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Does US Face "Stagflation?"

David He, Economist

Recently, the U.S. economy has shown a complicated scenario: a slowdown in first quarter economic growth, short-term employment growth rate was still at a respectable pace, and the market's expectation for Fed's rate cut was on the decline while Fed rate was still higher historically. US stocks, bonds and USD Index experienced short-term turmoil, causing murmuring of an US "stagflation" as a possibility again. Now, the short-term financial market has calmed down, new U.S. macro data are coming out and impacts on US policy are gradually surfacing. Therefore, it is worth analyzing the US macroeconomic data and recent financial market performance to find the answer to the question of how likely is the US economy to be in "stagflation".

I. A Look Back in History – US "Stagflation" in the 70s

Stagflation is an economic phenomenon in which economic growth has become stagnant, but unemployment and prices continue to rise (inflation). This phenomenon occurred across many countries in the 1970s, including the US. Against the backdrop of the collapse of the Bretton Woods system, then President Lyndon B. Johnson stimulated U.S. economic growth and lowered the unemployment rate through tax cuts and increased government spending, a series of measures that put a strain on the government's budget deficits, and ultimately, the U.S. economy as a whole experienced a period of stagflation in the academic definition of stagnation under the influence of both internal and external causes. This phenomenon was prevalent in 1970, 1974-1975, 1980 and 1982.

The US economy experienced negative growth, decreasing from 0.2% to 1.9% Y-o-Y%, during these years. While inflation and unemployment rates moved up 6% annually. In the end, a hike in the Fed rate to 20% causes a massive tightening of the US monetary supply, restarting the US economy. External environment also improved and crude oil prices dropped, helping the US to eventually exit out of "stagflation".

Table: US Stagflation Years During the 70s

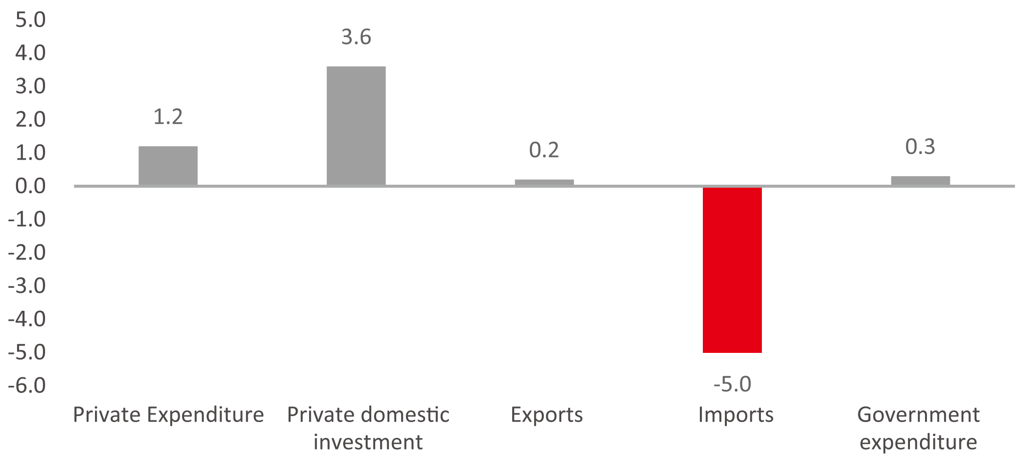
	GDP Growth	Core CPI	Unemployment Rate
1970	-0.2%	6.3%	4.9%
1974	-0.5%	8.3%	5.6%
1975	-0.2%	9.1%	8.5%
1980	-0.2%	12.4%	7.1%
1982	-1.9%	7.4%	9.7%

Source: Bloomberg, BOCHK Financial Research Institute

II. US Economy – A Slowdown Amidst Increasing Uncertainty

Single quarter US GDP growth experienced its first decline since 2022Q1, decreasing by 0.3%. A series of impacts caused by unclear Fed rate cut path, US policy, financial market volatility caused a reignition of the possibility of "stagflation" in the US economy. Looking from US GDP contributor perspective, the main negative driver was caused by a surge in imports (GDP growth attributed to imports was -5.0%). Recent years, US single quarter GDP growth managed to maintain in a range of 2% to 3%, despite The U.S. economy is suffering from high inflation and frequent interest rate hikes by the Fed. Thus the supply shock impact on the economy was more severe. Noticeably, while shock from imports was the market consensus, the degree of the shock caused wild market predictions. According Bloomberg's April consensus amongst the economists, there was a large range of GDP forecasts figures, with the highest being 1.7% and lowest being -2.4%; the forecast standard deviation was 0.80% when compared with 2024Q1 (0.31%).

