Financial Markets This Week

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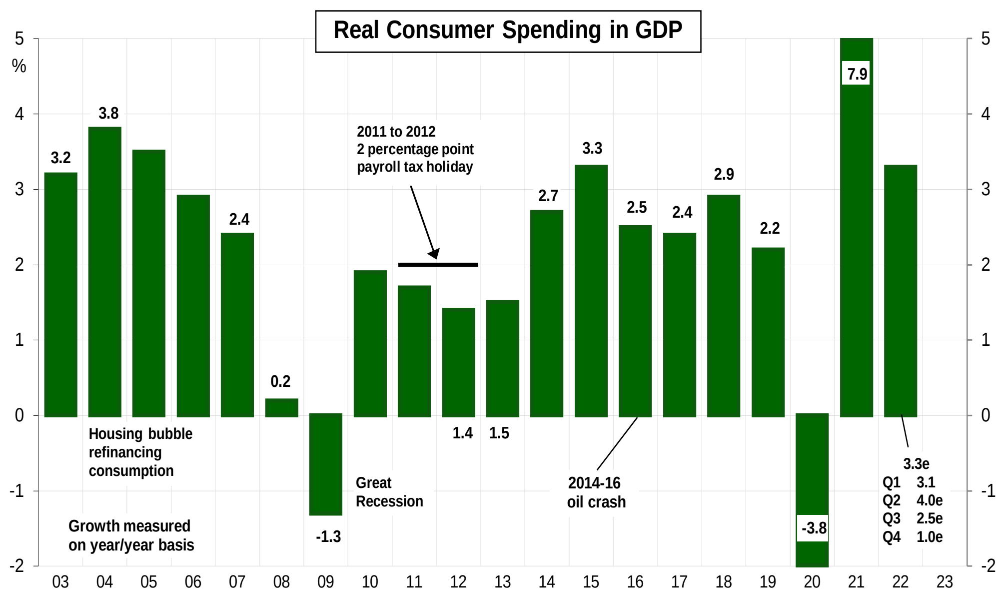
STRONG START TO Q2 REAL GDP FROM CONSUMERS

We meant to write about structures in the GDP accounts this week, but consumer spending was so strong in April in the monthly data Friday after the second revision to Q1 2022 real GDP on Thursday. Doesn't look like a recession though it never does until suddenly out of the blue, everyone everywhere pulls the plug on spending all at once and the economy goes vertical.



There have been fairly big revisions over the years, but real consumption expenditures still tell a tale of a steadier economy than the GDP figures that can bounce around a lot from volatile inventory changes and the trend of net exports quarter to quarter. The housing bubble years had strong consumption over three percent slowing to 0.2% in the first year of the Great Recession and then dropping 1.3% in 2009. Consumer spending doesn't decline much at all in some recessions as people still need to buy life's necessities and to eat. These are year-on-year changes which capture the economy's movements with some lag. The Fed estimates GDP on a Q4/Q4 basis. Times change. The 2011 to 2012 payroll tax holiday didn't boost consumer spending at all, and now the Federal government's Economic Impact Payments ($600 and $1400 checks) and other fiscal stimulus is blamed for setting off the inflation fire that the Fed is struggling to put out. The Fed with hindsight being without foresight should have realized this was the

