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Many Reasons to Doubt the Strength in Employment

The US labor market continues to be the star of the show, so to speak, for financial markets and for the US economy, delivering an impressive number in September and defying expectations. We remain suspicious of the current strength as we were suspicious (and were shown to be correct after the recent revisions), of past strength. But not because we believe somebody is manipulating the data but because of what we have said for more than 2 years: that the disruptive effects of the pandemic are still reverberating across the economy and giving incorrect signs, in this case, of the US labor market.

In order to gauge the US labor market, we typically use a back of the envelope calculation which is nothing more than the average monthly growth in nonfarm payrolls dating back to the 1940's. That average is close to 130,000 per month. It is not scientific; it is just an 85 year average. Thus, anything above that measure is judged to be strong and anything below is judged to be weak. The September number is on the very strong side. At the same time, other measures of economic activity are also pointing to a strong economic performance by the US economy so this may not seem like an outlier.

But we also have our ears on the ground, and we hear clients and advisors with also no-so-scientific but highly credible stories of friends and family members having trouble landing a job, with many of those stories including recent university graduates. And we believe many of those stories because there have been clear signs that the labor market is not as strong as portrayed by some of the official statistics.

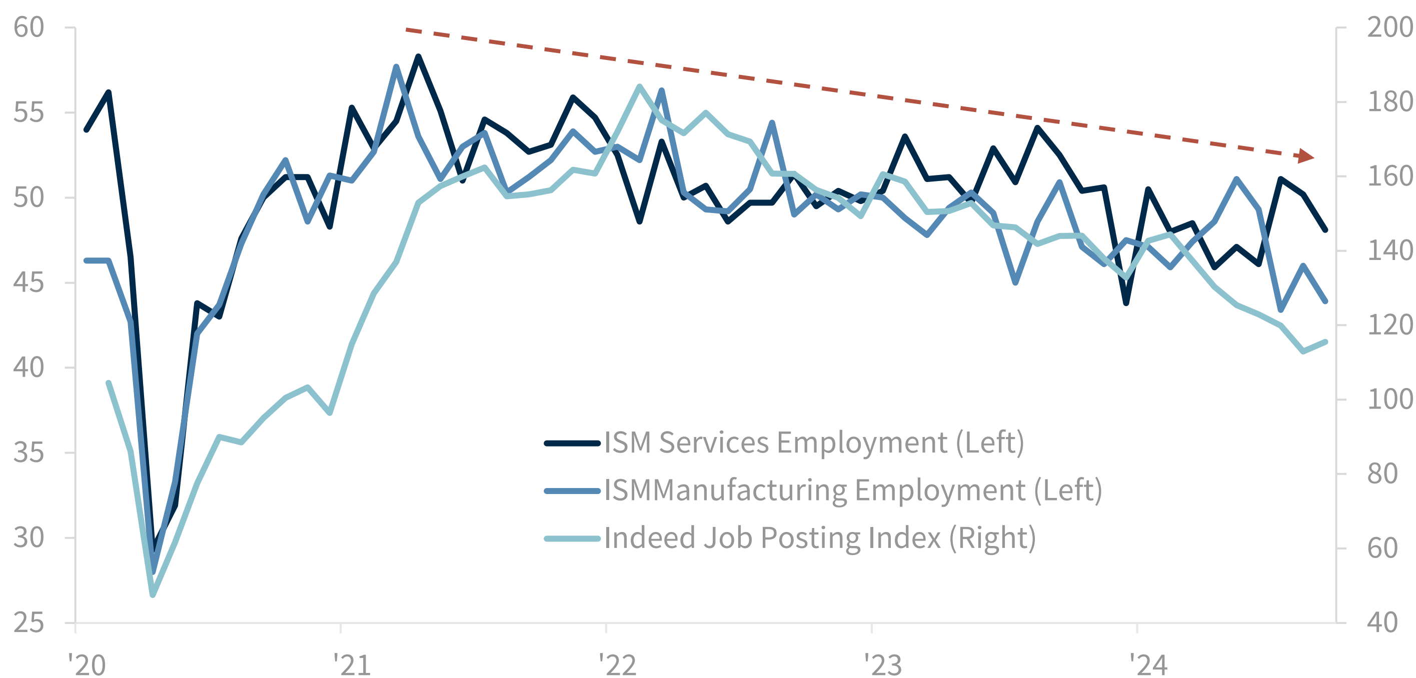
A recent research piece by the Federal Reserve Bank of Minneapolis titled "Fewer openings, harder to get hired: U.S. labor market likely softer than it appears" helps make sense of some of this data.[1] The authors concluded that the "official job-vacancy data likely overstate tightness of labor market" and that "adjusting for long-term up-trend in vacancies shows US Labor market has much more slack." That is, they argue that what is happening today is not considered a structural shift as the above adjustment is consistent with the current business cycle.

