



WEEKLY

Economic Commentary

October 8, 2021

A heavy dose of political and economic news buffeted the financial markets this week, inciting a good deal of turmoil and leaving more questions than answers at the end of the period. Importantly, the debt-ceiling time bomb was defused, at least for the moment, as the Senate voted on Wednesday to increase the cap by \$480 billion. The House is expected to pass the bill after returning to Washington within the next few days. Once President Biden signs it, the bill will avoid a possible Treasury default, amplified market turmoil, and a self-inflicted recession for now. But the increased headroom should last only until the beginning of December. At that point, we may be back to where we started, while also contending with the risk of a government shutdown as the continuing resolution currently funding the government ends on December 3.

That said, the markets heaved a collective sigh of relief that an imminent calamity was averted. Hence, stock prices recovered most of the precipitous drop since late September brought on by the impasse on Capitol Hill, with the S&P 500 tacking on a modest 0.8 percent gain this week. However, there is little comity between the two parties, and we suspect that debt-ceiling shenanigans will resurface in the weeks leading up to the December 3 deadline, resulting in more market turmoil. Still, with the near-term threat removed, investors turned their attention to more mundane issues involving the economy, inflation and Federal Reserve policy, not to mention the elephant in the room that binds them all together: the path of Covid-19.

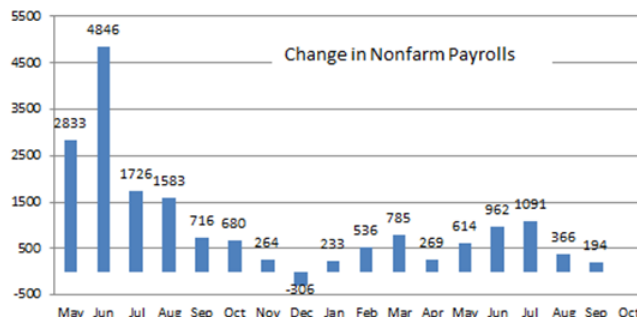
Perhaps the best news is on the health front, as new case counts of the virus have fallen significantly in recent weeks along with hospitalizations and fatalities. With vaccination rates steadily increasing and booster shots on the way, there is every hope that this is not just another “false dawn” that will be overridden by another flare-up down the road. Time will tell, of course, but we note two opposing influences that will bear on economic developments. With cold weather approaching, more activities will take place indoors, where the risk of infection is greater, a decided downside risk going forward. On the other hand, local governments and the public are not responding

to the virus as dramatically as they were earlier in the pandemic; no harsh lockdown restrictions are in place or planned, and people are learning to live with Covid, albeit cautiously. Simply put, the shock effect from Covid is wearing off, and the potential damage to the economy is not as dire as it was last year.

But while Covid’s grip on the economy may have loosened, it has not been lifted by any means. Thanks to pandemic-related hits to both the demand and supply sides of the ledger, the expansion hit a speed bump in the third quarter and is on track to grow at less than half the pace seen over the first half of the year. By far, the biggest hit has come from the supply side, as widespread shortages of goods and labor have restrained production. Until recently, the inability of producers to provide enough goods to keep up with demand has been the biggest restraint. While that’s still a major hurdle - particularly in the auto sector that continues to be plagued by a shortage of semiconductor chips - the squeeze on producers has eased as households shifted their buying preferences from goods to the more labor-intensive service sectors. Now most of the scarcity is for labor, as service providers are having a difficult time finding workers to fill open positions.

The September employment report, released on Friday, provided a glaring example of the problem. During the month, a highly disappointing 194 thousand jobs were created, less than half the consensus forecast and the weakest reading of the year. Some of the sting from the weak headline number is lessened by the upward revisions to the previous two months, which added 169 thousand jobs to earlier estimates.

Delta Constrained Job Growth



What's more, the biggest drag came from the public sector, as employment in education contracted sharply. As we feared, fewer teachers were hired than in typical years despite many schools reverting to in-person learning. This corroborates anecdotal evidence of schools struggling to find qualified teachers amid lingering virus fears and early retirements.

Employment in the private sector increased by a more respectable 317 thousand, but that too is nothing to write home about, as it is only about half the 630 thousand average increase over the previous four months. And as noted, the slowdown is concentrated mostly in the services sector where job growth cooled for a third straight month in September as employment rose by only 265 thousand - the weakest gain since January. A source of disappointment was another sluggish advance in leisure and hospitality payrolls. Hiring in this sector has stalled in the past two months amid a deteriorating Covid-19 situation. In September, leisure and hospitality industries added just 74 thousand jobs following a weak 38 thousand gain in August. Food and drinking places added only 39 thousand jobs after shedding jobs in August, while employment in the accommodation sector came to a halt.

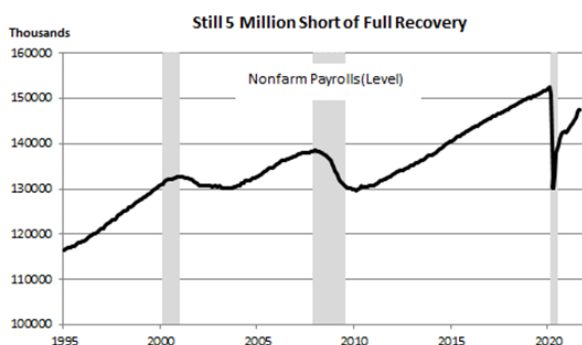
As of September, the leisure and hospitality sector had yet to recover a fifth of its employment shortfall since the onset of the pandemic. And the shortfall would be larger when accounting for all the jobs that would have been created absent the pandemic. The same observation applies to the overall jobs recovery. Despite gains in sixteen of the past seventeen months, there are still 5 million fewer jobs than

