Economic Commentary – June 2023

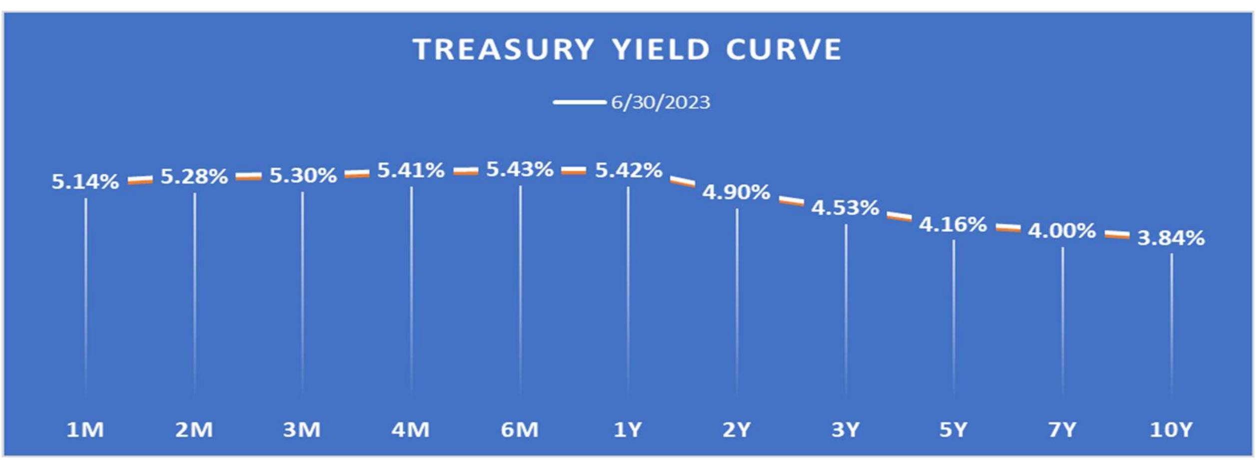
On June 1, the day following the vote by the House of Representatives (314-117) to settle the debt ceiling impasse, the Senate also obliged, ratifying the bipartisan legislative pact 63-36, ultimately suspending the federal statutory debt limit at $31.4 trillion until January 1, 2025, while also imposing two years of spending cuts appropriated to federally funded programs. On June 3, President Biden signed the bill into law, resolving months of partisan political rancor and animosity, but most importantly thwarting a potentially perilous U.S. debt default.

Continuing 2023's trend of the rates market accurately assigning a static rate hike probability ahead of a pivotal Fed decision, the result was once again spot on. On June 14, the FOMC unanimously voted to undertake a hawkish hiatus on its aggressive rate hiking crusade, a tenure that has seen the Committee raise its target benchmark rate at the conclusion of ten consecutive meetings dating back to March 2022. In its decision to pause, the FOMC left the federal funds target rate range unchanged at 5.00% - 5.25%. However, in the FOMC statement and Chair Powell's post-meeting press conference, Fed policymakers and the Chairman hinted at additional rate increases in 2023. In fact, all FOMC participants expect to enact one more 25 basis point rate hike in 2023, and all but two members anticipate there will be two 25 basis point upward adjustments in the policy rate before the completion of the year.

While not overlooking the verdict to maintain the target rate range for now, the Fed's newly released Summary of Economic Projections provided deeper insights into the Committee's assumptions and forecasted trajectory for the remainder of 2023. Revised from March's projections, the federal funds terminal rate was revised up to 5.6% from 5.1%, the change in real GDP was revised up to 1.0% from 0.4%, core PCE inflation was revised up to 3.9% from 3.6%, and the unemployment rate was revised down to 4.1% from 4.5%.

In short, the U.S. economy has sustained its resiliency despite the Fed's efforts to rein in economic activity aimed at stifling inflationary pressures. The labor market continues to display impeccable resolve amidst an enduring supply/demand imbalance, consumer spending has remained robust, GDP has consistently seen upward revisions, and inflation (especially components in the services sector) is still approximately twice the Fed's 2.00% objective. These factors constitute an impetus for the Fed to embark on further restrictive monetary policy.

