Economic Commentary – July 2023

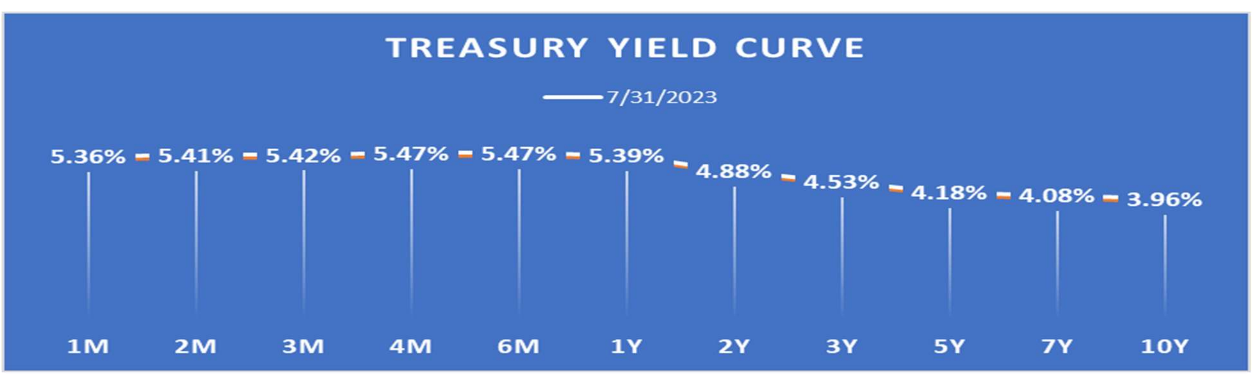
In comparison to the preceding three months (Q2 2023) which saw varying, disparate, yet correlated financial market perturbations, July was a considerably placid month. Sustaining 2023's overall macroeconomic theme, consumers continued to spend, the labor market remained resolute with the unemployment rate hovering around a 50-year low, and economic growth stood in expansionary mode.

On July 26, at the conclusion of its fifth FOMC meeting of the calendar year, substantiating the rate market's imputed 97% probability, the Fed enacted its 11th interest rate increase since March 2022, raising the federal funds target rate 25 basis points, effectively lifting the benchmark's range to 5.25% - 5.50%. Coming off the heels of the committee's June decision to undertake a hawkish pause, this particular rate hike was well-telegraphed as Fed policymakers have been unremitting in their rhetoric and intention to place rates in sufficiently restrictive territory until they see inflation on a sustainable path to their desired 2% objective. While the most recent headline inflation readings for both CPI and PCE came in only 100 basis points above the aforementioned objective, core inflationary measures (including those that strip out housing), which the Fed considers to be a better barometer of the overall trajectory of the economy, remain more than twice the target.

The battle to subdue inflationary pressures is still not complete, and the Fed's dot plot points to a scenario where interest rates will be higher for longer before there is any consideration of interest rate cuts. However, seemingly at odds with an unyielding, restrictive monetary policy stance, the consensus amongst most economists, including the staff economists at the Federal Reserve, is now for the U.S. economy to achieve a "soft landing", where inflation is suppressed, but the impact to economic growth and unemployment is moderate. Put simply, the prospect of avoiding a grim recession that results in millions of job losses is not only seen as attainable, but now forecasted to be the most probable outcome.

Contrarily, buffeting the soft-landing narrative was the Senior Loan Officer Opinion Survey (SLOOS) that was released on the last day of the month. Evidenced in the survey's results was the emergence of tighter credit conditions and more stringent lending standards affecting households and businesses across the entire nation. The overall banking system appears to have stabilized from the tremors experienced in the regional lenders' sector in the year's second quarter, but these strained conditions regarding the extension of credit may serve as a headwind to achieve this now coveted soft landing scenario.

Although it maintained its overall inversion, the U.S. Treasury yield curve underwent a bear steepening. The 2-year/10-year spread truncated its inversion to 92 basis points, while the 3-month/10-year pair was essentially unchanged at 145 basis points.



U.S. Treasury Yield Curve Source: Bloomberg

July 2023 Macroeconomic Highlights

Inflation, Expectations, and Consumer Sentiment[1]:
CPI: 3.0% year-over-year (0.2% month-over-month); ***Core CPI***: 4.8% year-over-year (0.2% month-over-month)
PCE: 3.0% year-over-year (0.2% month-over-month); ***Core PCE***: 4.1% year-over-year (0.2% month-over-month)
PPI: 0.1% year-over-year (0.1% month-over-month); ***Core PPI***: 2.4% year-over-year (0.1% month-over-month)
Core PPI less trade services: 2.6% year-over-year (0.1% month-over-month)
Inflation Expectations: 1-year horizon: 3.8%, 3-year horizon: 3.0%, and 5-year horizon: 3.0%
Consumer Sentiment: 71.6 vs. 64.4 in June; ***Current Conditions***: 76.6 vs. 69.0 in June
Consumer Expectations: 68.3 vs. 61.5 in June

Labor Market[2]: The U.S. economy added 209,000 nonfarm payrolls in June, short of the 230,000 expected by economists surveyed by Bloomberg. Notable job gains occurred in government (+60,000), health care (+41,000), social assistance (+24,000), and construction (+23,000).

- U-3 ***official*** unemployment rate: 3.6% vs. 3.6% expectation: -0.1% from May 2023.
- U-6 unemployment rate (marginalized, part-time workers for economic reasons): 6.9%.
- Labor force participation rate: 62.6% (unchanged), Employment-to-population ratio: 60.3% (unchanged).
- Average hourly earnings for private nonfarm payrolls rose 12 cents to $33.58 (+0.4% month-over-month, 4.4% year-over-year).
- Employment revisions: May 2023 trimmed by 33,000 to 306,000; April 2023 curtailed by 77,000 to 217,000.
- Employment Cost Index: 1.0% in the first quarter of 2023 vs. 1.2% in the fourth quarter of 2022.

Gross Domestic Product (GDP)[3]: According to the ***advance (initial)*** estimate, real GDP increased at annual rate of 2.4% in the second quarter of 2023 vs. 2.0% in the first quarter of 2023.

- *Second Quarter 2023:* GDP Price Index: +2.2%; PCE Price Index: +2.6%; Core PCE Price Index +3.8%.
- Real disposable personal income: +2.5% vs. +8.5% in the first quarter of 2023.
- Personal savings rate as a percentage of disposable income: 4.4% vs. 4.3% in the first quarter of 2023.

Housing Market[4]: Existing-home sales sank 3.3% (month-over-month) from May to a seasonally-adjusted annual rate of 4.16 million in June. Month-over-month sales in the South and West subsided 5.4% and 5.1%, respectively, while sales in the Northeast advanced 2.0%, but remained unchanged in the Midwest.

- Year-over-year sales tumbled 18.9%, down from 5.13 million in June 2022.
- Total housing inventory registered 1.08 million units, unchanged from May, but -13.6% from one year ago (1.25 million units). Unsold inventory sits at 3.1-month supply at the current sales pace.
- The median existing-home price for all housing types was $410,200 (second highest recorded), -0.9% from June 2022 (record high), as prices rose in the Northeast and Midwest, but abated in the South and West.
- Average commitment rate for a 30-year, conventional, fixed-rate mortgage: 6.81%.
- New Home Sales: 697,000 (-2.5% 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

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