Financial Markets This Week

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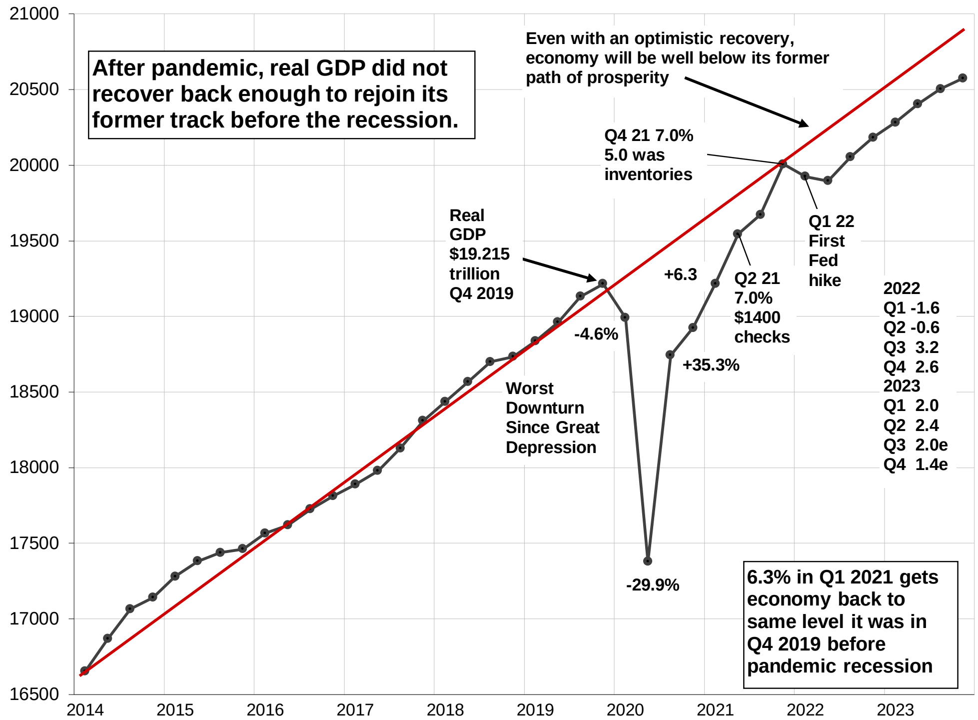
Christopher S. Rupkey, CFA
Chief Economist
crupkey@fwdbonds.com

ECONOMY NOT SLOWING DOWN

First look at second quarter GDP growth shows the economy is not slowing down. Powell said Wednesday that monetary policy tightening is slowing the economy's most interest rate sensitive sectors of housing and investment. Not any more. The economy is picking up speed and fast with a blizzard of economic data released Thursday from GDP to durable goods orders to weekly jobless claims and advance look at the June trade deficit in goods.



	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23p
REAL GDP	-1.6	-0.6	3.2	2.6	2.0	2.4
REAL CONSUMPTION	1.3	2.0	2.3	1.0	4.2	1.6
CONSUMPTION	0.9	1.4	1.5	0.7	2.8	1.1
Durables	0.6	-0.2	-0.1	-0.1	1.3	0.0
Nondurables	-0.7	-0.4	0.0	0.1	0.1	0.1
Services	0.9	2.0	1.6	0.7	1.4	1.0
INVESTMENT	1.0	-2.8	-1.8	0.8	-2.2	1.0
Business Plant	-0.1	-0.3	-0.1	0.4	0.4	0.3
& Equipment and	0.6	-0.1	0.5	-0.2	-0.5	0.5
Intellectual Property	0.5	0.5	0.4	0.3	0.2	0.2
Homes	-0.2	-0.9	-1.4	-1.2	-0.2	-0.2
Inventories	0.2	-1.9	-1.2	1.5	-2.1	0.1
EXPORTS	-0.5	1.5	1.7	-0.4	0.9	-1.3
IMPORTS	-2.6	-0.4	1.2	0.9	-0.3	1.2
GOVERNMENT	-0.4	-0.3	0.7	0.7	0.9	0.5
Federal defense	-0.3	0.1	0.2	0.1	0.1	0.1
Fed nondefense	0.0	-0.3	0.1	0.3	0.3	0.0
State and local	0.0	-0.1	0.4	0.3	0.5	0.4

Below line: Percentage point contributions to Q2 2023 2.4% real GDP
Second estimate for Q2 is Wednesday, August 30

