MORNING BRIEFING
August 14, 2023

Disinversion

Check out the accompanying chart collection.

Executive Summary: Is the federal budget deficit getting too big for the bond market to fund without yields moving higher? That seems to be a growing concern in both the bond and stock markets. In the past, bond yields were determined mostly by the Fed's response to inflation, which is moderating; supply and demand didn't matter much, but they may now. Today, we examine why this period of deficit widening is different than past ones. … We also examine two scenarios that could unwind the inversion of the yield curve—one bullish, one bearish—and recap data supporting both. … And: Dr. Ed reviews "The Man Who Saved the Game" (+ + +).

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Yield Curve I: Two Alternative Disinversion Scenarios. Over the years, I've frequently been asked why I am not more concerned about the widening US federal government budget deficit and the resulting mountain of mounting federal debt. I've consistently responded that I will care about this issue when the financial markets care about it. That time has come because the bond market seems to be concerned.

In the past, I've observed that the supply of and the demand for bonds isn't usually as important to the determination of the bond yield as are actual and expected inflation and the expectations of how the Fed will respond to them. So given that Debbie and I expect inflation to continue to moderate, we currently predict that the bond yield won't rise above 4.25%. It closed at 4.16% on Friday. If we are wrong about that, however, and the bond market has trouble financing the government's huge deficit at current market interest rates, then the Bond Vigilantes could go wild. We don't think that means that the 10-year jumps to 5.00%-5.50%, but it could rise to 4.50%-4.75%.

In the past, bond yields tended to fall when the federal budget deficit widened because it did so during recessions as the government's revenues decreased. Private credit demands decline during recessions. The Fed lowers short-term interest rates during recessions as inflation moderates, which causes investors to buy bonds.

This time, the budget deficit widened as the government sought to avert a pandemic-related depression by providing lots of fiscal spending, including three rounds of pandemic relief checks during 2020 and 2021. The combination of ultra-easy monetary and fiscal policies amounted to the dropping of trillions of dollars of "helicopter money" on the economy. The result was a surge in inflation during the second half of 2021 through the summer of 2022, when it peaked.

The inflation surge forced the Fed to raise the federal funds rate significantly, from zero at the start of 2022 to 5.25%-5.50% currently (*Fig. 1*). However, fiscal policy doubled down, with Congress enacting several spending initiatives promoted by the Biden administration in 2021. That's mainly why the US economy hasn't fallen into a recession: Tight monetary policy was offset by very stimulative fiscal policy.

The 10-year US Treasury bond yield has been rising along with the federal funds rate and the 2-year Treasury yield since 2022 but at a slower pace than them. As a result, the yield-curve spread between the 10-year and 2-year Treasuries inverted last summer (*Fig. 2* and *Fig. 3*).

That inversion was widely interpreted to be a reliable signal that a recession was coming. The only reason that investors would buy a 10-year bond at a yield below the 2-year note is that they see a good chance that increasingly restrictive monetary policy will break something in the financial system, setting off a broad credit crunch and a recession. Then the Fed would be forced to reverse course.

Sure enough, a banking crisis occurred in March, and on August 7 Moody's downgraded the credit ratings of several regional banks. However, there has been no credit crunch so far because the Fed responded quickly in March with an emergency liquidity facility for the banks. So far, the most widely anticipated recession of all times remains a no-show.

Bond investors therefore are concluding that, while the Fed might be done raising the federal funds rate, it won't be lowering that rate anytime soon. With short-term money market rates likely to stay elevated for longer than was expected earlier this year (when a recession was widely anticipated), there's less of a rush to buy bonds. Meanwhile, fears that a deluge of Treasury securities might push yields higher can be self-fulfilling as investors plow into money market instruments.

In the past, the yield curve disinverted during recessions, when the Fed lowered the federal funds rate faster than bond yields fell. This time, the risk is that with no recession in sight, the yield curve will disinvert as the bond yield rises toward the elevated level of money market rates.

