MORNING BRIEFING
July 3, 2023

Rolling Recovery

Check out the accompanying chart collection.

Executive Summary: Instead of the economywide recession that was widely expected to result from the Fed's monetary tightening, recessionary weakness rolled through different areas of the economy at different times. Now that rolling recession is turning into a rolling recovery. Accordingly, we're raising our Q2 real GDP forecast from 1.0% to 2.0%, followed by 2.0% in Q3 and Q4. We now see a 75% chance of a soft landing (up from 70%)—subject to change depending on what the Fed does, which depends on what inflation does. … We expect inflation to continue to moderate, with a headline PCED rate closer 3.0% by year-end, down from 4.6% in May. ... And: Dr. Ed reviews "Ghosts of Beirut" (+ + +).

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US Economy: Rolling Along. The Fed has raised the federal funds rate by 500bps since March of last year and seems to be on course to raise it by another 50bps over the rest of this year. Despite the monetary tightening, the US economy has avoided falling into an economy-wide recession. Instead, it has been experiencing a rolling recession since early last year, rolling through various industries at various times.

Now the economy is showing signs of experiencing a rolling recovery. Growing confidence in the resilience of the economy has been one of the main reasons why the stock market has been so strong since October 12, with the S&P 500 up 24.4%, the Nasdaq up 32.4%, and the S&P 500 Transportation index up 21.0% since that date.

Let's review some of the signs of that resilience and why we think that the rolling recession is turning into a rolling expansion:

(1) *GDP growth has slowed but remained positive.* It has been a soft-landing for real GDP so far. Here are the q/q increases over the past three quarters at a seasonally adjusted annual rate (saar): Q3-2022 (3.2%), Q4-2022 (2.6%), and Q1-2023 (2.0%). The most recent quarter's number was revised up from an initial estimate of 1.1% (*Fig. 1*).

Real final sales growth rates for the past three quarters were mostly strong at 4.5%, 1.1%, and 4.2% (*Fig. 2*). Real consumer spending remained remarkably resilient at 2.3%, 1.0%, and 4.2% notwithstanding rapidly rising interest rates. That's because employment gains remained robust and consumers spent some of the excess saving they had accumulated during the pandemic.

(2) *Residential investment has been in a recession for the past eight quarters, except for multi-family housing.* It first turned negative during Q2-2021, before the Fed started raising interest rates during March 2022. It fell 22.3% through Q1-2023 (*Fig. 3*). Contributing to the decline over this period were single-family housing (-25.6%), home improvements (-17.9%), and real estate brokers' commission (-33.6%). On the other hand, multi-family housing held up well, rising 5.4%.

Both new home sales and single-family housing starts soared during May by 12.2% and 18.5% m/m, respectively (*Fig. 4*). There's lots of pent-up demand for housing and a significant shortage of inventory. That may be enough to end the housing recession even if mortgage interest rates remain elevated. The Atlanta Fed's *GDPNow* tracking model is currently estimating a 0.7% increase in residential investment during Q2, up from -4.0% during Q1.

(3) *Capital spending on structures declined for six quarters (Q2-2021 through Q3-2022), but has risen for the past two quarters (through Q1-2023)* (*Fig. 5*). The latest rolling recession in capital structures was in spending on commercial, health, power, and communications facilities (*Fig. 6*). That weakness was partially offset by mining exploration, shafts, and wells structures. Spending on manufacturing plants was flat and depressed following the pandemic lockdowns, but it has surged over the past couple of quarters thanks to onshoring.

(4) *Capital spending on equipment declined during the past two quarters, but R&D and software spending have been strong* (*Fig. 7*). The weakness was widespread among information processing, industrial, transportation, and other equipment (*Fig. 8*). We are expecting information processing equipment spending to turn up soon. Meanwhile, business spending on software and R&D in real GDP rose to new record highs and should continue to do so. The Atlanta Fed GDPNow model is currently estimating that business equipment spending rose 6.7% (saar) during Q2.

(5) *Inventories rose sharply from Q4-2021 through Q4-2023, but inventories should no longer be a drag on real GDP going forward* (*Fig. 8*). Much of that was unintended, as

consumers pivoted from buying goods to purchasing services. Their goods buying binge during 2021 depleted inventories, causing wholesalers and retailers to order more merchandise, which piled up as unintended inventories when they finally arrived. Inventory investment in real GDP dropped sharply from $136.5 billion (saar) during Q4-2022 to $3.5 billion during Q1-2023, suggesting that the inventory overhang has been resolved. That drop in inventory investment reduced real GDP during Q1 by 2.14 ppts. Inventories won't be a negative contributor to real GDP growth over the remainder of this year, in our opinion.

