

PALOS

The Palos Perspective

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Turning Attention to the Economy

Economic indicators released last week by the Bureau of Labor Statistics revealed that US business, despite its apparent economic inequality, is enjoying “Goldilock” performance: inflation is falling, employment is rising, and productivity is accelerating.

First, progress toward the Fed’s 2% inflation target had been slow, but meaningful, even though 90% of the tariff burden had fallen on U.S. consumers and businesses, according to research published by the NY Fed. In this connection, the sticky-price CPI remains elevated, while disinflation has come from sharply lower energy prices, improved shelter costs and productivity improvements. As a result, the CPI rose 2.4% in January from a year earlier: much cooler than the 2.7% recorded in December and lower than expected by a consensus of economists.

Second, January payrolls rose by 130,000 - a welcome upward surprise - with private jobs up 172,000. Thanks to very healthy gains in healthcare and social services, the unemployment rate also improved, down to 4.3%.

Third, aggregate weekly hours worked in private industry rose 0.4% m/m in January, while average hourly earnings also increased 0.4% m/m, resulting in the so-called “Earned Income Proxy” jumping 0.8%, solidly above the January inflation rate, and suggesting that real GDP had started Q1/2026 with a bang.

What is significant is that these new data points have nudged the “Sahm Rule” - a real-time evaluation of the business cycle – favourably away from a recession forecast, and the “Misery Index” - a determinant of how well the economy is doing - closer to the optimal point.

In this regard, the rolling panics caused by current AI disruptions are perhaps as much indiscriminate as they are overdone.

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P.S.1 The Sahm Rule is a heuristic measure used to detect early signs of a recession. It states that when the 3-month moving average of the national unemployment rate rises by 0.5 percentage points or more above the low point over the past 12 months, it indicates that the economy is likely in the early stage of a recession. (It currently stands at 0.1%.)

P.S.2 The Misery Index is calculated by adding the seasonally adjusted unemployment rate to the annual inflation rate. Its optimal position is 6.5, with an inflation content of roughly 30%. It presently stands at 6.7, with an inflation content of 36%.

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