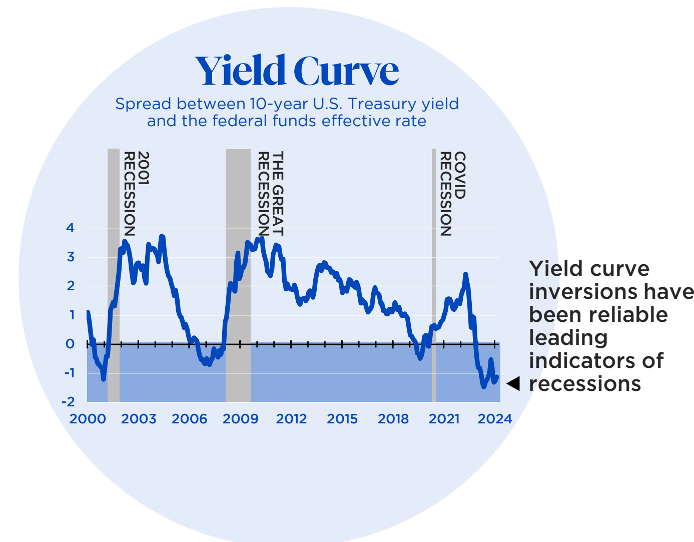
Economic & Financial Markets Monthly Review | March 2024

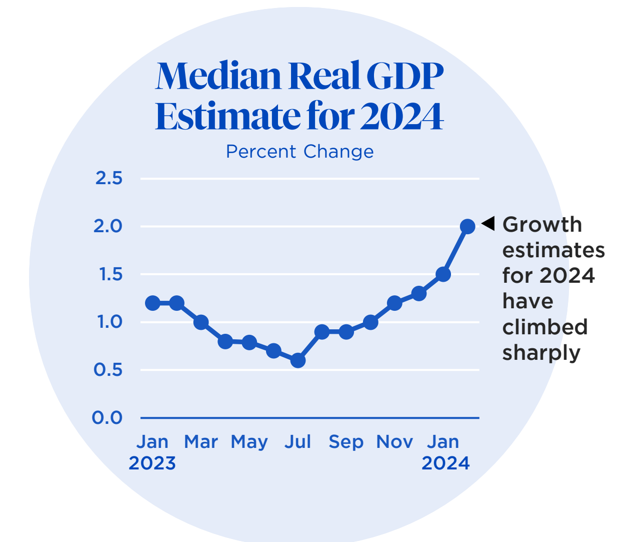
Optimism rising for the 2024 growth outlook

Economic Overview

Where is the economy now?

The incoming data show the economy remains far from being in a recession due to strong hiring and buoyant consumer spending despite elevated interest rates and signs of increasing cracks for some segments of the economy. Most leading indicators still suggest elevated recession risks in the year ahead, but these fears have been overshadowed by resilient activity. Fed policy easing should be delayed at least until June given elevated and sticky inflation, another risk for the outlook.





Where we are this month

Economy is staving off a recession

Real GDP growth in the first quarter is moderating from the strong pace seen in the second half of 2023 but remains solid and expansionary.

Lingering yield curve inversion

The 10-year to fed funds rate spread inversion was little changed in February and has now been sustained for more than 15 months.

2024 growth forecasts rising

The strong start to the year has caused forecasters to lift their estimates for real GDP in 2024, up to a median of 2.0 percent.

What does this mean

- Job gains have been resilient, even in the cyclically-sensitive industries, supporting consumer spending activity and likely further delaying recessionary conditions.
- Any projected recession should be short and mild with limited job losses and business closures — especially compared to the severe impacts recorded during the past two downturns.

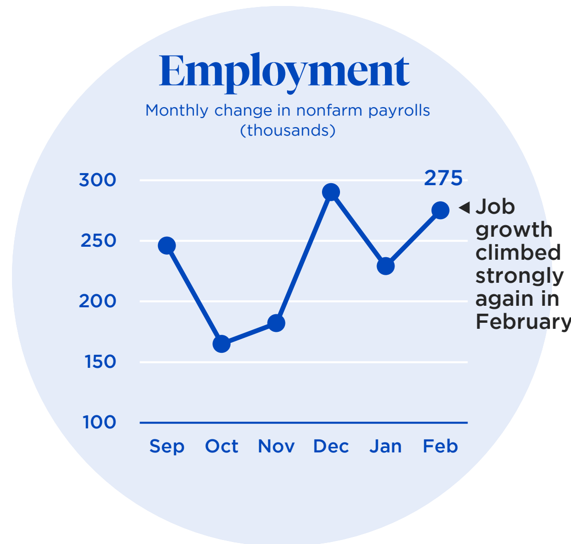
- The expected delay in Fed easing has pushed up Treasury yields again. The negative 2-year to 10-year Treasury spread has been steady since the start of the year and points to concerns about forward growth prospects.
- Still, credit spreads remain very tight and corporate credit issuance has been buoyant as investors increasingly embrace a soft-landing economic scenario.

