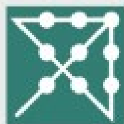
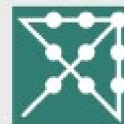
 Yardeni Research 

MORNING BRIEFING
January 25, 2023

What's in Style at S&P and the Fed?

Check out the accompanying chart collection.

Executive Summary: Standard & Poor's last month reshuffled the components of its S&P Growth and Value indexes, with dramatic impacts on their valuation metrics. Ejected from the Pure Growth index were most of the MegaCap-8 companies, along with their gargantuan capitalizations; now only Apple remains. The forward P/Es of the S&P 500 Growth and Pure Growth indexes plummeted as a result. … Also: While FOMC members can't share what's been on their minds during the current pre-meeting quiet period, Melissa recaps what they last said about their expectations for monetary policy.

Strategy: Value & Growth Recalculated. After the close of trading on December 19, Standard & Poor's released its new constituents for its various S&P Growth and Value indexes based on its annual recalculation of the growth and value scores for companies in the indexes. Their scores determined which companies appear in the Growth and Value indexes, which appear in both indexes (in a weighted fashion), and which companies meet the stricter criteria for inclusion in the Pure Growth and Pure Value indexes.

I asked Joe to dig deeper to see what really happened. He reports that the changes to the indexes and their forward valuations were stunning, to say the least:

(1) At year-end 2021, S&P's criteria had seven of the MegaCap-8 companies in the top 10 market-cap spots in the S&P 500 Pure Growth index, with Netflix a near miss. Fast-forward to year-end 2022, and only Apple remains. The ouster of seven MegaCap-8 companies, along with their massive collective capitalizations, from the Pure Growth index comes as no surprise since price momentum and sales growth are a big part of the Growth score, and theirs deteriorated considerably in 2022.

(2) During 2022, the S&P 500 Pure Growth stock price index fell 28.1%, slightly better than the 30.1% decline for Growth, but both were considerably worse than the 3.3% and 7.4% declines for Pure Value and Value. The S&P 500 fell 19.4% last year (*Table 1*).

(3) Recall that the S&P 500 Growth and Value indexes are further analyzed to determine which companies exhibit scoring characteristics of both Growth and Value and are weighted in each of those indexes by their scores. Meeting the criteria to appear in both indexes were

135 of the S&P 500 companies, including half of the MegaCap-8 stocks: Alphabet, Amazon, Meta, and Microsoft. Here's the classification for the MegaCap-8 stocks now and then:

Current MegaCap-8 classification in the various S&P 500 Growth/Value indexes:
Pure Growth: Apple
Growth only: Netflix, Nvidia, Tesla
Both Growth & Value: Alphabet, Amazon, Meta, Microsoft
Value only: None
Pure Value: None

Prior MegaCap-8 classification in the various S&P 500 Growth/Value indexes:
Pure Growth: Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, Nvidia, Tesla
Growth only: None
Both Growth & Value: None
Value only: None
Pure Value: None

(4) Here are the new top-eight constituents by market capitalization among the 73 companies in Pure Growth: Apple, Exxon Mobil, UnitedHealth, Chevron, Eli Lilly, Merck, Abbvie, and Pfizer.

The current top-eight market-cap companies of the 85 Pure Value companies are: Berkshire Hathaway, Bank of America, Verizon, Wells Fargo, AT&T, Intel, Goldman Sachs, and CVS Health.

Pure Growth's surprising additions include ExxonMobil and Chevron. Goldman Sachs' score deteriorated so considerably since a year earlier that it was shifted out of the Pure Growth index and into Pure Value.

(5) The net result of S&P's constituent changes to the indexes caused the forward P/E for S&P 500 Growth and Pure Growth to fall sharply relative to their Value counterparts. Pure Growth tumbled to 11.8 after Standard & Poor's announcement from 17.8 (now 12.3 as of January 19), Pure Value dropped to 9.1 from 10.4 (now 9.6), Growth dropped to 18.4 from 21.1 (now 18.9), and Value rose to 15.9 from 15.3 (now 16.7) (*Fig. 1* and *Fig. 2*).

