

Economic Indicators

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29 Sep 2022

The interest and importance of economic indicators are increasing due to the U.S. FED's interest rate hike this year. Accordingly, the KIS Research Center aims to help investors understand by preparing reports that introduce major global economic indicators, starting with the U.S market. We hope that this report will be helpful in understanding global economic indicators centered on the U.S.

The Personal consumption expenditure price index (PCE) and Michigan Inflation Expectation (MICH)

The inflation is going to be high and remain higher, that means it will lead to a rising of interest rate, as government attempt to get prices under control. Understanding inflation is crucial to investing because inflation can reduce the value of investment returns.

The PCE overview

The personal consumption expenditures price index (the PCE index) is one of the main measures of inflation and consumer spending trends in the U.S. economy. The Bureau of Economic Analysis (BEA) publishes the PCE index each month to track spending and inflation.

Understanding of the PCE

Prices for goods and services change constantly, rising and falling as companies and consumers react to trends in the economy. The PCE index tracks the consumer side of this dynamic by measuring changes in the cost of living for households—rather than for companies or other economic actors.

The Michigan Inflation expectation

University of Michigan Inflation Expectations (MICH) measures the percentage that consumers expect the price of goods and services to change during the next 12 months. The survey queries consumers on their views of their own personal finances, as well as the short-term and long-term state of the U.S. economy

Why should we check it at this time?

It is expected that the PCE (%YoY) will decrease slightly to 6.2% YoY and the core-CPE will increase 0.1% in August. This indicator will be released on Friday (U.S time: 7:30 A.M 30th September; VN time: 19:30 P.M 30th September) and we expect that it will have some impact on the FED decision in November. Above all, FED members value this indicator more than any other indicator.

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Latest economic indicators

The Federal Fed Funds Rate	21 st September 2022
The Philadelphia Manufacturing index	14 th September 2022
The U.S CPI	9 th September 2022
Unemployment Rate & Non-farm payroll	31 st August 2022

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I. The PCE overview

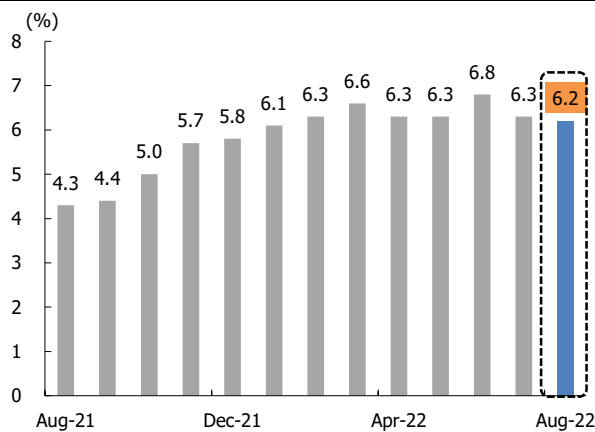
DEFINITION

- The personal consumption expenditures price index (the PCE index) is one of the main measures of inflation and consumer spending trends in the U.S. economy. The Bureau of Economic Analysis (BEA) publishes the PCE index each month to track spending and inflation.
- The PCE Price Index Excluding Food and Energy, also known as the core PCE price index, is released as part of the monthly Personal Income and Outlays report.
- PCE is considered as a lagging indicator, as it is the result of economic growth or decline.

WHY IT IS IMPORTANT

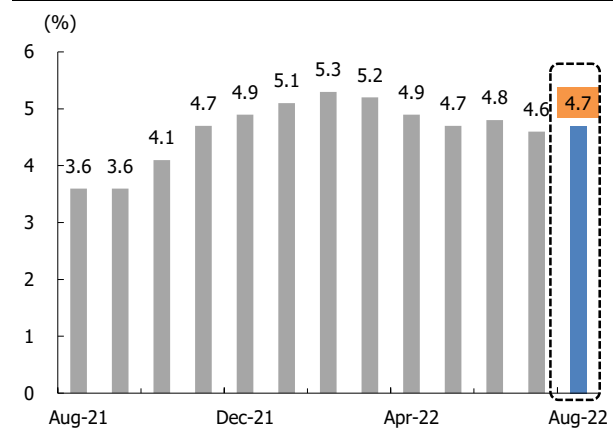
- Inflation is an important indicator of economy's health. Governments and central banks use the PCE and other indices to make economic decisions.
- Market participants will be keeping an eye on analysts' predictions of the data ahead of their release.
- Higher PCE make borrowing money more expensive and is designed to push down consumer spending – and, in turn, inflation. Lower PCE work the other way and is designed to encourage consumer spending, to keep inflation in line with a country's target.