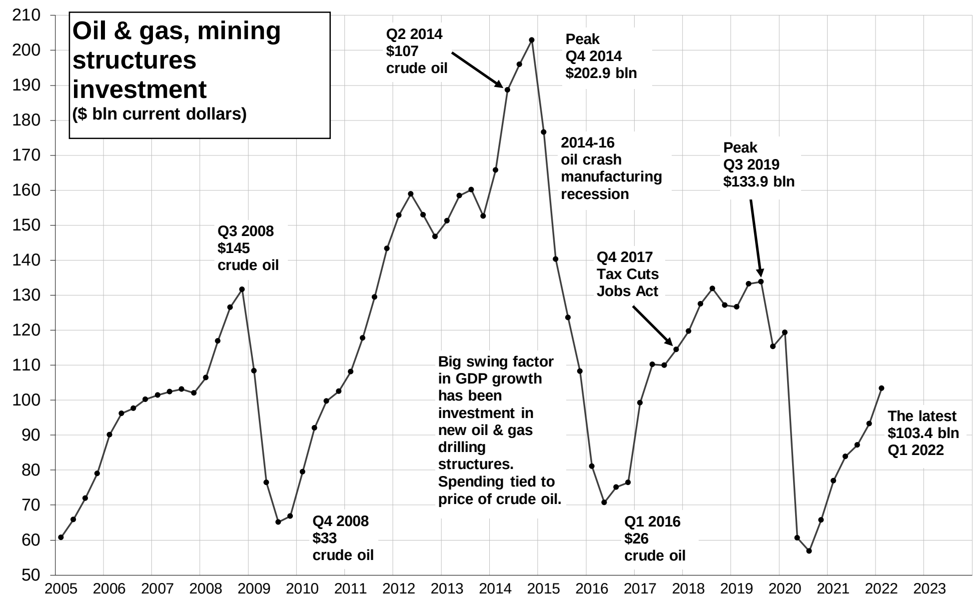
	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22p	Q1 22r
REAL GDP	4.5	6.3	6.7	2.3	6.9	-1.4	-1.5
REAL CONSUMPTION	3.4	11.4	12.0	2.0	2.5	2.7	3.1
CONSUMPTION	2.3	7.4	7.9	1.4	1.8	1.8	2.1
Durables	0.1	3.5	1.0	-2.5	0.2	0.4	0.6
Nondurables	-0.2	2.2	2.0	0.3	0.1	-0.4	-0.6
Services	2.3	1.8	4.9	3.6	1.5	1.9	2.1
INVESTMENT	4.0	-0.4	-0.7	2.1	5.8	0.4	0.1
Business Plant	-0.2	0.1	-0.1	-0.1	-0.2	0.0	-0.1
& Equipment and	1.3	0.8	0.7	-0.1	0.2	0.8	0.7
Intellectual Property	0.5	0.8	0.6	0.5	0.5	0.4	0.6
Homes	1.3	0.6	-0.6	-0.4	0.1	0.1	0.0
Inventories	1.1	-2.6	-1.3	2.2	5.3	-0.8	-1.1
EXPORTS	2.1	-0.3	0.8	-0.6	2.2	-0.7	-0.6
IMPORTS	-3.7	-1.3	-1.0	-0.7	-2.5	-2.5	-2.6
GOVERNMENT	-0.1	0.8	-0.4	0.2	-0.5	-0.5	-0.5
Federal defense	0.2	-0.3	0.0	-0.1	-0.2	-0.3	-0.3
Fed nondefense	-0.4	1.0	-0.3	-0.3	-0.1	-0.1	-0.1
State and local	0.1	0.0	0.0	0.5	-0.2	-0.1	-0.1
Below line: Percentage point contributions to Q1 2022 -1.4% real GDP							
Final estimate for Q1 is Wednesday, June 29							

fastest recession in history just two months long: the best economy in fifty years peak was February 2020 and the bottom hit in April 2020. Anyway, what has passed is past, real consumer spending in the first quarter was revised in Thursday's GDP report to 3.1% from 2.7%, and now April spending data with the personal income report on Friday looks like real consumer spending is 4.0% in Q2 2022. Not very recession-like we have to admit.

Real Structures ($billion)	Q4 19	Q1 22	% Chg
	570.0	440.0	-22.8
Commercial and health care	173.8	139.6	-19.7
Manufacturing	61.8	54.1	-12.5
Power and communication	126.8	88.4	-30.3
Mining exploration, shafts, and wells	110.4	94.4	-14.5
Other structures *	101.4	70.7	-30.3

* Religious, educational, vocational, lodging, railroads, farm, and amusement and recreational structures, other

