THOUGHTS OF THE WEEK
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WEEKLY ECONOMICS

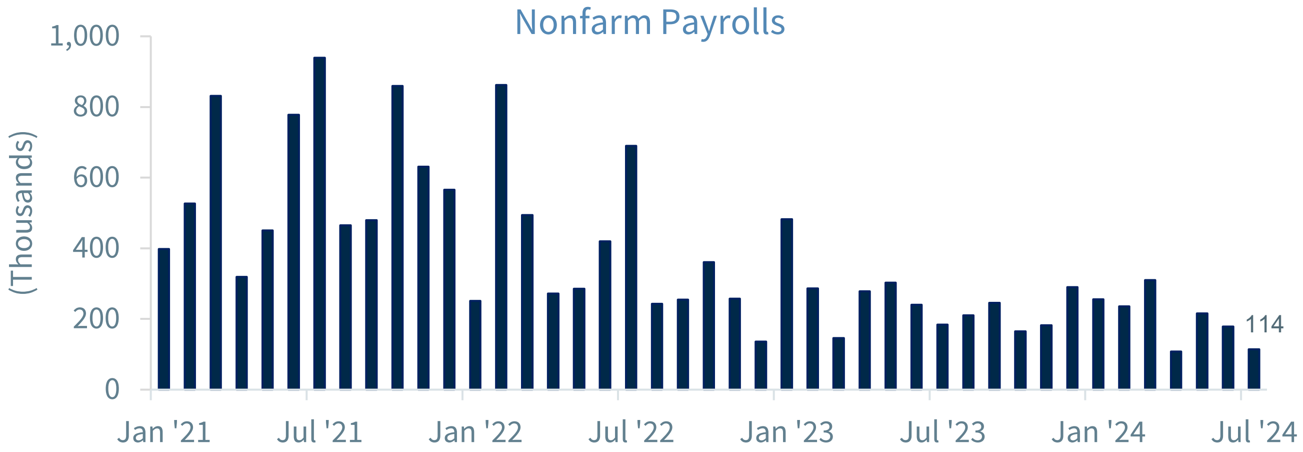
Employment Still Relatively Strong But The US Economy is Finally Downshifting

The relative weakness in July's nonfarm payroll employment number and the increase in the rate of unemployment from 4.1% in June to 4.3% in July, triggering the Sahm Rule is a reminder of the difficult tasks ahead for the Federal Reserve (Fed). We are going to give Fed officials the 'benefit of the doubt' in that it did not have advanced notice of the employment numbers we were going to get two days after the decision to keep interest rates unchanged in July.

Again, even if the Sahm Rule has been triggered, we agree with the author of the Sahm Rule, that this time is different. And it is different not only for the Sahm Rule but also for a plethora of other economic indicators, starting with the yield curve, which has been inverted for more than two years, to the Leading Economic Indicator, which had been pointing to a recession for more than two years, to the ISM, manufacturing as well as services, which have been pointing to economic weakness, to household employment, which has been signaling weakness for a long time compared to the still relatively strong nonfarm employment numbers, etc.

It is clear that the pandemic recession messed up every economic indicator that economists used to use to get a feel for economic activity. And, the normalization process for these indicators will continue to take time just because the pandemic completely destroyed typical trends and patterns we used to hold true. We do not blame those who are in charge of the calculations and data processing, both federal, state, and local officials as well as those private organizations that provide timely indicators because they are doing the best they can. However, this increases the importance of interpreting data and looking at more non-traditional data, as Larry Adam, Raymond James CIO indicated clearly during the RJ Summer Development Conference in Orlando in mid-July.

It is also important to remind everybody that although the nonfarm payroll number in July was much lower than expected, 114,000 jobs created is still a relatively strong number for the US economy which, on average, creates about 125,000 per month.



Source: FactSet, RJ Economics

Is The Federal Reserve Behind the Curve… Again?

This is the question almost everybody, including the markets, is asking: after being accused of being behind the curve as inflation started to accelerate as the economy reopened from the post-pandemic recession, something that we believe was unjustified and fundamentally out of its hands, the Fed now faces the prospects of being accused of being behind the curve as real interest rates continue to bite and could, potentially, send the US economy into a recession.

If this is the case and the US economy falls into a recession, this time around, it is all on the Fed!