Figure 1. PCE U.S in 1 year (%YoY)



Source: Bloomberg, KIS
 Note: The August-22 PCE forecast is from market consensus.

Figure 2. Core PCE U.S. in 1 year (%YoY)



Source: Bloomberg, KIS
 Note: The August-22 Core-PCE forecast is from market consensus.

As can be observed that compared to June, the PCE price index decreased 0.1 percent due to energy prices decreased 4.8 percent and food prices increased 1.3 percent. Excluding food and energy, the PCE price index increased 0.1 percent from June to July. According to the market consensus, the PCE will decelerate while the core-PCE will increase slightly.

II. Understanding of the PCE

Prices for goods and services change constantly, rising and falling as companies and consumers react to trends in the economy. The PCE index tracks the consumer side of this dynamic by measuring changes in the cost of living for households—rather than for companies or other economic actors.

While the PCE index has a lower profile than the consumer price index (CPI), it's notable for a few reasons:

- Core PCE is the Federal Reserve's preferred measure of inflation, helping to guide the central bank's monetary policy decisions.
- Price data for the PCE index comes from surveys of businesses, rather than what consumers say they're spending on goods and services.
- The PCE's basket of goods and services changes regularly to account for substitution—when prices for one item rise, consumers shift their spending to cheaper alternatives.
- It also measures expenditures on goods and services made on behalf of consumers, like spending on medical insurance by employers or government programs.

The PCE index is calculated each month based on BEA data on personal consumption expenditures from a wide range of sources including:

- Statistical reports from the U.S. Census Bureau and other government agencies
- Administrative and regulatory agency reports
- Reports from private organizations, such as trade associations

In its analysis, the BEA separates consumer goods and consumer services into three categories:

- Durable goods. Items that last three years or longer, like cars and trucks, furnishings and household equipment, recreational goods and vehicles.
- Non-durable goods. Items that last less than three years, like food and beverages, clothing, gasoline and other energy products.
- Services. Things like housing, health care, transportation, recreation services, restaurants, accommodations, financial services and insurance.

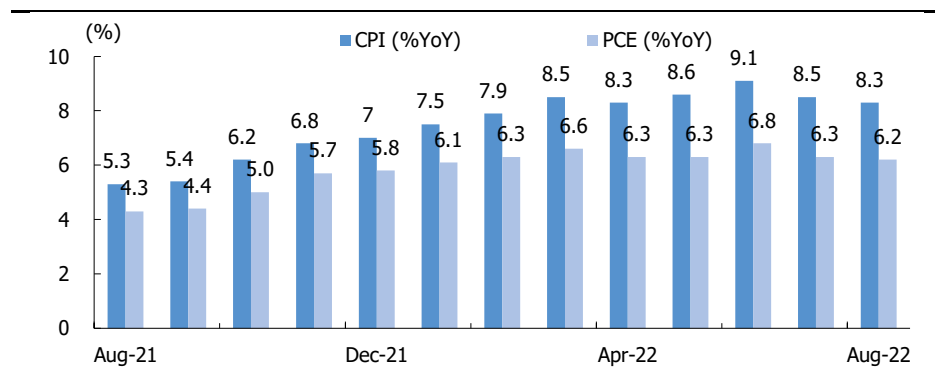
DIFFERENT BETWEEN CPI AND PCE

CPI and the PCE index both measure U.S. inflation in similar but ultimately different ways.

