



MORNING BRIEFING

June 1, 2020

The Twilight Zone: Free Money Theory

Check out the accompanying [chart collection](#).

(1) The outer limits of MMT. (2) The Plunge Protection Team is back with lots of free money. (3) Ending a meltdown with a meltup. (4) Stocks are cheap compared to bonds. (5) Is there really a disconnect between stock prices and the economy? (6) Earnings expectations could bottom in the next few weeks. (7) GVC is more like a natural disaster than another great depression. (8) HUGE increase in personal saving. (9) From March's dash for cash to April's cash stash, which could fuel consumer-led V-shaped recovery in coming weeks. (10) MMT is Heaven on Earth. (11) Is cash on banks' balance sheets really cash? (12) Movie review: "Grant" (+ + +).

US Economy: MMT, FMT & PPT. It's time once again for another episode of *The Twilight Zone*. Submitted for your consideration is the outer limits of Modern Monetary Theory (MMT), which isn't modern, isn't monetary, and isn't a theory. Melissa and I prefer to call it "Free Money Theory" (FMT) as implemented by the Plunge Protection Team (PPT).

Investopedia [explains](#): "The 'Plunge Protection Team' (PPT) is a colloquial name given to the Working Group on Financial Markets. Created in 1988 to provide financial and economic recommendations to the U.S. President during turbulent market times, this group is headed by the Secretary of the Treasury; other members include the Chairman of the Board of Governors of the Federal Reserve, the Chairman of the Securities and Exchange Commission and the Chairman of the Commodity Futures Trading Commission (or the aides or officials they designate to represent them). The name 'Plunge Protection Team' was coined by *The Washington Post* and first applied to the group in 1997."

In March 1988, in the wake of the stock market crash of 1987, then-President Ronald Reagan created the PPT by executive order. Its original purpose was to report specifically on the Black Monday events of October 19, 1987, when the S&P 500 plunged 20.5%, and to recommend measures to avoid a similar plunge in the future ([Fig. 1](#)). The February 15, 1999 issue of *Time* included a [story](#) titled "The Committee to Save the World: The inside story of how the Three Marketeers have prevented a global economic meltdown—so far." Featured on the [front cover](#) were Fed Chair Alan Greenspan, Treasury Secretary Robert Rubin, and Deputy Secretary of

the Treasury Larry Summers. That same year, the PPT supported legislation to deregulate the credit derivatives market, which arguably set the stage for the Great Financial Crisis (GFC) of 2008!

This year, in the April 14 [Morning Briefing](#), we wrote: “Money is power. Therefore, the three most powerful men in America today are Treasury Secretary Steve Mnuchin, Fed Chair Jerome Powell, and BlackRock CEO Larry Fink. They are today’s ‘Three Marketeers.’” Together, they succeeded in ending the 33.9% plunge in the S&P 500 over the 33 days from February 19 through March 23 ([Fig. 2](#)).

Just as remarkable is that the S&P 500 is up 36.1% since the March 23 low, is down 5.8% ytd, and up 9.4% y/y. It rose above its 200-day moving average last week. It is only 10.1% below its February 19 record high. It already exceeds our year-end target of 2900 and needs to rise only 15.0% to get to our 3500 target for the end of next year, which could very well happen ahead of schedule too! How did the PPT convert a meltdown into a meltup, resulting in an extraordinary disconnect between the joy in the financial markets and the depression in economic activity? Submitted for your approval, please consider the following:

(1) *MMT explains the disconnect.* Modern Monetary Theory was implemented on Monday, March 23, when the Fed adopted QE4Ever, and on March 27, when President Donald Trump signed the CARES Act. The rest, as they say, is (recent) history. The Fed’s unlimited and open-ended commitment flooded the credit markets with liquidity. That resulted in waves of rebalancing by investors out of bonds and into stocks. The CARES Act provided lots of fiscal stimulus checks that piled up as cash, which is likely to be spent in coming weeks. It also provided the Fed with enough capital to make \$4 trillion in loans to Main Street. The Fed is returning the favor by financing the Treasury’s huge budget deficit.

With the federal funds rate cut back down to zero on March 15 and the US Treasury bond yield trading under 1.0% since March 20, stocks were and remain cheap relative to bonds ([Fig. 3](#)). Recall that when the federal funds rate was zero from mid-December 2008 through mid-December 2015, the bond yield never fell below 1.43% and averaged 2.60%. Now Fed officials are hinting that they might peg the bond yield close to zero for the foreseeable future.

