Another month has passed in which the focus has mostly been on inflation, and it was another month of a disappointing inflation report. As inflationary pressures persist and have yet to peak, the Federal Reserve is becoming increasingly hawkish. This is creating more skepticism in the Fed’s ability to orchestrate a soft-landing of reigning in inflation without causing a recession, which is something the Fed has been unable to do when inflation has climbed above 5%.

Last week’s inflation report recorded an annualized increase of 8.6% - the highest since 1981. As we all are keenly aware, surging gasoline and energy prices propelled inflation higher. Gasoline prices are 50% higher than they were a year ago, energy prices are 35% higher, and food prices are 10% higher. While many are grumbling about mis-steps in monetary and fiscal policy, much of the pressures we are seeing are global in nature and are the result of supply chain disruptions and the War in Ukraine. The challenge with global problems like this is that monetary policy is not as effective at solving them.

The report on core inflation showed some encouraging signs. Core CPI, which excludes food and energy, increased at an annualized rate of 6%, which was down from 6.2% in April, but was above consensus expectations for 5.9%. Rising housing costs continue to drive Core CPI higher. Last month rents increased at an annualized rate of 5.5%. High demand for rentals is likely to persist given that home prices are at all-time highs and rising interest rates have made homeownership more expensive.

To fight inflation the Federal Reserve hiked interest rates 75 basis points this week, which was the largest rate hike since 1994. The overnight target rate range now sits at 1.5% to 1.75%. The Fed is expected to raise the Fed Funds rate at least another 175 basis points this year. As a result of a more hawkish Fed, we’ve seen large movements in Treasuries and foreign currencies. The 2-year Treasury has increased from 2.66% at the beginning of June to 3.20% as of June 15th. It started the year at 0.78%. The rapid increase in short-term rates is causing the yield curve to flatten. The 10-year Treasury sits at 3.30% just slightly above the 2-year Treasury.

Inflation continues to weigh on consumers. The University of Michigan Consumer Sentiment Index plunged in June to 50.2, from 58.4 in May. It’s now at the lowest level since 1980 – below any point reached in the Great Recession. Despite dire sentiment, most American’s are still spending, but we are beginning to see the decline in disposable income impact retail sales. May retail sales unexpectedly declined 0.3%, which was the first decline in five months. Excluding sales at gas stations, retail sales were down 0.7%.

While Americans have bleak feelings about the economy, and certainly the likelihood of a recession has increased, it’s important to note that the economy is still growing. Housing prices remain at all-time highs, and as a result many Americans have strong balance sheets. More importantly, the labor market continues to add jobs. In May, the economy added another 390,000 jobs, and the unemployment rate remained unchanged at 3.6%. Other economic reports that benchmark the health of the economy also continue to signal growth. The most recent ISM manufacturing index was 56.1 and ISM services was at 55.9. Readings above 50 signify growth, so both remain well in growth territory. Additionally, over the last 6 months, the Leading Economic Index has increase 0.9%, which suggests continued moderate growth. A more aggressive Fed may start to eat away at growth, and that’s part of the Fed’s objective in order to reign in inflation, but for now we’ve yet to enter a recession or experience economic signals of one eminently ahead.