Corporate Federal Credit Union

Economic Update

Andrew Kohl
Chief Investment Officer
Alloya Corporate FCU

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Commentary

April was a relatively uneventful month after the upheaval in March. Absent First Republic Bank, the slew of earnings reported this month did not reveal any further cracks in the banking system. Sensing that the crisis is largely over, the markets have stabilized. The S&P 500 posted a gain of 1.5% and the Treasury rates were largely unchanged.

What became clear from the earnings calls was that the banks are going to tighten the lending spigot further. This process started in the latter half of 2022 and is poised to accelerate as shoring up liquidity becomes their primary focus. This will hamper economic growth and bring a quicker resolution to the Fed's tightening cycle.

The economy is already showing signs of slowing down. First quarter gross domestic product (GDP) was weaker than expected. Growth slowed down to 1.1% from 2.6% in the fourth quarter of 2022. The market was expecting growth of 2%. To be fair, much of the downside miss was due to slowing inventory investments (one of the most volatile GDP components). However, this should normalize in the second quarter. The bigger concern is on the consumer spending side. Consumer spending was relatively strong in the first quarter, but was buoyed by an extremely strong January. The spending slowdown in February and March indicates a weak handoff for GDP growth in the second quarter.

The labor market is also showing signs of moderation. Continuing jobless claims have been steadily rising since September. The number of job cuts has reached levels that we have not seen since the COVID-19 pandemic caused mass layoffs. In addition, the job openings to the unemployment ratio is descending.

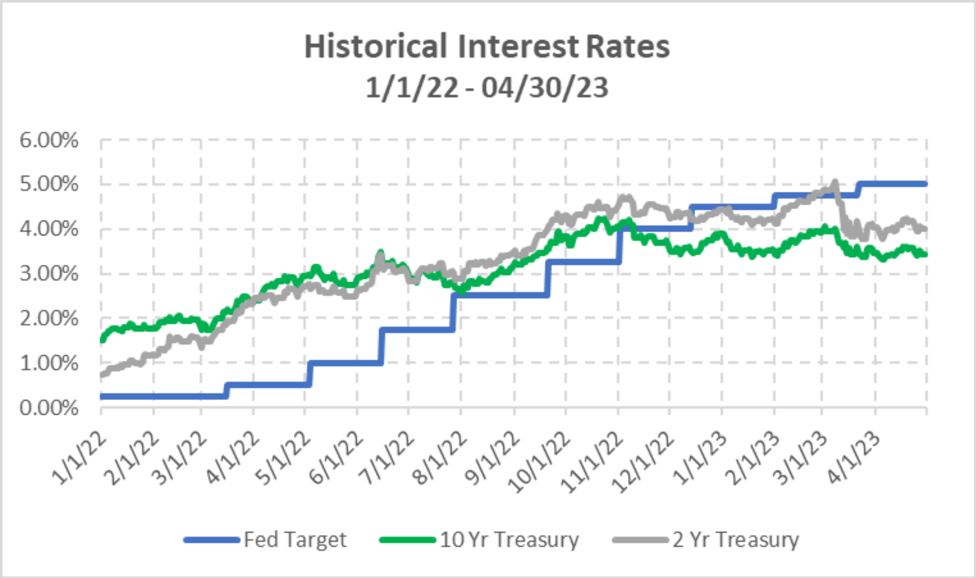
A similar trend is occurring with inflation. After peaking in June, the headline inflation rate has been almost cut in half. The problem is that for both inflation and the labor market, despite the slowdown, we are still at levels that can be considered "frothy." Inflation is currently running at twice the Fed's target rate. The unemployment rate is just a tick above a 40-year low. This puts the Fed in a quandary. Should they take a pause and let the momentum work in their favor, or should they keep hiking until inflation is all the way back to their target? After 500 basis points of rate hikes in a little more than year (assuming they hike on May 3 as broadly expected), the market believes that it will be time to pause, and we agree.

