MORNING BRIEFING
February 1, 2023

Peak Hawkishness?

Check out the accompanying chart collection.

Executive Summary: It's almost a given that the FOMC will decide today to ratchet up the federal funds rate by another 25bps. Less certain are how hawkish FOMC members will sound discussing the future course of monetary policy—starting with Fed Chair Powell today—and how much their words may perturb financial markets. But since the Fed remains ever "data dependent," we can gain insight into their thinking by examining the recent data releases that are likely to affect it. … Also: Improving global growth prospects are igniting commodities markets, especially for gold, copper, and other metals. Melissa takes a look.

The Fed: Squawking Hawks. The FOMC's two-day meeting ends today. At 2:00 p.m., the committee will issue its statement, and at 2:30 p.m., Fed Chair Jerome Powell will hold his usual after-meeting press conference. For the other Fed officials, the blackout period preventing public comments ends on Friday. The next blackout period starts on March 11.

So we can look forward to lots of commentary from the Fed heads in coming days. Most of it is likely to be hawkish. But on balance, they should be less so than they were during 2022. They are likely today to raise the federal funds rate by 25bps to 4.50%-4.75% and say that it is getting closer to restrictive, implying that they will vote for two more 25bps rate hikes at each of the next two meetings of the FOMC (on March 21-22 and May 2-3).

That would bring the federal funds rate to 5.00%-5.25%, which coincides with the committee's December 14, 2022 projection of the federal funds rate at 5.10% for this year, falling to 4.1% next year and 3.1% in 2025. Nevertheless, for now, Fed officials are likely to reiterate their intention to keep the federal funds rate at a restrictive level for the foreseeable future and to stress that they have no intention of lowering interest rates anytime soon.

Of course, the Fed heads could turn more hawkish, squawking that this key rate may have to be pushed even higher if the labor market remains too tight and inflation doesn't continue to moderate toward their goals of 3.1% this year, 2.5% next year, and 2.1% in 2025. (See our *FOMC Economic Projections*.)

Fed officials remain data dependent, so let's see what the latest relevant data show:

(1) *Employment.* December's JOLTS release and January's ADP employment report will be out this morning, just in time for these labor market indicators possibly to influence the FOMC's decision. We know that the labor market remains tight based on the recent historically low readings of initial unemployment claims (*Fig. 1*).

That was confirmed yesterday by the Conference Board's January survey used to construct the Consumer Confidence Index (CCI). The percent of respondents saying that "jobs are hard to get" also remained low at just 11.3%, while the "jobs plentiful" response edged up to 48.2%, which is a very high reading for this series (*Fig. 2*). The CCI's jobs-hard-to get series is highly correlated with the unemployment rate, which likely remained near recent lows during January (*Fig. 3*).

Powell and his colleagues have given extra weight to JOLTS' job openings series. They want to see fewer job openings to reduce the upward pressure on wages. However, the JOLTS series is highly correlated with the CCI's jobs-plentiful series, so the former probably stayed high during December (*Fig. 4*). The NFIB small business survey showed a sharp drop in job openings during December, but it also remains historically high (*Fig. 5*).

(2) *Inflation.* In a November 30 *speech* last year titled "Inflation and the Labor Market," Powell acknowledged that consumer goods inflation is moderating quickly (*Fig. 6*). He also observed that the rent inflation components of both the CPI and PCED are lagging indicators of rent inflation in recently signed leases, which came down sharply during the second half of 2022.

However, Powell's major hang-up is the PCED for core services excluding housing. It has been stuck around 4.0%-5.0% since late 2021 (*Fig. 7*). He blamed that mostly on high wage inflation, which is moderating but remains high. Here are the inflation rates of the six major components of Powell's PCED for core services excluding housing on a y/y basis and on a three-month annualized basis: transportation (13.2%, 5.9%), personal care (9.8, 10.1), recreation (5.6, 8.7), education (2.5, 2.4), health care (2.4, 1.6), and communications (-1.0, 3.6) (*Fig. 8*, *Fig. 9*, and *Fig. 10*).