We say this because the surge in inflation was not something the Fed could have done anything about it. As we have said so many times before, the pandemic economic cycle was a fiscal cycle, not a monetary cycle. The Fed could have hiked interest rates to, say, 5.25% immediately in the middle of the pandemic recession, but the fiscal expansion was so large that it wouldn't have made any difference with inflation, as other countries that didn't have the same fiscal expansion we had experienced similar inflationary pressures.

It, thus, started to increase interest rates to buy time to be in a good position once all the excess cash transferred to individuals and businesses by the federal government had been flushed out of the economy while at the same time, we waited for the disruptions to worldwide supply chains to normalize.

But the Fed knew that all those funds were almost entirely depleted during the first quarter of the year and Americans were only relying on 'good-old-disposable-income' to keep the economy going. But there were strong signs that this lifeline was also slowing down, so it was correct in pricing in three 25 basis points cuts for the federal funds rate before the end of the year.

Then the Fed got an inflation scare, a scare that should not have changed its view on the inflationary path and rate cuts. Many firms increased prices considerably during the first quarter of the year, something that seems to have been unexpected and probably further affected the treatment of seasonal factors. We will not know this for sure for several years, but this is what we believe happened.

This made the Fed overreact and change its view on the forward path for inflation, thus changing its view on the need to cut rates during this year. Now, this overreaction is threatening to put the Fed really against the ropes and behind the curve.

Hopefully, if we are correct, this is just a downshift in economic activity and we can avoid a recession, which is what we have in our forecast today. However, the August employment number, which is slated to be released before the Fed meets next time, will be the most important number to watch. If the August employment number is very weak, close to 100,000 or below, then it raises the probability of the Fed moving by 50bps in September. But before that, Fed officials are going to meet in Jackson Hole on August 22-24 for their Economic Policy Symposium, which has a very timely title: "Reassessing the Effectiveness and Transmission of Monetary Policy." We really hope they reassess their 'overreaction function' from earlier in the year.

Economic Forecast:

	Actual						Forecast						Actua	Forecast	
	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	2023	2024	2025
Real Gross Domestic Product [1]	**2.2**	**2.1**	**4.9**	**3.4**	**1.4**	**2.8**	**1.0**	**0.8**	**2.4**	**2.6**	**2.2**	**2.5**	**2.5**	**2.4**	**2.0**
Real Gross Domestic Product [2]	1.7	2.4	2.9	3.1	2.9	3.1	2.1	1.5	1.8	1.7	2.0	2.4	2.5	2.4	2.0
Consumer Price Index [2]	**5.7**	**4.0**	**3.6**	**3.2**	**3.2**	**3.2**	**2.7**	**2.6**	**2.3**	**2.2**	**2.4**	**2.3**	**4.1**	**3.0**	**2.4**
Ex-food & energy [2]	5.5	5.2	4.4	4.0	3.8	3.4	3.2	3.0	2.6	2.4	2.4	2.3	4.8	3.4	2.4
PCE Price Index [2]	**5.0**	**3.9**	**3.3**	**2.8**	**2.6**	**2.6**	**2.4**	**2.5**	**2.2**	**2.2**	**2.3**	**2.3**	**3.7**	**2.5**	**2.3**
Ex-food & energy [2]	4.8	4.6	3.8	3.2	2.9	2.7	2.7	2.7	2.3	2.2	2.2	2.2	4.1	2.8	2.2
Unemployment Rate	**3.5**	**3.5**	**3.7**	**3.7**	**3.8**	**4.0**	**4.2**	**4.2**	**4.1**	**4.0**	**3.9**	**3.9**	**3.6**	**4.0**	**4.0**
Fed Funds Rate [3]	5.00	5.25	5.50	5.50	5.50	5.50	5.25	5.00	4.75	4.50	4.00	4.00	5.1	5.3	4.3

[1] Annualized Quarter-Over-Quarter Growth
[2] Year-Over-Year Percentage Change
[3] Upper Bound of the Federal Funds Target Range

Economic Releases:

