

Research US

Good news is bad news for the Fed

- **Leading indicators point towards a turnaround in macro momentum amid easing financial conditions, but the Fed is still far away from price stability.**
- **The less negative growth outlook combined with a recovering China challenges the Fed's goal of suppressing demand.**
- **The ISM, JOLTs, NFP and CPI over the next week will be the final key releases ahead of the February meeting; we expect Fed to hike by 50bp**

While most global manufacturing leading indicators still remain at low recessionary levels, some are now beginning to show early rays of light. Taiwanese manufacturing PMI, which tends to lead the global PMI, had the largest uptick in December since spring of 2021 (Chart 1). Euro area new orders indices, German Ifo and ZEW as well as the Chicago PMI have all rebounded from the recent lows (see p. 2).

In *Fed review: FOMC signals Fed Funds above 5% in 2023*, 14 December, we warned that the pre-emptive easing in global financial conditions could risk prolonging the underlying price pressures. While the turnaround in leading indicators is positive from a growth perspective, **it goes against the Fed's goal to suppress aggregate demand.**

Yesterday, we also lifted our forecast for Chinese GDP growth amid the faster reopening (see *China Outlook: Earlier reopening to drive faster rebound*, 3 January), which could further **underpin commodity demand irrespective of western policy choices.**

In the US, the drop in gasoline prices has eased headline inflation (0.1% m/m), but as wage growth remains elevated (0.6% m/m), **real purchasing power recovered in November, and likely also in December.** Lower headline inflation is a double-edged sword for the Fed, as recovering purchasing power boosts private consumption, labour demand and thus sustained wage inflation. Furthermore, the drop in mortgage rates illustrates that financial conditions are not tightening anymore. The most recent NAHB expectations index suggested that even the hard-hit housing market's outlook has improved slightly.

As a result, real private consumption is still above its pre-pandemic trend, even though the economy's growth potential remains constrained by labour shortages (Chart 2). The recent decline in market's inflation expectations has lifted US real yields to restrictive levels, but given that the Fed appears to make very gradual progress towards closing the output gap, we continue to see risks tilted towards rates remaining higher for longer. Furthermore, deflating with consumers' inflation expectations **paints a less optimistic view (Chart 3).**

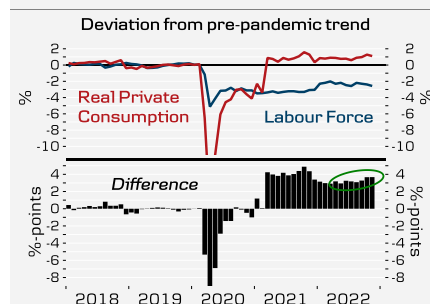
Bringing labour markets into balance would require several months of employment gains below 100 thousand, yet consensus is looking for twice as much this Friday. The rising employment costs feed into core services CPI, and even though normalizing energy and food prices will likely set next week's headline CPI near 0.0% m/m, core inflation will remain closer to 0.3%. Even in Europe, where the growth backdrop is weaker, flash data from Spain and Germany pointed towards a pick-up in core prices, and similar development in the US could well tilt the market towards **another 50bp hike in February.**

It is still too early for a turnaround in macro momentum



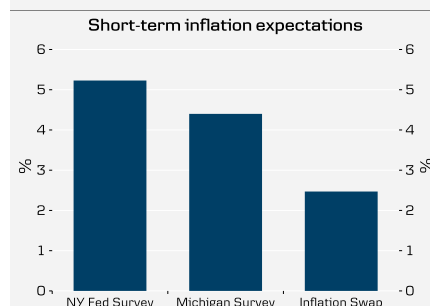
Sources: S&P Global/Markit

Fed is still far away from closing the output gap



Sources: Macrobond, U. S. Bureau of Labor Statistics (BLS).

