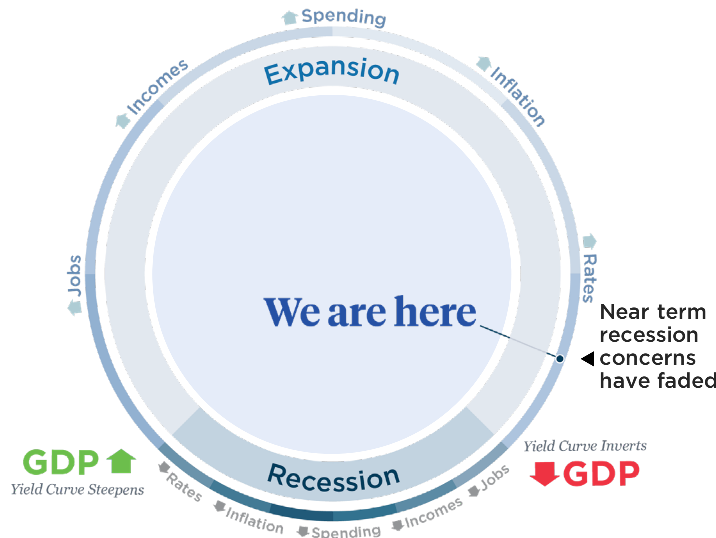
Economic & Financial Markets Monthly Review | May 2024

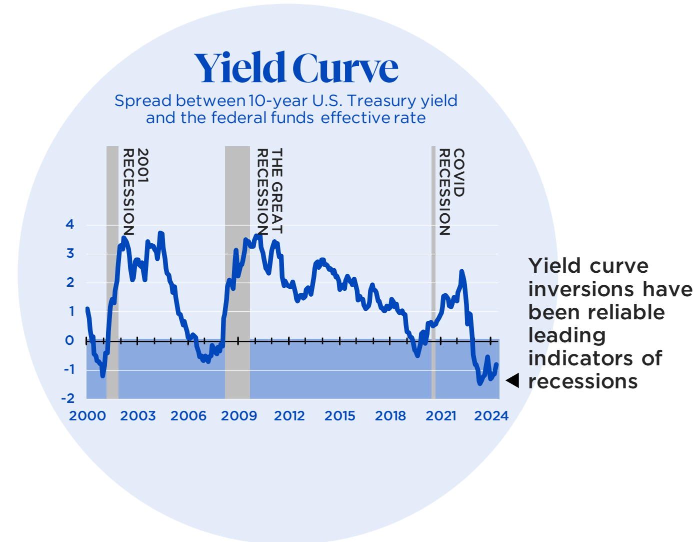
Inflation pushes higher despite the Fed's best efforts

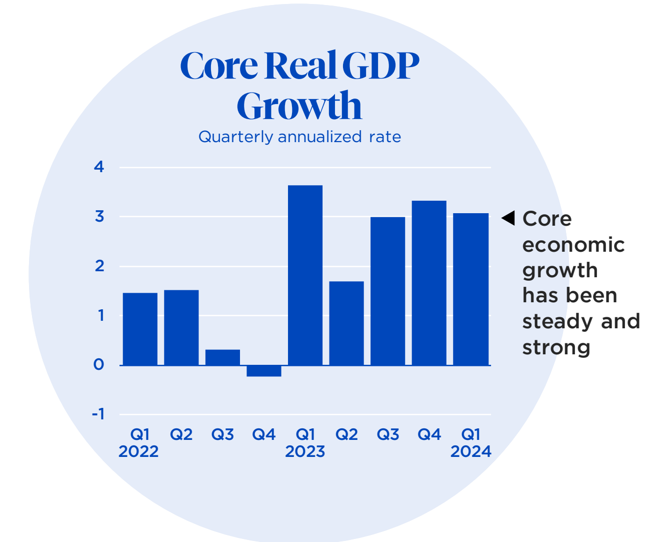
Economic Overview

Where is the economy now?

The economy remains on a solid growth path, bolstered by continued solid job gains and consumer spending which are expected to extend over 2024. The pickup in activity has also reignited inflation with costs likely rising at an elevated pace into 2025. This should further delay rate cuts from the Fed with restrictive monetary policy persisting for longer and lifting recession risks beyond this year.







Where we are this month

Continued growth projected over 2024

The positive momentum for consumers likely extends over 2024, pushing off recession concerns for this year despite higher interest rates and sticky inflation.

Yield curve steepens as rates rise

The yield curve inversion narrowed in April as Treasury rates adjusted to expectations of delayed Fed rate cuts, pushing up long-term yields more than short-term yields.