FHFA Home Price Index: The FHFA Home Price Index remained flat in May of this year compared to the previous month after a slight upward revision to the April number. Five regions of the country saw home prices increase in May compared to April while four regions saw home prices decline on a month-on-month basis. However, home price appreciation remained strong on a year-earlier basis with home prices increasing 5.7% for the US as a whole. This index is for May, while we already saw some weakness in new home sale prices in June and still positive price movements for existing home sales in June. However, the bottom line is that higher inventories have started to put downward pressure on home prices nationwide, even though the housing market is typically a regional market. This weakness in home price appreciation will help keep the disinflationary process going. Home prices remained unchanged in May compared to April of this year, according to the Federal Housing Finance Agency (FHFA). Compared to the same month a year earlier, the FHFA House Price Index (HPI) was up by 5.7%. The original month-on-month increase of 0.2% in April of 2024 was also revised higher to an increase of 0.3%. Four of the nine housing regions reported by the FHFA HPI saw a decline in home prices in May compared to April of this year. These regions were the Pacific (-0.3% m-o-m and 3.7% y-o-y); West-North Central (-0.5% m-o-m and 5.2% y-o-y); West South Central (-0.1% m-o-m and 2.4% y-o-y); East South Central (-0.3% m-o-m and 5.2% y-o-y). Meanwhile, five regions saw positive price changes in May compared to April of this year. These regions were Mountain (0.1% m-o-m and 5.1% y-o-y); East North Central (0.2% m-o-m and 7.1% y-o-y); New England (0.3% m-o-m and 9.2% y-o-y); Middle Atlantic (0.1% m-o-m and 8.9% y-o-y); and finally, South Atlantic (0.1% m-o-m and 6.3% y-o-y). According to the release: “The slowdown in US house price appreciation continued in May amid a slight rise in both mortgage rates and housing inventory.”

Consumer Confidence: The Consumer Confidence Index (CCI), as measured by The Conference Board, increased in July; however, the components were mixed, with the Present Situation Index declining compared to June while the Expectations Index was higher in July than in June but still pointing toward a potential recession in the future. The June CCI was revised downward considerably compared to the original release, at 97.8 compared to an original print of 100.4. The improvement in the Expectations Index is positive for the future, but at the current level it still indicates a potential recession. Inflation and high interest rates remain top of mind for consumers, according to the release. The Conference Board’s Consumer Confidence Index (CCI) was higher than FactSet expectations in July, at 100.3 compared to a downwardly revised print of 97.8 (compared to an original print of 100.4). One of the components of the Index, the Present Situation Index (PSI) declined to 133.6 in July compared to a reading of 135.3 in June while the Expectations Index (EI), which is “based on consumers’ short-term outlook for income, business, and labor market conditions” increased to 78.2 compared to a reading of 72.8 in June.According to The Conference Board, an Expectations Index below 80 typically signals a potential recession in the future. Dana M. Peterson, the Chief Economist at The Conference Board indicated that “Even though consumers remain relatively positive about the labor market, they still appear to be concerned about elevated prices and interest rates, and uncertainty about the future; things that may not improve until next year.”

Economic Releases:

JOLTS: Job openings remained unchanged in June at 8.2 million. Increases in accommodation and food services, as well as in state and local government, were offset by declines in the manufacturing, information, and financial activities sectors. Despite strength in state and local government hiring, continuing to contribute to higher job openings, labor demand is softening, which is consistent with our view of a slowing economy and job market. Job openings remained unchanged in June at 8.2 million job openings and were 941,000 lower than 12 months ago, according to the Bureau of Labor Statistics. FactSet expectations were for job openings to decline to 8 million in June. The job openings rate also remained unchanged at 4.9% in June. Hires were 5.3 million in June while the hires rate was at 3.4% and total separations were 5.1 million or 3.2%. After experiencing a large decline in May, accommodation and food services saw the largest increase in job openings, at 120,000. Meanwhile, jobs in state and local governments, excluding education, increased by 94,000. Job openings declined by 88,000 in durable goods manufacturing.

Employment Cost Index: The Employment Cost Index increased less than expected during the second quarter of the year as private industry workers' compensation costs slowed more than state and local government compensation. The difference between private workers' compensation costs versus state and local government compensation costs continues to reflect the difficulty of state and local governments to attract workers and compete against the private sector, which mimics the results between the strength in private employment growth and government employment growth. Compensation costs for civilian workers increased 0.9% during the second quarter of the year as wages and salaries also increased by 0.9% while benefit costs increased by 1.0%, all seasonally adjusted and compared to the previous quarter, according to the Bureau of Labor Statistics. Compared to June of 2023, compensation costs were up by 4.1%. The increase in compensation costs during the second quarter, both quarter-over-quarter as well as year-over-year, were lower than FactSet expectations, which were estimated at 1.0% and 4.3%, respectively. Compensation costs for private industry workers were up by 3.9% compared to a year earlier as wages and salaries increased by 4.1% while benefits increased by 3.5%. In inflation-adjusted terms, that is, in real or constant dollar terms, compensation costs for private industry workers increased by 0.9% in June of 2024 compared to the same period a year earlier. This was the consequence of an increase in real wages and salaries of 1.1% and an increase in real benefit costs of 0.5%. Compensation costs for state and local government workers increased by 4.9% on a year-earlier basis as wages and salaries increased by 5.1% while benefit costs increased by 4.8% during the period.

