THOUGHTS OF THE WEEK
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WEEKLY ECONOMICS

Uh, Oh, What a Difference a Data Point (or Two!) Make!!

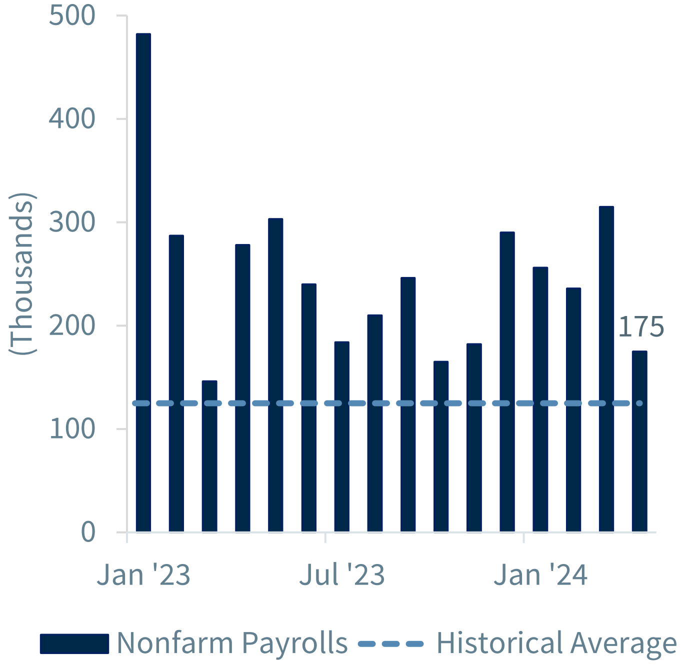
We try not to react to just one data point because, as we have always said, "a data point doesn't a trend make." Furthermore, we don't know if this is just a one-time event or if it is the start of something more. But we have been expecting a slowdown in economic activity for a while, and April's 175,000 nonfarm payrolls is the first sign that maybe, just maybe, our expectation for a slowdown in economic activity is finally here.

If you look at our forecast, we are still expecting a slowdown in economic activity, if not for any reason other than the famous "long and variable lags of monetary policy" which, for this cycle, have been really, really, long!

Still, the 167,000 jobs created by the private sector are very strong compared to a historic average of employment growth in the US economy. Furthermore, most of the jobs, 95,000, were in the private education and health services sector, but mostly in the health services sector, which typically does well in a growing as well as in a weak economic environment.

But today we had a potentially second not-so-good number, the ISM Services Index, which went into contraction territory for the first time since December of 2022. Thus, the ISM Services joined the ISM Manufacturing Index in April with both in contraction for the first time in several years, which could create problems for the economy, for firms, and for the Federal Reserve (Fed).

Nonfarm Payrolls



ISM Services

Source: RJ Economics, FactSet

Comments by firms that were included in the release of the ISM Services Index complained about increases in costs due to high labor and other input costs, which does not bode well for margins going forward. Although firms must continue to buy some of the inputs used in their businesses, the largest costs are labor costs. In general, 70% of businesses' input costs are represented by the cost of labor. Thus, we expect that the weakness seen in the employment market in April to continue during the next several quarters as some industries slow hiring and others even start to cut jobs.

For the Fed, its decisions will become more difficult in an environment of relatively high inflation. However, we still think the disinflationary path is in place and that the Fed will be able to start lowering interest rates by mid year, against what markets believe today.

Open Letter to the Federal Reserve

The Summary of Economic Projections (SEP) has been a great informative instrument from the Fed and has contributed considerably to our understanding of Fed policymaking, especially as it includes the dot plot which, although Fed officials say is not a 'forecast,' helps analysts understand the potential path for US interest rates. However, there are eight Federal Open Market Committee (FOMC) meetings per year but only four of these FOMC meetings include a release of the SEP.

We understand that preparing an SEP during every meeting of the FOMC may be a lot of work, but it is probably nothing compared to the uncertainty generated by not publishing an SEP, as markets have to do guess work on how Fed officials' views have changed during the 'dark' period when an SEP is not released.

