WEEKLY
Economic Commentary

November 5, 2021

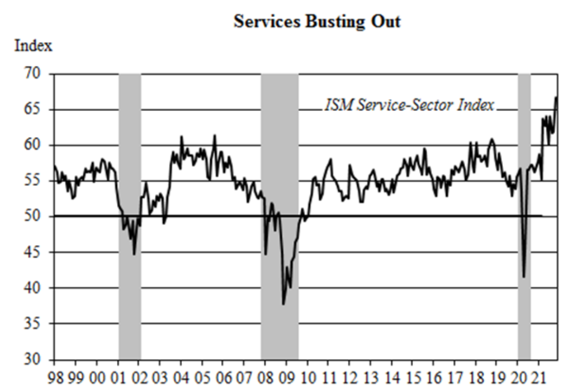
Millennium
CORPORATE CREDIT UNION

The Fed's announcement this week that it would start unwinding its bond-buying program produced little drama in the financial markets. Unlike the "taper tantrum" that occurred in 2013 when a similar announcement sent bond yields sharply higher, the policy intention this time was telegraphed well in advance, thus removing the surprise element that rattled investors earlier on. What's more, Fed chair Powell successfully delinked the tapering from rate hikes, which was not the case in the earlier episode. Instead, Powell signaled that the first rate hike would not occur until the tapering process was completed, most likely in the middle of next year, and that one of the Fed's primary goals - reaching maximum employment - was still far from being met.

Hence, in stark contrast to 2013, the Fed's actions this week elicited a big yawn in the bond market. Indeed, the bellwether 10-year Treasury yield actually receded from 1.61 percent on the day before the FOMC meeting, which concluded on Wednesday, ending the week at 1.46 percent. Not even a stronger than expected jobs report on Friday stopped the descent. Nor did the pending shift away from a turbo-charged easy policy shake up stock investors and derail the remarkable string of market advances posted this month. The S&P 500 continued to advance after the Fed meeting, ending the week at a new high.

It remains to be seen if market complacency holds up over time, given the unfolding economic landscape that points to higher inflation and a more aggressive Fed tightening than implied at the latest policy meeting. By all accounts, the economy has busted out of its summer lull and the inflation fires continue to burn hot. There's no mystery as to what's behind the resurgence. The pandemic's grip on the economy is steadily eroding. New cases of the virus are down by nearly 60 percent since early September, mirroring corresponding declines in hospitalizations and deaths. Meanwhile, vaccination rates are steadily increasing, prodded by government mandates and an expansion in eligibility to include children age 5-11. As health fears ease people are more willing - and eager - to resume normal activities - returning to restaurants, theaters, booking more travel and engaging in myriad in-person activities that had been stifled by the pandemic.

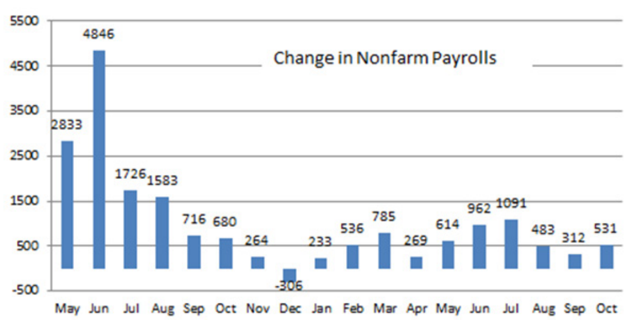
One indication that households are busting out as the pandemic eases is the astonishing revival in demand for services. When the surging Delta variant sent people back into their homes over the winter and early spring, service sector activity slumped, setting the stage for a sharp pullback in GDP during the third quarter. But as the pandemic loosened its grip in September and October, the demand for services came roaring back. The Institute for Supply Management's index of service sector activity jumped 4.8 points last month, hitting a fresh record high. And while all industries in the ISM index expanded, the gain was paced, not surprisingly, by the retail and transportation sectors.



Importantly, however, even as the demand for services shows no signs of cooling, supply side constraints continued to tighten. Respondents to the ISM survey noted that supply chain issues, including an insufficient number of workers, higher costs, materials shortages (nearly all commodities are in short supply), and ongoing logistics-related issues, prevented them from fully meeting demand. The steamy pace of demand, underpinned by elevated savings, surging stock portfolios and soaring home values, amidst these supply constraints is stoking the inflation fires. The index of prices paid by service-sector companies hit the highest level on record, except for one freakish month in 2005.

The ISM report came out before the Fed policy meeting, but Friday's post meeting jobs report only reinforced the notion that growth is vigorously reviving in the current quarter. Nonfarm payrolls were expected to grow by around 450 thousand. What's more the headline increase understated the hiring strength last month, as quirky seasonal factors reduced government employment by 73 thousand, mostly in state and local education. Jobs in the private sector rose by a more robust 604 thousand. What's more, the disappointing earlier estimates for jobs in August and September turned out to be not so bad after all. The revised data added 235 thousand new jobs for those months, bringing the three-month average gain to a solid 442 thousand.

