Weekly Market Commentary

June 6, 2022

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The search for clues as to whether inflation is peaking continues to be the main focus in the financial markets as well as among Federal Reserve officials. With the war in Ukraine and Covid-related shutdowns in China still buffeting oil, food and many commodity prices, it would be folly to predict the precise timing of an inflection point. But an array of recent data and anecdotal reports suggest that a turning point is near, if not already behind us. The price data alone suggest that some moderation has begun, as month-to- month increases in the consumer price index and consumption deflators are starting to slow, albeit they are still running at an elevated pace.

For sure, there is nothing to suggest the Federal Reserve is poised to ease up on its inflation-fighting campaign. If anything, recent comments from policymakers center on how aggressive future rate hikes should be, with a consensus forming around half-point increases in each of the next two monthly meetings and a bias towards a third in September. These moves belie growing recession concerns in recent weeks, which have not vanished and continue to have an influence in the financial markets. But despite these concerns, incoming data overwhelming indicate that the economy is alive and well and should remain on a solid, although slowing, growth path over the remainder of the year.

Friday's jobs report provides compelling evidence of the economy's underlying strength, even as it reveals easing wage pressure that sounds an encouraging note on the inflation front. In May, employers added a robust 390 thousand workers to payrolls, beating expectations of around a 320 thousand increase. With the latest gain, the labor market has recovered all but 3.7 percent of the job losses incurred during the pandemic recession in early 2020, although some sectors still lag well behind. Employment in leisure and hospitality, for example, is still a full 8 percent below its prepandemic level.

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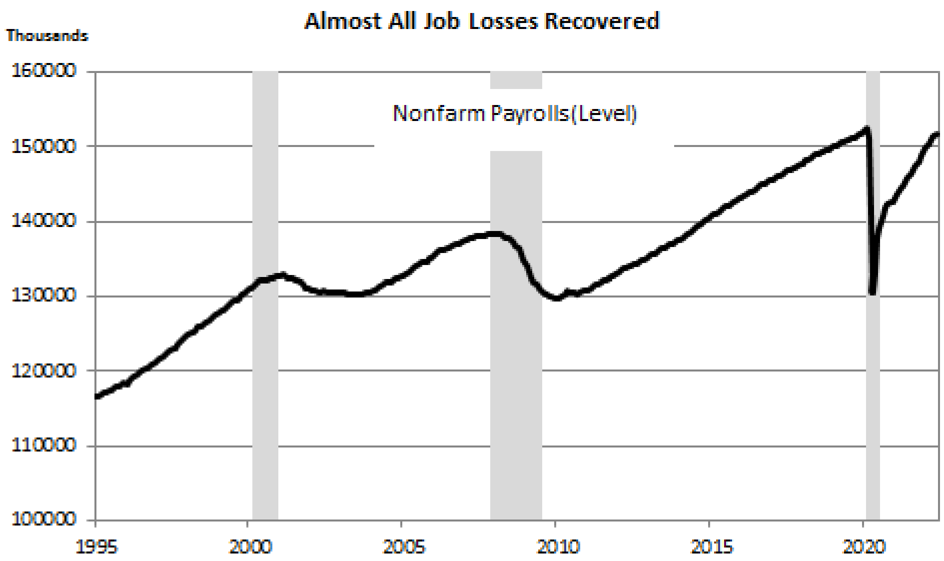
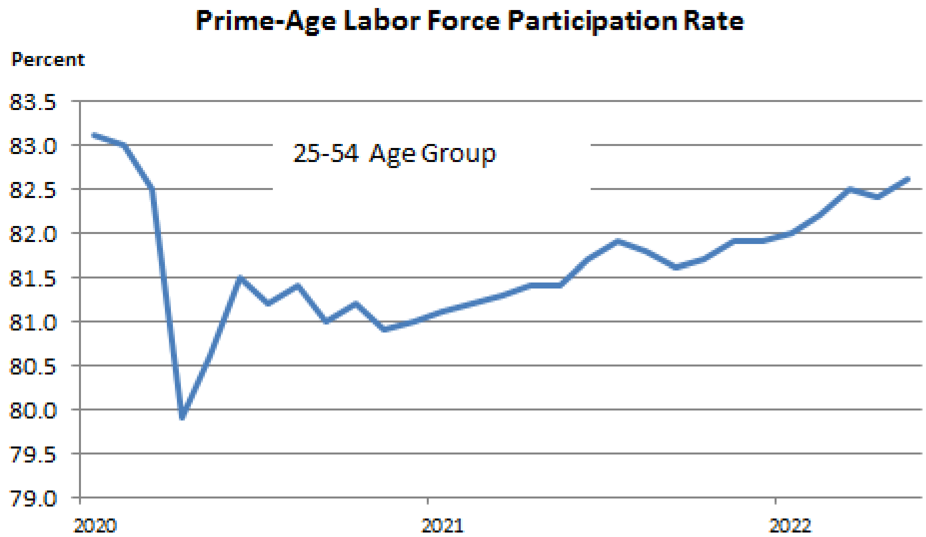


