MORNING BRIEFING
July 26, 2023

Over There & Over Here

Check out the accompanying chart collection.

Executive Summary: We keep tabs on how well the world economy is faring by monitoring our Global Growth Barometer as well as the “flash” S&P Global PMIs for the major developed economies. “Soft landing” best describes what the global economy has been undergoing, while “no landing” characterizes the slowly growing US economy. … China’s economy has struggled under the weight of several problems; we doubt the leadership can fix them as promised. … In the US, the latest consumer confidence survey shows that the labor market remains strong.

Global Economy I: Getting Softer. Here in the United States, the debate between the hard landers and soft landers continues even though the data suggest that the no-landing scenario might more aptly describe the performance of the economy.

On a global basis, there was much talk about a hard landing last summer, especially in Europe and China. But the Europeans enjoyed a warm winter and found plenty of natural gas to avoid freezing in the dark had it been a severe winter. The Chinese government abruptly ended its draconian policy of pandemic lockdowns at the end of last year. It was widely expected that the Chinese economy would experience a post-lockdown boom. Instead, the recovery has been anemic at best. Meanwhile, the US economy continues to grow, albeit slowly.

The flash S&P global PMIs for July suggest that the global economy continues to avoid a hard landing, while falling into a soft landing. Let’s review the data, starting with our Global Growth Barometer (GGB):

(1) *Global Growth Barometer*. Debbie and I like to monitor our daily GGB to assess whether global economic activity is growing or slowing (*Fig. 1*). The GGB is the average of the Brent crude oil nearby futures price and the CRB raw industrials index (multiplied by 2 and divided by 10). Our GGB closely tracks the S&P Goldman Sachs commodity index (*Fig. 2*). However, we prefer our GGB because it does not include agricultural and lumber prices and because we can track the contributions of the CRB index (which does not include energy, food, or lumber commodities) and the price of oil to our GGB (*Fig. 3*).

Our GGB peaked near the beginning of last year at 130.7 on March 8. It fell to 99.9 by the end of 2022. On Monday, July 24, it was down slightly to 97.2.

By the way, both our GGB and the S&P Goldman Sachs index are inversely correlated with the trade-weighted dollar (*Fig. 4* and *Fig. 5*). The dollar tends to be strong (weak) when the global economy is relatively weak (strong) compared to the US. The dollar has been lackluster and range-bound since the start of the year, even though the US economy has performed relatively well compared to the rest of the world.

(2) *US PMIs*. The S&P Global M-PMI for the US edged up in July to 49.0 (*Fig. 6*). It has been mostly below 50.0 since November 2022, as consumers have pivoted from buying goods to buying services. The NM-PMI edged down to 52.4 in July, remaining above 50.0 since February.

(3) *Eurozone PMIs*. The Eurozone M-PMI has been below 50.0 since July 2022 (*Fig. 7*). It was 42.7 in July, the lowest since May 2020. The region's NM-PMI was 51.1 during July, the weakest since January.

Especially weak has been Germany's M-PMI at only 38.8 during July (*Fig. 8*). During the month France had the weakest NM-PMI at 47.4 (*Fig. 9*).

(4) *Japan PMIs*. During July, Japan's M-PMI edged down to 49.4 from 49.8 in June (*Fig. 10*). It has been mostly below 50.0 since November 2022.

(5) *MSCI forward revenues*. Forward revenues for the US MSCI has been on a gradual uptrend since mid-2022 following a steep uptrend that started in mid-2020 (*Fig. 11* and *Fig. 12*). It rose to a record high during the July 13 week. Over the past year, the forward revenues for the developed world ex-US and for the emerging markets MSCI indexes have been flat. (FYI: Forward revenues is the time-weighted average of industry analysts' consensus revenues estimates for the current year and following one.)

Global Economy II: CCP to the Rescue? As we've previously observed, China's economy is having more difficulty than expected emerging from the three years of zero-Covid lockdowns that ended late last year. Real GDP fell 1.7% q/q (saar) during Q2-2023. China's property market is in decline and so is the construction work it generates—responsible for about a quarter of economic growth—as the air continues to come out of its property bubble. Consumer spending remains lackluster, as households are cautious about making big purchases. A rapidly aging demographic profile is also weighing on consumption.

The unemployment rate for 16- to 24-year-olds hit a record-high 21% last month. Indebted local governments are edging toward defaulting on their debts. A record 11.6 million people left college this summer and are finding fewer jobs than usual. Some of the young unemployed are living with their parents and jokingly describe themselves as “full-time children” again.

The Chinese Communist Party (CCP) has long justified its authoritarian rule by promising a brighter economic future. President Xi Jinping pledged to reduce inequality and deliver “common prosperity.” But the economy is sputtering, and the future is looking less bright.

China’s leaders are clearly worried about social unrest. The CCP is scrambling to boost economic growth. The government is shifting course to improve the business environment following three years of heavy-handed measures to regulate and supervise the economy more tightly. In addition, Beijing is formulating measures to boost consumption, particularly of electric vehicles. The government also has promised to “adjust and optimize policies in a timely manner” for its depressed property sector, and to “activate capital markets and boost investor confidence.”

