GDP grows, but inflation unchecked

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1 The FED keeps interest rates unchanged

The FED at its 12/13/2023 meeting [1] kept the prime interest rate at 8.5%, and the federal funds rate at 5.25%, with a vague hint that interest might be reduced in 2024.

2 How are we doing now?

2.1 Is inflation decreasing?

The Consumer Price Index (CPI) [2] is usually calculated compared to last year (solid line in Fig. 1). This line peaked at 9% on July 2022, and has been steadily declining. It misleadingly suggests that inflation is decreasing.

I instead calculated the change in the CPI on a month-to-month basis (dots in Fig. 1), not year-to-year. Inflation reached 12% on June 2022.

From July 2022 until Dec. 2023, all points were $\leq$ 7.5%, and were typically 3.4%. This is way above the FED's goal of 2%.

For the past 17 months, inflation has been flat at about 3.4%.

The FED MUST apply stronger medicine to tame inflation before it can cut interest.

2.2 Does the GDP indicate a healthy economy?

Yes. The Gross Domestic Product (GDP, adjusted for inflation) [3] for 2023 Q4 (Fig. 2) increased by 3.3% on an annualized basis. The previous four quarters were all above 2%–America's economic miracle!

America has been doing great compared with Germany (in recession), UK (near recession), and China (slow growth).

But every economist knows that GDP must slow in order to fight inflation.

2.3 Is unemployment going up?

When the economy slows, unemployment goes up. But it remains at 3.5-3.8% (Fig. 3). [4]

The Sahm Recession Index (Fig. 4) [5] [6] is derived from the recent unemployment rate. If this Index exceeds 0.5, then we're in a recession; the Index is now at 0.23.

[1] FOMCpresconf20231213.pdf
[2] Consumer Price Index for all urban consumers: All items in U.S. city average, fred.stloiuis.org/series/CPIAUCSL
[3] fred.stlouis.org/series/GDPC1
[4] fred.stlouis.org/series/UNRATE
[5] fred.stlouis.org/series/SAHMREALTIME
[6] America may soon be in recession, according to a famous rule, The Economist, 11/14/2023

2.4 Is the ratio of job openings to unemployed going down?

This ratio (Fig. 5) [7] indicates how difficult it is for employers to find workers. This ratio is still 1.45, way above 1. Help wanted signs are still frequent. Employers must offer higher salaries to attract applicants, or put on overtime. Workers often switch to higher-paying jobs, or union workers strike. Increased wages cause the cost of manufacturing to go up, while the wealthier workers have more money to spend–inflation!

2.5 Are wages and salaries exceeding inflation?

Since about 1980 (Fig. 6), wages and salaries in private industries [8] adjusted for inflation, have hardly gone up. During our present hyperinflation, wages have just kept up with inflation.

GDP and the wealth of America have risen greatly, but, as I showed in a previous article, this wealth has increasingly gone to the ultrarich. The lowest half only own 3% of the wealth, and earn the lowest salaries.

The median worker likely has only a high school education, 10-30 years of work experience, limited skills, but none that are in high demand. He/she can only hope for small promotions. This person is stuck forever in the middle class.

A worker in the bottom 10-20% is in a more precarious position. Other unemployed workers are eager to fill his/her position. He/she is first to be laid off come recession, and last to be rehired. He/she has few savings and a poor credit rating, living paycheck to paycheck.

Things are worse for minority workers.

So yes, unemployment is near a historic low, benefiting all workers, but inflation is eating away at their earnings.

2.6 Is the equity in my house going up?

For many Americans, much of their wealth is in the equity in their home. Prior to 2015, home values increased faster than inflation (Fig. 7). [9] I made 5% per year profit on several homes when inflation was 2-3%.

After 2015 the curve has flattened. But with real estate it's "location, location, location!" I made 8% per year profit on a condo sale here in West Bend WI during 2019-2023.

During the pandemic, Congress and the FED pumped incredible amounts of stimulus money into the economy, money which many did not need. Home prices got inflated along with everything else, so the inflation-adjusted curve in the figure stayed flat, but now is declining because of high mortgage rates.

[7] fred.stlouis.org/series/JTSJOL and /UNEMPLOY
[8] fred.stlouis.org/series/ECIWAG
[9] fred.stlouis.org/series/USSTHPI

2.7 Are stocks going up?

The wealthy have most of their funds invested in stocks, while many people have some of their retirement funds and savings in stocks.

The S&P 500 (Fig. 8) [10] now has surpassed its peak on 1/1/2022! The increase was caused primarily by 8 tech stocks. Stocks might go up more–investors seem optimistic.

2.8 Are long term bonds paying well?

Traditionally when an A-rated corporation needed to raise capital, they would issue 40-year A-rated bonds at 3.8-5% interest. A less-sound corporation might issue B or C-rated bonds at 6-10% interest.

An investor like myself would buy an A-rated bond at, say, 4.5%, and make 2% safe return when inflation was 2.5%. If I needed money, I could sell the bond at about what I had bought it for.

Now that inflation is at 3.4%, people don't want such bonds. I can only get about 80% of purchase price if I sell my old bonds now.

Put it another way, investors are demanding a higher rate of return on long term bonds, and the cost of borrowing for corporations and the Government is skyrocketing.

The benchmark 10-year treasuries now yield 4.07%, compared to about 2% during 2012-2018 (Fig. 9). [11]

Now might be a good time to purchase bargain-rate, used, long-term bonds, and wait for inflation to cool.

2.9 How is my pension doing?

I have a TIAA retirement fund yielding 5.0%.

2.10 Should I put my money into bank CDs and money market funds?

Most banks are now offering FDIC-insured certificates of deposit (CDs) at as much as 5.6% in order to raise money to make high-interest loans and mortgages. Money market mutual funds such as Fidelity FTYXX invest in short-term treasuries and yield 5.16%.

3 month treasuries (Fig. 10) [12] started going up with inflation in 2021, and now yield 5.45%! The graph shows that before and during periods of uncertainty–the 2000 recession, the 2008 Great Recession, the 2019 recession fear, and now–investors have moved money into short term treasuries, bidding up prices.

[10] fred.stlouis.org/series/SP500
[11] fred.stlouis.org/series/DGS10
[12] fred.stlouis.org/series/DGS3MO

3 The Atlanta FED GDPnow model

This model [13] estimates that real GDP will increase by 3.0% in 2024 Q1.

4 The Conference Board predicts a mild recession

The Conference Board publishes the Leading Economic Index (LEI). [14]

Updated 12/21/2023

"The...LEI for the U.S. declined by 0.5% in November 2023 to 103.0 (2016=100), following a (downwardly revised) decline of 1.0% in October. The LEI contracted by 3.5% over the six-month period between May and November 2023, a smaller decrease than its 4.3% contraction over the previous six months (November 2022 to May 2023).

"The US LEI continued declining in November, with stock prices making virtually the only positive contribution to the index in the month," said Justyna Zabinska-La Monica, Senior Manager, Business Cycle Indicators, at The Conference Board. "Housing and labor market indicators weakened in November, reflecting warning areas for the economy. The Leading Credit Index and manufacturing new orders were essentially unchanged, pointing to a lack of economic growth momentum in the near term. Despite the economy's ongoing resilience-as revealed by the US CEI-and December's improvement in consumer confidence, the US LEI suggests a downshift of economic activity ahead. As a result, The Conference Board forecasts a short and shallow recession in the first half of 2024."

About the LEI (Fig. 11): This composite economic index is designed to signal peaks and troughs in the business cycle. The LEI is a predictive variable that anticipates (or "leads") turning points in the business cycle by around 7 months. Shaded areas denote recession periods or economic contractions.

The LEI is a composite of ten other indices:

4.1 Leading credit index

This consists of six measures of credit availability.

4.2 Standard and Poors 500 stock average

The S&P500 (Fig. 8) is at an all-time peak, indicaking investor confidence. If a recession hits, business profits will plunge and the S&P500 will crash.

[13] https://atlantafed.org/cqer/research/gdpnow
[14] https://www.conference-board.org/topics/us-leading-indicators

4.3 Spread between 10 year and 3 month treasury bond yields

As conditions worsen, investors tend to take money out of risky stocks and long-term bonds which are *under water* (whose yield is less than inflation), and put their money into ultrasafe short-term treasury bills, thus driving up their prices. Thus the yield of 3 month bills becomes higher than that of 10 year bonds (Fig. 12). [15]

Stojanovic and Vaughan described this yield-inversion recession predictor in a 1997 FED article. [16]

4.4 Consumer Confidence Index

The CCI (Fig. 13) [17] indicates whether consumers are confident and want to spend (CCI>100), or are pessimistic and want to save (CCI<100). The CCI is based upon answers to survey questions. Consumers now are becoming less pessimistic.