The PPT did everything in its power to give stock investors every incentive to look past the current freefall in the economy and earnings to a recovery in both, possibly by the end of this year if not sooner. The forward P/E of the S&P 500 rocketed from 12.0 on March 23 to an

astonishing 21.6 on Friday, as the stock price index rebounded while forward earnings dropped ([Fig. 4](#) and [Fig. 5](#)). However, at a 0.65% yield currently, the bond is trading at a forward P/E of 54! The S&P 500 dividend yield remains at least 100bps above the bond yield.

The analysts' consensus estimate for S&P 500 earnings in 2020 has plunged from around \$175 per share just before the Great Virus Crisis (GVC) to \$126 during the May 21 week, while the 2021 estimate has dropped from around \$195 per share to \$164 ([Fig. 6](#)). Joe and I still expect that the time-weighted average of these series will bottom in the next few weeks as the economy reopens. We are still forecasting S&P 500 earnings of \$120 per share this year, \$150 next year, and \$175 in 2022.

(2) *FMT eliminates the disconnect.* Friday's personal income report suggests that there is no disconnect between the stock market and the economy. That may seem counterintuitive, since the Atlanta Fed's [GDPNow](#) tracking model lowered the Q2 estimate for real GDP from -40.4% to -51.2% on Friday following the release of the report, as the model's estimate for real consumer spending dropped from -43.3% to -56.5%.

The CARES Act provided lots of free money to individuals to help them financially during the GVC. That boosted disposable income more than job losses depressed it. Because the stores were closed, both employed and unemployed workers couldn't spend their incomes as they normally do. The result was a huge increase in personal saving during April that is likely to revive economic growth as stores reopen. The mad dash for cash during March led to a big stash of cash during April, which could fuel a consumer-led V-shaped recovery in the economy in coming weeks if the economy continues to reopen without major setbacks. The stock market may simply be discounting that the GVC is more akin to natural disasters, which more often are followed by a solid recovery than another great depression.

(3) *The micro of FMT.* The CARES Act provided \$300 billion in direct support payments to individuals, with advance tax rebate payments distributed mostly in April 2020. A \$1,200 refundable tax credit was provided to individuals (\$2,400 for joint taxpayers) who met specified criteria. In addition, qualified taxpayers with children received \$500 for each child. The amount of the rebate phased out at \$75,000 for individual filers, \$112,500 for heads of household, and \$150,000 for joint taxpayers at 5% per dollar of qualified income. The rebate phased out entirely at \$99,000 for single taxpayers with no children and \$198,000 for joint taxpayers with no children.

In the National Income and Product Accounts, these payments to individuals are recorded as “federal social benefit payments to persons” and include the total amount of the rebates (both the amount that was paid to individuals directly and the amount by which the rebates reduced taxpayers' personal tax liabilities). Social benefits are included in personal income.

Also boosting government payments in personal income are unemployment insurance benefits. The CARES Act added an incremental \$600 a week from the federal government to state unemployment benefits through July 31. An April 28 [WSJ article](#) noted that roughly half of American workers are eligible to receive more pay on unemployment compensation than they earned at their jobs prior to the pandemic's shuttering of businesses. Doing the math, the article observed that the average weekly payment for an unemployed worker could rise to about \$978 from nearly \$378 paid on average at the end of last year, according to the Labor Department. The new average payment could equate to about \$24 per hour over the standard workweek and compares to substantially lower minimum wages in most states. The federal benefit alone equates to about \$15 per hour.

(4) *The macro of FMT*. So here's what happens when the government shuts down the economy so that we can't go shopping while boosting personal income with \$3 trillion (at an annual rate) in social benefits during April, more than offsetting the \$1.0 trillion (annualized) fall in personal income excluding those benefits. Dropping sharply in personal income were wages and salaries (by \$740 billion) and proprietors' income (by \$198 billion) ([Fig. 7](#)).

