Corporate Federal Credit Union

Economic Update

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Commentary

The election turned out to be more of a one-sided affair than many had expected going into Election Day. The Republican Party won the presidential election and now also holds both chambers of Congress. The stock market cheered the outcome, with equities (as measured by the S&P 500) rallying by 2.5% the day after the election. Treasury rates also rose meaningfully on the expectation of a more pro-growth and increased inflationary impact of the shift in leadership.

Assuming President Trump follows through on his campaign promises, there could be significant impacts to the economy. He will have relatively wide latitude to make changes in immigration and international trade early on in his term. On the immigration side, a more closed border and even perhaps major deportations will decrease the supply of labor in the U.S. This should negatively impact gross domestic product (GDP) growth and be inflationary as the productive capacity of the economy would diminish and wages increase.

Trump proposed major changes to trade relations and increased usage of tariffs. We don't think that he will go as far as what he stated in his campaign rhetoric, but we do expect major changes to occur. He has pitched 60% tariffs on China and 20% on the rest of the world. We believe that a more likely path would be a doubling of where tariffs stand today. That would increase Chinese tariffs to 40% and the rest of the world to around 8%.

On the fiscal side, the 2017 tax cuts (which are due to expire at the end of 2025) will now almost assuredly be extended. There is also the potential for lower corporate taxes and the reconstitution of the full expensing of capital expenses. These measures should provide a boost to near-term GDP.

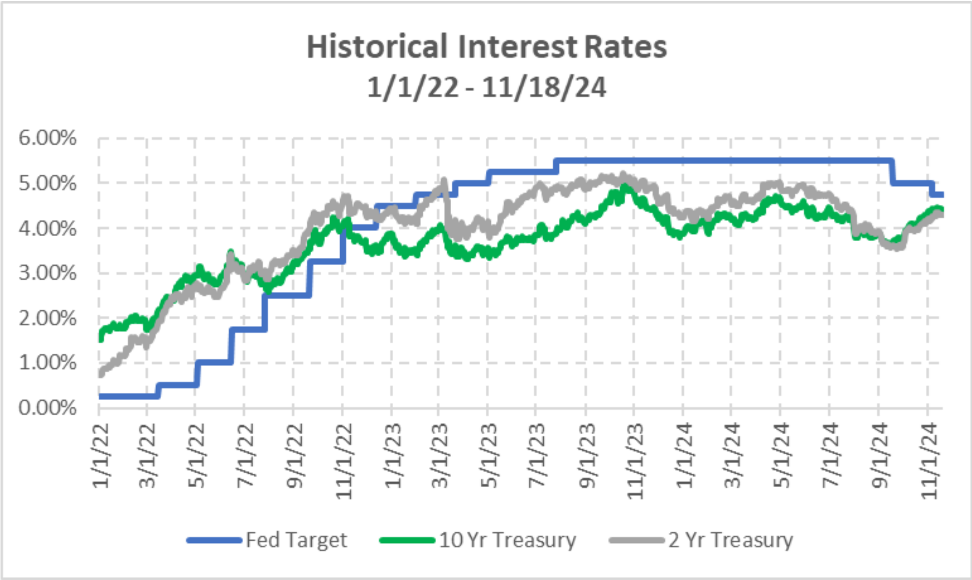
Lastly, Trump has promised a much looser regulatory landscape. In his first term, he targeted the reduction of two regulations for every new regulation. This time, he has set a target of a 10 to one ratio. In addition, he has created a new agency called the Department of Government Efficiency (DOGE), which will focus on reducing regulatory burden and expenses.

Altogether, we agree with the market's assessment of a more pro-growth and pro-inflationary impact of Trump's policies. Going into the election, the economy was already on solid footing. Annualized GDP growth has been 3% over the last seven quarters versus 1.8% in the pre-pandemic time frame. Much of the economic data has surprised to the upside over the past few months. We now see less risk of a recession in the near-term but see elevated risk in future years given the ever-worsening debt trajectory and reduced regulatory oversight.

THIS MONTH

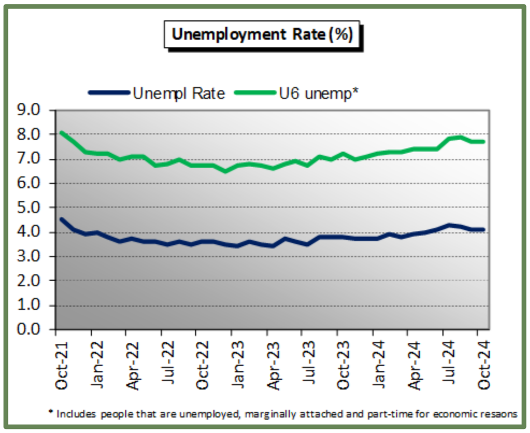
Fixed Income Outlook

Treasury bond yields have moved upwards thus far in November, with most of the move coming the day after the election. Intermediate to long-term yields are approximately 10 basis points higher in November and 70 basis points higher since the end of September. As expected, the Fed cut rates by 25 basis points at the Federal Open Market Committee meeting earlier this month. Powell’s press conference was relatively dovish as he noted the loosening of the labor market and improvement in inflation over the past 18 months. The market has priced in a 55% chance of a cut in December and cumulative rate cuts of 100 basis points from now until the end of 2025. We expect the Fed to ease in December and then take a more cautious approach going into next year. The market appears fairly priced at these levels.



