Economic Indicators: The Tale of Two Charts

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of light, it was the season of darkness, it was the spring of hope, it was the winter of despair..."

Global Sustainable Total Return Bond Strategy Portfolio Managers



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Iconic words indeed, penned in 1859 by Charles Dickens in "A Tale of Two Cities", words that aptly capture the paradoxical nature of economic indicators in the world of 2024. As we sift through labyrinthine data, we find ourselves confronted with a narrative that is as intricate as it is contradictory. On the one hand, some indicators paint a picture of prosperity and growth, while on the other hand, some data signal caution and uncertainty. In this tale of two charts, we delve into the perplexing landscape of economic indicators, where optimism clashes with apprehension, and where the story's ending will greatly depend on which chart and data prove to be correct.

We cannot recall a period of more divergent and conflicting economic signals in our years spent focusing on macro analysis and fixed-income portfolio management. Of late, this divergence has led to a sharp disparity of views around the future path of both the economy and monetary policy. What was believed to be a peak in rates that would lead to significant rate cuts in 2024 has now been called into question. Larry Summers, the former Treasury Secretary during the Clinton Administration, recently prognosticated that there is a 15% chance that the next move by the FOMC will be a rate hike.

With conflicting signals abound, we will focus on three areas that we find particularly interesting.

Growth – What is GDI?

The most widely accepted and understood measure of the U.S. economy's output—produced by the Bureau of Economic Analysis (BEA)—is Gross Domestic Product (GDP). A less followed, yet important alternative measure, is Gross Domestic Income (GDI). They both attempt to measure the same output, but through different lenses. While GDP measures the value of goods and services on the production side of the economy, GDI measures the sum of wages and profits on the income side. According to the BEA[1], GDI, in theory, should equal GDP, but different source data lead to different results. The difference between the two measures is euphemistically phrased as the "statistical discrepancy," which, in layman's parlance, could rightfully be translated as "we don't really know why they diverge." The BEA does, however, consider GDP to be more reliable because it's based on timelier, more expansive data. Over

[1] Source: https://www.bea.gov/resources/learning-center/what-to-know-income-saving

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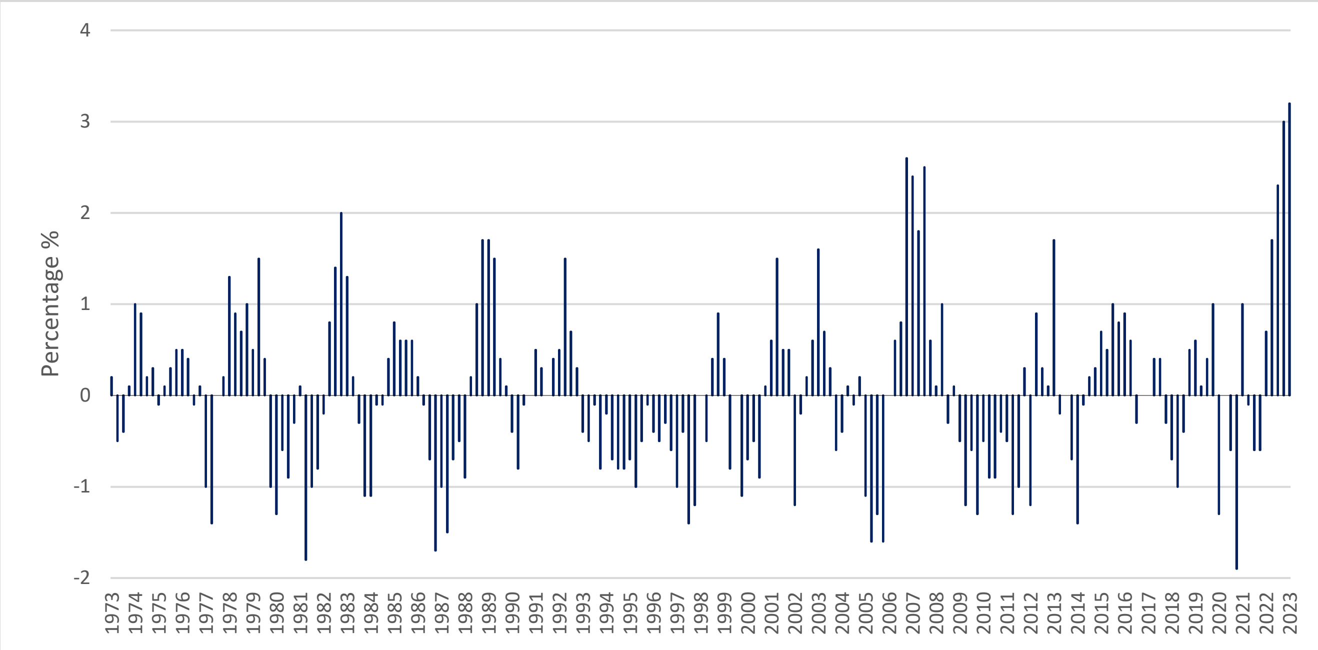
the last 50 years GDP has averaged 2.66% and GDI 2.62%[2], although some variation is not unusual over shorter time intervals. Today, the value difference is larger than it has ever been (shown in Figure 1), which begs the question: Which measure is correct? Some observers believe that averaging the two numbers yields a more accurate result. This approach would likely lead to much lower growth than has been assumed in the U.S. and, at the margin, strengthen the case for easier monetary policy.

