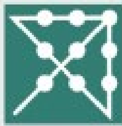

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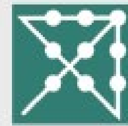

MORNING BRIEFING
July 31, 2023

The Godot Recession

Check out the accompanying chart collection.

Executive Summary: We're raising the subjective odds we assign to the no-landing economic scenario through year-end 2024 (by 10% to 85%) and lowering our odds of a hard landing (by 10% to 15%). But we're keeping close tabs on hard-landers' latest arguments. Today, we summarize the main ones and give our rebuttals. … The biggest issue dividing the two camps is the outlook for consumer spending, representing over two-thirds of nominal GDP. If consumers don't pull back on spending once their pandemic-related savings run out, an economy-wide recession would be a stretch. We say they won't retrench, having other sources of purchasing power. ... And: Dr. Ed reviews "Barbie" (+).

YRI Weekly Webcast. Join Dr. Ed's live webcast with Q&A on Mondays at 11 a.m. EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

US Economy I: The Honorable Opposition. There was no sign of a recession in Q2's real GDP. Yet Vladimir and Estragon are still *waiting for Godot* to show up. The hapless hard-landers have been frustrated so far, but they aren't giving up. In their opinion, a recession is still coming. Debbie and I have argued since early last year that the recession has already made its entrance on stage, but as a rolling recession relatively unnoticed rather than a dramatic economy-wide recession. Now that rolling recession is changing into a rolling recovery.

Our script has played out as expected so far. The soft-landing scenario looks increasingly like a no-landing one. As a result, we are raising the odds of a no-landing scenario from 75% to 85% and lowering the odds of a hard-landing scenario from 25% to 15% through the end of next year.

Nevertheless, now that we are even more optimistic about the economic outlook, it's even more important to remain on the lookout for that troublesome and elusive Godot. Last week, we discussed two items on our worry list—namely, the vulnerabilities in the commercial real estate market and the ongoing push by unions for higher wages, which could cause another wage-price spiral and force the Fed to keep tightening.

To make sure that we are covering all the bases, we are closely following the warnings of a few of the leading bears. Here is what they are currently saying:

(1) The strategists at JP Morgan rightly caution that the tightening of monetary policy in the US can have a long and variable depressing impact on the economy. The worst may still be ahead. They predict that once excess savings accumulated during the pandemic are depleted, consumers will be forced to retrench. They also observe that the global geopolitical situation remains "deeply troubling." They attribute the stock market rally to a handful of stocks that have been driven up by AI-hype. They conclude that "the level and increase of stock concentration in S&P 500 now is at 60-year highs" which is "indicative of a bubble." (See "*Top JP Morgan Strategist Says the Worst May Still Be Coming*," 24/7 Wall St., July 27, 2023.)

(2) The strategists at Morgan Stanley were correctly bearish last year, but recently acknowledged that they missed calling the bottom last October. Nevertheless, their year-end 2023 target for the S&P 500 is still 3900, and their year-end 2024 target is 4200. The S&P 500 closed at 4582.22 on Friday. They are still bearish. Their concern now is that moderating inflation will weigh on the growth rates of both S&P 500 revenues and earnings. They warn, "With price being the main factor that has held sales growth above zero for many companies this year, it would be a material headwind if that pricing power were to roll over." (See "'*We Were Wrong': Morgan Stanley's Wilson Offers Stocks Mea Culpa*," Bloomberg, July 24, 2023.)

(3) Our thought-provoking friend David Rosenberg at Rosenberg Research remains bearish as well. He recently opined: "There is no chance we're having a soft landing in the context of the most pernicious tightening by the Fed since the Paul Volcker years." He previously had warned that once consumers spend their excess savings, they'll have to cut their spending. He frequently has observed that the drop in the Index of Leading Economic Indicators (LEI)—including the inversion of the yield curve—has an excellent track record of forecasting recessions. He also thinks that the stock market is in a "get-rich-quick" speculative bubble, as evidenced by the jump in valuation multiples. (See "*The US stock market has become a 'get-rich-quick' scheme that's ignoring oncoming economic pain, top economist David Rosenberg says*," Yahoo! Finance, July 26, 2023.)

(4) *GMO.* Jeremy Grantham, the co-founder of GMO Investments, has lowered the likelihood he sees of a market crash from an earlier prediction of 85% to 70% now. He also thinks the jury is still out on the severity of the crash and how much it will impact the economy and profit margins. He attributes the current market bubble to the AI craze, which

has created a mini-bubble within a larger bubble. (See "*Billionaire Investor Jeremy Grantham Says the AI Craze Is Delaying a Looming and 'Epic' Market Crash*," The Motley Fool, July 8, 2023.)

