**Gregory Cater Sr., CRC®, AIF®**
WEALTH MANAGER

06/22/2023
Gregory Cater Sr. & Gregory Cater Jr.
What's Really Going on in This Economy?

Economists try to predict our economic future by looking at statistics. Some of the numbers tell us what happened in the past, some tell us what is happening now and some try to tell us what is going to happen in the future. The economic jargon is:

1) Lagging Indicators (past)
2) Coincident Indicators (now)
3) Leading Indicators (future)

The Federal Reserve has a dual mandate, maximum employment and price stability. To measure their progress they use the unemployment rate (Bureau of Labor Statistics) and the Personal Consumption Expenditure Index (Bureau of Economic Analysis). Both of these are lagging indicators.

My experience and common sense tell me we should give more weight to what is happening now and what we think will happen in the future versus what happened in the past. Let's start with what is happening now.

**Coincident Indicators**

| Indicator | Value | Period |
|---|---|---|
| 1) Personal Income | 0.4% | April'23 |
| 2) GDP | 1.3% | 1st Q'23 |
| 3) Industrial Production | -0.2% | May'23 |
| 4) US Existing –Home Prices | -3.1% | May'23 |
| 5) US Existing-Homes Sales | 0.2% | May sales fell 20.4% from a year earlier. |

Personal Income is not adjusted for inflation so it's basically flat. GDP is below trend, Industrial Production and US Existing- Home prices are down.

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Now let's look at what we think will happen in the future:

**Leading Indicators**

| | | |
|---|---|---|
| 1) Yield Curve | Highly Inverted | |
| 2) ISM Manufacturing Index | 46.9 | May'23 |
| 3) ISM Services Index | 50.3 | May'23 |
| 4) Conference Board Leading Index | -0.8 | May'23 |
| 5) Money Supply (M2) | -4.6% | Y/Y |

The yield curve has been inverted for a long time and this usually forecasts recession. ISM Manufacturing and ISM Services are on a scale of 0-100. Below 50 means the economy is contracting and above 50 means its expanding. The Conference Board Leading Index is not only negative; it has been negative since March'22. The money supply always grows because as our economy grows we need more to service it. In Feb'21 it peaked at over 25%, today its down (-4.6%).

Not only does the Federal Reserve use Lagging Indicators; they use the wrong one for inflation. The official index in the official instructions written in 2012 identifies the HEADLINE PCE. Chairman Powell has said time and again he favors the CORE PCE and has recently moved on to the CORE SERVICES LESS HOUSING PCE. Headline counts everything, Core strips out food and energy and Core Services Less Housing strips out more. They also use the year/year change in prices as opposed to the last month. If we want to know the direction and severity of change in inflation over time, we should measure the % change from the previous period. If we want to know what just happened to inflation, we should use the most recent month-over-month data. If, however, we want to make it seem like inflation will never budge, and that none of the Fed's actions have been successful, then and only then does it make sense to include and overweight eleven months of historical inflation in our metric. Also, when people complain about high prices they seem to mention gasoline, food and housing most, why does the Fed strip these out?

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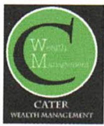

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They use the monthly unemployment rate from the Bureau of Labor Statistics (BLS) to measure their progress on the second mandate: maximum employment. They learned about the Phillips Curve in econ-101; miss-taught by Nobel Prize winner Paul Samuelson 40 years ago. They think A. W. Phillips identified an inverse relationship between unemployment and consumer inflation, he didn't. The title of his paper explains.

The Relation Between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861-1957 By A. W.Phillips

Phillips noticed the relationship between unemployment and wages but not between wages and consumer inflation. He explained that employers offered higher wages only when they got something in return: higher productivity. People had more money to spend but the amount of "stuff" available to spend it on also went up. The only times Phillips noticed wage inflation causing consumer inflation was in times of high import prices. Import prices peaked in Mar'22 at 13.01% and are down (-5.9%) year/year now. As I mention above it was Nobel Laureate Paul Samuelson (along with Robert Solow) who made the leap to consumer inflation.

The Consumer Price Index (CPI) peaked in June'22 at 9.1%. This was a few months after the Fed started tightening credit. It is now 4.0% (Y/Y). Next month it could fall another point (3.0%). The latest monthly increase was 0.1% (1.2% annualized). I don't see how the Fed can justify further tightening.

Our next note will look at the run-off of the Fed's balance sheet (is it really getting smaller?) and the strength of the regional banks.

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