

Economic Overview and Market Outlook

23 August 2022



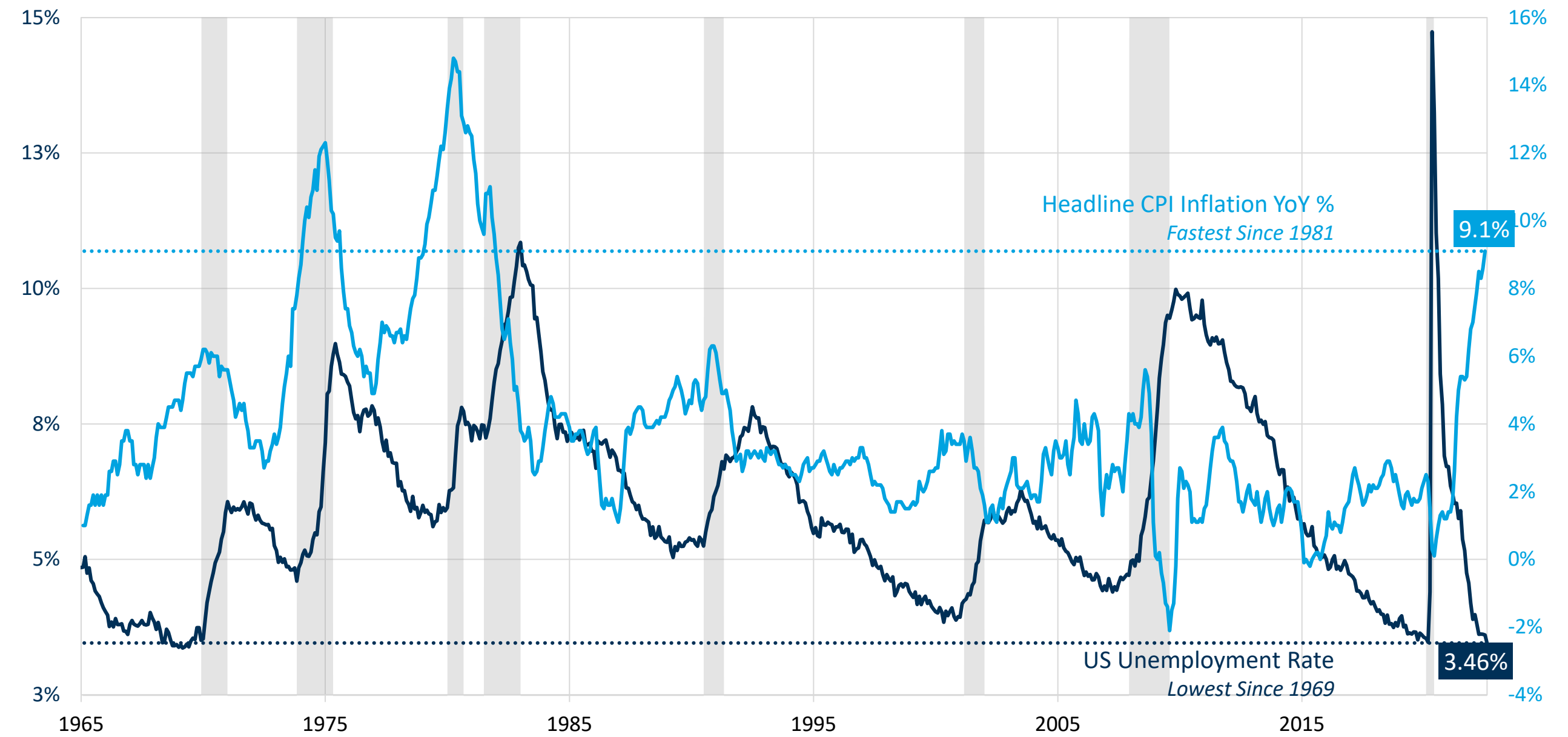
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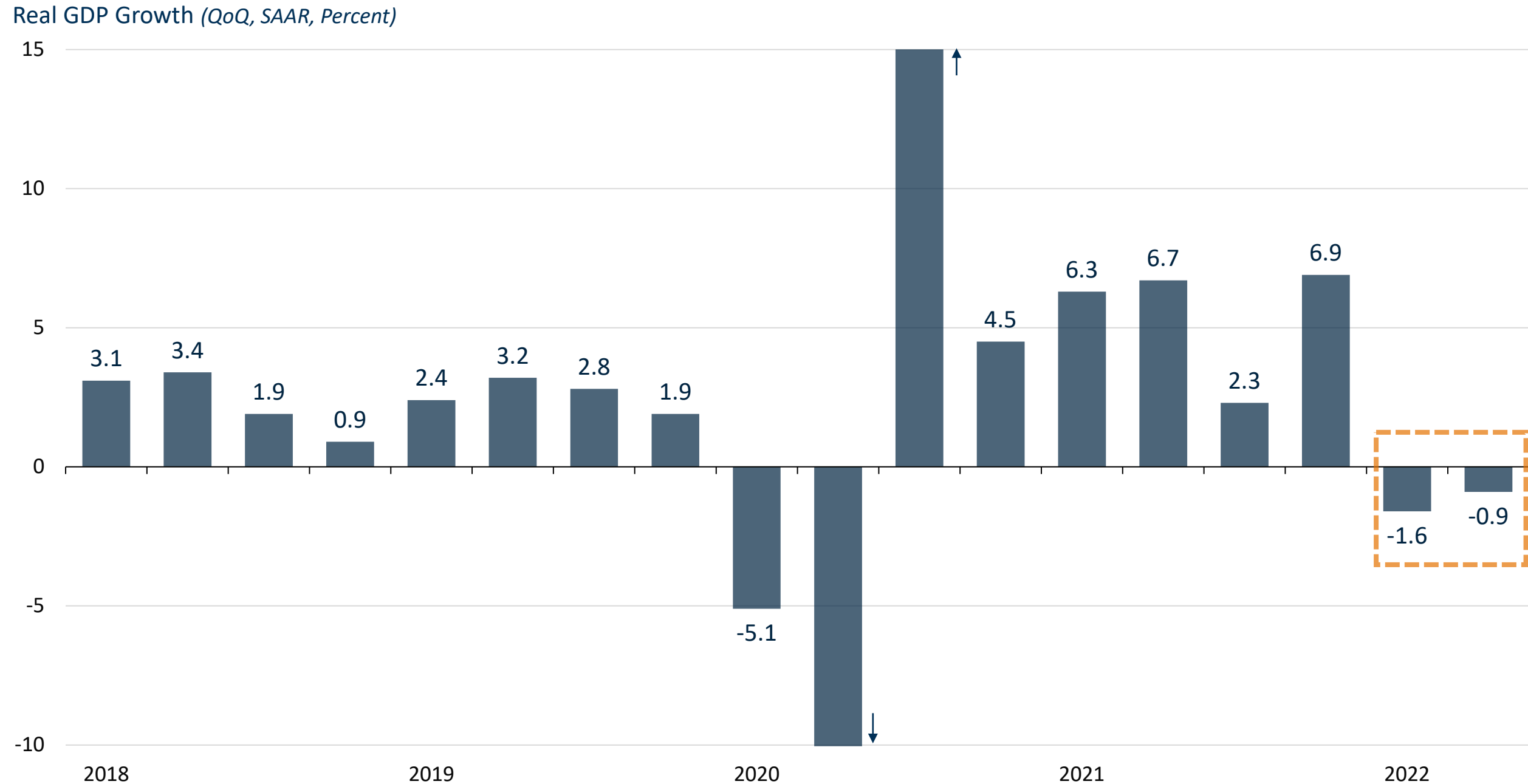
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Fed Faces 40-Year Fast Inflation, 50-Year Low Unemployment

Fed’s Powell: “Picture Is Plain to See: The Labor Market Is Extremely Tight...Inflation is Much Too High”

