Louisiana Corporate Credit Union

ECONOMIC & FINANCIAL DIGEST

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Rate Cuts Are On The Way

For the first week of the month, it looked like the we were entering the time-honored "dog days of August", that foreboding mindset people get when they feel stuck in the mud and sense that things just weren't going right. The first inkling of the blahs was delivered by the Labor Department on August 2, when it released a downtrodden employment report for July, which featured a weaker than expected job growth and a dispiriting rise in the unemployment rate. The report spurred a knee-jerk response in the financial markets as recession fears suddenly exploded and sent stock prices tumbling. Adding rain to the parade, a few days later the government agency delivered more grim news on the jobs front, reporting a spike in initial claims for unemployment insurance for the last week of July. Things looked grim indeed.

But after that first dispiriting week, the sun peaked out of the clouds and things started to look much brighter. The first silver lining came again from the Labor Department in its weekly report on jobless claims. As it turns out, the late-July spike in unemployment claims was caused primarily by Hurricane Beryl which hit Texas businesses particularly hard, causing shutdowns that temporarily sent workers to the unemployment lines. Once that unfortunate weather-related blow faded and businesses reopened their doors, workers were called back, and the unemployment lines thinned out. Over the next two weeks, initial filings fell below the level that prevailed before the hurricane struck.

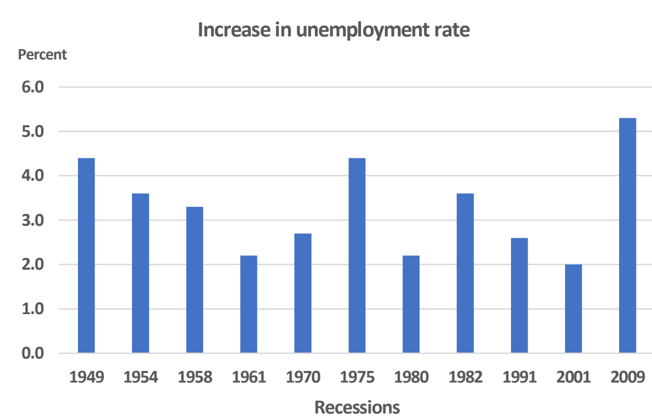
Unsurprisingly, the financial markets heaved a big sigh of relief, and the early losses in the stock market were rapidly recovered. Recession fears were further dampened in the second week of August when the government released its monthly retail sales report, revealing a much stronger pace of consumer spending in July than expected. If the job market was falling apart, as the July employment report signaled, households would be turning much more frugal than suggested in the retail sales report. We will have to wait until the September 6 release of the August employment report to see if the jump in the unemployment rate in July – from 4.1 percent to a three-year high of 4.3 percent -- was a fluke. If it continues to rise, the recession worriers will surely come out of the woodworks again, putting pressure on the Federal Reserve to cut rates more aggressively than is currently expected at the upcoming September 17-18 policy meeting. Perhaps it's biggest challenge will be to separate the signal from the noise in the data and not be unduly influenced by hyper-sensitive markets.

What To Expect if There is a Recession

Recession calls come and go among investors and commentators who are easily swayed by unexpected data reports. Fortunately, the folks who are officially responsible for determining when a recession begins and ends – the experienced economists on the National Bureau of Economic Research – are much more patient. Indeed, their official recognition of a recession tends to be made after it has already ended. That's because the NBER needs enough time to vet the data, which are frequently revised and not fully available until the economy is already on an upswing.

Yet, it's useful to know what to expect if the economy does head into a tailspin. No two recessions are alike, of course, but if there is one common denominator, it is that workers lose their jobs. On average, the unemployment rate has risen by 3.2 percent over the course of the 11 postwar recessions. But the climb ranged from the mild 2.2 percent in 1961 to over 5 percent during the Great Recession in 2009. We omitted the spike during the Covid-19 recession, because of its brevity and the rapid recovery of job losses as the economy quickly rebounded.

Still, a 3.2 percent rise from the 2023 low would throw 3.6 million more workers on the unemployment lines, which is certainly nothing to scoff at. The lost wages would clobber spending and dent corporate profits. That, in turn, would likely lead to punishing losses in the stock market and erase a chunk of the wealth gains that have contributed importantly to the robust spending of upper income households over the past year. That said, high stock prices and narrow credit spreads in the bond market indicate that investors are not expecting a recession soon. The markets are not always right, but recent events clearly suggest that the economy is holding up. GDP staged an impressive 2.8 percent growth rate in the second quarter and the main



growth driver, consumers, are stll forging ahead.

