Yardeni Research

MORNING BRIEFING

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Inflating Fundamentals vs Deflating Valuations

Check out the accompanying chart collection.

Executive Summary: The Ukraine crisis has triggered the stock market's 74th panic attack of this bull market, by our count. Coming on the heels of the 73rd panic attack, the two together qualify as a correction. Could it become a bear market? Perhaps if much higher oil and gas prices result from the crisis, but that's hard to conclude. What we do expect over the near term is more of the same sideways trading with volatile swings. Notably, however, geopolitical crises have often been buying opportunities for stock investors. … And while valuations have been deflating lately, fundamentals—revenues, earnings, and profit margins—have been inflating dramatically. … Also: What members of the "Federal Open Mouth Committee" have been saying about the course of monetary policy.

Geopolitics I: A New Cold War. The Cold War is back, as I discuss in the next section. Relations between both Russia and China, on the one hand, and the West, on the other hand, have been getting frostier in recent years. Relations just turned ice cold between Russia and the West. Cold War I ended during November 1989, when the Berlin Wall was toppled. A 1992 book by Francis Fukuyama titled *The End of History and the Last Man* argued that Western liberal democracy had vanquished totalitarianism. History isn't over, and neither is the inherent conflict between democracy and autocracy.

Geopolitical crises have tended to be buying opportunities for stock investors in recent years. We've counted 73 *panic attacks* that included a smattering of geopolitical crises since the start of the current bull market in 2009. We are counting the latest selloff since February 18 as Panic Attack #74 and attribute it mostly to the Ukraine crisis. The previous one started on January 5 and was attributable to another Fed taper tantrum. These back-to-back panic attacks have caused the S&P 500 to drop 10.3% since its record high on January 3, qualifying the downdraft as a correction.

The question is: Could it turn into a bear market, signaling a recession? It could if the crisis leads to much higher oil and gas prices in the US, Europe, and the rest of the world. Of course, it's hard to assess the likelihood of that scenario. It's less hard to conclude that, for the near term, the stock market may continue to trade sideways in a volatile fashion.

Geopolitics II: Putin's Counter-Revolution. On Monday, Russian President Vladimir Putin created Donetsk People's Republic and the Luhansk People's Republic. He did so by decree, carving them out of eastern Ukraine. The decree was signed by two Russia-backed separatist leaders from those new republics. Putin hasn't invaded Ukraine yet, but his army is moving into his new republics. He will probably wait to see how the West responds before deciding when (not whether) to invade the rest of Ukraine.

In a lengthy televised speech on Monday, looking visibly emotional, Putin described Ukraine as an integral part of Russia's history, calling eastern Ukraine ancient Russian lands. He said he was confident the Russian people would support his decision. He characterized the West's threats of sanctions as "blackmail," claiming that the West's goal is "to restrain the development of Russia."

Putin's speech reiterated many of the points he made in a July 12, 2021 *article* posted by the Kremlin titled "On the Historical Unity of Russians and Ukrainians." The Ukrainians should have filed for a restraining order, because the article strongly suggested that Putin is willing to kill and injure lots of Ukrainians to force them to unite with Russia.

Putin's aim seems to be to reestablish the Soviet Union. In his annual state-of-the-nation address on April 25, 2005, he said, "The collapse of the Soviet Union was the greatest geopolitical catastrophe of the century." He also wants to undo Ukraine's Orange Revolution. In late 2004, peaceful protests prevented Kremlin-backed candidate Viktor Yanukovych from stealing the Ukrainian presidency, allowing for the election of his reformist rival, Viktor Yushchenko. Six years later, infighting among the reformists paved the way for Yanukovych to mount an unlikely comeback and win the 2010 presidential election.

Nevertheless, according to a November 22, 2020 Atlantic Council *article* by Peter Dickinson, "The Orange Revolution also had a profound effect on the way Ukrainians perceived themselves and their national identity. For the first thirteen years of independence, the political, cultural, social, and economic boundaries between Ukraine and Russia had remained blurred. Most people on both sides of the border continued to regard the fates of the two notionally separate countries as inextricably intertwined. This changed dramatically in 2004 when millions of Ukrainians mobilized in defense of free elections."

