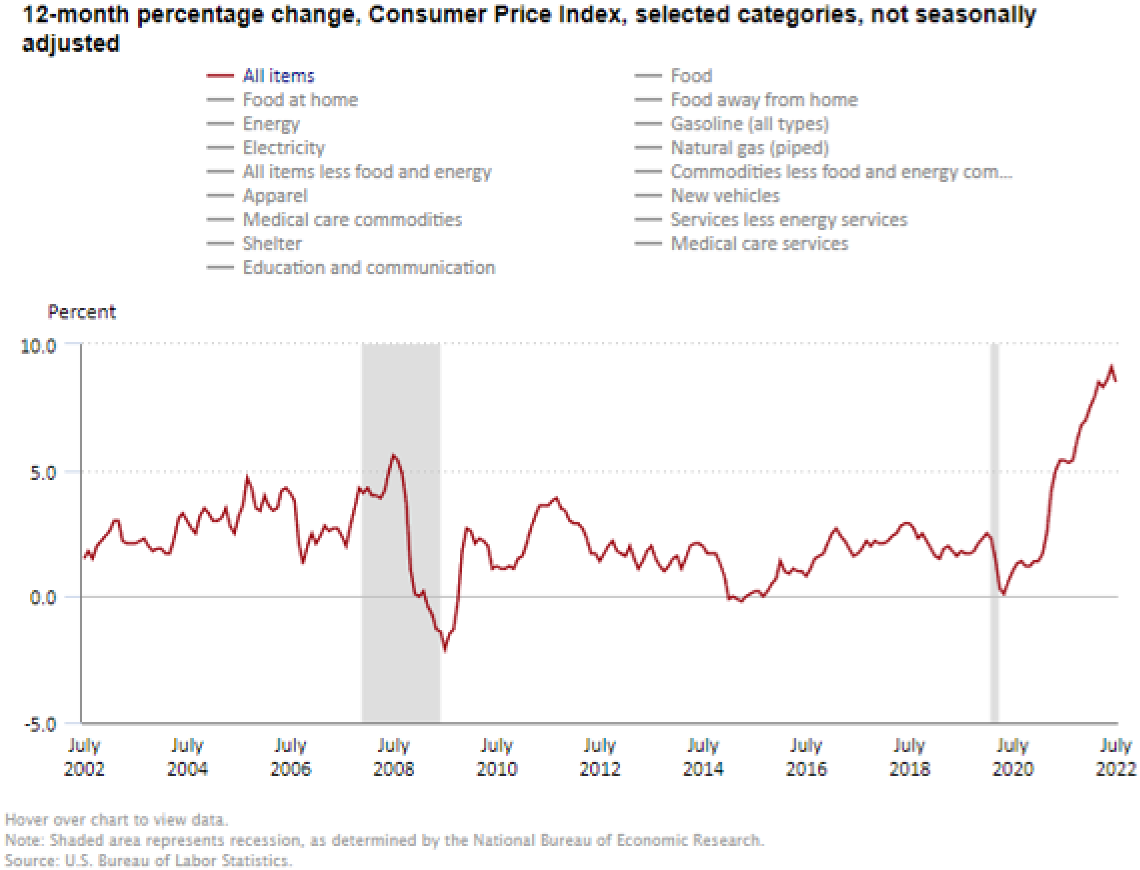
Week in Review

Friday, August 12th, 2022

1. Peak Inflation is Likely Now Behind Us but May Remain Elevated

Markets moved sharply upwards this week on the back of the U.S. Consumer Price Index (CPI) report released Wednesday that showed inflation during July finally slowing. The CPI was unchanged in July on a seasonal basis after rising 1.3 percent in June. Over the last 12 months, the all-items index increased 8.5 percent, smaller than the 9.1-percent increase for the period ending in June.



The energy index fell 4.6 percent over the month, driven by gasoline down 7.7 percent, and offset increases in the food and shelter indexes, resulting in the all-items index being unchanged over the month. The energy index increased 32.9 percent for the 12 months ending July, a smaller increase than the 41.6-percent increase for the period ending in June. The food index increased by 10.9 percent over the last year, the largest 12-month increase since the period ending May 1979.

The all items less food and energy index, known as the core index, rose 5.9 percent over the last 12 months, but the increase of 0.3 percent in July was lower than April, May or June. The indexes for shelter, medical care, motor vehicle insurance, household furnishings and operations, new vehicles, and recreation were among those that increased over the month. There were some indexes that declined in July, including those for airline fares, used cars and trucks, communication, and apparel.