GDP growth stronger than headline

While real GDP only expanded at an annualized rate of 1.6 percent in Q1, the underlying details for consumers and businesses were stronger.

What does this mean

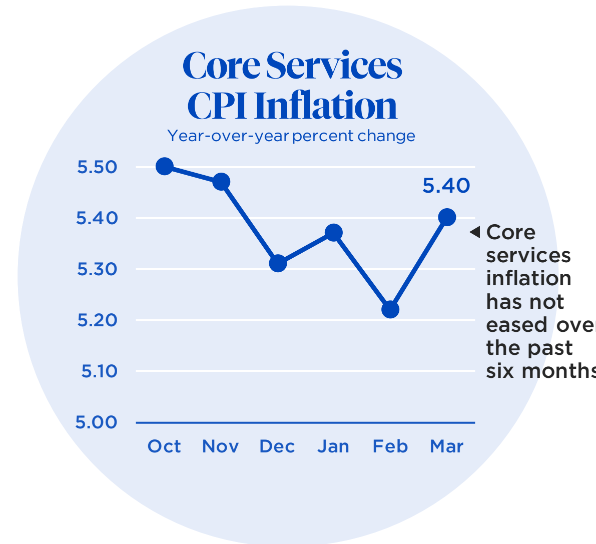
- Economic growth should remain solid in the second quarter but ease in the second half of 2024 under the weight of the extended period of restrictive monetary policy.
- The odds of a recession in 2024 are now lower with hiring and spending activity resilient through April. There are still recession risks for 2025 or beyond, led by the downside from higher-for-longer interest rates and companies pulling back their hiring reins.

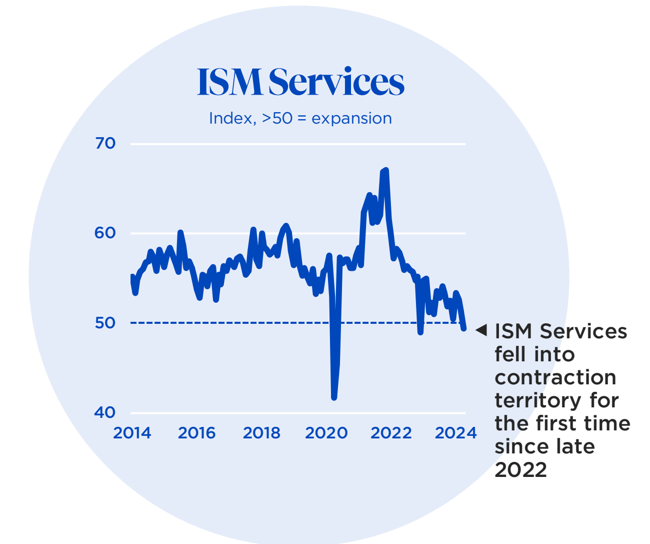
- Treasury rates across durations climbed in March and April as markets priced in a higher-for-longer rate path from the Fed. As a result, the negative spread between the 2-year and 10-year remained intact.
- Portions of the yield curve could remain inverted over much of 2025 with the Fed on course to ease rates only gradually over the next year.

- Final sales to private domestic purchasers (consumer spending and private fixed investment) increased at a 3.1 percent annualized pace in Q1, in line with the second half of 2023 as consumer and business activity remained solid to start 2024.
- Trade and inventories were a significant drag in the first quarter, but this is unlikely to be repeated in the second quarter with real GDP growth projected at around 2.0 percent.

Employment data show signs of cooling

Job gains were weaker in April, and the hiring was concentrated in a few industries, suggesting broadly slower demand for workers. Wage growth slowed to a multi-year nadir and the unemployment rate ticked up, albeit remains low on a historical basis. On the inflation front, services inflation surged in the first quarter, and input costs for the services sector spiked in April — indicating continued price pressures in coming months.





Where we are this month

What does this mean

Labor demand begins to ease

Nonfarm payroll growth slipped to a six-month low of 175,000 in April, while the unemployment rate climbed to a still-low 3.9 percent.

- Two-thirds of the headline gain in payrolls came from health care and social assistance, transportation and warehousing, and retail trade. Job gains were much weaker in most cyclically-sensitive industries.
- Annual wage growth was at its slowest pace since May 2021 and, in combination with a shorter average workweek and slower job growth, could result in nearly flat income growth on the month. This portends a weak start for consumer spending in Q2.

Services inflation surged in Q1

Year-on-year growth in core services inflation re-accelerated in March despite the Fed's restrictive policy stance. Price increases for residential rents remain rapid.