Odds are that Putin's least favorite color is orange.

Strategy I: Inflating Fundamentals. The S&P 500 is down 10.3% from its record high at the start of the year through yesterday's close (*Fig. 1* and *Fig. 2*). It is back below its 200-day moving average.

Yet the forward revenues, forward earnings, and forward profit margin of the S&P 500 were all at record highs last week (*Fig. 3*). All three weekly series are great coincident indicators of their quarterly S&P 500 counterparts for revenues, earnings, and the profit margin. Forward revenues and forward earnings have been on steep uptrends in record-high territory for the past 51 weeks through the February 17 week!

Consider the following:

(1) *Earnings hook.* There has been an "earnings hook" during the Q4 earnings reporting season as actual results once again beat analysts' consensus expectations (*Fig. 4* and *Fig. 5*). At the start of the earnings season, industry analysts' predicted that earnings rose 20.1% during Q4. The actual result so far is 26.5%.

(2) *Inflated revenues.* During inflationary times, stocks tend to be among the best inflation hedges and to beat bonds. That's because some of the strength in revenues obviously reflects the higher rate of price inflation. This is happening now as companies clearly are responding to rising costs by raising their selling prices.

We can see this in the regional business surveys conducted by five of the Federal Reserve's district banks (*Fig. 6*). The indexes of both prices paid and prices received have remained at or near record highs for the past six months through January. There's no sign of relief in February's readings for the New York, Philadelphia, and Richmond regions, though there are signs in these three surveys that supply-chain disruptions are easing (*Fig. 7*). During January, a record 61.0% of small business owners said that they are raising their average selling prices (*Fig. 8*).

(3) *Resilient margins.* The resilience of the S&P 500 forward profit margin is impressive. It has hovered around a record 13.0% since the start of the year despite rising labor and materials costs as well as outright shortages of labor and parts. While faster productivity growth may explain some of this resilience, a more obvious explanation is that most companies are passing their costs right into their selling prices. This may be a classic wage-price spiral, initially driven by demand-pull inflation but now also driven by cost-push inflation.

Remarkably, none of the 11 sectors of the S&P 500 are showing signs of any significant compression in their forward profit margins (*Fig. 9*). All are at either record or cyclical highs. Does every business have pricing flexibility? Apparently so! Here are the forward profit margins of the sectors from highest to lowest as of the February 17 week: Information

Technology (25.3%), Financials (18.6), Real Estate (16.9), Communication Services (16.4), Utilities (14.6), S&P 500 (13.3), Materials (13.1), Health Care (11.5), Industrials (10.2), Energy (9.3), Consumer Discretionary (8.1), and Consumer Staples (7.6).

(4) *Winners and losers.* Of course, interest rates rise along with inflation, tending to weigh on stock valuation multiples, which is what is happening now. This is one important reason why stock prices are likely to remain volatile for a while. Generally speaking, energy stocks do well during periods of inflation, while the stocks of financial services firms do well when interest rates are rising. Stocks with lots of air in their P/Es tend to lose air when interest rates are rising along with inflation, but they could turn into good buying opportunities.

Let’s have a closer look at valuations in the following section.

Strategy II: Deflating Valuations. The air continues to come out of the forward P/Es of the various S&P stock market indexes. Joe and I also calculate a series for the forward P/E of the MegaCap-8 stocks, and it is also losing altitude. Here are some observations on the latest developments:

(1) The MegaCap-8 (the eight highest-capitalization stocks in the S&P indexes) collectively account for about 25% of the market cap of the S&P 500 index and 50% of the market cap of the S&P 500 Growth index (*Fig. 10*). So the sharp drop in the MegaCap-8’s collective forward P/E from 33.8 at the start of the year to 28.3 on Friday has weighed on the broader indexes (*Fig. 11*).

Some of the air coming out of the valuations of these three indexes has gone into S&P 500 Value’s forward P/E, which is up since the start of the year. The S&P 500’s P/E was trading in a range between 20.0 and 23.0 during the second half of 2020 through the end of this year. It was down to 19.1 on Friday. Value is likely to continue to gain relative to Growth as long as investors are concerned about inflation and higher interest rates. However, lower prices for Growth stocks should provide some good buying opportunities too.