(6) *Total government spending on goods and services in real GDP has been rising fast for three quarters (through Q1-2023) after falling for five (Q2-2021 through Q2-2022)* (*Fig. 9*). It has been rising at a faster pace than real GDP for the past three quarters, at 3.7%, 3.8%, and 5.0%. That's likely to continue as the Biden administration's program to rebuild national infrastructure cranks up.

(7) *Consumers' spending on services should continue to rise, more than offsetting any weakness in their spending on goods.* The latter peaked at a record high during March 2021 (*Fig. 10*). It was down 3.9% through May of this year, though it has been essentially flat since H2-2021. Over this same period (since goods spending peaked), spending on services rose 9.5% to a new record high. Actually, during Q1-2023, consumers' spending on goods in real GDP rose 6.0% (saar), led by a 16.3% jump in spending on durable goods (*Fig. 11*). Their spending on services rose 3.2%.

Inflation-adjusted disposable personal income (DPI) has been trending higher over the past 11 months through May (*Fig. 12*). We expect that real DPI will continue to rise along with employment and real wages. We also predict that the personal saving rate will remain relatively low (*Fig. 13*). It is widely expected that it will move higher and depress consumers' spending once they deplete the excess savings they accumulated during the pandemic. We disagree, because retiring Baby Boomers have accumulated a much greater $75 trillion in "excess" net worth and we believe they intend to spend quite a bit of it during their retirement years.

(8) *Our rolling recovery scenario adds up to no recession ahead.* We are updating our soft-versus-hard-landing subjective odds from 70/30 to 75/25. We are raising our forecast for Q2's real GDP from 1.0% to 2.0% and maintaining this growth-rate projection for H2-2023 (*Fig. 14*).

We might have to return to 70/30 or even 60/40 for 2024 if the Fed turns too hawkish in response to the resilience of the economy in general and the labor market in particular. Of course, much will depend on inflation. If the headline inflation rate continues to moderate and the core rate shows more signs of moderating, then the Fed should become less hawkish even if the economy continues to defy the recession forecasters.

Let's turn now to an update of the inflation situation and outlook.

US Inflation: Headline Moderating, Core Stalling. The headline PCED inflation rate fell to 3.8% y/y during May, down from last year's peak of 7.0% y/y during June 2022 (*Fig. 15*). So it is now at the top end of our 3.0%-4.0% forecast range for 2023. We expect to see it closer to 3.0% by the end of this year. That would require the core PCED inflation rate to moderate. It has been stuck around May's reading of 4.6% y/y for the past five months.

Let's drill down into the latest inflation numbers:

(1) *PCED durable goods.* The PCED inflation rate for durable goods peaked at 10.5% y/y during February 2022 (*Fig. 16*). It was down to just 0.7% y/y in May of this year. It has a history of deflating from the mid-1990s through 2020. We think it could continue to be a negative contributor to inflation over the rest of this year.

(2) *PCED nondurable goods.* The PCED inflation rate for nondurable goods tends to be volatile and hard to predict (*Fig. 17*). That's mostly because food and energy prices tend to be volatile and unpredictable. Nevertheless, the three-month annualized percent changes and the y/y percent changes in energy (-25.8%, -11.7%) and food (1.0%, 6.7%) through May suggest that their y/y rates are likely to continue to fall (*Fig. 18*).

On the other hand, the inflation components in the core nondurable goods category remain persistently high: personal care (7.8% y/y), household supplies (7.3), magazines, newspapers & stationary (5.4), recreational items (5.0), and clothing & footwear (2.9) (*Fig. 19*).

(3) *PCED services.* The core PCED services inflation rate is also stalling (*Fig. 20*). It was 5.3% in May. Rent of shelter accounts for 23% of the core services PCED. The three-month annualized inflation rates versus the y/y rates for rent of primary residence (6.2%, 8.7%) and owners' equivalent rent (6.3%, 8.1%) suggest that they should moderate over the rest of this year.

The problem is that the PCED for core services excluding housing has stalled around 4.5% for the past several months (*Fig. 21*). Here are the y/y PCED inflation rates of the major core PCED services components: personal care (10.0%), housing (8.3) transportation (7.1), recreation (4.7), health care (2.7), education (2.6), and communication (0.0) (*Fig. 22*).