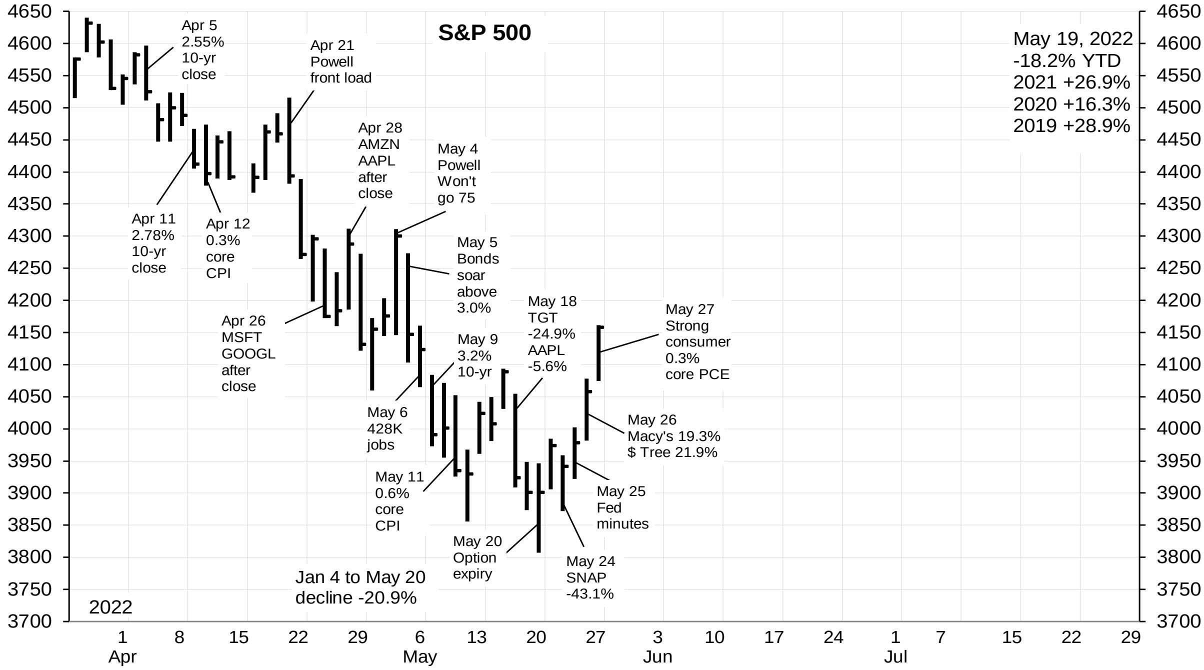
Back to spending on structures in the GDP accounts which have been a drag on real GDP growth for every quarter since the pandemic recession ended in Q2 2020 except for one. Business investment in structures in real dollars has fallen 22.8% from the end of 2019 before the pandemic. About the only thing going up was construction of warehouses. If the country needs more energy, mining exploration, shafts, and wells investment is 14.5% lower today than in Q4 2019. It is actually weaker because it fell sharply already in Q4 2019 to $110.4 billion from $127.4 billion in Q3 2019 because crude oil stuck at $60 instead of $70 where it was before market turbulence in stocks and the China U.S. trade war sent prices tumbling late in 2018.



Oil & gas investment has been a big driver of overall business capital investment and it recovered quickly from the 2007-09 recession. The 2014-16 oil crash that led to a manufacturing recession brought expenditures right back down to the bottom in nominal terms in the graph here. The nominal peak was $202.9 billion in Q4 2014 and the latest Q1 2022 data are $103.4 billion. Time will tell if more investment comes with the rebound in oil prices following the Russian invasion of Ukraine.

To conclude, real GDP was revised down modestly to a decline of 1.5% in Q1 2022, but appears to be strengthening in the second quarter on the backs of the consumer. There are so many warnings by U.S. corporations of macroeconomic risks and deteriorating business conditions that even the decline in jobless claims to 210K this week from 218K the prior week does not provide much comfort about what lies ahead for the economy. The stock market jumped 6.6% this week, but don't take risk off the table as the odds of recession in coming months remain elevated.

