Corporate Federal Credit Union

Economic Update

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APRIL 2024

Commentary

A third consecutive month of higher-than-expected inflation data (as measured by the Consumer Price Index (CPI)) has shaken the confidence that the Fed will be cutting interest rates any time soon. Market expectations of rate declines in 2024 have dropped to 1-2 cuts versus 6 rate cuts (assuming that each rate cut is 25 basis points) when the year began. The stock market does not like the prospect of a tighter Fed and fell for the first month thus far this year. The S&P 500 is down 3% in April.

Both headline and core inflation in March were elevated. Inflation related to shelter has proved to be sticky and services inflation appears to be re-accelerating. Goods prices in March shifted back to a monthly decline, but not enough to offset large increases in medical care and transportation prices. Unfavorable base effects in the second half of the year make it less likely that the Fed will see a pullback in inflation that's significant enough to begin cutting rates.

At first glance, the initial reading of first quarter gross domestic product (GDP) sparks fears of a stagflation scenario. The GDP growth rate declined to 1.6% from 3.4% the prior quarter. It is the slowest growth rate since the second quarter of 2022. Looking at the details of the report, the largest drags to growth came from net trade and inventories. These are two extremely volatile components where large swings one quarter are often reversed in subsequent quarters. We believe that a better metric to gauge the health of the economy is final sales to domestic purchasers (in essence, GDP less trade and inventories). This data showed a growth rate of 2.8% for the first quarter – a slowdown from the 3.5% rate the previous quarter, but still solid growth.

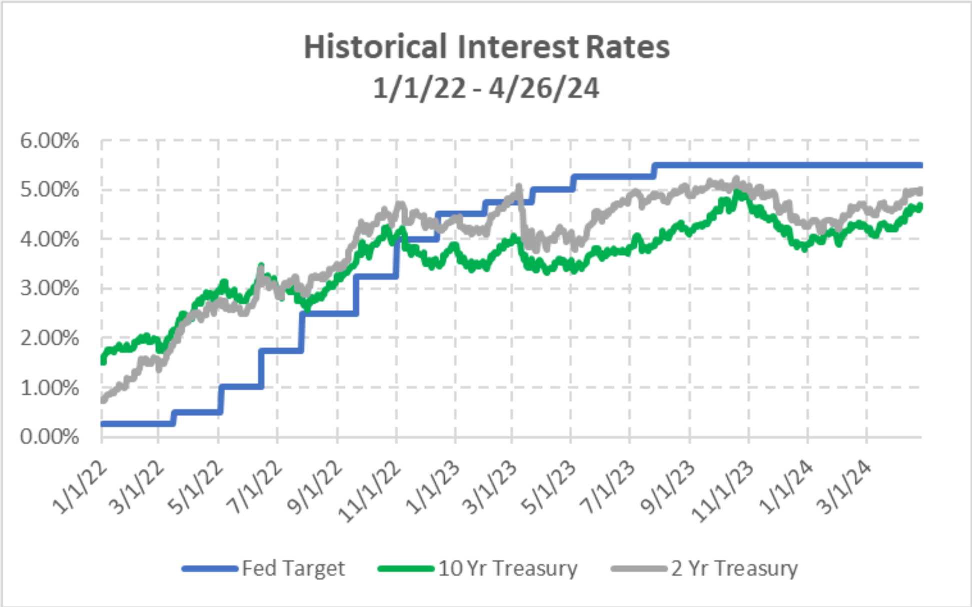
Consumer spending continues to drive the economy. The job market remains key and the quarterly pace of job gains is at its highest level in a year. This has helped to drive income higher. Inflation-adjusted spending levels grew at a stronger-than-expected pace in March and consumers appear to have little interest in saving the income that they are earning. In that regard, their actions are mirroring those of the government, which continues to spend at levels that are unprecedented for an economy not in a recession.

The handoff to growth in the second quarter appears strong. We look for GDP growth to bounce back above 2%. There are still some modest signs of cracks in the economy, but a downturn does not appear imminent. We no longer believe that a recession is in the cards for this year.

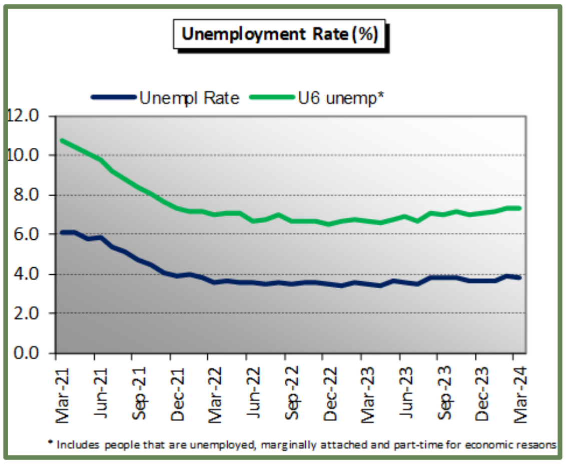
THIS MONTH

Fixed Income Outlook

Treasury yields moved sharply higher thus far in April. The middle-to-long end of the Treasury curve increased by almost 50 basis points during the month. Given the higher-than-expected inflation and employment data, the Fed's projections that were released about a month ago already look outdated. The Fed meets again next week and although their projections won't be updated at that meeting, the message will likely be that rates will stay higher for longer.

