Nationwide Economics

Weekly Economic Review & Outlook

September 11, 2023

Service sector is still humming

Consumers maintained their buoyant pace of spending on services, which includes travel and dining out, by further dipping into their remaining pandemic-related savings. This in turn is helping to propel service-side activity and the economy overall as real GDP growth is poised to accelerate to at least a four percent annualized rate in the current quarter. Even with this strong economic backdrop, multiple Fed officials signaled in speeches last week that another pause in its tightening cycle should be expected in September since inflation has been trending meaningfully lower and economic growth likely slows sharply in the fourth quarter.

Demand for services remains strong

Growth in the service sector climbed to a six-month high in August and remains solidly in expansion, according to the ISM services index. At 54.5, the August reading stood above the 12-month average and was supported by increases in all contributing sub-indices. While demand metrics perked up again, the largest increase came from the employment index, which climbed to its highest level since November 2021. While respondents noted that the labor market remains very competitive, there is anecdotal evidence that the increased slack in the market has made it somewhat easier for businesses to find qualified applicants for open positions.

One area of concern in ISM services report was the rise in input cost costs. Costs rose for a second straight month to a level that suggests increased cost pressures for businesses. The recent uptick highlights the ongoing sticky inflation on the service side that limits the Fed's ability to quickly bring overall inflation back to its 2 percent target. The ISM data align with August findings from the National Federation of Independent Business which showed over a quarter of small businesses plan to raise worker compensation.

The sturdy advance in services activity is more than outweighing the continued contraction in the manufacturing sector as the ISM composite index (manufacturing + services) climbed to its highest level in six months. In combination with consumer spending picking up over the summer, economic growth has accelerated at a rapid clip over the third quarter. We expect annualized real GDP growth of at least 4.0 percent with the risk that it comes in above 5 percent.

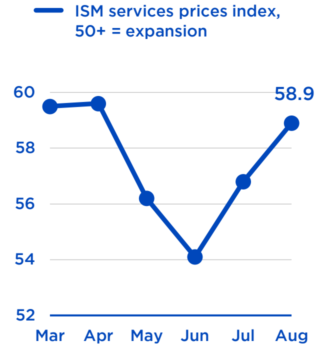
Fed officials lean into a September hold

Across a range of speeches and interviews, Fed officials showed a united front that the FOMC is likely to skip another rate hike at its upcoming meeting. John Williams, president of the New York Federal Reserve, said that monetary policy was in a "good place", while Dallas Fed president Lorie Logan (viewed as more hawkish) stated that "another skip could be appropriate." While not assured, this is typical Fedspeak for signaling to financial markets the baseline stance heading into the meeting. Following suit, fed fund futures now price in over 90 percent odds that the policy rate will remain within the 5.25-5.50 range this month.

Importantly, Fed policy makers also highlighted that future Fed decisions will be highly data-dependent, with an elevated focus on incoming inflation and wage readings. Officials are pleased with the slowing in the pace of inflation and wage growth, but they remain ready to raise rates further if the improvement in these measures stall or reverses direction in the coming months.

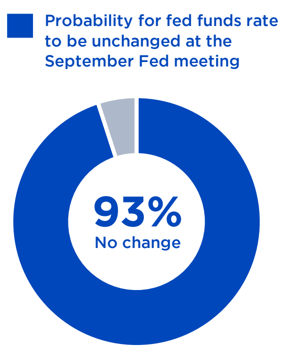
While falling back a bit, financial markets price a 40 percent probability of a 25bps rate increase by the FOMC November meeting. These high odds speak to the underlying uncertainty around the Fed's decision tree and the high importance of seeing additional signs of cooling inflationary pressures in the data.

Cost pressures increase for services



Cost pressures are still high in the service sector and represent a headwind in the Fed's efforts to bring inflation back to target.

High probability of a Fed pause in September



Financial markets fully expect the fed funds rate to remain within the current 5.25-5.50 range this month.

