Weekly Economic Update—March 11th, 2024

The latest jobs report had something for everyone. On its surface, the 275 thousand increase in nonfarm payrolls reported for February reveals a hiring boom that just won't quit. Wall Street had predicted an increase of roundly 200 thousand, so the outcome clearly exceeded expectations and supports the Federal Reserve's conviction that there is no hurry to cut interest rates. With inflation still well above the Fed's 2 percent target, the risk that the current high level of rates – which the Fed admits is well into restrictive territory – will topple the economy into a recession is remote. As long as people are working and getting decent wages, they will continue to spend and support growth. Indeed, Fed Chair Powell's semiannual testimony on monetary policy delivered just days before the Labor Department delivered its jobs report on Friday revealed just that sentiment. The Fed chief noted that rate cuts were likely coming at some point this year, but just not yet.

But under the surface, the details of the report also flashed warning signs that the Fed should not wait too long. By its own admission, the Fed is highly data dependent in shaping policy, something that is a commendable approach for making objective decisions. The problem is that the data is providing a backward-looking view of the economy, which may not provide an accurate reading of unfolding conditions. Remember the gangbuster 353 thousand increase in payrolls reported for January last month that sent the financial markets into a tizzy and wiped out all expectations of an early Fed rate cut? Well, Friday's jobs report provided a big oops on that score, revising down the increase to a more manageable 229 thousand. What's more, it also revised down, for the second time, the hefty 333 thousand increase reported for December, slicing 43 thousand from the tally and lowering it to 290 thousand.

Make no mistake, job growth remains sturdy; even with those downward revisions the 265 thousand average increase over the last three months remains well above trend and indicates a strong demand for labor by businesses. But these headline increases overstate the broader strength in the job market as the gains are becoming more narrowly based. In February, for example, healthcare, leisure and hospitality and government accounted for nearly three-quarters of the 275 thousand increase in payrolls. Labor shortages have been particularly acute in the healthcare and hospitality sectors so the filling up of job openings there is a welcome development that should contribute to an easing of wage pressures, something the Fed would like to see before it starts pulling the rate-cutting trigger.

Which brings is to the other data point that spooked the markets a month ago – the eye-popping 0.6 percent increase in wages that kept inflation fears simmering. That too was revised down a notch in the February report, to now show a 0.5 percent gain. More important, average hourly earnings virtually stalled out in February, edging up by a slim 0.1 percent. As we suspected last month, the initial surge reflected January quirks, most notably minimum wage hikes and weather-related influences. For example, nasty weather kept workers from their jobs, sharply reducing the workweek that, in turn, boosted earnings per hour for salaried workers. But the workweek expanded in February back to a normal 34.3 hours from 34.2 hours, lowering the gain in hourly pay. Unsurprisingly, the biggest expansion in hours worked last month occurred in weather-sensitive industries, such as construction and leisure and hospitality.

Taking a longer perspective, average hourly earnings increased 4.3 percent from a year ago, a tad slower than the 4.4 percent in January. That's the good news in the context of slower inflation. The bad news is that there is still more work to do, as the increase is well above the 3.5 percent that is consistent with the Fed's 2 percent target. That said, the signs are pointing to more easing of wage pressure as workers are not quitting their jobs are readily as they had, according to the latest Job Openings and Labor Turnover

survey (the so-called JOLTS report). Historically, changes in the quits rate have been a reliable leading indicator of wage trends. In January, the quit rate fell back to prepandemic levels.

While we believe that wage pressures should continue to ease in coming months, they may not do so fast enough for the Fed's comfort, as the strongest increases are occurring in the service sector, which is less sensitive to monetary policy than the goods-producing sector. Hence, the Fed may feel it has to keep its foot on the brakes until job conditions in the service sector deteriorates more severely. The danger, of course, is that by then it will be too late to stave of massive job losses and a recession. As we have noted before, when bad things start to happen in the job market, they happen quickly and are difficult to reverse.

For recession worriers, the February jobs report does provide some anxiety-inducing signals. Keep in mind that the sturdy increase in payrolls is derived from the Labor Department's survey of companies. But the department also polls households in a companion survey from which the unemployment rate is derived. That survey is sounding an ominous note, as the unemployment rate jumped from 3.7 percent to 3.9 percent in February, the highest level in more than two years. What happened is that the labor force expanded by 150 thousand and not all of the new entrants found jobs. In fact, household unemployment increased by 334 thousand. Household jobs include self-employed workers who do not show up in the payroll data reported by companies.

According to one rule of thumb, followed by some prominent economists, a half point increase in the unemployment rate over the course of a year is a time-honored leading indicator of a recession. Since the jobless rate was half percent lower, at 3.4 percent, last April that yardstick has been met. But no one believes the economy is on the cusp of a downturn, as this is just another rule that needs to be taken in context. At 3.9 percent, the unemployment rate is still historically low, remaining below 4 percent since January 2022. You would have to go back at least 50 years to find another time when the unemployment rate has remained at or below 4 percent for as long a stretch.

As noted earlier, the latest jobs report has something for everyone. Inflation hawks who believe the Fed should hold the line on rates are emboldened by another sturdy increase in job growth as well as the elevated pace of wage gains that keeps pressure on employers to raise prices. Inflation doves, on the other hand, can draw comfort from the jump in the unemployment rate which, while still low, is emblematic of a cooling labor market that should translate into lower wage-price pressure as worker job security fades and their bargaining strength weakens. For the Fed, the report further justifies its decision to adopt a wait-and-see approach before deciding when to cut rates. From our lens, nothing new in the report warrants a change in our perception that the economy is still chugging along, but the growth engine is slowly losing steam and will continue to downshift as the year progresses, eventually gliding into a soft landing. On the margin, the job market remains somewhat hotter than expected, which may push back the timing of the first rate cut to later this summer; but we still look for three reductions totaling about 1 percentage point from the current 5.25-5.50 percent range before the end of the year.

FINANCIAL INDICATORS

INTEREST RATES	Mar 8	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.37	5.38	5.38	4.83
6-month Treasury bill	5.29	5.31	5.28	4.93
2-year Treasury note	4.49	4.54	4.48	4.60
5-year Treasury note	4.05	4.16	4.14	3.96
10-year Treasury note	4.08	4.19	4.17	3.70
30-year Treasury bond	4.25	4.34	4.37	3.70
30-year fixed mortgage rate	6.88	6.94	6.64	6.73
15-year fixed mortgage rate	6.22	6.26	5.90	5.95
STOCK MARKET				
Dow Jones Industrial Index	38,722.69	39,087.38	38,671.69	31,909.64
S&P 500	5,123.69	4,137.08	5,026.61	3,861.59
NASDAQ	16,085.11	16,274.94	15,990.70	11,138.89
COMMODITIES				
Gold ($ per troy ounce)	2,184.50	2,091.60	2,039.60	1,920.20
Oil ($ per barrel) - Crude Futures (WTI)	77.82	79.80	76.60	77.31

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
ISM Nonmanufacturing Index (Februrary)	52.6	53.4	50.5	52.4
Consumer Credit (January) - Blns of $	19.5	0.9	28.3	9.3
Nonfarm Payrolls (February) - 000s	275	229	290	231
Unemployment Rate (February) - Percent	3.9	3.7	3.7	3.8
Average Hourly Earnings (February) - % change	0.1	0.5	0.3	0.3

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