Economic Releases:

Pending Home Sales: The recent decrease in mortgage interest rates as well as the recent increase in inventories, both in the new home sales as well as in the existing home sales market, seems to have helped push the Pending Home Sales Index higher in June. The large increase in the PHS Index in the South and in the Midwest helped the overall Index move much higher than expected in June. Although we have not seen the increase in inventories in the existing home sales market push existing home prices lower, the NAR release seems to be suggesting that weaker pressure and/or lower prices are 'coming to a theater near you' sometime soon. This is good news for the sustainability of the disinflationary process going forward. Pending home sales surged by 4.8% in June according to the National Association of Realtors (NAR) Pending Home Sales Index (PHS). FactSet was expecting an increase of 1.1% for June after a decline of 2.1% in May. The PHS Index declined by 2.6% in June of this year compared to last year. The increase in the PHSI index was broad based across all measured regions in the US with the Northeast experiencing an increase of 3.0%, month-over-month and a decline of 0.3% over a year earlier while the Midwest experienced an increase of 4.7% month-over-month but a 4.2% decline year-over-year. Meanwhile, the South saw the PHS Index surge by 6.3% on a month-over-month basis while it declined by 3.9% compared to June of last year. Finally, the West saw the PHS Index increase by 3.4% compared to May of this year and also recorded an increase of 1.0% compared to June of last year. The NAR Chief Economist indicated that "The rise in housing inventory is beginning to lead to more contract signings. Multiple offers are less intense, and buyers are in a more favorable position." The NAR release also indicates that the Pending Home Sales (PHS) Index is "a leading indicator of housing activity, measures housing contract activity, and is based on signed real estate contracts for existing single-family homes, condos, and co-ops. Because a home goes under contract a month or two before it is sold, the Pending Home Sales Index generally leads Existing-Home Sales by a month or two."

Unit Labor Cost: Although today's productivity measures are preliminary, the news was very uplifting for a continuation of the disinflationary process. Both, the relatively strong increase in productivity during the quarter and the weaker than expected increase in unit labor costs bode well for the Federal Reserve and the need to gain more conviction on the disinflationary path going forward. Nonfarm business labor productivity increased a better than expected 2.3% during the second quarter of the year at a seasonally adjusted annual rate, according to the Bureau of Labor Statistics (BLS). FactSet expectations were for an increase of 1.8%. According to the BLS release, the 2Q increase in productivity was due to an increase of 3.3% in output and a 1.0% increase in hours worked quarter-over-quarter. Compared to the second quarter of last year, labor productivity increased by 2.7%. Unit labor costs in the nonfarm business sector also increased a better than expected 0.9% during the second quarter. This increase in unit labor costs was the result of a 3.3% increase in hourly compensation and a 2.3% increase in productivity. Compared to the same quarter a year earlier, unit labor costs increased by just 0.5%. FactSet expectations were for an increase of 1.7% in unit labor costs during the second quarter. Productivity in the manufacturing sector was up 1.8% during the second quarter of 2024 as output increased by 3.4% and hours worked increased by 1.6%. Unit labor costs in the manufacturing sector increased by 3.2% during the quarter as hourly compensation increased by 5.1% while productivity increased by 1.8%. Nonfarm business productivity was revised up 0.2 percentage points during the first quarter of the year, to 0.4%, as output was revised up 0.1% percentage points to an increase of 1.0% while hours worked remained unrevised. Manufacturing sector productivity was revised down 1.1 percentage points to a decline of 1.1% during the first quarter as output was revised downwards by 1.1 percentage points; however, there was no revision to hours worked.