This has also caused their relative P/Es to reset drastically to multi-year lows. Growth's P/E is now just 2.0pts above Value's, near the lowest premium since 2010 (*Fig. 3*, *Fig. 4*, and *Fig. 5*).

The Fed I: Smaller Rate Hikes Ahead. In recent public commentary before the FOMC's required pre-meeting quiet period, Fed officials signaled that the upcoming January 31-February 1 meeting will likely result in a decision to continue their restrictive monetary policy but at a slower pace. The increase in the federal funds rate should slow to a more typical 25-point pace. Melissa and I anticipate a terminal rate—after this course of tightening is over—of around 5.00%-5.25%, both because Fed Chair Powell has indicated as much and because it's the peak rate in the Fed's latest policy *projections*.

Three more 25-point increases would get us there—expected after the next three FOMC meetings, concluding on February 1, March 22, and May 3. The projected terminal rate would be higher than twice the peak during the previous tightening cycle and the highest since mid-2007 (*Fig. 6*).

What then? Fed officials have talked about pausing for the remainder of the year, with possible further rate hikes later this year if inflation remains troublesome. In any event, policy will remain restrictive as the Fed further winds down its balance sheet. And the Fed likely will signal that rate cuts won't be coming anytime soon.

Why slow the tightening now? Fed officials want to wait to see the lagging effects of their tightening moves so far on inflation and the economy. They need to assess how far the moves already made will go toward their ultimate goals of a soft landing of the economy and sufficiently subdued inflation, ideally realized without hurting the job market too much.

The Fed II: Annual Rotation. With less dissention on the FOMC than in the recent past, the annual rotation of Fed voters (whereby four of the voting president-level participants are replaced by four others) matters less. So there's less uncertainty about what happens next than what happens after the Fed arrives at its terminal-rate destination.

Let's review the 2023 composition of the voters on the FOMC and the gist of their latest policy-related comments before their quiet period began:

(1) *Fed Governor Brainard.* Fed Governor Lael Brainard, as a nearly *decade-long* member of the Fed's Board of Governors, is in Powell's inner circle. Her voice matters for rate moves probably more than some of the other newer, less experienced Fed governors. "Even with the recent moderation, inflation remains high, and policy will need to be sufficiently restrictive for some time to make sure inflation returns to 2% on a sustained basis," Brainard said in a January 19 *speech*.

Downshifting the pace of increases "will enable us to assess more data as we move the policy rate closer to a sufficiently restrictive level," she added. Brainard noted "we are not currently experiencing a 1970s-style wage-price spiral." She concluded: "For these reasons, it remains possible that a continued moderation in aggregate demand could facilitate continued easing in the labor market and reduction in inflation without a significant loss of employment." In other words, Brainard sees a soft landing with ongoing restrictive policy.

(2) *Fed President Williams (New York FRB, voter)*. As a permanent voting president and FOMC vice-chair, John Williams' words carry weight too. "We are seeing the shifting gears of tighter monetary policy having the desired effects," Williams *said* in a recent speech. But with "inflation still high and indications of continued supply-demand imbalances, it is clear that monetary policy still has more work to do to bring inflation down to our 2% goal on a sustained basis."

"Bringing inflation down is likely to require a period of below-trend growth and some softening of labor market conditions," he added, saying also that "the labor market remains remarkably tight." He concluded that "restoring price stability is essential to achieving maximum employment and stable prices over the longer term, and it is critical that we stay the course until the job is done."

(3) *Fed Governor Waller.* Fed Governor Christopher Waller *joined* the Board in 2020, after positions at the FRB (Federal Reserve Bank) of St. Louis. The business sector's evidence of slowing demand is exactly what the Fed is aiming for, Waller *said* on January 20. Waller favors a 25-basis point increase at the next meeting.

