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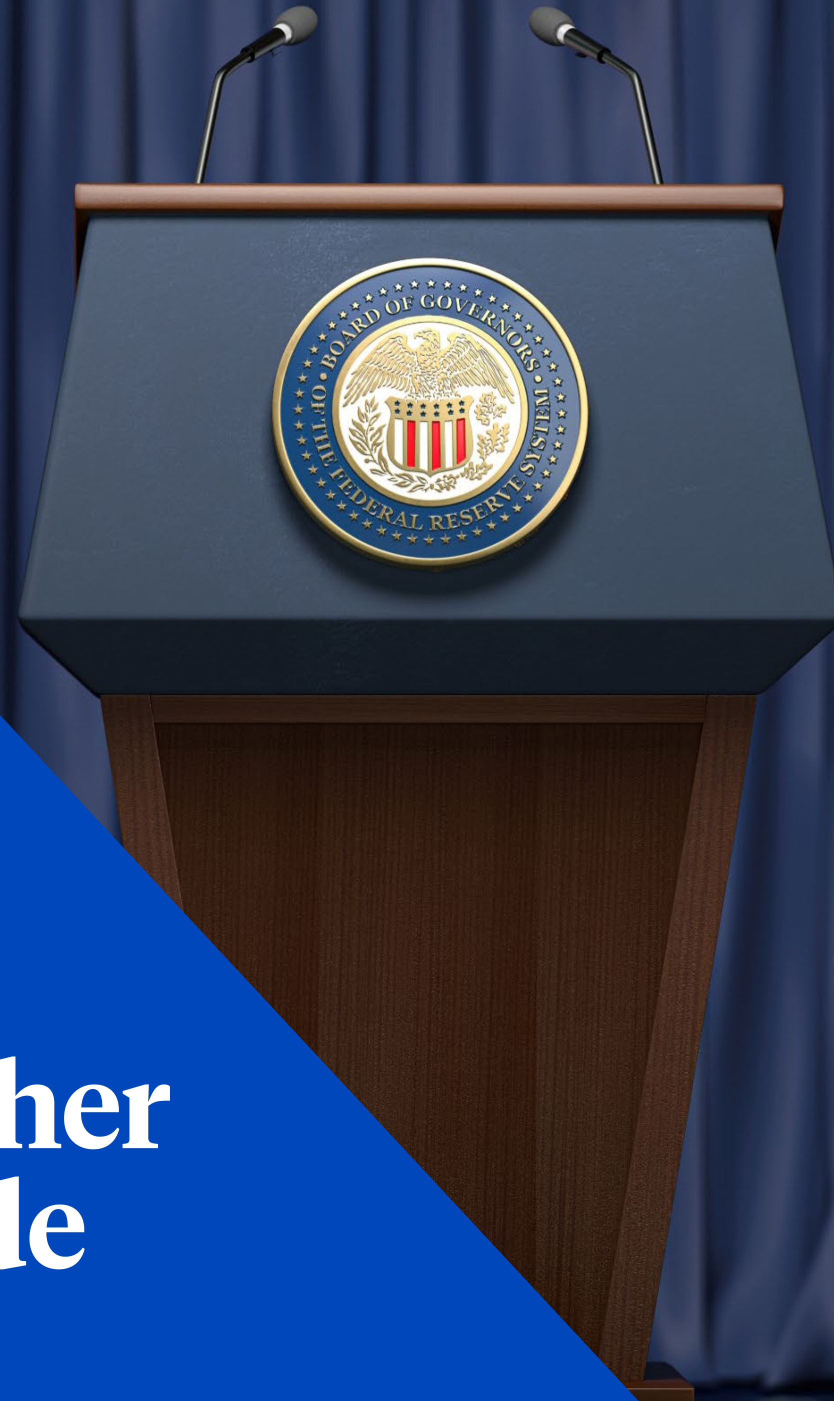