The article adds that, "In the context of the Fed's tighter monetary policy since 2022, open jobs have become less abundant, leading to a natural decline in job-finding. This development is the primary factor causing the unemployment rate to increase." That is, it is possible to have an increase in the rate of unemployment that is void of a large increase in layoffs. When they measure the tightness of the US labor market adjusting for the higher up-trend in vacancies, they find that "The unadjusted series suggests that right now each job seeker faces around 1.4 job openings. The adjusted series suggests the opposite: Each job faces 1.5 job seekers—much worse odds for unemployed workers." Furthermore, economic research over the years has shown that "layoffs are historically the smaller factor" explaining the rate of unemployment and they find that this is what is occurring today in the US labor market.

1: "Fewer openings, harder to get hired: U.S. labor market likely softer than it appears," by Simon Mongey and Jeff Horwich, Federal Reserve of Minneapolis, September 5, 2024: https://www.minneapolisfed.org/article/2024/fewer-openings-harder-to-get-hired-us-labor-market-likely-softer-than-it-appears?utm_source=substack&utm_medium=email

According to the authors, "the job-finding rate typically explains more than 80 percent of changes in unemployment." Thus, they conclude that even though there has been an increase in immigration since the end of the pandemic as well as tech sector layoffs, "the obvious explanation for the persistent rise in unemployment rate seems more likely to be the factor that affects everybody in the pool: a persistent decline in the demand for labor and, thus, the job-finding rate." This is in line with what we are seeing and hearing from other sources of data, including what we hear in from the "grapevine" of our advisors and clients.

Some of these other timely data sources include the Institute of Supply Management surveys, where employment in both services and manufacturing industries has been softening since peaking in 2021; job postings on Indeed have been weakening to the lowest levels since 2021 (see chart below), etc. Additionally, the Automatic Data Processing (ADP) National Employment Report was much weaker this past month, while the JOLTS report showed the quits rate falling to the lowest level since 2020 and the Challenger Layoffs Index were over 50% year-over-year, just to mention some.



Source: FactSet, FRED, RJ Economics

Thus, as many of these indicators show softening across the labor market, we expect the employment situation to continue to weaken as we move forward as we still expect economic activity to slow down from its current pace.

Extension to 2026 and Changes to Q3 2024

We have extended our forecast until 2026 and revised our forecast for Q3 2024 to reflect recent stronger data. This kept the overall rate of growth unchanged at 2.6% for the year but pushed the rate of growth for 2025 slightly higher, from 2.0% to 2.1%.