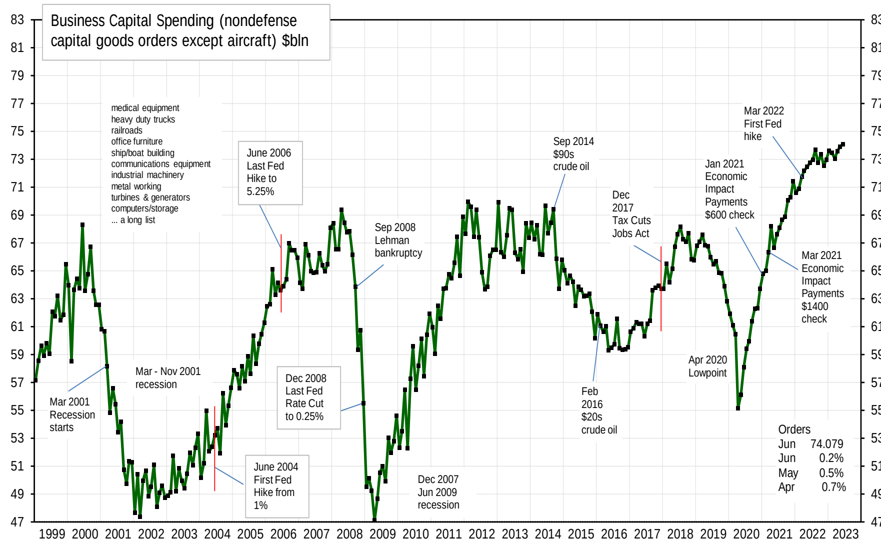
Economic growth beat expectations with a 2.4% increase in real GDP in Q2 2023 faster than 2.0% in Q1 2023. The economic staff at the Federal Reserve pulled their recession call at just the right time. Even interest rate sensitive sectors of the economy have remained resilient in the face of a year of Fed rate hikes with business investment in equipment jumping 10.8% SAAR in Q2 2023 after falling on the same basis by 8.9% in Q1 2023 and 3.5% in Q4 2022. Businesses would not be investing if they saw uncertainty in the economic outlook. On the other hand, with more detail in hand, most of the equipment purchases were computers, and in transportation equipment, which is normally new light truck sales. Residential housing, what about the Fed rate effects on housing? The drag on real GDP from residential fixed investment was 0.2 percentage points for a second consecutive quarter which is miles away from the average one percentage point drag on growth in each of the last three quarters of 2022. Again with more detail in hand, residential construction actually turned positive in Q2 2023, adding to growth for the first time since Q1 2021. The 0.2 percentage point drag in the table above is actually from a decline in the other structures category including manufactured homes, improvements (not declining in our town), and brokers' commissions.

Real Business Investment (% change SAAR)

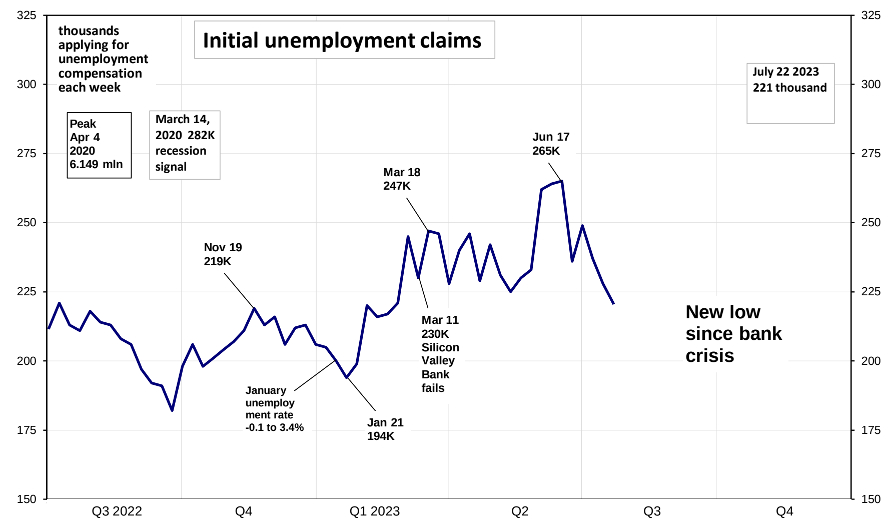
$bln 2022		2021	2022	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23
446.2	STRUCTURES	-6.4	-6.6	-12.7	-3.6	15.8	15.8	9.7
141.6	Commercial and health care	-7.6	-11.9	-12.7	-12.4	19.6	-1.9	-1.7
59.9	Manufacturing	-0.7	5.4	-11.8	22.3	34.3	77.9	94.0
83.5	Power and communication	-8.4	-19.3	-29.7	-15.4	-1.0	11.8	-5.1
100.3	Mining exploration, shafts, wells	14.0	14.5	3.0	-2.3	-0.6	13.5	-21.5
70.2	Other structures 1	-17.8	-4.0	-4.2	8.6	26.2	10.8	10.5
1,274.0	EQUIPMENT	10.3	4.3	-2.0	10.6	-3.5	-8.9	10.8
568.7	Information processing equipment	9.8	5.2	-6.3	9.2	-23.9	-6.1	1.4
156.1	Computers	7.7	2.3	-22.2	38.5	-40.6	-14.2	23.8
412.2	Other processing equipment 2	10.8	6.7	2.3	-2.7	-14.2	-2.1	-7.4
264.8	Industrial equipment	11.9	5.5	-6.1	-11.2	5.8	4.0	-2.6
233.5	Transportation equipment	15.7	4.8	11.6	90.4	30.6	-24.1	55.8
238.1	Other equipment 3	5.5	0.8	-0.1	-9.0	-5.8	-9.3	1.9
1,254.5	INTELLECTUAL PROPERTY	9.7	8.8	8.9	6.8	6.2	3.1	3.9
643.7	Software	12.8	12.1	10.2	15.1	13.5	4.1	7.6
539.5	Research & Development (R&D)	8.7	5.4	5.7	-1.1	1.1	1.8	1.7
91.8	Entertainment, literary, artistic	-0.1	14.7	24.3	18.6	2.5	5.5	-1.2