Consumers expect inflation to remain elevated in the near-term



Sources: NY Fed, University of Michigan, Refinitiv

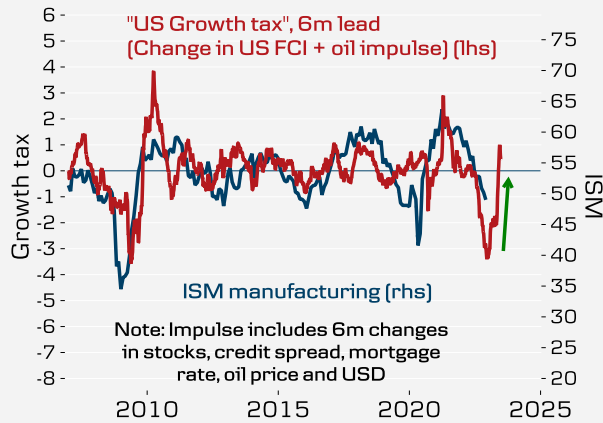
Analyst, US Economy

Antti Ilvonen

+358 445 180 297

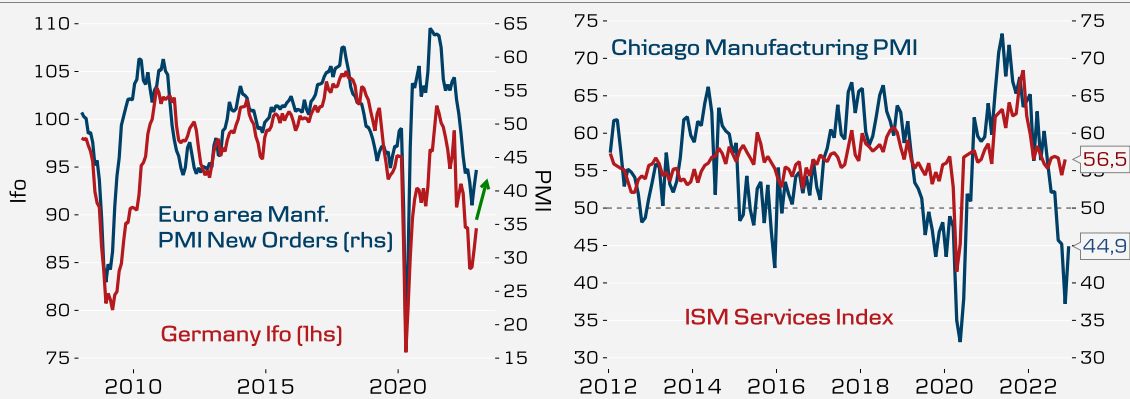
antti.ilvonen@danskebank.com

Financial conditions have eased prematurely, and now point towards a pick-up in growth.



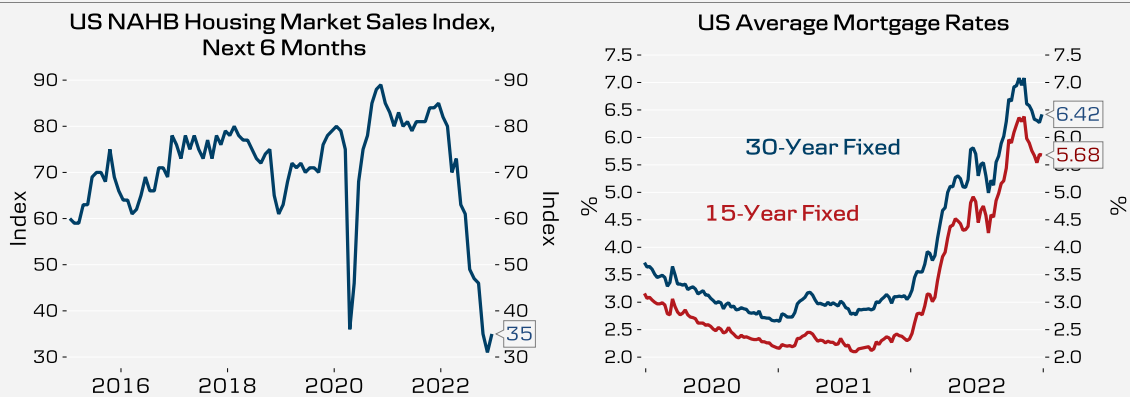
Sources: Macrobond, Bloomberg

European leading indicators point towards a turnaround. US manufacturing also seems to bounce from recessionary levels, while ISM services has remained above 50 throughout the fall.



Sources: Macrobond, Refinitiv, S&P Global/Markit, Ifo, ISM Chicago, ISM

US housing market is in a recession, but peak in mortgage rates suggests that the worst might soon be behind



Sources: Macrobond, U. S. National Association of Home Builders, Freddie Mac

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Antti Ilvonen, Analyst

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Authorised and regulated by the Danish Financial Services Authority (Finanstilsynet). Deemed authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Ad hoc

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank A/S's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 4 January 2023, 13:00 CET

Report first disseminated: 4 January 2023, 13:30 CET