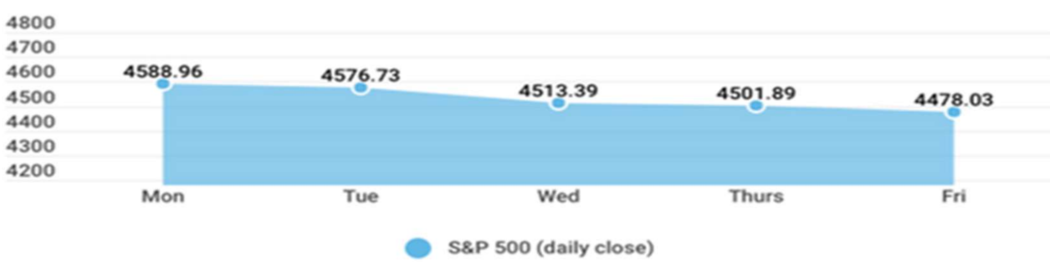
WEEKLY ECONOMIC UPDATE AUG. 7, 2023

Stocks retreated last week as bond yields increased following the Treasury's announcement indicating “a larger-than-expected funding need” and a downgrade in the federal government’s debt rating.

The Dow Jones Industrial Average dropped 1.11%, while the Standard & Poor’s 500 shed 2.27%. The Nasdaq Composite index lost 2.85% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, tumbled 3.27%.[1,2,3]

Market Index	Close	Week	Y-T-D
DJIA	35,065.62	-1.11%	+5.79%
NASDAQ	13,909.24	-2.85%	+32.89%
MSCI-EAFE	2,124.40	-3.27%	+9.28%
S&P 500	4,478.03	-2.27%	+16.63%



	Treasury	Close	Week	Y-T-D
	10-Year Note	4.05%	+0.09%	+0.17%

Sources: The Wall Street Journal, August 4, 2023; Treasury.gov, August 4, 2023
Weekly performance for the Dow Jones Industrial Average, Standard & Poor’s 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, July 28, to Friday, August 4 close. Weekly performance for the MSCI-EAFE is measured from Friday, July 28, open to Thursday, August 3 close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

Stocks Struggle

Stocks struggled as investor sentiment turned cautious amid rising bond yields. Markets were rattled initially by news that the Treasury raised its borrowing requirement for the third quarter by more than a quarter of a trillion dollars and on news that the Bank of Japan announced it would allow bond yields to rise after years of capping them.

Rising yields continued to pressure stocks in the wake of a surprise rating downgrade of U.S. government debt by a major credit rating agency due to its belief in expected fiscal deterioration over the next three years.

Stocks rebounded Friday morning, rising on modest employment data only to reverse and add to the week's losses.

Mixed Signals from the Labor Market

Fresh employment data last week gave some conflicting signals about the labor market. A new JOLTS (Job Openings and Turnover Survey) report showed a small decline in job openings and layoffs in June, leaving 1.6 job openings for each available worker.[4]

Automated Data Processing's (ADP) employment report reflected strong private sector hiring with a 324,000 increase in jobs, exceeding the consensus forecast of a 175,000 gain.[5]

The government's monthly employment report saw a cooling in hiring as employers added 187,000 jobs in July. This was slower than seen in the first six months but enough to shave the unemployment rate from 3.6% to 3.5%.[6]

This Week: Key Economic Data

Thursday: Consumer Price Index (CPI). Jobless Claims

Friday: Producer Price Index (PPI). Consumer Sentiment

"The state of medicine is an index of the civilization of an age and country—one of the best, perhaps, by which it can be judged."

– Oliver Wendell Holmes - 1869

Of Note

Starting in July, the Federal Reserve will be rolling out a new payment service dubbed "FedNow." Among many on the dissident side of politics, there is a growing worry that this new service may be a trojan horse for a central bank digital currency (CBDC).

The concern is a valid one. A CBDC, depending on how it is implemented, could eliminate the privacy allowed by a cash system, allow the freezing of accounts with greater ease, and open the door to social credit scores for individuals. One asks, is the fear of FedNow truly justified? Or is it a risk for another reason?

To analyze whether FedNow is a trojan horse for a CBDC, one must first understand what a CBDC would be in function. A CBDC, as defined by the Federal Reserve itself, would be "money that is a liability of the central bank." In essence, a CBDC would be a digital dollar with accounts held at the Federal Reserve itself, similar to what the Federal Reserve offers to banks today. Jerome Powell, the Federal Reserve chairman, has dubbed this a "wholesale" CBDC and stated on numerous occasions that such a currency could only be made so by an act of Congress. Legally, individuals cannot have accounts at the Federal Reserve. Changes to this must be made by Congress, to which Powell has not offered an opinion.

