

January 3, 2023

Slower momentum entering the new year

The holiday season typically brings a quiet close to the year in the financial markets. However, the chaotic abandonment of the zero-Covid policy by China has sparked concerns that recent cooling in inflation could reverse as China revives its enormous demand for commodities. At the same time, there are rising worries that the dramatic spike in Covid cases will curtail Chinese factory production, which would add further upward pressure on prices. These inflation concerns fueled an upward reversal in Treasury yields and dampened equity market sentiment, albeit these market moves were likely exacerbated by thin seasonal trading volumes. The yield on the benchmark 10-year note climbed back to 3.88 percent, the highest since November 9th, and the yield on the 2-year note rose to 4.43 percent, reversing the decline in yields posted in December.

The China development came on the heels of the European Central Bank's amplified hawkish policy guidance, the Bank of Japan's decision to lift its cap on long-term yields by 0.25 percentage points to 0.5 percent, and the Fed's continued hawkish guidance despite dialing back the size of its policy rate hikes. We expect the Fed to lift rates above 5.00 percent and hold that restrictive policy rate through 2023. The new year will bring ongoing assessments of how the Chinese Covid pivot and the hawkishness of central banks will affect inflation, economic activity, and the financial markets. We continue to look for a moderately-sized recession to unfold starting in mid-2023. As the Fed's restrictive monetary policy slows inflation, companies will also lose some of their strong pricing power that they acquired during the post-Covid period of rapid inflation. This should lead to further slowing in profit growth and eventually a year-on-year decline. Companies will respond by reducing costs, which notably includes first reducing the pace of hiring and then resorting to outright layoffs. The decline in employment levels and rising unemployment rates will suppress aggregate personal income gains and consequently lead to a pullback in consumer spending.

In the meantime, economic data over the past two weeks signal that overall real GDP growth ended the year sturdy, running above a three percent annualized rate. However, the incoming data also show that much of the strength in activity came early in the fourth quarter during October. As the year winded down, economic momentum started to weaken. Importantly, real consumer spending stalled in November, after rising a rapid 0.5 percent in October. This was presaged by the weak November retail sales report that showed a 0.6 percent decline in overall sales and 0.2 percent contraction in sales ex autos.

The latest batch of housing statistics underscore that the residential investment sector remains mired in a recession. Housing starts fell another 0.5 percent in November. The decline was due to a fall in single-family starts, which are down by nearly one-third since last December. Excluding the Covid lockdowns, November's pace of single-family starts was the slowest since February 2019. Building permits, a leading indicator for the housing market and the economy, fell a sharp 11.2 percent in November. Existing home sales fell by 7.7 percent in November to 4.09 million, following a 5.9 percent decline in October and stand 37 percent below the recent peak of 6.49 million in January. Not surprisingly home builders' sentiment has sunk to its lowest since June 2012 (excluding the Covid-induced recession).

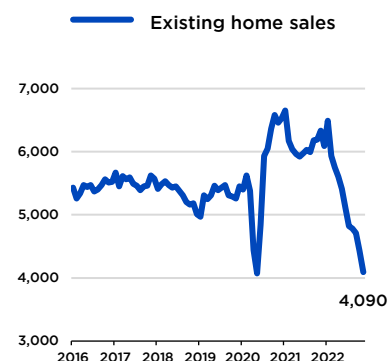
Readings on business investment softened as durable goods orders fell 2.1 percent in November as a drop in aircraft orders depressed the overall order tally. Excluding transportation, orders were up 0.2 percent. Core — nondefense capital goods ex aircraft — shipments, which are a proxy for business investment on equipment, declined 0.1 percent reflecting business caution given the uncertainty surrounding the economic outlook.

Good news on the inflation front continued as PCE inflation trended lower in November. The headline PCE price index decelerated to 5.5 percent from 6.0 percent, while the core reading eased to 4.7 percent from 5.0 percent in October. We look for continued gradual moderation of inflation in 2023, as goods inflation decelerates more sharply, offsetting some of the stickiness in services inflation.

↑ Treasury yields rose throughout 2022 on inflation concerns



↓ Housing market declined last year, approaching Covid-level numbers



Sources:
Federal Reserve Board; National Association of Realtors

The Week Ahead

Here's what we are watching this week:

ISM
Manufacturing
& ISM Services
Index



ISM Manufacturing and Non-Manufacturing indexes - a tale of two sectors

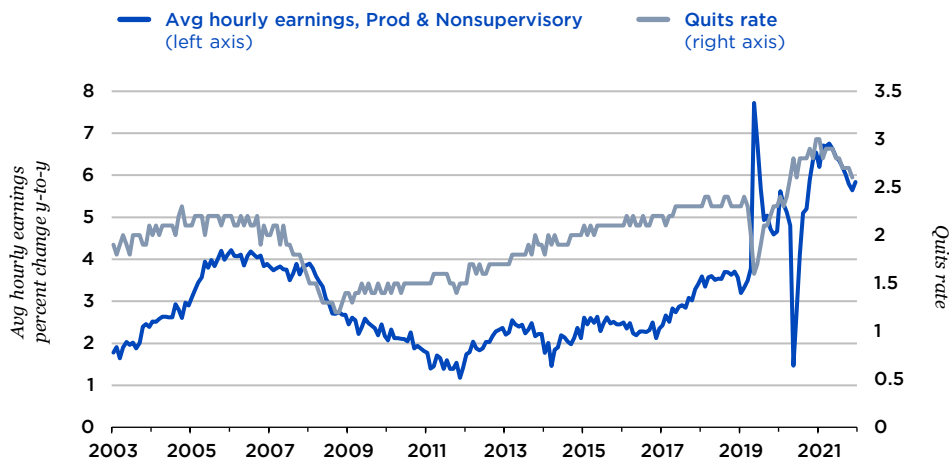
The ISM manufacturing index is likely to fall further below the 50 boom-bust mark to a reading of 48.5 in December, down from 49 in November. Manufacturing activity is contracting as new orders demand wanes. The new orders index has been below the 50-mark in five of the past six months. A silver lining is that supplier deliveries times have quickened due to the drop in orders demand and this has allowed the prices index to retreat sharply – falling to 43 in November, well off the cycle high reading of 92.1 recorded in June 2021. In contrast, the ISM non-manufacturing index likely remains well in expansion territory as we expect it to only slip to 55.3 from 56.5. The shift of consumer preferences toward service consumption from goods consumption buffers the services side of the economy. The prices index remains high – coming in at 70 in November.