(4) *Fed Governor Bowman.* A relative Fed newbie, Michelle Bowman joined the Board in 2018 and was *reappointed* in January 2020. Earlier this month, she said during a *speech*: "In recent months, we've seen a decline in some measures of inflation but we have a lot more work to do, so I expect the [FOMC] will continue raising interest rates to tighten monetary policy." Once a sufficiently restrictive federal funds rate is reached, "it will need to remain at that level for some time in order to restore price stability, which will in turn help to create conditions that support a sustainably strong labor market," she concluded.

(5) *Fed Governor Cook.* Another new *addition*, Lisa Cook joined the board last year. During a January 6 *speech*, she shared her thoughts on inflation in a supply-constrained economy. She reviewed several "novel" inflation indicators she monitors, noting that they show signs of inflation moderating.

However, she cautioned: "Crucially, we must be vigilant to ensure that pandemic-era cost pressures and disruptions do not have lasting effects on inflation. If cost shocks and supply disruptions keep inflation elevated for a long enough period, households' and firms' inflation expectations could move higher—a development that could put additional upward pressure on inflation."

(6) *Fed Governor Jefferson.* Also new to the Board as of 2022 but not new to the Fed, Jefferson *worked* previously as a Fed economist. So far, he has given only two speeches, both last year. In November, he *discussed* inclusivity, saying that "strong demand and a variety of supply constraints have contributed to the fastest increases in consumer prices since the early 1980s. Inflation, too, has disproportionate effects on, and is felt most acutely by, those who can least afford it."

Before that, he said that he was concerned about disparities in employment among racial groups, but that "these disparities have almost returned to the narrower ranges we saw just before the pandemic." In other words, Jefferson came into this year more concerned about inflation than unemployment.

(7) *Fed Governor Barr.* Michael Barr *joined* the Fed as governor and vice chair for Supervision, in charge of monitoring banks, in July 2022. Lately, Barr hasn't said much about interest rates, more *focused* on the banks and climate policy. His earliest *policy objective*, announced in September, was to impose a climate stress test on the banks. We suppose that Barr will vote with the crowd to slow rate hikes at the next meeting.

(8) *Fed President Harker (Philadelphia FRB, voter).* Harker is a *familiar face* on the FOMC, and he *agrees* with the majority of officials thinking that a 25-basis-point increase is appropriate next, with "a few more" rate hikes before a pause.

(9) *Fed President Goolsbee (Chicago FRB, voter).* Austan Goolsbee just took his *post* as FRB-Chicago's president this month. He may not be as dovish as Charles Evans, whom he replaces. "If you're raising 75 basis points a meeting, we're going to have to figure out what the timing is of the pivot," he *said* following the release of October's CPI report. "Unless and until you get that core monthly inflation down in a comfortable range, I think the voices that are saying 'slow down, cool off' are still going to be a little muted."

(10) *Fed President Logan (Dallas FRB, voter).* Prior to her FRB-Dallas post, Lori Logan *served* in FOMC and FRB-NY positions. After the Fed pauses, "we'll need to remain flexible and raise rates further if changes in the economic outlook or financial conditions call for it,"

said Logan in a recent *speech*. “I believe we shouldn’t lock in on a peak interest rate,” she said, adding that further rate hikes could follow any potential pause if inflation is not sufficiently subdued.

(11) *Fed President Kashkari (Minneapolis FRB, voter).* Neel Kashkari has been a vocal participant in FOMC meetings since he *became* a FRB president in 2016 and is currently among its most hawkish members. In a recent essay, he *wrote*: “I have us pausing at 5.4%, but wherever that end point is, we won’t immediately know if it is high enough to bring inflation back down to 2% in a reasonable period of time. ... Any sign of slow progress that keeps inflation elevated for longer will warrant, in my view, taking the policy rate potentially much higher.”