That shouldn't happen if inflation continues to moderate, raising expectations that the Fed might start to lower interest rates next year. Indeed, in an August 2 *NYT* *interview*, Federal Reserve Bank of NY President John Williams suggested that's a very plausible scenario:

"Assuming inflation continues to come down … next year, as many forecast, including the [FOMC members'] economic projections, if we don't cut interest rates at some point next year then real interest rates will go up, and up, and up. And that won't be consistent with our goals. So … from my perspective, to keep maintaining a restrictive stance may very well involve cutting the federal funds rate next year or [the] year after; but really, it's about how are we affecting real interest rates—not nominal rates."

That's the scenario we are rooting for, of course. The alternative is that while we are waiting for the happy one to occur, the mounting federal budget deficit spooks the bond market, causing bond yields to spike higher. In the first scenario, the yield curve disinverts as short-term interest rates fall faster than long-term ones. In the second scenario, bond yields rise to narrow their gap with short-term rates.

Yield Curve II: Supply & Demand vs Inflation. If we didn't all have skin in the game, the tug of war in the bond market between the bulls and the bears would be very entertaining. The consequences of who wins obviously matter greatly, not only to bond investors but also to stock investors.

Favoring the bears in both markets is the rapidly widening federal deficit and evidence that demand may not match the supply of Treasury securities unless their yields continue to rise. Favoring the bulls, in our opinion, is that since last summer inflation has been on a moderating trend that should persist through 2025 without any further increases in the federal funds rate. The Williams scenario should kick in next year if inflation continues to head toward the Fed's 2.0% y/y target by 2025.

Now let's review the latest relevant bearish and bullish data:

(1) *Lots of supply*. On August 1, Fitch Ratings downgraded US government debt from AAA to AA+ for all the reasons that have been concerning investors for years. None of this is news. However, the Fitch downgrade reminds us all that fiscal policy continues to get more and more profligate and that the supply of US Treasuries could weigh more and more on

the bond market.

The US federal deficit and the resulting mounting US debt are growing as percentages of nominal GDP. On a 12-month-sum basis, the former just jumped from $1.0 trillion last July to $2.3 trillion through July, as outlays have been rising while revenues have been falling over the past several months (*Fig. 4* and *Fig. 5*).

The net interest paid by the government has continued to rise rapidly along with interest rates since early last year. This outlay rose to a record $627.5 billion over the 12 months through July (*Fig. 6*). Just before the pandemic, it was $377.5 billion.

Total federal government debt subject to the debt limit rose to a record $32.5 trillion during July, up 6.5% y/y (*Fig. 7*). The publicly held debt excluding the Fed's holdings was $20.6 trillion. The government held $9.8 trillion of its own debt in trust funds and including the Fed's holdings of $5.7 trillion.

(2) *Dwindling demand.* The Fed's QT program will continue to reduce the Fed's holdings of Treasuries by about $60 billion per month (*Fig. 8*). Commercial banks in the US have also been reducing their holdings of government securities (including Treasuries and agencies) since early 2022 (*Fig. 9*).

On a 12-month sum basis, buying of US Treasury notes and bonds by private foreign investors peaked at a record $1.0 trillion last October (*Fig. 10*). It was down to $787.8 billion through May.

(3) *Moderating inflation.* The CPI inflation rate remained on a moderating trend during July. The CPI rent component continues to be the stickiest one, but it too is moderating. Excluding shelter, the headline and core CPI inflation rates were just 2.0% y/y and 2.5% y/y in July (*Fig. 11*).

Also in July, the PPI final demand inflation rate was only 0.8% y/y, with goods down 2.5% and services up 2.5% (*Fig. 12*). The report showed goods prices outside food and energy were unchanged last month, indicating that the recent goods disinflation was becoming entrenched. On the other hand, the cost of wholesale services jumped 0.5% m/m, the largest increase since last August, after dipping 0.1% in June. The PPI report noted that a huge 7.6% m/m surge in portfolio management fees accounted for 40% of the rise in services. Portfolio management fees had dropped 0.4% in June. Last month's surge was likely due to the strong performance of financial markets as investors bet that the Fed was probably done hiking rates.

Contributing to the moderation in the core CPI and PPI final demand goods inflation measures are falling prices on Chinese imports (*Fig. 13*). The US doesn't need to fall into a recession to bring inflation down if China falls into a deflationary recession instead.