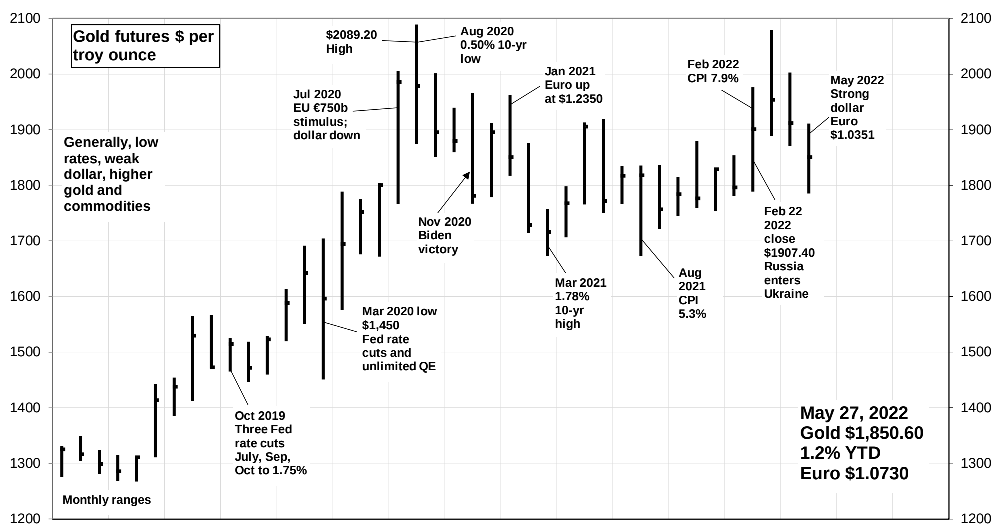
INTEREST RATES



First higher close for the week in eight weeks for the S&P 500, we checked and it's true; chart looks good although not many downtrend lines broke. Snap put out a letter and 8K Monday after the close talking about a macroeconomic deterioration in the outlook (they should be a macro strategist) since their April 21 earnings call. The stock fell 43.1% on Tuesday, but couldn't break the overall market and the Friday May 20 low held and the low close on May 19 held by the end of the day. Somehow stocks lifted after bouncing higher/lower on the Fed meeting minutes released Wednesday at 2pm ET. Don't ask, can't see much in the minutes to help stocks. Thursday had better earnings from Macy's, Dollar Tree, Dollar General and the rally kept going… for now. [S&P 500 -12.8%]() YTD.

Gold $1,850.60, up 1.2% YTD

Dollar up, gold down this month. The Euro fell as low as $1.0351 on May 13 around the time gold fell to its $1,785.00 low for the month. Dollar rally was on aggressive Fed communication on interest rates. Gold jumped $25.30 on May 19: the world was ending with the S&P 500 down 18.2% for the year at the close. Gold has been moving up with the dollar's losses since mid-May. ECB chatter on rate hikes finalized with Lagarde blog May 23 saying negative rates would be gone by September 30.



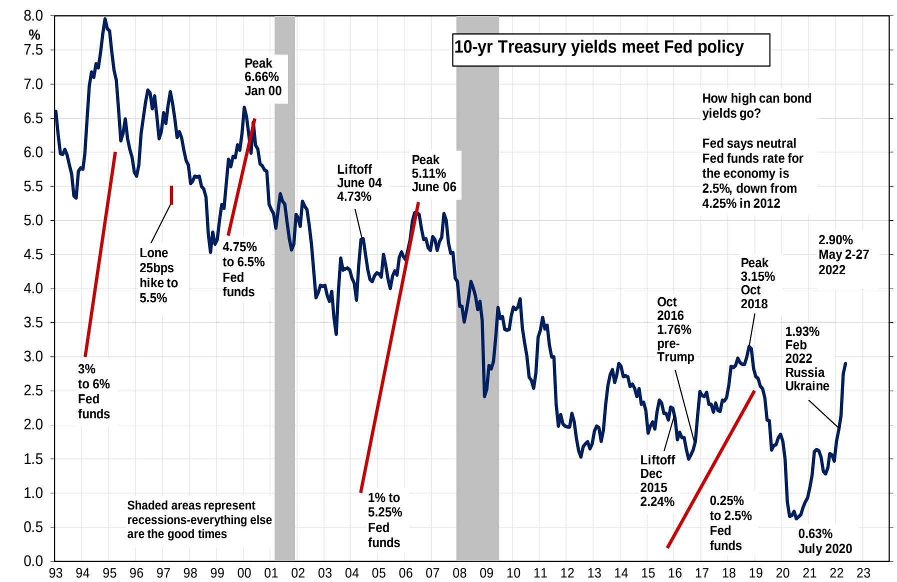
FEDERAL RESERVE POLICY

The Fed meets on June 14-15, 2022 to consider its monetary policy. It would be a shock if they did not hike 50 bps on June 15, and another 50 bps on July 27 as well to put the Fed funds rate at 2.0% in August 2022.

