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Corporate Federal Credit Union

Economic Update

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Commentary

In January, equity and bond markets moved higher under the premise that the economy was weakening, inflation was cooling at a rapid pace and the Fed would soon be switching from a hiking mode to an easing mode. Surprisingly, Fed Chairman Jerome Powell did not push hard against that narrative at his press conference following the Federal Open Market Committee (FOMC) meeting on February 1, 2023. This helped moved the markets even higher in early February. The S&P 500 was up 9% year-to-date on February 2. The 10-year Treasury bond was 50 basis points lower than where it closed in 2022. The labor report that was released later that week caused the market to rethink its beliefs.

Payroll growth surged ahead by almost three times the amount expected. The 500,000+ net new monthly jobs were the highest since July. The unemployment rate fell to 3.4% — the lowest since 1969. It’s tough to glean too much information from one employment report. The gain in jobs was mainly due to seasonal factors (the non-seasonally adjusted payroll change was a loss of 2.5 million jobs) and revisions to past data. Still, the unadjusted data showed the smallest loss in jobs in January since 1995, which is a month that is typically weak due to laying off holiday workers, and the revisions indicate a tighter labor market than was previously believed.

Subsequent data released during February also pointed to renewed vigor in the economy. The widely tracked Institute for Supply Management (ISM) Services Index had its largest monthly advance in two and half years and new orders surged. Retail sales were much stronger than expected and more than offset the decline in sales from the previous two months. The positive slew of economic reports indicate the consumer is still willing and able to spend as long as jobs remain plentiful.

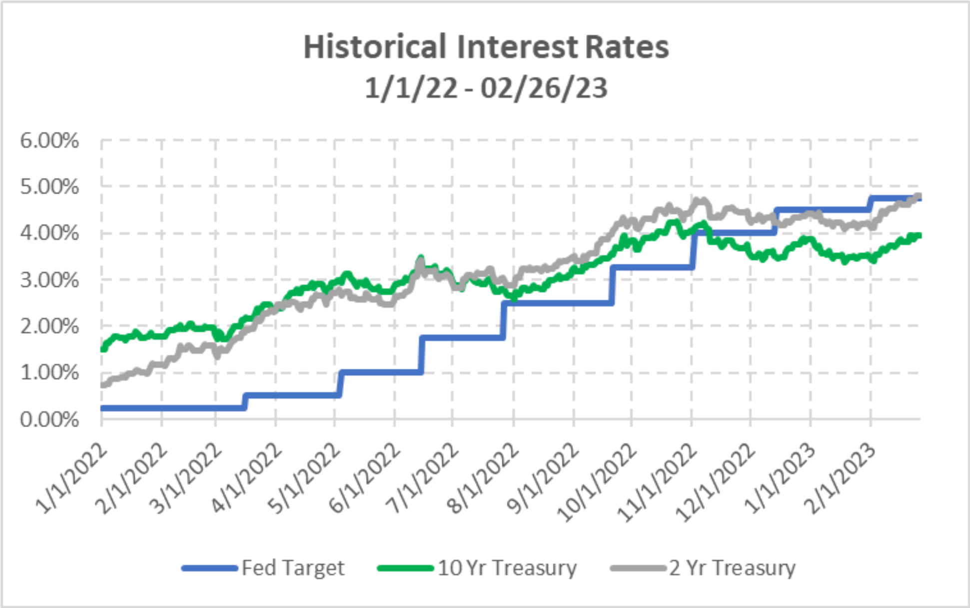
On the inflation side, the disinflationary trend of late 2022 showed signs of reversing. Core goods prices moved slightly higher after posting a series of declines late last year. Core services inflation remained stubbornly high. Core services (excluding shelter and medical costs), which is a key metric that the Fed is tracking, accelerated from December.

All of this means the Fed has more work to do, which increases the risk of a hard landing. The Fed will have to keep pushing rates higher until cracks in the labor market become clear, which likely means several more rate hikes and higher rates for an extended period.

