MORNING BRIEFING
October 2, 2023

Some Good News & Not So

Check out the accompanying chart collection.

Executive Summary: Last week's plentiful economic news netted out to support our optimistic economic outlook through next year, bringing more signs of improving productivity, surging investment in manufacturing, and manageable inventories. Last week also brought some mixed news and some outright bad news, but we still see a 75% chance of a soft-landing scenario with disinflation and a 25% chance of a hard landing. Longer term, we're still convinced that improving productivity will set the stage for a "Roaring 2020s" decade. Nevertheless, for the here and now, we are worrying quite a bit about the Bond Vigilantes' hostile response to profligate fiscal policy. ... And: Dr. Ed reviews "A Good Person" (+ +).

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*.

Good News I: Signs of Improving Productivity. There was lots of economic and financial news last week that mostly supports our optimistic economic outlook through the end of 2024. Debbie and I are still currently assigning subjective odds of 75% to a soft-landing scenario with immaculate disinflation (i.e., disinflation without a recession) and 25% to a hard-landing one.

We are also optimistic about the outlook for productivity growth over the rest of the decade. We still expect the decade will deserve to be called the "Roaring 2020s," though we've acknowledged that it could also turn out to be a repeat of the Great Inflation of the 1970s. Our current subjective odds on the former versus the latter are 75% and 25%. Like the Fed, we will continue to assess the data to guide our odds-making.

Let's start with the productivity story. As we've previously noted, there is a very good correlation between productivity and real hourly compensation growth, both on a 20-quarter percent change basis at an annual rate (*Fig. 1*). The standard of living as measured by consumers' purchasing power is driven by productivity.

The boom-and-bust cycle in real hourly compensation growth is nearly identical to that of productivity growth. Their peaks and troughs tend to coincide in both timing and magnitude.

There have been three productivity growth booms since the 1950s. There was a major bust in productivity growth from the mid-1960s through the early 1980s that coincided with the Great Inflation period (*Fig. 2*).

In our opinion, the latest productivity boom started during Q4-2015, when productivity growth troughed at 0.4% at an annual rate and rose to 1.4% during Q4-2019, just before the pandemic. The pandemic initially boosted productivity during the lockdowns then depressed it when quits soared. But now productivity is normalizing. It was back to 1.6% during Q2-2023.

Last week, the personal consumption expenditures deflator was up 0.4% m/m in August, above the 0.2% increase in average hourly earnings (of production & nonsupervisory workers) during the month. This measure of real wages stagnated last year but is up 0.9% since the start of this year through August (*Fig. 3*). It is back growing on its 1.2% upward trendline, which started in 1995. This can happen on a sustainable basis only if productivity is growing. What about August? The core PCED was up only 0.1%, just below the increase in the wage measure.

Another encouraging sign for our upbeat productivity story is that the S&P 500 profit margin seems to have bottomed during the first half of this year around 11.5%, not much below its record high of 13.7% during Q2-2021 (*Fig. 4*). Furthermore, the weekly series for the forward profit margin of the S&P 500 has been rebounding for the past 21 weeks through the September 21 week.

Good News II: Onshoring & Infrastructure Boom. Last week's real GDP report caused one of the series that we've been following very closely recently to soar off our chart's scale. It was fixed investment in manufacturing facilities (*Fig. 5*). It's up 64.5% y/y through Q2-2023 and 74.9% since Q4-2019, just before the pandemic. That's on an inflation-adjusted basis!

American and foreign manufacturing companies clearly are onshoring to the US. Supply-chain disruptions during the pandemic and growing geopolitical tensions between the US and China have stimulated the onshoring rush. So has a shortage of workers in China.

The onshoring boom and the federal government's increased spending on public infrastructure are boosting new orders for construction machinery, which is up 8.4% y/y through July (*Fig. 6*). Onshoring and infrastructure investment also explain why construction employment rose to yet another record high of 8.0 million during August despite the

recession in single-family housing starts (*Fig. 7*). Employment in heavy & civil engineering construction has been rising to record highs in recent months as well, at 1.1 million in August (*Fig. 8*).

There was one piece of bad news in the building trade two weeks ago. Multi-family housing starts plunged 26.3% m/m during August (*Fig. 9*). As we noted previously, that might have been a fluke or it might reflect that soaring commercial mortgage rates and disinflating rents are starting to depress the construction of rental housing, which may be facing a glut in some areas. That would be good news for our optimistic outlook for inflation. Meanwhile, the rolling recession in single-family housing starts may be bottoming (*Fig. 10*).

