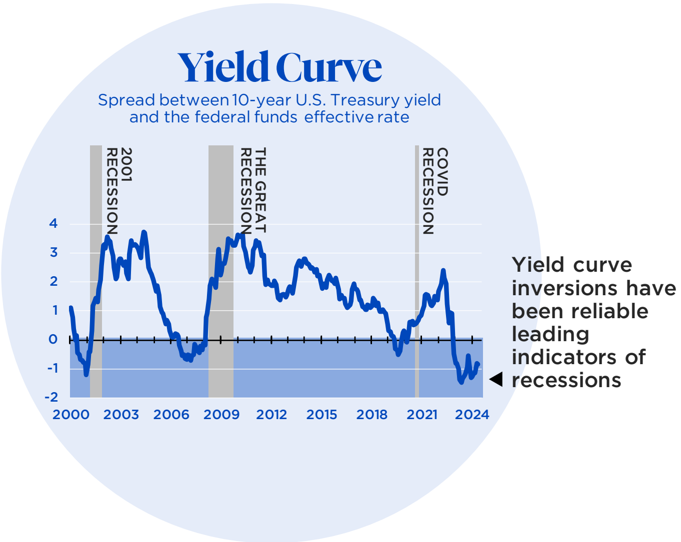
Economic & Financial Markets Monthly Review | June 2024

Strong May hiring carries economic momentum further

Where is the economy now?

The positive economic momentum from the first quarter has carried into mid-year with buoyant job gains likely supporting a rebound in income and spending in May. While there are signs of slowing activity from some segments of the economy, inflation remains too hot for the Fed to start lowering interest rates this summer. The delay by the Fed keeps borrowing costs high for consumers and businesses while adding downside risk to the outlook.



Where we are this month

Late cycle phase extended

The U.S. economy is set to expand into mid-2024 with little near-term concern that consumer activity will slow sharply, instead we anticipate a healthy moderation.

Yield curve inversion holds

Despite increased volatility for long-term interest rates, the spread between the 10-year Treasury rate and the fed funds rate was little changed in May from April.

Real incomes have flatlined recently

After surging from November through January, inflation-adjusted disposable income growth has leveled off.

What does this mean

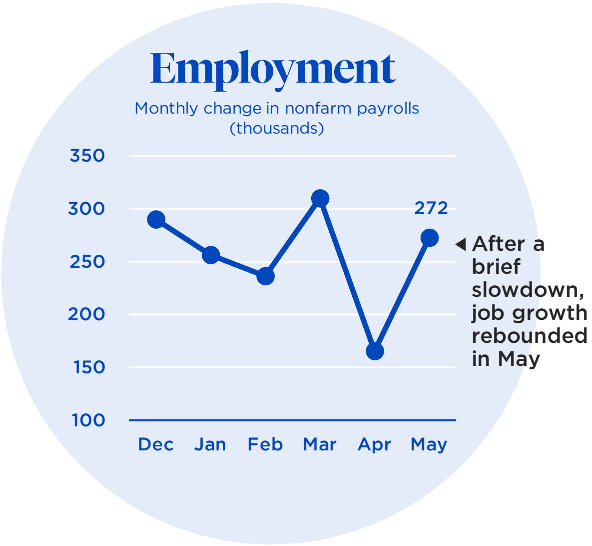
- We forecast real GDP growth to remain solid in the second quarter but ease in the latter half of 2024 under the weight of elevated interest rates and continued price increases.
- A sharp downturn is now unlikely in 2024 as hiring and spending activity should underpin moderate momentum into the second half of the year. But we see higher-than-normal recession risks in 2025, especially if the Fed stays on hold into next year.

