

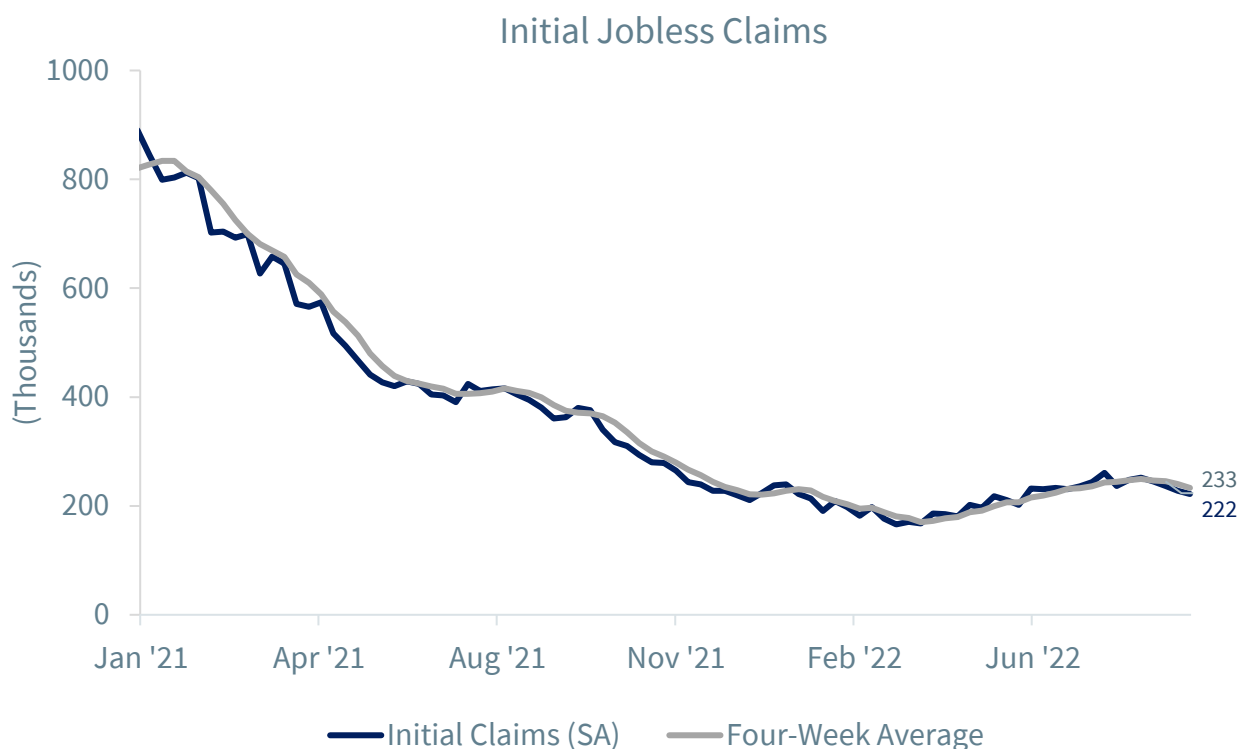
## THOUGHTS OF THE WEEK

Eugenio J. Alemán, PhD, *Chief Economist*Giampiero Fuentes, CFP®, *Economist***WEEKLY  
ECONOMICS****Is US Economic Growth Strengthening?**

For anybody watching the behavior of the US economy during the last couple of years it is clear that it is not-WYSIWYG (What You See Is What You Get). The presumed technical definition of two consecutive quarters of negative GDP growth is not the real definition of a recession, according to the NBER. Never mind that we believe that the NBER would never call for a recession during a period, the first half of 2022, when employment grew by 3.5 million jobs or by 438,000 jobs per month. Or 5.8 million jobs during the last 12 months at an average of 487,000 new jobs, or recovered jobs lost to the Covid-19 pandemic.

