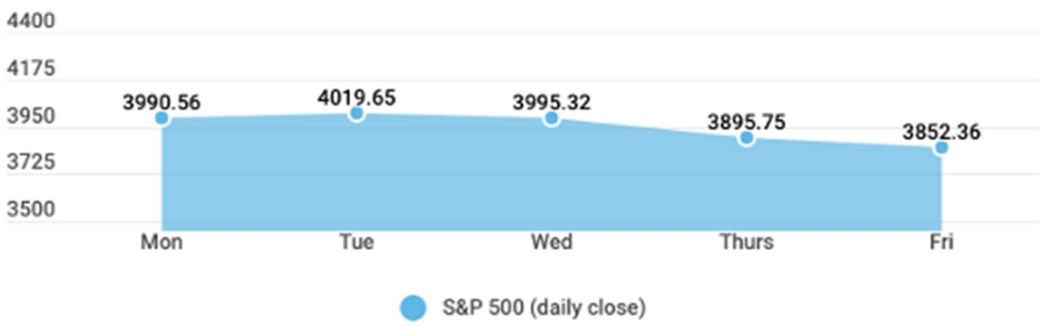
Hawkish comments by the Fed and weak economic data heightened investors' recession concerns and sent stocks lower last week.

The Dow Jones Industrial Average lost 1.66%, while the Standard & Poor's 500 retreated 2.08%. The Nasdaq Composite index declined 2.72% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, slipped 0.88%.[1,2,3]

Market Index	Close	Week	Y-T-D
DJIA	32,920.46	-1.66%	-9.41%
NASDAQ	10,705.41	-2.72%	-31.57%
MSCI-EAFE	1,961.54	-0.88%	-16.03%
S&P 500	3,852.36	-2.08%	-19.17%



	Treasury	Close	Week	Y-T-D
	10-Year Note	3.48%	-0.09%	+1.96%

Sources: The Wall Street Journal, December 16, 2022; Treasury.gov, December 16, 2022
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, December 9, to Friday, December 16, close. Weekly performance for the MSCI-EAFE is measured from Friday, December 9, open to Thursday, December 15, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

Stocks Under Pressure

Stocks began the week on a positive note, supported by a cooler-than-expected Consumer Price Index (CPI) report. Stocks reversed direction mid-week, however, following the Federal Open Market Committee (FOMC) meeting in which another 0.5% rate hike was announced.

The half-point increase was widely anticipated, but the increase in the terminal rate (i.e., the point at which the Fed stops raising rates) rattled investors. Continued hawkishness by Fed Chair Powell at the post-meeting press conference added to investors' anxiety. The potential for higher rates for longer, along with disappointing economic data, particularly a sharp decline in retail sales, amplified fears of a recession and sent stocks lower for the remainder of the week.

Inflation and the Fed

The release of November's CPI showed inflation cooling for the second consecutive month, as prices rose just 0.1% month-over-month and 7.1% from a year ago. Both were better than expected.[4]

The FOMC ended its last meeting of 2022 by raising interest rates another 0.5% and signaling that it would likely continue to hike rates into the new year. At a subsequent press conference, Fed Chair Powell commented that the next rate increase could be a quarter-percentage point. Most FOMC members appear to support raising the terminal rate (the point at which hikes end) to above 5%, up from its September projection of 4.6%.[5]

This Week: Key Economic Data

Tuesday: Housing Starts.

Wednesday: Consumer Confidence. Existing Home Sales.

Thursday: Jobless Claims. Gross Domestic Product (GDP). Index of Leading Economic Indicators.

Friday: New Home Sales. Durable Goods Orders. Consumer Sentiment.

Quote of the Week

"Patriotism is supporting your country all of the time and your government when it deserves it"

– Mark Twain

Of Note

The Federal Reserve is sowing the seeds for its central bank digital currency (CBDC). It may seem that the purpose of a CBDC is to facilitate transactions and enhance economic activity, but CBDCs are mainly about more government control over individuals. If a CBDC were implemented, the central bank would have access to all transactions in addition to being capable of freezing accounts.

It may seem dystopian—something that only totalitarian governments would do—but there have been recent cases of asset freezing in Canada and Brazil. Moreover, a CBDC would give the government the power to determine how much a person can spend, establish expiration dates for deposits, and even penalize people who saved money.

The war on cash is also a reason why governments want to implement CBDCs. The end of cash would mean less privacy for individuals and would allow central banks to maintain a monetary policy of negative interest rates with greater ease (since individuals would be unable to withdraw money from commercial banks to avoid losses).

