MORNING BRIEFING
May 24, 2023

Around The World

Check out the accompanying chart collection.

Executive Summary: Global economic growth has been lackluster this spring, neither a boom nor a bust. Rebounding global trade and the easing of supply-chain disruptions should moderate global inflationary pressures without a global recession. The Fed and the ECB are committed to raising rates to restrictive levels and keeping them there to bring inflation down. The Fed's rate is probably where it should be, while the ECB may have a couple more rate hikes to go. The BOJ's ultra-easy policy continues. The PBOC is massively stimulating, suggesting all is not well in China. Today, we survey the major indicators of global economic growth for insight into how vulnerable the global economy is at this juncture.

Global Economy: No Boom, No Bust. In 1897, an English journalist from the *New York Journal* contacted satirist Mark Twain to inquire whether the rumors that he was gravely ill or already dead were indeed true. Twain wrote a response, part of which made it into the article that ran in the *Journal* on June 2, 1897:

"Mark Twain was undecided whether to be more amused or annoyed when a Journal representative informed him today of the report in New York that he was dying in poverty in London ... The great humorist, while not perhaps very robust, is in the best of health. He said: 'I can understand perfectly how the report of my illness got about, I have even heard on good authority that I was dead. James Ross Clemens, a cousin of mine, was seriously ill two or three weeks ago in London, but is well now. The report of my illness grew out of his illness. The report of my death was an exaggeration.'" (Twain didn't actually quip, "Reports of my death are greatly exaggerated," as often attributed to him.)

The US economy continues to grow despite widespread expectations that its growth would be halted by the Fed's aggressive monetary tightening since March 2022, expectations that fed into forecasts of an imminent recession. Other recent, widely held expectations of economic downturns have proved likewise to be greatly exaggerated: Europe's natural gas shortages, a result of Russia's war on Ukraine, were expected to leave Europeans freezing in the dark last winter as the regional economy shut down. Didn't happen. China's extreme pandemic lockdowns late last year were expected to drive the nails into the coffin of global economic growth. Didn't happen.

Last summer, doomsters were warning “winter is coming!” Now they’re acknowledging (like the Chauncey Gardener character in the movie “Being There”) that there is “growth in the spring.”

But it’s been lackluster growth so far, with neither a boom nor a bust. Global supply-chain disruptions have eased. Global trade has rebounded. These developments are likely to moderate global inflationary pressures. Nevertheless, central banks still could choke off global economic growth if they believe that their monetary policies aren’t restrictive enough yet to bring inflation down to their holy-grail target of 2.0%. They’ve expressed a desire to do so ideally without causing a recession, but they’ve also stated that bringing inflation down is their top priority.

Let’s take a quick tour around the world to assess the outlook for the global economy:

(1) *Commodity prices.* The timeliest indicators of global economic activity, of course, are commodity prices. Debbie and I are big fans of the CRB raw industrials spot price index (*Fig. 1*). We like it because it does not include food, energy, or wood products, which have their own unique supply and demand characteristics independent of the global economy. The index is available weekly from 1951 to 1981, then daily. It includes copper scrap, lead scrap, steel scrap, tin, zinc, burlap, cotton, print cloth, wool tops, hides, rosin, rubber, and tallow. Most of these commodities are not traded in futures markets, thus removing speculative noise from their price movements.

The index staged a V-shaped recovery following the end of the US pandemic lockdowns. It jumped 69% from April 21, 2020 to a record high on April 4, 2022. It has been falling since then and was down by 20% as of May 22. One of the components of the index is the cash price of copper (*Fig. 2*). It is especially sensitive to developments in China. Last year, it bottomed at $3.21 per pound on July 14 before the Chinese government lifted its pandemic lockdown restrictions during December. It peaked at $4.27 on January 26 of this year, suggesting that China’s recovery might be weaker than widely expected.

The price of zinc followed the same pattern as the price of copper last year and early this year (*Fig. 3*). However, it has been much weaker in recent days. The price of steel also rebounded following the end of China’s lockdowns and has held its gains so far this year. It must be getting an additional boost from onshoring and infrastructure spending in the US.

We obviously also follow the price of a barrel of crude oil. It’s not only a sensitive indicator of global economic activity but also can significantly alter global economic activity when geopolitical events dominate its price swings. Spikes in oil prices have often been followed by recessions in the US (*Fig. 4*).

