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ECONOMIC TALKING POINTS

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The Recession Has Been Cancelled – And Inflation Is Fading

The single greatest mistake made by too many economists these days is the verbiage that often follows whenever economic activity turns out to surprise on the stronger side. Whether it is a report showing more robust homebuilding or stronger consumer spending or faster hiring trends, the reaction all too often goes something like this: The *Fed has not done enough to cool the economy. More rate increases are needed or they will lose the battle against inflation.*

What is concerning about such reactions is that it reflects a lack of analytical agility. This pleading for the Fed to keep hiking rates just because the economy shows vigor is precisely the wrong way to conduct monetary policy.

Indeed we got a taste of this anachronistic thinking again this week. The government revised up Q1 GDP to show the economy expanded at a "stronger than expected" 2.0% annual rate. Many analysts were particularly alarmed by what fueled all that activity --- consumer spending. Personal consumption expenditures rose at a 4.2% rate the first three months, the most in nearly two years and it followed a modest 1% rise in the final quarter of 2022.

We further see in that report that Americans are back purchasing durable goods. Such spending on pricier consumer products shot up at a 16.3% pace. We haven't seen this kind of exuberant shopping since the spring of 2021. Nor did this did come at the expense of spending on services, since it rose at a 3.2% rate, double the pace in the final quarter of last year.

Let's not stop there. The labor market also just demonstrated its unyielding strength. The number of Americans who lost jobs and filed for unemployment benefits in the latest week plummeted by 26,000, the biggest drop in 20 weeks. All good news… or so you would think.

Unfortunately far too many economic pundits (and frankly most voting members currently on the Fed' s Open Market Committee) argue the Fed is now fully justified in ratcheting up rates several more times this year. If they do not, this group argues, the Fed would be delinquent in their mandate to bring down inflation.

The problem with all such utterances is that it ignores another reality about this resilient economy. The dynamics that cause inflation have evolved in ways that current economic models fail to grasp. We've got to move away from the dogma that a robust economy with low unemployment is inherently inflationary and, instead, recognize that the rapid pace of technological innovation, the growing popularity of working from home, the recalibration of global supply chains have in part fundamentally altered the DNA of the US economy.

In practical terms it means that when the Fed says it is data dependent, they should *not* simply focus on the economy's vitality --- but whether inflation specifically is moving in the right direction, or not. That should be their sole concern in this business cycle.

Let's not forget that despite the economy's impressive performance so far this year, price increases have simultaneously also come down. Virtually every inflation metric has been in falling (CPI, PPI, average hourly earnings) --- and this morning we see the Fed's favorite gauge, the PCE price index, has tumbled to its lowest level in two years last month. Headline inflation in May sank to 3.8% from 12 months ago (down from 4.4% in April). Even core PCE managed to slip to 4.6% (compared with 4.7% the previous month).

Let me quickly add that all inflation measures are now *below the Fed's current policy rate of 5% - 5.25%,* which means that monetary policy is already quite restrictive!

So again, unless inflation shows signs of reversing course and accelerates, the Fed should not ratchet up rates anymore this year.

Bottom line: There should be no cause for alarm every time economic activity bolts ahead of expectations. If anything, all the recent economic data make a prima facie case that the economy's non-inflationary speed limit is considerably higher than what existing models show.

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United States

	I 2022	II 2022	III 2022	IV 2022	I 2023	II 2023	III 2023	IV 2023	I 2024	II 2024	III 2024	IV 2024	I 2025	II 2025	III 2025	IV 2025
Real Gross Domestic Product (GDP):																
%	-1.6	-0.6	3.2	2.6	2.0	1.6	2.1	1.9	1.3	3.0	2.2	2.6	1.7	1.9	3.0	2.6
Personal Consumption Expenditures:																
PCE %	1.3	2.0	2.3	1.0	4.2	2.7	1.2	2.0	1.5	2.9	3.1	2.7	1.7	2.8	3.1	2.9
Inflation, end of period, year-over-year:																
CPI %	8.5	9.1	8.2	6.5	5.0	4.2	3.8	3.6	3.3	3.0	2.8	2.6	2.6	2.5	2.5	2.5
Unemployment Rate (end of period):																
%	3.6	3.6	3.5	3.5	3.5	3.7	3.9	4.0	4.1	4.0	3.9	3.8	3.8	3.7	3.5	3.5
Non-farm Payrolls, monthly avg. thousand:																
	561	329	423	291	295	280	220	225	180	240	285	260	200	265	310	270
Treasury 10-yr Note Yield % (end of period):																
	2.32	2.97	3.80	3.83	3.47	3.38	3.28	3.35	3.20	3.35	3.60	3.65	3.60	3.48	3.35	3.35
Federal funds rate % (end of period):																
	0.38	1.63	3.13	4.38	4.88	5.13	5.13	5.13	5.13	4.88	4.38	4.13	3.88	3.63	3.13	3.13

GDP Growth - Global Economy - Year over Year

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
US	2.6	1.6	2.2	1.8	2.3	2.7	1.7	2.2	2.9	2.3	-2.8	5.9	2.1	1.5	2.5
Eurozone	1.7	1.4	-0.9	-0.2	1.4	2.1	1.9	2.5	1.8	1.6	-6.2	5.3	3.5	0.8	1.7
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.7	1.7	-9.3	7.6	4.1	-0.1	1.1
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	0.5	1.7	0.6	-0.2	-4.6	1.7	1.0	1.2	0.9
Canada	3.1	3.1	1.8	2.3	2.9	0.7	1.0	3.2	2.8	1.9	-5.1	5.0	3.4	1.6	2.4
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.4	3.8	-6.6	8.7	6.7	5.6	6.6
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.7	6.0	2.2	8.1	3.0	5.1	5.4
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	1.7	-3.6	5.3	3.0	2.1	2.7
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.2	-0.2	-8.2	4.9	3.0	2.5	2.2
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	1.8	-1.1	4.7	3.7	2.1	2.8
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.8	2.2	-2.7	5.6	-2.1	-0.2	1.5
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.6	--3.1	6.0	3.1	2.3	2.9

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