THIS MONTH

Fixed Income Outlook

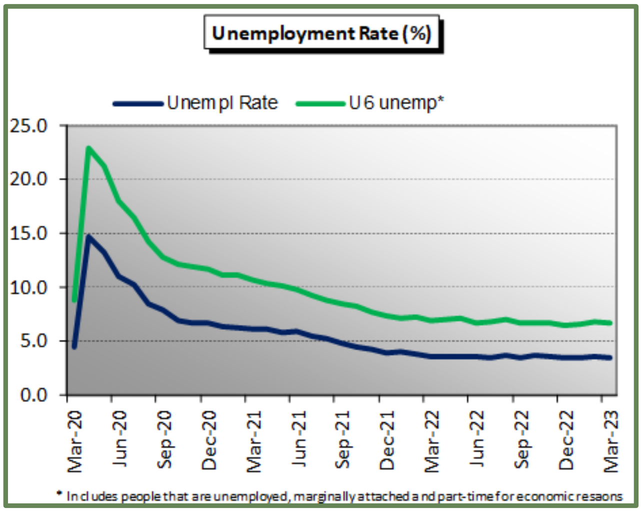
After a wild March, April was relatively boring in terms of rate moves. The Treasury curve, at the end of April, finished within 10 basis points of the prior month-end. All eyes are on the Fed meeting happening on May 3. Many believe that this will be the last hike of the cycle. We believe the Fed will clearly indicate that now is the time to pause and see if the trend of lower inflation and a slowing labor market continues. They will indicate if they are data-dependent and if they will push hard against the narrative of easing policy in the near-term.

The market is pricing in an easing cycle to begin in September and total rate cuts, which will bring us to a 3% fed funds rate by the end of 2024. We believe that path is too aggressive and look to the Fed to remain at 5.25% until the end of this year with more modest rate cuts in 2024.



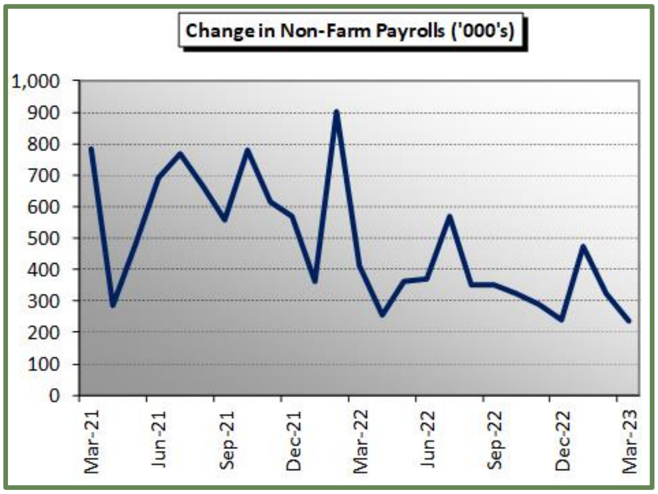
Labor Readings

(Data source: Bloomberg)



Labor Market Continues to Show Strength

The unemployment rate in March decreased to 3.5% from 3.6% the prior month and remains near a multi-decade low. The underlying details of the report were strong as there was significant growth in the labor force and the number of employed. In a separate report, there was some evidence of labor softening as the number of job openings fell more than expected and stand at their lowest level since May 2021.

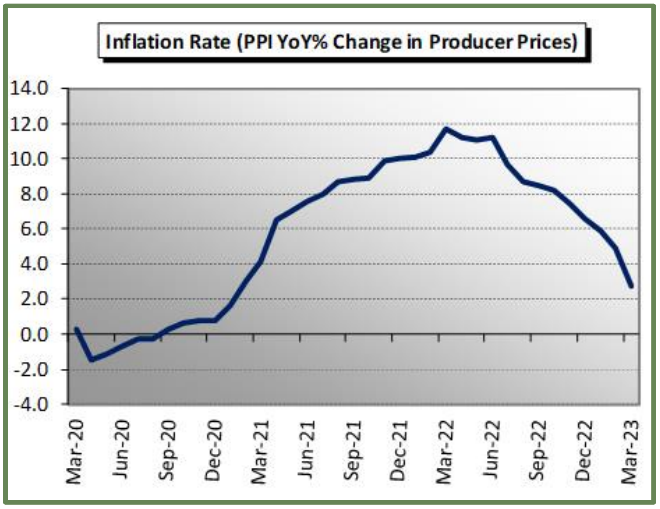


Payroll Growth Meets Expectations

Payroll growth in March was largely in line with market expectations. Jobs gained by 236,000 versus an estimated 230,000 increase. There were some signs of labor cooling as this was the lowest monthly payroll gain since December 2020 and wage growth has slowed. Still, both measures are still higher than the Fed would like in order to bring inflation down to their target.

