NATIXIS INVESTMENT MANAGERS | SOLUTIONS

MACRO COMMENTARY | December 2024

PORTFOLIO ANALYSIS & CONSULTING

Charts and Smarts®

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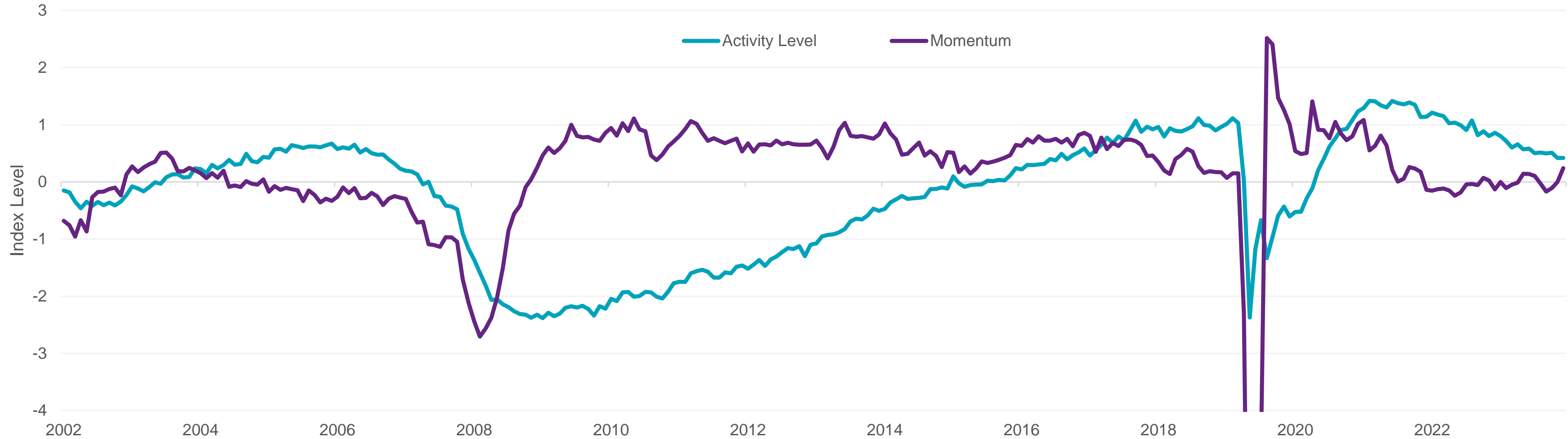
Warning

Kansas City Fed Labor Market Conditions Indicators (12/31/02–11/30/24)



Stasis has become a common term for us through this unique cycle. One which has seen a plethora of once-revered recession indicators shown to pasture. Despite the cacophony of recession calls that emerged in the late summer months, we've held steadfast in our belief that labor markets remained resilient, although risks were clearly skewed to the downside as labor activity continued to slowly cool. After a few months of noisy data, the verdict is little changed. The Kansas City Fed's Labor Market Conditions Index, which aggregates 24 labor market indicators into measures of activity and momentum, neatly demonstrates this dynamic in one chart: as the level of activity slowly drifts lower, it still remains above average as momentum has flatlined around average levels well below the pre-pandemic range. Stasis. While we've seen some early indications of stabilizing activity, the problem remains: hiring activity has slowed to a crawl leading to a bifurcation in vibes. Conditions are fine if you have a job, but it has become increasingly challenging for those in search of a new job. To be sure, layoff rates remain low as earnings continue to grow, supported by healthy revenues and expanding margins. But as momentum remains muted, downside risks continue as further slack builds. And while election uncertainty has compressed, it has given way to policy uncertainty, keeping near-term hiring intentions in check. The market's reaction function may be pivoting more hawkish as a downshift in the pace of recalibration comes into view, but the Fed's reaction function will continue to be guided by the data which clearly shows a resilient, but cooling, labor market with risks still skewed to the downside. Let's keep that hawkishness in check.

Source: Portfolio Analysis & Consulting, Bloomberg.

