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Economic Indicators | August 2023 | By Kim W. Suchy

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Well, from the looks of things inflation as measured by the consumer price index and the producer price index, is working its way lower. The Fed, through its restrictive policies coupled with a significant decline in energy prices over the past year, have served to cut inflationary levels in half and forge closer to the Fed inflation target of 2%. So, it looks like the first of two Fed mandates, inflation, is on the path to reasonable resolution.

Now, here comes the second mandate, maintain maximum employment, also referred to as full employment. Full employment is the total measure of jobs that the economy can experience without creating overt inflationary pressures. As such, almost everyone who wants a job can secure one during maximum employment. The current unemployment rate is roughly 3.6%, which is technically below what many believe to be the full employment level of 4%. That’s good, right? Not necessarily.

Tight labor markets mean that workers have more leverage regarding wage and benefit negotiations, and this has become more apparent of late. Consider that 340,000 UPS employees are renegotiating their collective bargaining agreement, auto workers and the United Auto Workers are lobbying for higher wages, writers and actors in Hollywood are striking and, FedEx pilots, nearly 5000 of them, have just rejected a labor contract offer. Finally, Southwest Airlines is locked in drawn-out negotiations with pilots and flight attendants, who have not received pay raises in several years. Unions are aiming to match higher wages won by counterparts at other airlines, including up to 40% more pay over four years at United. Yes, 40%!

Certainly, inflation has eaten into the wage base of the aforementioned groups, and others. Assuming they are successful in their negotiations, increased wage pressures will send costs of operations higher and force business owners to raise prices. Wait, we thought the Fed was winning that battle; not yet! We still have more wood to chop. Remember, once these prices work their way through the production and sale cycle, increased wage demands across many industries will likely surface. This would serve to reduce the demand for labor hence place a cap on wage demands.

The Fed's employment mandate is going to be a tough one to manage. Recall that there is a policy lag after each Fed rate increase. With the next Fed meeting 8 weeks away, plenty of economic reports will have their chance to reveal their impact from the last 11 rate hikes. If the hikes have made their mark and have worked their way through to slow initial wage inflation, then the Fed will feel it has made significant progress in the employment mandate. If not, we may have some market and rate turbulence as we move into Q4 2023.

Here is your look at developments in the global marketplace.

POSITIVE DEVELOPMENTS

- Over the past month, the equal weighted SP500 Index has outperformed the cap weighted SP500 Index indicating that more breadth is apparent in the investment marketplace.

- Retail sales rose 0.2% in June and are up 1.5% versus a year ago. The largest increases in June were for nonstore retailers (internet & mail order) and autos. The largest declines were for gas stations, grocery stores, and building materials. The declines stem from lower gas prices, people eating out more and the slowdown in building construction….these may all be temporary.

- Good news on the inflation front. Consumer prices rose 0.2% in June, coming in below the consensus expected 0.3%, and pushing the 12 mo. change down to 3.0%. It looks like inflation has been moderating rapidly recently, with yoy inflation dropping from 4.9% to 3.0% in the last 2 months. Producer prices rose 0.1% in June, but finished the first half of 2023 down from where we started the year. Prices further back in the pipeline were decidedly lower, as prices for intermediate demand processed goods fell 0.6% in June while unprocessed goods dropped 2.1% and are down 32.2% in the past year. Both inflation reports suggest we are on the right path, but the Fed will remain vigilant in its policies.

- Consumer confidence rose in July 2023, to its highest level since July 2021, reflecting pops in both current conditions and expectations" Dana Peterson, chief economist at The Conference Board stated, "Headline confidence appears to have broken out of the sideways trend that prevailed for much of the last year. Greater confidence was evident across all age groups, and among both consumers earning incomes less than $50,000 and those making more than $100,000."

- Real GDP increased at a 2.4% annual rate in Q2, beating the consensus expected 1.8%. The largest positive contributions to real GDP growth in Q2 came from personal consumption and business fixed investment, including equipment, commercial construction, and intellectual property. Government purchases also added to GDP while home building and international trade were small drags.

NEUTRAL DEVELOPMENTS

- Housing starts declined 8.0% in June to a1.4M a/r and starts are down 8.1% versus a year ago. Further, building permits declined 3.7% in June to a .4M a/r. Compared to a year ago, permits for single-family homes are down 2.7% while permits for multi-unit homes are down 31.2%. While the data has been choppy recently, many expect this to head higher. Note, many owners of existing homes are reluctant to list their homes and give up fixed sub-3% mortgage rates, so many prospective buyers have turned to new builds as their best option. This has boosted demand for developers and should help construction activity going forward.