Hard to Stop, Once it Starts

True, the recession fears that exploded earlier in the month did not come out of thin air. The July increase in the unemployment rate triggered the so-called "Sahm Rule" which states that a rise equal to that over the past year has never occurred outside of a recession since 1960. The increase, from the 3.4 percent low in 2023 to July's 4.3 percent, is still well below the 3.2 percent average seen in past recessions; but once it rises by that much, it is usually difficult to stop. The reason is that at that point, it usually enters a feedback loop.

Simply put, a rise of that magnitude heightens anxiety among workers that their jobs are insecure. That, in turn, leads to a pullback in spending, which causes employers to cut back on hiring. The hiring cutback then begets a further spending retreat that leads to more layoffs, setting in motion the feedback loop that continues until the economy enters a recession. Ominously, a recent NY Fed survey reveals that the percent of workers expecting to lose their jobs over the next four months rose to the highest level since the series began in 2014.

So, are we on the cusp of another recession? Even Claudia Sahm, author of the rule. does not think so. That's because the reasons for the current rise in the unemployment rate differs markedly from the catalysts that stoked the increase in past recession. The key difference is that the current increase is not being driven by massive layoffs, which would result not only in the lost paychecks that support spending but would also stoke anxiety among workers that their jobs were at risk. Instead, the rise in the unemployment rate over the past year has reflected more labor supply coming to the job market than the demand for workers, thanks mainly to a big influx of immigrants. These entrants are not landing jobs right away, which is lifting the unemployment rate.

Not Out of The Woods

In a sense, the faster rise in labor supply is good news in that it helped restrain wage growth, allowing inflation to recede faster than it otherwise would. But it would be a mistake to think that expanding supply is the only reason behind the cooling of wage pressures. The job market is also turning softer because the demand for workers is easing. The startling revelation unveiled on August 21 that the economy generated 818 thousand fewer jobs in the twelve months through March than initially estimated is a case in point. Ordinarily, these annual benchmark revisions -- based on more complete information than available in the monthly employment reports --are not a big story. But this was the largest adjustment to prior data since 2009.

While jolting, the response in the financial markets was relatively muted as traders already suspected that reported job gains overstated the strength in the labor market. Other data clearly depicted cooler worker demand by businesses, as they cut job openings and laid off a big swath of temporary help. So far, however, they have retained their full-time staff, hoping demand remains sufficiently strong do justify the labor costs.

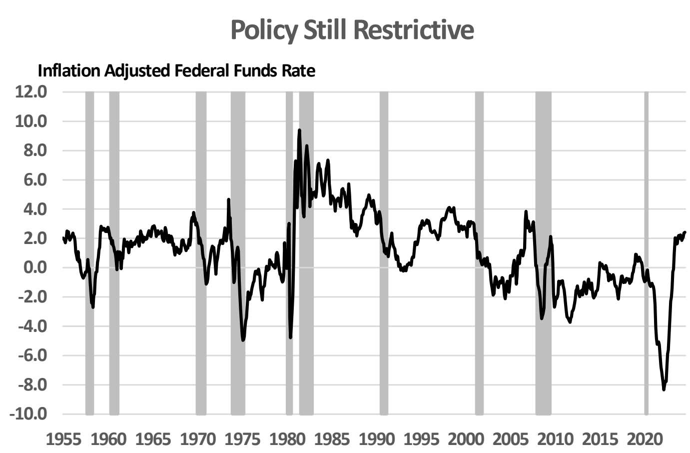
Broadly speaking, the job market is weakening but not crashing. Although job growth was revised sharply lower, the unemployment rate was not changed and, despite moving up, is still at a relatively low 4.3 percent. But as one policy maker recently commented, over the course of a business cycle unemployment tends to go up like a rocket and come down like a feather. The opposite is happening now, but only because the economy has not entered that dreaded feedback loop described earlier. The key is to short-circuit that prospect from coming to pass --and that job falls on the Federal Reserve.

Fed To The Rescue

There is an old economic adage that says expansions do not die of old age but are murdered by the Federal Reserve. By all accounts, the Fed has done a commendable job navigating the economy through the challenging dual objectives of taming inflation without spurring a big increase in unemployment. More often than not, it has overstayed its hand to bring inflation under control, either by jacking up interest rates too rapidly or leaving it too high beyond the point it is justified, thus killing the expansion.

While the economy has so far weathered the steep rate climb engineered by the Fed, the muscle that has sustained growth is rapidly losing strength. Pandemic -era savings have been used up and low- and middle-income households are struggling to keep up with debt payments. A broad swath of the population has been insulated from the rate hikes because they locked in the low rates that prevailed before the Fed stepped on the brakes. But as those loans mature and must be refinanced, they will incur the much higher cost associated with the current level of interest rates. In other words, the fabled lag effects of monetary policy are starting to kick in.