Good News III: Inventories Manageable. Thursday's real GDP report showed that inventory investment remained close to zero during the first half of this year (*Fig. 11*).

That followed five quarters of significant unintended inventory accumulation, particularly by wholesale and retail distributors (excluding auto dealers' inventories). That pileup occurred when inventories were depleted by consumers' buying binge for goods during the pandemic years of 2020 and 2021. Retailers scrambled to order more merchandise, which jammed the ports and overloaded the trucking industry. By the time all the goods finally were delivered to distributors in 2022, consumers had pivoted away from binging on goods to purchasing a lot more services.

Now inventories seem to be more in line with demand. In current dollars, they've been flat since mid-2022, consistent with flat retail sales in current dollars (*Fig. 12*). So an inventory-led recession is less likely now.

Mixed News I: Corporate Cash Flow at a Record High. Thursday's GDP report showed that after-tax profits as reported to the IRS fell 7.8% y/y during Q2-2023, but we think that might mark the bottom (*Fig. 13*). After-tax profits from current production fell 4.1% y/y over the same period. We refer to this series as "cash-flow profits" because it is adjusted for the historical cost basis used in profits tax accounting for inventory withdrawals and depreciation to the current cost measures used in GDP.

After-tax cash flow profits plus tax-reported depreciation edged up to $3.2 trillion (saar) during Q2-2023 (*Fig. 14*). This measure of corporate cash flow matched its record-high three quarters ago. This abundance of corporate cash flow following a very mild profits recession suggests that corporations have ample homegrown liquidity to avoid the adverse consequences of tightening credit conditions.

Mixed News II: Inflation Mostly Moderating. The bad news is that August's PCED rose 0.4% m/m and 3.5% y/y. Excluding food and energy, it was up just 0.1% m/m but 3.9% y/y. We are especially encouraged to see that the headline and core PCED, both excluding rent, rose only 2.8% and 3.2% y/y through August (*Fig. 15*). We know that the rent inflation component of the PCED is heading lower based on indexes of current rents. On the other hand, the non-housing services component of the PCED has been stuck at a pace of around 4.5% y/y since late 2021 (*Fig. 16*). We expect that it will moderate along with wage inflation in the coming months.

Meanwhile, in July, there was deflation in the price deflators of goods sold by manufacturers (-4.1% y/y), wholesalers (-5.6%), and retailers (-0.3%) (*Fig. 17*). Such deflation is consistent with what occurred during past recessions. However, so far this time, the recession has been a rolling recession among goods producers and distributors rather than an economy-wide recession.

Mixed News III: Consumers Cooling. Consumers continued to spend more on services than on goods during August. The 0.1% increase in real personal consumption expenditures in August reflected an increase of 0.2% in spending on services and a decrease of 0.2% in spending on goods (*Fig. 18*). Within services, the leading contributors to the increase were transportation services (led by air transportation) and health care (led by hospitals and nursing homes). Within goods, the largest contributor to the decrease was motor vehicles and parts (led by new motor vehicles). We like these numbers because in our outlook consumer spending slows; it doesn't fall.

Mixed News IV: Banks Lending Cautiously. Bank loans has stopped growing. The series is essentially unchanged over the past 18 weeks through the September 20 week. Over this same period, commercial & industrial (C&I) loans is down $99 billion. This sounds like bad news, but the other loans are up $74 billion collectively. In addition, the weakness in C&I loans reflects reduced demand because inventories have been holding steady, as noted above (*Fig. 19*).

Bad News I: Bond Vigilantes Are P.O.'d About Deficits. The September 30 *WSJ* features an *article* by Spencer Jakab titled "America's Debt Problem Is Too Big for the Bond Vigilantes." It discusses a festering problem that has come to the fore since Fitch Ratings downgraded US Treasuries on August 1. Simply put: The federal budget deficits are too d@mn wide!

In our August 8 *Morning Briefing*, we wrote: "The Bond Vigilantes may be turning more

vigilant following the Fitch downgrade. They are happiest when the economy is weak and inflation is subdued. They are not so happy right now. ...

"Over the years, we've frequently been asked why we aren't more concerned about the widening US federal government budget deficit. We've consistently responded that we will be concerned about it when the financial markets are concerned about it.

