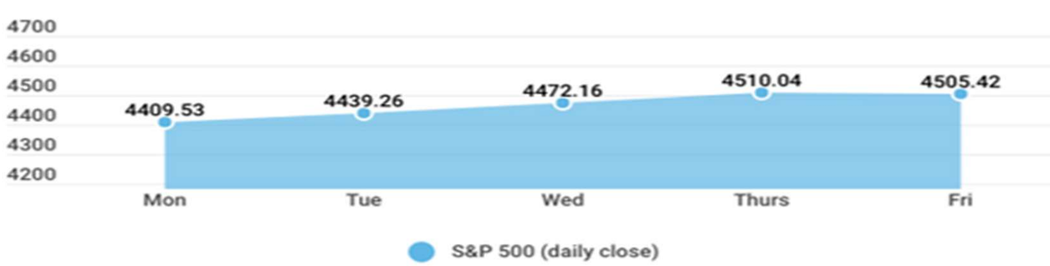
WEEKLY ECONOMIC UPDATE JULY 17, 2023

Better-than-expected updates last week on consumer and wholesale price inflation buoyed investor sentiment, driving stocks higher and lower bond yields.

The Dow Jones Industrial Average rose 2.29%, while the Standard & Poor's 500 increased 2.42%. The Nasdaq Composite index advanced 3.32% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, gained 4.67%.[1,2,3]

Market Index	Close	Week	Y-T-D
DJIA	34,509.03	+2.29%	+4.11%
NASDAQ	14,113.70	+3.32%	+34.85%
MSCI-EAFE	2,185.31	+4.67%	+12.42%
S&P 500	4,505.42	+2.42%	+17.34%



	Treasury	Close	Week	Y-T-D
	10-Year Note	3.83%	-0.23%	-0.05%

Sources: The Wall Street Journal, July 14, 2023; Treasury.gov, July 14, 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 7, to Friday, July 14 close. Weekly performance for the MSCI-EAFE is measured from Friday, July 7, open to Thursday, July 13 close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

Inflation Sparks Stocks

Back-to-back positive inflation reports emboldened investors, sending stocks to their highest levels since April 2022. Lower-than-forecast inflation on both consumer prices and producer prices sparked investor optimism that inflation may be able to fall further without tipping the economy into recession and provide the basis for the Fed to moderate its more hawkish rate hike stance.[4]

After four straight days of increases, investor attention turned to the kick-off of a new earnings season on Friday. Despite some positive earnings surprises from several big banks and a major healthcare provider, stocks closed out a good week with a slight decline.

Inflation Cools

Inflation continued its downward trend last month, falling at its slowest pace in over two years. Consumer prices rose 0.2% in June and 3.0% from a year ago. Both were below economists' consensus forecast. Core inflation (excludes food and energy), which has been more stubborn, fell to 4.8% year-over-year–its lowest level since October 2021.[5]

The positive disinflationary story continued the following day with a lighter-than-forecast increase in producer prices. Wholesale prices increased 0.1% in June, which was lower than the consensus forecast of 0.2%. The increase from a year ago was also 0.1%, representing the smallest gain in nearly three years. Core producer price rose 2.6% year-over-year.[6]

This Week: Key Economic Data

Tuesday: Retail Sales. Industrial Production.

Wednesday: Housing Starts.

Thursday: Existing Home Sales. Index of Leading Economic Indicators. Jobless Claims.

"What is inevitable is always certain. But it's not always punctual."

– Jim Grant

Of Note

There was an interesting number in the latest monthly US Budget Deficit report. No, it wasn't that US government outlays unexpectedly soared 15% to $646 billion in June, up almost $100 billion from a year ago, while tax receipts slumped 9.2% from $461 billion to $418 billion, resulting in a trailing twelve months government receipt drop of over 7.3%, the biggest since June 2020 when the US was reeling from the covid lockdown recession; in fact never have before tax receipts suffered such a big drop without the US entering a recession.

