Corporate Federal Credit Union

Economic Update

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Commentary

Thus far, October has witnessed a continued trend of higher long-term interest rates and weaker equity markets. The 10-year Treasury rate touched the 5% level for the first time since 2007 and has increased by 75 basis points in less than two months. It's hard to believe that it stood at one-tenth of the current level (0.50%) just three years ago. The higher rates have certainly stalled out the housing markets. Existing homes sales are at the lowest level since 2010 as owners, who previously locked in substantially lower mortgage rates, have little incentive to move. Yet, other sectors of the economy have shown few signs of wilting.

This month, arguably three of the most important economic indicators – jobs, the Consumer Price Index (CPI) and retail sales – all surprised to the upside. Job growth was nearly double the market consensus and gains from the prior two months were revised upwards. Retail sales followed this trend and also gained roughly twice as much as was expected. In addition, the inflation data was hotter than anticipated (albeit only slightly).

The strong data points to the third quarter gross domestic product (GDP) growth exceeding 4% (market consensus is 4.5%). This would be the strongest growth rate since the fourth quarter of 2021. Since then, the Fed has raised rates by over 500 basis points. The resiliency of the economy has continued to surprise the market and the Fed.

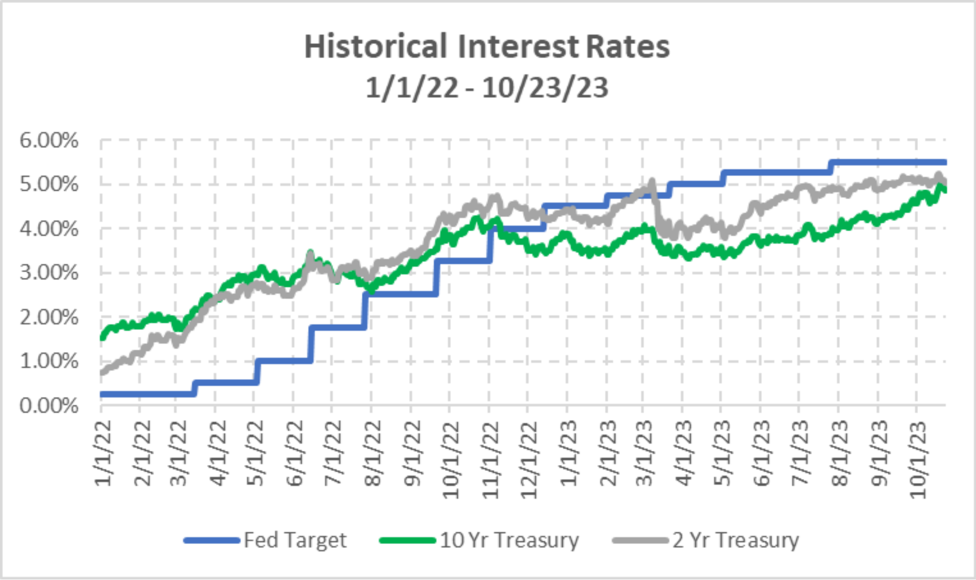
We still believe that risks are building for the economy. We were surprised that the government shutdown was avoided last month. However, the risk was only deferred until November 17. The mess in Congress has only worsened since the shutdown was averted. For the first time in history, a House Speaker was ousted by his own party. A new leader has yet to be determined and important spending decisions hang in the balance. Possibly, a creative solution can be found without naming a new speaker, but in any case, political dysfunction will continue to be the norm.

We now must add the Israeli conflict to the growing list of risks. When combined with the United Auto Workers (UAW) strike, renewal of student loan payments, the continued Russia-Ukraine war, a potential government shutdown and higher interest rates, we believe the economy will start to fade. We will look for a slight downturn to begin in early to mid-2024 with a possible, more severe downturn depending on the lengths and severities of the risks listed above.

