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**DYNAMIC ECONOMIC STRATEGY**



"Confluence of Conflicting Economic Factors Continues"  
Philadelphia Council for Business Economics

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Dynamic Economic Strategy

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# Perspective

“If a man begins with certainties, he shall end in doubts; but if he will be content to begin with doubts, he shall end in certainties.”

Francis Bacon



# Cycle Signals: Outlook for 2023 Continued Sub-Trend Growth

- **Jobless Claims**—up versus a month ago consistent with slower job gains
  - Initial claims, 4Wk MA continuing claims above a month ago, both still low
  - Employment gains momentum slows— three-month below twelve-month average
- **ISM-Manufacturing**—Signals of Moderation in Growth and Prices
  - ISM-March @ 46.3, Below 4Q average; orders, employment and production below breakeven
  - Supplier deliveries down, now below breakeven
  - Prices paid @49.2, indicates reduced input price pressures and big drop from 3Q average
- **Factory Orders Jan. above 2M ago, Unfilled Orders up L3M**
  - Non-defense, ex-aircraft, core orders and shipments (Jan.) above November
  - Unfilled orders +2.5% YOY, slower growth signals supply-side catch-up, again slower gains YOY
- **Building Permits**—Total and Single Family up in Jan., total above 3M ago.
  - Pending Home Sales up last three months, Home prices fall in Jan., down last four months
- **Confidence (Conf Bd) March above Jan., present flat and expectations down**
  - Net Jobs plentiful down in March but above January



# Negative Financial Signals: Lower Equity Returns, Slower Profits, Higher Rates, Dollar up

- Equity Market: SPX 500 @ 3895.08 (01/06/2023), below a month ago, and down 16.72% YOY
  - Global Impact--One-third of S&P 500 revenues earned abroad, Euro weak, U.K. recession, China modest recovery
  - "IMF Upgrades Outlook for Global Economy," 2.9% 2023, 3.1% 2024, Jan. 30, 2023, WSJ
- Dollar Index: DXY @ 102.51 (03/31/2023), below a month ago, up 3.93% YOY, flight to safety
  - Real broad dollar index (Feb.) below 3M ago
- After-tax Corporate Profits (4Q 2022): down 5.9% from 3Q, growth slower last five quarters
  - Profits down 1.4% YOY, compared to up 4.44% in 2022 overall, up 30.3% in 2021
- Ten-Year (3.471%, 03/31/2023), below month ago, reduced expectations for inflation/Fed moves?  
while Two-Year (4.03%, 03/31/2023), lower-- discounting fewer Fed moves, lower inflation fears
- Leading Index: down in November. Down last 9 months. Slowdown last six months (-3.7% L6M)
  - Widespread weakness for indicators
- Quality Spreads: IG (AA) and ICE HY Master spreads (03/30/2023)
  - HY and AA spreads both above a month ago, a realistic pricing of credit risk given recession forecasts?



# So, What Does All This Mean? Signals for Slower Growth, Lower Inflation in 2023

- **Four Sector Model: Subpar Growth, Persistent Inflation, War Tensions**
- Risk –volatility in existing paradigm--versus uncertainty—Inflation concerns, Fed Reaction, Ukraine
- Growth: Slower job gains but real personal income/consumer sentiment up last six months
  - China recovery mixed-COVID, Euro weak/U.K. recession, Japan 3.4% (BOJ)
  - Labor Participation rates stay low, limits potential GDP growth going forward
  - Fed-Atlanta Nowcast 2.5% for 1Q, my estimate 0.6% all of 2023
- Inflation: Core PCE Deflator (+4.9% L3M, +4.6% L12M), continues to exceed Fed's 2% target
  - FOMC expectation 3.6% 2023/2.6% 2024, my estimate 3.7% for all of 2023/2.8% 2024
  - Powell—raised rates since March 2022, expect another 25bp on May 3
  - Commodity prices —Prices Paid –ISM manufacturing lower, below breakeven, PPM-FRB-STL Feb. below Dec.
- Interest Rates: Benchmark UST 10-Y rate lower—inflation and Fed expectations lowered
  - UST 2-Y rates lower---expect less Fed action on rates, inflation
  - Real 1Y, 10Y rates (FRB-CLE) signify a return to more reasonable pricing
  - Underpricing of risk (AA, High Yield) persists
- Corporate Earnings: after-tax profits down 4Q 2022, -1.4% YOY, my estimate -1.3% for all 2023
- Dollar: Year-over-year up 3.93%, signals reduced flight to safety, Fed to halt raising rates ahead



