MORNING BRIEFING
July 25, 2022

Anatomy Of A Mid-Cycle Slowdown

Check out the accompanying chart collection.

Executive Summary: Investors still have plenty to fear. But our earnings and economic data analyses plus recent stock market action tend to support our relatively constructive outlooks for the economy and stock market (especially relative to the fears). … Specifically, we think the S&P 500 likely hit its bear-market low of 3666 on June 16 and will remain range bound between 3666-4150 pending economic improvement; the peaking of inflation should limit further valuation downside. … As for the economy, we think it's undergoing a mid-cycle slowdown that could flatten expected earnings growth—but not a conventional recession that causes earnings to tank.

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Strategy I: Time To Be Less Afraid? Sentiment indicators continue to show that fear is rampant in the equity markets. That's because there have been lots of fearsome developments since the start of the pandemic, including the global spread of Covid, supply-chain disruptions, Russia's invasion of Ukraine, the persistence of inflation, and increasingly hawkish central bankers. This litany of woes adds up to increasing risks of a global recession. That's triggered a significant drop in valuation multiples in global stock markets and fears that the second shoe, i.e., aggregate corporate earnings, is about to drop.

The fears have included apocalyptic ones, mostly associated with the war in Ukraine. At the start of the war, Russian President Vladimir Putin implied that he would not rule out using nuclear tactical missiles. Russia's blockade of Ukrainian ports on the Black Sea halted the country's grain exports, causing food prices to soar and raising fears of famine and social upheaval, particularly in Africa. The war also reduced the availability of Russian fertilizer, also heightening the risk of a global food shortage. Now, there is mounting concern that Russia will shut off gas supplies to its customers in Western Europe during the winter with dire consequences for the region's people and industry. The war has united the NATO nations, but it is also uniting an Axis of Evil including Russia, China, and Iran. And now we have new variants of Covid and even Monkeypox to worry about.

Notwithstanding all that, there is some good news (maybe) on a few of these fronts:

(1) *Russian gas.* An *article* posted July 22 by BBC News reported: “Russia has resumed pumping gas to Europe through its biggest pipeline after warnings it could curb or halt supplies altogether. The Nord Stream 1 pipeline restarted following a 10-day maintenance break but at a reduced level. On Wednesday, the European Commission urged countries to cut gas use by 15% over the next seven months in case Russia switched off Europe’s supply. Russia supplied Europe with 40% of its natural gas last year. Germany was the continent’s largest importer in 2020, but has reduced its dependence on Russian gas from 55% to 35%.”

(2) *Ukrainian grain.* An *article* posted July 22 by *NYT* reported: “After three months of talks that often seemed doomed, Russia and Ukraine signed an agreement on Friday to free more than 20 million tons of grain stuck in Ukraine’s blockaded Black Sea ports, a deal with global implications for bringing down high food prices and alleviating shortages and a mounting hunger crisis. Senior United Nations officials said that the first shipments out of Odesa and neighboring ports were only weeks away and could quickly bring five million tons of Ukrainian food to the world market each month, freeing up storage space for Ukraine’s fresh harvests.”

Nevertheless, the article warned: “It remains to be seen whether the deal works as planned. With each side deeply suspicious of the other, there will be plenty of chances for the agreement to break down.” Sure enough, on Saturday, Russian missiles hit Odesa, just one day after Ukraine and Russia agreed on the deal that would allow the resumption of vital grain exports from the region.

(3) *Checks and balances.* A major contributor to the jump in the inflation rate since March 2021 was the Biden administration’s American Rescue Plan. It provided a third round of Economic Impact Payments, which stimulated a demand shock in the US that overwhelmed global supply chains. Senator Joe Manchin (D-WV) voted for the stimulus package. But now the senator has been accused by many in his party of sabotaging the President’s agenda. Manchin is most concerned about the inflationary consequences of additional government spending. Without his support, the Democrats don’t have the votes they need for the additional spending programs championed by Biden. The Founding Fathers based our government on a constitutional system of checks and balances, which continues to work relatively well.