1 Religious, educational, vocational, lodging, railroads, farm, amusement/recreational, other
2 Communication, medical, photocopy, office and accounting equipment; nonmedical instruments
3 Furniture; agriculture, construction, mining/oilfield, and service industry machinery; electrical equipment

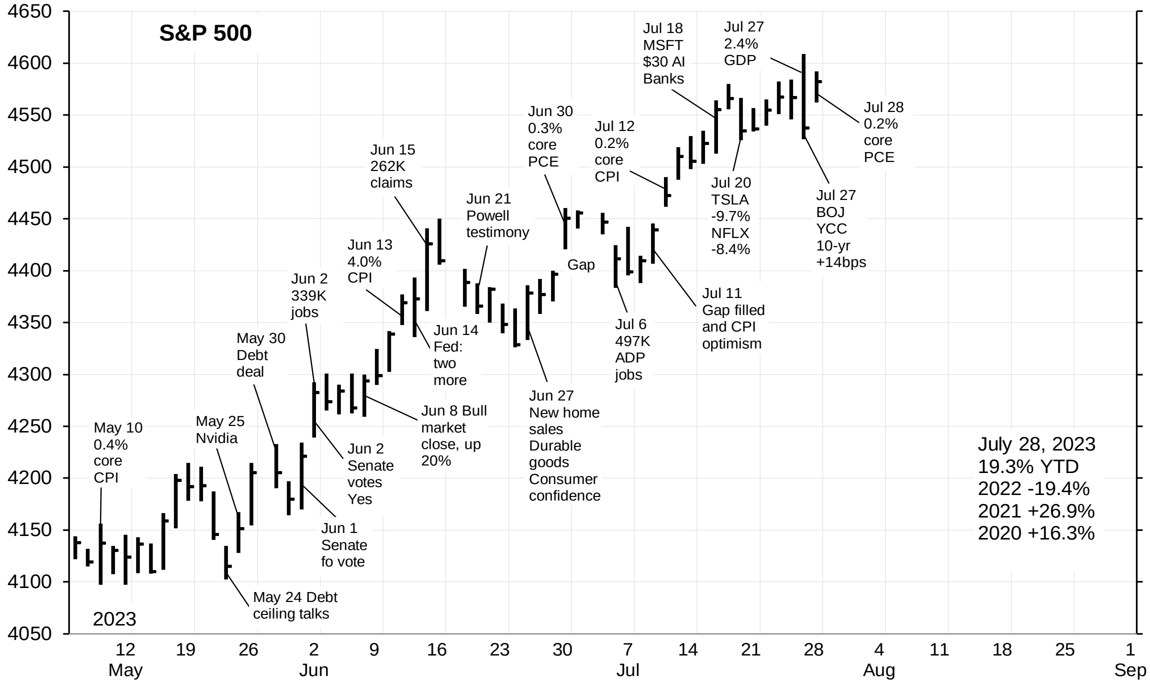
One note on structures since we talked about this last week, in real terms, structures added less to economic growth in Q2 2023. Much has been made of Bidenomics working, or at least construction of manufacturing factories was 94.0% SAAR in Q2 2023, but there was also a steep decline in Mining exploration, basically oil & gas drilling, of 21.5% in Q2 2023. In Q2 2023, the level of real investment in manufacturing was $87.7 billion and it was $97.2 billion for Mining exploration.