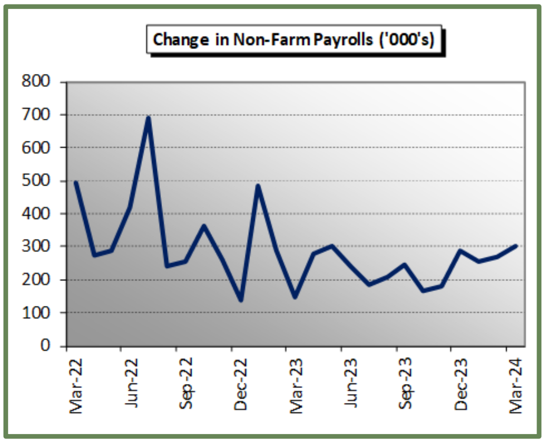


Labor Readings
(Data source: Bloomberg)



Unemployment Rate Declines

The unemployment rate in March declined slightly to 3.8% from 3.9% the prior month. The rate was in line with market expectations. The details of the report showed strong growth in both jobs and the number of people entering the labor force. Annual wage growth fell to the lowest level since the middle of 2021.

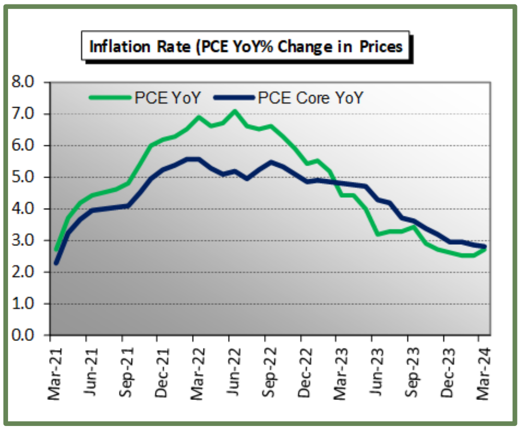


Payroll Growth Tops Estimates

Payroll growth in March came in well above expectations. Jobs gained by 303,000 versus an estimated gain of 214,000. The three-month moving average of payroll growth has moved to its highest level since March 2023. However, much of the job growth has been concentrated in just a few sectors.

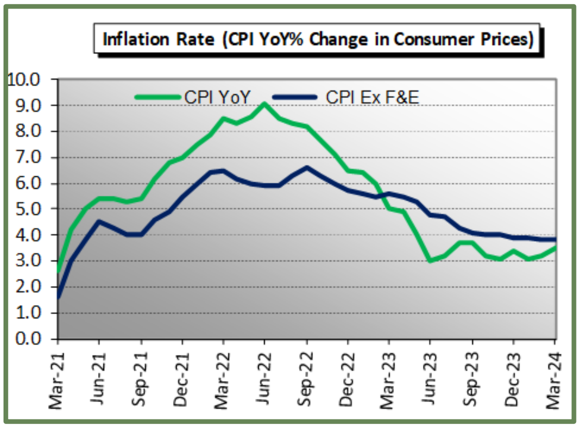
Inflation Readings

(Data source: Bloomberg)



Fed's Preferred Inflation Gauge Increases

Inflation, as measured by personal consumption expenditures (PCE), rose on a year-over-year basis from the prior month. This was the first time that the measure did not decrease since September 2023. Core PCE inflation declined slightly, but not as much as the market was expecting. The Fed is concerned that progress on reducing inflation has stalled.

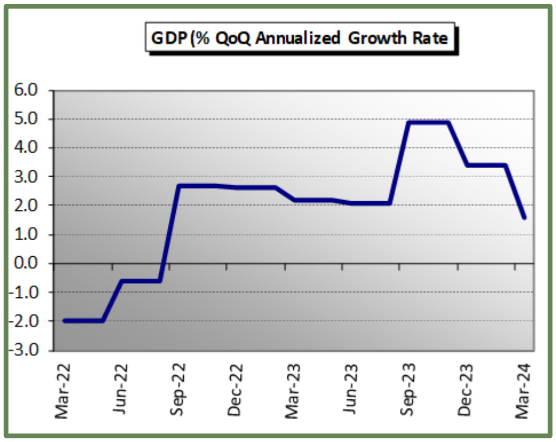


Consumer Inflation Continues to Top Estimates

Consumer inflation in March was hotter than expected for the third consecutive month. The year-over-year pace of inflation climbed to 3.5% from 3.2% the previous month. Core inflation held steady but was expected to dip from the pace in February.

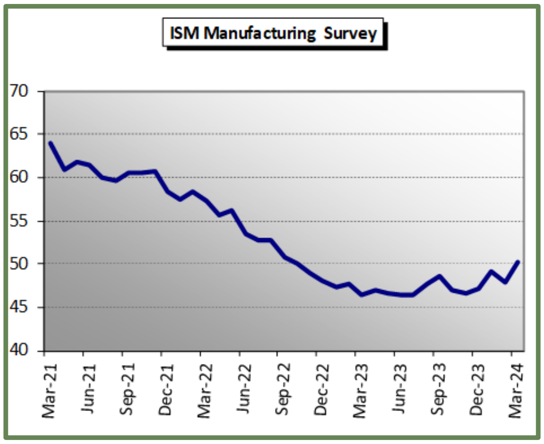
Economic Growth Readings

(Data source: Bloomberg)



Q1 GDP Growth Declines

The advance estimate of first quarter GDP growth showed a slowdown in the U.S. economy from prior quarters to 1.6%. Growth slowed to its slowest pace since the second quarter of 2022. The weaker headline growth number is somewhat deceiving as inventories and net exports subtracted 1.2 percentage points from growth. Final sales to domestic purchasers grew at 2.8% – a slowdown from the 3.5% pace from the prior quarter, but still indicative of a healthy economy.



Manufacturing Survey Improves

The Institute for Supply Management (ISM) manufacturing industry survey in March showed expansion for the first time since September 2022. New orders and production experienced a significant uptick and inventory management is improving.