Macro Outlook Summary

November 2022

The Fed hiked as expected by 50bps on 14th Dec and the BOE and ECB followed quickly with equal moves. Despite the clear signalling from every central banker, markets didn't really like the moves and sagged into the second half of December. So what is going on? There are two distinct sets of data to watch. One is inflation and the other is economic growth and employment. They are of course connected in that strength in the latter will create upward pressure in the former. Optimists are ignoring the resilient labour market and focusing on inflation data which is peaking. Entering the 4Q their conclusion was that the inflation crisis is over, the Fed will back off and the economy will soft land, so buying equities now is the right move. Pessimists are cognisant of the resilient labour market, note that US consumer confidence hit an 8 month high is December and realise that until this shows clear signs of weakening, the upward pressure on inflation has not been broken and softening inflation data may be transitory.

Fed Chair Jerome Powell is proving to be exceptional with his clear messaging and affirmative action. He is clearly messaging the optimists to say that he's not in their camp. Until the labour markets and consumers calm down his job is not done and even then he's fearful that inflation may not fall back as obediently as the optimists hope. We are firmly with the pessimists and Jerome Powell who believe that significantly higher rates are still required to slow the labour market and the economy and take the back pressure out of inflation. In addition we are doubtful that inflation will willingly dissipate as expected into 2023 and suspect that during the 2H of next year progress to lower inflation will look disappointing even as economic weakness becomes more visible.

At this juncture it seems the only central bank with clarity of purpose is the Fed where they are clear that their singular focus is on inflation suppression whatever the cost to employment and the economy. By contrast in the UK and Europe the BoE Governor Andrew Bailey and ECB President Christine Lagarde appear not to want to be blamed for causing a recession and hope that the coming slowdown will do their job for them.

The parlous state of the UK economy is well summed up by the recent comment "the UK economy has entered a winter of self-destruction triggered by waves of public sector strikes with a pattern of wilful dysfunction becoming entrenched". Both central banks should be pressing hard to reverse QE while credit markets allow and signalling their determination to fighting inflation and heading off what will otherwise be a disastrous pay-inflation spiral.