The result was that personal saving (at an annual rate) soared by \$4.0 trillion during April as consumption plunged \$1.9 trillion while disposable income was boosted \$2.1 trillion by government social benefits ([Fig. 8](#)). The personal saving rate vaulted from 8.2% during February to 12.7% during March to 33.0% during April ([Fig. 9](#))! A consumer-led V-shaped recovery in coming months is almost inevitable if the reopening of the economy continues without any major setbacks.

(5) *FMT in the Twilight Zone*. Where does all the free money come from? Previously, we've compared Fed Chair Jerome Powell to Spanky in the “Little Rascals” [throwing money out the window](#). He has certainly risen to the challenge of the GVC by embracing MMT, which posits that the government can borrow as much as it likes in its own currency, with the government's central bank buying most of its debt in an effort to keep a lid on interest rates, as long as inflation remains subdued. MMT promises Heaven on Earth. Remarkably, it seems to be working so far.

Of course, MMT isn't new. It's been the modus operandi of our government since the GFC. From fiscal 2008-19, the federal government budget deficits totaled \$10.2 trillion ([Fig. 10](#)). It could borrow so much because inflation and interest rates remained low even though the economy was expanding. Over this same period, the Fed's holdings of US Treasury debt rose \$1.3 trillion, while the Fed kept interest rates low by targeting the federal funds rate close to zero from the end of 2008 through the end of 2015 ([Fig. 11](#)). The Congressional Budget Office projects that the deficit will hit a record \$3.7 trillion during the current fiscal year. The Fed already has financed more than half of that by purchasing \$2.0 trillion in Treasuries since the start of October 2019, most of that since QE4Ever was announced on March 23.

Where does the Fed get all the money to purchase the Treasuries? It doesn't print it, as is widely believed. Rather, it issues IOUs to commercial banks, which show up as "cash" on the asset side of their balance sheets; they show up as "reserve balances" on the liabilities side of the Fed's balance sheet ([Fig. 12](#)).

This raises a couple of interesting questions. Why are banks sitting on all that cash (currently at a record \$3.4 trillion)? The fact that this series is nearly identical to their reserve balances on deposit at the Fed confirms that the cash is just an accounting item rather than a source of lendable funds. However, it is offset on the liabilities side of the banks' balance sheet by the deposits of investors who sold their bonds to the Fed. Those deposits don't go away if the investors buy something else with their proceeds; they just wind up as someone else's deposit account.

According to the Money Multiplier Model, the banks can lend out the increase in their deposits (less reserve requirements) resulting from the Fed's QE purchases of Treasuries. That would increase the banking system's loans on the assets side and deposits on the liabilities side. Interestingly, the ratio of the banks' total deposits to the Fed's holdings of US Treasuries and mortgage-backed securities has been remarkably flat around 3.0 since the start of QE following the GFC ([Fig. 13](#)). This suggests that there hasn't been any multiplier effect since then.

The Fed's inflationary expansion of the monetary base (i.e., currency plus reserves) hasn't caused an inflationary expansion in the money supply (i.e., currency plus deposits). Free money should remain free as long as inflation remains subdued, just as FMT (a.k.a. MMT) suggests.

Movie. “Grant” (+ + +) ([link](#)) is a three-part docudrama on the History Channel. It provides great insights, not only into the life of Ulysses S. Grant but also into the Civil War and the post-war Reconstruction Era. Grant was the general who won the war for Abraham Lincoln by defeating the forces of General Robert E. Lee, who surrendered the Confederate army to Grant at Appomattox Court House, Appomattox, Virginia on April 9, 1865. From 1861 to 1865, it is estimated that 620,000-750,000 soldiers died along with an undetermined number of civilians. Lincoln was assassinated five days after the end of the war. Vice President Andrew Johnson succeeded Lincoln as president until March 4, 1869. Then Grant was elected President and served for two terms through March 4, 1877. Sadly, the legacy of Grant’s turbulent era in many ways haunts Americans to this very day.

