OBSERVATIONS

- Spreads within the riskiest segment of the high yield corporate debt market, CCC rated bonds, reached 1,000 basis points for only the second time since 2020 as investors demand more risk premia as concerns of a slowdown in the U.S. take hold.[1]
- Job openings in the U.S. reached 11.2 million in July, higher than estimated, and remains near record highs. Meanwhile the 'quits rate'—the percent of voluntary job leavers as a percent of total employment—declined to 2.7%, a one year low.[1]
- U.S. labor market strength was also underscored by the 315,000 jobs created in August. The unemployment rate increased slightly to 3.7% from July's 3.5% figure, but the participation rate also increased in August signaling that more discouraged workers re-entered the labor market and began to look for work.[1]
- The ISM manufacturing PMI for August remained unchanged at 52.8—any number above 50 signals expansion within the U.S. manufacturing sector—however the index has fallen in recent months, and the 52.8 readings for July and August were the lowest since June-2020.[1]
- Construction spending declined in July from June dragged down by a slowing residential construction market. During the first seven months of 2022, construction spending was +10.8% above the same period of 2021—but this does not account for inflation which averaged +8.3% year-over-year in 2022.[2]
- Despite the weakening in residential construction, home prices continue to increase—albeit at a slower pace. The latest S&P CoreLogic Case-Shiller home price index shows that the median house cost 18% more in June compared to June-2021. However, this figure is down modestly from May's 19.9% year-over-year increase, and several analysts expect prices to continue to soften throughout the rest of this year.[3]

EXPECTATIONS

- U.S. and Chinese regulatory authorities announced last week an agreement that will allow the U.S. PCAOB—an accounting oversight board that is part of the SEC—to audit the books and accounting practices of over 200 Chinese firms that have an ADR listing trading on a U.S. stock exchange. U.S. authorities indicated that some audits could begin as early as mid-September. Chinese authorities re-iterated its commitment to working with U.S. regulators on this issue and signaled that this should preclude the need for any further Chinese firms to delist from any U.S. exchanges. Over the summer, five Chinese state-owned firms indicated they would move to delist as Beijing disallowed their participation in the PCAOB audit agreement.[4]
- Ukrainian forces began a counteroffensive in the southern portion of Ukraine to liberate the areas around the city of Kherson. The counteroffensive effort is likely to take several days to even weeks as Kiev chokes off supplies, destroys infrastructure, and completely isolates approximately 30,000 Russian troops.[5]

ONE MORE THOUGHT: *Supply constraints and surging demand…new evidence on the recent drivers of inflation*[6]

It's of no surprise now that the sources of inflation have been from both supply chain disruptions as well as surging demand. On the supply chain side, constraints resulting from labor shortages and bottlenecks were only made worse as demand increased due to the increase in fiscal and monetary responses by government officials, not only

