WEEKLY ECONOMIC UPDATE JAN. 15, 2023

Stocks pushed higher last week, led by big tech names and boosted by December inflation reports that were mixed but positive enough to shore up investor confidence in Fed rate cuts this year.

Stocks Rock and Roll

It was a rocky week that ended on a high note. Stocks rallied Monday after the prior week's decline. Tech shares led, with the Nasdaq posting its best day since November 14.

On Tuesday, stocks initially tumbled but recovered most of their losses late in the session. Stocks rallied on Wednesday ahead of inflation news the following two trading days. Stocks fell initially on Thursday in response to a hotter-than-expected inflation report, reflecting investor concerns about the certainty, timing, and extent of Fed rate cuts later this year.

On Friday, the start of earnings season brought mixed results from a handful of major banks. By close, stocks had recovered most of their losses, ending the week with solid gains.[1,2,3,4,5]

MARKET INSIGHTS

YCHARTS

Major Index Return Summary

Name	ROC 5	1M TR	YTD TR	1Y TR
Dow Jones Industrial Average	0.34%	2.84%	-0.21%	12.35%
MSCI EAFE	0.87%	3.95%	-0.39%	11.57%
Nasdaq Composite	3.09%	3.08%	-0.24%	37.24%
S&P 500	1.84%	3.15%	0.34%	22.08%

S&P 500 Daily Close

10-Year Note Review

Indicator Name Date	Latest Value	1M Ago 3M Ago 1Y Ago	1M Change 3M Change 1Y Change
10 Year Treasury Rate 01/12/24	3.96%	4.20% 4.70% 3.43%	-5.71% ▼ -15.74% ▼ 15.45% ▲

Source: YCharts.com, January 13, 2024. Weekly performance is measured from Monday, January 8, to Friday, January 12. ROC 5 = the rate of change in the index for the previous 5 trading days. TR = total return for the index, which includes any dividends as well as any other cash distributions during the period. Treasury note yield is expressed in basis points.

A Tale of Two Inflation Reports

The biggest economic news last week was fresh inflation data. The Consumer Price Index (CPI) rose 0.3 percent in December over the prior month and 3.4 percent compared with a year prior. That number was higher than the 3.2 percent increase economists expected and a few ticks elevated from the 3.1 percent figure in November.[6,7]

Core CPI for December, which excludes volatile food and energy components, rose 3.9%, a slight decrease from November's 4.0% gain.

On Friday, the Producer Price Index (PPI), which measures inflation by domestic producers, showed a drop of 0.1% for December, possibly suggesting that the CPI's uptick may have been an anomaly.[6,7,8]

This Week: Key Economic Data

Tuesday: Empire State Manufacturing Index.

Wednesday: Retail Sales. Industrial Production.

Thursday: Jobless Claims. Housing Starts. Petroleum Status Report.

Friday: Existing Home Sales.

"To what purpose are powers limited, and to what purpose is that limitation committed to writing, if these limits may, at any time, be passed by those intended to be restrained?"

– John Marshal, Chief Justice 1801-1835

Of Note

We now into the government’s fiscal year 2024, but if this year looks anything like last year, we can assume the federal government will continue to pile up debt at astonishing rates.

According to the September Monthly Treasury report, the US government accumulated an additional 1.7 trillion dollars in debt for the 2023 fiscal year, which ended October 31. That' up by $319 billion, or 23 percent, from the 2022 fiscal year. As recently as June, budget-watchers had estimated the year-end deficit would be $1.5 trillion, but deficits quickly added on an unexpected $200 billion by years' end.

The pace of increase, however, may have been even higher than 23 percent. As CNN noted, the $1.7 trillion number may reflect some creative accounting. As CNN reports, the Treasury Department reported the cancellation of Biden's student loan forgiveness program as a windfall for federal revenues, and thus reduced 2023's deficit by about $300 billion, bringing it down to $1.7 trillion. In other words, if we ignore the never-implemented student loan forgiveness program, the deficit actually doubled from FY 2022 to 2023. So, the year-over-year increase in the deficit may have actually gone from about $1 trillion to $2 trillion—or an increase of 100 percent instead of 23 percent.

