GENERALI INVESTMENTS

MARKET COMMENTARY

The Fed remains hawkish despite slowing down tightening

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- **The telegraphed 50 bps rise was followed by a strong and almost unanimous commitment to keep tightening. The FOMC projects a further 75bps tightening in 2023, to 5% to 5.25% peak (a 50-bps increase from what signalled in September), and plans cuts only the following year.**
- **Yet the FOMC thinks that a "softish" landing is still possible. Growth projections for 2023 were scaled down, but the increase in expected unemployment is marginal. Inflation should end next year at 3.1% and go back to target only after 2025.**
- **The Fed once again disappointed market's hopes of a softening of its stance and the S&P lost nearly 1% on the announcement.**

The unsurprising shift to a slower pace of tightening was the only dovish piece of news coming from the last Fed meeting of the year. FOMC members show a strong agreement on the need to raise rates further; the increase in the projected peak rate with respect to September, already anticipated, was stronger than what many (including us) expected. Despite basically no changes in the tone of the press release and the worsening of the growth outlook, the FOMC moved up the peak in policy rate by 50bps to the 5% to 5.25% range.

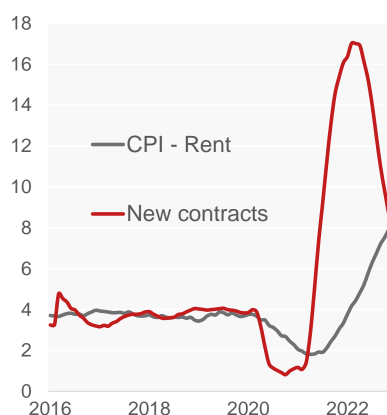
The darkening of the domestic and global perspectives and the impact of tighter money was reflected in the growth and labour market projections, but up to a point. The economic projections see just 0.5% growth at the end of next year, but the unemployment rate would rise by less than a percentage point, from the current 3.7%, to 4.6%. As Chair Powell reiterated during the Q&A session, the large overhang of job openings results from a significant skill mismatch. Therefore, even with a sizeable deceleration in activity firms would be reluctant, in the FOMC view, to lay off the workers it took them so much time to hire. Rebalancing the labour market would then require only a modest increase in unemployment. Therefore, disinflation may not be too painful and most of the FOMC members continue to think that a soft or not too hard landing is achievable. Yet NY Fed chair Williamson a couple of weeks ago warned that unemployment could shoot up to above 5% and most independent forecasters see a recession next year.

Powell welcomed the signs of inflation cooling in the latest to CPI reports, which confirm the FOMC view, but urged not to be carried away. Goods inflation is dropping sharply and the fast moderation in rents will show up at some point in H1 2023, but inflation in core non-housing services remains too high and does not shows many signs of descent. They are labour intensive sectors and therefore slower wage growth is critical.

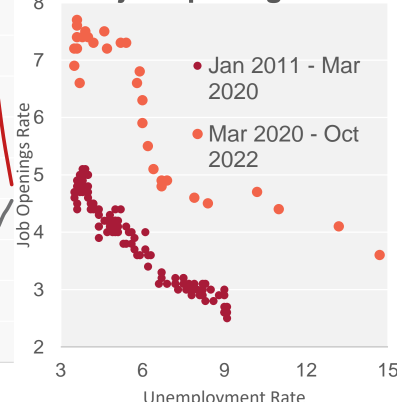
The projections for inflation worsened from September as the economy enters the new higher with a higher realised price increase, and risks are tilted to the upside. This requires a more energetic stance. Powell provided no details on how the 75bps rise will be distributed: February could see another 50bps increase followed by a final 25bps hike, or there will be 25bps hikes in February, March, and May. The latter options seems slightly more plausible as Powell stated that data allows for a more moderate pace of increase and that what matters for fighting inflation is no longer the speed of tightening but the peak level and for how long it will be kept. He underlined the strength of the commitment to a 5% to 5.25% peak by signalling that 17 out of 19 FOMC members called for a peak of at least 5% and noting that overall financial conditions are not restrictive enough yet. Rate cuts in 2023 are not seen as a possibility right now: FOMC members needs very strong evidence that inflation is on a convincing downtrend before easing. The projections points to a policy rate above the neutral level until at least 2025.

The meeting poured cold water on markets expectations of a more accommodative Fed. The S&P lost 0.8% on the announcement the NASAQ dropped by 1%. The two-year Treasury inched marginally up to 4.2%.

Median projections					
	2022	2023	2024	2025	Longer run
GDP growth (Q4/Q4 ann.)	0.5	0.5	1.6	1.8	1.8
Sept. projections	*0.2*	*1.2*	*1.7*	*1.8*	*1.8*
Unemployment rate	3.7	4.6	4.6	4.5	4.0
Sept. projections	*3.8*	*4.4*	*4.4*	*4.3*	*4.0*
PCE infl. (Q4/Q4 ann.)	5.6	3.1	2.5	2.1	2.0
Sept. projections	*5.4*	*2.8*	*2.3*	*2.0*	*2.0*
Core PCE infl. (Q4/Q4 ann.)	4.8	3.5	2.5	2.1	-
Sept. projections	*4.5*	*3.1*	*2.3*	*2.1*	-
Appropriate path for the policy rate					
Federal funds rate	4.4	5.1	4.1	3.1	2.5
Sept. projections	*4.4*	*4.6*	*3.9*	*2.9*	*2.5*



Source:BLS, Zillow, GIAM



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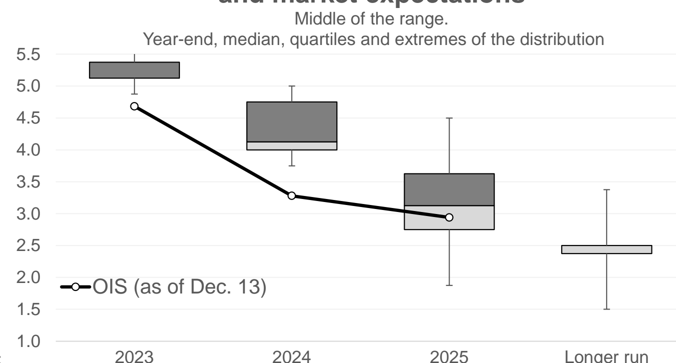

Source:Federal Reserve Board, Datastream,GIAM

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