Selected Fed assets and liabilities					March 11
Fed H.4.1 statistical release					2020**
billions, Wednesday data	25-May	18-May	11-May	4-May	pre-Covid
Factors adding reserves					
U.S. Treasury securities	5769.417	5768.021	5766.625	5765.229	2523.031
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347
Mortgage-backed securities (MBS)	2707.446	2733.823	2715.021	2715.020	1371.846
Repurchase agreements	0.000	0.000	0.000	0.001	242.375
Primary credit (Discount Window)	0.913	0.856	0.834	2.606	0.011
Paycheck Protection Facility	20.204	20.537	20.929	21.229	
Corporate Credit Facility (CCF)	0.000	0.000	0.000	0.000	
Municipal Liquidity Facility	5.535	6.661	6.660	6.659	
Main Street Lending Program	26.665	28.438	28.651	28.640	
Term Asset-Backed Facility (TALF II)	2.288	2.466	2.466	2.465	
Central bank liquidity swaps	0.209	0.219	0.222	0.225	0.058
Federal Reserve Assets	8963.8	8995.5	8991.6	8989.5	4360.0
~~3-month Libor %~~ SOFR %	0.78	0.79	0.78	0.30	1.15
Factors draining reserves					
Currency in circulation	2275.926	2273.025	2273.743	2272.695	1818.957
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	801.714	866.726	919.331	964.412	372.337
Treasury credit facilities contribution	17.940	21.258	21.258	21.258	
Reverse repurchases w/others	1995.750	1973.373	1876.119	1815.656	1.325
Reserve Balances (Net Liquidity)	3315.018	3297.142	3295.680	3313.993	1779.990
Treasuries within 15 days	74.558	82.052	125.895	131.150	21.427
Treasuries 16 to 90 days	349.105	346.689	286.505	281.662	221.961
Treasuries 91 days to 1 year	774.087	768.924	802.274	801.777	378.403
Treasuries over 1-yr to 5 years	2117.024	2116.508	2123.737	2123.221	915.101
Treasuries over 5-yrs to 10 years	1028.423	1027.982	1018.099	1017.659	327.906
Treasuries over 10-years	1426.220	1425.865	1410.114	1409.760	658.232

**March 11, 2020 start of coronavirus lockdown of country

The Fed meeting minutes from the May 3-4, 2022 meeting were released at 2pm ET Wednesday. We didn't learn too much more except we wonder if a pause is coming for their rate hikes once the Fed funds rate gets to neutral. If they front load rate hikes, maybe they finish the initial, re-righting of monetary policy job from stimulus to neutral earlier. They keep saying once policy gets back to normal, they will be in a good position to judge whether or not a restrictive monetary policy is needed to get the inflation genie back in the bottle. They might actually pause at 2.5% normal or they might just mention being in a good position to stop and observe the economy later this year in order to slow the runaway train on the market's thinking, fears really, about how tight monetary policy needs to be.



Still, we worry about the longer term future for interest rates. You would have to be born yesterday not to remember that the Fed funds rate peaked at 5.25% during the housing bubble economy of 2004-2006. It would be strange for the Fed to stop raising rates once they reach neutral in the current environment with the worst inflation since the 1980s. Don't make us fish around for our old newsletters from back in the 80s, we don't want to think about how high above 20% the Fed pushed interest rates. Might have been 25% or so with surcharges.

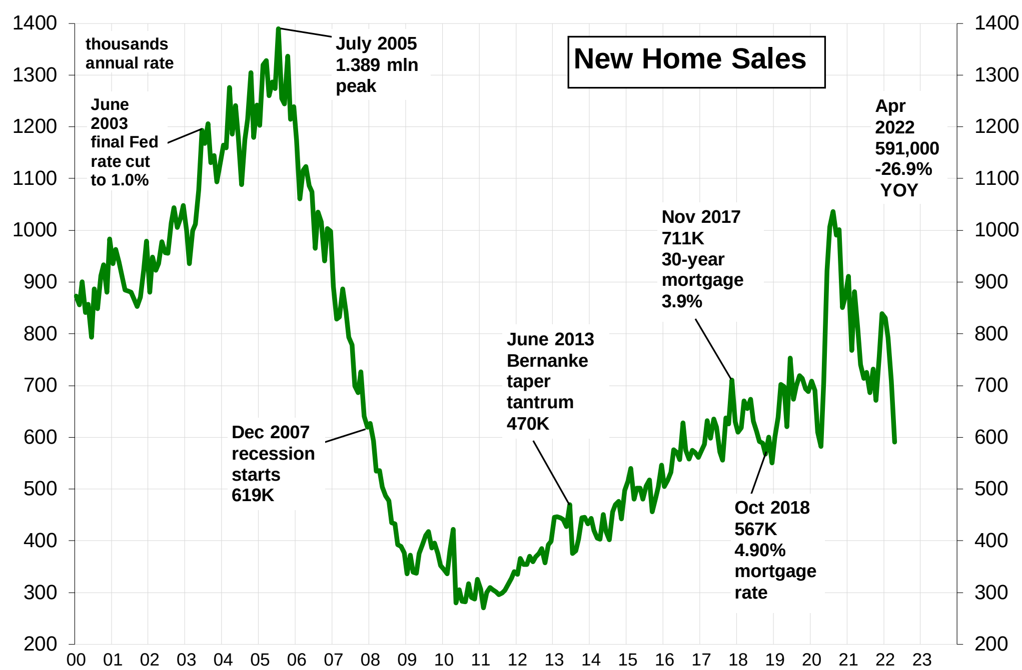
At the June 14-15 meeting, it isn't just how high they go, it is how high they forecast they might need to go. At the moment, Fed officials forecast a 2-7/8% Fed funds rate at the end of 2023 and that is going to go higher. They thought it might need to go to 3.5% when making forecasts in 2018 which is why 10-year Treasury yields went well above the final top in the Fed funds rate for the cycle of 2.5% in December 2018. Stay tuned. Core PCE inflation has slowed in rising 0.3% in each of the last three months and 0.3% is a 3.6% annual rate. That is still too high for those hit hardest by inflation in society, but we will learn what Fed officials think about it. Maybe it is a reason to pause for a time once getting the Fed funds rate to 2.5% neutral.

