WEEKLY
ECONOMICS

October 18, 2024

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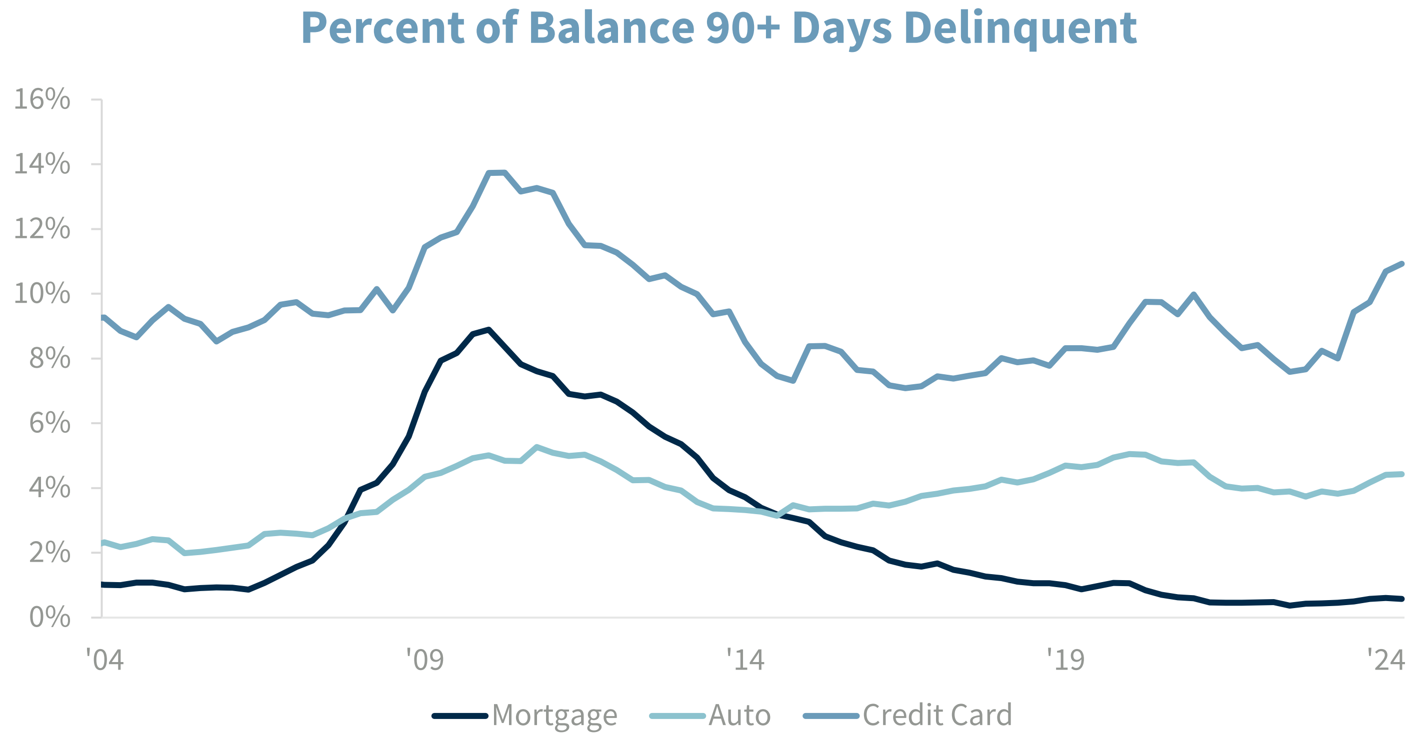
US Economy Remained Strong in Q3

From current data, it is clear there are no signs the US economy is currently facing challenges. Yesterday's retail and food services sales confirmed that barring any downward revision to September's estimates, the US consumer finished another strong quarter. But the headline numbers are probably not giving a completely correct picture of the health of the US consumer. Clearly, higher-income consumer sectors continue to engage in the economy due to strong interest income earnings, strong stock market returns, and thus a very strong increase in financial and housing wealth.

However, lower-income consumers are struggling, as shown by increased auto and consumer loan delinquencies. Business sector commentaries also show consumers penny-pinching and looking to save by changing brands and choosing more generic products. Yesterday's retail and food services sales data also showed that the consumption of big-ticket items weakened considerably in September even though the overall retail report was relatively strong. These large discretionary purchases are typically the first indication of trouble in consumer land.