Calendars

US: Wed: MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. **Thurs:** Real GDP & Price Index 2.6% & 3.3%; Durable Goods Orders Total & Core 2.5%/-0.2%; Nondefense Capital Goods Orders ex Aircraft -0.2%; Initial & Continuous Jobless Claims 205k/1.659m; Goods Trade Balance Advance Estimate; New Home Sales 617k; Kansas City Manufacturing Index; Chicago Fed Manufacturing Index; Natural Gas Storage. (Bloomberg estimates)

Global: Wed: Germany Ifo Business Climate Index Headline, Current Assessment & Expectations 90.2/95.0/85.0; UK Headline & Core PPI & Input & Output Prices -0.6%m/m/18.0%y/y & 0.3%m/m/16.4%y/y; Japan Leading Index; BOC Interest Rate Decision 4.50%; BOJ Summary Opinions; European Central Bank Non-Monetary Policy Meeting; Balz. **Thurs:** Italy Business & Consumer Confidence 101.8/102.7; Spain Unemployment Rate 12.5%; UK Labor Productivity; UK CBI Distributive Trades Survey -5; Australia PPI 1.7%. (Bloomberg estimates)

Strategy Indicators

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500’s forward profit margin dropped 0.1ppt last week to a 21-month low of 12.5%. That’s down 0.9ppts from its record high of 13.4% achieved intermittently from March to June. Since the end of April 2020, it has exceeded its prior record high of 12.4% in September 2018. It’s now up 2.2pts

from 10.3% during April 2020, which was the lowest level since August 2013. Forward revenues was down 0.1% w/w to 0.2% below its record high in mid-October. Forward earnings fell 0.5% w/w and is 4.9% below its record high in mid-June. Both had been steadily making new highs from the beginning of March 2021 to mid-June; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for forward revenues growth was unchanged w/w at a 30-month low of 2.7%. That's down from a record high of 9.6% growth at the end of May 2021 and compares to 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. Forward earnings growth dropped 0.3ppt w/w to a 31-month low of 4.0%. That's down from its 23.9% reading at the end of April 2021, which was its highest since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 11.5% (unchanged w/w) in 2022 and 2.3% in 2023 (down 0.1ppt w/w) compared to the 16.5% gain reported in 2021. They expect earnings gains of 7.4% in 2022 (down 0.1ppt w/w) and 2.3% in 2023 (down 0.5ppt w/w) compared to an earnings gain of 50.5% in 2021. Analysts expect the profit margin to drop 0.5ppt y/y to 12.4% in 2022 (unchanged w/w) compared to 12.9% in 2021 and to remain flat at 12.4% in 2023 (down 0.1ppt w/w). The S&P 500's weekly reading of its forward P/E dropped 0.1pt w/w to 17.5 from a four-week high of 17.4. That's up from a 30-month low of 15.3 in mid-October and is down from a four-month high of 18.2 in mid-August. It also compares to 23.1 in early September 2020, which was the highest level since July 2000 and up from a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio rose fell 0.03pt w/w to 2.17 from a four-week high of 2.20, up from a 31-month low of 1.98 in mid-October. That's down from a four-month high of 2.38 in mid-August and also compares to a record high of 2.88 at the end of 2021 and a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Looking at the 11 S&P 500 sectors, last week saw consensus forward revenues rise for six sectors and forward earnings rise for three sectors. The forward profit margin rose w/w for three sectors: Consumer Staples, Energy, and Industrials. Nearly all of the sectors are below recent record highs in their forward revenues, earnings, and profit margins. Consumer Staples and Health Care are the only sectors with forward revenues at a record high this week. Consumer Staples is the only sector with forward earnings at a record high. Forward earnings for Financials, Industrials, and Utilities still remains close to their recent record highs, but Energy's is quickly giving up its gains since its record high in October. Since mid-August, all sectors have seen forward profit margins retreat from their record highs. Those of Industrials and Tech remain close to their post-pandemic highs, and Energy's is now down 0.7ppt from its 12.8% record high in late November. Only three sectors posted a higher profit margin y/y during 2020: Consumer Staples, Tech, and Utilities; during 2021, all