Exhibit 1: Contributions to Percentage Change in Real GDP (%)



Source: Bloomberg, BOCHK Financial Research Institute

The Fed's two main gauges were fairly steady. US inflation averaged 2.7% Y-o-Y% in the first quarter (core inflation at 3.1%, Y-o-Y%), a slowdown from 3.2% and 3.8% in the first quarter of 2024, respectively. Core inflation decreased for the first time in March, falling below 3.0%. On the employment front, there has been short-term job creation, but unemployment rate also rose; some indicators of the overall job market health, such as job opportunities and openings, indicate gradual job market saturation. At the same time, inflation and employment data do not reflect the results of the new U.S. trade policy. The Fed itself has also remained on the sidelines in terms of rate cuts, in contrast to the "triple-dip" attitude it took third quarter of 2024. The Fed has kept the interest rate between 4.25% to 4.50% for the last three rate meetings. The Fed's Beige Book, published on April 23, also repeatedly emphasized the uncertainty of U.S. economic growth.

Exhibit 2: US Inflation (%)

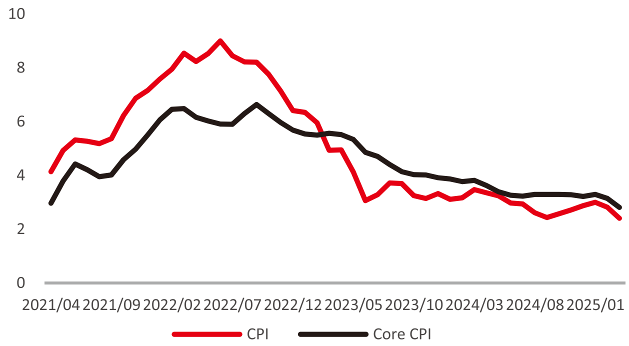
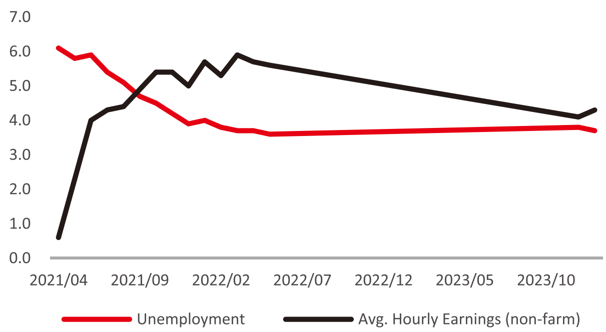


Exhibit 3: US Labour Market (%)



Source: Bloomberg, BOCHK Financial Research Institute

III. Financial Market – Relative Calm in Recent Times

The financial has been subject to trading volatilities, caused onset US trade and domestic policies. US stock, bond, and dollar index experienced simultaneous movements. The US stock market, under the premise of increased economic uncertainty and the possibility of "stagflation," declined as investors' risk appetite and sentiment changed. The S&P 500 hit a record high in February before falling. US bonds suffered the same fate, 10-year US bond yields fell below 4% in early April before sharply rebounded. The main reason being that foreign investors increased their holdings of US bonds, thus pushing up prices and suppressing yields, then a change in demand for USD financial product caused sharp rate surge. The dollar index was also affected by US stock market and bond market, as investors moved away from USD-denominated products due to risk appetite, and sharp yield changes etc., and opted to European and Japanese bonds. The US dollar index was once below 100 due to the euro and yen exchange rates, and then stabilized in the 100-101 range.

Recently, trade talks between US and China as well as between US and UK have proved constructive. On May 12, US and China issued a joint statement at the China-US Economic and Trade Meeting in Geneva, which the two countries recognized the importance of sustainable, long-term, and mutually beneficial bilateral trade, and agreed to suspend higher tariffs for 90 days starting from May 14. US tariffs on Chinese goods were temporarily reduced to 30%, while Chinese tariffs on US goods have been reduced to 10%, a far cry from the pre-talk tariff amount, and market optimism is high. The US dollar index rose from 100.68 to 101.69 in the two hours after the news was announced.

Exhibit 4: US Dollar Index

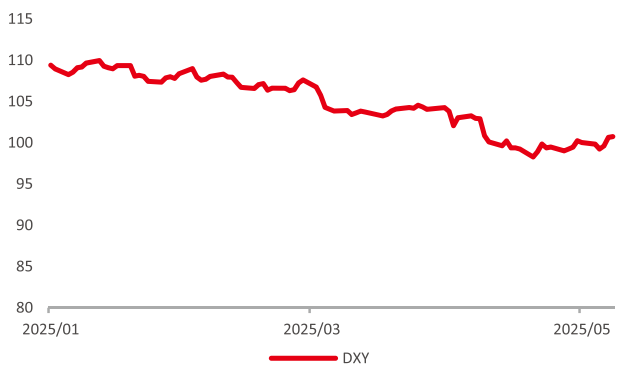
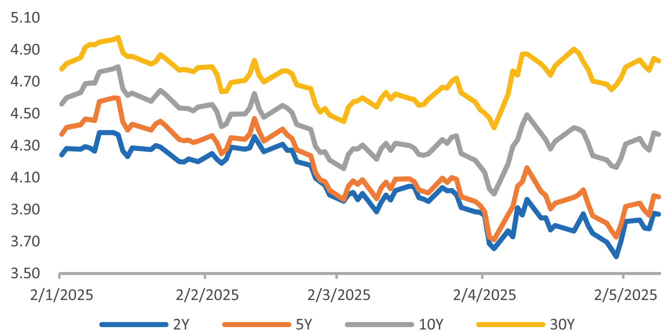