"We believe that supply and 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 we expect inflation to continue to moderate, we currently predict that the bond yield won't rise above 4.25%. If we are wrong about that, and the bond market has trouble financing the government's huge deficits at current market interest rates, then the Bond Vigilantes will go wild. If that happens, head for the hills for the rest of the summer and maybe September too."

We've been wrong about 4.25% because the Bond Vigilantes are mad as h€ll about profligate fiscal policy. They have no quarrel with the Fed's tough monetary stance. But seeing the federal deficit widen so rapidly this year with no relief in sight has provoked the Wild Bunch.

We are still counting on falling inflation to stabilize the bond yield. In the August 22 *Morning Briefing*, we wrote that the bond yield has normalized, returning to where it had been during 2003-07, before the period of abnormally low interest rates from the Great Financial Crisis through the Great Virus Crisis. We concluded that "the 10-year nominal bond yield should be around 4.50%."

In the past, the Bond Vigilantes didn't care much about federal budget deficits because it was normal to see them widen during recessions when inflation was moderating and the Fed was easing. Now that the Bond Vigilantes do care about deficits, we care about deficits too. Indeed, the biggest risk to our optimistic outlook for the economy is that the Bond Vigilantes are about to send a very loud message to Washington: "Cut the deficits or we will raise bond yields until they cause a credit crunch and a recession."

Bad News II: Round Up the Usual Suspects. There are lots of bricks in today's wall of worry. Fed Chair Jerome Powell in his *press conference* on September 20 noted: "So there is a long list, and you hit some of them. But, you know, it's the strike, it's government shutdown, resumption of student loan payments, higher long-term rates, oil price shock."

We are placing our bets on relatively happy outcomes over the next few weeks: The strike and the shutdown (in 45 days, maybe) are short. Employment and real wage gains support consumer spending, though at a slower pace than during Q3-2023. Bond yields and oil prices stabilize. Most importantly, core inflation continues to moderate. Wish us luck!

Movie. “A Good Person” (+ +) (*link*) is about dysfunctional people dealing with the adversities that life can deliver. There’s a terrible car accident, alcohol and drug addiction, and abusive fathers. So the movie is depressing, though it might be uplifting to be reminded that things aren’t all that bad in our own lives compared to the miserable fate that others suffer. The movie is slow and a bit long, but the acting performances of Florence Pugh and Morgan Freeman are superb and worthy of Oscars.

Calendars

US: Mon: ISM M-PMI & Price Index 47.8 & 48.6; Construction Spending 0.5%; Powell; Williams; Barr; Harker; Mester. **Tues:** JOLTS Job Openings 8.830; API Weekly Crude Oil Inventories; Bostic. (FXStreet estimates)

Global: Mon: Eurozone, Germany, France, Italy, and Spain M-PMI 43.4/39.8/43.6/45.4/46.5; Eurozone Unemployment Rate 6.4%; Spain Unemployment Change -12.2k; UK M-PMI 44.2; UK Nationwide HPI -0.4%m/m/-5.8%y/y; RBA Interest Rate Decision 4.10%; De Guindos; Mann. **Tues:** Lane. (FXStreet estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index fell 0.6% last week for its third straight decline and matching its longest losing streak since the end of December 2022. The index is back in a correction at 11.6% below its record high on December 27, 2021. The US MSCI ranked 22th 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 decline of 1.5% for the week and is flirting with bear market territory now at 9.5% below its June 15, 2021 record high. Nearly all regions fell for the week. EMEA was the best performer with a gain of 0.3%, ahead of BIC (-1.0%) and EM Asia (-1.3). EM Eastern Europe was the worst performing region last week with a 1.8% decline, followed by EMU (-1.6), EAFE (-1.6), and EM Latin America (-1.6). The Philippines was the best-