Figure 1: Difference Between U.S. Real Gross Domestic Product and Real Gross Domestic Income (%)



Source: Bloomberg, Bureau of Economic Analysis, as of 01/31/2024

Inflation – How Much Progress?

Although inflation remains a top focus for central bankers, today's elevated environment warrants additional scrutiny. The two most commonly followed measures of inflation in the U.S. are the Consumer Price Index (CPI) and the Personal Consumption Expenditure Index (PCE). Both the Federal Reserve and market participants alike tend to focus on the core measures of both data sets that exclude the more volatile food and energy components. For choice, the Federal Reserve considers the PCE to be the superior measure since it is a broader measure, accounts for substitution effects and more accurately reflects consumer spending patterns, among other reasons. Due to these differences, core PCE has had an average reading that has been 0.33% lower than core CPI over the last 25 years[3]. Yet today, that difference sits at the extreme end of its observed range over the past quarter century (shown in Figure 2). At the time of writing, core PCE is 1.1%[4] lower than core CPI and moving much closer to the Federal Reserve's inflation target. It may be a challenge for Fed officials to communicate this phenomenon to the general public, as CPI is the much more closely followed and understood gauge. That said, even with potential communication difficulties ahead, we expect the committee to continue to place more weight on PCE rather than CPI when formulating monetary policy.

[2] Source: Bloomberg, Bureau of Economic Analysis, as of 01/31/2024
[3] Source: Bloomberg, Bureau of Labor Statistics, monthly publishing, as of 01/31/2024
[4] Source: Bloomberg, Bureau of Labor Statistics, monthly publishing, as of 01/31/2024

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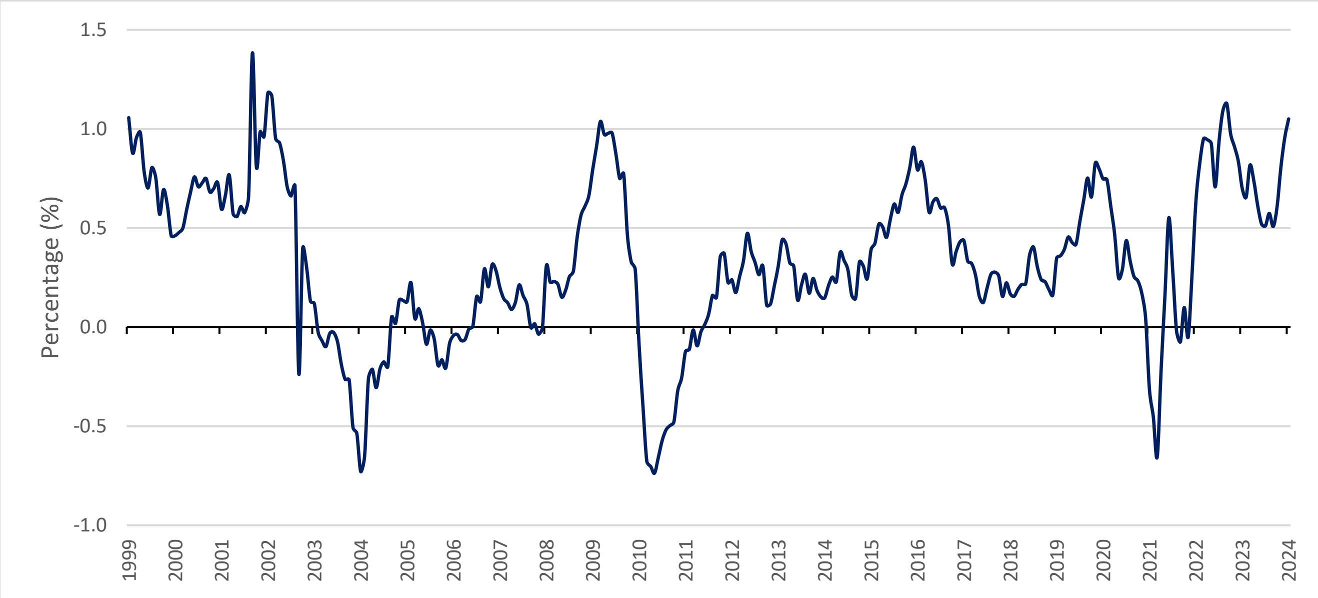
Figure 2: Difference Between U.S. Core CPI and Core PCE (%)

