AT LEAST FED POWELL HAS STOPPED SAYING THE ECONOMY IS STRENGTHENING.

> ***"Recent indicators of spending and production have softened."*** *This is the opening sentence to the statement issued after the 27th of July F.O.M.C. meeting which replaces the previous perspective just a month earlier on June 15th,* ***"Overall economic activity appears to have picked up after edging down in the first quarter."*** *So within the space of a month, a U-turn by the Committee whose decisions can make or break the world economy. Flying blind confused by their own fraudulent data.*

Readers will know I have been ridiculing the FED FOMC (Federal Open Market Committee) view that the US economy was strengthening when the FED's own analysis showed the opposite to be true at the time. Well at least the FED has now owned up, or should we say the data is so overwhelming they could no longer deny what was happening in production and distribution.

But this raises another question, if the FED recognizes the economy is softening why oh why go for a 0.75% rate rise? Well the FED semi-answered this question, they have to bring demand in line with supply. That means crashing the economy because the issues in the supply chain are so deep this is the only way to control inflation. It seems that those empires which the gods wish to destroy, they first drive mad. Here we have the USA provoking a war in the Ukraine at a time when the global market is still disturbed by the pandemic and in a world haunted by the specter of climate change. (July is looking to be the hottest month ever.) And all these messy disasters to be controlled by interest rates? Really! Making the bad, worse.

Not to be dissuaded the FOMC trots out the labour market. "*Nonetheless, job gains have been robust in recent months, and the unemployment rate has remained low."* And there I was thinking the US pledge of allegiance reads: "In God We Trust but not the Bureau of Labour Statistics". Here is a comment I made on a recent posting on Michael Roberts blog: *'There is another way of looking at employment data which investors like Buffet find more revealing and that is to examine what is happening with "withheld taxes". These are the taxes paid by companies on behalf of their employees each month to the Internal Revenue Service. All things being equal these taxes will grow as employment and wages rise, and conversely, they will fall if employment fall. The US fiscal year begins in October each year and ends in September. So let us look at the data from March which Michael correctly pointed out was the beginning of the softening of the data as recorded by the Household data. So using the data found in the links following, the monthly running total in March (month 6) was $273 billion and by June that had fallen to $262 billion (month 9) a fall of 4%. In addition the figure for June itself was $254 billion. Add in the 5.2% annual rise in wages and the adjusted real fall is between 5 and 6% in withheld taxes. This suggests a significant fall in employment beyond that expressed by the Household data. https://www.cbo.gov/system/files?file=2022-07/58219-MBR.pdf and https://www.cbo.gov/system/files?file=2022-04/57909-MBR.pdf'*

In addition total receipts received by the Federal Reserve in the 9 months to June were down 5% and that is before factoring for inflation of around 6.5% adjusted for the same period. A real fall of over 10% in receipts only happens in an economy which is deep in recession unless of course new ways of avoiding taxes have recently been discovered. The danger for any decision maker is when they unquestioningly believe the messenger delivering the data rather than analyzing the data itself. Its like a pilot taking off without double-checking that the altimeter setting is correct, a sure way to fly into a mountain.

The new target rate for the FED was in the 2.25 to 2.5% range, which the FED says was in the "*vicinity of the neutral rate*" needed to achieve a 2% inflation rate. Of courses the use of the word vicinity was the starting gun for the markets to rise. Naturally, there is no such thing as a neutral rate, the holy grail of central bankers. Interest rates are not independent rates. Rather they are the product of demand and supply for loanable funds themselves set by the rate of profit acting on investment, in turn acting on production. In the period since 2014, a rate of <0.25% was sufficient to keep inflation at 2% in a low investment environment. No doubt the FED is about to discover that a rate of >2.5% is not going to be neutral but catastrophic and by the time the FED reels back the rate, the damage will have been done.

In his press statement Powell said the growth in employment would underpin demand. So let us put him to the test. Kraft Heinz and Amazon (Retail) and Procter & Gamble reported their second quarter results this week. So how did they do in real terms factoring in 8.7% inflation? Kraft sales volumes fell 9.9%, Amazon's 11.2% and P&G by 5.7%. Seems that the consumer is not so resilient after all. There were exceptions but as my attached spreadsheet 'INCOME, REVENUE Q2 USA LARGE CORPS' reveals, of the 21 sector leading corporations show, revenue in real terms fell 1.3% despite the inclusion of Big Tech, while profits fell even more by 15.3% dragging down profit margins by 12%. (Generally there price rises tended to be higher than 8.7% offsetting falls in revenue and profits due to the stronger dollar.)