(4) *Bottom line.* The headline PCED inflation rate has moderated significantly. The core PCED inflation rate has been stickier. Both remain well above the Fed's 2.0% inflation target. The core rate's stickiness isn't attributable just to rent inflation. Core nondurable goods inflation was 5.3% in May, while the core services inflation rate excluding housing was 4.5%.

So why is the stock market so bubbly? Investors seem to have concluded that another 50bps increase in the federal funds rate won't knock our resilient economy into a recession, since it has already withstood a 500bps increase since last March. Yet investors must believe that even the stickier inflation components will moderate over the rest of the year. We agree.

Movie. "Ghosts of Beirut" (+ + +) (*link*) is an excellent docudrama about the efforts of the CIA and Mossad over several years to kill Imad Mughniyey, alias al-Hajj Radwan. He was the founding member of Lebanon's Islamic Jihad Organization and number two in Hezbollah's command. He was often referred to as an "untraceable ghost." US and Israeli officials accused him of orchestrating numerous terrorist attacks including the Beirut barracks bombing and US embassy bombings, both of which took place in 1983 and killed over 350, as well as the kidnapping of dozens of foreigners in Lebanon in the 1980s. He was indicted in Argentina for his alleged role in the 1992 Israeli embassy attack in Buenos Aires. He was accused of killing more US citizens than any other man prior to the September 11 attacks.

Calendars

US: **Mon:** Construction Spending 0.5%; ISM M-PMI 47.2. **Tues:** None. (Bloomberg estimates)

Global: **Mon:** Eurozone, Germany, and France M-PMIs 43.6/41.0/45.5; UK M-PMI 46.2; Nagel. **Tues:** Germany Trace Balance; Canada M-PMI 49.6; China Caixin NM-PMI; RBA Interest Rate Decision 4.35%. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index rose 2.4% last week for its sixth gain in seven weeks and moved out of a correction to 8.5% below its record high on December 27, 2021. The US MSCI ranked 13th of the 48 global stock markets that we follow in a week when 36 of the 48 countries rose in US dollar terms. The AC World ex-US index underperformed with a 1.2% gain and remains in a deep 15.8% correction from its June 15, 2021 record high. All of the developed regions rose w/w, while the EM regions all declined slightly. EMU was the best performer with a 3.1% rise, ahead of EAFE (1.6) and the AC World ex-US (1.2). EM Latin America (-0.7) was the worst performing region last week, followed by EM Eastern Europe (-0.4), EM Asia (-0.3), EMEA (-0.2), and BIC (0.5). Austria was the best-performing country last week, with a gain of 4.9%, followed by Spain (4.1), Italy (4.0), the Netherlands (3.7), and Canada (3.5). Among the 23 countries that underperformed the AC World ex-US MSCI last week, the 9.3% decline for the Czech Republic was the biggest, followed by those of Israel (-2.6), Taiwan (-2.4), Brazil (-1.8), and Turkey (-1.6). In June, the US MSCI ranked 14/48 as it rose 6.5%, ahead of the 4.2% gain for the AC World ex-US index, as 40 of the 48 countries moved higher. Argentina was the best performer, with a gain of 25.9%, followed by Brazil (14.6), Poland (14.2), Colombia (11.5), and Peru (11.1). The worst-performing countries in June: Pakistan (-4.6), Turkey (-4.4), the Czech Republic (-4.3), Jordan (-2.4), and Malaysia (-2.1). All of the regions rose in June, but EM Latin America with an 11.0% gain was in the lead, ahead of EM Eastern Europe (10.5), EMU (6.1), BIC (4.8), and EAFE (4.4). EM Asia was June's worst-performing region, albeit with a gain of 2.1% and followed by EMEA (3.4). Looking at 2023's performance so far, the US MSCI is up 16.2%; its ytd ranking jumped five spots w/w to 11/48. The AC World ex-US's ytd gain of 7.7% is trailing that of the US, with 32/48 countries now in positive territory. EM Eastern Europe is the best regional performer ytd, with a gain of 22.6%, followed by EMU (15.6), EM Latin America (14.6), and EAFE (9.7). The regional laggards so far in 2023: BIC (-1.6), EMEA (2.1), and EM Asia (2.9). This year's best ytd country performers: Greece (40.7), Argentina (40.5), Ireland (25.4), Hungary (25.3), and Mexico (25.1). Here are the worst-performing countries of the year so far: Pakistan (-31.1), Turkey (-21.2), Malaysia (-13.4), Norway (-11.9), and Thailand (-11.1).