US Economy II: Our Rebuttal. We've spent the past year and a half debating the hard-landers. Their debate with the soft-landers and no-landers certainly isn't over:

(1) *Leading indicators.* While the hard-landers use the LEI's weakness as support for their argument, we've observed that the LEI on a y/y basis is highly correlated with the M-PMI, confirming that it is biased toward the goods-producing sector, which has been in a rolling recession, at the expense of the services-providing sector, which has been very strong (*Fig. 1*). Nevertheless, the LEI does have a good track record of calling recessions, and it is still doing so. We will rest easier when we see the LEI turning higher, signaling that the goods recession is over. If instead, consumers do retrench their spending on both goods and services when their excess savings dry up, then the LEI and the hard-landers will finally be right.

(2) *Inverted yield curve.* We've also explained that the inverted yield curve doesn't cause recessions and doesn't directly predict them, as commonly believed. Rather, it indicates that monetary policy is restrictive and that if it gets more so, then something will break in the financial system, leading to an economy-wide credit crunch and a recession (*Fig. 2*). This time has been different so far. The inverted yield curve correctly called the banking crisis that occurred for two days, March 9 and 10. But the Fed averted a credit crunch by providing an emergency bank lending facility on March 12. This time, the inverted yield curve may be anticipating that inflation will continue to moderate toward the Fed's 2.0% target by 2025 without a recession.

(3) *Credit conditions.* So far, there are signs that credit conditions have tightened; but there's no outright credit crunch, as the hard-landers think is coming. We continue to monitor the weekly data compiled by the Fed on the US commercial banking industry. The deposits of commercial banks have been falling since mid-2022 but seem to have been stabilizing in recent weeks (*Fig. 3*). The banks have offset the weakness in their deposits by reducing their holdings of bonds as they mature and using the proceeds to fund their loan portfolios. Their major loan categories remain on uptrends (*Fig. 4*).

This morning, the Fed will release its Q3 Senior Loan Officer Opinion Survey (SLOOS). It undoubtedly will show that credit conditions have continued to tighten from Q2 levels (*Fig. 5*). At his press conference this past Wednesday, Fed Chair Jerome Powell revealed that

the next SLOOS "gives a picture of pretty tight credit conditions in the economy." The good news: That reduces the Fed's need to raise the federal funds rate again. The bad news: It gives the hard-landers another debating point.

(4) *Liquidity.* The hard-landers have been obsessed with the 3.6% y/y drop in M2 through June (*Fig. 6*). However, that's after peaking at a record 26.9% during February 2021. M2 is roughly $1.0 trillion above its pre-pandemic trendline. The sum of all commercial bank deposits and all money market funds remained in record-high territory at $22.8 trillion during the July 19 week, up a whopping $5.8 trillion since the last week of February 2020, just before the pandemic (*Fig. 7*). Apparently, there is lots of excess liquidity available to keep the economy growing and to drive stock prices higher, notwithstanding the tightening of monetary policy!

(5) *Capital spending.* The hard-landers mostly have failed to recognize the stimulative impact of onshoring as manufacturing returns to the US homeland. Among the strongest components of real GDP recently has been spending on manufacturing structures. It was up 54.4% y/y during Q2 to a record high (*Fig. 8*). That strength has boosted new orders for construction equipment, which rose 13.5% y/y during May to the second highest reading on record (*Fig. 9*).

The hard-landers mostly have dismissed AI as hype. That's probably a subject for another debate. But the facts are that software and research & development spending in real GDP rose during Q2 by 10.0% y/y and 1.0% y/y to fresh record highs (*Fig. 10*). The pessimists also have overlooked that new orders for nondefense aircraft are booming along with international tourism (*Fig. 11*).

(6) *Government spending.* Also missing from the hard-landers' debating points is any acknowledgement of the fact that tighter monetary policy has been offset by looser fiscal policy. Total government spending rose 2.6% (saar) during Q2 to a record high (*Fig. 12*). The 12-month US federal budget deficit has ballooned from $962 billion 11 months ago to $2.3 trillion through June (*Fig. 13*).

Some of the widening of the deficit is attributable to the ramping up of infrastructure spending by federal, state, and local governments. Also boosting the deficit have been record-high federal outlays on net interest, exceeding $600 billion during the 12 months through June (*Fig. 14*). On the flip side, the high cost of interest also is stimulative when it's paid out to consumers: The personal interest income of consumers rose to a record $1.8 trillion (saar) during June.

