THOUGHTS OF THE WEEK
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WEEKLY ECONOMICS

Live by the Numbers, Die by the Numbers

The third estimate for 2022 Q1 GDP from the Bureau of Economic Analysis was a real shocker. It was a shocker not only because it was released a day before the end of the second quarter or because it was revised further down to -1.6% from the second estimate of -1.5%. It was a shocker because of the large downward revision made to the growth in personal consumption expenditures (PCE) and the large upward revision to the growth in gross private domestic investment (GPDI). PCE went from an estimated growth of 3.1% in Q1 to a growth rate of only 1.8% while GPDI was revised up from 0.5% during the second estimate to 5.0% during the third estimate.

The downward revision to PCE, which accounts for approximately 70% of GDP, changes this year's trajectory for GDP growth, as the revision showed that what had been considered a strong consumer sector was significantly weaker than thought. It now appears that inflation had been taking much more out of real consumer demand than what the previous estimates were showing.

	1Q21	2Q21	3Q21	4Q21	1Q22 (2nd Est.)	1Q22 (Final)
Real GDP	**6.3**	**6.7**	**2.3**	**6.9**	**-1.5**	**-1.6**
Final Sales to Private Domestic Purchasers	11.8	10.1	1.4	2.6	3.9	3.0
Personal Consumption Expendituers	**11.4**	**12.0**	**2.0**	**2.5**	**3.1**	**1.8**
Durable goods	50	11.6	-24.6	2.5	6.8	5.9
Nondurable goods	15.9	13.9	2	0.4	-3.7	-3.7
Services	3.9	11.5	8.2	3.3	4.8	3.0
Gross private domestic investment	**-2.3**	**-3.9**	**12.4**	**36.7**	**0.5**	**5.0**
Gross private domestic investment (nonresidential)	**12.9**	**9.2**	**1.7**	**2.9**	**9.2**	**10.0**
Structures	5.4	-3	-4.1	-8.3	-3.6	-0.9
Equipment	14.1	12.1	-2.3	2.8	13.2	14.1
Intellectual property products	15.6	12.5	9.1	8.9	11.6	11.2
Residential Investment	**13.3**	**-11.7**	**-7.7**	**2.2**	**0.4**	**0.4**
Net exports *($bln)*	**-1,226**	**-1,245**	**-1,317**	**-1,350**	**-1,544**	**-1,545**
Exports	-2.9	7.6	-5.3	22.4	-5.4	-4.8
Imports	9.3	7.1	4.7	17.9	18.3	18.9
Government consumption and investment	**4.2**	**-2.0**	**0.9**	**-2.6**	**-2.7**	**-2.9**
Federal defense	-5.8	-1.1	-1.7	-6.0	-8.5	-9.9
Federal nondefense	40.8	-10.7	-9.5	-2.0	-2.6	-2.5
State and local	-0.1	0.2	4.9	-1.6	-0.6	-0.5
Real gross domestic income	**6.3**	**4.3**	**6.4**	**6.3**	**2.1**	**1.8**
Average of GDP and GDI	**6.3**	**5.5**	**4.3**	**6.6**	**0.3**	**0.1**
Final sales of domestic product	9.1	8.1	0.1	1.5	-0.4	-1.2
Final sales to domestic purchases	10.4	8	1.3	1.7	2.7	2.0
Real disposable personal income	54.7	-29.1	-4.1	-4.5	-6.7	-7.8
GDP Price Index	**4.3**	**6.1**	**6.0**	**7.1**	**8.1**	**8.2**
Ex-food & energy	3.4	5.8	5.3	6.4	6.5	6.6
PCE Price Index	**3.8**	**6.5**	**5.3**	**6.0**	**7.0**	**7.1**
Ex-food & energy	2.7	6.1	4.6	4.4	5.1	5.2

Furthermore, this week's release of personal income and expenditures, with real disposable personal income down 0.1% in May after increasing 0.2% in April and real personal consumption expenditures at -0.4% in May after increasing 0.3% in April puts the trajectory for consumer demand on an even weaker path than in Q1. Having said this, we still believe that personal consumption expenditures will remain positive in the second quarter. But the weakening in personal consumption expenditures is calling into question the staying power of the US consumer as well as the staying power of the savings accumulated during the COVID-19 pandemic.

