// THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.EconomicOutlookGroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

August 4, 2023

The Fed May Pull It Off!
A Soft Landing For The Economy Looks More Likely

Let's now give the Fed some overdue credit. They have so far managed to skillfully navigate the economy toward a gentle slowdown. July's employment report showed the pace of hiring is moderating. Each of the last two months saw nonfarm payrolls rise by less than 200,000, the slowest since December 2020.

Moreover, average weekly hours worked dropped back to 34.3 from 34.4 last month and wage inflation also eased. Average hourly earnings in the private sector rose 4.4% from a year ago, one-tenth less than June's annual increase. OK, not a massive pull back to be sure, but still noteworthy given the unemployment rate stands at multi-decade lows.

Drill down further into the report and we see some interesting trends.

One data point that we have been tracking for months is the jobless rate for those who do not even possess a high school degree. It dropped to 5.2% for this demographic group, the lowest level since March. It's an indication that employers are increasingly willing to hire individuals on the fringes of the labor market if they can demonstrate maturity, ambition and a willingness to learn. And, yes, it also helps keep labor costs down.

Another revealing metric was the jump in employment in child care services. Staffing rose by 5,900 in July, bringing total employment in this industry to more than a million (1.01 million), a level not seen since the outbreak of the Covid-19 pandemic. As more couples with children return to offices, the need for child care increases. Since many states require a minimum ratio of staffing to children under care, the demand for such workers keeps increasing.

Americans also continue to enjoy spending on travel and tourism so the hospitality industry has to keep beefing up their staff too. The number of workers in the accommodations and food service industry jumped another 16,200 last month, to 14.13 million, the highest level since February 2020.

But let me get to the real eye-opener in last month's jobs report. After a 16-month effort by the Fed to cool down inflation, one that saw the benchmark short term rate surge 525 basis points, it is remarkable that the unemployment rate now stands at 3.5%, which is ***below*** what it was before the Fed began to slam on the monetary brakes. That's not great news for devotees of the Phillips Curve who now have some creative explaining to do on why the jobless rate failed to increase given all that financial tightening.

Now---kindly forgive my quick and irresistible diversion here but I can't ignore that group of die-hard believers who repeatedly say the US economy is doomed to suffer a recession later this year or early 2024. We've heard such bearish sentiments since 2022. Yet not only has an economic downturn failed to materialize, there is no credible data out there to support such a forecast. Yes, it's true the yield curve has been grossly inverted for a prolonged period of time ---- and it is also true we have not yet seen all the effects of the Fed's previous rate increases. But economists should be more openminded to the probability that a new paradigm is at work here. It is not ironic that most forecasters who are steadfast believers that a recession is nearby tend to be ---how shall I say this tactfully? --- long time members of the profession who have codified the predictive value of an inverted yield curve and the inflationary implications of an expanding money supply.

I can only say that such absolutism in economics doesn't fare well in forecasting, not when the economy is undergoing fundamental changes due to innovative technologies, shifting supply chains strategies, and an acute shortage of workers.

What is beyond debate is that the economy has weathered the surge in interest rates.

- Companies are still posting job vacancies that far outnumber the unemployed.
- Consumer confidence remains sturdy.
- Furthermore, we not only saw a hefty 3.7% annualized increase in labor productivity in the second quarter, but GDP growth in 2Q accelerated to a 2.4% rate, compared to 2.0% in the first three months of the year.

Look, we do expect the economy to lose some momentum in the second half of this year. Consumers are not impervious to high borrowing costs. Some companies are taking the threat of recession more seriously and have been cutting back on rebuilding inventories. The latest

Institute for supply Management survey shows manufacturers have seen new orders shrink for months. With production thus declining, employment in manufacturing slipping in July ---the third decline in five months--- it is not surprisingly to see layoffs among truck drivers and warehouse personnel. Employment in the latter two sectors consequently fell by 8,500 last month.

So, what should we look for in the economy? Here's our bottom line:

What happens next largely depends on where labor market and inflation are headed. If next week's CPI report shows inflation finally fell below 3% in July, then it's highly likely the Fed is done raising interest rates. Indeed real (inflation-adjusted) interest rates are already at a very restrictive level. Consequently, we could well see rate cuts as early as Q1 2024.

The combination of softer GDP growth this fall and continued disinflation should produce a decline in treasury yields across all maturities. The result: Not only would we avoid a recession, but the prospect of lower rates in 2024 would help revive home sales and lead to a restocking of inventories. All this should pave the way for the economy to enjoy another upswing next year.

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	2.4	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	1.6	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	3.0	2.7	2.7	2.5	2.5	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	3.6	3.8	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	244	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	3.82	3.90	3.76	3.55	3.50	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	5.38	5.38	5.38	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

© Copyright 2023 ALL RIGHTS RESERVED
THE ECONOMIC OUTLOOK GROUP, LLC