Last year, the nearby futures price of a barrel of Brent soared from $78.98 per barrel at the start of the year to peak at $127.98 on March 8, 2022 (*Fig. 5*). That spike was clearly attributable to the impact of the Russian invasion of Ukraine on the global oil market. So far this year, the Brent price has been relatively weak notwithstanding the surprise announcement on April 2 by OPEC+ to cut production. In addition, the futures prices are in backwardation, with the nearby price at $75.99 and the 2-year price at $70.25 on Monday.

(2) *Inflation.* April's headline CPI inflation rates are down from their recent peaks in the US (4.9%), the Eurozone (7.0%), and Japan (3.5%) (*Fig. 6*). They all remain well above the official 2.0% targets of their central banks. The core CPI inflation rates also remain persistently high in the US (5.5%), Eurozone (5.6%), and Japan (2.5%) (*Fig. 7*).

(3) *Monetary policies.* The major central bankers found themselves falling behind the inflation curve early last year and scrambled to make up for their tardiness by raising their official policy rates aggressively and by reducing the size of their balance sheets. The Fed has raised the federal funds rate by 500bps starting last March (*Fig. 8*). The European Central Bank (ECB) has raised its official deposit rate by just over 325bps since last July. On the other hand, the Bank of Japan (BOJ) has kept its official rate unchanged at -0.10% since late September 2016. The total assets of the Fed, ECB, and BOJ (in dollars) peaked at $25.0 trillion during the last three weeks of February 2022. They were down to $22.2 trillion last week.

On Friday, Fed Chair Jerome Powell said that monetary policy is "restrictive." So Fed policy will be data-dependent and particularly dependent on inflation indicators. For those of us in the "Fed-should-pause" camp, he seemed to suggest that a pause in tightening is possible. He acknowledged that the banking crisis is bound to tighten credit conditions, reducing the need for the Fed to get more restrictive in its policy stance. Nevertheless, he and other Fed officials have said that they intend to keep monetary policy restrictive until they achieve their inflation target.

Also on Friday in an interview with Spanish state-run channel TVE, ECB President Christine Lagarde said, "Now is a moment which is also quite critical because inflation is beginning to go down." Like Fed officials, she said ECB's monetary policy will remain restrictive for a while: "We are beginning to see efficiency of measures, but we still need to have high and sustainably high interest rates."

The BOJ is on another planet. Expectations for the BOJ to tweak its ultra-loose policy have been receding, as Governor Kazuo Ueda repeatedly has said that the central bank will continue monetary easing until inflation sustainably hits its 2% target. He said so on Friday after the release of data showing Japan's core consumer inflation rose 3.4% in April, still well above the BOJ's 2.0% target, on rising food and services prices.

(4) *Purchasing managers.* S&P Global released its May flash PMIs on Tuesday (*Fig. 9*). For both the US and Eurozone, they show a rebound in their nonmanufacturing indexes from readings slightly under 50.0 at the end of last year to 55.1 and 55.9. The M-PMIs weakened for both, to 48.5 in the US and 44.6 in the Eurozone. Japan's flash M-PMI rose during May to 50.8.

In the US, we now have three of the May business surveys conducted by five of the Federal Reserve's district banks in hand. The ones for New York and Richmond showed deterioration, while the Philly survey showed some improvement (*Fig. 10*). On balance, they were weak.

(5) *Forward revenues & earnings.* Yesterday, we reviewed the latest data on S&P 500 forward revenues and earnings. Now let's analyze these metrics for various MSCI indexes around the world to get some insights on the global economy. The forward revenues of the US MSCI continued to hit record highs through the May 18 week (*Fig. 11*). The same metric for the All Country World ex-US MSCI (ACWXUS, in local currency) has stalled in record-high territory in recent weeks. The forward revenues of the EMU MSCI rose to a record high during the May 18 week, with Japan's moving closer to its 2008 record high (*Fig. 12*). Inflation has been boosting revenues growth around the world. But so has real economic activity.

Forward earnings of the ACWXUS (in local currency) has closely tracked the one for the US (*Fig. 13*). Forward earnings for the EMU, on the other hand, is rising in record territory notwithstanding widespread pessimism about Europe's economic outlook over the past year.