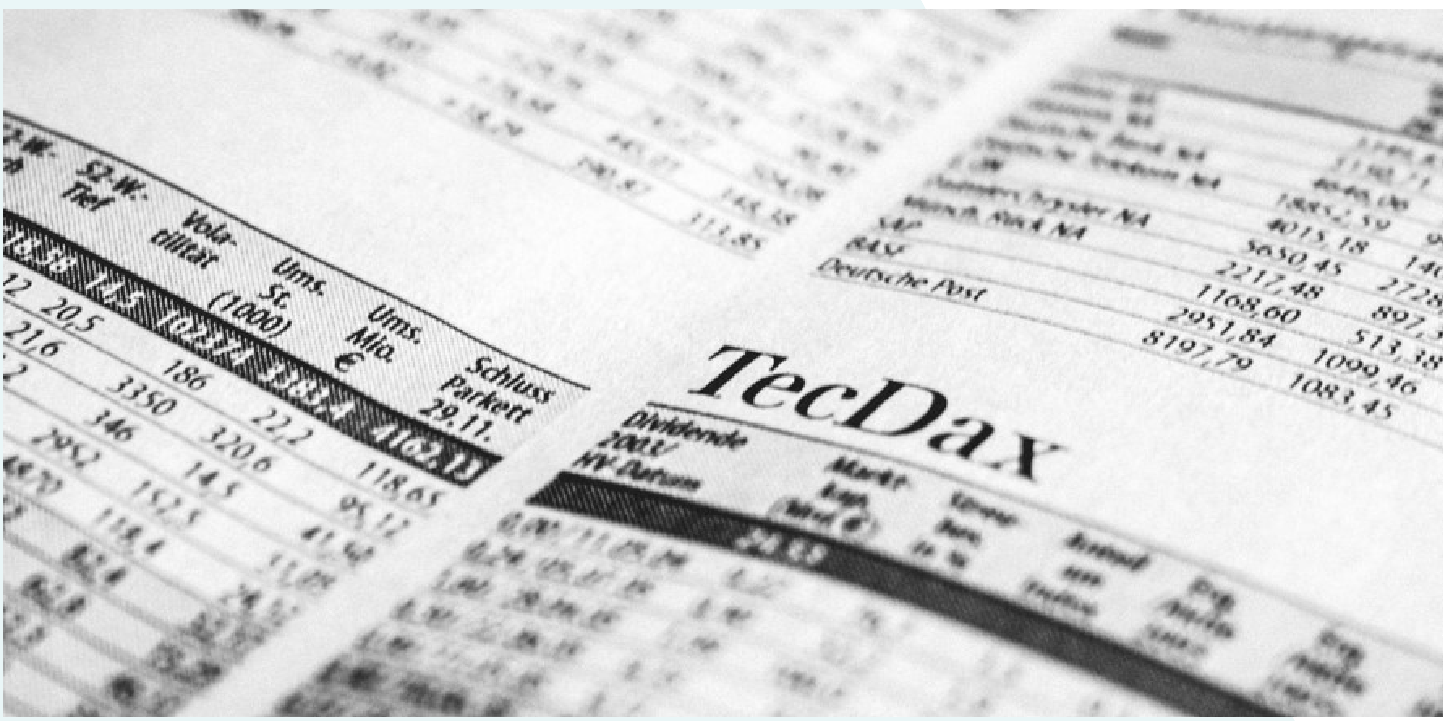
- Is China ready to play nice in the sandbox? Ed Yardeni noted that China's economy is having more difficulty than expected emerging from the 3 years of zero-Covid lockdowns that ended late last year. Real GDP fell 1.7% q/q in Q2. China's property market is in decline and along with that, construction—responsible for about a quarter of economic growth—as their property bubble is leaking air. Consumer spending remains lackluster, and a rapidly aging demographic profile is also weighing on consumption. It's logical to assume China's leadership will tone down its dicey rhetoric about Taiwan while the country's leaders are playing nice, for a change, to retain and attract foreign investors.

- Fed raised rates by 25bpin July after its June skip, as expected, bringing the funds rate to 5.25-5.50%. Also, as expected, Fed Cahir Powell's statement did not contain any meaningful changes. Powell repeatedly stressed Fed is data dependent on future policy moves.

NEGATIVE DEVELOPMENTS

- Industrial production declined 0.5% in June and overall capacity utilization fell to 78.9% in June from 79.4% in May. Industrial production fell for the 2nd mo. in a row with every major category contributing to the drop. The biggest source of weakness came from the manufacturing sector where activity fell 0.3%. Looking at the details, both auto and non-auto manufacturing posted declines, dropping 3.0% and 0.1%, respectively. It is becoming increasingly more evident that consumers are shifting their preferences back toward services and away from goods…the impact on GDP and employment waits in the wings.

