THINK STRATEGICALLY: The Year of the Rabbit is in peril, and inflation is heading down

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The Chinese year of the Rabbit, is not looking promising

Early this week, the Nationa Bureau of Statistics of China announced that its GDP growth for 2022 was a paltry 3.90%, or 52% less than its 2021 GDP of 8.11%.
Let's revise the last five years of GDP growth:

- 2018 6.75%
- 2019 5.95%
- 2020. 2.24%
- 2021 8.11%
- 2022 3.90%

Year	GDP	Change
2018	**6.75%**	**-0.20%**
2019	**5.96%**	**-11.7%**
2020	**2.24%**	**-62.4%**
2021	**8.11%**	**262.1%**
2022	**3.90%**	**-51.9%**

We became used to China delivering outsized economic growth; however, since COVID-19 became part of China's daily reality, its economy began to unravel.
When Covid-19 hit at the end of 2019 and grew out of control globally, China's GDP for 2020 dwindled to 2.24%. Then China implemented the Government's long-standing Zero-Covid Strategy, and by 2021 its GDP returned to a whopping 8.11%. However, as you and I know, Communism regimes are not known for their transparency and data availability. Throughout the past two years, a series of events have disrupted global supply chains to transportation and shipping costs due to continued COVID-19 outbreaks in China.
As we look into what went wrong in China during 2022, we discover that China's COVID-19 case count in 2022 was a whopping 660.47 million, a growth in 2022 of 3,880%. For comparison, the U.S. had 100.78 million cases in 2022, or an increase of 83.78%; Puerto Rico had 969,066 cases, or a growth of 255.9% and meanwhile, India's case count grew in 2022 by only 44.68 million or 28.10%.

According to the World Health Organization
China boasts an 86.82% vaccination rate, less than Puerto Rico's 96.75% rate but better than the U.S.'s 68.42% vaccination rate.

What went wrong?

The Chinese Government abandoned its Zero-Covid strategy last month due to protests, but that cannot be the only reason. The other reason is that the elderly in China have become reluctant to vaccinate, and the problems lie here.
According to China's National Health Commission, only 40% of those aged 80 and 69% of those aged 60 have had their shots.

Chinese Population Falls

However, the other issue that may also play a factor is the announcement that China's total population fell in 2022 for the first time in at least fifty years, a shift that shall have long-term impacts on the Chinese economy and the global economic landscape. The Chinese National Bureau of Statistics informed that the total population fell by 850,000 in 2022 to 1.41175 billion.
As deaths surpassed births, it shows how big of an impact COVID-19 has on China's overall population and well-being. Total births were 9.56 million in 202 versus 10.62 million in 2021, a 9.98% decrease year over year.

During the past three decades, most global corporations have bet big on China's manufacturing prowess, its large population, and the multiple opportunities to sell products at a vast scale if China suddenly begins to weaken and with the global chains disruptions from COVID-19 caused the world to be on its knees, its economic trends may start to change. While it could prove temporary, the fact is that many corporations were too exposed to China, and many have since diversified their exposure to other parts of the globe.
The Chinese year of the Water Rabbit begins on January 22, 2023, or the Chinese New Year, and ends on February 9, 2024, or the Chinese New Year's Eve. The Water Rabbit is a zodiac symbol of prosperity, longevity, and peace. The experts in China have predicted 2023 to be the year of hope, and hope is all we need.

Inflation is consistently coming down, allowing markets and Investor sentiment to rise.

The December inflation reading was expected with much hope and exceeded all expectations. The U.S. Consumer Price Index reading fell to 6.45%. The Inflation NowCast CPI forecast was 6.64%, while the consensus of economists was 6.50%, and both were beaten handsomely. Additionally, the closely followed Core CPI that excludes more volatile products like food and energy fell to 5.69%, ahead of the Inflation NowCast forecast of 5.87% by 3.06%.
Not only did the CPI beat estimates it became the smallest CPI increase since 2021.
As we revise the U.S. Core CPI that eliminates food and energy, has now decreased by 14.56% during these three consecutive months, and the numbers are as follows:

1. December 2022 5.69%
2. November 2022 5.96%
3. October 2022 6.31%

While price pressures continue higher than the long-term average of 3.66% Core CPI., we project that a gradual price decrease will allow the Fed to consider slowing down its interest rate pace.
Which Prices have fallen?

- Energy prices and slight increases in food prices allowed headline inflation to fall 0.1% from the last month.
- Core consumer prices increased by 0.3% last month.
- Used car prices declined for six consecutive months and new car prices for the first month.

The Inflation NowCast for January is as follows:

CPI	Core CPI	PCE	Core PCE
6.31%	5.58%	4.88%	4.34%

The CPI on a now consistent three-month decrease becomes an irrefutable trend.

However, it is way too early to do a victory dance, but it is not too early to consider slowing down the pace of interest rate increases.
Since the Fed inflation target is 2% inflation, and the current CPI at 6.45% is still 222.50% above the target, the most probable outcome is a lesser rate increase to 25 basis points.

The key question is How do markets perform once the Fed pauses or pivots?
During the last 40 years, the Fed has paused seven times after ending interest rate hike cycles.
In most cycles after the Fed ends, the rate increases and holds rates firm for six months to a year; shortly after that, it cuts rates to stimulate the economy.

Out of the seven, the stock markets have performed Stocks strongly in five of the seven times and declined only modestly in the other two. Of the last three that we highlighted of the three instances two were positive and one negative; see the chart below:

Last hike	First cut	S&P 500 return	Months Elapsed
May-00	Jan-01	-7%	7.6
Jun-06	Sep-07	25%	14.6
Dec-18	Jul-19	18%	7.3

Challenges remain; however, a recession may turn out to be a soft landing.
The CPI decreases provided a confidence boost to investors who feel inflation has turned the corner.
We project that during the second half of 2023, investors will focus on growth rather than inflation pressures.
The U.S. Economy remains strong, considering that the latest GDPNow for the Fourth Quarter of 2022 was updated to 4.10%, up from 3.80% on 1/5/23, a 7.32% Increase.
The leading economic indicators tell us that the impact of the interest rate increases will hit economic growth during the first semester of 2023. In contrast, we continue to have an inverted yield curve, steep declines in housing sales, and manufacturers' new orders.
The other item that a slower economy may impact will be corporate earnings, which could subside the pressure.

Finally, in the global economy, better-than-expected inflation data and economic numbers mixed with a balmy winter allowed Europe to avert an energy crisis and probably avoid a global recession.

We advise investors to prepare for a strong market rebound during the year's second half and should begin to perform the necessary asset rotations to prepare to seize essential investment opportunities.

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