WEEKLY
Economic Commentary

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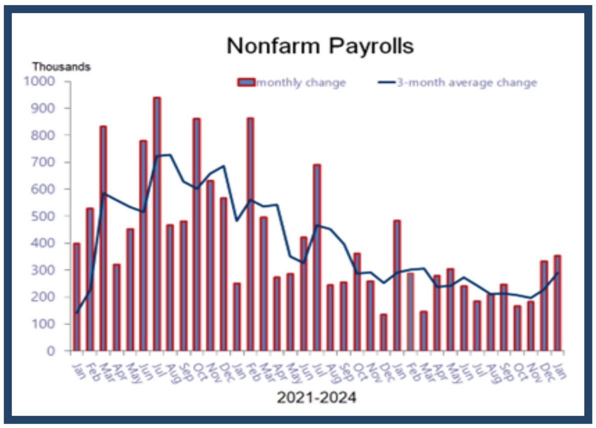
Friday's blockbuster jobs report makes it further unlikely that the Fed will cut interest rates as early as March, which most traders thought would take place heading into the FOMC meeting this week. To be sure, support for the early move had been waning due to the upside surprises contained in incoming data. But Chair Powell's comments in the post-meeting press conference was more definitive on the issue, noting that more time is needed before the Fed feels sufficiently confident that inflation is firmly on the path to its 2 percent target. While key price measures have hovered at or even slightly below the target over the past six months, Powell and his colleagues are still highly sensitive to the risk of moving prematurely and allowing the inflation embers to reignite.

Unsurprisingly, Powell is particularly tuned in to the performance of the labor market, where robust job growth is sustaining wage growth and keeping upward pressure on service prices. One comment at the presser highlights his reluctance to cut rates sooner rather than later, "If we saw an unexpected weakening in the labor market that would certainly weigh on cutting sooner. Absolutely. If we saw inflation being stickier, or higher, we would argue for moving later." Clearly, the outcome depicted in Friday's jobs report did not reveal any weakening. Instead, job growth surged as the economy generated an eye-opening 353 thousand nonfarm payrolls in January, far outpacing expectations of a 185 thousand increase. What's more, the gains in November and December were revised up by a combined 126 thousand jobs.



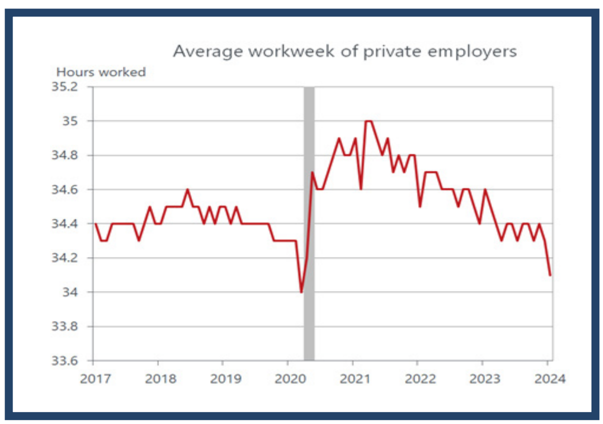
Hence, momentum is certainly not the friend of the Fed at this juncture. With the January surge and upward revisions, job growth has averaged 289 thousand over the last three months, up from 227 thousand in the three months to December and the strongest pace since last March. Nor is just a handful of sectors in the service sector powering the gain, as had been the case over the past year. The share of private industries expanding payrolls broadened to 65.6 percent, the widest in a year and up from 64.0 percent in December. The government also added 36 thousand workers, although that was less than the 55 thousand added in December.

The most disconcerting feature of the jobs report for the Fed was the strength in worker pay, as average hourly earnings jumped by a surprisingly strong 0.6 percent. That was the fastest increase in two years, lifting the year-over-year increase to 4.5 percent from 4.3 percent in December. This is not the direction the Fed wants to see, as it views taming wages as a critical step in wrestling inflation down to its target. Some analysts believe that strong wage growth will lead to margin compression instead of higher prices, as consumers are pushing back against price increases. But that argument becomes less plausible if strong wage and job growth makes households less resistant to higher prices. The stock market seems to favor the latter, as it staged a strong rally following the release of the jobs report on Friday.

For sure, inflation has been receding amid a strong job market for most of the past year, and many believe this Goldilocks economy can continue. We doubt the Fed agrees with that view unless it believes the productivity trend has permanently accelerated and/or the supply of labor and output capacity is much greater than thought. There is little reason to believe that is the case, although both are taking longer to prove otherwise. Indeed, it is hard to believe that the job market is running out of available workers when employers can fill more than 300 thousand positions in a month even as the unemployment rate hovers near historical lows at 3.7 percent.