US Economy III: A Guide to Consumers. The biggest debatable issue dividing the hard-landers from the soft-landers and no-landers is the outlook for consumer spending. That makes sense since it accounts for just over two-thirds of nominal GDP. It's hard to have an economy-wide recession if consumers don't retrench.

The hard-landers think that consumers will do so once their pandemic-related excess savings are depleted. Just before the pandemic, consumers saved around $1.5 trillion on a 12-month-sum basis (*Fig. 15*). Over the past 12 months through June of this year, they saved at half this pace. But their excess savings likely will be all gone within the next few months, setting the stage for a consumer-led recession. That's the key argument put forward by the hard-landers' ace debating team.

Our narrative posits that consumers have lots of other sources of purchasing power that should continue to support their spending. One of our accounts asked us to discuss the major economic indicators we track to assess the outlook for consumer spending. We wrote two chapters on this subject in our 2018 book *Predicting the Markets;* we could write an entire book just on this subject. Here is a very brief guide, based on the timeline of when the key consumer-related indicators come out and our current assessments of each:

(1) *Initial unemployment claims.* Jobless claims data are released by the Bureau of Labor Statistics (BLS) on Thursday mornings at 8:30 am. They are highly correlated with the unemployment rate (*Fig. 16*). They've remained near previous record lows so far this year. They indicate that the labor market remained strong through the July 22 week.

(2) *Consumer confidence.* The Conference Board's survey of consumer confidence is released near the end of each month and is also one of the earliest indicators of the month's labor market conditions. Its "jobs-hard-to-get" series is highly correlated with the unemployment rate too (*Fig. 17*). The July reading of just 9.7% suggests that the unemployment rate remained low near June's 3.6%. The survey's "jobs-plentiful" series is highly correlated with the job openings series in the JOLTS report (*Fig. 18*). This series' reading of 46.9% for July suggests that job openings (currently available through May) remained elevated through June and July.

(3) *JOLTS.* As noted above, the JOLTS report compiled by the BLS is a laggard. The report for June will come out tomorrow. Nevertheless, it includes useful data on hires, quits, and layoffs in addition to job openings. The May report shows that the labor market remained tight back then.

(4) *Employment.* The BIGGIE employment report is released by the BLS at 8:30 a.m. on the first Friday of each month and reflects the prior month's labor market conditions. So July's report will be available at the end of this week. It is the first of the four components of the Index of Coincident Economic Indicators (CEI) available for each month and provides clues to their likely readings.

For example, every month, we use the payroll employment data to calculate our Earned Income Proxy (EIP) for private-sector wages and salaries in personal income, which is a CEI component. Our EIP has been rising to new record highs all year and has been outpacing price inflation for the past three months (*Fig. 19*). It reflects both total hours worked and hourly wages. On an inflation-adjusted basis, the latter has been rising for the past 12 months along its long-term trendline of 1.2% per year (*Fig. 20*).

(5) *Retail sales.* Also included in the CEI is a series for the sales of goods by manufacturers & distributors, which includes retail sales. An advance report of the latter is released by the Census Bureau about a week after the BLS employment report for the previous month. Not surprisingly, it is highly correlated with our EIP and wages & salaries in personal income (*Fig. 21*). However, consumers spend on both goods and services. Since mid-2021, they've pivoted toward spending more on services than on goods. So the weakness in retail sales since then confirmed the rolling recession in the goods-producing sector, while the service-providing sector has been strong, averting an economy-wide consumer-led recession.

(6) *Personal income.* Near the end of each month, the Bureau of Economic Analysis reports personal income, saving, and consumption for the prior month, as well as the personal consumption expenditures deflator. We already have some insights into the data from the employment and retail sales reports. As noted above, personal saving has been relatively low over the past year as consumers have been spending their excess savings. However, inflation-adjusted personal income has been growing along with employment and real hourly wages.

The key driver of consumption is real disposable personal income (DPI), which represents the purchasing power of consumers' incomes after they've paid their taxes and received their government benefits. DPI received a big boost from pandemic relief checks paid by the government during 2020 and early 2021. It then dropped through mid-2022, but consumer spending continued to rise as excess savings were used to support consumption. DPI has been rising again since mid-2022, suggesting that consumers are now supporting their spending with employment and real wage gains.

The personal income release also includes series for unearned income, including dividends, interest, and rent, as well as proprietors' income and Social Security benefits. They all were at record highs during June.