Strategy II: The Current Earnings Reporting Season. While investors have plenty left to worry about, their main concern currently is focused on the current Q2-2022 earnings reporting season and company managements' earnings guidance for the rest of the year.

The S&P 500 fell 0.9% on Friday on disappointing earnings news from Snap. Its shares plunged by more than a third on Friday as reports of the social-media company's weakest-ever quarterly sales growth fanned fresh concerns about a slowdown in the digital advertising industry. The S&P 500 Communication Services sector fell 4.3%, and the Information Technology sector lost 1.4% (*Table 1*). Nevertheless, the S&P 500 is up 8.0% from its recent bottom of 3666.77 on June 16 through Friday's close of 3961.63 (*Table 2*). It is now down 17.4% from its record high on January 3.

The fear is that this rebound is an unsustainable short-covering rally in a bear market because analysts are just starting to reduce their earnings estimates for the rest of this year and next year to reflect weakening economic growth. But Joe and I still think that June 16's low could turn out to be *the* low for the latest bear market, a case we made a week ago in the July 18 *Morning Briefing*. Our basic premise is that inflation is peaking, and so is the 10-year US Treasury bond yield, so there shouldn't be much more downside risk in valuation multiples.

So what about earnings risk? We believe that the economy is in the midst of a mild recession (a.k.a. a mid-cycle slowdown), which suggests that downward earnings revisions should flatten forward earnings—whereas in a conventional recession, forward earnings would tank. As a result, the S&P 500 could meander in a trading range for several months, say between 3666 and 4150, before moving higher, possibly to a new record high in late 2023. Needless to say, lots could go wrong to subvert this scenario, as we reviewed a week ago. But for now consider the following:

(1) Q*uarterly consensus estimates for S&P 500.* The Q2-2022 earnings reporting season started at the beginning of this month and will end around mid-August. So far, the S&P 500's blended earnings, combining actual reported results and estimated ones, edged down during the July 14 week but remains relatively flat since the end of the previous earnings season (*Fig. 1*). However, Q3 and Q4 estimates have been cut slightly over the past four weeks, reflecting weaker guidance. The same can be said about the S&P 400's and S&P 600's estimates for the next two quarters. The growth rate of Q2's S&P 500 earnings is currently expected to be 4.5%, down from the 5.2% estimate during the July 7 week (*Fig. 2*).

(2) *Annual consensus estimates for S&P 500.* Analysts' consensus expectations for S&P 500 revenues during 2023 and 2024 remained on solid uptrends through the July 14 week

(*Fig. 3*). So forward revenues, the time-weighted average of the two, remained near a record high that week. On the other hand, forward earnings may be starting to flatten out after rising to a record high during the June 16 week, as 2023 and 2024 earnings estimates are just starting to look toppy.

The consensus analysts' data so far suggest that they still aren't seeing a recession, since their revenues estimates continue to rise. Rather, they are finally seeing reasons to be concerned about profit margins. They've been lowering their 2022 and 2023 profit margin estimates since the start of this year and only now is that starting to weigh on the forward profit margin.

(3) *Annual consensus estimates for S&P 500 sectors.* Joe has put together a handy-dandy chart publication, *Revenues, Earnings, & Profit Margin Squiggles*. Flipping through it, we see the following ytd percent changes in the forward revenues, forward earnings, and forward profit margins, respectively, of the 11 sectors of the S&P 500 (sorted by magnitude of margins' percent changes):

Energy (33.5%, 75.4%, 31.4%), Real Estate (5.1, 16.9,11.2), Information Technology (6.9, 7.7, 0.7), Industrials (8.2, 8.6, 0.4), Financials (5.0, 4.6, -0.4), S&P 500 (7.6, 7.7, -0.5), Materials (10.3, 8.2, -1.9), Consumer Staples (5.0, 1.9, -3.0), Health Care (4.5, 0.4, -4.0), Communication Services (4.3, 0.2, -4.0), Utilities (10.0, 4.1, -5.3), and Consumer Discretionary (4.9, -0.6, -5.2). Seven of the sectors are showing margin compression since the start of this year.