4.5 Manufacturing PMI

The Institute for Supply Management reported that the manufacturing sector contracted for the 14th consecutive month following a 28-month period of growth. [18]

4.6 New privately-owned housing permits

Fig. 14 shows that there was a sharp drop during the 2000 COVID recession. The Government pumped incredible amounts of stimulus money into the economy, some of which drove up home prices. When the FED raised the prime interest rate, mortgages became more expensive, and housing starts plummeted.

4.7 Average weekly manufacturing hours

The graph (Fig. 15) [19] indicates that manufacturing never fully recovered to the 2018 peak after the pandemic hit. Manufacturing hours have been steadily declining since 2021.

4.8 New manufacturing orders

Orders (Fig. 16) increased after the 2020 recession, but are now stagnating.

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[15] https://fred.stlouisfed.org/series/T10Y3M

[16] D. Stovanovic and M. Vaughan, Yielding clues about recessions: The yield curve as a forecasting tool, https://stlouisfed.org/publications/regional-economist/october-1997/yielding-clues-about-recessions-the-yield-curve-as-a-forecasting-tool

[17] OECD (2023), Consumer confidence index (CCI). doi.10.1787/46434d78-en, https://data.oecd.org/leading/consumer-confidence-index-cci-htm

[18] https://www.ismworld.org

[19] https://fred.stlouisfed.org/series/AWHMAN

4.9 New unemployment claims

When people are not working, GDP decreases, leading to recession. At present (Fig. 17) there is a slight uptick in unemployment claims.

4.10 ISM index of new orders

The Institute for Supply Management issued a September 2023 report: [20]

"Economic activity in the manufacturing sector contracted in September for the 11th consecutive month following a 28-month period of growth," said chairman Timothy R. Fiore.

5 Conclusions

Inflation is still about 3.4%. I get only a 3.2% cost-of-living increase (COLA) on my 2024 Social Security. It is difficult to make more than a 1.3% real return on bonds, bank accounts, pensions, and money market funds.

There is much uncertainty. I predict that the FED will manage to prevent a recession, but that inflation will continue at about 3.4%.

The Conference Board predicts a mild recession in 2024.

The chaotic 2024 presidential election could traumatize the economy.

Congress is disfunctional, with House Republicans divided. Will any useful legislation be passed?

We have two expensive proxy wars, one with Russia (Ukraine), and one with Iran (Hamas/Israel).

Our southern border crisis demands a solution, but the politicians are only using it to win campaign debate points.

Global warming is proceeding unstoppably, with expensive future consequences.

The ballooning National Debt will soon destroy America's credit rating.

My recommendations:

- Now's a good time to seek a better job or a promotion.

- Pay off high interest loans such as credit cards. Save for a stormy day.

- Avoid borrowing at high interest.

- Reduce unnecessary expenditures: Extra TV or streaming channels, too many videogames, toys, cruises, airplane or automobile trips, vacations etc.

- Eat out less; skip the coffee, alcohol, and dessert.

[20] https://www.ismworld.org/supply-management-news-and-reports/reports/ism-reports-on-business/pmi/september

• Buy a low mileage used car, not a new one.

• Resist the brainwashing advertising to buy, buy, buy.

• For stocks, sell high and buy low. Maybe don't buy stocks now. Put extra money into money market funds while waiting.

Hang in there, my friends!

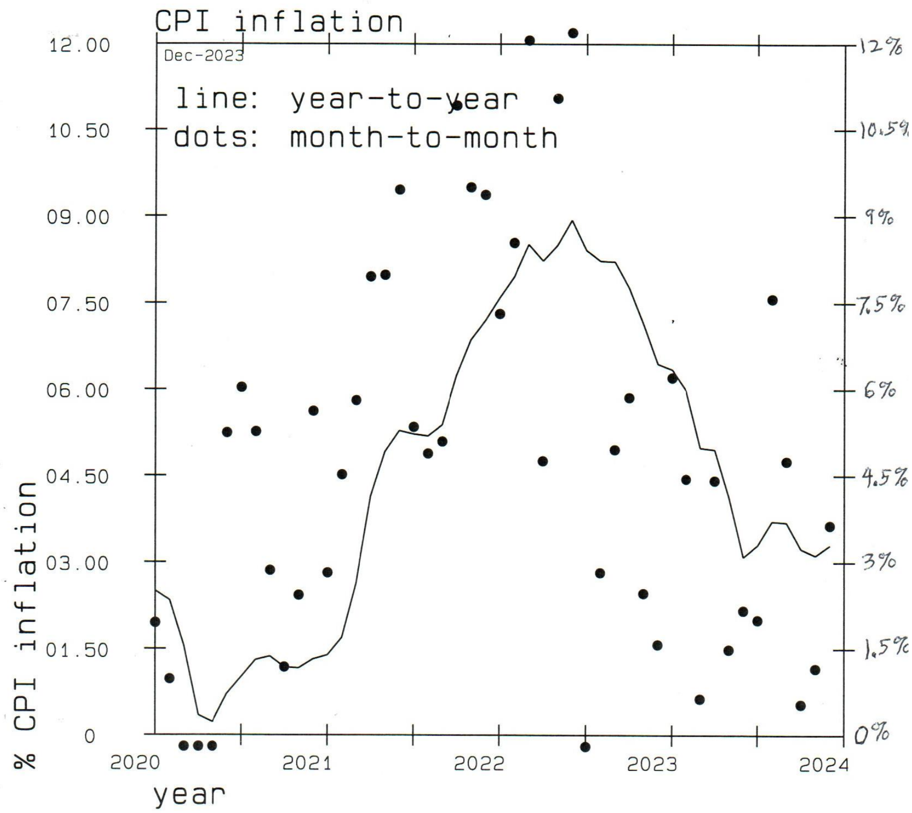

Figure 1: Inflation: The change in the CPI was computed compared to last year (line), which is the usual way, and compared to the previous month (dots). Inflation reached 9% on June 2022, but since has leveled off to about 3.4%–still too high.