(7) *Net worth*. Finally, Debbie, Melissa, and I continue to monitor the Fed's quarterly data on the net worth of the household sector. It rose to a record high of $148.8 trillion at the end of Q1. Recently, we've also analyzed the available data for the net worth of the major age cohorts, particularly the Baby Boomers, who collectively had a record $74.5 trillion in net worth at the end of Q1. As they retire, we expect they will spend some of their retirement assets, depressing the national personal saving rate. When they pass away, their children will inherit what's left. So the younger generations might also save less. This is all likely to boost consumption.

Movie. "Barbie" (+) (*link*) is a warm-hearted nostalgia movie for mothers and their daughters. My 22-year-old daughter saw it with her girlfriends and loved it. She wanted to see it a second time and convinced her mom and dad to join her. Barbie was created by Ruth Handler and launched by Mattel in 1959. The doll has become a cultural icon. Barbie has kept up with the times. She started as a teenage fashion model, but over the years had lots of interesting careers from astronaut to surgeon. After Barbie's debut on store shelves, little girls no longer were limited to playing with baby dolls and imagining being a mother but now could imagine being as successful as Barbie in whatever career they chose. She was aspirational. The History Channel featured Barbie in an excellent *docudrama* series titled "The Toys That Built America."

Calendars

US: Mon: Dallas Manufacturing Index -26.3; Chicago PMI 43.0; Loan Officer Survey. **Tues:** JOLTs Job Openings 9.62m; ISM M-PMI & Price Index 46.5/42.5; Construction Spending 0.0%; Weekly Crude Oil Inventories. (Bloomberg estimates)

Global: Mon: Eurozone GDP 0.0%q/q/0.5%y/y; Headline & Core CPI Flash Estimate 5.3% & 5.4% y/y; & Germany Retail Sales -0.5%m/m/-6.3%y/y; Germany Import Prices -1.5%m/m/-14.7%y/y; Italy GDP 0.0q/q1.9%y/y; Italy CPI -0.7%m/m/5.3%y/y; UK Nationwide HPI -0.2%m/m/-30.0%.8%y/y; Japan Unemployment Rate 5.2%; Japan M-PMI 49.4; Japan Household Confidence 36.0; China Caixin M-PMI 50.3. **Tues:** Eurozone, Germany, and France M-PMIs 42.7/38.8/44.5; Eurozone Unemployment Rate 6.5%; Germany Unemployment Rate 5.7%; Italy Unemployment 7.7%; UK M-PMI 45.0; RBA Interest Rate

Decision 4.35%. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index rose 1.0% last week for its ninth gain in 11 weeks, and moved further out of a correction to end the week at 5.6% below its record high on December 27, 2021. The US MSCI ranked 22nd of the 48 global stock markets that we follow in a week when 31 of the 48 countries rose in US dollar terms. The AC World ex-US index outperformed with a 1.4% gain but remains in a 12.8% correction from its June 15, 2021 record high. BIC was the best performing region with a 4.0% surge, ahead of EM Asia (3.0%), EM Latin America (1.9), EMEA (1.7), and EM Eastern Europe (1.4). EMU was the worst performing region last week, albeit with a gain of 0.6%, followed by EAFE (0.9). Turkey was the best-performing country last week, with a gain of 7.2%, followed by China (6.7), South Africa (5.2), Mexico (4.0), and the Czech Republic (3.8). Among the 31 countries that underperformed the AC World ex-US MSCI last week, the 4.4% decline for Denmark was the biggest, followed by those of Argentina (-3.5), Jordan (-2.7), Hungary (-2.6), and Portugal (-2.1). Looking at 2023's performance so far, the US MSCI is up 19.8% as its ytd ranking remained steady w/w at 15/48. The AC World ex-US's ytd gain of 11.6% is trailing the US's, with 39/48 countries now in positive territory. EM Eastern Europe is the best regional performer ytd, with a gain of 30.6%, followed by EM Latin America (20.1), EMU (19.1), and EAFE (13.0). The regional laggards so far in 2023, albeit with gains: BIC (4.5), EMEA (7.7), and EM Asia (8.3). This year's best ytd country performers: Greece (48.0), Argentina (41.2), Ireland (33.9), Poland (32.7), and Mexico (31.5). Here are the worst-performing countries of the year so far: Pakistan (-27.9), Finland (-10.3), Turkey (-7.2), Malaysia (-6.4), and Hong Kong (-6.3).