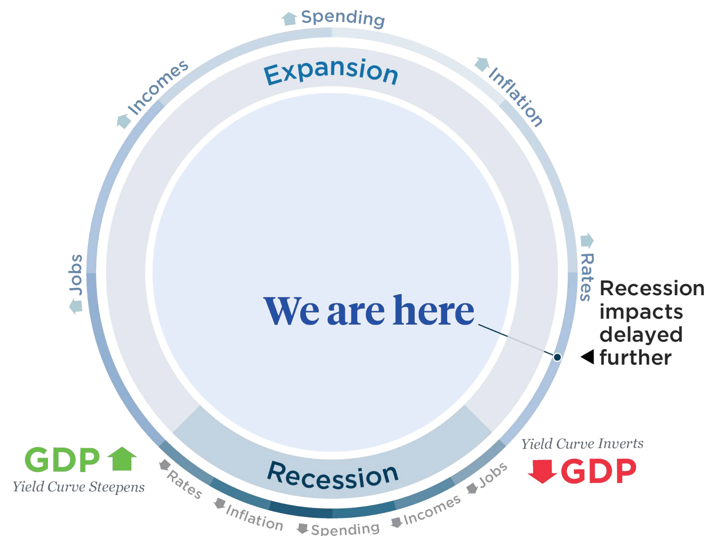
Economic & Financial Markets Monthly Review | April 2024

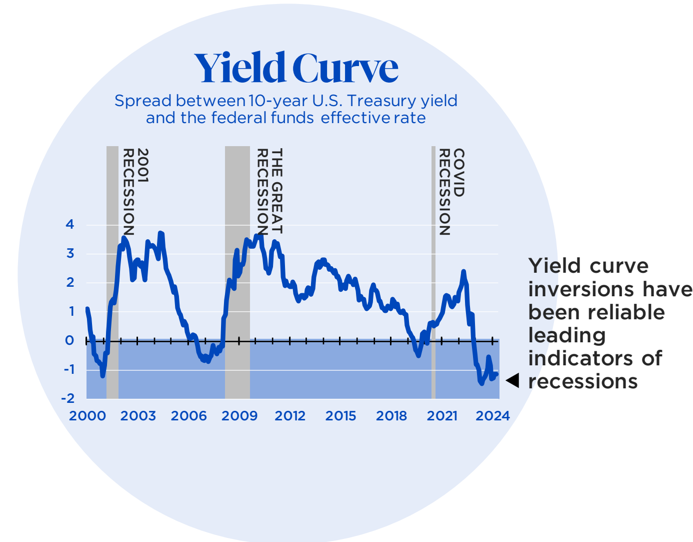
Fed to keep rates higher as recession fears fade

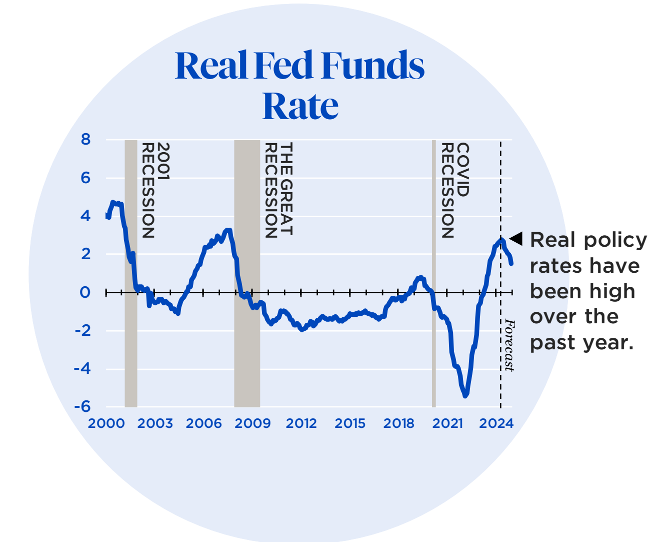
Economic Overview

Where is the economy now?

The economy remains on a solid growth path, fed by robust job gains and buoyant consumer spending which could carry throughout 2024. The extended expansion, however, poses the risk of sticky and elevated inflation, especially for housing and services. This is likely to drive a longer period of restrictive monetary policy from the Fed, which could renew recession concerns later down the road.







Where we are this month

Recession is less likely for 2024

Annualized real GDP growth for the first quarter should be above 2.0 percent with solid momentum expected to extend into mid-year.