It's obviously too soon to tell whether the barrage of promises to make things better for the economy will work. We are skeptical. So far, the reactions of the nearby futures price of copper and the China MSCI stock price index have been muted (*Fig. 13*). Both are sensitive indicators of China’s economic activity. We do expect China’s leadership will tone down its belligerent rhetoric about Taiwan while the country’s leaders are playing nice, for a change, to attract foreign investors.

US Labor Market: Still Booming. The earliest monthly indicator of the US jobs market is the consumer confidence survey conducted monthly by the Conference Board. July’s survey came out on Tuesday. The Consumer Confidence Index rose smartly this month, with solid gains in both its current conditions and expectations components (*Fig. 14*). Furthermore, consider the following:

(1) The survey’s “jobs plentiful” series edged up to 46.9% (*Fig. 15*). That’s down from readings of over 50.0% last year, but it remains elevated and suggests that the “job openings” series in the JOLTS report remained very high in June and July.

(2) The survey’s “jobs hard to get” series edged down to a near-record low (since 1967) of 9.7% this month (*Fig. 16*). This series is highly correlated with the unemployment rate and suggests that it remained near recent lows during July. July’s employment report will be

released on August 4. It could be another strong one. The next recession remains a no-show for now.

Calendars

US: Wed: New Home Sales 722k; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production; Fed Interest Rate Decision 5.50%; FOMC Statement. **Thurs:** GDP & GDP Price Index 1.7%/3.0%; Core PCE Prices 4.0%; Kansas City Manufacturing Index -6; Durable Goods Orders, Total and Nondefense Capital Goods Orders Ex Aircraft 0.7%/-0.1%; Goods Trade Balance -$91.8b; Initial & Continuous Jobless Claims 235k/1.75m; Pending Home Sales -0.6%; Natural Gas Storage. (Bloomberg estimates)

Global: Wed: France Consumer Confidence 84; Japan Leading & Coincident Indicators; China Industrial Profit. **Thurs:** Germany Gfk Consumer Climate -24.7; Italy Business & Consumer Confidence 99.8/107.6; Spain Retail Sales 0.6%; Spain Unemployment Rate 13.8%; ECB Interest Rate Decision & Deposit Facility Rate 4.25%/3.75%; BOJ Interest Rate Decision -0.10%; Lagarde. (Bloomberg estimates)

Strategy Indicators

S&P 500 Q2 Earnings Season Monitor (*link*): With the Q2-2023 earnings season now over 25% complete, the early indications from the companies that have reported so far suggest a similar earnings surprise than in Q1-2023 but a weaker revenues surprise. During Q4-2022, the earnings surprise was the lowest since Q4-2008 and the revenue surprise the smallest since Q1-2020. Furthermore, the earnings surprise failed to outpace the revenue surprise in Q4-2022 for the first time since we began tracking that data in Q1-2009. With 123 of the S&P 500 companies finished reporting for Q2-2023, revenues are ahead of the consensus forecast by 1.4%, and earnings have exceeded estimates by 7.9%. At the same point during the Q1 season, revenues were 2.3% above forecast, and earnings had beaten estimates by 8.5%. For the 123 companies that have reported Q2 results so far through mid-day Tuesday, 61% has reported a positive revenues surprise while 76% has reported an earnings beat. That’s on pace for the narrowest revenues beats reading since Q1-2020; but the percentage with positive earnings surprises is on par with those of the prior seven quarters. The reporters’ aggregate y/y revenues and earnings growth rates have improved from their Q1-2023 readings: to 1.3% from 0.8% for earnings growth and to 6.4% from 5.7%

for revenues growth. Over the past 57 quarters through Q1-2023, y/y earnings growth has trailed y/y revenues growth in only 15 quarters including the past five, and it's already doing so again in Q2-2023 as Energy sector results are being reported. Significantly fewer companies have been reporting positive y/y earnings growth in Q2 (55%) than positive y/y revenues growth (70%). These figures will continue to change as more Q2-2023 results are reported in the coming weeks. While we expect y/y revenues growth rates to remain positive in Q2, earnings are sure to decline for a third straight quarter.

