Corporate Federal Credit Union

Economic Update

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THIS MONTH

Commentary

September has historically been the worst month for stocks in the U.S. and this September follows this trend. The S&P 500 is down 5% thus far this month as the market has come to grips with interest rates being higher for an extended period of time. Long-term Treasury rates continued to march higher and make riskier assets less attractive. The yield gap between the stock market's earning yield and the 10-year Treasury bond has fallen to around 1%. This is the lowest level since the dotcom bubble days in the late 1990s.

The Fed has spent the last few months trying to steer the market away from large, expected rate cuts next year. At the Federal Open Market Committee (FOMC) meeting this month, the Fed showed just 50 basis points of cuts in 2024 compared to 100 basis points of cuts from their June projections. In addition, the Fed lowered its unemployment rate projections and raised its growth projections. Oddly enough, the Fed seems to be more confident in the economy at a time when risks are increasing.

New risks have popped up over the last few months and each has the potential to create a drag on economic growth. Oil prices have surged since June, mainly due to supply constraints. Higher oil prices have a negative impact of consumer spending and can keep headline inflation elevated. Higher oil prices aren't as detrimental to growth as it would have been decades ago since the U.S. has become a large oil producer. However, higher prices still hurt at the margin.

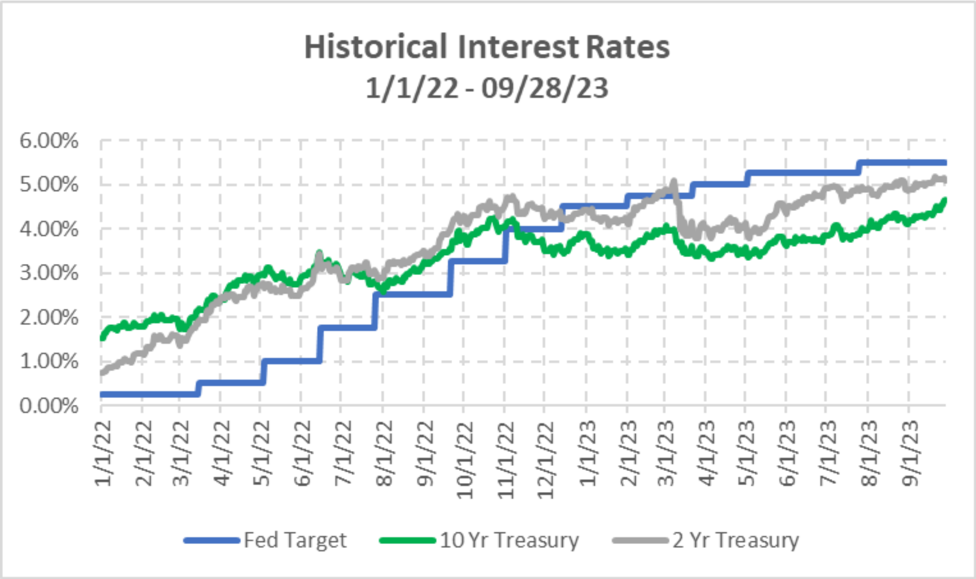
The United Auto Workers (UAW) strike will create a drag on incomes and consumer spending. If the strike is short-term in nature, and continues to only affect targeted operations, the impact will be minimal. If the strike becomes prolonged and more broad-based, the impact will be much larger and will be felt throughout the economy.

The same can be said for the looming government shutdown. The political parties are far apart to reach an agreement on how to fund the government. Steep differences remain in spending levels, funding to Ukraine and border security. At this point, a shutdown seems very likely to occur on October 1. A shutdown will mean federal agencies will close and pay will be withheld for federal workers and active military personnel. We expect a resolution to occur by October 13, which is the pay date for active military. A more protracted shutdown will cause greater harm to the economy.

These new risks, combined with the resumption of student loan payments in October, point to weakened consumer spending. Our baseline assumes that each of the risks discussed above are short-term and will only minimally impact economic growth. Even if that's the case, we expect a mild recession to begin late this year or early next year. If any of the risks become more prolonged, the recession will be much deeper.

