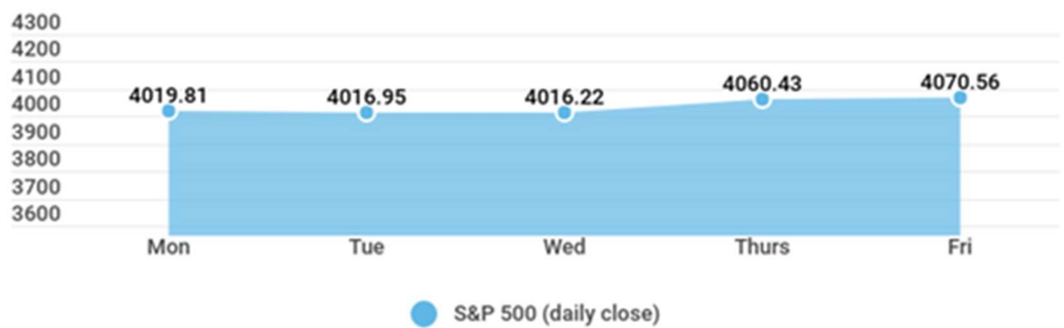
WEEKLY ECONOMIC UPDATE JAN. 30, 2023

Stocks added to their early 2023 gains amid a busy stream of mixed corporate earnings results and conflicting economic data.

The Dow Jones Industrial Average gained 1.81%, while the Standard & Poor's 500 added 2.47%. The Nasdaq Composite index rose 4.32% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, increased by 1.14%.[1,2,3]

Market Index	Close	Week	Y-T-D
DJIA	33,978.08	+1.81%	+2.51%
NASDAQ	11,621.71	+4.32%	+11.04%
MSCI-EAFE	2,104.05	+1.14%	+8.24%
S&P 500	4,070.56	+2.47%	+6.02%



	Treasury	Close	Week	Y-T-D
	10-Year Note	3.52%	+0.04%	-0.36%

Sources: The Wall Street Journal, January 27, 2023; Treasury.gov, January 27, 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, January 20, to Friday, January 27, close. Weekly performance for the MSCI-EAFE is measured from Friday, January 20, open to Thursday, January 26, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

Stocks Advance

With the backdrop of earnings reports and conflicting economic data, stocks climbed higher on cooling inflation, continued economic resilience, and fourth-quarter corporate earnings results that, while underwhelming, did not appear as bad as many had feared.

There was enough new economic data to support both the “recession is coming” and the “soft landing” camps. It was corporate results and continued labor market strength, along with a solid, if weakening, fourth-quarter Gross Domestic Product (GDP) growth number, however, that raised investors’ hopes that a potential recession may be mild and likely pushed out to later in the year.

GDP Report

The U.S. economy expanded at a 2.9% annualized rate in the fourth quarter, slightly exceeding consensus estimates of 2.8% but down from the third quarter’s 3.2% growth rate. Consumer spending, which accounts for over two-thirds of GDP, rose 2.1%. Increases in private inventory investment, government spending, and nonresidential fixed investment also contributed to

the fourth quarter's growth. Weakness in housing and a drop in exports subtracted from the quarter's result.[4]

Beneath the headline number, the personal consumption expenditures price index (the Fed's preferred measure of inflation) rose 3.2%. That was lower than the third quarter's 4.8% increase, though it remains above the Fed's 2% inflation target rate.[5]

This Week: Key Economic Data

Wednesday: Federal Open Market Committee Announcement. Job Openings and Turnover Survey (JOLTS). Institute for Supply Management (ISM) Manufacturing Index. Automated Data Processing (ADP) Employment Report.

Thursday: Factory Orders. Jobless Claims.
Friday: Employment Situation. Institute for Supply Management (ISM) Services Index.

"Not to know is bad. Not to wish to know is worse."
– African Proverb

There have been three major sovereign debt crisis episodes during the past 200 years. The first one occurred after the Napoleonic wars between 1827 and 1860. The second one occurred during and after the Great Depression and World War II, and the third one during the era of

commodity-price and banking crises from around 1987 till around 2000. We're now approaching a fourth one.