(6) *China.* The People's Bank of China (PBOC) stands out among the major central banks. It is the only one that has been continuing to provide additional monetary policy stimulus. This suggests that China's economy isn't performing as well as the government would like to see. The PBOC's required reserve ratio for commercial banks has been lowered three times since the start of 2022 (*Fig. 14*). Over the past 12 months through April, bank loans have increased by a record $3.4 trillion (*Fig. 15*)!

Another red flag is China's inflation rate. The CPI was up just 0.1% y/y in April despite the flood of bank loans (*Fig. 16*). The PPI for total industrial products was -3.6% over the same period. The country's imports (in yuan) have been flat since the second half of 2021 through April (*Fig. 17*).

Here is one simple explanation: China's rapidly aging demographic profile is inherently deflationary. The government's instigation of a Cold War with the West (as well as with its Asian neighbors) and massive military spending may be weighing on its economy.

Calendars

US: Wed: MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production; FOMC Minutes; Yellen. **Thurs:** GDP & GDP Price Index 1.1%/4.0%; PCE Headline & Core Prices 4.2%/4.9%; Real Consumer Spending 3.7%; Corporate Profits -0.9%; Initial & Continuous Jobless Claims 250k/1.80m; Kansas City Manufacturing Index -5; Chicago Fed Natural Activity Index -0.02; Pending Home Sales 0.5%; Natural Gas Storage; Collins. (Bloomberg estimates)

Global: Wed: Germany Ifo Business Climate Index, Current Conditions, and Expectations 93.0/94.7/91.9; UK Headline & Core CPI -0.8%m/m/8.3%y/y & 0.8%m/m/6.2%y/y; UK Headline PPI Input & Output Prices 7.0% & 8.6%y/y; UK CBI Industrial Trends Orders; German Buba Monthly Report; European Central Bank Non-Monetary Policy Meeting; Bailey. **Thurs:** Germany GDP -0.1%q/q/0.2%y/y; Germany Gfk Consumer Confidence -24.0; France Business Survey 101; Australia Retail Sales 0.3%; De Guindos; Nagel; Haskel. (Bloomberg estimates)

Strategy Indicators

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin remained steady w/w at 12.4% during the May 18 week, up from a 24-month low of 12.3% during the April 27 week. That's down 1.0pt from its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.1pts above its seven-year low of 10.3% during April 2020. Forward revenues was also steady w/w at 0.1% below its record high during the May 4 week. Forward earnings was flat at 4.3% below its record high during the

June 16, 2022 week. Both had been steadily making new highs from the beginning of March 2021 to mid-June; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for forward revenues growth of 3.1% is 0.8pt above its 33-month low of 2.3% during the February 23 week. That's down from a record high of 9.6% growth at the end of May 2021 and compares to 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. Forward earnings growth of 5.7% is now 2.2pts above its 31-month low of 3.5% in mid-February. That's down from its 23.9% reading at the end of April 2021, which was its highest since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 1.9% in 2023 (unchanged w/w) and 4.5% in 2024 (down 0.1pt w/w) compared to a revenues gain of 12.2% in 2022. They expect flat earnings in 2023 (unchanged w/w) and an 11.2% rise in 2024 (unchanged w/w) compared to an earnings gain of 7.2% in 2022. Analysts expect the profit margin to drop 0.2ppt y/y to 12.0% in 2023 (unchanged w/w), compared to 12.2% in 2022, and to rise 0.8ppt y/y to 12.8% in 2024 (up 0.1pt w/w). The S&P 500's weekly reading of its forward P/E rose 0.1pt w/w to 18.3, and is just 0.2pt below its 43-week high of 18.5 during the February 16 week. That's up from a 30-month low of 15.3 in mid-October. It also compares to 23.1 in early September 2020, which was the highest level since July 2000 and up from a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio rose 0.02pt w/w to 2.26, and is now down 0.03pts from a 24-week high of 2.29 during the February 16 week. That's up from a 31-month low of 1.98 in mid-October and down from a four-month high of 2.38 in mid-August; it also compares to a record high of 2.88 at the end of 2021 and a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Looking at the 11 S&P 500 sectors, the May 18 week saw consensus forward revenues and forward earnings rise for six sectors. The forward profit margin rose w/w for five sectors and fell for six. Health Care and Utilities are the only sectors with forward revenues at a record high this week. Among the remaining nine sectors, just two have forward revenues more than 5.0% below their post-pandemic highs: Energy and Financials. Industrials and Utilities have forward earnings at a record high this week, and Consumer Staples remains close to its their recent record on May 4. Among the remaining eight sectors, just three have forward earnings down more than 10.0% from their post-pandemic highs: Energy, Financials, and Materials. Since mid-August, all but the Industrials sector have seen forward profit margins retreat from their record highs, but half of them are showing early signs of recovering from their lows in early 2023. Industrials' forward profit margin is at a record high again this week, and Health Care is at a record low. Those of Consumer Discretionary, Financials, Real Estate, and Tech remain close to their post-pandemic highs. Energy and Industrials were the only two sectors to have their profit margins improve y/y for full-year 2022, and these five sectors are expected to see them improve y/y in 2023: Communication Services, Consumer Discretionary, Financials, Industrials, and Utilities. Here's how the sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (23.6%, down from its 25.4% record high in June 2022), Financials (18.5, down from its 19.8 record high in August 2021), Real Estate (17.0, down from its 19.2 record high in 2016), Communication Services (15.2, down from its 17.0 record high in October 2021), Utilities (12.9, down from its 14.8 record high in April 2021), S&P 500 (12.4, down from its record high of 13.4 achieved intermittently in 2022 from March to June 2022), Energy (11.4, down from its 12.8 record high in November), Materials (11.0, down from its 13.6 record high in June), Industrials (10.5, new record high this week), Health Care (9.5, new record low this week), Consumer Discretionary (7.6, down from its 8.3 record high in 2018), and Consumer Staples (6.7, down from its 7.7 record high in June 2020).