Forecast Table

	Actual		Forecast										Actual	Forecast		
	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26	2023	2024	2025	2026
Real Gross Domestic Product [1]	**1.6**	**3.0**	**2.4**	**1.6**	**1.7**	**2.2**	**2.3**	**2.5**	**2.0**	**2.0**	**2.0**	**2.2**	**2.9**	**2.6**	**2.1**	**2.2**
Real Gross Domestic Product [2]	2.9	3.0	2.5	2.1	2.2	2.0	1.9	2.2	2.2	2.2	2.1	2.0	2.9			
Consumer Price Index [2]	**3.2**	**3.2**	**2.6**	**2.3**	**1.9**	**1.7**	**2.0**	**2.2**	**2.2**	**2.2**	**2.2**	**2.2**	**4.1**	**2.8**	**1.9**	**2.2**
Ex-food & energy [2]	3.8	3.4	3.2	3.0	2.5	2.2	2.3	2.2	2.2	2.2	2.2	2.2	4.8	3.4	2.3	2.2
PCE Price Index [2]	**2.7**	**2.6**	**2.2**	**2.3**	**2.0**	**1.9**	**2.0**	**2.1**	**2.1**	**2.1**	**2.1**	**2.1**	**3.8**	**2.4**	**2.0**	**2.1**
Ex-food & energy [2]	3.0	2.7	2.6	2.6	2.2	2.1	2.1	2.2	2.2	2.2	2.2	2.2	4.1	2.7	2.1	2.2
Unemployment Rate	**3.8**	**4.0**	**4.2**	**4.3**	**4.4**	**4.5**	**4.5**	**4.5**	**4.4**	**4.4**	**4.3**	**4.3**	**3.6**	**4.0**	**4.5**	**4.4**
Fed Funds Rate [3]	5.50	5.50	5.00	4.50	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25	5.1	5.1	3.9	3.3

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

Economic Releases

Trade Balance: The trade deficit in goods and services declined more than expected in August and showed a strong increase in exports while at the same time it showed a decline in imports. With the exception of exports in foods, feeds, and beverages, the rest of the export sectors showed improvement. On the imports side, imports of crude oil were much lower due to the decrease in the price of petroleum in August. This effect is probably going to be reversed during the next several months. However, the large decline in the deficit is good news for economic growth in Q3 2024. The US trade deficit in goods and services was lower than expected at $70.4 billion compared to a deficit of $78.9 billion in July of this year, or a decline of $8.5 billion compared to the July deficit. Exports were up by 2.0% during the month to $271.8 billion while imports were down by 0.9% to $342.2 billion, according to the US Census Bureau and the US Bureau of Economic Analysis. The decline in the goods and services deficit was due to a decline of $8.4 billion in the goods deficit and a $0.1 billion increase in the surplus in services. The level of goods and services exports, at $271.8 billion in August, was the highest level of exports on record, according to the report. The report showed strength in exports of capital goods, automotive vehicles, consumer goods, and other goods. The decline in imports showed a large decrease in industrial supplies and materials' imports as well as imports of finished metal shapes and crude oil imports. Passenger cars imports also declined during August and compared to July of this year.

Wholesale Inventories: Inventories increased in line with market expectations while the inventories to sales ratio remained unchanged. However, several sectors saw a large increase in their corresponding inventories to sales ratio. Overall, the ratio remains stable and so far does not indicate trouble ahead for economic activity even though sales were slightly lower in August. Wholesale inventories increased by an expected 0.1% in August of this year compared to July, according to the US Census Bureau. On a year-earlier basis, wholesale inventories were up 0.6% versus August 2023. Sales of merchant wholesalers were down by 0.1% during the month of August compared to the previous month but were up 1.1% compared to August of 2023. Thus, the inventories to sales ratio was 1.35 at the end of August of 2024, the same ratio registered in August of 2023. The inventories to sales ratio in the durable goods sector increased from 1.79 in July to 1.81 in August. Although many sectors saw an increase in the ratio, the large decline in the Automotive sector, from 1.89 in July to 1.79 in August, kept the overall ratio unchanged. The nondurable sector inventories to sales ratio increased from 0.94 in July to 0.96 in August.

