Nationwide Economics
Weekly Economic Review & Outlook
October 2, 2023

# Inflation trends should keep Fed hawkish

Core PCE inflation slowed in August, but underlying trends are still too strong for the Fed's comfort and high prices caused consumers to dip further into savings. In housing news, new home sales continued to be strong in August, boosted by the historically low supply of existing homes for sale which is pushing homebuyers into the market for new builds.

**Inflation remains strong as momentum weakens for the consumer**

Consumer spending climbed a solid 0.4 percent in August, but only 0.1 percent after accounting for inflation. Even with a slower August, growth in real consumer spending is currently tracking around three percent annualized in the third quarter. There are downside risks going forward for the consumer, however, as real disposable income declined in August for a second straight month (down 0.2 percent), and the personal saving rate dipped below four percent for the first time this year. Consumers have been willing to dip into their savings to keep up spending habits – note the steady decline in the saving rate over the last three months – but this is not sustainable for continued growth in spending.

Year-on-year PCE inflation climbed slightly to 3.5 percent in August, while the core rate eased further to 3.9 percent (down from 4.3 percent in July). The super core rate (core PCE services ex housing) only increased by 0.1 percent in August, cooling the annual rate to 4.3 percent. But the three-month annualized rate was steady at 3.6 percent, indicating little slowdown in services inflation. With core PCE inflation still not on track to return to the 2.0 percent target, Fed commentary will likely maintain a hawkish stance. We still don't expect an additional rate hike in November or December, but it could be close call for Fed officials if upcoming inflation readings surprise to the upside.

**New homes still selling despite higher rates**

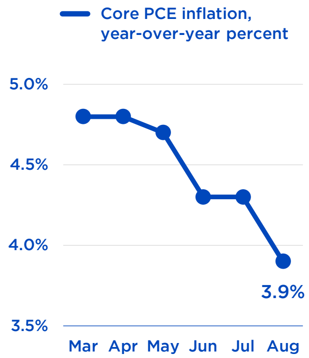
Even after a greater-than-expected decline in August (mainly caused by an upward revision to July's pace), new home sales continue to be the lone bright spot in the housing market. At 675,000 units, August's annual pace of sales was still well above the long-run median as it has been for much of the year — over the same stretch of months where existing home sales have weakened sharply.

Demand for new homes continues to be boosted by a lack of existing homes for sale and the price per square foot of the average new home recently fell below that of the average existing home for the first time ever. Builders have also been supporting sales by buying down mortgage rates, removing one of the biggest obstacles for prospective buyers. This relative strength of the new side of the market should continue into 2024 as high mortgage rates prevent most current homeowners from listing their homes. However, with mortgage rates climbing further (rising above 7.5 percent in late September), it is worth watching to see how long builders will continue to offer substantial rate incentives.

**Government shutdown averted, for now**

Investors fretted over the risk of a government shutdown during the workweek. Fortunately, a deal was reached over the weekend which funds the government at current spending levels through mid-November. The legislation includes funding for disaster relief, renews the expiring flood-insurance program, and omits financial assistance for Ukraine. We had estimated the shutdown would have reduced GDP growth by 0.2 percentage points for each week it persisted, though some of the losses would have been recouped once a budget deal was reached. Since lawmakers elected to kick the proverbial can down the road, the risk of a government shutdown will once again loom over the economy in the not-too-distant future.

## Core inflation dips below four percent




Core inflation fell significantly in August, but it remains too high and the underlying inflation trends too strong for the Fed's comfort.

## New home sales fall but remain elevated


New home sales fell to a five-month low, but the pace of sales was still strong from a historical perspective as new home sales continue to be a bright spot in the housing market.

Sources:
Bureau of Economic Analysis, Census Bureau

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# The Week Ahead

Here's our outlook for the days ahead. Subscribe to **Daily Insight** for updates throughout the week.

ISM Manufacturing & Services Index

Oct 2 & 4

## Services versus manufacturing dichotomy persisted in September

We expect the ISM Services PMI to drop to a still-expansionary reading of 53.2 in September amid signs of cooler economic momentum at the end of Q3. The post-pandemic boom in services looks to be coming to an end as moderating income growth, tighter lending standards, and elevated interest rates look set to drag down on consumer spending and business investment. Further, idiosyncratic factors, including the imminent restart of student debt repayments, may have weakened services activity on the margin.

Meanwhile, ISM Manufacturing is estimated to have risen to 47.7 but remained in contraction territory in September. Manufacturing activity has been weak for the first eight months of 2023 and we expect this trend persisted last month amid softening domestic demand for goods, a tighter lending environment, elevated interest rates, and weak external demand. The reading is anticipated to show weaker production and employment dynamics, while the prices index should point to somewhat cooler inflationary pressures and loosen supply chain conditions. The UAW strike likely posed a modest drag on motor vehicle production in the month.