(4) *The TIPS yield.* It wouldn't take much to see the 10-year Treasury yield trading at 4.50%-4.75%. The 10-year TIPS yield was 1.80% on Friday (*Fig. 14*). If economic activity remains as strong as it has been lately and the supply of Treasuries weighs on the bond market, this yield could easily rise to 2.00%-2.25%. It was there during 2006 and 2007. The spread between the nominal and TIPS yields on the 10-year Treasury closed at 2.36% on Friday (*Fig. 15*). If it rises to 2.50%, the nominal yield will range between 4.50% and 4.75%.

(5) *Hot & cold economic indicators.* The 13-week change in the 10-year Treasury bond yield closely tracks the Citigroup Economic Surprise Index (CESI) (*Fig. 16*). The CESI rose from zero on May 24 to 73.7 on Friday. Over the past 13 weeks, the yield is up 63bps. The Atlanta Fed's *GDPNow* tracking model is currently showing real GDP rising 4.1% (saar) during Q3, confirming that the economy remains hot.

(6) *Weak individual tax receipts.* The recent widening of the federal deficit is partly attributable to a significant drop in federal individual tax receipts so far this year (*Fig. 17*). Meanwhile, payroll tax receipts rose to a record high of $1.6 trillion over the 12 months through July. Corporate tax receipts totaled $430.7 billion, near their recent record high. But individual income tax receipts (over the past 12 months) fell from a record high of $2.7 trillion last April to $2.2 trillion through this July.

Our hunch is that last year's individual income tax revenues were boosted by capital gains tax revenues, as individual investors bailed out of their stocks during the 2022 bear market. So this year's decline reflects a more normal pace of income tax receipts. Unfortunately, without such one-time windfalls, the underlying trend in the federal deficit is a bearish one for bonds.

(7) *Bidenomics, MMT, and the Bond Vigilantes.* The current administration is attempting to take credit for any good economic news while blaming the previous one for the bad news. Of course, that's the *modus operandi* of all occupants of the White House.

What is unique about the current administration is that it has embraced Modern Monetary Theory (MMT), which claims that fears of widening federal deficits are based on several myths: that the federal government should budget like a household; that deficits will harm the next generation, crowd out private investment, and undermine long-term growth; and that entitlements are propelling us toward a grave fiscal crisis.

While the MMT proponents certainly have converted the Biden administration to their religion, the Bond Vigilantes remain heretics. The Biden administration may need to recall that in 1994, James Carville, a political adviser to President Clinton, famously remarked that if there were such a thing as reincarnation, he would like to be reincarnated as the bond market. By this, he meant that he would like to wield the bond market's immense power to discipline and rein in errant economic policymakers by driving up interest rates. In other words, don't incite the Bond Vigilantes!

Movie. "The Man Who Saved the Game" (+ + +) (*link*) is a warm-hearted movie about Roger Sharpe, the man who saved the pinball machine from decades of prohibition in many states around the country, including New York. It was widely deemed to be a gambling game controlled by the mob. Sharpe successfully convinced the powers-that-be in New York that pinball is a game of skill and provides lots of entertainment. What's heart-warming about the movie is Roger's relationship with his girlfriend, Ellen, and her son, who help him along the way. It's nostalgia time for those of us who were pinball wizards! Don't forget to listen to "*Pinball Wizard*" by the Who after you see the movie.

Calendars

US: Mon: Consumer Inflation Expectations. **Tues:** Retail Sales 0.4%m/m/1.5%y/y; Business Inventories 0.1%; Import & Export Prices 0.1%m/m/-6.5%y/y & 0.2%m/m/-14.1%y/y; NY Empire State Manufacturing Index; NAHB Housing Market Index; API Weekly Crude Oil Inventories; Kashkari. (Bloomberg estimates)