Source: FactSet, NYFed, RJ Economics

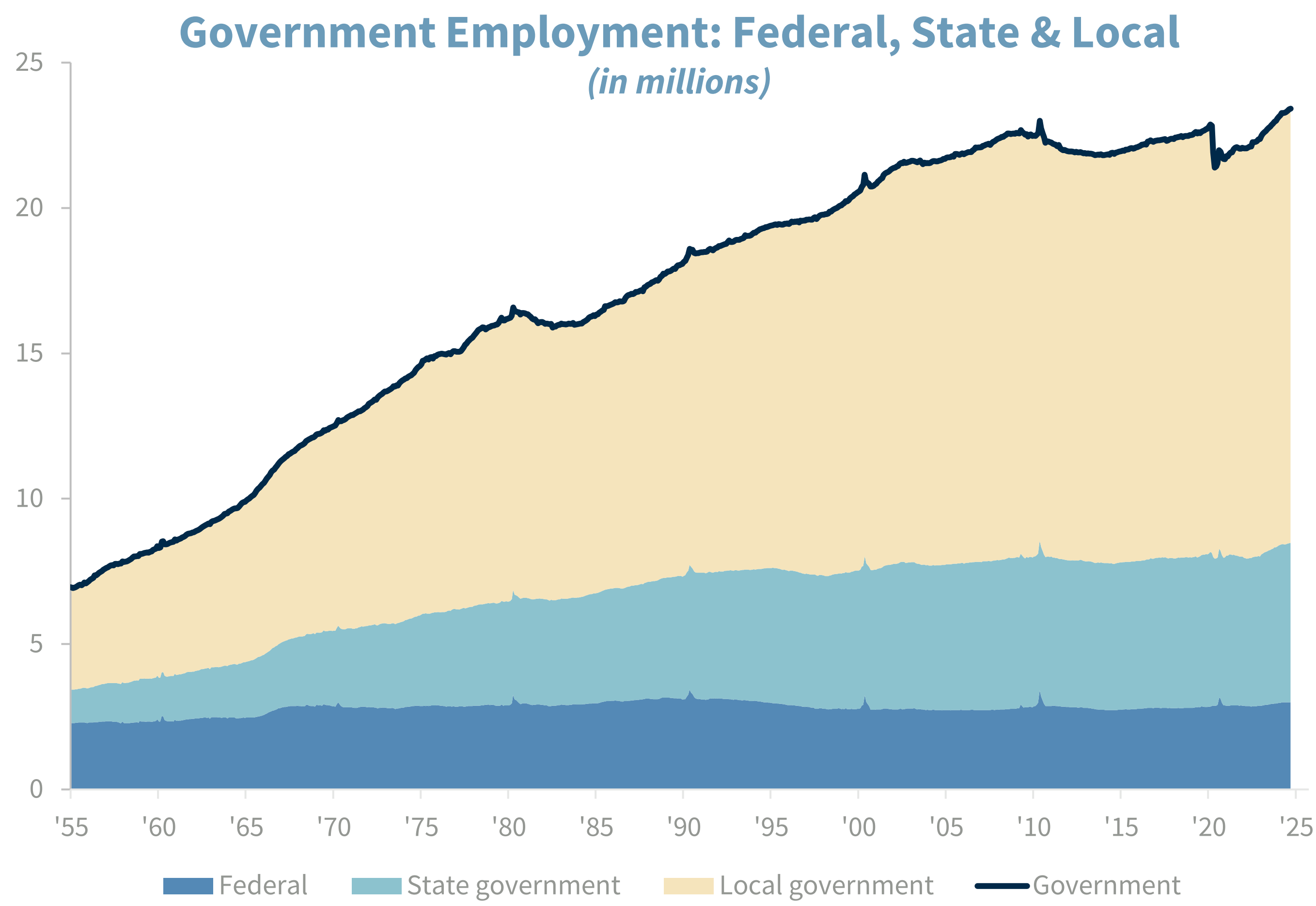
Hopefully, the Federal Reserve's strong move in interest rates in September plus the 50 basis points of expected rate cuts—one 25 bp cut in November and another 25 bp cut in December—will bring down interest rates and allow some recovery in these discretionary sectors over the next several quarters. We are still expecting some weakening in economic growth over the next several quarters but continue to expect the economy to achieve a soft landing.