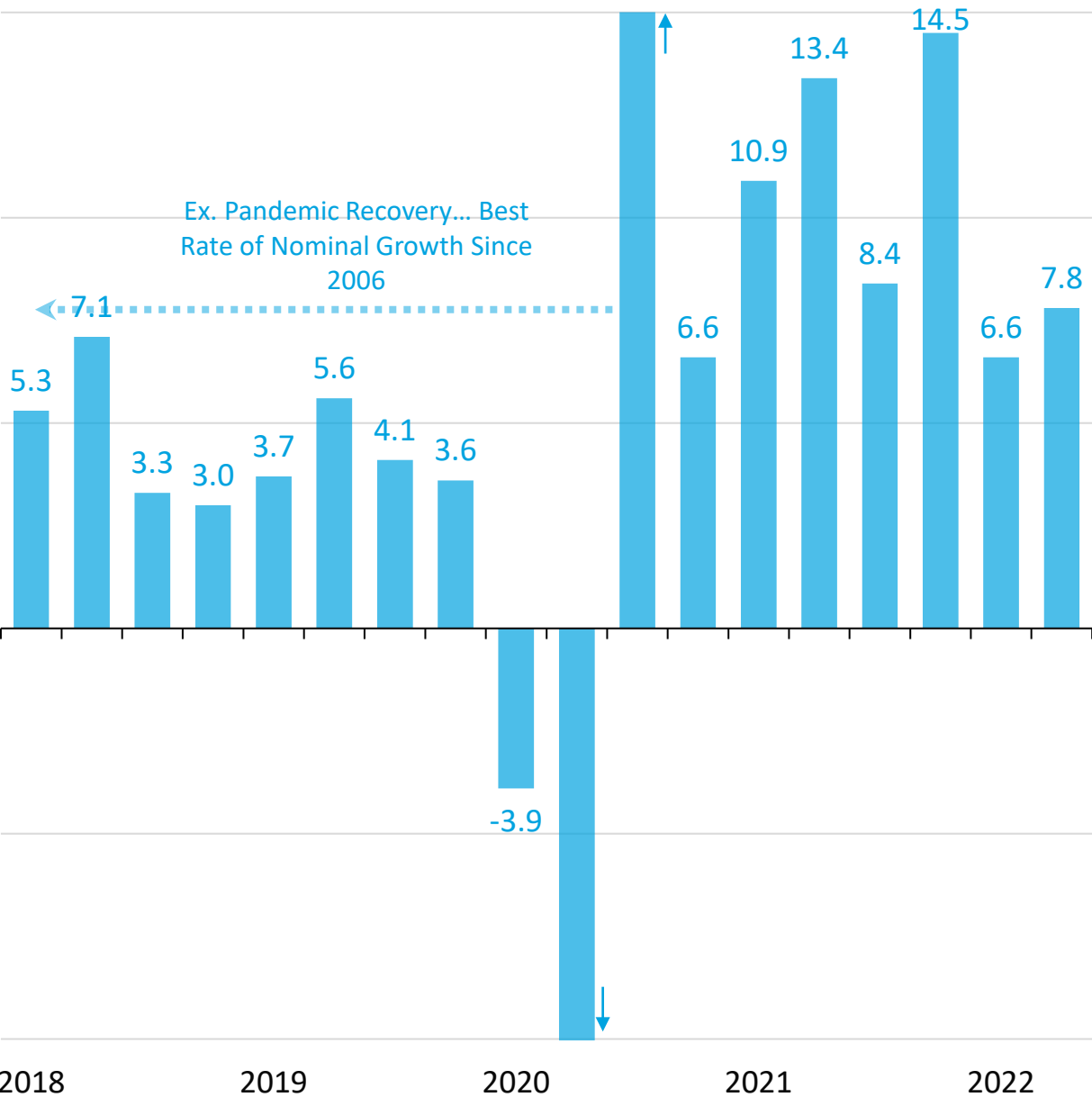


2Q GDP Declines as Inflation Overwhelms and Higher Rates Take a Toll

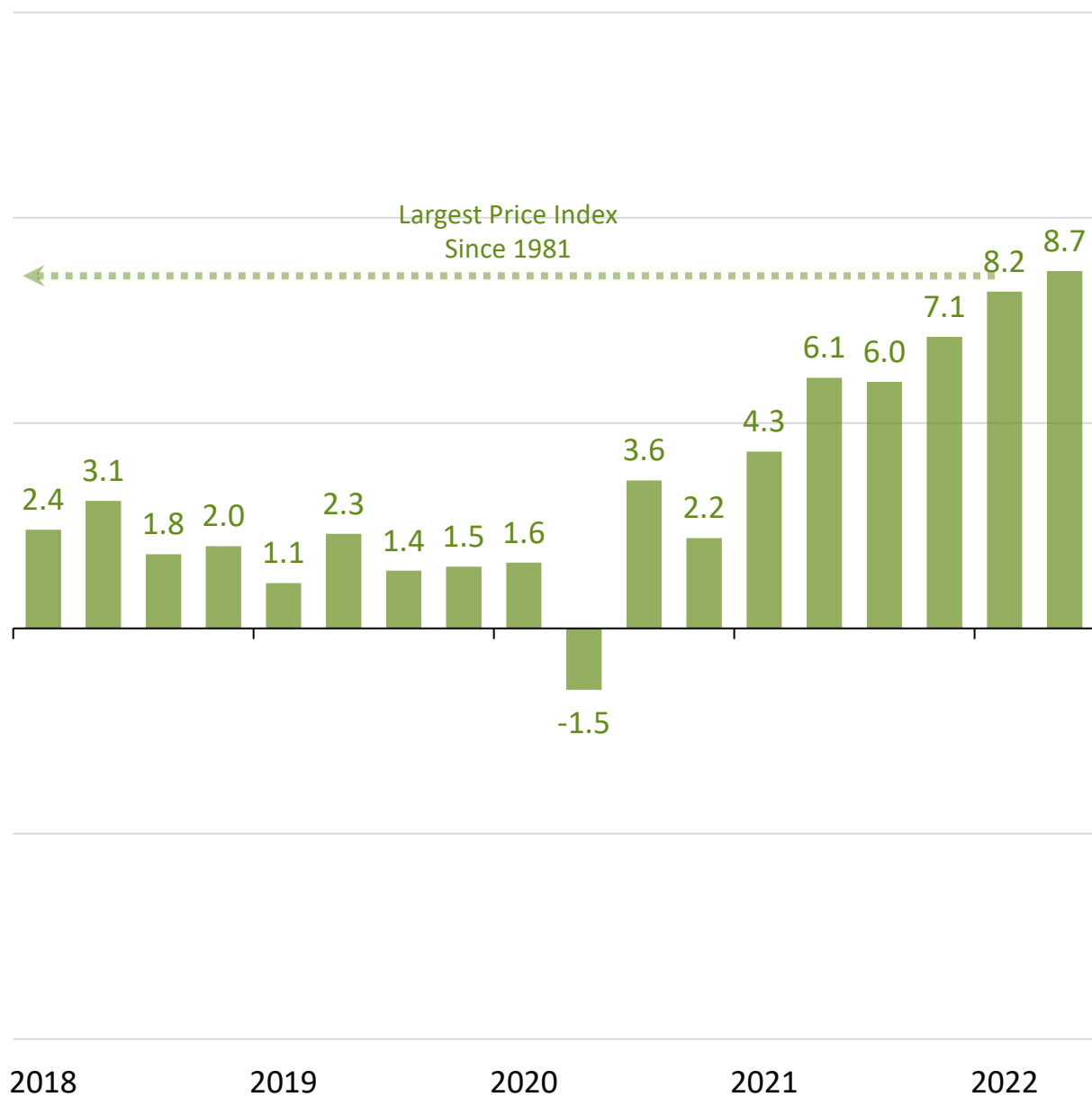


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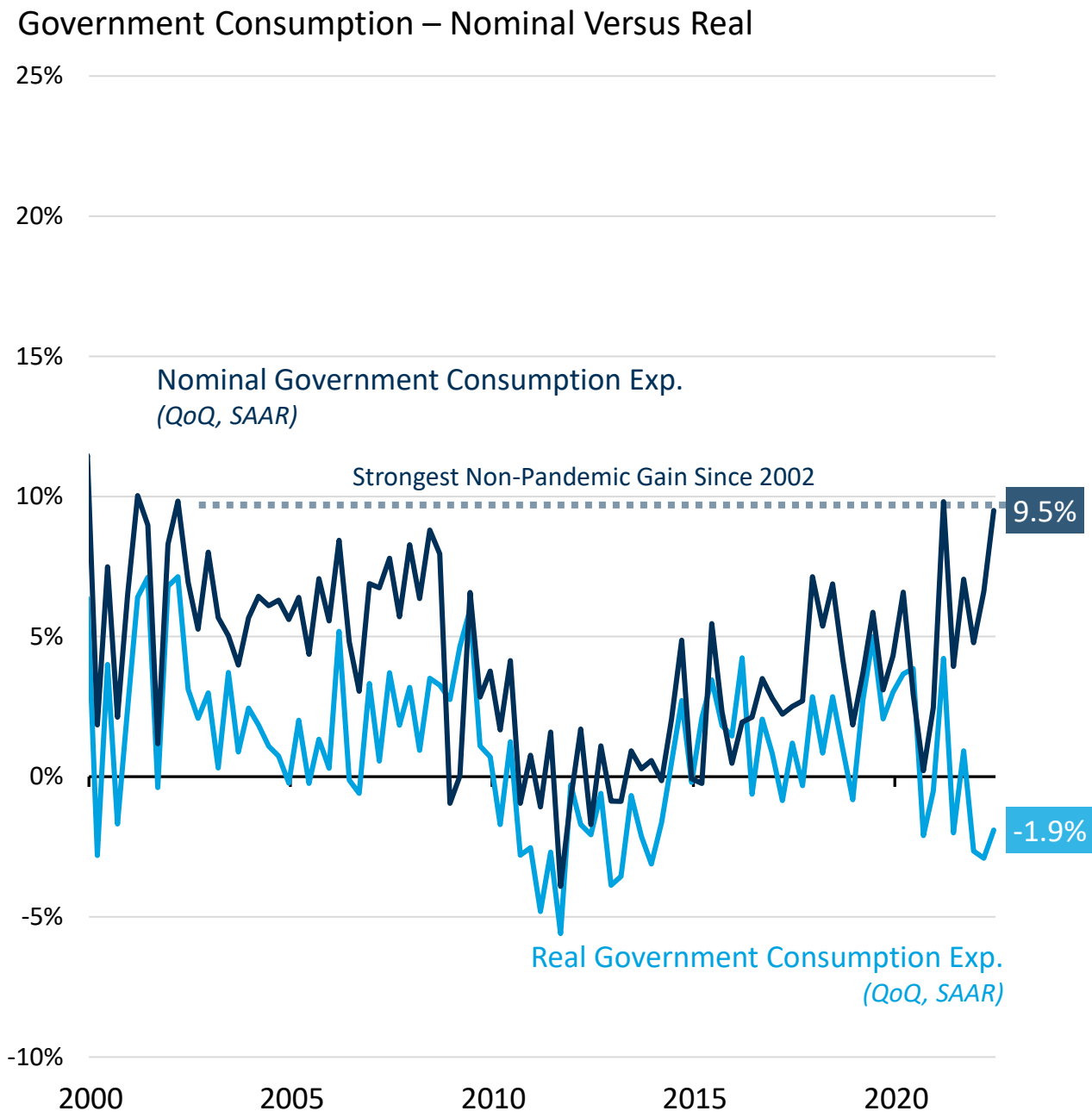
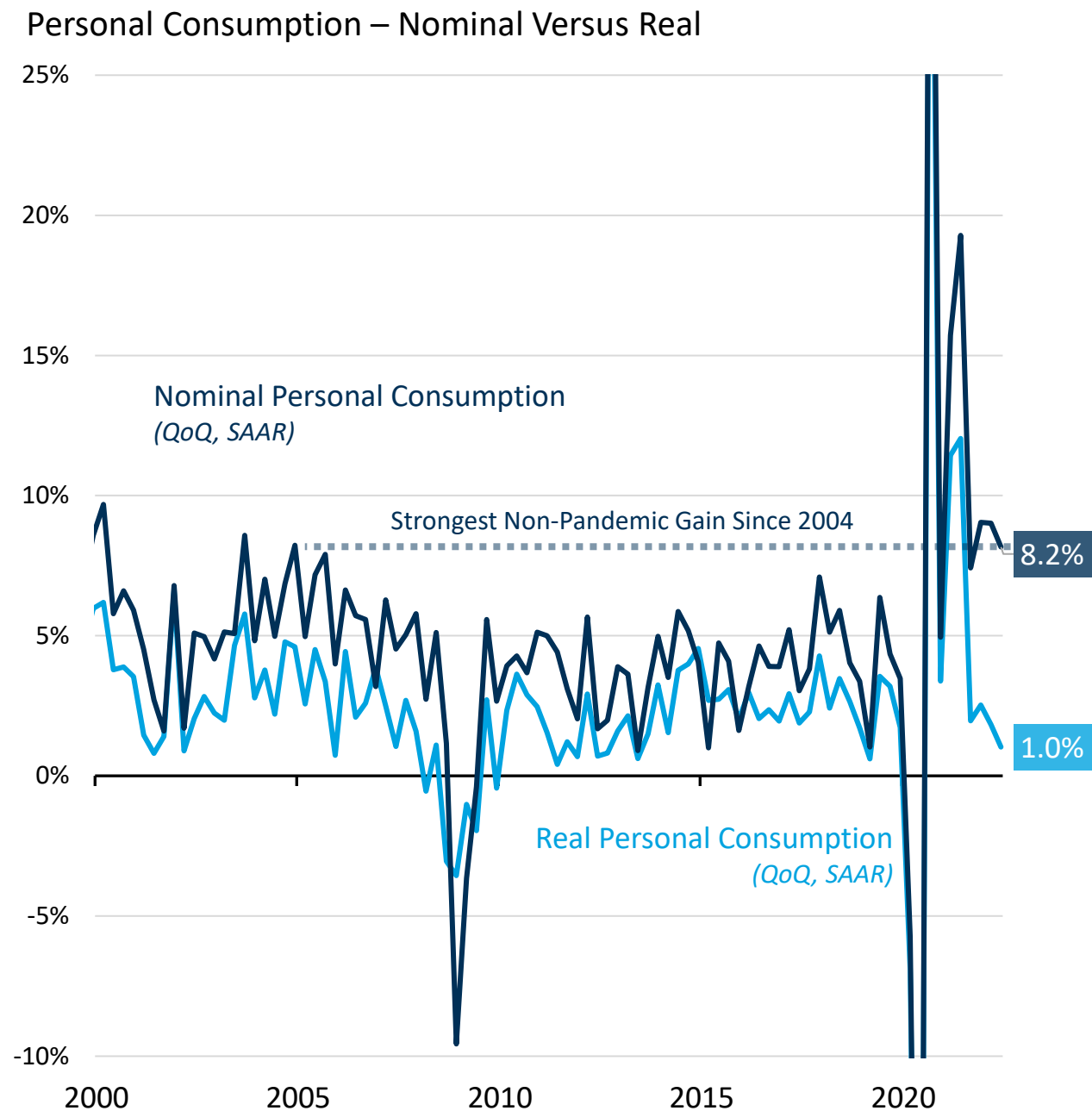
Nominal GDP Growth (QoQ, SAAR, Percent)



GDP Price Index (QoQ, SAAR, Percent)

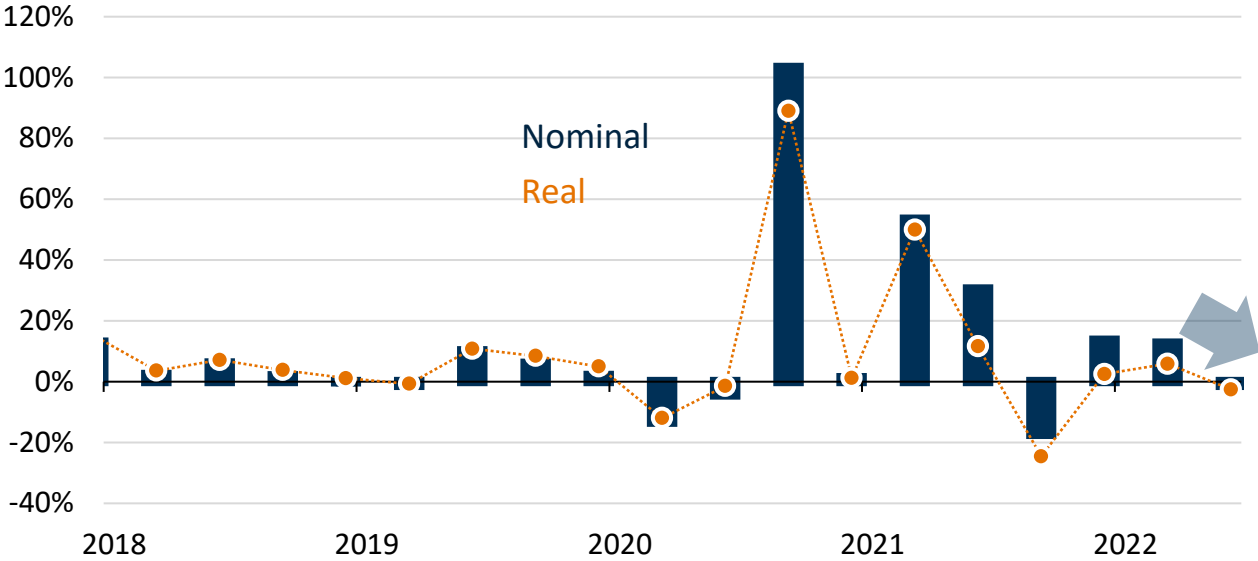


Inflation Erodes Strong Nominal Gains in Some Categories

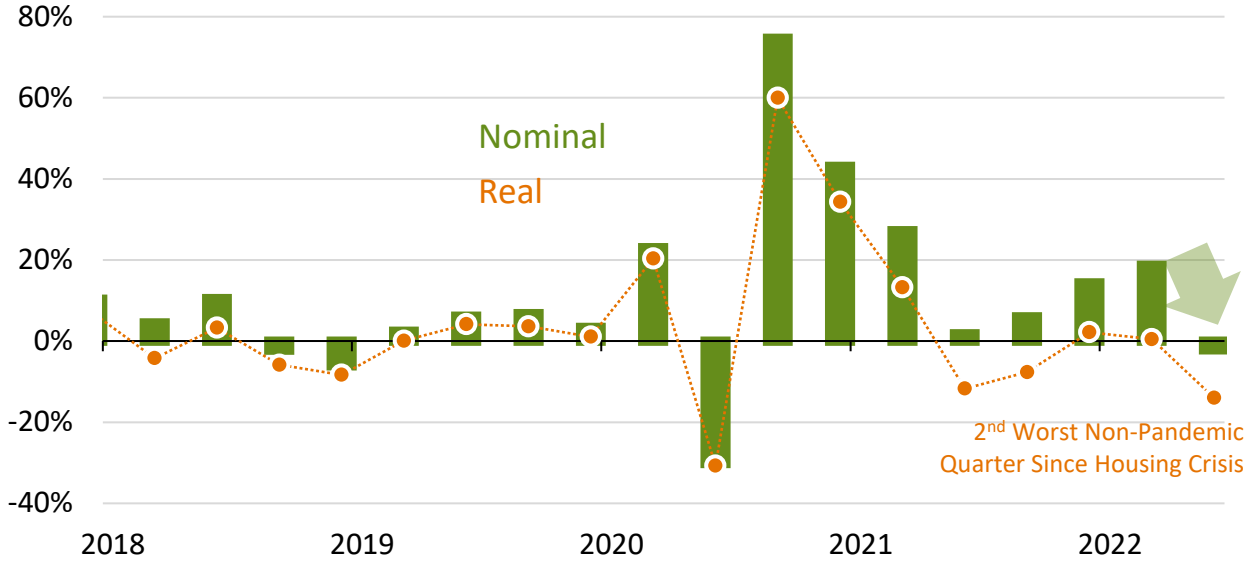


Interest Rate-Sensitive Categories Highlight Impact of Higher Rates

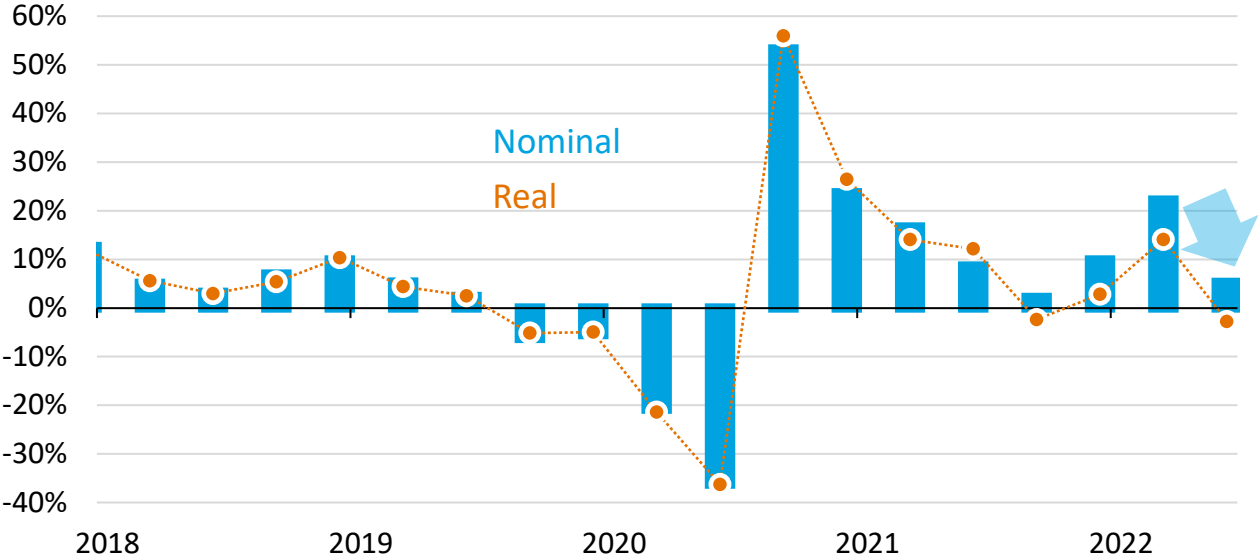
Personal Consumption – Durable Goods (QoQ, SAAR)



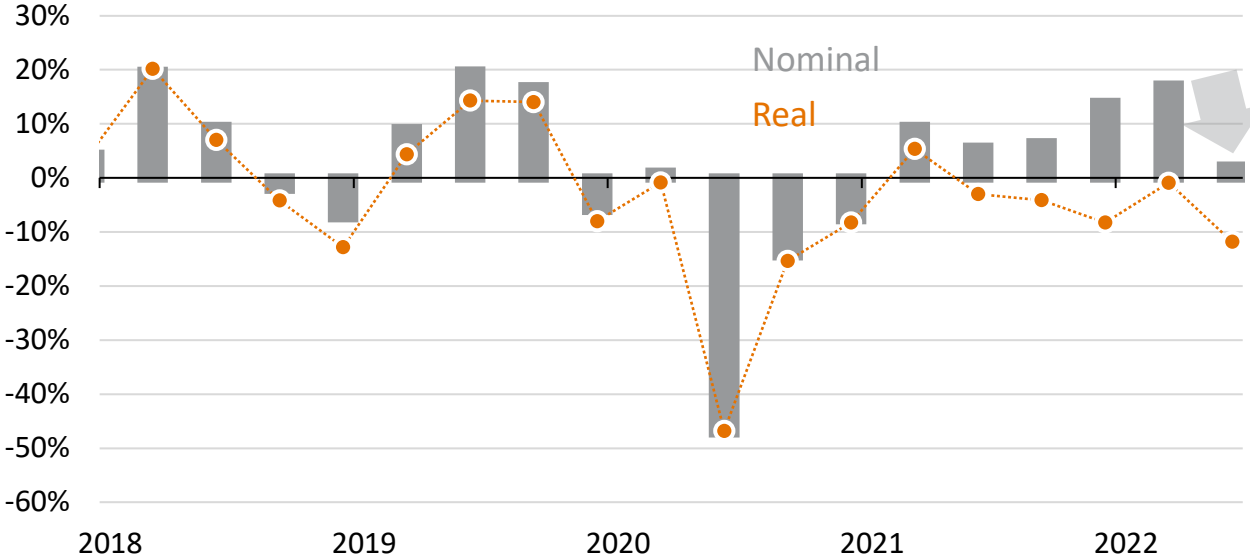
Investment – Residential (QoQ, SAAR)



Investment – Business Equipment (QoQ, SAAR)

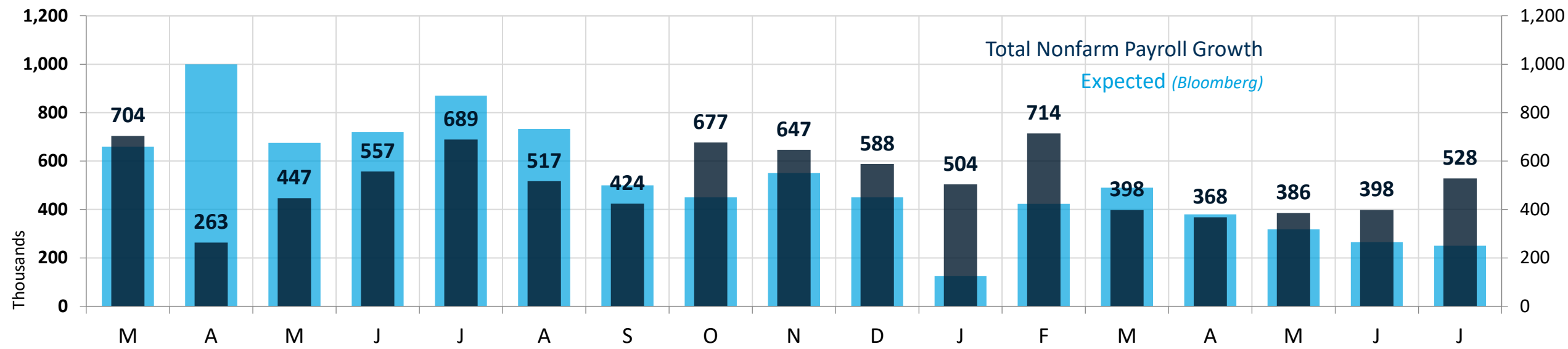


Investment – Business Structures (QoQ, SAAR)

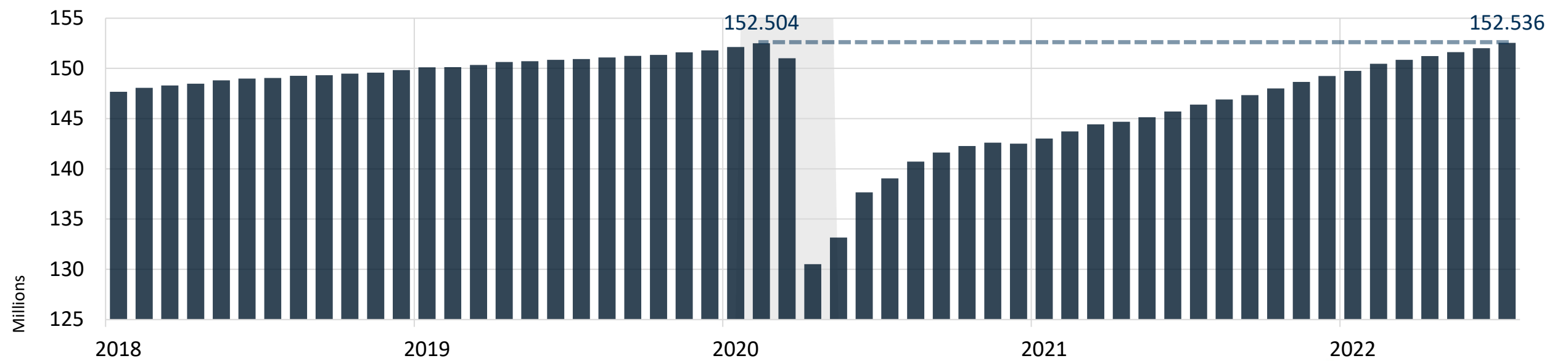


Labor Market Hotter Than Expected Again in July

Monthly Nonfarm Payroll Growth vs Expected | Job Growth Outpaces Declining Expectations

