2Q24 Economic Summary

Investor focus remained firmly on inflation and employment during the second quarter as markets gauged the probability and timing of the Fed's first rate cut. U.S. economic resiliency and hotter-than-expected inflation data during the first three months of the year had some questioning whether Fed officials would be able to justify easing monetary policy at all in 2024. However, inflation readings and job growth began to cool in May and June, increasing the odds that the Fed will embark on rate cuts during the second half of the year. After a large back up in April, Treasury yields began to reverse course in mid-May as traders re-evaluated the number of rate cuts expected in 2024-2025. Yields on the short-end of the curve were relatively unchanged while intermediate and long-term yields ended the quarter slightly higher.

U.S. economic indicators continued to soften during the second quarter as restrictive monetary policy finally began to take a toll. Manufacturing shrank as high borrowing costs constrained business investment and producers were hesitant to accumulate inventories as demand waned. The services sector, which has been the primary growth engine for the economy, also entered contraction territory during the quarter. Service providers pulled back as consumers reigned in spending on items they splurged on after the pandemic, including entertainment, eating out and travel. The pullback reflected a decline in consumer confidence as high prices began to erode living standards. Americans watched their wallets more closely, choosing to decrease discretionary spending in lieu of running up credit card balances. In addition, historically low housing affordability weighed on consumption as high mortgage payments and rents ate away at consumers' excess spending cash. Housing's positive contribution to GDP growth likely reversed during the quarter as buyers remain sidelined by high borrowing costs and elevated home prices. Suppressed demand dampened home builder sentiment, resulting in a decline in housing starts and building permits.

Cracks also began to emerge in the labor market. While still strong, job creation slowed as the U.S. added a lower-than-expected 532 thousand jobs during the quarter. The unemployment rate ticked up to 4.1% in June, the highest level since 2021. Positively, the increase did not result from a rise in layoffs but rather an increase in labor force participation due to an influx of immigrants. Supply and demand continued to come into better balance as job openings declined and quit rates moderated, reflecting less optimism from employers and employees about the strength of the labor market. Average hourly earnings continued to increase during the quarter, but with fewer people job hopping and employers less motivated to pay-up to fill positions, the pace of wage gains slowed.

The ease in wage pressures contributed to an overall cooling trend in inflation, with consumer prices as measured by the CPI coming in softer-than-expected during all three months of the quarter. After a flat reading in May, the June CPI showed inflation fell for the first time in four years. While falling gas prices accounted for a majority of the inflation relief, price declines were relatively broad-based across goods and services. A number of major retailers announced price cuts and offered discounts during the quarter as cost conscious consumers pushed back on price increases. In addition, shelter costs, one of the stickiest components of service inflation, finally showed signs of cooling in June as growth in rents slowed and hotel prices cheapened.

Fed officials acknowledged the easing of price pressures at the June FOMC meeting but needed greater confidence that inflation was moving sustainably toward their 2% objective before adjusting monetary policy. Therefore, the Fed held the fed funds target range steady at 5.25%-5.50%, marking the seventh consecutive meeting with no change. Consistent with the Fed's "higher-for-longer" mantra, the Committee's June dot plot reduced the number of rate cuts forecasted for 2024 from three 25 basis point cuts to one. In his post meeting press conference, Chair Powell stated that the Fed's restrictive policy was having the impact on inflation that the Committee wanted to see, but they didn't have the "confidence that would warrant beginning to loosen policy at this time."

Data released since the June FOMC meeting (including the June CPI and employment reports) provided further evidence that monetary policy was having the desired effect on the economy. Post-meeting Fed speak turned more dovish with "higher-for-longer" taking a back seat to a focus on the dual nature of the Fed's mandate, acknowledging not only the need to battle inflation but also to preserve employment. Officials are trying to balance the risk of moving too slowly, which could thwart their goal of a soft landing, with the risk of moving too soon, which could result in inflation reaccelerating. Investors are betting that the slowdown in hiring combined with the moderation in inflation will bump up the Fed's timetable for cutting rates, with markets currently forecasting an ease at the September FOMC meeting.

Any opinions herein, including forecasts, reflect our judgment as of this date and are subject to change.
American Beacon Advisors