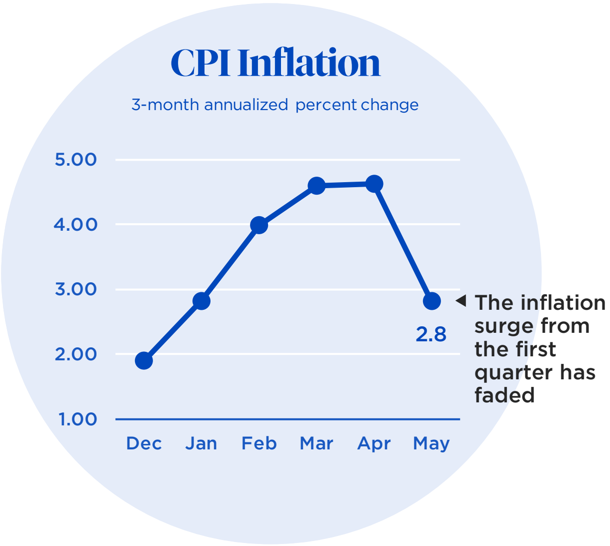
- Treasury rates continue to run just below the highs for the year as markets expect the Fed to delay rate cuts until at least September, with rising odds of a later start to easing. As a result, the negative spread between the 2-year and 10-year remained entrenched for the 23rd consecutive month.
- Portions of the yield curve could remain inverted over much of 2025 with the Fed on course to ease rates only gradually.

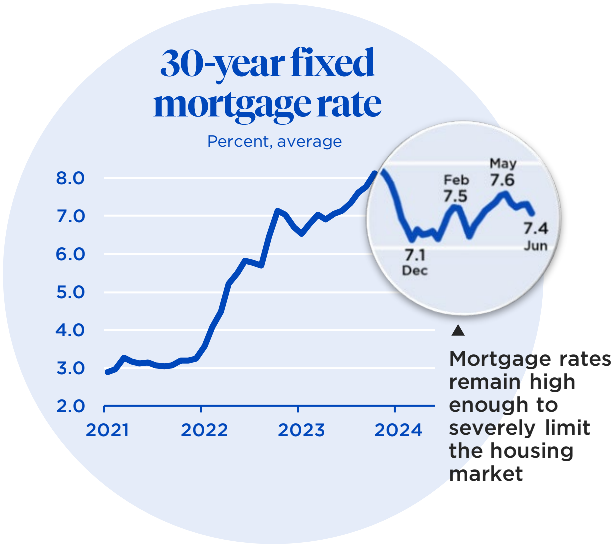
- The stalling of real income growth since February saps consumers' spending power and dampens consumer sentiment about the state of the U.S. economy.
- Based upon the May employment report, real incomes are poised to see an improved gain which should offset the decline seen in April. But with personal saving rates drawn down, there is little additional buffer to support spending.

Employment report bucks trend of weaker economic data

While hiring was still concentrated in a few industries, overall job growth was strong again in May as the economy's growth engine remains intact. Headline CPI inflation was flat in May, but the core rate indicates lingering pressure on services and housing costs — key focus areas for the Fed. Consumer loan rates have climbed again, a downside for spending on homes and autos.







Where we are this month

Hiring rebounded in May

Nonfarm payrolls advanced 272,000 in May, while the unemployment rate climbed to 4.0 percent for the first time since January 2022.

Softer inflation readings are encouraging

The overall CPI was flat in May while the core rate rose at a slower 0.2 percent pace, lowering the year-on-year readings to 3.3 percent and 3.4 percent, respectively.

Mortgage rates settle at high perch

Mortgage rates averaged 7.0 percent for the first week of June and have been at or above 7.0 percent for most of the last two months.

What does this mean

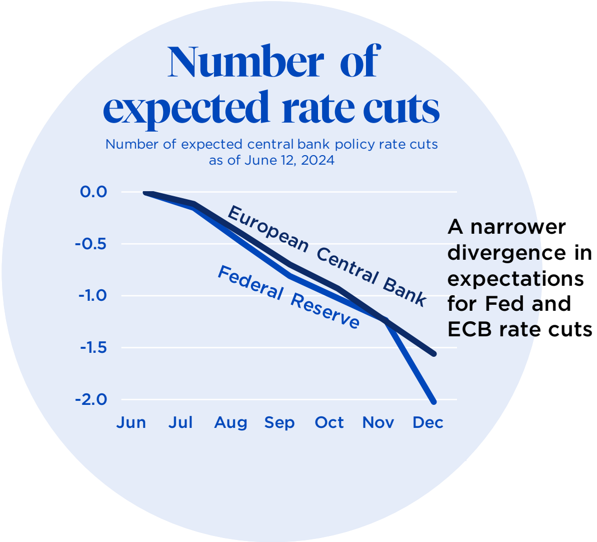
- Nearly half of the headline gain in payrolls came from health care and social assistance and the government sector. While there were healthy gains in several other industries, hiring in May was not particularly broad-based as firms in some sectors cut back.
- Annual wage growth advanced at a faster pace of 4.1 percent in May as tight labor conditions persist. This will drive solid aggregate income growth and should support a rebound in consumer spending.