Half of the three-month inflation rates are mostly below their y/y comparable ones. That certainly doesn't augur for a higher federal funds rate than 5.25%. But it doesn't rule out that the Fed will keep the rate at 5.25% for longer until the inflation rate for PCED core services excluding housing is clearly heading down.

(3) *Interest rates.* Meanwhile, the fixed-income markets are signaling that the FOMC's

monetary policy tightening cycle is nearing the end. The 2-year Treasury yield is a very good leading indicator of the federal funds rate (*Fig. 11*). It peaked last year at 4.72% on November 7. It was down to 4.21% yesterday. The yield-curve spread between the 10-year and 2-year Treasuries tends to turn negative near the tail end of monetary policy tightening cycles (*Fig. 12*). It has turned increasingly negative since July 8, 2022.

Commodities: Upbeat Disposition. Recently rebounding commodities prices suggest that the outlook for the global economy is improving; we think both will continue to do so this year. The price performance of gold, which tends to track the underlying trend in all commodities prices, is shining (*Fig. 13*). The markets for copper and other metals are aglow, reflecting China's brightening economic outlook and Europe's recession avoidance so far.

The importance to commodities markets of China's abandoning its unrealistically restrictive Covid policies cannot be overstated. Moreover, other recent China-related worries have lifted: The government has plans to stabilize China's ailing property sector, and it won't be invading Taiwan anytime soon, *according* to Fox; the economic cost would be too great, *opined* *Forbes*.

Energy markets are normalizing. The warmer winter in Europe helped to dampen demand amid the tightening of Russian energy supplies, and Europe has succeeded in securing alternative energy suppliers. The forthcoming ban on Russian diesel and petroleum products, however, recently bumped prices for those commodities back up, and China's post-lockdown reopening could increase the demand for diesel too.

The US economy's outlook is conducive to improving commodities markets as well. Signs point to a soft landing of the economy, as the Fed's aggressive interest-rate moves are moderating inflation without overly damaging the job market, a boon for consumer spending and sentiment.

Also favorable is the orderly, demand-driven way in which commodities prices have been rising—unlike when pandemic-related supply-chain problems caused a mismatch of supply and demand, sending prices through the roof.

Let's take a deeper dive into the commodities pits:

(1) *Oil.* Russia's invasion of Ukraine sent Brent crude oil futures prices soaring to a high of $123.58 per barrel last year. The oil price fell to a recent low of $76.10 per barrel on

December 9. But it has risen 11.6% since then to $84.90 per barrel as of January 30.

Diesel, heating oil, and gasoline have been rallying more significantly (*Fig. 14* and *Fig. 15*). The prices per gallon of these refined petroleum products have shot up from recent lows because on February 5, Europe plans to block Russian imports of diesel and other products made from crude oil, tightening supplies. Should Europe find sufficient alternative sources, the price increases could prove temporary. Already, it has cut Russian diesel imports from 50% of total imports before the war to 27%, *Time* *reported*. US suppliers have increased their shipments to Europe to a record 237,000 barrels per day from 34,000 at the start of 2022, according to S&P Global, *Time* wrote.

Time reported that massive new refining capacity is launching in Kuwait and Saudi Arabia later this year and in Oman in 2024, which could further alleviate the pricing pressure. But just as new supply opens, China's reopening could boost demand.

These countervailing pressures suggest to us that energy prices could settle somewhere around current levels. Markets already are anticipating this, as the spread between 2-year Brent crude oil futures prices and nearby contracts recently has fallen (*Fig. 16* and *Fig. 17*).

Notably, natural gas futures prices have tumbled to $3.11 per million Btus (British thermal units) as of January 27 from a trading range above $9 late in the summer. "The biggest reason for the decline is the warm weather this winter in Europe and the US," stated a recent *Barron's* *column*. "People are using less gas for heat, allowing more of it to build up in storage."

