

WEEKLY

Economic Commentary

FEBRUARY 9, 2024



Millennium
CORPORATE CREDIT UNION

The economy keeps on chugging along, reducing recession fears even further while heightening prospects of a soft landing. The downside of this otherwise brighter outlook is that it pushes back the timetable for a Fed rate cut, which most thought would take place as early as March. Fed chair Powell put the kibosh on that expectation in the press conference following the last policy meeting, and Fed officials have continued to push back on the notion of an imminent rate reduction ever since. That said, policymakers are not straying from their plan to cut this year, but most likely not until May at the earliest.

That delayed timetable should come as no surprise, as the economy’s resilience allows the Fed more time to assess the impact of past rate hikes and to see how conditions unfold. One particularly encouraging sign is that the economy’s stellar performance has not derailed the progress made on the inflation front. Just about all key price gauges are steadily receding and could well hit the Fed’s 2 percent target by late this year. There has been a ton of hand-wringing over the anticipated revisions to the consumer price index that the government

CONSUMER PRICE INDEX (ANNUAL RATES)				
	Before Revision		After Revision	
Headline CPI				
3-months		1.8		1.9
6-months		3.3		3.1
12-months		3.4		3.3
Core CPI				
3-months		3.3		3.3
6-months		3.2		3.2
12-months		3.9		3.9

makes early each year to adjust for possible changes in seasonal influences. Fears had been running high that the new seasonal adjustment factors would result in higher inflation rates than previously reported. That was the case last year, when revisions boosted the inflation rate in late 2022, prompting a more hawkish stance by the Fed and additional rate hikes in March, April, and July of 2023.

However, this time the revisions, released on Friday, turned out to be a nothingburger, prompting a big sigh of relief for inflation doves. As the table shows, the revised seasonal factors resulted in virtually no change to the trends over the past three, six or 12-month periods for the consumer price index. Keep in mind that the central bank’s preferred inflation measure, the personal consumption deflator, runs about a half percentage point lower than the CPI, so the road to 2 percent remains firmly on track. To be sure, there may be potholes along the way. Shipping costs have been climbing in recent weeks owing to Houthi attacks on vessels in the Red Sea, forcing ships to be rerouted that may well lead to delivery delays and temporary shortages of goods as well as higher prices than otherwise. Weather patterns, reflecting the effects of El Nino, could also cause supply chain problems.

But policy makers are likely to view these events as temporary disruptions that will fade over time and not alter the longer-term inflation landscape. This is where the rubber meets the road for the Fed, as chair Powell believes that the inflation retreat over the past three and six months is neither long or convincing enough that inflation is on a sustainable path towards the 2 percent target. Indeed, investors are now anxiously awaiting next week’s CPI report for confirmation of the disinflation trend. Any upside surprise could well jolt the markets. Odds are, however, a single month deviation from trend will not alter the Fed’s plans, particularly if special influences play a role. What the Fed will keep a keen eye on is the more substantive forces that underpin the longer-term trend in inflation.

Critically, that points directly to the job market and household spending patterns. Both have exceeded expectations and the longer that is the case, the more hesitant will the Fed be to pull the rate-cutting trigger. Last week’s blockbuster jobs report has already taken a toll on the bond market, sending yields higher since its release. Although the headline surge in jobs created in January was clearly a thumping surprise to investors,

we cautioned that many flaws in the report make it an unreliable portrayal of the labor market's fundamental strength. There is more noise in January's jobs data than in other months of the year, reflecting the big influence of seasonal hiring and weather patterns, and this January was much colder and stormier than usual. Hence, many workers had to stay home; but since many of them were salaried employees, they received full wages that boosted average earnings per hour worked. Yet, the outsized 0.6 percent increase in average hourly earnings during the month was one of the key components of the jobs report that rattled the financial markets.

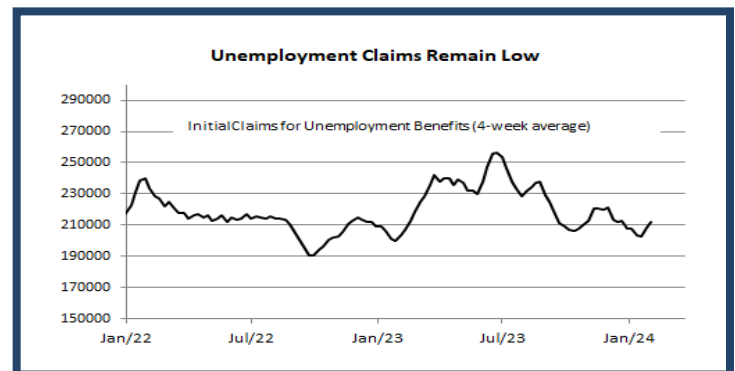
That surprising jump conveys the impression that workers are still in the driver's seat, demanding and getting bigger raises that pressure companies to cover higher labor costs by raising prices. But, as noted, that figure is misleading and clearly overstates the bargaining power that workers retain. Other measures of worker pay, such as the government's quarterly Employment Cost Index that adjusts for worker hours, showed a moderating trend in the fourth quarter. Likewise, the increase in the Federal Reserve Bank of Atlanta's wage tracker, which adjusts for the changing mix of jobs from month to month, fell in January for the first time in four months to the lowest level in a year. However, it is still running at a 5 percent pace over the past 12 months, which is higher than the 3.5 percent considered to be consistent with a 2 percent inflation rate after adjusting for 1.5 percent productivity growth.