Case in point is what has happened between the release of the March SEP, when we argued that it was clear that the dot plot was in flux while adding March's inflation number, which probably has made many of the members of the FOMC change their mind regarding where they want to go with interest rates. However, under today's SEP schedule, markets will have to wait until the release of the June SEP on June 12, 2024, to know how members' views of the path of the federal funds rate has been affected by the recent data releases.

If the SEP is too much, at least releasing a new dot plot at each meeting would be a very good addition to markets as it would reduce speculation about what Fed members are thinking during the period. In normal circumstances, a dot plot would probably not be very helpful, but since these times have been anything but normal, having access to a dot plot would help reduce the volatility created by lack of information. Just saying!

Economic Forecast:

	Actual					Forecast							Actual	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**	**1.6**	**0.9**	**1.0**	**1.6**	**2.4**	**2.6**	**2.1**	**2.5**	**2.5**	**2.1**	**2.0**
Real Gross Domestic Product [2]	1.7	2.4	2.9	3.1	2.9	2.6	1.7	1.3	1.5	1.9	2.2	2.4	2.5	2.1	2.0
Consumer Price Index [2]	**5.7**	**4.0**	**3.6**	**3.2**	**3.2**	**3.5**	**3.3**	**3.2**	**2.8**	**2.5**	**2.4**	**2.4**	**4.1**	**3.3**	**3.0**
Ex-food & energy [2]	5.5	5.2	4.4	4.0	3.8	3.6	3.6	3.5	3.1	2.7	2.5	2.4	4.8	3.7	2.7
PCE Price Index [2]	**5.0**	**3.9**	**3.3**	**2.8**	**2.6**	**2.8**	**2.8**	**2.9**	**2.6**	**2.3**	**2.2**	**2.2**	**3.7**	**2.8**	**2.3**
Ex-food & energy [2]	4.8	4.6	3.8	3.2	2.9	2.7	2.7	2.7	2.3	2.0	2.0	1.9	4.1	2.8	2.0
Unemployment Rate	**3.5**	**3.5**	**3.7**	**3.7**	**3.8**	**3.9**	**4.1**	**4.1**	**4.0**	**3.9**	**3.9**	**3.9**	**3.6**	**4.0**	**3.9**
Fed Funds Rate [3]	5.00	5.25	5.50	5.50	5.50	5.25	5.00	4.75	4.75	4.50	4.00	4.00	5.1	5.1	4.3

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

Economic Forecast:

Employment Cost Index: The Growth in the Employment Cost Index has been declining since 4Q22, which has been good news for the Federal Reserve, but the weakening in wage growth stalled in 1Q24 despite expectations of a lower reading. Wage growth is a key driver of inflation and while one data point doesn't make a trend, the current slight reacceleration confirms our view that the Fed will not cut rates at tomorrow's FOMC meeting and will continue to monitor incoming economic data between now and the summer. According to the Bureau of Labor Statistics, compensation costs for civilian workers increased more than expected by FactSet consensus, at 1.2% versus expectations of 1.0%, during the last quarter of the year. This release is preliminary as it is based on the advanced release for Q1 GDP. Wages and salaries, as well as benefits costs, increased by 1.1%, all compared to the fourth quarter of 2023. On a year-over-year basis, compensation costs remained unchanged at 4.2%. Wages and salaries increased by 4.4% year-over-year while benefit costs increased by 3.6% year-over-year. Compensation costs for private industry workers were up 5.3% on a year-over-year basis as wages and salaries increased 4.3% while benefits costs increased 3.8%. During the 12 months ending in March 2024, real compensation costs for private industry workers increased 0.7% while real compensation costs for state and local government workers increased 4.8%. Compensation costs increased more than expected during the first quarter of the year according to the BLS, both in quarter-over-quarter terms as well as on a year-earlier basis. While these numbers are preliminary and are based on the advance report on GDP released last week, an acceleration in labor costs would not be welcomed news by the Fed and its effort to bring inflation lower.

