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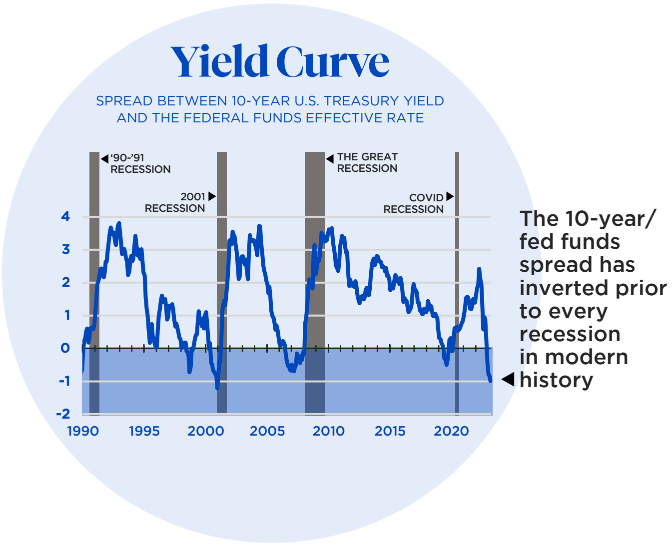
Economic & Financial Markets Monthly Review | April 2023

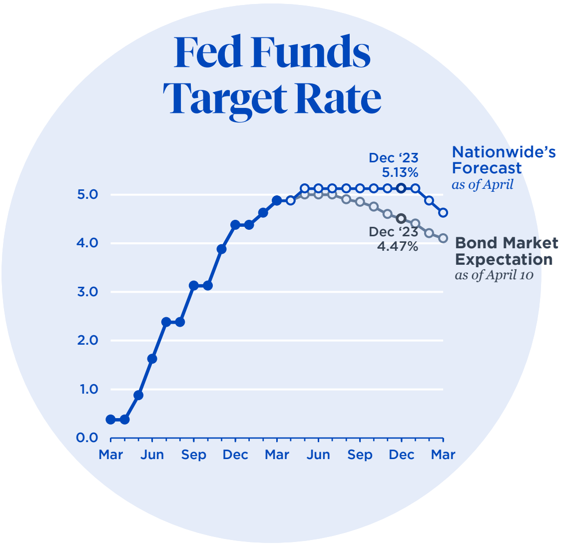
Businesses are starting to tap the brakes on growth

Economic Overview

Where is the economy now?

Signs of decelerating economic growth across the U.S. economy are indicative of a late-cycle period. Aggressive Fed rate hikes has significantly slowed consumer and business activity. Key leading indicators including the yield curve, housing building permits and manufacturing new orders point to elevated recession risks over the next year.





Where we are this month

CYCLE END GETTING CLOSER

The business cycle is on the verge of shifting into the recession phase as signaled by the yield curve inversion and weaker business activity.

SUSTAINED YIELD CURVE INVERSION

The 10-year to fed funds spread remains deeply inverted and the yield curve has shown a full inversion since November.

MARKETS PRICING IN RATE CUTS

Financial markets project a swift change of course for the Fed with several rate cuts priced in over the second half of 2023.

What does this mean

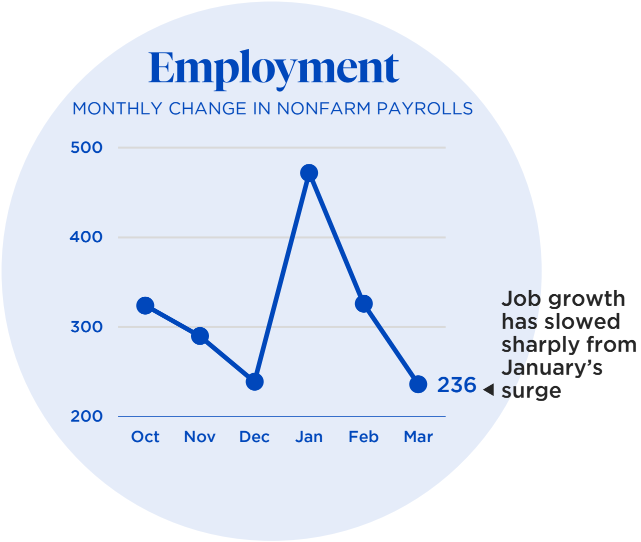
- Key recession signals, including the yield curve, manufacturing new orders and a tightening in bank lending standards point to a likely recession over the next year.
- Our baseline forecast assumes that a moderate recession hits in the second half of 2023. A much tighter commercial lending environment adds downside risk to the growth outlook.

