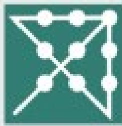
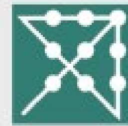
 Yardeni Research 

MORNING BRIEFING
May 16, 2023

Economic & Financial Stress & Stability

Check out the accompanying chart collection.

Executive Summary: Two different recent surveys taking the pulse of businesses—one measuring sentiment among small business owners nationwide and the other manufacturing activity in New York State—showed depressed readings. The problem isn't demand but the ability to supply given the tight labor market. … Two recent Federal Reserve reports—measuring the household debt and credit of US consumers and the financial stability of the economy generally—showed that neither the consumer nor the banking sector nor the financial system generally is especially stressed.

Weekly Webcast. If you missed Monday's live webcast, you can view a replay *here*.

US Economy I: Small Business Owners Are Depressed. April's *survey of small business owners* was released on Tuesday, May 9. It is conducted by the National Federation of Independent Business (NFIB). The Small Business Optimism Index decreased by 1.1 points in April to 89.0, the lowest reading since January 2013 (*Fig. 1*). Labor quality was the top business problem, at 24%, with inflation in second place at 23%. "Optimism is not improving on Main Street as more owners struggle with finding qualified workers for their open positions," said NFIB Chief Economist Bill Dunkelberg. "Inflation remains a top concern for small businesses but is showing signs of easing." Here are some more details from the NFIB report:

(1) *Job openings.* The percentage of all owners reporting job openings they could not fill in the current period rose 2 points to 45% in April (*Fig. 2*). The percentage with openings for skilled workers was 37%, up 3 points, and the percentage with openings for unskilled labor was 19% (unchanged). The difficulty in filling open positions is particularly acute in construction, transportation, and manufacturing industries. Openings are lowest in finance.

(2) *Capital spending.* Fifty-six percent of small business owners reported making capital outlays in the last six months, down 1 point from March. Nineteen percent plan capital outlays in the next few months, down 1 point from March and the weakest reading since April 2020 (*Fig. 3*).

(3) *Inflation.* The net percentage of owners raising average selling prices decreased 4

points from March to 33%, the lowest since March 2021. A net 21% plan price hikes, down 5 points from the March level (*Fig. 4*). That's the lowest reading since November 2020.

(4) *Credit.* Only 4% reported that financing was their top business problem (up 1 point). A net 6% reported that their last loan was harder to get than previous loans (down 3 points) (*Fig. 5*). A net 26% of owners reported paying a higher rate on their most recent loan, unchanged from March. The average rate paid on short maturity loans was 8.5%, 0.7ppt above the March level and the highest since October 2007. Thirty-one percent of all owners reported borrowing on a regular basis (up 1 point) (*Fig. 6*).

(5) *Bottom line.* Small business owners are still hiring but can't find enough workers to meet the demand for their goods and services.

US Economy II: Depressed in New York State Too. Business activity fell sharply in New York State, according to firms responding to the May 2023 *Empire State Manufacturing Survey* conducted by the Federal Reserve Bank of New York. The headline general business conditions index dropped forty-three points to -31.8. New orders and shipments plunged after rising significantly last month. Delivery times shortened somewhat, and inventories contracted. Both employment and hours worked edged lower for a fourth consecutive month. Prices increased at about the same pace as last month. Capital spending plans turned sluggish (*Fig. 7*). Looking ahead, businesses expect some improvement in conditions over the next six months.

This survey is the first of the regional business surveys conducted by five of the 12 Fed district banks. The New York survey provides among the most current insights into the latest month, in this case May. It's not a pretty picture, as we just saw. However, compared to the other four surveys, its results have been more volatile from month to month and have been especially so over the past 17 months (*Fig. 8*).

US Consumer: Good Credit. The Federal Reserve Bank of New York issued its Q1 report on *Household Debt and Credit* yesterday. The report shows no signs of financial distress even though aggregate household debt balances increased by $148 billion during the quarter to a record $17.05 trillion (*Fig. 9*). They have increased by $2.9 trillion since the end of 2019, just before the pandemic recession. Here are some of the other details from the report:

(1) *Balances.* Mortgage balances shown on consumer credit reports increased by $121 billion during Q1 and stood at $12.04 trillion at the end of March, a modest increase.

Balances on home equity lines of credit (HELOC) increased by $3 billion, the fourth consecutive quarterly increase following a nearly 13-year declining trend; the outstanding HELOC balance stands at $339 billion.

