VIEWPOINT

SPECIAL MID-QUARTER EDITION

Economic Commentary:

Storms, Strikes and Surveys Result in Unclear Economic Data

November 2024

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Much of the economic data received over the past month have been impacted by hurricanes and labor strikes. Additionally, government surveys are receiving historically low response rates which lead to higher magnitudes of revisions. Nevertheless, the U.S. economy continues to move forward at a rate that is considered to be above potential, and certainly faster than the economies of other major countries.

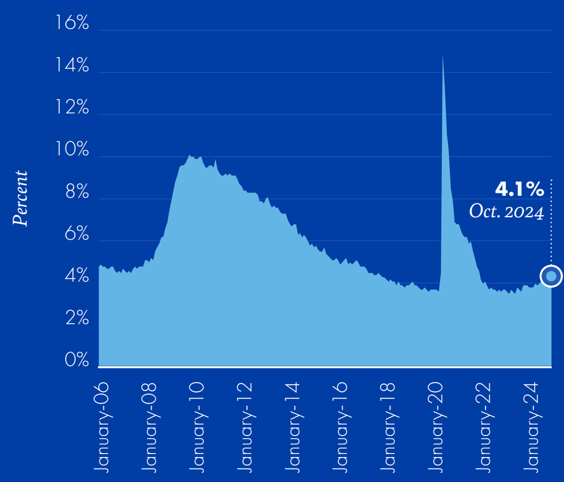
Inflation

Inflation continues to trend lower, although the monthly readings for September were slightly hotter than expected. The headline Consumer Price Index (CPI) was up 0.2% for the month, bringing the year-over-year number to 2.4% from 2.5%. That's the lowest year-over-year headline CPI number since February 2021. The Core CPI, which excludes food and energy, rose 0.3% for the second consecutive month, which caused the year-over-year reading to show the first increase since March 2023 – rising from 3.2% to 3.3%. The Fed's preferred measure of inflation, the Core Personal Consumption Expenditure Index (PCE), also came in a little higher at 0.3%, which kept the year-over-year reading at 2.7%.

Despite the welcome improvement in the year-over-year readings over the past two years, price levels have risen 23% since May 2020, creating pressure on consumers' pocketbooks as wages have largely not kept up with this increase in prices.

GROSS DOMESTIC PRODUCT (GDP)

UNEMPLOYMENT RATE



RETAIL / FOOD SERVICE SALES

Source: Northmarq, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Bureau of the Census

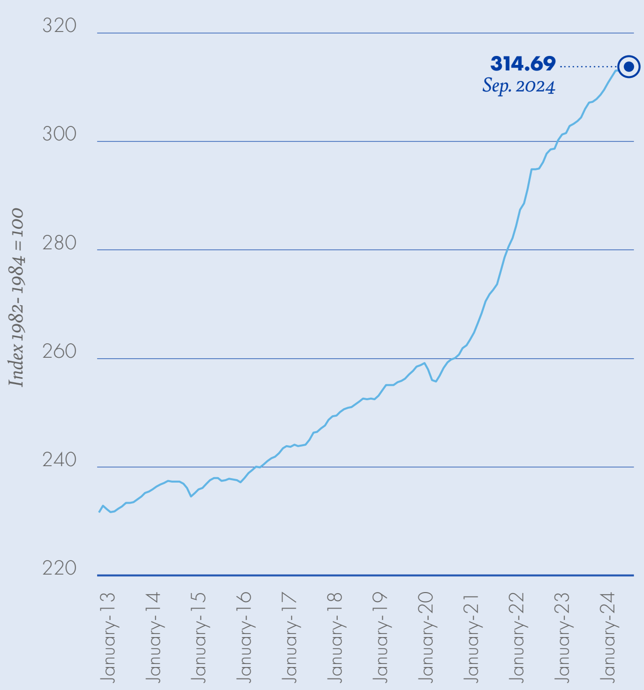
GDP, Consumer Spending & Manufacturing

The first reading of real GDP for third quarter 2024 indicated that the economy grew at a 2.8% annualized rate, slightly slower than the second quarter 2024 reading of 3.0%. The number was supported by strong personal consumption expenditures of 3.7% annualized – the strongest reading since first quarter 2023 and up from 2.8% in second quarter 2024. Strong government spending also supported GDP with a 14.9% annualized increase in defense spending – the biggest defense spending surge since 2003.