To conclude on a positive note, growth isn't just resilient, it is triumphant. The soaring stock market knows it. Record business durable goods orders, rock-bottom weekly job layoffs, and solid GDP growth do not lie. This economy is headed higher in the second half of the year. The world isn't slowing down, it is picking up. [See final economic news on the personal income report which shows real consumer spending jumped in June and is supportive of another 2% real GDP reading for the third quarter (release date October 26).



INTEREST RATES

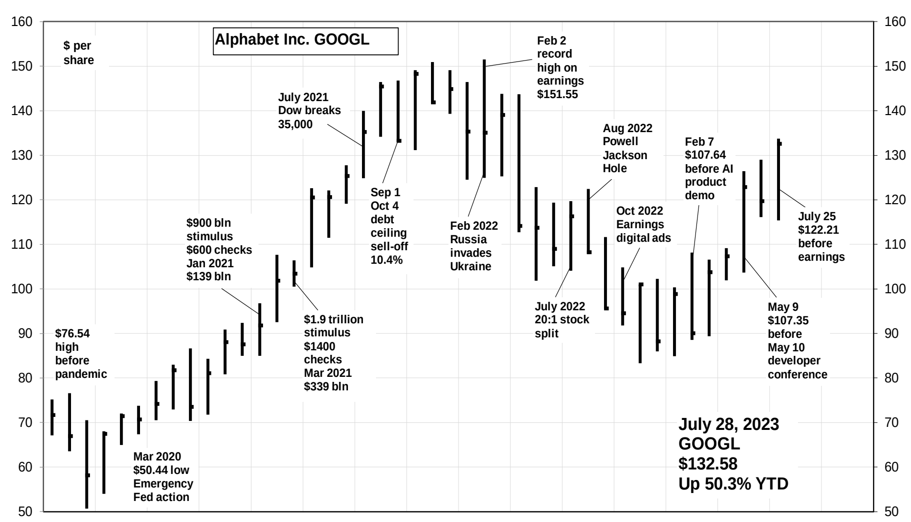


Stocks made a new 2023 high Wednesday early in the press conference Q&A or in Powell's brief opening remarks, something about future decisions will be made meeting to meeting maybe, or no rate cut this year. The intraday rally in stocks stalled, fell, breaking technical support, and tumbled back to the lows, stock investors like rapid-fire, ~~pork bellies~~ lean hog traders in the commodities futures markets. Powell emphasized they will have two more CPI reports and two more payroll jobs reports before the next decision date on September 20. A lot of data in the data-dependence. The decision is whether they need to raise rates further, not whether to cut rates. All the excitement was on Thursday around 1pm ET on the BOJ getting ready to adjust their yield curve control (YCC), and stocks fell as well on higher capital requirements for big banks. S&P 500 new 2023 high 19.3% YTD, 10-yr 3.95%.

Alphabet, Inc. (GOOGL) up 50.3% YTD

Alphabet reported better than expected earnings after the bell Tuesday and rallied 5.8% on Wednesday. Revenues and income were just short of the record "holiday quarter" in Q4 2021. Cloud was up over the last year, but less so quarter-quarter and was profitable again at $395 million. Headcount down to 181,798 from 190,711 in Q1 23 with some more adjustments before the end of the year. Despite the 12K announced layoffs in January, headcount is well above 174,014 in Q2 2022.

Calendar Year Mln $	Revenue	Advertising	Cloud	Operating Income
Q2 2023	74,604	58,143	8,031	21,838
Q1 2023	69,787	54,548	7,454	17,415
Q4 2022	76,048	59,042	7,315	18,160
Q3 2022	69,092	54,482	6,868	17,135
Q2 2022	69,685	56,288	6,276	19,453
Q1 2022	68,011	54,661	5,821	20,094
Q4 2021	75,325	61,239	5,541	21,885
Q3 2021	65,118	53,130	4,990	21,031