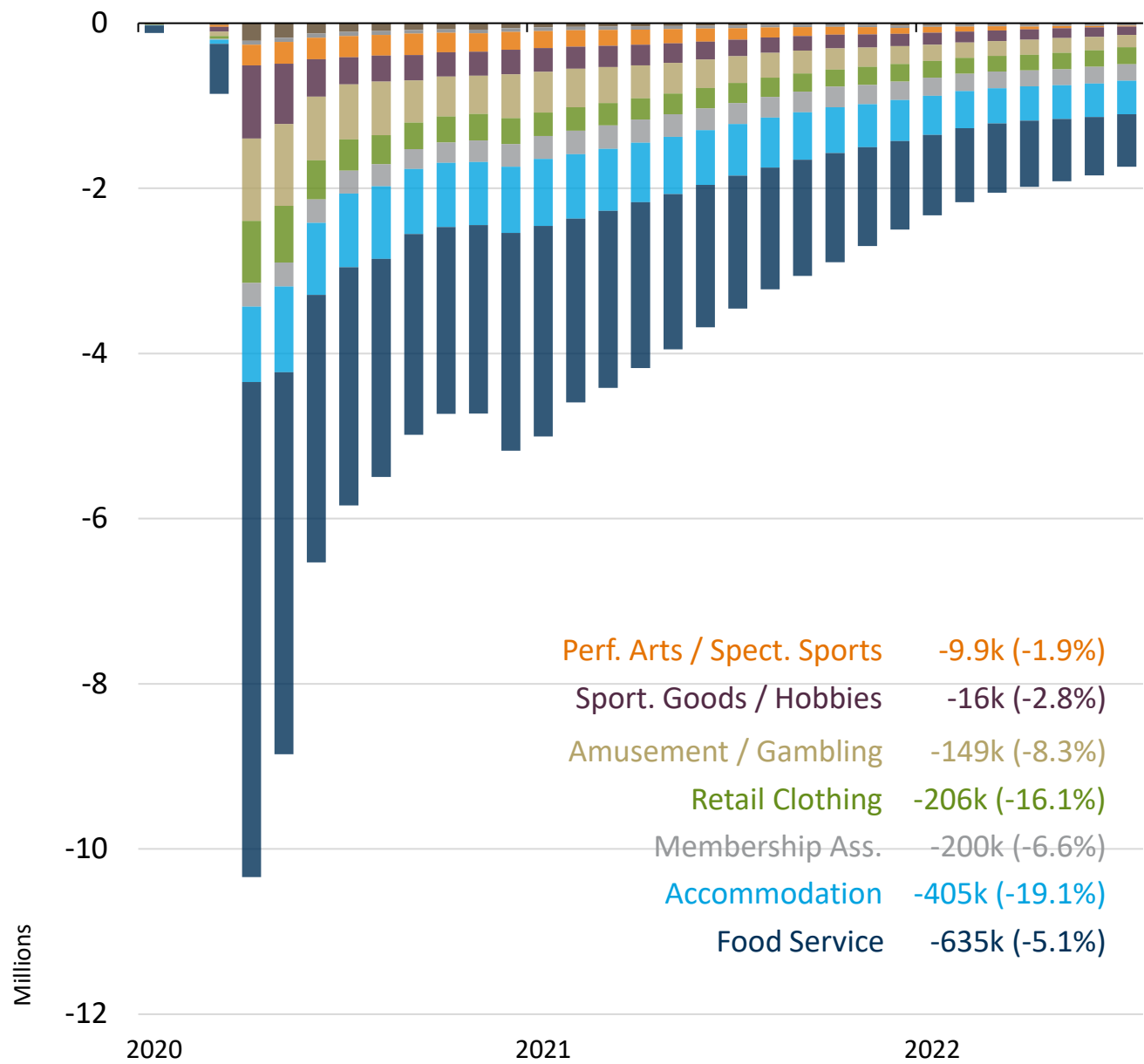


Total Nonfarm Payrolls | Full Recovery of Lost Jobs 27 Months Later

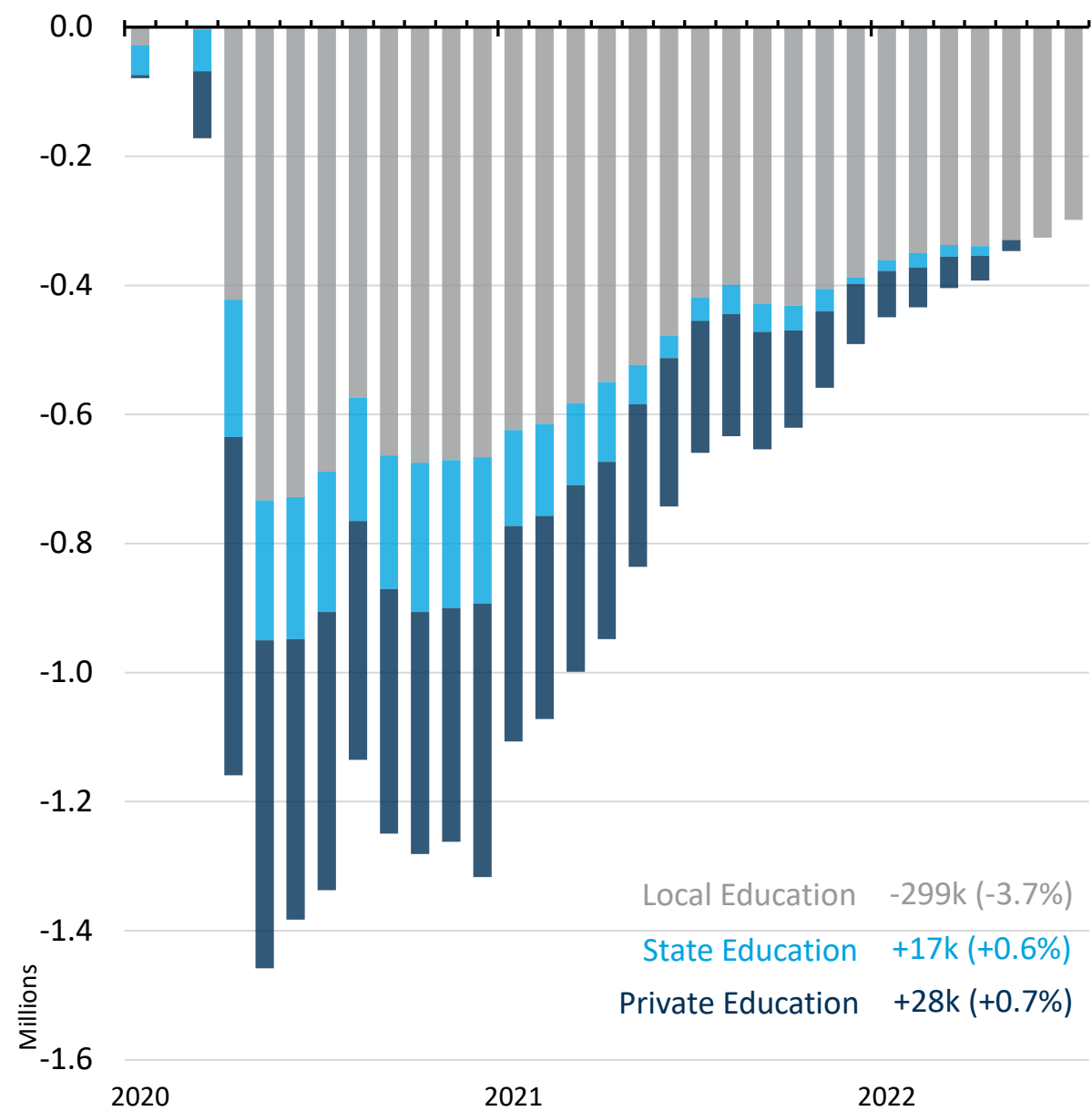


Residual Damage to Labor Market Remains in Service Sector and Education

Service Sector Payrolls (Change from February 2020)

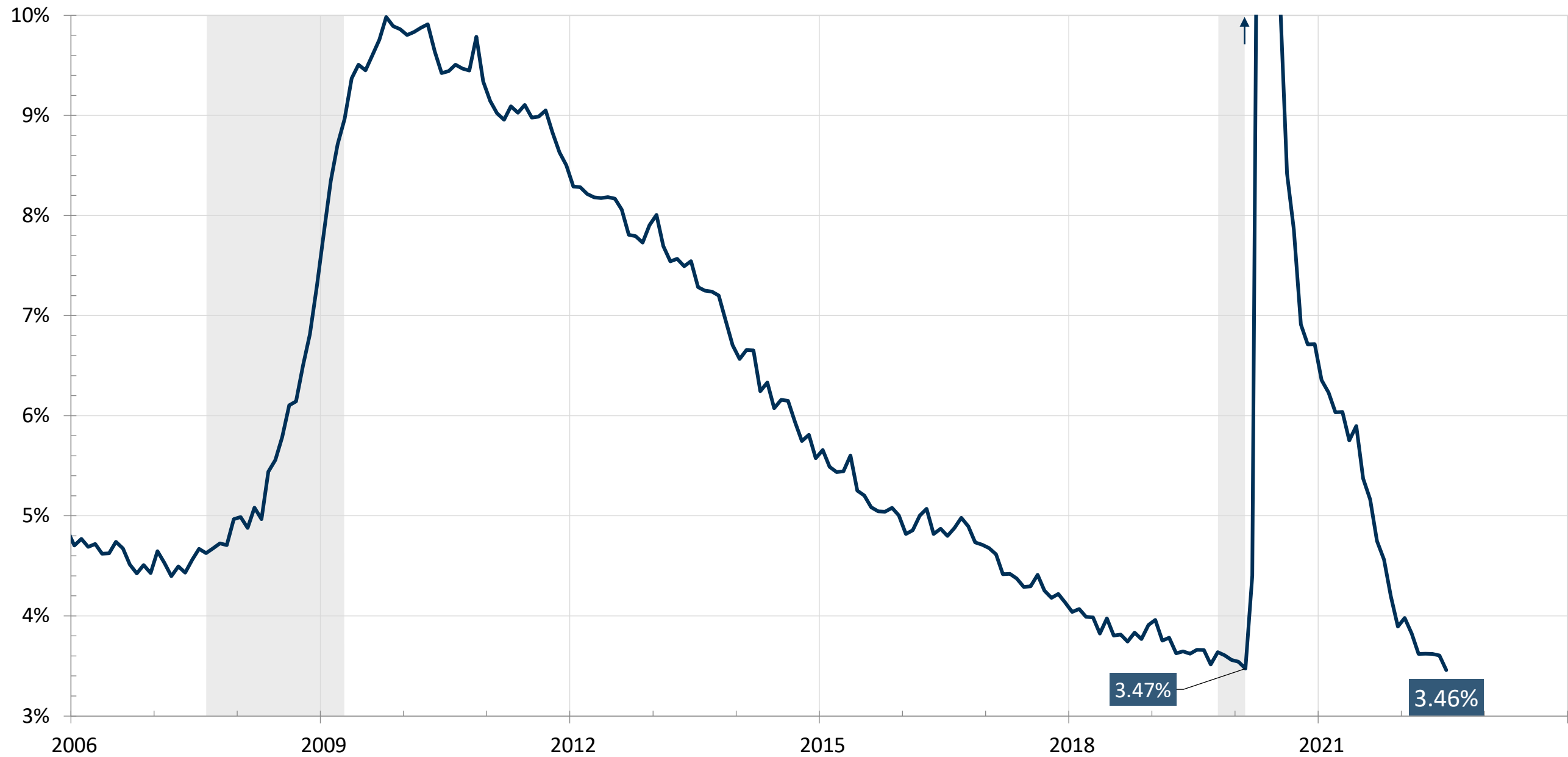


Education Payrolls (Change from February 2020)

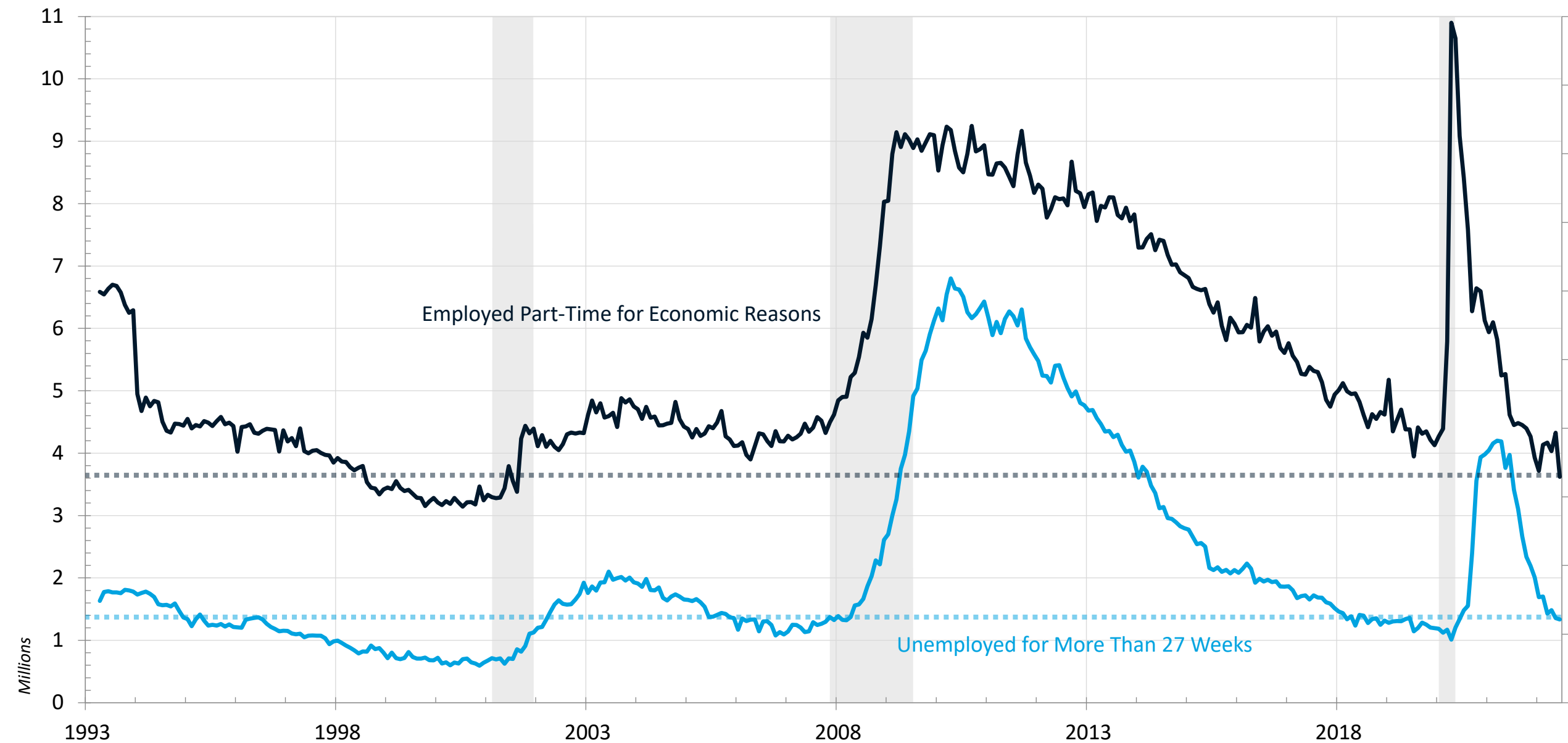


Unemployment Rate Now Below Pre-Pandemic Level

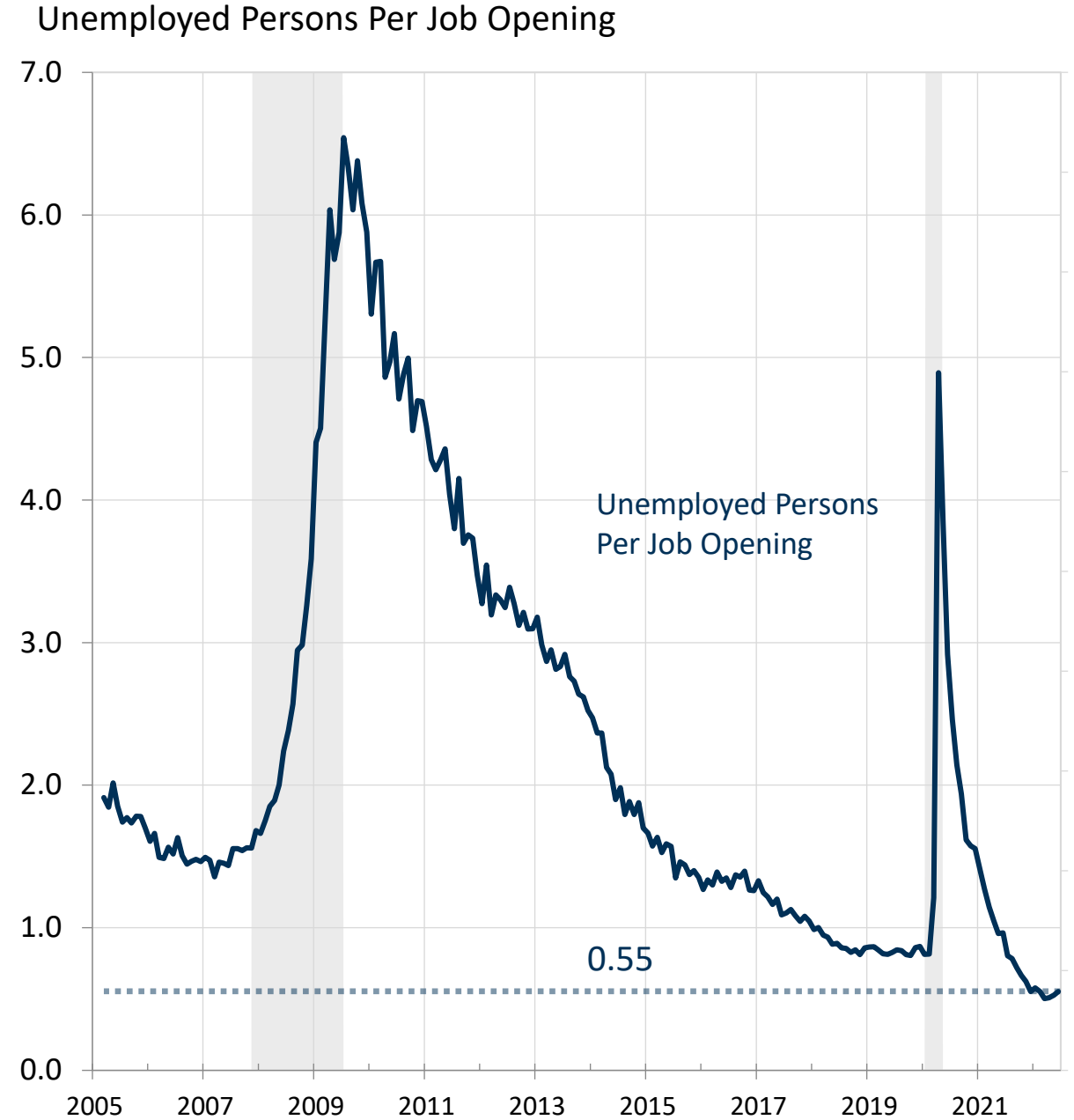
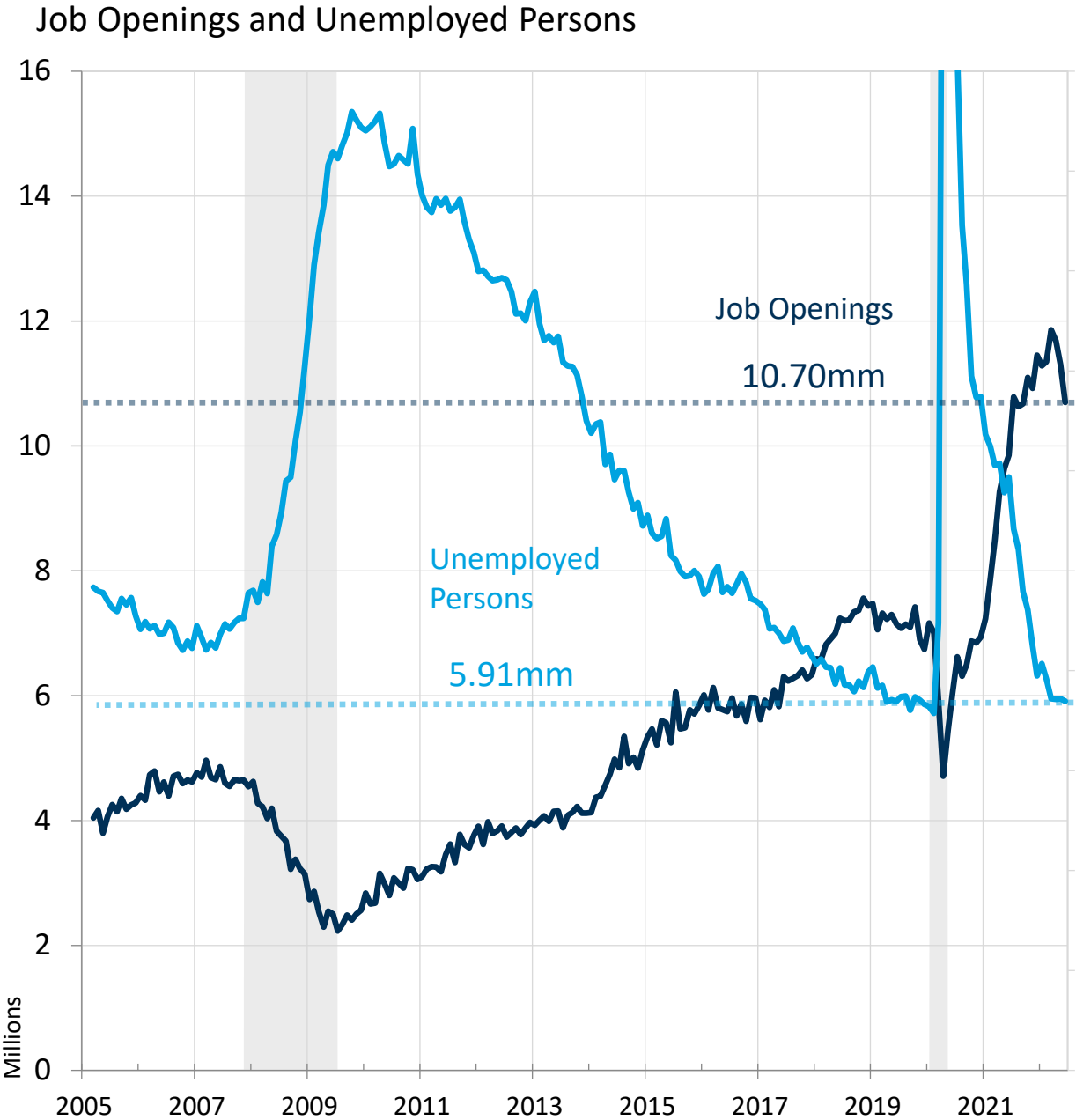
Unemployment Rate | Lowest Since 1969