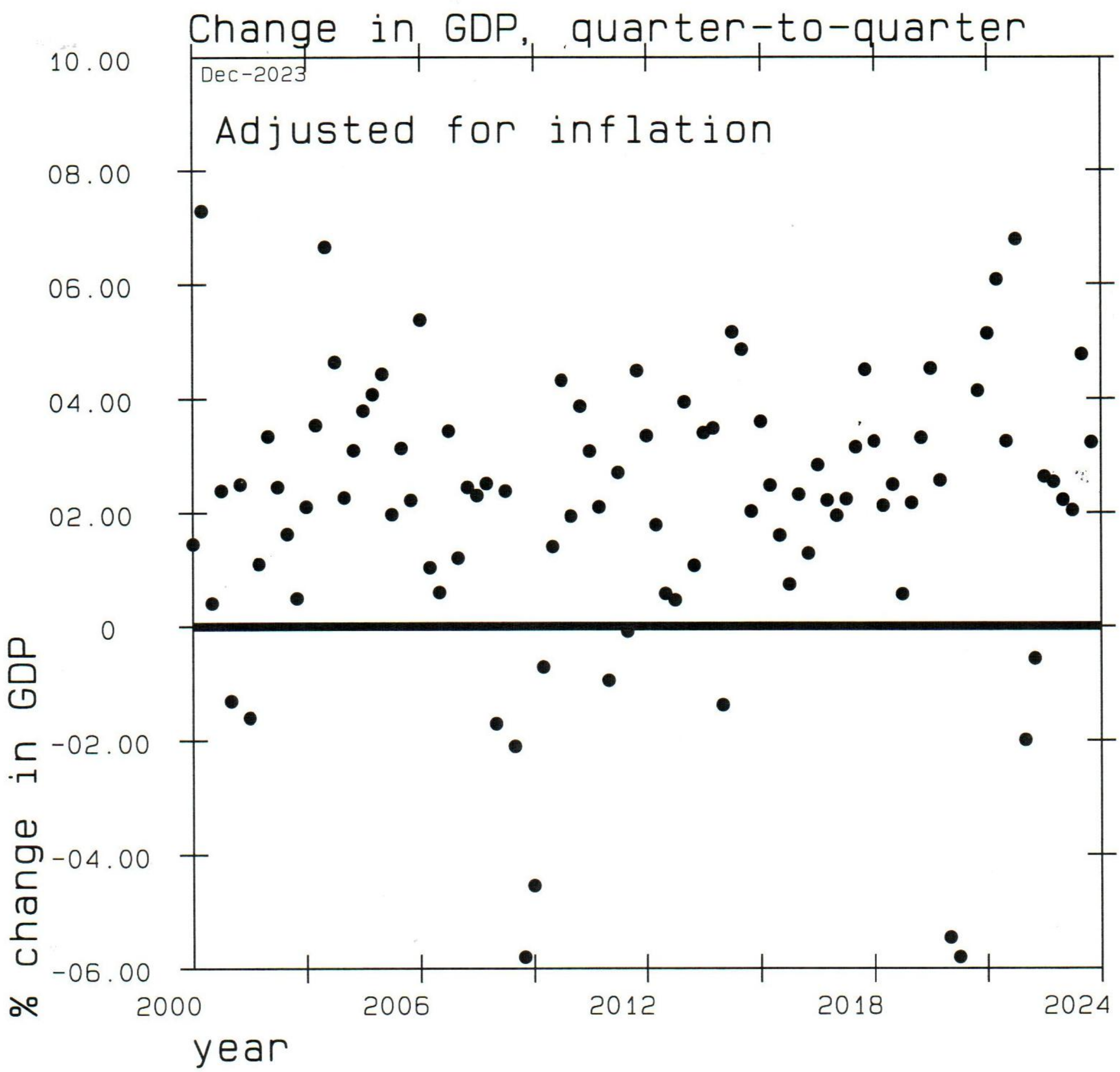

Figure 2: The American economy has been robust, with 3.3% growth in 2023 Q4.

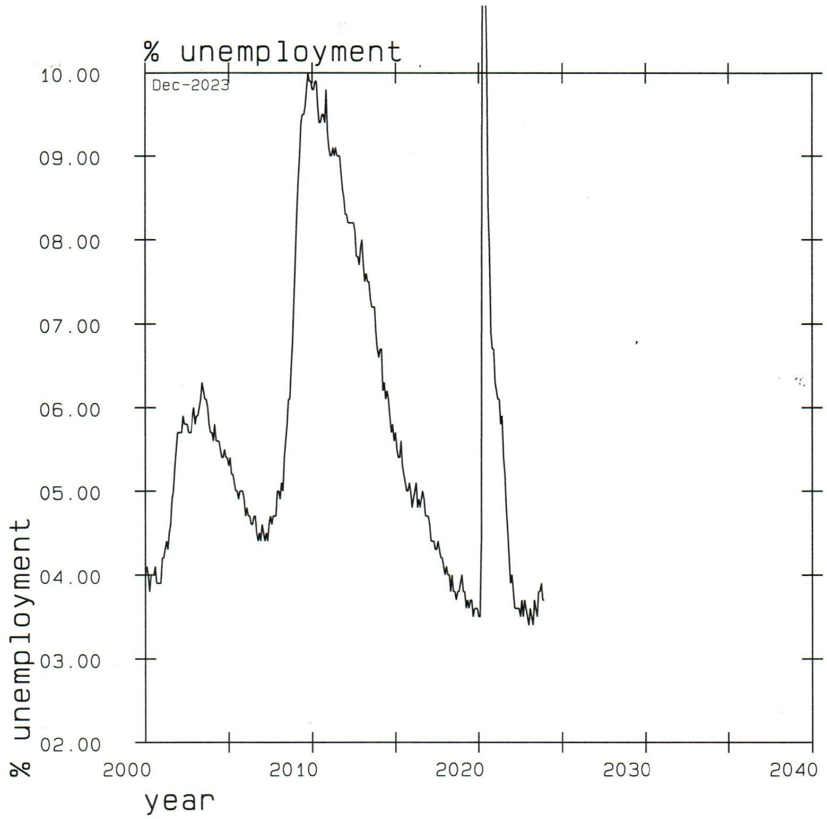

Figure 3: Unemployment remains at 3.5-3.8%, indicating a robust economy.

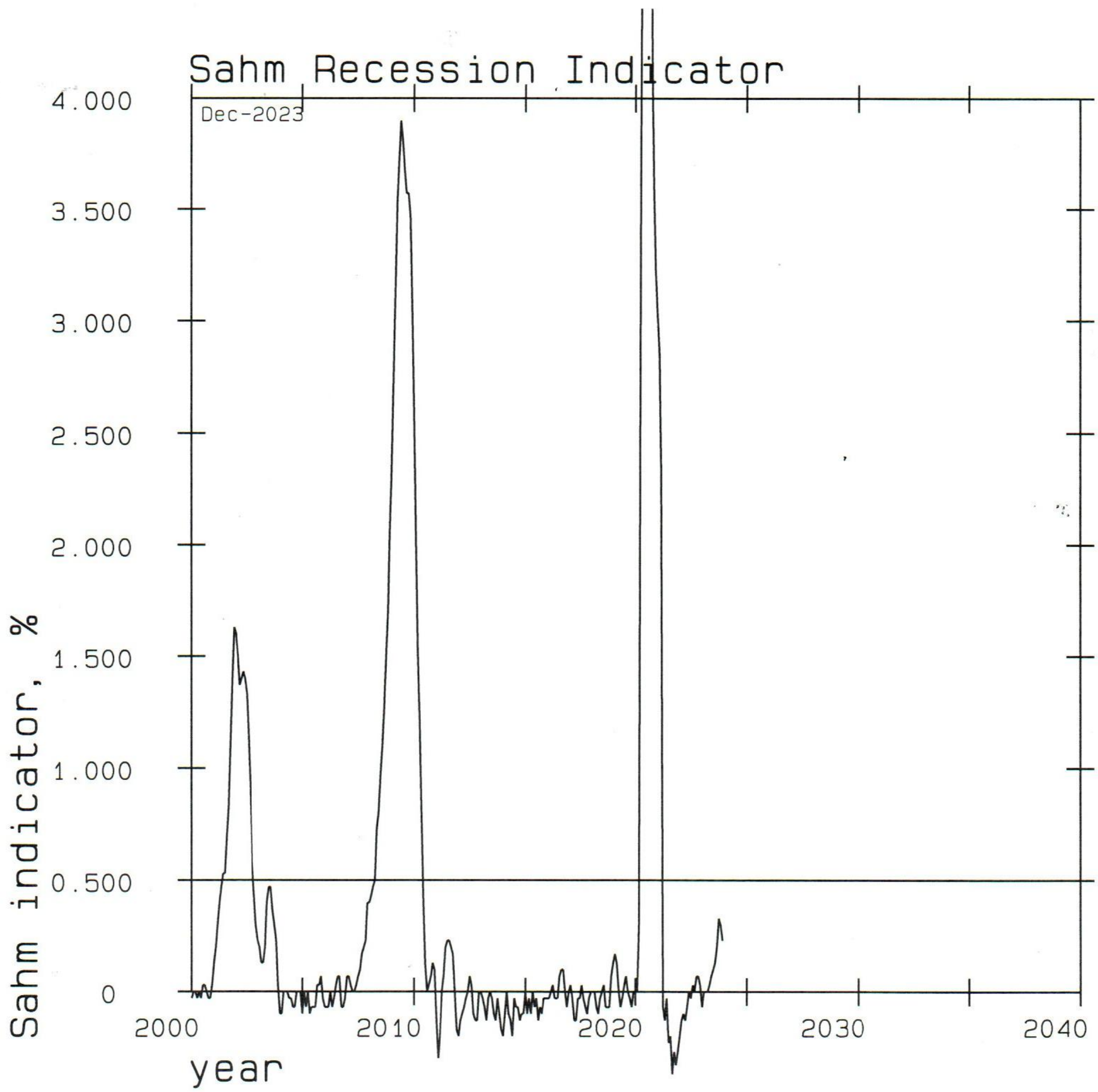

Figure 4: The Sahm unemployment index is derived from a 3-month moving average of unemployment. When it exceeds 0.5, we are in a recession.