Economic Releases

Consumer Price Index: Inflation in September was higher than expected even though both the year-over-year headline and core indices continued their disinflationary path. Shelter costs price increase moderated considerably, from 0.5% in August to just 0.2% in September, but many other components of inflation showed relative strength, which kept the September print higher than expected. This CPI result settles the discussion regarding the federal funds rate. The Federal Reserve (Fed) is expected to lower the rate by 25 basis points in November and probably another 25 basis points in December, but the December move will depend on incoming data. Both the headline Consumer Price Index (CPI) and the core CPI increased by a more than expected 0.2% and 0.3%, respectively, in September, according to the Bureau of Labor Statistics (BLS). According to the report, shelter and food price increases accounted for 75% of the overall increase in the headline. On a year-earlier basis, the headline CPI increased by 2.4%, also slightly higher than expectations, which had it at 2.3%. The core CPI increased by 3.3% on a year-earlier basis in September, also slightly higher than expectations. Shelter costs, which increased by 0.5% in August, slowed down in September to post a rate of increase of just 0.2%. However, food prices were strong during the month, up 0.4% after increasing just 0.1% in August. Energy prices were down 1.9% during the month of September as gasoline prices declined by 4.1%, month-on-month. Within core CPI, new vehicle prices increased 0.2% after a flat month in August while used cars and trucks' prices were up 0.3% after declining 1.0% in August. September's CPI report has good news and bad news for the Fed. The good news is that shelter costs slowed down to 0.2%, month-on-month, and 4.9%, year-over-year. However, it also showed that there are still plenty of upside risks for inflation going forward.

Producer Price Index: Producer prices remained unchanged in September due to a large decline in energy prices that offset an increase in the rest of the sectors of the Index. This benign energy price environment will probably be absent in October so we should expect some upward pressure in producer prices. This result, together with the fact that oil prices have increased in October plus the higher than expected Consumer Price Index report for September published yesterday settles the discussion on the Federal Reserve's path forward, which is to move with caution and lower interest rates by 25 basis points in November and another 25 basis points in December if "incoming data" is supportive. The Producer Price Index (PPI) for final demand remained unchanged in September according to the Bureau of Labor Statistics, compared to FactSet consensus for a 0.1% increase. By large components, the Index showed a 0.2% increase in final demand services that was offset by a 0.2% reduction in final demand goods prices. On a year-earlier basis, the PPI increased by a more than expected 1.8%. The PPI for final demand excluding foods, energy, and trade services increased by 0.1% and was up by 3.2% on a year-over-year basis. The PPI final demand goods showed a 1.0% increase in foods prices, a 2.7% decline in energy prices, and a 0.2% increase in final demand goods less foods and energy prices. The PPI final demand services showed a 0.2% increase in trade prices, a 0.3% increase in transportation and warehousing prices, and a 0.1% increase in other prices. Energy price declines had the largest impact on the PPI for final demand in September while the rest of the sectors showed upward pressures on producer prices.

Economic Releases

Consumer Sentiment: The Consumer Sentiment Index published by the University of Michigan Survey of Consumers declined in October according to the preliminary measure while expectations were for a slight increase. Inflation expectations for the next year increased once again and were the highest since July of this year and reflect the fact that gasoline prices have moved higher in October due to higher oil prices. However, longer-term inflation expectations declined slightly, which is good news for the Federal Reserve. The University of Michigan's Index of Consumer Sentiment (ICS) preliminary reading for October was 68.9 compared to a 70.1 print in September and a FactSet consensus for a slight increase, to 70.2. Both subcomponent indices were lower in October than in September, with the Current Economic Conditions (CEC) Index declining from 63.3 in September to 62.7 in October while the Index of Consumer Expectations (ICE) declined to 72.9 in October from 74.4 in September. This was the first decline in the ICS in three months. Inflation expectations were mixed in October, preliminarily. Inflation expectations for the next year, that is 12 months ahead, increased from 2.7% in September to 2.9% in October while longer-term inflation expectations, that is, during the next five years, declined from 3.1% in September to 3.0% in October. According to the release, "While inflation expectations have eased substantially since then, consumers continue to express frustration over high prices."

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. A value above 100 signals a boost in the consumers' confidence towards the future economic situation, as a consequence of which they are less prone to save, and more inclined to consume. The opposite applies to values under 100.

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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.

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: Aproducer 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 asthe 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 isan 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 isan 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: ThePMInew export orders indexallows us to track international demand for a country's goods and services on a timely, monthly, basis.

Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

Source: FactSet, data as of 10/4/2024

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