

December 19, 2022

The Fed downshifts, remains hawkish

This will be our last weekly publication for 2022, and we wish all our readers a happy holiday season. The Fed raised the federal funds rate by 50 bps at the conclusion of its December meeting, breaking its streak of four straight 75 bps hikes. In his comments, Chairman Powell maintained a hawkish stance as the Fed continues to prioritize reducing inflation, even if it means some economic pain. On the data front, November retail sales fell by more than expected, but October's strong gains and softer inflation readings over the last few months leave consumer spending in a relatively strong pace in the fourth quarter.

The FOMC slows the pace of rate hikes

As expected, the FOMC (the policy-making arm of the Fed) entered the next phase of its tightening cycle last week as it raised the fed funds rate by a reduced 50 basis points to increase the range to 4.25-4.50 percent. The updated summary of economic projections (SEP) showed a median fed funds forecast of 5.13 percent for 2023 (up from 4.6 percent in September), indicating that more rate hikes are expected at upcoming meetings. Chairman Powell also suggested that the future path to the terminal rate could be slower, implying only 25 bps increases as the Fed calibrates monetary policy more gradually.

The FOMC also cut its forecast for 2023 real GDP growth to 0.5 percent from 1.2 percent in September, while lifting its inflation forecast. Expected stickier inflation underpins Powell's comment that "historical experience cautions against prematurely reducing rates." While financial markets are pricing in rate cuts later in 2023, the Fed has strongly signaled that it will maintain restrictive monetary policy until it is convinced inflation is under control. We see the Fed keeping the fed funds rate above 5.00 percent through 2023, and it's not until 2024 that we anticipate rate cuts. This policy stance could be tested next year if the economy slips into a recession, but the less severe nature of a potential downturn should help the Fed to maintain its restrictive course.

Retail sales pull back in November with slower inflation

November's retail sales fell by 0.6 percent, and by 0.2 percent when excluding auto sales. A sharp decline in unit vehicle sales and falling gasoline prices were notable, but slower sales were broad-based and appears to be partly a result of lower-than-normal holiday spending. Sales for electronics and appliances, sporting goods and hobbies, clothing and clothing accessories, and nonstore retailers — all popular categories for gifts — declined. However, strong growth in restaurant spending suggests the trend of consumers shifting purchases from goods to services resumed in November after a one-month hiatus in October.

Consumers did get a reprieve from inflation in November as the consumer price index (CPI) climbed by only 0.1 percent, extending the weaker price increases seen in recent months. Sharp declines in energy and goods (especially used cars) prices helped to offset further acceleration in services costs. The core CPI also rose by a smaller 0.2 percent for November, with a reduced annual growth rate of 6.0 percent — the slowest pace of core inflation since July. Although improved, inflation continues to run well above trend, reinforcing the hawkish rhetoric from the Fed.

Despite the decline in retail sales, strong growth in October combined with weaker inflation readings mean that fourth quarter personal consumption expenditures should contribute strongly to growth. We expect the economy to end 2022 on the uptrend with annualized real GDP growth around 3.0 percent. Until the labor market and wage gains materially weaken, consumers should continue to support growth even with high inflation and rising interest rates. To date, the tight labor market has shown only modest signs of easing, with the number of job openings remaining at high levels and initial jobless claims at very low levels.



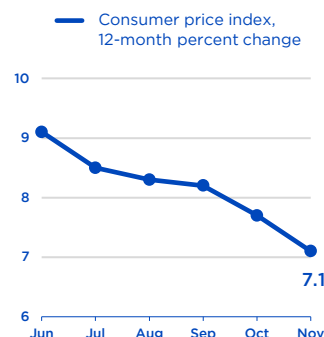
Amid pullback on goods, consumers continue to dine out



Although total retail sales were down in November, spending at restaurants remained strong — now up 14 percent over the past year.



Inflation cools further



The CPI fell for a fifth straight month in November. It remains far higher than the Fed's two percent goal, but the trend is distinctly downward

Sources:
Census Bureau; Bureau of Labor Statistics

The Week Ahead

Here's what we are watching the next two weeks:

