MACRO STRATEGY

Economic Monthly

If It's Fall, It Must Be Shutdown Season

The U.S. political situation is back into economic focus as a government shutdown looms, with funding set to expire on September 30 if no short-term funding agreements are passed. We do not expect a shutdown to change the trajectory of Federal Reserve policy. The 10-year Treasury may decline slightly in the short-run as it generally has after a shutdown, but equity markets have historically had a mixed response. That said, a shutdown would be one more item on a list of economic uncertainties and recession concerns, and markets are looking more critically at the U.S. fiscal situation and credit quality.

Longest Government Shutdowns

Start Date	President	Days
Dec. 22, 2018	Trump	34
Dec. 16, 1995	Clinton	21
Oct. 1, 1978	Carter	17
Oct. 1, 2013	Obama	16
Oct. 1, 1977	Carter	12

Source: New York Times—The Government Shutdown Was the Longest Ever. Here's the History. The New York Times (nytimes.com)

Even though government spending is a large part of GDP, the economic impact of a shutdown, in isolation, is relatively smaller. For example, the CBO estimated that the 2019 shutdown would cause a 0.2% reduction in GDP the first quarter of that year. In the 2013 shutdown, the BEA estimated a 0.3% decline in GDP growth due to the hours of federal employees being reduced. The effect is relatively small for multiple reasons. First, only discretionary spending is affected, not mandatory programs like Social Security; payments on Treasuries would continue. Second, many federal employees would continue working, as they provide services deemed essential. Finally, losses in growth can be recouped in subsequent quarters once the government reopens because much of the spending and wage payments are delayed rather than outright eliminated.

Compared to (for example) hitting the debt ceiling, the milder consequences may encourage more brinkmanship and make it less likely that lawmakers reach a deal in time to prevent the shutdown.

MetLife Investment Management

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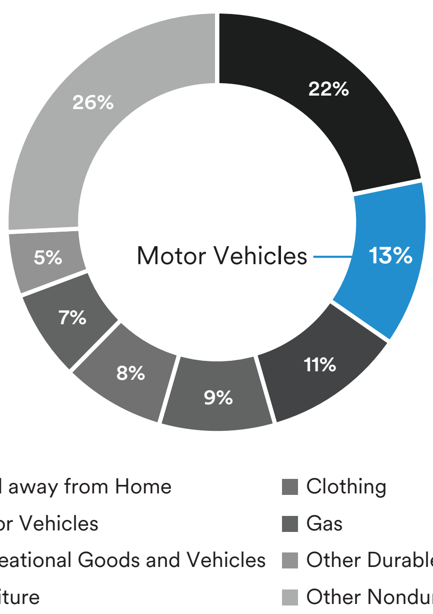
A good time for a strike?

The labor market continues to remain strong in absolute terms, but openings and hirings have been gradually declining, indicating softness and a positive sign for the Fed's fight against inflation. Labor demand in services sectors like healthcare and leisure and hospitality is still high, but manufacturing employment has stopped accelerating.

The United Auto Workers (UAW) union went on strike against all three of the large American carmakers—General Motors, Ford, and Stellantis—on September 15. The strikes are unusual in that to start out, just 13,000 workers are walking out at three specifically chosen plants; the union is employing a more targeted strategy to gain more leverage and flexibility in negotiations. More workers (up to the union's 145,000 membership) may be called upon to join the strike as needed.

The gradual ramp up means that if an agreement is reached quickly, the economic impact will likely be minimal. As of the start of September, the three automakers had enough vehicles to last about two months.[1] Used cars could also pick up some slack as demand has fallen off since mid-pandemic highs. A prolonged strike could be inflationary, forcing up the price of new and used vehicles, which are already scarce relative to pre-pandemic times.