The Myth of Government Employment

Sometimes we are accused of being lenient on the US government in our presentations and speeches, but what we are is against *misinformation*. We could probably argue that the US government is not good at administering taxpayers' money. But that label has fit both parties equally over the decades. As trained economists, we live and die by the numbers, and many of the things we hear and read are so way off that we feel that sometimes we have to intervene to settle the score.

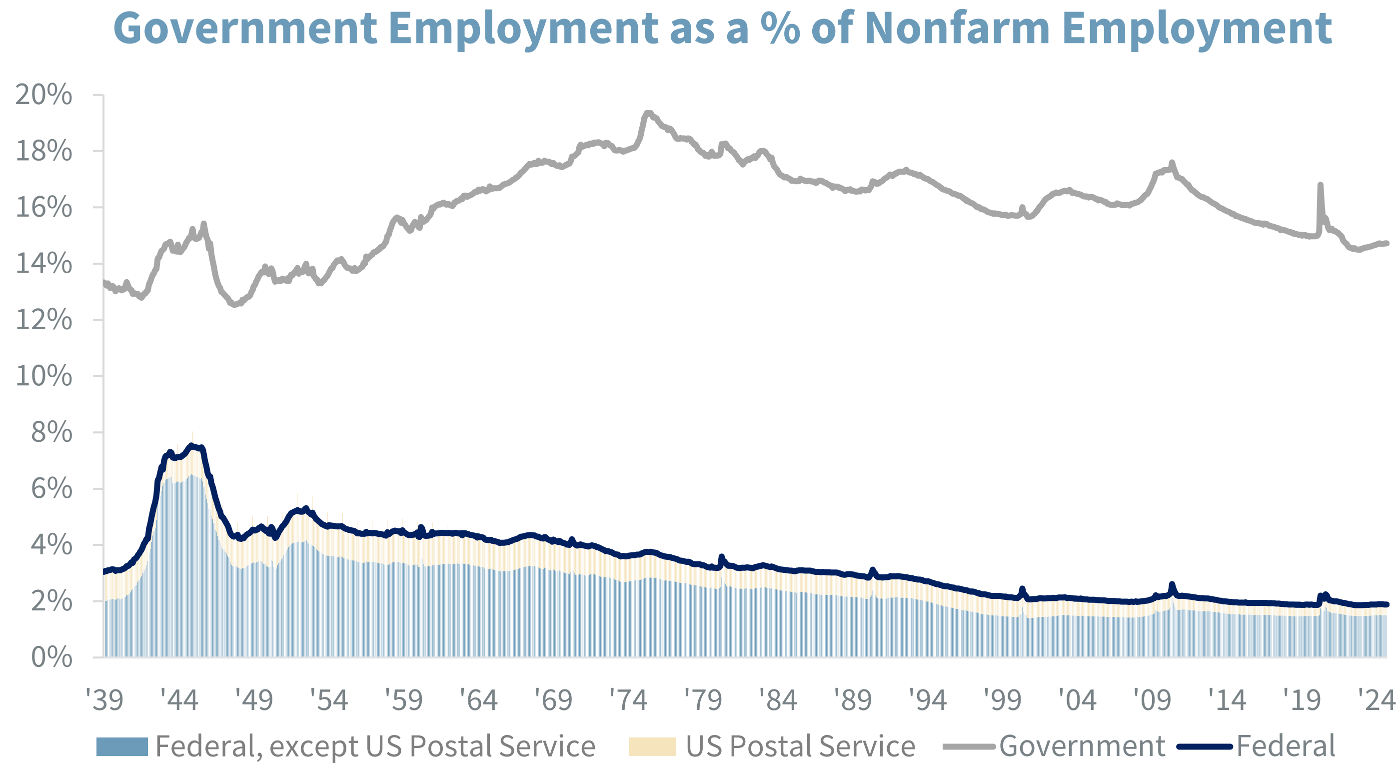
For the record, one of us worked as a federal government employee. So, if I do not rely on the data, many will probably assume that I am biased. And, I do have very fond memories of my work with some exceptional colleagues in the federal government as well as the many great colleagues I have worked alongside within the private sector, which is the sector I have worked for during 97% of my career as a professional economist.