Global: Mon: Germany WPI -1.4%m/m/-2.6%y/y; Spain Consumer Confidence 85.7; Japan GDP 0.8%q/q/3.1%y/y; China Industrial Production 4.5%y/y; Japan Retail Sales 4.8%y/y; China Unemployment Rate; NBS Press Conference; RBA Meeting Minutes**. Tues:** Germany ZEW Economic Sentiment -16.0; UK Employment Change 3m/3m 50k; UK Claimant Count Change -7.3k; UK Unemployment Rate 4.0%; Japan Industrial Production & Capacity Utilization 2.0%m/m/-1.6%y/y; Canada CPI 2.7%y/y; European Economic Forecasts. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index fell 0.4% last week in only its fourth decline in 13 weeks and ended the week at 8.2% below its record high on December 27, 2021. The US MSCI ranked 19th of the 48 global stock markets that we follow in a week when 14 of the 48 countries rose in US dollar terms. The AC World ex-US index underperformed with a 0.9% decline, and remains in a correction at 15.7% from its June 15, 2021 record high. All regions fell for a second straight week, but EMEA was the best performing region with a 0.4% decline, ahead of EAFE (-0.7%) and EMU (-0.8). BIC was the worst performing region last week with a decline of 2.5%, followed by EM Asia (-2.2), EM Eastern Europe (-1.7), and EM Latin America (-1.6). Denmark was the best-performing country last week, with a gain of 8.5%, followed by Hungary (5.2), Turkey (4.4), Argentina (2.9), and Sri Lanka (1.3). Among the 24 countries that underperformed the AC World ex-US MSCI last week, the 3.8% declines for Poland and Ireland were the biggest, followed by those of China (-3.7), Greece (-3.5), and New Zealand (-2.9). Looking at 2023's performance so far, the US MSCI is up 16.6% as its ytd ranking dropped one place w/w to 15/48. The AC World ex-US's ytd gain of 7.8% is trailing the US's, with 33/48 countries in positive territory. EM Eastern Europe is the best regional performer ytd with a gain of 27.1%, followed by EMU (14.7), EM Latin America (14.0), and EAFE (9.5). The regional laggards so far in 2023, albeit with gains: BIC (0.5), EM Asia (3.7), and EMEA (4.7). This year's best ytd country performers: Greece (41.1), Argentina (40.4), Sri Lanka (38.5), Hungary (35.2), and Ireland (29.4). Here are the worst-performing countries of the year so far: Pakistan (-21.8), Hong Kong (-12.0), Finland (-11.9), Thailand (-7.5), and Malaysia (-6.7).

S&P 500/400/600 Performance (*link*): All three of these indexes fell for a second straight week. LargeCap dropped 0.3% w/w, less than the 0.8% and 1.3% declines for MidCap and SmallCap, respectively. At Friday's close, LargeCap finished the week at 6.9% below its record high on January 3, 2022, MidCap dropped to 8.6% below its record high on November 16, 2021, and SmallCap slipped to a 15.2% correction from its November 8, 2021 record high. Fourteen of the 33 LargeCap and SMidCap sectors moved higher for the week, up from just five rising a week earlier. LargeCap Energy was the best performer with a gain of 3.5%, ahead of SmallCap Communication Services (3.3), LargeCap Health Care (2.5), SmallCap Energy (2.1), and MidCap Energy (1.9). Among the biggest underperformers for the week were MidCap Tech (-3.7), LargeCap Tech (-2.9), SmallCap Health Care (-2.8), SmallCap Tech (-2.5), and SmallCap Consumer Discretionary (-2.2). Looking at performances so far in 2023, LargeCap, with a gain of 16.3%, remains well ahead of MidCap (9.5) and SmallCap (7.4); 23 of the 33 sectors are higher ytd. The top sector performers in 2023: LargeCap Communication Services (41.1), LargeCap Tech (35.6), LargeCap Consumer Discretionary (33.1), MidCap Industrials (23.7), and MidCap Tech (18.4). Here are 2023's biggest laggards: MidCap Utilities (-13.5), LargeCap Utilities (-8.7), SmallCap Financials (-5.9), MidCap Communication Services (-5.3), and SmallCap Utilities (-4.6).

S&P 500 Sectors and Industries Performance (*link*): The S&P 500 fell 0.3% last week and weakened 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 20th week and its 200-dma for a 21st week. The S&P 500 dropped to a 19-week low of 0.4% above its rising 50-dma from 1.3% a week earlier, and 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 trading above its 50-dma from most of 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 nine-week low of 8.1% above its rising 200-dma, down from 8.9% a week earlier, 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 level of the Great Financial Crisis following the failure of Lehman Brothers, the S&P 500 index was 39.6% below its 200-dma on November 11, 2008. As for what the dmas themselves have been doing, the 50-dma moved higher last week for a 20th week in its longest positive streak since September 2021, while the 200-dma rose for an 11th week in its longest positive streak since March 2022.