Sturdy and Steady Job Growth



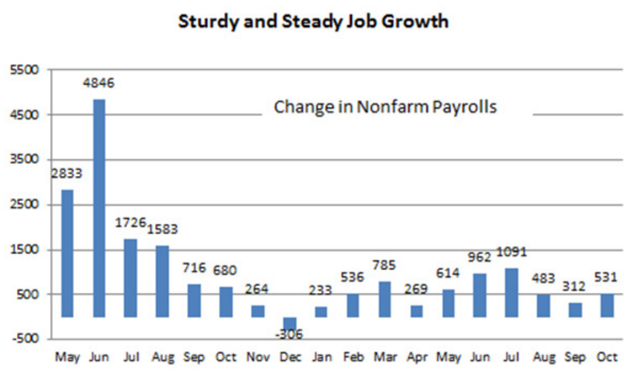
In keeping with the revival shown in the ISM report for services, the hiring gain last month received a mighty boost from the service sectors, where 496 thousand jobs were added. Leading the way was stronger hiring in the leisure and hospitality sector and professional and business services. Employment gains in leisure and hospitality had stalled in the prior two months amidst the Delta variant surge. But in October, leisure and hospitality industries added 164 thousand jobs following a weak 88 thousand jobs gain in September. Food & drinking places employment rose 119 thousand after adding just 40 thousand jobs in September, while employment in the accommodation sector increased by 23 thousand after advancing at just 9 thousand in September.

That said, the goods-producing sector pulled more than its weight, despite persistent supply chain bottlenecks and labor supply constraints. Collectively, they added 108 thousand jobs last month on the back of strong hiring in the manufacturing and construction sectors. Factory hiring posted a broad based 60 thousand gain, the largest since June 2020, led by a 28 thousand increase in the auto sector. Here the issue is not so much labor but the shortage of computer chips that is holding back production. Things on this score are not getting better anytime soon. Current wait times for chip deliveries have surged to 22 weeks, nearly double the normal rate of 9-12 weeks. Construction employment, however, is hobbled by a scarcity of workers as well as a shortage of building lots. That said, construction payrolls posted another buoyant increase of 44 thousand last month following a strong 33 thousand gain in September, so the labor shortage may be becoming less of an issue in this sector.

The encouraging payroll data is derived from the Labor Department's establishment survey, i.e., of companies that receive most of the headlines. But a separate household survey that produces the unemployment rate was just as promising. That survey showed household employment rising by 359 thousand last month and the number of unemployed plunging by 255 thousand. As a result, the unemployment rate fell by 0.2 percentage points to 4.6 percent in October - a new post-pandemic low. The one fly in the ointment is that the labor force participation rate remained at a low 61.6 percent despite expectations of a modest rise. Hence, a broad swath of would-be workers remains on the sidelines for a variety of reasons, contributing to the labor shortage that is restraining operations at many firms, particularly smaller establishments that can't fill open positions.

Not surprisingly, employers are offering more attractive pay packages to lure workers off the sidelines. In October, average hourly earnings for all private sector workers increased by 0.4 percent, lifting the annual gain to 4.9 percent from 4.6 percent in September. That's still below the headline consumer inflation rate likely to be reported for that month, but rank and file workers are faring better; earnings for nonmanagement workers jumped to 5.8 percent compared to a year ago, up from 5.5 percent in September. Employees in low-paid industries are in particular short supply and are receiving the biggest wage increases. In leisure and hospitality, for example, average hourly earnings surged by 12.4 percent from a year ago.

The bad news is that rising labor costs is a key catalyst driving up inflation and is likely to be one of the stickier influences keeping inflation elevated through at least the early months of next year. The good news is that lower-paid workers are finally reaping the rewards of a tightening labor market, something that will become ever more critical amidst high fuel and food prices, rising rents and the increasing cost for other essential items that comprise a larger share of budgets of lower-income families than for those higher up the income ladder. That said, we don't foresee an upward wage-price spiral that would feed into an accelerated inflation dynamic much beyond the early months of next year.



One reason is that the worker shortage fueling higher wages should ease over the course of 2022. Several developments point to a gradual rebound in the labor force supply. First, most schools have reopened for in-person learning, suggesting that some parents should be able to rejoin the workforce. Second, the expiration of emergency unemployment benefits in early September for more than 11 million individuals likely created an incentive for some to resume their job search. Third, an improving health situation should alleviate fears of contracting coronavirus. Fourth, vaccinations for the 5-11 age cohort should also diminish fears of the virus and allow some hesitant parents to re-enter the workforce. Keep in mind that following the 531 thousand job gain last month, there are still 4.2 million fewer workers drawing paychecks than there were in February 2020, just as the pandemic struck. We suspect that by the middle of next year, the labor force will have expanded enough to allow those missing workers to regain their jobs. The question is, will the Fed move too aggressively to raise rates and short-circuit the recovery before those jobs are recovered?

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	November 5	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.06%	0.06%	0.04%	0.08%
6-month Treasury bill	0.08	0.06	0.05	0.09
3-month LIBOR	0.14	0.13	0.13	0.22
2-year Treasury note	0.40	0.50	0.27	0.14
5-year Treasury note	1.06	1.19	0.93	0.49
10-year Treasury note	1.45	1.56	1.46	1.13
30-year Treasury bond	1.89	1.93	2.03	1.87
30-year fixed mortgage rate	3.09	3.14	3.01	2.65
15-year fixed mortgage rate	2.35	2.37	2.28	2.16
5/1-year adjustable rate	2.54	2.56	2.48	2.75
STOCK MARKET				
Dow Jones Industrial Index	36327.95	35819.56	34326.46	31097.97
S&P 500	4697.43	4605.38	4357.04	3824.68
NASDAQ	15971.59	15498.39	14566.70	13201.98
Commodities				
Gold ($ per troy ounce)	1819.50	1785.00	1761.30	1862.90
Oil ($ per barrel) - Crude Futures (WTI)	81.42	83.22	75.75	50.09

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Manufacturers Index (October)	60.8	61.1	59.9	60.4
ISM Services Index (October)	66.7	61.9	61.7	63.1
Nonfarm Payrolls (October) - 000s	531.0	312.0	483.0	666.0
Unemployment Rate (October) - Percent	4.6	4.8	5.2	5.3
Average Hourly Earnings (October) - % change	0.4	0.6	0.6	0.5

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