The Month Ahead – December 2022

Global equity markets moved higher in November, continuing a strong period which has seen some indices in the US and Europe rise by as much as 10% from their mid-October lows. Bond markets have also had a good November, helped in part by a lower-than-expected inflation print in the US that has some investors wondering if the pace of interest rate hikes by the Federal Reserve (Fed) may slow.

And in New Zealand, despite a record 75 basis point hike by the Reserve Bank of New Zealand (RBNZ), the 10-year government bond ended November lower, supporting bond prices.

As we head into December, inflation and central bank policy – especially in the US – remain the fundamental issues in assessing the outlook for the global economy. Unpacking all this is ANZ Investments' December Month Ahead.

Fed to lift interest rates again – but will it signal a small pivot?

The Fed meets on 15 December where it is expected to raise the fed funds rate by at least 50 basis points, which would take the central bank's key interest rate to its highest level in nearly 15 years. Over the past few weeks, investors have been wondering if, and when, the Fed would slow its pace of interest rate hikes and drop its hawkish rhetoric. Now it appears inflation has peaked – even though it remains well above the Fed's target level. And after the release of the minutes from the November Fed meeting, it appears committee members are becoming concerned about the cumulative effect of the near 400 basis points of hikes in 2021, with some members suggesting a pivot may be near.

"*A substantial majority of participants judged that a slowing in the pace of increase would likely soon be appropriate", the minutes showed. "The uncertain lags and magnitudes associated with the effects of monetary policy actions on economic activity and inflation were among the reasons cited regarding why such an assessment was important*".

Despite this, according to the CME FedWatch tool that tracks fed funds futures, as of 27 November, there is a 25% chance the Fed raises rates by 75 basis points.

Also of note will be the Fed's quarterly economic projections – notably inflation and employment figures. In September, the Fed projected core PCE (personal consumption expenditures) inflation, which strips out food and energy prices, would fall to 4.5% by the end of 2022, and 3.1% by the end of 2023. Meanwhile, it projected the unemployment rate to end 2022 at 3.8% before rising to 4.4% in 2023.

Employment and inflation data could sway Fed's decision

Whether or not the Fed decides to pivot in December, could boil down to some tier-one economic data leading up to the meeting, beginning on 2 December, together with the latest US employment report.

The tight labour market and subsequent wage-price pressure have been a thorn in the side of the central bank in its battle with inflation. While it is expected the US economy added about 200,000 jobs in November, a slowdown in wage prices and an easing of the unemployment rate should give the Fed more confidence it is getting on top of inflation.

And secondly, the all-important inflation report for November will be released on 13 December, where it is expected monthly inflation would have risen about 0.4%, translating to a year-on-year rate of about 7.7%. A second straight slower-than-expected number would be a welcome relief to policymakers, and likely cement a 50 basis point hike (rather than a 75 basis point) by the Fed.

Broadly neutral equities, awaiting more clarity

With several factors swaying market sentiment at the moment, including the ongoing inflation battle, central bank policy, and geopolitical tensions, we are broadly positioned neutral to growth assets.