Steady yield curve inversion

With the Fed on hold, the broad yield curve inversion has been maintained even with rates across the curve adjusting to higher-for-longer rate expectations.

Restrictive Fed policy may linger

The real fed funds rate, the nominal rate less the core PCE index, is about 2.5 percent — suggesting that monetary policy is quite tight.

What does this mean

- A surge in foreign-born workers has increased labor supply, acting to boost hiring again and fill the labor gap for many employers — while helping to lengthen the expansion.
- Recession risks are still present with most leading indicators suggesting weaker growth ahead. But the descent into a downturn has not occurred as expected and could be delayed into 2025 or beyond.

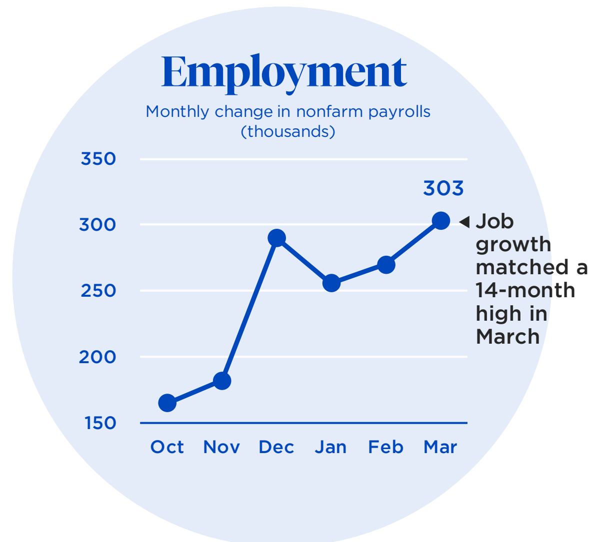
- Short-term interest rates, which dipped earlier in 2024, have climbed again as the market expects fewer rate cuts in the year ahead. As a result, the spread between the 2-year and 10-year Treasury rates has remained steady near 30-40 basis points.
- If the Fed sticks to the median estimate for the fed funds rate at the March FOMC meeting, portions of the yield curve could remain inverted over much of 2025.

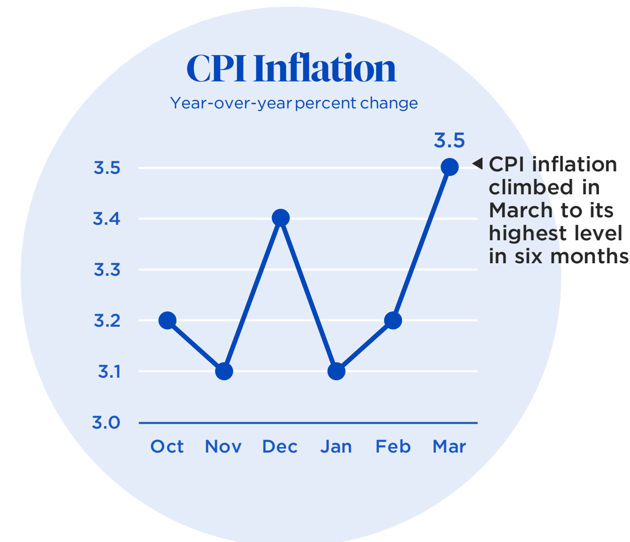
- Past recessions has usually been preceded by a real fed funds rate above 2.0 percent as high interest rates reduce consumer and business activity. Fed easing ahead of downturns usually causes the real fed funds rate to recede rapidly.
- This cycle may prove different with Fed easing expected to be delayed and inflation likely to remain sticky — keeping the estimate for the real fed fund rate higher into 2025.