Measures of Underemployment and Long-Term Unemployed Back Near Historically Low Levels

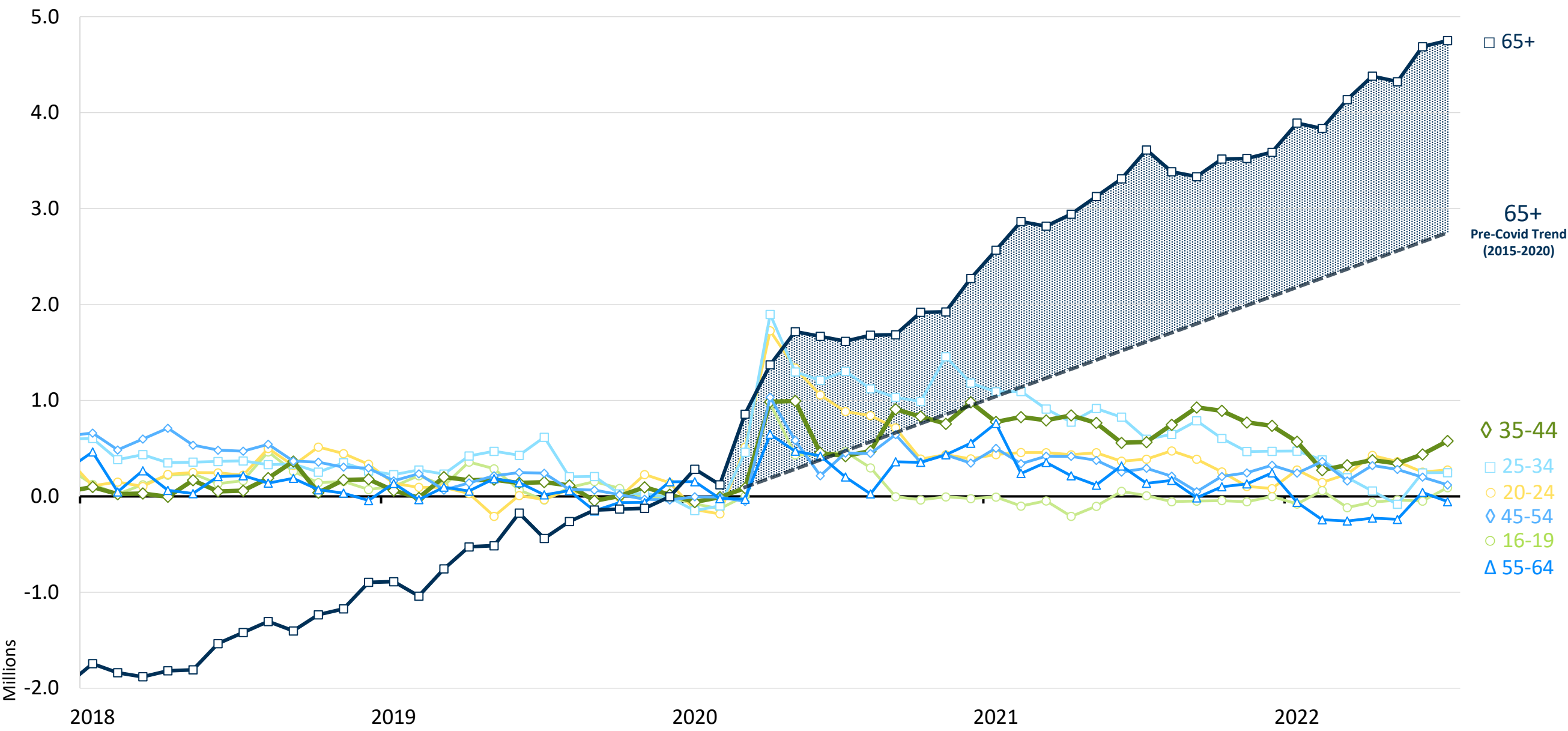


Imbalance Between Labor Demand and Labor Supply Biggest Post-Pandemic Challenge



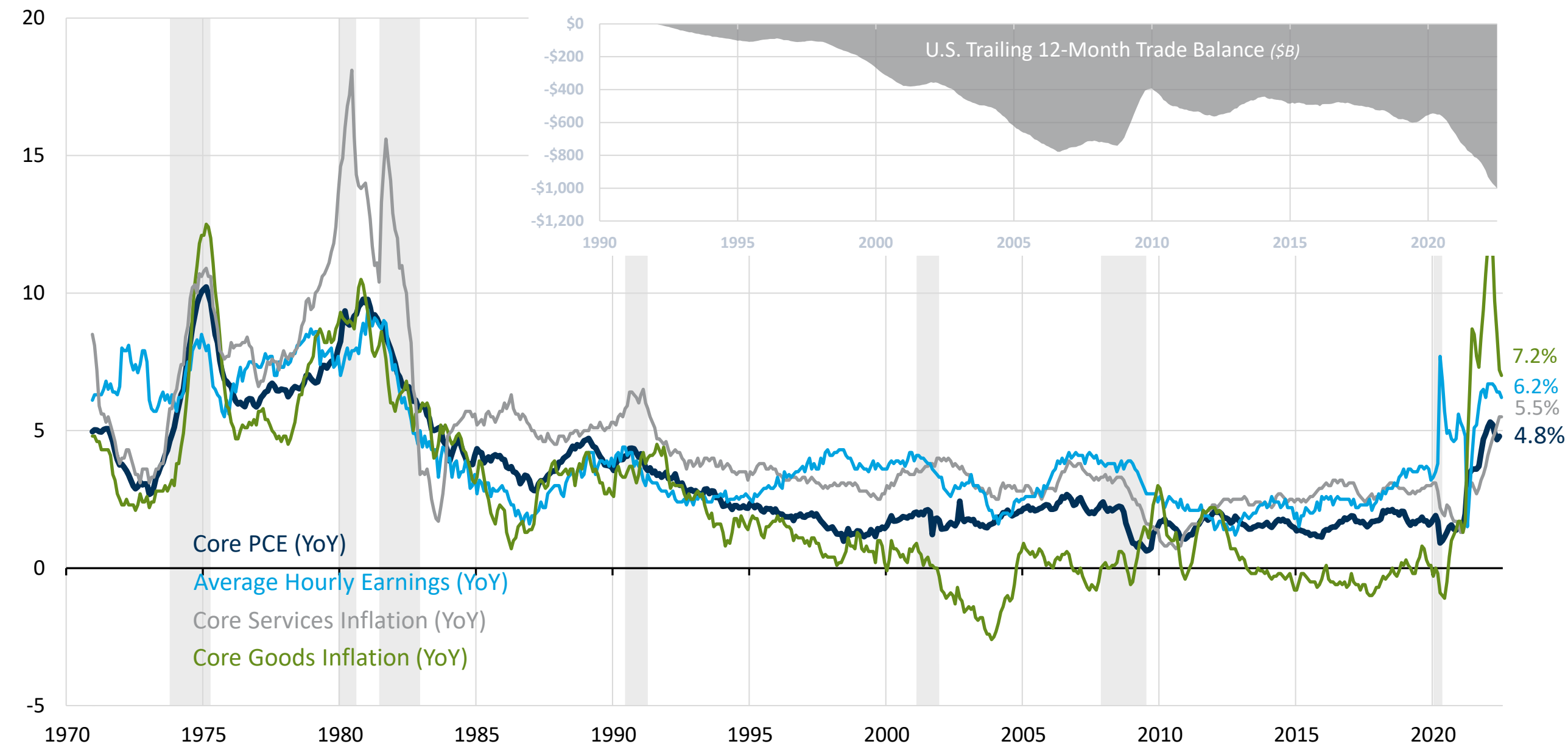
Wave of Retirements Results in Loss of 2 Million Workers

Change in Number of Persons Not in Labor Force from February 2020

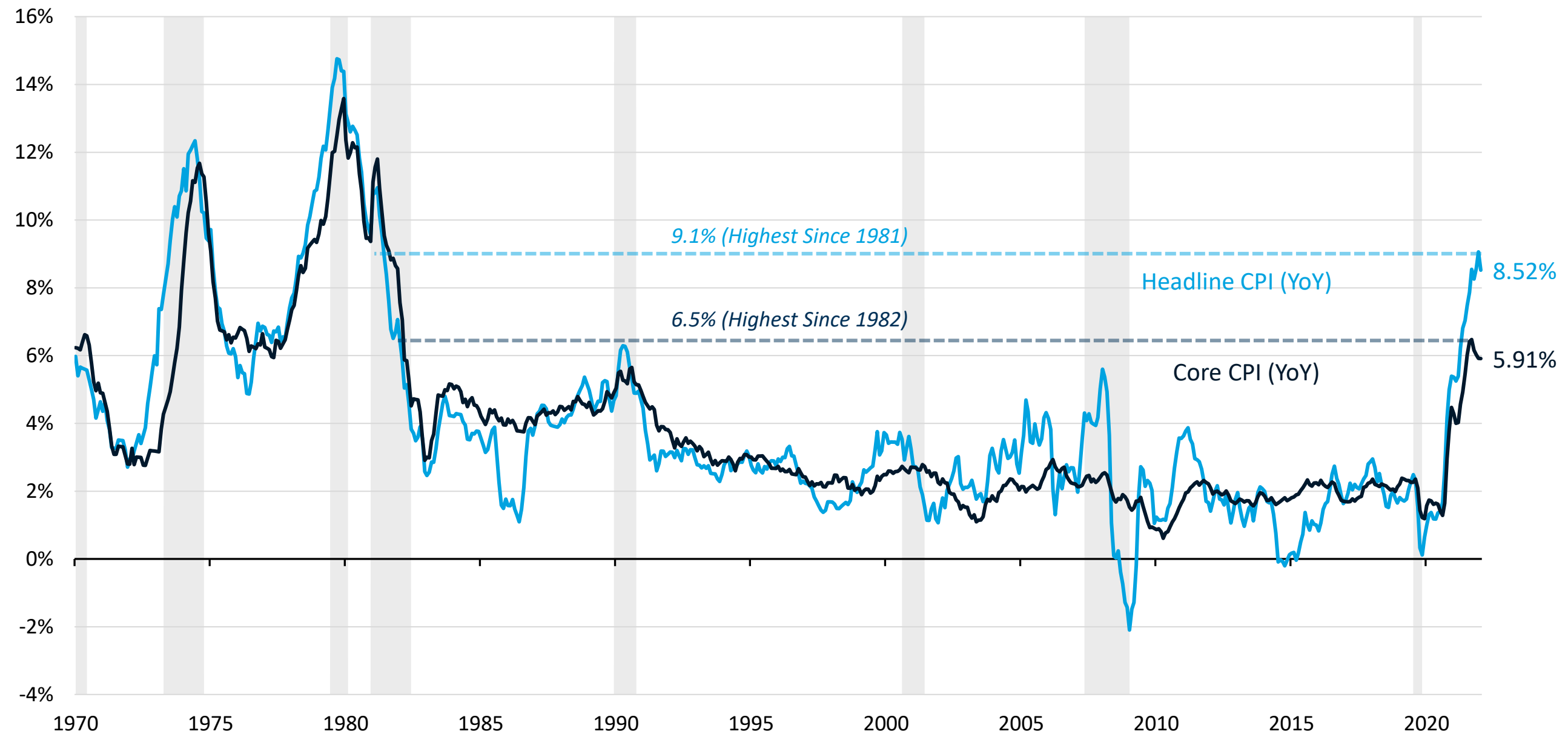


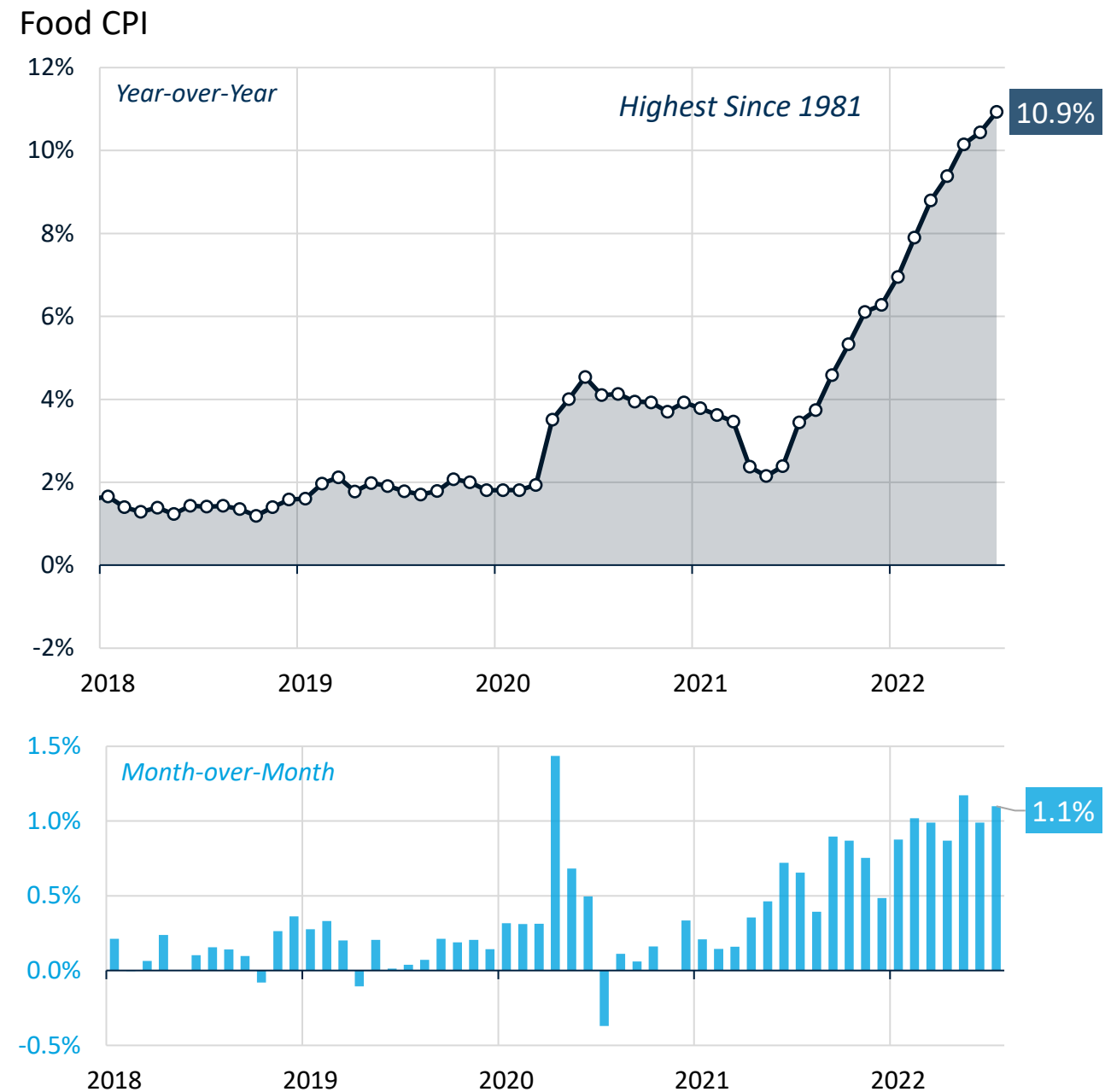
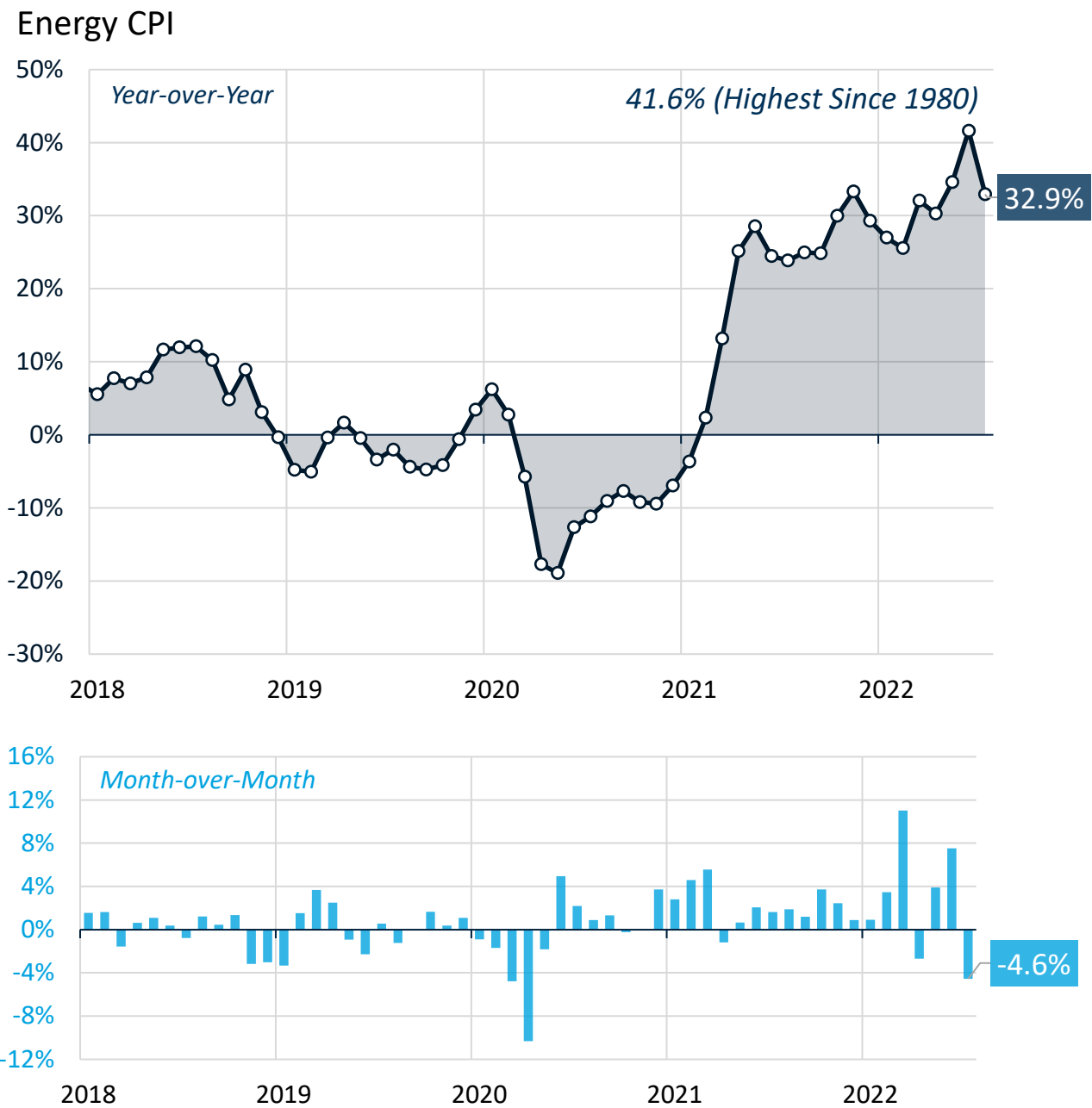
Economic Imbalances Have Resulted in Inflation from Every Corner