(2) *Basic metals.* It's no surprise that copper prices have rebounded on expectations of China's economic rebound. Copper prices have risen 10.5% ytd along with the rise in China's MSCI stock price index (in yuan) of 12.9% ytd (*Fig. 18*).

Copper is expected to experience a demand surge, *observed* CNBC, as well as a short-term supply shortage. Miners will need to restock after curbing production during the China Covid lockdowns. Over the long term, copper's demand prospects are supported by the global green energy infrastructure transition.

Additionally, the metals component of the CRB Raw Industrials Spot Price Index has been rebounding since its recent bottom on October 31, 2022 (*Fig. 19*). Before bottoming, it had risen to an unprecedented high on April 4, 2022, 27.5% higher than the previous record on April 11, 2011. The index is composed of scrap copper, lead scrap, steel scrap, tin, and zinc.

(3) *Lumber.* The price of US lumber may be starting to rebound because the US housing market may be close to hitting bottom (*Fig. 20*). We believe that mortgage rates peaked in early November of last year along with the 10-year US Treasury bond yield.

Calendars

US: Wed: Job Openings 10.23m; Crude Oil Inventories & Gasoline Production; ADP Nonfarm Employment 170k; ISM M-PMI & Price Index 49.5/39.5; Construction Spending -0.1%; MBA Mortgage Applications; Fed Interest Rate Decision 4.75%; OPEC Meeting. **Thurs:** Productivity & Unit Labor Costs 2.4%/1.5%; Factory Orders 2.3%; Initial & Continuous Jobless Claims 200k/1.677m; Natural Gas Storage. (Bloomberg estimates)

Global: Wed: Eurozone Headline & Core CPI -0.3%mm/9.0%y/y & -0.2%m/m/5.4%y/y; Eurozone Unemployment Rate 6.5%; Eurozone, Germany, France, Italy, and Spain M-PMIs 48.8/47.0/50.8/49.6/48; UK Nationwide HPI -0.3%m/m/1.9%y/y. **Thurs:** Germany Trade Balance €9.2b; China NM-PMI 51.6; ECB Interest Rate Decision 3.00%; BOE Interest Rate Decision 4.00%; BOE Meeting Minutes; Lagarde; Bailey. (Bloomberg estimates)

Strategy Indicators

S&P 500 Q4 Earnings Season Monitor (*link*): The Q4-2022 earnings season is off to a poor start, assessed by the four surprise metrics we measure for both earnings and revenues. Revenue and earnings surprises are deteriorating q/q due to the slowing economy, higher costs, and currency translation. With just over 33% of S&P 500 companies finished reporting for Q4, revenues are ahead of the consensus forecast by just 1.1%, and earnings have exceeded estimates by 2.5%. The surprises are tracking to be the weakest since Q2-2013 for earnings and since Q1-2020 for revenues. At the same point during the Q3 season, revenues were 1.1% above forecast and earnings had beaten estimates by 2.4%. For the 166 companies that have reported Q4 earnings through mid-day Tuesday, the aggregate y/y revenue and earnings growth rates have slowed considerably from their readings of Q2-2021 to Q3-2022. The collective y/y revenue gain for the 166 reporters so far has slowed from double-digit percentage gains in the prior seven quarters to 7.2%, and earnings are up just 5.2% y/y as higher costs and increased loan loss provisions continue to pressure profit margins. Just 68% of the Q4 reporters so far has reported a positive revenue surprise, and 69% has beaten earnings forecasts. Furthermore, significantly fewer companies have reported positive y/y earnings growth in Q4 (61%) than positive y/y revenue growth (73%). These figures will change markedly as more Q4-2022 results are reported in the coming weeks, particularly from non-financial firms with greater exposure to the strong dollar. While we expect y/y revenue growth rates to remain positive in Q4, earnings are expected to decline for the first time since Q2-2020.