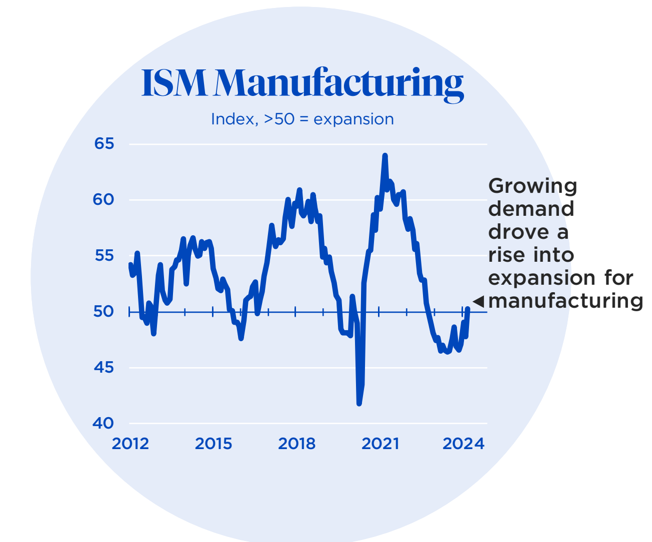
Economic Review

Job gains fuel growth and spending...but also inflation

The strong hiring in March was concentrated in a handful of industries, but the sheer volume of jobs created along with still-solid wage gains should keep consumer activity firm. Also, improved demand for goods has moved the manufacturing sector back into expansion, while lingering inflationary pressure underscores that the Fed is in no hurry to cut rates.







Where we are this month

More strong job growth data

The headline gain in nonfarm payrolls soundly beat consensus expectations in March, while the unemployment rate fell to a low 3.8 percent.

Hot inflation prints continued in March

Year-on-year growth in the consumer price index came in at a six-month high of 3.5 percent in March, while core inflation was steady at an elevated 3.8 percent

Manufacturing sector grows in March

The ISM manufacturing index climbed above 50 (i.e., expansion territory) in March for the first time since September 2022.

What does this mean

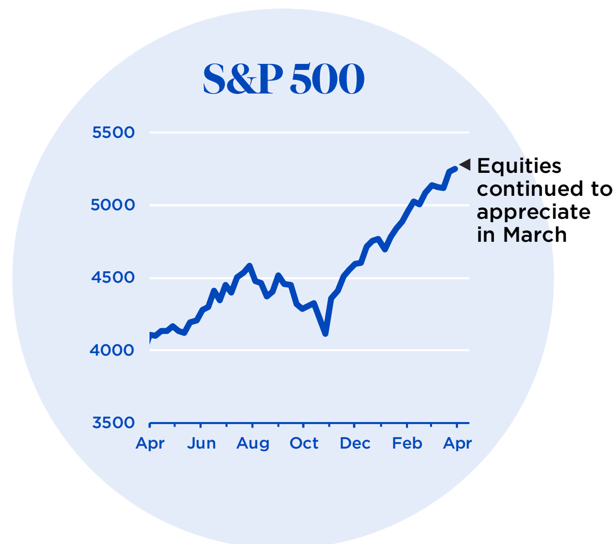
- The details weren't quite as strong as the headline indicated as more than half of the 303,000 new jobs were in government, health care and education. Job gains were much weaker in many of the more cyclically-sensitive sectors.
- While annual wage growth was at its slowest pace since June 2021, the strong jobs increase and a rise in the average work week still suggests buoyant aggregate earnings for workers in the near-term.

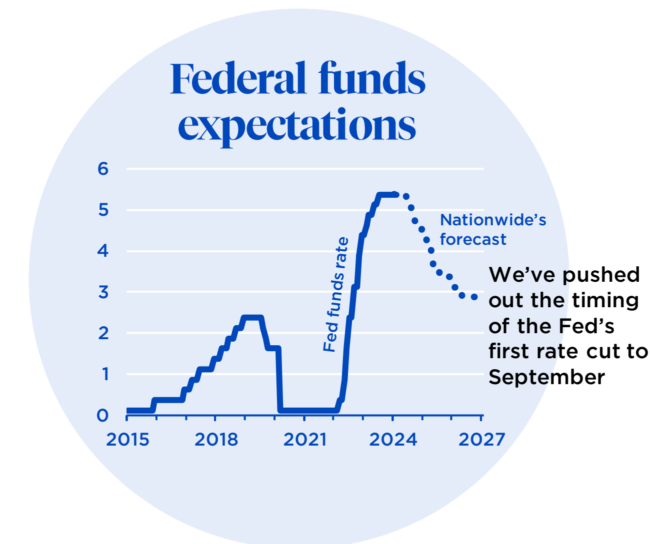
- Price pressures remain high in the service sector, particularly for medical care and transportation services. In March, the 3- and 6-month annualized rates for core services inflation climbed to 6.8 percent and 5.8 percent, respectively.
- Inflation readings have been consistently hot this year, which puts more pressure on the Fed to delay policy easing until later in 2024, with an outside chance that rate cuts are postponed until 2025.

