Macro Perspective
September 2024

AEGON **INSIGHTS**

The Fed's high-wire act continues

Friday's US payroll data continues to paint a picture of the economy cooling, but not collapsing. In one sense, the Federal Reserve is conducting a high-wire balancing act: Slow the economy enough to kill the inflationary pressures, but not so much that it kills the economy.

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Frank Rybinski, CFA, is head of macro strategy responsible for guiding the firm's global macroeconomic view as it pertains to tactical and strategic asset allocation. This includes analysis of the economy, interest rates, and the relative value between asset classes. In this capacity, Frank frequently appears in leading financial media outlets like Bloomberg, CNBC, Fox Business and the Wall Street Journal. Prior to his current role, Frank was a credit strategist for UBS Investment Bank. Prior to that, he worked as an analyst for ZT Zurich Trust in Zurich, Switzerland. Frank began his career as a trader for Spear, Leeds & Kellogg and held a similar position at The Royal Bank of Scotland. He has been in the industry since 1996 and started with the firm in 2008. Frank received his BA in economics from Boston College. He is a CFA® charterholder.

The thing about high-wire acts is that you can't sprint across the wire to the other side. Rather, it's a delicate process that takes time. That is challenging when you have a market that loves to magnify each miniscule movement—Ooh, the balance pole tilted left, it's a recession! Ahh, the balance pole tilted right, inflation is accelerating!

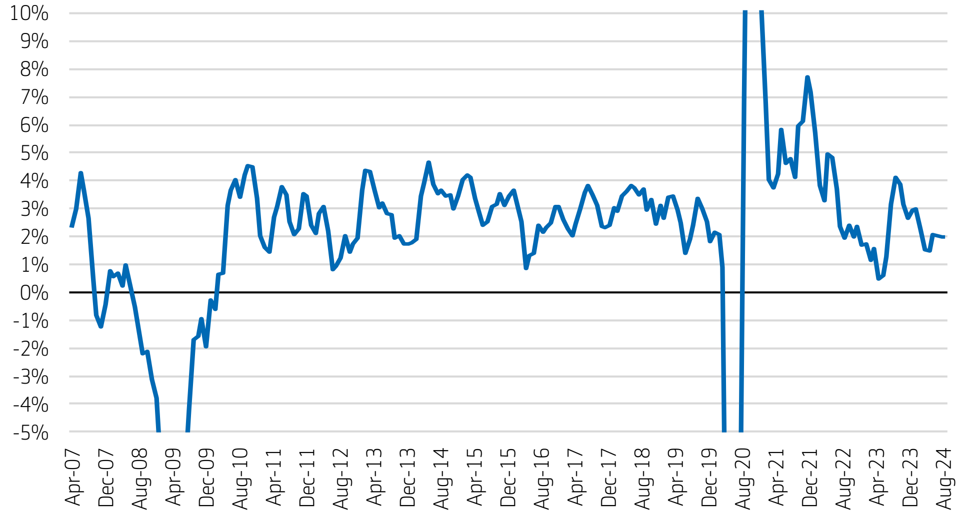
The thing about soft landings is that they are uncomfortable, but a recession is painful. Soft landings imply sub-trend growth, i.e., a growth recession. In that environment, unemployment increases, but at a slower rate than in a recession.

At Aegon Asset Management, we continue to believe that we are experiencing a much-needed cooling phase. Some key points from Friday's labor data illustrate this:

- Overall, the annualized 3-month rate of growth in the labor market is a little over 1%. If sustained, (which is a big if), that is supportive of 1.5% to 2.0% growth.
- Overall, 71% of the labor force is the private payrolls excluding healthcare. This is the cyclical part of the labor market and is growing at about a 0.7% annualized rate. That's not great, but not disaster either.
- The annualized labor income proxy in real terms is growing +/- 2% over 3-month, 6-month and year-over-year time frames. That is supportive of moderate consumption growth, which is the largest part of the US economy.

Asset Management

Labor income proxy
3-month annualized rate, deflated by core PCE



Sources: Bureau of Labor Statistics, Haver Analytics. Data as of September 2024.

We expect the broad economic data will continue to paint a picture of a cooling economy. However, we don't yet see the risk of collapse as so big that the Fed needs to signal concern with a 50-basis point (bps) cut at its meeting on September 18. Instead, a "dovish 25" bps cut gets the ball rolling, while keeping optionality (something the Fed loves to have).

Such an approach from the Fed would mean that short-term rates could continue their strength as every meeting would become a live meeting for a potential super-sized cut. Longer-term rates are reflecting a higher probability of recession than we would assign, but we expect some volatility as the economy navigates the Fed's high-wire act. Continued curve steepening is the most obvious consequence and we expect longer-term rates to have limited room to rally unless the data turns down more sharply.

We expect the broad economic data will continue to paint a picture of a cooling economy.

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