Money Talks

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The headlines are full of stories voicing concern of a possible recession or that inflation has reached peak levels. Will the Fed be able to engineer a soft landing or will they overshoot the mark and produce a hard economic landing? Have interest rates hit a high causing housing demand and prices to decline? Will the growth of the domestic economy slow or will activity pick up this fall with continuing resolution of supply constraints? Maybe you can find some solace in the quote from the noted economist Yogi Berra, "when you come to a fork in the road, take it".

For several months, commentators have been calling inflation at its peak, with the latest reading of the Consumer Price Index (CPI) at 9.1% year over year in June. Since that time, oil and gasoline prices have declined. Since peaking at $5.02 a gallon on June 14, the nationwide average price had fallen to $4.58 a gallon on July 15. The June CPI reading of 9.1% was the 7th consecutive month of inflation of at least 7% on a year over year basis. To place this into some perspective, the U.S. had 45 consecutive months of inflation of at least 7% year over year between June 1978 and February 1982. Again, to quote Yogi, "a nickel ain't worth a dime anymore".

The Federal Reserve Open Market Committee (FOMC) has taken steps to rein in inflation and inflation expectations. The FOMC has taken a more hawkish stance on rates and raised the short term fed funds rate by 75 basis points (0.75%) at its June meeting, the largest single increase since 1994. The market widely anticipates another 75 basis points increase at the conclusion of the next FOMC meeting on July 27. Some analysts were calling for a full percent increase at that time, but Fed officials pushed back some on this, calling for a more measured process with greater predictability for market participants. After the July meeting, the FOMC is not scheduled to meet again until September. In the interim, Fed officials will review data on the state of the economy, the effects its actions have had on inflation expectations, and the labor market. Again, our sage from the Bronx is instructive, "you can observe a lot by just watching".

The U.S. economy is not in a recession, at least not yet. Generally, a recession is defined as two consecutive quarters of negative growth. The domestic economy contracted by 1.6% in the first quarter, and, as of this writing, 2nd quarter figures were not yet released. The Atlanta Federal Reserve's tracker indicates contraction during the 2nd quarter, with a preliminary reading due July 28. However, the official call is made by the non-profit National Bureau of Economic Research, which employs a different methodology and criteria, in addition to gross domestic product.

Confounding economists is the strength of the labor market. One traditional sign of a possible recession is a weakening jobs market, yet the official unemployment rate is at a strong 3.6%. Initial jobless claims have been inching higher over the past month. Continuing claims have continued to move lower over the same time period. Job openings continue to greatly outnumber available workers and this has resulted in wage increases that have contributed to inflation numbers when businesses have been able to pass along these additional costs to the consumer. Several large companies have announced slowdowns in their hiring in the past week, but slower hiring is not the same thing as layoffs. Wage inflation can prove to be much stickier than increases in commodity or goods prices.

Many economists have placed a high probability of a recession before year-end 2023, though not a certainty. The Fed may be able to construct a soft landing, but its instruments are broad based and lack the capacity to make surgical adjustments. The markets are doing some of the work for the Fed, but we are coming from a period of a self-induced covid-related downturn, with unprecedented stimulus, supply constraints, and a time of more than a few geo-political developments affecting energy and food prices. Relying on Yogi for the final word, “the future ain’t what it used to be”.