Corporate Federal Credit Union

Economic Update

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THIS MONTH

Commentary

It's been a good time to be an equity investor, as the S&P 500 just completed back-to-back 24% annual returns and a cumulative gain of just over 80% over the past five years. This year, the gains happened with less help than expected from the Fed. Coming into the year, the market had expected the Fed to cut rates by 175 basis points. Instead, the Fed didn't execute its first rate cut until September and only lowered rates by 100 basis points.

At its final meeting of the year, the Fed indicated that they will be even less aggressive in 2025. The median projection shows just two rate cuts next year (versus a projection of four rate cuts in 2025 at their September meeting). Inflation has proven stickier than expected, and the labor market is still cooling, but at a more sluggish pace.

At the press conference following the Federal Open Market Committee meeting, Chairman Powell noted that the Fed is now in a new phase in the process of normalizing rates. He made it clear that the new phase meant a much slower pace of rate cuts moving forward. When pressed whether that meant a pause at the January meeting, he was evasive, but at this point it seems very likely.

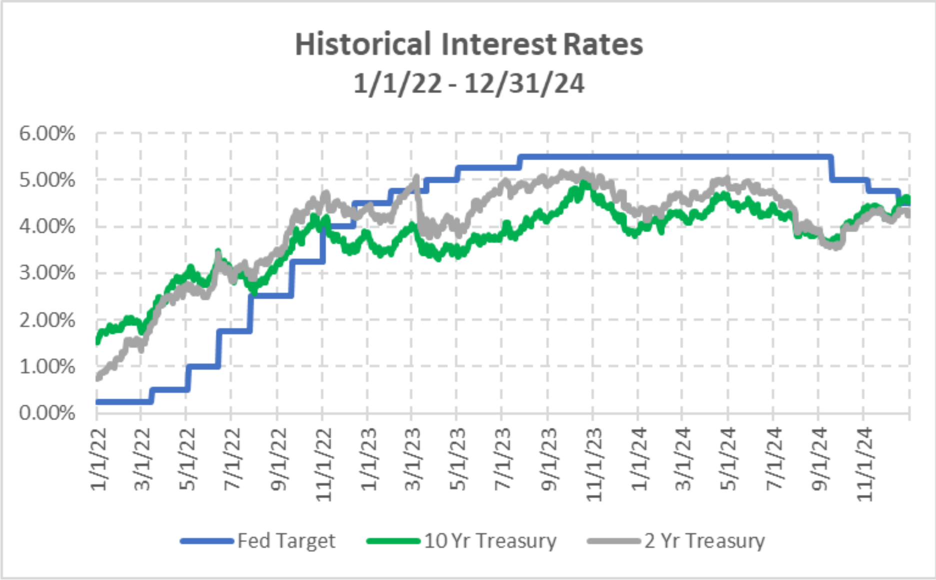
The economy has remained resilient in the face of higher rates. Third quarter gross domestic product (GDP) was just revised upwards from 2.8% to 3.1%. Consumer spending growth was marked higher and is now expanding at the quickest pace since early 2023. The economy has now grown for ten consecutive quarters, with an average real growth rate near 3%. Data to close the year has also looked relatively robust. The handoff to 2025 looks strong, yet challenges remain.

The incoming Trump administration has promised drastic changes in immigration and international trade policy. Most economic models indicate that these actions are likely to bias inflation higher. This would mean higher interest rates to fund the U.S. government at a time when U.S. debt to GDP is already growing rapidly. Geopolitical tensions remain high with wars in the Middle East and Ukraine. How those are resolved can greatly impact worldwide stability.

We look for growth to drift lower in 2025. The labor market is softening, which should start to impact consumer spending. Financial conditions have been easy with the stock market having been so strong, but we can't expect 16% returns every year (as we have averaged over the past five years). Sooner or later, the rising debt levels will concern the market, but we are doubtful that will happen next year.

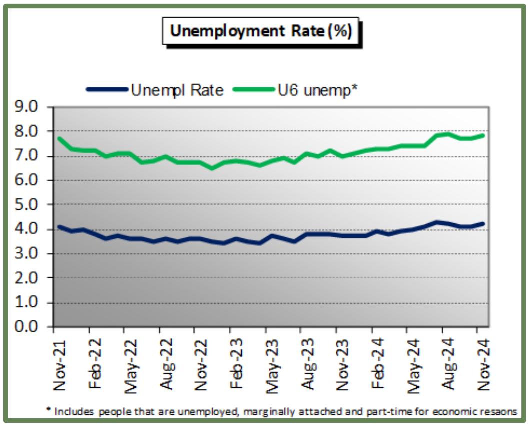
Fixed Income Outlook

Treasury bond yields have moved significantly higher in December given solid economic data and a more hawkish than expected Fed. The 10 year to three month Treasury curve dis-inverted this month for the first time in over two years. This ends one of the longest yield curve inversions in history. Historically, yield curve inversions have been a good predictor of recessions. This time has worked out differently. The Fed cut rates as expected at the December meeting but indicated a much slower pace of easing going forward. The market expects two rate cuts in 2025, which equals the Fed's projection. We look for a more aggressive path as we see the economy cooling more than expected.



