MORNING BRIEFING
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Inflated Economy

Check out the accompanying chart collection.

Executive Summary: Inflation is inflating corporate revenues: All 11 sectors of the S&P 500 boast rising forward revenues ytd, eight of them to record highs. It's also inflating nominal economic growth even as real economic growth slows. This is bullish for earnings provided that companies can keep offloading higher costs to customers via pricing and provided that no recession comes along to stop that. … Also: We review the latest economic releases, which jibe with our stagflationary outlook for 2022. … And: The global food crisis. Food shortages and food inflation are bound to worsen, with dire implications for poorer nations around the world.

Strategy: Inflating Revenues. Inflation is inflating business revenues. This is most apparent in the monthly series on manufacturing and trade sales (M&TS) that comes out at the same time of the month as retail sales but lagging it by a month. In other words, March retail sales was released on April 14; at the same time, February's M&TS was released. The inflation-adjusted M&TS series is available through January. Now consider the following developments:

(1) *Nominal and real.* M&TS rose 15.4% y/y in nominal terms but only 1.0% y/y in real terms through January (*Fig. 1*). Over this same period, the price deflator for M&TS rose 14.3% (*Fig. 2*).

Inflation clearly has boosted the nominal value of the three components of business sales. Here are the y/y percentage increases of the three in nominal terms and real terms through January: manufacturing (11.0%, -5.1%), wholesale sales (22.5, 6.3), and retail sales (12.2, 1.1) (*Fig. 3* and *Fig. 4*). Over this same period, their respective price deflators rose 16.7%, 14.8%, and 11.0% (*Fig. 5*).

(2) *S&P 500 revenues.* The y/y growth rates of quarterly S&P 500 aggregate revenues and monthly M&TS sales are very highly correlated (*Fig. 6*). Keep in mind that the former includes goods producers, goods distributors, and services providers, while the latter includes only producers and distributors of goods. Yet their growth rates have been nearly identical since 2005. Before then, they were still relatively close.

We've found that weekly S&P 500 forward revenues per share closely tracks the quarterly S&P 500 revenues-per-share series (*Fig. 7*). The former continued to rise to a new record high during the April 14 week, implying that the quarterly series probably also rose to a new record high during Q1 and began Q2 headed for yet another record high.

(3) *Good tracker.* How can this be when there's lots of evidence that the US and global economies are slowing? The weekly proxy for S&P 500 revenues per share has been an accurate indicator of economic growth and very useful for us. It accurately indicated the past two recession bottoms. It correctly traced the contours of the economic recovery and expansion following the 2008 recession. Now it's showing nominal economic growth rising apace, its mojo fueled by inflation as real economic growth slows.

We can see this in the weekly data showing analysts' consensus estimates for S&P 500 revenues growth (*Fig. 8*). The estimate for 2021 started the year at 8.1%, but the actual result came in at 16.2%. The 2022 estimate for revenues growth at the beginning of this year was 7.5%, and it is already up to 9.8% through the April 14 week. In both cases, most of the upward revisions were driven by higher-than-expected inflation.

The y/y growth rate in monthly S&P 500 forward revenues per share is highly correlated with the comparable growth rate of the actual quarterly revenues series (*Fig. 9*). The former was up 16.0% through April, implying that Q1's revenues growth might closely match the 15.2% growth rate of Q4.

(4) *Bullish for earnings.* All the above is bullish for earnings as long as there is no recession anytime soon and as long as the profit margin of the S&P 500 isn't squeezed by costs that they can't pass onto customers through their selling prices. They seem to be passing higher costs along to customers just fine so far, as the weekly series for the forward profit margin of the S&P 500 has been edging up to new high ground above 13.0% since the start of the year (*Fig. 10*).

Sure enough, the forward earnings of the S&P 500 rose to yet another record high during the April 21 week (*Fig. 11*). Industry analysts are projecting that S&P 500 earnings will grow 9.7% and 10.1% in this year and next year (*Fig. 12*).