CALENDARS

US: **Mon:** ISM & IHS Markit M-PMIs 43.0/39.8, Construction Spending -6.0%, Motor Vehicle Sales. **Tues:** API Crude Oil Stocks. (DailyFX estimates)

Global: **Mon:** Eurozone, Germany, France, and Italy M-PMIs 39.5/36.8/40.3/37.1, UK M-PMI 40.7, RBA Rate Decision 0.25%. **Tues:** Japan C-PMI & NM-PMI 27.4/25.3, China Caixin C-PMI & NM-PMI, Australia GDP -0.3%q/q/1.4%y/y. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): Last week saw the US MSCI index rise 3.0% for its sixth weekly gain of the 10-week-old bull market. The index ranked 30th of the 49 global stock markets we follow in a week when 43/49 countries rose in US dollar terms, and the AC World ex-US index gained 4.3% as all regions rose. The US MSCI index exited a correction during the latest week and is now just 9.8% below its 2/19 record high. EMU was the best-performing region last week, with a gain of 6.9%, followed by EM Latin America (6.3) and EAFE (5.1). EMEA was the biggest underperformer, albeit with a gain of 2.4%, followed by EM Asia (2.7), BRIC (3.2), and EM Eastern Europe (4.0). Greece was the best-performing country last week with a gain of 10.7%, followed by Poland (9.5), Belgium (9.4), Colombia (8.9), and Indonesia (8.9). Of the 28 countries that underperformed the AC World ex-US MSCI last week, Chile fared the worst with a decline of 3.0%, followed by South Africa (-1.8), Pakistan (-1.5), Argentina (-1.2), and Hong Kong (-0.6). In May, the US MSCI rose 5.0% and ranked 18/49 as the AC World ex-US index rose 3.0%. Thirty-nine of the 49 countries moved higher in May. Argentina was the best performer with a gain of 19.9%, followed by Israel (9.0), Finland (8.8),

Brazil (8.4), and Poland (8.2). The worst countries in May: Hong Kong (-8.9), Chile (-7.4), Jordan (-4.4), Singapore (-4.3), and Egypt (-3.3). The outperforming regions: EM Eastern Europe (7.9), EM Latin America (6.2), EMU (5.9), EMEA (4.4), and EAFE (4.1). EM Asia was May's worst-performing region with a decline of 0.5%, followed by BRIC (0.2). The US MSCI's ytd ranking remained steady last week at 4/49 as its ytd performance improved to -5.1%. It's still way ahead of the 15.8% ytd decline for the AC World ex-US. EM Asia is the best regional performer ytd, albeit with a decline of 11.3%, followed by BRIC (-14.7) and EAFE (-15.3). The worst-performing regions ytd: EM Latin America (-39.2), EM Eastern Europe (-24.3), EMEA (-21.9), and EMU (-18.0). The best country performers ytd: Denmark (6.0), Israel (-1.5), Finland (-5.0), the United States (-5.1), China (-5.4), and New Zealand (-5.4). The worst-performing countries so far in 2020: Colombia (-46.2), Brazil (-43.6), Greece (-37.5), Sri Lanka (-35.8), and Peru (-33.7).

S&P 1500/500/400/600 Performance ([link](#)): With the bull market now ten weeks old, all of these indexes rose together for the third time in four weeks. MidCap was 4.0% higher for the week, ahead of the gain for SmallCap (3.6%) and LargeCap (3.0). LargeCap was out of a bear market for a seventh week and improved to 10.1% below its 2/19 record high; and MidCap improved out of a bear market in the latest week to a 16.2% correction from its record high on 1/16. SmallCap remained the worst performer, in a 26.9% bear market below its 8/29/18 record. Thirty-two of the 33 sectors rose for the week, the same as a week earlier. Sixteen of the 33 sectors are out of a bear market now. Among them, five are out of a correction: MidCap Health Care ended the week at a record high, and these four are down less than 10%: LargeCap Consumer Discretionary, LargeCap Health Care, LargeCap Information Technology, and MidCap Consumer Staples. LargeCap Financials was the best performer last week, with a gain of 6.6%, ahead of LargeCap Industrials (6.0), LargeCap Real Estate (5.8), LargeCap Utilities (5.7), and SmallCap Industrials (5.6). MidCap Energy (-0.2) was the sole decliner last week and followed by these underperforming sectors: MidCap Health Care (0.6), LargeCap Communication Services (0.6), SmallCap Health Care (0.6), and LargeCap Energy (0.9). During May, MidCap's 7.1% gain easily trumped its LargeCap (4.5) and SmallCap (4.1) counterparts. Twenty-nine of the 33 sectors rose in May, compared to all 33 rising in April and all 33 falling in March. May's best performers: MidCap Consumer Discretionary (17.9), SmallCap Consumer Discretionary (12.2), MidCap Consumer Staples (9.8), SmallCap Materials (9.4), and MidCap Health Care (8.5). May's biggest laggards: MidCap Energy (-2.2), SmallCap Real Estate (-2.1), SmallCap Financials (-1.6), SmallCap Utilities (-0.7), LargeCap Energy (0.7), and MidCap Real Estate (0.7). All three indexes are still down on a ytd basis, but