(See also Tables 2R and 2E in our *Performance Derby: S&P 500 Sectors & Industries Forward Earnings & Revenues* and Table 7 in our *Performance Derby: S&P 500 Sectors & Industries Forward Profit Margin*.)

US Economy: Less Growth, Maybe Less Inflation Too. The S&P 500 composite includes corporations that produce goods and services. The earnings of goods producers tend to fluctuate along with the business cycle, while those of the services producers do so as well but with less amplitude. That explains why the y/y growth rates of S&P 500 revenues per share and operating earnings per share are highly correlated with the M-PMI, the manufacturing purchasing managers index compiled monthly by the Institute for Supply Management (*Fig. 4* and *Fig. 5*). Consider the following:

(1) *M-PMI, revenues & earnings*. The M-PMI peaked at a cyclical high of 63.7 during March 2021, falling to 53.0 during June. The revenues growth rate peaked at 21.8% during Q2-

2021. It was down to 13.6% during Q1-2022, which wasn't as weak as suggested by the M-PMI because inflation has been boosting revenues over the past year.

S&P 500 operating earnings growth peaked at 88.6% during Q2-2021, much more than suggested by the coincident peak in the M-PMI because profit margins tend to rebound more when the M-PMI is rising than when it is falling. Earnings growth fell to 11.8% y/y during Q1-2022.

(2) *Flash PMIs.* On Friday, S&P Global released July flash estimates for the US M-PMI and NM-PMI, which is the purchasing managers index of the nonmanufacturing sector (*Fig. 6* and *Fig. 7*). Not surprisingly, they tend to track the ISM's versions of these two indexes relatively closely.

July's S&P Global M-PMI for the US edged down from 52.7 in June to 52.3 in July. The drop in the comparable NM-PMI from 52.7 in June to 47.0 in July was surprisingly weak. On balance, Debbie and I believe that these numbers are consistent with our mid-cycle slowdown outlook (with 55% odds of a mild recession and 25% odds of a growth recession, leaving 10% for a boom and 10% for a bust).

(3) *Two regional business surveys.* Two of the regional business surveys conducted by five of the 12 Federal Reserve district banks are out for July. The average of the NY and Philly surveys' composite business activity indexes closely tracks the national M-PMI (*Fig. 8*). It suggests that July's M-PMI is likely to fall closer to 50.0; we'll see when it is reported at the start of next month.

Again, that would be consistent with a soft landing of the economy, rather than a hard one. Of course, the M-PMI could fall significantly below 50.0 in a hard landing, but that's not our most likely outlook.

The same can be said about the two regional surveys' comparable new orders indexes: July's two-regions average suggests that the national orders index, which was 49.2 in June, might have been somewhat weaker in July (*Fig. 9*).

(4) *LEI & CEI.* The Index of Leading Economic Indicators (LEI) peaked at a record high during February and is now down four months in a row through June (*Fig. 10*). On average, it has peaked 12 months prior to the peaks of the past eight business cycles. That suggests that the next recession will start early next year.

Again, that's not our forecast. But it is the forecast of the LEI. Meanwhile, the Index of Coincident Economic Indicators (CEI) rose to a new record high in June. If the LEI proves to be prescient, then the CEI, which peaks when the business cycle peaks (i.e., just before recessions) might do so during February 2023.

(5) *Yield curve & credit-quality yield spreads.* One of the LEI's 10 components is the spread between the 10-year Treasury bond yield and the federal funds rate. Perversely, it was one of the four positive contributors to June's LEI. Most investors have ignored it and focused on the recession signal emitted by the spread between the yields of the 10-year Treasury and 2-year Treasury; that spread has diverged from the official LEI interest-rate spread by falling since the start of the year and turning slightly negative last week (*Fig. 11*).

We are also keeping a close watch on the yield spread between the high-yield corporate bond composite and the 10-year Treasury bond (*Fig. 12*). The spread has widened from 283bps at the start of this year to 506bps on Friday. So far, it is signaling that credit conditions have tightened, but not to the extent of previous credit crunches that triggered severe recessions.