THIS MONTH

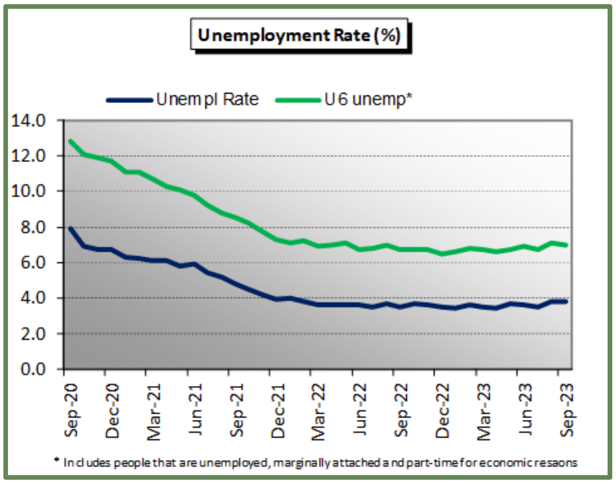
Fixed Income Outlook

The 2s/10s part of the curve flattened with the long-end moving higher by another 30 basis points thus far in October. That part of the curve is still inverted, but by the least amount since more than a year ago. Last week's Fedspeak all but confirmed that there will be no change in rates at the November 1 Federal Open Market Committee (FOMC) meeting. Many of the Fed speakers pointed to higher long-term rates acting as a substitute for having to move the fed funds rate higher. The market is pricing in a 20% chance of one more rate hike this cycle followed by the first rate cut occurring in mid-2024. We believe that the odds of a hike are closer to 50-50 but do agree that the economy may weaken enough to warrant cuts starting towards the middle of next year.



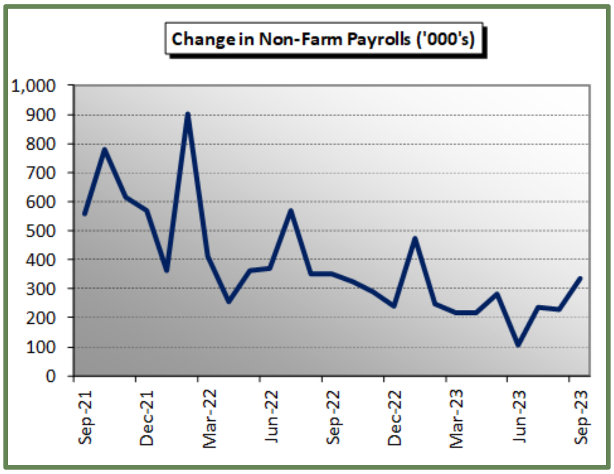
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Jumps

The unemployment rate in September held steady at 3.8%. The market was expecting 3.7%. As opposed to the establishment payroll survey, the household survey, which is used to calculate the unemployment rate, showed muted job growth. In addition, wage growth was slightly lower than expected.

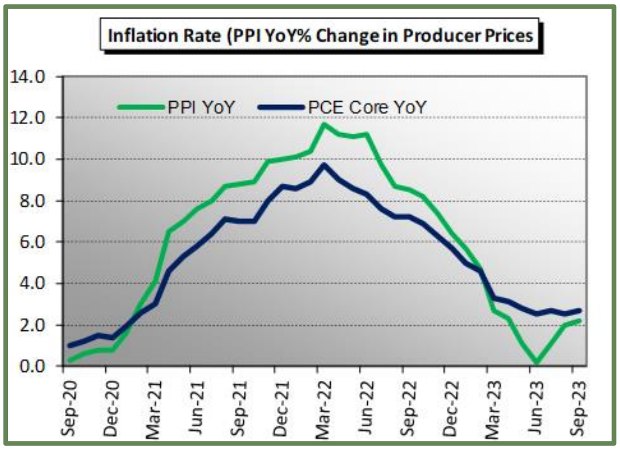


Robust Payroll Growth

Payroll growth in September was much higher than expected. Jobs gained by 336,000 compared to an estimated 170,000 gain. In addition, the previous two months' job gains were revised upwards by 119,000. The three-month average payroll growth now stands at its highest level since March**.**