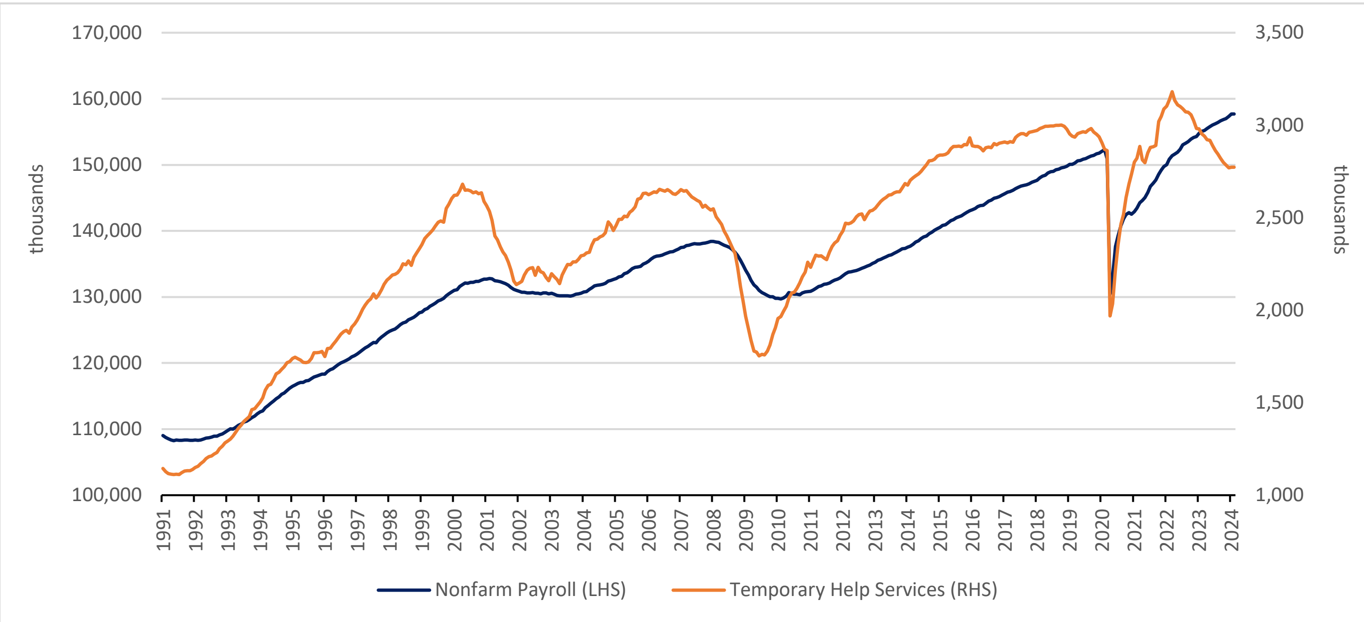


Source: Bloomberg, Bureau of Labor Statistics, Bureau of Economic Analysis, as of 01/31/2024

Employment – Too Hot, Too Cold, or Just Right?

Employment measures are generally viewed as lagging activity indicators, yet they are critically important to the understanding of the health of an economy, as personal consumption accounts for approximately two-thirds of U.S. GDP. Therefore, it is important to focus on leading indicators for future employment changes. It can be clearly observed that declines in temporary employment tend to foreshadow increases in unemployment. This is intuitively logical to us, as employers are most likely to cut temporary employees before full-time workers, as the latter are more difficult to replace. There has been a meaningful break in this relationship, as temporary jobs were lost for 21 consecutive months, from April 2022 through December 2023, while overall job growth averaged 285k per month over that period (shown in Figure 3).