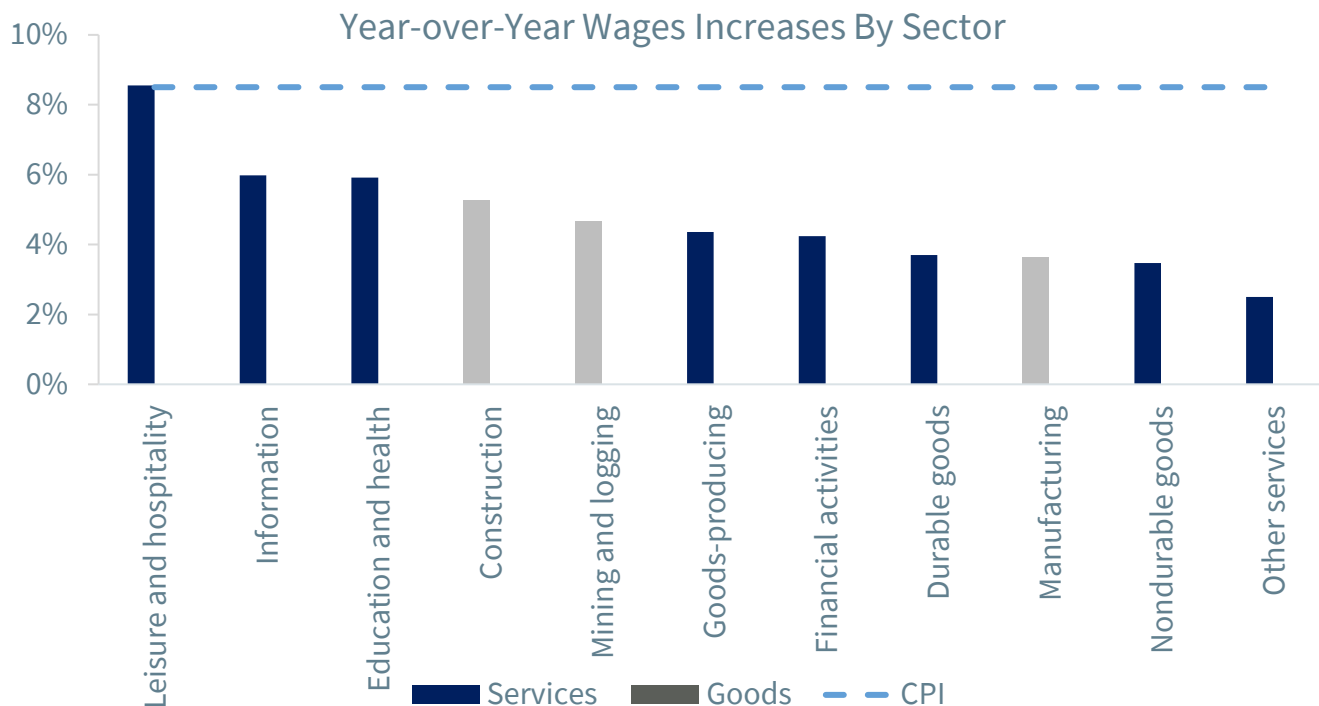
It is true that the economy weakened considerably during the second quarter of the year and compared to the first quarter for all those variables that really matter, but it seems that the economy is, once again, regaining some strength, according to some recent indicators. The ISM manufacturing index remained flat in August, according to the Institute of Supply Management, but in expansion territory, while the ISM services was slightly higher in August than in July and was also in expansion territory.

Meanwhile, initial jobless claims, which had been increasing early in the year and were used by some economists to show a weakening labor market and thus a weakening economy, have changed course lately and have been declining once again, tentatively showing an improving labor market, which is not what the Federal Reserve (Fed) wants to see.



Source: FactSet, data as of 9/9/2022

Since the Fed doesn't want to see a strengthening labor market because they want to see an increase in the rate of unemployment to reduce the pressure from salaries into higher inflation, the news of an improving economy could push them to increase rates more than what markets are expecting today.



Source: FactSet, data as of 9/9/2022

However, we do believe that the US economy is slowing down and will continue to slow down as the Fed continues to increase interest rates and as inflation continues to bite into real incomes. Today, the US economy is being helped by a recovering service sector economy, a very strong export sector, and a very weak imports sector that are taking advantage of the full reopening of the economy and of the strong need of energy resources by European countries, respectively. But the investment sector has been weakening considerably, especially investment related to residential construction. Thus, our expectation is for the US economy to continue to weaken as the year ends and then go into a recession until the Fed is able to bring down inflation convincingly and on a sustained basis.