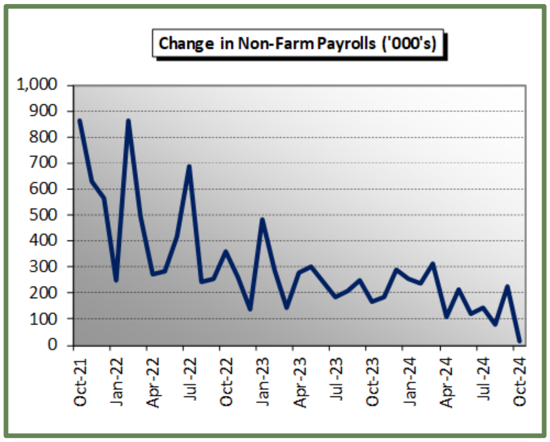
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Holds at 4.1%

The unemployment rate in October remained at 4.1%, which was in line with expectations. The data this month is hard to interpret since 512,000 people stated that they weren't at work due to weather (mainly due to the Florida hurricanes) and the number of part-time workers who usually work full time was five times the historical average.

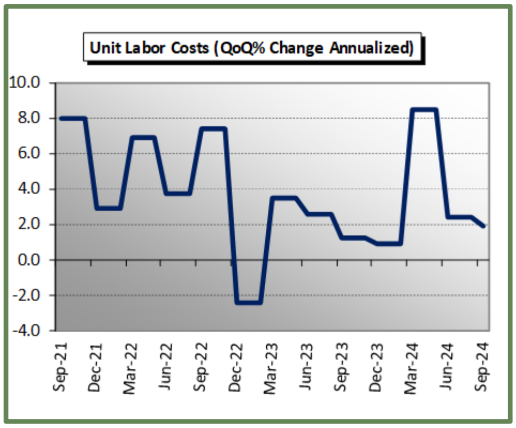


Payroll Growth Weaker than Expected

Payrolls expanded by just 12,000 jobs in October, but the data was significantly impacted by the Florida hurricanes and the Boeing strike. The survey response rate was also much lower than normal. The only thing to really glean from the report is that negative revisions of 112,000 jobs in the previous two months showed that the labor market continued to soften.

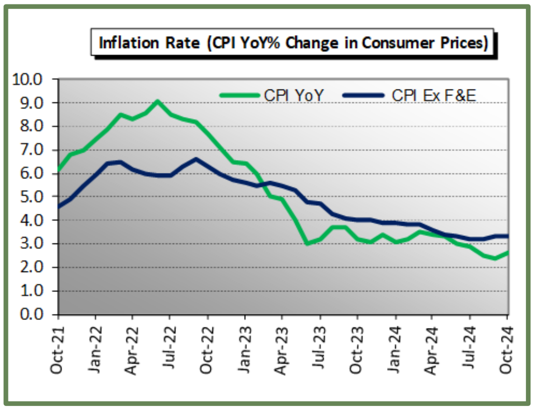
Inflation Readings

(Data source: Bloomberg)



Labor Costs Much Higher than Expected

Unit labor costs (what a business pays employees to produce one unit of output) came in much higher than expected in the third quarter. In addition, previous quarters experienced significant upward revisions. The revised data may help explain why consumer spending has remained strong.

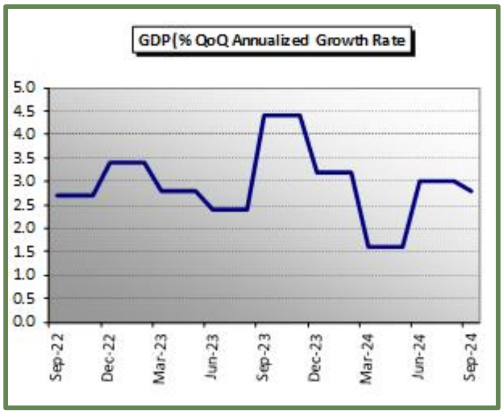


Consumer Inflation Comes in as Expected

Consumer inflation in October rose on a year-over-year basis but was in line with expectations. The monthly change in both core and headline inflation has been at the same level for at least three consecutive months. Basically, inflation isn't picking back up, but it has stopped cooling for now.

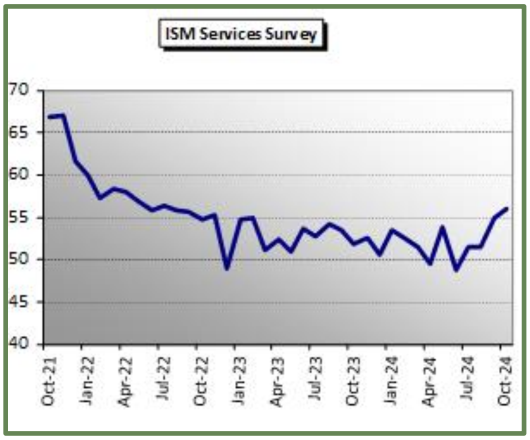
Economic Growth Readings

(Data source: Bloomberg)



GDP Growth Remains Strong

The advance estimate of third quarter GDP growth showed an economy that has remained resilient in the face of relatively high interest rates. Growth dipped slightly to 2.8% from 3.0% the previous quarter. Consumer spending advanced by the most since early 2023. Final sales to domestic purchasers grew at 3.2%, which was the largest increase this year.



Services Survey Bounces Higher

The Institute for Supply Management (ISM) services industry survey in October came in higher than expected and reached the highest level since July 2022. The employment component of the index experienced a significant increase, while business activity and new orders remained strong.