LargeCap's 5.8% drop is much smaller than those of MidCap (-14.5) and SmallCap (-21.4). Just five of the 33 sectors are now positive so far in 2020, with the best performers led by MidCap Health Care (8.7), LargeCap Information Technology (6.7), LargeCap Consumer Discretionary (1.6), SmallCap Communication Services (1.0), and LargeCap Health Care (0.8). The biggest laggards of 2020 to date: SmallCap Energy (-54.2), MidCap Energy (-49.7), LargeCap Energy (-36.1), SmallCap Financials (-32.8), and SmallCap Real Estate (-31.1).

S&P 500 Sectors and Industries Performance ([link](#)): All 11 S&P 500 sectors rose last week as seven outperformed the index's 3.0% gain. That compares to a 3.2% gain for the S&P 500 a week earlier, when nine sectors rose and eight outperformed the index. Financials' 6.6% gain made it the best performer for the week, ahead of Industrials (6.0%), Real Estate (5.8), Utilities (5.7), Materials (4.7), Health Care (3.4), and Consumer Staples (3.0). Communication Services was the biggest underperformer, albeit with a gain of 0.6%, followed by Energy (0.9), Information Technology (1.4), and Consumer Discretionary (2.0). The S&P 500 rose 4.5% in May for its second straight monthly gain and its best two-month performance since May 2009 as all 11 sectors moved higher and five beat the index. That compares to all 11 rising and five beating the S&P 500's 12.7% gain in April. The leading sectors in May: Information Technology (6.8), Materials (6.7), Communication Services (6.0), Industrials (5.1), and Consumer Discretionary (4.9). May's laggards, albeit with gains: Energy (0.7), Consumer Staples (1.4), Real Estate (1.7), Financials (2.4), Health Care (3.1), and Utilities (3.9). The S&P 500 is now down 5.8% so far in 2020, with four sectors leading the index and three in positive territory. The leading sectors ytd: Information Technology (6.7), Consumer Discretionary (1.6), Health Care (0.8), and Communication Services (-0.4). The laggards of 2020 so far: Energy (-36.1), Financials (-24.2), Industrials (-17.1), Real Estate (-10.8), Materials (-9.7), Utilities (-8.0), and Consumer Staples (-6.4).

Commodities Performance ([link](#)): Last week, the S&P GSCI index rose 1.8% for its fifth straight weekly gain and its longest winning streak since it rose for five weeks around the start of the year. It's now down 30.9% from its recent high on 1/6, and still in a severe bear market at 38.9% below its cyclical high on 10/3/18. Silver was the best performer last week, with a gain of 6.5%, followed by Feeder Cattle (5.0%), Cocoa (4.9), Crude Oil (4.4), and Brent Crude (3.9). Coffee was the biggest decliner for the week, with a drop of 8.1%, followed by GasOil (-4.3), Nickel (-3.6), Cotton (-0.8), and Sugar (-0.6). May saw 12 of the 24 commodities climb as the S&P GSCI Commodities index rose 1.8% in its second straight monthly gain. That compares to 12 rising in April when the S&P GSCI Commodities index rose 0.6% for its first gain in four months. May's best performers were Crude Oil (64.0%), Brent Crude (42.9),

Unleaded Gasoline (37.6), Heating Oil (24.4), and Silver (23.5). May's laggards: Coffee (-9.4), Natural Gas (-5.1), Kansas Wheat (-3.6), Lean Hogs (-3.3), and Soybeans (-1.7). Just two of the 24 commodities that we follow are higher so far in 2020, Gold (15.0) and Silver (3.2). The next-best performers ytd: Kansas Wheat (-3.2), Cocoa (-3.4), and Feeder Cattle (-6.2). The worst performers ytd: GasOil (-52.0), Heating Oil (-48.8), Brent Crude (-42.7), Crude Oil (-41.3), and Unleaded Gasoline (-36.2).

