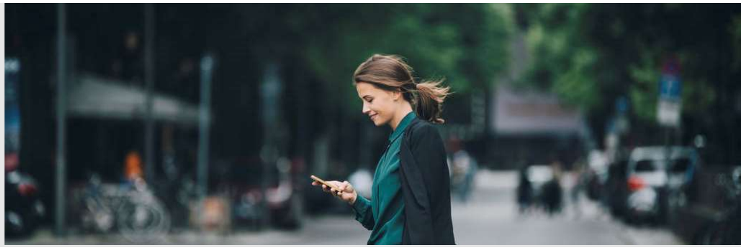


Inflation is finally falling !
But watch the persistent underlying pressures

Inflation reached 40 year highs across developed economies in 2022, prompting the world's leading central banks to clamp down hard on monetary policy. Now, the year-end inflation figures seem to show light at the end of the tunnel, suggesting that, at long last, we are over the peak. But we think it will be some time before central banks are confident about the future path of prices.

Why is inflation coming down?

In the United States, headline and underlying (i.e. ex food and energy) inflation have been falling for some months and hit 6.5% and 5.7% in December, respectively. In the euro zone, only headline inflation has so far started to fall, to 9.2% in December, while underlying inflation is still on the up, at 5.2%. The declines are explained by a fading out of both the main drivers of inflation in 2021. The first was the squeeze on supply chains caused by Covid, as rocketing demand tried to suck goods through production systems disrupted by Covid lockdowns. The second was post-Covid demand for energy, which sent prices spiralling, an effect massively exacerbated by the Ukraine war. Both these inflationary forces are now on the wane. The distortion of consumer demand toward goods, a hangover from Covid, is gradually fading away and production chains are now returning to normal. On the energy front, prices are now easing on both sides of the Atlantic.

Underlying inflation will take time to fall back

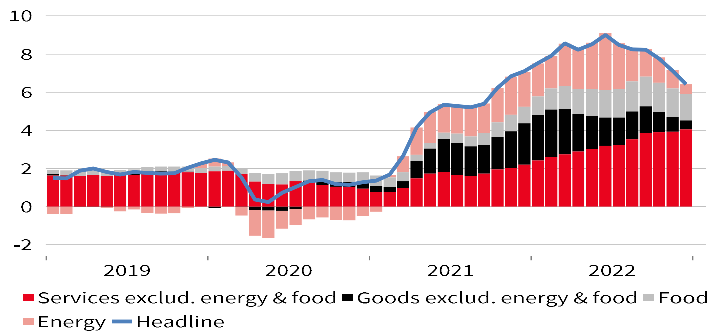
The price shock in 2021/22 has turned out to be so severe and so long-lasting that it has infected the whole economy, producing the phenomenon known as “sticky” inflation. First, price pressures have spilled out into all goods and services, keeping underlying inflation high. Second, labour markets remain tight, allowing workers to demand inflation-matching pay rises. The resulting wage-price spiral – although far from universal – also tends to make inflation stickier. We conclude that inflation should continue to ease, but its stickiness means it will be some time before central banks can get back near their 2% target.

Keep a close eye on central bank statements

Financial markets have responded enthusiastically to better inflation figures since the start of the year. Long-term interest rates have come down, with the T-bond and bund both dropping over 30 bp. Equity markets have rallied, particularly in the euro zone. But we counsel caution: central banks could easily curb this enthusiasm with a fresh round of hawkish comments about future monetary policy.

US inflation: all components fall except services prices

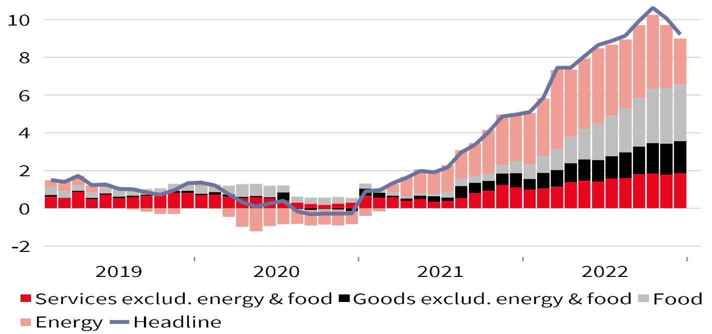
Main contributions to inflation



Sources: SGPB, Macrobond, Eurostat, BLS, 12/2022

Euro Area inflation: easing energy prices help reduces inflation

Main contributions to inflation



Sources: SGPB, Macrobond, Eurostat, BLS , 12/2022

OUR MACRO COMMENTS

Events of the week

European states have discussed the idea of creating a European sovereign wealth fund in response to the Inflation Reduction Act (IRA). The aim is to support local industrial porjects and strengthen the competitiveness of countries in order to avoid the relocation of companies to the United States. A strong message to illustrate European solidarity.