- Both measure changes in a basket of goods and services, but the CPI is based on survey data from tens of thousands of consumers instead of reports from businesses on what they sell.

- CPI doesn't account for substitution or costs paid by others that consumers benefit from, like employer-sponsored medical costs, making PCE more comprehensive, less volatile and more accurate.
- CPI is not revised once it's been published. That's because the CPI has been calculated using changing methodologies over time, preventing the Bureau of Labor Statistics (BLS) from refactoring historical CPI figures. When the methods for calculating PCE are revised, they are applied to historical data as well.
- CPI tends to show higher rates of inflation than the PCE index.

Figure 3. Historical data of CPI and PCE

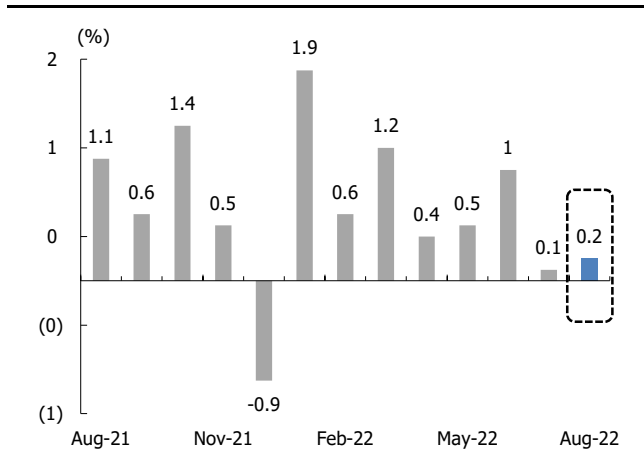


Source: Bloomberg, KIS
 Note: The August-22 PCE forecast is from market consensus

As can be observed that, from August 2021 to August 2022, the average rate of headline CPI inflation was 7.5% whereas headline PCE inflation was 5.8%.

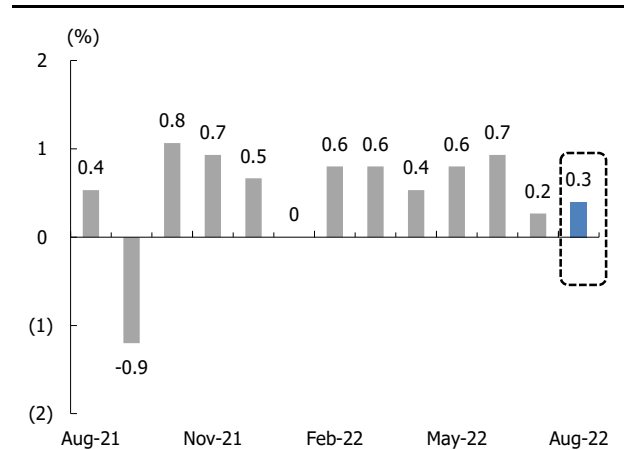
According to the BLS report, inflationary pressures remained strong across other components of the report and declining gas and energy prices were offset by increases in the food and shelter indexes.

Figure 4. Personal Spending in the U.S



Source: Bloomberg, KIS
 Note: The August-22 personal spending forecast is from market consensus.

Figure 5. Personal income in the U.S



Source: Bloomberg, KIS
 Note: The August-22 personal income forecast is from market consensus.

Personal income in the United States increased 0.2% MoM, easing from an upwardly revised 0.7 percentage rise in June and well below market expectations of 0.6 percent. It was still the sixth consecutive rise, primarily

reflecting an increase in compensation that was partly offset by decreases in proprietors' income, personal current transfer receipts, and rental income of persons. The increase in compensation was led by private wages and salaries. The decrease in proprietors' income was mainly in nonfarm income. The decrease in personal current transfer receipts followed an increase in June that reflected a legal settlement from corporate business to persons.

After rising 1% in June, personal spending in the U.S increased slightly by 0.1% MoM in July 2022, under market estimates of 0.4%. It is the year's worst performance to date since consumer spending fell on items like gasoline and other energy products while rising on services like overseas travel and housing. Due to summer tourism, rising salaries, and strong savings, consumer spending has remained steady despite rising inflation and interest rates. However, it may soon begin to slow down as a result of the Fed's continued monetary tightening, rising oil prices, and inflation that is near to 40-year highs, which are all straining consumer affordability.

