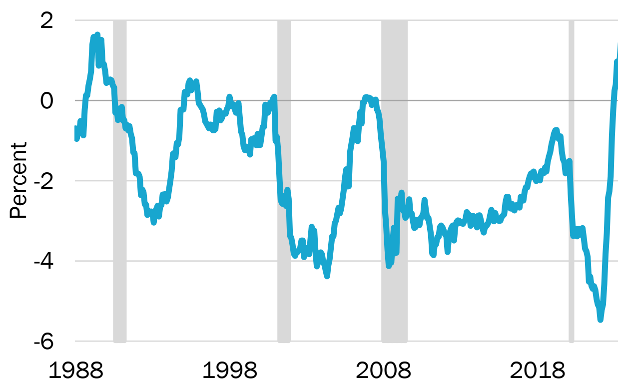
Slouching Towards a Slowdown

Over the first half of 2023, the US economy exhibited considerable resilience in the face of ongoing monetary tightening.

Households continued to draw on a large stockpile of savings to maintain spending despite inflation weighing on real income. In addition, many households and businesses had locked in low interest rates in 2020 and 2021, leaving them insulated from higher rates. A backlog of uncompleted housing units as a result of COVID-era supply bottlenecks also supported employment in construction even as the housing market adjusted to higher rates. And more recently, there have been early signs that the Biden administration's major policy initiatives are beginning to support investment in infrastructure projects and manufacturing facilities, adding an additional tailwind to the economy, albeit a modest one.

FIGURE 1: POLICY STANCE TURNED RESTRICTIVE IN 2023

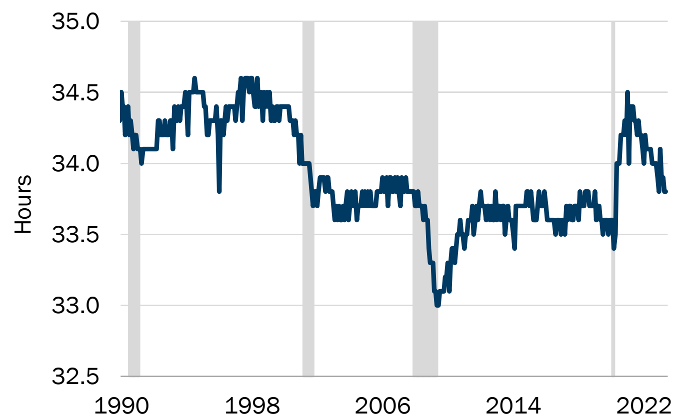
REAL POLICY RATE LESS NATURAL RATE ESTIMATE



Data as of May 31, 2023
Real policy rate subtracts near-term expected inflation from the effective federal funds rate, with inflation expectations calculated as the average of one-year inflation expectations measures from the Survey of Professional Forecasters and the University of Michigan Consumer Survey, and the inflation swaps market. Natural rate based on estimates of Holston-Laubach-Williams model, available from the Federal Reserve Bank of New York: https://www.newyorkfed.org/research/policy/rstar
Source: Federal Reserve Banks of New York and Philadelphia, Bloomberg, University of Michigan

All this raises the question of whether these sources of resilience can continue to underpin the economy, extending the runway for inflation to moderate and ultimately setting the stage for rate cuts and an extended expansion. We remain skeptical. First, excess household savings look set to run out by the end of this year. In addition, many households have increasingly turned to borrowing to support spending, an unsustainable trend in an environment where banks are tightening lending standards and looking to preserve net interest margins as funding costs increase. As for the corporate sector, profit margins remain elevated by historical standards but are likely to continue to compress given a weak global growth backdrop and ongoing cost pressures, including on the labor front. Margin compression could in turn weigh on capital investment and labor demand, which has already shown signs of moderating in recent quarters.

FIGURE 2: AVERAGE WEEKLY HOURS OF PRODUCTION & NONSUPERVISORY WORKERS



Data as of May 1, 2023
Shading Indicates NBER Recessions
Source: Bureau of Labor Statistics, Haver Analytics

In addition, the resilience story should not be overplayed. Monetary policy only turned restrictive this year, hence the economy's solid performance should come as no surprise. And policy will only turn more restrictive as the Federal Open Market Committee tightens further. The full effects of cumulative tightening still lie ahead.