- New single-family home sales declined 2.5% in June to a 0.7M a/r and sales are up 23.8% from a year ago. The average price of new homes sold was $495K, up 4.8% over last year. The main issue with the housing market has been declining affordability. Assuming a 20% down payment, the rise in mortgage rates since the Fed began its rate hike cycle amounts to a 21% increase in monthly payments on a new 30-year mortgage for the average price new home. With 30-year mortgage rates currently sitting near 7.0%, financing costs remain a headwind. Further, housing inventory is relatively low due to the difficulty of convincing current homeowners to give up the low fixed-rate mortgages they locked-in during the pandemic…some as low as 2.5%.



THE MARKETS

The SP500 is amid earnings season with just about half of all companies posting results. Of the roughly 250 companies that have reported their second-quarter figures, a lofty 80% have beaten earnings expectations. Favorable earnings have given the broader markets a boost. In July, energy, communications, and financials were the market leaders while utilities, consumer staples and real estate were laggards.

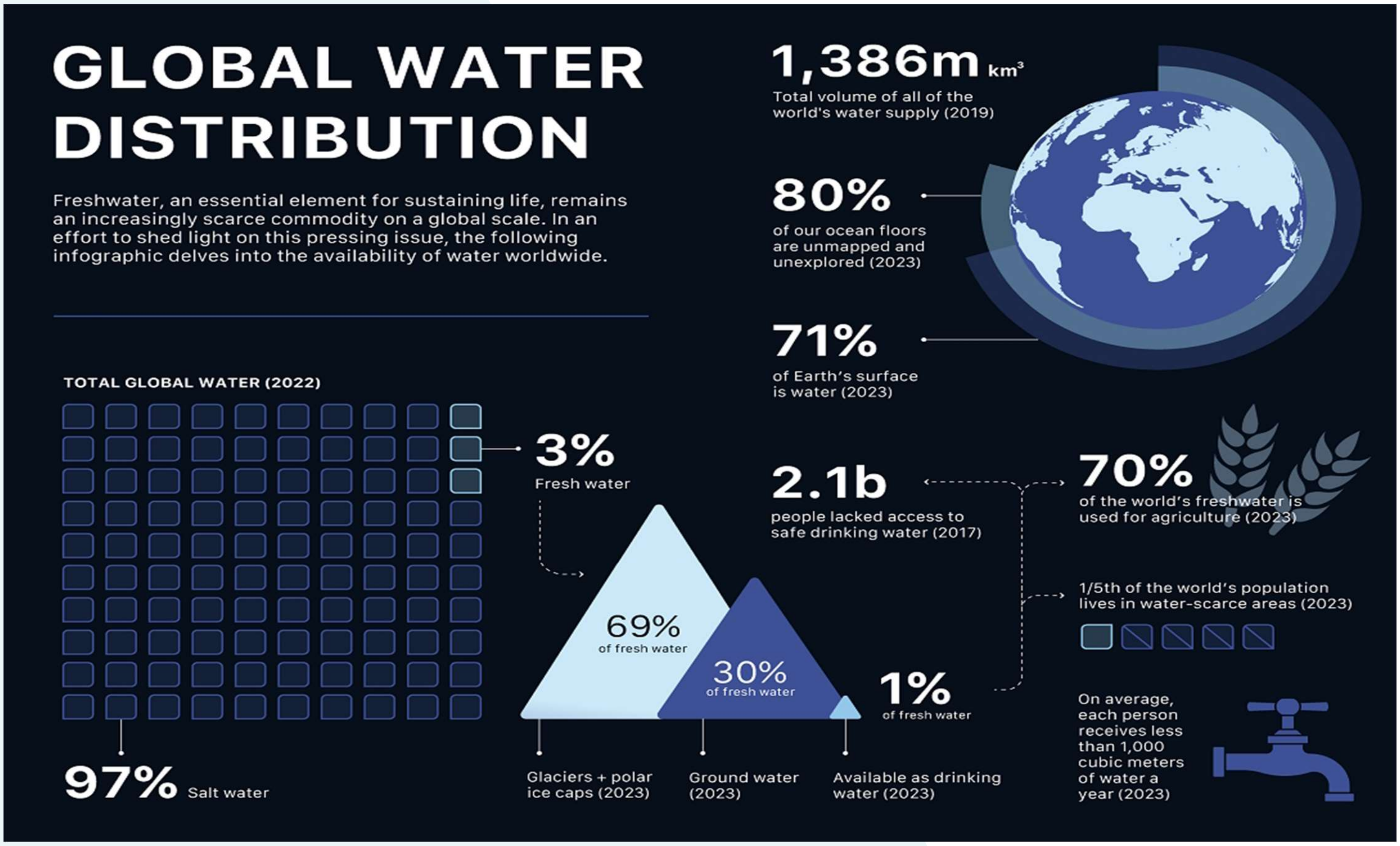
The U.S. equity markets were broadly higher last month with small cap stocks leading the charge. On the international front, most markets legged higher across Europe and Asia. The Japanese Nikkei was the only Asian market that posted a negative return in July. The Indian market, BSE Sensex, continued its trek higher this year posting a healthy return in July.