# Perspective

## **Money and Income: Post Hoc Ergo Propter Hoc?**

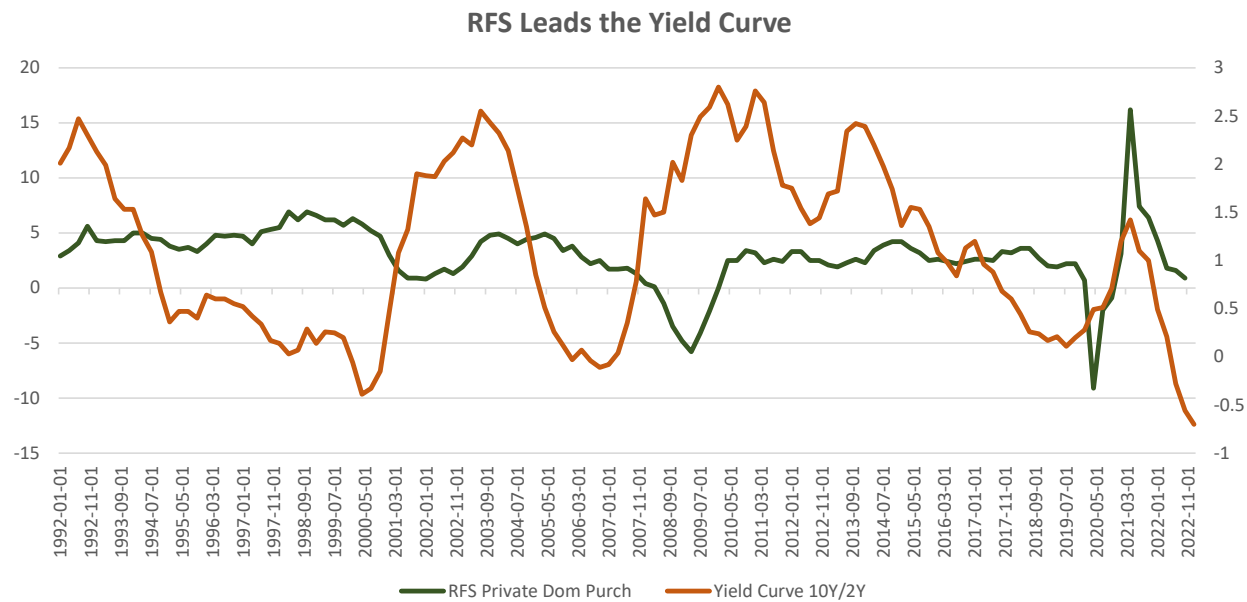
*The Quarterly Journal of Economics*, Volume 84, Issue 2

