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Economic & Financial Markets Monthly Review | February 2024

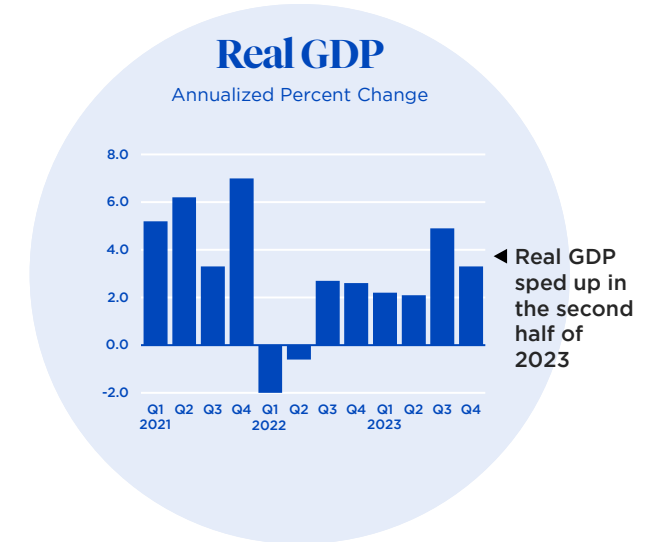
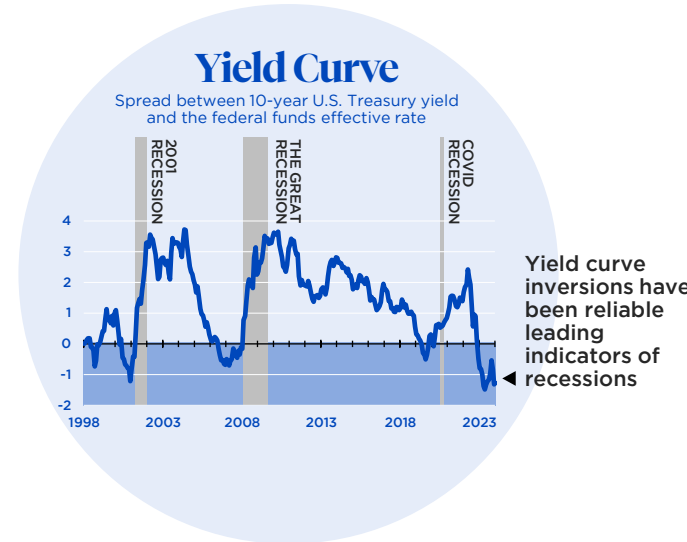
Hiring heats up despite winter headwinds



Economic Overview

Where is the economy now?

Rather than slowing down, topline readings for hiring and spending activity gained steam at the end of 2023 and into early 2024. Underlying readings suggest weakness is building on the edges, but recession concerns have again been delayed by resilience from consumers and businesses. This lingering strength may keep inflation elevated for longer, increasing the risk of a slower shift to policy easing by the Fed.



Where we are this month

What does this mean

Strong hiring delays recession concerns

Economic growth in early 2024 should remain solid as buoyant job and income gains support consumer activity.

- But we expect job gains in cyclical sectors and overall spending to weaken sharply by mid-year — driving the expectation that a mild recession is still more likely than a soft landing in 2024.
- The projected recession should be short and modest with limited job losses and business closures — especially compared to the severe impacts over the past two downturns.

Protracted yield curve inversion

The 10-year to fed funds rate spread inversion narrowed in January but has now been sustained for more than 14 months.

- Shorter-term Treasury yields have dropped since November as the bond market expects the Fed to ease rates over 2024 — also narrowing the 2-year Treasury vs. the 10-year spread.
- The yield curve typically steepens (and can un-invert) ahead of a recession in response to outright Fed easing or in anticipation of lower rates by financial markets.

