Weekly Economic Update—November 20th, 2023

It would be hard to find another week that had as many positive developments as the one just past. On the political front, the prospect of an imminent government shutdown was averted as the House passed a bifurcated funding bill that was approved by the Senate and White House. On the economic front, reports of lower inflation and slower consumer spending put the economy more firmly on the path to a soft landing. That virtuous combination, in turn, likely means that the Federal Reserve's rate-hiking campaign has come to an end. For investors, all the above made for a joyous occasion, and the markets celebrated by sending stock prices sharply higher and yields lower.

To be sure, this chapter of good news does not close the book on the economy's performance. Stuff happens, and the road ahead is littered with potholes. The continuing resolution approved by the House just punts the ball for a few months, so another round of political hijinks looms shortly after the calendar turns to 2024. The favorable economic readings this week are highly welcome, but still covers too brief a period to justify enduring optimism that a soft landing will be accomplished. For its part, the Fed is more likely than not to hold rates steady for the immediate future, but Chair Powell repeatedly referred to "head fakes" in recent public appearances, including at an IMF conference just over a week ago. Even if it keeps rates unchanged at upcoming meetings, as expected, there is no consensus over when it will start cutting them. The longer rates remain elevated, the greater the odds that the elusive soft landing will morph into something more dire.

Then there is the ominous geopolitical environment that casts a dark shadow over the economic landscape. At this point, no serious economic fallout from the Mid-East conflict has occurred. Indeed, the most likely culprit, oil, has experienced sharp price declines since the outbreak in early October. But should the war expand beyond the borders of Israel and Gaza and require more US involvement, all bets are off. As it is, the travel industry is starting to feel the pain, as tourists report fearing a hostile environment abroad. Even some of the good news this week conveys a tinge of worry. The Fed has long embraced the financial markets as an ally in its efforts to curb growth and restrain inflation. Until recently, the markets have complied as the steep rise in long-term rates, including mortgages, over the spring and summer lifted some of the burden off the Fed's shoulders to slow demand with additional rate hikes. But the Goldilocks data over the past month has transformed investors into doves, and the yield declines and wealth-boosting stock rally may well stoke growth. That probably won't prompt the Fed into another rate hike, but it could lead to a more hawkish comments from officials in coming weeks. Jawboning is a tried-and-true vehicle of the Fed to alter investor perceptions.

That said, unlike Antony, we come to praise, not bury incoming data under a litany of worries. The prospect of a soft landing received a significant boost from this week's batch of data. For one, the latest reports on consumer and wholesale prices confirm that the disinflationary trend is alive and well. The most dramatic reading from the consumer price report was that prices overall showed no change in October, the first time since July 2022 that the CPI has not increased. That, in turn, lowered the increase over the past year to 3.2 percent from 3.7 percent in September. The slide in the CPI from a peak of 9.1 percent in June 2022 is as breathtaking as it is record-breaking. Not since 1951 has the annual inflation rate fallen as steeply outside of a recession as has been the case this time.

The Fed, correctly, notes that the plunge reflects unusual forces that have come to bear over this unique Pandemic recession/recovery inflation cycle that have disrupted supply chains and consumer spending behavior, both of which are rapidly normalizing. It also insists that the hardest part is squeezing out the last mile of the disinflation journey down to the 2 percent target. That may be the case, particularly since the stickiest prices are heavily linked to labor costs, which have not fallen nearly as much. But the success of wrestling price gains from 9 percent to almost 3 percent without causing a recession understandably raises hopes that another 1 percent reduction can be accomplished amidst a still growing economy.

Less dramatic but still impressive is the moderation in the core consumer price index, which strips out volatile food and energy prices. This measure, which economists believe is more representative of underlying inflation trends, increased 0.2 percent in October, lowering the annual gain to 4.0 percent from 4.1 percent in September. The core index shows a much shallower decline from the 6.6 percent peak in September 2022 and, of course, is further above the Fed's 2 percent target than the overall CPI. But while the magnitude of the decline has been less dramatic than the headline CPI, it has been steadier. October marks the 13th consecutive month that the core CPI fell from a year earlier. Records for this measure only go back to 1958, but that's the longest stretch of continuous declines in the annual rate since the series began, including the deep recessions of the 1980s.