S&P 500/400/600 Performance (*link*): All three of these indexes moved higher for a third straight week. LargeCap rose 1.0% w/w, outperforming MidCap (0.4%) but trailing the 1.1% gain for SmallCap. At Friday's close, LargeCap finished the week at 4.5% below its record high on January 3, 2022, MidCap moved further out of a correction to end at 6.7% below its record high on November 16, 2021, and SmallCap improved to a 13.3% correction from its November 8, 2021 record high. Twenty-four of the 33 LargeCap and SMidCap sectors moved higher for the week, down from 26 rising a week earlier. LargeCap Communication Services was the best performer with a gain of 6.8%, ahead of SmallCap Energy (4.5), MidCap Energy (4.0), SmallCap Financials (3.3), SmallCap Consumer Discretionary (2.0), and SmallCap Consumer Staples (2.0). Among the biggest underperformers for the week were SmallCap Utilities (-2.7), MidCap Real Estate (-2.2), LargeCap Utilities (-2.1), MidCap

Communication Services (-2.0), and MidCap Utilities (-1.9). Looking at performances so far in 2023, LargeCap, with a gain of 19.3%, remains well ahead of MidCap (11.8) and SmallCap (9.8); 24 of the 33 sectors are now higher ytd compared to 26 a week earlier. The top sector performers in 2023: LargeCap Tech (45.6), LargeCap Communication Services (44.8), LargeCap Consumer Discretionary (34.8), MidCap Tech (26.1), and MidCap Industrials (24.2). Here are 2023's biggest laggards: MidCap Utilities (-9.6), SmallCap Utilities (-5.1), LargeCap Utilities (-5.0), SmallCap Financials (-4.0), and LargeCap Energy (-2.5).

S&P 500 Sectors and Industries Performance (*link*): Seven of the 11 S&P 500 sectors rose last week, and five outperformed the composite index's 1.0% gain. That compares to a 0.7% gain for the S&P 500 a week earlier, when seven sectors rose and six outperformed the index. Communication Services was the best performer with a gain of 6.8%, followed by Materials (1.8%), Energy (1.7), Tech (1.3), and Consumer Discretionary (1.2). Utilities was the worst performer, with a drop of 2.1%, followed by Real Estate (-1.8), Health Care Tech (-0.8), Financials (-0.2), Industrials (0.6), and Consumer Staples (0.7). Looking at 2023's performance so far, the S&P 500 is up 19.3% ytd, with just three sectors still outperforming the index but eight higher for the year. The best ytd performers: Tech (45.6), Communication Services (44.8), and Consumer Discretionary (34.8). These are 2023's worst performers: Utilities (-5.0), Energy (-2.5), Health Care (-0.7), Real Estate (2.3), Consumer Staples (2.4), Financials (2.7), Materials (9.6), and Industrials (12.1).

S&P 500 Technical Indicators (*link*): The S&P 500 rose 1.0% 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 18th week and its 200-dma for a 19th week. The S&P 500 improved to 4.6% above its rising 50-dma from 4.4% a week earlier, but is down from a 20-week high of 5.4% above its rising 50-dma in mid-June. 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 last 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 11.9% above its rising 200-dma, which compares to a 24-month high of 12.4% above its rising 200-dma in mid-July. 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 17.0% above in December 2020, which was the highest since November 2009 and up from the 26.6% below registered during the Great Virus Crisis on

March 23, 2020—the lowest reading since March 2009. At its worst levels of the Great Financial Crisis, the S&P 500 index was 25.5% below its 50-dma on October 10, 2008 and 39.6% below its 200-dma on November 11, 2008. The 50-dma moved higher for an 18th week in its longest positive streak since September 2021. The 200-dma rose for a ninth week in its longest positive streak since March 2022.

S&P 500 Sectors Technical Indicators (*link*): For a third straight week, all 11 S&P 500 sectors are trading above their 50-dmas. All sectors now have a rising 50-dma for the first time since September, up from nine a week earlier, as Consumer Staples and Utilities turned up in the latest week. Looking at the more stable longer-term 200-dmas, the positive club was unchanged w/w at 10 members; Energy turned up, and Utilities turned down. The rising 200-dma club fell to 10 sectors w/w, as Energy's 200-dma turned back down.