(5) *S&P 500 sectors.* The forward revenues of all 11 sectors of the S&P 500 have been rising so far this year (*Fig. 13*). Rising to new record highs during the April 14 week were all but Communication Services, Energy, and Utilities.

Here is the performance derby of the y/y increases in the forward revenues of the 11 sectors: Energy (47.6%), Materials (22.1), Industrials (18.0), Information Technology (18.0), Real Estate (16.2), Consumer Discretionary (16.1), S&P 500 (16.0), Communication Services (12.8), Consumer Staples (11.3), Health Care (10.8), Financials (10.3), and Utilities (8.1). (See Table 1R in our *Performance Derby: S&P 500 Sectors & Industries Forward Earnings & Revenues*.)

US Economy: More Stagflationary Indicators. The latest batch of economic indicators is consistent with our stagflationary outlook for 2022. We are expecting higher-for-longer inflation (6.0%-7.0% PCED inflation during H1 and 4.0%-5.0% during H2) with slow real GDP growth around 2.0%. Here are the latest indicators:

(1) *GDPNow.* The *Atlanta Fed's GDPNow* tracking model shows real GDP for Q1 rising only 0.4% (saar) as of April 26.

(2) *Durable goods orders.* March's nondefense durable goods orders rose 10.2% y/y during March to yet another record high. However, according to the Conference Board's inflation-adjusted series, which is included in the Index of Leading Economic Indicators, it was up only 2.3% y/y (*Fig. 14*). Again, inflation is inflating many of the economic indicators.

(3) *Regional business surveys.* Four of the five regional business surveys conducted during April by the Federal Reserve Banks are available for Dallas, New York, Philadelphia, and Richmond. The averages of their composite indexes and their orders indexes rose to readings consistent with moderate economic growth (*Fig. 15* and *Fig. 16*). The average of their employment indexes remained high (*Fig. 17*).

Meanwhile, there's no relief on the inflation front as the averages for both the prices-paid and prices-received indexes remained elevated (*Fig. 18*).

Global Inflation: Food for Thought. Urgent action is needed on food security, according to an April 13 *statement* issued jointly by the World Bank, International Monetary Fund, World Trade Organization, and United Nations World Food Program. "Sharply higher prices for staples and supply shortages are increasing pressure on households worldwide and pushing millions more into poverty," the global organizations said.

Indeed, prices are rising for critical agricultural products from already elevated levels. Wheat futures prices recently hit a record high and remain elevated (*Fig. 19*). Soybean futures prices are near the highest levels seen in about a decade (*Fig. 20*). Corn futures prices

recently returned to near records (*Fig. 21*). For each percentage-point increase in food prices, 10 million people are thrown into extreme poverty worldwide, the World Bank estimates. A recent *FT* *article* cited World Bank predictions that the proportion of household income spent on food in Asia and Africa will rise over the next year from 20% to 30%.

The prices of agricultural products began to surge in 2020, when Covid-19 disrupted the global labor supplies and factory production worldwide. Before that problem has resolved itself, recent lockdowns in China, especially Shanghai, are shocking global supply systems further. Russia's war on Ukraine has exacerbated the upward price pressure on food products; the two countries produce around 12% of all calories consumed in the world, according to a *Spiegel International* *article*. Additionally, droughts in many areas of the globe have worsened the food shortages resulting from the pandemic and war. And many countries are compounding the problem by *tightening* export restrictions, fearing food shortages at home.

But those aren't even all the factors contributing to the global food shortages and soaring food prices. Here's more detail on the reasons behind the global food crisis:

(1) *War on wheat.* Before the war, Russia and Ukraine accounted for nearly 30% of world wheat exports. Their combined wheat production is expected to drop in 2022 due to lack of access to resources for crops. *Spiegel* published alarming images showing the destruction of food supplies, including photos of a rocket that had slammed into a storage facility containing 68,000 tons of corn, hundreds of cattle starving to death in a stall located in occupied territory, and the burning of a grain silo full of 30,000 tons of wheat. "Tons of grain is sitting unused in storage facilities because of a lack of fuel or because roads are unusable, and ports are blocked," the article added.

