

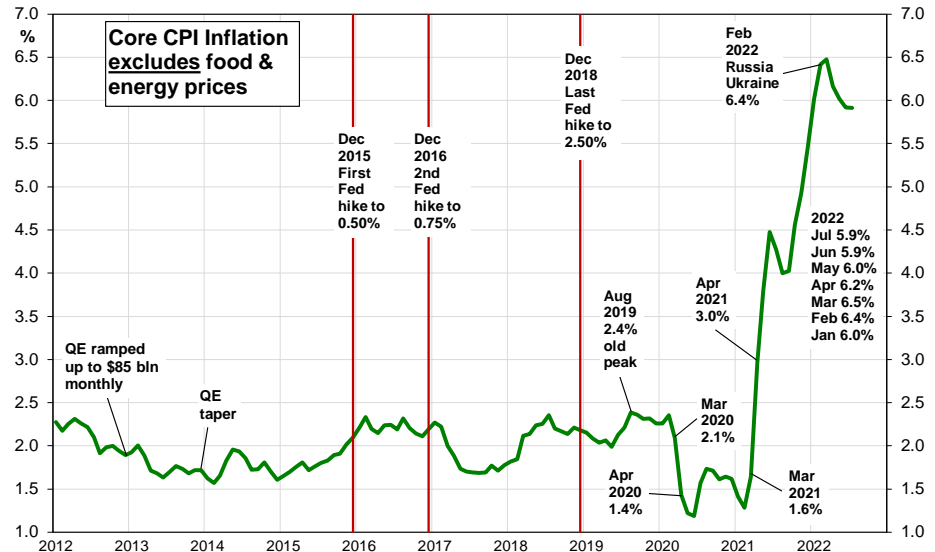
Financial Markets This Week

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FALLING GASOLINE PRICES REDUCE INFLATION TO ZERO

Headline CPI inflation was unchanged this month, 0.0% in July, after a 1.3% jump in June. The stock market was happy even with Fed officials less so. Regulators are never happy, and while they smiled, they also said the Fed funds rate is still on its march upward to near 4% from 2.5% currently. Anyway, for this month, when it comes to inflation, live by the sword, die by the

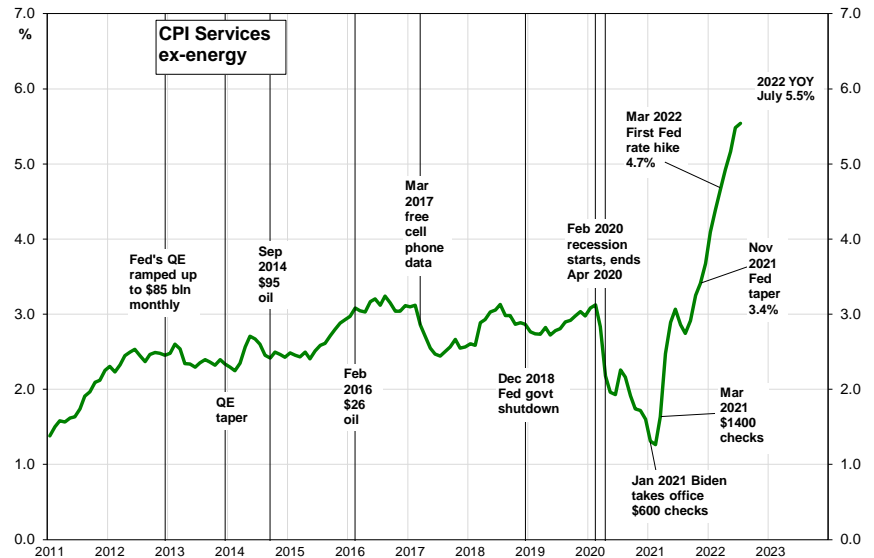


gasoline prices with their 5.227% weight in the CPI basket of goods and services (not mine, I take the train) rose 11.2% in June and fell 7.7% in July. More inflation suppression from gasoline is coming with [AAA gas prices](#) \$3.978 currently, down 20.7% from the June 14 peak of \$5.016. A 5.227% gasoline weight on the 7.7% decline this month cuts 0.4 percentage point off headline CPI inflation all on its own. For the August CPI report to be released Tuesday, September 13, it looks like falling gasoline prices will subtract 0.6 percentage point from headline CPI which should produce another 0.0% month assuming core inflation doesn't increase too much more than the relatively modest 0.3% monthly change in July, and food prices don't accelerate from the 1.1% monthly increase in July.