performing country last week, with a gain of 4.0%, followed by Turkey (3.4), Singapore (1.9), and Sweden (1.8). Among the 19 countries that underperformed the AC World ex-US MSCI last week, the 5.1% decline for Argentina was the biggest, followed by those of Thailand (-4.0), Colombia (-3.8), Portugal (-3.7), and Japan (-3.1). In September, the US MSCI ranked 31/48 as it fell 4.8%, more than the 3.4% decline for the AC World ex-US index, with only eight of the 48 countries moving higher. Pakistan was the best performer, with a gain of 5.9%, followed by Egypt (5.8), Norway (4.8), Sri Lanka (3.0), and Turkey (2.9). The worst-performing countries in September: Argentina (-16.3), Poland (-11.6), Ireland (-10.5), Greece (-10.4), and Thailand (-9.3). All of the regions fell in September, but BIC (-1.2) dropped less than EM Latin America (-2.5), EM Asia (-2.8), and EMEA (-3.1). EM Eastern Europe was September's worst-performing region with a drop of 9.5%, followed by EMU (-5.6) and EAFE (-3.7). Looking at 2023's performance so far, the US MSCI is up 12.2%, as its ytd ranking remained dropped one place w/w to 13/48. The AC World ex-US's ytd gain of 2.9% is trailing the US's, with 31/48 countries in positive territory. EM Eastern Europe is the best regional performer ytd with a gain of 10.3%, followed by EM Latin America (8.1), EMU (7.0), and EAFE (4.5). The regional laggards so far in 2023: BIC (-3.2), EM Asia (-0.8), and EMEA (0.2). This year's best ytd country performers: Sri Lanka (33.2), Greece (29.1), Hungary (24.4), Argentina (19.4), and Italy (17.6). Here are the worst-performing countries of the year so far: Pakistan (-29.4), Hong Kong (-20.2), Thailand (-15.6), Finland (-15.6), South Africa (-12.2), and Malaysia (-11.0).

S&P 500/400/600 Performance (*link*): Two of these three indexes rose w/w. SmallCap rose 0.4%, ahead of the 0.3% gain for MidCap and the 0.7% decline for LargeCap. At Friday's close, LargeCap finished the week back in a correction at 10.6% below its record high on January 3, 2022, MidCap remained in a correction to end at 14.0% below its record high on November 16, 2021, and SmallCap remained in bear market territory at 21.5% from its November 8, 2021 record high. Thirteen of the 33 LargeCap and SMidCap sectors moved higher for the week, compared all 33 falling a week earlier. MidCap Energy was the best performer with a gain of 3.0%, followed by MidCap Tech (2.5), SmallCap Energy (2.4), LargeCap Energy (1.3), and SmallCap Consumer Discretionary (1.3). Among the biggest underperformers for the week were LargeCap Utilities (-7.0), MidCap Utilities (-3.7), SmallCap Utilities (-3.5), LargeCap Consumer Staples (-2.1), and MidCap Real Estate (-1.7). During September, LargeCap fell 4.8% for its second straight monthly decline and its biggest since December 2022. That compares to the bigger 5.4% and 6.2% declines for MidCap and SmallCap, also their biggest since December 2022. Just two of the 33 sectors rose in September, the lowest count since December and down from four rising in August. September's best performers: Large Energy (2.5), SmallCap Energy (2.0), MidCap Energy (-0.9), MidCap Consumer Staples (-3.0), and LargeCap Health Care (-3.1). September's

biggest laggards: SmallCap Health Care (-9.2), SmallCap Tech (-8.9), LargeCap Real Estate (-7.8), MidCap Real Estate (-7.8), and MidCap Communication Services (-7.7). Looking at performances so far in 2023, LargeCap, with a gain of 11.7%, remains well ahead of MidCap (3.0) and SmallCap (-0.5); 19 of the 33 sectors are higher ytd. The top sector performers in 2023: LargeCap Communication Services (39.4), LargeCap Tech (33.8), LargeCap Consumer Discretionary (25.7), MidCap Tech (16.3), and MidCap Industrials (16.1). Here are 2023's biggest laggards: MidCap Utilities (-21.7), SmallCap Utilities (-17.0), MidCap Communication Services (-16.7), LargeCap Utilities (-16.5), and SmallCap Financials (-14.8).