MSCI World & Region Net Earnings Revisions (*link*): Analysts' recent earnings revisions through January suggest they are optimistic about profits in EM Eastern Europe and EM Latin America. They're less pessimistic about EM Asia and the United States, but more pessimistic about the EMU and Europe. The US MSCI's NERI was negative in January for a seventh month following 23 straight positive readings, but improved to a four-month high of -9.9% from -14.0% in December. That compares to a post-pandemic high of 21.1% in July 2021 and an 11-year low of -36.9% in May 2020. The AC World ex-US MSCI's NERI was negative for an 11th month following 17 straight positive readings, as it edged down to -5.4% from -5.3% in December. NERI was positive for an 11th month for EM Latin America and a third month for EM Eastern Europe. EM Asia was negative for a 15th month. Here are January's scores among the regional MSCIs: EM Eastern Europe (5.5% in January [11-month high], up from 2.3% in December), EM Latin America (0.9, 1.2), EMU (-2.6 [27-month low], -0.5), EAFE (-3.9 [28-month low], -2.8), Europe (-3.9 [29-month low], -2.7), Europe ex-UK (-4.4 [29-month low, -3.3), AC World ex-US (-5.4, -5.3), Emerging Markets (-5.9, -6.5), EM Asia (-6.5, -7.1), AC World (-6.6, -7.7), and the United States (-9.9, -14.0).

MSCI Countries Net Earnings Revisions (*link*): NERI was positive for 18/41 MSCI countries in January, up from 16 a month earlier. December's count was the lowest since September 2020 and down from a peak of 35/41 during May 2020, which nearly matched the record-high 36/41 from June 2004. That also compares to zero countries with positive NERI from April to June 2020. NERI improved m/m in January for 26/41 countries, the broadest improvement since July 2021 and up from 19/41 in December. NERI was at a 22-year high in January for New Zealand, followed by: Singapore (20-month high), Portugal (17), Belgium (16), Poland (14), and the Philippines (14). Denmark and Korea were at 31-month lows, followed by the Netherlands (30), Japan (28), and France (27). Italy and Turkey have had positive NERI for 27 straight months, followed by Austria (26), Chile (24), and Mexico (22). Hong Kong has the worst negative-NERI streak, at 20 months, followed by China (17), Brazil (15), India (13), and Germany (10). NERI flipped back into positive territory in January for Belgium, Peru, and the United Kingdom. It turned negative m/m for France. The highest NERI readings in January: Turkey (16.9%), Egypt (15.0), New Zealand

(10.1 [22-year high]), Greece (9.2), and Mexico (8.7). The weakest NERIs occurred this month in Taiwan (-14.8), Canada (-13.9), Denmark (-12.8 [22-month low]), Switzerland (-10.0), and Korea (-9.1 [31-month low]).

AC World ex-US MSCI (*link*): This index is up 6.8% in local-currency terms so far in 2023. In US dollar terms, the index is up a greater 8.6% so far. Local-currency forward revenues has risen 18.5% since it bottomed in January 2021 and is at a record high now. However, local-currency forward earnings is down 3.5% from its record high in early September but is still up 53.5% since it bottomed in July 2020. Revenues are expected to rise 2.9% in 2023 and 3.4% in 2024 following an expected gain of 13.6% in 2022, and earnings are expected to increase 1.1% (2023) and 8.9% (2024) after rising an expected 13.1% (2022). The industry analysts' sales forecasts imply short-term 12-month forward revenue growth (STRG) of 3.2% and short-term 12-month forward earnings growth (STEG) of 1.8%, compared to 4.1% and 10.0% before Covid-19 hit the news. These measures bottomed at -0.1% and -0.3%, respectively, during May 2020. The profit margin implied by analysts' earnings and revenue estimates calls for a decrease to 8.8% in 2023 from 9.0% in 2022, before rising to 9.3% in 2024. The forward profit margin forecast of 8.8% is down 0.5ppt from its record high of 9.3% during March 2022 but remains well above its 10-year low of 6.6% at the end of May 2020. The Net Earnings Revision Index (NERI) for the AC World ex-US MSCI was negative in January for an 11th straight month following 17 positive readings, as it edged down to -5.4% from -5.3% in December. That compares to a 12-year high of 6.4% in July 2021 and an 11-year low of -23.9% in May 2020. The forward P/E is at a nine-month high of 12.6, up from its 29-month low of 10.8 in mid-October. That compares to an 18-year high of 17.1 in February 2021 and its March 2020 low of 10.8. The index is at a 17% discount to the World MSCI P/E, up from its record-low 22% discount during the first half of 2022.

