clearstead

RESEARCH CORNER

December 19, 2022

Research Corner will take a break on 12/26/22 and will resume on 1/9/2023.

OBSERVATIONS

- US equities traded down last week -2.1% after the US Fed Reserve raised its policy interest rate (see One More Thought below) by 50 basis points and revised its economic projections for 2023.[1]
- US inflation eased a bit more than markets were expecting last week. Headline CPI fell to 7.1% year-over-year (YoY) in November down from October's 7.7% YoY print, while core CPI fell to 6.0% YoY in November down from 6.3% YoY the month prior.[1]
- Nominal US retail sales softened in November, climbing 6.5% YoY down from October's 8.3% YoY figure.[1]
- The Architectural Billing Index—a leading indicator of commercial construction activity—weakened further in November, falling to 46.6 from October's 47.7 figure. Any figure below 50 represents a net contraction in activity, with the weakest sub-components coming from firms specializing in multi-family housing and commercial/industrial practices.[2]
- China is in the midst of its largest Covid outbreak since the start of the global pandemic. Cases in Beijing, as well as other major cities, are surging and real-time measures of consumer mobility are plummeting as tens of millions of Chinese citizens experience Covid for the first time.[1]
- Chinese industrial production and retail sales figures missed estimates in November, underlining the impact of widespread lockdowns on output and consumer demand. Retail sales fell by -5.9% year-over-year in November, while industrial production fell to +2.2% YoY in November down from +5.0% YoY in October.[1]

EXPECTATIONS

- The European Central Bank (ECB), along with the Bank of England (BoE) and the Swiss National Bank also raised interest rates last week by 50 basis points, as European central bankers grapple with decades high inflation, in part, spurred by record setting high energy prices.[3] Statements by ECB President Christine Lagard as well as the BoE suggest that global monetary conditions are going to further tighten in 2023 as more policy hikes are needed to ease inflationary pressures.

ONE MORE THOUGHT: *Fed Dot Plots Estimates Move Higher for 2023*[4]

The FOMC meeting last week resulted in a 50 basis-point increase in the Federal Fund's policy rate moving it to the 4.25% to 4.5% range. This latest hike was well anticipated by the markets, but markets are less sure of how high the Fed will raise rates next year and how long they will remain high. Chairman Powell emphasized at his press conference that more needed to be done in order to restore price stability and drive inflation rates back down to their 2% target. He also indicated that the pace of the hikes was now much less important than at previous Fed meetings, setting the stage for more incremental—most likely 25 basis points—rate hikes going forward. Overall, Chairman Powell emphasized that the Fed was not done hiking and the median expectation among the FOMC members (see Chart of the Week) had risen from between 4.5% to 4.75% at the September Fed meeting to between 5% to 5.25% currently for the terminal rate of Fed hikes. He also reminded participants that this, so called terminal rate, had been steadily revised upwards by Fed officials as inflation only gradually began to slow and it was possible that it could still be revised higher still in subsequent meetings depending upon inflation data. Lastly, he emphasized that the Fed was particularly focused on the tightness of the labor market and the recent increase in

