Weekly Economic Update—July 10th, 2023

Downside surprises are relatively rare these days, so it comes as a welcome relief that the June employment report did not further inflame inflation fears and possibly send the Fed's rate-hiking campaign into higher gear. To be sure, while the 209 thousand increase in nonfarm payrolls came in below the expected 225 thousand gain, it will not deter the Fed from raising rates again later this month. That prospect became a foregone conclusion following the release of the minutes from last month's FOMC meeting when more policy makers were against the decision to keep rates unchanged than thought. Dallas Fed president Lorie Logan affirmed her dissent in a speech this week. Indeed, there is hardly enough evidence in the latest report to suggest the job market is anywhere near the breaking point that the Fed is seeking.

Still, the 209 thousand increase in nonfarm payrolls was the weakest increase since December 2020. What's more, job growth for the previous two months was revised down by 110 thousand, lowering the average increase over the last three months to 244 thousand from 334 thousand at the start of the year. The breadth of the increase also narrowed; only 58 percent of industries expanded payrolls last month, down from 61.2 percent in May and the second lowest share since the 2020 recession. These details clearly suggest that the job market is losing some steam-- not breaking but bending. It also raises the hope that the Fed can achieve its inflation-fighting goal without causing a massive increase in unemployment, creating just enough slack in the labor market to temper wage demands. It received some encouragement earlier this week when the Labor Department reported a sizeable 496 thousand decline in job openings in April.

But while the Fed is encouraged by the slowdown in job growth, there are few signs that the inflation indicators in the jobs report are cooling. Average hourly earnings increased by a sturdy 0.4 percent in June, matching the upwardly revised 0.4 percent increase in May. Hence, the trend remained firm, with the year-over-year increase in worker pay remaining at 4.4 percent for the third consecutive month. The Fed believes a 3.5 percent increase would be more consistent with its 2 percent inflation target, after accounting for 2 percent productivity growth. Even that might be overoptimistic, given that there has been no productivity growth to speak of for almost two years. And, while companies scaled back on hiring, they required employees to work longer, from 33.3 to 33.4 hours a week. That gave weekly earnings a 0.7 percent boost, the largest in nearly two years.

A drop in the unemployment rate to 3.6 percent from 3.7 percent is another sign that the labor market remains tight and bargaining power is tilted more towards workers than their employers. Interestingly, employment growth in the household survey, from which the unemployment rate is derived, generated a stronger increase in employment than the establishment survey last month – 273 thousand versus 209 thousand, after lagging over the previous two months. Over time, the two surveys should show similar results, and they almost align over the past six months as job growth averaged 292 thousand in the household survey and 278 thousand in the establishment survey. Hence, neither the hawks nor the doves have an edge in choosing which survey supports their view.

The labor force increased by 133,000 in June, leaving the labor force participation unchanged at 62.6%. Since an aging population puts downward pressure on the participation rate, our preferred measure of the health of the labor market is the prime-age employment-to-population ratio. That ratio increased from 80.7% in May to 80.9% in June and is among the highest since the early 2000s, arguably the previous time that there was a consensus among economists that the economy was at full employment. The prime-age employment-to-population ratio for women was a record high 75.3% in June.

It takes time for investors to digest the meaning of key economic reports, but the initial response in the financial markets to the jobs report was favorable. Stock prices staged a modest rally shortly after the report's release before fading late in the day and bond traders stepped back from pricing in an ever-tightening Fed policy. The 2-year Treasury yield, which is highly sensitive to policy expectations, slipped back under 5 percent after blowing past it earlier this week. The longer-term, 10-year yield, edged up a tad on Friday, reducing the negative inversion over the 2-year yield that is widely viewed as a leading recession indicator. This reaction is somewhat understandable as the slowing job growth depicted in the June report suggest the Fed may not have to step on the brakes as aggressively as thought a week ago, which would extend the life of the expansion.

No doubt, the relatively benign jobs report lowers the odds that the Fed will hike rates in consecutive meetings in July and September, which had become more widely expected following the release of the FOMC minutes this week. From our lens, however, the Fed would have to see more evidence of a sustained cooling of inflation for it to remain on the sidelines. We expect a rate hike at the July 26 meeting, and Wednesday's CPI report for June may determine what happens next. The jobs report while encouraging in some respects, clearly does not show a slowdown in wage growth. Even more discouraging, from the Fed's perspective, is that job creation in the rate-sensitive sectors remain stubbornly resilient. Most notably, construction jobs increased by 23 thousand in June, the same as in May and stronger than the 19 thousand average monthly increase since the Fed embarked on its rate hiking campaign in March of last year.

The downside of the slowdown in job growth the Fed is determined to bring about is that the most vulnerable sectors of the workforce will be the first to be victimized. It's a mistake to draw any conclusion from one month, but the June jobs report does provide some disconcerting omens. While the overall unemployment rate fell from 3.7 to 3.6 percent, it increased for all minority groups – to 6.0 percent from 5.6 percent for Black and African Americans and to 4.3 percent from 4.0 percent for Hispanic or Latinos. Meanwhile, the rate for less educated residents also spiked, to 6.0 percent from 5.7 percent for those with less than a high school diploma. One positive consequence of a strong job market is that it reduces racial and income inequality. A deteriorating jobs environment threatens to undermine that progress, particularly if the growth-retarding inflation battle results in a hard landing.

FINANCIAL INDICATORS

INTEREST RATES	Jul 7	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.36	5.32	5.25	1.88
6-month Treasury bill	5.48	5.45	5.38	2.57
2-year Treasury note	4.96	4.90	4.61	3.12
5-year Treasury note	4.37	4.15	3.92	3.13
10-year Treasury note	4.07	3.83	3.74	3.08
30-year Treasury bond	4.05	3.87	3.88	3.25
30-year fixed mortgage rate	6.81	6.71	6.71	5.30
15-year fixed mortgage rate	6.24	6.06	6.07	4.45
STOCK MARKET				
Dow Jones Industrial Index	33,734.88	34,407.60	33,876.38	31,338.15
S&P 500	4,398.95	4,450.38	4,298.86	3,899.38
NASDAQ	13,660.72	13,787.92	13,259.14	11,635.31
COMMODITIES				
Gold ($ per troy ounce)	1,930.50	1,926.80	1,975.30	1,740.30
Oil ($ per barrel) - Crude Futures (WTI)	73.67	70.50	70.35	104.36

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Quarters Ago	Average-Past Six Months or Quarters
ISM Manufacturing Index (June)	46	47	47	47
ISM Services Index (June)	53.9	50.3	51.9	52.9
Nonfarm Payrolls (June) - 000s	209	306	217	278
Unemployment Rate (June) - Percent	3.6	3.7	3.4	3.5
Average Hourly Earnings (June) - % change	0.4	0.4	0.4	0.4

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