Back to our topic. One of the myths we have to tackle over and over again has to do with the size of the US government, which typically means the *federal government*. One way to measure the size of the US government is by looking at the number of workers. However, when we talk about the US government, we are not only referring to the federal government as is typically the case, but also to *state and local governments*. And if you measure the size of the different levels of government by the number of workers each one has, it is easy to see that the federal government is a highly efficient machine, as well as a very small one, at least by this measure!



Source: FactSet, RJ Economics

The number of federal government employees in September of 2024 was about 3.0 million out of total nonfarm employment of more than 159 million, or barely 1.88% of the total. If we take out US Postal Service workers, the number declines to 2.4 million, which is about 1.5% of total nonfarm payrolls.[1] Furthermore, federal government employees are about 12.8% of total government workers while the rest are state and local government workers. By the way, federal government workers as a percentage of total nonfarm payrolls was 3.05% in January of 1939! (See the graph below.)



Source: FactSet, RJ Economics

So, 87.2% of total government employment occurs at the state and local government levels, not at the federal government level. Thus, whenever people use federal government workers as scapegoats to criticize the federal government, they should remember that for the size of our economy, the size of our federal government workforce is negligible.

Furthermore, according to the Congressional Budget Office (CBO), of all the money spent by the federal government in compensation in 2022, "About 60 percent of that total was spent on civilian personnel working in the Department of Defense, the Department of Foreign Affairs, and the Department of Homeland Security."[2] Thus, we can criticize the US government for other reasons, but in terms of employment, federal government employment as a percentage of total employment has continued to decline. By the way, the spikes every ten years are due to temporary hiring for the US Census.

1: "These are civilian workers. The US Government also employs about 2.1 million in the military and another 700 thousand are employed by government enterprises. This information is from the CBO for 2022.

2: "Comparing the Compensation of Federal and Private-Sector Employees in 2022," Congressional Budget Office, April 2024.
https://www.cbo.gov/publication/60235#:~:text=the%20Postal%20Service,The%20Federal%20Workforce,Veterans%20Affairs%2C%20and%20Homeland%20Security.

Forecast Table

	Actual		Forecast										Actual	Forecast		
	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26	2023	2024	2025	2026
Real Gross Domestic Product [1]	**1.6**	**3.0**	**2.4**	**1.6**	**1.7**	**2.2**	**2.3**	**2.5**	**2.0**	**2.0**	**2.0**	**2.2**	**2.9**	**2.6**	**2.1**	**2.2**
Real Gross Domestic Product [2]	2.9	3.0	2.5	2.1	2.2	2.0	1.9	2.2	2.2	2.2	2.1	2.0	2.9			
Consumer Price Index [2]	**3.2**	**3.2**	**2.6**	**2.3**	**1.9**	**1.7**	**2.0**	**2.2**	**2.2**	**2.2**	**2.2**	**2.2**	**4.1**	**2.8**	**1.9**	**2.2**
Ex-food & energy [2]	3.8	3.4	3.2	3.0	2.5	2.2	2.3	2.2	2.2	2.2	2.2	2.2	4.8	3.4	2.3	2.2
PCE Price Index [2]	**2.7**	**2.6**	**2.2**	**2.3**	**2.0**	**1.9**	**2.0**	**2.1**	**2.1**	**2.1**	**2.1**	**2.1**	**3.8**	**2.4**	**2.0**	**2.1**
Ex-food & energy [2]	3.0	2.7	2.6	2.6	2.2	2.1	2.1	2.2	2.2	2.2	2.2	2.2	4.1	2.7	2.1	2.2
Unemployment Rate	**3.8**	**4.0**	**4.2**	**4.3**	**4.4**	**4.5**	**4.5**	**4.5**	**4.4**	**4.4**	**4.3**	**4.3**	**3.6**	**4.0**	**4.5**	**4.4**
Fed Funds Rate [3]	5.50	5.50	5.00	4.50	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25	5.1	5.1	3.9	3.3