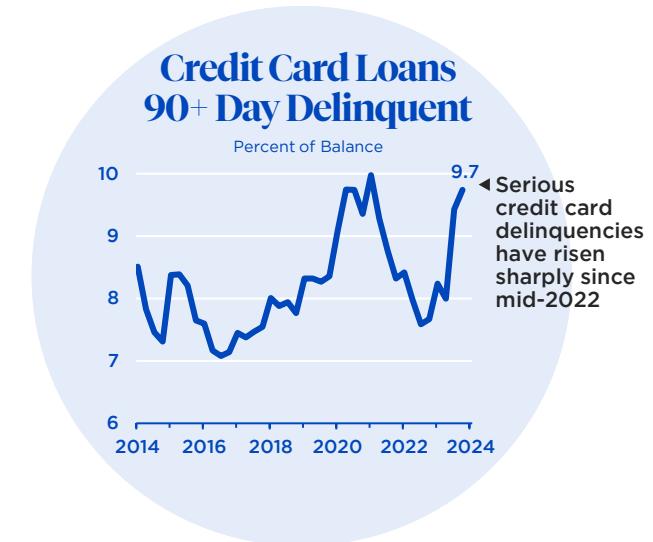
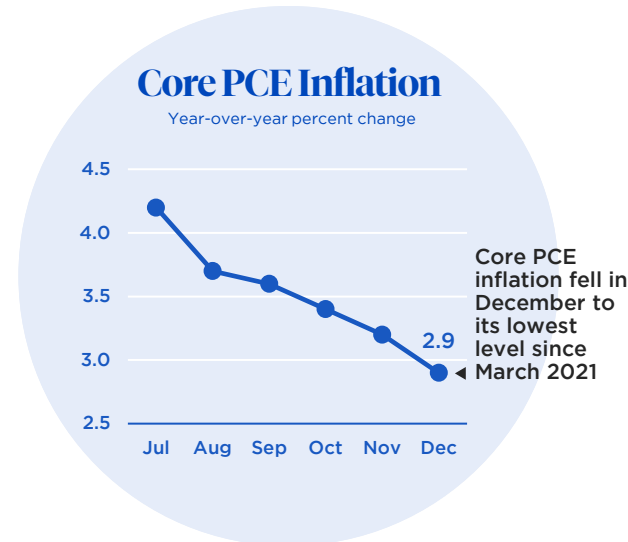
Strong end to 2023

Real GDP expanded at a 3.3 percent annualized pace in the fourth quarter to round out an accelerated second half of 2023.

- Ebullient consumer spending led the way in the fourth quarter as income-fueled households spent soundly on goods and services around the holiday season.
- The reacceleration in growth creates a solid handoff to 2024 and likely indicates a longer runway to the long-expected slowdown within the U.S. economy.

The labor market is strong, but consumer debt is rising

Job gains were much higher than expected in January, while the unemployment rate remains low and wage growth fast. Falling inflation readings suggest the Fed's goal of securing a 2 percent inflation target and a soft landing could be in sight. On the other hand, the sharp upward trend in serious credit card delinquencies (as well as the low saving rate) suggest the consumer is in poor position to handle a slowdown in the labor market — a warning sign for consumer spending that keeps a mild recession in the 2024 outlook.



Where we are this month

What does this mean

Blowout jobs report in January

Nonfarm payrolls outpaced all expectations in January, climbing by 353,000, while the unemployment rate held steady at a low 3.7 percent.

- In addition to the robust headline jobs number, upward revisions to December and November totaled 126,000, showing a much stronger pace of job growth at the end of 2023 than previously thought.
- Annual growth in average hourly earnings accelerated to 4.5 percent, but a decline in the average workweek to below pre-pandemic levels offset much of the positive income impact from higher pay as more firms cut back worker hours.

Core PCE inflation falls below 3.0 percent

Year-on-year PCE inflation remained at a lower 2.6 percent in December, while the core rate fell to 2.9 percent.

- The Fed's preferred inflation measures for overall and core inflation have now fallen below 3.0 percent, shifting the policy conversation to the timing and depth of rate cuts.
- Still, easing may not be imminent as the FOMC had the following guidance in late January: "The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent."

Credit card delinquencies are climbing

Serious delinquency for credit cards rose in Q4 to 9.7 percent despite low interest rates. Barring pandemic disruptions, this was the highest level since 2013.