OTHER ECONOMIC NEWS

Recession comes for the housing market (Tuesday)

Breaking economy news. New home sales fell ten times as much as forecast if forecasts matter anymore in a fast-changing economy that is near the tipping point. New home sales plummeted 16.6% to 591,000 at an annual rate in April to start the stock market's second quarter recession worries off with a bang. The data were revised back to January 2017 in this month's release, but this does not take away from that sinking feeling for new home sales. New home sales at the turn of the year have had a stunning reversal of fortune. From 839K in December and 831K in January, April's 591K new homes sold are 29.6% to 28.9% lower. Plummeting new home sales is what we see at the start of most economic recessions and it will be a miracle if the country can avoid another recession coming its way.

Net, net, the macroeconomic environment has deteriorated faster than we thought just a month ago with new home sales tumbling lower under the weight of higher financing costs and home valuations where even the cost of the gas home buyers put in the car to tour new homes is soaring. This could be the first recession to be caused by consumers pulling back their spending due to sticker shock on the prices of everything everywhere. America is getting too expensive to live here. Inflation in new home prices continues to advance to a record $450,600 in April. Home prices move up every spring and this year, new home prices are 19.6% higher than a year ago. No wonder new home sales are down; they are unaffordable especially when the down payment you had saved in the stock market or in Bitcoin has melted away.



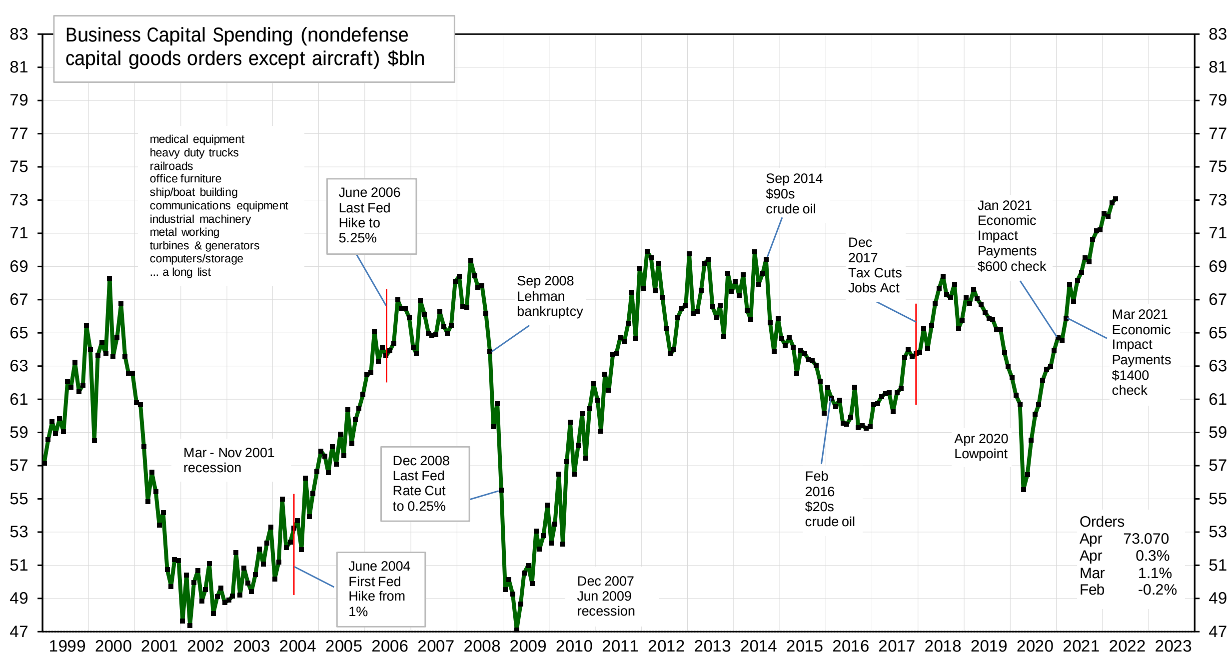
For new home sales the worst is likely still to come with 30-year mortgage rates finishing April at 5.10% on their way up to 5.25% in the latest week of May 19. Rising financing costs are likely to make new home sales fall even harder in the months to come as new home buyers are facing higher costs on everything they buy and will have little left over to splurge on home prices that have surged during the pandemic. Recession today comes for the housing market. Tomorrow recession comes for everyone else. Get your affairs in order. This economy is going down. Bet on it.