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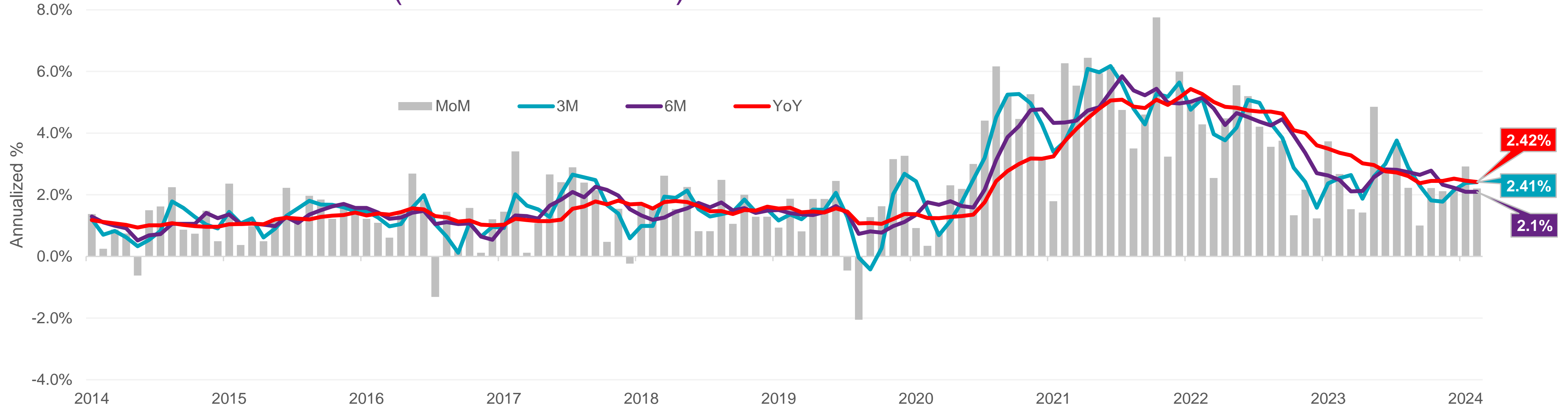
Paranoid

Market-Based Core PCE (9/30/14–10/31/24)



Another reason to keep that hawkishness in check: the inflation side of the mandate. Recent inflation prints have indeed been firmer as the past two months have seen a notable uptick to a 3.25% annualized pace, after trending below 2% annualized from May through August. The recent firming has helped to fuel the sticky inflation narrative as year-over-year prints have stalled out at, or above, 2.7% since July. But what's behind the recent firming matters, and much of it appears to be idiosyncratic in nature – just as we witnessed after the hot prints of the first quarter. Once again, technical factors – not excess demand – appear to be fueling the recent stall out as imputed prices, or those prices that cannot be directly observed, overstate inflationary pressures. Over time, imputations generally track the broader macroeconomy, but in the short run they can deviate considerably, thereby introducing noise into the trend. While core PCE may appear to be stalling out in recent months, market-based core PCE, which excludes those imputed prices, like financial services, continues to show progress. Yes, base effects have helped flatten out progress on a year-over-year basis and recent prints have been volatile, in large part due to the bumpy disinflation in shelter costs, but the trend remains clear as the 6M annualized pace slows to 2.1%. In short, imputed prices are overstating the degree of stickiness, just as core CPI has overstated stickiness relative to core PCE over the past year. The vast majority of the inflation basket remains consistent with the Fed's 2% target and, to the extent that idiosyncratic factors are driving the recent firming, we are likely to see some giveback in these imputed prices as inflation remains on a trend back toward 2%.

Source: Portfolio Analysis & Consulting, Bloomberg. PCE represents Personal Consumption Expenditures Price Index.

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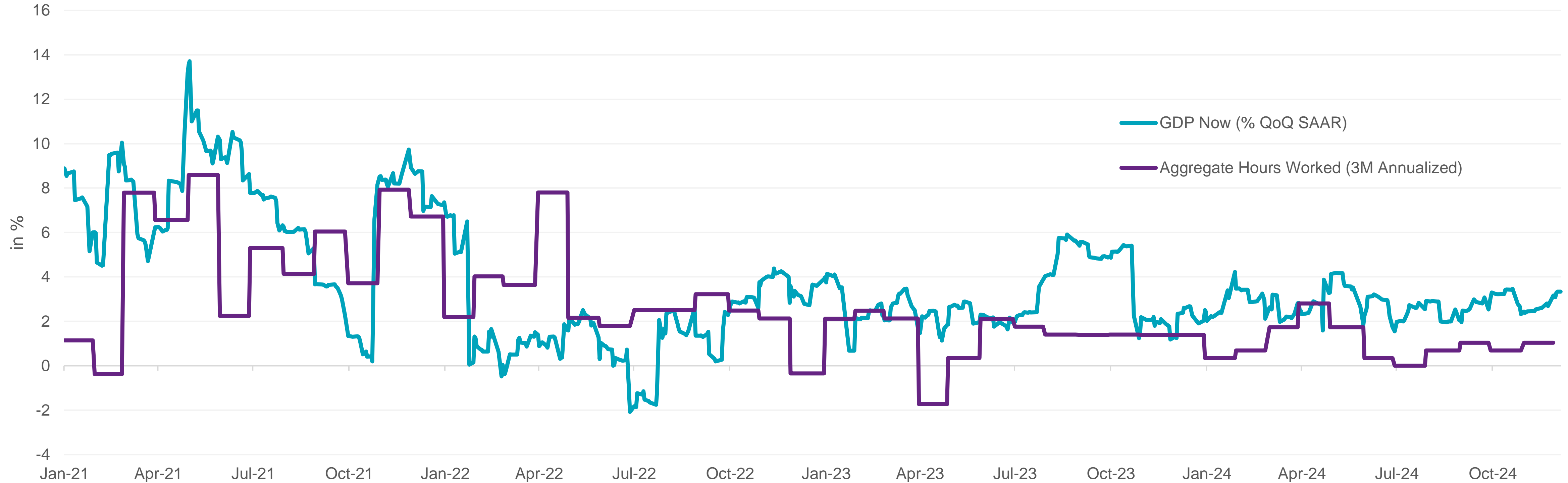
The Wizard