FHFA Home Price Index: US home prices in January experienced their first monthly decline since August 2022, with significant differences among regions. However, home prices across all regions rebounded in February on a month-over-month basis, while the US index increased by 7% year-over-year, the largest increase since November 2022. S home prices, as measured by the FHFA Home Price Index (HPI), increased by 1.2% in February, according to the Federal Housing Finance Agency (FHFA). Home prices increased by 7.0% on a year-over-year basis. All US regions experienced monthly increases in home prices, with the New England region growing the most at 3.0% month-over-month. The Middle Atlantic region was a close second, growing at 2.6% between January and February, while the South Atlantic region increased by 1.4%. The Pacific, East South Central, and West North Central region, grew by 1.3%, 1.2%, and 1.1%, respectively. The Mountain and West South Central regions both grew by 0.4% month-over-month. All of the US regions saw home prices up on a year-over-year basis, with the Middle Atlantic region experiencing the largest increase, up 10.8%, while the West South Central saw prices increase the least, up 3.7%, year-over-year. US home prices started the year with a small decline but are now back to all-time highs. The supply of homes remains below the long-term average, which combined with weak homebuilding activity, continues to push prices higher.

Economic Forecast:

ISM Manufacturing: The April ISM Manufacturing PMI was lower than FactSet expectations, at 49.2 compared to expectations of a 50.0 reading, returning to contraction territory after briefly reaching expansion territory in March. Today's report showed weakness in several indices, with new orders declining and customers' inventories increasing, suggesting slower demand. On the other hand, while it displayed slower growth than last month, production remained in expansion, which is consistent with our view of a slowing but growing economy. Lastly, the Prices Index increased to the highest level since June 2022 as both raw materials prices and energy prices increased further, which could be concerning for the Fed and its efforts to bring inflation lower. The ISM Manufacturing PMI returned to contraction territory, declining from 50.3 in March to 49.2 in April, according to the Institute For Supply Management. The New Orders Index moved back into contraction territory, declining from 51.4 last month to 49.1 in April. After experiencing a large increase last month, the Production Index declined from 54.6 in March to 51.3 in April. The Employment Index increased again, but remains in contraction territory, from a level of 47.4 in March to 48.6 in April. The Supplier Deliveries Index declined slightly from 49.9 to 48.9, while the Backlog of Orders Index declined 0.9 percentage points to 45.4 in April. The Inventories Index remained unchanged at 48.2 in April and the Prices Index increased further from 55.8 in March to 60.9 in April. After crossing the demarcation line (a level of 50) last month, the ISM Manufacturing Index returned into contraction, largely driven by declining negative readings in the Supplier Deliveries, New Orders, and Net Export Orders indices.

ISM Services: This ISM Services report was weaker than expected as well as unexpected by the markets, as it went into contraction territory. Perhaps the most negative number from the report, however, was the strong pricing pressures mentioned by firms, which was also similar to what happened to the ISM Manufacturing Index. Firms in the industry are dealing with higher pricing pressure from, according to some, unresolved supply chain constraints while the avian flu effects are being mentioned by food services firms. This is a tough spot for the Federal Reserve, especially if the economy is slowing because it will be tricky to start lowering rates if pricing pressures are increasing. However, for firms, this means that they will have to start slowing job growth or even cut jobs at some point in the near term, which is consistent with what we saw today with the employment report. The Institute of Supply Management PMI Services Index was lower than expected in April, at 49.4 compared to a reading of 51.4 in March as well as below the 50-demarcation point for the first time since December of 2022. If we discount that number as an outlier, the previous time it was in contraction territory was in May of 2020, as the effects of the pandemic were starting to show up in economic numbers. FactSet consensus called for the Index to improve from 51.4 in March to 52.0 in April. The Business Activity/Production Index declined from 57.4 in March to 50.9 in April but remained in expansion while the New Orders Index came down from 54.4 in March to 52.2 in April. The Employment Index fell more into contraction in April, at 45.9 compared to a reading of 48.5 in March. The Supplier Deliveries Index improved a bit, but remained in contraction, from 45.4 in March to 48.5 in April. The Inventories Index improved from 45.6 in March to 53.7 in April, meaning that firms' inventories are growing again. The Prices Index moved much higher, from a reading of 53.4 in March to 59.2 in April. The Backlog of Orders number came back into expansion, from 44.8 in March to 51.1 in April while the New Export Orders Index fell into contraction, from 52.7 in March to 47.9 in April. The Imports Index improved slightly, from 52.4 in March to 53.6 in April while the Inventory Sentiment Index surged from 55.7 in March to 62.9 in April, indicating that companies feel inventories are too high. This ISM Services report was a surprise and underscores our belief that the US economy is slowing down. However, we must point out that we need to wait for more data points because we remember that we had a contractionary month back in December 2022 that was an outlier and we would need more signs that the service economy is slowing down.