Now that this supply has been cut, a "shockwave can be felt in many areas of the world including the Horn of Africa and the Middle East. Fewer deliveries are arriving in countries like Lebanon, Egypt and Yemen, which import almost all of their cereals from Ukraine and Russia. Prices could now explode."

In addition to wheat, Russia and Ukraine export substantial amounts of corn, oats, and barley, according to the International Trade Centre, *observed* CNN. "These grains go into everything from breakfast cereal to bread, pasta and corn syrup, which sweetens beverages. Further, they provide feed for animal stocks, meaning inflation for proteins, like chicken or pork, will also continue to rise."

(2) *Veggie oil shortage.* Russia and Ukraine both are big producers of sunflower oil. Together, they account for about two-thirds of global sunflower oil trade, which makes up about 15% of world trade among the major vegetable oils (palm, sunflower, soybean, and rapeseed). With sunflower oil exports suffering the woes of war, demand has increased for the alternative vegetable oilseeds.

(3) *Burning food for fuel.* The Biden administration bid up the price of corn futures when it *said* that the Environmental Protection Agency would allow the sale of gasoline blended with increased levels of ethanol through the summer. The intent is to offset some of the price increases in natural gas resulting from shortages due to the war in Ukraine.

Ethanol is made from a byproduct of corn. So tempered prices at the pump may come at the expense of higher prices for corn eaten by livestock and humans, reflecting the higher overall corn demand. By the way, Ukraine is responsible for about 15% of global corn exports.

(4) *Fertilizer needs gas.* The surge in the cost of natural gas, a key ingredient of nitrogenous fertilizer, also is exacerbating the rising price of food. Major food producers and exporters rely heavily on fertilizer imports.

In its joint statement, the World Bank urged countries to avoid restrictive measures such as export bans on food or fertilizer. Even in the absence of sanctions, however, "[n]obody wants to touch a Russian product right now," said Deepika Thapliyal, a fertilizer expert at Independent Commodity Intelligence Services, *according* to CNN. "Countries without domestic fertilizer production may also struggle to access it, with huge consequences for the global food system," the article noted.

(5) *Not enough water.* Drought is a major risk component to food insecurity in southern Africa, western Asia, and central Asia, according to a *report* by the United Nations' Intergovernmental Panel on Climate Change 2022. Soybean futures had been rising since late last year as a drought caused key exporter South America to curb production, Reuters reported.

The North American "drought will very likely persist through 2022, matching the duration of the late-1500s megadrought," estimated an *analysis* published in *Nature Climate Change*. Facing extreme to exceptional droughts, some US agricultural producers are being denied loans for lack of a sustainable water plan, reported *Forbes* in an April 21 *article*. As a result, many farmers who can't get enough access to water are going out of business or focusing

on high-value products, further boosting prices.

Calendars

US: Wed: Goods Trade Balance; Wholesale Inventories; Pending Home Sales -1.5%; Crude Oil Inventories; MBA Mortgage Applications. **Thurs:** Real GDP & GDP Price Index 1.1%/7.3%; Core PCED 5.4%; Kansas City Fed Manufacturing Index; Initial & Continuous Jobless Claims 180k/1.403m; Natural Gas Storage. (Bloomberg estimates)

Global: Wed: Germany Gfk Consumer Climate -16.0; France Consumer Confidence 92; Italy Trade Balance; Japan Retail Sales 0.4%; BOJ Rate Decision -0.10%; Lagarde; Beerman; Rogers. **Thurs:** Eurozone Business & Consumer Survey 108.0; Eurozone Consumer Confidence -16.9; Germany CPI 0.6%m/m/7.2%y/y; Italy Business & Consumer Confidence 110.0/100.4; Spain Unemployment Rate 14.2%; China Caixin M-PMI 50.0; Japan Housing Starts -0.5%; BOJ Press Conference; ECB Economic Bulletin; Guindos; McCaul. (Bloomberg estimates)