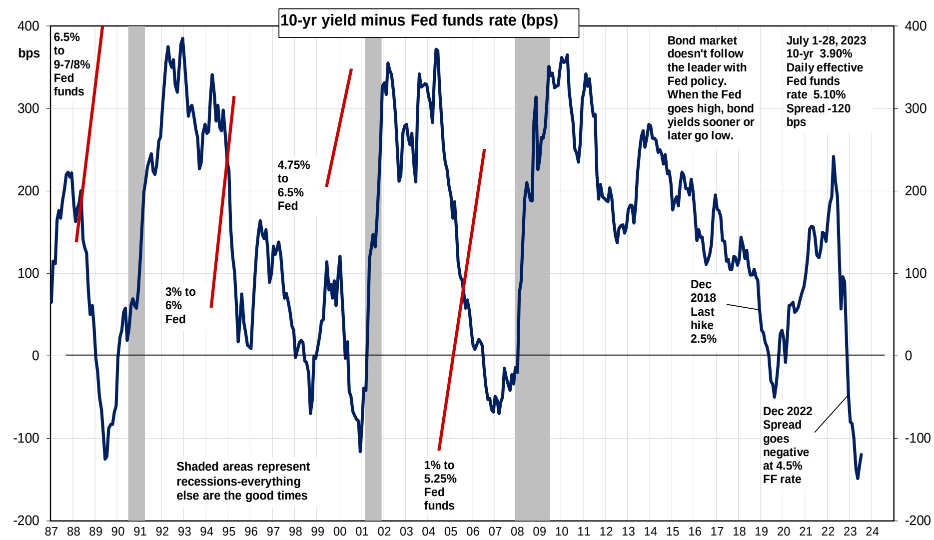


FEDERAL RESERVE POLICY

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	26-Jul	19-Jul	12-Jul	5-Jul	3/11/20*	3/11/20
Factors adding reserves						to July 26
U.S. Treasury securities	5080.981	5083.036	5104.348	5106.460	2523.031	2557.950
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2517.559	2538.059	2538.138	2538.138	1371.846	1145.713
Repurchase agreements	0.001	0.025	0.003	0.000	242.375	-242.374
Primary credit (Discount Window)	2.249	2.633	2.292	3.356	0.011	2.238
Bank Term Funding Program	105.078	102.927	102.305	101.959		
FDIC Loans to banks via Fed	152.455	159.640	162.438	164.775		
Paycheck Protection Facility	6.553	6.828	6.898	7.218		
Main Street Lending Program	19.734	19.713	19.992	19.969		
Municipal Liquidity Facility	5.604	5.601	5.598	5.595		
Term Asset-Backed Facility (TALF II)	1.644	1.642	1.641	1.639		
Central bank liquidity swaps	0.255	0.235	0.243	0.219	0.058	0.197
Federal Reserve Total Assets	8293.5	8324.8	8347.1	8348.3	4360.0	3933.448
~~3-month Libor %~~ SOFR %	5.06	5.05	5.05	5.06	1.15	3.910
Factors draining reserves						
Currency in circulation	2333.001	2335.473	2341.919	2347.266	1818.957	514.044
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	549.897	726.632	517.418	446.864	372.337	177.560
Treasury credit facilities contribution	13.358	13.358	13.358	13.358		
Reverse repurchases w/others	1749.733	1732.804	1820.146	1867.061	1.325	1748.408
Federal Reserve Liabilities	5126.707	5104.239	5184.998	5168.611	2580.036	2546.671
Reserve Balances (Net Liquidity)	3166.767	3220.590	3162.124	3179.646	1779.990	1386.777
Treasuries within 15 days	78.359	74.279	61.800	63.003	21.427	56.932
Treasuries 16 to 90 days	282.668	288.159	311.030	307.238	221.961	60.707
Treasuries 91 days to 1 year	645.487	646.383	623.851	628.810	378.403	267.084
Treasuries over 1-yr to 5 years	1740.436	1740.319	1761.872	1761.756	915.101	825.335
Treasuries over 5-yrs to 10 years	842.230	842.168	854.140	854.072	327.906	514.324
Treasuries over 10-years	1491.801	1491.728	1491.655	1491.581	658.232	833.569
Note: QT starts June 1, 2022	Change	7/26/2023	6/1/2022			
U.S. Treasury securities	-689.798	5080.981	5770.779			
Mortgage-backed securities (MBS)	-189.887	2517.559	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

The Fed met July 25-26, 2023 to consider its monetary policy. They raised rates 25 bps to 5.5% and did not know whether they were done. Decisions on whether interest rates go higher will be made on a meeting to meeting basis. Powell noted there are two more CPI inflation reports and two more monthly payroll jobs reports before they meet again in September. The futures market before and after the Powell conference does not see any more rate hikes this year on the Sep 20, Nov 1, Dec 13 meeting decision dates.

