Economic Commentary – January 2024

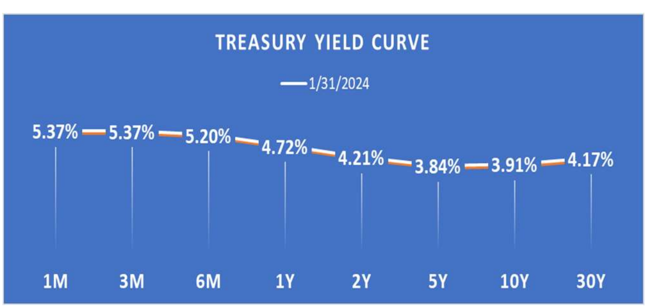
2024 may be the year that will ultimately unveil whether the Federal Reserve has been able to orchestrate its much desired economic "soft-landing" after imposing 23 successive months of monetary policy restraint, as January saw the return of traditional negative correlations amongst risk assets. While equity market indices sustained their several months-long upward momenta, U.S. bond market indices finished in negative territory on the backdrop of non-dovish comments and rhetoric from Chairman Powell as the month came to an end.

On January 31, at the conclusion of the Fed's first policy meeting of the calendar year, the FOMC unanimously voted to undertake its fourth consecutive pause (inaction) since it began hiking its overnight benchmark rate in March 2022, leaving the federal funds target rate range at 5.25% - 5.50%. This target range, which is at a 22-year high, has been maintained since July 2023, and has been characterized by Fed policymakers and other economists alike to be in "sufficiently restrictive" territory. However, as the economy has continued to expand above potential trend growth, job creation and wage growth display persistent strength, and disinflationary forces are indisputably at work as inflation approaches the Fed's 2% objective, one would be remiss not to question whether or not the description of "sufficiently" restrictive is in fact restrictive enough to stifle economic activity.

Prior to the FOMC meeting and the overnight rate policy decision, the interest rate futures market anticipated six to seven, 25 basis point rate cuts in 2024, which was in direct contrast with the Fed's projection of three rate cuts outlined in its most recently released Summary of Economic Projections in the previous month. Moreover, in the weeks leading up to the meeting, traders at times assigned over a 50% probability that there would be one, 25 basis point rate cut at the upcoming March meeting. Captivating those who find delight in following the erratic second-by-second oscillations of market movements, during Chairman Powell's press conference, the probability jumped to roughly 68% as he delivered his prepared remarks, but gradually plunged to approximately 35% as he wrapped up his comments after the Q&A session with reporters.

Underscoring that a rate cut in March was not the central bank's base case scenario, Chairman Powell was quoted, "Based on the meeting today, I would tell you that I don't think it's likely that the committee will reach a level of confidence by the time of the March meeting." He also emphasized that the committee doesn't necessarily need to see "better" data, just a continuance of "good" data and incoming information in making a determination of when to loosen its currently enacted policy restraint. Furthermore, in its FOMC statement, the committee reiterated its intention to continue reducing its balance sheet by $95 billion/month, with preliminary, in-depth conversations regarding the reduction of quantitative tightening to commence at the upcoming March meeting.

Clearly, the rates market had contrarian views on the timing and scope of rate cuts, however it calls back into play the long-tenured adage, "Don't fight the Fed."



U.S. Treasury yield curve was broadly unchanged with a slight steepening bias as longer-dated yields and shorter-dated yields saw meager upticks and downticks, respectively.

2-year/10-year spread: -30 basis points
3-month/10-year spread: -146 basis points
2-year/5-year spread: -37 basis points
3-month/30-year spread: -120 basis points

U.S. Treasury Yield Curve Source: Bloomberg

January 2024 Macroeconomic Highlights

Inflation, Expectations, and Consumer Sentiment[1]:
CPI: 3.4% year-over-year (0.3% month-over-month); ***Core CPI***: 3.9% year-over-year (0.3% month-over-month)
PCE: 2.6% year-over-year (0.2% month-over-month); ***Core PCE***: 2.9% year-over-year (0.2% month-over-month)
PPI: 1.0% year-over-year (-0.1% month-over-month); ***Core PPI***: 1.8% year-over-year (0.0% month-over-month)
Core PPI less trade services: 2.5% year-over-year (0.2% month-over-month)
Inflation Expectations: 1-year horizon: 3.0%, 3-year horizon: 2.6%, and 5-year horizon: 2.5%
Consumer Sentiment: 79.0 vs. 69.7 in December; ***Current Conditions***: 81.9 vs. 73.3 in December
Consumer Expectations: 77.1 vs. 67.4 in December

Labor Market[2]: The U.S. economy added 216,000 nonfarm payrolls in December, outstripping the 175,000 expected by economists surveyed by Bloomberg. Notable job gains occurred in government (+52,000), leisure and hospitality (+40,000), health care (+38,000), social assistance (+21,000), and construction (+17,000).

- U-3 ***official*** unemployment rate: 3.7% vs. 3.8% expectation: unchanged from November 2023.
- U-6 unemployment rate (marginalized, part-time workers for economic reasons): 7.1%.
- Labor force participation rate: 62.5% (-0.3%); Employment-to-population ratio: 60.1% (-0.3%).
- Average hourly earnings for private nonfarm payrolls rose 15 cents to $34.27 (+0.4% month-over-month, +4.1% year-over-year).
- Employment revisions: November 2023 cut -26,000 to 173,000; October 2023 reduced -45,000 to 105,000.
- Employment Cost Index: 0.9% in the fourth quarter of 2023 vs. 1.1% in the third quarter of 2023.

Gross Domestic Product (GDP)[3]: According to the ***advance (initial)*** estimate, real GDP increased at annual rate of 3.3% in the fourth quarter of 2023 vs. 4.9% in the third quarter of 2023. Real GDP increased 2.5% in 2023.

- *Fourth Quarter 2023:* GDP Price Index: +1.5%; PCE Price Index: +1.7%; Core PCE Price Index +2.0%.
- Real disposable personal income: +2.5% vs. +0.3% in the third quarter of 2023.
- Personal savings rate as a percentage of disposable income: 4.0% vs. 4.2% in the third quarter of 2023.

Housing Market[4]: Existing-home sales faded -1.0% (month-over-month) from November to a seasonally-adjusted annual rate of 3.78 million in December. Month-over-month sales in the Midwest and South receded -4.3% and -2.8%, respectively, while sales advanced +7.8% in the West, but remained unchanged in the Northeast.

- Year-over-year sales ebbed -6.2%, down from 4.03 million in December 2022.
- Total housing inventory registered 1.00 million units, -11.5% from November, but +4.2% from one year ago (0.96 million units). Unsold inventory sits at 3.2-month supply at the current sales pace.
- The median existing-home price for all housing types was $382,000, +4.4% from December 2022 ($366,500), as prices rose in all four major U.S. regions.
- Average commitment rate for a 30-year, conventional, fixed-rate mortgage: 6.69%.
- New Home Sales: 664,000 (+8.0% month-over-month).

[1]Source: Bureau of Labor Statistics (BLS), U.S. Department of Commerce, Federal Reserve Bank of New York – Survey of Consumer Expectations, and University of Michigan Surveys of Consumers
[2]Source: Bureau of Labor Statistics (BLS)
[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