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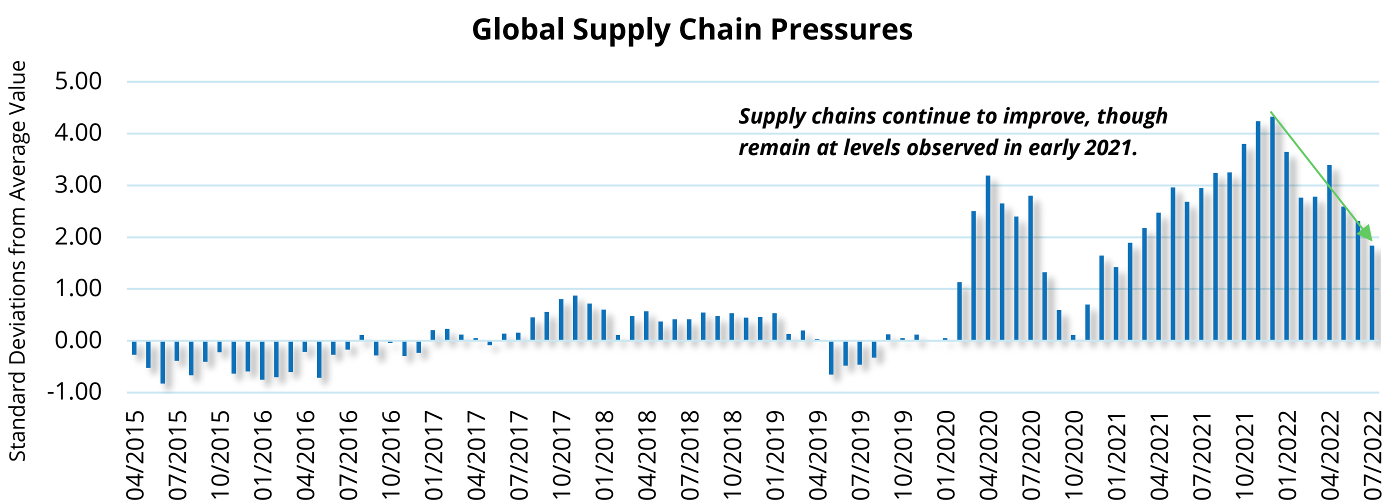
[1] *Bloomberg LP*
[2] *https://www.census.gov/construction/c30/pdf/release.pdf*
[3] *https://www.spglobal.com/spdji/en/documents/indexnews/announcements/20220830-1455422/1455422_cshomeprice-release-0830.pdf*
[4] *https://www.wsj.com/articles/u-s-and-china-reach-agreement-on-chinese-company-audits-11661517519?mod=Searchresults_pos1&page=1*
[5] *https://www.ft.com/content/708cd4cb-1979-4617-ad36-8f67f464d166*
[6] *https://www.ecb.europa.eu/pub/conferences/ecbforum/shared/pdf/2022/Kalemli-Oezcan_paper.pdf, Liberty Street Economics*

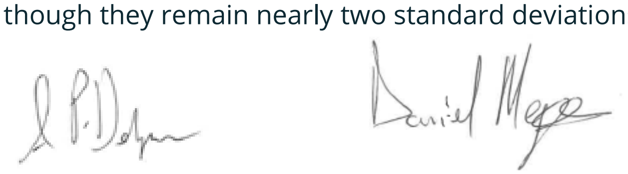
in the U.S. but around the world. A recent study (published here) noted that during the period of study, 2019-2021, nearly 90% of U.S. sectors experienced constraints of some sort as the intersection of a constrained supply chain was met with surging demand. The study goes on to attempt to disaggregate, quantitatively, how much of recent inflation has been from supply chains as opposed to demand. The authors found that demand side factors (i.e., the increase in fiscally stimulated demand) accounted for 60% of U.S. inflation, while supply constraints accounted for 40% of inflation. *Bear in mind, this is before the war in Ukraine which will continue to have an impact on food and energy prices.* Given the attribution found in the analysis, the study finds that inflation at the end of 2021 would have been closer to 6% instead of 9% had supply chain factors not been in place. The results validate the notion of the Fed being significantly behind the curve entering this interest rate hiking cycle. Even in a world where supply chains are fully normalized, the base inflation resulting from the demand side of the economy would have supported the hiking cycle to commence sooner. While there is evidence of supply chain normalization (Chart of the Week), the Fed will continue to be aggressive in its inflation fighting narrative as it attempts to blunt inflation by slowing the demand side of the economy.

CHART OF THE WEEK



Source: Clearstead, Federal Reserve Bank of New York, Global Supply Chain Pressure Index, https://www.newyorkfed.org/research/gscpi.html

The New York Federal Reserve Bank's Global Supply Chain Index (GSPI) incorporates several metrics including U.S. Census Bureau and Purchasing Manager surveys data to establish how strained supply chains are — with the index measuring how many standard deviations away from the average the data is. Most recent readings continue a multi month downward trend, though they remain nearly two standard deviations away from their long-term average.



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