(2) The forward P/Es of the S&P 400 and S&P 600 indexes (a.k.a. the SMidCaps) have been falling since early last year mostly because their prices moved sideways, while their forward earnings soared (*Fig. 12* and *Fig. 13*). At 14.4 and 13.7 as of Friday’s close, they are much cheaper and have shown better earnings momentum than S&P 500 or LargeCaps.

(3) Foreign stocks look cheaper than US ones. The latest data show that the forward P/E of

the All Country World ex-US MSCI is down to 13.6 (*Fig. 14*). The forward P/E of this index tends to trade like the valuation multiple of the S&P 500 Value index, which was 16.2 on Friday.

So why stick with a Stay Home investment strategy when stocks are cheaper overseas? The Fed is about to tighten US monetary policy, which could weigh more on foreign than US stocks, especially in emerging markets. Geopolitical tensions and soaring energy costs in Europe are an issue for investors as well. And the Chinese government continues to impose onerous regulations on business.

(4) Here are the forward P/Es of the major MSCI indexes during the February 17 week from highest to lowest: US (20.2), EMU (14.4), ACW ex-US (13.6), Japan (13.4), UK (12.2), and Emerging Markets (12.1).

The Fed: The 'Federal Open Mouth Committee.' In the past, the Federal Open Market Committee (FOMC) started to tighten monetary policy when the committee judged that inflationary pressures were starting to heat up. This time around, the Committee has let inflation run wild, apparently hoping that it would be transitory. That strategy hasn't been working out so well.

Nevertheless, interest-rate increases totaling 75bps are coming this year if the FOMC's December 15 *Summary of Economic Projections* (SEP) bears out: All 18 officials submitting projections saw rates rising in 2022, and most saw three 0.25bps increases. The next SEP will be released along with the FOMC's March 15-16 meeting decision.

Following the latest inflation "surprise," the hawks' squawks have gotten louder, advocating for faster rate hikes and swifter balance-sheet reduction, while the doves' coos of "easy does it" have faded as their camp has thinned to just two. But more dovish allies may soon be added to the divided committee if the Senate confirms US President Joe Biden's three progressive-leaning and presumably dovish nominations to the open Fed governor seats. Biden admits that he feels badly for consumers, but his administration *insists* that the surge in inflation is only temporary and that further stimulus can't hurt the US economy.

Few FOMC members agree. Let's do a round-up of what *2022 FOMC voters* have been saying about policy lately. Most favor the initiation of rate hikes and/or further reduction in the balance sheet at the March meeting. But how much and how fast are up for debate:

(1) *Five loud hawks.* Since late last year, Federal Reserve Bank Presidents James *Bullard*,

Esther *George*, and Loretta *Mester* and Fed Governor Christopher *Waller* have chatted about the need to quickly tighten to combat rising inflation. In recent weeks, they've turning up the volume, and Fed Governor Michelle Bowman has joined in the hawkish chorus.

Bullard has been the most vocal hawk lately, *telling* Bloomberg on February 10 that he wants a full percentage point hike to be "in the bag" by July 1, *telling* CNBC on February 14 that the bank's "credibility is on the line" and needs to "front-load" rate hikes, and *saying* at a Columbia University event on the 17th that inflation "could get out of control."

During a Valentine's Day *WSJ* interview, George *said* that the Fed's "policy is out of sync with where we are. I don't think you can look at 7.5% inflation and a tight labor market and think that zero interest rates are the right calibration." She added: "I don't think I would rule out asset sales."

Mester *said* during a New York University virtual event: "I anticipate that it will be appropriate to move the funds rate up at a faster pace [than during the Great Recession] and to begin reducing the size of the balance sheet soon and more quickly than last time."

Bowman referenced both rates and the balance sheet during a *speech* in California on Monday: "My intent would be to take forceful action to help reduce inflation, bringing it back toward our 2 percent goal, while keeping the economy on track."

Waller implied at a conference on February 18 that the Fed's maximum-employment goal has been met, *saying*: "There have been clear improvements for less advantaged groups in terms of longer-term labor market trends."

(2) *Two possible doves.* At the same conference, New York Fed President John Williams qualified his support for raising rates in March, not wanting to see a hike as big as 50bps.