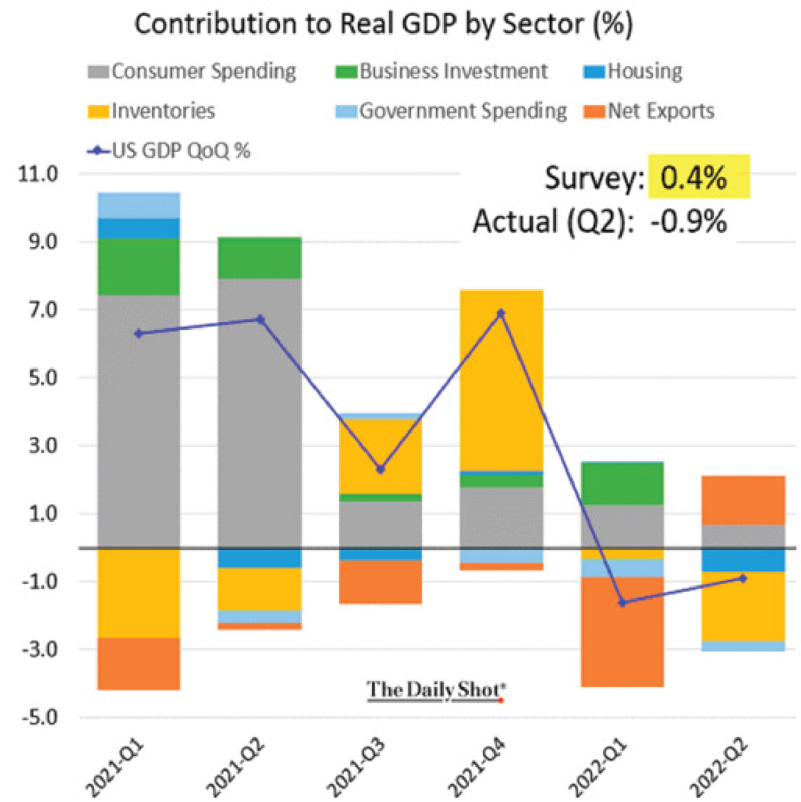
	Seasonally adjusted changes from preceding month							Un-adjusted 12-mos. ended Jul. 2022
	Jan. 2022	Feb. 2022	Mar. 2022	Apr. 2022	May 2022	Jun. 2022	Jul. 2022	
All items	0.6	0.8	1.2	0.3	1.0	1.3	0.0	8.5
Food	0.9	1.0	1.0	0.9	1.2	1.0	1.1	10.9
Food at home	1.0	1.4	1.5	1.0	1.4	1.0	1.3	13.1
Food away from home[1]	0.7	0.4	0.3	0.6	0.7	0.9	0.7	7.6
Energy	0.9	3.5	11.0	-2.7	3.9	7.5	-4.6	32.9
Energy commodities	-0.6	6.7	18.1	-5.4	4.5	10.4	-7.6	44.9
Gasoline (all types)	-0.8	6.6	18.3	-6.1	4.1	11.2	-7.7	44.0
Fuel oil[1]	9.5	7.7	22.3	2.7	16.9	-1.2	-11.0	75.6
Energy services	2.9	-0.4	1.8	1.3	3.0	3.5	0.1	18.8
Electricity	4.2	-1.1	2.2	0.7	1.3	1.7	1.6	15.2
Utility (piped) gas service	-0.5	1.5	0.6	3.1	8.0	8.2	-3.6	30.5
All items less food and energy	0.6	0.5	0.3	0.6	0.6	0.7	0.3	5.9
Commodities less food and energy commodities	1.0	0.4	-0.4	0.2	0.7	0.8	0.2	7.0
New vehicles	0.0	0.3	0.2	1.1	1.0	0.7	0.6	10.4
Used cars and trucks	1.5	-0.2	-3.8	-0.4	1.8	1.6	-0.4	6.6
Apparel	1.1	0.7	0.6	-0.8	0.7	0.8	-0.1	5.1
Medical care commodities[1]	0.9	0.3	0.2	0.1	0.3	0.4	0.6	3.7
Services less energy services	0.4	0.5	0.6	0.7	0.6	0.7	0.4	5.5
Shelter	0.3	0.5	0.5	0.5	0.6	0.6	0.5	5.7
Transportation services	1.0	1.4	2.0	3.1	1.3	2.1	-0.5	9.2
Medical care services	0.6	0.1	0.6	0.5	0.4	0.7	0.4	5.1

Source: BLS

Overall, the leveling off of inflation growth after several months of strong increases is a welcome change in the trend. It is likely that peak inflation has been reached with further declines or at least easier year over year comparisons ahead. However, certain aspects of inflation including shelter and the impact of wages will likely remain in place for at least the remainder of the year resulting in core inflation (currently at 5.9 percent) well ahead of the Federal Reserve's longer-term target of 2%.

2. Mixed Signals on Economic Growth but No Cliff Insight in the Near Term

There has been a lot of discussion as to whether we are currently in a recession in recent weeks. One technical measure of recession is two consecutive quarters of negative Gross Domestic Product (GDP). GDP is the total monetary value of all the finished goods and services produced within a country's borders in a specific period. As illustrated in the following chart, the U.S. GDP has slipped into negative growth in each of the past two quarters.



Source: The Daily Shot

The nature of the negative growth is different. In the first quarter, consumer spending and business spending remained positive, but net exports driven by a surge in imports and lower government spending drove GDP into the red. The second quarter saw net exports turn positive (driven by more exports than imports) but inventory saw large drawdowns as well as a slowdown in housing and weakening consumer and business spending also resulting in negative GDP growth.

While the first quarter could be seen as an aberration in data coming off the Covid recovery driven by restocking of inventories, the second quarter appears more representative of at least a slowdown in the economy.

A recent Fed research paper notes—the economy sometimes slows too abruptly at the start of recessions for policymakers to accurately track current conditions. One particular concern is that real-time economic data might understate how quickly activity is slowing at the start of a recession. Two key forces at work, inflation and rising tightening monetary policy, may still take a while to play out in terms of their visible effects on the economy.

For financial markets, the negative GDP data and peaking inflation have been greeted with an expectation that possibly the worst of the slowdown in growth and rising of rates have been realized or at least priced into the markets. This may or may not prove to be optimistic, but at least it is a welcome development from the heightened level of negative sentiment concern over inflation and corporate prospects coming into the summer.

Thinking Ahead

The financial markets greeted lower-than-expected inflation data this week with enthusiasm. Inflation is a long way from being defeated but expectations are now that the Federal Reserve can be more measured in the aggressiveness of rate hikes. The Federal Reserve's stance may also be influenced by evidence of a slowing economy enabling patience to see the lagging impact of initiatives already in place. Future data on both inflation and economic growth will continue to be important to watch to see the emergence of trends. For the time being, latest data has been the market's friend, or at least providing balance to the recent levels of extreme negativity.

Pallas Capital Advisors will continue to monitor economic, political, and corporate data for implications to markets.