What's more, despite widespread reports of layoffs, including a big jump in layoff announcements reported by the Challenger Report in January, there is little evidence that workers are flocking to the unemployment lines. Initial claims for unemployment insurance have remained historically low since last November and the unemployment rate has remained under 4 percent for 24 consecutive months, a stretch not seen since the 1960s. It's unclear why the bulge in layoff announcements has not translated into more applicants for jobless benefits. One reason is that layoff announcements are just that – announcements -- not actual layoffs. Announcements can be rescinded or delayed. For another, as already noted laid-off workers are being quickly rehired or expect to land a position soon and, hence, do not even bother filing for benefits.

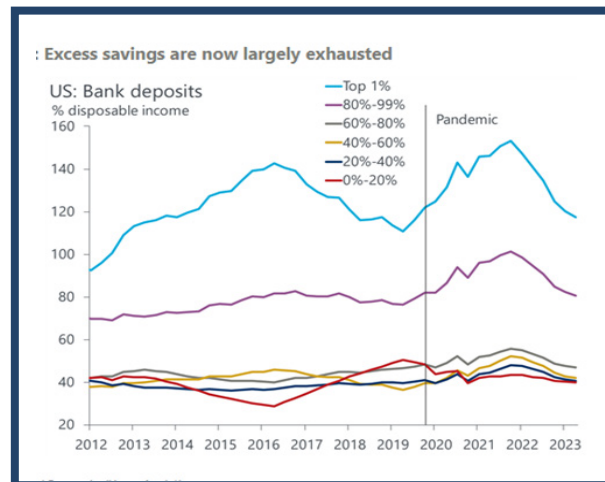
Finally, the biggest wave of layoff announcements is occurring in the highly-paid tech industries, including a whopping 234 thousand in January alone. However, these workers usually receive hefty severance packages and most likely have built up a healthy financial cushion that can tide them over for an extended period of time. It's possible that this cushion encourages them to avoid filing for unemployment benefits as well, at least until the funds run out. It's important

to remember that millions of workers get laid off every month, which is more than offset by the millions that get hired during the same month. The difference between the two yields the net change in payrolls, which is usually a net gain that shows up in the monthly jobs report.

Despite their many flaws, the Fed relies on incoming data to guide it through its interest rate decisions. Unsurprisingly, the statistical evidence so far this year favors a "wait-and-see" approach rather than a quick pivot towards easing policy. Indeed, the GDPNow tracker compiled by the Federal Reserve Bank of Atlanta is tracking a first-quarter growth rate in GDP of 4.2 percent, which would be an acceleration from 2023. From our lens, however, the data is poised to turn more friendly for a rate cut in coming months. We expect the job market to soften and unemployment to start rising by the spring, topping 4 percent by the end of the year. One reason:



labor hoarding by businesses is starting to diminish as more workers become available. According to the Conference Board's latest survey of CEOs, released this week, there was a big uptick in the number of companies expecting to lay off workers this year. Meanwhile, those highly paid laid-off workers who are not filing for unemployment claims may see their savings depleted more quickly than expected. The Federal Reserve's latest figures on household balance sheets show that excess savings are being run down sharply, with the sharpest draw downs among wealthier individuals. This suggest not only that robust consumer spending will soon start to cool off, but that formerly cash-rich unemployed workers may be more willing to return to the labor force for a lower-paying job. Both developments bode well for the inflation picture and should weaken the Fed's reluctance to cut rates by the summer.



KEY FINANCIAL INDICATORS

INTEREST RATES	February 9	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.38%	5.37%	5.22%	4.66%
6-month Treasury bill	5.28	5.24	4.98	4.75
2-year Treasury note	4.48	4.37	4.14	4.50
5-year Treasury note	4.14	3.99	3.84	3.93
10-year Treasury note	4.17	4.02	3.96	3.74
30-year Treasury bond	4.37	4.22	4.20	3.83
30-year fixed mortgage rate	6.64	6.63	6.66	6.12
15-year fixed mortgage rate	5.90	5.94	5.87	5.25
STOCK MARKET				
Dow Jones Industrial Index	38671.69	38654.42	3759.98	33869.27
S&P 500	5026.61	4958.61	4783.83	4090.46
NASDAQ	15990.70	15628.95	14972.76	11718.12
COMMODITIES				
Gold (\$ per troy ounce)	2039.60	2057.10	2107.20	1926.00
Oil (\$ per barrel) - Crude Futures (WTI)	76.60	72.40	72.03	77.51

KEY ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Services Index (January)	53	51	53	53
Consumer Credit (December) - \$blns	1.6	23.5	7.1	6.4

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