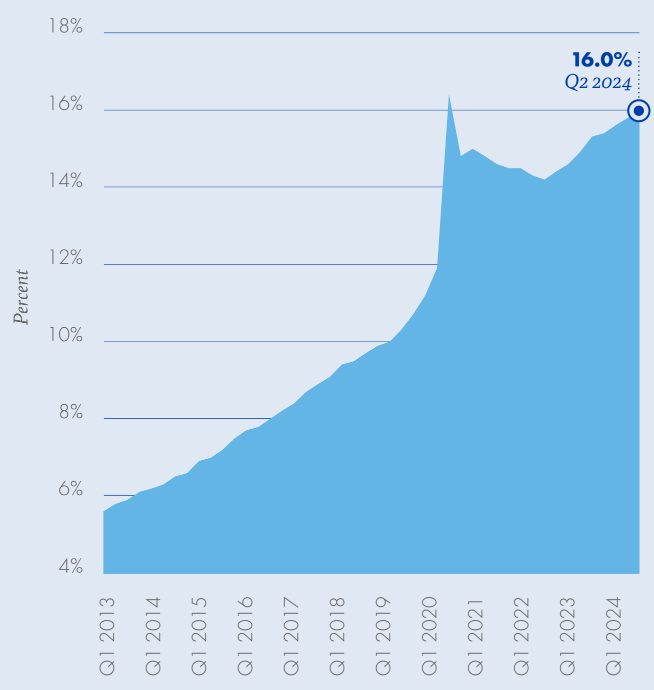
Real consumer spending in September rose by 0.4%, while real disposable personal income only rose by 0.1%. The increase in spending came from disposable income, accounting for 54% of the rise, while the remainder came from savings. The savings rate is 4.6% and has been trending down throughout 2024. It is the trend of the savings rate, rather than the actual percentage, that is more important, and the trend is suggesting increasing tightness in consumers' finances.

The ISM Manufacturing index declined to 46.5 in October from 47.2 in September. The index has been registering around the 47.0 level since mid-year, and readings below 50 indicate contraction. Production and New Orders remain weak, and respondents to the survey indicate that uncertainty around the presidential election is causing customers to be reluctant to invest in capital equipment or inventory. At the same time, with customer inventories low, the need to replenish stocks will likely support future production at some point.

CONSUMER PRICE INDEX (CPI)



E-COMMERCE RETAIL SALES (% OF TOTAL SALES)



Source: Northmarq, U.S. Bureau of Labor Statistics, U.S. Bureau of the Census

The Labor Market

The Employment report for October showed that job growth was weaker than expected, with nonfarm payrolls rising only 12,000. Recognizing the impact of the hurricanes and labor strikes, expectations were for a 100,000 increase. Additionally, employment in the previous two months was revised down by 112,000. Government payrolls increased 40,000, while private payrolls contracted 28,000. This is the first time that private payrolls have contracted since December 2020.

The unemployment rate remained at 4.1%, as the number of employed in the household survey fell by 368,000, while the labor force contracted by 220,000. The actual number of unemployed rose by 148,000. There was a rise in permanent layoffs by 153,000, bringing the total of permanent layoffs to the highest level since November 2021.

In total, the Employment report was weak, but with a record low response rate to the survey, along with the impact of hurricanes and strikes, any conclusion about the overall strength of the labor market needs to look for verification from upcoming reports.

The Employment Cost Index (ECI) is viewed by the Fed as the most reliable labor cost indicator since it includes both wages and benefits. For third quarter 2024, the ECI showed that wage pressures are easing, as they showed the smallest rise during the quarter (+0.8%) since second quarter 2021. On a year-over-year basis, the ECI is rising at 3.9%, down from 4.1% in second quarter 2024. Most encouraging was the fact that employment costs in the service sector were growing at the slowest pace in over three years.

