WEEKLY
Economic Commentary

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Millennium
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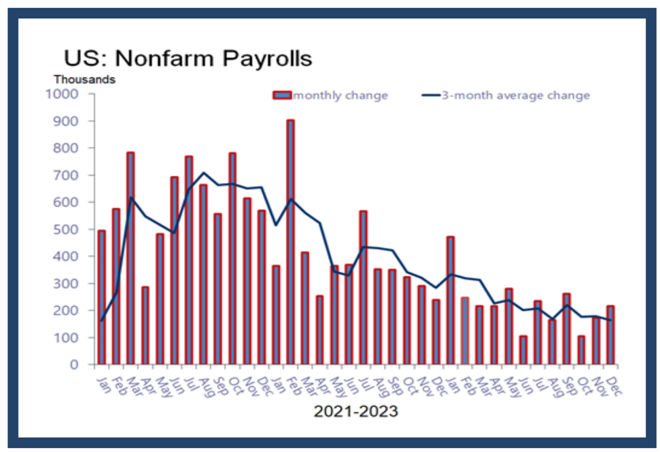
Fed chair Powell recently reiterated that the one big mistake Paul Volker made forty years ago was easing policy before inflation was fully under control, prompting an embarrassing resumption of rate hikes when price increases reaccelerated. Powell's reference was meant to discourage investors from getting ahead of themselves by pricing in more – and earlier -- rate cuts than the Fed is likely to make in 2024. While that message failed to resonate in the closing months of last year, the December jobs report on Friday may be a wake-up call for investors to curb their enthusiasm. The journey to a soft landing has not been derailed, but the ride may be bumpier than thought.

No doubt, the three headlines coming out of the jobs report must be unsettling for the rate-slashing advocates. Job growth exceeded expectations, worker pay accelerated and unemployment remained at a historically low level. For a Fed hoping for a cooler labor market, these attention-getting gauges didn't help. But as usual the devil is in the details; not only do the headline readings overstate the strength in labor conditions, they also may not be an accurate rendering of unfolding conditions. Thanks to the ongoing problem of low response rates to the Bureau of Labor Statistics surveys, it is best to wait a month or two for revised data to gain a more complete picture of what actually transpired. The revisions to back data have been particularly large this year, and the corrections made in the December report is no exception.

Hence, while the 216 thousand increase in nonfarm payrolls last month was significantly hotter than the 175 thousand consensus forecast, it comes on the heels of revised data that cut 75 thousand jobs from the previous estimates for October and November. Whether or not the same fate awaits the December estimate, the trend of cooling job growth remains firmly intact. The three-month average increase in nonfarm employment fell to 165 thousand in December, the slowest since January 2021, from 180 thousand in December. What's more, the overall increase last month reflected another sizable increase in government jobs. Private sector payrolls grew by a much more subdued 165 thousand in December and the three-month average increase of 115 thousand was the weakest since June 2020.



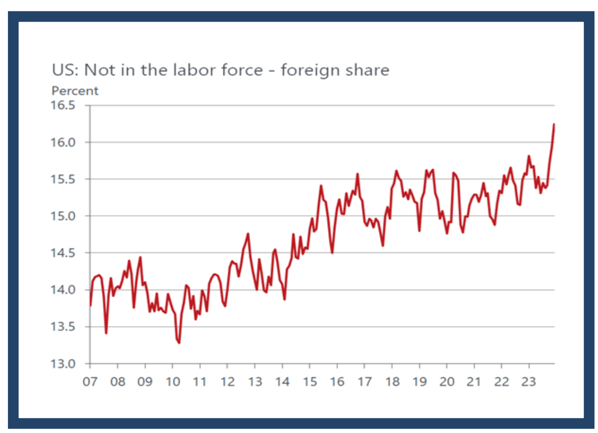
Keep in mind that changes in government jobs are not influenced by cyclical conditions, which the Fed aims to control. That's also the case, although less so, for jobs in health and social services, which contributed almost a third of the increase in private sector jobs last month. Besides, this is one sector where a cooling of job growth is not desired, as there is an acute shortage of nurses and caregivers to accommodate an aging population that has coped with myriad health crises in recent years. We suspect that the Fed is not unhappy with the current pace of private sector job growth, as it is well below the 191 thousand average monthly increase between 2010 and the end 2019.

