Weekly Economic Update—June 5th, 2023

With the debt-ceiling drama receding from the headlines, investors could once again focus on incoming data and reengage in the speculative game of what will the Federal Reserve do next, particularly at the upcoming policy meeting on June 13-14. Unfortunately, those who hoped the all-important jobs report for May would make the Fed's decision easier will be disappointed. The mixed messages generated by the latest reading for employment leaves more questions than answers for the Fed to ponder. That said, at least the markets do not have to grapple with the unfathomable consequences of a debt default, as Congress was able to overcome partisan bickering and approve a bill that suspends the debt ceiling for two years. The legislation that President Biden is poised to sign comes in the nick of time, as the Treasury had less than $50 billion on hand at the end of May, which would not be enough to pay bills much beyond the weekend.

The resolution of the debt-ceiling crisis that was finalized on Friday enabled the financial markets to shift attention to the jobs report. On the surface, the report confirms that the demand for labor remains strong despite the aggressive rate-hiking campaign of the Fed over the past year. The consensus on Wall Street was that the economy would generate about 195 thousand new jobs in May, which would represent a modest slowing from recent months. Instead, nonfarm payrolls accelerated, growing by a robust 339 thousand, even as revisions added a net 93 thousand to the total over the previous two months. The May gain was the largest since January and followed a 217 thousand increase March and a 295 thousand advance in April. Indeed, the 339 thousand May increase was spot-on with the average monthly increase over the past year. If there is any slackening in the demand for labor, it clearly did not show up last month.

The headline growth in nonfarm payrolls suggests that the Federal Reserve still has more work to do in cooling off the job market, a precondition to ease wage pressure that Fed officials believe is essential to lowering inflation. In fact, one of the most rate-sensitive sectors is showing a surprising amount of resilience, as hiring in construction increased by 25 thousand, the strongest increase in five months. The industry appears to be getting a lift from the administration's infrastructure bill, as the boost it imparts to commercial building could be offsetting the rate-induced weakness in residential construction. What's more, if the tightening of credit conditions is making it more difficult for service establishments to expand operations, it is not yet showing up in the leisure and hospitality sector, where payrolls increased by 48 thousand last month compared to 30 thousand in April.

Simply put, the Fed may justifiably feel that the "long and variable lags" of its policies have yet to kick in as consumers are still spending freely and companies are still hiring at a breakneck pace. No doubt, the latest jobs report bolsters the case against the Fed cutting rates anytime soon, something that the financial markets are increasingly pricing in. But neither does it strengthen the case for a rate increase at the June FOMC meeting. As is usually the case with the jobs report, the devil is in the details. A look under the hood reveals that the blockbuster payroll growth overstates the strength in the labor market.

Importantly, the acceleration of job growth last month did not stoke stronger wage gains, which the Fed considers a key source of inflationary pressure. Average hourly earnings increased at a slower pace in May – 0.3 percent versus a downwardly revised 0.4 percent in April. The year-over-year increase also ticked down from 4.4 percent to 4.3 percent. That's still too high for the Fed's comfort, as it would like to see wage increases slow to about 3.5 percent to be consistent with its 2 percent inflation target, but it is moving in the right direction. What's more, employees worked fewer hours last month, so average weekly earnings showed no increase for the period. That said, all the slowdown, both in hourly and weekly earnings, was incurred by the higher-paid management and supervisory workers. Blue-collar workers – production and nonsupervisory workers – received a sturdy 0.5 percent increase in average hourly earnings, which equals the strongest increase since April of last year. Their weekly earnings also increased by 0.5 percent during the month. Keep in mind that lower-paid workers spend more of their paychecks than higher earners, so the discrepancy in wage changes last month is probably a net positive for consumption.

Ultimately, the trend in wages will depend on how much bargaining power workers have. Clearly, the demand for labor is still strong, as evidenced by the eye-opening increase in payrolls last month. But the demand is also bringing in supply, and the increase in competition mitigates the impact on wages. The labor force participation rate among prime age, 25–54-year-old workers increased 0.1 percent to 83.4 percent in May. You would have to go back more than 20 years, to May 2002, to find a higher rate. The overall participation rate did hold steady at 62.6 percent, matching the cyclical high since the Covid-induced recession. But the overall rate is under constant downward pressure from aging baby boomers who are exiting the labor force.

Just as the buoyant payroll gain garnered headlines, so too did the unemployment rate, which jumped from 3.4 to 3.7 percent. This measure, like the participation rates, is derived from a separate survey of households and is considered to be a less reliable indicator of job market trends. The big leap reflects an outsized increase in household unemployment, which appears to be mainly among self-employed workers. When the household data are adjusted to align with the calculation in the payroll survey, the results show comparable strength, with household employment increasing by over 300 thousand during the month. It may well be that self-employed workers abandoned their jobs to take a position with a firm, which affords more stability and a steady paycheck in an increasingly uncertain economy.

That said, finding a job is becoming more difficult. In the Labor Department's Job Opening and Labor Turnover Survey (JOLTS) report released earlier in the week, it was revealed that fewer workers were voluntarily quitting their jobs in April, a sign that they are not as confident in landing a better position elsewhere. One component of the May jobs report confirms that sentiment, as the job finding rate – the share of unemployed workers in one month that found a job in the next month – fell to the lowest level since August 2021. In fact, jobless workers are staying unemployed for a longer stretch of time, as the duration of unemployment has increased for three consecutive months, rising to 22.2 weeks in May from 19.3 weeks in February.

We doubt that the jobs report will cause any significant shift in the Fed's thinking regarding its next move. The well-telegraphed position prior to this week was that the Fed would skip raising rates at the June meeting but keep the door open for additional hikes later this year. Given the mixed messages conveyed in the May jobs report, there is little reason to justify a departure from that stance. Fed officials have repeatedly said they would like to buy time to assess the impact of past rate hikes. That cautionary note still makes sense given the tightening of credit conditions that is expected due to the recent banking turmoil. But unless job growth slows more dramatically in coming months, there is little reason to think that the Fed will start cutting rates before the end of the year.

FINANCIAL INDICATORS

INTEREST RATES	Jun 2	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.38	5.27	5.23	1.18
6-month Treasury bill	5.47	5.40	5.01	1.65
3-month LIBOR	5.50	5.46	5.23	1.63
2-year Treasury note	4.51	4.56	3.91	2.68
5-year Treasury note	3.85	3.93	3.41	2.93
10-year Treasury note	3.70	3.81	3.44	2.94
30-year Treasury bond	3.89	3.96	3.76	3.09
30-year fixed mortgage rate	6.79	6.57	6.39	5.09
15-year fixed mortgage rate	6.18	5.97	5.76	4.32
STOCK MARKET				
Dow Jones Industrial Index	33,762.76	33,093.34	33,674.38	32,899.70
S&P 500	7,282.37	4,205.45	4,136.25	4,108.54
NASDAQ	13,240.77	12,975.69	12,235.41	12,012.73
COMMODITIES				
Gold ($ per troy ounce)	1,964.60	1,946.70	2,024.90	1,853.90
Oil ($ per barrel) - Crude Futures (WTI)	72.00	72.89	71.33	120.26

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two- Months/ Quarters Ago	Average- Past Six Months or Quarters
Nonfarm Payrolls (May) - 000	339	294	217	302
Unemployment Rate (May) - Percent	3.7	3.4	3.5	3.5
Average Hourly Earnings (May)- % change	0.3	0.4	0.3	0.4
ISM Manufacturing Index (May)- % change	46.9	47.1	46.3	47.3

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