Another reading on the labor market came from the Job Openings and Labor Turnover Survey (JOLTS) for September. It was a bit of a mixed bag. Overall, the data showed a softening in labor demand as job openings declined and have dropped 20% over the past year. New hires in September were up, but still down 5.0% year-over-year. While new hires rose, the number of layoffs rose sharply in September. As with all recent data, the impact of the hurricanes is unclear. In total, this report suggests that the labor market is normalizing to 2019 levels.

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The Federal Reserve

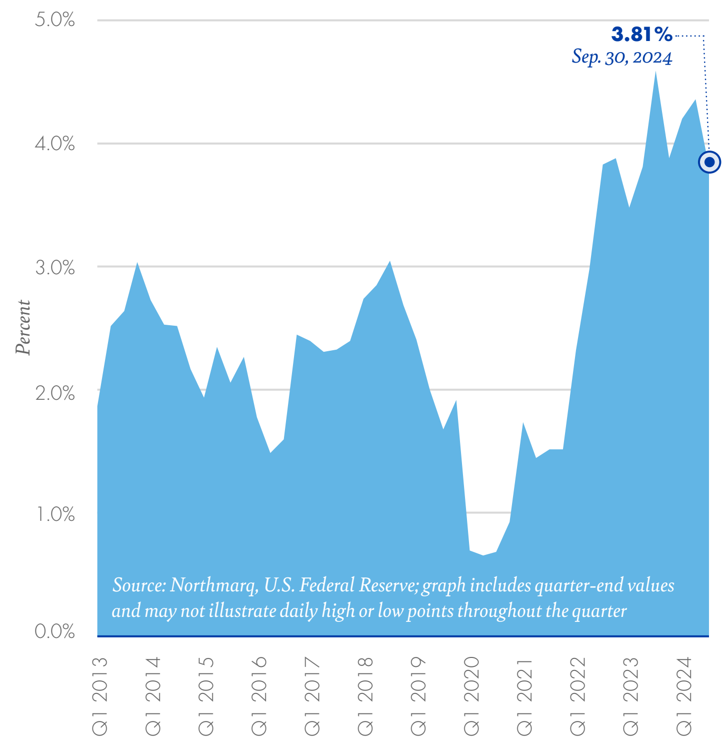
At the November meeting of the Federal Reserve's Open Market Committee (FOMC), they announced a 0.25% cut to the Fed Funds as expected. Since their previous meeting in September, there have been two Employment reports. The September report was very strong, and, as noted above, the October report was weak but impacted to some degree by storms and labor strikes. Due to their concerns about the labor market, these two reports were likely top of mind, but the ability to draw any firm conclusions regarding the labor market will have to wait for additional data.

Besides the labor market and inflation, the Fed will likely continue discussions about the level of the neutral Fed Funds rate – the level at which the Fed Funds rate is neither restrictive nor stimulative to economic activity. This rate cannot be calculated definitively, but the latest Fed thinking is that it is around 3.0%. With GDP still running above 2.0%, while interest rates are elevated, ongoing discussions are considering that the neutral rate may be higher than 3.0%. This thinking is impacting market pricing of forward interest rates.

Markets have been factoring in how the election may impact inflation, the U.S. fiscal situation and consequently interest rate policy. Adding these thoughts to the discussion of the neutral Fed Funds rate, over the last six weeks, the long-term expectations for the Fed Funds rate have risen by about 0.50%, pricing in a final level of Fed Funds at 3.5% in 2026, up from 3.0%. At the same time, yields on 10-year Treasury bonds have risen 75 basis points, which has a direct slowing impact on the real estate market in particular.

The uncertainty surrounding the impact of election results, and the incompleteness of recent economic data are making this a challenging time for the Federal Reserve, businesses and investors alike.

10-YEAR TREASURY RATE



Source: Northmarq, U.S. Federal Reserve; graph includes quarter-end values and may not illustrate daily high or low points throughout the quarter

For more information please contact:

John Beuerlein | *Chief Economist, Pohlad Companies*

Lanie Beck | *Senior Director, Content and Marketing Research*
lbeck@northmarq.com | (918) 494-2690

Northmarq

3500 American Blvd W
Suite 500
Minneapolis, MN 55431
(952) 356-0100
www.northmarq.com