

WEEKLY

Economic Commentary

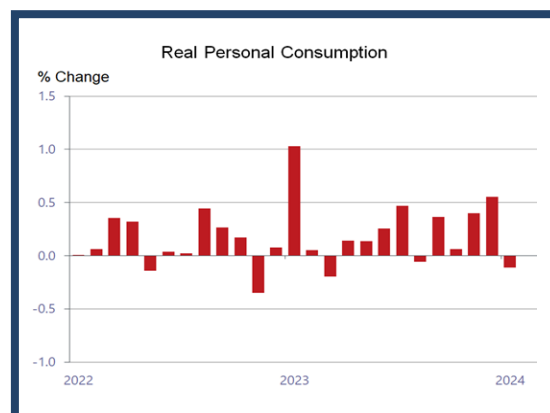
MARCH 1, 2024



Millennium
CORPORATE CREDIT UNION

This week's batch of economic reports came in much as expected, but the divergence of opinion they generated could not be more stark. Depending on what data point or component is used as a reference, the economy is either faltering or forging ahead, inflation is cooling, stalling or accelerating and, importantly, the Fed has more reason to ease, stay put or, as some notable economists are whispering, should consider raising interest rates. Taking center stage this week, the much-anticipated personal income and spending report had enough conflicting information to suggest the parable of the blind men trying to describe an elephant by touching different parts of the pachyderm's mammoth body.

For sure, the Commerce Department's report touches just about every aspect of the economy. The personal consumption component drives roughly two-thirds of GDP so changes here are closely watched for guidance on growth prospects for the broader economy. As expected, consumers took a breather in January, with purchases of goods and services slipping after accounting for inflation. However, the setback follows a robust, upwardly revised, increase in December, reflecting strong holiday sales, so the year started on a higher plane that will give heft to the first-quarter's growth rate, unless consumers decide to go into hibernation in February and March. That's highly unlikely given the sturdy fundamentals underpinning household spending; balance sheets remain healthy; the job market is chugging along, and wages are advancing at a solid clip.



The other side of the household ledger provides ample evidence that consumers are not about to close their wallets. Personal income jumped 1.0 percent in January, the strongest advance in a year. However, the catalyst for the leap did not come from organic sources. Wages did grow by a decent 0.4 percent but compared to previous monthly increases that's not something to write home about. In fact, wage growth over the previous twelve months averaged 0.6 percent, pointing to some downshifting in labor compensation. Instead, households enjoyed a big boost from the Social Security cost-of-living adjustment that typically occurs in January. Incomes were also bumped up by rental payments and dividends.

These are one-off influences that are not sources of sustained purchasing power. The COLA bump primarily benefits the elderly and should enter the spending stream fairly quickly; the jump in rental income and, particularly, dividend payments will pad the financial cushion of wealthier households who are more likely to save than spend the proceeds. More broadly, the 1 percent increase in aggregate personal income was siphoned off by higher taxes and prices, transforming the outsize increase in nominal personal income into a slim decline in real disposable income. Looked at this way, household purchasing power received no lift at all last month. But since real consumption fell by more, the personal savings rate remained mostly intact, edging up to a still historically low 3.8 percent from 3.7 percent.



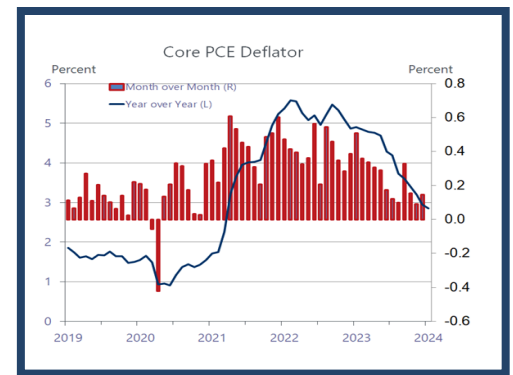
However, it would be a mistake to view that low savings rate as a sign of budgetary stress. People save less when they feel richer, and the year-long surge in stock prices together with the strong pandemic-induced advance in housing equity have propelled household net worth to record highs relative to incomes. Still, the

wealth effect cuts both ways, and we expect that slower job growth and cooler wage gains will motivate households to build up precautionary savings as the year progresses. Indeed, the latest surveys by the Conference Board and University of Michigan suggest that households are becoming somewhat less

optimistic about job and income prospects. The question is, how long will the momentum from late last year drive consumer spending in coming months. That's a critical question for the Fed, which must decide how long to keep rates at current levels if inflation retreats more slowly towards its 2 percent target than forecast.