The second look at June core consumer inflation (CPI was July 12 0.2% for month, 4.8% for year) was the one the Fed actually targets and forecasts and lucky for them it is lower than CPI inflation always; Friday's core PCE inflation slowed to 0.2% in June and is 4.1% higher than a year ago and close to the Fed's 3.9% Q4 2023 forecast. Never really seen a soft landing for the economy after such a big Fed interest rate adjustment to curb inflation by "slowing aggregate demand." All the other ones were crash landings meaning thousands of Americans lost their jobs in the Fed's war on inflation. With the exception perhaps of the one episode in the mid-90s where 300 bps of Fed rate hikes to 6% didn't lead to recession and job losses.



Soft landing and Fed reversal is maybe what the 3.95% 10-year yield is telling us. The way we count it, the 5.50% Fed target is 155 bps higher which is a record. In the chart above, the daily effective Fed funds rate in July through the 28th is 5.10% and the average 10-yr Treasury yield is 3.90% for a negative spread of 120 bps. [The daily effective rate is fairly steady at 17 bps under the top of the target: July 27, daily effective was 5.33% and target is of course 5.50%.]

Fed funds futures call Fed hikes		
Current target: July 28 -- 5.50%		
Rate+0.17	Contract	Fed decision dates
5.545	Oct 2023	Sep 20
5.550	Jan 2024	Sep 20, Nov 1, Dec 13
Last trade, not settlement price		

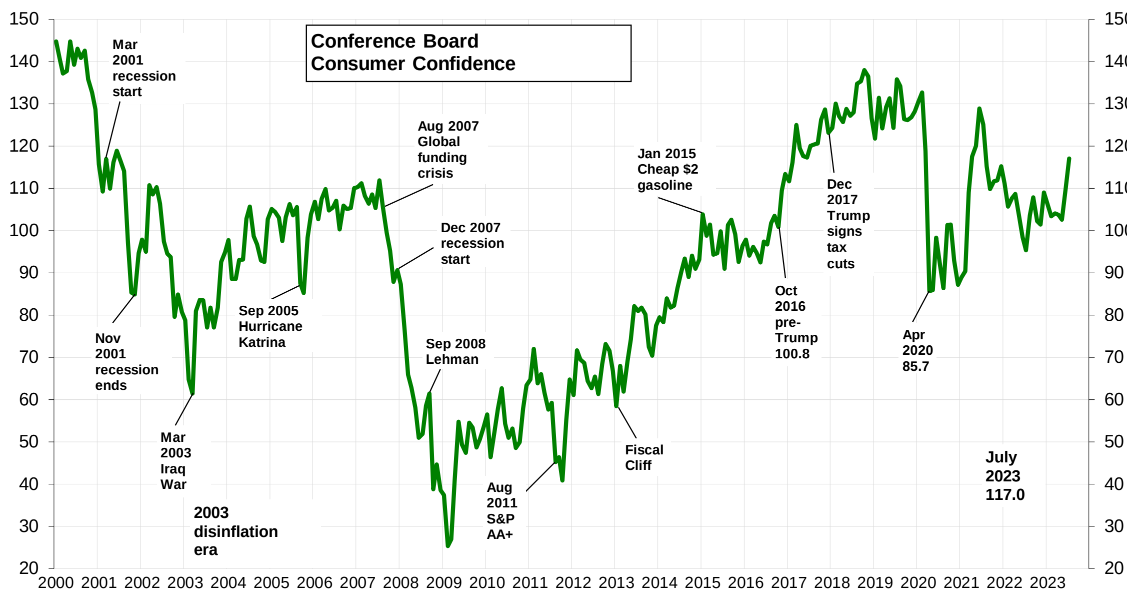
Throughout the Fed meeting news and inflation and GDP data, the market continues to look for no more Fed rate hikes this year. Powell can always try and talk up the need for one more rate hike this year to 5.75% at Jackson Hole. Last year's comments on August 26 were interpreted as being cross with the markets, "Today, my remarks will be shorter, my focus narrower, and my message more direct," and stocks fell 3.4% that day, after the S&P closed 4,199 the night before. The 2022 low was 3,491 on October 13.

OTHER ECONOMIC NEWS

Confidence rockets higher (Tuesday)

Breaking economy news. Consumer confidence is rocketing higher as Americans see the glass half full to brimming over and the big bad wolf of the Fed's interest rate hikes is not a reason to doubt that the outlook for the economy looks the best it has been since the summer of 2021. The Fed didn't take away enough punch as the party for the U.S. economy rocks on and on and on. Consumer confidence in July jumped to 117.0 from a revised 110.1 in June, the best reading and happiest consumer seen since the summer of 2021. The Fed's rate hikes haven't broken the consumer's spirit yet. Many workers are on strike for higher wages and the bills on student loan debt are coming any day now, but consumers overall are bullish on America. It's summertime and the times are getting better every day. Here comes Barbie, time to party.

