NOVEMBER 2023 ECONOMIC COMMENTARY by Colton Krueger, Economic Analyst

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As has been the case, the US economy continues to demonstrate exceptional resilience, with growth accelerating in Q3, particularly in September, despite tightening monetary conditions. Economic data since July has shown an incredibly strong job market, although it is beginning to show signs of slowing, and robust consumer spending. Consequently, the progress in fighting inflation has been somewhat uneven. Gross Domestic Product (GDP) for the third quarter showed the economy grew at an annualized pace of 4.9%, an increase from the annualized pace of 2.1% in the second quarter and was ahead of expectations for a 4.3% rate. Growth was led by robust consumer spending, demonstrating that consumers continue to spend despite high borrowing costs and stubborn inflation.

The Consumer Price Index (CPI) experienced a 0.4% increase in September, slightly exceeding expectations but showing a deceleration compared to the 0.6% rise observed in August. Year-on-year, the CPI has risen by 3.7%, which was unchanged from August. Meanwhile, the Core CPI, which excludes food and energy, increased by 0.3% and is now 4.3% higher than a year ago. At first glance, it may seem like inflation is spiraling beyond the control of the Federal Reserve. However, the broader trend of moderating inflation remains intact. When examining the drivers behind the CPI increase, nearly half can be attributed to rising rents, the largest single component of the CPI. If we adjust the Core CPI to also exclude housing costs, the inflation rate stands at just 1.9% higher than a year ago, falling below the Fed's overall inflation target of 2%. In fact, prices of consumer goods have declined over the past four months and are nearly back to levels from a year ago.

The labor market continues to exhibit remarkable strength, accelerating over the last several months. However, the most recent labor market report from October revealed that trend may be reversing. Employers added 150,000 jobs in October, which was a sharp deceleration from the 297 thousand jobs added in September. The unemployment rate rose 0.1% to 3.9% and is up 0.5% since April. Furthermore, only three sectors – healthcare, government, and hospitality – added jobs, meaning the rest of the economy had no job growth.

What had been alleviating pressure on the Fed to raise rates was the surge in yields on long-term rates. Over the course of mid-September until early November, long-term yields experienced a significant rise, particularly the yield on the 10-year Treasury note. The 10-year Treasury rose to 5%, marking its highest level since 2007, just before the Great Recession. At the beginning of September, the yield stood at approximately 4.5%. This abrupt increase in yields contributed to a further tightening of financial conditions. It also reflected that the economy's strength would likely require the Fed to raise rates again. All of this changed when the October jobs report was released, showing a slowing labor market. In response to the report, the 10-year Treasury fell to 4.57%, marking the largest weekly decline since March. Before the report, the market was increasingly certain that if the labor market continued its torrid pace, the Fed would opt to raise rates further at the December meeting. If November's labor report confirms the trend of a slowing job market, further rate hikes are unlikely.

Despite tightening financial conditions, declining savings rates, record levels of credit card debt, and the resumption of student loan payments, consumers continue to spend. Retail sales in September showed a 0.7 percent increase over August, marking an impressive 8.4 percent rise compared to a year ago. The spotlight of economic growth has undeniably shifted from interest-rate-sensitive sectors like housing and manufacturing, which supported the economy during the pandemic, to less interest rate-sensitive sectors, such as retail sales.

On the other hand, the housing market continues to experience a sharp decline, primarily due to historically high mortgage rates. This has resulted in a drop in demand from new homebuyers and a decrease in supply as homeowners are discouraged by the prospect of financing a new home at current high rates, as opposed to the lower rates they had locked in. In September, sales of existing homes declined for the fourth consecutive month, reaching the lowest levels since 2010. With mortgage rates hovering around 8%, the Mortgage Bankers Association reports that applications are at their lowest level since 1995. Contrasting the dismal existing home sales due to low inventory, new home sales are incredibly strong. In September, new home sales increased 12.3% from the prior month and are 33.9% higher than a year ago.

Economic growth is expected to slow in the coming months; nevertheless, the calls for a recession are diminishing. In a recent poll of economists by The Wall Street Journal, 48% of them expect a recession next year, down from 54% in July. This marks the first time the poll has fallen below 50% since the middle of 2022. Though it may be premature to make a definitive judgment, the economy appears to be on course for a soft landing, aimed at curbing inflation without causing a severe recession.

ECONOMIC CHARTS