The good news is that with inflation having receded considerably, the Fed can now shift its priority to sustaining job growth. At its upcoming policy meeting in mid-September, the question is not if, but by how much policy makers will cut rates. The anticipation of a Fed pivot has been building for some time, with the bets on Wall Street ranging from the normal quarter-point reduction in the Fed's benchmark policy rate to a more aggressive – and unusual – half point cut from the current median level of 5.30 percent. From our lens, a more normal quarter-point cut is all that is necessary for the first move, unless the next employment report due out on September 6 turns out to be weaker than the July report. But one thing is clear: one cut will not be enough to keep the economy out of a downturn. Even after a quarter or half point reduction, interest rates will still be restrictive and taking an ever-greater toll on an economy that is already cooling.



KEY ECONOMIC AND FINANCIAL INDICATORS

Financial Indicators *

	July	June	May	April	March	February	January	12-Month Range High	12-Month Range Low
Prime Rate	8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50
3-Month Treasury Bill Rate	5.20	5.24	5.25	5.24	5.24	5.24	5.22	5.34	5.20
5-Year Treasury Note Rate	4.16	4.32	4.50	4.56	4.20	4.19	3.98	4.77	3.98
10-Year Treasury Note Rate	4.25	4.31	4.48	4.54	4.21	4.21	4.06	4.80	4.02
30-Year Treasury Bond Rate	4.46	4.44	4.62	4.66	4.36	4.38	4.26	4.95	4.14
Tax-Exempt Bond Yield	3.94	3.94	4.00	3.87	3.54	3.53	3.36	4.13	3.36
Corporate Bond Yield (AAA)	5.12	5.13	5.25	5.28	5.01	5.03	4.87	5.61	4.74
Conventional 30-Year Mortgage Rate	6.85	6.92	7.06	6.99	6.82	6.78	6.64	7.62	6.64
Dow Jones Industrial average	40086	38904	39129	38401	39106	38721	37764	40086	33319
S&P 500 Index	5538	5415	5235	5112	5171	5012	4804	5538	4269
Dividend Yield (S&P)	1.31	1.33	1.36	1.39	1.37	1.42	1.47	1.63	1.31
P/E Ratio (S&P)	25.8	25.6	24.7	24.1	25.1	24.3	23.4	25.8	20.6
Dollar Exchange Rate (vs. Major Currencies)	123.7	124.0	122.2	122.5	121.0	121.4	120.6	124.0	120.2

* Monthly Averages

Economic Indicators

	July	June	May	April	March	February	January	12-Month Range High	12-Month Range Low
Housing Starts (Thousands of Units)	1238	1329	1315	1377	1299	1546	1376	1568	1238
New Home Sales (Thousands of Units)	739	668	666	736	683	643	664	739	611
New Home Prices (Thousands of Dollars)	430	417	408	415	436	421	430	440	408
Retail Sales (% Change Year Ago)	2.7	2.0	2.6	2.8	3.6	2.0	0.2	5.00	0.2
Industrial Production (% Change Year Ago)	-0.2	1.1	0.3	-0.7	-0.3	-0.2	-1.2	1.1	-1.2
Operating Rate (% of Capacity)	77.8	78.7	78.3	77.7	77.7	78.0	77.2	78.9	77.2
Inventory Sales Ratio (Months)		1.38	1.38	1.37	1.37	1.37	1.38	1.39	1.36
Real Gross Domestic Product (Annual % Change)		2.8			1.4			4.9	1.4
Unemployment Rate (Percent)	4.3	4.1	4.0	3.9	3.8	3.9	3.7	4.3	3.7
Payroll Employment (Change in Thousands)	114	179	216	108	310	236	256	310	108
Hourly Earnings (% Change Year Ago)	3.6	3.8	4.0	3.9	4.1	4.2	4.3	4.5	3.6
Personal Income (% Change Year Ago)		4.3	4.6	4.4	4.3	4.3	4.6	4.9	4.3
Savings Rate (Percent of Disposable Income)		3.4	3.5	3.5	3.5	3.7	4	4	1.37
Consumer Credit (Change in Blns. Of Dollars)		8.9	13.9	7.8	-1.0	11.9	13.1	18.2	-16.3
Consumer Prices (% Change Year Ago)	2.9	3.0	3.3	3.4	3.5	3.2	3.1	3.7	2.9
CPI Less Food & Energy (% Change Year Ago)	3.2	3.3	3.4	3.6	3.8	3.8	3.9	4.3	3.2
Wholesale Prices (% Change Year Ago)	2.3	2.7	2.4	2.2	1.9	1.6	1.0	2.7	0.8

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