S&P 500 Sectors and Industries Performance (*link*): Only two of the 11 S&P 500 sectors rose last week, but six outperformed the composite index's 0.7% decline. That compares to a 2.9% decline for the S&P 500 a week earlier, when all 11 sectors fell and seven outperformed the index. Energy was the best performer with a gain of 1.3%, followed by Materials (0.2%), Communication Services (0.0), Tech (-0.1), Consumer Discretionary (-0.3), and Industrials (-0.5). Utilities was the worst performer, with a drop of 7.0%, followed by Consumer Staples (-2.1), Financials (-1.8), Real Estate (-1.6), and Health Care (-1.1). The S&P 500 fell 4.9% in September for its biggest monthly decline since December as only one sector moved higher and five outperformed the broader index. That compares to one sector rising and five outperforming the S&P 500's 1.8% gain in August. The leading sectors in September: Energy (2.5), Health Care (-3.1), Financials (-3.2), Communication Services (-3.3), and Consumer Staples (-4.8). September's laggards: Real Estate (-7.8), Tech (-6.9), Industrials (-6.1), Consumer Discretionary (-6.0), Utilities (-5.8), and Materials (-5.0). Looking at 2023's performance so far, the S&P 500 is up 11.7% ytd, with just three sectors still outperforming the index and six higher for the year. The best ytd performers: Communication Services (39.4), Tech (33.8), and Consumer Discretionary (25.7). These are 2023's worst performers: Utilities (-16.5), Real Estate (-8.0), Consumer Staples (-6.6), Health Care (-5.3), Financials (-3.1), Materials (1.0), Industrials (3.1), and Energy (3.2).

S&P 500 Technical Indicators (*link*): The S&P 500 fell 0.7% last week and weakened relative to its 50-day moving average (50-dma) and its 200-day moving average (200-dma). The index remained below its 50-dma for a fourth week, but has been above in 21 of the past 27 weeks. It remained above its 200-dma for a 28th week. As for what the dmas themselves have been doing, the 50-dma moved lower w/w for just the fourth time in 27 weeks, but the 200-dma rose for an 18th week in its longest positive streak since March 2022. The S&P 500 dropped to a 28-week low of 3.7% below its now-falling 50-dma from 3.4% below its falling 50-dma a week earlier. For perspective, the latest reading is also down from a 20-week high of 5.4% above its (rising) 50-dma in mid-June and up from a 20-

week low of 3.6% below its (falling) 50-dma at the beginning of March. Other comparison points include: a four-month low of 10.6% below its (falling) 50-dma at the end of September 2022, a 23-month high of 8.7% above its (rising) 50-dma in August 2022, 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. Turning to the 200-dma, the price index weakened to a 27-week low of 1.8% above its (rising) 200-dma from 2.8% above a week earlier. That 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.

S&P 500 Sectors Technical Indicators (*link*): Energy remains the one of the 11 S&P 500 sectors trading above their 50-dmas, down from four sectors above several weeks earlier and all 11 S&P 500 sectors above in the three weeks before the end of July. Energy is also the only sector with a rising 50-dma, down from four sectors several weeks earlier. Looking at the more stable longer-term 200-dmas, the positive club was unchanged w/w at four members. The four sectors still trading above their 200-dmas are Communication Services, Consumer Discretionary, Energy, and Information Technology. The rising 200-dma club weakened w/w to five sectors, as Financials turned down w/w and joined these five sectors in the falling 200-dma club: Consumer Staples, Health Care, Materials, Real Estate, and Utilities.

US Economic Indicators

Personal Income & Consumption (*link*): Both personal income and consumption were in line with expectations in August. *Personal income* rose 0.4% in August, double the 0.2% gains recorded the prior two months. *Wages & salaries* has increased the first eight months of this year, by 0.5% in August and 5.3% ytd; *adjusted for inflation*, wages & salaries have expanded 3.0% during the past eight months through August to a new record high, after contracting 1.2% the final three months of 2022. *Personal consumption expenditures* continued to set new record highs in August, with spending climbing the first eight months of

his year, by 0.4% in August and 4.4% ytd; spending on goods and services were up 3.7% and 4.7%, respectively, ytd. In *real terms*, consumer spending in August edged up 0.1%, with spending on goods down 0.2% and services up 0.2%. Year to date, real goods consumption climbed 2.6%, while real services consumption was up 1.9%; compared to a year ago, the former was up 2.2% and the latter 2.4%. Meanwhile, *personal saving* dropped $279.3 billion over the last three months through August, to $794.1 billion, as spending rose faster than income. The *saving rate* dropped to 3.9% in August, down from 5.3% in May.