And a dove may wait in the wings: On July 1, the Boston FRB's interim leader Kenneth Montgomery will be *replaced* by Susan Collins, a PhD-trained economist who has *called* for raising the Fed's inflation target to 3.0% from 2.0%. However, Philadelphia Fed President Patrick Harker, generally viewed as a centrist on monetary policy, is acting as a substitute voter for the Boston leader as an FOMC alternate member until the new president is in place, *reported* the *WSJ.*

(3) *Three vacant heads.* Biden's five picks for Fed seats (including Jerome Powell, current chair, and Lael Brainard, now a sitting governor nominated for the vice chairwoman

position) *await* Senate confirmation. The appointments have been held up by staunch disagreements over Biden's pick for the dual lead supervisory and governor role, Sarah Bloom Raskin.

Republicans feel that Raskin's background as a climate activist could lead to "mission creep" at the Fed. The two other nominees are Michigan State University Professor Lisa *Cook* and Davidson College Professor Philip *Jefferson*. All three are presumed to be in the go-slower camp, but that remains to be determined.

(4) *Two Fed heads-in-chief.* Both Powell and Brainard seem to lean toward tightening, but perhaps more gradually than the Fed's hawks would have it. Brainard seems more focused lately on central bank *digital currencies* than monetary-policy setting but did say during a recent panel *discussion* that she anticipates it will be "appropriate at our next meeting to initiate a series of rate increases." Melissa and I interpret "a series" to mean that she may not be up for front-loading.

The last public comment Powell has made on monetary policy was during his January 11 confirmation hearing, when he leaned toward tightening soon depending on the path for inflation: "If we see inflation persisting at high levels longer than expected," we will "have to raise interest rates more over time." He added that if inflation "does become too persistent" and gets "entrenched in our economy," then "inevitably that will lead to much tighter monetary policy from us, and it could lead to a recession, and that would be bad for workers," *according* to the *NYT.* Powell will give his next official *policy updates* before Congress on March 2 and 3.

Calendars

US: Wed: MBA Mortgage Applications; Weekly Crude Oil Inventories. **Thurs:** Real GDP & GDP Price Deflator 7.0%/6.9%; PCE Headline & Core PCED (Q4) 6.4%/4.9%; Initial & Continuous Jobless Claims 235k/1.58m; New Home Sales; Kansas City Fed Manufacturing Index; Chicago Fed Manufacturing Index; Natural Gas Storage; Crude Oil Inventories; Mester; Waller. (Bloomberg estimates)

Global: Wed: Eurozone Headline & Core CPI 0.3%m/m/5.1%y/y & -0.8%m/m/2.3%y/y; Germany Gfk Consumer Climate -6.2; France Business Survey 112; UK Inflation Report Hearings; Tenreyro; Elderson. **Thurs:** France Business Confidence 100; UK Gfk Consumer

Confidence -18; McCaul; Schnabel; Bailey. (Bloomberg estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): Two of these three indexes had forward earnings at a record high last week. LargeCap's was at a record high for an eighth week after dropping for a week earlier due to index changes. MidCap's was at a record high for an 11th straight week after dropping 0.1% below at the end of November. SmallCap's dropped 0.1% from its record high a week earlier after being down as much as 0.6% during December due to index changes. In what has shaped up to be an extraordinary V-shaped recovery, LargeCap's forward earnings has risen during 87 of the past 91 weeks, with the down weeks due to Tesla's addition to the index in December 2020, Amazon's earnings shortfall last August, and index changes in September and December. MidCap's forward earnings is up in 85 of the past 89 weeks, and SmallCap's posted 84 gains in the past 90 weeks. Forward earnings for these indexes had been on an uptrend from November 2019 until February 2020, before tumbling to a bottom by June 2020 due to the Covid-19 economic shutdown. LargeCap's forward earnings has risen 61.8% from its lowest level since August 2017; MidCap's is now up 120.8% from its lowest level since May 2015; and SmallCap's has soared 181.4% from its lowest point since August 2013. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act but began to tumble in October 2018 as y/y comparisons became more difficult. In the latest week, the yearly rate of change in LargeCap's forward earnings improved to 28.7% y/y from 28.6%; that's down from a record-high 42.2% at the end of July. That's up from -19.3% in May 2020, which was the lowest since October 2009. The yearly rate of change in MidCap's forward earnings edged down w/w to 44.2% y/y from 44.3%; that's down from a record high of 78.8% at the end of May and compares to a record low of -32.7% in May 2020. SmallCap's rate dropped to 48.4% y/y from 50.5%; it's down from a record high of 124.2% in late June and up from a record low of -41.5% in June 2020. Companies have been beating consensus estimates quite handily since the Q2-2020 earnings season, causing analysts' y/y earnings growth forecasts for 2021 to improve instead of decline as is typical. Here are the latest consensus earnings growth rates for 2021 and 2022: LargeCap (49.2%, 8.1%), MidCap (84.6, 8.8), and SmallCap (123.1, 12.6).

