Nationwide Economics

Weekly Economic Review & Outlook

January 17, 2023

Cooler inflation numbers are encouraging

Encouragingly consumer price inflation continued to cool in December. The easing of inflation should provide reason and room for the Fed to slow the size of the policy rate hikes to 25 basis points starting at the next FOMC policy meeting on January 31 – February 1. In other economic news, the NFIB small business survey showed decreasing optimism among small business owners, many of whom have a negative outlook on the economy and expected sales for 2023.

Inflation slows further but housing costs are still on the rise

The consumer price index (CPI) rose a buoyant 6.5 percent in all of 2022 including December's month-over-month decline of 0.1 percent. Slowing inflation was once again led by energy prices, which fell by 4.5 percent and have dropped in five of the last six months. The core rate, which strips out food and energy, climbed by 0.3 percent but the 12-month change eased to 5.7 percent from 6.0 percent in November.

Core services inflation accelerated again as it has in each of the last 16 months, but this was entirely due to rents. Core services excluding rents — Fed Chair Powell's new preferred inflation measure — had a 12-month trend rate of 6.2 percent in December, equal with November and down slightly from its recent peak of 6.5 percent. This indicates that, outside of the housing sector, core services inflation may have leveled off and could retreat further in coming months. Core goods inflation, on the other hand, continued its freefall (aided by a third straight sharp decline in used car prices), dropping from a peak of 12.3 percent in February 2022 to only 2.1 percent in December.

Although inflation is still far higher than the Fed's two percent target, December's CPI data provide evidence that the large tightening monetary policy has been effective at slowing the pace of inflation. This latest reading provides support for the Fed to pare its rate increases to 25 basis points. Still, we expect the tightening cycle to continue over the first half of the year until the fed funds rate has reached at least 5.0 percent.

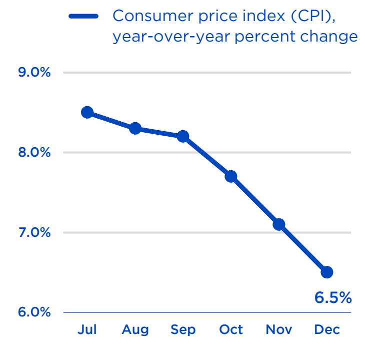
Small business optimism deteriorated further at the end of 2022

The small business optimism index fell in December to a six-month low and its second-lowest reading since 2013. There was some evidence in the survey of softening labor demand — both job listings and hiring plans were lower than in November. Still, both measures remained elevated and the percent of firms with job openings they are unable to fill right now would have been a record prior to the current cycle.

Similarly, inflationary pressures were materially lower than earlier in 2022 but still elevated — note the percent of firms raising selling prices fell significantly but was still three times higher than the long-run average. This aligns with the prices paid component of the ISM services survey which showed that input price growth has improved but is still far from normal.

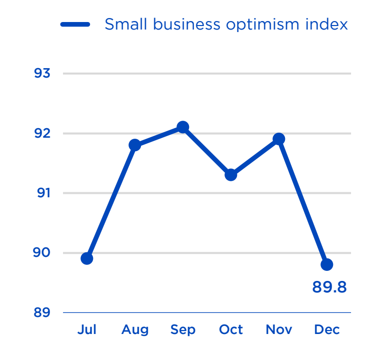
Small business owners generally have a negative outlook on the economy. The net percent of firms expecting the economy to improve over the next six months was near a record low, as was the percent of firms reporting now is a good time to expand. These softer business readings support the building consensus that economic conditions should weaken further from here, culminating in a moderate recession starting in mid-2023. As businesses look for ways to cut costs in coming months, hiring should weaken with job cuts likely later this year, which in turn weakens consumer spending and acts to slow growth.

CPI growth falls again



The 12-month change in the CPI fell for a sixth straight month and is now at its lowest level since October 2021.

Small business optimism falls to six-month low



Small business optimism fell in December as firms reported lower earnings and reduced expectations for economic growth in the first half of 2023.