- Demand for goods has firmed in early 2024 as new orders and production climbed into expansion after a lengthy period in contraction.
- The service sector has driven economic growth since 2022, but survey responses suggest manufacturers are increasingly optimistic on the prospects for growth going forward. This could be another factor which pushes recession concerns farther out into the future.

Strong growth and inflation force a rethink

Risk assets remained on an encouraging course into early Q2 as Fed policymakers signal no additional rate hikes and investors grow more confident a recession will be avoided. Enduring economic momentum has led us to remove the anticipated mild recession from our forecast for 2024. We now expect gradually cooling real GDP growth through year end, though we stress that persistent vulnerabilities pose downside risks to our outlook. Hardy growth and buoyant inflation also led us to push back the initial Fed rate cut to September with risks of further delays.





Where we are this month

Equities keep rising

Buoyant economic growth and clear indications from Fed officials that the next policy move is most likely a rate cut kept the S&P 500 on an upward track in March.

Interest rates maintain their uptrend

The 10-year Treasury yield was flat on the month but stayed on a gentle rising trend that began after rates bottomed out at the end of 2023.

Resilient economy delays the initial rate cut

Stronger inflation and spending are leading investors to postpone the timing of the Fed's first rate cut, while estimates for cumulative easing are also being revisited.

What does this mean

Equities

- An upbeat environment of rising spending and employment, solid corporate earnings, and loose financial conditions kept the benchmark U.S. equity index on a rising trajectory. Nearly all major sectors contributed to the S&P 500's 3.1 percent rise in March, led by energy and utilities.
- Investors are holding onto constructive views even as traditional valuation metrics flash warning signs, suggesting the bull run will extend its gains.

Interest rates

- The 2-year Treasury yield, which is highly sensitive to Fed policy, rose slightly in March as investors reassessed their expectations amid persistently solid GDP growth and stubborn inflation pressures.
- Interest rates will remain vulnerable to swings in the economic data and the Fed's messaging on monetary policy. Sturdy pressures within core and super core inflation (as well as robust government spending) lend upside risks to our interest rate forecasts.

Federal funds

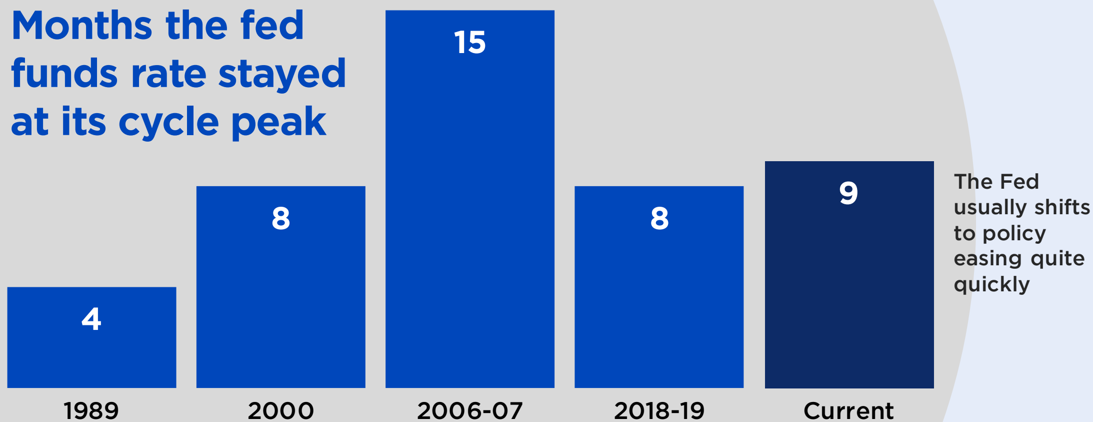
- Investors have now postponed the timing of the first Fed rate cut to September from June previously. The fed fund futures market foresees only 50 basis points (bps) of cumulative easing by year end, down from expectations of more aggressive easing to start in 2024.
- We think the initial rate cut may not occur until September and highlight the risk that easing begins even later if economic growth stays healthy. The FOMC may end up lowering rates by less than the 50bps we expect if inflation and growth surprise to the upside.

