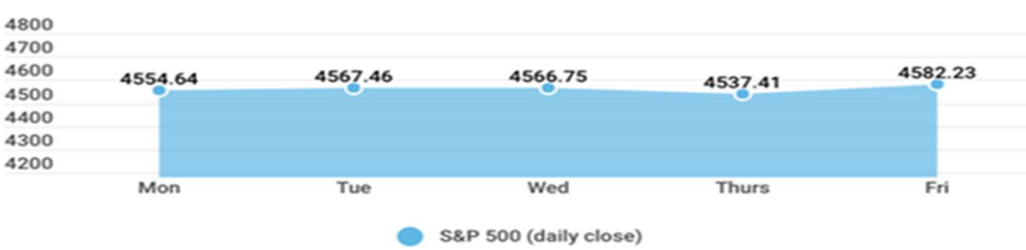
WEEKLY ECONOMIC UPDATE JULY 31, 2023

A Friday surge pushed stocks solidly into positive territory last week, ignited by cooling in an inflation gauge closely tracked by the Federal Reserve.

The Dow Jones Industrial Average advanced 0.66%, while the Standard & Poor's 500 climbed 1.01%. The Nasdaq Composite index rose 2.02% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, gained 0.74%.[1,2,3]

Market Index	Close	Week	Y-T-D
DJIA	35,459.29	+0.66%	+6.98%
NASDAQ	14,316.66	+2.02%	+36.79%
MSCI-EAFE	2,192.76	+0.74%	+12.80%
S&P 500	4,582.23	+1.01%	+19.34%



	Treasury	Close	Week	Y-T-D
	10-Year Note	3.96%	+0.12%	+0.08%

Sources: The Wall Street Journal, July 28, 2023; Treasury.gov, July 28, 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 21, to Friday, July 28 close. Weekly performance for the MSCI-EAFE is measured from Friday, July 21, open to Thursday, July 27 close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

Stocks Pop

Stocks were flat for much of last week amid a batch of new earnings, a 0.25% interest rate hike, and strong economic data. After beginning with gains, stocks lost momentum following the Fed's expected rate-hike announcement on Wednesday. A bounce on Thursday sparked by a positive mega-cap tech company earnings reversed after bond yields increased.

Stocks recovered strongly Friday on the release of the personal consumption expenditures price index, which fell to its lowest level in two years.[4]

Much of the market action was related to earnings results. With 44% of S&P 500 companies reporting, 78% have exceeded Wall Street forecasts.[5]

Recession Deferred

Expectations of a recession were high coming into 2023. Last week may have erased this recession narrative overhang.

Second-quarter gross domestic product (GDP) data released last week was one big reason why. Economic activity expanded by 2.4%, which was above the forecast of two percent and represented an acceleration from its first quarter GDP of 2.0%. Consumer spending was a major driver of that expansion, rising 1.6%.[6]

Joining the recession-deferred camp this week was Fed Chair Powell, who stated that the Fed was no longer forecasting a recession.

This Week: Key Economic Data

Tuesday: Institute for Supply Management (ISM) Manufacturing Index. Job Openings and Labor Turnover Survey (JOLTS).

Wednesday: Automated Data Processing (ADP) Employment Report.

Thursday: Jobless Claims. Institute for Supply Management (ISM) Services Index.

Friday: Employment Situation.

Quote of the Week

"Organizations that fail to distinguish ethics from mere compliance can end up with neither."

– Fr. Robert Spitzer

Of Note

Central banks bought more gold last year than any year in the past 55 years - since 1967. Though many don't realize it, 1967 was a significant year in financial history, mainly due to the events at the London Gold Pool. The London Gold Pool was an agreement among central banks of the United States and Western European countries to stabilize the price of gold. The goal was to maintain the price of gold at $35 per ounce by collectively buying or selling gold as needed.

However, in 1967 the London Gold Pool collapsed due to a shortage of gold and increased demand for the metal. That's because European central banks bought massive amounts of gold as they began to doubt the US government's promise to back the dollar to gold at $35/ounce. The buying depleted the London Gold Pool's reserves and pushed the price of gold higher.

In short, 1967 was the beginning of the end of the Bretton Woods international monetary system that had been in place since the end of World War II. It ultimately led to severing the US dollar's last link to gold in 1971. The dollar has been unbacked fiat confetti ever since—though the petrodollar system and coercion have propped it up.

The point is large global gold flows can be a sign that a paradigm shift in the international monetary system may be on the horizon. Central banks are the biggest players in the gold market. And now that we have experienced the largest year for central bank gold purchases since 1967, we may be on the cusp of a radical change in the international monetary system, perhaps with profound implications.

According to the Financial Times, the big buyers of gold in 2022 were China and Middle East oil producers. That's not a coincidence, as these countries will be at the center of the changes to the international monetary system. It's no secret that China has been stashing away as much gold as possible for many years. China is the world's largest producer and buyer of gold. Most of that gold finds its way into the Chinese government's treasury. Nobody knows the exact amount of gold China has, but most observers believe it is many multiples of what the government declares.