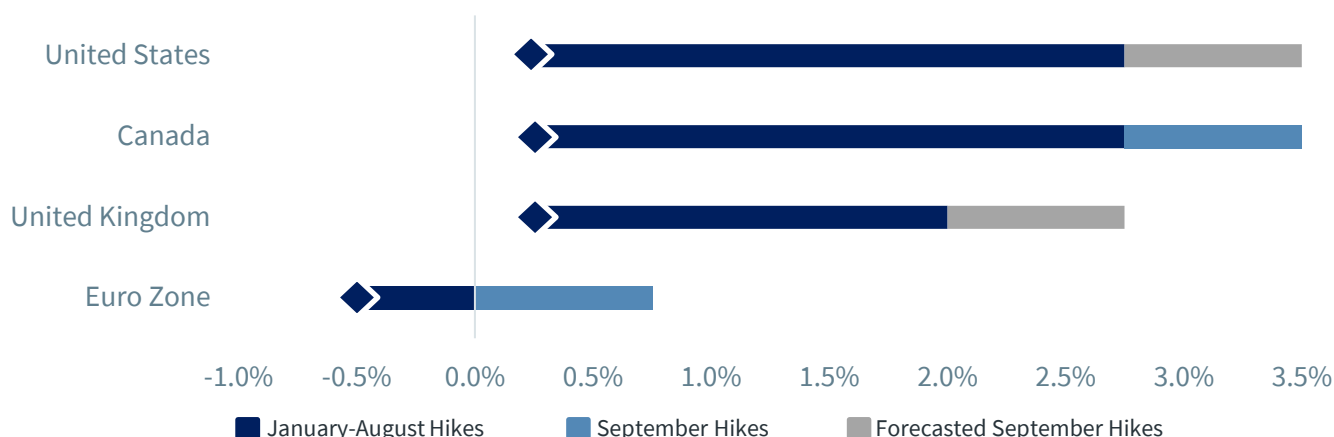
### Welcome to the 75 Basis Point Club

With Euro Zone consumer prices hitting 9.1% in August, the ECB revised its inflation expectations higher, forecasting an average inflation rate of 8.1% in 2022 and 5.5% in 2023. Without an end in sight for the conflict between Ukraine and Russia, and the latter's ability to cut off energy supplies, prices are likely to remain high and continue to negatively impact other areas of the economy.

Higher inflation pushes wages higher as workers demand wage increases to cope with higher prices. That is, expectations of higher inflation tend to add to future inflation as higher wages set up a wage-price spiral that could keep inflation going for a longer period. Christine Lagarde, the president of the ECB, raised rates in July for the first time in over a decade, and it raised rates by a record 75 basis points on September 8. This increase brought the benchmark deposit rate to the highest level since 2011 and markets are already pricing more increases in coming months.

The Bank of Canada raised rates on September 7, from 2.50% to 3.25%, to the highest level since 2008. While this number is above the Central Bank's neutral range, the current expectation is that monetary policy will have to tighten further to bring down inflation. The Bank of England is meeting next week, on September 15, and it is also expected to raise rates by 75 basis points, which would be the largest hike in almost thirty years. Finally, on September 21, the US Federal Reserve will meet and further tighten monetary policy.

## Global Central Banks – YTD Rate Changes



Source: Factset, data as of 9/9/2022

The markets are expecting the US to follow suit with a 75 basis point hike as the labor market continues to remain strong. In fact, in August, the US economy added 315,000 jobs and this week's initial jobless claims reported the fourth consecutive week of declines. Additionally, the employment component of the August Services PMI is back in expansion territory after being in contraction in July. All these reports indicate that the labor market continues to be resilient. On the other hand, labor force participation finally increased in August, which, if the trend continues, should help to increase the rate of unemployment and thus limit the pressure from higher wages on inflation.

