SMBC Capital Markets, Inc.

fxPoetry

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# Negative Growth = Growing

While pundits worldwide are in sync
And see US growth set to shrink
According to Yellen,
In words uncompellin',
Recession's not close as we think

Though data may indicate slowing
To those of us who are unknowing
The White House explained,
Though some might be pained,
That negative growth = growing

In the fashion of both Humpty Dumpty ('When I use a word, it means just what I choose it to mean — **neither more nor less**.") and George Orwell ("But if thought corrupts language, language can also corrupt thought." Or perhaps "It's a beautiful thing, the destruction of words."), Treasury Secretary Janet Yellen has set out to redefine the meaning of a recession. After last week's dreadful PMI data, as well as the consistency of the decline in the regional Fed surveys, the inevitable questions about recession were raised to Ms. Yellen on the Sunday talk shows. But in true Orwellian style, she was quick to "debunk" the myth that negative growth is a recession, specifically that two consecutive quarters of negative real GDP results is so defined.

This is not the venue to wade through her entire response which can be seen here, but the essence is that just because GDP declines for two consecutive quarters, that is neither technically a recession (correct, the NBER is the official arbiter of US recessions) nor even an indication of a slowing in the economy given how strong the labor market and spending continues to be. If you ever wondered why policymakers are always late to the party, it is this mindset that keeps them forever looking in the rearview mirror.

However, despite Secretary Yellen's protests to the contrary, it is abundantly clear that the market sees a recession pending. Whether one looks at the short-term interest rate markets, where Fed funds futures are now peaking at 3.36% (down from >3.7% two weeks ago) in December and declining back below 3% by the middle of 2023, or the Treasury market, where the 2yr-10yr Treasury yield curve has been consistently inverted since the beginning of July having previously first inverted in early April, fixed income investors are clearly looking at much slower growth ahead.

But perhaps, this is a good time to ask that very question; what is a recession? Forgetting the NBER for a moment because the timeliness (or lack thereof) of their announcements makes them useless from a market perspective, the quick and dirty estimate of two consecutive quarters of negative real GDP output is widely accepted, even if not by this White House. But what about nominal GDP growth? Remember, for the past 40+ years, with CPI/PCE inflation hovering either side of 2%, the real number was always seen as appropriate from both an academic perspective as well as a descriptor of economic reality on the ground. After all, it implied that nominal GDP was flat to potentially falling depending on the depth of the recession. However, with inflation running at 9.1%, nominal GDP can still be growing nicely as prices rise and the dollar amount of activity continues to expand even though the real amount of activity shrinks.

For those academics with a more liberal leaning (i.e. almost all of them) eliding into an acceptance of nominal GDP as the descriptor of activity suits their explanations for the current policies better than accepting a recession is a result of those policies. This is especially true of the MMT crowd. This idea is also in keeping with the overall financialization of the economy where company management is wont to consider share repurchases as the most effective growth stimulus rather than reinvestment into their business via R&D or capex. Thus, everything is not only measured in dollars, but the number of dollars trumps the number of goods or services created/purchased. We will hear much more about this going forward, count on it. And with inflation at 9%, nominal GDP is nowhere near shrinking. The evolution of the meaning of words, a so-called semantic shift, is ongoing and eternal. Alas, Joseph Goebbels was exactly correct when he said. “If you tell a lie big enough and keep repeating it, people will eventually come to believe it.”

And with that cheery thought, let’s say if those ~~lies~~ comments have impacted markets today, or if not, what has.

Risk has had a mixed session with Asian equity markets (Nikkei -0.8%, Hang Sent -0.2%, Shanghai -0.6%) suffering in the wake of the US sell-off Friday, while Europe (DAX +0.4%, CAC +0.5%, FTSE 100 +0.25%) must be expecting a more dovish ECB after much weaker than expected German IFO data, with July’s Expectations print at 80.3, the third lowest in the series history. Only the Covid collapse and the worst GFC month were lower. US futures, too, are higher, about 0.6% across the board, clearly responding to the idea that slower growth means the Fed is not going to be hiking as aggressively, although 75bps is built in for this week.

Bond yields are higher this morning with Treasuries (+5.6bps) the weakest of the bunch, although this is after a remarkably strong rally last week where yields fell 27bps peak to trough. In Europe, Bunds (+2.4bps), OATs (+2.8bps) and Gilts (+1.4bps) are all a bit softer and Italian BTPs (+3.7bps) are faring even worse, widening that all important spread somewhat. JGB’s though, have seen yields fall to 0.196%, miles away from the cap as it appears the investor community, as well as the speculative community, are finally accepting that the BOJ is not going to cave.

Oil prices (+0.95%) are a bit higher, and quite frankly, given the positive supply news from Libya, which continues to increase its production levels after ending the force majeure declaration last week, holding up quite well. Meanwhile, NatGas (+0.8%) continues to rebound from its lows seen immediately in the wake of the Freeport fire outside Houston and are now well above $8/MMBtu. Of course, compared to Europe, where prices are ~$57/MMBtu, that's still quite cheap. And those prices are very likely to continue to converge over time. Gold (+0.2%) continues its modest rebound and copper (+0.7%) does as well although aluminum (-0.4%) is a touch softer on continued high electricity prices.

Finally, the dollar is under pressure this morning with NOK (+1.1%) leading the way in the G10 followed by SEK (+0.8%) and GBP (+0.65%), while only the yen (-0.2%) is under water. Obviously, oil is helping NOK this morning while SEK and GBP are rebounding from what have been sharp declines in recent weeks. The yen, too, is a reflexive move after the sharp decline seen Friday, when stop-loss levels were broken and the dollar fell more than 1%. In the emerging markets, PLN (+0.95%) and MXN (+0.6%) are the leaders with the zloty benefitting from declining inflation expectations in the country while the peso bathes in the warm glow of rising oil prices.

Of course, there is a great deal of data coming this week plus the FOMC meeting on Wednesday.

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| Today | Dallas Fed Mfg Activity | -22.0 |
| Tuesday | Case Shiller Home Prices | 20.60% |
| | Richmond Fed | -15 |
| | Consumer Confidence | 97.0 |
| | New Home Sales | 662K |
| Wednesday | Durable Goods | -0.3% |
| | -ex transport | 0.2% |
| | Retail Inventories | 1.1% |
| | FOMC Meeting | 2.25%-2.50% |
| Thursday | Q2 GDP | 0.5% |
| | Q2 Consumption | 1.2% |
| | Initial Claims | 250K |
| | Continuing Claims | 1380K |
| Friday | Employment Cost Index | 1.2% |
| | Personal Income | 0.5% |
| | Personal Spending | 0.9% |
| | Core PCE | 0.5% (4.7% Y/Y) |
| | Chicago PMI | 55.1 |
| | Michigan Sentiment | 51.1 |

Source: Bloomberg

So, obviously there is a lot to anticipate this week. The Fed will be the dominant discussion for the next two days, and then depending on just what Mr Powell says at the press conference, could well be the dominant discussion for the rest of the week. But PCE data as well as more manufacturing surveys are going to help get a better handle on the US economy.

Meanwhile, with US rates having softened, as well as the Fed funds futures market removing some of its erstwhile tightening expectations, the dollar is under a bit of pressure. Remember, the dollar's strength is largely a function of market belief that the Fed is not going to stop. At such time as the market begins to believe they are going to halt, the dollar is likely to suffer, and suffer hard.

Good luck and stay safe

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The views expressed are his own and may differ from Research.

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