Economic Releases:

ISM Manufacturing: The July ISM Manufacturing PMI was lower than FactSet expectations, at 46.5 compared to expectations of a 48.9 reading, remaining in contraction territory for the fourth consecutive month after briefly reaching expansion territory in March. Today's report showed weakness in several indices, with the Employment and Production indices falling further into contraction, suggesting expectations of slower demand ahead. The Employment Index experienced the largest monthly decline since April of 2022 and reached the lowest level since June 2020. While manufacturing is not the largest sector of the US labor market, today's weak reading may suggest that tomorrow's nonfarm payroll could be lower than expectations, aligning with our expectations of a slowing labor market. The ISM Manufacturing PMI remained in contraction territory, declining from 48.5 in June to 46.8 in July, according to the Institute For Supply Management. The New Orders Index declined further from 49.3 in June to 47.4 in July. While the Production Index declined from 48.5 in June to 45.9 in July. The largest decline can be attributed to the Employment Index, declining by 5.9 points in July, from 49.3 to 43.4. On the other hand, supplier deliveries returned to expansion, increasing from 49.8 in June to 52.6 in July. Lastly, prices increased slightly from 52.1 in June to 52.9 in July. The ISM Manufacturing Index fell deeper in contraction, largely driven by lower readings in these indices: Production, Employment, and Customers' Inventories.

Construction Spending: The decline in construction spending during June and the downward revision to construction spending in May will probably, all else being equal, push down the real investment spending component of GDP and thus bring a downward revision to GDP growth during the second quarter of the year, which is in line with our expectations. Furthermore, it is clear that there has been a change in residential investment as construction spending in new single-family units has started to decline on a month-over-month basis while construction spending in multifamily units has moved higher.Total construction spending was weaker than expected in June compared to May as it declined by 0.3% while FactSet expectations were for a 0.2% increase. At the same time, May's construction spending was revised down to a 0.4% decline compared to an original decline of 0.2%, according to the US Census Bureau. On a year-over-year basis, total construction spending was up by 6.2%. Private construction spending was also down by 0.3% in June of this year compared to May as residential construction was also lower by 0.3% during the month. Nonresidential consumption was also down, by 0.1%, compared to May of this year. Within residential private construction spending, construction spending in new single-family homes was down by 1.2% during the month, month-over-month, while new multifamily residential construction spending increased by 0.1% during the same period. On a year-earlier basis, residential construction was up 7.3% as new single-family construction spending increased by 9.9% while new multifamily construction spending declined by 7.4%. Public construction was down by 0.4% in June compared to the previous month as educational construction spending was down by 0.9% during the period. Highway construction spending was also down 0.4% in June compared to May. Manufacturing construction spending, which had been a leading sector into construction spending has continued to slow down with a 0.1% increase during June compared to May of this year and a year-over-year rate of 19.1%.

Economic Releases:

Employment: Employment was weaker than expected in July while the strong increase in the labor force participation rate pushed the unemployment rate from 4.1% to 4.3% in July, triggering the Sahm Rule. However, as the creator of the Sahm Rule has indicated, this time is different, and the rule should not be interpreted as the US economy being in recession. One of the reasons for this is that the surge in the labor force participation rate was the main culprit for the large increase in the rate of unemployment. However, it is clear that the economy is downshifting rapidly. It is important to note that 114,000 jobs are in line with what a healthy US economy has added on average in the past (~125,000). Therefore, while today's number was lower than what markets were expecting, the labor market remains healthy, just returning to its long-term trend. For us, it is hard to understand the Federal Reserve's (Fed) inaction in July if it had advance notice of this number. If it did not have advance information on July's employment results then it may be behind the curve and markets are probably going to push the Fed into further action after not cutting rates in July. August's employment number will probably be the most important number for monetary policy and the US economy during this year. Nonfarm employment increased by less than expected in July, up 114,000 compared with market expectations for a 175,000 increase. June's original increase was revised down from 206,000 to 179,000 while the May number was revised down from 218,000 to 216,000 for a total downward revision of 29,000 during the previous two months. The unemployment rate increased from 4.1% in June to 4.3% in July. Total private employment increased by 97,000 with the goods-producing sector creating 25,000 while the service-providing sector created 72,000 jobs during the month. Government employment increased by just 17,000 after increasing by 43,000 during the previous month. Within the goods-producing sectors, the strongest sector was construction employment with 25,000 new jobs during the month after creating 20,000 in June. Manufacturing jobs increased by 1,000. Within the service-providing sector, the strongest sector was, once again the private education and health services sectors, adding 57,000, mostly driven by the health care and social assistance sector which added 64,000 jobs during the month. The leisure and hospitality sector added a strong 23,000 jobs after adding just 1,000 jobs in June. The weakest sector was the information sector, shedding 20,000 jobs during the month. Average weekly hours declined from 34.3 in June to 34.2 in July while average hourly earnings increased from $34.99 in June to $35.07 in July. Average weekly earnings declined slightly, from $1,200.16 in June to $1,199.39 in July. The civilian labor force surged by 420,000 during July, pushing the labor force participation rate to 62.7% compared to 62.6% in June while household employment increased by just 67,000 during the month. This was the reason why the rate of unemployment increased from 4.1% in June to 4.3% in July.