JOLTS
Job Openings



JOLTS report likely shows a modest easing in labor market tightness

The number of job openings should continue to trend gradually lower. In October, job openings totaled 10.334 million; extending the decline from the all-time high of 11.855 million in March. The highly monitored ratio of the number of openings relative to unemployed workers also fell to 1.7 in October from a record high of 2 in March. However, Chairman Powell has indicated that the 1.7 ratio remains too high since it represents a labor market that is unhealthy too tight. The quits ratio is another key metric because as the share of workers that quit their jobs fluctuates, so does the rate of wage gains workers are able to garner. As more workers have quit their jobs searching for better opportunities, wage growth has increased.



Sources: Bureau of Labor Statistics

Unemployment
Rate & Average
Hourly
Earnings



Employment to slow, but the unemployment rate remains low

We look for the monthly advance in non-farm payrolls to shrink from 263k in November to 185k in December. The slowing in job creation should be broad-based across the services and goods sectors. However, the unemployment rate is likely to remain low at 3.7 percent. Most importantly, average hourly earnings should rise 0.3 percent, significantly more moderate than the 0.6 percent jump in November. This would allow the year-on-year gain for hourly earnings to ease, but only to an elevated 4.9 percent rate from a 5.1 percent pace in November. Pre-pandemic the annual pace of average hourly earnings was running around 3 percent.

Additional Economic Indicators

Previous Week's Indicators

| | Period | Actual | Previous |
|---------------------------------|-------------------------|------------|------------|
| NAHB Housing Market Index | December | 31 | 33 |
| Building Permits | November | 1342k | 1526k |
| Building Permits MoM | November | -11.20% | -2.40% |
| Housing Starts | November | 1427k | 1425k |
| Housing Starts MoM | November | -0.50% | -4.20% |
| Current Account Balance | 3Q | -\$217.1 b | -\$251.1 b |
| Existing Home Sales | November | 4.09m | 4.43m |
| Existing Home Sales MoM | November | -7.70% | -5.90% |
| Conf. Board Consumer Confidence | December | 108.3 | 100.2 |
| GDP Annualized QoQ | 3Q | 3.20% | 2.90% |
| GDP Price Index | 3Q | 4.40% | 4.30% |
| Initial Jobless Claims | Week ending December 17 | 216k | 211k |
| Leading Index | November | -1.0% | -0.80% |
| Personal Income | November | 0.40% | 0.70% |
| Personal Spending | November | 0.10% | 0.80% |
| Durable Goods Orders | November | -2.10% | 1.10% |
| PCE Deflator MoM | November | 0.10% | 0.30% |
| PCE Core Deflator MoM | November | 0.20% | 0.20% |
| New Home Sales | November | 640k | 632k |
| New Home Sales MoM | November | 5.80% | 7.50% |
| Advance Goods Trade Balance | November | -\$83.3b | -\$99.0b |
| Pending Home Sales MoM | November | -4.0% | -4.60% |

This Week's Indicators

| | Release Date | Period | Forecast* | Previous |
|------------------------------------|--------------|-------------------------|-----------|----------|
| Construction Spending MoM | Tuesday | November | -0.40% | -0.30% |
| ISM Manufacturing | Wednesday | Week ending December 30 | 48.5 | 49.0 |
| Wards Total Vehicle Sales | Wednesday | December | 13.3m | 14.14m |
| Trade Balance | Thursday | November | -\$63.0b | -\$78.2b |
| Change in Nonfarm Payrolls | Friday | December | 185k | 263k |
| Unemployment Rate | Friday | December | 3.70% | 3.70% |
| Average Hourly Earnings MoM | Friday | December | 0.30% | 0.60% |
| Average Weekly Hours All Employees | Friday | December | 34.4 | 34.4 |
| ISM Services Index | Friday | December | 55.3 | 56.5 |
| Factory Orders | Friday | November | -1.30% | 1.0% |



Interested in learning more from Nationwide Economics? Find this and other content from Nationwide at blog.nationwidefinancial.com/markets-economy.

The information in this report is provided by Nationwide Economics and is general in nature and not intended as investment or economic advice, or a recommendation to buy or sell any security or adopt any investment strategy. Additionally, it does not take into account any specific investment objectives, tax and financial condition or particular needs of any specific person.

The economic and market forecasts reflect our opinion as of the date of this report and are subject to change without notice. These forecasts show a broad range of possible outcomes. Because they are subject to high levels of uncertainty, they will not reflect actual performance. We obtained certain information from sources deemed reliable, but we do not guarantee its accuracy, completeness or fairness.

Nationwide, the Nationwide N and Eagle and Nationwide is on your side are service marks of Nationwide Mutual Insurance Company. © 2023 Nationwide.

NFM-9898AO.7