THIS MONTH

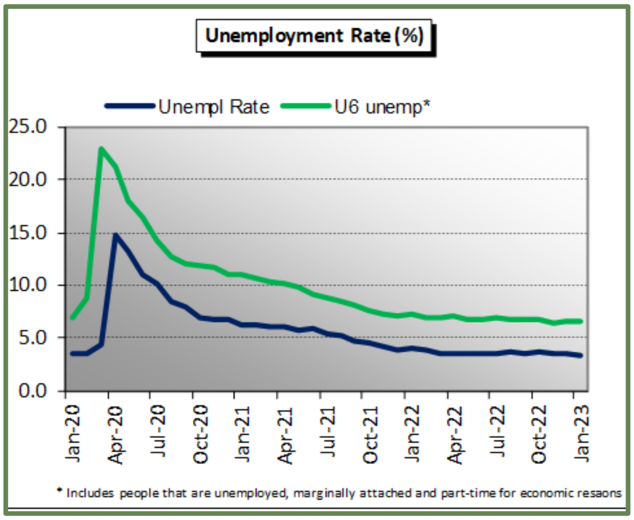
Fixed Income Outlook

Interest rates shifted significantly higher in February. Medium-to-longer-term rates moved 50 basis points higher as hopes of an easing cycle beginning in 2023 have largely faded. The market is now pricing in three more 25-basis-point interest rate hikes this year. We agree with this path and believe the bar is high for either pausing rate hikes or hiking by more than 25 basis points per meeting. The March FOMC meeting will bring new economic and rate projections. It is likely that many FOMC participants have shifted to a "higher for longer" rate path.



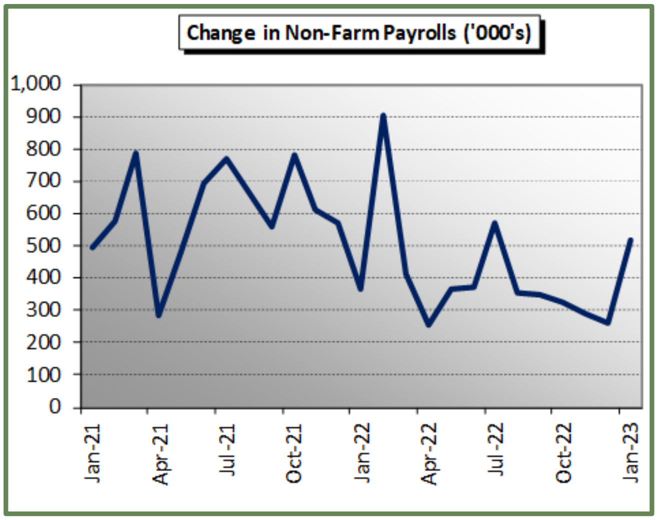
Labor Readings

(Data source: Bloomberg)



Labor Market Strength Continues

The unemployment rate fell to 3.4% in January — the lowest level since 1969.The household report was very strong. The labor force participation rate is back to its highest level since last March.

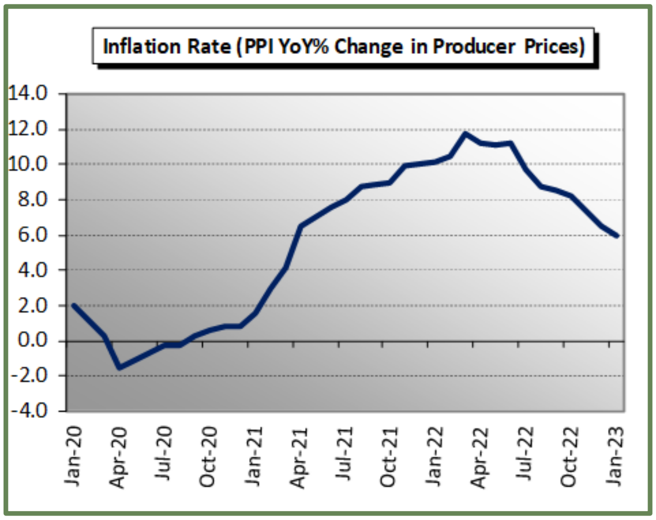


Payrolls Surge

In January, payrolls increased by almost three times the amount expected. The 500,000+ monthly job gain was the highest since July and the three-month moving average is the highest since October.