Atlanta Fed GDPNow (1/4/21–12/9/24)



Structurally, there remains little evidence of entrenched inflationary pressures in the economy. Quite the contrary, nearly everywhere one looks there are disinflationary impulses. Core goods have returned to their pre-pandemic pattern of oscillating between modest inflation and deflation. Shelter continues to slowly, but surely, realize its massive pipeline of disinflation. Motor vehicle insurance prices are following the value of the underlying assets lower. The dollar has strengthened over 5%, which should weigh on import prices. Labor market slack continues to build, placing downward pressure on wages. And perhaps the most important factor, productivity growth, remains alive and well. As we've repeatedly stressed over the past few years, strong productivity growth is a powerful buffer to elevated wage and income growth. In other words, wages are already consistent with the Fed's 2% target, given the elevated trend of productivity growth we've settled into in the post-pandemic world. Over the past 6 quarters, nonfarm productivity has averaged an annualized pace of 2.6% quarterly growth, well above the 1.2% average pace experienced between 2010 to 2019. With the Atlanta Fed's latest GDP Now estimate for Q4 tracking over 3.3% as aggregate hours worked have risen only 1% over the past three months and just 0.5% annualized in Q4, we're tracking for yet another quarter of robust productivity gains which should continue to ameliorate what little inflationary pressures remain.

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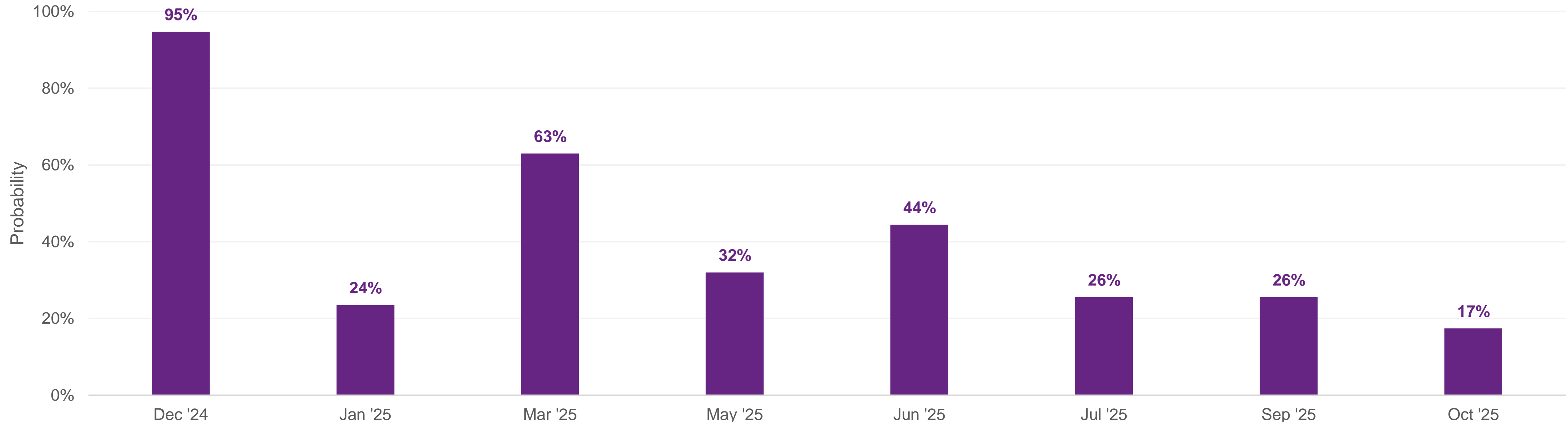
Into the Void

Odds of Fed Cut at Given Meeting (As of 12/11/24)