The entire U.S. Treasury yield curve sustained its overall inversion, further emboldening practitioners in the impending recessionary camp. The 2-year/10-year spread widened its inversion to 106 basis points, but the 3-month/10-year pair abridged its inversion to 146 basis points.



U.S. Treasury Yield Curve Source: Bloomberg

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<u>June 2023 Macroeconomic Highlights</u>

<u>Inflation, Expectations, and Consumer Sentiment[1]:</u>
CPI: 4.0% year-over-year (0.1% month-over-month); ***Core CPI***: 5.3% year-over-year (0.4% month-over-month)
PCE: 3.8% year-over-year (0.1% month-over-month); ***Core PCE***: 4.6% year-over-year (0.3% month-over-month)
PPI: 1.1% year-over-year (-0.3% month-over-month); ***Core PPI***: 2.8% year-over-year (0.2% month-over-month)
Core PPI less trade services: 2.8% year-over-year (0.0% month-over-month)
Inflation Expectations: 1-year horizon: 4.1%, 3-year horizon: 3.0%, and 5-year horizon: 2.7%
Consumer Sentiment: 64.4 vs. 59.2 in May; ***Current Conditions***: 69.0 vs. 64.9 in May
Consumer Expectations: 61.5 vs 55.4 in May

<u>Labor Market[2]:</u> U.S. economy added 339,000 nonfarm payrolls in May vastly outstripping the 195,000 expected by economists surveyed by Bloomberg. Notable job gains occurred in professional and business services (+64,000), government (+56,000), health care (+52,000), leisure and hospitality (+48,000), and construction (+25,000).

- U-3 ***official*** unemployment rate: 3.7% vs. 3.5% expectation: +0.3% from April 2023.
- U-6 unemployment rate (marginalized, part-time workers for economic reasons): 6.7%.
- Labor force participation rate: 62.6% (unchanged), Employment-to-population ratio: 60.3% (-0.1%).
- Average hourly earnings for private nonfarm payrolls rose 11 cents to $33.44 (+0.3% month-over-month, 4.3% year-over-year).
- Employment revisions: April 2023 bumped up 41,000 to 294,000; March 2023 boosted 52,000 to 217,000.

<u>Gross Domestic Product (GDP)[3]:</u> According to the ***third and final*** estimate, real GDP increased at annual rate of 2.0% in the first quarter of 2023 vs. 2.6% in the fourth quarter of 2022.

- *First Quarter 2023:* GDP Price Index: +4.1%; PCE Price Index: +4.1%; Core PCE Price Index +4.9%.
- Real disposable personal income: +8.5% vs. +5.0% in the fourth quarter of 2022.
- Personal savings rate as a percentage of disposable income: 4.3% vs. 4.0% in the fourth quarter of 2022.
- Average of Real GDP and Real GDI: +0.1% vs. -0.4% in the fourth quarter of 2022.

<u>Housing Market[4]:</u> Existing-home sales marginally increased 0.2% (month-over-month) from April to a seasonally-adjusted annual rate of 4.30 million in May. Month-over-month sales in the Midwest and Northeast dwindled 2.9% and 2.0%, respectively, while sales in the West and South rose 2.6% and 1.5%, respectively.

- Year-over-year sales plunged 20.4%, down from 5.40 million in May 2022.
- Total housing inventory registered 1.08 million units, +3.8% from April, but -6.1% from one year ago (1.15 million units).
- The median existing-home price for all housing types was $396,100, -3.1% from May 2022, as prices climbed in the Northeast and Midwest, but receded in the South and West.
- Average commitment rate for a 30-year, conventional, fixed-rate mortgage: 6.71%.
- New Home Sales: 763,000 (+12.2% month-over month).

[1]Source: Federal Reserve Bank of New York – Survey on Consumer Expectations, and University of Michigan Consumer Sentiment Index
[2]Source: Bureau of Labor Statistics
[3]Source: Bureau of Economic Analysis (BEA)
[4]Source: National Association of Realtors (NAR), U.S. Census Bureau, and The Department of Housing and Urban Development