Nationwide Economics
Weekly Economic Review & Outlook
February 20, 2023

Indicators suggest economy is still running hot

Consumer inflation cooled only mildly in January, leaving prices to continue climbing far too rapidly for the Fed. Additionally, retail sales kicked off the year with a large jump, suggesting the very tight labor market and solid income growth is supporting more-than-healthy consumer activity. These data strengthen the argument that further tightening of monetary policy is needed to reduce demand, but the question of how much remains.

Inflation and retail sales start the year too rapidly

The strong advances in the overall consumer price index (+0.5 percent) and the core reading (+0.4 percent) in January resulted in only modest declines in the year-on-year rates, which eased only to 6.4 percent overall and 5.6 percent at the core level. Ongoing firm increases in food prices (which are up double digits from a year ago) and a rebound in energy prices after declines in five of the last six months helped to drive the headline rate, while the gain in the core reading was led again by core services prices that remain uncomfortably sticky and more than offset the small rise in core goods prices.

Rents inflation, which stood at 8.0 percent year-on-year in January, continues to push up core services, but even the "super" core services reading (which excludes rents) was down only marginally on a year-on-year basis, remaining above a six percent annual pace.

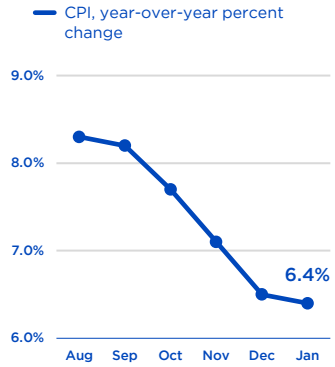
Retail sales surged in January, joining the recent wave of economic indicators suggesting economic activity sped up at the outset of the year. Sales climbed three percent on the month, fueled in large part by the strong personal income gains generated by the blowout January jobs report. Outside of the distortions stemming from Covid and Covid-related fiscal stimulus, it was the largest monthly advance in retail sales since 2001, when car dealers were offering no-interest loans to boost sales after 9/11.

Like the gain from 2001, sales in January were boosted by auto sales, but not nearly to the same extent. Sales excluding autos were up a very strong 2.3 percent as high inventory levels led to discounted goods after the holidays, likely contributing to the jump in sales at electronics, furniture, and especially department stores. Sales at restaurants and bars — the lone services category tracked in the retail sales report — sprung 7.2 percent higher.

The re-acceleration in domestic activity in January along with the persistently elevated inflation readings signal that the terminal level for the fed funds rate is likely to be higher than we and the markets previously expected, with the fed funds target range easily now on track to be 5.25 – 5.5 percent by June versus our prior forecast of 5 – 5.25 percent. Two notable Fed hawks, Cleveland Fed President Loretta Mester and St. Louis Fed President Jim Bullard have suggested they could support a 50bps rate hike at the March 22 FOMC policy meeting, though neither are current voting members. With Vice Chair Brainard, who has been the intellectual leader of the doves on the FOMC, leaving the Fed for the White House on February 20, this could provide less resistance on the committee to increase the size of the rate increase back to 50bps from 25bps.

However, the incoming economic data, particularly the February readings for employment, inflation and retail sales will dictate the size of the next rate hike by the Fed. In the meantime, the minutes from the January 31 – February 1 monetary policy meeting will be closely scrutinized this week for insights on how Fed officials might not react to inflation readings that so far remain persistently high and a labor market that continues to be extremely strong and tight.

Inflation slows, but not by much



Consumer price growth slowed modestly in January, ending the three-month streak of larger declines in headline inflation.

Retail sales surge

Retail sales experienced rarely-seen growth in January after declining in four of the previous six months.

Sources:
Bureau of Labor Statistics; Census Bureau

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The Week Ahead

Here's our outlook for the days ahead. Subscribe to **Daily Insight** for updates throughout the week.

Existing Home Sales & New Home Sales

Feb 21

The housing market rebounds in January

Pending homes sales rose by 2.5 percent in December, signaling an increase in existing home sales for January. Additionally, while still very elevated, mortgage rates saw a large dip in January and local realtor data reported housing price cuts, likely encouraging some prospective homebuyers to jump into the market. On the downside, existing home inventory continues to be low and a limiting factor for sales. Taken together, we project existing home sales to tick up three percent January.

New home sales should also increase by one percent. While still at a low level from an absolute standpoint, the NAHB housing market index for January recorded a small rebound and the present sales component jumped to a three-month high. Consequently, we project a small increase in new home sales of one percent.