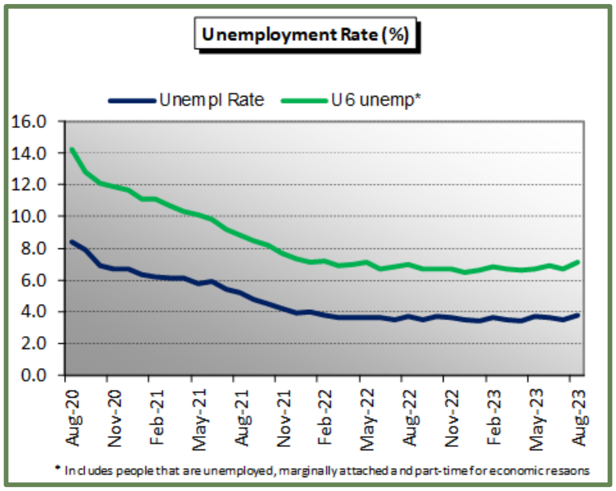
Fixed Income Outlook

The Treasury curve shifted higher and steepened during September as the “higher for longer” thesis gained more traction in the market. Treasury rates are at +15-year highs across most of the curve. The Fed held rates steady, as expected, at the September FOMC meeting. However, they did indicate there is at least one more hike in the cards. The market is pricing in approximately a 40% chance of one more rate hike this year and 75 basis points of rate cuts in 2024. The market is now more closely aligned with the Fed’s expectation. Given heightened risks for the economy and the recent increase in yields, we believe it is a good time to add duration.



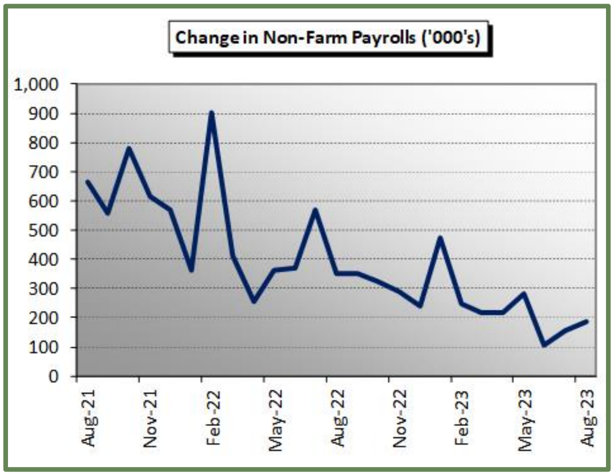
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Jumps

The unemployment rate in August increased to 3.8% from 3.5% the previous month. The market was expecting no change in the rate. The main reason for the higher-than-expected unemployment rate was a strong surge in the number of people in the labor force. The labor force participation rate hit its highest level since February 2020. An increased supply of workers should help to keep wage gains muted and lessen inflation risks.

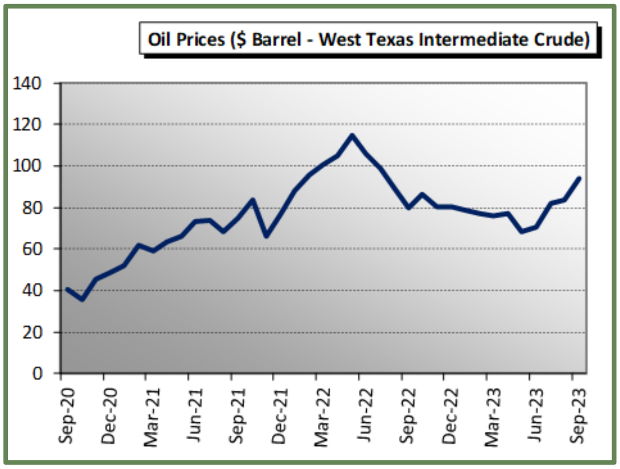


Payroll Growth Moderating

Payroll growth in August was slightly higher than expected, but the prior two months were revised lower. Jobs gained by 187,000 compared to an estimated 170,000 gain. The prior two-month gains were revised lower by 110,000 jobs. The three-month average payroll growth is at its lowest level since the COVID-19 pandemic hit in March 2020.