The only above average growth was for luxury goods. In this regard Ford is educative because its revenue went up, not because of volume, but because it sold so many top end vehicles.

In the accompanying spreadsheet I have also added in Big Oil in the form of ExxonMobil and Chevron. Their sales & income relate purely to the USA. The spike in the oil price was sufficient to elevate their revenues and profits to the point where total revenues and profits for all the companies aggregated rose instead of falling. Of course this is a large chunk of the oil industry compared to the other corporations which represent a much smaller chunk of non-financial corporations, so the effect is over-dramatic but illustrative of the huge profits being made by the oil industry. Big Oil now plays a bigger role in the economy despite global warming.

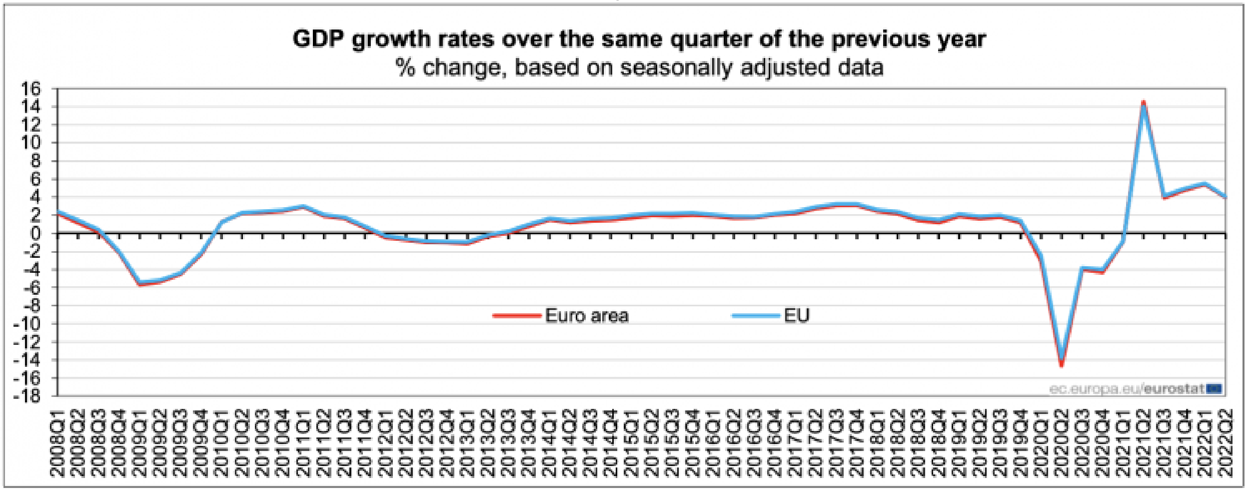
When a recession is not a recession.

In the past the saying went: "nothing is as it appears". Today that translates into: "nothing is as reported". We were previously drowned by the media declarations of the "unprovoked Russia's invasion" now we are over-told that a recession is stagflation and if the FED is to be believed it has been unprovoked by them. If the contractions in each quarter was less than 0.5% perhaps, but not a cumulative contraction over two quarters of 2%. Further, if the economy was strengthening towards June i.e. towards the end of the second quarter, then maybe. But the truth is the fall in GDP is accelerating. June was weaker than May and high frequency data shows July to be weaker than June. Further, further, the big plus was the trade deficits because exports rose faster than imports for two reasons. Oil and gas exports surged and import growth faded, but the fading of import growth is not a sign of strength but of waning demand, accordingly it reflects weakening. And of course, as I have always maintained, personal consumption is overstated.

In NIPA Table 1.17.6. there is found domestic sales without inventory adjustments. Remember GDP is the value of production and not the value of final sales. It is obtained by deducting opening inventory from the sum of total final sales plus closing inventory. Table 1.17.6 provides final sales unadjusted by inventory and its shows a definite weakening in demand both for consumption and investment.

In the EU GDP grew unexpectedly in Q2. This is shown in the Graph below. And I thought the figures could not get worser than the USA. Wow! With all the problems of energy supply, dislocations etc. the EU is growing faster than 2015 to 2018 including the "Trump Bump". Someone should tell the Euro that its wilting is unwarranted and tell Eurostat that European tourists can't be spending in two countries at once.

Graph 1.



The markets.

The stock markets were in buoyant mood this week. In fact July is turning into the best month for the markets since November 2020. The Nasdaq which had fallen the most is up over 10% this month. At its lowest point in June it had fallen by 35% from its November high. Now it is 23.5% down, still in bear territory but recovering.