Emerging Markets MSCI (*link*): The EM MSCI price index is up 9.2% in US dollar terms so far in 2023. In local-currency terms, EM is up a lesser 7.6% year-to-date. Local-currency forward revenues has risen 13.1% since its bottom in January 2021 but remains 2.9% below its record high in May 2019. Local-currency forward earnings is up 23.8% since its bottom in June 2020 but is now 13.4% below its record high in March 2022. Revenues are expected to rise 5.1% in 2023 and 5.9% in 2024 after jumping an expected 12.6% in 2022. That's expected to lead to an earnings gain of 0.5% in 2023 and 14.8% in 2023, following an expected 6.5% rise in 2022. Forecasted STRG of 5.2% is down from April 2021's 11-year high of 12.6%, which compares to a five-year low of 3.6% at the end of April 2020. STEG has dropped to a 14-year low of 1.3% from a record high of 33.7% in December 2020. The implied profit margin is expected to drop to 6.9% in 2023 from 7.2% in 2022 and recover to 7.4% in 2024. The forward profit margin of 6.9% is up from a four-year low of 6.1% at the end of May 2020 and compares to its 10.3% record high in December 2007. NERI was negative in January for a 15th straight month, but improved to -5.9% from -6.5% in December. That compares to an 11-year high of 6.0% in February 2021 and an 11-year low of -18.7% in May 2020. Emerging Markets' forward P/E of 12.1 is at a 12-month high and up from a 30-month low of 10.2 in October. That compares to a record high of 16.3 in February 2021 and its March 2020 low of 10.1. The index is trading at a 20% discount to the World MSCI P/E. That's up from a 33% discount at the start of 2022, which was its biggest discount since 2005.

EMU MSCI (*link*): The EMU MSCI price index leads all regions so in 2023 with a gain of 9.5% in local-currency terms. The index is up a greater 11.5% in US dollar terms so far, which also leads all regions. Local-currency forward revenues is down 1.7% from its record high in November, its first since September 2008. Revenues has risen 21.8% since its bottom in January 2021. Local-currency forward earnings is up 78.2% from its bottom in July 2020, but has dropped 0.3% from early January's record high. That was its first record since January 2008. Revenues are expected to rise 1.3% in 2023 and 2.7% in 2024 after gaining a forecasted 13.7% in 2022. That's expected to lead to an earnings gain of 0.9% in 2023 and 8.4% in 2023 following an expected rise of 19.7% in 2022. Forecasted STRG of 1.4% is down from a record-high 8.3% during April 2020, but that's up from an 11-year low of -0.9% during April 2020. STEG has dropped to 1.3% from a record high of 47.4% in December 2020, but that's up from a record low of -6.7% in April 2020. The implied profit margin is expected to remain unchanged y/y at 8.9% in 2023 and rise to 9.4% in 2024. The forward profit margin of 8.9% remains near a 13-year high, which compares to a 12-year low of 6.0% at the end of July 2020 and its 9.1% record high in October 2007. EMU's NERI was negative in January for a second month after 23 straight negative readings and dropped to a 27-month low of -2.6% from -0.5% in December. That compares to a record low of -35.9% in May 2020 and is down from a record high of 15.2% in September. EMU's forward P/E is at a nine-month high of 12.5, up from a 29-month low of 10.2 in mid-October, which compares to a record high of 18.3 in July 2020 and low of 10.2 in March 2020. The index is trading at an 18% discount to the World MSCI P/E, which is up from September's 11-year low of 25%.