S&P 500 Sectors Technical Indicators (*link*): Eight of the 11 S&P 500 sectors are trading above their 50-dmas, unchanged from a week earlier and down from all 11 S&P 500 sectors above in the three weeks before that. Real Estate, Tech, and Utilities are on the only sectors trading below their 50-dmas. Nine sectors have a rising 50-dma, down from 10 a week earlier and 11 the week before that in the highest count since September. Tech turned down in the latest week and joined Utilities. Looking at the more stable longer-term 200-dmas, the positive club improved to nine members w/w from eight as Health Care moved above in the latest week. Real Estate and Utilities are the only two sectors trading below their 200-dmas. The rising 200-dma club rose to nine sectors w/w from eight as the 200-dma turned higher w/w for Health Care.

US Economic Indicators

Consumer Price Index (*link*): The CPI continues to ease, though the housing components are keeping core inflation stubbornly high. The headline CPI rose 0.2% for the second month in July, a tick above May's 0.1%, while the core CPI also advanced 0.2% for the second month—the smallest monthly gain since summer 2021 and half the 0.4% gain of the prior three months. On a yearly basis, the *headline CPI* ticked up to 3.2% after slowing a full percentage point, to 3.0% y/y in June—the lowest since March 2021 and only one-third of last June's 9.1% peak. Meanwhile, the *core prices* yearly rate remained at an elevated level, easing for the fourth month from 5.6% in March to a 21-month low of 4.7%. Excluding shelter, the yearly core rate was only 2.5%. Here's a laundry list of CPI yearly rates for July. The rate for consumer durable goods fell 1.4% y/y, its seventh negative reading in eight months, while the rate for *consumer nondurable goods* excluding food (-5.3 y/y) was in negative territory for the fifth straight month. The *services rate excluding energy* eased a bit for the fifth month to 6.1% y/y, after rising from 1.3% in January 2021 to 7.3% this February—which was the highest since summer 1982. Food costs (4.9% y/y) eased for the 11th month from last August's 11.4%, which was the fastest pace since April 1979. Within food, the rate for *food at home* (3.6) slowed steadily from 13.5% last August (the highest since March 1979); the yearly rate for *food away from home* slowed slightly for the fourth month to 7.1% y/y from March's 8.8%—which was the highest since the highest since fall 1981. *Energy costs* were below zero for the fifth month, tumbling from last June's 41.6%—which was the fastest pace since April 1980—to -12.5% y/y this June. Within energy, the yearly rate for *fuel oil* plummeted to -36.6% y/y in June, down from last May's record high of 106.7%, though did tick up to -26.5% in July. The rate for *gasoline* prices fell 19.9% y/y, remaining in negative territory for the sixth successive month; it peaked at 59.9% last June (fastest since March 1980). The rate for *natural gas* prices has been dropping y/y: Prices fell below the year-ago level in April (-2.1) for the first time since August 2020 and was at -13.7% in July, narrowing from June's -18.6%. The y/y rate was 38.4% last June, which was the highest since October 2005. The *electricity* rate eased to a 28-month low of 3.0% y/y in July; it peaked at 15.8% last August—which was the highest since August 1981. Within *consumer durable goods*, the rate for *new cars* rose 3.6% y/y, the lowest rate since May 2021, down from last April's near-record high of 13.2%, while the rate for *used cars & trucks* was -5.6% y/y last month, up from February's -13.6% bottom—which was the lowest since