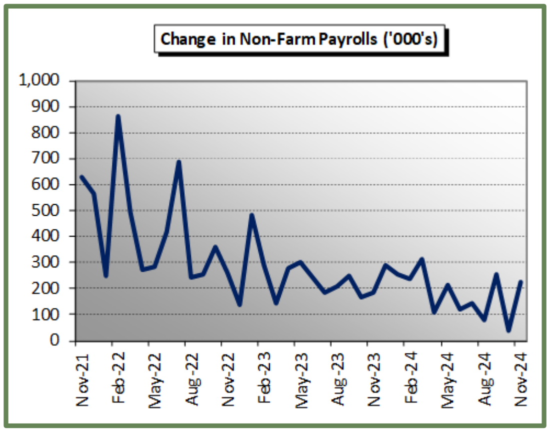
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Ticks Up

The unemployment rate in November marginally increased to 4.2% from 4.1% the prior month. The market expected the rate to remain unchanged. The underlying details of the report were weak. Both the number of employed and the labor force experienced sizeable declines from the prior month.

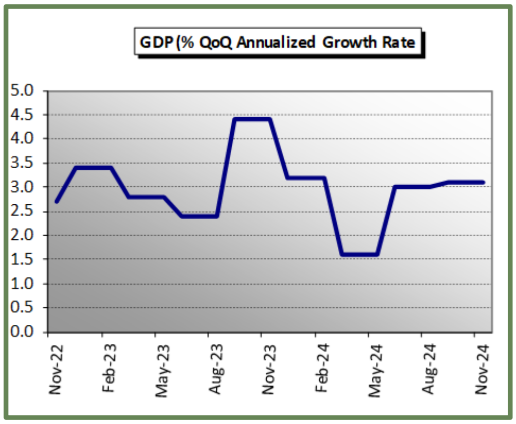


Payroll Growth Broadly In-Line with Estimates

Payrolls bounced back after being dragged down in October by the impact of two hurricanes and a strike at Boeing. The number of jobs gained by 227,000 in November versus an estimated gain of 220,000. Three month average payroll growth is at its highest level in six months.

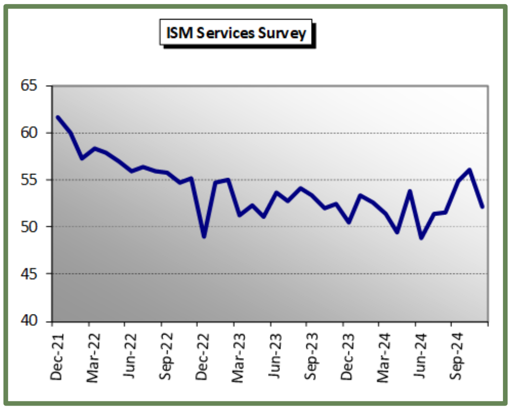
Economic Growth Readings

(Data source: Bloomberg)



GDP Growth Revised Upwards

The third estimate of third quarter GDP growth showed that the economy expanded at a faster pace than previously believed. The GDP growth rate was revised up to 3.1% from 2.8%. Consumer spending was stronger than expected and reached the highest growth rate since early 2023.

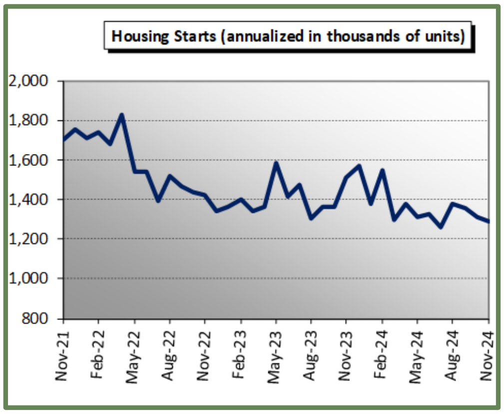


Services Survey Declines

The ISM services industry survey in November fell much more than expected and to the lowest level in three months. Survey respondents noted that uncertainty about tariffs and the composition of the new presidential administration created concern.

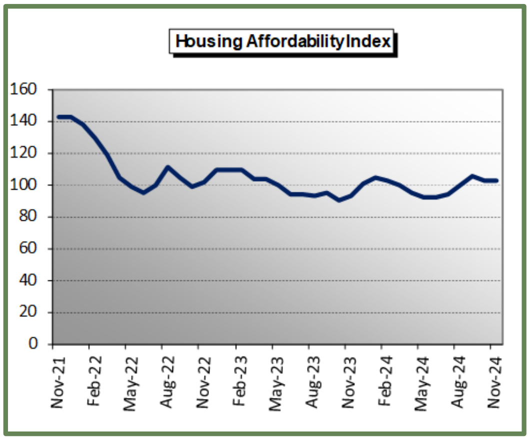
Housing Readings

(Data source: Bloomberg)



Housing Construction Slows

New housing construction declined to a four-month low in November. The gain in single-family construction was more than offset by the large decline in multifamily building. Single family home construction has ramped up in 2024, but new homes for sale now stand at their highest level in almost 17 years.



Housing Affordability Remains Low

The increase in mortgage rates and higher housing prices has driven affordability measures down to their lowest level since the index was created back in 1986.