There is still a ways to go before the 2 percent target is reached, not only for the core CPI but for the Fed's preferred inflation yardstick, the core personal consumption deflator, which as of September stood 3.7 percent above its year-earlier level. With the pandemic-related forces that distorted prices mostly resolved, further progress on the inflation front will require a softening in demand and a cooler job market that restrains labor costs. Both were on full display in this week's data. Retail sales slipped 0.1 percent, the first setback since March, with most retail categories posting declines. However, the pullback was smaller than expected and came on the heels of upwardly revised spending estimates for September. Adjusted for prices, retail sales fell 0.2 percent, which was also less than expected and off of upwardly revised totals for September.

The subset of sales, the so-called control group that feeds into the GDP accounts, which excludes food, gasoline, building supplies and autos, did eke out a dollar gain of 0.2 percent and an inflation adjusted increase of 0.1 percent. This too was not as weak as expected and confirms that consumer spending is not falling off a cliff. What's more, the retail report mostly describes spending on goods whereas spending for services has been the primary growth engine, reflecting revenge spending on social activities that were denied consumers during the health crises. We will get a fuller picture of consumer outlays, including services, in the personal income and spending report later this month. However, it is noteworthy that the 0.3 percent increase in the one retail category that reflects spending on services, restaurants and bars, was the smallest since March, and the 8.6 percent increase from a year ago was the weakest since March 2021. That suggests revenge spending is running out of steam, both because discretionary funds are shrinking and pent-up demand has been satisfied.

We expect the slowdown in consumer spending to continue as higher borrowing costs, rising delinquencies, tighter credit conditions, the restarting of student loan repayments and slowing wage gains are formidable headwinds squeezing household budgets. The good news for the soft-landing narrative is that households are still benefiting from a powerful tailwind, a resilient job market. Not only is that sustaining growth in paychecks, but the decline in inflation allows those paychecks to go further. But here too, the ground underneath is starting to buckle. Job growth is slowing and employers, particularly in the retail sector, are gearing up for a softer sales environment, cutting back on seasonal hiring. The National Retail Federation is forecasting a 3-4 percent increase in holiday sales, down noticeably from the 5.3 percent increase in 2022 and the 21 percent surge in 2021.

The combination of slowing job growth, which would restrain wage increases, and falling inflation is the recipe for a soft landing, which we believe has a greater than even chance of coming to pass. The risk is that the cooling job market will freeze up and send enough workers to the unemployment lines to bring on a recession. So far, the unemployment rate has inched up, but from historically low levels, even as job growth is running above its pre-pandemic pace. Likewise, companies are still holding on to workers despite a gloomier outlook, fearing rehiring difficulties when activity picks up. But their tight grip on payrolls may be loosening, as initial claims for unemployment benefits are rising. New applications are still historically low, but the upward trend bears watching. The history of business cycles provides ample evidence that once unemployment rises for more than a few months, however slowly, it is hard to stop and tends to gain momentum. Recent data have undoubtedly heightened the prospects for a soft landing, but it will not be a smooth journey and the risks of derailment remain ever-present.

FINANCIAL INDICATORS

INTEREST RATES	Nov 17	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.37	5.37	5.46	4.23
6-month Treasury bill	5.38	5.46	5.53	4.63
2-year Treasury note	4.91	5.05	5.11	4.46
5-year Treasury note	4.44	4.67	4.87	4.01
10-year Treasury note	4.44	4.62	4.93	3.78
30-year Treasury bond	4.59	4.74	5.09	3.89
30-year fixed mortgage rate	7.44	7.50	7.63	6.61
15-year fixed mortgage rate	6.76	6.81	6.92	5.98
STOCK MARKET				
Dow Jones Industrial Index	34,947.38	34,332.00	33,127.28	33,745.69
S&P 500	4,514.02	4,431.50	4,224.16	3,965.34
NASDAQ	14,125.48	15,608.75	12,983.81	11,146.06
COMMODITIES				
Gold ($ per troy ounce)	1,983.50	1,941.80	1,993.10	1,752.60
Oil ($ per barrel) - Crude Futures (WTI)	75.84	77.38	89.02	80.11

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Consumer Price Index (October) - % change	0.0	0.4	0.6	0.3
Core CPI (October) - % change	0.2	0.3	0.3	0.3
Producer Price Index(October) - % change	-0.5	0.4	0.8	0.2
Retail Sales (October) - % change	-0.1	0.9	0.7	0.5
Industrial Production (October) - % change	-0.6	0.1	0.0	-0.1
Housing Starts (October) - 000s	1,372	1,346	1,305	1,413

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