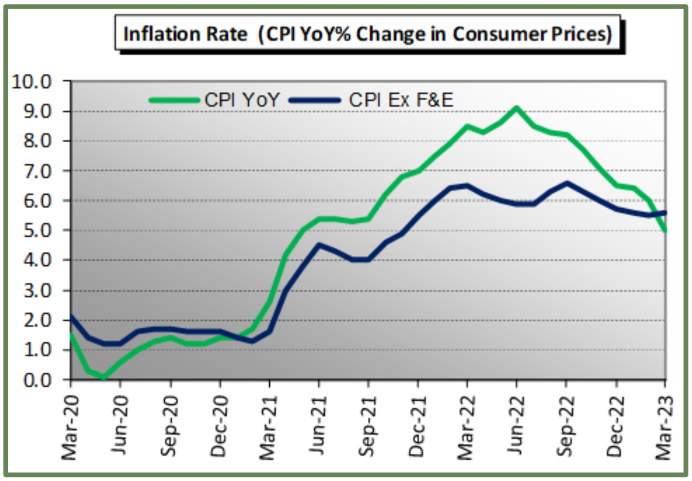
Inflation Readings

(Data source: Bloomberg)



Producer Prices Decline More than Expected

Producer prices fell in March and reached the lowest year-over-year level since January 2021. The drop was mainly due to lower gasoline prices. Overall, producer prices have fallen sharply over the past year as supply chains have improved and commodity prices have fallen.

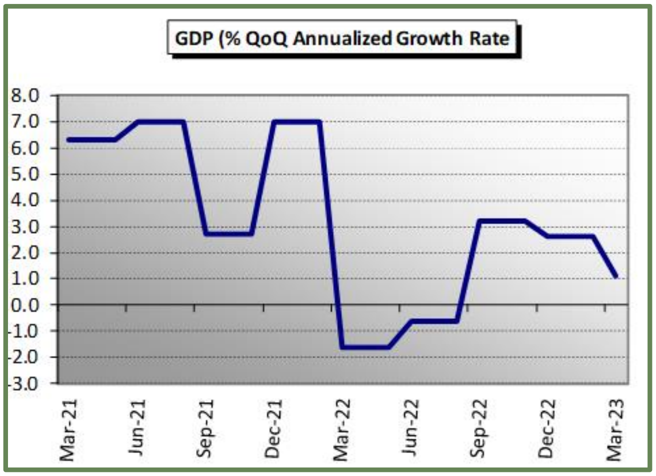


Headline Inflation Continues Downward Trajectory

The headline inflation data came in largely as expected in March and now stands at its smallest year-over-year increase since May 2021. Unfortunately, "core" inflation (which excludes food and energy prices) has proven to be sticky and remains near its high. The Fed is most likely to hike again in May with inflation remaining far above their target.

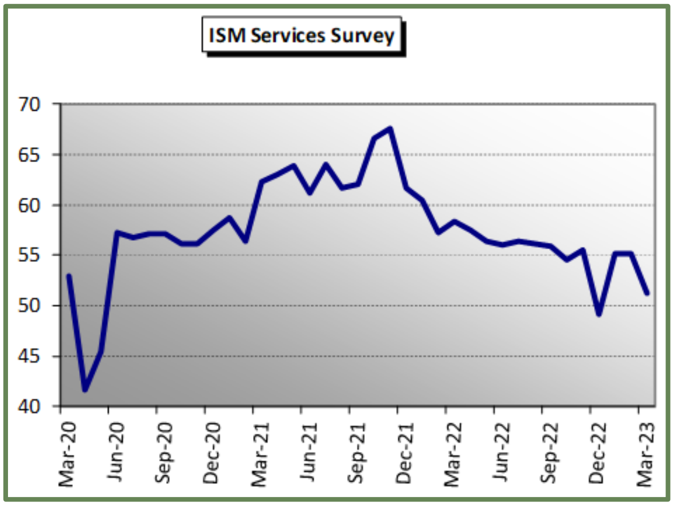
Economic Growth Readings

(Data source: Bloomberg)



GDP Growth Lower than Expected

The advance estimate of the first quarter GDP growth showed a slowdown to 1.1% from 2.6% in the previous quarter. The market was expecting growth of 1.9%. Real final sales accelerated at 3.4%, which was an uptick from the 1.1% pace in the fourth quarter. Capex and business spending on equipment were weak.



Services Survey Points to Slower Growth

The ISM service industry survey in March came in lower than expected and registered the second lowest reading since May 2020. The new orders category fell by a significant amount from the prior month. The manufacturing survey was also weaker than expected, pointing to slower growth or a contraction in coming months.