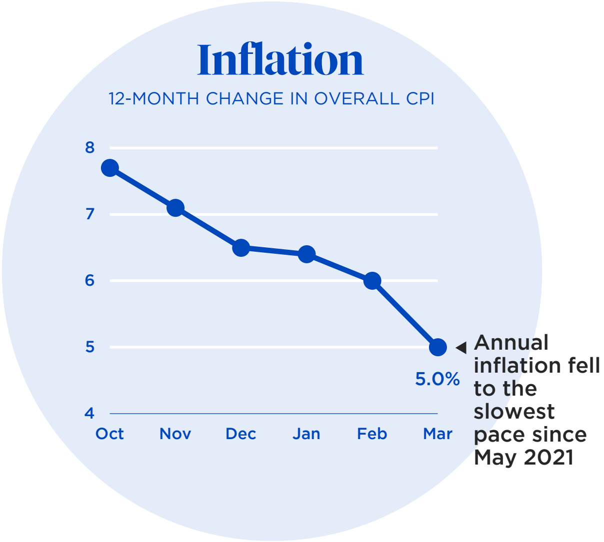
- Since at least 1962, a recession has always followed a sustained yield curve inversion, although the depth of the inversion has not historically correlated well with the severity of the downturn.
- The deep inversion reflects the bond market's elevated expectation of a recession in the year ahead.

- This expectation runs counter to our estimates and those of the Fed which sees restrictive monetary policy maintained into early 2024. The Fed expects to hold rates high and steady to lower inflation.
- The pace of inflation and the depth of the prospective recession will determine the Fed's policy responses and the timing of future interest rate reductions.

Weaker trends heading into the second quarter

While 2023 started with hotter-than-expected economic readings, activity slowed considerably by the end of the first quarter. Businesses are seeing demand for goods and services fade, which should drive further cooling of the labor market in coming months. A recession may not be imminent, but signals of weaker growth continue to spread across the economy.





Where we are this month

HIRING SLOWS FURTHER IN MARCH

Nonfarm payroll gains moderated to 236,000, the weakest month in more than two years, while the unemployment rate dropped to 3.5 percent.

INFLATION COOLS FURTHER

Consumer inflation cooled more sharply than expected in March with a 12-month trend rate of 5.0 percent, down from 6.0 percent in February.

NEW ORDERS ARE WANING

Falling consumer demand is driving production decreases across the business sector, with manufacturing in contraction for five months.

What does this mean

- Job gains continue to be led by service industries — especially restaurants and health care — where firms have had the most difficulty filling staffs over the pandemic period.
- While hiring conditions remain tight, the labor force has climbed sharply over the past five months — a positive sign for improved supply of workers for businesses.

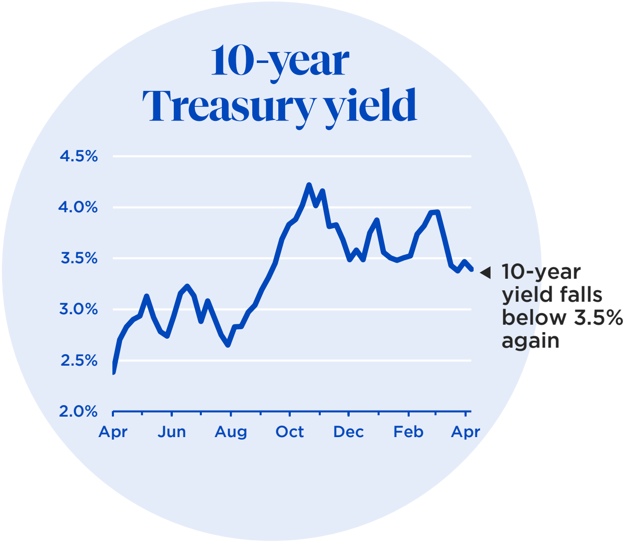
- Costs for food at home dropped in March, easing the burden on household expenses. Gasoline prices were also lower but have moved higher again in April in response to the OPEC+ supply cut.
- But core inflation was still highly elevated at 5.6 percent in March as services inflation remained strong in response to the tight labor market, while costs for housing and rent climbed further.