1 Annualized Quarter-Over-Quarter Growth
2 Year-Over-Year Percentage Change
3 Upper Bound of the Federal Funds Target Range

Economic Releases

Retail Sales: Total retail and food services sales were in line with expectations in September and rounded out a relatively strong quarter for US consumers. There were downward revisions to control group sales, which are used to calculate consumer demand in real GDP, but this component of retail sales was strong in September. Sales of big-ticket items like furniture, electronics, appliances, and automobiles were weak as consumers were becoming more discerning in their purchases. However, the report shows that consumers remained in the driver's seat during the third quarter of the year. Total retail and food services (R&FS) sales increased in line with expectations in September, up 0.4%, according to the US Census Bureau. Total R&FS sales excluding motor vehicle & parts sales increased by 0.5% while total R&FS sales excluding gasoline station sales were up by 0.6%. Total R&FS excluding motor vehicle & parts & gasoline sales was up 0.7%. Retail trade sales were up 0.3% during the month. Sales at motor vehicles & parts dealers stores were flat in September while sales at furniture stores declined 1.4%. Sales at electronics & appliance stores plunged 3.3%. Sales at food & beverage stores saw a strong, 1.0% increase during the month while sales at health & personal care stores also saw strong growth during the month, up 1.1%. However, sales at gasoline stations were much lower, down 1.6%, due to lower gasoline prices. Sales at clothing stores were also strong, up 1.5%. The strongest sector in September was the miscellaneous store retailers, whose sales surged 4.0% during the month. Lastly, sales at food services & drinking places were up 1.0%. Control group sales were stronger than the headline number, up 0.7%. However, this group's sales were revised down, on net by 0.3% during the previous two months. Consumer demand seems to have maintained a relatively strong pace during the third quarter of the year even though there was weakness in several sectors of the economy.

Jobless Claims: Initial jobless claims were 241,000 for the week ending on October 12, lower than last week's upwardly revised 260,000, and lower than the 261,500 FactSet consensus. Meanwhile, continuing claims increased again and are at the highest level since July. However, recent data shouldn't raise concerns as both data points remain relatively low compared to history, and labor strikes and natural disasters are playing a large role in these increases, especially in states like Michigan, Florida, and North Carolina. However, this steady increase supports our view that the labor market is cooling down. Advanced seasonally adjusted initial jobless claims declined by 19,000, to 241,000 during the week ending on October 12. The four-week moving average for initial jobless claims, which smooths out weekly volatility, increased by 4,750 to 236,250, according to the Department of Labor. The insured unemployment rate remained at 1.2% for the week ending on October 5 according to the release. Five states reported non-seasonally adjusted initial jobless claims of more than 1,000, Michigan (+9,389), North Carolina (+8,714), Ohio (+4,648), California (+4,068), and Florida (+4,021). While it has remained close to historic lows, we follow initial jobless claims because they give an idea of the employment stance of small businesses, which are the largest employers in the US, and gauge the strength of the US labor market.

Economic Releases

Industrial Production: Industrial production was lower than expected in September, as two industry groups saw weaker production during the month, although production of utilities was stronger. But even this positive print was not enough to erase the previous two monthly declines. Manufacturing continues to struggle, as we have seen also with the ISM Manufacturing Index. We should point out that this index is revised considerably every month. However, the index, even with the slight upward revisions to previous months, continues to show a struggling industrial sector. The Industrial Production Index was lower than expected in September, down 0.3% versus FactSet expectations for a 0.1% contraction. At the same time, there were large revisions to previous months, as it is normal for this index. An original increase of 0.1% percent in June was revised up to a 0.2% increase, while an original decline of 0.9% in July was revised up to a decline of 0.6%. The strong print for August, up 0.8%, was revised down to a 0.3% increase. On a year-earlier basis, industrial production was down by 0.6%. The major industry groups showed the following: manufacturing production was down 0.4% in September and 0.5% on a year-earlier basis. Mining production was down 0.6%, month-on-month, and 2.2% lower compared to a year earlier. Meanwhile, the production of utilities was up 0.7% in September, month-on-month, and also up 0.6% compared to a year earlier. Production by major market groups showed the following: final products were down 0.6% as consumer goods increased 0.2%, but the production of business equipment was down a strong 3.5%. Nonindustrial supplies increased by 0.2% while construction was down 0.1%. Finally, materials production was down by 0.2%. Industrial production was lower than market expectations and while revisions were mostly positive, the sector remained in contraction compared to a year earlier. Capacity utilization was lower for the two major industry sectors while slightly higher for utilities. The overall capacity utilization index was lower in September compared to August.

