

November 14, 2022

An unexpected inflation reprieve

October's consumer inflation report came in lower than forecasted. Equity markets responded positively to expectations of smaller Fed rate hikes ahead with the S&P 500 jumping by 5.5 percent last Thursday. But inflation remains highly elevated and one month of cooler prices does not make a trend. Elsewhere, survey results indicate that optimism is very low for small business owners and consumers alike.

Inflation slows in October

The consumer price index (CPI) climbed by 0.4 percent in October while the core rate — excluding food and energy components — rose by 0.3 percent. Both measures were lower than consensus expectations while core prices were notably cooler than in recent months. Although the changes brought the 12-month trend rates down to 7.7 percent and 6.3 percent, respectively, the journey back to price stability remains long as these rates are still very high.

Significant declines in health insurance and used car prices helped to cool inflation in October. The Cleveland Fed's median CPI measure, although slower than in August or September, increased by 0.5 percent — suggesting more pervasive price pressure than the headline figure. Food and energy costs were still up 10.9 and 17.6 percent, respectively, over the past year as households continue to struggle with everyday expense increases.

With only one month of slower inflation signs, the Fed is unlikely to alter its hawkish policy stance. While there is one more CPI release between now and the next FOMC meeting, a hike of 50 basis points then seems more likely than a fifth straight hike of 75 basis points. Still, we expect the terminal fed funds rate in 2023 to be higher than previously estimated by the Fed — up to 5.13 percent.

Small business and consumer surveys decline

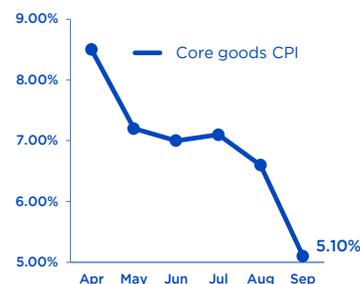
The NFIB small business optimism index fell to a three-month low in October and was only marginally higher than its Covid recession trough. Inflation continues to be the number one concern for small business owners, and the percent of firms ranking it as such remains the highest since the early 1980s.

Firms continue to project weaker economic conditions ahead, with earnings in the current quarter expected to be lower than last quarter. It should be noted that lower earning expectations are standard in this survey — the net percent of firms expecting higher earnings has been positive only a few times in the survey's history — but the current reading is very low even by those standards.

Inflationary pressures are still evident for small businesses, with the percent of owners raising average selling prices still high at 50 percent. This is well down from the record high seen in March, but still more than five times higher than the long-run median. Also evident is the tight labor market. The percent of firms with job openings they are unable to fill right now was unchanged and still extremely elevated, and the percent of firms planning to raise worker compensation matched an all-time high.

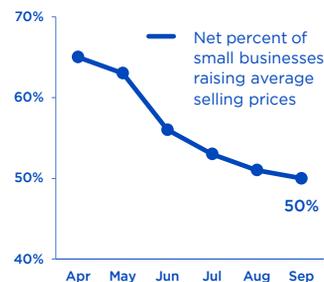
November's consumer sentiment index indicated a similarly less optimistic outlook. While still above June's all-time low, the lower reading from the first half of the month reflected a worsening view of the current economy and future expectations. Consumers are feeling the effects of higher interest rates — as seen in the sharp drop for buying conditions of durable goods — and recession fears continue to heighten. Declines in sentiment were seen broadly across the distribution of age, education, income, geography, and political affiliation in November.

Sharp drop in core goods inflation



Due to weakening global demand and improving supply chains, core goods inflation fell in October to an 18-month low

Fewer small businesses are raising prices



The net percent of small businesses raising average selling prices has fallen significantly in recent months but, at 50 percent, suggests inflationary pressures are still widespread.