Credit card balances were flat, at $986 billion, bucking the typical trend of balance declines during first quarters. Auto loan balances increased by $10 billion in Q1, continuing the upward trajectory in place since 2011. Other balances, which include retail cards and other consumer loans, increased by $5 billion. Student loan balances stood at $1.60 trillion at the quarter's end, up by $9 billion from the previous quarter's end. In total, non-housing balances grew by $24 billion (*Fig. 10*).

Among individuals with a credit report, here are the Q1 per-capita balances for all debt ($60,300), mortgages ($42,600), home equity revolving credit ($1,200), auto loans ($5,500), credit card debt ($3,500), and student loans ($5,600), and other ($1,800) (*Fig. 11* and *Fig. 12*).

(2) *Originations.* The median credit score for newly originated mortgages decreased slightly to 765. The median credit score on newly originated auto loans ticked up 10 points, to 721, suggesting some tightening (*Fig. 13* and *Fig. 14*).

(3) *Delinquencies.* Aggregate delinquency rates were roughly flat in Q1 and remained low after declining sharply through the beginning of the pandemic. As of March, 2.6% of outstanding debt was in some stage of delinquency, 2.1ppts lower than in Q4-2019, just before the Covid-19 pandemic hit the US.

(4) *Foreclosures.* Although the CARES Act's foreclosure moratorium has been lifted nationally, new foreclosures have stayed very low since the moratorium began. About 35,000 individuals had new foreclosure notations on their credit reports, roughly flat with Q4 (*Fig. 15*).

(5) *Student loans.* As mentioned above, outstanding student loan debt stood at $1.60 trillion at the quarter's end. Less than 1% of aggregate student debt was 90+ days delinquent or in default, a small decline from the previous quarter. Delinquency rates fell substantially in the previous quarter due to the implementation of the Fresh Start program, which made previously defaulted loan balances current (*Fig. 16*).

(6) *Bottom line.* Keep walking: There's nothing new to see or to worry about here, for now.

The Fed: A Remarkably Calm Report on Financial Stability. On Monday, May 8, the Fed released its semiannual *Financial Stability Report*. "Frequently cited topics in this survey included persistent inflation and tighter monetary policy, banking-sector stress, commercial and residential real estate and geopolitical tensions," the report stated. It was remarkably relaxed about the recent banking crisis: "Overall, the banking sector remained resilient, with substantial loss-absorbing capacity."

Furthermore: "Substantial withdrawals of uninsured deposits contributed to the failures of SVB, Signature Bank, and First Republic Bank and led to increased funding strains for some other banks, primarily those that relied heavily on uninsured deposits and had substantial interest rate risk exposure. Policy interventions by the Federal Reserve and other agencies helped mitigate these strains and limit the potential for further stress."

What if the banking crisis flares up again? Here is the Fed's answer: "The Federal Reserve is prepared to address any liquidity pressures that may arise and is committed to ensuring that the U.S. banking system continues to perform its vital roles of ensuring that depositors' savings remain safe and providing access to credit to households and businesses in a manner that promotes strong and sustainable economic growth. These additional funding sources bolster the capacity of the banking system to safeguard deposits and ensure the ongoing provision of money and credit to the economy. The additional funding to eligible depository institutions will continue to serve as an important backstop against further bank stresses and support the flow of credit."

In other words, keep walking: There's nothing to worry about here, for now.

The Fed's report did devote a couple of pages (pages 15-16) to financial institutions' exposure to commercial real estate (CRE) debt. The analysis observed: "The shift toward telework in many industries has dramatically reduced demand for office space, which could lead to a correction in the values of office buildings and downtown retail properties that largely depend on office workers. Moreover, the rise in interest rates over the past year increases the risk that CRE mortgage borrowers will not be able to refinance their loans when the loans reach the end of their term."

The report also noted that small banks as well as insurance companies are most exposed to the higher credit risks in CRE debt. The Fed "has increased monitoring of the performance of CRE loans and expanded examination procedures for banks with significant CRE concentration risk."

Keep walking: The Fed is on the case.

Calendars

US: Tues: Retail Sales Total, Core, Control Group 0.7%/0.4%/0.3; Industrial & Manufacturing Production -0.1%/0.1%; Capacity Utilization 79.7%; Business Inventories 0.1%; Housing Market Index 45; API Weekly Crude Oil Inventories; IEA Monthly Report; Williams; Barr; Bostic; Mester. **Wed:** Housing Starts & Building Permits 1.40mu/1.43mu; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. (Bloomberg estimates)