III. How is the PCE used?

The PCE is widely used by financial market participants to gauge inflation and by the Federal Reserve to calibrate its monetary policy. Businesses and consumers also use the PCE to make informed economic decisions. Since PCE measures the change in consumers' purchasing power, it is often a key factor in pay negotiations.

The CPI and its components are also used as a deflator for other economic indicators, including retail sales and hourly/weekly earnings, to separate fundamental change from that reflecting change in prices.

PCE reveals how much households spend on immediate consumption versus saving for the future. Higher consumption levels translate into greater GDP growth in the short term. On the other hand, a higher savings rate is good for long-term economic health. Banks use savings to fund loans for mortgages and business investments.

Analysts use the PCE report to understand household buying habits. For example, it shows how shopping patterns change in response to sharp price increases. That happens most often when gas prices rise or fall. In that way, PCE reveals the elasticity of demand. When demand for a good or service is elastic, people cut back even if the price goes up just a little.

IV. The Michigan Inflation expectation

DEFINITION

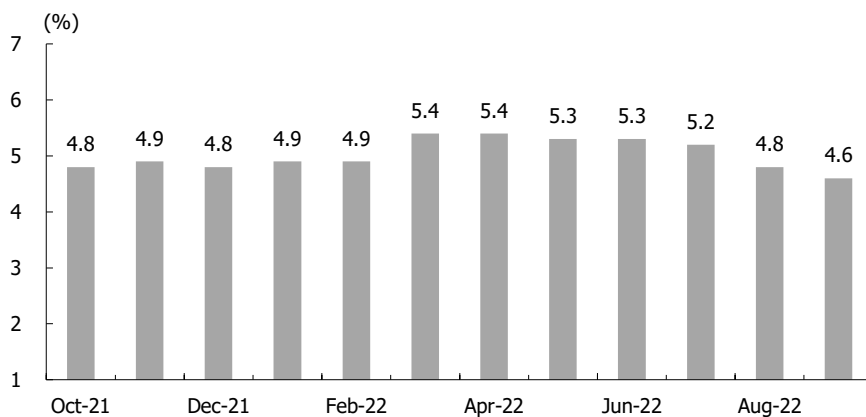
- University of Michigan Inflation Expectations (MICH) measures the percentage that consumers expect the price of goods and services to change during the next 12 months.

- The survey queries consumers on their views of their own personal finances, as well as the short-term and long-term state of the U.S. economy.
- There are two versions of this data released two weeks apart, Preliminary and Revised. The preliminary release is the earliest so tends to have more impact.

WHY IT IS IMPORTANT

- Inflation is an important indicator of economy’s health. Governments and central banks use the MICH and other indices to make economic decisions.
- Market participants will be keeping an eye on analysts’ predictions of the data ahead of their release.

Figure 6. Historical data of Michigan Inflation Expectation



Source: Bloomberg, KIS

According to the data of Michigan University, Michigan Inflation Expectations in the United States decreased to 4.60 percent in September from 4.80 percent in August of 2022. It is expected that Michigan Inflation Expectations in the United States will reach 4.70 percent by the end of this quarter.

V. Why should we check it at this time?

At the moment, the PCE and core-PCE of the U.S. in July was 6.30% and 4.60%, respectively. The PCE data indicated a slower annual increase compared with August, as inflationary pressure eased on the fall of gasoline price.

It is expected that the PCE (%YoY) will decrease slightly to 6.2% YoY and the core-CPE will increase 0.1% in August.

With headline inflation still at 6.3 per cent and core inflation at 4.6 per cent, this is not yet the meaningful decline in inflation the Fed is looking for (2.0% - 3.0%).

This indicator will be released on Friday (U.S time: 7:30 A.M 30th September; VN time: 19:30 P.M 30th September) and we expect that it will have some impact on the FED decision in November.

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