Another month another all-time high for core capital goods orders (Tuesday)

Breaking economy news. Durable goods orders for April. Core capital goods orders continue to set a new all-time record although there was a substantial benchmark revision that cut billions from the order count. Nondefense capital goods orders ex-aircraft coming into today were $72.652 billion, a massive downward revision from $81.113 billion which will hit the revisions to GDP growth over the last year at some point. Today's April data for nondefense capital goods orders rose 0.3% to $73.070 billion after rising 1.1% in March. Businesses continue to make plans for a better tomorrow despite rocky financial markets and sharply higher long-term borrowing costs from rising corporate bond yields. There's uncertainty about the outlook, but perhaps the supply chain disruptions are resulting in precautionary just-in-case orders to make sure companies have the needed materials on hand.

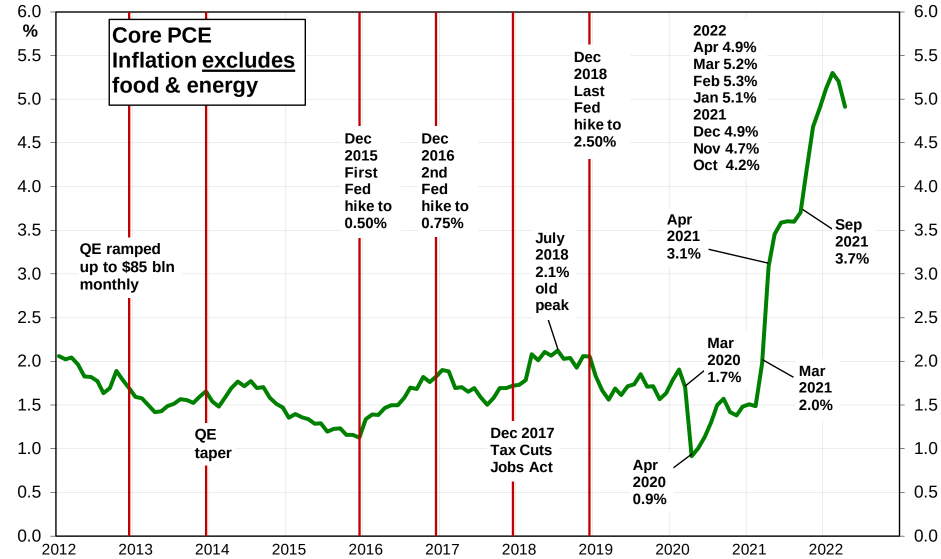
Machinery orders jumped 1.0%, Computers and electronic products rose 0.1% somehow, despite big declines for Computers, and Communications equipment. Electrical equipment, appliances and components fell 0.1% after strong gains of 2.5% in March and 3.1% in February.

Net, net, business continues to order up record amounts of new capital equipment as they plan on meeting the demand for their goods and services in the months ahead. There is no revision to the macroeconomic outlook in April in these durable goods data, although the warnings of a slowdown in sales from some companies are occurring since late April, so there could be a change in the trend for new orders of capital goods ahead. There's plenty of uncertainty out there and clouds on the horizon, but companies continue to order up a better tomorrow for now. Stay tuned. Story developing.

