The Weekly Snapshot

19 December 2022

ANZ Investments brings you a brief snapshot of the week in markets

It was a busy week for financial markets, with key central banks raising interest rates and a raft of economic data releases – some good, some not so. Equity markets delivered their second consecutive week of falls, with the S&P 500 Index in the US ending down 2.08%, and the tech-heavy NASDAQ 100 Index falling 2.72%. European markets were weak too, with the UK and German markets down 1.91% and 3.27% respectively, although the New Zealand market fared better, but finished unchanged.

US bond markets performed a bit better, despite higher interest rates, as many feel that central banks are pushing their economies closer to recession – an environment that would be supportive for bonds. The yield on the US 10-year government bond fell 9 basis points, to 3.49%. Other bond markets struggled to make headway though, particularly in Europe.

What's happening in markets?

Global equity markets had a good start to the week, fuelled by a weaker-than-anticipated inflation report in the US. November's consumer price index (CPI) reading was 7.1% on an annual basis, less than the 7.3% expected. Core CPI, which excludes food and energy prices, rose 6% over the same period. While the inflation rate remains well above the Fed's target level of 2%, it's the lowest reading in over a year.

It was another sign that inflation may have peaked and this was positive for equity markets. Equity markets initially soared, but later gave back their gains as the market's attention turned to the US Federal Reserve meeting – with investors expecting the Fed to raise interest rates, but by a smaller amount to what they have done at their previous few meetings.

In the event, the Fed met market expectations, raising the fed funds rate by 0.50% (to a target range of 4.25%-4.50%), its highest level in 15 years. However, many had hoped the Fed would signal a more cautious approach ahead. In its accompanying statement, it made it clear the fight against inflation is not over and that it remains steadfast in getting inflation back to its target level:

> ***"The Committee anticipated that ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time".***

Equity markets continued to retreat as investors also digested the Fed's accompanying economic projections, and as a weaker-than-expected US retail sales number (which fell 0.6% in November) suggested that the relentless rates hikes are finally starting to bite. The Fed now sees interest rates peaking at 5.1%, higher than the 4.6% it had predicted in its September forecasts.

Other overseas central banks kept the pressure on too. In Europe, the European Central Bank (ECB) raised interest rates by 0.50%. While it's a smaller hike than its last two moves (each of 0.75%), it said it would need to raise rates "*significantly*" further in order to tame inflation. It also announced it would begin reducing the amount of bonds it holds on its balance sheet – unwinding the purchases it had made during the pandemic to support financial markets.

At its news conference following the announcement, ECB president Christine Lagarde reinforced its commitment to further rate hikes:

> **"Anybody who thinks this is a pivot for the ECB is wrong. We're not pivoting, we're not wavering. We're showing determination and resilience in continuing a journey… If you were to compare with the Fed – we have more ground to cover".**

The Bank of England and Swiss National Bank raised interest rates too, also by 0.50%. The Bank of England indicated that further tightening was required to rein in inflation, and said it was prepared to respond "*forcefully*" if needed.

While annual inflation figures had earlier shown that the pace of price rises in the UK had eased slightly, inflation was still 10.7% in the year to November, higher than most other developed countries. It comes as the so-called 'winter of discontent' deepens, as widespread strike action begins to kick-in, as workers demand better pay to deal with the cost of living crisis. Nurses, rail workers, postal workers, ambulance and airport staff are amongst those planning action in the coming weeks.

Meanwhile, in New Zealand, the highlight of the week was third quarter GDP data, which showed that the domestic economy continued to grow at a strong pace. The economy grew by 2.0%, surpassing the 0.9% expectation. The move higher was driven primarily by a return of tourism following the reopening of New Zealand's borders.

What's on the calendar

On the back of what was a busy week, things are a bit quieter this week – at least in terms of economic data releases. The Fed's preferred inflation reading, the core personal consumption expenditures (PCE) price index, is released on Friday and most will be looking to see if prices (excluding volatile food and energy prices) continue their recent downwards trend.

Also in the US, we have consumer confidence on Wednesday. At its last reading, the index fell from 107.8 to 102.5 as higher interest rates are starting to affect homeowners. Expectations are for November's reading to fall below 100.

Other than that, the Bank of Japan is meeting on Tuesday, where no change in policy is expected.

Chart of the week

The Fed released an update to its Summary of Economic Projections, which suggests the central bank expects further economic hits to come from monetary tightening to date.

It believes inflation will remain higher for longer. It now expects consumer prices to rise 3.1 percent next year and 2.5 percent in 2024. Chairman Powell said that, despite some recent moderation in price pressures, "*inflation risks are to the upside*". It also projects that economic growth will fall sharply and that unemployment will rise, a sign of how the Fed's efforts to control inflation will take a toll on both workers and the broader economy.

FOMC summary of economic projections - December 2022

Variable	Median (%)[1]				
	2022	2023	2024	2025	Longer run
Change in real GDP	0.5	0.5	1.6	1.8	1.8
September 2022 projection	0.2	1.2	1.7	1.8	1.8
Unemployment rate	3.7	4.6	4.6	4.5	4.0
September 2022 projection	3.8	4.4	4.4	4.3	4.0
PCE inflation	5.6	3.1	2.5	2.1	2.0
September 2022 projection	5.4	2.8	2.3	2.0	2.0
Core PCE inflation[2]	4.8	3.5	2.5	2.1	N/A
September 2022 projection	4.5	3.1	2.3	2.1	N/A
Federal funds rate	4.4	5.1	4.1	3.1	2.5
September 2022 projection	4.4	4.6	3.9	2.9	2.5