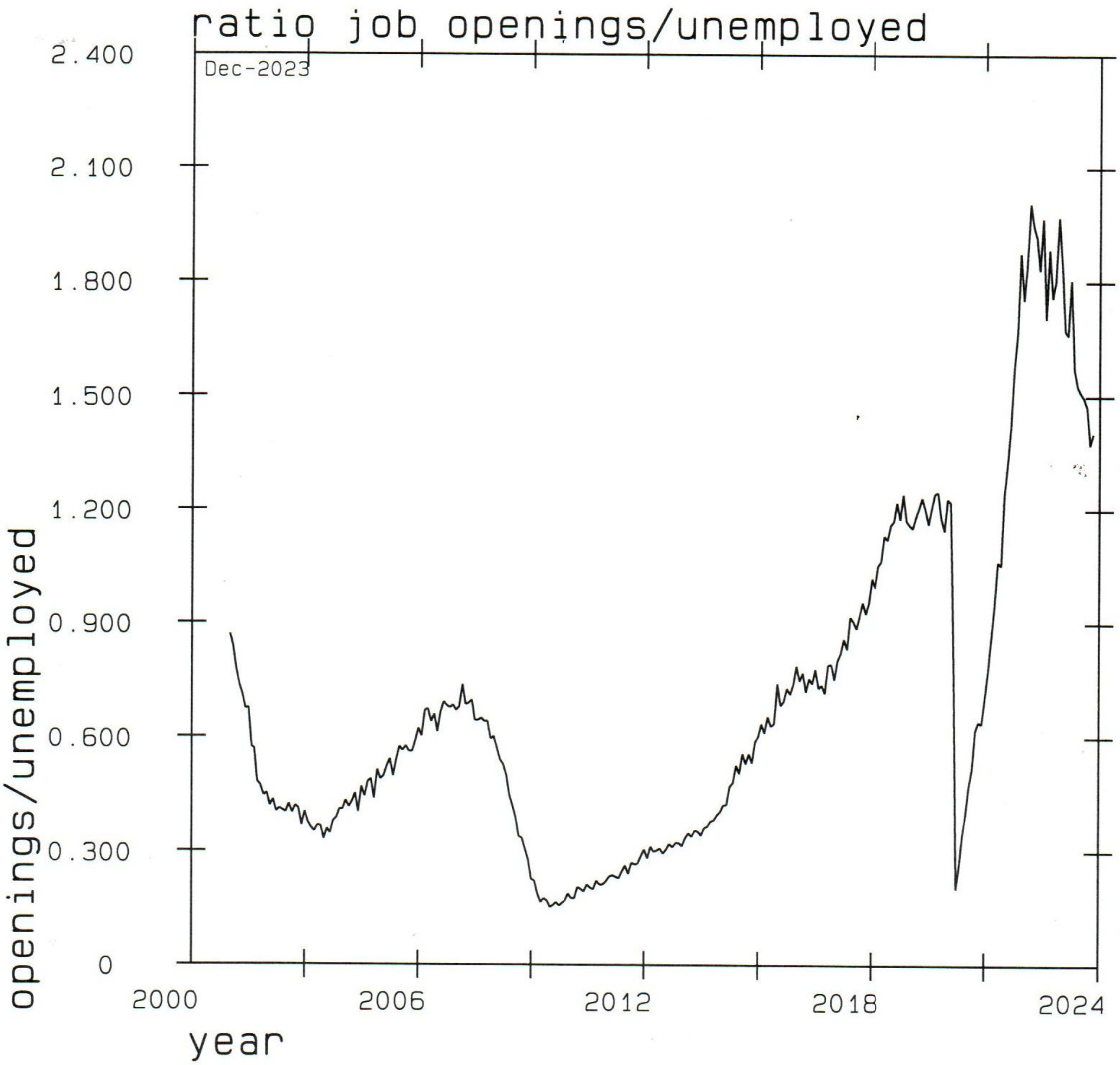

Figure 5: The ratio of job openings to unemployed indicates how difficult it is for employers to find workers. Presently the ratio is 1.45, explaining all the help-wanted signs, and the increases in wages, which drive inflation.

Figure 6: Median weekly wages index for private industry was corrected for inflation. Since 1980, real earnings have stagnated, going up only slightly after 2015. During our hyperinflation (2021-3), wages have just barely kept up with inflation.

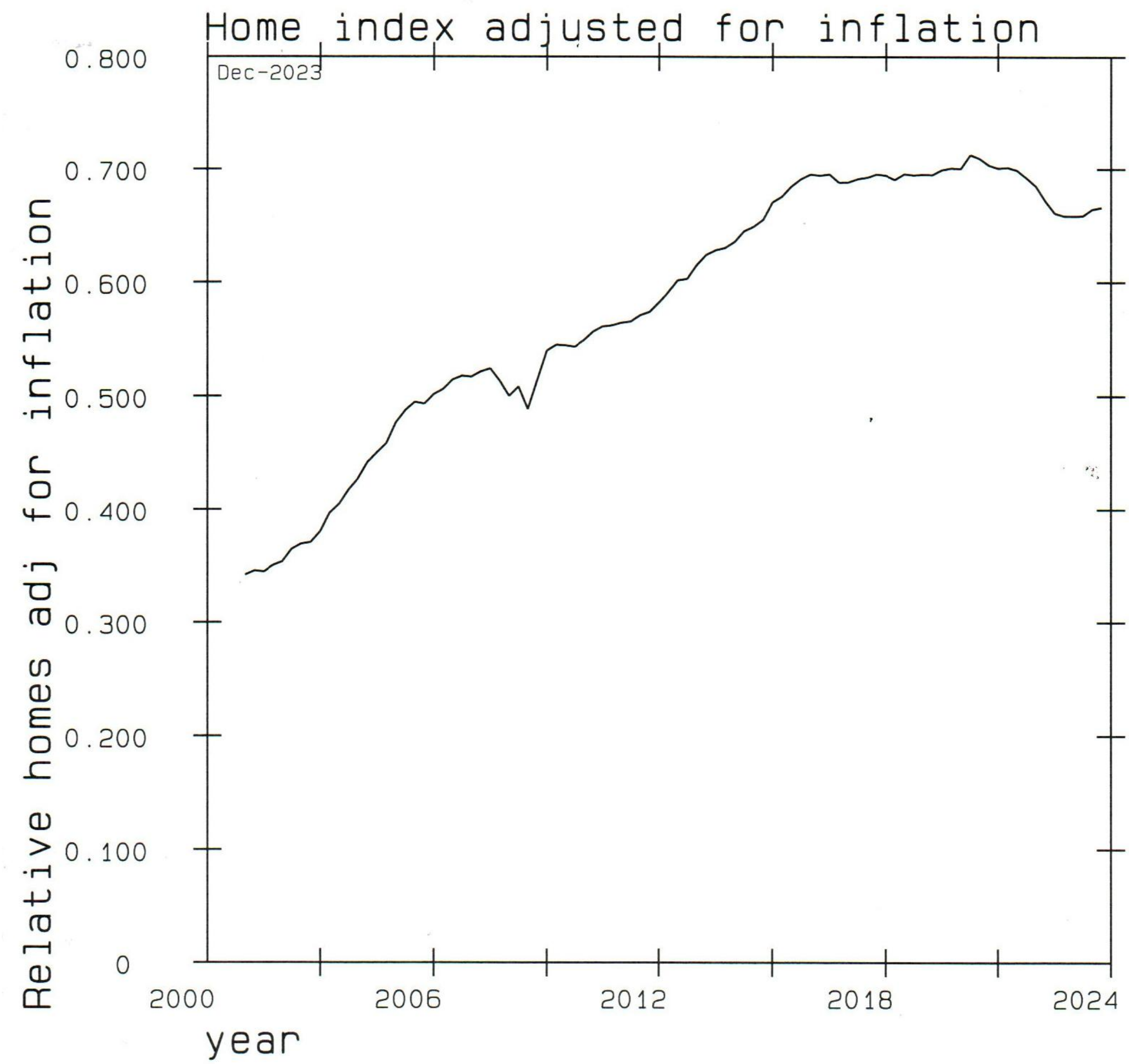

Figure 7: Home price index adjusted for inflation. With high mortgage rates, home prices are going down.

