

March 28, 2022

FOMC speakers signal faster pace of rate hikes

Federal Open Market Committee (FOMC) members suggested last week that continued strong inflation data could lead the Fed to increase short-term rates at a faster pace than previously expected. These comments caused interest rates to rise and flattened parts of the Treasury yield curve. Economic data were mixed, with new and pending home sales falling again while initial jobless claims fell to the lowest level since 1969.

Interest rates up again

While several FOMC members spoke about the outlook last week, the key talk came from Fed Chair Jerome Powell. At the National Association for Business Economics (NABE) annual policy seminar, he was asked what would keep the Fed from tightening by 50 basis points (bps) at the next (May) FOMC meeting. His response was “nothing.” This was new news to financial markets that had been expecting a string of 25 bps moves this year and suggested that if inflation doesn't soon peak, the Fed would be prepared to take stronger action to bring it down and keep long-term inflation expectations anchored. As a result, interest rates moved higher across the yield curve.

The key 10-year Treasury note yield jumped by 34 bps over the week, ending at 2.48 percent — the highest level since May 2019. Rates in the middle of the Treasury yield curve rose by even more, with the curve inverting a tad from 3- to 10-years (i.e., when shorter-term rates move above longer-term rates). The shape of the yield curve is an important leading indicator of economic downturns, with recessions typically following inversions. While the widely viewed 2-year to 10-year spread has fallen substantially, it remains upward sloping. But the key spreads are those from shorter-term rates to longer-term rates, such as the 3-month to 10-year, as this shows when Fed policy has tightened sufficiently to cause a downturn. Rather than falling, this yield spread has been rising, despite an increase in short-term rates. But as the Fed follows through on its expected tightening over the course of the year, this spread is likely to decline — especially if the Fed tightens by 50 bps at coming meetings (perhaps at more than one). While our forecasts do not show enough Fed tightening to fully invert the yield curve, if inflation remains elevated the Fed may be compelled to tighten by more than financial markets currently expect — increasing the odds of an eventual yield curve inversion and a following recession.

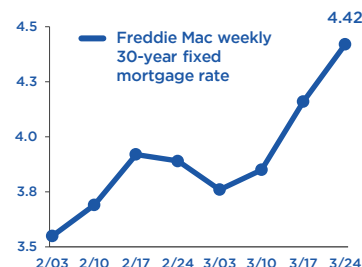
The odds of a near-term recession remain low but given the likely flattening of the yield curve they will rise, although given the lags involved probably not for 2022 (or even 2023). The Conference Board's index of leading economic indicators (LEI) is another good forward-looking recession predictor, and it is not close to showing a downturn in the near term. Moreover, business cycles back to the early 1970s show that the soonest recessions began after the start of Fed tightening was 20 months, and it is usually longer than that. Of course, further negative shocks could occur to make this cycle different and bring a downturn closer — or the Fed may be able to pull off a soft-landing, as it did in 1966, 1984, and 1995.

Home sales slow while jobless claims trend lower

New home sales fell again for February, down to an annualized pace of 772,000 units. Housing fundamentals are becoming mixed with mortgage rates now up to 4.42 percent, but job growth solid and unemployment back down to near pre-pandemic lows. Pending home sales (a leading indicator of existing home sales) dropped as well and are now at the lowest level since the end of the Covid recession. Lack of supply remains an impediment for existing home sales, while homebuilders have been throttling back new orders given supply chain issues (labor, lots, and material costs and availability).

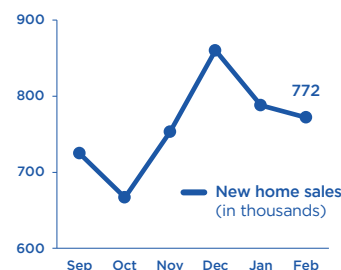
But the labor market remains strong, as weekly unemployment claims dropped to the lowest level since 1969. Job and income gains are the key for continuing economic expansion, as they translate into consumer spending — the largest part of the U.S. economy. While unemployment claims remain at ultra-low levels, growth should be sustained, but given their weekly frequency, claims may be the best near-term indicator of a problem with the economy.

Mortgage rates reach fresh post-pandemic highs



Mortgage rates continue to move higher with other longer-term rates, pushed up by expected Fed tightening and higher expected inflation.

New home sales dip again



New home sales fell again for February but remain at a solid pace.

Source: Haver Analytics

The Week Ahead

Here's what we are watching this week:

Personal income, consumer spending, and PCE price index



↑ Solid growth expected for income/spending, but another jump in inflation

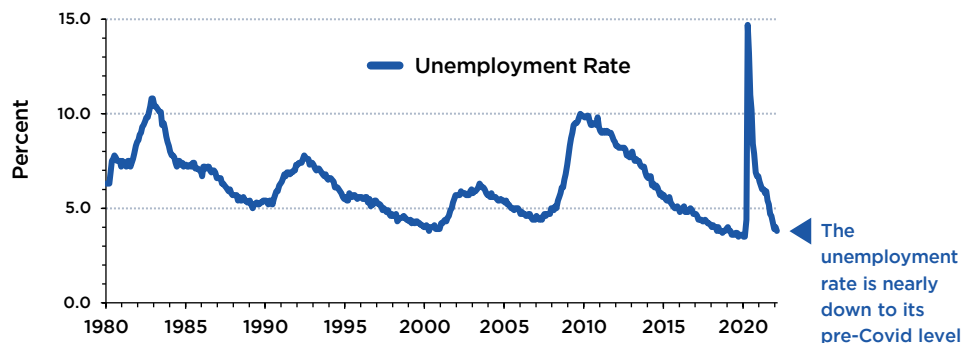
Growth in personal income was flat for January, but that was mostly due to the elimination of advance Child Tax Credit payments. Wage and salary income should continue to provide upward pressure and we project growth in personal income of 0.5 percent. Personal consumption expenditures (PCE) likely climbed due to an increase in spending on services (e.g., dining out) and fuel as Omicron subsided. With only a modest 0.3 percent gain for retail sales, we project growth in PCE of 0.6 percent. Lastly, February's CPI suggests that consumer prices continued to climb for both goods and services, and we project growth in the core PCE price index (which strips out the volatile food and energy components) of 0.4 percent. This growth would bring the 12-month trend rate up 5.5 percent, the fastest since 1983.

Nonfarm payrolls, unemployment rate, and average hourly earnings



↑ Another sizable increase in payrolls expected for March

It's likely that labor force participation made more incremental gains for March as Covid's impact continued to diminish, and high-frequency data suggest labor demand remained robust throughout the month. But with payrolls rising by more than 500,000 in seven of the past nine months, job gains probably slowed a bit, with an increase of 475,000 for March — still a very strong pace. With rising labor force participation, we look for the unemployment rate to remain steady at 3.8 percent. Additionally, February's pause in average hourly earnings growth was likely more about the rise in hours worked following the drop in January due to Omicron than it was about slowing wage growth; as a result, we believe strong growth in wages resumed and we project growth in average hourly earnings of 0.4 percent.



Sources: Bureau of Labor Statistics/Haver Analytics

ISM manufacturing index



↑ Manufacturing growth likely accelerated for March

Regional Fed manufacturing surveys were mostly up for March (with the Dallas Fed's survey being released this week) and generally indicated continued growth in order backlogs and upward input price pressures. Additionally, growth in manufacturing new orders for February was at a five-month high, suggesting faster growth for the sector in the short run. Moreover, the flash manufacturing index from IHS Markit showed a strong gain. Taken together, we project a rise in the Institute for Supply Management (ISM) manufacturing index to 59.1 for March.

Weekly Market Snapshot

Provided by IMG Business and Product Development – Data Analytics Team

Equity

	Last	1 Week	Returns YTD*	1 Year *
S&P 500 (Large)	4,543	1.81%	-4.35%	17.85%
S&P 400 (Mid)	2,712	0.25%	-4.26%	7.05%
S&P 600 (Small)	1,331	-0.55%	-4.78%	3.70%
S&P 500 (High Quality)	51	0.80%	-4.75%	18.15%
Russell 1000	4,818	1.65%	-4.96%	15.34%
Russell 2000	5,164	-0.38%	-7.22%	-3.81%
Dow Jones	34,861	0.31%	-3.60%	8.88%
NASDAQ	14,169	1.99%	-9.28%	9.90%
MSCI EAFE	2,160	0.20%	-7.01%	1.24%
MSCI EM	1,125	0.23%	-8.35%	-10.50%

* represents total return

S&P Metrics

	LTM P/E	NTM P/E	LTM EPS Growth	NTM EPS Growth
Current	20.75	19.57	38.71	9.36
Prior Month	20.80	19.16	41.42	8.59
Prior Year	26.02	21.62	-2.71	23.03

Fixed Income

	Last	1 Week	Returns YTD	1 Year
U.S. Aggregate	3.04%	-1.82%	-6.89%	-5.34%
U.S. Inv Grade	3.77%	-1.73%	-9.04%	-6.05%
U.S. High Yield	6.35%	-0.64%	-5.68%	-1.20%
TIPS	2.64%	-1.41%	-2.72%	4.21%

Rates

	Last	1 Week	Returns YTD	1 Year
6M T-Bill	1.01%	0.18	0.82	0.97
2 Yr Treasury	2.30%	0.33	1.57	2.16
5 Yr Treasury	2.55%	0.41	1.29	1.73
10 Yr Treasury	2.48%	0.34	0.96	0.85
30 Yr Treasury	2.60%	0.18	0.7	0.26

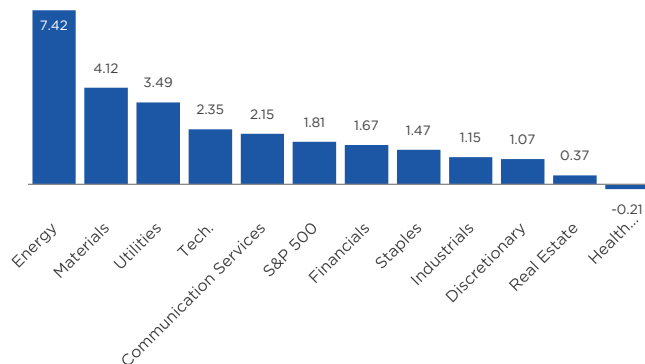
Spreads

	Last	1 Week	Change (Abs %)	YTD	1 Year
AAA Rated	0.6	-0.06	0.09	0.06	0.06
BBB Rated	1.67	-0.09	0.44	0.40	0.40
High Yield	3.51	-0.30	0.41	-0.02	-0.02
10 to 2 yr Treasury	0.18	0.00	-0.61	-1.31	-1.31