In any case, annual deficits are rapidly growing toward the unprecedented deficits of 2020 and 2021 when the federal government went deeply into debt to avoid an immediate economic catastrophe as a result of government-mandated lockdowns and business closures. In the wake of these enormous deficits, the national debt—the sum of accumulated annual deficits—has now topped $33 trillion. That's an increase of more than $6 trillion just since the beginning of the Covid Panic, and an increase of $18 trillion since the beginning of the 2008 financial crisis.

Some jaded readers may now be telling themselves, "so what? ... the national debt has been huge for decades, and nothing catastrophic has happened." Things are different now because interest rates generally fell from the mid-1980s to 2022. But that trend ended last year as the central bank was forced to allow interest rates to rise in an effort to combat price inflation. The new problem we now face arises from the fact that huge deficits are only manageable so long as interest rates remain very, very low. Once interest rates head upward, debt service on an enormous debt

begins to swallow up large portions of federal revenues.

When this happens, we can see that even if federal debt flattens, interest obligations can continue to quickly mount when interest rates are increasing. As of the end of the second quarter, for example, federal interest on the debt had already surged to over $900 billion. By comparison, that's more than the likely Pentagon budget for 2024.

This is both a political problem and an economic problem. It's a political problem because as interest payments mount, Congress must reduce its spending on popular programs like Social Security and defense—or go even more deeply into debt to pay off the old debts. It's an economic problem because attempts to avoid budget cuts to federal programs will mean more deficits and a need to use the central bank to suppress interest rates via monetary easing. That will lead to more price inflation (whether on assets or consumer goods) which creates its own economic and political problems.

The only real problem then is austerity in which the federal government actually cuts federal spending to bring federal interest payments under control. Should the federal government choose any path other than budget austerity to address this problem, the federal government will enter into a debt spiral in where mounting debts are "solved" with even more debts, and more monetary inflation.

Keep in mind that all of this is taking place during a period when we're told the economy is – as The Wall Street Journal put it - "great." Or, as Paul Krugman has put it, the economy is "surreally good." Yet, deficits are supposed to stabilize or go down during periods of economic expansion. Surging deficits are supposed to be a characteristic of recessionary periods and times of economic crisis. We saw this in at work in response to the financial crisis of 2008.

Of course, if it were true that the economy is in wonderful shape right now, we would not see such huge deficits because tax revenues would not be falling as they have in ten of the last twelve months. Were the state of the economy so strong, federal tax money would be pouring in as economic activity expanded, and deficits would at least be stable, if not falling. Yet, it's tax revenues that are falling as incomes, corporate profits, and consumer activity underwhelms. Falling revenues, of course, when combined with continued runaway spending, means ever-larger deficits.

What will happen when the economy turns into an undeniable recession and a weak job market? Federal tax revenues will plummet, and deficits will soar. The conventional view of the media and policymakers is that the Fed will then intervene to force down interest rates to "stimulate" the economy while simultaneously making government debt more affordable. Yet, the Fed cannot just implement lower interest rates whenever it feels like it. In practice, the Fed forces down interest rates via open market

operations. It can influence market interest rates but cannot dictate them.

In other words, the Fed cannot ignore the challenges that ensue when the Treasury dumps large amounts of new debt into the marketplace. All else being equal, if the amount of government debt surges—as it will do in the next period of recession and crisis—the Fed must buy up a substantial amount of that debt if the Fed seeks to prevent increases in interest on the new debt. If the Fed does not intervene in this way, interest rates will increase because that's the only way the Treasury will be able to attract enough buyers to the new mountains of debt the Treasury must issue to avoid budget cuts.
Yet, if the Fed begins buying up large amounts of this debt, where will the Fed get the money to do so? The Fed will create new money to do this, which also means price inflation, a falling dollar, and declining real wages for workers.

What will the deficit look like by the end of fiscal year 2024? The Committee for a Responsible Federal Budget estimated $1.8 trillion back in March. Looking at trends since last Spring, $1.8 trillion is a conservative estimate, especially if the economy continues to worsen.[9]

Footnotes and Sources

1. CNBC.com, January 8, 2024.
2. CNBC.com, January 9, 2024.
3. CNBC.com, January 10, 2024.
4. The Wall Street Journal, January 11, 2024.
5. The Wall Street Journal, January 11, 2024.
6. The Wall Street Journal, January 11, 2024.
7. The Wall Street Journal, January 11, 2024.
8. The Wall Street Journal, January 11, 2024.
9. mises.org/wire/theres-no-easy-way-out-debt-spiral

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