



Despite encouraging data, CIO expects central banks to stick with a hawkish stance at present. (ddp)

Inflation cools, but too early to sound the all-clear

05 January 2023, 1:12 pm CET, written by UBS Editorial Team

The year has started with further promising signs that inflation is falling on both sides of the Atlantic. In the US, the prices paid component of the ISM manufacturing survey fell to its lowest level since February 2016, excluding a sharp drop in the early stages of the COVID-19 lockdowns.

This provides further evidence that the disruptions to supply chains that arose during the pandemic are continuing to clear. In the Eurozone, consumer price inflation releases have been surprisingly tame in Germany, France, and Spain. Most notably, German inflation slowed to 9.6% in the year to December, well below the 10.7% forecast by economists surveyed by Reuters.

The data has contributed to a positive start to equity markets in 2023, with the Euro Stoxx 50 gaining more than 4% at the time of the writing so far this week and the S&P 500 rising a more modest 0.4%.

But despite the encouraging data, we expect central banks to stick with a hawkish stance at present.

Inflation readings in the Eurozone were not all good news and core inflation remains high. German core inflation, excluding volatile food and energy prices, actually rose to 4.9% from 4.6%. The December reading was also flattered by a one-off government payment to help with household energy bills. And in Spain, while headline inflation in the year to December fell to its slowest pace in 2022 at 5.8%, core inflation rose to 6.9% from 6.3% in the prior month. Meanwhile, European Central Bank President Christine Lagarde has continued to stress that the fight against inflation has not yet been won, saying in an interview on 31 December that wages were probably rising “at a faster pace than expected.”

Rapid wage increases in the US raise the risk of more entrenched inflation. Monthly job openings data pointed to an employment market that is too tight for comfort, with vacancies declining only 54,000 to 10.458 million for November. Economists had expected a larger fall and the vacancy rate for October had also been revised higher. The data also showed that there remain 1.74 vacancies for every unemployed person in November, continuing to point to excessive demand for

workers. That is likely to discourage Federal Reserve officials, who are eager to see a cooling labor market leading to lower wage rises. The three-month moving average of median wage growth for November was 6.4%, based on the Atlanta Fed's Wage Growth Tracker. This is inconsistent with the Fed's 2% inflation target.

The minutes of the Fed's latest policy meeting underlined that further tightening lies ahead. The minutes of the December meeting, at which the Fed raised rates by 50 basis points, showed officials would need to see "substantially more evidence" of easing inflation. The Fed insisted that the slower pace of tightening in December, following four consecutive 75bps hikes, "was not an indication of any weakening of the committee's resolve to achieve price stability." Officials also warned that premature expectations of a dovish pivot by markets could "complicate the committee's effort to restore price stability" by leading to an "unwarranted easing in financial conditions."

We do expect an inflection point in inflation in 2023, for which more risk-tolerant investors can prepare. But with the fight against inflation still ongoing, we enter the year with a preference for [defensive assets](#) in both equity and fixed income markets.

Main contributors - Mark Haefele, Christopher Swann, Vincent Heaney, Patricia Lui, Jon Gordon

Content is a product of the Chief Investment Office (CIO).

Original report - [Inflation cools, but too early to sound the all-clear, 5 January 2023.](#)

Important information

As a firm providing wealth management services to clients, UBS Financial Services, Inc is registered with the U.S. Securities and Exchange Commission (SEC) as an investment adviser and a broker-dealer, offering both investment advisory and brokerage services. Advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate contracts. It is important that you carefully read the agreements and disclosures UBS provides to you about the products or services offered. For more information, please visit our website at www.ubs.com/workingwithus.

© UBS 2021. All rights reserved. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.

There are two sources of UBS research. Reports from the first source, UBS CIO Global Wealth Management, are designed for individual investors and are produced by UBS Global Wealth Management (which includes UBS Financial Services Inc. and UBS International Inc.). The second research source is UBS Group Research, whose primary business focus is institutional investors. The two sources operate independently and may therefore have different recommendations. The various research content provided does not take into account the unique investment objectives, financial situation or particular needs of any specific individual investor. If you have any questions, please consult your Financial Advisor. UBS Financial Services Inc. is a subsidiary of UBS AG and an affiliate of UBS International Inc.