But with the economy reopening and consumer preferences shifting from goods purchases towards services, including travel, dining and entertainment, leisure and hospitality firms are rapidly staffing up – although a shortage of available workers is impeding the process. In May, payrolls in this sector increased by 84 thousand accounting for 30 percent of all service-sector job gains last month. That's an outsized contribution from a sector that accounts for only 12 percent of total jobs in that sector. Still, a few other industries propelled services employment forward in May, including professional and business services (+75 thousand), healthcare and education (+74 thousand), and transportation and warehousing (+47 thousand).

One outlier was in retail, where employment plunged by a remarkable 61 thousand last month, the steepest drop in more than a year. That setback is consistent with the recent disappointing earnings reports from some high-profile retailers who faced weaker demand for big-ticket goods, reflecting the rotation in purchases towards services. This sector had been rehiring workers at a rapid pace throughout most of the pandemic as homebound consumers ramped up spending on durable goods, home furnishing and other items aligned with remote work. By January of this year, retail employment exceeded its prepandemic peak. But the hiring spree fizzled out early this year as many retailers, like Walmart and Amazon, acknowledged that they probably over hired and stocked up with too much merchandise. Over the past three months, retail firms have been cutting their workforces, and we expect cutbacks will continue as they adjust to rising costs and a cooling demand environment.

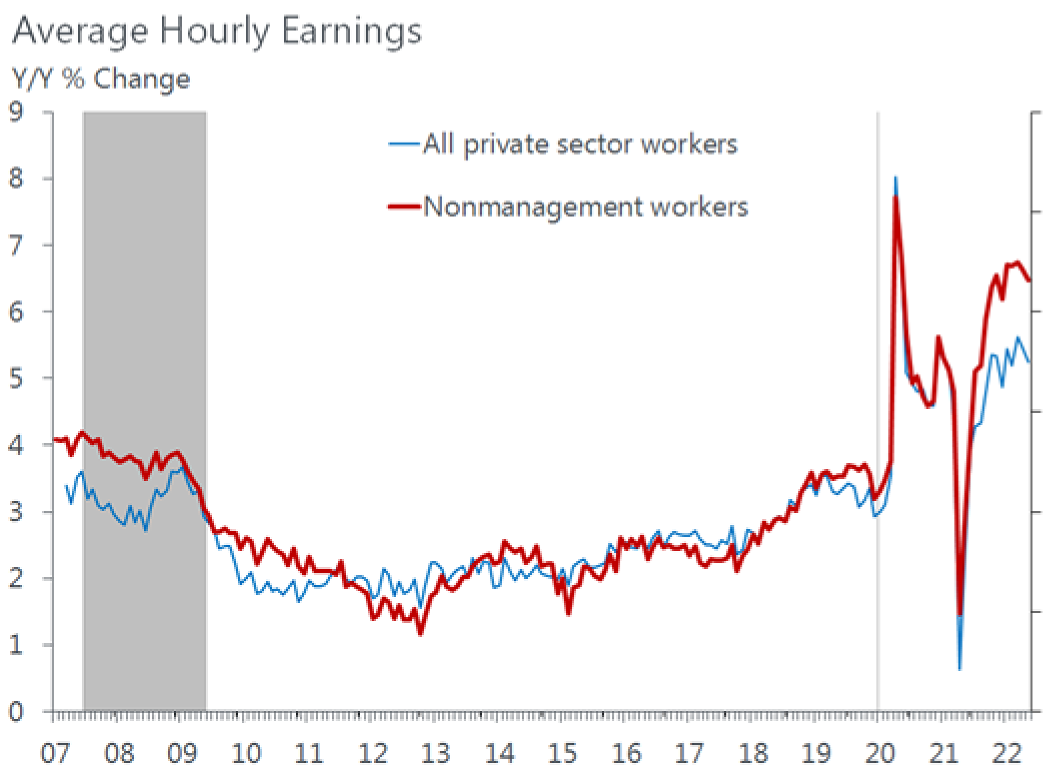
But retailers had been losing ground to online sellers well before the pandemic struck, and softness in this sector is not a sign that consumers are pulling back. Importantly, as long as the overall job market remains hot, it is hard to see a recession looming anytime soon. By all accounts, the latest jobs report confirms that labor conditions remain on a solid footing. Not only is job growth still much greater than the increases seen before the pandemic, but gains are also spreading among a broader swath of the economy. Almost 70 percent of all private industries expanded payrolls in May, which is among the highest share on record.

