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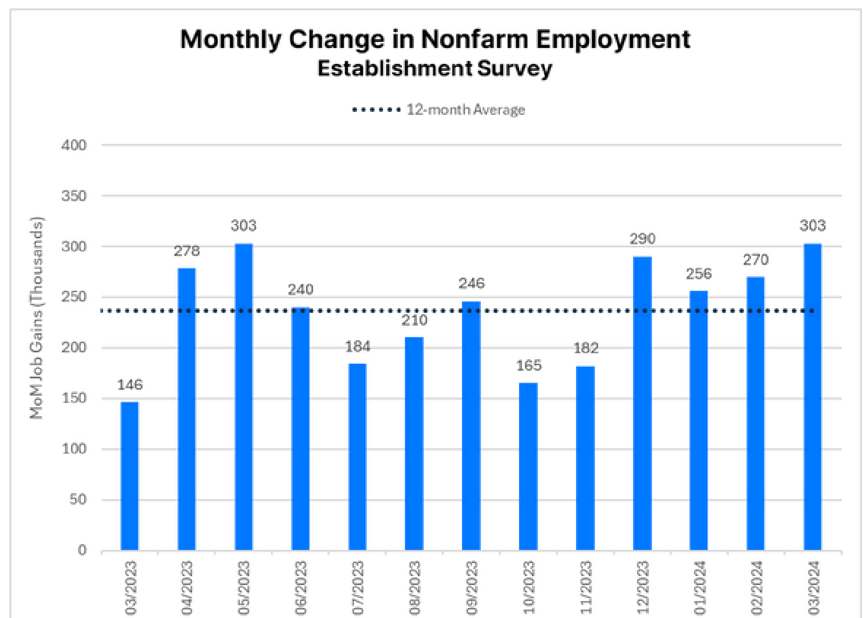
on topical economic issues

April 2024 Economic Outlook: A Blockbuster Jobs Report, a Hot CPI Release, and the Fed

Key takeaways:

- **The March jobs report showed stronger-than-expected growth, with the economy adding 303,000 new jobs and the unemployment rate ticking down. However, job gains remain concentrated in four sectors and wage growth remains above levels consistent with the Fed's 2% inflation target.**
- **The latest CPI data left much to be desired, as inflation is proving much stickier than the Federal Reserve would like to see.**
- **Given the latest employment, wage, and inflation data, mid-year Fed rate cuts are off the table, as the central bank continues to struggle with the last mile of disinflation.**

The latest employment data from the U.S. Bureau of Labor Statistics showed stronger-than-expected job growth in March, with the US economy adding 303,000 new jobs last month. This far exceeded the 205,000 gain that consensus had projected and rounded off an impressive first quarter in terms of job gains.



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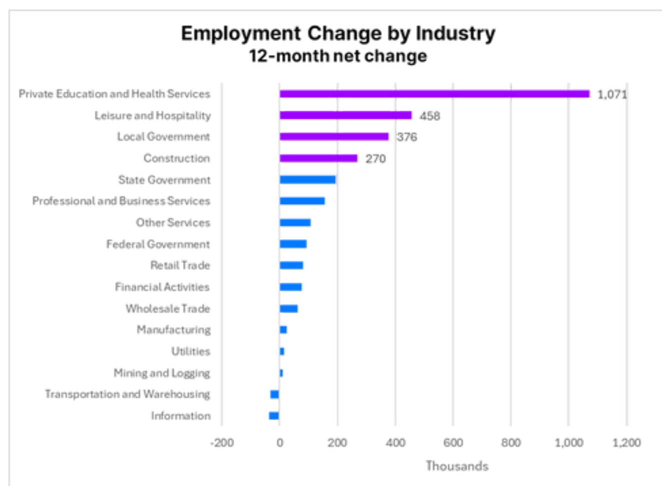
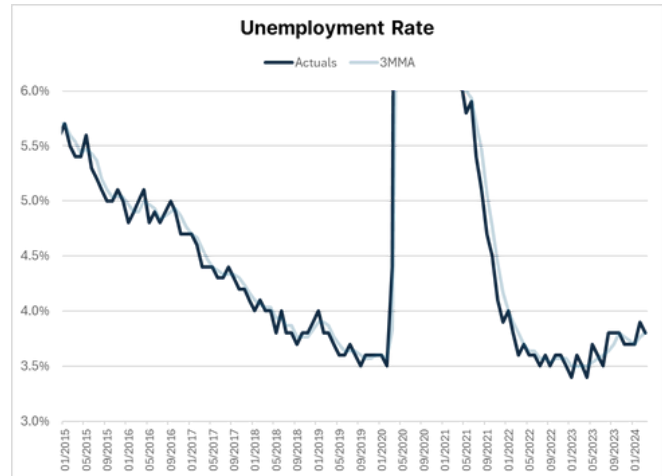
What added jobs means for the health of the economy