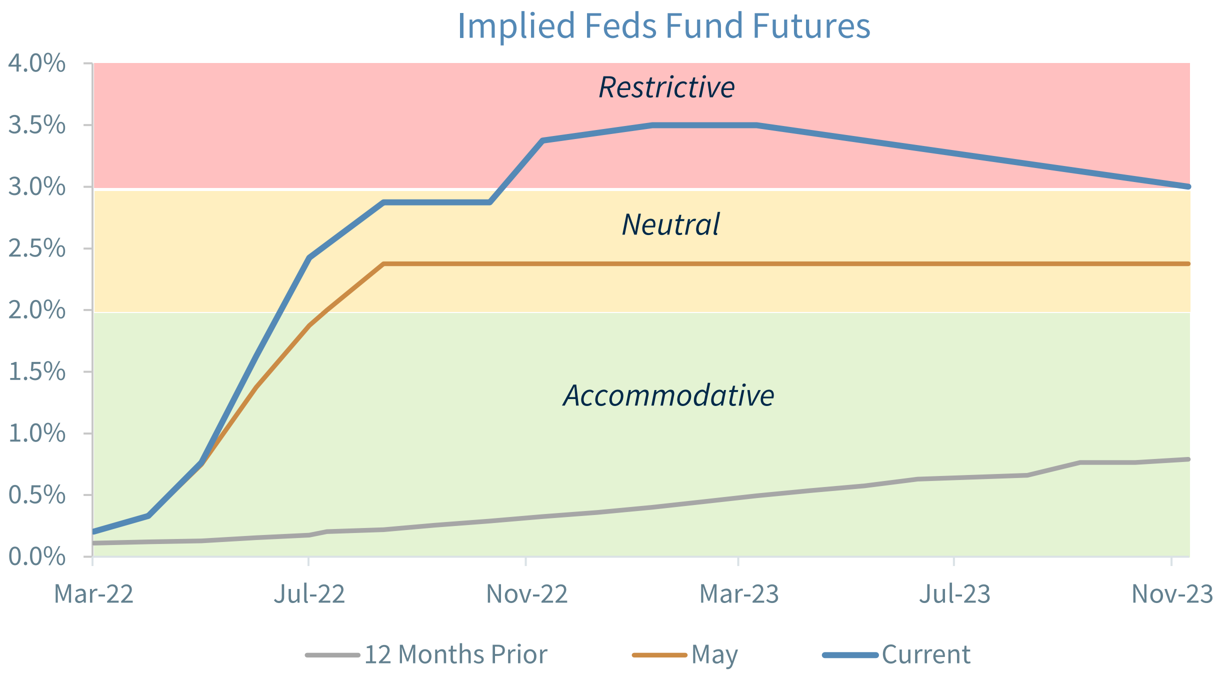
What is in store for the Federal Reserve?

This week's information could be a game-changer, again, for the Federal Reserve (Fed). The only thing that is still not certain is the path of inflation. The core PCE price deflator came down from 4.9% in April to 4.7% in May and if this year-over-year decline is sustained over the next several months, the Fed may not have to raise interest rates as high as markets are expecting today.

We still believe that July's increase in the fed funds rate is going to be 75 bps but after that, the path seems less certain, especially if core PCE continues to slow down. Two weeks ago the higher than expected CPI plus the preliminary Michigan Survey five-year inflation expectations sent shivers into Fed officials and they decided to 'up-the-ante' This week's revision to personal consumption expenditures growth during the first quarter of the year, even though it was 'water under the bridge,' puts consumer demand at a weakened pace compared to previous expectations. This means that there is a real possibility that inflation numbers during the second half of the year could come down at a faster pace than markets were expecting before.

This also means that current monetary policy (plus inflation) has been very effective in slowing down consumption and could prompt Fed officials to be more patient with their future rate increases because the economy is on a clear slowing path.