Factory Orders: Factory orders in June were much lower than expectations and declined for the second consecutive month. However, the weakness was driven almost entirely by transportation equipment, and if we exclude this large and volatile component, overall new ordFactory orders, or new orders for manufactured goods, declined by 3.3% in June, the second consecutive monthly decline, according to the US Census Bureau. FactSet expectations were for a 0.5% increase. The weakness in new orders for manufactured durable goods was driven by a large decline in durable goods orders of transportation equipment, which were down 20.6% in June. More specifically, the decline in transportation was due to Nondefense aircraft and parts (-127.2%). ers increased slightly. New Orders excluding transportation equipment increased by 0.1% in June versus a 0.7% decline in May.

DISCLOSURES

Economic and market conditions are subject to change.

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Statistics. Currencies investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation. Current Situation Index (CSI) and Future Expectations Index (FEI) are the end-results of CCI, covering economic conditions, employment, price, income, and expense. The reading is 100 plus the average of said five factors

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GDP Price Index: A measure of inflation in the prices of goods and services produced in the United States. The gross domestic product price index includes the prices of U.S. goods and services exported to other countries. The prices that Americans pay for imports aren't part of this index.

The Conference Board Leading Economic Index: Intended to forecast future economic activity, it is calculated from the values of ten key variables.

The U.S. Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" when compared to other currencies.

The FHFA House Price Index (FHFA HPI®) is a comprehensive collection of public, freely available house price indexes that measure changes in single-family home values based on data from all 50 states and over 400 American cities that extend back to the mid-1970s.

The Pending Home Sales Index (PHSI) tracks home sales in which a contract has been signed but the sale has not yet closed.

Supplier Deliveries Index: The suppliers' delivery times index from IHS Markit's PMI business surveys captures the extent of supply chain delays in an economy, which in turn acts as a useful barometer of capacity constraints.

Backlog of Orders Index: The Backlog of Orders Index represents the share of orders that businesses have received but have yet to start or finish. An increasing index value usually indicates growth in business but shows that output is below its maximum potential.

DISCLOSURES

Import Price Index: The import price index measure price changes in goods or services purchased from abroad by U.S. residents (imports) and sold to foreign buyers (exports). The indexes are updated once a month by the Bureau of Labor Statistics (BLS) International Price Program (IPP).

ISM Services PMI Index: The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers' Index (PMI) (also known as the ISM Services PMI) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

Consumer Price Index (CPI) A consumer price index is a price index, the price of a weighted average market basket of consumer goods and services purchased by households.

Producer Price Index: A producer price index (PPI) is a price index that measures the average changes in prices received by domestic producers for their output.

Industrial production: Industrial production is a measure of output of the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Although these sectors contribute only a small portion of gross domestic product, they are highly sensitive to interest rates and consumer demand.

The NAHB/Wells Fargo Housing Opportunity Index (HOI) for a given area is defined as the share of homes sold in that area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

Conference Board Coincident Economic Index: The Composite Index of Coincident Indicators is an index published by the Conference Board that provides a broad-based measurement of current economic conditions, helping economists, investors, and public policymakers to determine which phase of the business cycle the economy is currently experiencing.

Conference Board Lagging Economic Index: The Composite Index of Lagging Indicators is an index published monthly by the Conference Board, used to confirm and assess the direction of the economy's movements over recent months.

New Export Index: The PMI new export orders index allows us to track international demand for a country's goods and services on a timely, monthly, basis.

Durable Goods: Durable goods orders reflect new orders placed with domestic manufacturers for delivery of long-lasting manufactured goods (durable goods) in the near term or future.

Source: FactSet, data as of 8/2/2024

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