Economic Review

June 2024

May employment surprises to the upside, but most other data point to a slowdown

U.S. employers added a better than expected 272,000 new jobs to the economy in May, well ahead of the 190,000 estimate. In other employment news:

- The unemployment rate rose to 4.0%, the first time it has reached that level since January 2022
- Job gains were concentrated in health care, government, and leisure and hospitality, consistent with recent trends
- Average hourly earnings were also higher than expected, rising 0.4% month-over-month (M/M) and 4.1% year-over-year (Y/Y).

One concern is the concentration of job gains from government and government-related industries. This report increased uncertainty over the timing of the Fed's anticipated rate cut cycle.

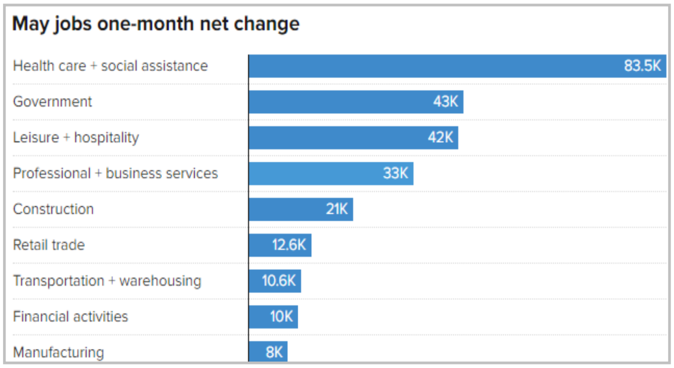
U.S. GDP was revised down to 1.3% annualized in Q1, below consensus expectations. Consumption growth was revised downward, while housing and capital expenditures were revised upward. The latest Q2 GDP estimate from the Atlanta Fed sits at +1.8%.

Inflation eased in May:

- Headline CPI was flat M/M or 3.3% Y/Y
- Core CPI rose 0.2% M/M or 3.4% Y/Y.
- Shelter inflation jumped 5.4% Y/Y.
- The Fed's preferred inflation gauge, the PCE Index, rose 2.7% Y/Y or 2.8% Y/Y when excluding food and energy.

PCE has been lower due to the factoring in of substitutions, but various inflation measures remain around 3% and well above the Federal Reserve's 2.0% target.

The ISM Manufacturing PMI remained in contraction territory with a May reading of 48.7 (down from 49.2 in April). Employment showed some strength but was more than offset by weakness in new orders and production. The closely watched prices component also fell in May. The ISM Services PMI jumped back above 50 in May, led by strength in business activity and new export orders. The headline reading of 53.8 was above expectations and April's reading of 49.4. New orders and employment gained ground while prices softened. Figures above 50 indicate expansion.



Source: U.S. Bureau of Labor Statistics, CNBC

Durable goods orders rose 0.7% in April, slightly below the 0.8% increase in March but far better than the expectation for a 1.0% decline. Excluding transportation items, orders still accelerated 0.4%. New home sales in the U.S. fell 4.7% in April following weakness in March. The April number came in at 634,000, down from the revised 665,000 for March. Meanwhile, the median price of a new house rose to $433,500 from the $430,700 level posted in March. Existing home sales also fell 1.9% as the housing market faces high prices and high mortgage rates.

ECB cuts rates! Is growth rebounding?

After months of speculation, the European Central Bank (ECB) finally cut rates. **They took down their key rate to 3.75% from 4%, where it had been since September 2023.**

Unlike the U.S., which has been struggling to get inflation below 3%, the eurozone has faced less of an inflationary headwind in 2024. Slower economic growth and less fiscal stimulus have allowed restrictive monetary policy to combat higher inflation. In contrast, the ECB upgraded its inflation forecasts for the remainder of 2024 and 2025. Canada was the first G7 country to cut interest rates earlier this week. Their next rate cut is expected in September.