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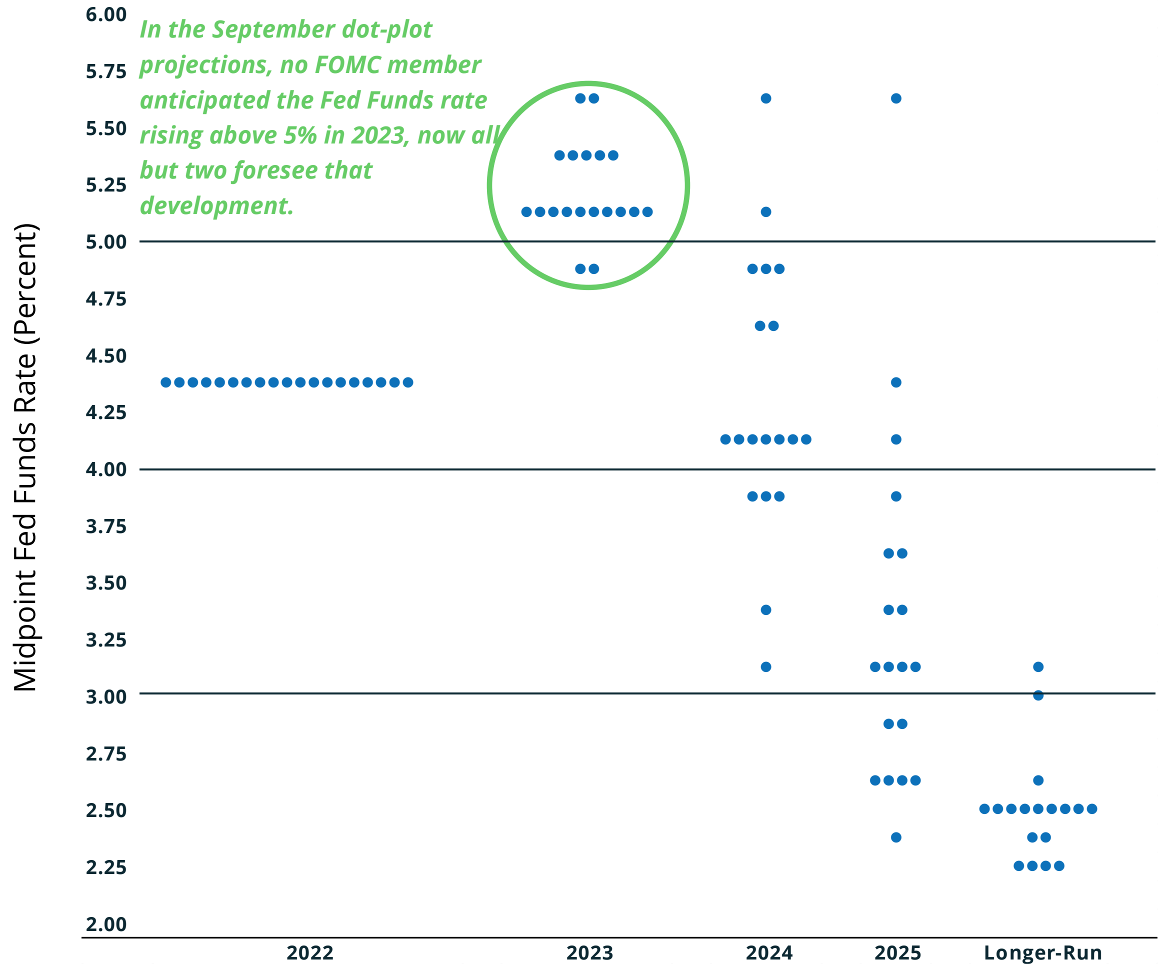
[1] *Bloomberg LP*
[2] *https://www.aia.org/press-releases/6576939-demand-for-design-services-continues-to-sl*
[3] *https://www.wsj.com/articles/swiss-central-bank-follows-fed-with-0-5-point-rate-rise-11671096704?mod=hp_lead_pos1*
[4] *https://www.wsj.com/articles/fed-raises-rate-by-0-5-percentage-point-signals-more-increases-likely-11671044561*

average hourly wages—the last job report showed they grew by 5.1% year-over-year—was too high for the service sector of the economy to see a meaningful decline in inflation next year. Powell emphasized this is a key reason that most Fed officials believe they will need to hike further and keep rates higher for longer. All this suggests that the Fed will keep rates at or above 5% for all of next year—a prospect that is currently at odds with futures options trading related to the Fed Funds rate which projects a decline in rates starting in H2-2023.

CHART OF THE WEEK: FOMC Fed Fund Rates Expectations (Policy Midpoint)



Source: Clearstead, Federal Reserve Board Press Release 14-Dec-2022; each dot represents a projection of a FOMC member.

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