Graph 2.

What is driving this mood. Firstly, retail investors are being lured in by Wall Street's siren call that the US economy is not in recession. They accept the headline official data that employment is strong, and that the consumer is resilient, all of which means the US simply cannot be in a recession. Secondly, this week, while more corporations missed expectations than beat them, with very few exceptions these misses and beats were marginal. However they were sufficient to reduce the surprises week over week as FactSet points out: "*In aggregate, companies are reporting earnings that are 3.1% above estimates, which is below* *last week's percentage of 3.6% and below the 5-year average of 8.8%."* FactSet reported blended earnings went up by 6% so far but, *"The Energy sector is also the largest contributor to earnings growth for the S&P 500 for the second quarter. If this sector were excluded, the index would be reporting a decline in earnings of 4.2% rather than growth in earnings of 6.0%."* This compares to my spreadsheet where profits are down by 6.6% partly because FactSet base their data on a per share basis which is distorted because of share buybacks in the interim. In contrast to Energy's 290.3% increase in profits, Information Technology, the previous driver eked out only 1.3%. It is worth mentioning that the other profit driver was Healthcare.

Finally, the other positive factor was the outlook. Many of the largest corporations provided outlooks which soothed frayed nerves which is why the market this week rewarded them all: "*Companies that have reported positive earnings surprises for Q2 2022 have seen an average price increase of +2.9%"* as well as those who were less positive: "*Companies that have reported negative earnings surprises for Q2 2022 have seen an average price increase of +1.2%."* It seems all is forgiven when it's a 'risk-off' market.

Not everyone was enthusiastic about the market mood. JP Morgan analyst Mike Wilson warned his clients about the fragility of the market. I would go further, the market is being set up for a fall, investors think the worst of inflation is behind them and that future tightening by the FED will be lighter than earlier anticipated, which makes them vulnerable to bad economic news over the next two weeks particularly retail spending and possibly employment data. If inflation falls, if the FED relaxes its dot plot, this wont be due to good news but undeniably bad news. Those CEO's who blithely reported that the future is not so bad may come to rue the day they expressed those views.

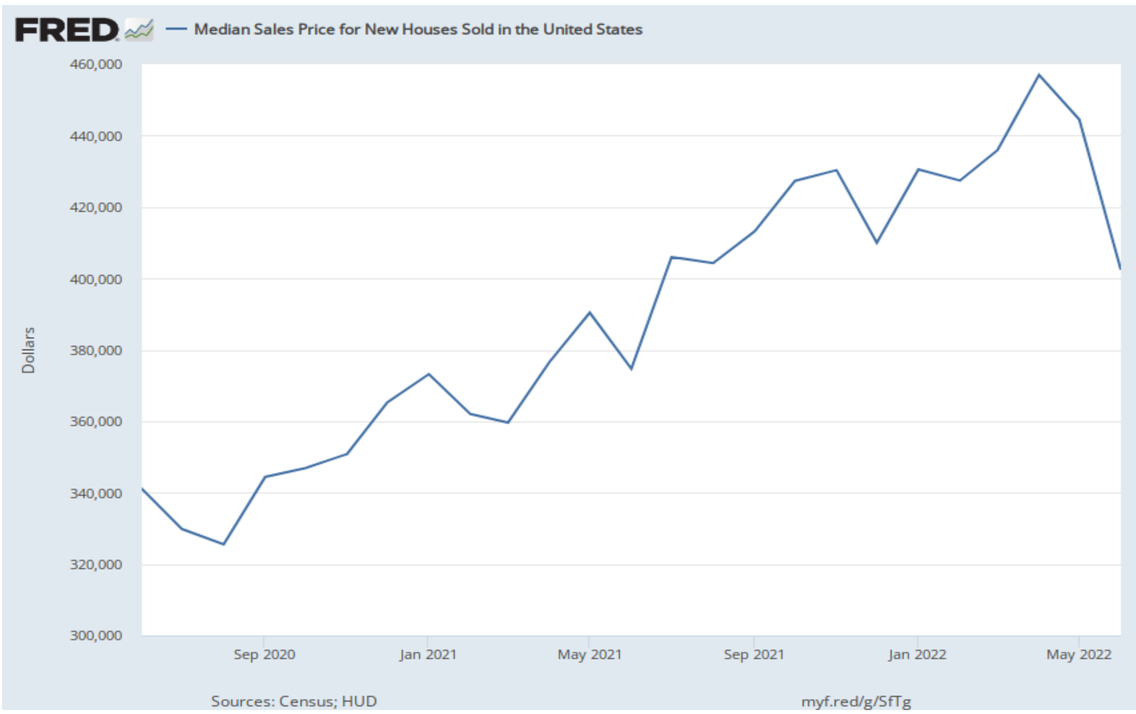
The Housing Market.