Needless to say, surging government outlays coupled with shrinking tax revenues meant that in June, the US budget deficit nearly tripled from $89 billion a year ago to $228 billion, far greater than the consensus estimate of $175 billion. (A politically incorrect aside - one can only imagine which Ukrainian billionaire oligarch's money laundering bank account is currently enjoying the benefits of that unexpected incremental $50 billion US deficit hole).

And with the monthly deficits coming in higher than expected and also far higher than a year ago, it is also not at all surprising that the cumulative deficit 9 months into the fiscal year is already the 3rd highest on record, surpassed only by the crisis years of 2020 and 2021: at $1.393 trillion, the fiscal 2022 YTD deficit is already up 170% compared to the same period last year.

Again, while sad, none of the above numbers are surprising: they merely confirm that the US is on an ever faster-track to fiscal death, but not before the Fed is forced to monetize the debt once again (one wonders what financial crisis the folks in charge will invoke this time to greenlight the next multi-trillion QE).

No, the one number that was truly shocking was found all the way on page 9, deep inside Table 3 of the latest Treasury Monthly Statement, the one which shows that in the 9 months of the current fiscal year, the US has already accumulated a record $652 billion in gross debt interest. This number was more than 25% higher compared to the Interest

Expense payment for the comparable period a year ago, which amounted to $521 billion.

Soaring interest rates, driven by the panicked Fed's scramble to undo its epic policy failure of 2020 and 2021 when the Fed kept rates at zero for far too long while injecting trillions into various asset bubbles, have been the key driver of the deficit, with the Federal Reserve boosting its benchmark rate by 5% since it began hiking in March last year. Five-year Treasury yields are now about 3.96%, versus 1.35% at the start of last year. As lower-yielding securities mature, the Treasury faces steady increases in the rates it pays on outstanding debt: that's right - even when the Fed starts cutting rates, due to the delay of rolling over maturing debt, actual interest payments will keep rising for the foreseeable future.

For context, the weighted average interest for total outstanding debt at the end of June was only 2.76%, a level that's not been surpassed since January 2012, according to the Treasury. That's up from 1.80% a year before, the department's data show, and if the Fed indeed keeps rates "higher for longer", the blended rate on the debt will surpass 4% in one year.

That would be a complete disaster for the US, and it would mean that interest payments on total US debt of $32.3 trillion would hit $1.3 trillion within 12 months, potentially making interest on the debt the single biggest US government expenditure and surpassing social security!

But we don't even have to wait that long until the exploding interest on US government debt becomes a major talking point ahead of the coming presidential elections. According to the St Louis Fed's FRED and the BEA, the interest payments by the Federal Government have now surpassed $900 billion for the first time ever, and within a quarter will hit probably rise above $1 trillion, a historic benchmark that will probably begin the countdown to the US Minsky Moment.

Treasury Secretary Janet Yellen has played down concerns about higher rates. She has instead flagged that the ratio of interest payments to GDP, after adjustment for inflation, remains historically low. The problem with Yellen's argument is that GDP will crater after the next recession (which will also spark the next financial crisis), but US debt will never again drop in either absolute or relative terms, as the good folks at the CBO have been so kind to make clear to the former Fed chairwoman.

In short, the endgame has now arrived, and all the US can do now is rearrange the deck chairs.[7]

Footnotes and Sources

1. The Wall Street Journal, July 14, 2023
2. The Wall Street Journal, July 14, 2023
3. The Wall Street Journal, July 14, 2023
4. The Wall Street Journal, July 13, 2023
5. The Wall Street Journal, July 12, 2023
6. The Wall Street Journal, July 13, 2023
7. zerohedge.com/markets/endgame-us-debt-interest-payments-about-hit-1-trillion

Investing involves risks, and investment decisions should be based on your own goals, time horizon, and tolerance for risk. The return and principal value of investments will fluctuate as market conditions change. When sold, investments may be worth more or less than their original cost.

The forecasts or forward-looking statements are based on assumptions, may not materialize, and are subject to revision without notice.

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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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