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February 13, 2023

MARKET COMMENTARY

Fig. 1: Financial Conditions Have Loosened since October

Source: Bloomberg, Mill Creek. The GS Financial Conditions Index is a weighted average of riskless interest rates, exchange rates, equity valuations, and credit spreads, with weights that correspond to the direct impact of each variable on GDP. Higher index levels imply tighter financial conditions.

In our 2023 outlook, we posed the following question:

"Will holding the Fed Funds rate at 5% for 6–9 months, as the market expects, be enough to crush inflation? In our opinion, probably not. We believe there remains a good chance that the Fed will either continue hiking above 5% or hold rates at 5% for longer than is currently priced into markets."

In our opinion, *"a good chance"* is now the most likely outcome. Economic data has started to suggest that the US economy is reaccelerating rather than slowing and that financial conditions (Fig. 1) are loosening rather than tightening.

Economic data around jobs, payrolls, new home sales, used car prices, and credit card usage all point in one direction: consumers delayed some consumption after rates rose in early 2022, but they are tired of waiting and are back to spending. The Fed has not acknowledged this turn in the data – they can't until they are ready to communicate a higher terminal Fed Funds Rate — but the longer they wait, the further they will fall behind the curve.

QUICK LINKS

- House View Summary
- February Update: Is the 60/40 Portfolio Dead?
- The Labor Market Remains Very Tight
- Why Corporate Borrowers Remain Well-Positioned

This week's contributor: Michael Crook, CAIA

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