Motor Vehicles Manufacturing—Still Critical



Note: Data for Q3 2022; other nondurable goods includes pharmaceuticals, home goods and toiletries, among other categories.
Source: BEA, Haver, MIM

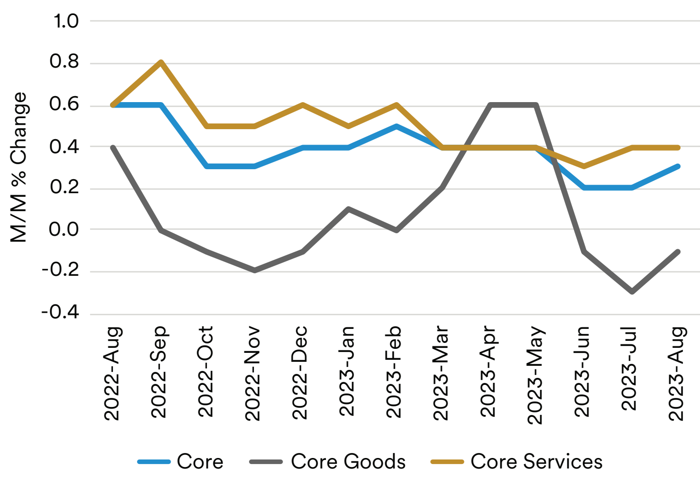
A longer strike also has the potential to put pressure on GDP, especially in the Midwest. About 3% of U.S. GDP comes from the auto industry, and in a 2019 UAW strike that lasted 40 days, GM alone lost a potential $3.6 billion.[1] The strikes may also marginally reduce consumer spending in the current quarter, as striking workers receive a fraction of their regular wages in strike pay.

Inflation: Mostly Dead is Slightly Alive

Recent BLS data indicate that goods prices continue to be in deflation for the third month in a row, resulting in overall levels of core inflation that are closer to the Fed's 2% target. Housing inflation also has been posting smaller increases in recent months. Higher energy prices are putting upwards pressure on headline inflation, so we continue to expect no headline disinflation.

While we believe that inflation is on the right track and the Fed is done hiking for this cycle, there are three key areas to watch for trouble.

Services Inflation Remains Above Target



Source: BLS, Haver, MIM

First, consumers continue to face high inflation for essential services such as auto insurance and medical care. Core services excluding housing, a key metric watched by the Fed, continues to remain sticky and is even showing some signs of acceleration.

Second, housing costs may be close to plateauing. Although rent prices continue to fall, monthly home prices have started to increase in the face of low inventory and weak new construction. Further progress on this front may be difficult.

Third, oil prices have risen again. Although not as worrying as immediately after the Russian invasion of Ukraine, high oil prices—if they persist—could filter through the rest of the economy.

Risks to the Outlook

While we do not expect a recession in the last quarter of the year, continued high services inflation, continuing tightening credit conditions, and labor market slowdowns (along with instability and strikes) continue to weigh on the outlook. Fiscal concerns and the government shutdown, while not a sufficient catalyst alone, add to a long list of uncertainties.

Multiple gauges of consumer confidence showed improvement in the earlier parts of the summer, and spending continued to buoy the economy. However, recent readings show much of those confidence improvements have been undone going into the holiday season, putting the ability of consumers to continue spending into question.

U.S. Outlook Summary

Our outlook remains unchanged from last month.

We expect that a recession will likely be avoided until 2024. We have raised our U.S. growth forecast to 2.1% in 2023 on the back of an unexpectedly high Q2 GDP print. We have also raised our 2024 forecast to 0.0% (from -0.2% previously). Despite the improvement, we still expect at least two quarters of negative growth in 2024.

We believe the Fed has completed its hiking cycle with the July rate hike. We expect a rate cut cycle to begin in 2024, whether or not a recession takes place.

We foresee a 10-year U.S. Treasury yield of 4.00% at year-end 2023. We believe, the downgrade to U.S. debt is unlikely to lead to an enduring rise in rates, although they are approaching cycle highs.

As noted in our Q3 2023 Relative Value Allocation, we still do not think credit markets have priced in sufficient downside risk yet. Looking forward, we expect the credit cycle to turn in the coming quarters, with spreads widening further on continued recession risk. As a result, we continue to recommend “up-in-quality.”

MIM Forecast

U.S.	2023	2024
GDP	2.1	0.0
CPI	3.0	2.8
10 Year	4.00	3.50
Policy rates	5.50	3.00

Note: GDP is annual average growth rate, CPI is Q4 year/year, 10 year is year-end, policy rate is the upper bound year-end rate.
Source: Metlife Investment Management

Endnote

[1] UAW: 13,000 auto workers go on strike. What’s at stake | AP News

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