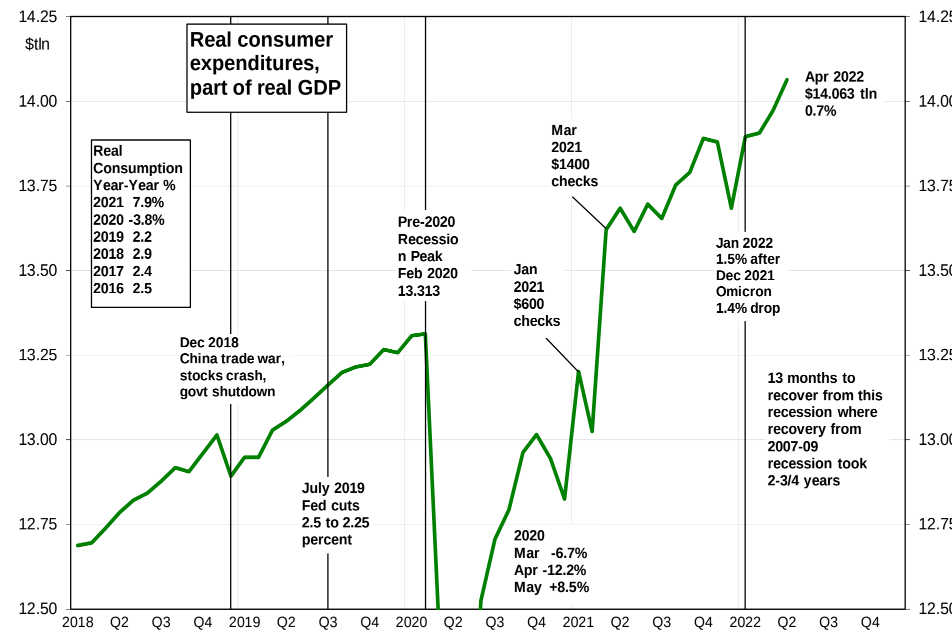


Stronger consumer, cooler inflation (Friday)

Breaking economy news. The personal income report for April. They should rename this month's report the personal savings report. Those Economic Impact Payments from the Federal government's $600 and $1400 checks last January and March 2021 are long gone, so consumers have to rely on whatever savings they have to keep spending at a surprisingly rapid pace this month. Real consumer spending was revised upward to 3.1% in Q1 2022 from 2.7% in yesterday's second guesstimate of real GDP, and now spending continues to be rapid in April. Real consumption was strong at 0.7% in April following on March's 0.5% increase. Looks like consumers raided their piggy banks with the savings rate falling, falling, falling from 5.9% in February, 5.0% in March, and 4.4% in April. The economy can always turn on a dime, but at this point in the economic cycle, consumers are still spending their hearts out, keeping the recessionary winds at bay.



The good news is that Inflation isn't as hot to the touch this month with headline PCE inflation falling to 6.3% year-year from the 6.6% year-year peak in March. Don't get your hopes up on inflation as gasoline prices set a new 2022 high in May ahead of the start of summer's Memorial Day weekend. The economy isn't out of the woods yet from the inflation threat, but at least the wolf isn't howling at the door threatening to blow the house down.



Fed officials can't do anything about food and energy prices, so the focus is on core PCE inflation which has slowed if you call it that to 0.3% monthly increases now in February, March and April. A 0.3% monthly increase is a 3.7% annual rate, so at least we aren't talking scary numbers like 5 or 6 or 7 percent anymore. The year-on-year increase in core PCE inflation is 4.9% down from 5.2% in

March and 5.3% in February. We keep getting more inflation readings like this and Fed officials may indeed pause to look around a little once they get rates to 2.5% neutral.

Net, net, inflation won't fall back to normal overnight, but at least it is moving in the right direction providing some relief for Americans this Memorial Day. Consumer spending is strong at the start of the second quarter so it would be incredible to see a recession occur in the next few months. This is April data, and the reports from companies about a deterioration in the macroeconomic outlook have come starting in May, so more data is needed to assess the outlook later this year. Stay tuned.

The bottom line is inflation remains elevated and is still dangerous for the economic outlook where consumers will soon run out of money to spend to make the economy grow later this year if they haven't already. Not yet though as real consumer spending behind real GDP is running 4.1% in Q2 2022 with May and June data left to go which is a quicker pace than 3.1% in Q1 2022. Guess Fed officials were right to ignore the 1.5% drop in real GDP for the first quarter as the second quarter is miles away from recession at the moment.

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