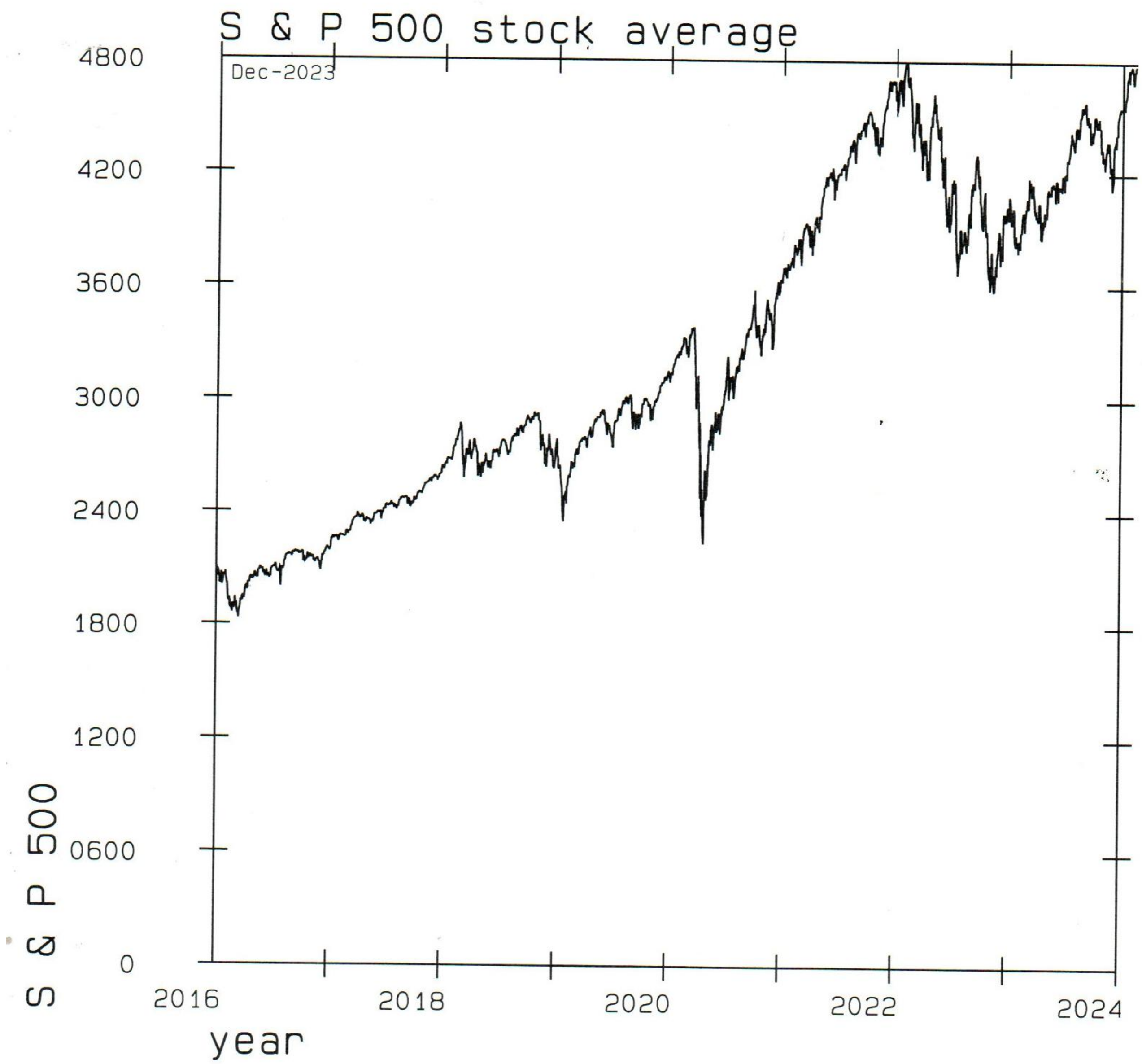

Figure 8: The S&P 500 stock average gives the weighted value of 500 major stocks. Pumped up with stimulus money, it reached a peak of 4,700.58 on 1/5/2022. It has now just passed that peak. I predict losses if/when a recession comes.

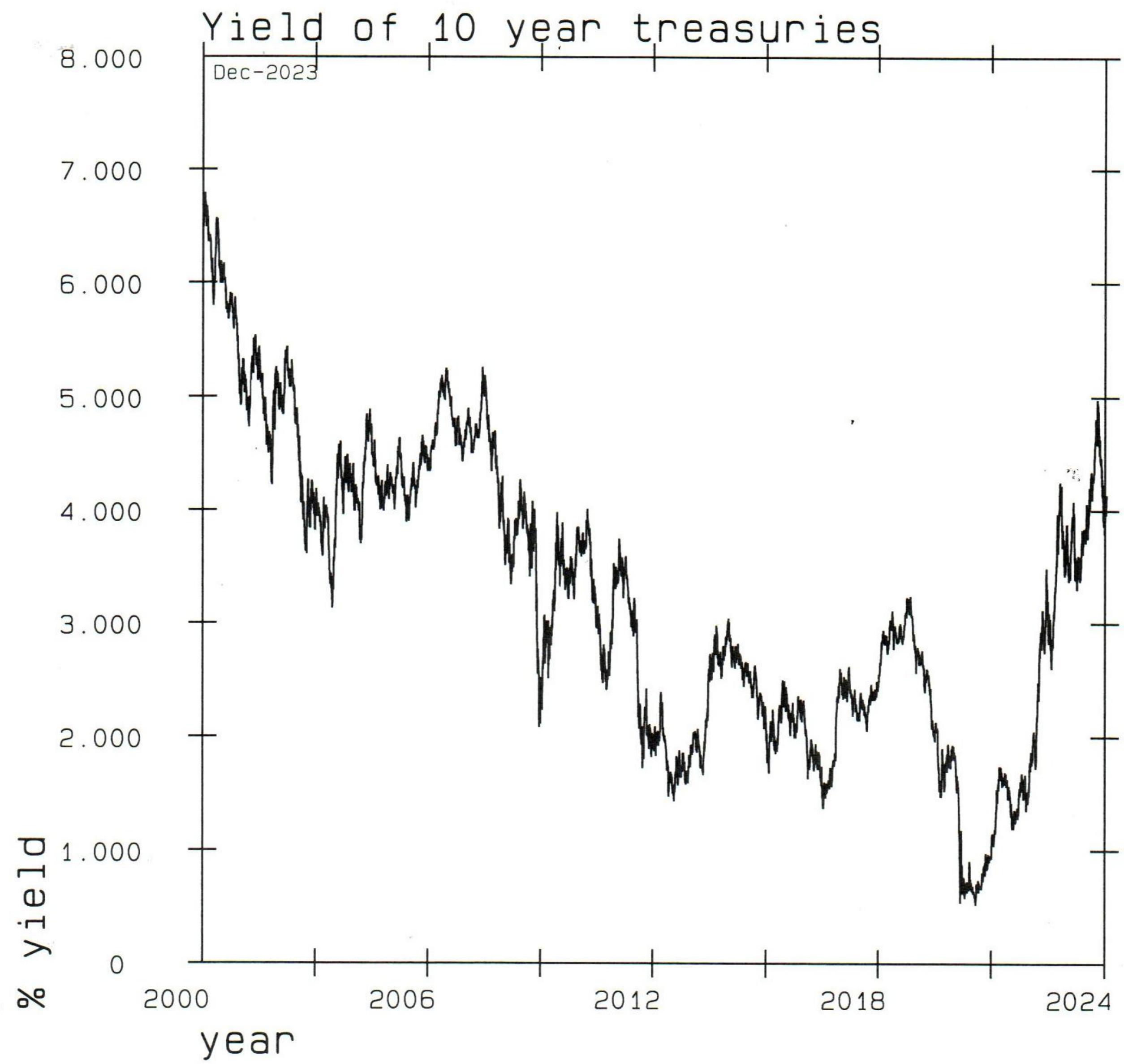

Figure 9: Ten year treasuries reached nearly 5%, but now have declined to 4.14%. It is very expensive for the Goverment, businesses, and individuals to borrow.