Jun 22 Weight	CPI Inflation	Monthly Percent Changes			YOY %
		May 2022	Jun 2022	Jul 2022	
100.0	Total	1.0	1.3	0.0	8.5
13.372	Food	1.2	1.0	1.1	10.9
5.077	Food away from home	0.7	0.9	0.7	7.6
9.200	Energy	3.9	7.5	-4.6	32.9
77.428	Ex-food & energy	0.6	0.7	0.3	5.9
3.999	New vehicles	1.0	0.7	0.6	10.4
4.008	Used cars/trucks	1.8	1.6	-0.4	6.6
2.419	Clothing	0.7	0.8	-0.1	5.1
1.465	Medical care goods	0.3	0.4	0.6	3.7
32.065	Shelter	0.6	0.6	0.5	5.7
23.502	Owner equiv. rent	0.6	0.7	0.6	5.8
5.900	Transportation	1.3	2.1	-0.5	9.2
6.772	Medical care services	0.4	0.7	0.4	5.1
Special: Where inflation might come back down to					
56.306	Services ex-energy	0.6	0.7	0.4	5.5

The Fed cannot do much about food or energy prices is the thinking, so the focus is on the July 5.9% year-year rise in core CPI if policymakers want to return inflation to their 2% target. Among core prices shelter rose 5.7% year-year which is about 40% of core inflation. Same story. Shelter costs of 5.7%

runs counter to the common sense observation of home prices rising 20 percent the last year. Other notable core price increases year-on-year are new vehicles +10.4%, used cars and trucks +6.6%, motor vehicle insurance +7.4%, and airline fares +27.7%. Only used cars and trucks and airline fares could be slowing with actual declines recorded in July.



Where will inflation settle in at? How entrenched is the problem? Services prices ex-energy (electricity and gas used in your home or apartment) are one measure of how sticky the inflation problem might be. Careful interpretation is required. No twitter quips allowed. CPI services ex-energy are up 5.5% year-year in July, increasing from 3.4% last November when the Fed started tapering and 4.7% in March 2022 with the first Fed rate hike for the cycle. Core services prices were fairly steady at call it 2.5 to 3.0 percent from 2016 up until the 2020 pandemic. The Fed thought they had a too-low inflation problem for much of that time or at least some officials thought that in 2012 to 2015 certainly. Maybe if the Fed wants PCE inflation to return to 2.0%, then perhaps CPI core services should be targeted at 2.5-3.0 percent. Slowing aggregate demand in 2020 brought these prices down close to 1%, but that was the pandemic where demand didn't just slow, it plummeted, and that won't happen again.



To conclude, the inflation story is still spinning. Headline CPI was 0.0%, but other than energy prices, few commodities or services that consumers purchase were zero or down in July. Airline fares fell 7.8%, coming back down finally after all summer holidaymakers already bought their tickets. Clothing fell 0.1% as stores had the wrong merchandise out on the floor and had to discount, especially with millennials refusing to go back to the office/work, office/work, office/work. Used cars and trucks also fell 0.4%. The final thought to remember is the Fed targets PCE inflation not CPI. They chose the measure that always finds less inflation in the economy decades ago under Fed Chairman Greenspan.

Core Consumer Inflation and stickier services prices ex-energy

Monthly % Changes	2022					2021												2021	
	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar		
Core CPI inflation	0.3	0.7	0.6	0.6	0.3	0.5	0.6	0.6	0.5	0.6	0.3	0.2	0.3	0.8	0.7	0.9	0.3		
Services x-energy	0.4	0.7	0.6	0.7	0.6	0.5	0.4	0.3	0.4	0.4	0.2	0.1	0.3	0.4	0.4	0.5	0.3		
Core PCE inflation		0.6	0.3	0.3	0.3	0.3	0.5	0.5	0.5	0.5	0.2	0.3	0.3	0.5	0.6	0.6	0.4		
Services x-energy		0.6	0.4	0.4	0.4	0.3	0.3	0.3	0.4	0.5	0.3	0.2	0.3	0.4	0.4	0.4	0.5		