Personal Consumption Deflator (*link*): August's PCED increased 0.4%, the highest monthly gain since January and double the prior two months' 0.2% gains. Meanwhile, core prices rose 0.1%, the smallest monthly gain since November 2020 and half the prior two months' 0.2% gains. The yearly headline rate accelerated to 3.5% from June's 3.2% (the lowest since March 2021), slowing from a peak of 7.1% last June—which was the highest since the end of 1981. The yearly core rate eased to 3.9% in August, from a recent peak of 5.6% during February and March of last year. On a *three-month annualized* basis, the core rate eased for the sixth month to 2.1% (saar) in August from 5.0% in February, and below its yearly rate of 3.9%. The three-month rate for durable goods fell back below zero in July (-3.3%), after hovering around zero the prior few months, widening to -5.5% (saar) to August, while the three-month rate for core nondurable goods prices dipped below zero, to -0.1% (saar), after accelerating to 9.6% in March—from a recent low of 0.9% during December 2022. Meanwhile, services prices ex energy slowed to 3.8% (saar), from a recent peak of 6.2% at the start of the year. The three-month annual rates for consumer services ex energy (3.8%, saar & 5.1% y/y), core nondurable goods (-0.1 & 4.3), and consumer durable goods (-5.5 & -1.9) all were below their yearly rates, with both measures below zero in the latter two. *PCED components for which three-month rates lag yearly rates*: lodging away from home (-25.4 & 3.0), video audio & information processing (-17.3 & -7.7), used motor vehicles (-12.1 & -6.7), airfares (-9.8 & 2.9), motor vehicles parts (-3.8 & 1.8), alcoholic beverages purchased for off-premise consumptions (0.5 & 2.7), new motor vehicles (0.9 & 3.1), food & nonalcoholic beverages purchased for off-premise consumption (1.7 & 3.2), prescription drugs (1.8 & 2.8), clothing & footwear (2.2 & 2.9), professional & other services (3.4 & 8.1), transportation services (4.0 & 6.4), personal care products (4.0 & 5.6), tobacco (4.9 & 5.6), owner-occupied rent (5.3 & 7.3), and tenant rent (5.5 & 7.8). *PCED components for which three-month rates exceed yearly rates*: gasoline & other energy products (45.1 & -4.0), physician services (1.2 & 0.6), sports & recreational vehicles (0.7 & 0.1), and household appliances (-3.6 & -6.7). *PCED components for which three-month rates & yearly rates are comparable*: furniture & home furnishings (-1.9 & -2.1), hospitals (2.1 & 2.4), education services (2.5 & 2.2), and recreation services (5.6 & 5.3).

Consumer Sentiment Index (*link*): *Sentiment* dropped for the second month, according to September's final reading, falling from a 21-month high of 71.6 in July to 68.1 in September, slightly above its mid-month reading of 67.7. "Consumers are understandably unsure above the trajectory of the economy given the multiple sources of uncertainty, for example over the possible shutdown of the federal government and labor disputes in the auto industry," Joanne Hsu, the survey director, noted on Friday. However, late Saturday night, the Senate passed a 45-day funding bill to avert the government shutdown; stay tuned. The *present situation* component fell for the second month, to 71.4 in September, after climbing five of the prior seven months by 17.2 points to 76.6 in July—its highest level since October 2021. The *expectations* component edged up to 66.0 in September, after falling from a 19-month high of 68.3 in July to 65.5 in August. Turning to inflation, the *one-year expected inflation rate* fell from 3.5% in August to 3.2% in September—the lowest since March 2021—and is above the 2.3%-3.0% range seen in the two years prior to the pandemic. The rate was at 4.6% in April. The *five-year expected inflation rate* sank to 2.8%, below the narrow 2.9%-3.1% range for only the second time in the past 26 months. In comparison, long-run inflation expectations ranged between 2.2%-2.6% in the two years just before the pandemic.

Regional M-PMIs (*link*): Five Fed districts have reported on manufacturing activity for September—New York, Philadelphia, Dallas, Kansas City, and Richmond—and the results were a mixed bag. *Manufacturing* activity (to -6.5 from -6.2) contracted at a steady pace in September, though narrowed from its recent low of -16.5 in May. The New York (to 1.9 from -19.0) and Richmond (5.0 from -7.0) regions swung from contraction to expansion, while Philadelphia's (-13.5 from 12.0) swung from expansion to contraction. Activity in the Kansas City (-8.0 from 0.0) region also moved into contractionary territory. Meanwhile, the Dallas (-18.1 from -17.2) region contracted at a steady pace. The *new orders* (-4.3 from –6.7) gauge is moving closer to the breakeven point of zero, up from its recent low of -18.4 in March. The Philadelphia (-10.2 from 16.0) area experienced a wide 26.2-point swing back into contractionary territory, while the Kansas City (-14.0 from -3.0) measure moved deeper into negative territory. Meanwhile, New York's (5.1 from -19.9) measure recorded a positive 25.0-point swing back into expansionary territory, Richmond's (3.0 from -11.0) recorded a positive 14.0-point swing, and the Dallas (-5.2 from -15.8) measure moved nearer to expansionary territory. *Employment* (2.8 from -1.0) has been bouncing around the breakeven point of zero for several months, with September readings showing slight contractions in the rate of manufacturers' hiring in both the New York (-2.7 from -1.4) and Philadelphia (-5.7 from -6.0) regions and little growth in the Kansas City (2.0 from 1.0) region. Both the Dallas (13.6 from 4.3) and Richmond (7.0 from -3.0) regions showed an acceleration in hiring, with Richmond's measure rebounding from an August decline.