The soft landing narrative also anticipates a near-normalization of inflation without a meaningful hit to growth and employment. This may be challenging to achieve. Inflation in many categories, such as durable goods and housing, should continue to moderate in the months ahead. But if the labor market remains strong, with firm wage growth, discretionary services inflation may remain sticky. That would set the stage for a sustained period of restrictive policy. And the historical record of such periods suggests that risks of an outright contraction remain elevated, even if the economy's recent performance and various tailwinds signal that a downturn is not imminent.

IMPORTANT DISCLOSURE

Availability of this document and products and services provided by MacKay Shields LLC may be limited by applicable laws and regulations in certain jurisdictions and this document is provided only for persons to whom this document and the products and services of MacKay Shields LLC may otherwise lawfully be issued or made available. None of the products and services provided by MacKay Shields LLC are offered to any person in any jurisdiction where such offering would be contrary to local law or regulation. This document is provided for information purposes only. It does not constitute investment or tax advice and should not be construed as an offer to buy securities. The contents of this document have not been reviewed by any regulatory authority in any jurisdiction.
This material contains the opinions of certain professionals at MacKay Shields but not necessarily those of MacKay Shields LLC. The opinions expressed herein are subject to change without notice. This material is distributed for informational purposes only. Forecasts, estimates, and opinions contained herein should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. Any forward-looking statements speak only as of the date they are made and MacKay Shields assumes no duty and does not undertake to update forward-looking statements. No part of this document may be reproduced in any form, or referred to in any other publication, without express written permission of MacKay Shields LLC. ©2023, MacKay Shields LLC. All Rights Reserved.

Information included herein should not be considered predicative of future transactions or commitments made by MacKay Shields LLC nor as an indication of current or future profitability. There is no assurance investment objectives will be met. **Past performance is not indicative of future results.**

"New York Life Investments" is both a service mark, and the common trade name, of certain investment advisors affiliated with New York Life Insurance Company.

NOTE TO UK AND EUROPEAN AUDIENCE

This document is intended only for the use of professional investors as defined in the Alternative Investment Fund Manager's Directive and/or the UK Financial Conduct Authority's Conduct of Business Sourcebook. To the extent this document has been issued in the United Kingdom, it has been issued by MacKay Shields UK LLP, 80 Coleman Street, London, UK EC2R 5BJ, which is authorised and regulated by the UK Financial Conduct Authority. To the extent this document has been issued in the EEA, it has been issued by MacKay Shields Europe Investment Management Limited, Hamilton House, 28 Fitzwilliam Place, Dublin 2 Ireland, which is authorised and regulated by the Central Bank of Ireland.

NOTE TO CANADIAN AUDIENCE

The information in these materials is not an offer to sell securities or a solicitation of an offer to buy securities in any jurisdiction of Canada. In Canada, any offer or sale of securities or the provision of any advisory or investment fund manager services will be made only in accordance with applicable Canadian securities laws. More specifically, any offer or sale of securities will be made in accordance with applicable exemptions to dealer and investment fund manager registration requirements, as well as under an exemption from the requirement to file a prospectus, and any advice given on securities will be made in reliance on applicable exemptions to adviser registration requirements.

当資料は、一般的な情報提供のみを目的としています。

当資料は、投資助言の提供、有価証券その他の金融商品の売買の勧誘、または取引戦略への参加の提案を意図するものではありません。

また、当資料は、金融商品取引法、投資信託及び投資法人に関する法律または東京証券取引所が規定する上場に関する規則等に基づく開示書類または運用報告書ではありません。**New York Life Investment Management Asia Limited**およびその関係会社は、当資料に記載された情報について正確であることを表明または保証するものではありません。

当資料は、その配布または使用が認められていない国・地域にて提供することを意図したものではありません。

当資料は、機密情報を含み、お客様のみに提供する目的で作成されています。**New York Life Investment Management Asia Limited**による事前の許可がない限り、当資料を配布、複製、転用することはできません。

New York Life Investment Management Asia Limited

金融商品取引業者　登録番号　関東財務局長（金商）第**2964** 号

一般社団法人日本投資顧問業協会会員

一般社団法人第二種金融商品取引業協会会員

"New York Life Investments" is both a service mark, and the common trade name, of certain investment advisors affiliated with New York Life Insurance Company.