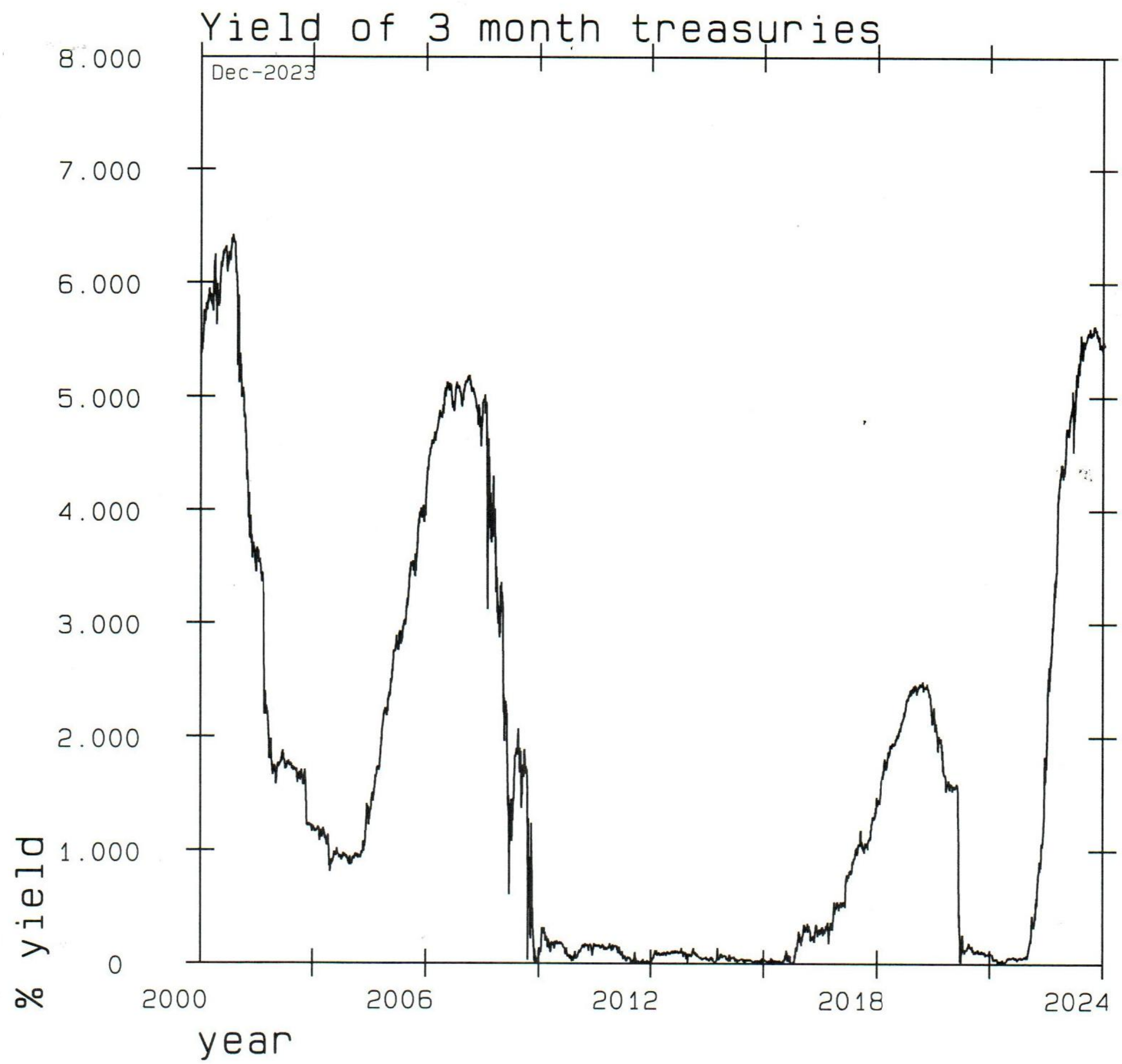

Figure 10: Interest on 3 month treasuries has now reached nearly 5.6%! Investors bid up the price of 3 month treasuries before and during periods of uncertainty, such as the 2000 recession, the Great Recession of 2008, the recession fear of 2019, and now.

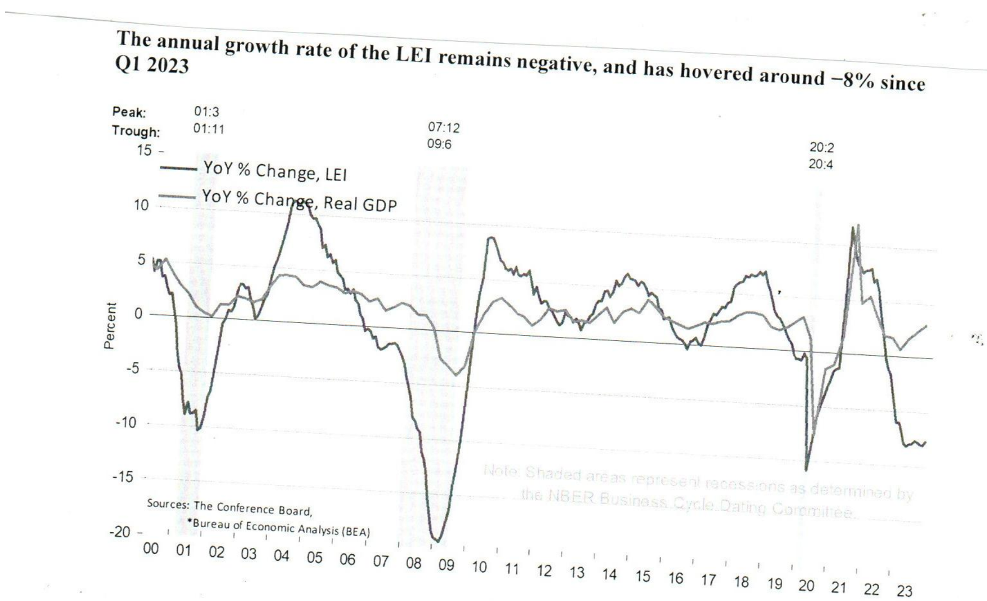

Figure 11: The Leading Economic Index (LEI) is a composite index. Changes in the LEI (thick black line) have well predicted changes in GDP (thin black line). The LEI has been going down since April 2022, an almost certain predictor of recession in 2024.

