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Amadeus Wealth Alternatives
Your Compass to Alternative Investments

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In this week's recap: White hot inflation report alarms investors.

Weekly Economic Update

Presented by Ed Papier, September 19, 2022

THE WEEK ON WALL STREET

A hotter-than-expected inflation report sent stocks sharply lower last week as investors faced the prospect of more aggressive interest rate hikes by the Federal Reserve for perhaps a longer period.

The Dow Jones Industrial Average fell 4.13%, while the Standard & Poor's 500 lost 4.77%. The Nasdaq Composite index dropped 5.48% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, dipped 1.78%. [1,2,3]

INFLATION DEFLATES MARKETS

Stocks suffered their worst day in more than two years last Tuesday as markets were caught off-guard by a higher-than-anticipated August inflation report.

Markets expected the August report to show a substantial cooling of inflation, potentially allowing the Fed to ease up on interest rate hikes. Instead, the elevated inflation number not only undercut those easing hopes but raised the possibility of a more significant rate hike. On Tuesday, traders assigned a 28% probability of a 100 basis point hike, from a 0% chance just the day before. Price action remained choppy for the remainder of the week, closing the week with additional losses as a global package-delivery company warned of a worldwide recession. [4]

AUGUST CPI DISAPPOINTS

August's Consumer Price Index (CPI) rose 8.3% from a year ago, showing a continued deceleration in price increases (July's CPI was 8.5%, and June's was 9.1%). Despite moderating price increases, traders were disappointed, given the general expectation of a more substantial slowdown in inflation. [5]

Core inflation (excluding food and energy) was particularly alarming to investors, which jumped 6.3% year-over-year. That number was well above the 5.9% rate from June and July. From the market's perspective, sufficient inflationary pressures exist for the Fed to maintain its hawkish interest rate policy for possibly longer than investors had hoped. [6]

THE WEEK AHEAD: KEY ECONOMIC DATA

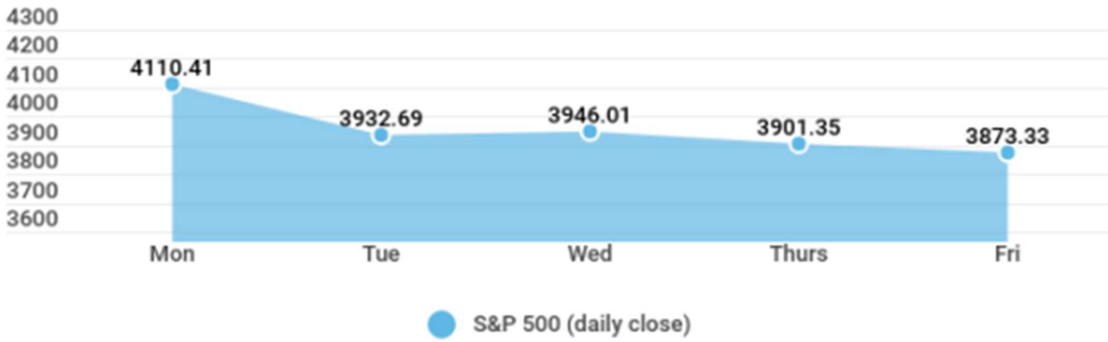
Tuesday: Housing Starts.
Wednesday: Federal Open Market Committee (FOMC) Meeting Announcement. Existing Home Sales.
Thursday: Index of Leading Economic Indicators. Jobless Claims.
Friday: Purchasing Managers' Index (PMI) Composite.

QUOTE OF THE WEEK

"Relieving people of the burden of freedom in order to make them feel safe is a recurring theme in the history of authoritarianism."

FRANK FURETI

Market Index	Close	Week	Y-T-D
DJIA	30,822.42	-4.13%	-15.18%
NASDAQ	11,448.40	-5.48%	-26.82%
MSCI-EAFE	1,806.03	-1.78%	-22.69%
S&P 500	3,873.33	-4.77%	-18.73%



	Treasury	Close	Week	Y-T-D
	10-Year Note	3.45%	+0.12%	+1.93%

Sources: The Wall Street Journal, September 16, 2022; Treasury.gov, September 16, 2022
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, September 9, to Friday, September 16, close. Weekly performance for the MSCI-EAFE is measured from Friday, September 9, open to Thursday, September 15, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

Wall Street lenders are calling on the US government to hold off on launching a digital dollar, the so-called Central Bank Digital Currency or CBDC. [7] CBDCs are digital tokens, similar to cryptocurrency, issued by a central bank. They are pegged to the value of that country's fiat currency. Many countries are developing CBDCs, and some have even implemented them. Governments like CBDCs because they are issued by the state, and it allows for tight regulation within a closed system. CBDCs are under the direct control of the government unlike cryptocurrencies which are issued by the private sector or public blockchains. [8] Because so many countries are researching ways to transition to digital currencies, it's important to understand what they are and what they mean for society.