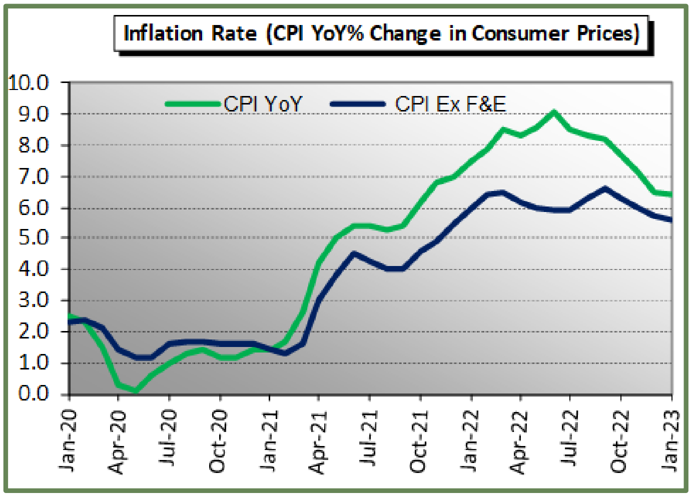
Inflation Readings

(Data source: Bloomberg)



Producer Prices Higher than Expected

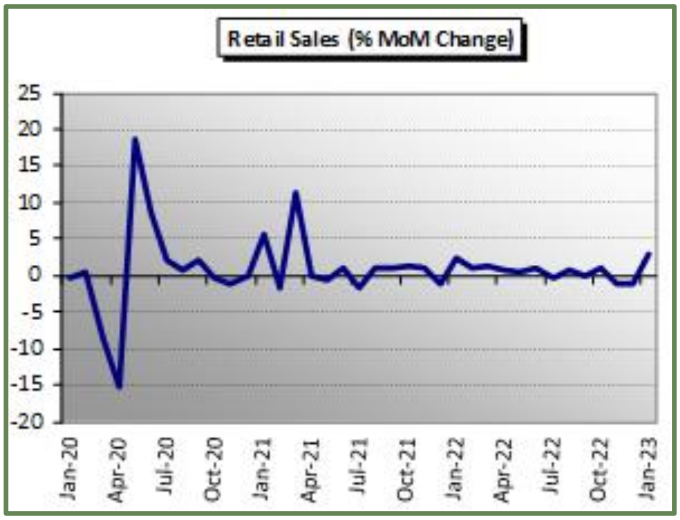
Producer prices in January jumped by the most since June (on a month-over-month basis). The monthly gain was 0.7% versus an expected increase of 0.4%. Increased energy prices were one of the main drivers for the upward move.



Disinflation Trend Stalls

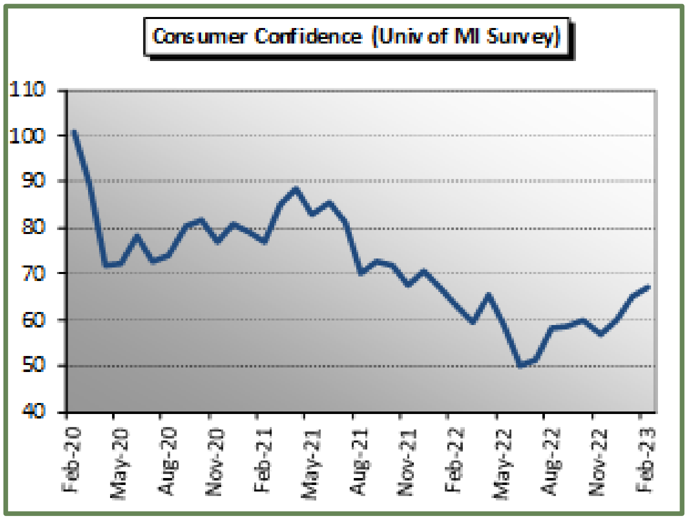
The month-over-month change in inflation rose the most in three months and the year-over-year change was higher than expected at 6.4%. The decrease in the core goods sector stalled out and services inflation remained elevated.

Consumer Readings
(Data source: Bloomberg)



Retail Sales Strong

Retail sales in January were much higher than expected and were more than enough to offset the declines from the previous two months. Gains were broad-based with strong gains from auto sales, electronic stores and apparel.



Consumer Confidence Continues to Climb

Consumer confidence in February rose to the highest level in a year. Current economic conditions and the expectations components both climbed from the previous month.