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The Big Summer Surprise: A Red-Hot Economy & Interest Rate Surge

Could the US economy be growing at close to 6% this summer?

8/18/2023 Highlights from Advisorpedia & Barron's

The closely watched Atlanta Fed "GDPNow" report released its latest guesstimate of economic growth; a red-hot 5.8% surge is possible this quarter, according to the forecasters.

Anything over 5% this quarter seems unlikely. But there's no question that the economy is hitting on all cylinders. Consumers are spending on plastic surgery, cruises, pet care, Taylor Swift and Beyonce concerts, the Barbie movie, motorcycles, and dozens of other discretionary outlays. Cruise bookings for 2024 are at an all-time high.

With unemployment near 50-year lows, inflation edging down, and wages rising faster than prices, businesses, and families are still spending. The US is in much better economic shape than China, Russia, and much of Western Europe.

Inflation remains the elephant in the room, as commodity prices surge and organized labor seeks dramatic wage gains.

The strong US economy forces investors to rethink interest rates.

8/18/2023 Highlights from Financial Times (FT)

US retail sales data this week was significantly more buoyant than expected, while the Philadelphia Fed's manufacturing business outlook survey for August surged to its highest level since April 2022. [In July FT reported that US manufacturing employment was at the highest level since 2008] It may take sustained higher 10-year yields to slow the economy and the housing sector to reach the 2 percent inflation target.

While US core inflation, which strips out volatile food and energy prices, has cooled to 4.7 percent in recent months, it remains far above the Fed's target. The UK is still grappling with persistently sticky price pressures, with core inflation at 6.8 percent, while in the eurozone, the rate is 5.5 percent. Higher commodity prices across the continent have helped push up inflation expectations to decade highs.

Labour markets also remain tight, with average hourly earnings in the US increasing by 4.4 percent year over year in July. In the UK, official figures this week showed annual pay growth of 7.3 percent, the highest growth on record.

"You are seeing wage pressures everywhere, which pressure employers to charge higher prices. It's just not conducive with a quick drop back to target inflation", said Robert Tipp, head of global bonds for PGIM Fixed Income.

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