Likewise, not too much should be read into the stubbornly low unemployment rate, which remained at 3.7 percent in December instead of ticking up to 3.8 percent as forecast. The unemployment rate is compiled in a separate survey of households, which draws from a much smaller sample than the payroll survey and is far noisier. Indeed, employment in the household survey plunged by 683 thousand last month, more than erasing the 586 thousand increase in November (confirming the noise). The only reason that plunge did not lift the unemployment rate is because the labor force also shrunk by an eye-opening 676 thousand, the steepest drop since January 2021. Had the labor force remained unchanged, the unemployment rate would have jumped to 4.1 percent. This is bad news for the Fed that is hoping to draw people off the sidelines to expand the labor supply as a means of controlling labor costs. Instead, the labor force participation rate slipped to 62.5 percent from 62.8 percent in November That matches the steepest monthly drop since April 2020.

Which brings us to the third hawkish headline of the jobs report, a stronger than expected increase in worker pay. Average hourly earnings rose 0.4 percent in December, lifting the increase over the past year to 4.1 percent from 4.0 percent. The markets and the Fed were hoping for a breakthrough below 4 percent, bringing the annual increase closer to the 3.5 percent pace that would be compatible with a 2 percent inflation rate after accounting for 1.5 percent productivity growth. We note, however, that earnings for nonmanagement workers – who comprise 80 percent of the workforce – did slow from 0.4 percent to 0.3 percent on a month-to-month basis and to 4.3 percent from 4.4 percent year-over-year. The good news is that wage growth continues its recent trend of exceeding inflation, boosting real incomes and, importantly, the purchasing power needed to sustain consumption. The bad news is that sticky wage gains give the Fed less room to cut rates as early as the markets had been expecting.

On this score, some Fed officials are cautious about cutting rates because they believe the healing of supply chains that was so instrumental in wrestling inflation down is complete, and further progress would only come from softer demand and a cooling of wage growth linked to a weaker job market. However, the December jobs report, most notably the pullback in the labor force participation rate, suggest that there are now more workers on the sidelines to draw from. What's more, there may be a larger shadow pool of available workers than is generally perceived.

One intriguing feature of the December jobs report is that the number of workers not in the labor force shot up by nearly a million, and only a small fraction of the increase reflected discouraged job seekers. By far the fastest-growing contingent of people outside of the labor force are foreign born. Indeed, the foreign-born share surged to a record 16.2 percent in December. The BLS does not distinguish between documented and undocumented immigrants in its calculations, but it may be that the wave of immigrants over the past year includes many who are undocumented and are prevented from taking a job. Expanding, and easing, government restrictions on work visas would expand the labor supply and, perhaps, contribute to the slower wage growth the Fed hopes to see. It's important to note that the foreign-born labor force participation rate is more than 3 percentage points higher than the overall rate, so the positive impact on labor supply would be swift.



KEY FINANCIAL INDICATORS

INTEREST RATES	January 5	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.38%	5.36%	5.38%	4.62%
6-month Treasury bill	5.24	5.27	5.38	4.84
2-year Treasury note	4.40	4.25	4.73	4.28
5-year Treasury note	4.02	3.85	4.25	3.91
10-year Treasury note	4.05	3.88	4.23	3.56
30-year Treasury bond	4.20	4.04	4.32	3.69
30-year fixed mortgage rate	6.62	6.61	7.03	6.48
15-year fixed mortgage rate	5.89	5.93	6.29	5.73
STOCK MARKET				
Dow Jones Industrial Index	37466.40	37689.50	36247.87	33630.61
S&P 500	4697.20	4769.80	4604.37	3895.08
NASDAQ	14524.10	15011.40	14403.97	10569.29
COMMODITIES				
Gold ($ per troy ounce)	2052.60	2071.80	2019.00	1871.00
Oil ($ per barrel) - Crude Futures (WTI)	74.00	71.30	71.20	73.76

KEY ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Manufacturing Index (December)	47.4	46.7	46.7	47.3
ISM Service Index (December)	50.6	52.7	51.8	52.7
Nonfarm Payrolls (December) - 000s	216	173	105	193
Unemployment Rate (December) - Percent	3.7	3.7	3.8	3.7
Personal Consumption (November) - % change	0.4	0.4	0.3	0.3

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