Once the CBDC arrives, instead of a deposit being a commercial bank’s liability, a deposit would be the central bank’s liability.

In 2020, China launched a digital yuan pilot program. As mentioned in Seeking Alpha, China wants to implement a CBDC because “this would give [the government] a remarkable amount of information about what consumers are spending their money on.”

The government could easily track digital payments with a CBDC. Bloomberg noted in an article published when the digital yuan pilot program was launched that the digital currency “offers China’s authorities a degree of control never possible with cash.” A CBDC could allow the Chinese government to monitor mobile app purchases (which accounted for about 16 percent of the country’s gross domestic product in 2020) more closely. Bloomberg describes how much control a CBDC could give Chinese authorities:

The PBOC [People’s Bank of China] has also indicated that it could put limits on the sizes of some transactions, or even require an appointment to make large ones. Some observers wonder whether payments could be linked to the emerging social-credit system, wherein citizens with exemplary behavior are “whitelisted” for privileges, while those with criminal and other infractions find themselves left out.

The Chinese government is waging war on cash. And they are not alone. In 2017, the International Monetary Fund (IMF) published a document offering suggestions to governments—even in the face of strong public opposition—on how to move toward a cashless society. Governments and central bankers claim that the shift to a cashless society will help prevent crime and increase convenience for ordinary people. But the real motivation behind the war on cash is more government control over the individual.

And the US is getting ready to establish its own CBDC (or something similar). The first step was taken in August, when the Fed announced FedNow. FedNow will be an instant payment system and is scheduled to be launched between May and July 2023.

FedNow is practically identical to Brazil's PIX. PIX was implemented by the Central Bank of Brazil (BCB) in November 2020. It is a convenient instant payment system (using mobile devices) without user fees, and a reputation as being safe to use.

A year after its launch, PIX already had 112 million people registered, or just over half of the Brazilian population. Of course, frauds and scams do occur over PIX, but most are social engineering scams and are not system flaws; that is, they are scams that exploit the public's lack of knowledge of PIX technology.

Bear in mind that PIX is not the Brazilian CBDC. It is just a payment system. However, the BCB has access to transactions made through PIX; therefore, PIX can be considered the seed of the Brazilian CBDC. It is already an invasion of the privacy of Brazilians. And FedNow is set to follow suit.

Additionally, the New York Fed has recently launched a twelve-week pilot program with several commercial banks to test the feasibility of a CBDC in the US. The program will use digital tokens to represent bank deposits. Institutions involved in the program will make simulated transactions to test the system. According to Reuters, "the pilot [program] will test how banks using digital dollar tokens in a common database can help speed up payments."

Banks involved in the pilot program include BNY Mellon, Citi, HSBC, Mastercard, PNC Bank, TD Bank, Trust, US Bank, and Wells Fargo. The global financial messaging service provider SWIFT is also participating to "support interoperability across the international financial ecosystem."

The IMF is also thinking of a way to connect different CBDCs under a single system. In other words, the IMF plans to create a PIX/FedNow for CBDCs around the globe:

Things could change as money becomes tokenized; that is, accessible to anyone with the right private key and transferable to anyone with access to the same network. Examples of tokenized money include so-called stablecoins, such as USD Coin, and central bank digital currency.

The reception of Brazil's PIX shows that FedNow will likely be widely adopted due to its convenience; however, this positive economic and technological element should not overshadow the increased control instant payment systems will give to central banks. The BCB has access to all transactions made by Brazilians through PIX, and this would only get worse should a CBDC be implemented. With a CBDC, it would be easier for the government to carry out expansionary monetary policies which cause misallocations of resources and business cycles, and exert greater control over citizens' finances.[6]

Footnotes and Sources

1. The Wall Street Journal, December 16, 2022

2. The Wall Street Journal, December 16, 2022

3. The Wall Street Journal, December 16, 2022

4. CNBC, December 13, 2022

5. The Wall Street Journal, December 14, 2022

6. mises.org/wire/digital-currency-fed-moves-toward-monetary-totalitarianism

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The Dow Jones Industrial Average is an unmanaged index that is generally considered representative of large-capitalization companies on the U.S. stock market. Nasdaq Composite is an index of the common stocks and similar securities listed on the NASDAQ stock market and is considered a broad indicator of the performance of technology and growth companies. The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) and serves as a benchmark of the performance of major international equity markets, as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia. The S&P 500 Composite Index is an unmanaged group of securities that are considered to be representative of the stock market in general.

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