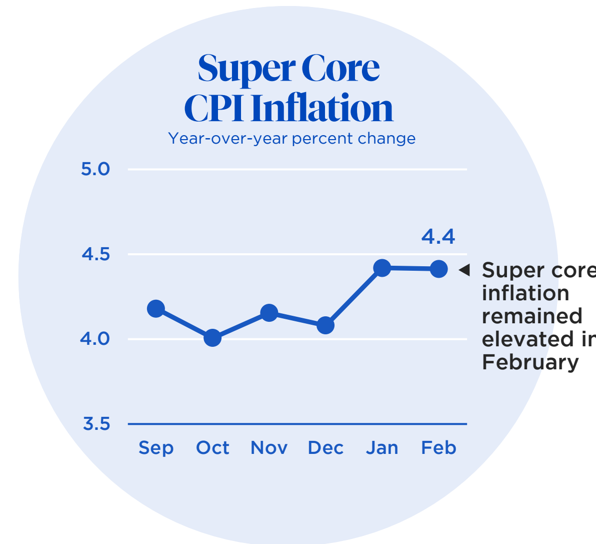
- This represents a sharp increase from mid-2023 when growth was expected to struggle this year with elevated odds of a recession.
- There is also growing optimism that the economy can avoid a recession this year with continued job gains and consumer spending offsetting the negative effects from an extended period of restrictive monetary policy.

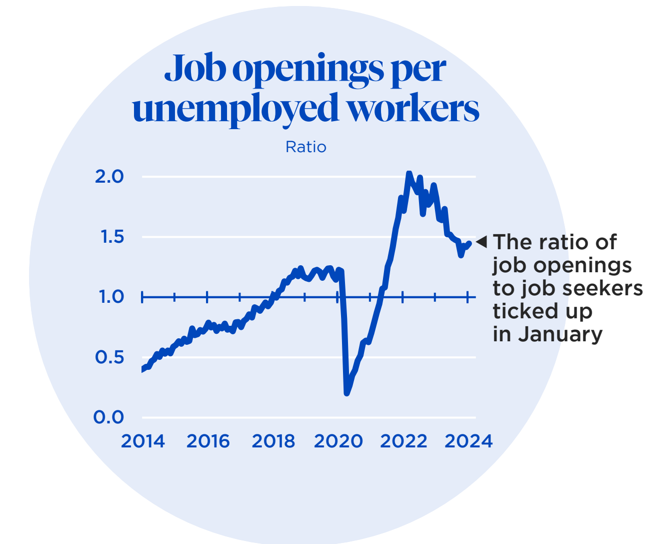
Economic Review

Labor market still solid, but inflation is concerning

Job gains were strong again in February, but substantial downward revisions to prior months dampened some of the exuberance in the recent hiring trend. The market for workers remains tight with the ratio of job listings to unemployed persons still above pre-pandemic levels. On the inflation front, continued strong growth in service costs has stalled the broader disinflationary trend for the economy.







Where we are this month

What does this mean

Strong, but conflicting signals in jobs data

The headline gain in nonfarm payrolls soundly beat expectations in February, while unemployment rose by 0.2 percentage points to 3.9 percent.

- Underneath the strong headline 275,000 increase, the gains were concentrated in a few sectors, and downward revisions to January and December totaling 167,000 revealed a slower overall hiring pace than prior reports indicated.
- Average hourly earnings only increased by 0.1 percent in February, but a tick up in the workweek combined with the gain in net new jobs still suggests a healthy rise in aggregate earnings for workers.

Core services inflation remains sticky

Year-on-year growth in CPI super core inflation (i.e., core services less rents) was steady in February at 4.4 percent to match the fastest pace since last May.

- Disinflation has stalled as price pressures in the service sector continue to prop up CPI readings. In February, the 3- and 6-month annualized inflation rates for the super core measure climbed by 6.8 percent and 5.9 percent, respectively.
- These hotter inflation prints will likely add to the Fed's cautiousness regarding the shift to policy easing — with a delay for rate cuts until June or later an increasing probability.