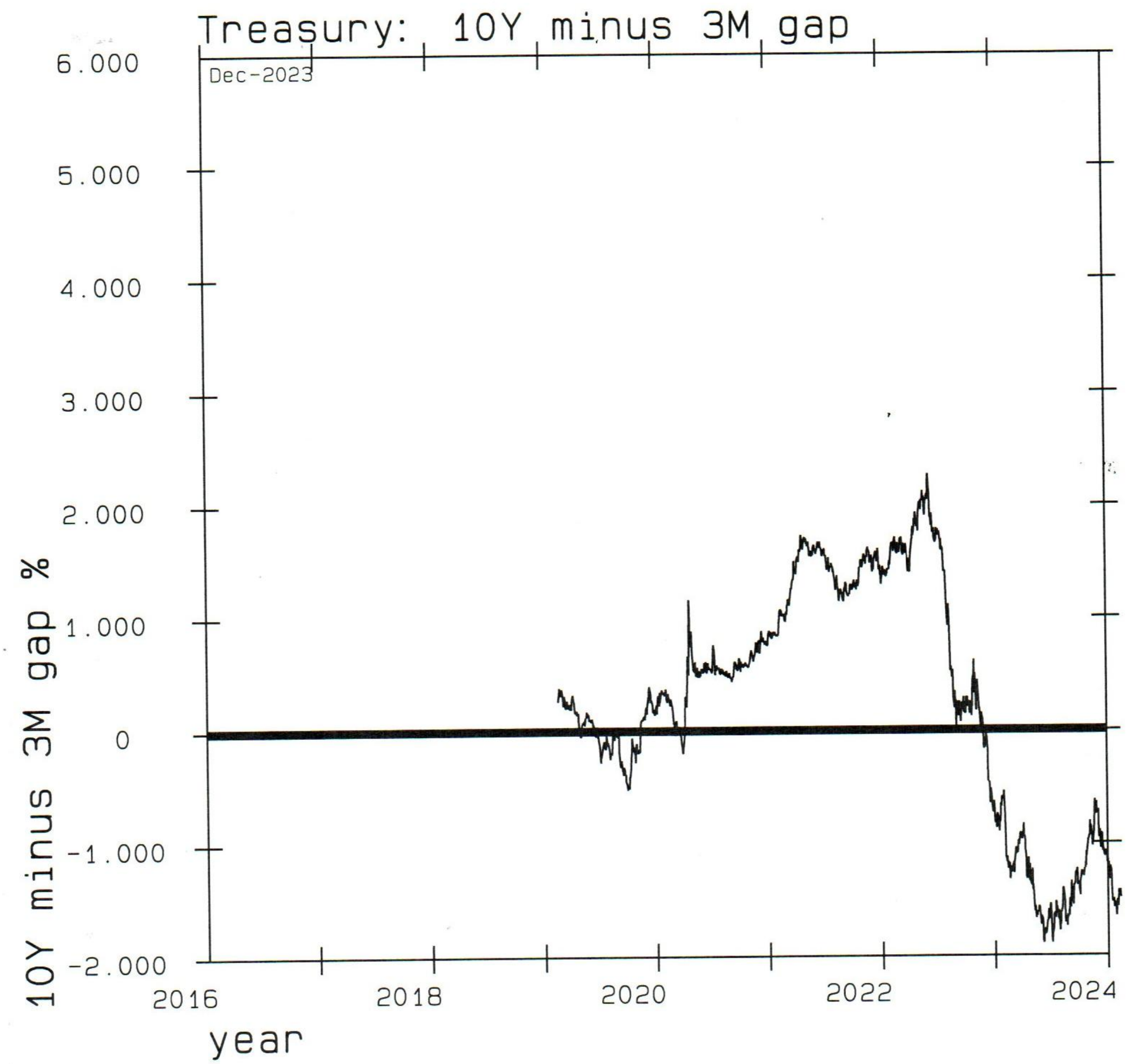

Figure 12: The difference between the yields of 10 year and 3 month treasury bonds is a predictor of recession when it goes negative, as it is now.

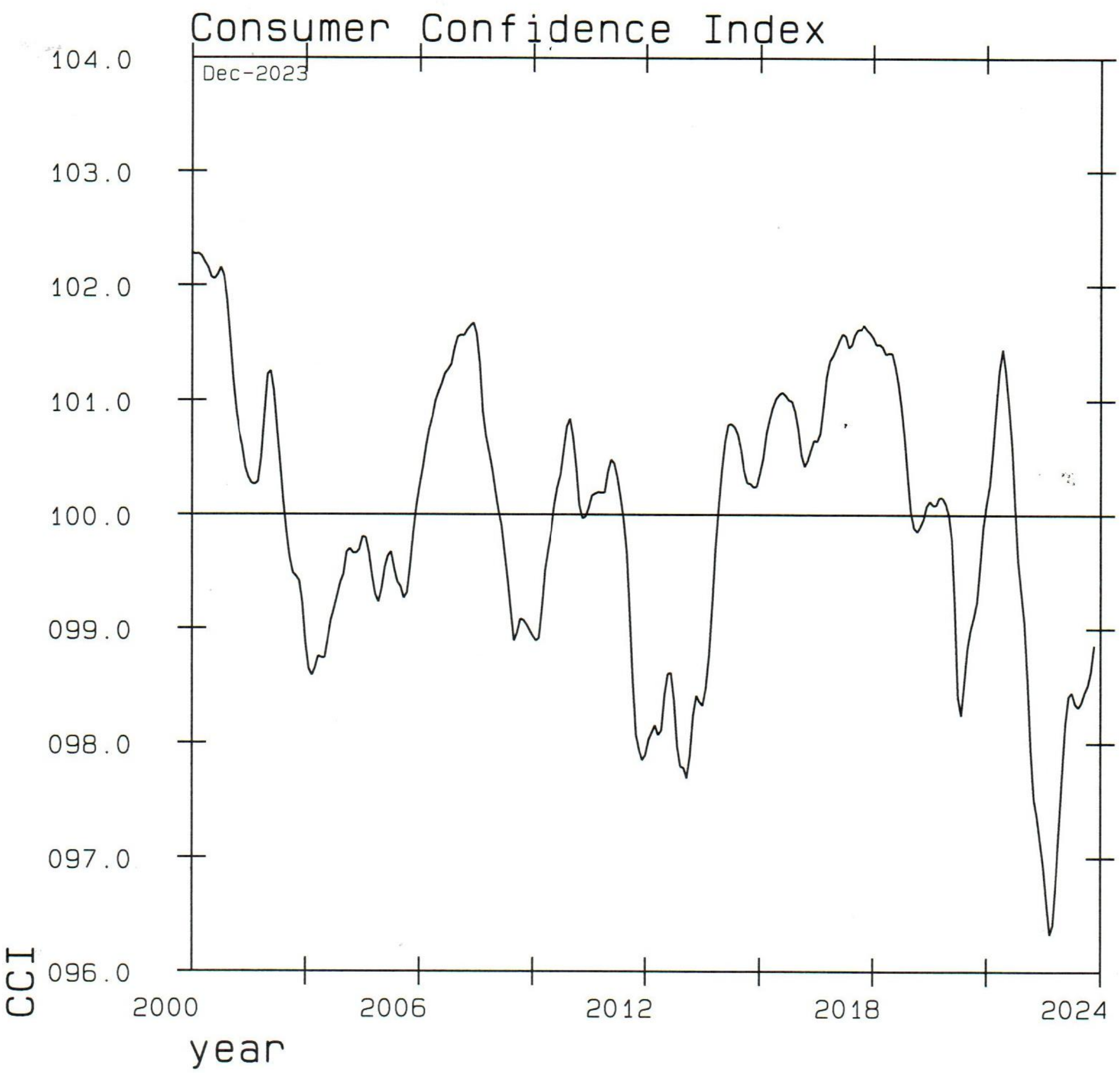

Figure 13: The Consumer Confidence Index (CCI) indicates consumers' propensity to spend (CCI>100) or, if they think times are getting worse, to save (CCI<100). Consumers now are somewhat pessimistic.

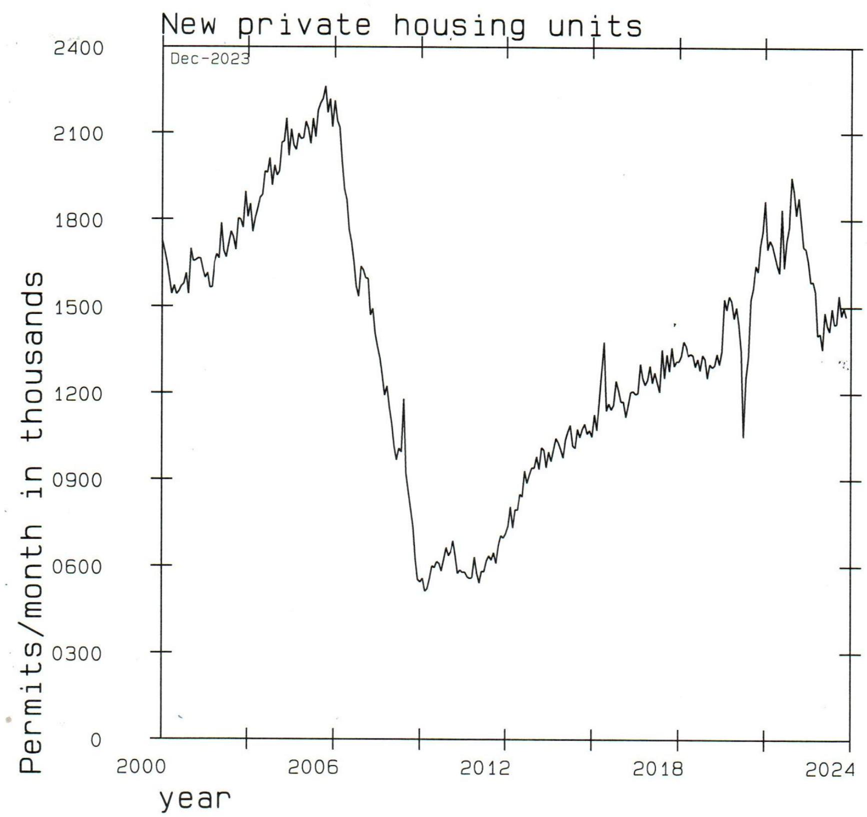

Figure 14: New privately-owned housing units started (permits issued each month) reflects people's willingness to take on long-term mortgages. Since the increase in mortgage rates, the housing market has plummeted.

