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Weekly Commentary

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Macro View

By Hubert Marleau

The Job Market is Cooling. So is Inflation:

Earlier last month, a poll conducted by The Economist and YouGov showed that Americans view employment and inflation as their 2 most important issues, yet they were not even vaguely apprised of what was actually going on in the economy.

My job is to explain where the markets are heading based on what is happening in the economy, as simply as possible, if not simpler. There are three big factors that drive it: employment, productivity and inflation. And each of these is affected by its own set of specific factors.

Last week's deluge of key macro data is putting to shame those who deride the no-landing and soft-landing narratives, as the widening gap between the policy rate and the neutral rate, the yield curve inversion and falling money supply, is producing a predictable decrease in non-shelter core inflation without a precipitous fall in business activity, bolstering the so-called "immaculate disinflation". Those who have scorned this narrative are in an awkward spot. Former Treasury Secretary Lawrence Summers admitted on Bloomberg Television that the odds that the US economy may avert a downturn as the policymakers battle inflation are improving and they can.

Employment is Normalizing:

Last week's labour-economic prints pointed to a significant improvement in the supply of, and demand for, workers as hiring has slowed while more people joined the labour force without any job losses. There is no historical precedent whatsoever for such a development. Perhaps this time is indeed different because there is still enough variance between job openings and unemployment for this unusual phenomenon to continue for several more months. Hence there might be a lot of "mea culpa" from the naysayers who believed lower inflation was impossible under a soft-landing scenario. Immigrants saved the day. Indeed, increased immigration and its participation in the labour force had played a disproportionate role in rebalancing the labour market. As a rule, immigrants are generally willing to work for less and for longer hours. Goldman noted that growth in the foreign-born labour force has accelerated to 160,000 per month this year, 50,000 faster than in 2022. Tim Krupa, an economist at Goldman Sachs wrote: "I expect foreign-born labour force growth to add 40,000 workers per month

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more than the 2010-2019 trend. This 100,000/month pace could add an incremental 500,000 workers over the next 3 quarters above trend levels and meaningfully dent the job-workers gap, which we (Goldman Sachs) estimate remains roughly 1.2 million above the 2 million level we think would be consistent with 3.5% wage growth and 2% inflation."

We are all entitled to our opinions, but the fact is that immigration is disinflationary.

First, job openings are falling. These continued to drop to 8.827 million in July, following a downwardly revised 9.165 in June. This print came below the consensus-expectation of 9.5 million, bringing the total job rate to a 30-month low of 5.3%. There are still a lot of openings, however: 1.5 for each person counted as unemployed, in comparison with an average of 1.2 in 2019 (which incidentally was itself a good job market). Although still elevated against pre-Covid levels, Macro Strategy Partnership demonstrated graphically that openings are back on trend.

Second, churn in the labour market is abating. The number of people quitting their jobs fell to 3.5 million in July, versus 3.8 million in June and 4.0 million a year earlier. That brought the quit rate - the number of job resignations as a share of total employment - down to 2.3% from a high of 3.0% in April 2022. That was the lowest level since January 2021, matching the 2019 average.

Third, layoffs are virtually nonexistent. Employers are in no rush to fire workers. On the contrary, they are instituting innovative recruiting strategies. There has not been any pick-up in job loss, only job gains. There were 1.56 million discharges in July, which compares favourably with the 1.5 million recorded 12 months earlier. Accordingly, the layoff rate - expressed as a share of employment - was unchanged from a year earlier at 1%. Unsurprisingly, initial claims are holding firm around the 225K mark, as they have since last April

Fourth, employment growth is declining. ADP reported a177,000 increase in private payrolls in August, cooler than the consensus of 195,000 and lower than the prior month reading of 312K. Meanwhile, employers added 187,000 jobs in August, a bit more than expected, but there were 2 downward revisions to the 2 prior months. Nevertheless, the report showed a slower pace of employment growth without an imminent recession, even though the unemployment rate rose to 3.8%. This was brought about by a 0.2% jump in the labour participation rate, which now stands at 62.8%.