With respect to the level of central government debt as a share of gross domestic product (GDP), Japan is, of course, in its own league, but what is striking, yet unsurprising, is that sovereign debt has basically exploded in the US, the UK and China since the global financial crisis of 2007–09. This phenomenon was recognized in the March 2017 issue of the Q-Review series, where the authors wrote:

"The crisis of 2007–2008 reversed the trend of financial globalization, which has undermined global growth. The pull-back in financial globalization has been masked by central bank-induced liquidity and continuous stimulus from governments which have created an artificial recovery and pushed different asset valuations to unsustainable levels. This implies that we live in a 'central bankers' bubble.'"

To be more precise, the issue explains that central banks had pushed bond yields to historical lows, which made it possible for governments to take extraordinary amounts of debt. This also coincides with another worrying global phenomenon—the collapse of global productivity growth.

Stagnating global productivity growth is extremely worrying because it implies that firms are unable to increase their productivity, which means that they will be unprofitable as well. And when their indebtedness grows, yet profitability stagnates or falls, their ability to service debt will also diminish over time.

This, quite straightforwardly, implies that the ability to increase profitability and service debt, at the national level, has also diminished for several years, while governments have been racking up debt at record speed. Our economies quite simply have been on an utterly unsustainable path for over a decade, and now 'chickens are coming home to roost' with rapidly rising interest rates.

The first "victim" of this was the United Kingdom, where the reckless fiscal policies, especially during the coronavirus crisis, pushed the country to a brink of debt and financial crisis saved only, at the nick of time, by the Bank of England. The crisis also forced the newly appointed Prime Minister Liz Truss to resign, making her the shortest-serving prime minister in British history, with just 45 days in power.

But there surely will be more to follow. Debt or fiscal crises emerge when an over-indebted nation loses the trust of investors to its debt-servicing capacity. There are numerous examples of such episodes in history. During the above-mentioned periods, close to half of the countries of the world were in some state of default on their external (foreign) debt obligations.

Solving fiscal crises is also not easy or pleasant. Fiscal (or debt) crises consist of periods of severe deficits in public financing and/or of periods in which the government fails to meet domestic or foreign obligations. Gerling et al. (2017) identify a fiscal crisis by four criteria: credit event (a default of foreign currency-denominated debt); exceptional official financing (e.g., from the International Monetary Fund); implicit domestic default (e.g., monetization or domestic arrears by the government); and loss of market access.

If a government defaults on its foreign or domestic debt obligations (i.e., interest payments and/or principal payment of its bonds), it eases the debt burden of a country, but tends to lead to capital market exclusions as investors will not be willing to lend to the country, for a while at least. Exclusion from income sources outside its tax revenue leaves the government with just two options: it either has to "live by its means," meaning that it has to cut expenditures so that they can be covered with diminished revenues, or it can resort to monetization of budget deficits through a central bank. So, in practice, governments need to choose between self-imposed austerity or a runaway inflation after the default. Now that central banks have raised, and most likely will keep raising, interest rates to combat soaring inflation, the debt-service costs of governments will continue to soar. Thus, it's just a matter of time before more governments of even the advanced economies will lose the trust of investors, like Britain did.

As pointed above, at that point our governments (and central banks) have only two options left: to "tighten the belt" considerably or to monetize "everything." Alas, we (the world) are either on the brink of the greatest austerity period in history or the possibility of global hyperinflation. Today's choices could not be more dire, but fiscal irresponsibility, which we have allowed, breeds suffering in one form or another. It seems that we need to learn that lesson, yet again.[6]

Footnotes and Sources

1. The Wall Street Journal, January 27, 2023

2. The Wall Street Journal, January 27, 2023

3. The Wall Street Journal, January 27, 2023

4. CNBC, January 26, 2023

5. CNBC, January 26, 2023

6. theepochtimes.com/into-a-global-debt-crisis_4843182.html

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The Dow Jones Industrial Average is an unmanaged index that is generally considered representative of large-capitalization companies on the U.S. stock market. Nasdaq Composite is an index of the common stocks and 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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