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Monthly Market Commentary: September 2023

Despite recent optimism about declining inflation, the Consumer Price Index (CPI) recorded its largest monthly increase this year, up 0.6% in August[1]. On an annual basis, prices rose 3.7%, compared to 3.2% in July[1]. Core inflation, which excludes more volatile food and energy prices, rose 0.3% in August, marking the first acceleration in six months[1]. Since February, year-over-year core inflation has consistently outpaced headline inflation, however, the silver lining is that core inflation continues to improve by falling to 4.3% in August, from 4.7% in July[1]. Transportation-related items replaced shelter as the largest contributor in August[1]. Surging energy and gas prices were a large contributor to the monthly increase; however, the latest consumer sentiment report showed the median expected year-ahead inflation rate decreased to the lowest levels since March 2021[2]. While it appears that consumers believe the slowdown in inflation will continue, overall low levels of optimism may mean it would not take much for the economy to slide into a contraction.

The labor market continues to soften and has thus far been as smooth as policymakers could have hoped. Seasonally adjusted jobless claims remain close to pre-pandemic levels, with employee retention higher than expected[3]. Despite this, economists anticipate the labor market to cool further, with jobless claims expected to rise in the fourth quarter as layoffs continue[3]. While the strong labor market has led to wage growth, with nominal wages growing by 5.3% in August, wage gains have also been cooling since July 2022[4]. At the current rate, wage growth may be expected to reach pre-pandemic levels later this year or early in 2024.

Headline retail sales rose 0.6% in August[5], stronger than the consensus estimate of 0.1%. However, in real terms, retail sales declined by 0.1%, suggesting a slight decline in overall real consumer spending last month. Among the factors affecting retail sales are dwindling excess savings, increasing credit card balances, and a softer labor market[3]. Tighter economic conditions due to cumulative Fed rate hikes and inflationary headwinds are weighing on consumption, including the resumption of student loan repayments.

The bottom line: While surging energy prices in August may dampen optimism regarding an improving inflationary picture, transportation price increases may attract more attention than the headline figure from the Fed. September’s inflation report will be critical in the Fed’s decision-making if further rate hikes may be necessary later this year. However, cooling retail sales, coupled with a softening labor market and the resumption of student loan payments, may signal an environment where consumers tighten their belts further in upcoming months. While economic risks remain no matter which direction the Fed decides to take, a path toward a soft landing is still on the table.

Sources:

1. Bureau of Labor Statistics, https://www.bls.gov/news.release/cpi.nr0.htm
2. University of Michigan, http://www.sca.isr.umich.edu/
3. Bloomberg Economics
4. Federal Reserve Bank of Atlanta, https://www.atlantafed.org/chcs/wage-growth-tracker
5. Census Bureau, https://www.census.gov/retail/sales.html