S&P 500/400/600 Valuation (*link*): Valuations were mixed for these three indexes last week. LargeCap's forward P/E fell 0.3pt w/w to a 22-month low of 19.1. That's down from a six-month high of 21.5 in early November, and compares to its prior 11-month low of 20.3 in early October. LargeCap's forward P/E also compares to a 19-year high of 22.7 in early January and is up from 13.3 in March 2020, which was the lowest since March 2013. MidCap's fell 0.2pt to 14.4 from 14.6. That's up from a 22-month low of 14.3, and is down from a 13-week high of 17.1 in early November. That also compares to a seven-month high of 20.5 in March 2021 and is 8.4pts below its record high of 22.9 in June 2020. SmallCap's was steady w/w at 13.7, slightly above its 22-month low of 13.5 at the end of January. That's down from a 13-week high of 16.1 in early November and is now down 13.0pts from its record high of 26.7 in early June 2020 when forward earnings was depressed. During March 2020, MidCap's 10.7 and SmallCap's 11.1 were their lowest readings since March 2009. LargeCap's forward P/E in February 2020—before Covid-19 decimated forward earnings—was 18.9, the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E was below LargeCap's P/E yet again last week, as it has been for most of the time since August 2018. In contrast, it was last solidly above LargeCap's from April 2009 to August 2017; MidCap's current 24% discount to LargeCap is up from 25% a week earlier, which was its biggest since September 2000. SmallCap's P/E was below LargeCap's for a 78th week. That's the longest stretch at a discount since 1999-2002; SmallCap's current 28% reading has improved from 31% several weeks earlier, which was its biggest since February 2001. SmallCap's P/E had been mostly above LargeCap's since 2003. Looking at SmallCap's P/E relative to MidCap's, it was at a discount for a 34th straight week; SmallCap's current 5% discount to MidCap's is up from a 9% discount in December but remains near its lows during 2000-01.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Since the Q2-2020 earnings season—which came in substantially better than greatly reduced forecasts—analysts as a whole have been raising their consensus forecasts for all future quarters instead of lowering them as is the norm. Those gains endured through the latest Q4 earnings warnings season, when forecasts typically decline. The S&P 500's Q4-2021 earnings-per-share estimate rose 25 cents w/w to $53.88, and is up from $51.08 at the beginning of the quarter. That $53.88 estimate represents a gain of 26.5% y/y on a frozen actual basis and a 27.2% y/y gain on a pro forma basis. Q4 is on pace to mark the fourth straight quarter of double-digit percentage earnings growth, but growth is slowing for a second straight quarter. All 11 sectors are expected to post positive y/y earnings growth for a third straight quarter during Q4-2021, but double-digit growth is expected for only eight sectors; that's down from 10 sectors doing so during Q3. For Q1-2022, analysts expect S&P 500 earnings growth to weaken to 5.3% y/y on a frozen actual basis and 7.0% on a proforma basis. Double-digit growth is expected for just five sectors in Q1-2022 and three are expected to record a y/y decline. Here are the S&P 500 sectors' latest earnings growth rates for Q1-2022 versus their blended Q4-2021 growth rates: Energy (190.5% in Q1-2022 versus 11,180.4% in Q4-2021), Industrials (38.8, 40.6), Materials (34.7, 64.1), Real Estate (14.5, 14.9), Health Care (11.4, 23.8), Information Technology (7.6, 23.3), Utilities (7.1, 1.6), S&P 500 (7.0, 27.2), Consumer Staples (3.2, 4.6), Consumer Discretionary (-2.2, 11.9), Communication Services (-3.1, 15.7), and Financials (-19.1, 8.3).