US Economic Indicators

GDP (*link*): *Real GDP* for Q2 exceeded expectations, expanding 2.4% (saar), stronger than the 1.8% expected gain. That followed gains of 2.0%, 2.6%, and 3.2% the prior three quarters—climbing 2.6% y/y to a new record high. There's no recession in these numbers. Q2 growth was led by consumer spending, business spending, inventory investment, and government spending. These gains were partially offset by declines in exports and residential investment. *Real consumer spending*, which accounts for two-thirds of real GDP, increased a larger-than-expected 1.6% (saar), after surging 4.2% at the start of the year. *Services* consumption advanced 2.1% (saar) after a 3.2% gain during Q1, while *goods* consumption slowed to 0.7% (saar), coming on the heels of Q1's 6.1% jump—which was the largest quarterly gain in nearly two years. Within goods consumption, durable goods spending was at a near standstill, edging up 0.4% (saar) after soaring 16.3% during Q1, while *nondurable goods* consumption rose 0.9% (saar), in line Q1's 0.5%. Meanwhile, *real gross private domestic investment* swung from contraction to expansion, rebounding 5.7% (saar) last quarter following Q1's 11.9% shortfall. Real *nonresidential investment* accelerated 7.7% (saar), following little growth during Q1 (0.6%, saar), as *equipment spending* rebounded 10.8% (saar) during Q2 after contracting 8.9% and 3.5% the prior two quarters. Meanwhile, *structures* posted its third successive quarterly gain following a six-quarter string of declines, climbing 9.7% (saar) during Q2; that was a slowdown from identical double-digit gains of 15.8% in each of the prior two quarters. Spending on intellectual property products picked up a bit to 3.9% (saar) during Q2, after slowing steadily from Q1-2022's 10.8% to 3.1% during the Q1 of this year. *Residential investment* contracted for the ninth consecutive quarter, but declines have slowed the first half of this

year, dropping 4.2% (saar) during Q2; that was nearly identical to Q1's 4.0% loss, which followed double-digit quarterly declines the prior three quarters ranging from -17.8 to -27.1. Meanwhile, *inventory investment* picked up a bit during Q2, by $5.8 billion (to $9.3 billion from $3.5 billion, saar). It had increased a whopping $97.8 billion during Q4 (to $136.5 billion during Q4 from $38.7 billion during Q1). *Real government spending* advanced for the fourth successive quarter, though slowed to 2.6% (saar) from 5.0% during Q1—and was the slowest in the string of gains. Both federal (to 0.9% from 6.0%) and state & local (3.6 from 4.4) government spending slowed during the quarter. Turning to trade, it had little impact on Q2's real GDP, subtracting just 0.12ppts, as the decline in exports (-10.8%, saar) was virtually offset by a decline in imports (-7.8). (Imports are subtracted in the calculation of GDP, so Q1 imports contributed positively.)

Contributions to GDP Growth (*link*): *Consumer* spending (1.12ppts) was the biggest positive contributor to real GDP growth during Q2, mostly *services* (0.95) consumption. The contribution from *goods* (0.16) spending was negligible, with nondurables goods (0.13) and durable goods (0.03) barely registering. *Nonresidential* (0.99) investment moved up to the number-two spot, as spending on equipment (0.53) contributed positively to GDP growth for the first time in three quarters—with transportation equipment (0.51) accounting for nearly the entire gain. Meanwhile, structures (0.26) and intellectual property products (0.21) also contributed to the gain, but not as much as equipment. *Government* spending (0.45) was the third biggest contributor to GDP growth during Q2, primarily state & local governments (0.39). Meanwhile, *inventory investment* (0.14) contributed positively to GDP growth during Q2, after being a big drag on growth during Q1, subtracting 2.14ppts. *Trade* (-0.12) also subtracted from growth, as the negative contribution in exports (-1.28) more than offset the positive contribution from imports (1.16). *Residential investment* (-0.16) was the biggest negative contributor—subtracting from GDP growth for the ninth straight quarter.

Personal Income & Consumption (*link*): Personal income continued to rise in June, though fell short of expectations, while consumer spending was slightly higher than expectations. *Personal income* rose 0.3% in June (vs 0.5% expected), slowing from an upwardly revised 0.5% gain in May. It was the 17th successive gain, climbing 7.7% over the period. *Wages & salaries* has posted only two declines in the past 28 months, climbing 0.6% in June and 19.9% over the period; *adjusted for inflation*, wages & salaries have expanded 1.2% the past four months through June to a new record high, after contracting 0.9% during the five months through February. *Personal consumption expenditures* continued to set new record highs in June, with spending climbing the first six months of his year, by 0.5% in June and 3.7% ytd; spending on goods and services were up 3.7% and 3.6%, respectively ytd. In *real terms*, consumer spending in June climbed 0.4%, with

spending on goods up 0.9% and services up 0.1%. Year to date, real goods consumption climbed 3.1%, while real services consumption was up 1.4%; compared to a year ago, the former was up 2.1% and the latter 2.5%. Meanwhile, *personal saving* fell $41.9 billion in June, as spending rose at a faster pace than income during the month. Still, saving is up $356.1 billion from its recent low last June of $506.3 billion to $862.4 billion this June. The *saving rate* was at 4.3% in June, fluctuating in a range from 4.3% to 4.6% since February.