The economic recovery in the eurozone gained momentum in May, according to the Flash Composite PMI data. Faster increases in business activity, new orders, and employment were all recorded midway through Q2. Growth continued to be centered on the service sector, but manufacturing production neared stabilization in May, falling only marginally. Based on current PMI data, **GDP is on pace to grow 0.3% quarter-over-quarter (Q/Q)**. In the eurozone, year-over-year headline and core inflation were 2.6% and 2.9%, respectively. Strong services prices predominantly drove the above-consensus prints as the job market remains tight.

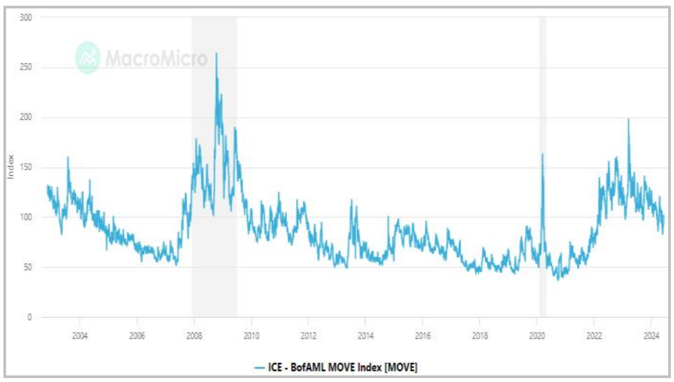
Mixed signals from China

China's May manufacturing PMI fell to 49.5, down from 50.4 in April. May's manufacturing PMI marked a three-month low and was disappointing after the recent strength of industrial activity data. **The main reason for this month's decline was a drop in new orders (49.6) and new export orders (48.3), which both fell back into contraction after two months of expansion.** While the official manufacturing PMI fell back into contraction territory, the smaller company-focused Caixin Manufacturing PMI increased to its highest level since June 2022 at 51.7. To counter soft domestic demand and a years-long property crisis, China has boosted infrastructure investment and invested in high-tech manufacturing to bolster the broader economy.

China's official Non-Manufacturing PMI fell in May to 51.1 from 51.2 in April. Retail sales in China grew only 2.3% Y/Y in April, the slowest pace in 15 months. While CPI has increased slightly for the last three months, producer prices have fallen for 19 straight months. These bearish reports from China suggest that the economic recovery may still be facing headwinds due to the ongoing downturn in the property sector.

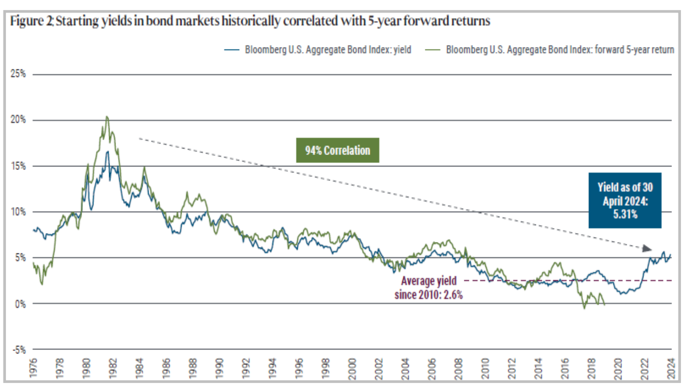
Rate volatility signals uncertainty while equity volatility shows complacency

Interest rate volatility surged higher in late 2021 when the Fed embarked on its current rate hiking cycle to combat rising inflation. The Merrill Lynch Option Volatility Estimate (MOVE) Index reflects the level of volatility in U.S. Treasury futures. The index is considered a proxy for term premiums of U.S. Treasury bonds (i.e., the yield spread between long-term and short-term bonds). After two years of elevated interest rate volatility, the past few months have seen some reprieve. While rate volatility has been very elevated, equity volatility remains quite low based on the VIX, signaling overall complacency in financial markets.



Source: MacroMicro, ICE

Historically, starting yields are highly predictive of bond returns over a multiyear horizon. With starting yields on the Bloomberg US Aggregate benchmark near 4.7% today, investors should expect favorable returns moving forward. Higher returns are also possible with opportunistic mandates that can allocate beyond traditional core sectors.



Source: Pitchbook