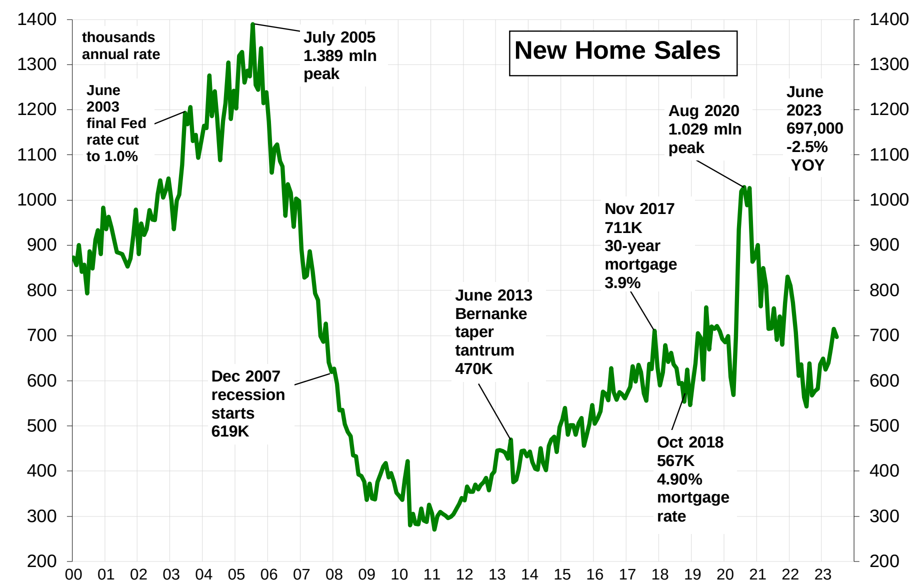
Net, net, there will be a lot of head-scratching going on at today's Fed confab down in Washington because the unprecedented interest rate hikes haven't made a dent yet in economic demand with Elon Musk and GM earning billions from new vehicle sales and home prices in major cities across the country moving higher for a second month. We can chock up some of the Fed's recent wins on easing inflation due to blind luck because the economy's growth seems stronger than ever. We wouldn't want to be in Fed officials' shoes as the current political climate down in Washington would not be as welcoming of rising unemployment which has been the result of higher interest rates in past cycles when the Fed tried to bring inflation under control. The economic data say rates aren't high enough to take the wind out of the economy's sails. Bet on it.



Homebuyer confidence on upswing (Wednesday)

Breaking economy news. New home sales living up to its reputation as being unreliable with large revisions. May's new home sales figure of 763K was revised to 715K, and June is down 2.5% to 697K from May's revised level. The nationwide total was down 2.5%, but regions showed wide swings, 20.6% increase in the Northeast, and 4.3% for South. Meanwhile the West tumbled 13.9% and the Midwest was down 28.4%.

Median sales prices are off sharply from last October's $496,800 peak. June home prices were $415,400, off 0.5% this month, and down 16.4% from the peak. Other nationwide home price indexes show prices rising in May and June to record or near-record levels.



Net, net, new home sales were scared to death last summer of the Fed's rate hikes which pushed up mortgage rates at a near record pace. But homebuyer confidence has gradually recovered from the trough in sales last July. There is a definite trend towards recovery and the worst appears to be over for now. It is not just the cost of financing, a major factor behind housing recessions and a buyer retreat from the sales market is joblessness and the unemployment rate remains fairly low at near the best levels seen since the 1960s. Low unemployment means there are more potential buyers. There is a housing shortage and the 697K in new home sales this June is close to the 688K in single-family housing units completed in June from the housing starts report.

The key for Fed officials as they make their decision today about additional rate hikes this year is whether the soft landing "dream" scenario is happening or not, where core inflation pressures come down without engendering a deterioration in the labor market and spike in joblessness that normally accompanies monetary policy tightening of this historic magnitude. The news on inflation was good in June from the CPI report, but data on the Fed's targeted PCE inflation rate in the June monthly personal income report won't be released until Friday. Will they give guidance on future rate hikes after today's expected 25 bps move to 5.5%? Stay tuned. Story still to come in the press statement today at 2pm ET and Powell's press conference at 230pm ET.

