CAPITAL ECONOMICS

GLOBAL ECONOMICS UPDATE

Interest rate-sensitive activity still holding up

- **Interest rate-sensitive activity in advanced economies has fallen, but is still holding up rather well given how much interest rates have risen. This is partly due to the rebound in auto sales and more recently mortgage approvals. But we still think interest rate-sensitive activity will take a further leg down in DMs.**
- A year ago we created our proprietary Interest Rate-Sensitive Activity Indicators in order to track how activity across and within advanced economies is responding to higher interest rates. They are weighted averages of the categories which have historically felt the strongest adverse effects from rising interest rates, and are expressed as 3m/3m growth rates. (Data and methodology can be found here.)
- **Our indicators suggest that high interest rates are having an impact on interest rate-sensitive activity**, which has fallen for a little over a year now on average in DMs. **Nonetheless, activity has remained far more resilient than would be expected given the extent to which financial conditions have tightened.** Indeed, based on its past relationship with our in-house Financial Conditions Indices – which are still flagging recession risks in major advanced economies – the fall in DM interest rate-sensitive activity would be expected to be closer to 7-8% 3m/3m at this stage, compared to the 0.9% fall that we saw in May. (See Chart 1.) This divergence can probably be partly explained by a lengthening in the transmission of monetary policy to the real economy compared to previous tightening cycles, following a general shift to more fixed-rate mortgages since the global financial crisis. **But our FCIs suggest that this resilience won't last, and we still think that a lot of the monetary hit is yet to be felt.**
- At a regional level, while interest rate-sensitive activity is clearly starting to weaken in the euro-zone, it has rebounded recently in the US (where all the data is available up until June) and the UK. (See Chart 2.)

Chart 1: DM Interest Rate-Sensitive Activity Indicator & DM Broad Composite FCI

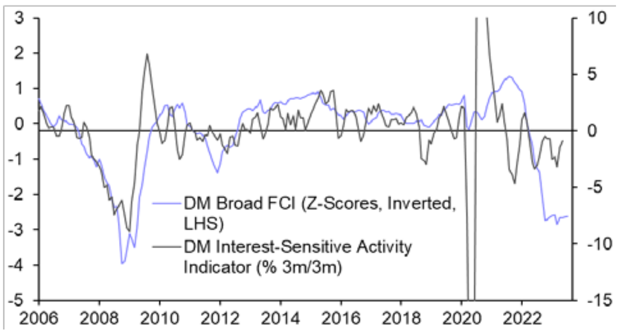
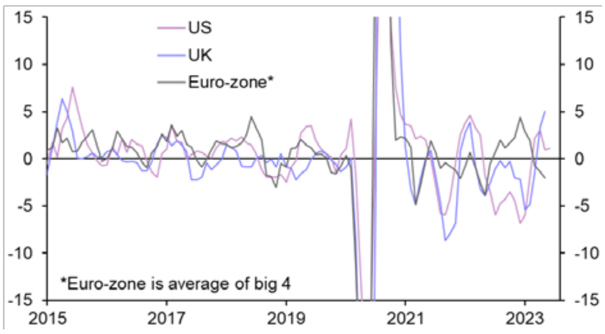


Chart 2: Interest Rate-Sensitive Activity Indicators (% 3m/3m)



Sources: Refinitiv, Capital Economics

- **A large reason for the resilience earlier this year was a sharp rise in auto sales as supply shortages eased.** But we think the auto sector rebound has largely run its course, and in fact auto sales have already slowed in recent months. Meanwhile, other interest-sensitive components of activity like household goods sales and capital goods orders are now falling. (See Chart 3.) All three components have fallen particularly sharply in the euro-zone – largely due to big declines in Germany – which explains the relative weakness in interest rate-sensitive activity in recent months.
- **More recently, the resilience in activity has been due to a rebound in mortgage approvals in June and July as housing markets stage recoveries.** (See Chart 4.) But we don't think housing markets are out of the woods just yet, not least because we expect mortgage rates to remain high for some time, which will weigh on housing activity and house prices, particularly in the UK. (See our latest UK and US housing market outlooks.) Indeed, housing starts are still contracting. And this could start to weigh on construction activity – which has been broadly flat until now – more widely.

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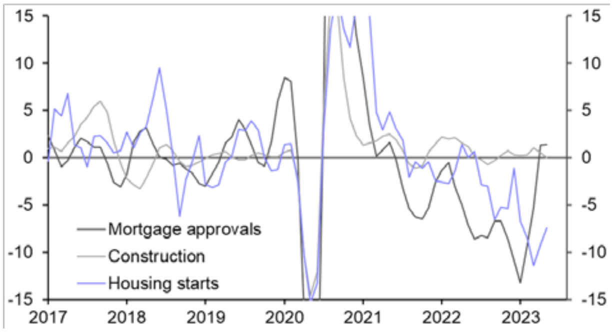
- **The upshot is that as those factors which have supported activity recently fade, and high interest rates start to take a toll more widely across the most interest-sensitive components of activity, we think interest rate-sensitive activity in DMs will fall further.**

Chart 3: DM Auto Sales, Household Goods Sales & Capital Goods Orders (% 3m/3m)

Chart 4: DM Mortgage Approvals, Housing Starts & Construction (% 3m/3m)



Sources: Refinitiv, Capital Economics

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