Weekly Economic Briefing | US

Labor market shows no signs of recession

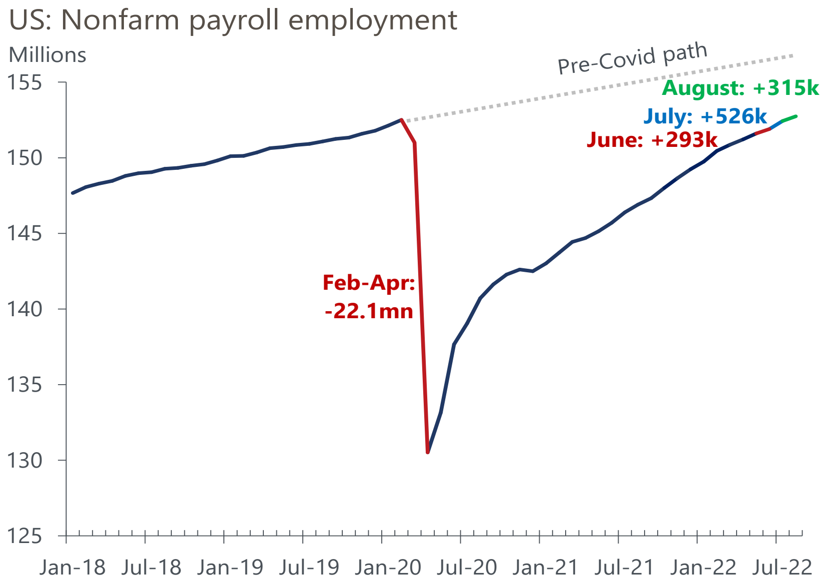
- **There's plenty to cheer about on the labor market front heading into the Labor Day holiday. Payroll growth remains very buoyant and strong wage inflation is mitigating the sting of higher prices. What's more, the return of more side-lined workers into the labor force is pushing labor supply into better balance with demand. However, looking ahead, we expect a marked slowdown in job creation heading into 2023 as the economy faces significant strains.**
- **The Fed has more work to do if it wants to bring down price pressures. Job creation is strong, wage inflation is holding above 5%, and the labor market remains very tight. Given Fed Chair Powell's hawkish rhetoric in Jackson Hole last week and that the next CPI report should show renewed core price pressures, we continue to expect a 75bps rate increase in September. We now look for a total of 150bps of rate hikes before year-end.**

The economy added 315k jobs in August, a modest slowdown in hiring following July's torrid pace, which corroborates some anecdotal evidence indicating companies are starting to turn cautious amid waning economic growth (**Chart 1**). However, the labor market remains very robust overall as payroll growth has averaged 380k in the past three months compared to an average monthly gain of 190k in the last expansion.

Also encouraging was the jump in the labor force participation rate, which rose 0.3ppts to 62.4% in August, matching its March 2022 peak, and putting upward pressure on the unemployment rate as it increased from 3.5% to 3.7%. Meanwhile, average hourly earnings rose at their slowest monthly pace since April, which left wage inflation steady at 5.2% for a third straight month - well above the pre-pandemic trend of around 3%.

Looking ahead, we expect labor market conditions to deteriorate as high interest rates, elevated inflation and a weakening global backdrop weigh on the economy. Labor force participation is expected to increase, however bringing worker demand and supply into better balance will be a slow process - meaning wage pressures will ease only gradually. In this type of environment, we expect the Fed to continue raising interest rates.

Chart 1: Job creation was vigorous in August



Source: Oxford Economics/BLS/Haver Analytics

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The most recent high frequency labor market data corroborate the strength highlighted by the August jobs report. Initial jobless claims were lower than expected in the week ended August 27, falling 5k to 232k, and claims for the prior week were revised lower. We don't expect claims to fall sharply from current levels. Rather, in an environment of strong labor demand, we look for employers to slow hiring as the economic expansion softens. We don't think employers will resort to laying off significant numbers of workers unless economic conditions deteriorate meaningfully.

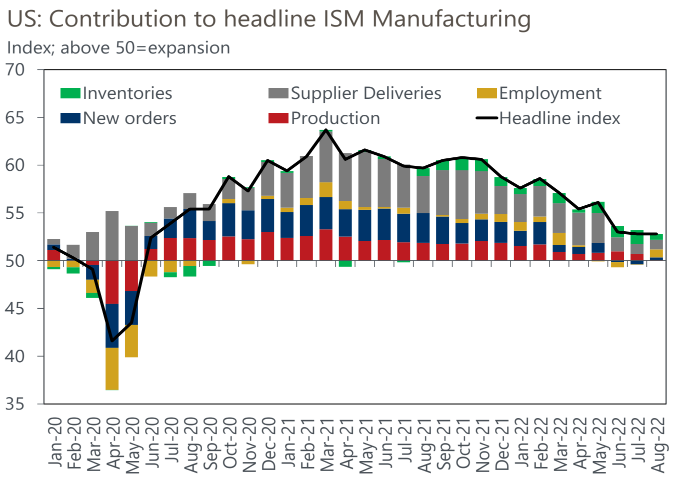
Meanwhile, the latest JOLTS report showed that the job market is still way off balance. The ratio of unemployed per job opening - which Fed officials pay close attention to - climbed back to a series high of 2.0 in July. At the same time, the number of quits declined for a fourth consecutive month though it remained above 4 million and 21% higher than before the pandemic. Companies held onto workers as layoffs were steady at very low levels while workers quit their jobs at a relatively high rate. It will take time and a weaker economy to bring labor demand and supply into better balance - a necessary step to take the heat off inflation.