of the sectors but Utilities posted a y/y improvement. Energy and Industrials are the only two sectors expected to see margins improve y/y for full-year 2022, followed by these five sectors in 2023: Communication Services, Consumer Discretionary, Financials, Industrials, and Utilities. Here's how they rank based on their current forward profit margin forecasts along with their record highs: Information Technology (24.0%, unchanged w/w from a 20-month low and down from its 25.4% record high in early June), Financials (17.6, down 0.3ppt w/w to a 22-month low and down from its 19.8 record high in August 2021), Real Estate (17.3, down 0.1ppt w/w and down from its 19.2 record high in 2016), Communication Services (14.1, unchanged w/w and down from its 17.0 record high in October 2021), Utilities (13.7, down 0.1ppt w/w and down from its 14.8 record high in April 2021), Energy (12.1, unchanged w/w and down from its 12.8 record high in November), S&P 500 (12.5, down 0.1ppt w/w to a 21-month low and down from its record high of 13.4 achieved intermittently from March to June), Materials (11.4, unchanged w/w at a 22-month low and down from its 13.6 record high in June), Health Care (10.0, down 0.1ppt w/w to a 32-month low and down from its 11.5 record high in March), Industrials (10.1, unchanged w/w and down from its 10.5 record high in December 2019), Consumer Discretionary (7.2, down 0.1ppt w/w to a 32-month low and down from its 8.3 record high in 2018), and Consumer Staples (7.1, unchanged w/w at a 56-month low and down from its 7.7 record high in June 2020).

S&P 500 Sectors & Industries Forward Profit Margin Since Peak (*link*): Since the S&P 500's forward profit margin peaked at a record-high 13.4% during the June 9 week, it has fallen 6.8% to 12.5% through the January 19 week. The drop has been paced by five of the 11 sectors, though all but the Energy sector is down since the peak. Here's the sector performance since the June 9 peak: Energy (up 1.7% to 12.1%), Utilities (down 0.8% to 13.7%), Industrials (down 2.5% to 10.1%), Consumer Staples (down 2.7% to 7.1%), Real Estate (down 3.4% to 17.3%), Information Technology (down 5.6% to 24.0%), S&P 500 (down 6.8% to 12.5%), Consumer Discretionary (down 7.3% to 7.2%), Financials (down 7.4% to 17.6%), Health Care (down 8.7% to 10.0%), Communication Services (down 12.8% to 14.1%), and Materials (down 16.1% to 11.4%). These are the best performing industries since the June 9 peak: Wireless Telecommunication Services (up 53.0% to 10.4%), Oil & Gas Refining & Marketing (up 48.8% to 5.1%), Airlines (up 23.4% to 5.0%), Oil & Gas Equipment & Services (up 16.8% to 10.7%), and Hotels, Resorts & Cruise Lines (up 14.0% to 11.3%). The worst performing industries since the June 9 peak: Alternative Carriers (down 39.5% to 5.3%), Commodity Chemicals (down 37.9% to 6.4%), Copper (down 35.8% to 12.4%), Home Furnishings (down 35.7% to 5.7%), and Gold (down 33.0% to 12.8%).

S&P 500 Sectors Net Earnings Revisions (*link*): The S&P 500's NERI was negative for a

seventh straight month in January, but improved m/m for the first time since May. NERI rose to -11.0% in January from a 30-month low of -15.6% in December. It had been negative for 13 straight months through July 2020 due to the pandemic shutdown. The 23-month positive streak that ended in June had exceeded the prior 18-month positive streak during the cycle that ended October 2018, when NERI reached a tax-cut-induced, then-record high of 22.1% in March 2018. November's reading compares to a record-high 23.1% in July 2021 and an 11-year low of -37.4% in May 2020. All 11 sectors had negative NERI for a second straight month, matching the lowest count since July 2020 when all 11 were negative for four straight months. Among the 11 sectors, all but Energy gained m/m in the broadest improvement since May 2021. Communication Services was negative for a 15th month, Consumer Staples for an 11th, and Consumer Discretionary and Health Care for a tenth month. Here are the January NERIs for the S&P 500 and its sectors compared with their December readings: Consumer Staples (-0.9% in January [11-month high], up from -8.9% in December), Energy (-4.9 [30-month low], -0.4), Utilities (-7.8, -7.9 [29-month low]), Industrials (-9.4, -18.1 [30-month low]), Information Technology (10.6, -16.9), S&P 500 (-11.0, -15.6 [30-month low], -13.1), Financials (-11.0, -11.7 [30-month low]), Consumer Discretionary (-11.1, -15.6), Real Estate (-13.9, -18.0 [30-month low]), Health Care (-15.1, -19.0 [30-month low]), Materials (-16.7, -28.1), and Communication Services (-19.1, -21.0 [30-month low]).

