US Macroeconomics

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Conflicts Abound

The macroeconomic data are highly conflicting. Over the past month, initial jobless claims have edged up to around 260k having been as low as 190k last fall. Claims are expected to stay around that level for now. In percentage terms, this is a large enough increase to expect a pullback in hiring, however job gains remain robust. Nonfarm payrolls rose 339k in May and are expected to stay above 200k when the June data are released next Friday. This itself should push the Fed toward another 25 basis point rate hike on July 26th regardless of what the rest of the report shows.

The manufacturing ISM survey has been below 50 for seven consecutive months, and the various regional purchasing series suggest this weakness will persist. The factory workweek has been shortening with the amount of overtime historically low. Yet, the Fed's industrial production data continues to expand, albeit modestly, while the Commerce Department's durable goods orders recently made a new high.

The Conference Board's consumer confidence index unexpectedly improved, consistent with healthy household spending. But its companion series from the University of Michigan shows the opposite, sitting at levels that — in the past — have been consistent with recession.

Housing starts, permits and residential sales have all improved from distressed readings. However, mortgage rates remain high, and home prices continue to soften. Overall housing affordability is still below where it was during the 2007 to 2009 financial crisis.

Headline consumer prices have plunged — they are likely to be up just 3% in June compared to last year's 9% peak. Inflation expectations are low and stable. But core inflation is hovering near 5%.

Clashing signals have not just been limited to the economic data, of which there are still more examples. The financial markets are also sending a divergent message. The stock market is up over 20% from last October's low, but the treasury yield curve has been inverting further. Its negative slope is approaching levels last seen before the US regional banking crisis erupted.

Arguably, **even monetary policy is conflicted**. The Fed has been aggressively increasing interest rates and may still hike more. But at the same time, monetary policymakers have been adding liquidity to the financial system. Higher rates explain the curve inversion while the added liquidity explains the rise in equity prices. How does this economic, financial market and policy tension get resolved?

The Fed wants to slow the economy to increase the unemployment rate which policymakers believe will put downward pressure on core inflation — their focus at present. Since the economy has never experienced a soft landing when the unemployment rate has risen more than half of one percent from its cyclical low, and the Fed's own forecast shows such an increase, a downturn remains the mostly likely outcome.

Consequently, **investors should expect more widespread softening in the macroeconomic data in the months ahead**. In turn, this should lead to some retracement in stock prices. The extent of the anticipated downturn, and its duration, will be function of what the Fed's response is when such an outcome becomes apparent. Stay tuned.

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