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Corporate Federal Credit Union

Economic Update

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Commentary

The economy continues to defy expectations and displays strength in the face of one of the fastest and steepest rate hiking cycles in history. Both the latest gross domestic product (GDP) and employment data came in well above expectations. At the same time, inflation trends have been positive. The stock market has certainly taken notice and has powered ahead to an all-time high and is up almost 4% to start 2024.

The fourth quarter GDP data showed an economy with few signs of entering a recession. Quarterly growth (annualized) was 3.3% compared to an expected growth rate of 2.0%. Importantly, the consumer sector remains resilient, with consumer spending coming in much higher than expected at 2.8%. Consumer strength will endure as long as the job market remains tight, and the latest jobs data showed just that.

Job growth in January was well above expectations. Employment increased by 353,000 jobs, which was almost double the estimated 185,000 gain and the largest monthly increase in a year. In addition, jobs for the prior two months were revised upwards by 126,000. The three-month average payroll expansion is at its highest level since March and is almost three times what is necessary to offset labor force growth. This helped to push wages higher than expected.

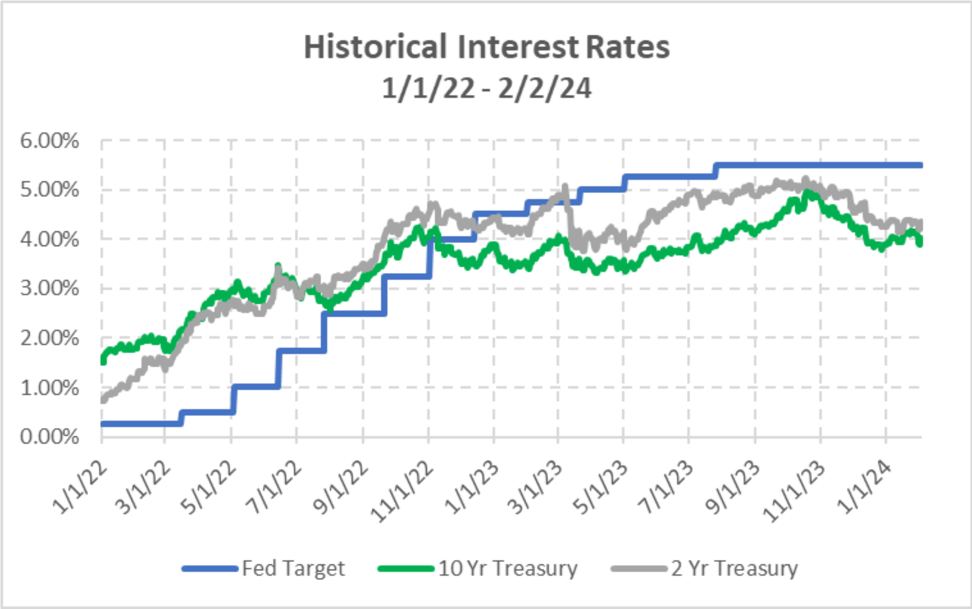
Given the strong data highlighted above, it seems like an odd time for the Fed to end its rate tightening bias, but inflation levels continue to recede. The Fed's preferred inflation measure, the core PCE, came in at the Fed's 2% target for the second consecutive quarter. The three-month and six-month annualized core PCE growth rates are at 1.5% and 1.9%, respectively. With such tepid inflation numbers, many economists are calling on the Fed to start easing immediately. However, the year-over-year inflation data is still well-above the Fed's target and there is wariness that the trend in goods deflation will reverse.

The Fed's bar to decrease rates is still relatively high as they are keenly aware of the policy mistakes made in the late 1970s when inflation wasn't effectively stamped out and resurfaced soon after declaring victory. We hope that this "goldilocks" economy could continue forever, but sooner or later something must give. The cumulative effect of over 500 basis points of rate hikes will continue to bite and we see a mild downturn in the latter half of this year.

THIS MONTH

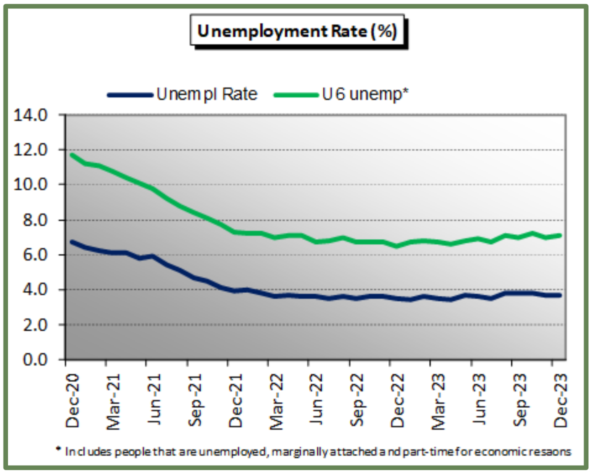
Fixed Income Outlook

Treasury yields were relatively stable throughout the month of January. There was a flight to quality, which drove rates lower, when the New York Community Bancorp posted large write offs on its commercial real estate loan portfolio. This reignited concerns over the health of the regional banking sector. Yields then reversed course and vaulted higher when the employment report was much stronger than expected. The Federal Open Market Committee (FOMC) meeting saw the Fed remove its tightening bias, but also guide against a rate cut as soon as March. The market is pricing in a 22% chance of a rate cut in March and 125 basis points of cuts in 2024. We look for the first rate cut in May or June and see 75 basis points of cuts this year.