US Economic Indicators

Consumer Confidence (*link*): "Consumer confidence rose in July 2023, to its highest level since July 2021, reflecting pops in both current conditions and expectations" notes Dana Peterson, chief economist at The Conference Board. "Headline confidence appears to have broken out of the sideways trend that prevailed for much of the last year. Greater confidence was evident across all age groups, and among both consumers earning incomes less than $50,000 and those making more than $100,000," she added. *Headline* consumer confidence posted back-to-back sharp gains, jumping 6.9 points in July and 14.5 points during the two months through July to 117.0, with both the *expectations* (+16.8 points to 88.3) and *present situation* (11.0 to 160.0) components posting sizeable gains over the two-month period. The expectations component moved above 80.0—a level the Conference Board associates with a recession within the next year—for the first time since February 2022. *Current business conditions* were slightly less optimistic in July, with the percentage of consumers saying business conditions were good slipping to 21.9% from 23.4% in June, while 15.2% said business conditions were bad, essentially unchanged from 15.3% in June. Meanwhile, consumers' assessment of the *current labor market* improved in July, with 46.9% of consumers saying jobs are plentiful, up from 45.4% in June, and 9.7% saying jobs are hard to get, much lower than June's 12.6%. *Short-term business conditions* (six-month outlook) improved again in July: 17.1% expected business conditions to improve this month, up from 14.6% in June and 13.2% in May, while the percentage expecting conditions to worsen sank to 14.0% from 17.7% in June and 21.4% in May. Consumers' assessment of the *short-term labor market* was also more favorable, with the percentage of consumers expecting more jobs to be available six months from now climbing to 16.4% from 15.4% in June and 13.8% in May; only 14.8% anticipated fewer jobs, down from 16.7% in June and 21.1% in May. Consumers' *short-term financial prospects* became more tempered in July, with 16.3% expecting their incomes to improve, down from 18.6% in June, while 9.7% expect their incomes will decrease, down from 11.8% in June. As for the *family's current financial situation*, 31.6% of consumers say their situation is good, up from 28.8% in June, while 17.6% say finances are bad, down from 18.6% in June.

Regional M-PMIs (*link*): Three Fed districts have reported on manufacturing activity for July—New York, Philadelphia, and Richmond—and show *manufacturing activity* (to -7.1 from -5.0) contracted at a slightly faster pace than in June, as activity in the Philadelphia (to -13.5 from -13.7) region continued to contract at a fast pace and Richmond's (-9.0 from -8.0) was also in the red. Meanwhile, activity in the New York (1.1 from 6.6) region expanded at a slower rate than last month, falling toward the breakeven point of zero. *New orders* (-10.9 from -8.0) fell at a slightly faster pace in July, as billings in the Philadelphia (-15.9 from -11.0) area fell at the fastest pace in three months and Richmond's (-20.0 from -16.0) orders were also weaker. Meanwhile, New York (3.3 from 3.1) orders held steady. *Employment* (2.9 from –1.6) showed factories hired for the first time in six months, albeit at a slow pace, as hirings at New York (4.7 from -3.6) factories posted the first gain since the start of this year and Richmond's (5.0 from -1.0) posted its second gain; Philadelphia (-1.0 from -0.4) factories continue to fluctuate just below the breakeven point of zero. Looking at *prices-paid* indexes, the Philadelphia (9.5 from 10.5) measure held steady, not far from April's 8.2 reading—which was its lowest since mid-2020—while New York's (16.7 from 22.0) posted its lowest reading since August 2020. Meanwhile, Richmond's (40.7 from 45.6) eased to its lowest reading since January 2021. *Prices-received* indexes were mixed: New York's (3.9 from 9.0) eased to its lowest reading since July 2020, while Philadelphia's measure moved up for the second month to 23.0 after falling from 37.6 last November to -7.0 this May—which was the weakest since April 2020. Richmond's (40.1 from 45.6) was the weakest since March 2021. (Note: The New York, Philadelphia, Dallas, and Kansas City 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.)

Global Economic Indicators

Germany Ifo Business Climate Index (*link*): German business confidence fell for the third straight month in July, to an eight-month low. This report comes on the heels of Germany's PMI report on Monday, which shows the C-PMI also posted a three-month decline in activity to an eight-month low. Germany's economy slipped into a technical recession in early 2023, defined by two consecutive quarters of negative growth. Preliminary data for Q2 are expected to be reported this Friday. German business *confidence* fell for the third month to 87.3 in June, after climbing the prior six months from 85.2 last October to 93.5 this April—which was the highest since February 2022. *Expectations* took the biggest hit over the three-month period, dropping 8.4 points to 83.5, after a seven-month upswing of 15.3 points—from 76.6 last September to 91.9 this April. Meanwhile, *current conditions* fell for the fourth successive month, slipping 4.2 points to 91.3 this month. The *manufacturing* sector saw its business climate index deteriorate again this month, sinking 20.9 points over the past four months to -14.2 this month. The expectations component tumbled 28.2 points over the past three months to -30.4 this month, while current conditions sank 15.5 points over the past four months to 3.6 in July. The *service sector* saw its business climate index (to 0.9 from 9.0 in March) drop 8.1 points over the past four months, with expectations ticking up to -14.1 in July after sinking 11.3 points the prior three months, to -15.4 in June from -4.1 in March. The current conditions component fell during three of the past four months, by 5.6 points, to 17.2. Sentiment in the *trade sector* continued to deteriorate, dropping 13.6 points (to -23.7 from -10.1 in March) over the past four months, as the current conditions fell 15.2 points over the period (to -7.1 from 8.1), and expectations declined for the second time in three months, by 14.2 points (to -38.8 from -24.6) deteriorated. The *construction* sector remained entrenched in negative territory, falling to -24.0—which matched its lowest level since February 2010—as the expectations component remains deep in negative territory, at -37.1, though is up from its recent low of -47.1 last October. Meanwhile, current conditions have tumbled from 33.4 last February to -9.8 this July, falling below zero in May for the first time since December 2015.

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