One such good news item based on bad developments is the ticking down of the mortgage rate. *The average rate on the popular 30-year fixed mortgage fell to 5.22% on Thursday from 5.54% on Wednesday. "This is an exceptionally fast drop!" wrote Matthew Graham of Mortgage News Daily. The rate fell even further Friday to 5.13%".* Reported by CNBC. This fall is being driven primarily by the softening of the 10-year yield. As the graph below shows, the 10-year yield has fallen by 0.8% in the last two weeks, the mirror opposite of the FED's rate rise of 0.75% this week. Talk about a vote of no confidence in the future.

Graph 3. (10-year interest rate)

The sharp fall in the 30-year mortgage rate will delay the collapse in the housing market. Pending home sales released this week fell by 20% year on year. Pending home sales are now well below the level found before the pandemic. Buyer cancellation rates outside the pandemic era are at an all-time high. And as CNBC reports once again, builders are now actively considering offering incentives to buyers to move unsold homes. This coincides with the sharp fall in the median sales prices for new homes despite the prevalence of sales in the higher end.

Graph 4.



Despite the improvement in mortgage rates because of a softening economy, the housing market remains a black swan further weighing on the market. As the BEA reported in its analysis of GDP, residential construction subtrated -0.71% from GDP in the second quarter or more than personal consumption added.

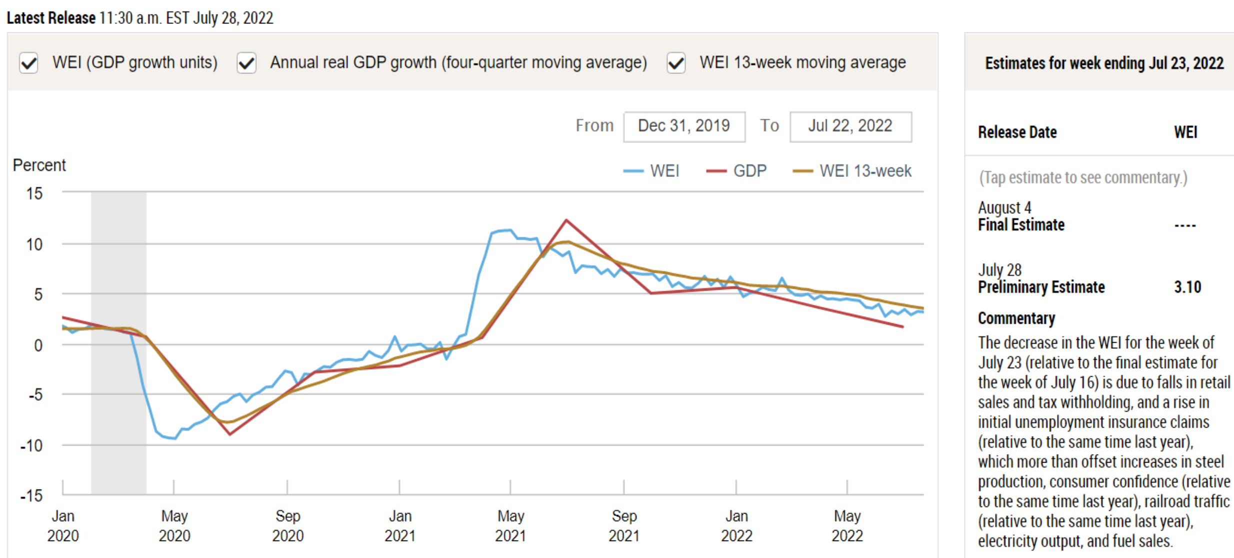
Conclusion.

The FED has decided to comment less frequently on the economy. In short, its guidance is to become more opaque due to having had its fingers burnt so often. After all it is quite embarrassing to have to change one's tune from a strengthening to a weakening economy within a month. The Chief Executive Officers of the large corporations whose forward guidance was positive should follow the FED's lead and refrain from issuing guidance, but then they have ulterior motives in propping up their shares.

There is nothing in the data to suggest the downward trend is decelerating rather than accelerating. This can be seen in the detail of the Conference Board's report on Consumer Confidence in July. All components weakened well below consensus expectations. In particular intentions to buy cars, homes and appliances all weakened significantly driven by higher interest rates and prices as well as falling expectations for the labour market.

