![alloya Corporate Federal Credit Union]

Economic Update

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THIS MONTH

Commentary

The Federal Reserve surprised many (including us) by cutting rates by 50 basis points instead of 25 basis points at its meeting earlier this month. The Fed pitched its move as a "recalibration" of policy rather than a start of an aggressive easing cycle. The markets celebrated the move and rose considerably higher on the news. Stocks, as measured by the S&P 500, ended September at an all-time high and are up 21% on the year.

Despite Fed Chairman Jerome Powell's best efforts to downplay the large cut, the Fed seems worried about the direction of the labor market. Clearly, the labor market has been weakening and flashing warning signs. The unemployment rate has risen significantly since the beginning of last year, and the oft-mentioned "Sahm rule" recession indicator has been triggered. In addition, job gains have been narrowing, which has been largely driven by a few sectors of the economy rather than experiencing broad-based support.

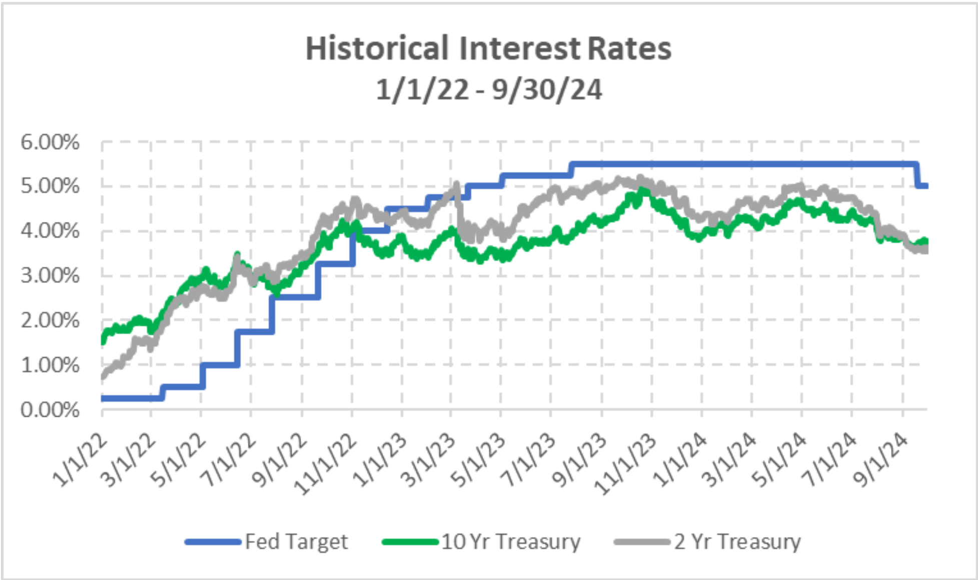
Still, other labor market measures are more sanguine. Jobless claims remain relatively subdued, and the layoff rate remains below pre-pandemic levels. Much of the rise in the unemployment rate has been due to "voluntary" reasons (e.g., people quitting their jobs and new entrants into the labor force).

Recent revisions to the National Economic Accounts paint a rosier image of the consumer. There has been a concern that consumer spending has been outpacing disposable income with the rise in consumer debt making up the difference. The revision showed that disposable income outpaced spending over the past year, and the savings rate in the second quarter was revised upwards from 3.3% to 5.2%.

Risks of a recession are rising, but we continue to believe that the economy will be able to avoid one in the near term. If there is a recession, it should be relatively mild given that the household sector remains in good shape. An aggressive easing cycle would make a recession even less likely.

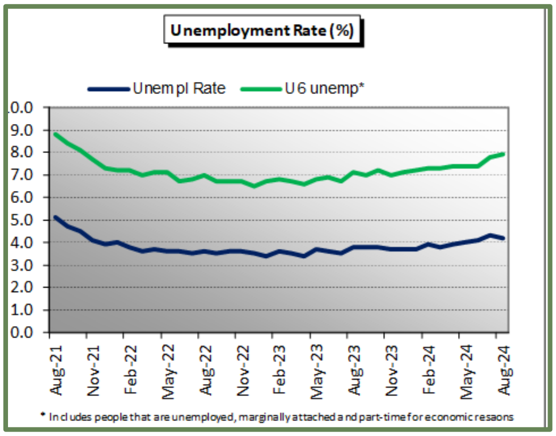
Fixed Income Outlook

The much-anticipated easing cycle finally began 14 months since the last Fed hike, which is much longer than it normally takes for the Fed to cut after the end of a hiking cycle. The Fed decided to cut by 50 basis points but only forecasted another 50 basis points of cuts through the end of the year. Medium-to-longer-term Treasury yields have moved slightly higher since the Fed's action. The market is pricing another 75 basis points of cuts through year-end and anticipating the fed funds rate to decline to 3% by the end of next year. The Fed's new projection has the fed funds rate at 3.5% at the end of 2025. We think that the market pricing is reasonable and that the Fed will quickly move close to what they believe the neutral risk-free rate is given their heightened labor market concerns.