(6) *Less inflation, maybe.* The good news in July's two regional business surveys is that supply-chain disruptions are abating, as evidenced in recent months by the drops in the NY delivery-time index and the Philly unfilled-orders index (*Fig. 13*). This undoubtedly also reflects some slowing in demand for goods. The result is that the prices-paid and prices-received indexes in both regions have turned down over the past couple of months from their elevated readings of the past year (*Fig. 14*).

(7) *Bottom line.* Debbie and I have found that inflation-adjusted S&P 500 forward earnings is a good coincident indicator of the US economy (*Fig. 15* and *Fig. 16*). It rose to a record high during June, though at a slower pace since the start of this year than during its V-shaped recovery from the pandemic lockdown recession. Its growth rate has slowed to 9.6% y/y through June from a recent peak of 35.2% during May 2021.

In the mid-cycle slowdowns of the mid-1980s, mid-1990s, and mid-2010s, the growth rates of both nominal and real forward earnings dropped to zero, but not much below that before moving higher again.

In our current mid-cycle slowdown outlook, we expect that S&P 500 forward earnings will also flatten out for several months and that the forward P/E bottomed on June 16. In this scenario, the S&P 500 would have bottomed on June 16 at 3666 and remain range bound above that level for a few months, say between 3666 and 4150, until better economic growth boosts forward earnings again.

(8) *Feshbach on the market.* Finally, I checked in with my friend Joe Feshbach on his latest market call. In his opinion, “The sentiment indicators got to extreme bearish levels and indicate little major downside risk. Even if there is another retest of the low, it should be successful. As I said previously, if I was running a $5 billion fund I’d be increasing exposure to stocks on weakness. The put/call ratio got sloppy on this initial rally phase but started to improve again during the second half of last week. The US dollar is showing signs of topping, which would also be a plus for the stock market.”

Calendars

US: Mon: Dallas Fed Manufacturing Index; Chicago Fed National Activity Index. **Tues:** Consumer Confidence 97.3; Richmond Fed Manufacturing Index -17; New Home Sales 664k; S&P/CS HPI Composite 1.5%m/m/20.8%y/y; API Weekly Crude Oil Inventories. (Bloomberg estimates)

Global: Mon: Germany Ifo Business Climate Index, Current Assessment, and Expectations 90.2/98.0/83.0; UK CB Industrial Trends Orders; China FDI; Japan Monetary Policy Meeting**. Tues:** Spain CPI; Japan CPI; Australia CPI 1.9%q/q/6.3%y/y; China Industrial Profits. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index rose 2.6% last week as the index moved back out of bear market territory again to end the week at 18.4% below its record high on December 27. The US MSCI ranked 34th of the 48 global stock markets that we follow in a week when a whopping 43 countries rose in US dollar terms. That was the broadest positive performance since October 2021. The AC World ex-US index rose 4.0% for the week, but remained in a bear market at 22.0% below its June 15, 2021 record high. All regions rose last week, but EM Eastern Europe was the best-performer with a gain of 6.8%, followed by EMEA (6.7%), EMU (4.8), and EAFE (4.4). EM Latin America (1.9), BIC (1.9), and EM Asia (2.5) underperformed last week. Chile was the best-performing country last week with a gain of 10.1%, followed by the Netherlands (9.1), Sweden (8.0), Greece (7.7), and Hungary (7.6). Among the 25 countries that underperformed the AC World ex-US MSCI last week, Pakistan's 12.4% decline was the worst, followed by Sri Lanka (-1.0), Argentina (-0.8), and Jordan (-0.8). The US MSCI's ytd ranking remained steady at 25/49, and the gap narrowed between the US MSCI, now with a 17.9% ytd drop, and the AC World ex-US, with an 18.5% ytd decline. EM Latin America is down 6.7% ytd and is the only region outperforming the AC World ex-US. The laggards: EM Eastern Europe (-83.9), EMEA (-33.4), EMU (-25.3), BIC (-21.0), EM Asia (-19.3), and EAFE (-18.8). The best country performers so far in 2022: Jordan (26.2), Chile (16.4), Indonesia (-1.8), the Czech Republic (-2.8), and Brazil (-5.8). Apart from Russia, in which investors have lost 100.0% of their investment this year, here are the worst-performing countries ytd: Sri Lanka (-67.7), Pakistan (-42.8), Hungary (-40.3), Egypt (-39.7), Poland (-36.2), and Austria (-35.8).