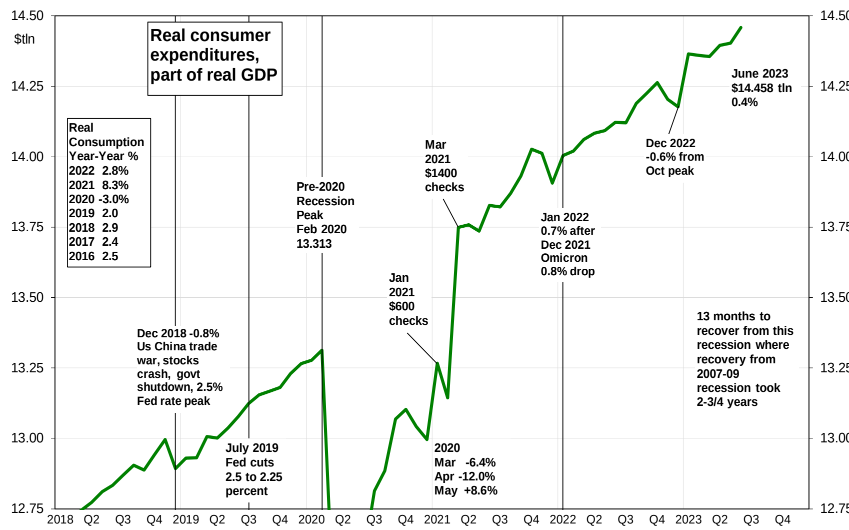
New Home Sales

	Total	Northeast	Midwest	South	West	Median Price $
2021 Year	771	36	86	453	196	397,100
2022 Year	641	33	66	392	150	457,800
Oct	577	39	47	369	122	496,800
Nov	582	29	46	368	139	462,300
Dec	636	34	67	404	131	479,500
Jan 2023	649	41	73	414	121	432,100
Feb	625	23	72	408	122	433,000
Mar	640	53	64	374	149	438,900
Apr	671	33	68	421	149	410,600
May	715	34	74	441	166	417,300
Jun	697	41	53	460	143	415,400
	Thousands at Seasonally Adjusted Annual Rate					

Inflation is dead, the consumer is alive (Friday)

Breaking economy news. The story is right in front of you in the headlines with real consumer expenditures jumping 0.4% in June while core PCE inflation drops back to an increase of 0.2%, the weakest since November 2022. Core PCE inflation year-on-year peaked at 5.4% in March 2022 a month after Russia invaded Ukraine, and is now down to 4.1%, just inches away from the Fed's forecast of 3.9% in the fourth quarter this year. If core PCE averages 0.2% for the second half of the year, then inflation comes down to 3.2% in December 2023. The Fed's inflation fight with the highest rates in over 20 years isn't slowing down the economy or sending consumers into their foxholes hiding out for the war on inflation to end.

Inflation isn't dead, but it is mortally wounded, and the price pressures that consumers see the most have definitely come off the boil and it is time to switch the name calling from the Bidenflation to the Bidenboom. Food prices have averaged negative 0.1% monthly changes for four consecutive months. Energy goods and services (air conditioning and gasoline) have fallen 18.9% from year earlier levels. Gasoline prices at the pump peaked at $5 in June 2022 and this week were $3.59.



Consumer spending? Makes you wonder why we look at monthly retail sales at all in this inflationary environment. Retail sales are below January levels, while real consumer expenditures jumped 0.4% in June to a new record high: Q1 2023 was 4.2%, Q2 2023 was 1.6%, and now because of the jump at the end of the quarter, purchases are running 1.1% in Q3 2023 even before we get July, August, September data. Lots of spending on durable goods up 0.9% in June (mostly new light trucks and TVs/computers, the latter called recreational goods. Services overall in June were slower at 0.1% but Americans spent more on portfolio management and investment advice services; we guess the public still trusts Wall Street after stocks fell as much at 27.5% at one point during 2022.

Net, net, the inflation outbreak is winding down quicker and with less pain for the labor markets than economists could have imagined just a year ago. This means policymakers can most likely skip a rate hike at the upcoming September meeting and just leave one more rate hike on the table in the forecasts for 2023 just in case of an unexpected late-cycle inflation flare up. Inflation isn't dead, but it's dying on the vine, and through it all, the consumer is still standing.

	Core PCE inflation: price index for personal consumption expenditures, seasonally adjusted											
	Jan	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
2022	0.5	0.4	0.4	0.3	0.4	0.6	0.1	0.6	0.5	0.3	0.2	0.4
2023	0.5	0.3	0.3	0.4	0.3	0.2						
	Core PCE inflation: year-to-year % change of not seasonally adjusted index											
	Jan	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
2022	5.2	5.4	5.4	5.0	4.9	5.0	4.7	4.9	5.2	5.1	4.8	4.6
2023	4.7	4.7	4.6	4.6	4.6	4.1						
	Core drops from 4.1% YOY to 3.2% YOY at end of year if July-Dec changes average 0.2%											

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