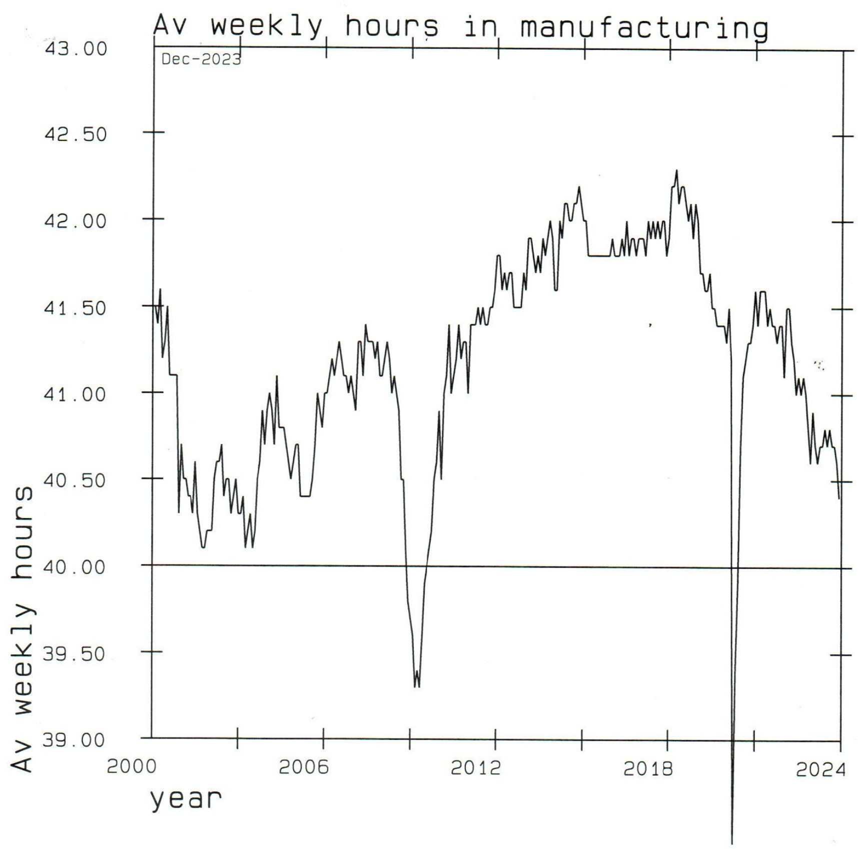

Figure 15: The average weekly hours in manufacturing for nonsupervisory personnel have been declining.

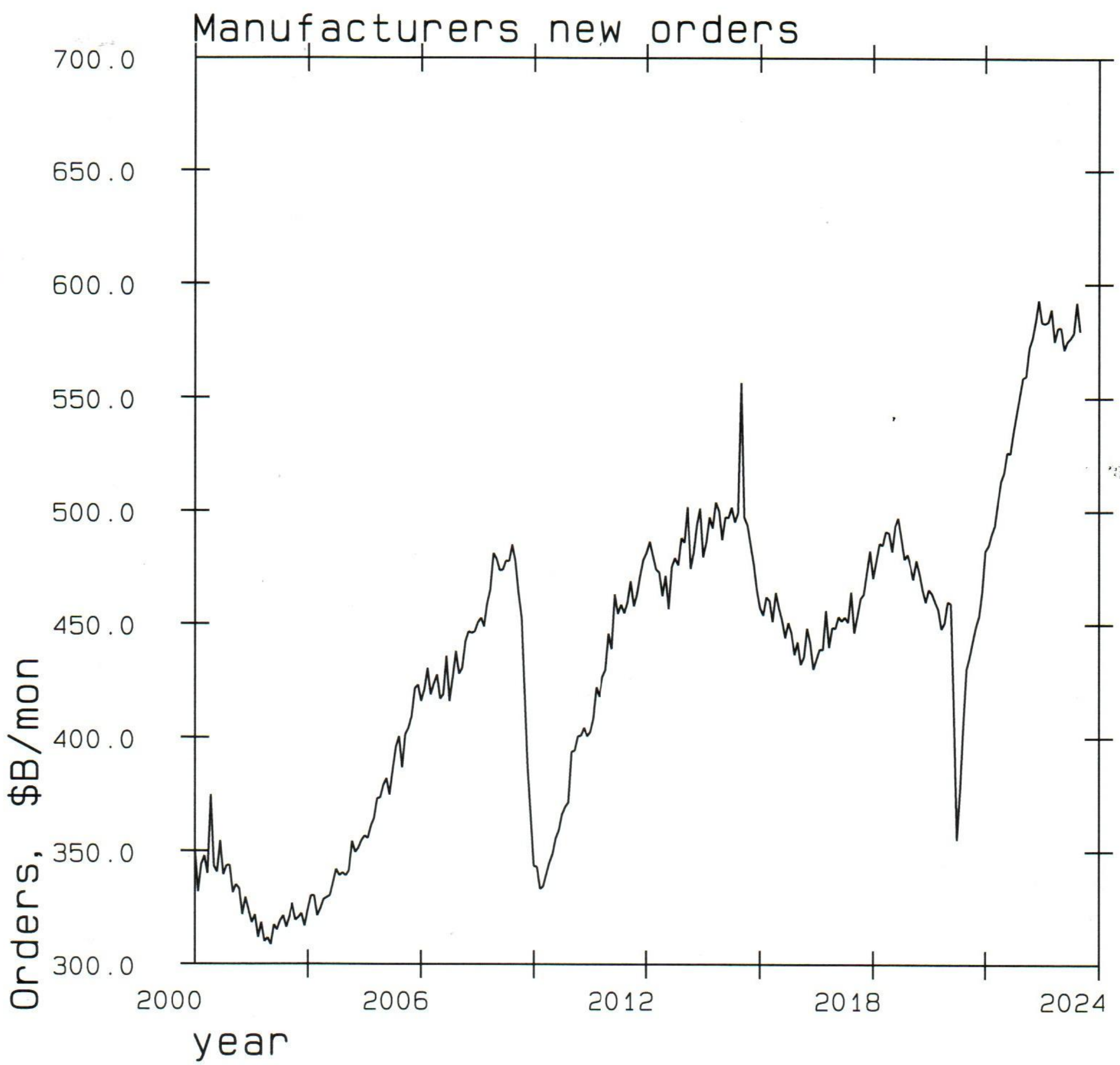

Figure 16: New manufacturing orders indicate manufacturers' expectations that sales will increase. They are now stagnating.

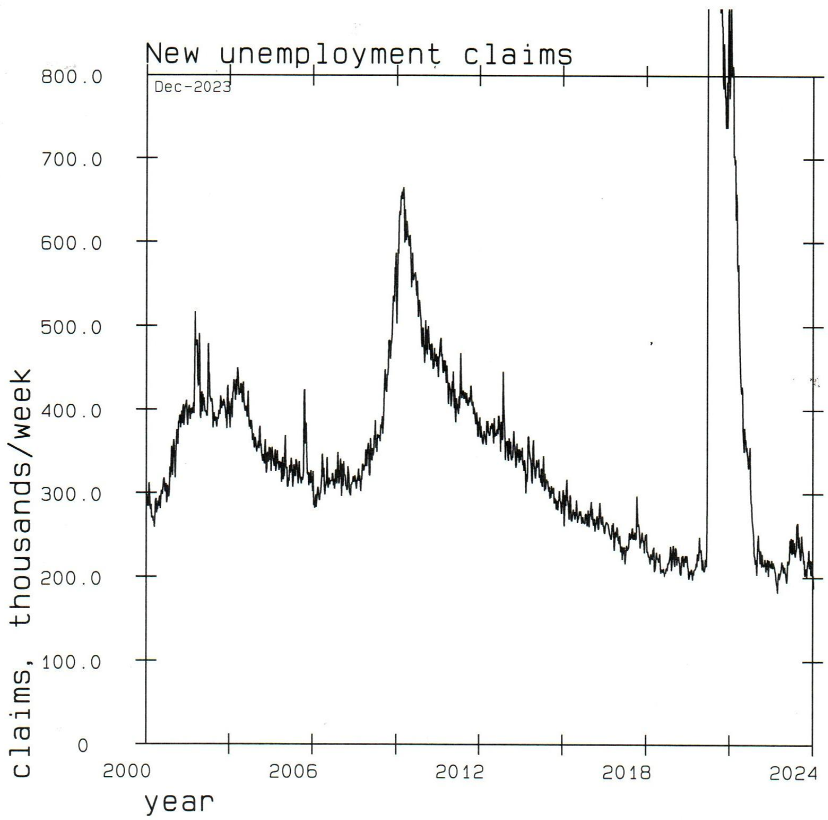

Figure 17: The slightly increasing new unemployment claims indicates that businesses are slightly slowing down.