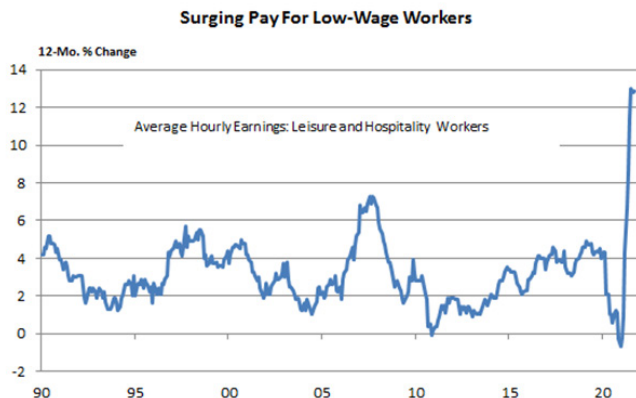
there were just prior to Covid-19. And again that does not capture all the jobs that would have been created in the absence of the pandemic.

On the surface, not all of the details of the September jobs report were disappointing. The report itself is based on two surveys -- a household survey, which generates the unemployment rate, and the larger establishment survey of companies from which the headline-grabbing payroll changes are derived. Once again, the household survey provided a brighter picture, as the unemployment rate fell 0.4 percent to a post-pandemic low of 4.8 percent in September. But the decline was not entirely for the right reason, as fewer people were looking for a job. During the month 183 thousand workers left the labor force, sending the labor force participation rate down to 61.6 percent from 61.7 percent. More than 3 million workers have left the labor force since the onset of the pandemic, when the participation rate stood at 63.4 percent.

As much as anything, the decline in the unemployment rate reflects the worker shortages that impede the ability of companies to fully operate. This is particularly the case in the services sector where many workers are staying away from low-paying positions that expose them to the virus. At the end of August, there were a record 10.9 million unfilled positions in the economy, and that number likely increased last month. In September, there were only 7.7 million unemployed workers looking for jobs. The good news for low-paid workers is that this imbalance between supply and demand is driving up their pay. Average hourly earnings for all workers increased by a sizeable 0.6 percent, driving up the year-over-year increase from 4.0 percent to 4.6 percent. However, for non-management workers, the annual increase in pay is a more impressive 5.5 percent. And for hardest-hit sector in leisure and hospitality, where labor shortages are particularly severe and workers are among the lowest paid, wages are skyrocketing, up 12.9 percent from a year ago in September.

To be fair, the September jobs report was based on surveys taken earlier in the month when the Delta variant was in the upswing and holding back hiring. As we noted at the outset, case counts have since





starts to lift rates. However, Powell very deliberately separated the tapering process from the lift-off date for a rate increase, which most Fed officials are not expecting until the second half of 2022. From our lens, the first increase will probably not take place until late in the year, as the reduction of fiscal stimulus and lack of pent-up demand will restrain growth and help cool off inflation.

receded markedly, down 38 percent since early in the month, and nearly 60 percent of the population is fully inoculated. With schools reopening and the forthcoming vaccination of children 5 to 11 years old, more parents should be liberated to seek out job offerings. The incentive to resume the job search should receive a further boost from the expiration of emergency jobless benefits last month. The program's termination occurred just one week before the September jobs survey was taken, so its impact on getting workers back to the workplace should be more fully captured in the October's jobs report.

Importantly, the weaker than expected increase in payrolls last month should not delay the Fed's plan to start tapering its asset purchases, much less derail it. Recall that Fed chair Powell asserted that only a "decent" jobs report for September would be necessary in the press conference following the last policy meeting. While he didn't quantify what decent meant, the general view is that anything showing a positive increase would suffice. The September gain, particularly on the heels of the upward revisions for July and August, would certainly meet that yardstick.

Keep in mind that the tapering process is just incrementally withdrawing the emergency support that the Fed instituted over the past 18 months, and it's fairly clear that the economy is no longer in an emergency situation. Indeed, following the third quarter slowdown, we expect job gains and overall economic growth to accelerate in the fourth quarter and retain momentum heading into 2022. An actual tightening of monetary policy occurs when the Fed

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

	October 8	Week Ago	Month Ago	Year Ago
INTEREST RATES				
3-month Treasury bill	0.05%	0.04%	0.05%	0.10%
6-month Treasury bill	0.06	0.05	0.06	0.12
3-month LIBOR	0.12	0.13	0.11	0.22
2-year Treasury note	0.32	0.27	0.22	0.16
5-year Treasury note	1.01	0.93	0.81	0.34
10-year Treasury note	1.61	1.46	1.34	0.79
30-year Treasury bond	2.17	2.03	1.93	1.58
30-year fixed mortgage rate	2.99	3.01	2.88	2.87
15-year fixed mortgage rate	2.23	2.28	2.19	2.37
5/1-year adjustable rate	2.52	2.48	2.42	2.89
STOCK MARKET				
Dow Jones Industrial Index	34746.26	34326.46	34607.72	28586.90
S&P 500	4391.34	4357.04	4458.58	3477.13
NASDAQ	14575.54	14566.70	15115.49	11579.95
Commodities				
Gold (\$ per troy ounce)	1756.70	1761.30	1788.20	1923.25
Oil (\$ per barrel) - Crude Futures (WTI)	79.50	75.75	69.71	40.19

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Services Index (September)	61.9	61.7	64.1	62.4
Trade Deficit (August) - \$billions	73.3	70.3	73.2	70.7
Nonfarm Payrolls (September) - 000s	194.0	366.0	1091.0	583.0
Unemployment Rate (September)	4.8	5.2	5.4	5.5
Average Hourly Earnings (Sept.) - % change	0.6	0.4	0.4	0.5

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