WEEKLY
Economic Commentary

FEBRUARY 23, 2024

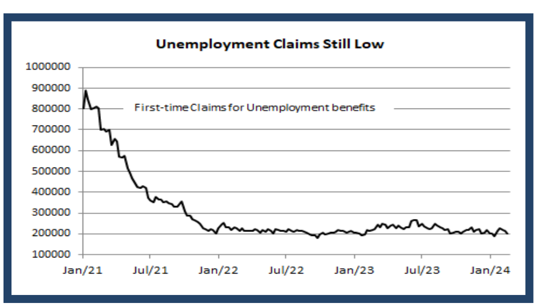
Millennium
CORPORATE CREDIT UNION

The week was devoid of significant economic data, with only sales of existing homes and claims for unemployment benefits on the calendar. Neither were market-moving events, nor did they provide any surprises. Perhaps no news constituted good news for a market that has been buffeted by noisy and conflicting reports on inflation as well as the economy's performance during the opening month of the year. Stock prices did hit fresh records on Thursday, as the headline-grabbing chip maker, Nvidia, reported blockbuster results, highlighting the ongoing positive influence the AI revolution is having on investor expectations. To be sure, the stock market is not the economy, as economists repeatedly caution. But nor is it not related to economic developments. The $277 billion increase in Nvidea's stock value on Thursday contributes to the wealth effect of its holders as well as to the portfolios of the broader stock-holding public. This, in turn, does have an impact on consumer spending, although one that is not as powerful as the boost provided by income growth. There is also a modest feedback loop to the job market, as managers of corporations whose stocks are rising are under less pressure to lay off workers.

In contrast to stocks, bonds continue to struggle, with long-term yields having retraced about 50 percent of the decline since October, when expectations ran high that the Fed was poised to cut rates as early as March. Since then, the rate-cutting mindset among investors has faded considerably, and following the hotter than expected jobs and inflation reports for January, it has completely vanished. At the end of this week, the bellwether 10-year Treasury yield hovered around 4.25%, up from a nearby low of 3.88 percent on February 1. The most direct impact of the rebound is being felt in the mortgage market, where rates are moving back towards the 7 percent threshold, up from 6.60 percent in mid-January. Sales of existing homes enjoyed a modest bounce in January, but those sales were for contracts signed one or two months ago, when rates were lower. Those lower rates also encouraged some homeowner to put their properties on the market, easing the inventory shortage a bit. Odds are, however, the recent climb in mortgage rates will slam the door on the nascent recovery unless it is quickly reversed.

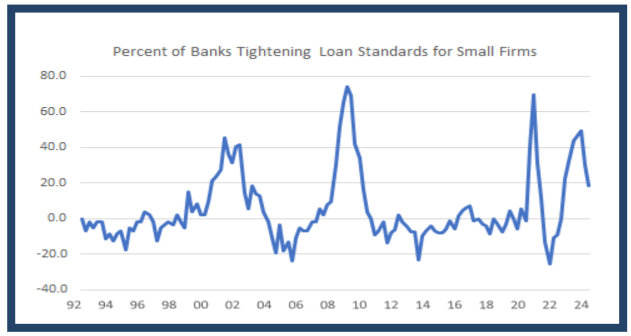
Until more economic data comes in, speculation on monetary policy will continue to swirl. In fact, a raft of economic speeches by Fed officials and, importantly, the release of the Fed's last policy meeting in late January took center stage this week. From our lens, the minutes provided the most interest, as it fleshed out details of the post-meeting summary statement and provided background for Chair Powell comments at the following press conference. The key takeaway from the minutes from the January meeting of the FOMC is that policymakers believe the risks of cutting too soon outweigh waiting too long. It is clear the Fed still lacks confidence that inflation is on sustainable path toward its 2% target. Some Fed officials are concerned that disinflation could "stall."

The solid gain in real GDP during the fourth quarter and robust trend job growth could give the Fed pause about the prospect for disinflation to continue, let alone intensify. While we believe the surge in payrolls reported for January overstates the strength of hiring, it is clear that the job market remains tight. True, some high-profile layoffs in the tech and media sectors are garnering much attention. But millions of workers get fired every month, and millions more get hired. On balance, the unemployment lines remain short, as initial claims for jobless benefits continues to hover at historically low levels. However, that alone does not mean that wages are coming under increasing pressure. Companies may be hoarding labor, but they are posting fewer openings and the recent decline in



vacancies suggest that the labor market is less tight than was the case last year. Indeed, wage growth has, and will, continue to decelerate.

That said, the Fed's concern about taming inflation is not misplaced because it is putting an enormous burden on households. The minutes showed concern that elevated inflation continued to harm households, especially those with limited means to absorb higher prices. Lower-income households are being hurt by high food prices and higher rents. Food and rent account for a large share of low-income household budgets. The issue for the Fed is that monetary policy is a blunt instrument, and it cannot directly impact food. The good news is that market rents are declining, pointing to significant relief on the horizon.



Aside from the growth drag from inflation and high borrowing costs, the Fed is also monitoring credit availability, the lifeblood of the economy. The minutes referenced the January Senior Loan Officer Opinion Survey on Bank Lending Practices, in which banks reported tightening standards and terms on commercial and industrial loans. Banks tightened the screws aggressively on lending following the sudden stress among regional banks last year, but the drag on the economy was not as significant as feared. There are a few reasons behind that, including stable net interest margins and a better ability to hedge interest rate risk. The use of nonbanks as a source of credit also played a role. For example, following the stress caused by regional banks last year, nonbank lenders reduced lending to businesses by less than banks.

Remember that the minutes are dated, and policymakers did not have recent data on consumer or producer prices, both of which came in hotter than expected. That's not the start of the year the Fed wanted, but it is only one month. The Fed should not worry about the inflation outlook based on a single month, particularly January when seasonal adjustment and residual seasonality can wreak havoc on the data. Plenty of inflation data will be released before the May meeting, when we and the financial markets are now pricing in the first rate cut.

We are not too concerned about whether the Fed will cut rates in May or at the following meeting because the macroeconomic implications are minimal. The issue for the Fed is that markets like clarity and it is going to become increasingly difficult for the Fed to push back on cuts, particularly as inflation continues to decelerate, putting upward pressure on real interest rates. The Fed has mentioned that it is worried that rising real interest rates will become overly restrictive on the economy. We agree, and the longer it waits, the greater the odds that the economy will descend into a hard landing.

KEY FINANCIAL INDICATORS

INTEREST RATES	February 23	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.41%	5.37%	5.21%	4.72%
6-month Treasury bill	5.36	5.32	5.01	4.91
2-year Treasury note	4.68	4.64	4.34	4.78
5-year Treasury note	4.28	4.28	4.04	4.19
10-year Treasury note	4.25	4.28	4.15	3.95
30-year Treasury bond	4.37	4.43	4.38	3.93
30-year fixed mortgage rate	6.90	6.77	6.69	6.50
15-year fixed mortgage rate	6.29	6.12	5.96	5.76
STOCK MARKET				
Dow Jones Industrial Index	39131.53	38627.99	38109.43	32816.92
S&P 500	5088.80	5005.57	4890.97	3970.04
NASDAQ	15996.82	15775.65	15455.36	11394.94
COMMODITIES				
Gold ($ per troy ounce)	2046.40	2025.40	2072.80	1869.30
Oil ($ per barrel) - Crude Futures (WTI)	150.48	79.22	76.36	75.42

KEY ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Existing Home Sales (January) - mlns of units	4.0	3.9	3.9	3.9

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