Economic Forecast:

Productivity & Unit Labor Cost: This was, overall, a very weak labor productivity report while unit labor costs surged during the quarter. However, labor productivity increased slightly on a year-over-year basis while unit labor costs declined on a year-over-year basis, which were both positive for the economy. We should expect an upward revision to first quarter GDP numbers, which will affect productivity and unit labor costs numbers during the first quarter of the year. Productivity increased less than expected, up just 0.3%, during the first quarter of this year, according to the Bureau of Labor Statistics (BLS). FactSet expectations were for a 0.9% increase during the quarter. Productivity growth was revised slightly up during the last quarter of 2023, from an original print of 3.3% to 3.5%, according to the report. Output increased 1.3% while hours worked increased 1.0% during the quarter at seasonally adjusted annual rates. On a year-earlier basis, productivity was up 2.9%. Unit labor costs surged by 4.7% during the first quarter of the year compared to an expectation for a 2.3% increase. This was the consequence of a 5.0% increase in hourly compensation and a 0.3% increase in productivity. Compared to the previous year, unit labor costs increased by 1.8%. Labor productivity in the manufacturing sector increased by 0.2% during the first quarter of the year as output did not change and hours worked declined by 0.2%. Meanwhile, unit labor costs in the total manufacturing sector increased by 3.2% with a 3.4% increase in hourly compensation and a 0.2% increase in productivity. This was a very weak report on labor productivity, pushing unit labor costs higher. Productivity was positive for the fourth consecutive quarter while the year-over-year rate increased slightly.

Trade Balance: The trade deficit in goods and services was unchanged, experiencing a slight decline of 0.1%. Both imports and exports declined in March, mostly reversing last month's increases. On a three-month moving average basis, imports continue to outpace exports, underscoring the strength in consumer demand as already seen in the 1Q24 GDP release last week. The US goods and services trade deficit was virtually unchanged in March, at $69.4 billion compared to a deficit of $69.5 billion in February, according to the US Census Bureau and the US Bureau of Economic Analysis. Exports were down by $5.3 billion in March compared to February while imports were down by $4.3 billion compared to February. Exports of goods measured on a Census basis were down by $5.2 billion as industrial supplies and materials exports decreased by $1.9 billion due to a decrease of $0.9 billion in nonmonetary gold exports. Exports of foods, feeds, and beverages decreased by $1.3 billion as exports of soybeans decreased by $1.0 billion. Exports of capital goods decreased by $2.0 billion on the back of a decrease of $1.2 billion in civilian aircrafts. Import of goods on a Census basis decreased by $4.7 billion in March as consumer goods imports increased by $3.0 billion. Within this category, imports of cell phones and other household goods increased by $1.7 billion while imports of pharmaceutical preparations increased by $2.5 billion. Imports of automotive vehicles, parts, and engines declined by $4.7 billion, driven by a decrease of $3.2 billion in passenger cars imports. The March real goods deficit (deficit adjusted for inflation) increased $1.3 billion. This was the consequence of a decrease in real exports of goods increasing by $4.7 billion and real imports of goods decreasing by $3.4 billion, both measured on a Census basis.