S&P 500/400/600 Performance (*link*): All three of these indexes moved higher w/w. LargeCap rose 2.3% w/w, less than the 4.3% gains for SmallCap and MidCap. At Friday's close, LargeCap finished the week at 7.2% below its record high on January 3, 2022, MidCap left a correction to end the week at 9.9% below its record high on November 16, 2021, and SmallCap left a bear market to finish at 17.0% below its November 8, 2021 record high. All 33 LargeCap and SMidCap sectors moved higher for the week, up from just one rising a week earlier. SmallCap Communication Services was the best performer with a gain of 6.8%, ahead of MidCap Energy (6.3), MidCap Tech (6.2), SmallCap Materials (6.2), SmallCap Tech (6.2), and SmallCap Real Estate (6.2). Among the biggest underperformers for the week were LargeCap Communication Services (0.4), LargeCap Consumer Staples (0.6), LargeCap Health Care (0.6), LargeCap Utilities (0.7), and MidCap Utilities (1.0). During June, LargeCap rose 6.5% for its fourth straight monthly gain, compared to the first gain in five months for MidCap (9.0) and SmallCap (8.0). Thirty-one of the 33 sectors rose in June compared to just five rising in May. June's best performers: SmallCap Energy (14.0), MidCap Industrials (13.9), SmallCap Industrials (12.7), MidCap Energy (12.0), and LargeCap Consumer Discretionary (12.0). June's biggest laggards: SmallCap Utilities (-3.3), MidCap Utilities (-1.3), LargeCap Utilities (1.5), LargeCap Communication Services (2.6), and LargeCap Consumer Staples (2.9). Looking at performances so far in 2023, LargeCap, with a gain of 15.9%, remains well ahead of MidCap (7.9) and SmallCap (5.1); 20 of the 33 sectors are higher ytd. The top sector performers in 2023: LargeCap Tech (42.1), LargeCap Communication Services (35.6), LargeCap Consumer Discretionary (32.3), MidCap Tech (24.3), and SmallCap Tech (23.0). Here are 2023's biggest laggards: SmallCap Financials (-16.0), MidCap Utilities (-10.8), MidCap Financials (-8.2), SmallCap Energy (-7.3), and LargeCap Energy (-7.3).

S&P 500 Sectors and Industries Performance (*link*): All 11 S&P 500 sectors rose last week, and seven outperformed the composite index's 2.3% gain. That compares to a 1.4% decline for the S&P 500 a week earlier, when one sector rose and four outperformed the index. Real Estate was the best performer, with a gain of 5.0%, followed by Energy (4.8%), Materials (4.0), Industrials (3.9), Financials (2.9), Tech (2.9), and Consumer Discretionary (2.5). Communication Services was the worst performer, albeit with a 0.4% gain, followed by Consumer Staples (0.6), Health Care (0.6), and Utilities (0.7). The S&P 500 rose 6.5% in June as all 11 sectors moved higher and five outperformed the broader index. That compares to three sectors rising and three outperforming the S&P 500's 0.2% gain in May. The leading sectors in June: Consumer Discretionary (12.0), Industrials (11.2), Materials (10.8), Tech (6.5), and Financials (6.5). June's laggards: Utilities (1.5), Communication Services (2.6), Consumer Staples (2.9), Health Care (4.2), Real Estate (4.8), and Energy (6.5). Looking at 2023's performance so far, the S&P 500 is up 15.9% ytd, with just three sectors still outperforming the index but five are higher for the year. The best ytd performers: Tech (42.1), Communication Services (35.6), and Consumer Discretionary (32.3). These are 2023's worst performers: Energy (-7.3), Utilities (-7.2), Health Care (-2.3), Financials (-1.5), Consumer Staples (0.0), Real Estate (1.9), Materials (6.6), and Industrials (9.2).