May 1970

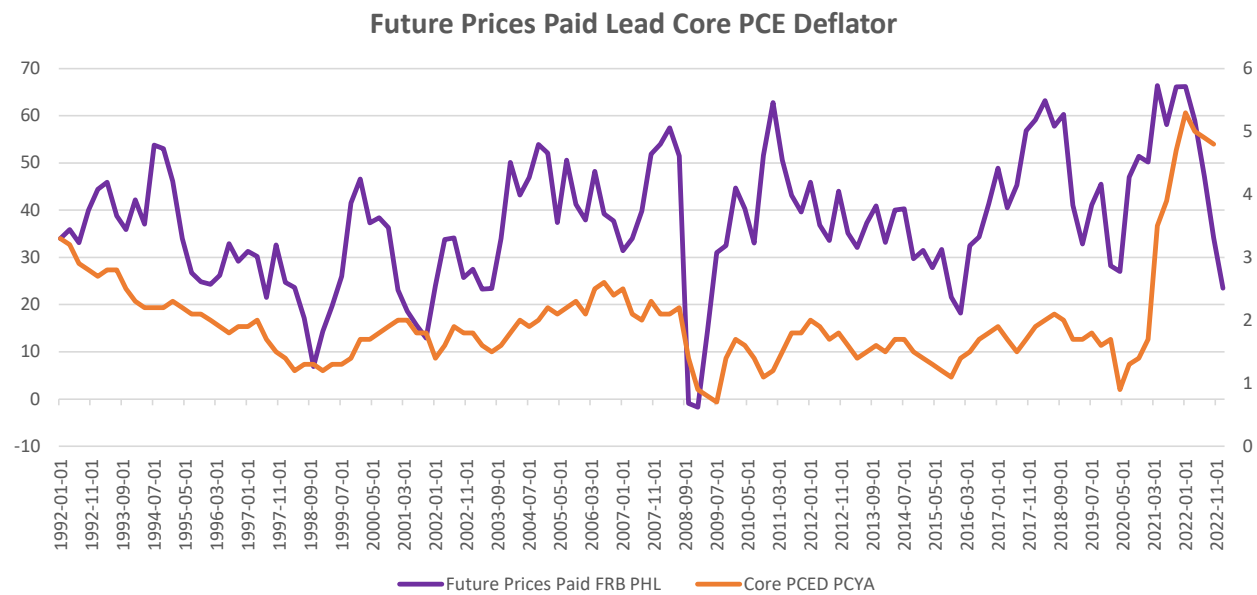
James Tobin



# Real Final Sales Leads Yield Curve: Not the Reverse

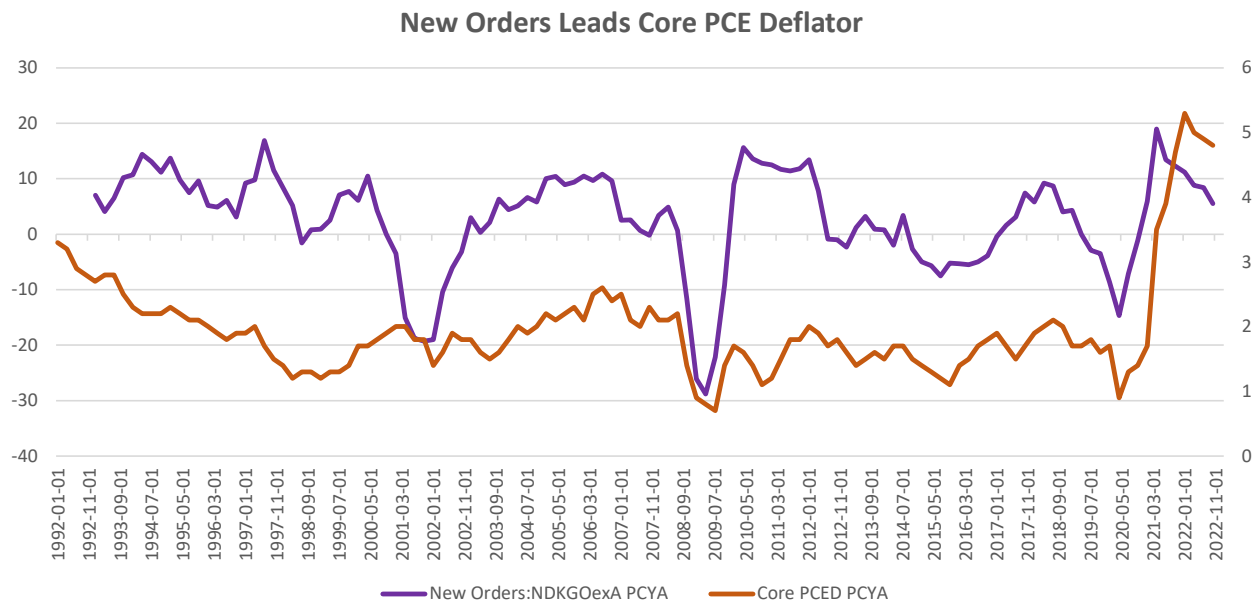