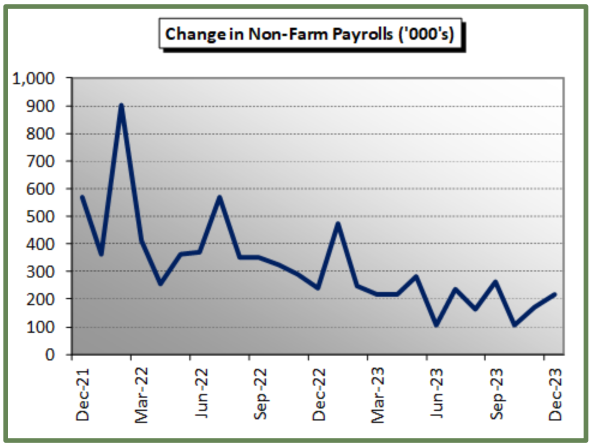
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Holds Steady

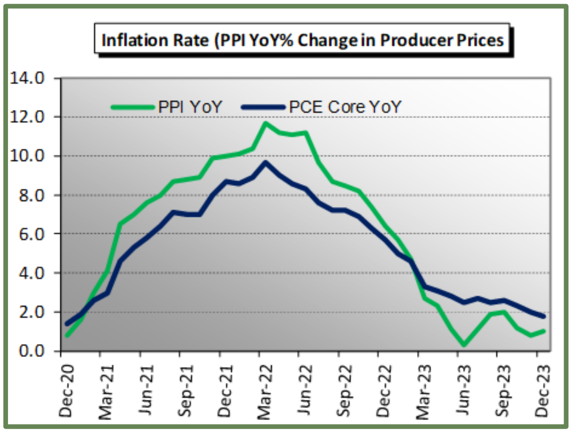
The unemployment rate in December held steady at 3.7% — near a 50-year low. The market expected the rate to tick up to 3.8%. The underlying details of the report were weak as both the labor force and the number of employed experienced sizable declines. The labor force participation rate dropped to its lowest level since February.



Payroll Growth Tops Estimates

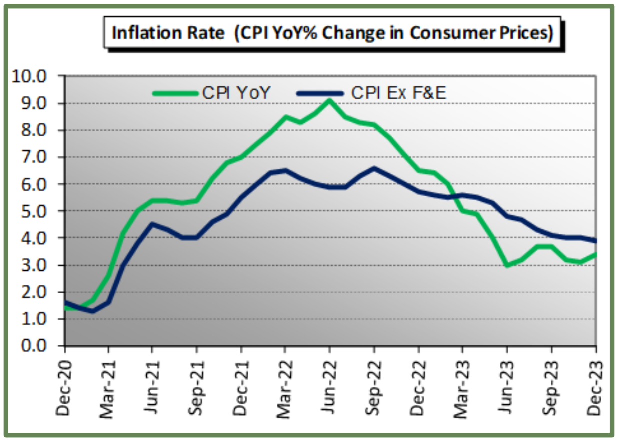
Payroll growth in December was 216,000 compared to an estimated 175,000 gain. The previous two months' job gains were revised downwards by 71,000. The three-month average payroll growth is at its slowest pace since January 2021.

Inflation Readings
(Data source: Bloomberg)



Producer Prices Continue to Decline

Producer prices deflated for the third consecutive month. Both the headline and core producer inflation levels were lower than expected. On a year-over-year basis, core producer inflation is at its lowest level since the end of 2020.

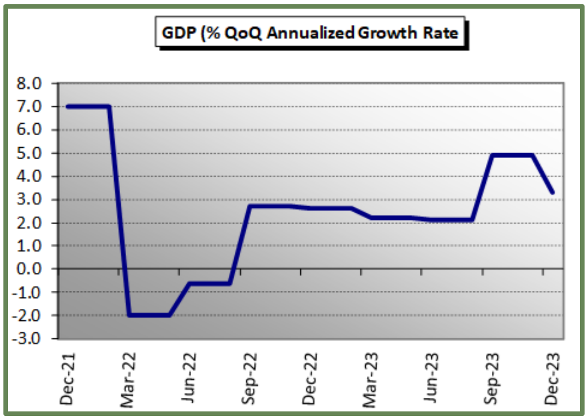


Consumer Inflation Higher than Expected

The year-over-year inflation level came in higher than expected and hit a three -month high. Prices rose at a 3.4% pace compared to year-ago levels. Energy prices rose for the first time since September and core goods prices pushed higher as clothing and used car prices rose.

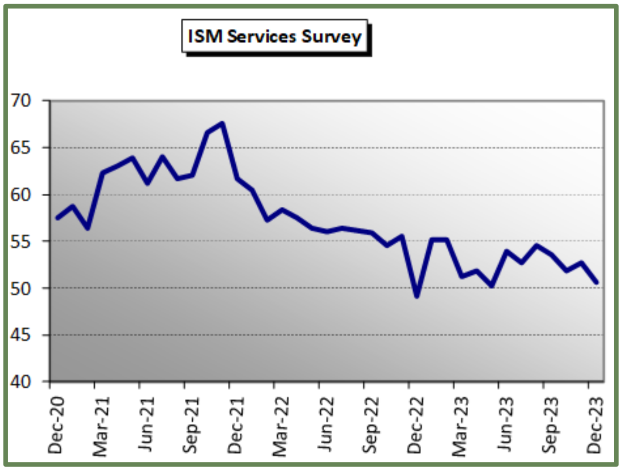
Economic Growth Readings

(Data source: Bloomberg)



Fourth Quarter GDP Growth Higher than Expected

The advance estimate of the fourth quarter GDP growth showed an economy growing much faster than expected. The fourth quarter GDP rose at an annualized rate of 3.3% compared to an expected rate of 2.0%. Growth for all of 2023 was 2.50% while many were forecasting a recession.



Services Survey Declines

The ISM service industry survey in December came in much lower than expected and near the level that indicates a recession. The survey results were 50.6 compared to an expected rate of 52.5 (levels below 50 indicate a recession). The employment component of the survey dropped to its lowest level since July 2020.