Last week, the Fed lifted the Fed Funds rate to 5.25-5.5%, the highest since 2001. Looking at Fed Fund futures, they suggest no more rate hikes, but that will depend on economic data that will surface over the next few months.

U.S Index	Last Month (% return)	YTD (%)
S&P 500	3.1	19.6
Dow Jones	3.4	7.3
NASDAQ Comp	4.1	37.1
Russell 2000	6.0	13.7

Source: https://tradingeconomics.com/stocks

Graph of the Month: Global Water Supply



Source: https://www.visualcapitalist.com/cp/global-water-distribution/

Water is one of the most valuable resources for humans, vital for survival and essential for meeting our various needs. The demand for water has grown immensely through population growth and the expansion of agricultural activities to support the growing population. 100 years ago, freshwater consumption was 6x lower than today, and this heightened demand has put strain on our freshwater resources, reservoirs and water infrastructure.

It is a well-know concept that the Earth's surface is made up of 70% water (or 326 million trillion gallons of water), however, how is it that humans have a tight supply? 97% of that water is saline (undrinkable) and 3% is freshwater. Moreover, 2% of the 3% of the freshwater is locked away in snow, glaciers, and ice caps, leaving just 1% readily available from rain, rivers, and lakes.

Despite the need for freshwater for personal and commercial consumption, a significant portion (about 70%) of the world's freshwater is used for agricultural purposes. Sadly, it is estimated that nearly 40% of that 70% is lost to the environment due to poor irrigation systems, evaporation, and poor water management.

Scarcity of freshwater is a pressing issue for a substantial part of the global population. Around 20% of the world's population resides in water-scarce areas, and a staggering 2.1B people lack access to safe drinking water.

As the global population continues to grow and food demand escalates, concerted efforts will be necessary to promote water conservation, develop efficient water technology, advanced irrigation systems and other water infrastructure. Over the years, several initiatives have emerged to address water inequality and alleviate water scarcity around the world. Collaborative efforts, innovation and international cooperation play essential roles in addressing these water challenges.

https://htt.io/water-usage-in-the-agricultural-industry/

NEWS YOU CAN USE

August 1 is the MLB trade deadline, and this past week, the Chicago White Sox sent five starters packing in return for four minor league players, and an ex-White Sox outfielder, Trayce Thompson. Even with a terrible Central Division this year, the White Sox failed to deliver a respectable start, thus, it may seem our beloved team has gone into rebuild mode. Lance Lynn, Joe Kelly, Kendall Graveman, Lucas Giolito and Reynaldo Lopez have all been traded, so far, with rumors hovering over ace Dylan Cease and All-Star Luis Robert Jr.

https://www.chicagotribune.com/sports/white-sox/ct-cb-chicago-white-sox-trade-returns-20230730-y2ffrlpls5gdjbzmpzyqvoczeu-story.html

For the entire month of July, Phoenix managed to break 110F (43.3C) or 31 days in a row in an unprecedented stretch for the city. However, Phoenix is not alone as record breaking heat has spread the globe. Globally, June and July of 2023 have been the hottest months since records began in the 1940s. Earth temperatures were 1.5 degrees warmer than pre-industrial times for a record 16 days in July, passing over a key warming threshold, the internationally accepted goal of limiting global warming to 1.5 degree Celsius.

https://fortune.com/2023/07/31/what-will-summer-be-like-climate-change-rain-heat-smoke/

Bolivian President Luis Arce announced his country's confirmed lithium reserves had increased to 23 million tons, up from 21 million tons in January 2023, making Bolivia the world's biggest known deposits of lithium. Also known as the new 'white gold' companies such as Tesla, GM and BMW have been rushing to obtain the metal to meet the demand for their vehicles. Bolivia has gone in search for international partners to help boost production and plan to intelligently manage its position as the world's leading source of this valuable element.

https://www.independent.co.uk/news/bolivia-ap-la-paz-argentina-chile-b2379224.html

As always, if I can be of additional guidance, please feel free to call me at 312.485.6847.

Best regards,

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