- The 3-month annualized rate for overall CPI inflation dropped to 2.8 percent, reversing the surge posted in the first quarter and putting the inflation trend on the right track again.
- While the supercore CPI measure (core services less rents) was also encouragingly flat for May, the year-on-year reading was still too hot at 4.9 percent. Shelter costs were also buoyant again in May, a hurdle for faster disinflation of consumer prices.

- There was a brief and minor reprieve on mortgage rates in late 2023 and early 2024, but that has unwound as rates have jumped roughly 40 basis points since mid-February.
- High rates continue to stifle the housing market and other rate-sensitive industries. With rates expected to maintain a higher-for-longer path, substantial relief for these industries is unlikely until well into 2025.

Investors eagerly anticipate Fed rate cuts

Risk assets stayed on an encouraging path and interest rates edged lower in May as mixed signals in the economic data were not enough to throw the positive-growth narrative off track. A summer rate cut by the Fed looks highly unlikely as policymakers won't yet have the confidence that inflation is on a clear path to their two percent objective. While there are risks around the start and degree of policy easing, we think conditions will be right at the end of Q3 for them to start easing monetary policy.



Where we are this month

Equities gain ground

Encouraging macroeconomic data, positive Q1 corporate earnings, and Fed officials' clear reluctance to raise interest rates despite stubborn inflation data pushed the S&P 500 higher in May.

Interest rates stay high

The 10-year Treasury yield fell six basis points on the month, averaging 4.48 percent in May. The long-term benchmark interest rate continued to hold above its post-Global Financial Crisis average.

Investors think the Fed won't lag far behind

After widening in May, the divergence in investors' policy rate expectations between the Federal Reserve and European Central Bank (ECB) narrowed in early June.

What does this mean

- All major sectors contributed to the S&P 500's rise, except for energy. For the most part, the softening April and May data represent a healthy normalization in the economy. The Q1 corporate earnings were favorable and financial conditions stayed supportive for continued economic expansion.
- Investors maintain constructive views even as traditional valuation metrics flash warning signs, suggesting limited downside risks.

- Investors lowered their expectations for Fed rate cuts amid resilient growth and inflation. The 2-year Treasury yield held steady in May, not far below the recent high posted in October 2023.
- Interest rates will be vulnerable to swings in the economic data and the Fed's messaging on monetary policy. Stubborn inflation and concerns over the federal government's fiscal trajectory lend upside risks to our interest rate forecasts.

- Sturdy services inflation and solid GDP growth in the U.S. are preventing the Fed from starting to ease. Meanwhile, the economic environment in Europe has cooled enough that the ECB lowered interest rates in June, but a string of cuts looks unlikely.
- We think the Fed will hold off on rate cuts until September and implement only 50 basis points of easing this year. ECB officials are likely to take their time cutting rates, so the divergence between the two central banks should not be that wide.