Strategy Indicators

S&P 500 Q1 Earnings Season Monitor (*link*): With 27% of S&P 500 companies finished reporting revenues and earnings for Q1-2021, revenues are beating the consensus forecast by 2.5%, and earnings have exceeded estimates by 9.5%. We expect these figures to change markedly going forward because early reporters in Energy are boosting the revenue surprise by 1.0% and companies in the Financials sector are dragging down y/y earnings growth. At the same point during the Q4 season, revenues were 1.7% above forecast, and earnings beat by 3.0%. For the 135 companies that have reported Q1 earnings through mid-day Tuesday, the aggregate y/y revenue and earnings growth rates have slowed considerably from their double-digit percentage readings from Q2-2021 to Q4-2021. The current sample of Q1 reporters so far collectively has a y/y revenue gain of 11.2% and an earnings gain of just 3.6%. While just 71% of the Q1 reporters so far has reported a positive revenue surprise, 79% has beaten earnings forecasts. However, fewer companies have reported positive y/y earnings growth in Q1 (61%) than positive y/y revenue growth (80%). We expect to see revenue and earnings surprises moderate q/q due to missed deliveries, higher costs, and increased company guidance ahead of the earnings season.

US Economic Indicators

Consumer Confidence (*link*): Consumer confidence dipped a bit this month, from 107.6 in March to 107.3; it had tumbled 9.5 points (to 105.7 from 115.2 in December) the first two months of this year. This month saw an uptick in the expectations component (77.2 from 76.7), though it was little changed from March's level, which was the lowest since February 2014. Meanwhile, the present situation component (152.6 from 153.8) was also little changed—though not far from its recent peak of 159.6 in mid-2021. Consumers' appraisal of current business conditions was mixed in April, with the percentage saying business conditions are good (to 20.8% from 19.6%) moving slightly higher and the percentage saying conditions are bad (21.9 from 21.4) likewise moving slightly higher. The current appraisal of the labor market was less upbeat, though very strong: The percentage saying jobs plentiful (55.2 from 56.7) edged down from March's record high, while the percentage saying jobs are hard to get (10.6 from 9.6) was only a percentage point above the record low seen in both March and during summer 2000. Looking at expectations six months from now, it was also a mixed bag, with the percentage expecting better business conditions (18.1 from 19.0) edging lower and the percentage expecting business conditions to worsen (21.8 from 24.1) also down. Consumers were less optimistic about the short-term outlook for the labor market, with the percentage of consumers expecting more jobs to be available (17.4 from 17.6) edging lower, the percentage expecting fewer jobs (18.9 from 18.0) edging higher, and the vast majority (60.1%) expecting things to remain the same. Lynn Franco, senior director of economic indicators at The Conference Board, noted "purchasing intentions are down overall from recent levels as interest rates have begun rising. Meanwhile, concerns about inflation retreated from an all-time high in March but remained elevated. Looking ahead, inflation and the war in Ukraine will continue to pose downside risks to confidence and may further curb consumer spending this year."

Durable Goods Orders & Shipments (*link*): Core capital goods orders and shipments both reached new record highs again in March. Nondefense capital goods shipments excluding aircraft (used in calculating GDP) has climbed every month but one since its April 2020 bottom, rising 0.2% in March and 34.2% over the period. Meanwhile, core capital goods orders (a proxy for future business investment) rebounded 1.0% in March, more than reversing February's 0.3% loss—which was only the second decline since its April 2020 bottom; it has climbed 34.9% since that bottom. Orders for total durable goods rebounded 0.8% last month, after slumping 1.7% in February, which was its first decline in five months, led by gains in bookings for communications equipment (7.0%), motor vehicles & parts

(5.1), electrical equipment (3.9), and machinery (0.7). Orders for electrical equipment reached a new record high in March, while those for motor vehicles & parts and machinery were within 0.3% and 2.3% of new record highs. Excluding transportation, durable goods orders recovered 1.1% in March—to a new record high—after slipping 0.5% in February, which was only its second decline in 22 months. These orders are up 38.8% since their April 2020 bottom.

