First Trust Portfolios Canada
Monday Morning OUTLOOK

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Hard Landing, Soft Landing, or No Landing

In the past few weeks, a growing chorus of economists and investors have decided that the pessimistic narrative had it wrong all along, that the US isn't headed for a hard landing, which would mean a recession, it isn't even headed for a soft landing, which would mean a prolonged period of low economic growth.

What they think we're going to get is no landing at all, that the US economy reaccelerates from here and does just fine. No fuss, no muss. In turn, that means the bottom for the S&P 500 back on October 12 at 3577 was the bottom for the bear market, which is already likely over.

We wish.

Instead, we think that's a very rosy interpretation of recent economic reports. Yes, consumer spending was reported very strong for January, even when adjusted for inflation. But this is something we predicted based on unusually warm winter weather and how the policy response to COVID, including massive fiscal stimulus, has wreaked havoc with traditional seasonal adjustments, making November and December look worse by comparison and January look better.

The problem for the "No Landing" theory is that inflation remains a major problem. The Consumer Price Index is up 6.4% from a year ago, not that much of a decline versus 7.5% in the year ending in January 2022.

The Federal Reserve is following something called "SuperCore" inflation, which is part of the PCE Deflator. That figure excludes food and energy, like the regular "core," but also excludes all other goods as well as shelter costs (where some claim that inflation measures are misjudging rents). But SuperCore PCE prices rose at 7.4% annual rate in January, the fastest increase for any month since 2021. SuperCore PCE prices are up 4.6% in the past twelve months, barely lower than the 5.0% increase in the year ending January 2022.

Either way, this is not enough progress on inflation to satisfy the Fed, which means a higher risk of ongoing hikes in short-term interest rates, until there's more evidence inflation is coming back down toward 2.0%.

Meanwhile, the economic morphine of government checks and loose monetary policy is wearing off. The federal government was handing out checks like candy in 2020-21 and the Fed had kept short-term rates below the pace of inflation for most of the last fifteen years.

But after surging in 2020-21, the M2 measure of the money supply hit a wall in early 2022 and declined during the past year by the most for any year since the Great Depression. The yield curve is steeply inverted and likely to get more so in the next few months, which is consistent with risk aversion among investors and in Corporate America. We expect prolonged weakness in business investment in equipment as well as commercial construction. And after surging rapidly last year, the pace of inventory accumulation should cool off, too. Combined, these should pose a big headwind for GDP growth later this year.

While some are heartened by low unemployment and recent rapid job growth, we don't think these are hurdles to a recession. The labor market is a lagging indicator of economic performance. Meanwhile, job growth and wages are likely to slow, which means tepid gains in consumer purchasing power at the same time low-income households have run out of stimulus-induced savings.

The bottom line is that none of the recent reports has changed our forecast of a recession. Given the Fed's reaction function and the decline in M2 that's already happened, if we get more growth than expected in the near-term, that means more pain later on when the recession hits.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-27 / 7:30 am	Durable Goods – Jan	-4.0%	**-4.5%**	-4.5%	+5.6%
7:30 am	Durable Goods (Ex-Trans) – Jan	+0.2%	**+0.2%**	+0.7%	-0.2%
2-28 / 8:45 am	Chicago PMI – Feb	45.7	**43.3**		44.3
3-1 / 9:00 am	ISM Index – Feb	48.0	**48.2**		47.4
9:00 am	Construction Spending – Feb	+0.2%	**+0.2%**		-0.4%
afternoon	Total Car/Truck Sales – Feb	14.7 Mil	**14.5 Mil**		15.7 Mil
afternoon	Domestic Car/Truck Sales – Feb		**11.5 Mil**		12.4 Mil
3-2 / 7:30 am	Initial Claims – Feb 25	195K	**195K**		194K
7:30 am	Q4 Non-Farm Productivity	+2.5%	**+2.6%**		+2.6%
7:30 am	Q4 Unit Labor Costs	+1.6%	**+1.9%**		+1.9%
3-3 / 9:00 am	ISM Non Mfg Index – Feb	54.6	**54.7**		55.2