S&P 1500/500/400/600 Performance (*link*): All three of these indexes rose last week and ended the week out of a bear market. In the last 16 weeks, LargeCap has posted only four gains while MidCap and SmallCap have risen five times. LargeCap's latest gain of 2.5% meant that the index finished the week at 17.4% below its record high on January 3. MidCap rose 4.0% to end the week 17.7% below its record high on November 16, while SmallCap jumped 4.2% to finish at 19.2% below its November 8 record high. Twenty-nine of the 33 sectors moved higher for the week, up from seven sectors rising a week earlier. MidCap Energy was the best performer with a gain of 6.9%, followed by LargeCap Consumer Discretionary (6.8%), SmallCap Consumer Discretionary (6.5), SmallCap Tech (6.3), MidCap Tech (5.6), and SmallCap Communication Services (5.6). SmallCap Utilities (-1.2) and LargeCap Communication Services (-1.2) were the biggest underperformers last week, followed by LargeCap Utilities (-0.5), LargeCap Health Care (-0.3), and MidCap Utilities (0.1). In terms of 2022's ytd performance, LargeCap's 16.9% decline is now ahead of those for SmallCap (-15.4) and MidCap (-15.7). Just three of the 33 sectors are positive so far in 2022, unchanged from a week earlier. Energy continues to dominate the top performers: LargeCap Energy (28.4), MidCap Energy (21.5), SmallCap Energy (20.6), MidCap Utilities (-2.1), and LargeCap Utilities (-3.0). The biggest ytd laggards: LargeCap Communication Services (-29.8), SmallCap Consumer Discretionary (-24.8), LargeCap Consumer Discretionary (-24.6), SmallCap Real Estate (-23.8), and MidCap Consumer Discretionary (-22.1).

S&P 500 Sectors and Industries Performance (*link*): Eight of the 11 S&P 500 sectors rose last week, and seven outperformed the composite index's 2.5% gain. That compares to a 0.9% decline for the S&P 500 a week earlier, when one sector rose and six outperformed the index. Consumer Discretionary was the top performer with a gain of 6.8%, followed by Materials (4.1%), Industrials (4.1), Tech (3.6), Energy (3.5), Real Estate (3.0), and Financials (2.9). The worst performers: Communication Services (-1.2), Utilities (-0.5), Health Care (-0.3), and Consumer Staples (0.4). The S&P 500 is down 16.9% so far in 2022 with six sectors ahead of the index, but just one in positive territory. The best performers in 2022 to date: Energy (28.4), Utilities (-3.0), Consumer Staples (-5.4), Health Care (-8.0), Industrials (-14.6), and Financials (-16.3). The ytd laggards: Communication Services (-29.8), Consumer Discretionary (-24.6), Tech (-21.4), Real Estate (-18.5), and Materials (-17.1).

S&P 500 Technical Indicators (*link*): The S&P 500 rose 2.5% last week and improved relative to its 50-day moving average (50-dma) and its 200-day moving average (200-dma). The index closed above its 50-dma for the first time in 15 weeks, but closed below its 200-dma for the 22nd time in 24 weeks. It had been above its 200-dma for 81 straight weeks through early February. The S&P 500's 50-dma moved lower for a 15th week as the index improved to 1.2% above its falling 50-dma from 1.4% below a week earlier. That's up from a 27-month low of 11.1% below its falling 50-dma in mid-June and compares to a 27-week high of 4.9% above its rising 50-dma in early November. The index had been mostly trading above its 50-dma since late April 2020; in June 2020, it was 11.7% above, which was the highest since its record high of 14.0% in May 2009. That compares to 27.7% below on March 23, 2020—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. The price index closed Friday at 9.0% below its falling 200-dma, up from 11.5% below a week earlier and from a 26-month low of 17.1% below its falling 200-dma in mid-June. The latest reading is down sharply from 10.8% above its rising 200-dma in early November. That compares to 17.0% above in December 2020, which was the highest since November 2009 and up from the 26.6% below registered during the Great Virus Crisis on March 23, 2020—the lowest reading since March 2009. At its worst levels of the Great Financial Crisis, the S&P 500 index was 25.5% below its 50-dma on October 10, 2008 and 39.6% below its 200-dma on November 11, 2008. The 200-dma declined for a 14th straight week.