Sources:
Bureau of Labor Statistics; National Federation of Independent Business

Contributors: Daniel Vielhaber, Economist | Ashleigh Leonard, Economic Specialist

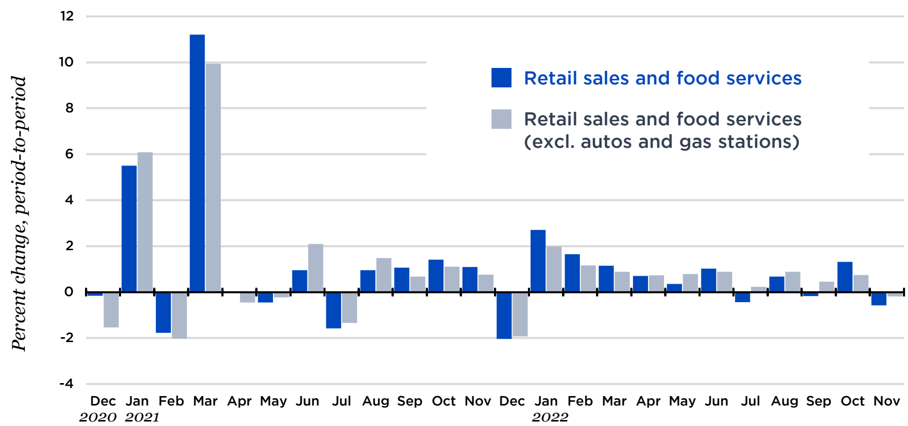
The Week Ahead

Here's what we are watching this week:

Retail Sales Jan 18

Autos wear down retail sales

Overall retail sales are expected to decline moderately in December, down one percent on the month, weighed down by autos. Auto unit sales fell by 5.6 percent in December, following a 6.1 percent decline in November. The pullback in auto sales should suppress headline retail sales as autos historically are a primary contributor to retail sales — accounting for over 18 percent of the total in November. The decline in retail sales, even when adjusted for lower inflation, indicates that consumer spending was cooling as we exited 2022, likely due to inflationary pressures, rising interest rates and the drawdown of excess pandemic-related savings.



Sources: Census Bureau/Haver

Industrial Production Jan 18

Industrial production to fall further

The unexpected deterioration of ISM measurements in November and December is likely a sign that the Fed's interest rate hikes are beginning to set in. Manufacturing production should fall 0.3% as businesses prepare for the anticipated recession. New orders have been declining and firms have tried to keep activity steady, fearing the loss of hard-to-find workers. However, the fight is being lost with orders persistently weak. A retreat in mining activity should add to the weakness as raw material stockpiles have been refilled.

Housing Starts Jan 19

Housing starts continue to plunge

Housing starts in November were down over 19 percent from the beginning of 2022, with notable weakness in single-family starts. Interest in new construction plummeted as mortgage applications declined 10.3 percent at the end of 2022, the largest decline in three months. We expect a further 5.0 percent decline in starts for December as activity waned towards year end. However, over the first week of January the volume of applications climbed after the average 30-year fixed mortgage rate dropped to 6.42 percent from 6.58, encouraging some buyers to take advantage of lower rates while they last.

Additional Economic Indicators

Previous Week's Indicators

	Period	Actual	Previous
Consumer Credit	November	$28b	$27b
CPI MoM	December	-0.1%	0.1%
CPI Ex Food and Energy MoM	December	0.3%	0.2%
Initial Jobless Claims	Week ending January 7	205,000	204,000
Monthly Budget Statement	December	-$85.0b	-$21.3b
Import Price Index MoM	December	0.4%	-0.6%
U. of Mich. Sentiment	January	64.6	59.7

This Week's Indicators

	Release Date	Period	Forecast*	Previous
Empire Manufacturing	Tuesday	January	-8.5	-11.2
Retail Sales Advance MoM	Wednesday	December	-1.0%	-0.6%
Retail Sales Ex Auto and Gas	Wednesday	December	-0.7%	-0.2%
PPI Final Demand MoM	Wednesday	December	-0.1%	0.3%
PPI Ex Food and Energy MoM	Wednesday	December	0.1%	0.4%
Industrial Production MoM	Wednesday	December	-0.2%	-0.2%
Capacity Utilization	Wednesday	December	79.5%	79.7%
NAHB Housing Market Index	Wednesday	January	32	31
Building Permits	Thursday	December	1335k	1342k
Building Permits MoM	Thursday	December	-0.5%	-11.2%
Housing Starts	Thursday	December	1355k	1427k
Housing Starts MoM	Thursday	December	-5.0%	-0.5%
Philadelphia Fed Business Outlook	Thursday	January	-15.0	-13.8
Initial Jobless Claims	Thursday	Week ending January 14	220k	205k
Existing Home Sales	Friday	December	3.98m	4.09m
Existing Home Sales MoM	Friday	December	-2.7%	-7.7%

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.

NFM-9898AO.7

Nationwide®