INTEREST RATES

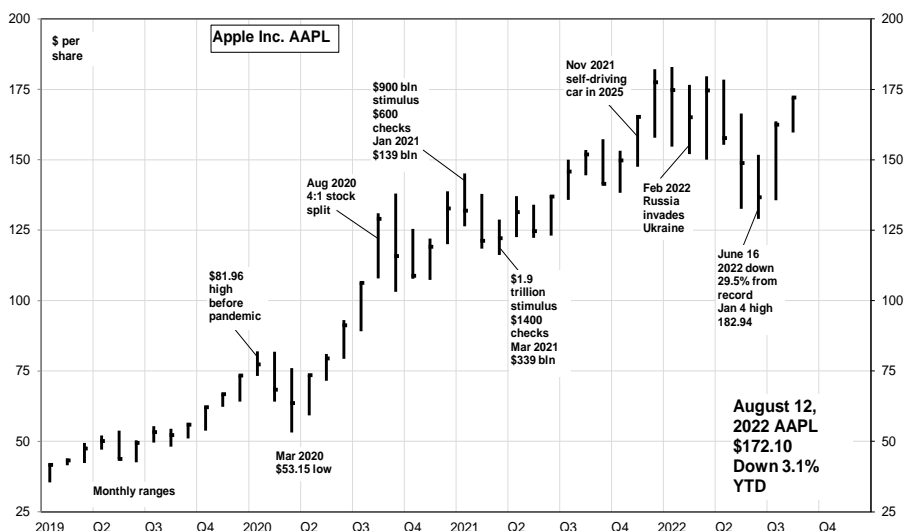


[New high this week for stocks](#) on the rebound from the S&P 500's 24.5% high-low recession magnitude loss. The Wednesday 0.0% CPI report following a 1.3% jump last month was the catalyst with the S&P 500 rallying 2.1% on the day. Stocks closed Friday above the 4,227 50% retracement of that 24.5% drop, encouraged by market lore that the bear market is over once stocks come back more than 50%, i.e. they don't revisit the bottom again. Except for the Global funding crisis in the summer of 2007 before the recession with a smaller 11.9% decline: stocks rallied back through the 50% retracement and made a new record high before collapsing over 50% in the Great Recession and financial crisis. Bond yields headed back up despite 0.0% CPI: some Fed officials said they aren't done. Fed funds futures are close to evenly split between a 50 or 75 bps rate hike on September 21.

Apple Inc. AAPL better than expected iPhone revenue

Apple was \$157.35 the night of its earnings release on July 28. Someone thought iPhone revenue was better than expected and the stock jumped 3.3% on Friday July 29. iPhone sales were \$40.665 billion in Q2 2022, up only 2.8% from last year, accounting for 49.0% of Total Net Sales. Greater China sales were \$14.604 billion, slowing year-year on the Covid lockdowns.

S&P 500 Weights	
Top 6: 24% of S&P	
7.31	AAPL
6.05	MSFT
3.47	AMZN
2.04	TSLA
1.51	Berkshire
2.02	GOOGL
1.86	GOOG
24.26	Top 6



FEDERAL RESERVE POLICY

The Fed meets September 20-21, 2022 to consider its monetary policy. Powell said at the press conference on July 27 that the forecasts made in June were a good guide on where the Committee saw interest rates going the next couple of years. This means the 2.5% Fed funds rate is going to 3.5% by December and up to 3-7/8% in 2023 based on the median forecast.

It was nice CPI inflation didn't move this month, but it certainly sounds like the Fed will raise interest rates until the economy crashes and produces job losses. Minneapolis Fed President Kashkari said the most likely scenario was for interest rates to keep climbing and then stay up there because inflation will remain high. It almost sounds like the reverse of Fed policy from 2020 which was to keep rates low and print money until the unemployment rate dropped back to the 3.5% best economy in fifty years level. Now they will keep interest rates high until inflation drops back to the 2% target. That could be a while.

Real GDP has fallen the first two quarters of the year (Q1 -1.6, Q2 -0.9), one measure of recession, but private nonfarm payroll jobs increased 2.684 million from December 2021 to June 2022. In the first two quarters of the 2007-09 recession, real GDP fell 1.6% in Q1 2008 and actually rose 2.3% in Q2 2008, but private nonfarm payroll jobs fell 0.846 million over the first six months of 2008. The GDP economy can fall for a couple of quarters, but you can't have a recession without job losses. The recession call will have to wait and Fed officials will keep pushing interest rates higher until we see some job losses.