With growth remaining resilient, recent inflation prints firming, and labor markets continuing to hold up, it's no surprise that as the narrative has swung back toward a no landing consensus chatter about a looming pause in the easing cycle has grown louder. While markets are now nearly fully pricing a December cut in the wake of the November jobs report, pricing after that meeting is now reflecting a more measured pace of easing with an every-other-meeting cadence showing through the probabilities, beginning with a pause in January followed by the next cut in March. While some investors are busy extrapolating a pause into the end of the easing cycle, a pause by no means implies the Fed has reached its estimate of neutral. Just as the Fed slowed the pace and size of hikes on the way up as it felt out the terminal rate, it will moderate the pace of recalibration as it feels its way to neutral. The market has been hard at work pricing out cuts since recession fears reached a zenith in early September, with the strip now showing just 100 basis points more of cuts by year end 2025 from the current 4.75% upper bound. While we've grown accustomed to wild swings in rate expectations over the past few years, expectations feel fairly priced at current levels. The data will continue to guide the path of policy rates from here, but given our expectations of continued disinflation and the potential for unwanted further cooling in labor markets in the near term, the greatest risk to rate expectations moving forward isn't further pricing out of cuts but rather a pull forward of those every-other-meeting cuts should the data soften further in the months ahead. Despite the growing chatter of sticky inflation, the easing bias remains intact even if the pace of recalibration may soon be moderating, which will continue to put a floor below confidence and activity. The Powell Put remains alive and well.

Source: Portfolio Analysis & Consulting, Bloomberg.

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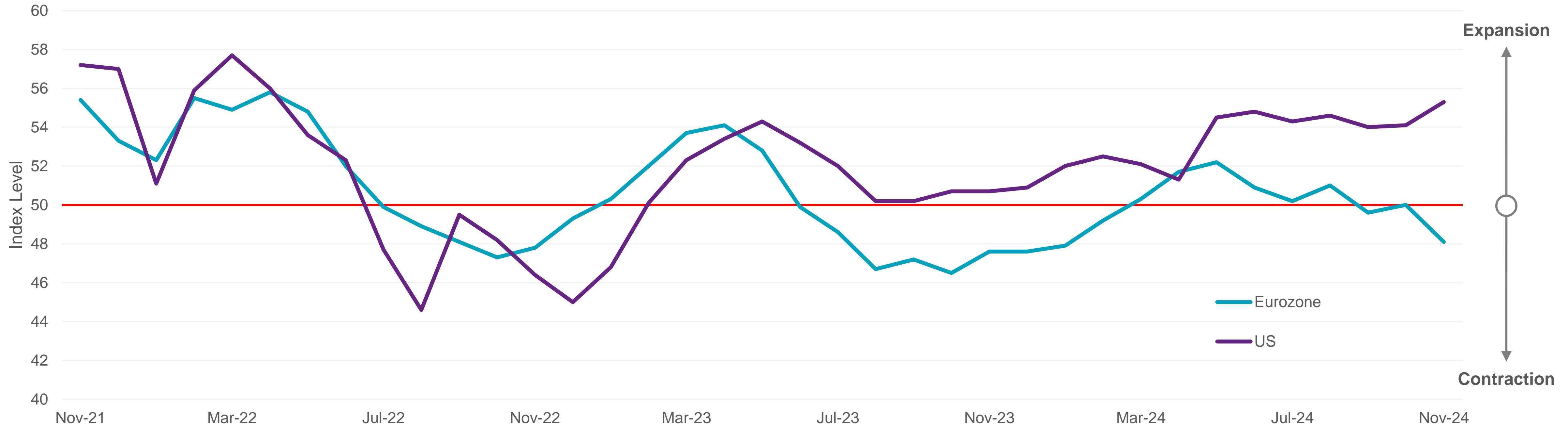
Time Machine

Composite Purchasing Managers' Index (11/30/21–11/30/24)



The Powell Put is a powerful force to counter risks that remain skewed to the downside, but it's not the only put in play. The Trump Put is in the money as well. While we've noted the potential headwinds to growth and downside risks to labor markets in the near-term, the starting point for US growth is robust, particularly relative to the rest of the world. While by no means perfect, Purchasing Managers' Indices tend to correlate with growth momentum, and in that regard, US growth momentum is strong and drifting higher as manufacturing sector sentiment improves and expectations of a pro-growth agenda under the Trump administration take root. Meanwhile, across the Atlantic, Eurozone growth expectations continue to slide as the key growth engines of core Europe falter, despite peripheral strength – an odd inversion of the crisis that gripped the region just a decade ago. US exceptionalism is alive and well from both a cyclical and secular perspective, a dynamic that is unlikely to change meaningfully in the near term. While there will likely be short-term, catch-up trade opportunities in global equities, one of which may play out in the near term as European equities revert from historic levels of short-term underperformance, structurally the deck remains stacked against the Eurozone: Growth differentials are pressuring rate differentials wider and pushing King Dollar stronger, providing yet another headwind for returns in USD terms for equities already facing headwinds from tepid global growth, weaker domestic demand, soft productivity growth, and looming tariff risks. Keep favoring US equities over the longer run.

Source: Portfolio Analysis & Consulting, Bloomberg.

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