Fed's Preferred Core PCE and Drivers of Inflation



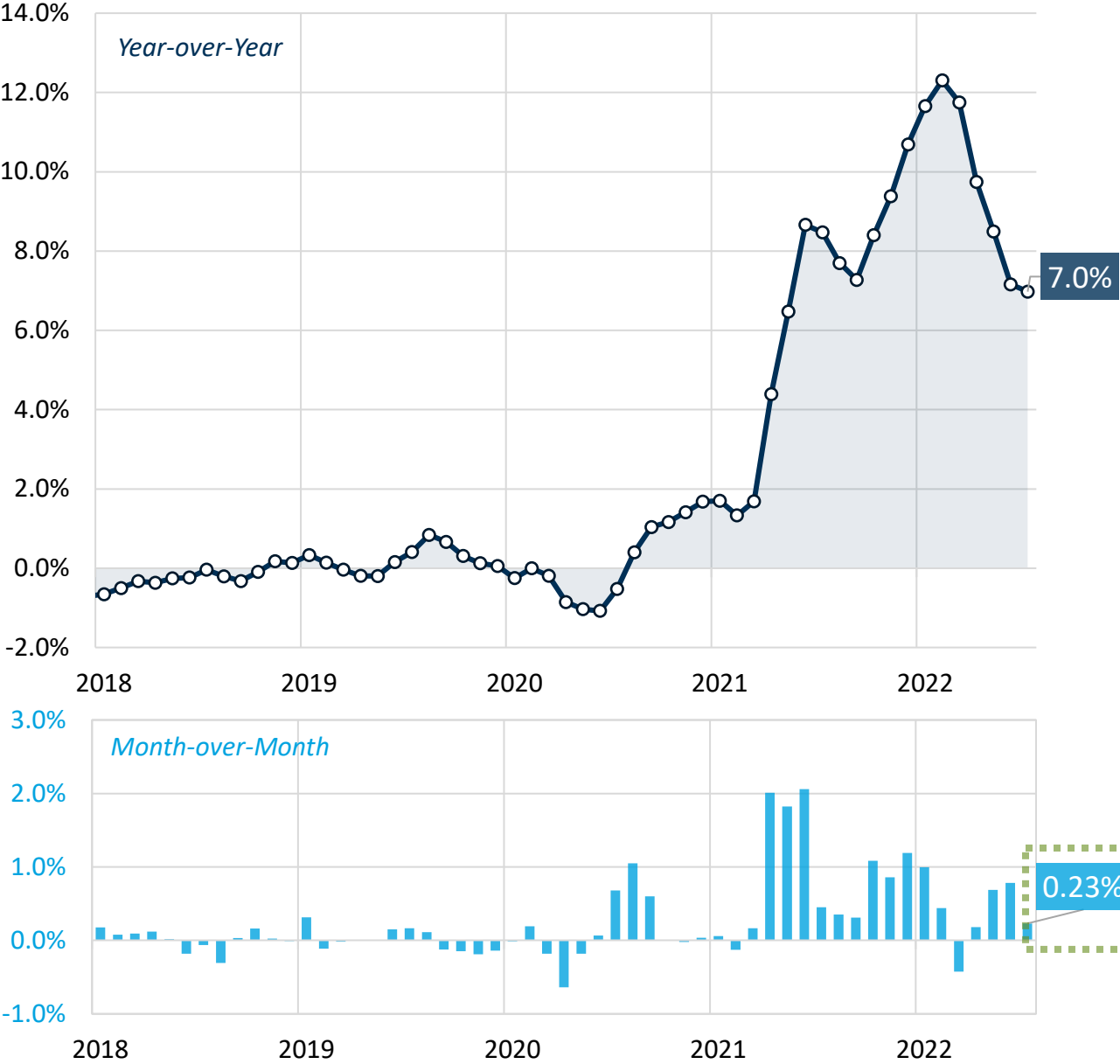
Headline and Core CPI (Year-over-Year)



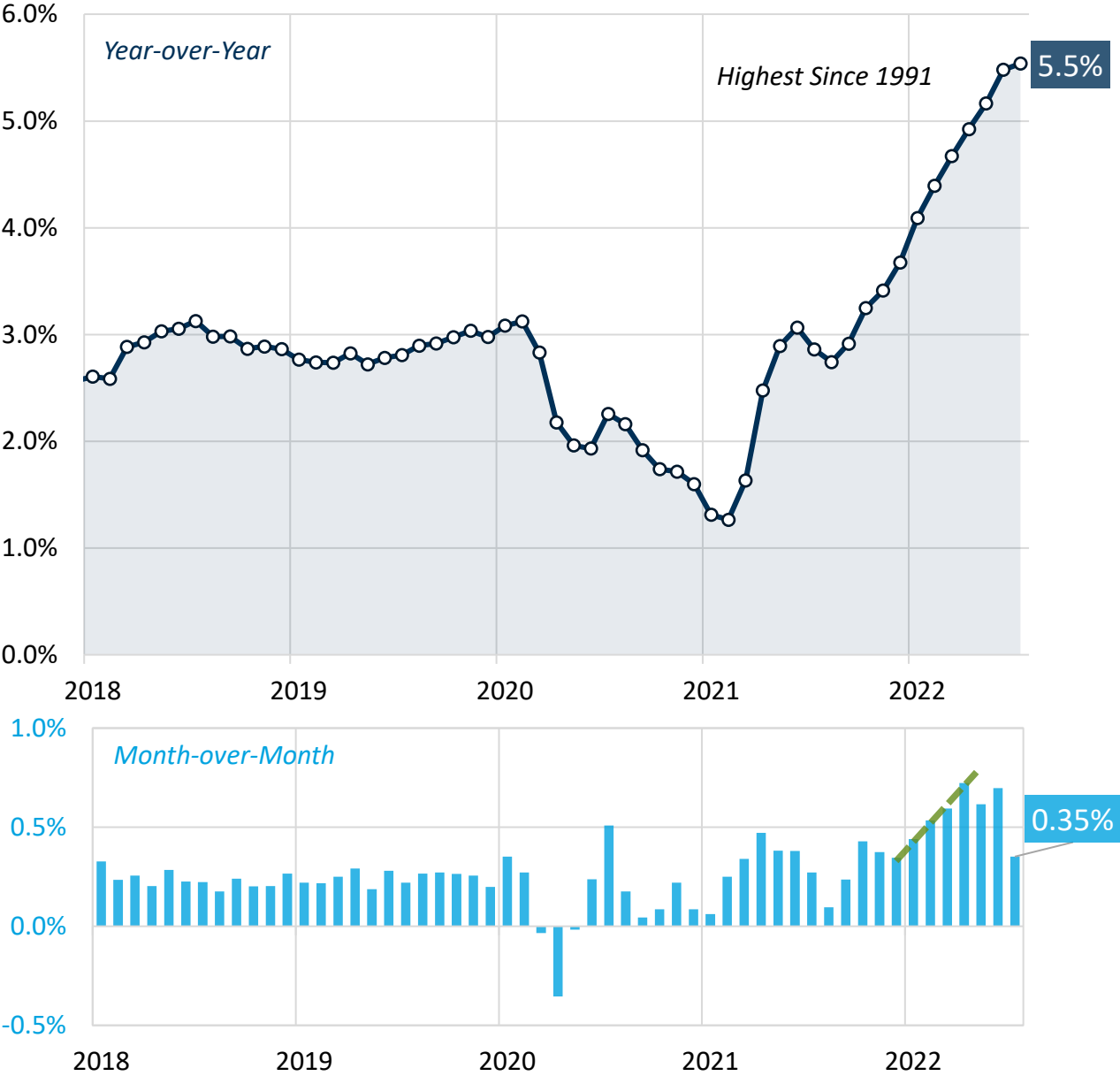


Core Inflation Rises at Slowest Pace in 10 Months

Core Goods CPI

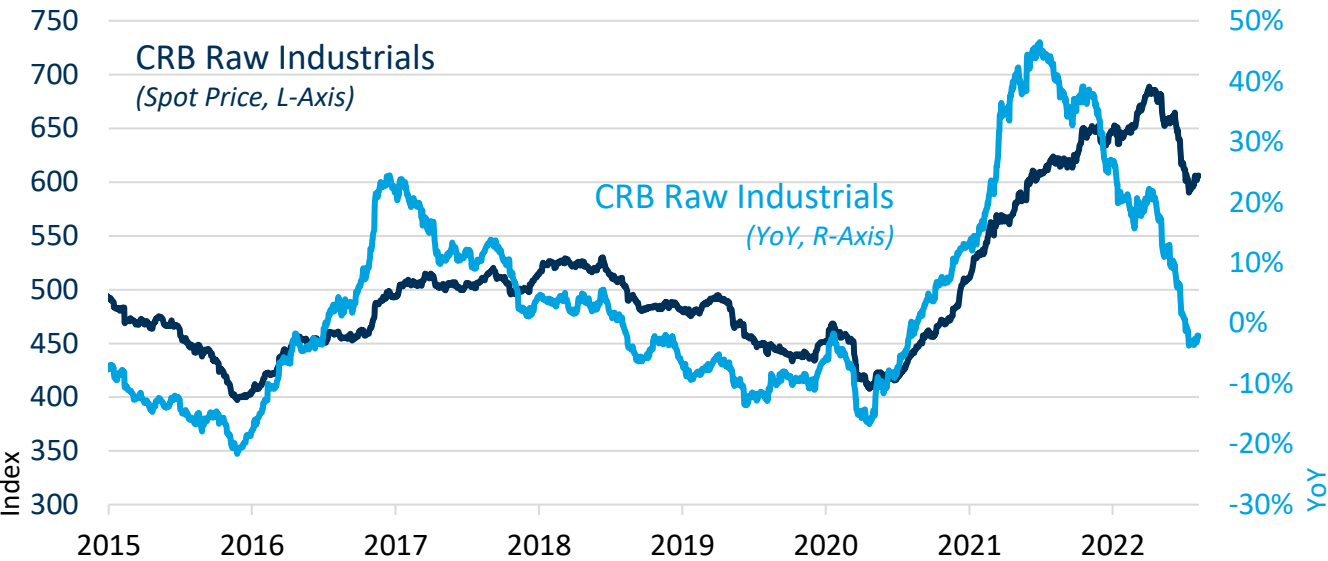


Core Services CPI

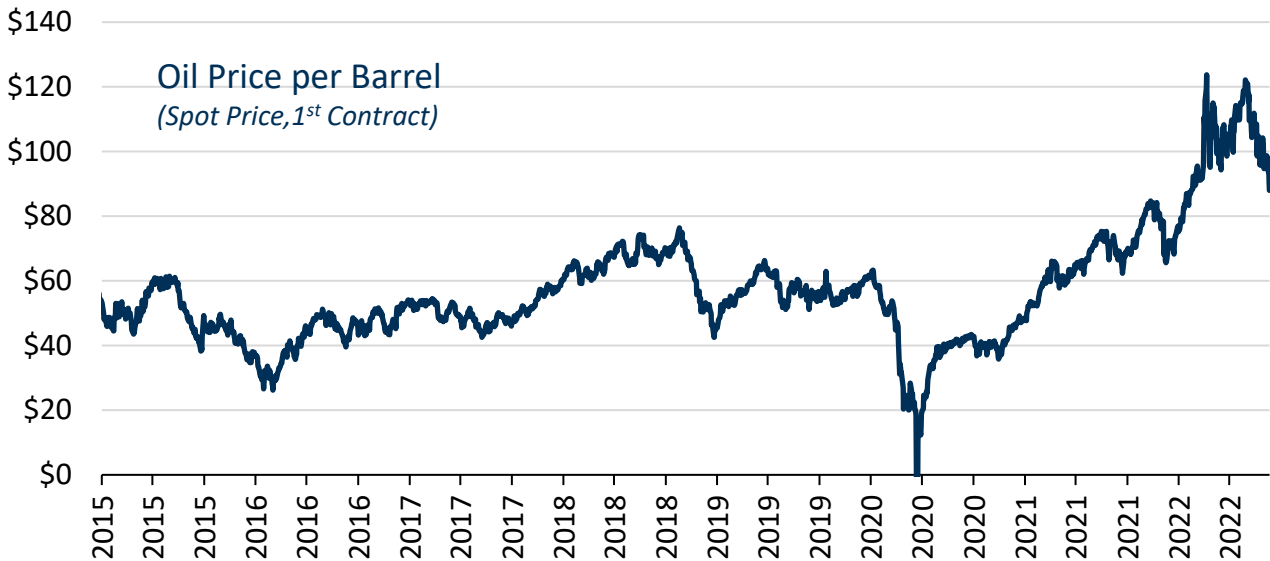


Reasons for Optimism - Commodity Prices Portend Easing of Some Cost Pressures

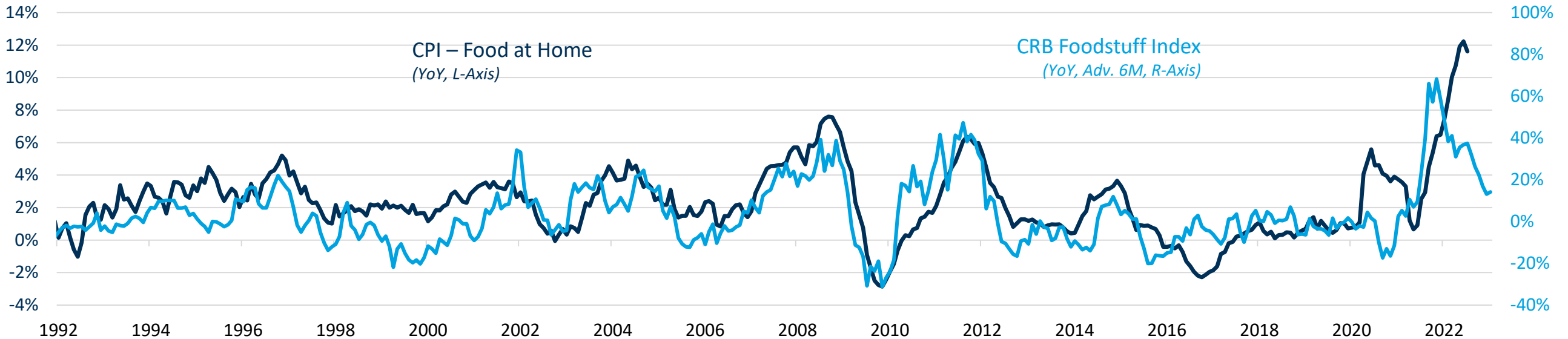
Raw Industrials Still Elevated but Decline 14%