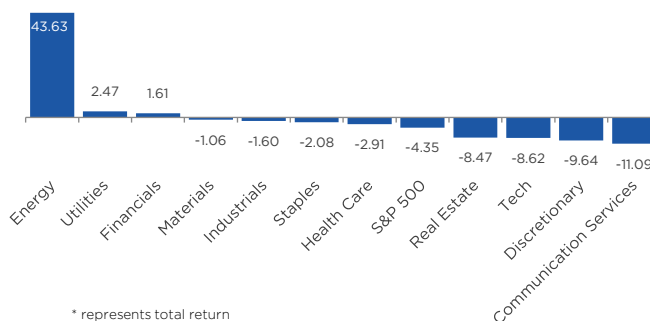
Commodities/FX

	Last	Returns (Currencies in \$ strength)	1 Week	YTD	1 Year
Gold	1953.80	1.33%	6.91%	13.27%	
Bitcoin	44399.57	6.23%	-4.29%	-13.60%	
WTI Oil	113.9	8.80%	51.20%	94.80%	
EUR/USD	1.0984501	0.58%	3.41%	6.72%	
USD/JPY	121.98	2.36%	5.93%	11.77%	

S&P Sector Returns – Week (%)

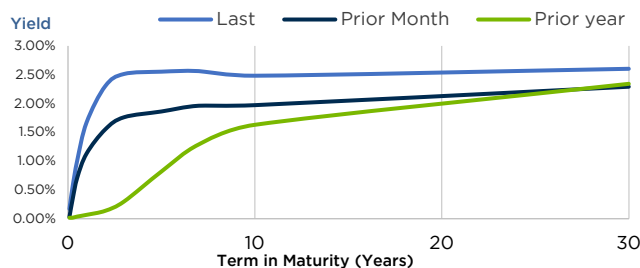


S&P Sector Returns – YTD (%)*



* represents total return

U.S. Yield Curve



Russell Style Returns - Week

	Value	Core	Growth
Large	1.6	1.7	1.7
Mid	1.5	1.0	-0.2
Small	0.7	-0.4	-1.5

Russell Style Returns - YTD

	Value	Core	Growth
Large	0.2	-5.0	-9.5
Mid	-1.3	-5.6	-13.3
Small	-1.4	-7.2	-13.0

Additional Economic Indicators

Previous Week's Indicators

	Period	Actual	Previous
Richmond Fed manufacturing survey	Mar.	13	1
New home sales	Feb.	772,000	788,000
Initial jobless claims	Week ending Mar. 19	187,000	215,000
Durable goods orders	Feb.	-2.2%	1.6%
Markit flash manufacturing PMI	Mar.	58.5	57.3
Markit flash services PMI	Mar.	58.9	56.5
Kansas City Fed manufacturing survey	Mar.	37	29
Consumer sentiment	Mar.	59.4	59.7
Pending home sales	Mar.	-4.1%	-5.8%

This Week's Indicators

	Release Date	Period	Forecast*	Previous
Dallas Fed manufacturing survey	Mon.	Mar.	16	14
S&P/Case-Shiller 20-city HPI (y/y)	Tues.	Jan.	18.4%	18.6%
Consumer confidence	Tues.	Mar.	109.0	110.5
JOLTS (job openings)	Tues.	Feb.	11.3 M	11.3 M
ADP private payrolls	Wed.	Mar.	565,000	475,000
Real GDP (revision)	Wed.	Q4	6.9%	7.0%
GDP price index (revision)	Wed.	Q4	7.2%	7.1%
Initial jobless claims	Thurs.	Week ending Mar. 26	195,000	187,000
Personal income	Thurs.	Feb.	0.5%	0.0%
Personal consumption expenditures	Thurs.	Feb.	0.6%	2.1%
Core PCE price index (m/m)	Thurs.	Feb.	0.4%	0.5%
Core PCE price index (y/y)	Thurs.	Feb.	5.5%	5.2%
Chicago PMI	Thurs.	Mar.	58.5	56.3
Nonfarm payrolls	Fri.	Mar.	475,000	678,000
Unemployment rate	Fri.	Mar.	3.8%	3.8%
Average hourly wages (m/m)	Fri.	Mar.	0.4%	0.0%
Average hourly wages (y/y)	Fri.	Mar.	5.5%	5.13%
Markit manufacturing survey	Fri.	Mar.	58.3	58.5
ISM manufacturing survey	Fri.	Mar.	59.1	58.6
Construction spending	Fri.	Feb.	0.8%	1.3%

* Nationwide Economics Forecast



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