Weekly Economic Update—February 7th, 2023

There were no actionable surprises coming out of this week's FOMC meeting as the Fed's quarter-point rate hike was spot on with expectations. Anything less or more would surely have thrown the financial markets into a tizzy and cause widespread recriminations from the hawks and doves. That said, chair Powell did his utmost best to push back on market expectations that the end of the rate-hiking campaign is near and a pivot to cuts is poised to start soon thereafter, most likely before the end of the year. As explicitly stated in the policy statement, "The Committee anticipates that ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time." In the press conference, Powell sounded all the appropriate hawkish notes, striving to push back on the evolving easing of market conditions, which runs counter to the Fed's efforts to slow growth.

For a while, the Fed's jawboning efforts fell on deaf ears, as the stock market continued to rally following the meeting, augmenting the 6.2 percent gain in the S&P 500 in January – the strongest start to a year since 2019. Indeed, February started with two consecutive daily gains of over 1 percent. But on Friday, investors faced a harsh reality that a data dependent Fed has every reason to stick to its guns, not only lifting rates again at the March meeting (which the markets priced in) but to at least keep rates elevated longer if not bump them up again in coming months. Simply put, the perception that the Fed's aggressive rate-hiking campaign was hobbling the economy's job-creating engine blew up in flames with the latest jobs report. The blockbuster 517 thousand increase in nonfarm payrolls in January was the strongest in seven months and more than double expectations. Adding to the headline strength, the unemployment rate fell 0.1 percent to 3.4 percent, a level not seen since 1969.

The eye-opening jobs gain was not a fluke, skewed by outsized increases in one or two sectors or by updated seasonal adjustment factors that some alluded to. Fully 69 percent of private industries expanded staff during the month, up from an average of 64 percent over the previous five months. Some alluded to the notion that the payroll increase may have been distorted by seasonal adjustments that correct for the normal payroll contraction that occurs in January following a burst of hiring during the holiday season. Indeed, the raw data show that payrolls did contract by 2.5 million during the month, so the seasonal adjustment added a little over 3 million jobs to the headcount. But that seasonally adjusted boost was actually the smallest since January 2015. On average, the seasonal adjustment factor boosted payrolls by 3.16 million over the previous 7 Januarys.

That said, the stock market buckled but didn't fall off a cliff following the jobs report. As is usually the case with economic reports, it's common to cherry pick among the components to find support for any given view. In this case, the doves drew comfort from the tame reading on wages. Average hourly earnings rose 0.3 percent during the month, milder than the 0.4 percent increase in each of the previous three months. Compared to a year ago, the growth in earnings slowed to 4.4 percent from 4.8 percent in December and a post-pandemic high of 5.9 percent set last March. With wage gains apparently slowing, the doves argue that the Fed is well on the road towards taming inflation without having to extinguish job creation by hiking rates even more. They also point out that more workers are coming off the sidelines to take jobs, as the labor force participation rate rose 0.1 percent to 64.4 percent, matching the post-pandemic high set last March.

We caution, however, that the average hourly earnings data has many flaws that give a misleading impression of how the typical worker is faring or how it impacts the collective paychecks of the workforce. First, the average earnings data are just that – averages that can be drastically skewed by changes in the

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mix of occupations that drive the growth in payrolls. For example, during the worst of the pandemic-induced recession that saw 22 million workers get pink slips in March and April of 2020, the brunt of the layoffs occurred in low-paying industries. Stripped of these low-paying jobs, average hourly earnings jumped to 8.1 percent in April from 3.6 percent in March. Just the opposite is happening now. As demand shifts from goods to services, which is more labor intensive, the biggest payroll increases are occurring in lower-paying industries. Leisure and hospitality led the way in hiring last month, taking on 128 thousand new workers. According to the Federal Reserve Bank of Atlanta, payrolls in industries that employ workers with less than average earnings increased by 333 thousand in January compared to a 133 thousand increase in higher-paying sectors. Hence, the increase in average earnings last month was tilted downward by the larger concentration of lower paid workers.

Just as important, workers put in longer hours in January. The average work week increased to 34.7 hours from 34.4 hours, equaling the longest workweek since last March. As a result, average weekly earnings jumped by 1.3 percent compared to a 0.1 percent increase in December. Except for the aberrational spike in April 2020, when both earnings and hours leaped coming out of the recession, the January advance was the largest for a month since at least 2006 when data collection for all workers began. From a macro perspective, the weekly earnings increase is more significant than the average hourly slowdown, as it means that paychecks are stuffed with more dollars to support spending.

