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FEBRUARY 2024 ECONOMIC COMMENTARY by Colton Krueger, Economic Analyst

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The US economy began 2024 on solid ground, with positive trends in economic activity, consumer sentiment, a strong labor market, and moderating inflation. Consensus growth forecasts for 2024 anticipate GDP will exceed 2.0%. However, there are economic headwinds, including rising consumer debt, and elevated interest rates that may weigh on growth.

Beginning with the labor market, January saw remarkable job growth, with 353,000 jobs added, surpassing expectations and marking the largest increase since January 2023. Additionally, job figures for both November and December were upwardly revised. The unemployment rate remained steady at 3.7% for the third consecutive month. Furthermore, average hourly earnings exceeded expectations, posting a 0.6% increase from the previous month and standing 4.5% higher than a year earlier, outpacing the rate of inflation. With wages rising faster than inflation, workers are experiencing real wage increases. However, this trend in real wage growth, while boosting consumer spending, also signals to the Federal Reserve that the labor market may be contributing to inflation.

Inflation continues to trend downward, though the journey has been somewhat uneven. The Consumer Price Index (CPI) for January exceeded expectations, causing a temporary stir in the markets upon its release. The CPI increased by 0.3%, and the Core CPI, excluding food and energy prices, went up by 0.4% from the previous month. On a year-over-year basis, the CPI has risen by 3.1%, and the Core CPI by 3.9%, both notably above the Federal Reserve's 2.0% target. Last month's CPI increase can be solely attributed to inflation in services, with core service prices rising by 5.4% from the previous year, while core goods prices saw a slight decline of 0.3% over the same period. The rise in service costs has been broad, with the shelter component, which accounts for a 40% weight in the Core CPI, being the primary factor. It's important to note that the shelter component is a lagging indicator, reflecting changes in costs such as rents negotiated over the past year. Recent benchmarks in housing and rents, however, indicate they are beginning to cool, suggesting that Core Inflation is likely to continue its downward trend towards the Fed's target. Additionally, the Producer Price Index also increased more than expected in January, rising by 0.3% and standing 0.9% higher than a year ago.

Over the past several weeks, Fed Chairman Jerome Powell has dampened investor expectations for rate cuts. At the end of 2023, there were expectations that the Fed might start reducing rates in March. However, the recent labor market and inflation reports have taken that off the table. Consequently, the dollar has strengthened, as investors anticipate the interest rate differential between the US and other countries will remain wide, and yields have increased across all durations. For instance, the 10-year Treasury rate, which was at 3.95% at the year's beginning, now stands at 4.30%. This shift in yields is attributed not only to revised expectations regarding the Fed's monetary policy timeline but also to January's economic performance exceeding forecasts.

The resilience of consumers propelled the economy out of the pandemic and throughout all of 2023. However, recently there have been signs of vulnerability. In January, retail sales experienced a slump of 0.8 percent, marking the largest drop in 10 months, with sales from the previous two months also being revised downward. Consumer borrowing has reached an all-time high, and the burden of high interest rates is beginning to weigh on consumers. Yet, this decline in retail sales and the surge in debt are not necessarily harbingers of economic downturn. Consumer spending remains bolstered by a strong labor market and wage growth that continues to outpace inflation.

The combination of strong economic reports and revised expectations around when the Fed may begin to cut rates, has caused the 30-year mortgage rate to cross back over the 7% threshold after dipping to close to 6.5% in December. With mortgage rates rising again, housing starts fell 14.8% in January, which was the sharpest drop since April 2020, and building permits fell 1.6%. The housing market though remains healthy with national home prices around 5% higher than the year prior.

Looking ahead, the key to sustaining growth and navigating potential headwinds lies in leveraging the labor market's vitality, managing inflationary pressures wisely, and the Fed adapting monetary policy. With responsive strategies from the Fed, the US economy is well-positioned to maintain another year of resilient growth.

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