KKR

Flash Macro Update

U.S. CPI | April 2024

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What You Need to Know

1 How are we thinking about the March U.S. CPI report?

The latest data confirm our view that markets have been too complacent in expecting the Fed to cut rates quickly. See below for details, but 'left tail' risks of low growth and low inflation in the second half of 2024 look increasingly remote, which leaves little incentive for cuts. **Against this backdrop, our Regime Change thesis is unfolding even more powerfully than we thought. As such, we are having to make few changes to our forecasts.**

Key Forecast Changes			
	New	**Old**	**Rationale / Comments**
2024 Fed Funds	5.375%	4.875%	No Fed cuts in 2024 due to strength and resilience of the economy. Our previous forecast was two cuts, where consensus remains.
2024 U.S. GDP	2.7%	2.5%	ISMs are back in positive territory, job growth printed above +300k for the first time in ten months, and commodities have rallied. Consensus is at 2.2%.
2025 U.S. GDP	2.0%	1.5%	Economic resilience will continue into 2024. Consensus is at 1.7%.
2024 U.S. Inflation	3.4%	3.1%	Shelter inflation is still moderating, and goods prices remain well-behaved, but 'sticky' supercore services inflation remains too hot. Consensus is at 2.9%.

Drilling down on the details, our key points are as follows:

- **Bigger picture, we stick to our view that inflation is on a cooler path but will not return to two percent** in the near term, consistent with a 3.125% 'neutral' rate for fed funds this cycle in 2027 and beyond, and a U.S. 10-year yield that does not run sustainably below four percent in coming years.
- **Growth is resilient, leading us to tweak up our GDP outlook**. We think growth will be even more resilient than we anticipated in the back half of this year, driving our 2024 GDP up slightly to 2.7% from 2.5%, well above consensus of 2.2%. As mentioned earlier, we believe GDP growth will remain resilient next year too and raise our 2025e GDP to 2.0% from 1.5% previously.
- **Disinflation is taking longer to play out.** Shelter inflation is still moderating, and goods prices remain well-behaved, but 'sticky' supercore services inflation remains too hot. Against that backdrop, our inflation forecast rises to 3.4% for 2024 from 3.1% previously, which is well above consensus of 2.9%.
- **We now think the Fed will hold rates at current levels through year end.** At the end of last year, 3-month moving average Core CPI was 3.4% annualized and payroll growth was just +165k. Today, those numbers are 4.5% and 276k. What this means is that the risks for the Fed have fundamentally shifted, and we think policymakers will no longer see a need to hurry to ease financial conditions. We raise our 2024 forecast to 5.375% (no cuts), from 4.875% previously (two cuts) and our 2025 forecast to 4.375% (four cuts) from 4.125% previously.
- **We continue to think duration is attractive with 10-year yields in the 4.5-4.75% range.** We are not changing our long-term rates or inflation forecasts and maintain our year-end 2024 10-year U.S. Treasury forecast of 4.25%. In terms of market technicals, net issuance, foreign demand (driven by lower hedging costs and domestic yields), and investor positioning all suggest 10-year U.S. Treasury yields cannot sustain just above 4.75%.

WHAT DOES THIS MEAN FOR MARKETS

The fact that growth, not just inflation, is resilient means the macro backdrop is still a reasonably friendly one for risk assets. We maintain our long-held 'Glass Half Full' conviction that hard landing risks are remote, and now see less risk of even a mild stall-out in late 2024 / early 2025. Amid this firmer nominal growth backdrop, we think the Fed will be less focused on downside risks to GDP and inflation and inclined to hold rates at current levels through year-end.

Importantly, we do not think economy is overheating, which continues to give us confidence that Fed rates have peaked. Labor indicators are still softening at the margin, the global context is weak (most other OECD economies are in, or flirting with, mild recession), and leading inflation indicators are better.

In terms of investment implications, a few things are top of mind for us:

Earnings growth for the S&P 500 already troughed at *negative* four percent in 1H23 amidst downcycles for housing, semiconductors, financials, energy, and pharma. Today, earnings are improving on a broad basis, with S&P 500 EPS expected to expand by about 10% in 2024.

The U.S. manufacturing economy also now seems to be improving following a long period of malaise. The headwinds from normalizing supply chains and inventories seem to be lessening, as the U.S. Manufacturing PMI moved above 50 in March for the first time in fully 17 months.

Beyond equities and credit, higher-for-longer U.S. rates as well as persistently elevated energy prices likely continue to hold major FX crosses, including JPY, at weak absolute levels. In terms of market technicals, net issuance, foreign demand, and investor positioning all suggest more support for bonds near current levels.

From an asset allocation perspective, the inflation and rates backdrop further increases our conviction in the case for Real Assets, including Infrastructure, Real Estate, and Asset-Based Finance.

Exhibit 1: On Net, We Continue to See Disinflation Ahead, But Higher Near-Term Prints Raise Our Forecast for 2024 CPI Inflation

KKR GMAA U.S. CPI FORECAST DETAIL								
	4Q23a	1Q24a	2Q24e	3Q24e	4Q24e	Full-Year 2023	Full-Year 2024e	Full-Year 2025e
Headline CPI	**3.2%**	**3.2%**	**3.5%**	**3.5%**	**3.4%**	**4.1%**	**3.4%**	**2.5%**
Energy (7%)	-3.9%	-1.3%	4.8%	2.5%	3.9%	-4.8%	2.5%	2.5%
Food (13%)	3.0%	2.3%	2.3%	2.2%	1.9%	5.8%	2.2%	1.5%
Core CPI (80%)	**4.0%**	**3.8%**	**3.7%**	**3.8%**	**3.6%**	**4.8%**	**3.7%**	**2.7%**
Core Goods (19%)	**0.1%**	**-0.4%**	**-1.6%**	**-1.6%**	**-1.5%**	**0.9%**	**-1.3%**	**0.1%**
Vehicles (6%)	-0.6%	-0.6%	-2.5%	-2.2%	-2.5%	-0.4%	-2.0%	-0.5%
Other Core Goods (12%)	0.5%	-0.4%	-1.2%	-1.3%	-1.1%	1.7%	-1.0%	0.5%
Core Services (61%)	**5.4%**	**5.3%**	**5.5%**	**5.6%**	**5.4%**	**6.3%**	**5.4%**	**3.6%**
Shelter (34%)	6.7%	6.0%	5.6%	5.3%	4.9%	7.5%	5.4%	3.5%
Medical (7%)	-1.1%	1.3%	3.1%	4.6%	5.0%	-0.4%	3.5%	3.5%
Education (2%)	2.5%	2.5%	2.6%	2.7%	2.9%	3.1%	2.7%	2.8%
Other Core Services (18%)	6.0%	6.0%	6.7%	6.8%	6.7%	6.8%	6.6%	4.0%

Data as at March 31, 2024. Source: Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

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