Overall, the Fed was probably not happy with the latest jobs report as its mission to curb inflation is linked to the strength of the labor market, particularly the wage component. Odds are, it will not be swayed by the slowdown in average hourly earnings, recognizing the impact that the composition of payroll growth had on the outcome. Even as lower paying jobs had a bigger influence on the overall increase, those workers are still getting hefty raises. Over the past year, average earnings in leisure and hospitality have increased by 7.0 percent, well above the overall average increase of 4.3 percent. And while the latter is slowing, the former is accelerating, climbing from a 6.5 percent annual increase in December. Importantly, the fastest growing payrolls are in sectors that have the greatest need for workers – leisure and hospitality and health services – and where labor shortages are still acute, as employment remains below prepandemic levels. The imbalance between supply and demand should keep upward pressure on wages in those sectors regardless of the direction in total employment.

Still, the outsized increase in payrolls last month flies in the face of other indicators that point to a distinct slowing in job growth. The Labor Department's jobs report comes on the heels of an ADP report this week that tracked a significant downshift in private payrolls. Anecdotal evidence also points to softer hiring; retailers and other small businesses are reporting an easier time filling open positions, layoffs among high profile tech companies are ballooning and even Friday's ISM index of services, which otherwise showed more headline strength than expected, had its employment component at 50, indicating no change during the month. On Thursday, Challenger, Gray and Christmas reported that corporate announced job cuts more than doubled in January from December, with the total reaching the highest level since August 2020. Skeptics of the strength in the job market believe that these pipeline layoffs will eventually filter through into a higher unemployment rate.

No doubt, the hawks have the upper hand following Friday's blockbuster jobs report. But it's hard to ignore the widespread signs pointing to slower economic growth, with the housing industry and manufacturing already in recession territory and consumer spending falling over the final two months of last year. It remains to be seen if the outsize jobs gain last month injects fresh juice into demand that will reinvigorate activity in coming months. From our lens, it won't. More than likely, the jump in job growth was an outlier amid a slowing trend that will reassert itself in the months ahead. Even if the January report is taken at face value, with job growth resilient but wage growth slowing, it bolsters the dovish soft landing scenario that argues for a pause in rate hikes, as it indicates that inflation can be tamed without the need to spur higher unemployment.

But the jobs report is just as likely to bolster the case for a hard landing. We suspect that the Fed sees the robust jobs gain as evidence that more rate hikes will be needed to short-circuit accelerating wage gains,

which it still perceives as a key threat to price stability. It will not take many more rate increases to bring about the policy-induced recession that we see beginning in the second quarter. As it is, the Fed's policy rate already exceeds the inflation rate over the past three months by the widest margin since 2006. Together with the quantitative tightening underway, and the Fed shrinking its balance sheet by $95 billion a month, it is hard to see the already-slowing economy holding up under the increasingly restrictive policy being put in place.

FINANCIAL INDICATORS

INTEREST RATES	Feb 3	Week Ago	Month Ago	Year Ago
3-month Treasury bill	4.62	4.67	4.62	0.23
6-month Treasury bill	4.78	4.84	4.84	0.55
3-month LIBOR	4.81	4.80	4.81	0.32
2-year Treasury note	4.29	4.20	4.28	1.32
5-year Treasury note	3.66	3.61	3.91	1.77
10-year Treasury note	3.52	3.51	3.56	1.92
30-year Treasury bond	3.62	3.62	3.69	2.21
30-year fixed mortgage rate	6.09	6.13	6.48	3.55
15-year fixed mortgage rate	5.14	5.17	5.73	2.77

STOCK MARKET				
Dow Jones Industrial Index	33,926.01	33,978.08	33,630.61	35,089.74
S&P 500	4,136.48	4,070.56	3,895.08	4,500.53
NASDAQ	12,006.95	11,621.71	10,569.29	14,098.01

COMMODITIES				
Gold ($ per troy ounce)	1,877.70	1,927.60	1,871.00	1,808.30
Oil ($ per barrel) - Crude Futures (WTI)	73.27	79.38	73.76	91.94

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Quarters Ago	Average-Past Six Months or Quarters
Nonfarm Payrolls (January) - 000s	517	260	290	349
Unemployment Rate (January) - Percent	3.4	3.5	3.6	3.6
Average Hourly Earnings (January) - % change	0.3	0.4	0.4	0.4
ISM Manufacturing index (January)	47.4	48.4	49.0	49.8

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