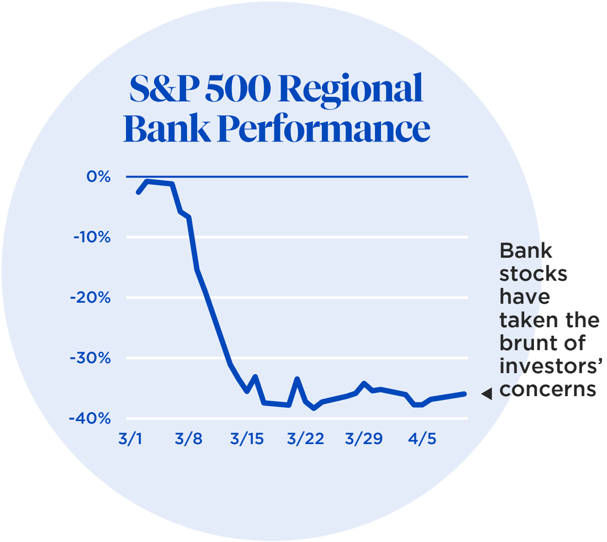
- Firms are holding on to their workers so far, but many have reduced hiring plans to control costs ahead of expected weaker sales.
- Tighter bank lending standards for commercial loans are making it more expensive for companies to run operations, a further restriction on business sector growth this year.

Financial Market Review

Earnings on the rocks

The banking crisis continued to weigh on the market and Treasury yields even as policymakers reassured that the financial system was sound. Recession concerns also gripped the bond market as investors focused on building expectations of rate cuts over the next year. OPEC+ added to the nervousness with a surprise cut in oil production, reigniting sticky inflation concerns.





Where we are this month

PROFITS FALL

The S&P 500 index has traded in a narrow range, caught between the hope for a mild recession and the fear of the worst earnings since 2020.

INTEREST RATES RETREAT

The yield on the 10-year Treasury note fell further in early April as additional Fed hikes were discounted and markets price in earlier cuts.

REGIONAL BANKS TAKE A HIT

The bankruptcy of several high-profile regional banks led to a sharp sell-off within bank stocks that are still down nearly 40 percent.

What does this mean

- Nearly 20 percent of the S&P 500 companies have issued warnings about earnings for the first quarter, suggesting that April profit announcements will be pessimistic.
- Lower valuations should provide little optimism for investors since the market trades above its ten-year price-to-earnings average, making buying decisions riskier.

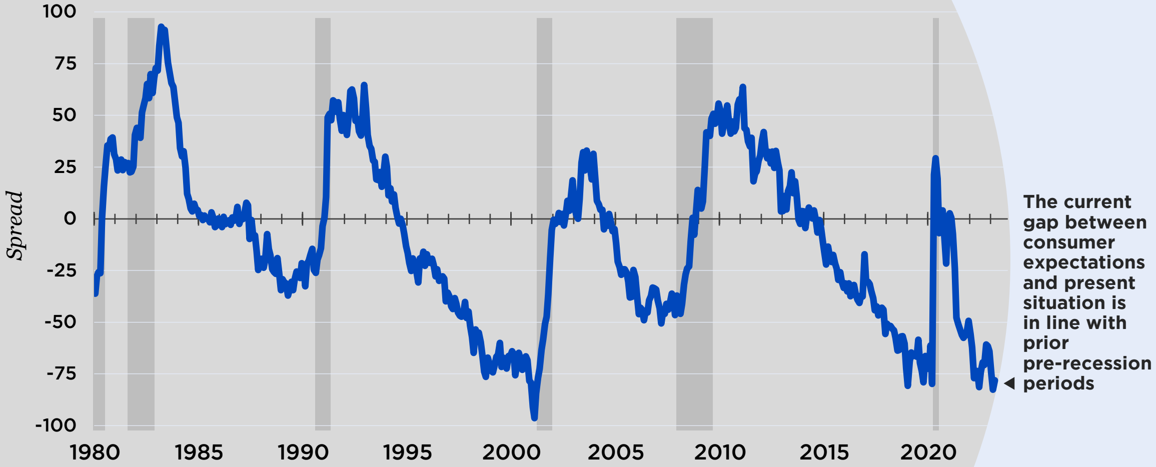
- 2024 is the focus of fixed-income investors who predict inflation to fall further next year with the cracks in the labor market spreading.
- The sharp pullback in long-term rates means the spread inversion will persist while flashing a red light that an economic downturn is brewing and suggesting that a return to a normally shaped yield curve could be lengthy.