Labor market is cooling gradually

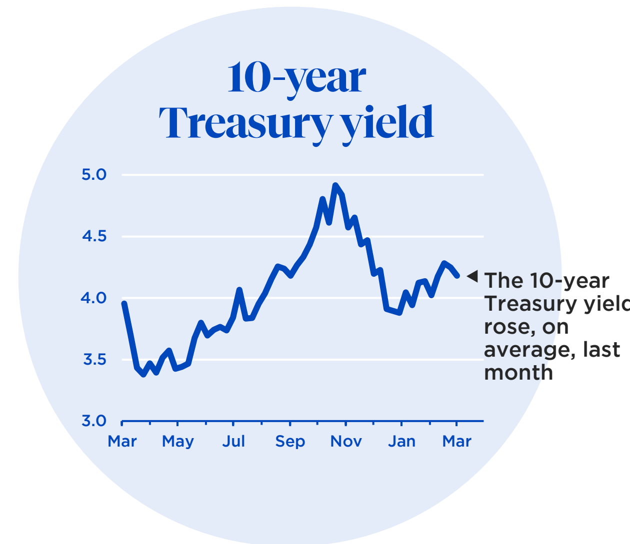
The ratio of job openings to unemployed persons climbed to 1.45 in January as the market for workers remains tight in many sectors.

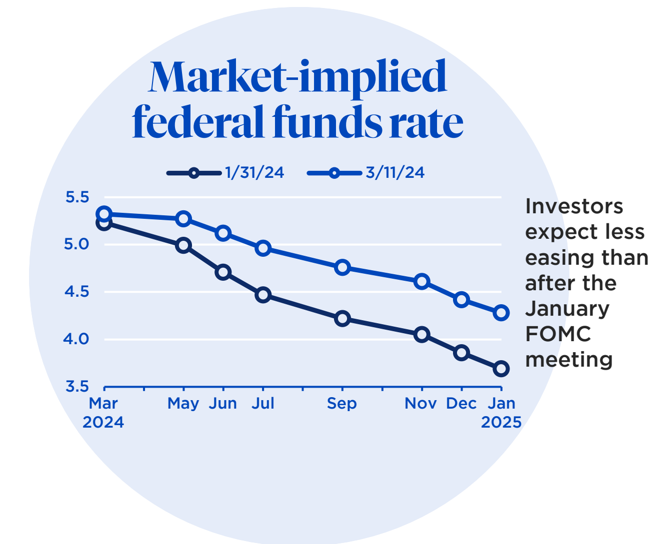
- This measure has fallen from its pandemic peaks but remains well above normal and continues to signal that the scale favors job seekers more than employers.
- There is some evidence of increased slack as the quits rate fell in January to 2.1 percent — its lowest level since 2018 and an indication that fewer workers are looking for new employment opportunities.

Financial Market Review

Resilient economy forces investors to rethink rate cuts

Healthy economic data and improved confidence in the outlook kept the S&P 500 index on an upward trajectory and raised medium- and long-term U.S. Treasury yields in February. A solid first half of 2024 could precede a short and shallow recession later in the year, but the economy's ongoing resilience bolsters the case for a soft landing. The Fed intends to lower interest rates this year, however persistently buoyant growth and inflation and loose overall financial conditions risk delaying the start and extent of easing.





Where we are this month

Equities continue to climb

Solid economic momentum and Fed officials expressed desire to cut rates kept the S&P 500 on an upward course in February, rising by 4.3 percent.

Interest rates increase

The 10-year Treasury yield rose 15 basis points on the month to average 4.21 percent in February, but still held below its late-2023 peak.

Investors push back first Fed rate cut timing

Markets are adjusting to resilient data and the Fed's commitment to hitting its inflation target. Investors now expect less policy easing by the Fed over 2024.

What does this mean

- Persistently upbeat activity, relatively solid corporate earnings, slowly moderating inflation, and easing financial conditions drove the benchmark U.S. equity index to new highs. Consumer discretionary and industrial stocks led the way as all the major equity sectors contributed to the headline index's gain in February.
- Valuations remained stretched but investors took on more risk in February and into early March, suggesting the rally has room to run.

- The 2-year Treasury yield, which is highly sensitive to Fed policy, rose at a sharper clip than the 10-year as investors recalibrated their expectations for the timing and magnitude of Fed rate cuts amid robust GDP growth and upside pressures within the January and February inflation data.
- Interest rates will remain vulnerable to swings in the data and the Fed's messaging on monetary policy. Sturdy pressures within core and super core inflation lend upside risks to interest rate forecasts.