- Core services inflation was resurgent in the first quarter, climbing by at least 0.5 percent in each of the first three months of the year. This renewed strength lifted the 3- and 6-month annualized rates up to 6.8 and 5.8 percent, respectively.
- Hotter services inflation has halted the progress toward the Fed's two percent inflation goal and is expected to delay the first rate cut at least until September.

Services sector falls into contraction

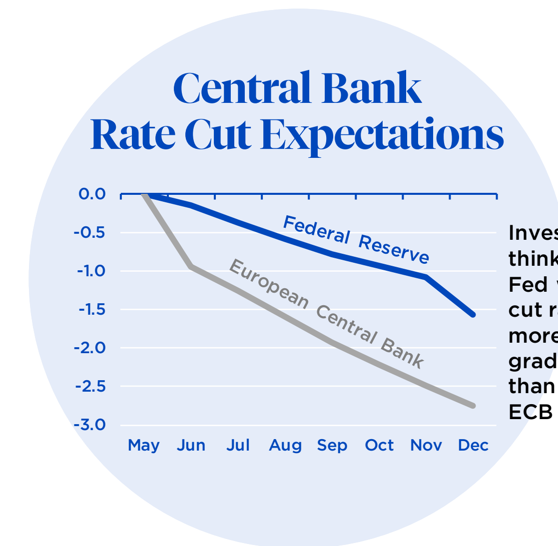
The ISM services index surprisingly dropped below 50 (i.e., contraction territory) in April for the first time since December 2022.

- Demand metrics in the survey softened considerably, with new orders and exports pulling back. Business activity also plunged, dropping to the weakest reading since the 2020 pandemic lockdowns.
- The prices paid index spiked to its second-highest reading in the last year — an unwelcome sign on the heels of the strong services inflation in the first quarter.

Financial Market Review

Fed pause gets a little longer

Relatively hawkish Fed rhetoric caused risk assets to take a breather and pushed interest rates higher in April. A Fed rate cut is not imminent, with Fed Chair Powell and other Fed officials signaling the easing cycle cannot begin until inflation pressures have been sufficiently contained. We anticipate gently moderating GDP growth and inflation to remain sticky over 2024, further delaying Fed easing. We think the Fed will wait until September to start lowering interest rates, with a growing risk of a later start and fewer rate cuts.



Where we are this month

What does this mean

Equities step down in April

Persistent economic momentum and stalled progress on disinflation led Fed officials to strike a more hawkish stance in April, causing the S&P 500 to fall.

- Nearly all major sectors contributed to the S&P 500's decline in April. The economic backdrop remained encouraging despite a roughly one percent monthly decline in the benchmark equity index. Spending and investment continued to rise and hiring was solid. Meanwhile, Q1 corporate earnings reports so far are favorable and financial conditions remain loose.
- Investors maintain constructive views even as traditional valuation metrics flash warning signs, suggesting limited downside risks.

Interest rates maintain their uptrend

The 10-year Treasury yield rose more than 30bps in April. The long-term benchmark interest rate ended the month just below its October 2023 high.

- Markets repriced their expectations for Fed policy amid a persistently buoyant growth and inflation environment. The two-year Treasury yield climbed in April and remains well above its post-Global Financial Crisis average.
- Interest rates will be vulnerable to swings in the economic data and the Fed's messaging on monetary policy. Sturdy inflation pressures and some concerns over the federal government's fiscal health lend upside risks to interest rate forecasts.

Fed may lower rates less than peers

A stronger U.S. economy relative to Europe is spurring a divergence in expectations for policy easing as investors think the ECB will cut rates faster than the Fed.

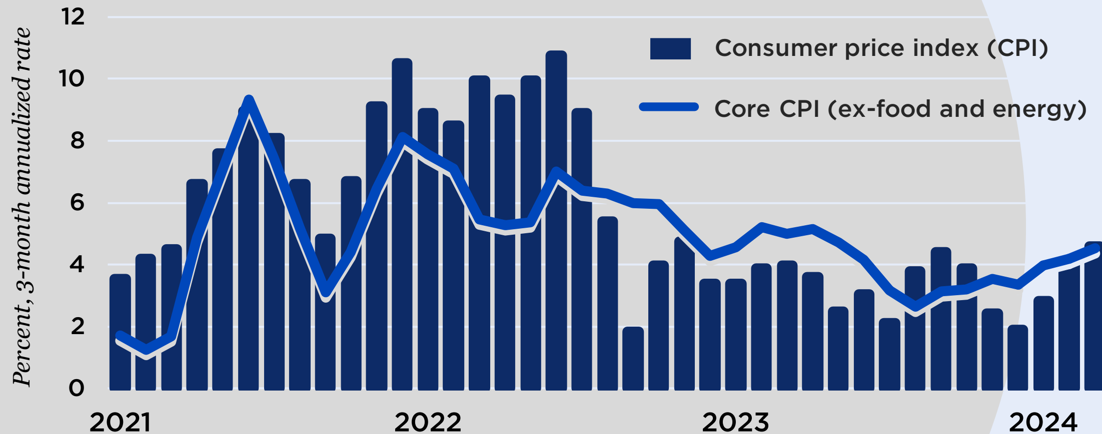
- This makes sense since U.S. activity is not as weak as the headline Q1 GDP growth print suggests, and inflation is proving to be stubborn. Meanwhile, inflation is advancing on a more encouraging path in Europe and activity has cooled in many countries.
- We think the Federal Reserve will hold off on rate cuts until the end of Q3, and we expect only 50 basis points of cumulative easing this year. If the U.S. economy stays resilient, Fed officials will likely ease by less than their European counterparts.