Regional M-PMIs (*link*): Four Fed districts (New York, Philadelphia, Dallas, and Richmond) now have reported on manufacturing activity for April and show growth accelerated for the third month to 14.3 this month, after easing from 23.1 in November to 8.1 at the start of this year. Growth in the New York (to 24.6 from -11.8) region moved from contraction to expansion in April, while the Philadelphia (17.6 to 27.4) area saw slower though still robust growth; activity in the Richmond (14.0 from 13.0) area continued at a steady pace. Meanwhile, manufacturing in the Dallas (1.1 to 8.7) region was at a near standstill. New orders (15.3 from 8.8) picked up steam this month, expanding at nearly double March's pace, also led by a swing in New York (25.1 to -11.2) orders growth from contraction to expansion. Billings in the Dallas (12.1 from 10.5) region showed a slight acceleration, while growth in the Philadelphia (17.8 from 25.8) and Richmond (6.0 from 10.0) areas eased, though Philadelphia's was the second strongest in the group behind New York. Meanwhile, jobs growth (23.8 from 25.5) continued at a healthy pace, with factory hirings in the Philadelphia (41.4 from 38.9) region accelerating at a record rate and those in the Dallas (24.6 from 25.5) and Richmond (22.0 from 23.0) areas holding at a steady robust pace. Factories in the New York (7.3 from 14.5) region grew jobs at half March's pace and one-third of recent highs.

Regional Prices Paid & Received Measures (*link*): We now have prices-paid and -received data for April from the Philadelphia, New York, Richmond, and Dallas regions. (Note: The Philadelphia, New York, Kansas City, and Dallas 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 measure in the New York (to 86.4 from 73.8) area shot up to a new record high in April, while Philadelphia's (84.6 from 81.0) accelerated at its fastest pace since 1979—closing in on its record high of 91.1 during March 1974. Dallas' prices-paid (61.5 from 74.0) measure has eased from November's record-high 83.3, while Richmond's (118.3 from 110.5) ticked up this month, though is down from its record high of 143.2 at the start of this year. Turning to the prices-received measures, New York's (49.1 from 56.1) slowed this month from March's record high, while Philadelphia's (55.0 from 54.4) accelerated for the third month, moving back toward November's 62.9, which was close to its record high of 63.8 in the mid-

1970s. Dallas' prices-received measure (43.5 from 47.8) followed a trend similar to that of its prices-paid measure, easing from its record high of 50.9 in October, while Richmond's eased to 89.3 this month after shooting up to a record-high 112.7 in January.

New Home Sales (*link*): New home sales (counted at the signing of a contract) dropped in March for the third month after a strong finish in 2021, as soaring mortgage rates and home prices reduced affordability. New home sales plunged 8.6% in March and 12.4% over the three months through March to 763,000 units (saar). (Revisions saw February sales revised up to 835,000—initially reported at 775,000 units.) Sales peaked at 993,000 units in January 2021, which was the highest since the end of 2006. Of the 763,000 homes sold during March, only 179,000 were completed, while 329,000 were under construction and 255,000 were yet to be started. Meanwhile, there were 407,000 new homes for sale at the end of March (the highest since August 2008)—though only 35,000 units were completed, with 267,000 units under construction and 105,000 units yet to be started. At the current sales pace, it would take 6.4 months to run through the supply of new homes, compared with 4.2 months' supply in March 2021. Data for April show builders' confidence fell for the fourth time this year, from 84 at the end of 2021 to a seven-month low of 77 this month. Builders remain challenged by rising mortgage rates and supply-chain problems—which are boosting housing construction costs. "Policymakers must take proactive steps to fix supply chain issues that will reduce the cost of development, stem the rise in home prices and allow builders to increase production," noted NAHB Chairman Jerry Konter. Here's a look at the ytd changes in the three components of NAHB's Housing Market Index: traffic of prospective homebuyers (-11 points to 60 in April), current sales (-5 points to 85), and future sales (-12 points to 73, albeit with a 3-point gain this month).

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