Figure 3: Nonfarm Payrolls vs Temporary Help Services



Source: Bloomberg, Bureau of Labor Statistics, as of 01/31/2024

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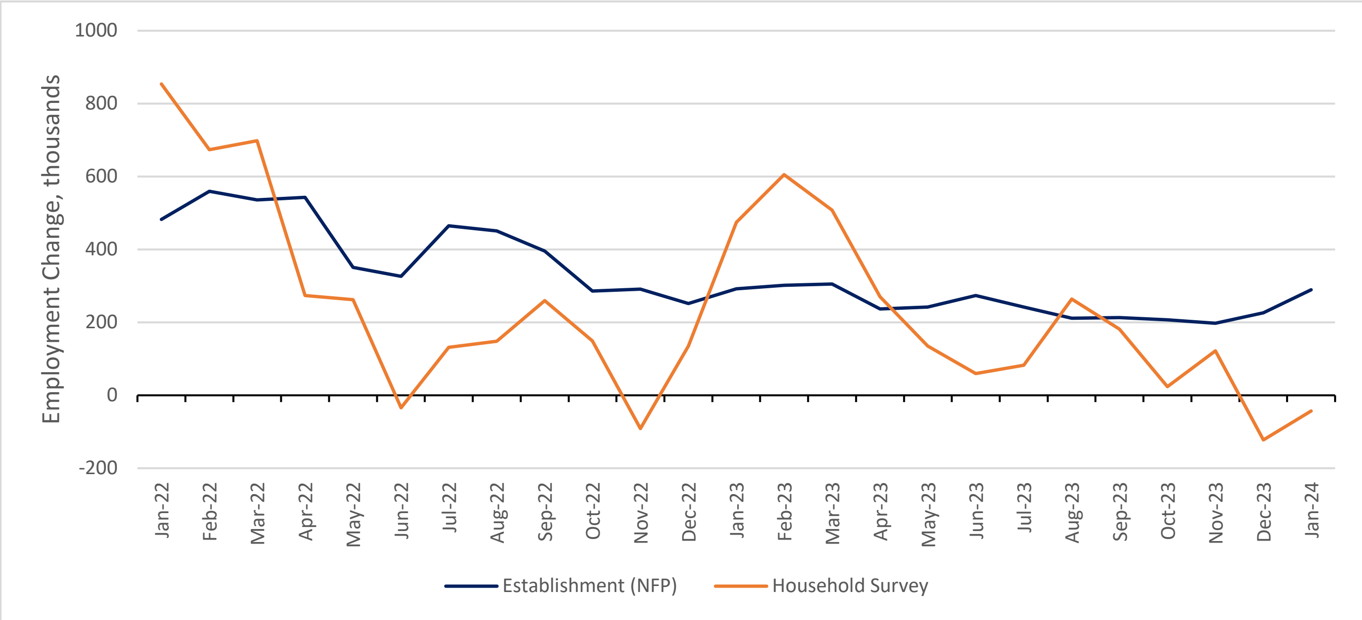
Additionally, there are two different surveys conducted by the Bureau of Labor Statistics (BLS) to measure U.S. employment—establishment and household. The establishment survey measures the changes in nonfarm payrolls, including hours and wages, and is considered to be the more accurate of the two by the BLS. The household survey, conversely, is designed to measure the employment status of the civilian noninstitutional population, with detail around demographics, and ultimately produces the unemployment rate. These two measures have been sending starkly different messages as of late (shown in Figure 4). The three-month moving average of job gains/losses for the establishment, or nonfarm payroll survey, is +289k, while the household measure is -43k.[5] It is not abnormal to have short-term divergences, but the magnitude is striking. We suspect these measures will converge in the direction of a weaker labor market.

Figure 4: 3-Month Moving Average of Employment Change (,000s)



Source: Bloomberg, Bureau of Labor Statistics, as of 01/31/2024

These are interesting times to be a market participant, as the post-Covid world has created some challenging and conflicting breakdowns in data that will be crucial to monitor and assess in order to understand the future direction of travel for the U.S. economy. It's not uncommon to see data sets diverge as we reach turning points in the economic cycle—our view is that the data will resolve itself, in this case with GDP and CPI coming down to meet their alternative measures. This should have meaningful implications for the health of the U.S. economy and the reaction function of the Federal Reserve, as well as the bond market's reaction to both.

We look forward to continuing to share our views with you, and as always, appreciate your support and interest in the strategy.

Chris, Ryan, and Colby

[5] Source: Bloomberg, Bureau of Labor Statistics, monthly publishing, as of 01/31/2024

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The **Consumer Price Index (CPI)** measures the monthly change in prices paid by U.S. consumers. The Bureau of Labor Statistics (BLS) calculates the CPI as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending.

Personal consumption expenditures (PCE), also known as consumer spending, is a measure of the spending on goods and services by people of the United States. According to the Bureau of Economic Analysis (BEA), a U.S. government agency, PCE accounts for about two-thirds of domestic spending and is a significant driver of gross domestic product (GDP).