For the last twelve months until earlier this year, we expected the Fed to remain accommodative to help the economy 'accelerate' its way back to its pre-pandemic levels. However, as inflation started to increase significantly, we changed our view to a more 'Neutral' Fed, which is where interest rates are consistent with the Fed's dual mandate of full employment and price stability. At the time we believed a moderate increase in rates would have sufficed with inflation peaking by March, on a year earlier basis. However, the sudden increase in oil (gasoline) and food prices brought about by the Ukraine-Russia conflict changed the whole inflationary path. By June, the Fed changed its tone and went into a more aggressive posturing with a 75 basis points hike after a worse-than-expected CPI reading and five-year inflation expectations moving higher than expected. With this fast change of heart, the Fed is expected to continue to raise rates likely to a 'Restrictive' level, which will put further pressure on the economy. Currently, we don't expect the Fed to have to raise rates as high as the FOMC projections of 3.8%, but if inflation doesn't improve quickly, it will likely have to move into the 'Restrictive' territory.



Summary of the week:

1Q22 GDP (Final): The third estimate of first-quarter GDP was not very positive for the previously reported strength of personal consumption expenditures and is clearly showing the effects of higher prices on American consumers. GDP for the first quarter of 2022 was revised slightly downward during the third estimate, according to the Bureau of Economic Analysis. GDP was revised down to -1.6%, compared to the second estimate of -1.5% a month ago, due to a downward revision in personal consumption expenditures (PCE). PCE increase is now 1.8% compared to the previously reported rate of 3.1%. There were large downward revisions to durable goods consumption and services consumption between the two estimates. However, there was a large upward revision to gross private domestic investment, which was estimated to have increased 0.5% during the second estimate, but was upgraded to an increase of 5.0%. Almost every component of investment was upwardly revised during the third estimate, except for intellectual property products, which went from growing at 11.6% to growing 11.2%. Residential investments remained unchanged, up 0.4%. Exports were also higher during this estimate, down 4.8% versus a decline of 5.4% in the second estimate release. Imports, on the other hand, grew a bit faster, at 18.9% versus 18.3%. Government consumption and investment was also lower, declining 2.9% in this estimate compared to a 2.7% decline as reported in the second estimate. The large downward revision to PCE is a clear sign that inflation is taking much more out of the US economy that previous estimates had suggested. Meanwhile, the upward revision to investment is not in sync with consumption and could be a harbinger for weaker investment growth during the rest of the year.

Personal Income: This report was good news for prices and inflation, but it was not good for personal consumption expenditures (PCE) and the overall economy. This report adds to yesterday's large downward revision of PCE during the first quarter and puts consumer demand at a very weak spot during the second quarter of the year. Personal income increased 0.5% in May, similar to April, according to the Bureau of Economic Analysis. Disposable personal income increased by 0.5%, also similar to the rate of growth in April. However, real disposable personal income declined 0.1% as inflation bit into the purchasing power of income during the month after increasing 0.2% in April. Personal consumption expenditures increased only 0.2% during the month after increasing 0.6% in April while real personal consumption expenditures declined 0.4% compared to a 0.3% increase in April, as inflation took a larger bite from consumption during the month. On the positive side, the PCE price deflator increased 0.6% during the month compared to a 1.0% increase for the May CPI reading while the core PCE, which excludes food and energy and is the one used by the Federal Reserve (Fed) to conduct monetary policy, increased 0.3% versus an increase of 0.6% for the core CPI (CPI excluding food and energy). On a year-earlier basis, the PCE remained unchanged at 6.3% while the core PCE deflator declined from 4.9% to 4.7%. Perhaps the biggest question this release poses is whether the Fed is going to slow down their interest rate increases after this report. Our view is that they will go on with its 75 basis point increase in July and will wait it out until July and August inflation numbers are in to see if it will proceed with further interest rate increases. The behavior of inflation in July and August will be the determinant for the Fed's future interest rate path.

Initial Jobless Claims: This week's initial jobless claims number declined by 2,000 compared to the previous week on a seasonally adjusted basis, according to the Bureau of Labor Statistics. The 4-week moving average continued to increase, up 7,250, but still low compared to historical levels. Initial jobless claims for the week ending June 25 were 231,000, a decrease of 2,000 from the previous week's revised level of 233,000, according to the Bureau of Labor Statistics. The 4-week moving average was 231,750, an increase of 7,250 from the previous week's average, which was 224,500. The advance seasonally adjusted insured unemployment rate was 0.9% for the week ending June 18, a decrease of 0.1% point from the previous week's revised rate of 1.0%. Initial jobless claims declined in the week ending June 25 on a seasonally adjusted basis and are still very low compared to history.

