

U.S. ECONOMIC & INTEREST RATE OUTLOOK

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- **Unfinished Business**

The first half of the year has brought severe risks to the forefront. The failure of three large banks sparked fears of systemic distress in the financial sector. Worries then shifted to the worst-case potential outcomes of the debt ceiling standoff. Mercifully, neither episode has led to a financial crisis; the broader economy has persevered.

Speculation has returned to the potential for a soft landing. Last summer, it felt like a long shot; however, a year later, it's still possible. Employment and consumer spending remain strong. The challenge will be to calibrate the appropriate monetary policy to make further progress against inflation.

Our outlook remains one of marginal growth in the quarters ahead for the economy overall. The low rate of growth reflects substantial ups and downs in individual sectors. A key risk looms from the lagged effects of monetary and credit tightening; headwinds from slower demand and higher borrowing costs are not to be dismissed. But as long as employment holds up, so too will prospects for growth.

Key Economic Indicators

	2022	2023				2024				Q4 to Q4 change			Annual change		
	22:4a	23:1a	23:2f	23:3f	23:4f	24:1f	24:2f	24:3f	24:4f	2022a	2023f	2024f	2022a	2023f	2024f
Real Gross Domestic Product (% change, SAAR)	2.6	1.3	2.0	0.8	0.7	1.1	1.1	1.4	1.6	0.9	1.3	1.3	2.1	1.7	1.2
Consumer Price Index (% change, annualized)	4.2	3.8	3.0	2.8	2.5	2.4	2.2	2.1	2.0	7.1	3.0	2.2	8.0	4.1	2.4
Civilian Unemployment Rate (% average)	3.6	3.5	3.6	3.8	4.0	4.1	4.1	4.1	4.0				3.6*	3.7*	4.1*
Federal Funds Rate	3.65	4.56	5.04	5.30	5.38	5.38	5.13	4.88	4.63				1.68*	5.07*	5.00*
2-yr. Treasury Note	4.39	4.34	4.18	4.25	4.25	4.10	4.00	3.90	3.80				2.98*	4.26*	3.95*
10-yr. Treasury Note	3.83	3.65	3.57	3.50	3.25	3.25	3.25	3.25	3.25				2.96*	3.49*	3.25*

a=actual
f=forecast

Influences on the Forecast

- The Consumer Price Index (CPI) for May presented a mixed picture. Overall, year-over-year inflation of 4.0% is great progress from a peak over 9% last summer. However, that low rate is driven by falling energy prices relative to their ascent a year ago. On a core basis, excluding food and energy, CPI improved only two-tenths to 5.3%. The volatile component of used cars came in hot, and the measure of shelter is still elevated despite stable rents and house prices.
- Jobs growth continued with 339,000 jobs created in May. Few workers remain on the sidelines, as the prime-age (25-54) labor force participation rate reached a 16-year high of 83.4%. However, the unemployment rate, which surveys households rather than establishments, rose by a surprising three-tenths to 3.7%. The increase was

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driven by a change in reported self-employment. When the two measures show diverging trends (as happened in four months of 2022), the establishment survey tends to be more reliable. Continually elevated job openings and favorable private job market surveys corroborate a trend of hiring. Initial unemployment claims have risen but are not yet at a level consistent with net job losses.

- The June meeting of the Federal Open Market Committee (FOMC) was the first to not feature a rate increase since March of last year. The FOMC deemed it appropriate to pause to ingest more data while determining the extent of further tightening required. However, the hiking cycle is very likely not done: the accompanying Summary of Economic Projections (SEP) showed that the median FOMC member expects 50 basis points of additional rate increases this year before cutting in 2024.
 - In light of this projection and the persistence of core inflation, we have revised our projection to include one additional hike this year, and a slower pace of cuts in 2024. At its new cadence, a hike in July leaves open the potential of a hike in September, or another skip to November. In the months ahead, we anticipate sufficient progress against inflation to defend an enduring pause.
 - The difficulty calling an end to the hiking cycle portends a challenging future decision to set the timing and pace of rate cuts. The median forecast in the SEP shows one percentage point of rate reductions in 2024, a pace that would require more than two years to reach the projected long-run rate of 2.5%.
- Retail sales for May again showed resilient consumer spending, with gains across most categories. Three consecutive months of growth in spending at food services and drinking places illustrated the ongoing demand for services. Recovery in other retail sectors suggests that demand for goods is normalizing after the pandemic-driven boom and bust.
- The resolution of the debt ceiling focused on caps to federal spending growth; without any substantial reductions to spending, we expect its effect on economic growth will be *de minimis*. However, the agreement included a pledge to resume federal student loan payments, the last vestige of COVID support to households. Individual obligations vary, but over 25 million borrowers will resume monthly payments of over \$200 in the fall. We are tracking this as a headwind to consumer spending, with the potential to crowd out other purchases or push borrowers into default.

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