S&P 500 Technical Indicators (*link*): The S&P 500 rose 2.3% last week and improved relative to its 50-day moving average (50-dma) and its 200-day moving average (200-dma). The index was above its 50-dma for a 14th week and its 200-dma for a 15th week. It had been above its 200-dma for eight weeks through early March in its longest positive 200-dma streak since it was above for 81 straight weeks through January 2021. The S&P 500 improved to 5.1% above its rising 50-dma from 3.3% a week earlier, down from a 20-week high of 5.4% above its rising 50-dma the week before that. That compares to a 20-week low of 3.6% below at the beginning of March, a four-month low of 10.6% below at the end of September, a 23-month high of 8.7% above the index's rising 50-dma in early August, and a 27-month low of 11.1% below its falling 50-dma in June 2022. The index had been mostly trading above its 50-dma from late April 2020 to early April 2022; 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 a 19-month high of 11.0% above its rising 200-dma, up from 8.8% above a week earlier. The S&P 500 is well above its 26-month low of 17.1% below its falling 200-dma in June 2022 and compares to 10.8% above its rising 200-dma in November 2021. That also 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. As for what the dmas themselves have been up to, the 50-dma moved higher for a 15th week, and the 200-dma rose for a fifth week but has risen in just 17 of the past 59 weeks.

S&P 500 Sectors Technical Indicators (*link*): Nine of the 11 S&P 500 sectors are trading above their 50-dmas, up from seven a week earlier and down from all 11 sectors above during the April 28 week. Energy and Real Estate moved above in the latest week, leaving these two as the only sectors still trading below their 50-dma: Consumer Staples and Utilities. Seven sectors have a rising 50-dma, up from four a week earlier, as Financials, Materials, and Real Estate turned back up w/w. That leaves these four sectors as the only members in the falling 50-dma club: Consumer Staples, Energy, Health Care, and Utilities. Looking at the more stable longer-term 200-dmas, the positive club improved to nine members w/w from seven as Financials and Real Estate turned up w/w. That leaves Energy and Utilities as the only sectors still trading below their 200-dmas. The rising 200-dma club rose to 10 members w/w from seven as Energy, Financials, and Real Estate turned up w/w. That leaves Utilities as the only sector with a falling 200-dma.

US Economic Indicators

GDP (*link*): Real GDP for Q1 was revised higher for the *second* time to 2.0% (saar), from the second estimate of 1.3% and the *initial* estimate of 1.1%. That followed gains of 2.6% and 3.2% the prior two quarters. The *latest* GDP estimate was revised up by 0.7ppt, reflecting upward revisions to consumer spending and exports, while there was a downturn in inventory investment and a slowdown in business investment. Growth in real consumer spending, which accounts for just over two-thirds of GDP, was revised higher to a seven-quarter high of 4.2% (saar) during Q1 from Q4's 1.0%, led by a 16.3% (saar) jump in *durable goods* expenditures—driven by a 45.2% surge in motor vehicles spending. Real services spending picked up to 3.2% (saar), double Q4's 1.6% increase, led by health care, food services & accommodation, and other services. Real *nondurable* goods consumption was subdued again last quarter, increasing a downwardly revised 0.5% (saar) during Q1, following a 0.6% gain during the final quarter of last year; spending had declined the first three quarters of 2022. Meanwhile, *real gross private domestic investment* contracted a slightly steeper 11.9% (saar) during Q1, after increasing 4.5% during Q4-2022, as real inventory investment dropped $133.0 billion during Q1 (to $3.5 billion from $136.5 billion). *Residential investment* contracted for the eighth consecutive quarter, falling a slower 4.0% (saar) during Q1, easing from double-digit declines the prior three quarters, while nonresidential investment expanded 0.6% (saar), about half the second estimate of 1.4%, slowing from 4.0% and 6.2% the prior two quarters. Within *nonresidential investment*, equipment spending contracted 8.9% (saar) after a 3.5% setback at the end of last year. Meanwhile, structures posted the first back-to-back quarterly gains since 2019, jumping 15.8% (saar) during both Q1 and Q4; investment had declined for six successive quarters. Spending on intellectual property products increased 3.1% (saar), slowing steadily from Q1-2022's 10.8%; it hasn't posted a decline since Q2-2020 at the height of the pandemic. Turning to trade, *real net exports of goods & services* narrowed for the fourth straight quarter—to $1.21 trillion from a record high of $1.49 trillion a year ago—as real exports rebounded 7.8% after declining 3.7% in Q4 and imports rose 2.0% after falling for two quarters. (Imports are subtracted in the calculation of GDP, so Q1 imports contributed negatively.) *Real government spending* advanced for the third successive quarter, accelerating 5.0% (saar) during Q1 from 3.8% and 3.7% the previous two quarters, as *federal* spending rose 6.0%, led by nondefense spending. *State & local government* expenditures increased 4.4% (saar) during Q1, following gains of 2.6% and 3.7% the prior two quarters, which followed three quarters of contraction.