Powell is not the only policy maker at the Federal Reserve to express concern or show dismissal toward possible benefits of a CBDC. Federal Reserve governor Michelle Bowman did as much during a speech to Georgetown University in April 2023. Bowman discussed the listed benefits of a CBDC, including possible speeding up of the financial system and the inclusion of more Americans in the banking system. She, however, dismissed all of these. She touted the benefits of FedNow in speeding up interbank transactions but expressed the fears many hold as to the politicization of a possible CBDC. Powell has also dismissed a CBDC on similar lines, stating to the House Financial Services Committee, "We'll have real-time payments in this country very, very soon" (this being a reference to CBDC's being proposed as a solution to transaction speeds).

On the possible smoothing of the payment system, Bowman touted FedNow as a solution that would make a CBDC unnecessary. On the subject of including more Americans in the banking system, she noted the skepticism that many hold toward banks. She posited that a CBDC would solve that issue in no way, shape, or form. Among key players on the Federal Reserve Board there is clear opposition to CBDCs.

But to address the elephant: FedNow. Is FedNow a central bank digital currency trojan horse? Short answer: no. Long answer: FedNow is a new settlement system for member banks of the Federal Reserve System. Historically accounts have been settled physically by vehicles moving money between banks at the end of business days. Today it is primarily done by the system known as Fedwire. Very similar name, but it is not the same entity.

Many Americans use different banks providing money warehousing services, thus resulting in transfers of money between different banks as billions of transactions occur each day. This constant stream of transfers results in a figurative spaghetti monster of assets and liabilities changing hands second after second. No bank can possibly process these transactions all at once. Fedwire accumulates payments between various banks, allowing individual account balances to be managed by banks themselves, and at the end of the business day processes payments between them in gross amounts.

The result is massive end-of-day transfers of money between various financial institutions. This service, however, is only possible during banking hours and not at all on weekends or during bank closures. FedNow, in contrast, settles payments instantaneously between banks and continues to do so even past banking hours. This new system is, to put it plainly, an upgrade over the old settlement systems in place at the Federal Reserve. It isn't a CBDC, but it does pose a new risk.

The recently failed Silicon Valley Bank almost saw 81 percent of its deposits, worth $142 billion, withdrawn in two days. What would have taken longer in the era of physical cash was accelerated by online banking. Apps like Cash App, Zelle, and PayPal, and even those of other banks, have made the old market mechanism of bank runs far more efficient and deadly for banks. Silicon Valley Bank, thus, nearly collapsed and was seized by regulators.

FedNow, as a system, would worsen this risk. Fractional reserve banking is a confidence game. By issuing more liabilities than assets, a fractional reserve bank relies on the hope of having enough cash on hand if depositors come knocking. The market correction comes in the form of bank runs, where depositors rush to their bank and withdraw all their deposits. The bank, being unable to meet all redemption requests, goes insolvent and must liquidate other assets to meet the demands.

The gamble of a fractional reserve bank is anticipating the depositors' demand for their physical deposits. So long as it is only a minority of depositors who choose to redeem their claims, the bank may continue to operate. Thus, it is a confidence game. The system works so long as nobody looks under the table.

FedNow heightens the risk of bank failures. While libertarians acknowledge the market at work in bank runs, every bank in the United States operates on a model of fractional reserve banking.
Operating alongside online banking, this new system will increase bank runs and systemic bank failures. While this is certainly a market solution, the effects may be catastrophic. Depositors last in line, deceived by the fraud, may lose everything as a result. Businesses placing their funds in an ordinary bank might lose it all. There will be victims of fraud who may not be able to get restitution.

So, while FedNow is not a CBDC, it does pose a different kind of threat to the economy. Rather than create a risk of government overreach through the Federal Reserve, it opens a massive door to the collapse of the system itself. FedNow, while made to allow better settlement on the market, will be a near-fatal reform to the system that created it.[7]

Footnotes and Sources

1. The Wall Street Journal, August 4, 2023
2. The Wall Street Journal, August 4, 2023
3. The Wall Street Journal, August 4, 2023
4. CNBC, August 1, 2023
5. CNBC, August 2, 2023
6. The Wall Street Journal, August 4, 2023
7. mises.org/wire/fednow-isnt-cbdc-it-dangerous

similar securities listed on the NASDAQ stock market and is considered a broad indicator of the performance of technology and growth companies. The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) and serves as a benchmark of the performance of major international equity markets, as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia. The S&P 500 Composite Index is an unmanaged group of securities that are considered to be representative of the stock market in general.

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