However, there are three very important economic releases before the September 21 meeting that the Federal Reserve will be paying close attention to: CPI, PPI, and Retail Sales. The first, the consumer price index (CPI) release should confirm that inflation peaked in June. With energy prices down almost 10% in August, we expect inflation to remain high at 8.2%, but lower than June's peak of 9.0%. Similarly, the producer price index (PPI) should decline on a year-over-year basis. Although our expectations for the headline CPI and PPI are expected to be lower, markets will be watching the Core number for CPI (ex. Food and Energy) more closely, as that is yet to turn the corner. Lastly, we expect Retail Sales to increase by 0.3% after remaining flat in July, but the focus will remain on the Control Group retail sales number, which is used to estimate personal consumption expenditures in the GDP calculation.

Unless next week's economic releases differ significantly from consensus expectations, the Federal Reserve is likely to raise rates for the fifth time this year for a total of 300 basis points, making it the largest increase in rates in six months since 1980. This next hike will raise the Fed funds rate to levels unseen since the Great Recession, and it will continue to slowdown the economy, further increasing the odds of a recession in the earlier part of next year. However, if economic data next week suggest that inflation and the economy are slowing down at a faster pace than expected, the Fed could only raise the fed funds rate by only 50 basis points in September. Either way, we believe the Fed will raise rates to a terminal rate of 3.50% to 3.75% for year-end.

## Summary of the week:

**ISM Services:** Overall, a good report for the service sector in August, with employment coming back to expansion territory, 50.2, after being in contraction, at 49.1, in July. For the Federal Reserve, this report also shows that there is still some work ahead to slow down the pace of growth of the US economy. The Services PMI increased slightly, from 56.7 in July to 56.9 in August, according to the Institute of Supply Management. This was the 27th consecutive month of expansion for the service sector according to this indicator. By individual component, the Business Activity Index was at 60.9 while the New Orders Index was 61.8. The Employment Index was slightly above the demarcation point between expansion and contraction, at 50.2 while the Supplier Deliveries Index was 54.5. The Employment Index returned to expansion territory after falling below 50 in July, at 49.1. The Prices Index declined slightly, from 72.3 in July to 71.5 in August but remained very high, showing that price pressures, which have come down considerably in the manufacturing sector, continue to be an issue in the service sector. ISM Services remained in expansion territory during the month of August, slightly improving from the print recorded in July. Business Activity, New Orders, Employment, and New Export Orders were better in August than in July. Meanwhile, inventories continued to contract. Supplier deliveries slowed down a bit in August but remained in expansion territory.

**Trade Balance:** Exports of goods and services continued the stellar performance that started during the second quarter of the year. The increase in exports and the decline in imports in July helped bring down the trade deficit by \$10.2 billion during July. This will add strength to the third quarter GDP number. The US trade balance in goods and services recorded a deficit of \$70.6 billion in July, a reduction of \$10.2 billion from the \$80.9 billion deficit recorded in June, according to the US Census Bureau and the US Bureau of Economic Analysis. In July, exports were \$259.3 billion, or \$0.5 billion higher than in June while imports were \$329.9 billion, or \$9.7 billion less than those recorded in June. The decline in the deficit in July was a result of a decrease of \$8.2 billion in the deficit of goods and an increase in the services surplus of \$2.1 billion. The year-to-date deficit in goods and services increased \$136.6 billion, or 29.0%, compared to the same period a year earlier with exports increasing 19.9% and imports increasing 22.1% during the period. The US trade deficit in goods and services continued to moderate during the seventh month of the year. However, the strong increase in the deficit and in imports during the first quarter of the year has continued to weigh down the important increase observed in exports of goods and services that started during the second quarter of the year.

**Initial Jobless Claims:** The initial jobless claims report showed a reduction in initial jobless claims for the fourth consecutive week to the lowest level since May. This number continues to highlight the current strength of the US labor market despite the Federal Reserve raising rates to dampen the economy. Good economic data such as today's release is considered to be bad news as we approach the September FOMC meeting. Initial jobless claims pushed lower during the week ending on September 3, according to the US Department of Labor. Initial jobless claims were 222,000, a decrease of 6,000 compared to the previous week. The previous week's number was revised lower by 4,000, from 232,000 to 228,000. The four-week moving average was 233,000, a decline of 7,000 from the previous week's revised average of 240,500. The advanced seasonally adjusted insured unemployment rate was 1.0% for the week ending on August 27, unchanged from the previous week. New York (4,360) and Michigan (1,199) experienced the largest increase in initial claims for the week ending on August 27, while Connecticut, Oklahoma, and Missouri all reported a reduction in claims greater than 1,000.