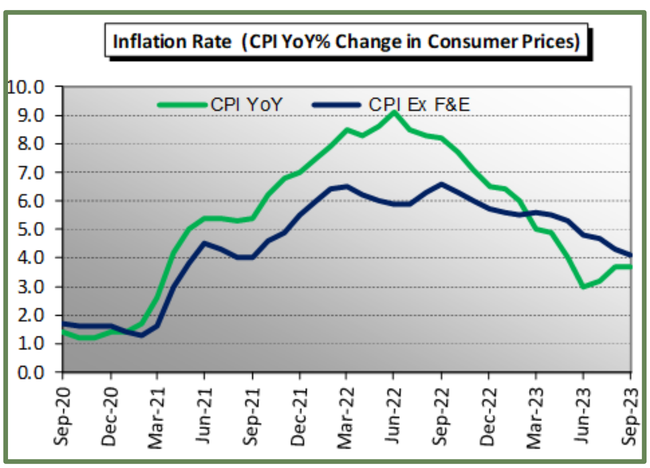
Inflation Readings

(Data source: Bloomberg)



Producer Prices Accelerate

Producer prices increased at an accelerating level (on a month-over-month basis) for the third consecutive month. Higher energy prices have been the main culprit, with oil prices hitting their highest levels in over a year during September**.**

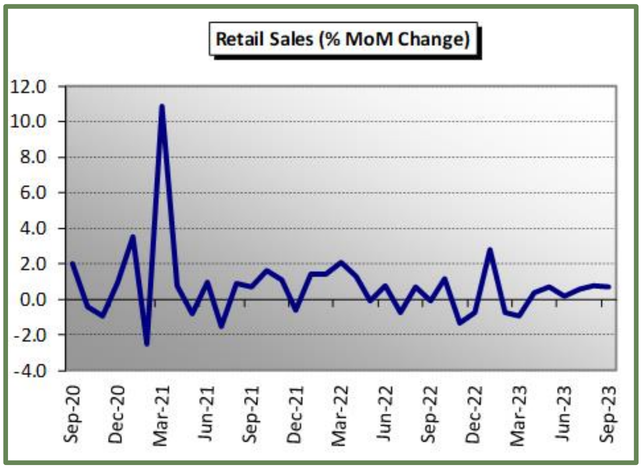


Consumer Inflation Levels Remain High

The overall inflation rate increased by 3.7% on a year-over-year basis in September, which was unchanged from the previous month. The market was expecting a decline to 3.6%. Core goods prices continue to fall, but core service prices accelerated in September. Core inflation is still running at twice the Fed's target.

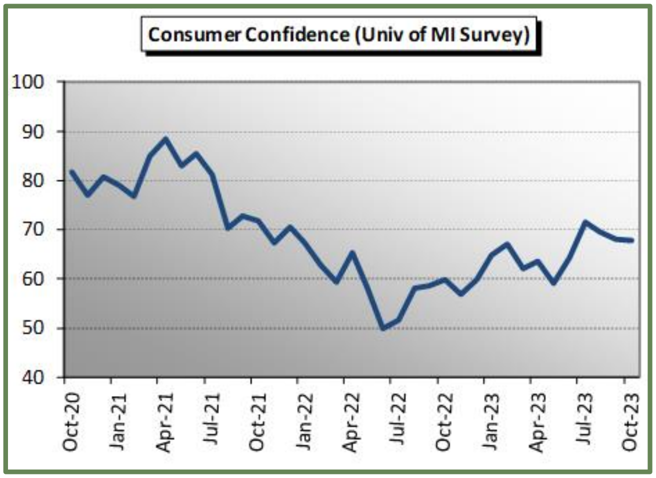
Consumer Readings

(Data source: Bloomberg)



Retail Sales Show Strength

Retail sales in September were much higher than expected. In addition, August sales were revised upwards. Month-over-month, sales increased by 0.7% compared to an expected gain of 0.3%. If consumer spending continues on this path, it will point to a stronger third quarter GDP number.



Consumer Confidence Declines

Consumer confidence in October fell as expectations for higher inflation have increased. Prices are expected to climb 3.8% over the next year. This is a sharp increase from the previous month (3.2%) and the highest expectation in five months. Longer-term inflation expectations also ticked up.