US Economic Indicators

Consumer Confidence (*link*): "Concerns about inflation rose again in February, after posting back-to-back declines. Despite this reversal, consumers remain relatively confident about short-term growth prospects," said Lynn Franco, senior director of economic indicators at The Conference Board. "While they do not expect the economy to pick up steam in the near future, they also do not foresee conditions worsening. Nevertheless, confidence and consumer spending will continue to face headwinds from rising prices in coming months," she warned. Consumer confidence slumped for the second month to 110.5 in February, after climbing steadily from 109.8 in September to 115.2 by December, as the expectations component moved south. Consumer expectations fell for the second month to 87.5, after rebounding from 86.7 in September to 95.4 by the end of the year, while the present situation component ticked up slightly from 144.5 last month to 145.1 this month; it has been moving sideways the past five months. Consumers' appraisal of current business conditions and their appraisal of the labor market both were mixed in February. The percentage of consumers saying conditions are "good" fell to 18.7% this month, after improving from 17.9% in November to 20.0% in January, while the percentage saying conditions are "bad" fell to a six-month low of 24.7% from 27.4% in January. As for the labor market, the percentage of consumer saying jobs are "plentiful" dropped for the second month to 53.8% after rising from 54.8% in October to 55.9% by December—though this month's percentage is not far from September's record high of 56.5%. The percentage saying jobs are "hard to get" fell from 12.0% to 11.8% this month—not far from its record low of 9.6% posted during the summer of 2000. Meanwhile, the percentage of consumers expecting business conditions to improve fell from 25.6% in November to 23.4% this month; it was at a record high 42.5% in May 2020. Those expecting business conditions to worsen eased from 19.7% to 18.1% this month; it was at a recent low of 11.1% last March.

Regional M-PMIs (*link*): Three Fed districts (New York, Philadelphia, and Richmond) now have reported on manufacturing activity for February and show the manufacturing sector slowed for the third month. The composite index (to 6.7 from 10.2) slumped to a 21-month low this month and was roughly one-quarter November's pace. Both New York (to 3.1 from -0.7) and Richmond (1.0 from 8.0) composite measures show their regions' manufacturing activity at a near standstill in February, while growth in the Philadelphia (16.0 from 23.2) region lost steam—though remained at a respectable level. The new orders (4.2 from 6.3) measure remained weak, considerably below its recent high of 27.1 in November. The Richmond (-3.0 from 6.0) area showed a slight contraction in manufacturing growth this month, while New York's (1.4 from -5.0) moved from contraction to expansion, though barely. New orders growth in the Philadelphia (14.2 from 17.9) area slowed a bit this month—considerably below November's 47.4. Jobs (25.1 from 15.4) growth remained at a relatively healthy rate in February, with growth picking up all three regions—Philadelphia (32.2 from 26.1), New York (23.1 from 16.1), and Richmond (20.0 from 4.0) regions—and Philly's back near its record high of 33.9 in December.

Regional Prices Paid & Received Measures (*link*): We now have prices-paid and -received data for February from the Philadelphia, New York, and Richmond regions. (Note: The Philadelphia and New York measures are diffusion indexes, while Richmond's measures are average annualized inflation rates—which we multiply by 10 for easier comparison to the other regional measures). The prices-paid measures eased in all three regions this month: Richmond's (to 122.7 from 143.2) slowed from January's record high; New York's moved slightly lower for a third month from 83.0 in November to 76.6, just south of May 2021's record high of 83.5; and Philadelphia's eased to 69.3 in February from last June's cyclical high of 80.7. Meanwhile, New York's (54.1 from 37.1) prices-received index shot up to a new record high in February, while Richmond's (87.7 from 112.7) slowed from January's record high. Philadelphia's was little changed at 49.8 this month, down from November's 62.9—which was close to its record high of 63.8 in the mid-1970s.