Beijing has been waiting for the right moment to pull the rug from beneath the US dollar. And now is that moment. The key to understanding it all is Chinese President Xi's recent historic visit to Saudi Arabia and other Gulf Cooperation Council (GCC) states to launch, in his words, "a new paradigm of all-dimensional energy cooperation."

The GCC includes Saudi Arabia, Kuwait, Qatar, Bahrain, Oman, and the United Arab Emirates. These countries account for more than 25% of the world's oil exports, with Saudi Arabia alone contributing around 17%. In addition, more than 25% of China's oil imports come from Saudi Arabia. China is the GCC's largest trading partner.

The meetings reflect a natural—and growing—trade relationship between China, the world's largest oil importer, and the GCC, the world's largest oil exporters. During Xi's visit, he made the following crucial remarks: "China will continue to import large quantities of crude oil from GCC countries, expand imports of liquefied natural gas, strengthen cooperation in upstream oil and gas development, engineering services, storage, transportation and refining, and make full use of the Shanghai Petroleum and National Gas Exchange as a platform to carry out yuan settlement of oil and gas trade."

After years of preparation, the Shanghai International Energy Exchange (INE) launched a crude oil futures contract denominated in Chinese yuan in March 2018. It's the first oil futures contract to be traded in China. The contract is based on Brent crude oil, the global benchmark for oil prices, and is settled in cash.

Since then, any oil producer can sell its oil for something besides US dollars… in this case, the Chinese yuan. The INE yuan oil futures contract provides a new pricing benchmark for the global oil market, which the US dollar has traditionally dominated. By trading in yuan, the contract is expected to increase the use of the Chinese currency in global trade and reduce the reliance on the US dollar.

Its significance lies in its potential to shift the balance of power in the oil market away from the US and towards China and to increase the use of the Chinese yuan in global trade. There's one big issue, though. Most oil producers don't want to accumulate a large yuan reserve, and China knows this. That's why China has explicitly linked the crude futures contract with the ability to convert yuan into physical gold—without touching China's official reserves—through gold exchanges in Shanghai (the world's largest physical gold market) and Hong Kong.

PetroChina and Sinopec, two Chinese oil companies, provide liquidity to the yuan crude futures by being big buyers. So, if any oil producer wants to sell their oil in yuan (and gold indirectly), there will always be a bid. After years of growth and working out the kinks, the INE yuan oil future contract is now ready for prime time. Xi wouldn't promise the GCC large and consistent oil purchases if it wasn't ready.

Why is China purchasing oil and gas from the GCC in yuan important? Because it undercuts the petrodollar system, which has been the bedrock of the US and international financial system since the Bretton Woods system broke down in 1971. For nearly 50 years, the Saudis had always insisted anyone wanting their oil would need to pay with US dollars, upholding their end of the petrodollar system. But that all changed recently. After Xi's historic visit and bombshell announcement, the Saudi government isn't hiding its intention to sell oil in yuan. According to a recent Bloomberg report: "Saudi Arabia is open to discussions about trade in currencies other than the US dollar, according to the kingdom's finance minister." In short, the Saudis don't think the US is holding up its end of the petrodollar deal. So they don't feel like they should hold up their part. The Saudis are angry at the US for not supporting it enough in its war against Yemen. They were further dismayed by the US withdrawal from Afghanistan and the nuclear negotiations with Iran.

In this context, China swooped in and, after many years, finally compelled the Saudis to accept yuan as payment. Saudi Arabia—the linchpin of the petrodollar system—is openly agreeing not to sell its oil exclusively in US dollars. It signals an imminent and enormous change for anyone holding US dollars. It would be incredibly foolish to ignore this giant red warning sign. Even the WSJ admits such a move would be disastrous for the US dollar.

"The Saudi move could chip away at the supremacy of the US dollar in the international financial system, which Washington has relied on for decades to print Treasury bills it uses to finance its budget deficit."

Here's the bottom line. The end of the petrodollar system is imminent. For over 50 years, this arrangement has allowed the US government and many Americans to live way beyond their means.

The US takes this unique position for granted. But it will soon disappear. There will be a lot of extra dollars floating around suddenly looking for a home now that they are not needed to purchase oil. As a result, a lot of oil money—hundreds of billions of dollars and perhaps trillions—that would typically flow through banks in New York in US dollars into US Treasuries will instead flow through Shanghai into yuan and gold. The end of the petrodollar system is bad news for Americans. Unfortunately, there's little any individual can practically do to change the course of these trends in motion. And you thought inflation couldn't go much higher! [7]

Footnotes and Sources

1. The Wall Street Journal, July 28, 2023.
2. The Wall Street Journal, July 28, 2023.
3. The Wall Street Journal, July 28, 2023.
4. CNBC, July 28, 2023.
5. CNBC, July 27, 2023.
6. CNBC, July 27, 2023.
7. internationalman.com/articles/rise-of-the-petroyuan-the-end-of-the-petrodollars-reign-and-the-impact-on-global-markets/

quality, inflation risk, market valuations, prepayments, corporate events, tax ramifications and other factors.

International investments carry additional risks, which include differences in financial reporting standards, currency exchange rates, political risks unique to a specific country, foreign taxes and regulations, and the potential for illiquid markets. These factors may result in greater share price volatility.

Please consult your financial professional for additional information.