Global: Tues: Eurozone GDP 1.3%y/y; Germany Employment; Eurozone Trade Balance; Germany ZEW Economic Sentiment -5.5; Italy CPI 0.8%m/m/8.8%y/y; UK Average Earnings Including & Excluding Bonus 5.8%/6.8%l UK Employment Change 3m/3m 160k & Unemployment Rate 3.8%; UK Labor Productivity; Canada CPI 0.4%m/m/4.4%y;y; Japan GDP 0.1%q/q/0,7%y/y; China Manufacturing Sales 0.7%; Lagarde; Tuominen. **Wed:** Eurozone & Core CPI 0.7%m/m/7.0%y/y & 1.0%m/m/5.6%y/y; France Unemployment Rate 7.1%; Spain Consumer Confidence 78.9; Japan Industrial Production 0.8%; Japan Capacity Utilization 1.5%; Japan Trade Balance; Australia Employment Change & Unemployment Rate 25k/3.5%; De Guindos; Panetta; Mauderer; Bailey; Elderson. (Bloomberg estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): Forward earnings rose last week for just one of these three indexes, and none of them saw record-high forward earnings for a 46th straight week. A week earlier, forward earnings for all three rose simultaneously for the first time in six weeks and only the third time since they peaked at record highs last June. However, all three indexes' forward earnings are up from their lows during February and March. Through the week ending May 12, LargeCap's forward earnings fell 0.2% w/w to 1.6% above its 54-week low during the week of February 10. MidCap's increased 2.2% w/w to 2.3% above its 55-week low during the week of March 10. SmallCap's fell 0.9% w/w to 1.6% above its 72-week low during the March 17 week. However, forward earnings remains on a modest downtrend for these three indexes compared to their deep declines during the Great Virus Crisis and the Great Financial Crisis. LargeCap's is 4.3% below its record high at the end of June; MidCap's is 6.1% below its record high in early June; and SmallCap's is 12.9% below

its mid-June record. Forward earnings momentum remains near two-year lows. The yearly rate of change in LargeCap's forward earnings was negative for a 15th straight week and weakened to a 27-month low of -3.1% y/y from -2.4%; that compares to a record-high 42.2% at the end of July 2021 and is up from -19.3% in May 2020, which was the lowest since October 2009. MidCap's rate of -4.8% y/y is near a 30-month low, which compares to a record high of 78.8% in May 2021 and a record low of -32.7% in May 2020. SmallCap's rate of -11.0% y/y is at a 31-month low during the May 11 week, down from a record high of 124.2% in June 2021; it compares to a record low of -41.5% in June 2020. Analysts' consensus earnings forecasts for 2023 and 2024 had been heading steadily lower since last June, but 2023's estimates briefly ticked higher as analysts added Q1's strong earnings beats into their forecasts. Here are the latest consensus earnings growth rates for 2023 and 2024: LargeCap (0.9% and 11.7%), MidCap (-9.1, 11.9), and SmallCap (-9.5,15.4).

S&P 500/400/600 Valuation (*link*): Valuations mostly ticked lower w/w through the May 12 week for these three indexes. LargeCap's forward P/E was steady w/w at 18.0, down from its nine-month high of 18.2 the week before that. It's up 2.9pts from its 30-month low of 15.1 at the end of September, which compares to an 11-year low of 11.1 during March 2020. MidCap's forward P/E fell 0.3pt to an eight-week low of 13.0, which is 1.7pts below its recent 10-month high of 14.7 in early February. It's now 1.9pts above its 30-month low of 11.1 at the end of September, which compares to a record high of 22.9 in June 2020 and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E dropped 0.1pt to a 19-week low of 12.5 and remains 1.8pts below its recent 12-month high of 14.3 in early February. It's 1.9pts above its 14-year low of 10.6 at the end of September and compares to a record low of 10.2 in November 2009 during the Great Financial Crisis. That also compares to its record high of 26.7 in early June 2020 when forward earnings was depressed. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's P/E is back down to a 28% discount relative to LargeCap's, matching its 23-year-low 28% discount last July. It had been at a 21% discount during the March 17 week, which was near its best reading since November 2021. SmallCap's 30% discount to LargeCap's P/E last week is not much improved from a 21-year low of 32% in April 2022. That compares to a 22% discount during the March 10 week, which was near its lowest discount since August 2021. 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 100th straight week; the current 3% discount has weakened from 1% during the March 31 week. That 1% discount had been its lowest since July 2021 and an improvement from its 20-year-low 9% discount in December 2021.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Following the Q3-2020 earnings