# Slower Economic Growth but Persistent Inflation

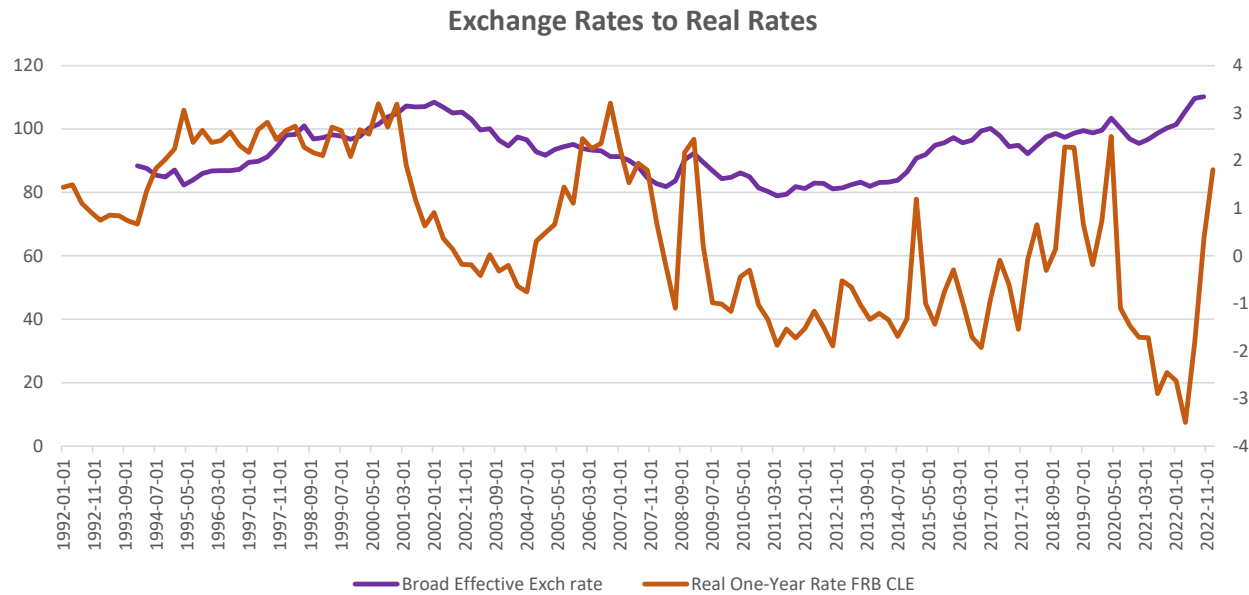




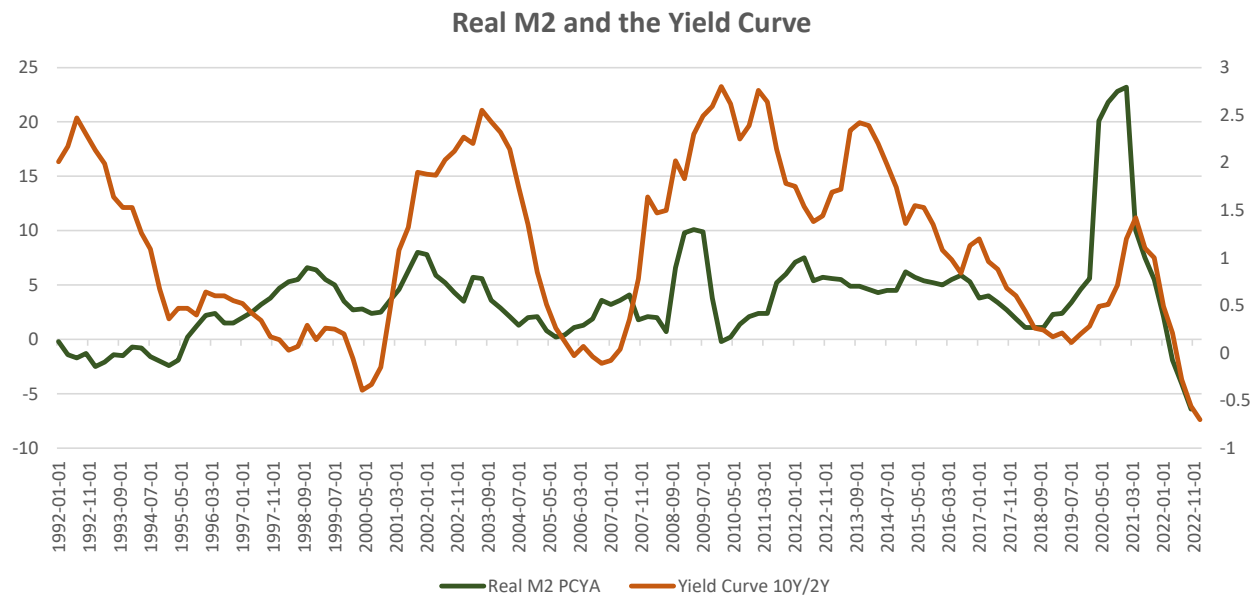