S&P 500 Technical Indicators ([link](#)): The S&P 500 rose 3.0% last week and improved relative to both its short-term, 50-day moving average (50-dma) and its long-term, 200-day moving average (200-dma). It was above its 50-dma for a seventh week after seven weeks below and was above its 200-dma for the first time in 14 weeks. It had been below its 200-dma for 13 weeks, matching its prior streak that ended during February 2019. The index's 50-dma relative to its 200-dma rose for a second week after 12 declines, but the index remained in a Death Cross (with 200-dmas higher than 50-dmas) for a tenth week. It had been in a Death Cross for 13 straight weeks ending in March 2019. The index's 50-dma improved last week to 7.2% below its 200-dma, up from 9.2% below in the prior week. It had been 9.9% below the week before that, which was the worst reading since May 2009. During late February, the 50-dma had been 7.6% above its 200-dma, which was the highest since May 2012. The S&P 500's 50-dma rose for a second week after declining for 12 straight weeks. The price index improved to 9.0% above its now-rising 50-dma from 8.1% above its falling 50-dma a week earlier. That's down from 9.8% above its 50-dma on Wednesday, which was its highest since May 2009. That compares to 27.7% below on 3/23—its lowest reading since it was 29.7% below on Black Monday, 10/19/87. The 200-dma also rose for a second week, and at a faster rate after falling for five weeks. It had been rising for 39 weeks through early March. The index moved above its 200-dma for the first time in 14 weeks. It had been above for 38 weeks through mid-February. It ended the week 1.1% above its rising 200-dma, compared to 1.8% below its slightly rising 200-dma a week earlier. That's up from 26.6% below on 3/23—its lowest reading since March 2009 and down from a 24-month high of 11.2% in mid-February. That compares to a seven-year high of 13.5% above its rising 200-dma during January 2018 and 14.5% below on 12/24/18, which was then the lowest since April 2009. At its worst during the Great Financial Crisis, the S&P 500 price index was 25.5% below its 50-dma on 10/10/08 and 39.6% below its 200-dma on 11/20/08.

S&P 500 Sectors Technical Indicators ([link](#)): All 11 S&P 500 sectors traded above their 50-dmas last week for a second week and the first time since January 20, but only four traded above their 200-dmas. That compares to just one sector above its 50-dma and 200-dma six

weeks ago. These four sectors trade above their 50-dma and 200-dma: Communication Services, Consumer Discretionary, Health Care, and Information Technology. Tech moved back into the Golden Cross club (50-dmas higher than 200-dmas) in the latest week, but 10 sectors are still out. At the prior low, just two sectors (Real Estate and Utilities) were in the club during February 2019. Energy has not been in a Golden Cross for 82 straight weeks. All 11 sectors have a rising 50-dma now for the first time since late January, up from eight a week earlier. That's a big improvement from the beginning of May when all 11 had falling 50-dmas for ten straight weeks. Just five sectors have rising 200-dmas, up from four a week earlier, as Materials turned positive in the latest week. These sectors also have rising 200-dmas: Communication Services, Consumer Discretionary, Health Care, and Tech. Financials' 200-dma was down for a 13th week for the first time since late August. Energy's 200-dma has been mostly falling since October 2018.

US ECONOMIC INDICATORS

Personal Income & Consumption ([link](#)): Personal income and saving soared in April, while consumer spending continued to collapse. Personal income jumped a record 10.5% in April, after a 2.2% drop in March, as government social benefits nearly doubled—rising 91.1%, or \$3.0 trillion—owing to the stimulus payments distributed under the CARES Act. Wages & salaries plummeted a record 8.0% in April, following a 3.5% drop in March. Meanwhile, personal consumption expenditures tumbled a record 13.6% in April, eclipsing the previous record decline of 6.9% recorded in March. The jump in income, along with the plunge in spending, boosted personal saving by \$4.0 trillion in April alone to a record high of \$6.1 trillion—which should help fuel a recovery in spending as the country opens up. The saving rate soared to a record 33.0% in April from 12.7% in March and 8.2% in February. Adjusted for inflation, consumer spending tanked 13.2% in April, with real goods and services spending sinking 15.8% and 12.0%, respectively—all record declines. According to BEA's report, "Within goods, decreases in all subcomponents were led by a decrease in food and beverages. Within services, the largest contributors to the decrease were spending for health care as well as food services and accommodations." As for inflation, April data show core inflation—the Fed's preferred measure—increased 1.0% y/y, holding below its target rate of 2.0% for the 19th consecutive month, while the headline inflation rate eased to 0.5% y/y, the lowest since the end of 2015.