NAHB Housing Market Index: The NAHB/Wells Fargo Housing Market Index increased to a level of 43 in the preliminary October reading, from a reading of 41 in September. Elevated interest rates continued to be the reason for buyer hesitation, but lower mortgage rates are pushing all the subindices higher. With the Federal Reserve expected to ease rates two more times this year, and several more next year, mortgage rates are likely to soften. Therefore, we believe this positive trend in the housing market is likely to continue. The NAHB/Wells Fargo Housing Market Index (HMI) came in higher than FactSet consensus of 42 in October, at 43 compared to an unrevised reading of 41 in September. The Single-Family Sales: Present increased from 45 in September to 47 in October while the Single-Family Sales: Next 6 Months was higher, at 57 in October compared to a reading of 53 in September. The Traffic of Prospective Buyers was also higher at 29 in October compared to 27 in September. The regional HMIs were mixed. The Northeast region decreased from 55 in September to 52 in October. The Midwest increased from 41 in September to 43 in October, the West region increased from 41 in September to 44 in October, and the South region increased from 40 in September to 43 in October. According to the NAHB release: “The share of builders cutting prices held steady at 32% in October, the same rate as last month. Meanwhile, the average price reduction returned to the long-term trend of 6% after dropping to 5% in September. The use of sales incentives was 62% in October, slightly up from 61% in September.”

Economic Releases

Consumer Sentiment: The Consumer Sentiment Index published by the University of Michigan Survey of Consumers declined in October according to the preliminary measure while expectations were for a slight increase. Inflation expectations for the next year increased once again and were the highest since July of this year and reflect the fact that gasoline prices have moved higher in October due to higher oil prices. However, longer-term inflation expectations declined slightly, which is good news for the Federal Reserve. The University of Michigan's Index of Consumer Sentiment (ICS) preliminary reading for October was 68.9 compared to a 70.1 print in September and a FactSet consensus for a slight increase, to 70.2. Both subcomponent indices were lower in October than in September, with the Current Economic Conditions (CEC) Index declining from 63.3 in September to 62.7 in October while the Index of Consumer Expectations (ICE) declined to 72.9 in October from 74.4 in September. This was the first decline in the ICS in three months. Inflation expectations were mixed in October, preliminarily. Inflation expectations for the next year, that is 12 months ahead, increased from 2.7% in September to 2.9% in October while longer-term inflation expectations, that is, during the next five years, declined from 3.1% in September to 3.0% in October. According to the release, "While inflation expectations have eased substantially since then, consumers continue to express frustration over high prices."

Business Inventories: Overall, inventory levels remained healthy in August while the inventories to sales ratio increased slightly, but also stayed in line with healthy levels even if sales and shipments were down during the month. This is consistent with our view that the US economy remains in relatively good shape and the soft landing continues to progress. Manufacturers and trade inventories increased as expected, up 0.3%, in August, according to the US Census Bureau. On a year-earlier basis, inventories were up by 2.4% in August. The value of trade sales and manufacturers' shipments were down by 0.2% in August, month-on-month, but up by 1.3% compared to August of last year. Thus, the total business inventory to sales ratio at the end of August was 1.38—slightly higher than the 1.37 reported in July and also slightly higher than the 1.36 reported in August of last year. The inventory to sales ratio for merchant wholesalers was steady, at 1.35 in August compared to July and it was also unchanged from a year earlier. The inventory to sales ratio for retailers was slightly higher in August, at 1.33 compared to 1.32 in July and 1.27 in August of last year. The inventory to sales ratio for manufacturers was slightly higher in August, at 1.46 compared to a 1.45 print in July but unchanged from August of last year.