S&P 500 Sectors Technical Indicators (*link*): Six of 11 S&P 500 sectors traded above their 50-dmas last week, up from four a week earlier, as Industrials and Real Estate moved back above. That's an improvement from the two weeks before the end of June when all 11 sectors were below. Health Care was above for a fourth week as Consumer Discretionary, Consumer Staples, and Tech each marked their second straight week above. Three of the 11 sectors had a rising 50-dma, up from one a week earlier, as Tech and Consumer Discretionary turned higher and Health Care's rose for a third week. Looking at the more stable longer-term 200-dmas, Utilities dropped below in the latest week, leaving only Energy above for a 44th straight week. For perspective, at the depths of the Great Virus Crisis in April 2020, Health Care was the only sector trading above its 200-dma. Four sectors have a rising 200-dma, unchanged from a week earlier. Consumer Staples, Energy, Health Care, and Utilities remain the only members of the rising 200-dma club.

US Economic Indicators

Leading Indicators (*link*): Leading economic indicators (LEI) in June contracted for the fourth successive month and the fifth month this year, sinking 0.8% in June and 1.8% ytd; this weakness followed a consistent string of new highs during the final nine months of 2021. June's reading is 1.9% below the record high posted in February of this year. "Consumer pessimism about future business conditions, moderating labor market conditions, falling stock prices, and weaker manufacturing new orders drove the LEI's decline in June," noted Ataman Ozyildirim, senior director of economic research at The Conference Board. In June, six of the 10 components of the LEI fell, while four rose. Dragging the index down were consumer expectations (-0.37ppt), average workweek (-0.17), jobless claims (-0.15), stock prices (-0.15), ISM new orders diffusion index (-0.14), and building permits (-0.02); these gains were partially offset by gains in the interest rate spread (+0.24), leading credit index (+0.05), real core capital goods orders (+0.02), and real consumer goods orders (+0.01). According to the report, "Amid high inflation and rapidly tightening monetary policy, a US recession around the end of this year and early next year is now likely." The Conference Board lowered its annual real GDP forecast for 2022 to 1.7% y/y (from 2.3%) and 2023 to 0.5% (from 1.8%).

Coincident Indicators (*link*): The Coincident Economic Index (CEI) climbed to yet another record high in June after posting only two minor declines over the past nine months. The CEI rose 0.2% in June and 2.1% over the past nine months—after showing no growth last August and September. Three of the four components contributed positively to June's CEI, with industrial production (-0.04ppt) being a drag on the index for the first time this year, slipping 0.2% from May's record high. Here's how the remaining three components performed: 1) payroll employment (+0.08ppt) in June climbed a stronger-than-expected 372,000, though gains for May and April were revised lower for a net loss of 74,000 over the two-month period. Total payroll employment has recovered 21.5 million jobs since bottoming in April 2020, though is still 524,000 below its pre-pandemic level. 2) Real personal income less transfer payments (+0.07) has increased in four of the past five months, climbing 0.2% in May and 0.7% over the period to a new record high. 3) Real manufacturing & trade sales (+0.04) recovered for the second month, by 0.6%, after a three-month decline of 2.1%; it's within 2.2% of last March's record high.