Outlook

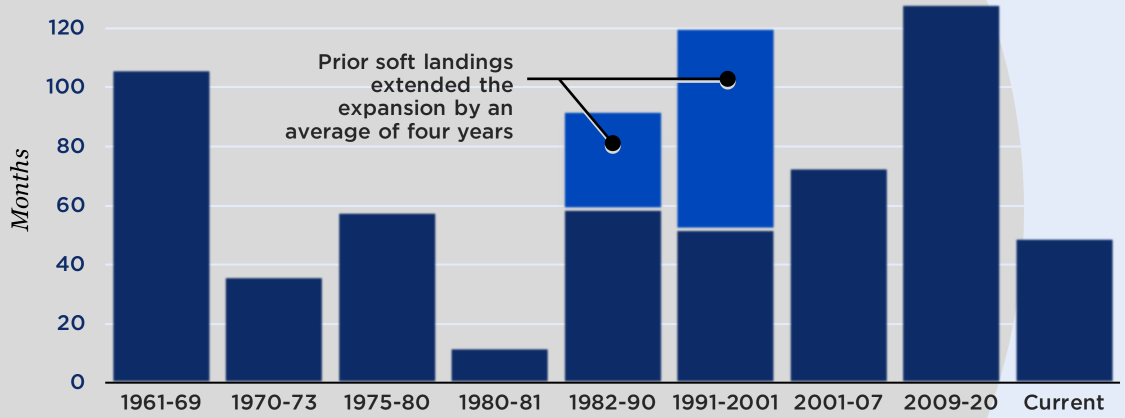
A soft landing does not signal the start of a new expansion

Consensus expectations (including our outlook) have coalesced around a soft-landing scenario for 2024-25 given the persistent strength of hiring and consumer activity. A key tenet of the soft-landing outlook is that cooling inflation allows the Fed to ease interest rates before employment and spending buckle sharply under the weight of restrictive interest rates. In this outcome, the current expansion continues as economic growth moderates but does not contract.

Importantly, achieving a soft landing extends the current expansion but does not reset the business cycle entirely. Two examples of soft landings that unfolded in the 1980s and 1990s postponed recession conditions by an average of four years.

The good news is that it produced two of the longest periods of economic expansion in U.S. history. The bad news is that it only extended the late-portion of the business cycle that eventually was followed by a recession — it did not place the economy into the first or early portion of a new economic cycle.

Length of economic expansions



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Data as of June 2024

	2023 ACTUAL	2024 ESTIMATE	2025 FORECAST	2026	2027
REAL GDP	2.5%	2.4%	1.6%	1.9%	1.8%
UNEMPLOYMENT RATE	3.6%	3.9%	4.2%	4.0%	4.0%
INFLATION [1] (CPI)	3.2%	3.5%	2.3%	2.1%	2.0%
TOTAL HOME SALES	4.75	4.77	5.10	5.95	6.15
S&P/CASE-SHILLER HOME PRICE INDEX	5.5%	4.8%	3.3%	3.2%	3.0%
LIGHT VEHICLE SALES	15.5	15.5	15.6	16.4	16.5
FEDERAL FUNDS RATE [2]	5.25%	4.75%	3.50%	2.75%	2.75%
5-YEAR TREASURY NOTE [2]	3.84%	4.05%	3.50%	3.10%	3.10%
10-YEAR TREASURY NOTE [2]	3.88%	4.15%	3.60%	3.50%	3.50%
30-YEAR FIXED-RATE MORTGAGE [2]	6.61%	6.45%	5.20%	4.80%	4.80%
MONEY MARKET FUNDS	5.09%	5.09%	3.78%	2.97%	2.78%

[1] Percent change Q4-to-Q4
[2] Year-end

Low unemployment expected to continue

While job gains are likely to slow later in 2024 and into 2025, the unemployment rate should remain around 4.0 percent in the outlook. Demand for labor remains robust within many service industries which should prevent a sharp slowdown in overall hiring and keep job options open for workers.

High mortgage rates to limit home sales

The higher for longer path for mortgage rates should keep many home buyers on the sidelines while curtailing home listings from existing owners over 2025. Falling rates should prompt more activity later in 2025 but a stronger recovery is likely delayed until 2026.

Contributors

Kathy Bostjancic
SVP & Chief Economist

Ben Ayers, MS
AVP, Senior Economist

Oren Klachkin
AVP, Financial Market Economist

Daniel Vielhaber, MA
Economist

Ashleigh Leonard
Economics Specialist

Brian Kirk
Communications Consultant

Sources

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	Business Cycle	*Nationwide Economics*
	Yield Curve	*Bloomberg; National Bureau of Economic Research*
	Real disposable personal income	*Bureau of Economic Analysis*
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	Nonfarm payroll gains	*Bureau of Labor Statistics*
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	30-year fixed mortgage rate	*Freddie Mac*
3 |	**Financial Markets Review**	
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