Selected Fed assets and liabilities						Change from 3/11/20 to Aug 10
Fed H.4.1 statistical release billions, Wednesday data	10-Aug	3-Aug	27-Jul	20-Jul	3/11/20*	
Factors adding reserves						
U.S. Treasury securities	5720.572	5719.119	5734.180	5733.027	2523.031	3197.541
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2717.568	2717.552	2717.379	2726.261	1371.846	1345.722
Repurchase agreements	0.000	0.000	0.001	0.000	242.375	-242.375
Primary credit (Discount Window)	2.934	2.731	3.710	3.064	0.011	2.923
Paycheck Protection Facility	15.755	16.107	16.456	16.855		
Main Street Lending Program	26.154	26.138	26.053	26.038		
Municipal Liquidity Facility	5.551	5.549	5.547	5.546		
Term Asset-Backed Facility (TALF II)	2.158	2.157	2.182	2.181		
Central bank liquidity swaps	0.191	0.213	0.206	0.195	0.058	0.133
Federal Reserve Total Assets	8928.9	8924.3	8939.3	8949.0	4360.0	4568.844
3-month-Libor-% SOFR %	2.28	2.29	1.53	1.53	1.15	1.130
Factors draining reserves						
Currency in circulation	2276.462	2275.786	2274.830	2275.924	1818.957	457.505
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	561.140	566.577	615.515	616.348	372.337	188.803
Treasury credit facilities contribution	17.940	17.940	17.940	17.940		
Reverse repurchases w/others	2177.646	2182.238	2188.994	2240.204	1.325	2176.321
Federal Reserve Liabilities	5571.377	5581.813	5663.723	5713.793	2580.036	2991.341
Reserve Balances (Net Liquidity)	3357.493	3342.517	3275.609	3235.172	1779.990	1577.503
Treasuries within 15 days	136.625	140.902	87.825	85.856	21.427	115.198
Treasuries 16 to 90 days	279.513	269.234	321.128	322.875	221.961	57.552
Treasuries 91 days to 1 year	809.524	815.460	816.043	816.212	378.403	431.121
Treasuries over 1-yr to 5 years	2039.330	2038.765	2054.223	2053.774	915.101	1124.229
Treasuries over 5-yrs to 10 years	1018.180	1017.734	1019.483	1019.129	327.906	690.274
Treasuries over 10-years	1437.400	1437.025	1435.479	1435.181	658.232	779.168
Note: QT starts June 1	Change	10-Aug	1-Jun			
U.S. Treasury securities	-50.207	5720.572	5770.779			
Mortgage-backed securities (MBS)	10.122	2717.568	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

Powell July 27, 2022 I think the Committee broadly feels that we need to get policy to at least to a moderately restrictive level. And maybe the best data point for that would be what we wrote down in our SEP at the—at the June meeting. So I think the median [federal funds rate] for the end of this year, the median would've been between 3¼ and 3½ [percent]. And, then, people wrote down 50 basis points higher than that for 2023. So that's—even though that's now six weeks old, I guess, that's—that's the most recent reading.

Fed Policy-key variables	2022	2023	2024	Long Term
Fed funds	3.4	3.8	3.4	2.5
PCE inflation	5.2	2.6	2.2	2.0
Core inflation	4.3	2.7	2.3	
Unemployed	3.7	3.9	4.1	4.0
GDP	1.7	1.7	1.9	1.8
June 2022 median Fed forecasts				