Regional M-PMIs (*link*): Two Fed districts (New York and Philadelphia) have reported on manufacturing activity for July and show the manufacturing sector held just below the demarcation line between expansion and contraction. The composite index improved for the second month to -0.6 this month after sinking from 21.1 in April to -4.5 in May—which was the first negative reading since May 2020—as activity in the New York (to 11.1 from -1.2) region swung from negative to positive this month. Meanwhile, the activity in Philadelphia (-12.3 from -3.3) factories dropped further into contractionary territory. Orders (-9.3 from -3.5) in July fell at a sharper rate, as billings in the Philadelphia (to -24.8 from -12.4) region contracted at double June's rate while New York's (6.2 from 5.3) held at a steady pace. Employment (18.7 from 23.6) slowed a bit but continued its strong readings, with a solid pace of hirings by factories in both Philadelphia (19.4 from 28.1) and New York (18.0 from 19.0). Turning to prices, the prices-paid measure in the New York region slowed to 64.3, the lowest since last February, down from April's record-high 86.4, while Philadelphia's gauge eased for the third month to an 18-month low of 52.2 from April's cyclical high of 84.6—which wasn't far from its record high of 91.1 in the mid-1970s. Meanwhile, prices-received in the New York area eased for the fourth month, from a record-high 56.1 in March to a 16-month low of 31.3, while Philadelphia's is at 30.3, down from October's cyclical high of 62.9.

Global Economic Indicators

US PMI Flash Estimates (*link*): "US private sector output contracts for the first time in over two years amid muted client demand" was the headline of July's flash report. The C-PMI slowed for the fourth month from 57.7 in March to 47.5 this month—the lowest since May 2020. The report notes that excluding the pandemic lockdown months, output is falling at its fastest pace since 2009 (amid the financial crisis), with the survey data indicative of GDP falling at an annualize rate of 1.0%. The service sector's rebound from the pandemic has gone into reverse, with July's NM-PMI dropping into contractionary territory, sinking from 58.0 in March to 47.0, posting its first decline since June 2020 and its sharpest since May 2020. Meanwhile, the M-PMI slowed from 59.2 in April to 52.3 this month—the slowest growth in two years—while the manufacturing output index dropped below the 50.0 no-change mark for the first time since June 2020; new sales and new export orders contracted at their sharpest rates since the initial stages of the pandemic over two years ago. On the price front, while supply constraints remained problematic, weakening demand has helped ease inflationary pressures. The report notes that average costs charged for both goods and services rose at a much reduced rate in July, slowing to a 16-month low though still high by historical standards.

Eurozone PMI Flash Estimates (*link*): Manufacturing activity in the Eurozone contracted in July for the first time since the Covid-19 lockdowns of early 2021, according to flash estimates, with output and new orders following suit. The Eurozone C-PMI eased for the third month from 55.8 in April to 49.4 this month, as the M-PMI plummeted from 58.7 at the start of the year to a 25-month low of 49.6 this month, while the NM-PMI showed the service sector at a near standstill, dropping from 57.7 in April to a 25-month low of 50.6 this month. The report noted that the concerns over weakening demand were exacerbated by energy supply and inflation worries—pushing business expectations lower. While both input and output pressures eased in July, they remained at elevated levels not seen prior to the pandemic. Looking at the two largest Eurozone economies, the C-PMI for Germany (to 48.0 from 51.3) contracted for the first time this year and posted its worst performance in two years. Both the M-PMI (49.2 from 52.0) and NM-PMI (49.2 from 52.4) slipped into contractionary territory, with the former the lowest in 25 months and the latter in seven months. The C-PMI (50.6 from 52.5) for France dropped toward the break-even point between expansion and contraction as the M-PMI (49.6 from 51.4) fell below 50.0 and the NM-PMI (52.1 from 53.9) was headed south—with the former at a 20-month low and the latter at a 15-month low. The rest of the region, as a whole, recorded a marginal contraction in output, with the C-PMI sinking to 49.9—the first decline since February 2021.

Japan PMI Flash Estimates (*link*): Activity in Japan's private sector eased for the first time in five months, with the C-PMI falling to 50.6 this month, according to flash estimates, after climbing steadily from 45.8 in February to a seven-month high of 53.0 in June, with growth in both the manufacturing and service sectors slowing. The M-PMI fell for the fourth successive month from 54.1 in March to a 10-month low of 52.2 this month, while the NM-PMI slowed for the first time in five months, falling to 51.2, after rallying from 44.2 in February to 54.0 in June. According to the report, there were tentative signs that price pressures were peaking, as input cost inflation eased for the first time in six months while output cost inflation slowed to a three-month low.

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