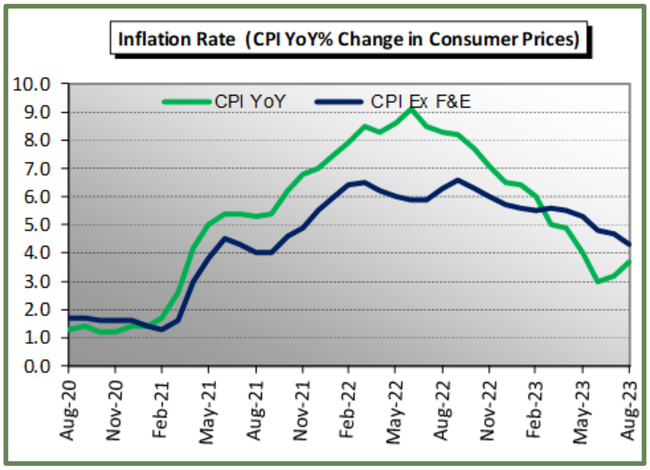
Inflation Readings

(Data source: Bloomberg)



Oil Prices Nearing $100 per Barrel

Oil prices have surged since June. Prices have increased by over 30% since June 30. The gains are mainly due to supply-side effects. Saudi Arabia and Russia extended supply cuts through the end of the year and supplies from Libya are being impacted by the catastrophic flooding. Additionally, inventories in the U.S. have declined. Higher oil threatens to undo some of the recent moderation in inflation.

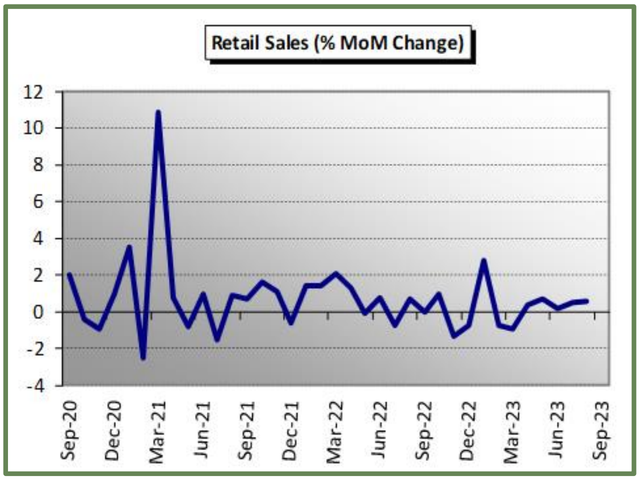


Headline Inflation Increases

The overall inflation rate increased by 3.7% on a year-over-year basis in August. The increase was slightly larger than expected and can be attributed to the significant increase in gasoline prices. Rents and used car prices have been declining, but transportation services (e.g., airfare, car insurance, and car repair) have shown persistent increases.

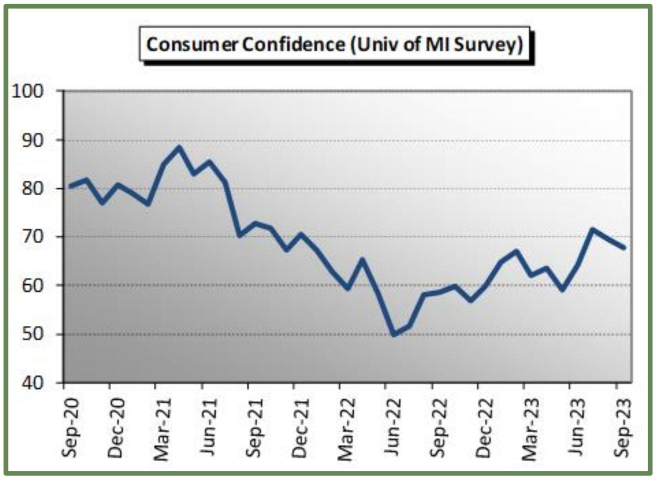
Consumer Readings

(Data source: Bloomberg)



Retail Sales Remain Positive

Retail sales in August were higher than expected, but mainly due to higher gasoline prices. Sales from the prior month were revised downwards. While still positive, the pace of gains in September decelerated from the prior month. We expect consumer spending to continue to moderate in the months ahead.



Consumer Confidence Declines

Consumer confidence in September declined largely due to higher gasoline prices. Additionally, inflation expectations for the year ahead fell to the lowest level since early 2021. Longer-term inflation expectations also declined, matching the lowest level since the end of 2020.