Wards total vehicle sales

Oct 3

## Motor vehicle sales likely jumped on Labor Day deals

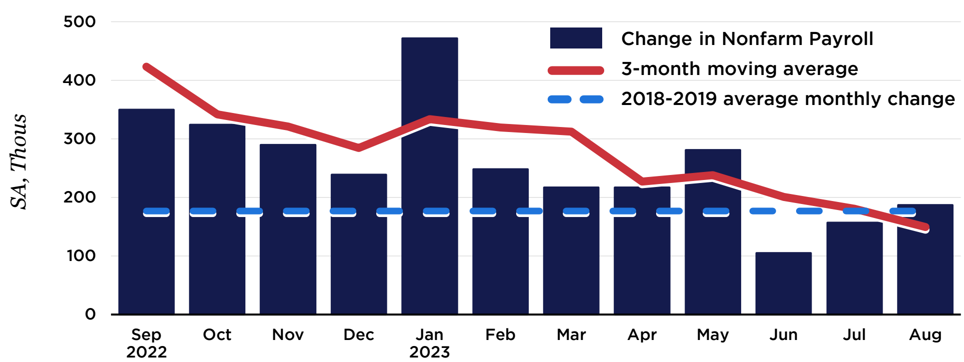
Vehicle sales are expected to rise to an annualized pace of 15.3 million units in September. Demand has remained strong in recent months, despite high prices, tighter lending standards, and elevated interest rates, as consumers snap up autos after the pandemic severely constrained the number of motor vehicles on dealer lots. Discounts tied to the Labor Day holiday also likely boosted sales in September. The UAW strike won't have a material impact on sales in this reading since it started in mid-month and has been implemented gradually. If the strike persists, it would reduce the inventory of motor vehicles and sales activity in subsequent months. At the time of writing, the UAW had announced it would expand its strike.

Nonfarm Payrolls

Oct 6

## Labor market weakened slightly last month

The September employment report will cap the week and is expected to reveal slightly cooler labor market conditions at the end of Q3. We estimate that nonfarm payroll growth moderated to a still-healthy 165,000 in September as demand for labor cooled slightly amid softer activity at the end of the quarter. Meanwhile, we believe that an increase in labor force participation outweighed the rise in employment and pushed the unemployment rate up to 3.7 percent in September. However, the jobless rate will stay low relative to historical standards and show that the labor market remains persistently tight. We also anticipate cooler dynamics on the wage front, with average hourly earnings expected to post a modest 0.2 percent.




*Sources: Haver Analytics, Nationwide*

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# Additional Economic Indicators

## Previous Week's Indicators

| Previous Week's Indicators | Period | Actual | Previous |
|---|---|---|---|
| S&P CoreLogic CS 20-City MoM SA | July | 0.87% | 0.92% |
| New Home Sales | August | 675k | 714k |
| New Home Sales MoM | August | -8.7% | 4.4% |
| Conf. Board Consumer Confidence | Sept | 103.0 | 106.1 |
| Durable Goods Orders | August P | 0.2% | -5.2% |
| Durables Ex Transportation | August P | 0.4% | 0.4% |
| GDP Annualized QoQ | 2Q T | 2.1% | 2.1% |
| Personal Consumption | 2Q T | 0.8% | 1.7% |
| Initial Jobless Claims | Week ending Sept 23 | 204,000 | 201,000 |
| Pending Home Sales MoM | August | -7.1% | 0.9% |
| Advance Goods Trade Balance | August | -$84.3b | -$90.9b |
| Wholesale Inventories MoM | August P | -0.1% | -0.2% |
| Personal Income | August | 0.4% | 0.2% |
| Personal Spending | August | 0.4% | 0.9% |
| Real Personal Spending | August | 0.1% | 0.6% |
| PCE Deflator MoM | August | 0.4% | 0.2% |
| PCE Core Deflator MoM | August | 0.1% | 0.2% |
| U. of Mich. Sentiment | Sept F | 68.1 | 67.7 |

## This Week's Indicators

| This Week's Indicators | Release Day | Period | Forecast* | Previous |
|---|---|---|---|---|
| Construction Spending MoM | Monday | August | 0.3% | 0.7% |
| ISM Manufacturing | Monday | Sept | 47.7 | 47.6 |
| JOLTS Job Openings | Tuesday | August | 8550k | 8827k |
| Wards Total Vehicle Sales | Tuesday | Sept | 15.30m | 15.04m |
| Factory Orders | Wednesday | August | 0.1% | -2.1% |
| Factory Orders Ex Trans | Wednesday | August | 0.2% | 0.8% |
| ISM Services Index | Wednesday | Sept | 53.2 | 54.5 |
| Trade Balance | Thursday | August | -$66.0b | -$65.0b |
| Initial Jobless Claims | Thursday | Week ending Sept 30 | 210,000 | 204,000 |
| Change in Nonfarm Payrolls | Friday | Sept | 165k | 187k |
| Unemployment Rate | Friday | Sept | 3.7% | 3.8% |
| Average Hourly Earnings MoM | Friday | Sept | 0.2% | 0.2% |
| Average Weekly Hours All Employees | Friday | Sept | 34.4 | 34.4 |
| Labor Force Participation Rate | Friday | Sept | 62.9% | 62.8% |
| Underemployment Rate | Friday | Sept | 7.1% | 7.1% |
| Consumer Credit | Friday | August | $11.000b | $10.399b |

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