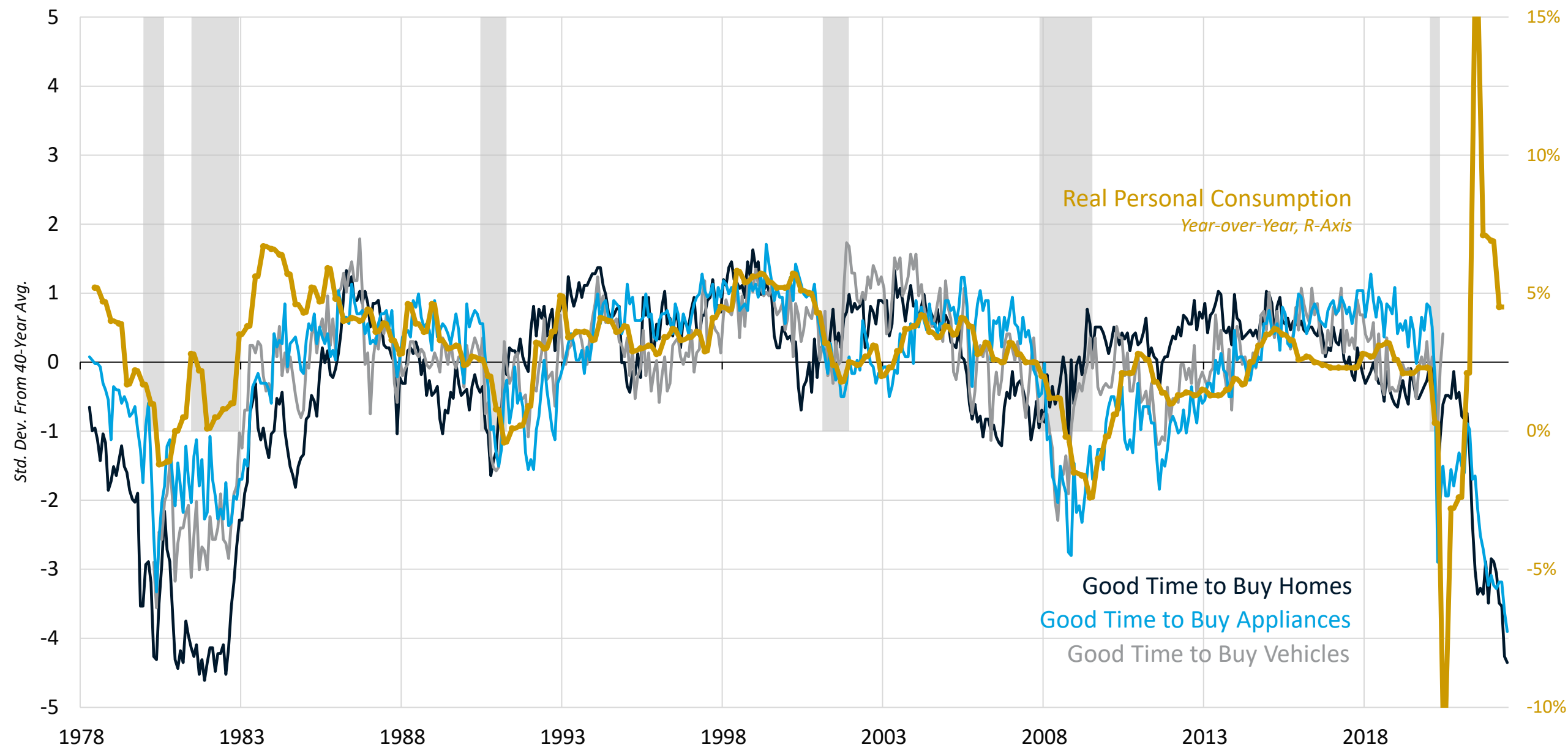
Oil Prices Still Elevated but Decline 29%



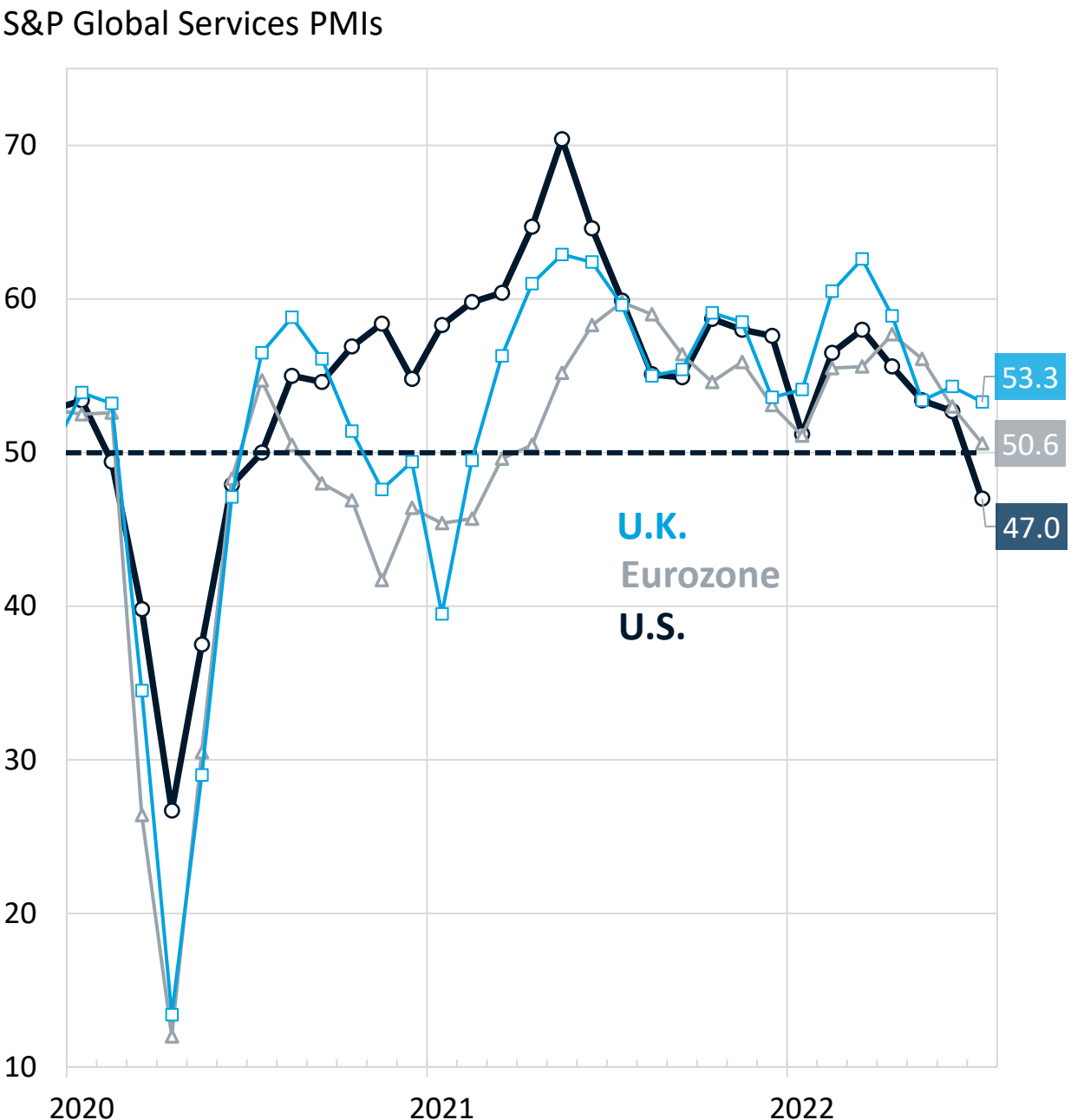
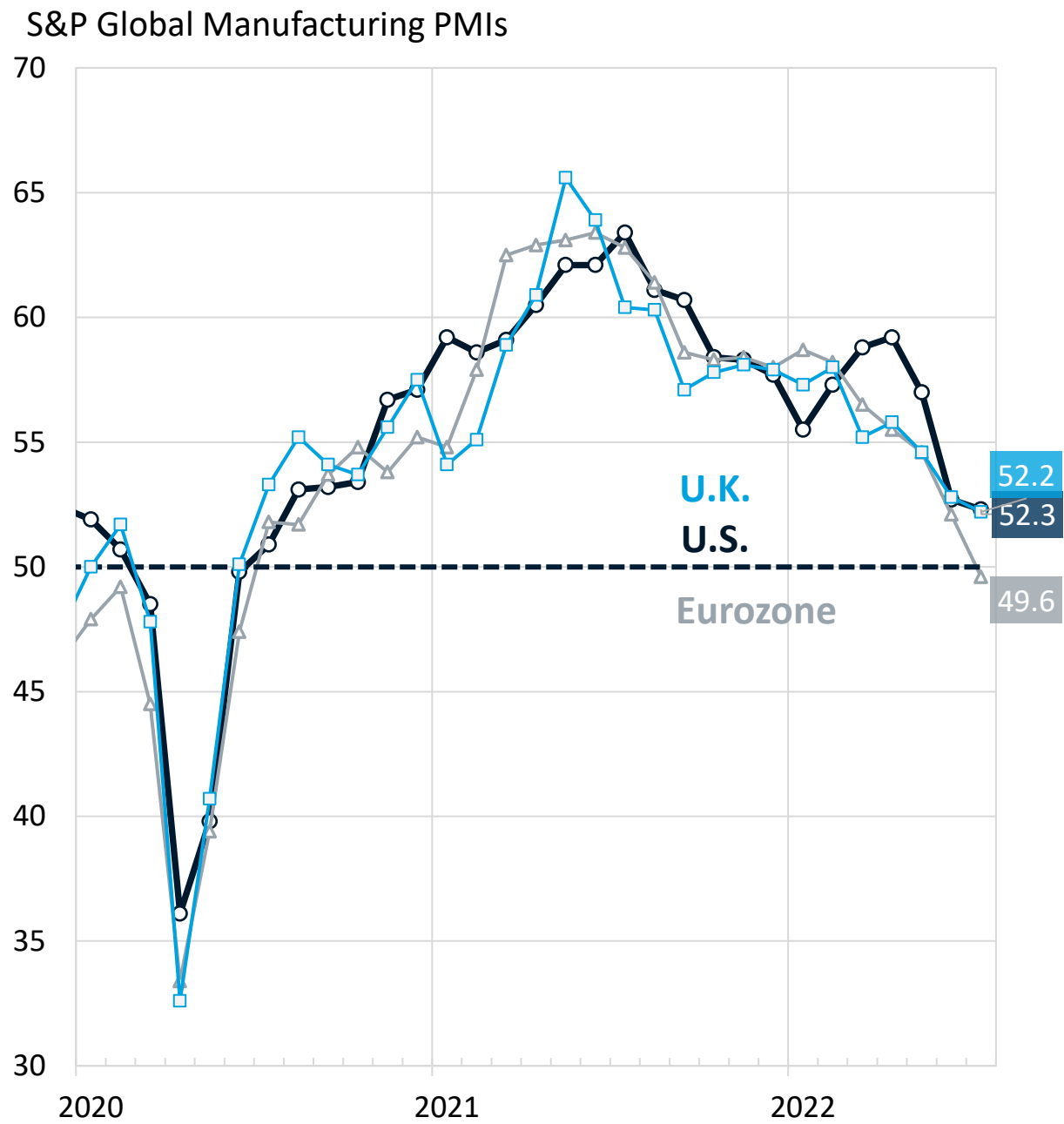
CRB Foodstuff Prices and Food-at-Home CPI



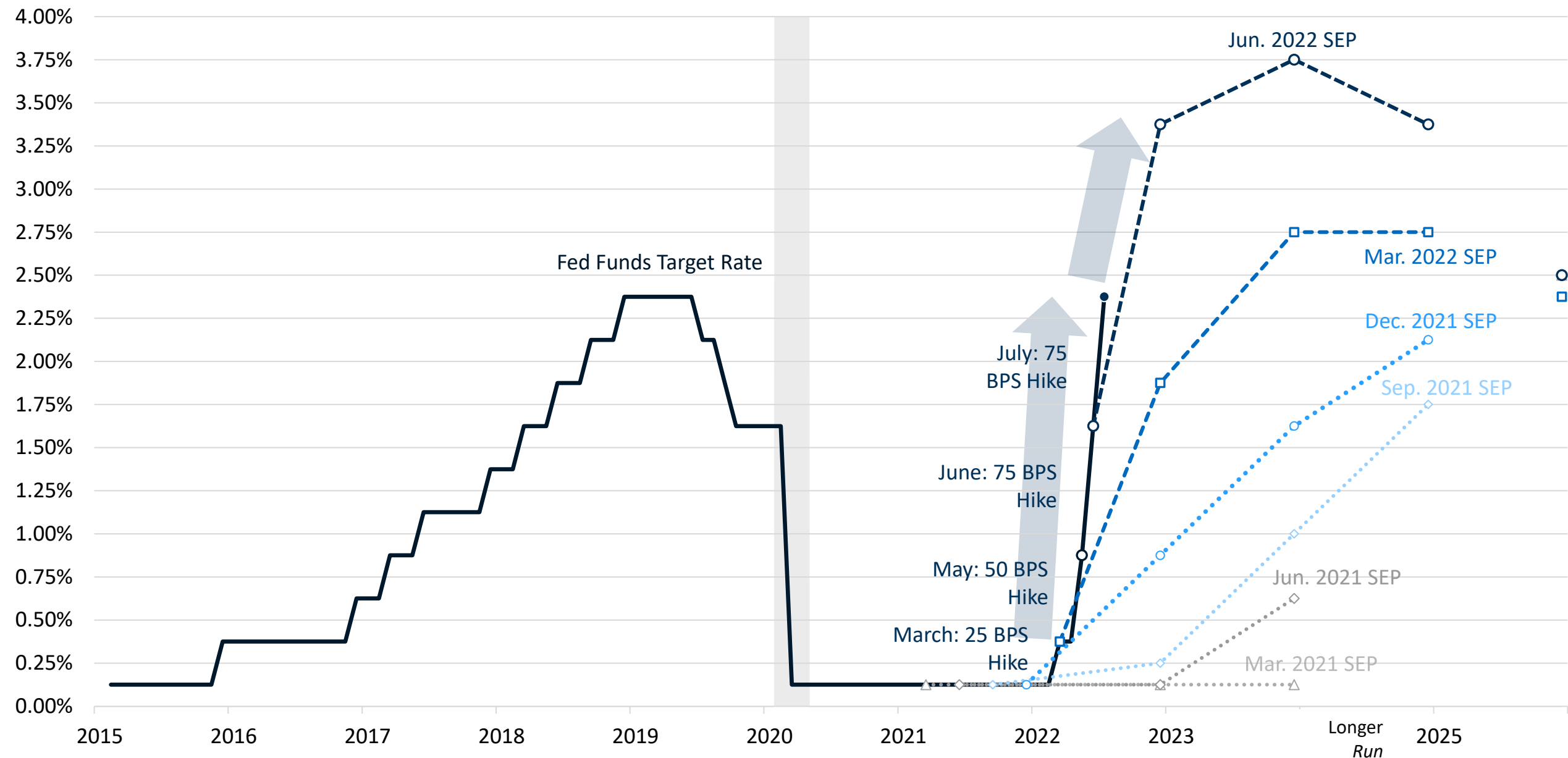
Consumer Confidence Regarding Buying Conditions for Big-Ticket Items



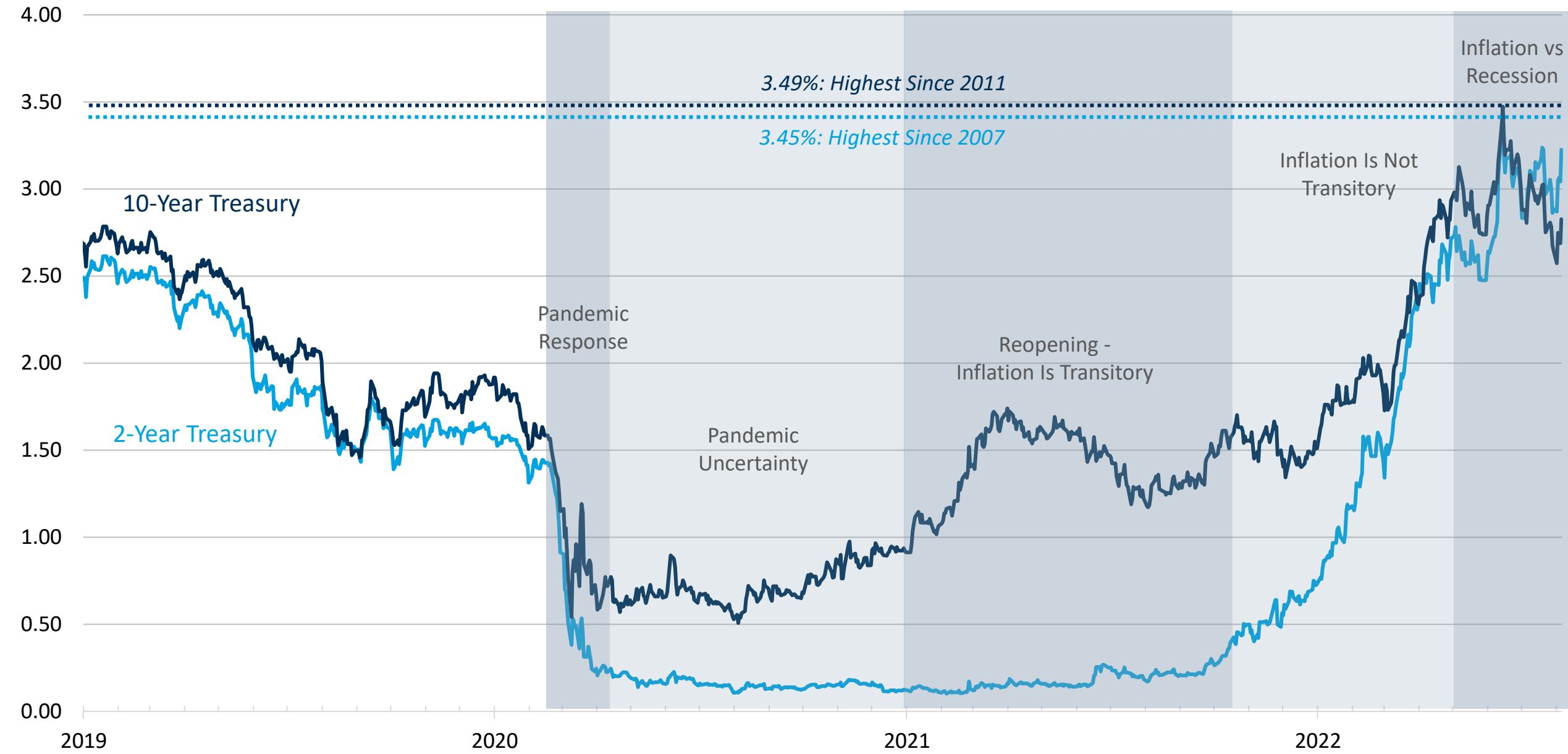
Inflation's Impact: Inflation Weighing on Economic Activity According to PMIs