Regional Prices Paid & Received Measures (*link*): We now have September prices-paid and -received data for the five Fed regions—New York, Philadelphia, Richmond, Kansas City, and Dallas. (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.) The *prices-paid* measure in September accelerated for the fourth month, to 24.8, after slowing steadily from 40.7 in February to 16.7 in June. It peaked at 90.1 during November 2021. Looking at the prices-paid indexes, the Philadelphia (25.7 from 20.8) measure showed an acceleration from April's 8.2 reading—which was its lowest since mid-2020—while the Dallas (25.0 from 17.4) gauge also continued to accelerate from its 38-month low of 1.4 in June, and Richmond's (40.6 from 31.7) from August's 32-month low. New York's (25.8 from 25.2) measure held steady, while Kansas City's (7.0 from 13.0) slowed. Turning to the *prices-received* measure, it rose to 13.8 after falling from 12.5 in July to 10.8 in August, which was the lowest since October 2020. It was at a record high of 59.0 in March 2022. Prices-received indexes were mixed: New York's (19.6 from 12.8) measure picked up a bit from July's three-year low, while Philadelphia's (14.8 from 14.1) barely budged in September though did ease from May's 23.0, while Richmond's (30.6 from 31.3) also was little changed. The Dallas measure was unchanged at 1.8, while Kansas City's (2.0 from -6.0) moved back above zero after two months below. (Note: The New York, Philadelphia, and Dallas 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

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Indexes (ESIs) for the both the EU and Eurozone have dropped seven of the last eight months through September. The *EU's measure* fell 4.8 points to 92.8 during the eight months through September, while the *Eurozone's gauge* fell 6.2 points to 93.3—down from their January readings of 97.6 and 99.5, 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 September, with ESIs in Spain (-3.2 to 99.0) and Italy (-2.2 to 97.9) posting the biggest declines, while France's (+2.7 to 95.9) posted the biggest gain. Sentiment in Germany (+0.3 to 89.0) and the Netherlands (+0.3 to 93.3) edged higher, while Poland's (-0.1 to 95.5) edged lower. By sector, *consumer* confidence in the overall EU edged lower for the second month by 2.6 points to -18.7, following a surge of 13.7 points from last September's record low of -29.9 to -16.1 by this July. *Retail trade* confidence fell for the fourth time in five

months, by 3.6 points to -5.0, though some optimism about expected business conditions returned. *Industrial* confidence has been in a freefall since reaching a record high of 12.8 in December 2021, plunging 22.1 points over the 20 months through this August, to -9.3, though did stabilize in September, ticking up to -9.0. *Construction* confidence continued its slide, deteriorating to -8.6 in September from a record high of 8.4 at the end of 2021. Meanwhile, *service* confidence dipped 3.4 points during the five months through September, from 7.6 to 4.2. It's down 15.3 points from its recent peak of 19.5 during October 2021.

Eurozone CPI Flash Estimates (***link***): The CPI rate for September is expected to slow to 4.3% y/y—the lowest since October 2021; it peaked last October at a record-high 10.7%. Looking at the main components, *energy* is forecast to fall 4.7% y/y, its sixth negative reading in seven months, up from July's -6.1%, which was the weakest since December 2020. It posted 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 predicted to slow for the sixth month to 8.8% 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 expected to ease for the seventh month to 4.2% y/y from February's record-high 6.8%. Meanwhile, the *services* rate is forecast to ease for the second month, to 4.7% y/y, from 5.6% in July—which was the highest since fall 1992. Of the *top four Eurozone economies*, Italy (5.7% y/y) and France (5.6) inflation rates were above the Eurozone's 4.3% rate, while Spain's (3.2) was below. Germany's matched the Eurozone's rate. Here are the record-high inflation rates and months 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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