Sources: Institute for Supply Management, CME Group

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The Week Ahead

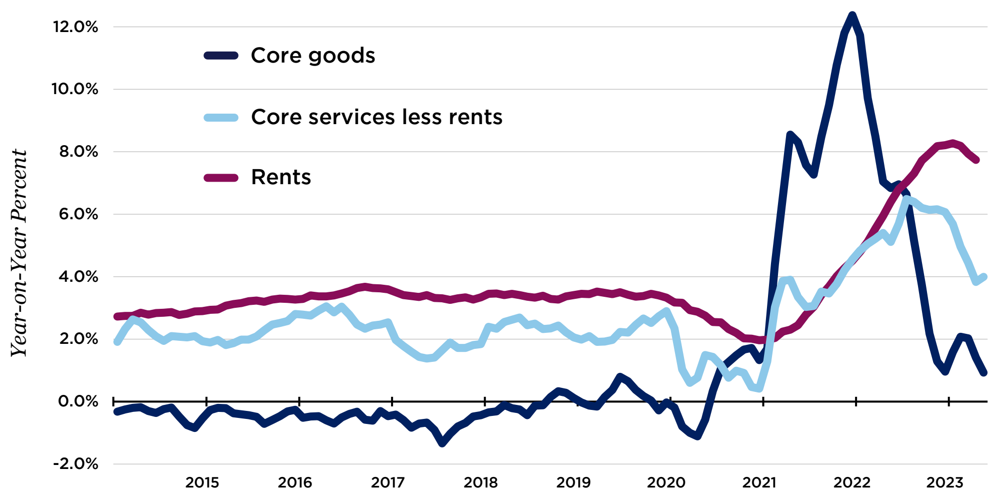
Here's our outlook for the days ahead. Subscribe to [Daily Insight](#) for updates throughout the week.

Consumer Price Index (CPI)

Sept 13

Prices to spike from energy price surge

Higher energy prices should push headline inflation up by 0.6 percent in August, which would be the fastest increase since June 2022. Excluding food and energy, core CPI inflation should climb a much more moderate 0.2 percent although strong service sector demand should underpin core services inflation. This would lower the annual core inflation rate from 4.7 percent to 4.3 percent, but it would still be far above the Fed's comfort level since its not yet consistent with an overall 2 percent inflation pace. Consumer spending and housing costs should slow in coming months, but the disinflation of underlying prices continues to play out slowly.



Sources: Nationwide Economics, BLS, Haver Analytics

Retail Sales

Sept 14

Sapped savings, student loan payments likely drag down retail sales

After a blowout July, we expect August's retail sales to retreat slightly as more households may be reaching their spending limits. Sales ex-autos and gas should be weaker, too, only up a meager 0.1 percent on the month after a 1 percent jump in July. Income growth has gradually slowed causing more consumers to tap into dwindling savings — with excess pandemic savings projected to be depleted soon according to a San Francisco Fed report. Moreover, some borrowers got an early start on student loan payments in August with the remainder beginning in September, which should drag on spending.

Industrial Production

Sept 15

Production should rise led by mining and utilities

August's industrial production report should show a moderate increase as weak manufacturing production offsets some of the rise in utilities output. S&P Global's Manufacturing PMI report showed that the manufacturing sector contracted in August from a decline in new orders, slowing employment, and input price pressures which should pull down headline production. However, August recorded widespread scorching temperatures, resulting in high utility usage to cool homes, and oil production spiked to more than offset manufacturing's weakness.

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Additional Economic Indicators

Previous Week's Indicators

	Period	Actual	Previous
Factory Orders	July	-2.1%	2.3%
Factory Orders Ex Trans	July	0.8%	0.2%
Trade Balance	July	-$65.0b	-$65.5b
ISM Services Index	August	54.5	52.7
Initial Jobless Claims	Week ending Sept 2	216,000	228,000
Consumer Credit	July	$10.399b	$17.847b

This Week's Indicators

	Release Day	Period	Forecast*	Previous
NFIB Small Business Optimism	Tuesday	August	91.2	91.9
CPI MoM	Wednesday	August	0.6%	0.2%
CPI Ex Food and Energy MoM	Wednesday	August	0.2%	0.2%
Initial Jobless Claims	Thursday	Week ending Sept 9	225,000	216,000
Retail Sales Advance MoM	Thursday	August	-0.1%	0.7%
Retail Sales Ex Auto and Gas	Thursday	August	0.1%	1.0%
PPI Final Demand MoM	Thursday	August	0.4%	0.3%
PPI Ex Food and Energy MoM	Thursday	August	0.2%	0.3%
Import Price Index MoM	Friday	August	0.3%	0.4%
Industrial Production MoM	Friday	August	0.3%	1.0%
Capacity Utilization	Friday	August	79.4%	79.3%
U. of Mich. Sentiment	Friday	September P	69.1	69.5

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