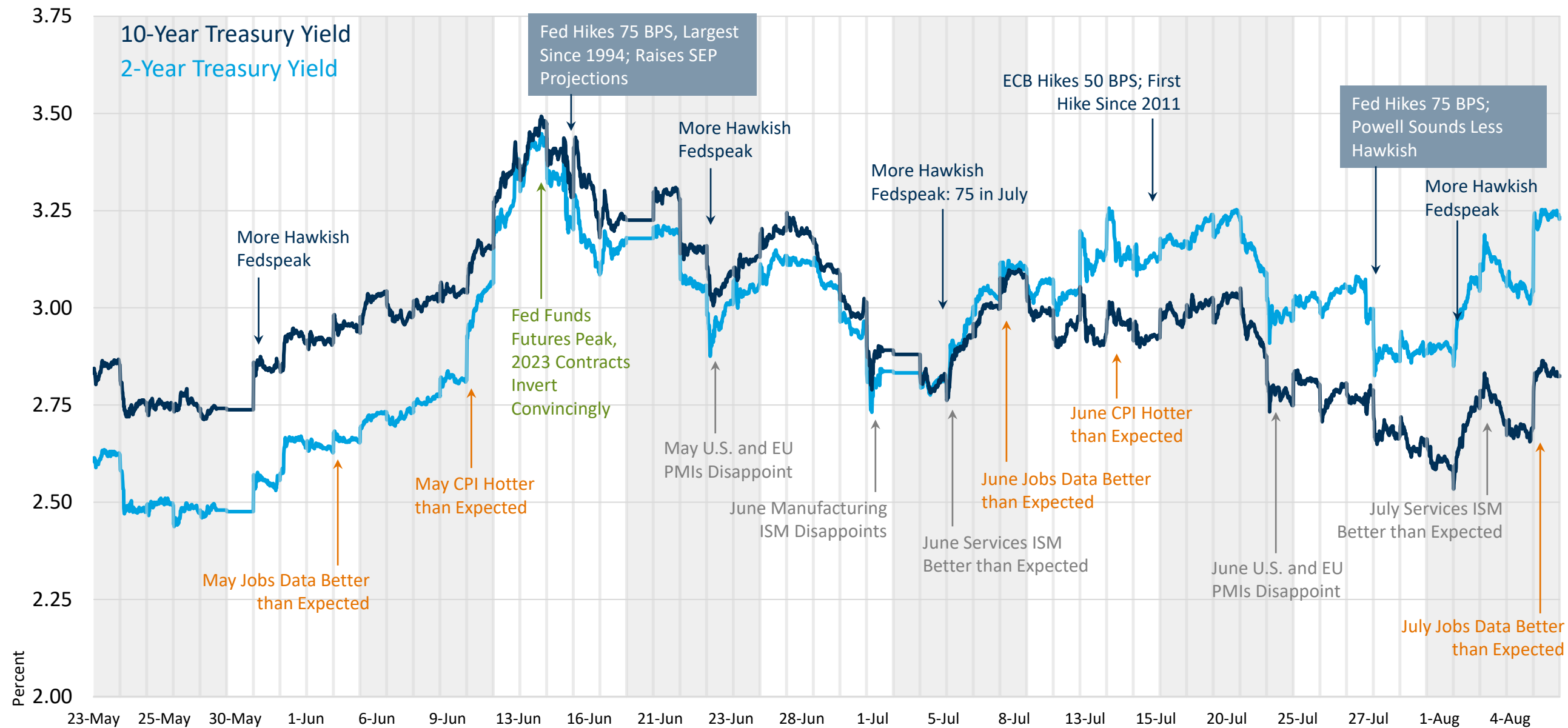
Fed Funds Rate and FOMC Median Projections (by Meeting)



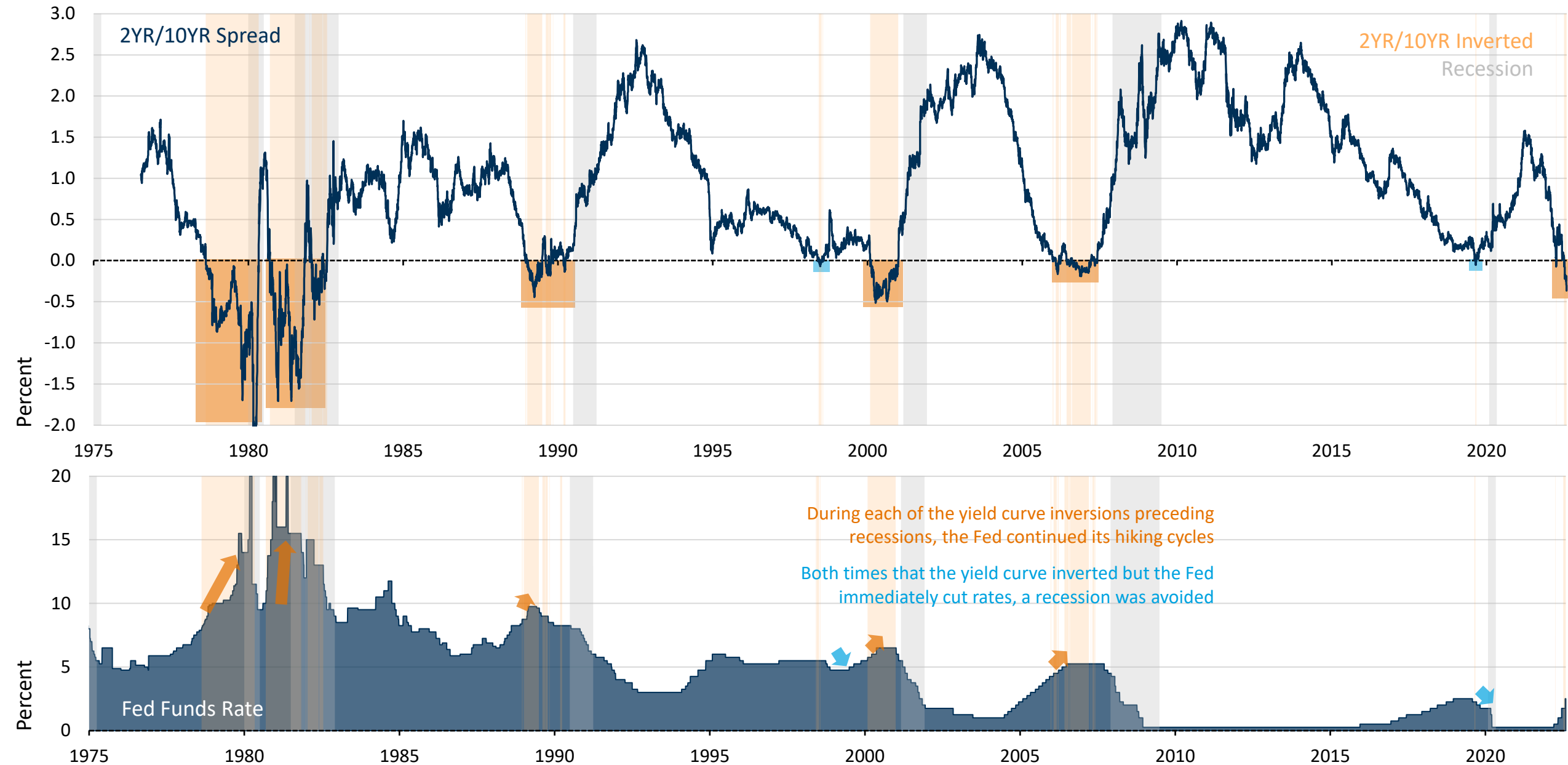
Rate Cycle Moves into New Territory: Weighing the Risk of Recession Against the Durability of Inflation



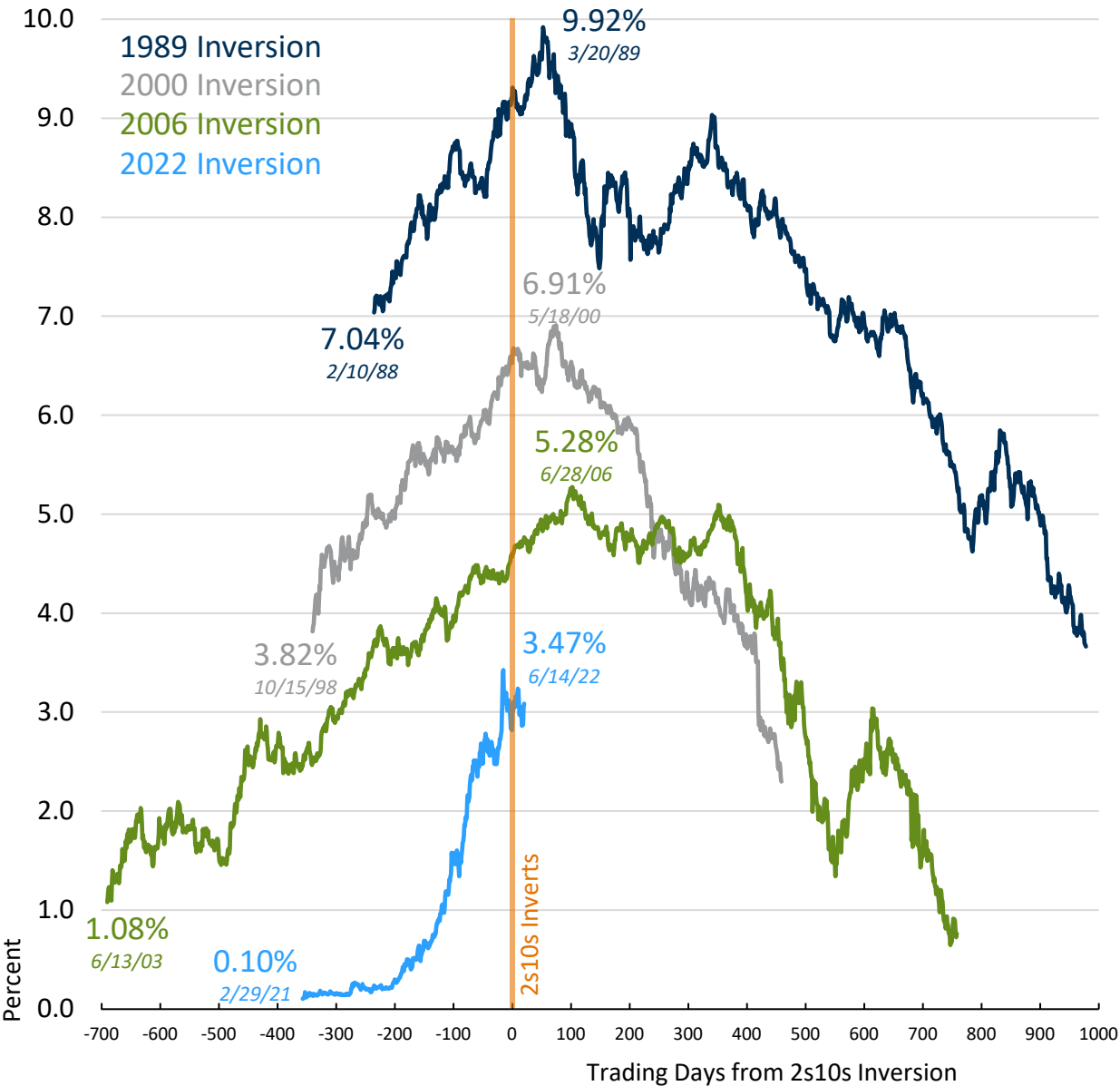
Curve Inverts on Rising Inflation, Strong Labor Reports, Hawkish Fed Response, and Recession Fears



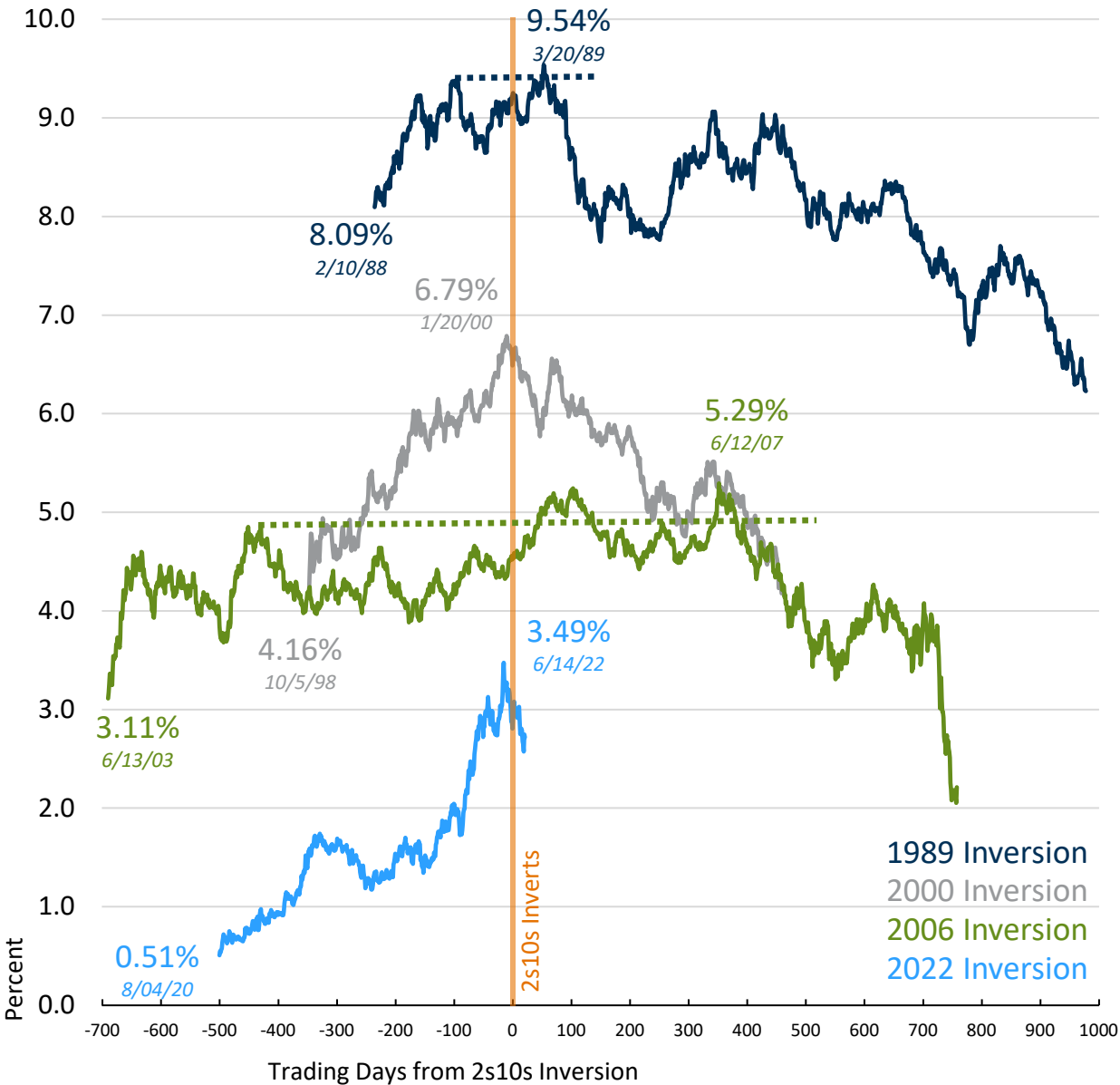
2YR/10YR Spread Has Historically Been One of the Most Accurate Indicators of Economic Downturns

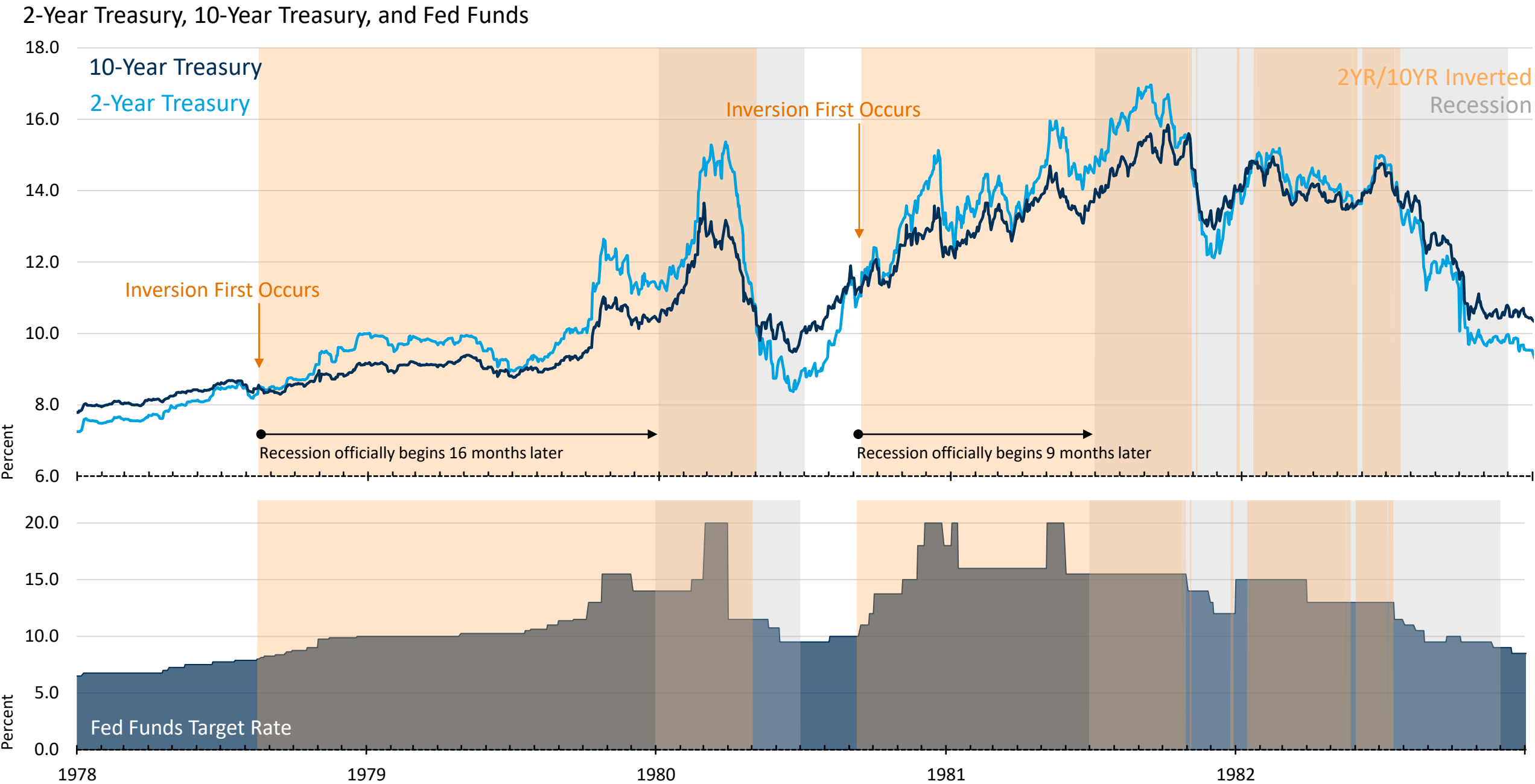


2-Year Treasury Yield by Rate Cycle (Percent)