- The high share of credit card balances 90+ days delinquent in Q4 indicates building financial stress for households. Auto loan delinquencies have also increased markedly as households struggle with high costs and loan rates.
- Rising delinquencies and a low personal saving rate suggest that many consumers may be ill-prepared for a slowdown in the labor market — a risk to the spending outlook.

Investors are forced to rethink their expectations

Persistently upbeat economic data and confidence that Fed policymakers will soon lower interest rates drove the S&P 500 to all-time highs in January and pushed short-term interest rates lower. However, the Fed caused investors to rethink their views at the end of January after Chair Powell clearly signaled that a rate cut isn't imminent. We anticipate the Fed will wait until mid-year to lower interest rates with consistently solid economic data, accommodative financial conditions, and still-high inflation delaying the start of rate cuts and the extent of easing over 2024.



Equities set record highs

The S&P 500 rose 1.6 percent in January to fresh historic highs as encouraging economic data raised hopes that the economy would elude a recession.

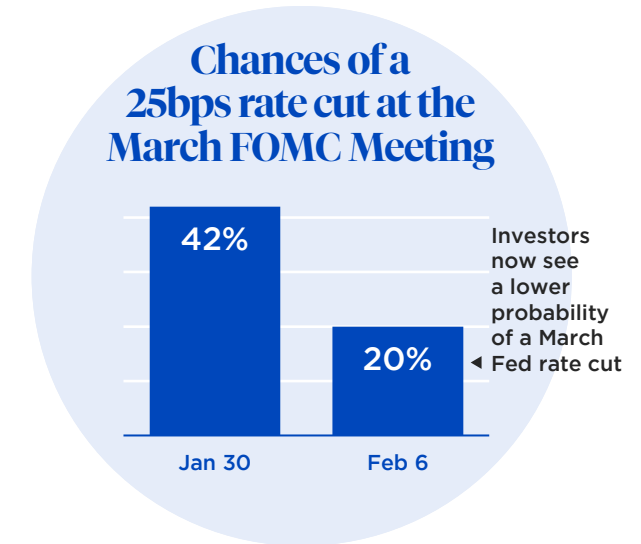
- A continued streak of positive economic news, cooling inflation, relatively solid corporate earnings, and moderating interest rates pushed the benchmark U.S. equity index to new highs. Performance was mixed across the major equity sectors and the Magnificent Seven tech stocks offered less of a boost than in December.
- Stocks were more expensive as market valuation metrics rose last month with investors taking on more risk amid solid economic trends.



Interest rates steady

The 10-year Treasury yield was essentially flat on the month, averaging 4.06 percent in January, but held well below its late-2023 peak.

- The 2-year Treasury note yield, which is sensitive to Fed policy, continued to decline in January as more investors subscribed to the view that policymakers were finished raising interest rates and that the next move would be to loosen policy.
- Fed officials have removed the tightening bias from their policy statement and are signaling that easier policy is in the pipeline as they pivot to considering the timing and scope of rate cuts.



Powell deflates hopes for a March cut

Fed Chair Powell reset expectations after January's FOMC meeting as he indicated the Committee needs to see a continued streak of low inflation readings before easing policy.

- Stronger economic activity and looser financial conditions make it unlikely the Fed will lower interest rates at March's meeting. Continued strength shouldn't prevent rate cuts as long as inflation falls, but it may limit the amount of easing.
- The Fed's data-dependent approach means the economy needs to continue to moderate for officials to be confident that inflation is on a clear path to the two percent target.

