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Ceteris Paribus

Gerhard Winzer



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The indications that the inflation peak will be exceeded are growing. If the relationship between inflation surprises (upside) and asset prices (downside) were to hold, that would be, all other things being equal, good news for the financial market. Unfortunately, at the same time, reports on economic activity point to weak growth as well as downside risks. The global economy is probably at the beginning of a transition phase from inflation to growth fears, at least for the next few months.

Inflation peak

On the inflation side, inflationary pressures are easing at two important levels. Both commodity prices and freight rates (the supply bottlenecks) are falling. At the producer level, price increases have already fallen significantly. As a result, first-round effects will also gradually diminish. This argues for falling monthly inflation rates in the coming months. However, it is very uncertain at what level inflation will ultimately stabilize or whether there will even be a renewed acceleration. This depends on the intensity of the second-round effects. If an immediate global recession does not materialize, inflation persistence could anchor at an uncomfortably high level – inflation therefore remain at a high level. This would put pressure on central banks to raise key interest rates again in the second half of 2023.

Mixed purchasing managers' indices

On the economic activity side, the preliminary purchasing managers' indices for the month of November for important countries in the industrialized nations showed a mixed picture in terms of change. However, all indicators were below the 50 mark, which theoretically marks the boundary between growth and contraction.

USA: Difference between “soft” and “hard” indicators

On the one hand, the overall index for the USA disappointed with a drop to a low level. Together with the leading indicator of the Conference Board, this is already the second important economic report pointing to immediate recession risks in the U.S.. However, the “hard” data such as new orders for capital goods once again suggested some resilience. Similarly, this week, private consumption is also expected to show good growth for the month of October. The publication of the [ISM Purchasing Managers Index](#) could tip the scales on whether the economic optimistic or – pessimistic camp is strengthened.

Europe: GDP decline not so bad

On the other hand, purchasing managers' indices rose for both the euro zone and the United Kingdom. This is in line with the assessment that the expected contraction in GDP in the fourth quarter of 2022 and the first quarter of 2023 will not be as bad as feared in the summer. In addition, the important Ifo business climate index in Germany rose for the second time in a row in the month of November, as did (preliminary) consumer sentiment in the eurozone.

Asia: weak exports

The news flow from Asia remains negative. On the one hand, exports are falling in key countries such as Taiwan, Singapore and South Korea. On the other hand, the slump in the real estate market and the zero-tolerance policy for new infections are depressing economic activity in China. The Chinese purchasing managers' indices will provide an important update on the extent. In addition, the subcomponents of the Purchasing Managers' Report for the manufacturing sector will provide information on any impairment of the supply chain.

Pause in sight

Expectations for future key interest rates, driven by inflation dynamics, remain the most important factor for the markets. In this respect, for the U.S.A. the focus is on the inflation report for private consumption (Personal Consumption Deflator for October) and the labor market report for the month of November. Expectations for a cooling of inflation as well as employment growth have led to the assessment that the U.S. Federal Reserve will reduce the pace of rate hikes (+0.5 percentage points to 4.5% in December) and at least pause at 5% in the first quarter of 2023.

Focus on inflation in the euro zone

For the euro area, a reduction in the path of interest rate hikes is not so clear. This week, the release of the flash estimate of consumer price inflation for the month of November is on the calendar. This is the most important report until the next ECB meeting in December. A higher-than-expected price increase would raise the probability of a policy rate hike by 0.75 percentage points to 2.25% (deposit rate). To date, market prices reflect a 0.5 percentage point hike.

Better environment for bonds

In summary, the crossing of the inflation peak supports bonds. However, increased recession risks could keep equities under pressure.

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Gerhard Winzer

Gerhard Winzer has worked at Erste Asset Management since March 2008. Up until March 2009, he was Senior Fund Manager in Fixed Income Asset Allocation; he has been Head Economist since April 2009.

He holds a degree from a polytechnical college and studied economics and business at Vienna University with a special focus on financial markets. He holds a CFA charter and participated from 2001 to 2003 in the doctoral programme for finance at the Center for Central European Financial Markets in Vienna.

From July 1997 to June 2007, he worked in research at CAIB, Bank Austria Creditanstalt, and UniCredit Markets & Investment Banking. His last position was as Executive Director for Fixed Income / FX Research and Strategy. He was responsible for research on asset allocation at Raiffeisen Zentralbank (RZB) in Vienna from July 2007 to February 2008.