US Macroeconomics

February 3, 2023

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Fade the Jobs Report

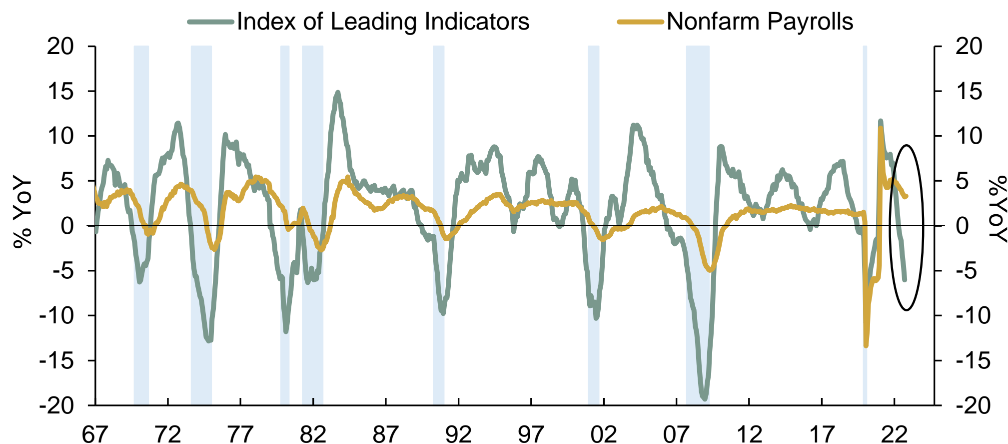
The January employment report was super strong. Most major categories surprised the consensus of forecasters. **Nonfarm payrolls increased 517k after 71k in net upward revisions to the prior two months**; the unemployment rate fell a tenth to a 3.4%, a new multi-decade low and the nonfarm workweek lengthened 0.4 to 34.7 hours, a near record large gain. The one area of moderation was average hourly earnings (0.3%) whose three-, six- and 12-month rates of changed continued to decelerate.

As strong as the January data were, **one month never makes a trend. In fact, forward looking measures of output, best proxied by the Index of Leading Economic Indicators (LEI), are shrinking**. This tells us that the huge gain in January employment was an outlier and that the weakening underlying trend in job growth evident late last year will soon reassert itself. The chart below shows the year-over-year growth rate in the LEI and nonfarm payrolls. Notice the yawning gap between the two series.

Over the 12-months ending December 2022, the LEI was in recessionary territory at -6% compared to a 3.2% increase in employment. The resulting nine-point spread is the largest since the deep 2008-09 downturn. According to our calculations, the current gap is the fifth largest on record. In the past, the spread collapsed with employment initially moving sharply lower. History is likely to repeat and should first become evident in the construction sector.

Despite the fastest and largest rise in the funds rate since the early 1980s and a more than doubling in mortgage rates, **construction jobs continue to grow**. Employment is up 12 months in a row to a record high. Yet during this time, builder sentiment, housing starts, and home sales have plunged, spending on commercial structures has shrunk and banks have been tightening lending standards. Given the lags between changes in monetary policy and interest sensitive spending, construction employment will slow in the months immediately ahead.

We do not expect the Fed to be more hawkish in response to the January employment data because a pivot back to larger than 25 basis point (bp) rate hikes would damage policymakers' credibility. Instead, the Fed will lift the level of the funds rate a bit more (another 25 bps) and then leave it there until inflation (or the economy) sufficiently slows. The LEI tells us that we are getting close to peak fed funds and that rate cuts, notwithstanding January jobs data, remains in the picture later this year. Stay tuned.



Source: Conference Board, BLS, Haver, SMBC Nikko

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