# Corroborating Evidence: Orders Lead Inflation



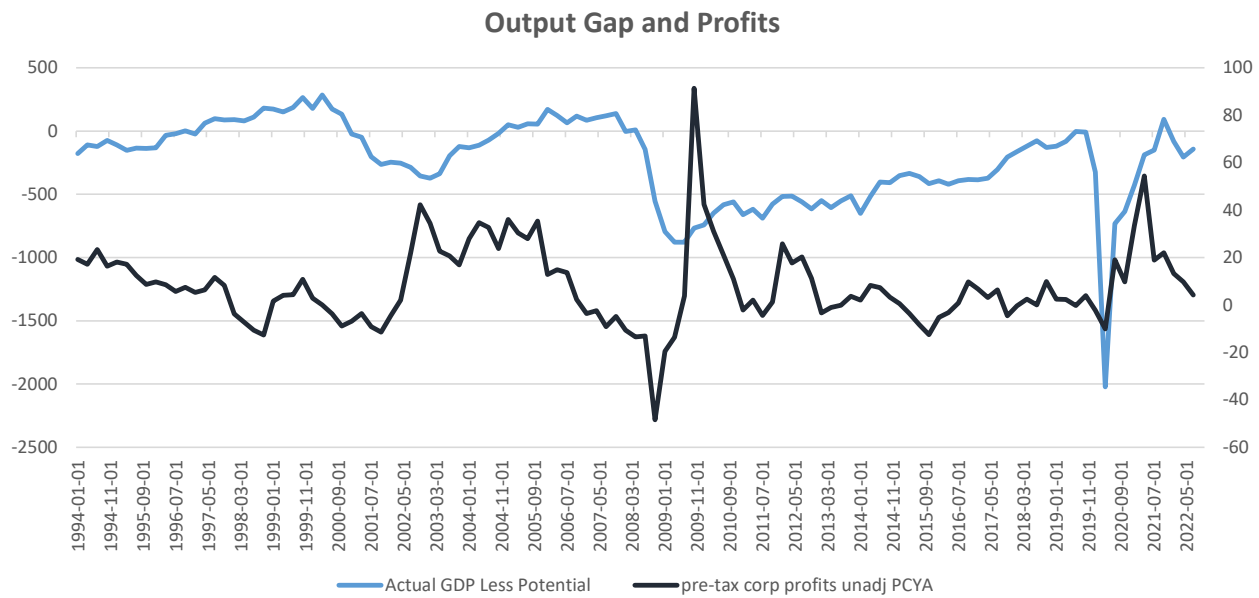
# Beyond the Fed Funds Rate: Exchange Rates Influence Real Interest Rates