Where we are this month

What does this mean

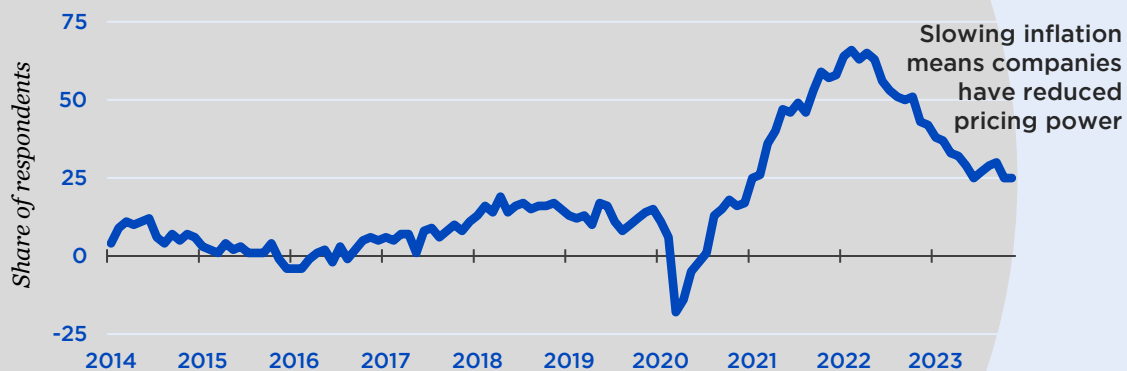
Outlook

Reduced pricing power adds to profit concerns for businesses

Earnings expectations for the fourth quarter of 2023 are still solid, buoyed by resilient consumer spending around the holidays. But corporate profits face multiple headwinds in 2024 as rising labor costs, elevated interest rates, and an over extended consumer act to compress margins. Firms in many sectors are also seeing their pricing power fade with fewer small business owners able to raise their selling prices at the end of 2023. This places a greater onus on maintaining or increasing quantities sold to make up for reduced increases in selling prices.

Weaker pricing adds to the disinflationary trends across the economy and should help to cool consumer costs this year. But the downward pressure on profits should lead businesses to reduce expenses through staffing reductions. As evidenced by the outsized job gains in January, the labor market has room to cool without leading to a recession. But historically job cuts have gathered enough momentum to dampen consumer spending and result in an eventual downturn. This is especially the case with consumers having depleted essentially the entire \$2.1 trillion of pandemic-related savings and increased their reliance on credit.

Fewer small businesses are raising their selling prices



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Data as of February 2024

	2023 ACTUAL	2024 ESTIMATE	2025 FORECAST	2026 FORECAST	2027 FORECAST
REAL GDP	2.5%	2.0%	1.2%	1.7%	1.5%
UNEMPLOYMENT RATE	3.6%	4.3%	4.5%	4.1%	4.0%
INFLATION ¹ (CPI)	3.2%	2.8%	2.4%	2.1%	2.0%
TOTAL HOME SALES	4.77	4.40	5.30	5.95	6.15
S&P/CASE-SHILLER HOME PRICE INDEX	5.3% ^e	2.0%	3.4%	3.2%	3.0%
LIGHT VEHICLE SALES	15.5	15.1	16.0	16.5	16.5
FEDERAL FUNDS RATE ²	5.25%	4.00%	3.00%	2.50%	2.50%
5-YEAR TREASURY NOTE ²	3.84%	3.75%	3.00%	2.90%	2.90%
10-YEAR TREASURY NOTE ²	3.88%	4.00%	3.45%	3.25%	3.25%
30-YEAR FIXED-RATE MORTGAGE ²	6.61%	6.25%	5.10%	4.60%	4.60%
MONEY MARKET FUNDS	5.09%	4.59%	3.40%	2.59%	2.53%

Modest inflation easing over 2024

Inflation readings were still elevated heading into 2024, led by housing and services. Price increases should cool further over the year with both overall and core inflation dropping to around 3.0 percent by year-end. Upside risks linger, though, including geopolitical impacts for energy and goods markets.

Later Fed easing still most likely

Fed rate cuts should be delayed until May or June with modest easing projected over the second half of 2024. But, should the economic data continue to run hotter, Fed officials may choose to maintain a more restrictive policy stance into 2025 than projected.

¹ Percent change Q4-to-Q4

² Year-end

^e Estimate

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Sources

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Business Cycle
Yield Curve
Real GDP growth

Nationwide Economics
Bloomberg; National Bureau of Economic Research
Bureau of Economic Analysis

2 | Economic Review

Nonfarm payroll gains
Consumer Price Index
Credit card delinquency

Bureau of Labor Statistics
Bureau of Labor Statistics
Federal Reserve Bank of New York

3 | Financial Markets Review

S&P 500
10-year Treasury yield
Fed funds futures

Standard & Poor's
Federal Reserve Board
CME Group

4 | Outlook

Businesses raising selling prices
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