Consumer Sentiment Index ([link](#)): "The CARES relief checks and higher unemployment payments have helped to stem economic hardship, but those programs have not acted to

stimulate discretionary spending due to uncertainty about the future course of the pandemic,” according to Richard Curtin, director of the Consumer Sentiment Index (CSI) survey. The CSI climbed to 72.3 in May (below the mid-May estimate of 73.7) after plunging a record 29.2 points from a near-15-year high of 101.0 in February to 71.8 in April—which was the lowest since December 2011. The present situation of the CSI rebounded 8.0 points last month, to 82.3, after tumbling 40.5 points (to 74.3 from 114.8) from February through April. Meanwhile, the expectations component slumped for the third month, by a total of 26.2 points (to 65.9 from 92.1 in February).

Durable Goods Orders & Shipments ([link](#)): Both core capital goods orders and shipments posted sizable declines in April, following more modest losses the prior two months. Nondefense capital goods orders ex aircraft (a proxy for future business investment) fell for the third month, by 5.8% in April and 7.3% over the period. Core capital goods shipments (used in calculating GDP) fell 5.4% and 7.1% over the comparable periods. Meanwhile, total durable goods orders have been in a freefall, plummeting 17.2% in April after a 16.6% drop in March. April’s decline was the second largest in the history of the series going back to the early 1990s. The biggest decline occurred in August 2014 (-18.4%), reflecting an unusually large decline in orders for Boeing passenger planes following a substantial order the prior month. Declines in orders were broad-based, led by a 47.3% plunge in transportation equipment orders during April and 70.0% over the past two months—as orders for motor vehicles fell by 52.8% and 62.0% over the same periods. Excluding transportation, billings fell 7.4% in April and 9.0% over the two months through April.

Pending Home Sales ([link](#)): “With nearly all states under stay-at-home orders in April, it is no surprise to see the markedly reduced activity in signing contracts for home purchases,” said Lawrence Yun, NAR’s chief economist. The Pending Home Sales Index tumbled 21.8% in April and 33.8% y/y to 69.0. Regionally, it was a sea of red, with sales once again falling at double-digit rates on both a monthly and yearly basis across the board: Northeast (-48.2% m/m & -52.6% y/y), Midwest (-15.9 & -26.0), South (-15.4 & -29.6) and West (-20.0 & -37.2). According to Yun, “[w]hile coronavirus mitigation efforts have disrupted contract signings, the real estate industry is ‘hot’ in affordable price points with the wide prevalence of bidding wars for the limited inventory. In the coming months, buying activity will rise as states reopen and more consumers feel comfortable about homebuying in the midst of the social distancing measures.”

GDP ([link](#)): Revisions show real GDP contracted at a revised 5.0% (saar) during Q1— not far from the initial estimate of a 4.8% drop. It was the first decline in six years, and the steepest

since the Great Recession, as COVID-19 triggered plant shutdowns and a surge in unemployment. Data for Q2, so far, suggest this quarter could decline at seven times Q1's rate! While the Q1 revision to the headline number was small, there were notable revisions in some components. Real consumer spending was still the biggest drag on growth during Q1, plunging 6.8% (saar), though slower than the initial decline of 7.6%. Services consumption contracted 9.7% (saar), slightly less than the 10.2% decline first reported, while spending on goods edged up 0.2% rather than declining 1.3%. Within goods consumption, the upward revision reflected a smaller decline to durable goods spending (to -13.2% from -16.1%, saar) and a bigger gain in nondurable goods consumption (7.7 from 6.9). Inventory investment was weaker than first reported, falling from \$13.1 billion during Q4 to a revised -\$67.2 billion (saar) during Q1—considerably steeper than the -\$16.3 billion initial guesstimate. The decline in nonresidential investment (to -7.9% from -8.6%, saar) was slightly smaller than first reported, with the drop in structures (-3.9 from -9.7) roughly one-third the initial estimate, while spending on intellectual property products (1.0 from 0.4) was slightly faster; investment in equipment (-16.7 from -15.2) was revised lower—posting its biggest decline since Q1-2009. Though lower than first estimated, real residential investment soared a whopping 18.5% (saar) last quarter (vs the 21.0% initial increase)—its strongest performance since Q4-2012. The trade data were nearly identical to the initial estimates, with real exports falling an unrevised 8.7% (saar), while imports (-15.5) fell at near double the pace of exports—little changed from the -15.3% advance estimate. As for trade, federal government spending (to 0.8% from 0.7%, saar) barely budged from initial reports.