season when the US economy emerged from the Covid shutdown, analysts began raising their consensus forecasts for future quarters instead of lowering them as is the historical norm. That six-quarter streak of positive revisions throughout the quarter ended during Q1-2022, and the declines began to accelerate considerably beginning with Q3-2022. With over 90% of the Q1 earnings season complete, analysts expect the S&P 500's earnings growth rate to decelerate q/q for a seventh straight quarter in Q1-2023 to -3.3% y/y from -1.6% in Q4-2022 on a frozen actual basis. On a pro forma basis, they expect the y/y earnings decline to lessen in Q1-2023, to -0.6% from -3.2% in Q4-2022. Four sectors are expected to record positive y/y percentage earnings growth in Q1-2023, up from only two sectors doing so in Q4-2022. Here are the S&P 500 sectors' latest expected earnings growth rates for Q1-2023 versus their final Q4-2022 growth rates: Consumer Discretionary (55.1% in Q1-2023 versus -15.6% in Q4-2022), Industrials (25.7, 41.4), Energy (19.2, 59.1), Financials (7.8, -8.9), Consumer Staples (-1.0, -2.5), S&P 500 (-0.6, -3.2), Real Estate (-7.7, -3.2), Communication Services (-8.9, -28.2), Information Technology (-9.8, -10.0), Health Care (-14.7, -2.7), Utilities (-22.2, -4.6), and Materials (-22.2, -20.4).

US Economic Indicators

Regional M-PMI (*link*): The New York Fed has provided the first glimpse of manufacturing activity for May, and it shows April's big gain was more than wiped away as activity slumped back into contractionary territory this month. May's *composite index* plunged 42.6 points to -31.8 after rebounding 35.4 points in April to 10.8, a 12-month high. Both orders (to -28.0 from 25.1) and shipments (-16.4 from 23.9) swung from expansion to contraction in May—after growing in April at the strongest pace since April 2022 and July 2022, respectively. Meanwhile, *delivery times* (-5.7 from 0.0) shortened a bit, and inventories (-12.3 from 8.2) contracted. As for the labor market, *employment* (-3.3 from -8.0) contracted for the fourth month, though at a slightly slower pace for the second straight month, after adding jobs for 31 straight months, while *hours worked* (-3.5 from -6.4) shrank for the sixth month, also at a slower pace. Turning to *prices,* the prices-paid (34.9 from 33.0) ticked up slightly this month after matching January's pace in April—which was the slowest since November 2020—while prices-received (23.6 from 23.7) continued to bounce in a volatile flat trend around recent lows. Both price measures are down sharply from their record highs of 86.4 and 56.1, respectively, during April and March of last year. Looking ahead, *the index of future business conditions* remained in expansionary territory, edging up for the second month to 9.8 from 2.9 in March, suggesting that firms don't expect activity to improve much over the next six months; the measure was as high as 52.0 in October 2021. The expansion in new orders (18.0 from 6.6) was encouraging, the strongest performance in 14 months, while

shipments (15.8 from 7.6) picked up but remained in its narrow flat trend—moving to the top of the range this month. Employment (7.5 from 13.5) expanded at a slower pace, while hours worked eased for the third month, to 1.9, from a recent peak of 10.1 in February. Both the prices-paid (33.0 from 37.1) and prices-received (26.4 from 29.9) gauges continue to trend lower, down sharply from their record highs of 76.7 and 62.1, respectively, last January.

Global Economic Indicators

Eurozone Industrial Production (*link*): Headline production, which excludes construction, posted its largest decline since last July, sinking to its lowest level since October 2021. Output slumped 4.1% in March, after rebounding 2.1% the first two months of the year from December's 1.0% shortfall. Among the *main industrial groups*, capital goods production accounted for much of March's decline, tumbling 15.4% to its lowest reading since September 2020, after climbing six of the prior seven months by 7.9%—following last July's 19.0% plunge. Also in the red were in March were production of intermediate goods (-1.8%), energy (-0.9), and consumer nondurable good (-0.8) output—with only consumer durable goods (2.8) production in the black. *Compared to a year ago*, headline production was down 1.4%, the second yearly decline in the past eight months, led by losses in energy (-6.1% y/y) and intermediate goods (-4.7) production, followed by capital goods (-2.1) and consumer durable goods (-0.8) output; consumer nondurable goods (6.8) was the only sector in the plus column. Production data are available for the *top four Eurozone economies* and show Germany (-3.1), France (-1.1), and Italy (-0.6) were in the red, while Spain (1.4) posted its third gain in the past four months. Over the 12 months through March, production was in the plus column in Spain (5.6), Germany (2.9), and France (0.2) while below year-ago levels in Italy (-3.2). In the *overall Eurozone*, Ireland posted the biggest decline both on a monthly (-26.3) and yearly (-26.1) basis, as the country's statistical office has been reviewing its seasonal adjustment methodology for industrial production.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102

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