Housing Starts
MoM, Building
Permits MoM



↓ Housing market slowdown continues

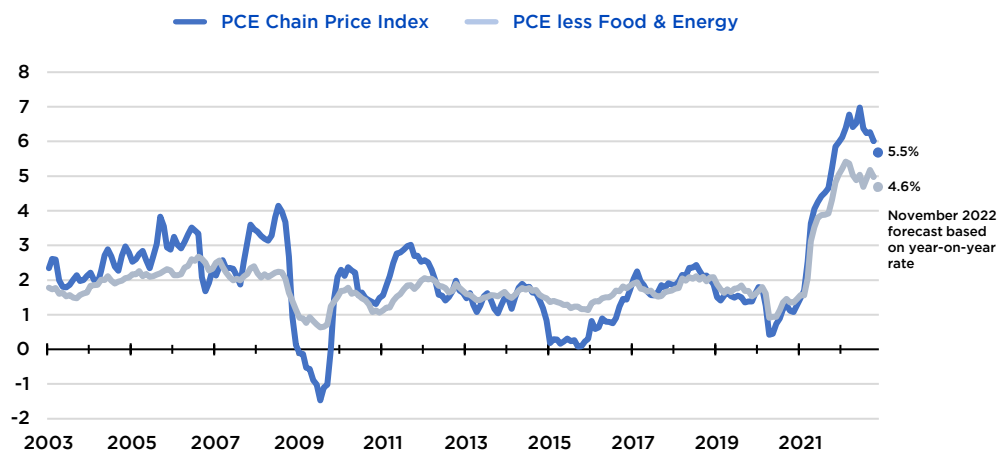
We look for November housing starts to decline 1.4 percent from October, falling to an annualized 1.41 million units. That level would represent a 22 percent decline from the peak 1.8 million in April 2022 — recorded just a month after the Fed started to lift rates from the effective zero lower bound. Building permits, a key leading indicator for the housing market and the overall economy, likely fell 1.7 percent in November to a 1.50 million annualized level.

Personal
Income,
Personal
Spending,
PCE Deflator



↓ Income, spending, and inflation to cool

Personal income likely slowed to a 0.3 percent advance in November, following a strong 0.7 percent jump in October. However, income gains remain sturdy, underpinned by strong employment and wage growth. Consumer spending should also cool to a 0.2 percent increase in November as retail sales were weak. However, the strong rise in October places real consumer spending on a buoyant trajectory for the fourth quarter — around 3 percent annualized. Headline and core PCE inflation should trend lower, with the headline year-on-year pace falling to 5.5 percent from 6 percent in October and core reading decelerating to 4.6 percent from 5 percent in October.



Sources: Bureau of Economic Analysis

Durable
Goods Orders



↓ Durable goods orders fall with decline in aircraft orders

Durable goods orders likely fell 1.1 percent in November as a drop in aircraft orders depress the overall order count. Excluding transportation, orders likely were flat on the month. The core — nondefense capital goods ex aircraft — orders and shipment advances should be soft on the month, reflecting businesses' caution given the uncertainty surrounding the economic outlook.

Additional Economic Indicators

Previous Week's Indicators

	Period	Actual	Previous
Monthly Budget Statement	November	-248.5 b	-191.3 b
NFIB Small Business Optimism	November	91.9	91.3
CPI MoM	November	0.10%	0.40%
CPI Ex Food and Energy MoM	November	0.20%	0.30%
Import Price Index MoM	November	-0.60%	-0.20%
FOMC Rate Decision (Lower Bound)	Week ending December 14	4.25%	3.75%
Empire Manufacturing	December	-11.2	4.5
Retail Sales Advance MoM	November	-0.60%	1.30%
Retail Sales Ex Auto and Gas	November	-0.20%	0.90%
Initial Jobless Claims	Week ending December 10	211k	230k
Philadelphia Fed Business Outlook	December	-13.8	-19.4
Industrial Production MoM	November	-0.20%	-0.10%
Capacity Utilization	November	79.70%	79.90%
Business Inventories	October	0.30%	0.40%

This Week's Indicators

	Release Date	Period	Forecast*	Previous
NAHB Housing Market Index	Monday	December	34	33
Building Permits	Tuesday	November	1500k	1526k
Building Permits MoM	Tuesday	November	-1.70%	-2.40%
Housing Starts	Tuesday	November	1405k	1425k
Housing Starts MoM	Tuesday	November	-1.40%	-4.20%
Current Account Balance	Wednesday	3Q	-\$225 b	-\$251.1 b
Existing Home Sales	Wednesday	November	4.18m	4.43m
Existing Home Sales MoM	Wednesday	November	-5.60%	-5.90%
Conf. Board Consumer Confidence	Wednesday	Dec	101.5	100.2
GDP Annualized QoQ	Thursday	3Q	2.90%	2.90%
GDP Price Index	Thursday	3Q	4.30%	4.30%
Initial Jobless Claims	Thursday	Week ending December 17	220k	211k
Leading Index	Thursday	November	-0.50%	-0.80%
Personal Income	Friday	November	0.30%	0.70%
Personal Spending	Friday	November	0.20%	0.80%
Durable Goods Orders	Friday	November	-1.10%	1.10%
PCE Deflator MoM	Friday	November	0.10%	0.30%
PCE Core Deflator MoM	Friday	November	0.20%	0.20%
New Home Sales	Friday	November	590k	632k
New Home Sales MoM	Friday	November	-6.30%	7.50%
Advance Goods Trade Balance	Tuesday 12/27	November	-\$96.8b	-\$99.0b
Pending Home Sales MoM	Wednesday 12/28	November	-1.30%	-4.60%



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