US Economic Indicators

Regional M-PMIs (*link*): So far, three Fed districts have reported on manufacturing activity for May—New York, Philadelphia, and Richmond—and show *manufacturing activity* (to -19.1 from -10.2) contracted at its fastest pace since May 2020. New York's (to -31.8 from 10.8) activity showed a big swing from expansion to contraction, while Richmond's (-15.0 from -10.0) activity fell at a faster pace than in April and Philadelphia's (-10.4 from -31.3) fell at a third of March's rate. *New orders* (-22.0 from -5.9) fell deeper into contractionary territory—matching January's pace, which was the weakest since May 2020—and the 13th consecutive reading in negative territory. Billings in the New York (-28.0 from 25.1) region showed a deep contraction in May after a big expansion in April, while Richmond's (-29.0 from -20.0) contracted at its fastest pace since the height of the pandemic. Philadelphia's (-8.9 from -22.7) continued to contract, though at a slower pace. *Employment* (-2.3 from -2.7) contracted for the fourth month, virtually matching April's pace, as hirings in the Richmond (5.0 from 0.0) region showed the first expansion in employment this year, while Philadelphia's (-8.6 from -0.2) contracted at a faster pace, while New York's (-3.3 from -8.0) expanded at a slower pace. Looking at *prices-paid* indexes, the Philadelphia (10.9 from 8.2) measure picked up marginally this month, after slowing dramatically in April, to its lowest percentage since mid-2020, while New York's (34.9 from 33.0) was little changed near two-year lows. Meanwhile, Richmond's (49.5 from 75.7) posted its slowest pace since February 2021. Philadelphia's was at a recent high of 83.6 in November 2021, while New York's was at a record high of 86.4 in April 2022, and Richmond's at a record high 150.1 last May. *Prices-received* indexes were mixed: New York's (23.6 from 23.7) held steady in March, not far from January's two-year low of 18.8; it was at a record high of 56.1 in March 2022, while

Philadelphia's moved down for the fourth month to -7.0—the weakest since April 2020—and Richmond's (53.9) was the weakest since May 2021. Philadelphia and Richmond were at record highs of 65.8 and 103.1 in November 2021 and June 2022, respectively. (Note: The New York and Philadelphia 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.)

New Home Sales (*link*): New home sales (counted at the signing of a contract) continued to increase in April, climbing for the sixth time in seven months, up 4.1% m/m and 20.5% over the period to 683,000 units (saar)—the highest since March 2022. Sales were 11.8% above a year ago—the first positive reading since February 2022—led by sales in the South (23.4% y/y) and Midwest (20.6), which both showed double-digit gains. Meanwhile, sales in the Northeast (-46.7% y/y) and West (-2.8) remained in the red—though the yearly decline in the West has narrowed dramatically from January's 46.5% y/y drop. Of the 683,000 homes sold in April, 266,000 units were under construction, while 262,000 were completed and 155,000 not yet started—the highest since March 2022. Meanwhile, there were 433,000 units for sale last month, with only 70,000 units completed and 100,000 not yet started; 263,000 were under construction. At the current sales pace, it would take 7.6 months to run through the supply of new homes, a 13-month low and down from 10.1 months last July—which was the highest since April 2009.

