Philequity Corner (December 19, 2022)
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Fed Grinch spoils Christmas rally

Just like the character in the books of Dr. Seuss, Federal Reserve (Fed) Chair Jerome Powell is now acting like the Grinch who stole Christmas. After staging an impressive rally from recent lows, equities plunged as the Fed hiked its policy rate to a 16-year high and announced a higher terminal rate. Powell's speech reinforced the Fed's resolve to keep interest rates higher for longer despite an imminent economic slowdown. In the last three trading days, the S&P 500 and Nasdaq slid by 4.2% and 4.9%, respectively, while the Dow dropped 1,188 points. The PSEi fell 1.8% in the past two days and closed below 6,500 last Friday.

Scrooge Powell spooks markets anew

Powell and the Fed are now playing the role of Scrooge, the protagonist from Charles Dickens' "A Christmas Carol." Scrooge is a selfish, unpleasant miser who hates Christmas, enjoys hoarding, and does not like to spend. In contrast to everyone's festive, jovial, and gift-giving mood during the Yuletide season, the Fed remained hawkish even though there are signs that inflation is already starting to slow down. More importantly, Powell and the Fed provided a higher terminal rate while indicating a higher dot plot trajectory. These stoked fears that the US and other major economies will experience a sharp slowdown or a painful recession. The market narrative has actually shifted from the angst of inflation to the fear of a sharp global economic recession. This explains the recent price action of financial assets. Below, we list quotes from Powell's statement that outlined a more hawkish outlook for Fed policy.

1. "We continue to anticipate that **ongoing increases will be appropriate** in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time."
2. "As shown in our Summary of Economic Projections, **the median projection for real GDP growth stands at just 0.5 percent this year and next**, well below the median estimate of the longer-run normal growth rate."
3. "The inflation data received so far for October and November show a welcome reduction in the monthly pace of price increases. But it will take **substantially more evidence to give confidence that inflation is on a sustained downward path**."
4. "Of course, 50 basis points is still a historically large increase, and **we still have some ways to go**."
5. "As shown in the SEP, **the median projection for the appropriate level of the federal funds rate is 5.1 percent at the end of next year**, 1/2 percentage point higher than projected in September."
6. "The median projection is 4.1 percent at the end of 2024 and 3.1 percent at the end of 2025, still above the median estimate of its longer-run value."
7. "**Reducing inflation is likely to require a sustained period of below-trend growth** and some softening of labor market conditions."
8. "I would say it's our judgment today that we're **not at a sufficiently restrictive policy stance yet**, which is why we say that we would expect that ongoing hikes would be appropriate."

Major central banks follow hawkish Fed

Following the Scrooge-like actions of the Fed, several major central banks were forced to respond with their own policy moves. Last week, the European Central Bank (ECB) hiked its policy rate by 50 basis points, matching the Fed's latest rate hike. ECB President Christine Lagarde clarified that the ECB has to continue hiking rates to bring down inflation. Lagarde said, “Anybody who thinks this is a pivot for the ECB is wrong… If you compare with the Fed, we have more ground to cover. We have longer to go… We’re not slowing down. We’re in for the long game.” The Bank of England (BOE) raised rates by 50 basis points, its ninth increase in the past year, despite fears that the UK is entering a long, painful recession. The central banks of Switzerland, Norway, and Mexico likewise hiked their policy rates last week. The Fed and other central banks played the role of the Grinch. Their hawkishness caused global stock markets to tank and stymied the Santa Claus rally. The Euro Stoxx 50 fell 4.3% in the last two days while the MSCI All-Country World Index (ACWI) ETF dropped 3.4%.

BSP matches Fed

Following the Fed’s 50 basis-point-hike and similar rate adjustments by major central banks, the Bangko Sentral ng Pilipinas (BSP) increased its policy rate by 50 basis points to a 14-year high of 5.5%. BSP Governor Felipe Medalla foresees more policy rate hikes would be needed to tame high inflation. Nonetheless, Medalla clarified that moving forward, the BSP no longer has to match the Fed in light of the recent rebound of the peso and the pullback of the US dollar.

Repeat or redeem

As the fight between central banks and inflation continues, an intense rivalry between two universities is also brewing. UP and Ateneo are fighting for supremacy not only in the field of education but also in basketball. The Battle of Katipunan will ensue later today in Game 3 of the UAAP Finals. Filipinos are avid basketball fanatics and UAAP basketball has become one of the nation’s favorite pastimes. LaSalle has traditionally been Ateneo’s fierce rival in the UAAP. However, UP has experienced an impressive resurgence driven by the support of its alumni. This has resulted in a stronger basketball team and a newfound rivalry with Ateneo (see *Destiny vs. Dynasty*, May 23, 2022). Will the Fighting Maroons achieve a repeat championship, or will the Blue Eagles redeem themselves and regain their long-standing dominance?