- A central bank digital currency is the digital form of a country's fiat currency.

- A CBDC is issued and regulated by a nation's monetary authority or central bank.
- As a centralized form of currency, they will not anonymize transactions as some cryptocurrencies do.

Wall Street lenders argue that a virtual currency backed by the Federal Reserve risks draining hundreds of billions of dollars out of the banking system. According to the American Bankers Association and the Bank Policy Institute (BPI), a CBDC would act as a direct competitor to private bank deposits and make credit less available to businesses and households, The trade groups were responding to a Fed discussion paper released in January that laid out the potential benefits and risks of launching a new virtual tender.

"As we have evaluated the likely impacts of issuing a CBDC it has become clear that the purported benefits of a CBDC are uncertain and unlikely to be realized, while the costs are real and acute," the ABA said in a May 20 letter to the Fed. "Based on this analysis, we do not see a compelling case for a CBDC in the United States today."

The prospect of a Fed-backed CBDC has become a hot-button issue in Washington as crypto has grown to a more than $1 trillion market and so-called stablecoins have drawn concerns from regulators and lawmakers. In March, the White House said in an executive order on cryptocurrency policy that it was placing "highest urgency" on research and possible development of a US digital dollar.

While supporters say a Fed-backed digital currency would help ensure the dollar's dominance as countries including China move forward with their own versions, the Wall Street trade groups say such a move could backfire.

BPI, for example, said that a digital dollar would dry up a key source of funding for banks. "By attracting deposits away from banks, particularly during a period of economic stress, a CBDC likely would undermine the commercial banking system in the United States, and severely constrict the availability of credit to the economy," the group said in a separate letter also dated May 20.

Even if banks and other financial firms were to act as intermediaries, any funds their customers place into a CBDC account couldn't be used to finance loans and other investments in the economy, the groups said. ABA and BPI said that's because unlike standard commercial deposits, the tender would remain a direct liability of the Fed.

Furthermore, capping the size of CBDC accounts to limit fallout is unlikely to help much, the groups said. The ABA predicted that a cap of $2,500 would still drain $446 billion in deposits from traditional banking. A $10,000 limit would result in more than $1 trillion in deposits leaving the system, the group said.

Inflation is also a legitimate concern with CBDCs because central banks still maintain control over the monetary supply. There's nothing to stop a government from issuing more of its CBDC whenever it chooses, or circumstances necessitate. In fact, it might be even easier to inflate CBDCs because they are entirely digital, and it takes no physical inputs to create more of the currency. Just a few keystrokes and a government can create more money out of thin air.

Privacy is a major concern when it comes to CBDCs because CBDCs are inherently centralized. Centralization provides many avenues for corruption or abuse to occur, especially because CBDCs create massive treasure troves of data about who is paying who, and this could be harnessed to begin censoring certain transactions that the government deems unlawful or illegitimate.

If CBDCs are the only payment method by which one person can pay another, then the government has the power to block transactions or freeze your bank account whenever it chooses. Also, with all this data, it will be tempting for some governments to use it for surveillance over their populace.

CBDCs could be opt-in or could be mandatory. One example of a CBDC that is being built with surveillance as a priority is the Chinese Digital Yuan. The Digital Yuan aims to replace cash in Chinese society. China's digital yuan allows for the surveillance of all transactions across the entire financial system and China has the ability to remotely freeze accounts or block transactions that use the digital yuan.

The basic rights outlined in the Bill of Rights depend on economic freedom to be exercised. If economic freedom becomes more limited through the strict oversight of financial transactions using CBDCs, then fundamental rights become impinged and threatened.

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CITATIONS:

1. The Wall Street Journal, September 16, 2022
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