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

The Week Ahead

Here's what we are watching this week:

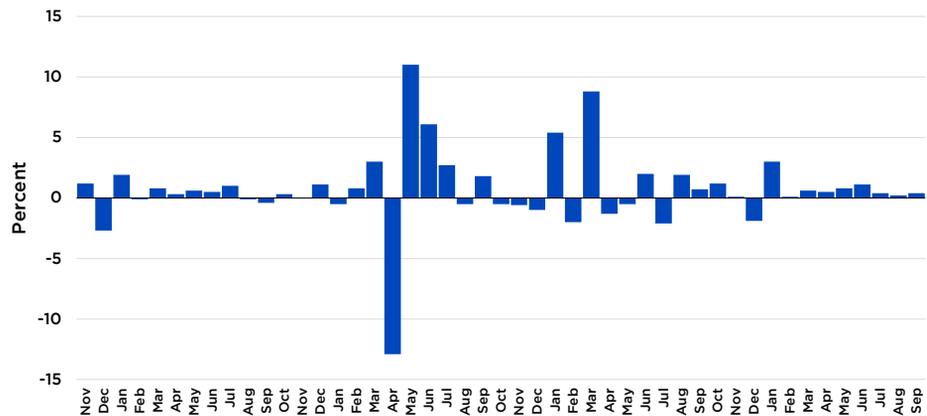
Retail Sales



↑ Retail sales should be boosted by autos

Overall retail sales are expected to be boosted by strong auto sales in October — unit sales jumped to an annualized pace of 14.9 million. However, momentum for core consumer spending is slowing heading into the holiday shopping season as elevated inflation and high interest rates pinch consumers' wallets. Core retail sales, which stagnated over the summer, were likely weaker again in October.

Monthly Change in Core Retail Sales



Sources: U.S. Census Bureau

Industrial Production



↓ Production expected to level off

Manufacturing activity looks to be grinding slower as domestic and global demand for goods cools. Factories' capacity utilization rates though remain high, adding upward pressure to inflation despite falling input costs. Industrial production should be slightly positive in October, weighed down by cuts in manufacturing output.

Housing Starts



↓ Further declines in housing due to higher mortgage rates

Residential housing activity continues to be hit hard by mortgage rates that have jumped to around 7.0 percent. Construction declines are led by a sharp retrenchment in single-family activity, while multifamily starts are holding up better. For October, we expect further contraction in total starts and permits.

Additional Economic Indicators

Previous Week's Indicators

	Period	Actual	Previous
Consumer Credit	September	25.0 b	32.2 b
NFIB Small Business Optimism	October	91.3	92.1
CPI (m/m)	October	0.4%	0.4%
CPI (y/y)	October	7.7%	8.2%
Core CPI (m/m)	October	0.3%	0.6%
Core CPI (y/y)	October	6.3%	6.6%
Jobless Claims	Week ending November 5	225,000	217,000
Consumer Sentiment	November	54.7	59.9

This Week's Indicators

	Release Date	Period	Forecast*	Previous
PPI Final Demand MoM	Tuesday	October	0.4%	0.4%
PPI Ex Food and Energy MoM	Tuesday	October	0.3%	0.3%
Empire Manufacturing	Tuesday	November	-6.5	-9.1
Retail Sales Advance MoM	Wednesday	October	0.8%	0.0%
Retail Sales Ex Auto and Gas	Wednesday	October	0.2%	0.3%
Import Price Index MoM	Wednesday	October	0%	-1.2%
Export Price Index MoM	Wednesday	October	0.1%	-0.8%
Industrial Production MoM	Wednesday	October	0.1%	0.4%
Capacity Utilization	Wednesday	October	80.3	80.3
NAHB Housing Market Index	Wednesday	November	36.0	38
Housing Starts	Thursday	October	1400	1439
Building Permits	Thursday	October	1460	1564
Housing Starts MoM	Thursday	October	-2.7%	-8.1%
Building Permits MoM	Thursday	October	-3.8%	1.4%
Philadelphia Fed Business Outlook	Thursday	November	-6	-8.7
Initial Jobless Claims	Thursday	Week ending November 12	220k	225k
Existing Home Sales	Friday	October	4.30m	4.71m
Existing Home Sales MoM	Friday	October	-8.7%	-1.5%
Leading Index	Friday	October	-0.4%	-0.4%



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