Diving into the numbers, over the last 12 months about 75% of the gains we've seen have been concentrated in four sectors: Healthcare, Leisure and Hospitality, Local Government, and Construction. This trend was mirrored in the month-over-month employment gains in March.

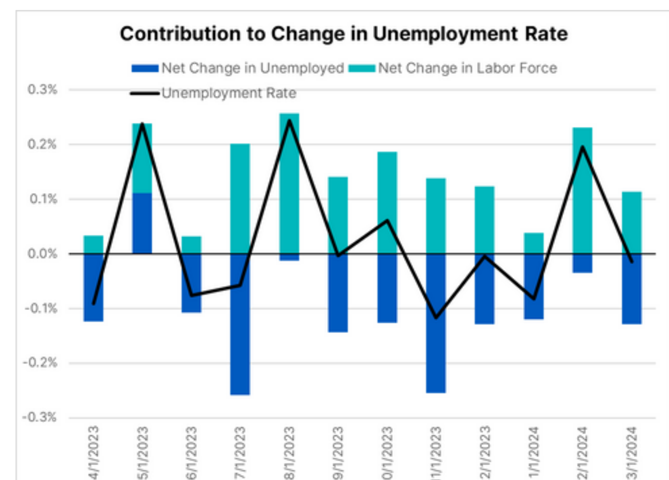


While the sheer number of jobs added may be good news for the top line jobs report, it isn't great news as a signal for the health of the overall economy. This is because more broad-based gains signal that economic expansion is well-rounded and sustainable, rather than overly reliant on cycles in specific industries. As hiring in specific industries continues to be affected by pandemic-era impacts, such as below trend employment in Health Services and Leisure and Hospitality, this will be a trend to watch closely. We will need to see more broad-based labor gains to signal economic stability and health as we proceed throughout the year.

In addition to exceptionally strong job gains, the unemployment rate ticked down from 3.9% to 3.8%.



Diving into the drivers of the change in the unemployment rate, March saw a relatively even spread between the number of unemployed workers finding jobs and the number of individuals entering the labor force. In other words, the number of individuals that found jobs offset the number of individuals entering the labor force, resulting in the unemployment rate ticking down from 3.9% to 3.8%.



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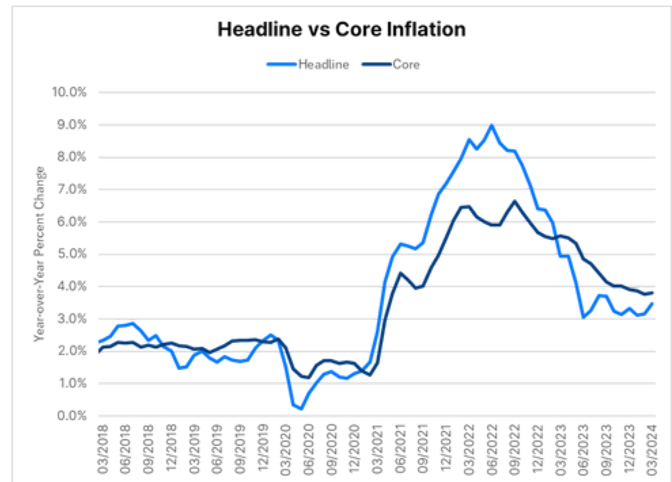
Over the last several months, we've seen similar trends, which suggests that the rising labor force participation rate explains some of the increase in the unemployment rate from a low of 3.5% in July 2023 to the current rate of 3.8%. At the same time, the number of individuals finding employment has put a similar degree of downward pressure on the unemployment rate in recent months, reflecting relatively steady job losses so far. This is consistent with stable initial unemployment claims. However, there are key metrics that still show softening, such as the rise in continued unemployment claims and the underemployment rate over the last year (U-6 Unemployment). While job gains have proven robust and the unemployment rate low, we are still in a much different labor market position today than we were just last year.