# Money Matters: Real M2 and the Yield Curve

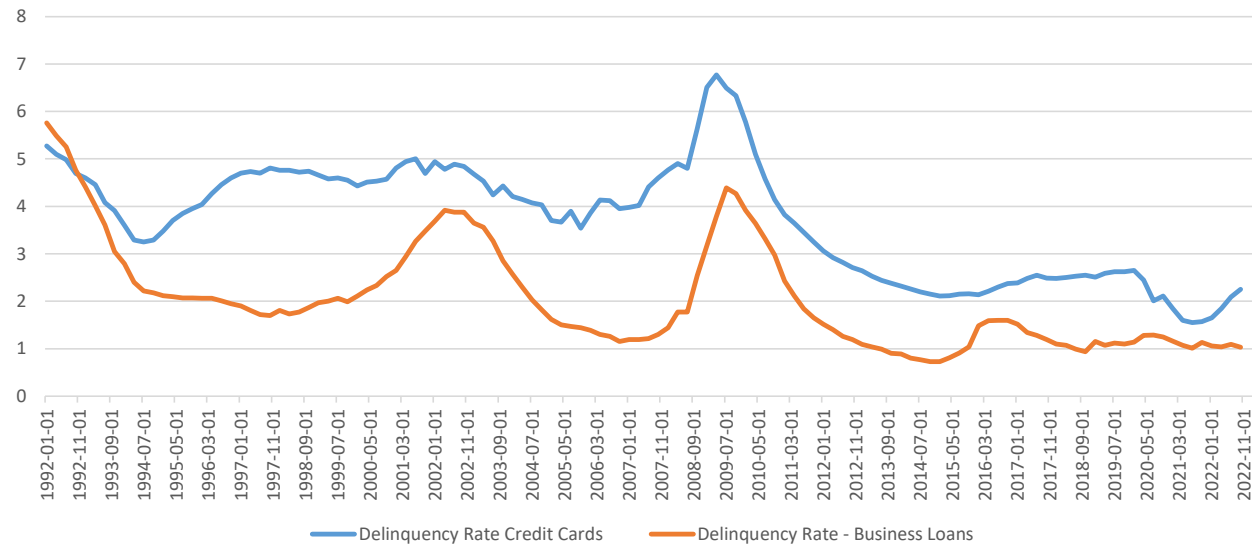


# Output Gap and Profits



# One Signal On Rising Credit Risk

Delinquency Rates: Consumer and Business



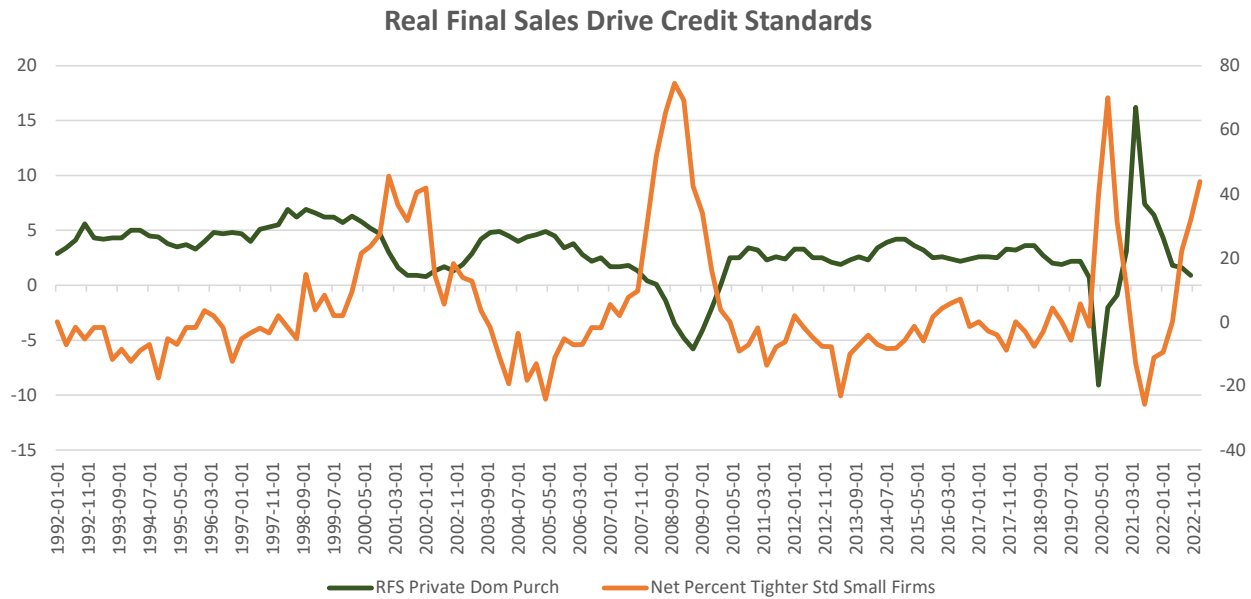
# Perspective

“Most people, when they think they are thinking, are merely reorganizing prejudices.”