Summary of the week:

ISM Manufacturing: The US manufacturing industry remains in expansionary mode (a reading above 50), but appears to have weakened in June according to the ISM manufacturing index. The manufacturing ISM was 53 in June compared to consensus expectations for 55 and a May reading of 56.1. The new orders and employment components of the index were in contraction territory, below 50, at 49.2 and 47.3, respectively. However, the production index was in expansion territory and higher than the May reading, at 54.9. The supplier deliveries index was also in expansion territory but lower than the May reading, at 57.% versus 65.7. The inventories index was higher than in May, at 56 compared to 55.9. The prices index was lower than in May, at 78.5 compared to 82.2 while the backlog orders number was also lower than in May but still expanding, at 53.2 compared to 58.7. The new export orders index was lower but still expanding, at 50.7 compared to 52.9 for the May report. The imports index moved from contracting in May, at 48.7, to expanding in June, at 50.7. Although the manufacturing sector continued to expand in June, the sector is showing signs that it is slowing down. The good news is that price pressures have continued to come back down even though they remain very high. Although production improved a bit in June, the new orders and employment indices contracted in June.

Economic Forecasts:

	Quarterly Historical					Quarterly Forecast							Annual	Annual Forecast	
	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	2021	2022	2023
GDP (annual rate)	**6.3**	**6.7**	**2.3**	**6.9**	**1.6**	**2.0**	**1.0**	**0.7**	**0.5**	**-0.1**	**-0.2**	**0.9**	**5.7**	**2.1**	**0.5**
Year-over-year	0.5	12.2	4.9	5.5	3.5	2.4	2.0	0.5	1.1	0.5	0.2	0.3			
Private Domestic Final Purchases	**11.8**	**10.1**	**1.4**	**2.6**	**3.0**	**2.3**	**1.2**	**0.7**	**-0.6**	**-0.7**	**-0.8**	**0.4**	**7.9**	**2.8**	**0.1**
Year-over-year	2.5	16.0	7.3	6.4	4.4	2.5	2.4	2.0	0.9	0.2	-0.3	-0.4			
CPI (y/y)	**1.9**	**4.8**	**5.3**	**6.7**	**8.0**	**8.3**	**8.4**	**7.9**	**6.9**	**5.7**	**4.8**	**3.9**	**4.7**	**8.2**	**5.3**
Ex-food & energy	1.4	3.7	4.1	5.0	6.3	5.9	6.2	6.0	5.3	4.5	3.6	2.7	3.6	6.1	4.0
PCE Price Index (y/y)	**1.8**	**3.9**	**4.3**	**5.5**	**6.3**	**6.3**	**6.2**	**5.9**	**5.1**	**4.3**	**3.5**	**2.7**	**3.9**	**6.2**	**3.9**
Ex-food & energy	1.7	3.4	3.6	4.6	5.2	4.7	4.5	4.1	3.8	3.5	2.9	2.3	3.3	4.6	3.1
Unemployment Rate	**6.2**	**5.9**	**5.1**	**4.2**	**3.8**	**3.6**	**3.6**	**3.5**	**3.6**	**4.1**	**4.7**	**5.0**	**5.4**	**3.6**	**4.3**

Fed Funds Target Rate:

	Fed Meeting	Fed Funds Target Rate
2022	Current	1.50-1.75
	July 26-27	2.25-2.50
	September 20-21	2.75-3.00
	November 1-2	2.75-3.00
	December 13-14	3.25-3.50
2023	January 31-February 1	3.25-3.50
	March 21-22	3.25-3.50
	May 2-3	3.25-3.50
	June 13-14	3.25-3.50
	July 25-26	3.25-3.50
	September 19-20	3.25-3.50
	October 31-November 1	3.25-3.50
	December 12-13	3.00-3.25

DISCLOSURES

Economic and market conditions are subject to change.

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Studies. Currencies investing are generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

Consumer confidence index is an economic indicator published by various organizations in several countries. In simple terms, increased consumer confidence indicates economic growth in which consumers are spending money, indicating higher consumption.

Source: FactSet, data as of 7/1/2022

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