In line with the movement observed in the job gains and the unemployment rate, Average Hourly Earnings ticked up on a month-over-month basis, from 0.2% in February to 0.3% in March. However, on a year-over-year basis, growth in earnings fell from 4.3% to 4.1%. Wage growth in the 3.0-3.5% range is largely considered consistent with the Fed's 2.0% inflation target. This means that while wage growth continues to trend in the right direction, it still has a way to go before more pieces are in place for the Federal Reserve to achieve their 2% target.

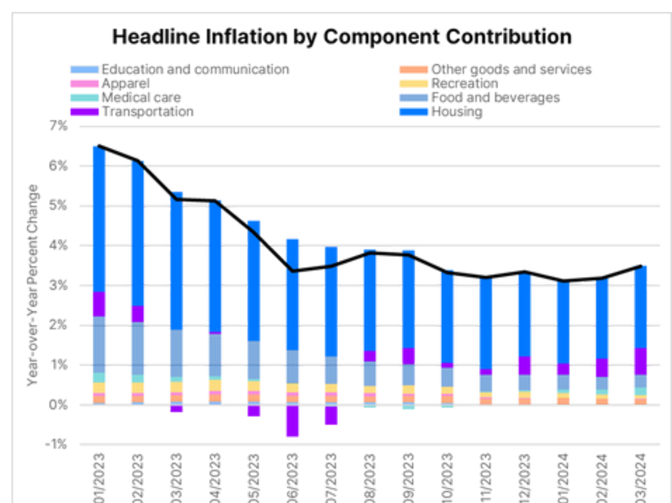
On the Heels of a Hot CPI Release

Unfortunately, March's inflation report showed that it isn't just wage inflation that is keeping the Federal Reserve on tenterhooks.

Consumer prices picked up again last month, with headline inflation increasing from 3.2% in February to 3.5% in March, and core inflation remaining steady at 3.8%



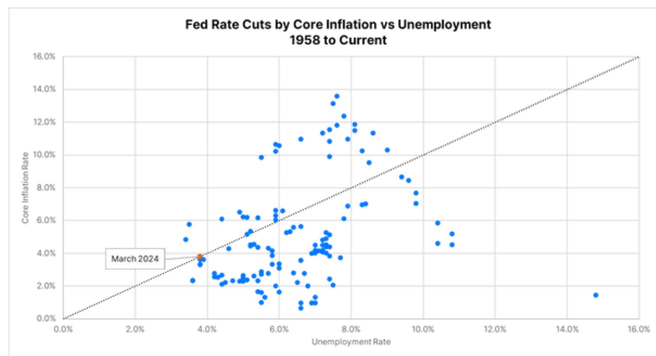
The March CPI data left a lot to be desired, as many of the underlying inflation components are proving much stickier than the Federal Reserve would like to see.



Notably, shelter and transportation prices reaccelerated on a year-over-year basis. These two components account for about 61% of total inflation, so this is a particularly troubling trend to watch. In short, this is not the movement that the Federal Reserve wants to see as its struggle with disinflation continues, and all but extinguishes any chance of rate cuts in the first half of the year.

Impact of Recent Releases on Potential Rate Cuts

How does this all tie together? Breaking down the chances of rate cuts from the Federal Reserve given current unemployment and inflation rates, we get a further sense that the economy is not where it needs to be for the Federal Reserve to feel comfortable cutting rates for some time. Historically, the Federal Reserve has been much less likely to cut rates when inflation outpaces or is close to the unemployment rate.



This is because, traditionally, as unemployment decreases, inflation tends to increase and vice versa. This is partly driven by the relationship between unemployment and wages, as during periods of lower unemployment wage pressures increase, which in turn puts pressure on demand-side inflation (such as transportation and apparel, for example). In this current business cycle, we have seen markedly low unemployment and consequently high wage growth, as employers struggled to meet surging demand.

Although inflation has fallen markedly in the last year and a half without a strong reversal in the labor market, wage growth still outpaces rates consistent with the Federal Reserve's 2.0% target, which is contributing to demand-side inflation proving sticky. Before we get rate cuts, it's likely we're going to have to continue to see some more softening in the labor market to continue alleviating pressure on wages and inflation.

Considering the current economic climate, decision-makers should closely monitor not only the inflation report, but also the labor report. The relationship with employment and wages will provide valuable insights into not only the overall health of the economy but also the likelihood and timing of potential rate cuts in 2024. In short, to see what the Fed is going to do – watch the labor reports.

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