

Central Banks Continue Tightening as Growth Fades

The first reading of third quarter GDP was front-page news, but there were several other important economic releases this week along with action by global central banks, that provide fresh clues to future rate policy in front of next weeks' Fed meeting.

On Wednesday, the Bank of Canada raised its overnight target by 50 basis points to 3.75%. This was a bit of a surprise as the markets had braced for a larger 75 bp increase. Canada has now hiked by a total of 350 bps since March, and although its inflation rate is lower than in the United States, Canadian food prices remain at a 41-year high. Earlier this month, the Bank of Australia also raised its overnight rate by a smaller increment. The 25 bp move, which brought Australia's cash rate to 2.60%, followed four straight 50 bp increases.

Yesterday morning, the European Central Bank (ECB), as expected, announced its second straight 75 basis point increase, bringing its key deposit rate up from 0.75% to 1.50%. At a news conference after the meeting, ECB President Christine Lagarde noted inflation risks were still skewed to the upside and that wage growth seemed to be picking up, threatening a future wage-price spiral. The ECB delayed tightening longer than other central banks and may not have the luxury of slowing its pace in the near-term.

Last Friday (before Fed officials entered their pre-FOMC blackout period) San Francisco Fed President Mary Daly cautioned that the U.S. central bank should avoid overtightening, suggesting the Fed was nearing a point where it too should consider hiking in smaller increments. A few days earlier, St. Louis President James Bullard had said he expects the Fed will end "front-loading" of aggressive interest-rate hikes early next year and shift to small adjustments as inflation cools.

So, the Fed discussion on slowing the pace of rate hikes has begun. Incoming data will shape it. The next CPI release is less than two weeks away, and considering that energy prices had moved slightly higher during the reporting period, the October report isn't likely to indicate a whole lot of relief. Fed officials might not consider CPI as the chosen inflation measure, but the markets do.

As of this morning, the bond market has fully priced-in a 75 bp increase at next week's FOMC meeting, slightly more than a 50 bp move at the December meeting, and another 50 split between the February and March 2023 meetings. Next week's 75 bp increase is near certain, but what Powell chooses to say at the post-meeting press conference is open for debate. *All ears will be on Powell again next Wednesday.*

The Fed's aggressive rate tightening is having a rapid effect on the housing market. Freddie Mac reported an average 30-year fixed mortgage rate of 7.08% this week. This is up from 3.11% at the beginning of the year, and translates into a +56% increase in monthly principal payments.

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2012
greg.warner@hilltopsecurities.com

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Pending home sales (which track contract signings that have not yet closed) fell another -10.2% in September and are now down -30% from a year ago *to the lowest level in more than 12 years*. Existing home sales (which typically account for 85% to 90% of all sales) fell for the eighth straight month, and are now at a seasonally-adjusted, annual sales pace of 4.71 million units, down sharply from 6.5 million units in January.

The available supply of existing homes (at the current sales pace) held steady at 3.2 months. Although this is double the 1.6 month supply from January, it's roughly half of what would be considered normal.

New home sales fell by -10.9% in September and -17.6% year-over-year. The available supply of new homes was 9.2 months in September, nearly triple the pandemic low point. Unfortunately, these are in various stages of completion. The months' supply of *completed new homes* is still exceedingly low at 1.1 months. Finding skilled *and willing* construction workers remains a central issue for homebuilders.

Declining sales are affecting supply, which in turn is beginning to impact prices. The S&P CoreLogic Case-Shiller National Home Price Index fell -0.9% in August, the largest single month deceleration in the index history. On a year-over-year basis, the index is still up +13%, but the annual pace was +20.6% as recently as March. In another key housing measure, the FHFA Home Price Index fell -0.7% in August, after a -0.6% decline in July. Weakness in the housing sector weighed on Q3 GDP, and is likely to have a negative impact well into next year.

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Market Indications as of 12:42 P.M. Central Time

DOW	Up 778 to 32,811 (HIGH: 36,800)
NASDAQ	Up 262 to 11,055 (HIGH: 16,057)
S&P 500	Up 77 to 3,885 (HIGH: 4,797)
1-Yr T-bill	current yield 4.56%; opening yield 4.43%
2-Yr T-note	current yield 4.40%; opening yield 4.28%
3-Yr T-note	current yield 4.37%; opening yield 4.25%
5-Yr T-note	current yield 4.18%; opening yield 4.06%
10-Yr T-note	current yield 4.01%; opening yield 3.93%
30-Yr T-bond	current yield 4.13%; opening yield 4.09%

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