**Economic Forecasts:**

	Quarterly Historical						Quarterly Forecast						Annual	Annual Forecast	
	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	2021	2022	2023
<b>GDP (annual rate)</b>	<b>6.3</b>	<b>6.7</b>	<b>2.3</b>	<b>6.9</b>	<b>-1.6</b>	<b>-0.6</b>	<b>0.9</b>	<b>0.4</b>	<b>-0.3</b>	<b>-0.5</b>	<b>-0.2</b>	<b>0.9</b>	<b>5.7</b>	<b>1.6</b>	<b>0.0</b>
Year-over-year	0.5	12.2	4.9	5.5	3.5	1.7	1.4	-0.2	0.1	0.1	-0.2	-0.1			
<b>Private Domestic Final Purchases</b>	<b>11.8</b>	<b>10.1</b>	<b>1.4</b>	<b>2.6</b>	<b>3.0</b>	<b>0.2</b>	<b>0.1</b>	<b>-0.1</b>	<b>-1.0</b>	<b>-1.1</b>	<b>-0.8</b>	<b>0.4</b>	<b>7.9</b>	<b>2.2</b>	<b>-0.5</b>
Year-over-year	2.5	16.0	7.3	6.4	4.4	1.9	1.6	0.9	-0.2	-0.5	-0.7	-0.6			
<b>CPI (y/y)</b>	<b>1.9</b>	<b>4.8</b>	<b>5.3</b>	<b>6.7</b>	<b>8.0</b>	<b>8.6</b>	<b>8.2</b>	<b>6.8</b>	<b>5.1</b>	<b>3.2</b>	<b>2.7</b>	<b>2.8</b>	<b>4.7</b>	<b>7.9</b>	<b>3.4</b>
Ex-food & energy	1.4	3.7	4.1	5.0	6.3	6.0	6.1	5.6	4.9	4.1	3.3	2.9	3.6	6.0	3.8
<b>PCE Price Index (y/y)</b>	<b>1.8</b>	<b>3.9</b>	<b>4.3</b>	<b>5.5</b>	<b>6.3</b>	<b>6.5</b>	<b>6.1</b>	<b>5.1</b>	<b>3.9</b>	<b>2.8</b>	<b>2.4</b>	<b>2.4</b>	<b>3.9</b>	<b>6.0</b>	<b>2.9</b>
Ex-food & energy	1.7	3.4	3.6	4.6	5.2	4.8	4.6	4.2	3.9	3.6	3.2	2.9	3.3	4.7	3.4
<b>Unemployment Rate</b>	<b>6.2</b>	<b>5.9</b>	<b>5.1</b>	<b>4.2</b>	<b>3.8</b>	<b>3.6</b>	<b>3.5</b>	<b>3.5</b>	<b>4.0</b>	<b>4.3</b>	<b>4.7</b>	<b>5.0</b>	<b>5.4</b>	<b>3.6</b>	<b>4.5</b>

**Fed Funds Target Rate:**

Fed Meeting		Fed Funds Target Rate
2022	July 26-27	2.25-2.50
	September 20-21	2.75-3.00
	November 1-2	3.00-3.25
	December 13-14	3.50-3.75
2023	January 31-February 1	3.50-3.75
	March 21-22	3.50-3.75
	May 2-3	3.50-3.75
	June 13-14	3.50-3.75
	July 25-26	3.50-3.75
	September 19-20	3.50-3.75
	October 31-November 1	3.50-3.75
	December 12-13	3.50-3.75

## 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.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation.

Leading Economic Indicators: The Conference Board Leading Economic Index is an American economic leading indicator intended to forecast future economic activity. It is calculated by The Conference Board, a non-governmental organization, which determines the value of the index from the values of ten key variables.

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Source: FactSet, data as of 9/9/2022

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