interest rate hikes



Source: UOB Global Economics & Markets Research Estimates (as of July 2022)

Key Takeaways from US 2Q GDP Data

- The US economy has entered a technical recession, with second-quarter GDP data released last week indicating a 0.9% fall. GDP fell by 1.6% in the first quarter, which means the US economy has now contracted for two consecutive quarters.

- The decline in 2Q GDP was attributed to decreases in private inventories, residential fixed investment, federal government spending, state and local government spending, and non-residential fixed investment. This was offset in part by a smaller increase in private consumption expenditures and a rebound in net exports.

- While two consecutive quarters of contractions meet one definition of a recession, US officials determine a recession based on a comprehensive study of broad-based economic data, including jobs, consumer and business spending, industrial production and income.

- The US labour market has yet to show significant signs of weakness, with recent data indicating the country is adding jobs at a healthy pace. The unemployment rate remains at an all-time low of 3.6% (Figure 2). A strong and robust labour market cannot justify a recessionary economy.

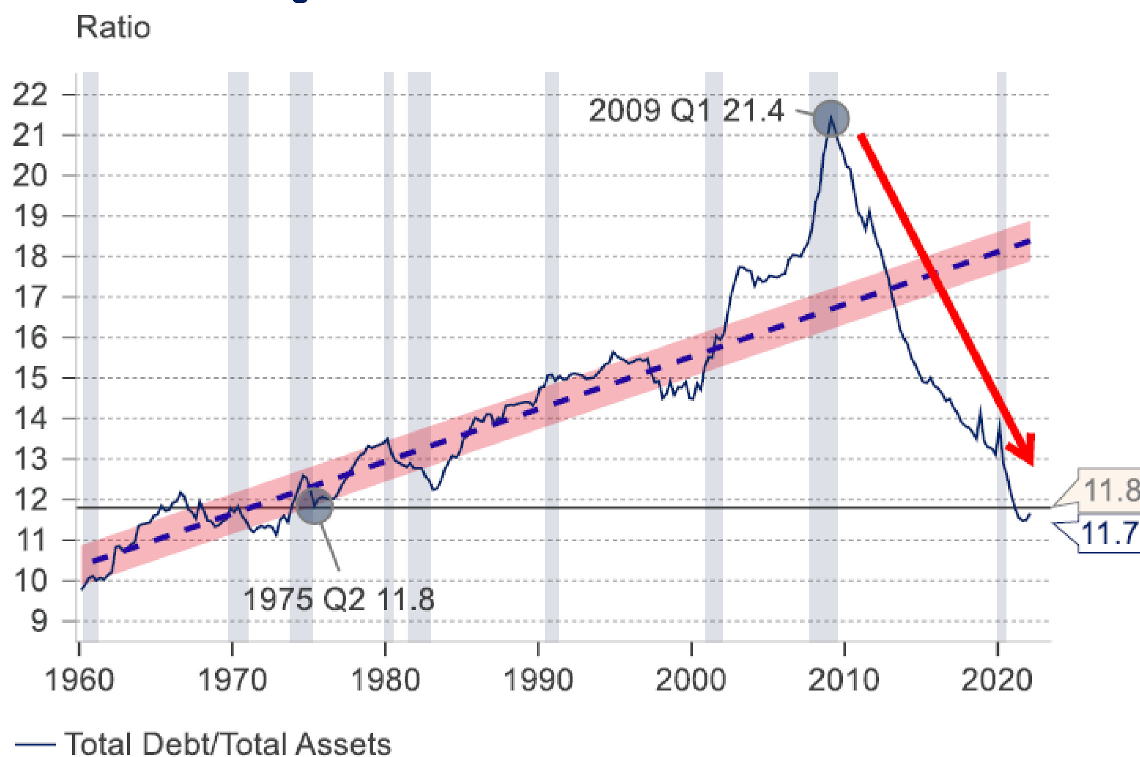
Figure 2: US Unemployment Rate

Source: Macrobond, UOB Private Bank (as of July 2022)

- However, the growth outlook reflects a worsening assessment of the negative impact on growth from high inflation and aggressive Fed rate hikes. UOB is expecting economic growth to slow down further, and we are lowering our forecast for 2022 GDP growth to 1.8% (previous forecast: 2%), before easing further to 1.5% in 2023.

- Recession risks cannot be ruled out but any recession is expected to be shallow. US household balance sheets remain healthy and current levels of borrowing are not excessive (Figure 3).

Figure 3: US Household Balance Sheets



Source: Macrobond, UOB Private Bank (as of July 2022)

What should investors do?

- As central banks hike rates aggressively to curb multi-decade high inflation and as growth slows, investors should take shelter from market volatility and weather through lower growth with quality bonds and defensive stocks. Hold more bonds than stocks in your portfolios during this period. Also review your risk tolerance and time horizon using our Risk-First approach.

- Even though economic growth is slowing, you should remain invested to meet long-term financial goals. Build portfolio resilience with Core holdings and generate a stable source of income from lower-risk dividend-paying funds, as well as intermediate-duration investment grade corporate bonds.

- If you have a longer time horizon, consider tapping on Megatrends such as China, Artificial Intelligence and Sustainability to capitalise on long-term structural drivers. Meanwhile, defensive sectors like Healthcare can limit downside risk during market selloffs.

- If your risk appetite is higher, consider High Conviction Calls like US Financials which stand to benefit from rising interest rates.

- As market volatility is expected to remain high, investors should invest in tranches and keep some spare cash for future opportunities.

- Please speak to your UOB Advisor to find out what works best for you.

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