Economic Forecast:

Employment Report: Although employment growth was lower than expected in April, private job growth remained healthy. Most of the weakness was due to a downshift in job growth in construction jobs as well as in government jobs. This slowdown in job growth, if sustained, will be an important discussion topic for analysts and markets going forward as it will ease some fears that economic growth will continue at the strong pace recorded so far. We believe that Chairman Powell was probably referring to this relative weakness in job growth during his press conference after the FOMC meeting earlier this week. Nonfarm employment increased by a less than expected 175,000 during the fourth month of the year while the rate of unemployment increased to 3.9%, according to the Bureau of Labor Statistics (BLS). FactSet consensus expected an increase of 235,000. Total private nonfarm employment increased by a healthy pace, up 167,000 during the month, with goods-producing sectors adding 14,000 while manufacturing jobs were up by 8,000 and construction jobs were up by 9,000. Private service-providing jobs increased by 153,000 with wholesale trade adding 10,100 while retail trade added another 20,100 jobs. Transportation and warehousing added 21,800 jobs. Professional and business services jobs declined by 4,000 during the month. Within this sector, temporary help services shrunk by 16,400. Once again, the private education and health services sector lead the way, adding 95,000 new jobs during the month, spearheaded by the health care and social assistance sector, up 87,000. Finally, leisure and hospitality added just 5,000 jobs after adding 53,000 in March. On the public sector side, government jobs increased by just 8,000 after increasing by 72,000 in March and 55,000 in February. Average weekly hours were 34.3, down slightly from 34.4 in March while average hourly earnings were still up, at $34.75 compared to $34.68 in March while average weekly earnings were down slightly, from $1,192.99 in March to $1,191.93 in April. Construction jobs downshifted considerably in April, up only 9,000 jobs, after an increase of 24,000 in February and 40,000 in March. Something similar happened to government jobs, which were growing strongly over the last several years. Government jobs inched up by only 8,000 new positions after increasing by 55,000 in February and by 72,000 in March. March employment growth was revised up by 12,000, from 303,000 to 315,000 while February job growth was revised lower to 236,000 from an original print of 270,000. Overall, revisions to the last two months were negative by 22,000 jobs.

JOLTS: Job openings fell (-325,000) in March at the quickest monthly pace since October 2023 and were weaker than FactSet expectations. The job openings rate also moved lower to 5.1% after printing 5.3% for three consecutive months. This report supports our view that the US labor market is slowly cooling. The number of job openings ticked lower in March compared to February, at 8.5 million, according to the Bureau of Labor Statistics. Job openings in February were revised up by 57,000 to 8.8 million. The same was true for total hires and separations, which stood at 5.5 million and 5.2 million, respectively. Quits and layoffs and discharges were also little changed, at 3.5 million and 1.7 million, respectively. The job openings rate moved lower to 5.1%, after three consecutive months at 5.3%. By industry, Construction lost the most job openings (-182,000), while Information saw the most job openings added (+43,000). By region, the West saw the biggest loss in job openings (-194,000), while the Northeast was the only region that saw an increase (+22,000). While not alarming or in a free fall, today's report reinforces our view that the labor market will continue to see signs of slowing. This was evident from a declining number of job openings (near March 2021 levels) and rate (lowest since January 2021), and a decline in the quits rate to 2.1%—the lowest rate since August 2020.

DISCLOSURES

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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.

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.

Sahm Rule: The Sahm Rule is a recession indicator that identifies signals related to the start of a recession. The rule states that a recession begins when the three-month moving average of the national unemployment rate (U3) rises by 0.50 percentage points or more relative to its low during the previous 12 months.

Employment Cost Index (ECI): The Employment Cost Index, or ECI, is a Principal Federal Economic Indicator that provides data on how labor costs are changing and how the economy is performing.

Source: FactSet, data as of 5/3/2024

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