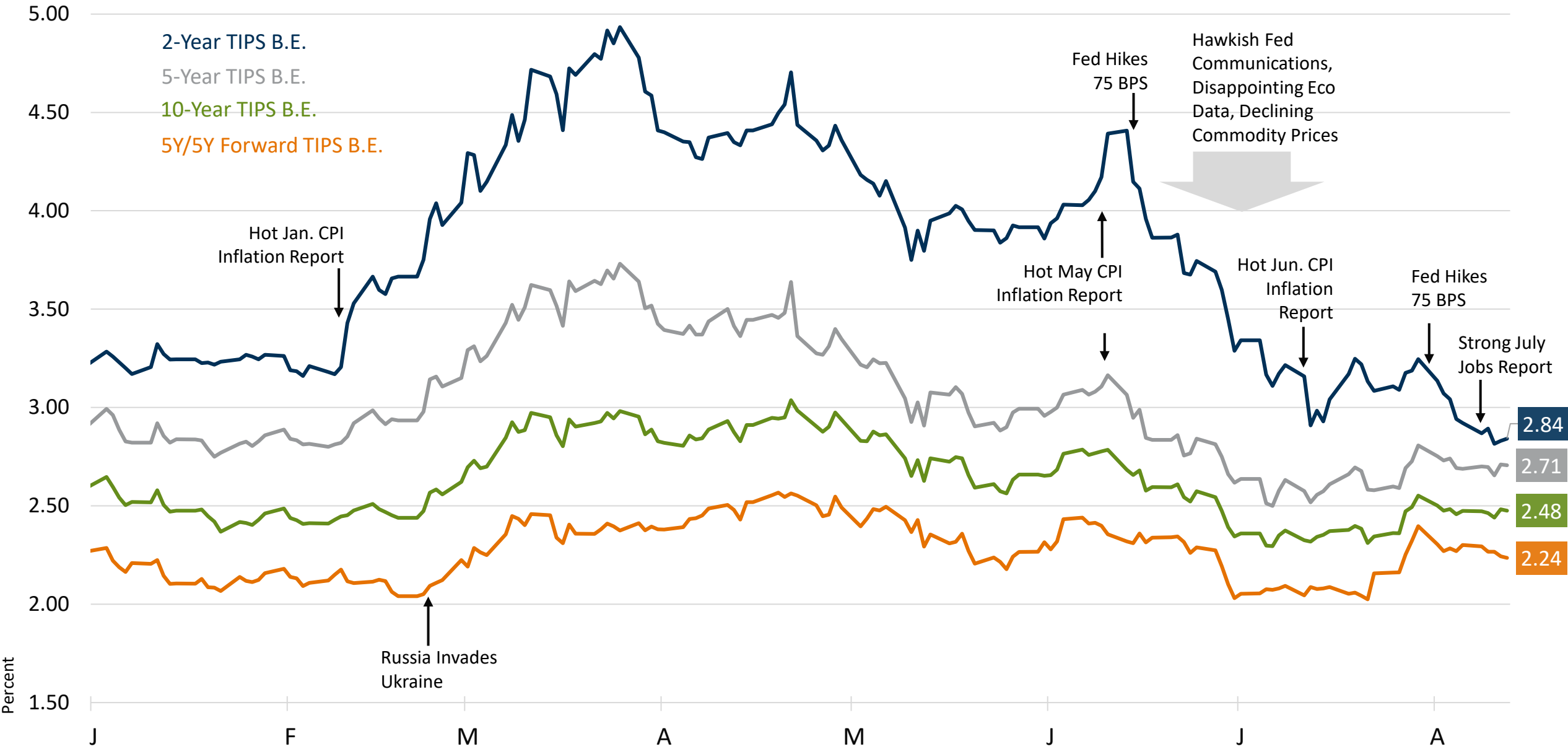


10-Year Treasury by Rate Cycle (Percent)



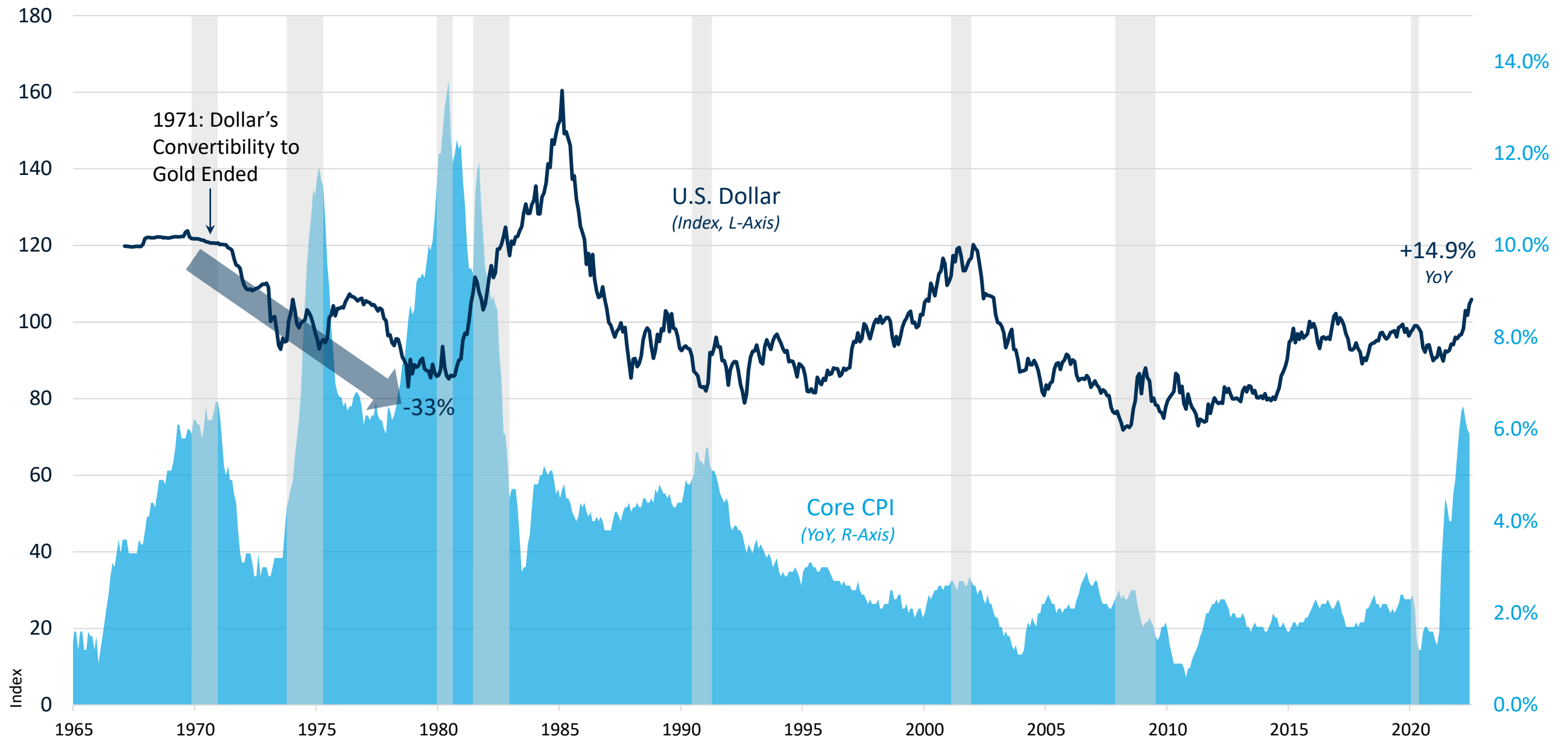


TIPS Implied Inflation Breakeven Rates | Expectations Decline Across Horizon



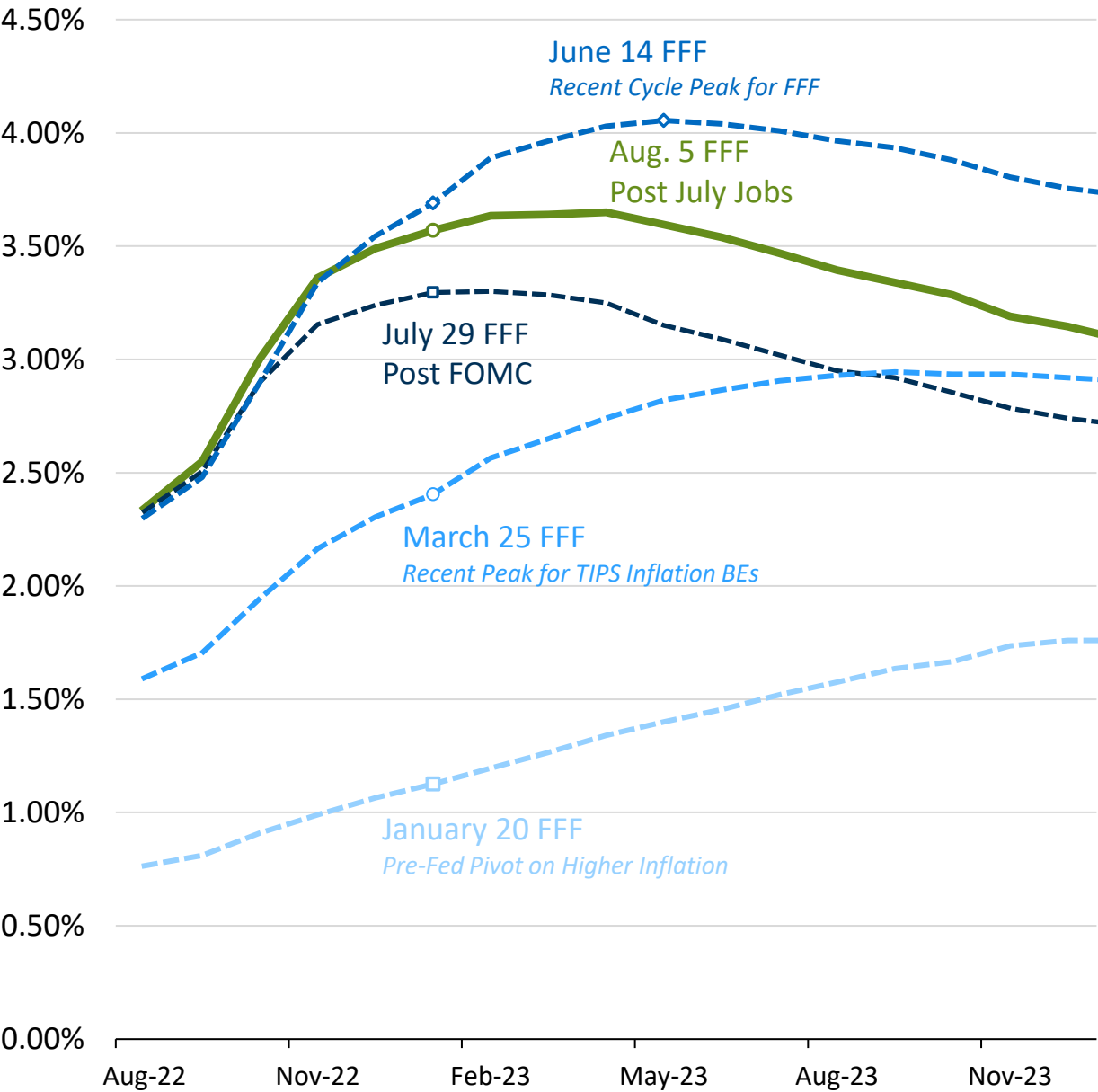
Dollar Environment Materially Different Than Early-Seventies

Dollar up 15 Percent Year-over-Year As Fed Leads Other Central Banks in the Pace of Tightening

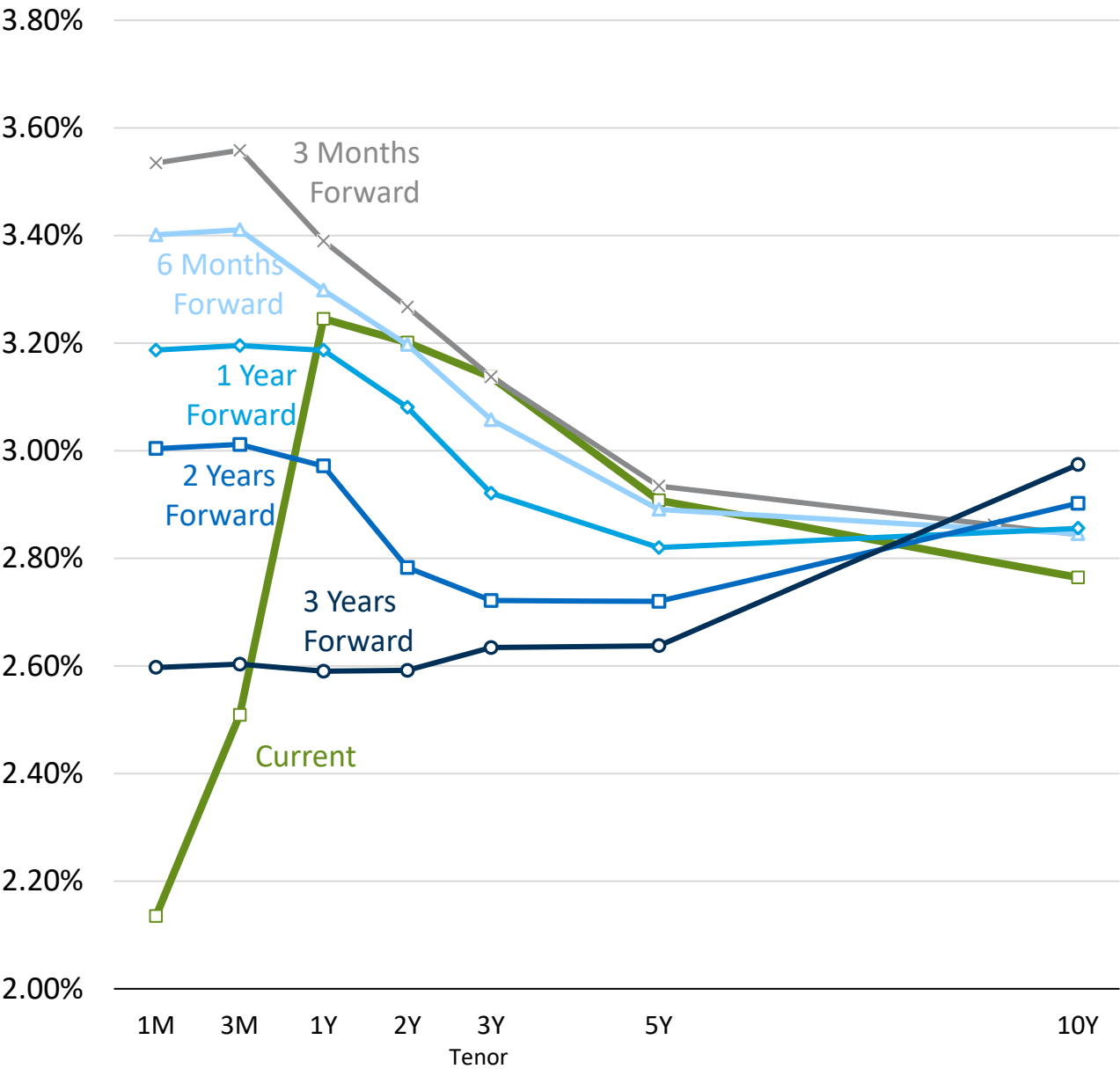


Forward Rates Imply Goldilocks Scenario

Fed Funds Futures | 1H23 Peak Then Decline



Forward Curve | Short-End Higher Before Dropping



	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	Q1 2024	Q2 2024	Annual Rate		
											2022	2023	2024
Growth indicators													
GDP, QoQ %	-1.6%	-0.9%	-1.1%	-2.1%	-0.8%	0.3%	1.1%	0.9%	1.4%	1.8%	-1.4%	0.4%	1.6%
Consumer Spending, %	1.8%	1.0%	-0.6%	-2.3%	-0.8%	0.1%	1.5%	1.2%	1.5%	1.6%	0.0%	0.5%	1.6%
Fixed Investment, %	7.4%	-3.9%	-0.7%	-0.5%	-2.5%	-1.3%	-0.8%	0.0%	0.5%	0.8%	0.6%	-1.1%	0.7%
Housing Starts, k, end of quarter, yr end	1,716	1,559	1,500	1,480	1,425	1,400	1,475	1,525	1,585	1,630	1,480	1,525	1,630
Unemployment Rate, %, qrt avg, yr end	3.8%	3.6%	3.9%	4.4%	4.8%	5.2%	5.8%	5.6%	5.5%	5.3%	4.4%	5.6%	5.3%
Nonfarm Payrolls, k, qrt avg, ann avg	398	372	250	150	-75	-50	100	150	200	225	293	31	213
Inflation indicators, YoY%, yr end													
PCE	6.6%	6.8%	6.8%	5.7%	5.4%	4.5%	3.9%	3.5%	3.2%	3.0%	5.7%	3.5%	3.0%
Core PCE	5.2%	4.8%	5.2%	4.5%	4.0%	3.7%	3.5%	3.2%	3.0%	2.9%	4.5%	3.2%	2.9%
PPI	11.6%	11.3%	9.6%	8.8%	7.2%	6.5%	6.0%	4.8%	3.9%	3.2%	8.8%	4.8%	3.2%
Interest rate, %, end of quarter, yr end													
FF	0.50	1.75	3.00	3.75	4.00	4.00	3.50	3.00	2.50	2.50	3.75	3.00	2.50
3month UST bills	0.50	1.67	3.10	3.80	4.05	4.00	3.40	2.90	2.45	2.40	3.80	2.90	2.40
2yr UST notes	2.34	2.96	3.20	4.00	4.25	4.00	3.25	3.00	2.40	2.40	4.00	3.00	2.40
5yr UST notes	2.46	3.04	3.05	2.85	2.75	2.70	2.65	2.50	2.30	2.30	2.85	2.50	2.30
10yr UST notes	2.34	3.02	2.90	2.70	2.70	2.65	2.60	2.45	2.25	2.20	2.70	2.45	2.20
30yr UST bonds	2.45	3.19	3.00	2.80	2.75	2.70	2.65	2.50	2.30	2.25	2.80	2.50	2.25
3mon to 2s spread bps	184	129	10	20	20	0	-15	10	-5	0	20	10	0
3mon to 10s Spread bps	185	135	-20	-110	-135	-135	-80	-45	-20	-20	-110	-45	-20
2s to 10s Spread bps	0	6	-30	-130	-155	-135	-65	-55	-15	-20	-130	-55	-20

Actual data in red (Source: Bloomberg) | GDP figures shown as annual change

With the onset of weakness increasingly apparent, yet prices still elevated beyond earlier expectations, the Fed will expectedly continue to move along a pathway to higher rates eventually surpassing earlier forecasts and reaching a peak of near 4% early next year. As the Fed continues to focus on inflation, the short end of the curve will likely follow the upward trajectory of monetary policy. Meanwhile, the longer end of the yield curve is likely to exhibit mounting downward momentum restrained by the prospect of ongoing – and compounding – negative activity as the Committee moves towards the terminal rate.

Only after inflation appears to be tamed will the Fed begin to loosen policy, likely mid-2023. Coupled with sustained positive growth returning to the domestic economy, potentially as early as next year, shorter rates will expectedly subside, easing the curve inversion with steepness slow to return until late 2024 or until domestic activity can surpass a minimum of 2% GDP.

As Fed Chair Powell noted following the July rate announcement, predicting the market is difficult in the best of times, and given today's unprecedented uncertainty, it is even more challenging. Thus, rather than trying to pinpoint the exact level of rates, the more important takeaway from a forecasting perspective is understanding the directional momentum of rates and policy, as well as the potential factors driving that pressure in one direction or the other.

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