Rodney's Take

June 27, 2022

And, It's Gone… Poof!

The Great Financial Crisis spawned countless shows, both serious and comical, that tried to explain what had happened and how the economy's financial plumbing works. We had everything from the movie *The Big Short* to the animated talking bear series that took shots at "The Bernank" and the Fed. Among the funniest was a recurring bit on South Park, where various characters put money with a stockbroker who seconds later says, "And, it's gone… Poof!" That came to mind last week when the Federal Reserve Bank of Atlanta updated its GDPNow model. The expected real GDP growth for the second quarter before today was exactly zero, down from 2% at the beginning of the quarter. It's gone. Poof!

By the time this article gets to you, the U.S. Census Bureau will have released the advance estimate of Manufacturers' Shipments, Inventories, and Orders (M3), which is likely to have declined in May, as auto manufacturers struggled to produce inventory and other sectors slowed down. The Atlanta Fed will incorporate that number into the GDPNow model and release its latest estimate sometime this morning. It's not much of a stretch to think that the latest forecast will be for negative real GDP growth, which will make two consecutive quarters of falling growth. This fits one of the definitions of a recession, but whether it's called a recession will be determined by the National Bureau of Economic Research.

Recessions typically aren't cause for celebration, but many people on Wall Street will smile a little bit more if the economy continues to slow. Those people aren't sadistic, and they aren't reveling in the misery of the nation.

Instead, they're betting that faster the nation falls into a recession, the faster the Fed will have to change course, which will lead to a face-ripping rally in equities. In the May 16 Rodney's Take, I wrote:

> "The good news is that weak second-quarter growth could give both the equity and bond markets a bounce if investors expect the Fed to pause in its tightening cycle. The harder the economic landing, the more dramatic the rebound might be. While we wait for more data, conserve your cash and make a wish list of stocks and bonds you'd like to own. In the financial markets, we might get Christmas in July."

It looks like this is coming to pass, as equities rebounded last week with every negative economic release. The more Fed Chair Powell spoke of hewing to tight monetary policy, the higher the markets climbed. Market participants keep lowering the odds of a 50-basis point move in September, and the chance of any rate hike in December is growing dim.

None of this is cast in stone. The Fed governors might stick to their economic guns even as the economic numbers show weakness, but if the past is any guide, that's not likely. Instead, they'll adjust their language after the July meeting to talk more about "watching the data" even as they raise rates, and then by September they will be pushing through smaller rate hikes to show that they remain serious. But after that, if the economy is mired in a technical or actual recession, they might not raise rates at all.

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Got a question or comment? You can contact us at info@hsdent.com.