Exhibit 5: US Bond Yield Comparison



Source: Bloomberg, BOCHK Financial Research Institute

IV. Looking Ahead – “Stagflation” Chances Low, However, Risks Remained

Compared to the previous “stagflation” that the US experienced, the current inflation and unemployment trend is moderate. Taking the unemployment rate as an example, the US would need to add 5.1 million new unemployed people (in comparison, Hong Kong has a population of around 7.5 million) for unemployment rate to reach average “stagflation” rate in the 1970s (7.2%), Other external factors contributing to the “stagflation” in the US, such as the surge in crude oil prices experienced at the time, are also not present. Meanwhile, the global trade situation is expected to ease further, and if as Fed Chairman Powell said that inflation will only rise for a short period of time, then it is unlikely that the US will face “stagflation”. However, the impact of US trade and immigration policies and future tax cuts on its industry and consumer demand are still unknown. In terms of tax cuts, the extension of the Tax Cuts and Jobs Act of 2017 (TCJA) alone will bring an additional USD3.3 trillion to USD4.5 trillion financial burden to the US government over the next ten years; at the same time, Department of Government Efficiency achieved only USD160 billion in savings, and revised down their original of saving USD2 trillion in budget. On the industry and demand side, the largest US steel producer noted that current trade policy adjustments have a positive impact on the industry, citing solid demand in infrastructure, manufacturing and industrial-related projects. In contrast, leading automotive companies believe that the industry’s supply chain will be negatively affected in the future, and the industry’s profits will also be hit by the demand downturn.

Although the global economy and trade remain uncertain, and the impact of US trade policy on its economy has not fully realised; however, based on the progress from China and US, as well as UK and US trade negotiations, US trade policy-led negative impact on the economy may be mitigated, the financial markets also reacted positively. Therefore, while the U.S. “stagflation” is less likely, although any negative signals from its import growth, job market and inflation should not be ignored.

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主要經濟指標 (Key Economic Indicators)

一、本地生產總值 GDP	**2022**	**2023**	**2024**	**2025/Q1**
總量 (億港元) GDP(HKD 100million)	28,090	29,010	29,729	7,966
同比增長率 (%) YoY change(%)	-3.7	3.3	2.5	3.1
二、對外商品貿易 External merchandize trade			**2025/3**	**2025/Q1**
外貿總值 (億港元) Total trade(HKD 100million)				
總出口 Total exports	45,317	41,774	4,555	11,711
總進口 Total imports	49,275	46,450	5,009	12,517
貿易差額 Trade balance	-3,958	-4,676	-454	-807
年增長率 (%) YoY Growth(%)				
總出口 Total exports	-8.6	-7.8	18.5	10.1
總進口 Total imports	-7.2	-5.7	16.6	9.8
三、消費物價 Consumer Price				
綜合消費物價升幅 (%) Change in Composite CPI(%)	1.9	2.1	1.4	1.6
四、零售市場 Retail market				
零售額同比升幅 (%) Change in value of total sales YoY(%)	-0.9	16.2	-3.5	-6.5
五、訪港遊客 Visitors				
總人數 (萬人次) Total arrivals(10 thousands)	60.5	3,400.0	382.0	1,220.0
年升幅 (%) YoY change(%)	561.5	5,523.8	12.0	9.0
六、勞動就業 Employment			**2024/12-2025/2**	**2025/1-2025/3**
失業人數 (萬人) No. of unemployed(10 thousands)	16.3	11.3	11.2	12.3
失業率 (%) Unemployment rate(%)	4.3	2.9	3.2	3.2
就業不足率 (%) Underemployment rate(%)	2.3	1.1	1.1	1.1
七、住宅買賣 Domestic property sales and price index			**2025/2**	**2025/3**
合約宗數 (宗) No. of agreements	45,050	43,002	3,200	5,367
住宅售價指數 (1999=100) Domestic price index	369.7	337.4	284.7	284.2
八、金融市場 Financial market			**2025/3**	**2025/4**
港幣匯價 (US$100=HK$) 期末值 HKD exchange rate (US$100 = HK$), end of period	780.8	781.1	778.0	775.7
銀行體系收市總結餘 (億港元) 期末值 Closing aggregate balance(HKD 100million), end of period	962.5	449.5	446.2	446.1
銀行總存款升幅 (%) Change in total deposits(%)	1.7	5.1	3.5	-
銀行總貸款升幅 (%) Change in total loans & advances(%)	-3.0	-3.6	0.6	-
最優惠貸款利率 (%) 期末值 Best lending rate (%), end of period	5.6250	5.8750	5.2500	5.2500
恒生指數 Hang Seng Index	19,781	17,047	23,120	22,119