Outlook

Inflation's faster trend may linger over 2024

Robust economic activity at the start of 2024 has contributed to a reacceleration in inflation. The 3-month annualized rate for the consumer price index surged to 4.6 percent by March, after bottoming out at 1.9 percent at the end of 2023. Rising energy prices have played a role, but core inflation is climbing, too — led by rapid price increases for services and housing. Our supercore CPI measure (core services ex-rents) accelerated to a concerning 6.8 percent 3-month annualized pace as inflation trends have shifted in the wrong direction.

The recent momentum for hiring and spending indicate that these concerning inflation trends may not abate soon. We expect services inflation, especially for transportation and medical care, to remain sticky over 2024. This, in combination with upside for energy costs from geopolitical wars, should keep monthly inflation readings higher for at least a few more months. The recent inflation pressure may ease later in 2024, but the damage could already be done, with year-on-year CPI inflation set to run just below 4.0 percent for much of 2024, an uptick from 2023.



Podcast

The Fed's pause just got a little longer

PLAY

22 min

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Latest Forecast

Data as of May 2024

	2023	2024	2025	2026	2027
	ACTUAL	ESTIMATE	FORECAST		
REAL GDP	2.5%	2.4%	1.6%	1.9%	1.8%
UNEMPLOYMENT RATE	3.6%	3.9%	4.2%	4.0%	4.0%
INFLATION [1] (CPI)	3.2%	3.8%	2.5%	2.1%	2.0%
TOTAL HOME SALES	4.77	4.76	5.10	5.95	6.15
S&P/CASE-SHILLER HOME PRICE INDEX	5.5%	3.7%	3.3%	3.2%	3.0%
LIGHT VEHICLE SALES	15.5	15.5	15.6	16.4	16.5
FEDERAL FUNDS RATE [2]	5.25%	4.75%	3.50%	2.75%	2.75%
5-YEAR TREASURY NOTE [2]	3.84%	4.05%	3.50%	3.10%	3.10%
10-YEAR TREASURY NOTE [2]	3.88%	4.15%	3.60%	3.50%	3.50%
30-YEAR FIXED-RATE MORTGAGE [2]	6.61%	6.45%	5.20%	4.80%	4.80%
MONEY MARKET FUNDS	5.09%	5.09%	3.78%	2.97%	2.78%

[1] Percent change Q4-to-Q4
[2] Year-end

Higher inflation expectations for 2024

The stronger inflation trend in early 2024 is now expected to carry at least until mid-year. Rising costs for services and housing should keep year-on-year inflation around 4.0 percent for much of the year. Upside from renewed climbs for energy and goods prices are also a lingering risk.

Delayed rate cuts keep long-term rates higher, too

With the Fed likely on hold until later in 2024, long-term Treasury rates have shifted higher. While we expect rates to slowly ease later this year, the projected path should be more elevated into 2025 with additional upside risk.

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Sources

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Business Cycle	*Nationwide Economics*
Yield Curve	*Bloomberg; National Bureau of Economic Research*
Core GDP growth	*Bureau of Economic Analysis*

2 | Economic Review

Nonfarm payroll gains	*Bureau of Labor Statistics*
Consumer Price Index	*Bureau of Labor Statistics*
ISM services index	*Institute for Supply Management*

3 | Financial Markets Review

S&P 500	*Standard & Poor's*
10-year Treasury yield	*Federal Reserve Board*
Fed vs ECB expectations	*Bloomberg*

4 | Outlook

3-month annualized CPI trends	*Bureau of Labor Statistics*
Latest Forecast	*Nationwide Economics*

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