Global Economic Indicators

US PMI Flash Estimates (*link*): The US private sector expanded in May at its fastest pace in 13 months, according to flash estimates, as the divergence between the services and manufacturing sectors widened further. The *C-PMI* has increased the first five months of this year, climbing to 54.5 in April after falling in eight of the prior nine months, from 57.7 last March to 45.0 by December. The *NM-PMI* advanced for the fifth month, from 44.7 at the end of last year to a 13-month high of 55.1 this month, while the *M-PMI* fell back into contractionary territory in May, dropping to 48.5—its sixth month below 50.0 in the past seven months (it made a brief trip above 50.0 in April, hitting 50.2). Business *expectations* are improving for both service providers and goods producers, with the latter a bit more upbeat. Goods producers' hopes are tied to a pickup in demand conditions along with plans to invest in new products and marketing. Turning to *prices*, the report notes that the inflation picture is changing. During the pandemic manufacturing prices spiked due to strong demand and deteriorating supply, while now the service sector is hiking prices "amid resurgent demand and an inability to cope with order inflows due to lack of capacity."

Eurozone PMI Flash Estimates (*link*): Economic activity in the Eurozone slipped to a three-month low in May, according to flash estimates, as the M-PMI sank to a three-year low. The Eurozone's *C-PMI* fell to 53.3 this month after climbing the prior six months from a 23-month low of 47.3 in October to 54.1 by this April. The *M-PMI* slipped for the fourth month to 44.6 this month after advancing the prior three months, from 46.4 to 48.8, while the *NM-PMI* dipped to 55.9 after increasing the prior five months from 48.5 in November to a 12-month high of 56.2 this April. Looking at the two largest Eurozone economies, *Germany's C-PMI* moved further into expansionary territory, improving for the seventh straight month, from 45.1 in October to a 13-month high of 54.3 this month, as *Germany's NM-PMI* climbed during seven of the past eight months from 45.0 last September to a 21-month high of 57.8 this month. Meanwhile, *Germany's M-PMI* deteriorated for the fourth month, to a 36-month low of 42.9. Activity in France has lost momentum, with *France's C-PMI* slowing for the second month, to a four-month low of 51.4 this month, after advancing the prior three months from 49.1 in December to an 10-month high of 52.7 in March. It was at 57.6 last April. *France's NM-PMI* slipped to 52.8 this month after climbing steadily from 49.4 in January to an 11-month high of 54.6 in April; it was as high as 58.9 last April. Meanwhile, *France's M-PMI* was in contractionary territory for the eighth time in nine months, ticking up to 46.1 this month from a 35-month low of 45.6 last month. *Elsewhere across the region*, activity continued to expand, though cooled to its slowest pace since February due to slower, though still buoyant, growth in the service sector, while there was a steep fall in manufacturing output. Looking at *inflation*, it varies by sector. Pricing power in the services sector is getting a boost from a resurgence of post-pandemic demand, enabling service providers to pass on higher costs, mainly wages, to customers. Meanwhile, in manufacturing, weak demand and lower raw material prices, linked to surplus supply, pushed selling prices lower for the first time since September 2020.

Japan PMI Flash Estimates (*link*): Japan's private sector expanded at its best pace since October 2013 and its second strongest rate in survey history (going back to September 2007). Firms were optimistic about the outlook in activity over the near and medium terms. Japan's *C-PMI* hasn't posted a decline in six months, climbing from 48.9 in November to 54.9 this month, with the *NM-PMI* accelerating from 50.3 in November to a record-high 56.3 this month—with survey respondents attributing the pickup to the resumption of both domestic and international tourism. The *M-PMI* increased for the third successive month from 47.7 in February to 50.8 this month—the first reading above the breakeven point of 50.0 in seven months—with both new orders and production increasing at the strongest rate in 13 months. Manufacturers were encouraged as the suppliers' delivery time shortened for the first time since January 2020, though fractionally. Turning to prices, some firms mentioned hopes that inflationary pressures would soon peak, then ease throughout the remainder of this year. May saw a marked rise in input prices, though it was the softest rise since October 2021.

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