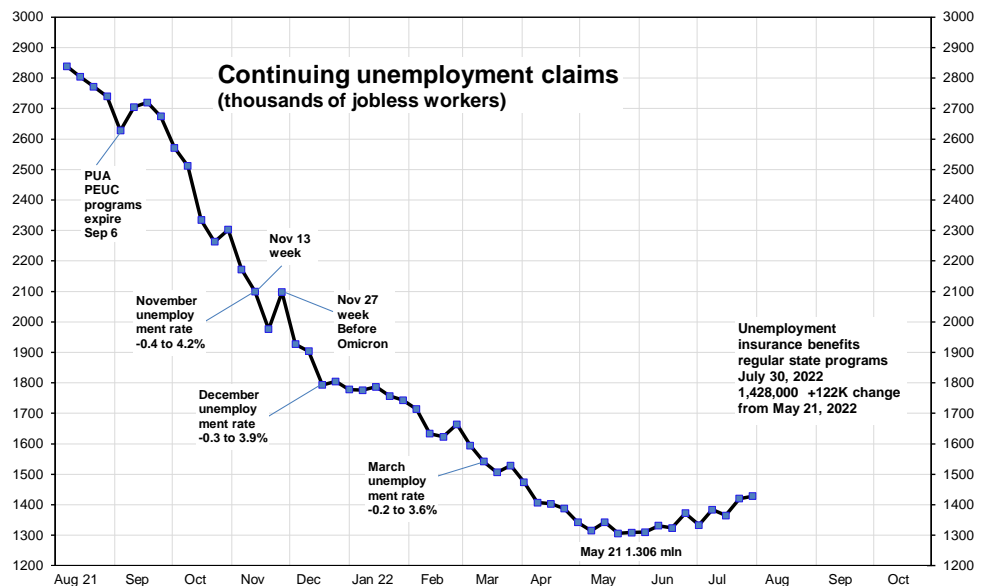
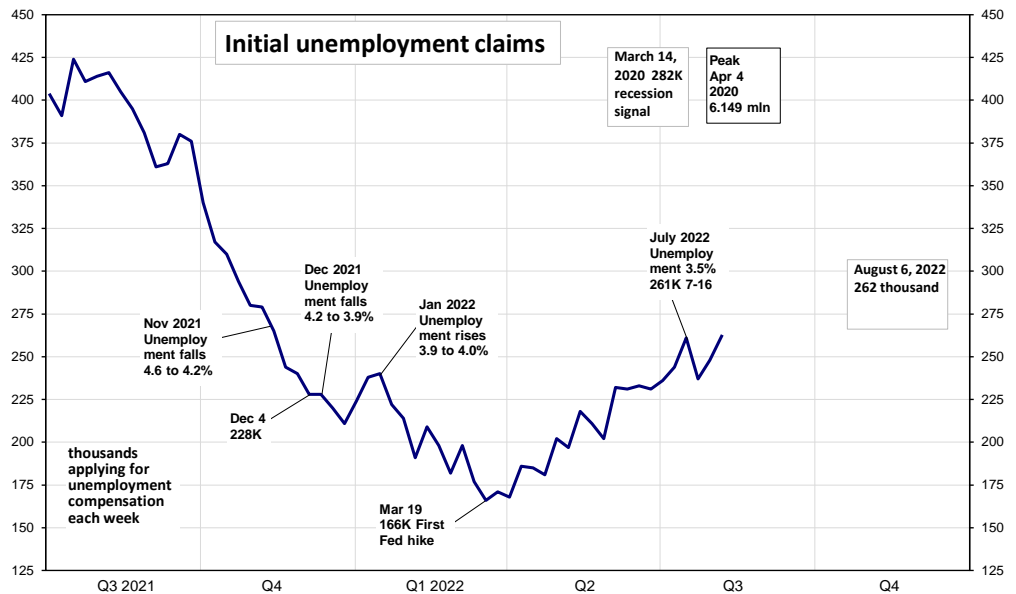
Fed Individual Forecasts				
Fed funds rate at year-end				Longer
Votes	2022 End	2023 End	2024 End	run
1	3.125	2.875	2.125	2.000
2	3.125	3.375	2.250	2.250
3	3.125	3.625	2.875	2.250
4	3.125	3.625	2.875	2.250
5	3.125	3.625	3.125	2.250
6	3.375	3.625	3.125	2.250
7	3.375	3.625	3.375	2.250
8	3.375	3.625	3.375	2.375
9	3.375	3.625	3.375	2.500
10	3.375	3.875	3.375	2.500
11	3.375	3.875	3.375	2.500
12	3.375	3.875	3.375	2.500
13	3.375	3.875	3.375	2.500
14	3.625	4.125	3.375	2.500
15	3.625	4.125	3.625	2.500
16	3.625	4.125	3.625	3.000
17	3.625	4.125	3.875	3.000
18	3.875	4.375	4.125	
Median	3.375	3.750	3.375	2.500
Meeting	Jun 22	Jun 22	Jun 22	Jun 22

OTHER ECONOMIC NEWS

More layoffs signal recession (Thursday)

Breaking economy news. First-time jobless claims rose 14K to 262K in the August 6 week. Unemployment claims have risen enough from the March 19 low to signal a recession is approaching even though nothing has happened yet to the monthly labor statistics to indicate the economy is on the edge of turning down.

The historical recession-signal sequence is initial jobless claims rise, then continuing jobless claims rise, then we can be certain the number of unemployed behind the 3.5% unemployment rate will rise. Continuing unemployment claims, or the total number of Americans qualifying for and receiving benefits, rose 8K to 1.428 million in the July 30 week which is 122K higher than its low for this cycle back on May 21: 63K of the increase is in the last two weeks beyond the July 16 reference period for that July 3.5% unemployment rate. We need to continue to watch this. The recession is still coming if the job losses mount in the weeks to come. It is an odd time this cycle with the thousands of 58 to 76 year old baby boomers retiring each day, leaving job openings that need to be filled.



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