Productivity is Rising:

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Over the past few weeks, I've pushed the idea that technological advancements are ushering the economy into a mini productivity boom. I've said enough about this. Suffice to say that in real terms business activity rose 3.3% from the June quarter of 2022 to the September quarter of 2023, compared to 1.9% for total employment, and that this 1.4% gap is a rough approximation of productivity. It may actually be above that trend because total hours worked has been flat over the past 6 months, and the average workweek has declined to the lower end of its pre-pandemic range. Productivity remains an accurate measure of efficiency, which allows growth to occur without inflationary impulses.

Inflation is Falling:

There are some concerns that a second inflation wave is in the making. This is based on the relentless increase in core PCE services ex-housing - a major Fed focus - rising 0.5% in July due to a 7.3% jump in portfolio management fees (not us, incidentally). It is just too noisy for me to subscribe to this inflation-hypothesis, which has nothing to do with wages. In fact, another welcome surprise was the below-consensus 0.2% m/m increase in average hourly earnings. Actually, core PCE increased 0.2%, extending the run of 0.2-to-0.3% prints since February. The truth is that it's becoming increasingly difficult to dismiss the improvement in inflation numbers. Overall, the core PCE deflator rose at a 2.9% annualized rate in the 3 months ended July, compared to 3.3% the previous 3 months - the lowest on this basis since March 2012. Meanwhile the headline July PCE deflator was up 0.2% month-over-month with the 3-month annualized rate at 2.02%. On another note, online prices in July fell 0.9% m/m and 1.6% y/y, marking the 11th consecutive month of y/y price decreases, with the majority of categories (11 of 18) tracked by Adobe seeing falling prices on an annual basis.

Monetary Policy is Just Fine:

All told, it looks as if the economy is returning gradually toward a "2 plus 2" plot: 2% for inflation and 2% for growth, with corporate profit margins sticking around 10% of N-GDP. The Citigroup Economic Surprise Index declined softly from 79 to 40 over the past few weeks, pointing to a scenario where the exceptional gains tied to the pandemic recovery are over. The economy is clearly pivoting to normal sustainable growth and price stability, suggesting that no further hikes are needed and setting the stage for a change in the Fed's monetary stance in 2024.

Meanwhile, the Atlanta Fed reduced its 3rd quarter GDP growth estimate to 5.6% from 5.9% and more decreases can be expected, the dynamics that have kept spending robust having significantly changed. Personal saving rates

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fell too, to 3.5% in July, down from 4.3% in June and 4.7% in May. In 2019, saving rates were much higher, averaging 8.8%. In this connection, a cooler personal spending trend is in the making. Indeed, Atlanta Fed President Bostic believes that monetary policy is tight enough to take inflation back to 2% over a reasonable period. He said: "I feel the policy is appropriately restrictive. We should be cautious and patient and let the restrictive policy continue to influence the economy, lest we risk tightening too much and inflicting unnecessary economic pain."

The Stock Market:

In the week ended September 1, the S&P 500 rose 110 points or 2.5% to close at 4516, after a tough month, as investors were betting that it was likely that the status quo on interest rates would persist. Mutual funds and ETFs focused on US equities took in $4.6 billion last week, snapping a 3-week streak of outflows. Right now, investors are more focused on inflationary pressures than profits. That, however, should soon change as more and more people lose their fear of inflation. When everybody becomes convinced that this is clearly under control, profits will again dominate the agenda.

In this respect, the earnings recession may have ended in Q2. Analysts' consensus expectations for S&P 500 operating earnings are heading in an upward direction. Here are the actual and anticipated y/y quarterly growth rates: -3.1%, -5.3%, -0.1% for 2023 and 9.1% 8.8%, 12.0%, 12.7% for 2024. On an annual basis, analysts are currently anticipating that earnings will rise 11.8% next year to $247 from $221 this year and rise a further 12.6% in 2025 to $278. I think the next stop for the S&P 500 is 4800.

P.S. Perhaps because I'm a sucker for designer clothes, I was impressed with BCA Research on the French luxury industry that was conducted by its chief strategist David Joshi. He claims persuasively that the stock market's pre-eminent growth sector is not US tech, it is French luxuries. He has good reasons. This industry has incredible pricing power and can keep its cachet, making its goods very desirable for the ballooning increase of the super-rich, while benefiting from barriers to entry. As a result, French luxuries consistently beat US technology on profit growth. Yet stocks like Hermes and Louis Vuitton are relatively cheap as they have underperformed against US Tech. In this respect, they offer good entry points.

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