GDP Annualized QoQ

Feb 23

GDP growth little changed in second estimate for Q4

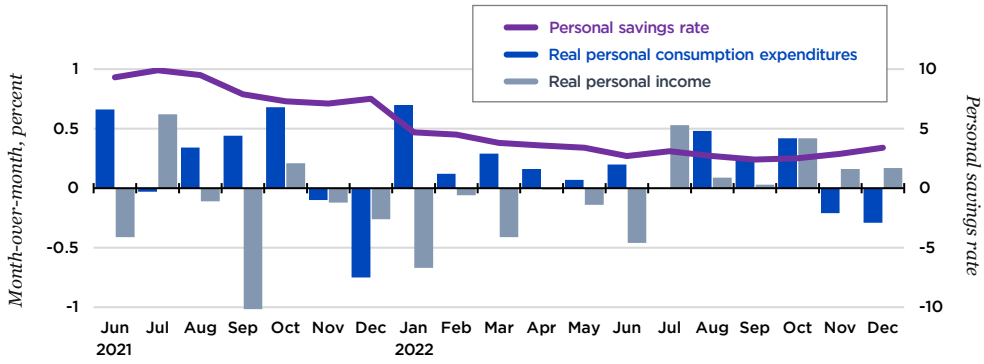
We look for the second estimate of Q4 real GDP to remain unchanged at 2.9 percent. In the details, consumer spending benefitted from higher wages, longer average workweeks, and higher disposable incomes as the labor market tightened further. However, contributing slightly more to GDP was the large unwanted gain in inventories. Business spending increased, but only modestly and residential investment was extremely weak in Q4. The core GDP measure – final sales to private domestic purchasers – was up a minute 0.2 percent. While we ended 2022 on a soft note, 2023 is beginning with much more core strength.

Personal Income & Personal Spending

Feb 24

Hot labor market stimulates personal income and spending

Consumer confidence may have dropped in January, but that didn't keep consumers from opening their wallets as retail sales surged three percent last month on an estimated strong 1.2 percent gain in personal income. Personal spending should increase an ebullient 1.2 percent in January. The strength of the labor market, led by the surge of job growth in January combined with increases in the average workweek and hourly earnings, continues to fuel households and boost spending capacity. Even with a dour long term economic outlook, consumers should continue to spend as long as the labor market remains tight.



Sources: BLS/Haver Analytics

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Additional Economic Indicators

Previous Week's Indicators

	Period	Actual	Previous
NFIB Small Business Optimism	January	90.3	89.8
CPI MoM	January	0.5%	-0.1%
CPI Ex Food and Energy MoM	January	0.4%	0.3%
Empire Manufacturing	February	-5.8	-32.9
Retail Sales Advance MoM	January	3.0%	-1.1%
Retail Sales Ex Auto and Gas	January	2.3%	-0.7%
Industrial Production MoM	January	0.0%	-0.7%
Capacity Utilization	January	78.3%	78.8%
NAHB Housing Market Index	February	42	35
Building Permits MoM	January	0.1%	-1.6%
Housing Starts MoM	January	-4.5%	-1.4%
Initial Jobless Claims	Week ending Feb 11	194,000	196,000
Philadelphia Fed Business Outlook	February	-24.3	-8.9
PPI Final Demand MoM	January	0.7%	-0.5%
PPI Ex Food and Energy MoM	January	0.5%	0.1%
Import Price Index MoM	January	-0.2%	0.4%
Leading Index	January	-0.3%	-0.8%

This Week's Indicators

	Release Date	Period	Forecast*	Previous
Existing Home Sales	Tuesday	January	4.14m	4.02m
Existing Home Sales MoM	Tuesday	January	3.0%	-1.5%
GDP Annualized QoQ	Thursday	4Q S	2.9%	2.9%
Initial Jobless Claims	Thursday	Week ending Feb 18	195,000	194,000
GDP Price Index	Thursday	4Q S	3.5%	3.5%
Core PCE QoQ	Thursday	4Q S	4.0%	3.9%
Personal Income	Friday	January	1.2%	0.2%
Personal Spending	Friday	January	1.3%	-0.2%
Real Personal Spending	Friday	January	0.8%	-0.3%
PCE Deflator MoM	Friday	January	0.5%	0.1%
PCE Core Deflator MoM	Friday	January	0.4%	0.3%
New Home Sales	Friday	January	622k	616k
New Home Sales MoM	Friday	January	1.0%	2.3%
U. of Mich. Sentiment	Friday	February	66.6	66.4

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