Unfortunately for policy doves, the inflation component in the personal income and spending report suggests that Fed officials should be in no hurry to pull the rate-cutting trigger. To be sure, the central bank's main inflation gauges, the personal consumption deflator, with and without volatile food and energy prices, both receded from their year-earlier pace. The annual increase in the overall deflator slipped to 2.4 percent from 2.6 percent in December while the core deflator fell to 2.8 percent from 2.9 percent. But the hotter inflation rates of a year ago made the year-over-year comparison more favorable, and those earlier increases will soon drop out of the calculation.

It is the more recent changes that the Fed and financial markets focus on, as that provides a better indication as to whether the disinflation process is continuing or stalling out. If the January change is any indication, the downward slope is getting flatter. Both the overall and core deflators turned markedly higher, with the core index leaping by 0.4 percent, the biggest monthly increase in a year. More disconcertingly, prices of services excluding energy and housing – the so-called Supercore rate – staged the biggest monthly increase in January, at 0.6 percent, since December 2021. Fed chair Powell has repeatedly noted that he and his colleagues are watching this gauge closely, as it reflects domestic conditions, particularly wage trends, that have a heavy influence on prices in the services sector.



While alarming on the surface, the acceleration had little impact on the financial markets, and we doubt that a one-month outlier will derail the Fed's thinking about its plans to cut rates later this year. Most believe that the January surge was an outlier, reflecting in part, an outsize increase in portfolio management fees linked to the strong stock market last year. We agree and believe that the disinflation trend will resume in coming months. That said, with the Fed laser focused on the Supercore rate, it is not likely to make the first rate cut until it is convinced this measure is on a sustainably slowing course. That, in turn, heightens the risk that rates will be held higher for longer, with the first expected easing move pushed back from May to June.

It is important to remember that a rate cut is not necessarily the same as a policy easing. If the Fed follows inflation down by cutting rates less than the decline in the inflation rate, it is actually tightening policy as real rates would rise and pose a bigger drag on economic activity. At this juncture, the economy has enough muscle to withstand a brief uptick in real rates, thanks to the ongoing strength in the job market. We caution, however, that when bad things start to happen, particularly in the job market, they tend to deteriorate quickly and by then the Fed would be behind the curve, much as it waited too long for inflation to gain traction before starting its tightening cycle in the spring of 2002. Only this time, it would be fighting against a recession by delaying the easing cycle longer than necessary.

KEY FINANCIAL INDICATORS

INTEREST RATES	March 1	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.38%	5.41%	5.37%	4.74%
6-month Treasury bill	5.31	5.36	5.24	4.94
2-year Treasury note	4.54	4.68	4.37	4.86
5-year Treasury note	4.16	4.28	3.99	4.26
10-year Treasury note	4.19	4.25	4.02	3.97
30-year Treasury bond	4.34	4.37	4.22	3.90
30-year fixed mortgage rate	6.94	6.90	6.63	6.65
15-year fixed mortgage rate	6.26	6.29	5.94	5.89
STOCK MARKET				
Dow Jones Industrial Index	39087.38	39131.53	38654.42	33390.97
S&P 500	4137.08	5088.80	4958.61	4045.64
NASDAQ	16274.94	15996.82	15628.95	11689.01
COMMODITIES				
Gold (\$ per troy ounce)	2091.60	2046.40	2057.10	1907.80
Oil (\$ per barrel) - Crude Futures (WTI)	79.80	150.48	72.40	77.54

KEY ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
New Home Sales (January) - 000s	661	651	607	657
Personal Income (January) - % change	1	0.3	0.3	0.5
Personal Consumption (January) - % change	0.2	0.7	0.4	0.4
Personal Savings Rate (January) - Percent	3.8	3.7	4.1	4.0

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