Contributions to GDP Growth (*link*): *Consumer* spending (2.79ppts) was the biggest positive contributor to real GDP growth during Q1, led by durable goods (1.28) consumption—boosted by motor vehicles (1.06)—while services (1.44) consumption got a lift from health care (1.03). Meanwhile, nondurable goods (0.07) spending had little impact. *Government* spending (0.85) was the second biggest contributor, with both federal (0.38) and state & local (0.47) expenditures adding to the gain. *Trade* (0.58) also added to the top line, as a positive contribution from exports (0.86) more than offset a negative contribution from imports (-0.28). Nonresidential (0.08) investment had little impact, as gains in structures (0.40) and intellectual property products (0.16) spending were depressed by the continued decline in equipment (-0.48) spending. Meanwhile, inventory investment (-2.14) was a major drag on Q1 growth—all nonfarm (-2.24)—while residential investment (-0.16) was a minor drag.

Personal Income & Consumption (*link*): Personal income continued to rise in May, boosted by big gains in wages & salaries, while consumer spending continued to set new record highs, though the pace slowed. *Personal income* rose 0.4% in May, following gains of 0.3% and 0.4% the prior two months. It was the 16th successive gain, climbing 7.3% over the period. *Wages & salaries* has posted only two declines in the past 27 months, climbing 0.5% in May and 19.1% over the period; *adjusted for inflation*, however, wages & salaries remain stalled just below last September's record high. *Personal consumption expenditures* continued to set new record highs in May, with spending climbing the first five months of his year, by 0.1%m/m and 3.0% ytd; spending on goods and services were up 2.6% and 3.2%, respectively ytd. In real terms, consumer spending in May was flat, with spending on goods down 0.4% and services up 0.2%. Year to date, real goods consumption climbed 1.9%, while real services consumption was up 1.3%; compared to a year ago, the former was up 1.1% and the latter 2.6%. Meanwhile, *personal saving* rose for the seventh time in eight months, climbing $335.9 billion over the period to $910.3 billion in May, with the *saving rate* rising climbing from 4.3% to 4.6%, matching March's 4.6%, which was the highest since May 2022.

Consumer Sentiment Index (*link*): Consumer sentiment continued to recover during the second half of June. "Overall, this striking upswing reflects a recovery in attitudes generate by the early-month resolution of the debt ceiling crisis, along with more positive feeling over softening inflation," noted Joanne Hsu, director of consumer survey for the University of Michigan. *Overall consumer sentiment* rose for the fifth time in seven months, by 5.2 for all of June and 7.6 points over the period to 64.4, with the *present situation* component climbing 4.1 points and 10.2 points over the comparable periods to 69.0. They were at record lows of 50.0 and 53.8, respectively, a year ago. The *expectations* component rose 6.1 points and 5.9 points over the comparable periods to a four-month high of 61.5. Turning to inflation, the *one-year expected inflation rate* moved down for the second month, from a five-month high of 4.6% in April to 3.3% in June; that's the lowest reading since March 2021, easing worries about sticky inflation. The *five-year expected inflation rate* eased from 3.1% to 3.0% in June. It was at 2.9% the first three months of this year, remaining within the narrow 2.9%-3.1% range of 22 of the past 23 months. Long-run inflation expectations remained elevated relative to the 2.2%-2.6% range seen in the two years pre-pandemic.