Consumer Sentiment Index (*link*): Consumer sentiment for the full month of July shot up to its highest reading since October 2021, reflecting the continued slowdown in inflation and stability in the labor market. Sentiment among lower-income consumers fell on concerns that both inflation and their income prospects will worsen in the year ahead. *Overall consumer sentiment* rose for the sixth time in eight months, by 7.2 in July and 14.8 points over the period, to 71.6. That puts the *headline CSI* roughly halfway between the all-time historical low of 50.0 during June 2022 and the February pre-pandemic reading of 101.0. The *present situation* component climbed 7.6 points and 17.8 points over the comparable periods to 21-month high of 76.6, while the *expectations* component rose 6.8 points and 12.7 points over the comparable periods to a 19-month high of 68.3. Turning to inflation, the *one-year expected inflation rate* was little changed at 3.4% in July, after falling the prior two months from a five-month high of 4.6% in April to 3.3% in June, which was the lowest reading since March 2021. The *five-year expected inflation rate* also was unchanged, at 3.0%. It was at 2.9% during the first three months of this year, remaining within the narrow 2.9%-3.1% range in 23 of the past 24 months.

Personal Consumption Deflator (*link*): June's PCED increased 0.2% and has averaged gains of only 0.2% the past five months. Core prices also rose, by 0.2% in June, a seven-month low and slower than the average 0.4% gain the first five months of the year. The yearly headline rate eased to 3.0% (the lowest since March 2021), slowing from a peak of 7.0% last June—which was the highest since the end of 1981. The yearly core rate slowed to 4.1% 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 fourth month to 3.3% (saar) in June from 5.0% in February, below its yearly rate of 4.1%. The three-month rate for durable goods has hovered around zero the past few months, slowing to 0.5% (saar) in June, while the three-month rate for core nondurable goods prices eased to 5.6% (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 fourth month to 4.0% (saar) during the three months through June, from 6.1% in February. The three-month annual rates for both core nondurable goods (5.6%, saar & 5.0% y/y) and consumer durable goods (0.5% & -0.4%) were above their yearly rates—though the latter is hovering around

zero in both measures. Meanwhile, the three-month rate for consumer services ex energy (4.0 & 5.0) was below its yearly rate for the third straight month. *PCED components for which three-month rates lag yearly rates*: airfares (-27.2 & -5.5), household appliances (-18.6 & -9.8), lodging away from home (-15.0 & 3.3), sports & recreational vehicles (-7.8 & 0.8), video audio & information processing (-6.8 & -4.7), transportation services (-5.5 & 3.6), furniture & home furnishings (-4.9 & -0.2), new motor vehicles (-1.3 & 4.4), food & nonalcoholic beverages purchased for off-premise consumption (-0.3 & 4.8), motor vehicles & parts (0.4 & 4.0), prescription drugs (1.5 & 3.1), recreation services (1.6 & 4.7), alcoholic beverages purchased for off-premise consumptions (1.7 & 3.2), tobacco (3.1 & 5.8), tenant rent (6.1 & 8.4), and owner-occupied rent (6.1 & 7.9). *PCED components for which three-month rates exceed yearly rates*: used motor vehicles (34.9 & -4.6), professional & other services (15.4 & 7.6), hospitals (4.1 & 2.4), clothing & footwear (4.1 & 2.4), physician services (1.3 & 0.7), and gasoline & other energy products (-10.0 & -28.5). *PCED components for which three-month rates & yearly rates are comparable*: personal care products (7.4 & 7.2) and education services (2.4 & 2.5).

Employment Cost Index (*link*): The *overall ECI* for private industry workers, slowed from 1.2% to 1.0% (saar) during Q2, the slowest quarterly pace in two years. Both *wages & salaries* (from 1.2% to 1.0%, saar) and *benefits* (1.1 to 0.9) showed smaller gains, with wages & salaries at a two-year low, and the benefits matching its smallest quarterly gain since Q2-2021's 0.4%. On a yearly percent change basis, *overall labor costs* for the private sector slowed for the fourth consecutive quarter since peaking at a recent high of 5.5% y/y during Q2-2022 (the highest since mid-1984) to 4.5% last quarter, with wages and salaries (from 5.7% to 4.6%) and benefits (5.3 from 3.9) both easing over the comparable periods. Meanwhile, the *Atlanta Fed's median wage growth tracker*, which tracks the ECI wages & salaries component closely, fell in June to a 17-month low of 5.6% based on the three-month average, down from 6.4% y/y in March; prior to that, it had fallen from 6.7% last summer to 6.1% at year-end 2022.