The end of health restrictions in China would allow economic activity to rebound in 2023. The reopening of borders has raised concerns about the spread of the virus, prompting various Asian countries to impose Covid test at border crossings. In response, China has suspended short-term visas for travellers from these countries

Figures of the week

	Actual		Forecast	Previous
• Inflation (YoY, December)	6.5%	↓	6.7%	7.1%
• Michigan Consumer Sentiment (January)	64.6	↑	59	59.7
• Unemployment rate (November)	6.5%		6.5%	6.5%
• Industrial Production (MoM, December)	-2%	↓	0.5%	0.1%
• Inflation Rate (YoY, December)	1.8%	↑	1.8%	1.6%
• Trade Balance (December)	78Mds$	↑	76.2 Mds$	69.84Mds $
• GDP (MoM, November)	-0.1%	↓	-0.2%	0.5%
• Tokyo's Inflation (YoY, December)	4%	↑	4.5%	3.7%

Sources: Macrobond, 13 January 2023

The week ahead

Tuesday

Unemployment Rate (November)

ZEW Economic Sentiment (January)

GDP (Q4), Retail Sales (December)

Wednesday

Monetary Policy Commitee

Inflation (December)

Industrial production (December)

Friday

Consumer Confidence (January)

MARKET PERFORMANCES

Interbank rates	Last.	-1W	-3M	YTD	-12M
€STER O/N	1,90	1,90	0,66	1,91	-0,58
USD SOFR O/N	4,30	4,30	3,04	4,30	0,05
JPY TONAR O/N	-0,03	-0,04	-0,03	-0,02	-0,02
GBP SONIA O/N	3,43	3,43	2,19	3,43	0,20
CHF O/N	0,80	0,80	0,63	0,80	-0,71

Long term sov. rates	Last.	-1W	-3M	YTD	-12M
10Y OAT	2,66	2,78	2,98	2,98	0,27
10Y Bund	2,18	2,27	2,38	2,44	-0,10
10Y BTP	4,04	4,29	4,84	4,55	1,25
10Y JGB	0,50	0,45	0,23	0,41	0,11
10Y Bonos	3,19	3,31	3,56	3,51	0,62
10Y Swiss	1,32	1,37	1,48	1,57	0,06
10Y Gilt	3,39	3,49	4,47	3,66	1,18
10Y USTnote	3,54	3,69	3,91	3,88	1,74

Credit & EM	Last.	-1W	-3M	YTD	-12M
EUR Corporate Aaa	3,01	3,04	3,34	3,12	0,40
EUR Corporate Baa	4,35	4,44	4,81	4,65	0,74
GBP Corporate Baa	4,29	4,44	5,75	4,59	1,64
USD Corporate Aaa	4,31	4,53	4,90	4,62	2,35
USD Corporate Baa	5,35	5,61	6,15	5,70	2,83
USD EM aggregate	7,25	7,41	8,31	7,52	4,58

Commodities	Last.	-1W	-3M	YTD	-12M
Brent, USD/BL	82,92	6,3%	-10,2%	-3,5%	-2,2%
Or, USD/oz	1 876	1,1%	12,1%	2,7%	2,7%
Copper, USD/metric ton	8 990	9,2%	18,9%	7,0%	-9,5%
Platinium, USD/oz	1 096	0,3%	22,6%	2,9%	12,6%
Palladium, USD/oz	1 788	3,8%	-16,8%	0,0%	-6,5%
Silver, USD/oz	23,87	-1,7%	24,4%	-0,3%	4,9%

FX rates	Last.	-1W	-3M	YTD	-12M
EUR/USD	1,07	1,4%	10,7%	0,6%	-5,5%
EUR/CHF	1,00	1,6%	3,4%	1,5%	-4,2%
USD/GBP	0,82	-0,7%	-8,7%	-0,7%	12,9%
USD/JPY	132,60	0,4%	-9,7%	1,4%	15,5%
USD/BRL	5,20	-4,6%	-1,7%	-2,5%	-6,3%
USD/CNY	6,77	-1,7%	-5,7%	-1,9%	6,5%
USD/RUB	68,84	-5,5%	6,4%	-5,7%	-8,0%

Equity indices	Last.	-1W	-3M	YTD	-12M
MSCI AC World (USD)	1 093	2,1%	17,3%	3,0%	-8,2%
Eurostoxx 50	4 100	3,2%	23,1%	6,3%	-5,0%
Dax 40	14 948	3,2%	22,8%	6,2%	-6,6%
CAC 40	6 924	2,2%	19,0%	5,0%	-4,3%
FTSE 100	7 725	1,8%	13,2%	3,7%	2,3%
SMI	11 246	0,9%	10,3%	4,8%	-11,2%
SP500	3 970	3,0%	11,0%	3,4%	-16,0%
TOPIX	1 901	1,8%	1,7%	0,5%	-5,8%
iBovespa	112 517	6,8%	-2,0%	5,8%	6,5%
Hang Seng	21 436	3,1%	28,4%	8,4%	-12,2%
Sensex 30	60 106	-0,9%	4,3%	-1,7%	-1,7%
CSI 300	4 010	3,0%	6,0%	3,6%	-17,2%

Source: Bloomberg, on 12 January 2023.
-1W = 1-week change, -3M = 3-month change, -12M = 12-month change, YTD = year-to-date change. Equities; total return in local currency. Government bonds = 10-year returns. Figures are rounded.

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