One encouraging feature of the jobs report is that more people are joining the labor force. Thanks to high inflation, lessening health fears and perhaps shrinking savings buffers, workers are coming off the sidelines. The labor force participation rate increased 0.l percent to 62.3 percent in May, reversing half of the surprising decline in April. More important, the participation among prime-age workers increased to a pandemic high, climbing to 82.6 percent, only a half percent below its prepandemic peak. That's less than half the 1.1 percent shortfall for all workers, as the prime-age cohort is not affected by the wave of retirements that has dragged down the participation rate for all workers.



Expanding the supply of labor is a key objective of the Federal Reserve for two reasons. For one, it means that disenfranchised workers who have been shut out of the job market for a variety of reasons are now finding greater employment opportunities. This is an important step towards lessening the income and wealth inequality that has been a blemish on the American economy over the past three decades. With the unemployment rate at a rock bottom 3.6 percent and nearly two job openings for every unemployed worker, those on the lower end of the income and wage scale are in a stronger bargaining position to close the gap.

For another, worker shortages have been a key element driving up wages and stoking the inflation embers that the Fed is desperately striving to cool. Raising interest rates, of course, dampens the demand for labor and helps accomplish that goal. But the hope is that wage increases can be tamped down without causing too much of a rise in unemployment, which could lead to a recession. A big help would be forthcoming if more workers joined the labor force, easing wage pressures stemming from the formidable unsatisfied demand for labor. The good news is that the latest jobs report suggests wage increases may be slowing. Average hourly earnings for all private-sector workers rose a tolerable 0.3 percent for the second consecutive month, lowering the increase over the past year to 5.2 percent from 5.5 percent in April and 5.6 percent in March. What's more, the slowdown has not cut into the wage gains achieved by lower paid workers. Average hourly earnings for nonmanagement workers increased by a torrid 0.6 percent in May, although their annual increase did slip to 6.5 from 6.6 percent in April.



Simply put, there's a good chance that wage growth is past its cyclical peak and a cooling trend is underway. Several major companies announced a hiring freeze in recent weeks and some, including Tesla this week, plan to cut staff outright. An outsized share of these companies is in the technology sector, which generally employ high earners, whereas demand in the service sector, where lower-paid workers are more prevalent, should remain strong. Should this mix of layoffs and hiring persist, the gap in wage growth between high and low-paid workers would narrow, a tradeoff generally deemed positive from a social viewpoint. Importantly, the general cooling in overall wage growth would be a welcome development by the Federal Reserve, as a less aggressive rate-hiking cycle than otherwise would be needed to rein in inflation, upping the chances of avoiding a recession.