Weakening Retail Sales and a Surprising Hawkish ECB Announcement

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This morning as expected, the European Central Bank (ECB) followed the Fed's lead with a 50 bp rate hike, and raised eyebrows with a much higher inflation outlook and significantly hawkish forward guidance. Like the U.S. Central Bank, the ECB clearly believes it has more work to do. In a sense, this aggressive stance helps the Fed by clamping down on global demand, which should put additional downward pressure on overall prices.

In other news this morning, U.S. retail sales came in well below expectations, signaling a slowdown in fourth quarter GDP growth. Overall purchases fell -0.6% in November, triple the Bloomberg median forecast and the weakest reading of the year. The slowdown was widespread with nine of 13 categories retreating last month. One notable exception was restaurant and bar sales, which rose by a solid +0.8%, emphasizing the ongoing spending shift from goods to services.

The retail sales control group, which excludes sales at auto dealers, gas stations, building materials stores and food service establishments and is used in the GDP calculation, dropped -0.2%, double expectations.

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Initial jobless claims for the week ending December 10th unexpectedly declined by -20k to 211k, the lowest in 10 weeks. Fed officials have been particularly concerned about wage inflation and the extreme tightness of the labor market. *The initial claims report won't ease those concerns*. The decline in first-time filings for unemployment benefits implies that employers are reluctant to lay workers off, despite evidence of softening demand.

So far, the financial market reaction is mixed. Between this morning's hawkish ECB announcement, weaking consumer data, resilient labor numbers and yesterday's Fed meeting, there's a considerable amount of information to sort through. For the moment, economic growth remains too brisk for the Fed's taste.

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The last GDPNow forecast (as of December 9th) showed Q4 growth tracking at +3.2%. The weak retail sales numbers should lower this measure considerably, but as the fourth quarter draws to a close, it appears that demand remains a bit too solid. Inflation is definitely trending lower, but stubbornly buoyant economic growth will impede price declines and keep the Fed in tightening mode.

The FOMC does not expect to cut rates at all in 2023, and in fact has signaled another 75 bps of hikes for the first quarter. On the other hand, the bond market continues to trade as if rate cuts will begin in the second half of 2023. Time will tell.

Market Indications as of 9:45 A.M. Central Time

DOW	Down -612 to 33,355 (HIGH: 36,800)
NASDAQ	Down -257 to 10,914 (HIGH: 16,057)
S&P 500	Down -86 to 3,909 (HIGH: 4,797)
1-Yr T-bill	current yield 4.65%; opening yield 4.57%
2-Yr T-note	current yield 4.26%; opening yield 4.23%
3-Yr T-note	current yield 3.97%; opening yield 3.93%
5-Yr T-note	current yield 3.65%; opening yield 3.63%
10-Yr T-note	current yield 3.47%; opening yield 3.49%
30-Yr T-bond	current yield 3.49%; opening yield 3.53%

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