

# MARKET SIGHT LINES



## Employment remains strong. Will the Fed pause rate hikes? Is a soft landing possible?

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Over the past year, we've discussed how inflation, employment, Federal Reserve (Fed) policy, interest rates, economic growth, and earnings are all interrelated, ultimately driving market performance. The Fed has been aggressively shifting to a more hawkish policy. As we look to find balance, we're monitoring for related signposts on Fed forecasts, wage growth, shelter costs, and labor market equilibrium. In this week's Sight|Lines, we unpack a positive employment report, a possible Fed rate hike pause, and the resulting possibility of a soft landing.

### **THE TAKEAWAY: THE JOB MARKET REMAINS TIGHT, FED HIKES TO CONTINUE, AND A SOFT LANDING REMAINS POSSIBLE**

The January employment report shows that the job market remains strong. The Fed continues to signal higher rates, but the debate about when to pause seems to be in full swing. And a strong job market, along with a pausing Fed, means a soft landing is still possible, allowing us to avoid a deep recession. In summary:

- The January unemployment rate declined to 3.4%, the lowest level since 1969.
- Nonfarm payrolls rose 517,000 in January, well above market expectations for a rise of 188,000.
- The ratio of the number of unemployed persons to the number of job openings rose to 1.9 from 1.8.
- The annual growth of average hourly earnings on a yearly basis fell to 4.4%.
- In speeches and other media appearances, Fed officials say they will hike rates further, but they are debating when to pause.

Of course, next week's January inflation reports will be important inputs to future Fed policy. All said, at this point, a soft landing appears possible.

### **IN-DEPTH: ALL ARE WATCHING FOR THE JOB MARKET TO SOFTEN, THE FED MAY PAUSE, AND A SOFT LANDING IS STILL POSSIBLE**

Let's go a little deeper into the strong January employment report. Although subtle, a couple of less positive elements of the report mean inflation pressures may be easing. So, as the Fed continues to signal higher rates, officials are debating a pause, which could come soon. Some Fed and other government officials believe the economy is holding up, so a soft landing remains still possible. Going deeper:

- While the January unemployment rate declined to 3.4%, some people have stopped looking for work:
  - The U-6 rate, which includes those too discouraged to look for work, plus those in part-time jobs who want to work full-time, rose to 6.6% in January from 6.5% in December.

- The nonfarm payrolls increase of 517,000 was strong by any measure, with:
  - Notable job gains in leisure & hospitality, professional & business services, and health care
  - Increases in private employment by 443,000 and government employment by 74,000
  - A 397,000 rise in private service-producing jobs
  - A 46,000 rise in private goods-producing jobs
- The 1.9 ratio of the number of unemployed persons to the job openings may decline.
  - If accurate, this means there are almost two jobs for every person looking for work.
  - We're watching to see if some job postings go unfilled, meaning the employer has actually decided not to fill the role but has not yet taken the job posting down.
- The January annual wage growth of 4.4% is approaching the Fed's desired rate:
  - This rate has fallen meaningfully since the recent high of 5.9% in March 2022.
  - We're not far from a 3.5%-4% rate, levels some Fed officials see as consistent with 2% inflation.
- Fed and other government officials communicate their views in speeches and other media appearances:
  - Some comments from Fed Chair Jerome Powell:
    - "The labor market remains very, very strong, and that's job creation, that's wages."
    - "Our forecasts – there are different participants of different forecasts, but generally, those forecasts are for continued subdued growth, some softening in the labor market but not a recession, not a recession."
    - "If we continue to get strong labor market reports or higher inflation reports, it may well be the case that we raise by more and raise rates more than is priced in."
  - San Francisco Fed President Daly recently said that "the direction of policy is for additional tightening and then holding that restrictive stance for some time. But the 'how we get there,' the tactics, the meeting-by-meeting decisions really have to be data-dependent."
  - Treasury Secretary Janet Yellen recently shared this view: "You don't have a recession when you have 500,000 jobs and the lowest unemployment rate in more than 50 years."
  - I was fortunate to see former Fed Vice Chair Richard Clarida speak, when he reaffirmed the idea that 4% wage growth would be consistent with the Fed's 2% inflation target. He also said the Fed's neutral rate is now about 2.5%-3%, so the current policy is highly restrictive.

## CONCLUSION

Inflation trends, employment, Fed policy, interest rates, economic growth, and earnings are all interrelated, together contributing to future market performance. The January employment report was strong, and Fed officials continue to signal higher rates. But the Fed will pause at some point, and a strong job market increases our chances of a soft landing.

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