Contributions to GDP Growth ([link](#)): Revisions show real consumer spending, by far, was the biggest negative contributor to Q1 real GDP growth, though it wasn't the only one. The details: 1) Real consumer spending subtracted a whopping 4.69ppts from Q1 GDP, with services (-4.75) spending accounting for all of the drag. Goods consumption (0.6) was neutral—as a positive contribution from nondurable goods (1.04) consumption partially offset the negative contribution from durable goods (-0.98) spending. 2) Inventory investment (-1.43) subtracted from real GDP growth for the fourth straight quarter; once again, it was all nonfarm (-1.52). 3) Real nonresidential fixed investment (-1.06ppt) subtracted from GDP growth for the fourth consecutive quarter, led by continued declines in both structures (-0.11) and equipment (-1.00); spending on intellectual property products (0.05) was relatively neutral, eking out a small gain. 4) Meanwhile, trade was the biggest positive contributor to Q1 GDP growth—as real net exports added 1.32ppt to growth, with imports (2.34) contracting at a much faster pace than exports (-1.02). 5) Real residential investment (0.66ppt) added to growth for the third straight

quarter, posting its best growth in seven years, after subtracting from real GDP from Q1-2018 through Q2-2019. 6) Real government spending (0.15ppt) contributed to GDP growth every quarter of 2019 and continued to do so during Q1 of this year, though federal (0.12) spending accounted for last quarter's gain.

GLOBAL ECONOMIC INDICATORS

Eurozone Economic Sentiment Indicators ([link](#)): The Economic Sentiment Indexes (ESI) for both the Eurozone (+2.6 points to 67.5) and the EU (+2.9 to 66.7) may have hit bottom in April, with both showing the first signs of recovery in May. ESIs for the former and the latter plummeted by 38.5 points and 39.2, respectively, during the two months ending April, to new record lows. Among the main Eurozone economies, ESIs showed signs of recovery in the Netherlands (+3.5 points to 69.1), Germany (+3.2 to 75.3), and Spain (+1.6 to 74.9), with France's (-0.3 to 67.6) moving sideways. Italy's ESI dropped to a record low of 63.0 in May from 83.7 in March—as strict confinement measures in Italy during April blocked data from being collected that month. At the sector level, industry (+5.0 points to -27.5) confidence moved up last month and “was entirely attributable to a vivid improvement in managers’ production expectations which reversed roughly half of the decline registered over March and April.” Also moving higher was consumer (+3.2 to -18.8) confidence, reflecting “much improved expectations in respect of their financial conditions, their intentions to make major purchases and the general economic situation.” Meanwhile, retail (+0.4 to -29.7) confidence held steady in May after tumbling 29.9 points during the two months through April. In the meantime, services (-5.0 points to -43.6) confidence continued to fall to new record lows, though the rate of decline has slowed, while construction (-1.3 to -17.4) confidence sank to a four-year low.

Eurozone CPI Flash Estimate ([link](#)): May's CPI headline rate is expected to slow for the fourth month to 0.1% (the lowest rate since June 2016), after accelerating the prior three months from 0.7% in October to 1.4% in January. It would be the 18th consecutive month that the headline rate was below 2.0%. Meanwhile, the core rate is expected to remain at April's rate of 0.9% y/y after edging down from 1.2% in February. Looking at the main components, food, alcohol & tobacco (to 3.3% from 3.6% y/y) is expected to record the highest rate in May, though easing from April's recent high, while energy prices is expected to post the lowest rate (-12.0 from -9.7)—falling at the fastest pace since July 2009. Meanwhile, the rate for services (1.3 from 1.2) is expected to accelerate slightly, while the rate for non-energy industrial goods (0.3 from 0.2) is forecast to continue to hover just above zero.

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