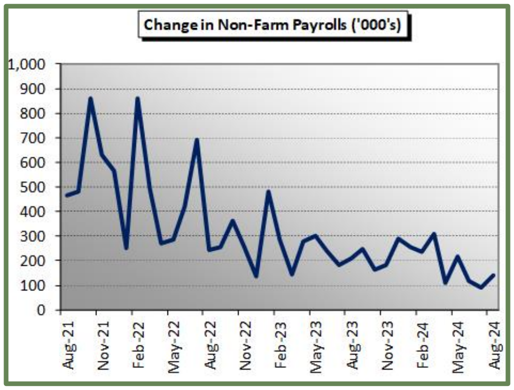
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Slightly Declines

The unemployment rate in August met expectations and fell to 4.2% from 4.3% the prior month. This broke a string of four consecutive increases. The underlying details of the report were positive, as both employment and the labor force experienced gains.

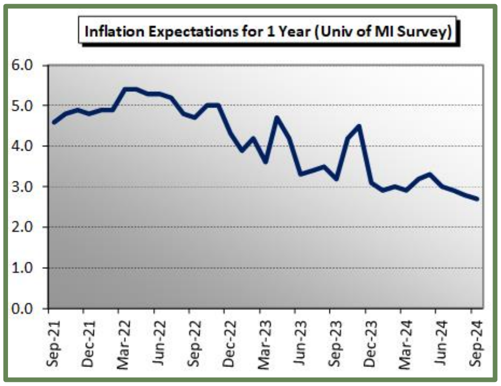


Payroll Growth Below Expectations

Payroll growth in August was weaker than expected. The number of jobs gained by 142,000 compared to the 165,000 forecasted. Jobs in the prior two months were revised downwards by 86,000.

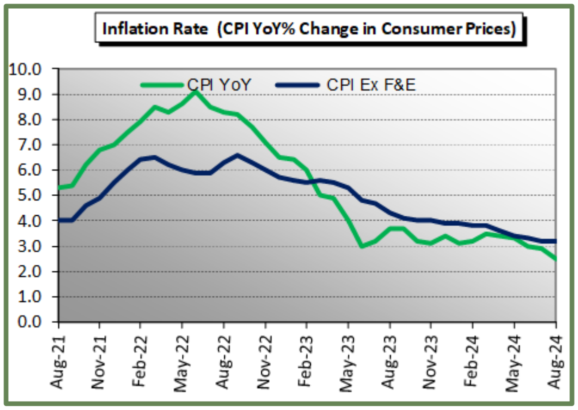
Inflation Readings

(Data source: Bloomberg)



Inflation Expectations Continue to Decline

In September, consumers' inflation expectations for the next year reached the lowest level since 2020. Surprisingly, inflation expectations on a longer-term basis remain near recent highs.

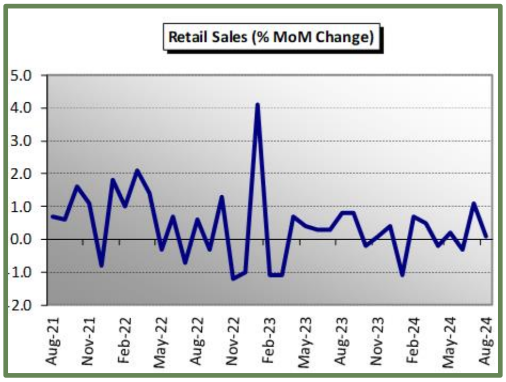


Consumer Inflation Continues to Recede

Consumer inflation in August was largely in line with expectations, but the monthly core inflation was above estimates. The year-over-year change in inflation experienced a large decline and has fallen for five consecutive months.

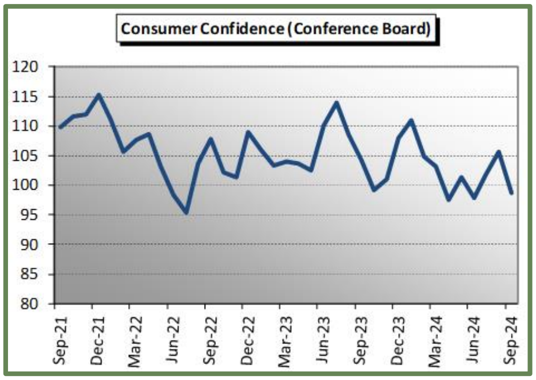
Consumer Readings

(Data source: Bloomberg)



Retail Sales Higher than Expected

Retail sales in August were higher than expected, and the previous month was revised upwards. Sales (on a month-over-month basis) increased by 0.1% compared to the market expectation of a 0.2% decline. The details of the report were relatively weak with eight out of the fourteen categories experiencing declines.



Consumer Confidence Declines

Consumer confidence in September came in well below estimates and fell by the largest amount in three years. The share of consumers that said that jobs were plentiful declined for the seventh consecutive month, which is the longest streak of declines since 2008.