Regional M-PMIs (*link*): Four Fed districts have reported on manufacturing activity for July—New York, Philadelphia, Richmond, and Kansas City—and show *manufacturing activity* (to -8.1 from -6.8) contracted at a slightly faster pace in July, but not as fast as it did during the first five months of this year. Activity in the Philadelphia (to -13.5 from -13.7) region continued to contract at a fast pace, while Richmond's (-9.0 from -8.0) and Kansas City's (-11.0 from -12.0) activity levels are contracting at a steady pace. 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* (-13.2 from -9.5) declined at a 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 (-20.0 from -16.0) and Kansas City (-20.1 from -14.0) orders also deteriorated. Meanwhile, New York (3.3 from 3.1) orders held steady. *Employment* (3.2 from –4.3) showed factories hired for the first time in five 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, while Richmond's (5.0 from -1.0) posted its second gain this year, and Kansas City (4.0 from -12.0) factories added to payrolls for the fifth time. Philadelphia (-1.0 from -0.4) factories continued to fluctuate just below the breakeven point of zero. Looking at *prices-paid* indexes, the New York (16.7 from 22.0) region posted its lowest reading since August 2020, while Richmond's (40.7 from 45.6) was the lowest since January 2021. Meanwhile, the Philadelphia (9.5 from 10.5) and Kansas City (9.0 from 4.0) measures remained on steep downtrends, with the former not far from April's 8.2 reading—which was its lowest since mid-2020 and the latter not far from June's reading—which was the lowest since mid-2020. *Prices-received* indexes were mixed: Kansas City's (-7.0 from 3.0) eased to its lowest reading since May 2020, while New York's (3.9 from 9.0) was the lowest reading since July 2020. Meanwhile, Philadelphia's measure was 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.)

Durable Goods Orders & Shipments (*link*): Durable goods orders blew past forecasts in June, climbing for the fourth successive month, as transportation equipment orders continued to soar. *Durable goods orders* shot up 4.7% in June (vs 1.0% expected) and 11.7% over the four months through June—more than reversing the 4.0% drop the first two months of the year—with transportation equipment orders climbing 12.1% and 34.5% over the comparable periods. Excluding transportation, durable goods orders expanded for the sixth time in seven months, by 0.6% in June and 1.8% over the period, to a new record high. Meanwhile, *nondefense capital goods orders excluding aircraft* (a proxy for future business investment) rebounded for the third month, by 0.2% in June and 1.4% over the period, to a new record high, more than erasing the 0.8% decline recorded during the two months through March. *Nondefense capital goods shipments excluding aircraft* (used in calculating GDP) was flat at its record high in June, after climbing 0.8% during the two months through May—and 1.4% ytd. In June, orders for both motor vehicle & parts and electrical equipment, appliances & components climbed to new record highs, while orders for machinery held just below its record high. Meanwhile, orders for both primary metal and fabricated metals remained in record-high territory.

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 4.1 points to 93.6 during the six months through July, while the *Eurozone's gauge* fell 5.1 points to 94.5—down from their January readings of 97.7 and 99.6, respectively; they were at record highs of 117.8 and 118.8 during October 2021. ESIs among the *six largest EU economies* were mixed in July, with ESIs in France (-2.3 to 94.3) and Germany (-2.1 to 91.2) posting the largest declines, followed by the Netherlands (-0.9 to 92.8). Meanwhile, Spain (+1.3 to 100.9) and Poland (+0.9 to 94.1) posted gains, while Italy's (+0.1 to 101.4) ESI was little changed. They were at 98.4, 97.8, 94.4, 101.8, 90.2, and 102.6, 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 13.7 points during the 10 months through July to -16.1. *Retail trade* confidence improved a bit, recovering partially from the losses of the prior two months, climbing 1.4 points in July from the two-month drop of 3.9 during the two months through June. *Industrial* confidence remains in a freefall since reaching a record high of 12.9 in December 2021, plunging 22.4 points over the period to -9.5 this July, while *construction* confidence deteriorated to -6.2 in July from a record high of 8.4 at the end of 2021. Meanwhile, *service* confidence dipped 2.7 points during the three months through July, from 7.8 to 5.1. It's down 14.4 points from its recent peak of 19.5 during October 2021.

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