S&P 500 Sectors Net Revenue Revisions (*link*): The S&P 500's NRRI improved for a second straight month in January, but was negative for a sixth month following two years of positive readings. It improved to a four-month high of -5.2% in January from -10.3% in December. Before the 24-month positive streak ended in August, it had been negative for 21 straight months. That positive streak exceeded the prior 19-month streak during the cycle that ended in October 2018, when NRRI reached a tax-cut-induced then-record high of 14.7% in March 2018. January's reading compares to a record-high 25.9% in August 2021 and an 11-year low of -35.8% in May 2020. Four of the 11 S&P 500 sectors had positive NRRI in January, unchanged from the prior two months and down from all 11 positive during July-October 2021. All but the Energy and Utilities sectors had NRRI move higher m/m in the broadest improvement since December 2020. Financials' NRRI turned positive m/m, but Energy's turned negative. Communication Services was negative for a 15th straight month, followed by Health Care at ten months and Consumer Discretionary at nine. Here are the January NRRIs for the S&P 500 and its sectors compared with their December readings: Consumer Staples (16.9% in January, up from 5.1% in December), Utilities (6.8 [10-month low], 9.0), Real Estate (1.8, 1.4), Financials (0.2, -0.4), Industrials (-3.1, -12.9), Materials (-4.2, -15.1), S&P 500 (-5.2, -10.3), Energy (-7.1 [30-month low], 1.7), Consumer Discretionary (-7.4, -12.1), Health Care (-7.6, -13.2), Information Technology (-

12.0, -17.2), and Communication Services (-21.8, -25.5).

US Economic Indicators

Regional M-PMIs (*link*): Three Fed districts (New York, Philadelphia, and Richmond) have reported on *manufacturing activity* for January and show activity contracted for the sixth successive month to a 32-month low of -17.6 (from -8.0 in December), as activity in the New York (to -32.9 from -11.2) area deteriorated sharply, while Richmond's (-11 from 1) swung from positive to negative, though they were partly offset by a narrowing in the Philadelphia (-8.9 from -13.7) area's decline. *New orders* (-22.0 from -10.0) fell for the ninth month, sliding at its fastest pace since spring 2020, with billings in the New York region (-31.1 from -3.6) and Richmond (-24.0 from -4.0) regions plunging, while Philadelphia's (-10.9 from -22.3) fell at half December's pace. *Employment* (3.6 from 5.4) gains slowed for the third successive month, from 12.2 in October, as hirings in the Philadelphia (10.9 from -0.9) region swung from negative to positive, while the Richmond (-3.0 from 3.0) region saw a swing from positive to negative and New York hirings (2.8 from 14.0) slowed to a near standstill. *Turning to prices*, the prices-paid and -received measures for the New York and Philadelphia regions are diffusion indexes, while Richmond's measures are average annualized inflation rates—which we multiply by 10 for easier comparison to the other regional measures. Looking at *prices-paid* indexes, the New York measure is decelerating again after a brief acceleration, easing to 33.0 this month—its lowest since November 2020—and down sharply from its record-high 86.4 last April, while Richmond's (79.1 from 90.8) is down sharply from its record high of 150.1 last May. Philadelphia's has been on a decelerating trend since reaching its cyclical high of 83.6 in November 2021 (which wasn't far from its record high of 91.1 in the 1970s), easing to a 29-month low of 24.5 this month. *Prices-received* indexes were mixed: New York's prices-received measure eased to 18.8, the lowest since January 2021, after a brief blip up; it was at a record high of 56.1 last March, while Richmond's (65.2 from 76.3) continued to slow from its record-high 103.1 last June. The Philadelphia measure edged up from 28.1 (which was the lowest since March 2021) to 29.9 this month, down from its record high of 65.8 in November 2021.