- Investors have pushed back the timing of the initial Fed rate cut until June. The fed fund futures market now expects 75 basis points of cumulative easing by year end, down from 150bps at the start of the year.
- We also expect an initial rate cut in June, but with the economy showing persistent strength, there is an increasing risk that Fed officials push the start of policy easing even later. Further, the FOMC may end up lowering rates by less than the 75bps that we now expect – which is down from 100bps previously.

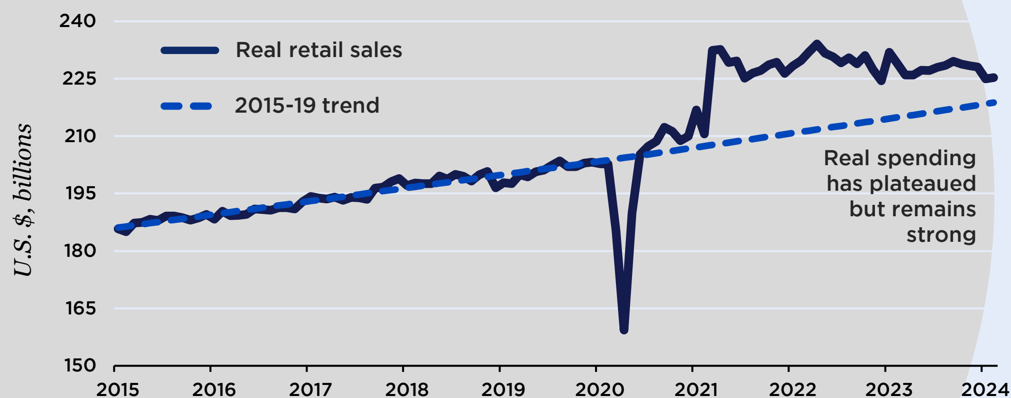
Outlook

How long can consumers keep up their spending habits?

The driving force behind the recovery from the 2020 Covid Recession has been supercharged consumer spending — on goods early in the pandemic and then shifting more towards services as pandemic restrictions eased and health conditions improved. This strong spending extended through 2023 with retail sales adjusted for inflation far above the pre-pandemic trend, fueled by excess pandemic savings and buoyant wage gains for workers. Income growth remains a tailwind for most households, with solid hiring into early 2024 and the market for workers still tight. But excess savings have been largely been depleted while consumers are increasingly tapping into credit to maintain spending levels.

The path forward for the consumer sector will be the key determinant for whether the economy slips into a recession later this year or continues to defy expectations. As long as the labor market remains on solid footing, it's unlikely that most households will cut spending substantially in coming months, which will extend the expansion later into 2024. But if hiring does falter, many households may not be positioned to handle a drop in income, a significant risk to activity ahead.

Retail spending is running well above the pre-Covid trend



Podcast
The Fed is still waiting for cooler inflation
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19 min

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Data as of March 2024

	2023 ACTUAL	2024 ESTIMATE	2025 FORECAST	2026 FORECAST	2027 FORECAST
REAL GDP	2.5%	1.9%	1.3%	1.7%	1.5%
UNEMPLOYMENT RATE	3.6%	4.2%	4.5%	4.1%	4.0%
INFLATION [1] (CPI)	3.2%	2.9%	2.4%	2.1%	2.0%
TOTAL HOME SALES	4.77	4.46	5.25	5.95	6.15
S&P/CASE-SHILLER HOME PRICE INDEX	5.5%	2.1%	3.4%	3.2%	3.0%
LIGHT VEHICLE SALES	15.5	15.1	15.8	16.4	16.5
FEDERAL FUNDS RATE [2]	5.25%	4.50%	3.25%	2.50%	2.50%
5-YEAR TREASURY NOTE [2]	3.84%	3.90%	3.30%	2.90%	2.85%
10-YEAR TREASURY NOTE [2]	3.88%	4.00%	3.50%	3.25%	3.20%
30-YEAR FIXED-RATE MORTGAGE [2]	6.61%	6.30%	5.10%	4.60%	4.55%
MONEY MARKET FUNDS	5.09%	4.90%	3.65%	2.72%	2.53%

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

Mild recession likely delayed until H2 2024

A stronger start to the year for hiring and spending activity should push off recessionary conditions again. But elevated interest rates and tight credit could weigh on consumers and businesses later in the year, with modest real GDP declines projected over the second half of 2024 and a rebound in 2025.

Interest rates may be near peak for this cycle

While Fed easing is likely to be delayed until mid-year, the next move in policy rates should be downward. This implies that long-term Treasury rates should also retreat from current levels over the second half of 2024 — although the decrease is also expected to be modest.

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