- Additional regulations and oversight could drag on regional bank shares and other financials as investors worry about the long-term growth prospects for these institutions.
- Investors will miss the diversification value from bankk shares, which offered stable returns and dividends and balance to other perceived high-risk sectors.

Outlook
Leading indicators signal recession

The risks of a hard landing continue to build as the yield curve remains broadly inverted, household expectations remain subdued, and lending activity is slowing in the wake of the Silicon Valley Bank failure. In fact, the spread between long-term rates and short-term rates, the gap between consumer expectations and present situation confidence (shown below), and the breadth of financial institutions tightening lending standards on business loans are now at levels that was consistent with prior recessions. Moreover, the economy's bulwark, the labor market, is also cooling in a sign that the positive feedback loops that have sustained the expansion to this point are fading. Job growth is still healthy and remains unlikely to contract soon, but the recent pattern points to further slowdown ahead and a growing risk of a broader downturn.

Difference between the Conference Board's Expectations and Present Situation Indices



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Data as of April 2023

	2022 ACTUAL	2023 ESTIMATE	2024 FORECAST	2025	2026
REAL GDP	2.1%	1.2%	-0.2%	2.2%	1.7%
UNEMPLOYMENT RATE	3.6%	4.1%	5.3%	4.7%	4.3%
INFLATION (CPI)	7.1%	4.1%	3.0%	2.4%	2.0%
TOTAL HOME SALES	5.67	4.61	5.05	5.50	6.00
S&P/CASE-SHILLER HOME PRICE INDEX	5.8%	-3.2%	2.5%	3.5%	4.0%
LIGHT VEHICLE SALES	13.8	14.8	15.5	16.2	16.5
FEDERAL FUNDS RATE	4.25%	5.00%	3.00%	2.00%	2.00%
5-YEAR TREASURY NOTE	3.99%	3.80%	3.10%	2.70%	2.50%
10-YEAR TREASURY NOTE	3.88%	3.70%	3.15%	2.90%	2.70%
30-YEAR FIXED-RATE MORTGAGE	6.42%	6.30%	5.20%	4.65%	4.40%
MONEY MARKET FUNDS	2.27%	4.97%	3.78%	2.40%	2.03%

Auto sales boosted by higher production

Despite high loan rates and likely recession impacts, auto sales should climb over 2023-24 as new vehicle production improves. This should also help to cool prices for both new and used cars and trucks.

Fed tightening cycle near its end

We expect one more 25 bps point rate hike from the Fed in early May as the Fed moves to wind down policy tightening. If inflation remains elevated over 2023, the Fed is unlikely to ease until 2024 — but this stance could be tested by a moderate recession or other signs of financial market stress like the recent bank failures.

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Sources

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	Business Cycle	*Nationwide Economics*
	Yield Curve	*Bloomberg; National Bureau of Economic Research*
	Fed Funds Futures	*CME Group*
2	**Economic Review**	
	Nonfarm payroll gains	*Bureau of Labor Statistics*
	Consumer Price Index	*Bureau of Labor Statistics*
	New orders	*Institute for Supply Management*
3	**Financial Markets Review**	
	S&P 500	*Standard & Poor's*
	10-year Treasury yield	*Federal Reserve Board of Governors*
	Regional bank stocks	*Bloomberg*
4	**Outlook**	
	Expectations & confidence spread	*The Conference Board*
	Latest Forecast	*Nationwide Economics*

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