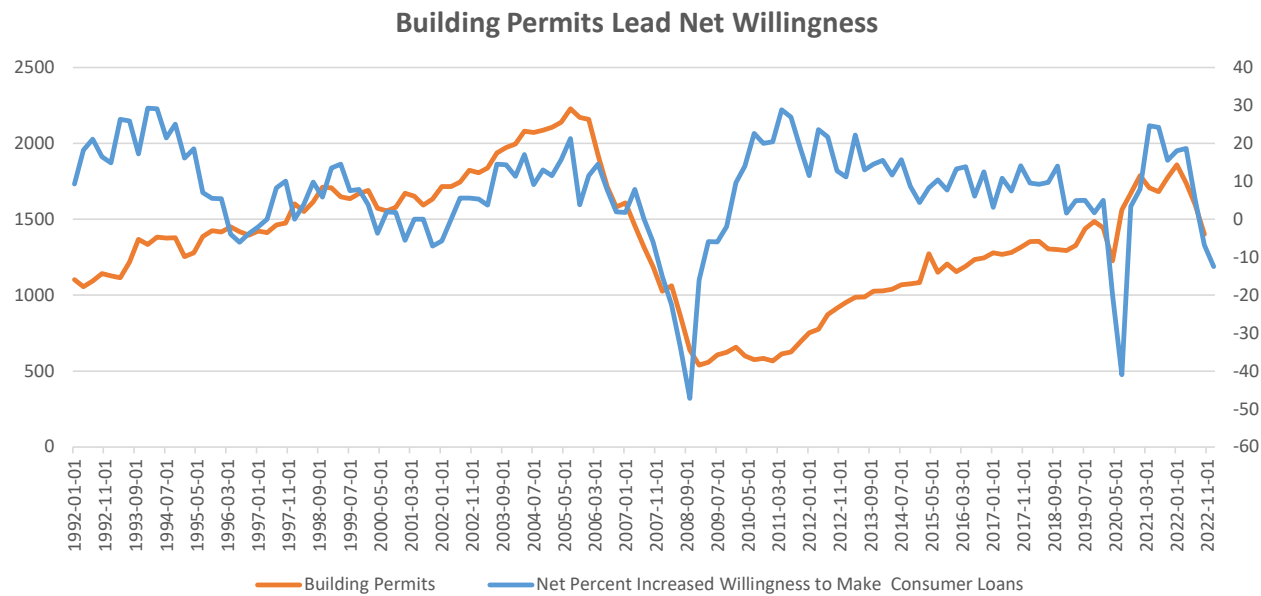
Knute Rockne



# Economy Drives Credit: Not Vice Versa

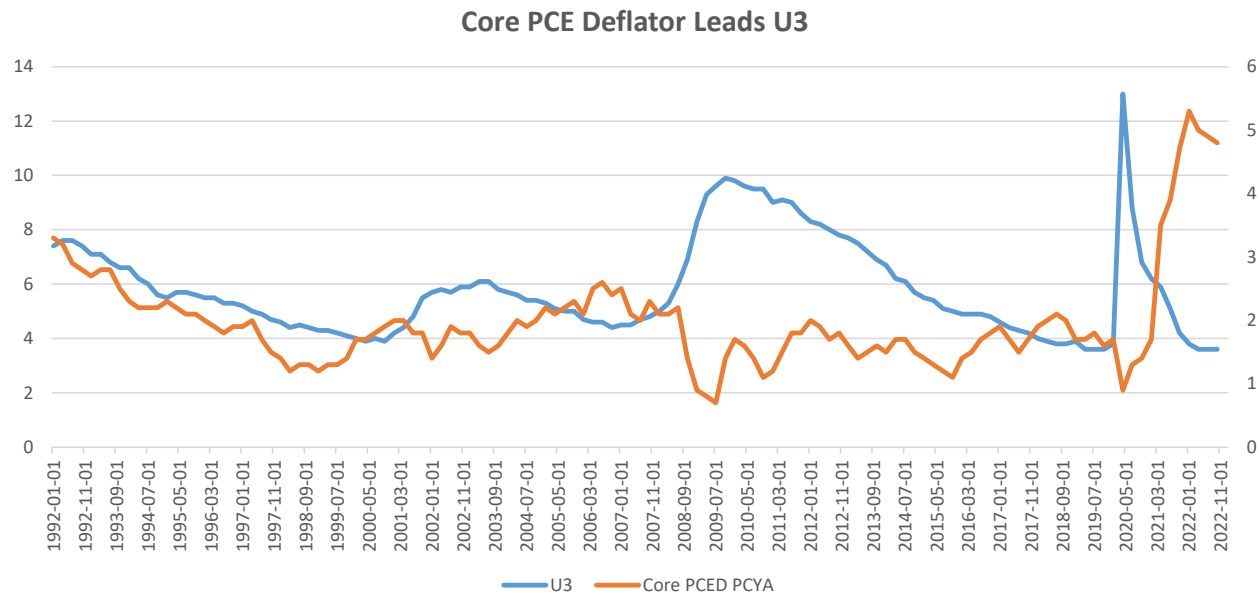


# Building Permits Lead Net Willingness to Lend





# Core PCE Deflator Leads Unemployment Rate



# Wile E. Coyote Approach to Risk

- “Fed Raised Concerns About SVB’s Risk Management in 2019,”  
March 20, 2023, WSJ
- “Goldilocks Economy Is a Fairy Tale Too Good to Be True,” Feb. 08, 2023, WSJ
- “The 10-Year Is Back From the Dead. But There’s Still Risk in Long-Term Bonds,” Jan. 12, 2023, Barron’s
- “SPAC Boom Ends in Frenzy of Liquidation,” Dec. 25, 2022, WSJ
- “The \$80tn “hidden debt” and what it really means, Calling something debt is a choice,” Dec. 12, 2022, FT
- “We haven’t reduced financial risk, just transformed it,” Dec. 10, 2022, FT
- Why the Investing Pros Were Such Suckers for FTX With billions of dollars at stake, lots of smart people turned a blind eye to the crypto company’s red flags Nov. 18, 2022, WSJ
- “Sam Bankman-Fried Led ‘Years-Long Fraud’ at FTX, SEC Says,” Dec. 13, 2022, WSJ