Economic Releases

Housing Starts: Housing starts and building permits were weak in September, driven by weakness in housing starts of multifamily housing units. Single-family unit starts were strong in the Northeast and the South but weak in the other two regions of the country. The Northeast region was the standout region in the country for housing starts in September in both single-family units as well as in multi-family units. However, it is clear that builders are favoring the construction of single-family units rather than multi-family units. Furthermore, it is clear that mortgage rates are still not low enough to drive the new home construction market. Privately-owned housing starts declined slightly less than expected in September, down 0.5% versus expectations for a 0.7% decline, to a seasonally adjusted annual rate of 1.354 million. On a year-earlier basis, housing starts were down by 0.7%. Single-family housing starts were up by 2.7% in September compared to the previous month, at a seasonally adjusted rate of 1.027 million. Compared to last year, single-family housing starts increased by 5.5%. Housing starts of five or more units were down by 4.5%, month-over-month, and down by 15.7%, year-over-year. By region, the Northeast continues to lead the way in terms of housing starts as they increased by 57.9%, month-over-month, and by a staggering 109.3% compared to September of last year. The Midwest saw housing starts decline by 9.1%, month-over-month, and by 6.3% on a year-earlier basis. In the South, housing starts were down 3.4%, month-over-month, and 6.6% versus a year ago. Finally, in the West, housing starts were down by 10.1%, month-over-month, and by 13.2% compared to a year earlier. Building permits of privately-owned units were down by 2.9% compared to August of this year, to a seasonally adjusted annual rate of 1.428 million while down by 5.7% compared to September of last year. Single-family building permits were up 0.3% in September compared to August of this year. By region, the Northeast saw building permits down by 13.1%, month-over-month, while they were also down, but only by 2.3% on a year-earlier basis. The Midwest also showed weakness in building permits, as they declined by 2.9% but were up slightly, by 0.5%, compared to a year earlier. The South showed building permits declining by 6.1%, month-over-month, and 9.0% compared to a year earlier while the West was the only region showing improvement month-over-month, as they increased by 10.9%. However, they were still down on a year-over-year basis, by 2.6%. The Northeast saw a surge in housing starts in September but since it is one of the smallest regions for housing starts in the country, the surge was not able to erase the decline in the largest region of the country, the South.

Disclosures

Economic and market conditions are subject to change.

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Statistics. Currencies investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation. A value above 100 signals a boost in the consumers' confidence towards the future economic situation, as a consequence of which they are less prone to save, and more inclined to consume. The opposite applies to values under 100.

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GDP Price Index: A measure of inflation in the prices of goods and services produced in the United States. The gross domestic product price index includes the prices of U.S. goods and services exported to other countries. The prices that Americans pay for imports aren't part of this index.

The Conference Board Leading Economic Index: Intended to forecast future economic activity, it is calculated from the values of ten key variables.

Disclosures

Import Price Index: The import price index measure price changes in goods or services purchased from abroad by U.S. residents (imports) and sold to foreign buyers (exports). The indexes are updated once a month by the Bureau of Labor Statistics (BLS) International Price Program (IPP).

ISM Services PMI Index: The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers' Index (PMI) (also known as the ISM Services PMI) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

Consumer Price Index (CPI) A consumer price index is a price index, the price of a weighted average market basket of consumer goods and services purchased by households.

Producer Price Index: A producer price index(PPI) is a price index that measures the average changes in prices received by domestic producers for their output.

Industrial production: Industrial production is a measure of output of the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Although these sectors contribute only a small portion of gross domestic product, they are highly sensitive to interest rates and consumer demand.

The NAHB/Wells Fargo Housing Opportunity Index (HOI) for a given area is defined as the share of homes sold in that area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

Conference Board Coincident Economic Index: The Composite Index of Coincident Indicators is an index published by the Conference Board that provides a broad-based measurement of current economic conditions, helping economists, investors, and public policymakers to determine which phase of the business cycle the economy is currently experiencing.

Conference Board Lagging Economic Index: The Composite Index of Lagging Indicators is an index published monthly by the Conference Board, used to confirm and assess the direction of the economy's movements over recent months.

New Export Index: The PMI New export orders index allows us to track international demand for a country's goods and services on a timely, monthly, basis.

Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

Source: FactSet, data as of 10/18/2024

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