November 1960. It was as high as 41.2% last February and at a record-high 45.2% during June 2021. The rate for f*furniture & bedding* fell 2.8% y/y in July, after posting its first negative reading since July 2020 in May (-0.5%), and is down dramatically from last February's record high of 17.1%. The rate for *major appliances* fell 9.9% y/y, down from its recent peak of 12.4% last March. Within *consumer nondurable goods*, the rate for apparel prices continues to hold between 3.1% and 3.6% the first seven month of this year, not too far from the 20-month low of 2.9% at the end of 2022; before that, it fluctuated in a 5.0%-5.5% range from last April through September. It was at a recent peak of 6.8% last March (the highest since the end of 1980). Within services, *owners' equivalent rent* eased for the third month, to 7.7% y/y, holding near its record high of 8.1% in April, while the rate for rent of *primary residence* dipped to 8.0% y/y, easing from 8.8% y/y during February through April, which was the highest since fall 1981. These rates compare with recent lows of 1.8%. Meanwhile, the yearly rate for *lodging away from home* accelerated for the third month, to 6.0% y/y, after easing from 7.7% at the start of the year to 3.3% in April; it was at a record high of 25.1% in both March and February of 2022. Turning to *medical care*, the yearly rate for *hospitals'* services (3.1) eased from June's 4.1% to not far from March's 20-month low of 2.7%. The *physicians' services* (0.4) rate has hovered around zero the past five months. Meanwhile, the yearly rate for *airfares* fell 18.6% y/y, holding near June's -18.0%, which was its steepest drop since February 2021; that compares with last October's 42.9%, which wasn't far from the record high of 45.0% in September 1980.

Producer Price Index (*link*): The gain in July's headline PPI was slightly larger than expected, as services prices posted its largest monthly gain in a year. *Final demand* has been volatile around zero so far this year, rising 0.3% in July after no change in June and a 0.3% decline in May—averaging monthly gains of zero the first seven months of this year. *Core prices*—which excludes food, energy, and trade services—advanced 0.2% in July, following a 0.1% increase in June and no change in May, with April and March also posting 0.1% upticks. It increased 0.5% and 0.3% the first two months of the year. The yearly rate held at June's 28-month low of 2.7%, down from March 2022's record-high of 7.1%. *Final demand goods* ticked up 0.1% in July after no change in June, following a1.5% decline in May. It has declined during three of the seven months of 2023. The yearly rate ticked up to -2.5% after easing from a record high of 17.6% last June to -4.3% this June—the lowest since April 2020. *Final demand services* rose 0.5%, the most since last summer; it had fluctuated from -0.1% to +0.2% during the first half of this year. A 7.5% surge in portfolio management fees accounted for 20% of the increase in services. The yearly rate inched up to 2.5% in July, after sinking to a 29-month low of 2.3% in June, down sharply from its record high of 9.4% last March. The PPI for *personal consumption* rose 0.3% in July following a 0.2% gain and a 0.4% loss the prior two months. The yearly rate edged up to

1.2% after slowing from a record high last March of 10.4% to a 34-month low of 0.5% this June. The yearly rate for *personal consumption excluding food & energy* eased for the third month to 2.8% in July; it peaked at a record high of 8.1% during March 2022. Looking at *pipeline prices*, the yearly rate for intermediate goods prices remained below zero, though ticked up from -9.1% in July to -7.7% in June. It fell below zero in March for the first time November 2020; it was at a cyclical high of 26.6% during November 2021. The yearly crude goods rate was in negative territory for the sixth successive month, falling 25.0% y/y in July. However, it narrowed from June's decline of 32.7%—which was the steepest yearly decline since summer 2009; the rate was at a recent peak of 50.7% last June.

Consumer Sentiment Index (*link*): Consumer sentiment for the mid-August period was little changed, after shooting up in July to its highest reading since October 2021. The report noted: "In general, consumers perceived few material differences in the economic environment from last month, but the saw substantial improvements relative to just three months ago. *Overall consumer sentiment* dipped 0.4 points mid-August, to 71.2, bringing its three-month climb through August to 12.0; prior to August, it had climbed in six of the past eight months, by 7.2 points in July and 14.8 points over the period to 71.6. August's reading puts the *headline CSI* 42% above its all-time historical low last June (50.0), and is approaching the historical average reading of 86.0. The *present situation* component climbed for the sixth time this year, by 0.8 points in mid-August and 18.0 points ytd to 77.4—its highest level since October 2021. The *expectations* component took a small step back mid-month, slipping a point to 67.3; this was after climbing during five of the first seven months of the year by 8.4 points to a 19-month high of 68.3. The present situation and expectation components have increased 12.5 points and 11.9 points, respectively, over the last three months. Turning to inflation, the *one-year expected inflation rate* edged down to 3.3% (back at June's recent low) from 3.4% in July; this was 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* remained stable at 2.9% in mid-August, still within its narrow 2.9%-3.1% range in 24 of the past 25 months.

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