Global Economic Indicators

US PMI Flash Estimates (*link*): Private-sector growth gained momentum this month as companies "reported a notable recovery in demand from Covid-related disruptions at the start of the year," according to the report. February also saw an acceleration in both input and output prices. February's C-PMI recovered to 56.0 after dropping from 57.6 in October to an 18-month low of 51.1 last month. The service sector led this month's gain, with the NM-PMI rebounding 5.5 points (to 56.7 from 51.2), while the M-PMI climbed 2.0 points (57.5 from 55.5), boosted by stronger gains in output and new orders—though the supplier delivery times index continued to inflate the index somewhat. The report notes that both sectors recorded stronger expansions in output, with "companies linking growth to substantial gains in new business, employees returning from sick leave, increased travelling and greater availability to raw materials." Inflationary pressures intensified, with firms' costs rising at another near-record pace, and companies passing these costs onto their customers—resulting in the biggest increase in average prices charged in the history of the survey.

Eurozone PMI Flash Estimates (*link*): Growth in the Eurozone accelerated sharply in February, according to flash estimates, and prices rose at a record rate. A relaxing of Covid-19 restrictions pushed the Eurozone's C-PMI up 3.5 points (biggest monthly gain since March 2021) to 55.8, after a rise in Covid-19 infections—associated with the Omicron variant—pushed it down from 55.4 last November to 52.3 by January. A big rebound in the service sector accounted for this month's jump in the C-PMI, with the NM-PMI shooting up 4.7 points to 55.8 this month, following a two-month slide of 4.8 points to 51.1 in January. The M-PMI (to 58.4 from 58.7) was little changed at a robust rate. By country, growth was especially strong in France, with the C-PMI (57.4 from 52.7) climbing to an eight-month high, boosted by a big jump in the NM-PMI (57.9 from 53.1) to a 49-month high. France's M-PMI (57.6 from 55.5) also contributed, picking up to a seven-month high. The service sector also pushed growth higher in Germany, with its NM-PMI (56.6 from 52.2) accelerating to a six-month high, while the M-PMI (58.5 to 59.8) slowed a bit from January's rapid rate—though continued to outpace the service sector. Meanwhile, the report notes that growth in the rest of the region, as a whole, continued to lag behind the two biggest economies, though did show strong growth in February, after stalling in January.

Japan PMI Flash Estimates (*link*): "Private sector output falls sharply amid Omicron wave," was the headline of Japan's flash report. Activity contacted at is fastest pace since June 2020, as the Omicron variant of Covid-19 led to record case numbers and renewed restrictions. The C-PMI contracted for the second month to 44.6 in February from 49.9 in January and 52.5 at the end of 2021—with both the service and manufacturing sectors contracting. The NM-PMI sank to a 21-month low of 42.7 this month from 47.4 and 52.1 the prior two months, while the M-PMI showed slower growth in the manufacturing sector, easing from 55.4 in January to a five-month low of 52.9 in January—though manufacturers signaled a reduction in output for the first time in five months.

Germany Ifo Business Climate Index (*link*): "The German economy is betting on an end to the coronavirus crisis," Ifo said in a statement. "However, the escalation of the crisis engulfing Ukraine remains a risk factor." Ifo's business climate index advanced the first two months of this year, to 98.9 in February, after sliding the last six months of 2021 from 101.7 in June to 94.8 by December. The expectations component drove the gain, climbing 6.5 points the first two months of this year to 99.2, after falling steadily from 103.1 last June to 92.7 in December. The current situation improved for the first time since August, climbing to 98.6, after sliding the prior five months, from 101.7 to 96.2. The manufacturing sector (to 23.5 from 20.0) improved again in February, with both the present situation (35.7 from 32.0) and expectations (11.9 from 8.6) measures moving higher. The service sector (13.5 from 7.7) also improved noticeably, with its present situation (19.1 from 13.4) and expectations (8.1 from 2.2) components also moving higher; the latter had dipped into negative territory at the end of last year. Sentiment in the construction sector (8.3 from 8.0) barely budged this month, as an improvement in current conditions (33.6 from 33.0) offset a deterioration in expectations (-14.2 from -11.9). The business climate in the trade sector (6.6 from -1.3) moved from negative to positive, though both wholesalers and retailers continue to report supply bottlenecks.

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