Still, it would be a mistake to exaggerate the importance the latest jobs report, particularly the headline numbers that likely overstate the strength in the job market. For one, January contains more seasonal noise than other months, and it may be no coincidence that job growth in the last four January's came in stronger than expected. Companies tend to lay off workers following the holiday season, which the seasonal adjustment factors should take into account. But when employers retain more workers than usual, the seasonally adjusted figure for employment receives an outsized boost. We know that companies have been holding on to workers even in the face of softer demand, fearing rehiring difficulties when sales pick up. That may be on the cusp of changing, as tech and media companies have been laying off workers in droves in recent months. That trend may weaken the resolve of other companies to hold on to staff if employers sense there would be a sufficient pool of available workers to tap into down the road.

Importantly, instead of laying off staff, businesses are cutting hours worked. The average workweek dipped to 34.1 hours in January, the fewest for any month since the Pandemic. Prior to that, you would have to go back more than 20 years to find a shorter workweek. Quite possibly, some bitter storms and colder than usual weather last month led to the cutback in hours, so a few more months of data would be needed to confirm the trend. That said, a shortening of the workweek is a time-honored precursor of wider layoffs. And while employers may be holding on to staff, unemployed workers are finding it harder to land a new job. The number of jobless workers receiving unemployment benefits has been climbing over the past several months and the share of unemployed workers out of a job for more than half a year has increased to the highest level since June 2022.



Despite the over-the-top headline jobs data for January, we still believe that a cooling trend – in both job growth and wages – is poised to get underway, if not already unfolding. The torrid increase in average hourly earnings looks less impressive when viewed against the shorter workweek, which cuts into weekly pay. In fact, average weekly earnings were unchanged for the month, and it is the weekly paycheck that shapes the spending budget for most households. That's particularly the case for non-management workers, who received a weaker 0.4 percent increase in average hourly earnings and suffered an outright 0.2 percent decline in weekly earnings last month. Moreover, other measures of labor costs show a moderating trend, most notably the Labor Department's Employment Cost Index, that captures both wages and benefits. The increase in the ECI slipped to an annual rate of 3.7 percent in the fourth quarter, which is only a tad higher than the 3.5 percent deemed consistent with 2.0 percent inflation after subtracting an assumed productivity trend of 1.5 percent.

Simply put, the blockbuster headline increase in both payrolls and wages last month likely solidifies the Fed's reluctance to cut rates as early as March. Even if the increase in jobs was skewed higher by seasonal factors and other temporary influences, there is little evidence that labor conditions are weakening enough to justify policy easing aimed at staving off a recession. At the very least, it undermines the notion that the current level of rates is overly restrictive. But it doesn't derail the prospect of cuts later on in the spring or summer. Inflation continues to ease and the longer the Fed keeps rates unchanged, the more restrictive they become in real terms. That cuts into the affordability of big-ticket purchases and discourages borrowing, which we expect to steadily weaken in coming months. Auto sales already weakened considerably in January. And despite the jump in average hourly earnings last month – which may also have been juiced by the increase in the minimum wage in 22 states – worker inflation expectations are declining. That, in turn, should temper wage demands particularly since wages are now growing faster than inflation.

KEY FINANCIAL INDICATORS

INTEREST RATES	February 2	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.37%	5.35%	5.24%	4.57%
6-month Treasury bill	5.24	5.22	5.05	4.68
2-year Treasury note	4.37	4.34	4.40	4.30
5-year Treasury note	3.99	4.03	4.02	3.67
10-year Treasury note	4.02	4.14	4.05	3.53
30-year Treasury bond	4.22	4.37	4.21	3.63
30-year fixed mortgage rate	6.63	6.69	6.62	6.09
15-year fixed mortgage rate	5.94	5.96	5.89	5.14
STOCK MARKET				
Dow Jones Industrial Index	38654.42	38109.43	37466.11	33926.01
S&P 500	4958.61	4891.00	4697.24	4136.48
NASDAQ	15628.95	15455.40	14524.07	12006.95
COMMODITIES				
Gold ($ per troy ounce)	2057.10	2072.80	2106.30	1927.40
Oil ($ per barrel) - Crude Futures (WTI)	72.40	78.20	72.49	76.51

KEY ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Manufacturing Index (January)	49	47	47	48
Consumer Confidence Index (January)	114.8	108.0	101.0	106.0
Nonfarm Payrolls (January) - 000s	353.0	333.0	182.0	248.0

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