China MSCI (*link*): The China MSCI price index is the fourth-best performer of the 49 MSCI countries so far in 2023, with a gain of 12.9% in local currency terms. In US dollar terms, its 13.0% gain ranks as eighth best. Local-currency forward revenues has risen 7.9% from its 12-year low in October, but is still 33.5% below its record high in October 2014. Local-currency forward earnings is up 8.6% from its five-year low in October, but remains 16.0%

below its record high in June 2018. Revenues are expected to rise 7.4% in 2023 and 6.1% in 2024 after rising an expected 10.0% in 2022. That's expected to lead to earnings gains of 14.7% in 2023 and 14.0% in 2024, following an expected rise of 8.2% in 2022. Forecasted STRG of 7.2% is down from an 11-year high of 13.5% in April 2020, but that's up from a five-year low of 5.0% at the end of April 2020. STEG has dropped to 14.6% from a 10-year high of 18.6% during December 2020, which compares to a four-year low of 8.0% in April 2020. The implied profit margin ranks as the lowest in the world; it's expected to rise to 4.6% in 2023 from 4.3% in 2022 and improve further to 4.9% in 2024. The forward profit margin of 4.6% is down from a record high of 5.2% in July 2021, but is up from its post-pandemic low of 4.5% during November 2022. NERI was negative for a 17th straight month in January, but improved to -6.8% from -7.7% in December. That compares to a 23-month low of -11.7% in May and ranks as ninth worst among the 41 MSCI countries that we follow. China's forward P/E of 11.2 is at a seven-month high and up from a seven-year low of 8.5 in late October. That compares to 12.1 at the start of 2022 and its March 2020 pandemic-low of 10.5. The index is trading at a 26% discount to the World MSCI P/E, up from a 22-year low discount of 46% in March 2022.

US Economic Indicators

Consumer Confidence (*link*): "Consumer confidence declined in January, but it remains above the level seen last July, lowest in 2022," noted Ataman Ozyildirim senior director, economic indicators at The Conference Board. "Consumer confidence fell the most for households earning less than $15,000 and for households aged under 35." Consumer confidence fell 1.9 points in January to 107.1 after rebounding 7.6 points in December from the 6.4-point drop during the two months through November. The expectations measure was a drag on confidence in January, while consumers' assessment of the present economic and labor market conditions improved. The *present situation* component climbed for the second month, by 3.5 points m/m and 12.6 points over the period, to a nine-month high of 150.9. Meanwhile, the *expectations* component sank 5.6 points last month to 77.8, following a 6.7-point jump in December from the 2.8-point decline over the prior two-month span. *Current business conditions* improved in January: The percentage of consumers saying business conditions were good rose from 19.2% to 20.2% in January, while the percentage saying conditions were bad fell from 19.7% to 19.2%. As for the *current labor market*, it was also more favorable, with 48.2% of consumers saying jobs were plentiful last month, up from 46.4% last month, while 11.3% said jobs were hard to get, down from 11.9% in December. *Short-term business conditions* (six-month outlook) remained pessimistic: The percentage of consumers expecting business conditions to improve fell from 20.9% in December to 18.6% last month, while the percentage expecting conditions to worsen rose to 21.6% from 19.9% in December. The *short-term labor market* deteriorated: The percentage of consumers expecting more jobs to be available six months from now fell from 20.0% to 17.9%, while the percentage anticipating fewer jobs rose from 18.7% to 20.1%. As for their *short-term financial prospects*, the outlook held steady, with 17.2% of consumers expecting their incomes to increase, compared to 17.3% last month, and 13.4% expecting their incomes to decrease, similar to December's 13.3%.

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