Outlook

Fed looking to ease rates but likely delayed further

Historically, the Fed has not kept monetary policy restrictive for long, realizing the negative impacts on business and consumer activity from elevated interest rates. Over the past 40 years, the fed funds rate has only held at its cycle peak for an average of nine months, on par with the pause in rates since the last rate hike in July 2023. This suggests that the FOMC could be on the verge of lowering interest rates, a stance confirmed by recent Fed commentary and market expectations.

But while many Fed officials have signaled a desire to shift to policy easing, persistent strength from the economy should delay rate cuts until the second half of 2024. 3- and 6-month annualized inflation readings are far above the Fed's 2.0 percent target, a sign that economic conditions remain too hot. The FOMC is also likely to be more cautious than usual with rate cuts in the year ahead. The fed funds rate has declined an average of 175 basis points in the first six months of the past four easing cycles, but we project it to drop only 50bps by year end — underscoring an expected higher-for-longer interest rate path into 2025.



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Data as of April 2024

	2023 ACTUAL	2024 ESTIMATE	2025 FORECAST	2026 FORECAST	2027 FORECAST
REAL GDP	2.5%	2.5% 1.6%	1.9%	1.8%	
UNEMPLOYMENT RATE	3.6%	3.9%	4.2%	4.0%	4.0%
INFLATION [1] (CPI)	3.2%	3.7%	2.4%	2.1%	2.0%
TOTAL HOME SALES	4.77	4.73	5.00	5.95	6.15
S&P/CASE-SHILLER HOME PRICE INDEX	5.5%	3.5%	3.3%	3.2%	3.0%
LIGHT VEHICLE SALES	15.5	15.4	15.6	16.4	16.5
FEDERAL FUNDS RATE [2]	5.25%	4.75% 3.50%	2.75%	2.75%	
5-YEAR TREASURY NOTE [2]	3.84%	3.95%	3.50%	3.10%	3.10%
10-YEAR TREASURY NOTE [2]	3.88%	4.05%	3.60%	3.50%	3.50%
30-YEAR FIXED-RATE MORTGAGE [2]	6.61%	6.30%	5.20%	4.80%	4.80%
MONEY MARKET FUNDS	5.09%	5.09%	3.78%	2.97%	2.78%

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

The odds of a 2024 recession have dropped considerably

Continued solid job gains and consumer spending suggest that if a recession occurs, it is likely to be delayed beyond 2024. Recession risks remain but extended solid growth over 2024 now looks more probable while the positive momentum could carry into 2025.

Risk of later and fewer Fed rate cuts

The Fed looks increasingly likely to wait until at least the September FOMC meeting to lower interest rates in response to resilient activity and inflation. But rate cuts could be delayed further, reducing total policy easing over 2024 and extending restrictive rate conditions into 2025.

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Sources

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Business Cycle	*Nationwide Economics*
Yield Curve	*Bloomberg; National Bureau of Economic Research*
Real fed funds rate	*Federal Reserve Board; Bloomberg*

2 | Economic Review

Nonfarm payroll gains	*Bureau of Labor Statistics*
Consumer Price Index	*Bureau of Labor Statistics*
ISM manufacturing index	*Institute for Supply Management*

3 | Financial Markets Review

S&P 500	*Standard & Poor's*
10-year Treasury yield	*Federal Reserve Board*
Fed funds futures	*CME Group; Nationwide Economics*

4 | Outlook

Fed funds rate at cycle peak	*Federal Reserve Board*
Latest Forecast	*Nationwide Economics*

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