Personal Consumption Deflator (*link*): May's PCED increased only 0.1%, and has averaged gains of only 0.2% the past four months. Core prices also rose, by 0.3% in May—matching its average over the past four months. The yearly headline rate eased to 3.8% (the lowest since April 20201), slowing from a peak of 7.0% last June—which was the highest since the end of 1981. The yearly core rate slowed to 4.6%, hovering around that rate the past six months, easing from a recent peak of 5.4% during February and March of last year. On a *three-month annualized* basis, the core rate eased for the third month to 4.1% (saar) in May, from 5.0% in February, a few ticks below its 4.6% yearly rate. The three-month rate for durable goods returned to positive territory, rising 1.5% (saar) in May after not posting a gain since October, while the three-month rate for core nondurable goods prices was little changed at 9.3% (saar) after accelerating to 10.3% in March—from a recent low of 1.0% during December and November. Meanwhile, services prices ex energy slowed for the third month to 4.4% (saar) during the three months through May, from 6.1% in February. The three-month annual rates for both core nondurable goods (9.3%, saar & 5.3% y/y) and consumer durable goods (1.5% & 0.7%) were above their yearly rates, while three-month rate for consumer services ex energy (4.4 & 5.4) was below yearly rate. *PCED components for which three-month rates lag yearly rates*: gasoline & other energy products (-31.0 & -21.9), household appliances (-14.6 & -8.7), sports & recreational vehicles (-9.2 & 0.6), airfares (-4.5 & 2.6), video audio & information processing (-4.2 & -2.7), furniture & home furnishings (-2.6 & 0.7), recreation services (-1.0 & 4.7), food & nonalcoholic beverages purchased for off-premise consumption (-0.5 & 6.1), transportation services (-0.4 & 7.1), new motor vehicles (0.1 & 5.1), alcoholic beverages purchased for off-premise consumptions (1.2 & 3.9), prescription drugs (1.9 & 3.1), motor vehicles & parts (3.7 & 4.1), tobacco (5.8 & 6.3), tenant rent (6.2 & 8.7), and owner-occupied rent (6.3 & 8.1). *PCED components for which three-month rates exceed yearly rates*: used motor vehicles (32.9 & -2.6), professional & other services (18.3 & 8.3), personal care products (10.1 & 7.8), lodging away from home (6.4 & 2.3), hospitals (4.9 & 3.0), and clothing & footwear (4.4 & 2.9). *PCED components for which three-month rates & yearly rates are comparable*: education services (2.4 & 2.6) and physician services (1.0 & 0.7).

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): Neither the Economic Sentiment Index (ESI) for the EU nor the ESI for the Eurozone has posted a gain since January. The *EU's measure* fell 3.7 points to 94.0 during the five months through June, while the *Eurozone's gauge* fell 4.3 points to 95.3—down from their January readings of 97.7 and 99.6, respectively; they were at record highs of 117.8 and 118.7 during October 2021. ESIs among the *six largest EU economies* were mostly lower in June, with ESIs in Germany (-1.9 to 93.4), Italy (-1.1 to 101.2), the Netherlands (-1.0 to 93.9), and Spain (-0.9 to 99.6) falling, Poland's (-0.1 to 93.3) little changed, and France's (+0.8 to 96.4) improved. They were at 97.8, 102.6, 94.4, 101.7, 90.2, and 98.4, respectively, at the start of the year. *By sector*, *consumer* confidence in the overall EU hasn't posted a decline since sinking to a record low of -29.8 last September, rebounding 12.6 points during the nine months through June to -17.2. *Retail trade* confidence sank for the third time in four months in June, by 4.2 points, from -1.2 in February to -5.4 in June. *Industrial* confidence remains in a freefall since reaching a record high of 12.9 in December 2021, dropping to -8.1 this June, while *construction* confidence deteriorated to -4.6 in June from a record high of 8.4 at the end of 2021. Meanwhile, *service* confidence dipped 2.6 points during the two months through June, from 7.5 to 4.9.

Eurozone CPI Flash Estimates (*link*): The CPI rate for June is expected to move down to 5.5%—its lowest since January 2022—from 6.1% in May; it peaked last October at a record-high 10.7%. Looking at the main components, *energy* is expected to contract 5.6% y/y, its third negative reading in four months and the weakest since December 2020, following double-digit yearly gains from April 2021 through February of this year. It peaked at a record high of 44.3% last March. The rate for *food, alcohol & tobacco* is expected to slow for the third month to 11.7% y/y after accelerating steadily from June 2021's 0.5% to a record high of 15.5% this March. The rate for *non-energy* industrial goods is forecast to ease for the fourth month to 5.5% y/y from February's record-high 6.8%. The *services* rate is predicted to accelerate to 5.4% y/y in June, the highest since February 1993. Of the *top four Eurozone economies*, only Germany (6.8% y/y) and Italy (6.7) showed rates above the Eurozone's 5.5% rate, while France's (5.3) was only a few ticks below. Meanwhile, Spain's (1.6) rate was one of the lowest of the overall Eurozone economies. Here are the record-high inflation rates and dates they were achieved for the four countries: Germany (11.6%, October 2022), Italy (12.6%, October & November 2022), France (7.3%, February 2023), and Spain (10.7%, July 2022).

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