ISM Manufacturing came in at 52.8 in August which, alongside similar readings for June and July, means that factory activity expanded slowly over the summer (**Chart 2**). Factory output will continue to rise in the coming months, but the sector will face challenges. Fairly soft domestic demand and recession worries will drag on growth and supply chain struggles will continue to bite. Cost pressures will slowly recede - but prices will stay high - and hawkish Fed policy will exert upward pressure on interest rates. Also, we are fairly negative on the foreign demand outlook and think the US dollar will remain strong, meaning manufacturers can't look to overseas markets to mitigate domestic weakness.

The Conference Board's Consumer Confidence Index increased in August after three consecutive months of declines, rising 7.9 points to 103.2 as inflation concerns moderated amid falling gas prices. August's confidence reading augurs for fairly resilient consumer outlays in H2 2022 despite the challenging economic environment. While the Fed's "forceful" use of its policy tools to restore price stability will exert downward pressure on consumer confidence in the coming months, we don't expect a contraction in spending.

On the housing front, we learned this week that home price growth weakened in June, with the S&P CoreLogic Case-Shiller national Home Price Index (HPI) advancing 18.0% y/y, the slowest pace of growth since May 2021, and the FHFA HPI increasing 16.2% y/y, the weakest annual gain since April 2021. It's worth highlighting that the home price data are reported with a two-month lag and therefore don't reflect the most current conditions in the housing market. We expect home price growth to moderate more significantly through the rest of 2022, falling into single digits by year-end. Prices will adjust as deteriorating affordability sidelines many potential buyers.

Chart 2: ISM Manufacturing is holding in modest expansion territory



Source: ISM/Oxford Economics/Haver Analytics

The week ahead

There are fewer economic data releases to look forward to in the holiday-shortened week. **ISM Services** will likely show a fairly solid pace of expansion in August even as high inflation, higher interest rates, and recession concerns dragged on activity. On the labor market front, **initial jobless claims** will stay pinned down at historically low levels as employers hold onto workers amid a tight labor market and positive, albeit it moderate, economic growth. **Consumer credit** growth slowed in July, mainly because of much weaker non-revolving credit growth. The **trade balance** narrowed in July as nominal exports were fairly resilient while imports weakened.

Table 1: Week ahead calendar

Date	Events	Period	Previous	Consensus	Estimate
9/6/2022	ISM Services Index	Aug	56.7	55.2	56.0
9/7/2022	Trade Balance	Jul	-$79.6b	-$70.1b	-$70.2b
9/8/2022	Initial Jobless Claims	44807	232k	--	230k
9/8/2022	Consumer Credit	Jul	$40.154b	$32.5b	$20.0b

Source: Bloomberg/Federal Reserve/Oxford Economics

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Table 2: Latest US forecast overview

(Annual percentage changes unless specified)						
	2019	2020	2021	2022	2023	2024
GDP	2.3	-3.4	5.7	1.7	0.9	2.3
Private consumption	2.2	-3.8	7.9	2.5	1.5	2.2
Fixed investment	3.1	-1.5	6.1	1.0	0.6	2.6
Government consumption	2.0	2.0	1.0	-0.9	0.7	0.7
Exports of goods and services	-0.1	-13.6	4.5	6.5	4.2	5.1
Imports of goods and services	1.1	-8.9	14.0	10.0	1.9	2.1
Industrial production	-0.7	-7.0	5.0	4.4	1.1	1.6
Consumer prices	1.8	1.2	4.7	7.9	3.7	2.2
Unemployment rate (%)	3.7	8.1	5.4	3.6	3.7	3.8
Current a/c balance (% of GDP)	-2.1	-3.0	-3.7	-4.3	-4.3	-3.7
Government balance (% of GDP)	-4.6	-15.0	-12.1	-3.3	-4.6	-5.7
Cen. bank policy rate (%, EOP)	1.63	0.13	0.13	3.63	2.13	2.00
10yr govt. bond yield (%, EOP)	1.92	0.93	1.52	3.40	2.80	2.75
Exchange rate (Yen per US$, EOP)	109.12	103.54	115.00	132.18	119.36	109.02
Exchange rate (US$ per euro, EOP)	1.12	1.23	1.13	1.05	1.08	1.11

Source: Oxford Economics/BLS/Haver Analytics

Key forecasts

Table 3: Latest quarterly forecasts for the US

	2021	2021	2022	2022	2022	2022	2023	2023
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
GDP (% chg, saar)	2.3	6.9	-1.4	-0.6	1.6	1.1	0.8	0.5
CPI inflation (% year)	5.3	6.7	8.0	8.6	8.1	7.0	5.5	3.7
Core CPI inflation (% year)	4.1	5.0	6.3	6.0	6.2	6.0	5.3	4.4
PCE inflation (% year)	4.3	5.5	6.3	6.5	6.1	5.1	4.2	3.1
Core PCE inflation (% year)	3.6	4.6	5.2	4.8	4.9	4.6	4.1	3.6
10-year Treasury yield (%, EOP)	1.5	1.5	2.3	3.0	3.2	3.4	3.4	3.3
Federal funds rate (%, EOP)	0.1	0.1	0.4	1.6	3.1	3.6	3.9	3.9

Source: Oxford Economics/BLS/Haver Analytics

Latest Country Economic Forecast:

10 August 2022

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