Global Economic Indicators

US PMI Flash Estimates (*link*): Private-sector activity was in contractionary territory for the seventh consecutive month in January, according to flash estimates, though the decline did

soften a bit. However, the rate of decline is among the steepest seen since the global financial crisis, as activity declined across both the manufacturing and services sectors. Meanwhile, there was a renewed pickup in cost pressures. The *C-PMI* climbed to 46.6 this month after falling eight of the prior nine months, sinking from 57.7 in March to 45.0 by December. Both the *M-PMI* (to 46.8 from 46.2) and *NM-PMI* (46.6 from 44.7) recorded slight upticks in January, though were down sharply from last March's readings of 58.8 and 58.0, respectively. Turning to *prices*, input prices accelerated in January, ending a string of moderating rates that began in mid-2022. Chris Williamson, chief business economist at S&P Global Market Intelligence, notes, "The worry is that, not only has the survey indicated a downturn in economic activity at the start of the year, but the rate of input cost inflation has accelerated into the new year, linked in part to upward wage pressures, which could encourage a further aggressive tightening of Fed policy despite recession risks."

Eurozone PMI Flash Estimates (*link*): "Eurozone edges back into growth at the start of 2023, selling price inflation ticks higher" is the headline of this month's Eurozone PMI report. In addition, business confidence jumped higher, an encouraging sign. The Eurozone's *C-PMI* rose for the third month, to 50.2, after falling steadily from 55.8 last April to a 23-month low of 47.3 by October. The *M-PMI* advanced for the third month to 48.8 this month, after falling steadily from 58.7 at the start of last year to a 29-month low of 46.4 in October, while the *NM-PMI* increased for the second month, moving back above 50.0 to 50.7, after falling the prior seven months, from 57.7 last April to 48.5 by November. Looking at the two largest Eurozone economies, *Germany's C-PMI* was in contractionary territory for the seventh month this month, though is on the cusp of moving into positive territory. The measure rose for the third consecutive month, to 49.7, after sliding the prior eight months from 55.6 last February to 45.1 in October. *Germany's NM-PMI* moved back above 50.0, climbing three of the past four months to 50.4 after sliding the prior five months from 57.6 last April to 45.0 in September. Meanwhile, *France's C-PMI* declined for the eighth time in nine months, from 57.6 last April to 49.0 this month. *France's NM-PMI* fell further below the breakeven point of 50.0, declining for the eighth month since peaking at 58.9 last April, sinking to a 22-month low of 49.2 this January. Meanwhile, *France's M-PMI* rose for the third month to 50.8, after falling five of the prior six months, from 55.7 last April to 47.2 in October—the lowest since May 2020. *Elsewhere across the region*, the report noted that output returned to growth, after four months of decline, led by the steepest rise in service-sector activity in seven months and a near stabilization in the manufacturing output. Looking at inflation for the entire Eurozone, *input* inflation cooled further in January, reflecting alleviating supply-chain pressures, though average *selling price* inflation for both goods and services ticked higher, reflecting still elevated cost growth and upward wage inflation.

Japan PMI Flash Estimates (*link*): Activity in Japan's private sector returned to growth at the start of 2023, though the divergence between the manufacturing and services sectors continued. Japan's *C-PMI* climbed to 50.8 this month from 49.7 at the end of 2022—with the measure bouncing around the demarcation line between expansion and contraction most of last year. The *NM-PMI* (to 52.4 from 51.1) this month was above 50.0 for the fifth successive month, benefitting from the travel subsidy program and a recent relaxation of Covid measures. Meanwhile, January's *M-PMI* was unchanged at 48.9 after falling steadily from 54.1 last March through year-end, as the sector continued to face weak customer demand. On a more hopeful note, the sector saw a softening of the declines in output and new orders, and firms registered a relatively elevated degree of confidence. In terms of *pricing*, the service sector saw an acceleration in input costs, while hikes in output prices were the weakest since last summer; gains in input costs and selling prices in the manufacturing sector were the slowest in 17 and 16 months, respectively.

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