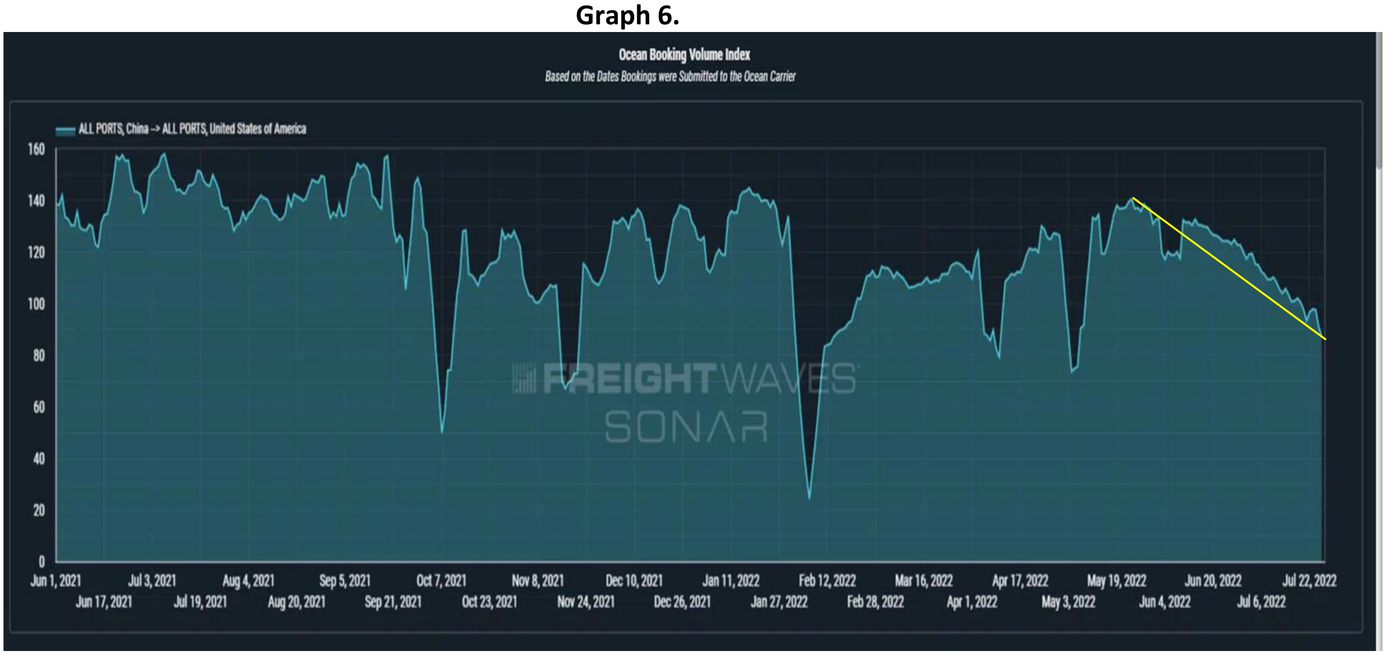
[The New York Fed](#) published its high frequency data on the 28th of July covering the period up to the 23rd of July. This confirmed the downward trend. If we factor in the 0.9% fall in GDP estimated by the BEA versus the +1.62% estimate by the NY FED, then the actual figure is not 3.1% but 0.58%.

Graph 5.



A [FreightWaves Report](#) gives a mixed picture about freight movements towards the end of the quarter and in July with some carriers suggesting a fall in volumes towards the end of the quarter and others saying volumes are holding up. All agree the 2nd half will be "*more constructive*" than earlier predictions based on the bullwhip effect because the overstocking of inventories in retailers has had less an effect on freight movements than expected. [Another report](#) shows that while ocean freight bookings are down 50% from their peak and falling, congestion in the freight chain continues to prop up freight charges benefitting shippers and hurting consumers.

Graph 6.



On balance the official contraction was less than I anticipated though higher than the consensus view. The reporting season is now more than halfway over with all the big hitters having reported. Future reports, which will include retailers, will be generally weaker. Given the enthusiasm with which some of these profit reports were received, one could be forgiven for thinking profits YoY had risen when in fact they had fallen. Already a picture is emerging of a sharp fall in non-financial corporate profits despite the boost from energy, which in turn will depress the all-important rate of profit back to 2019 levels. This will re-establish the trend in profitability which led to the world economy stalling that year. Add in a rising interest rate burden, price pressures and ongoing supply disruptions due to a deranged US imperialism, and the outlook for capitalism remains grim.

Brian Green, 30th July 2022.