US Macroeconomics

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Major Crosscurrents in The Labor Market

Two major cross currents were evident in the December jobs report. The labor market remains extraordinarily tight, but counterintuitively the trend in wages shows further evidence of slowing.

December nonfarm payrolls were in line with consensus expectations net of revision (223k vs. 256k in November). The growth in nonfarm payrolls continues to slow—weakest since January 2021—as measured by its three-month moving average (247k vs. 263k).

The unemployment rate unexpectedly fell 0.2% to 3.5%, matching its cyclical low. This drop was matched by the broader U-3 series as well (6.5% in December vs. 6.7% previously). Importantly, **the decline in the unemployment rate was impressive** as it was due to a combination of a 717k increase in Household employment and a 278k drop in the number of unemployed.

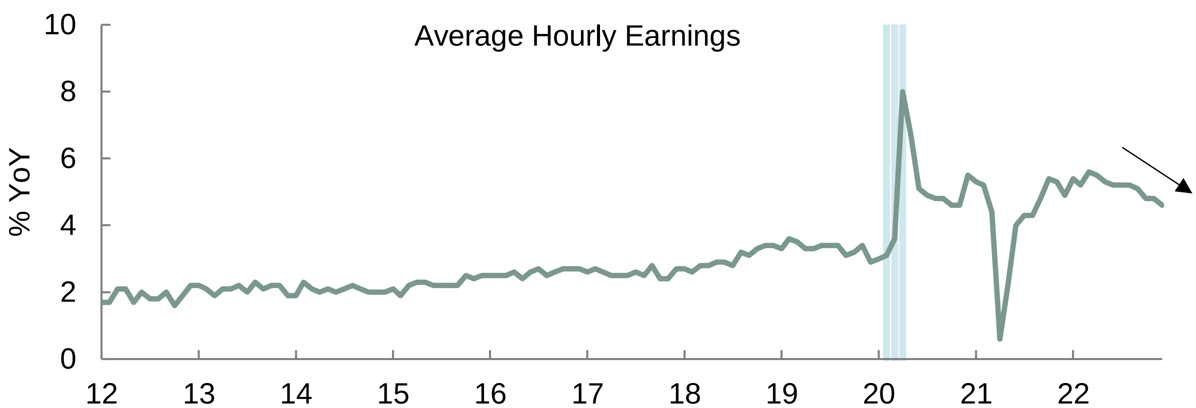
The labor force participation rate ticked up 0.2% to 62.3% but remains firmly within its trailing 12-month range. Participation is still down a large one percentage point from its pre-pandemic level. **Remarkably, the tight labor market is not leading to faster wage gains**. Average hourly earnings increased a smaller than expected 0.3%, and this came after a 0.2% downward revision to the previous month.

Over the last year, earnings are up 4.6%, down from 4.8% in November. As the chart below shows, wage growth has been slowing since last March (5.6%). Will the renewed low in the unemployment rate reverse this downtrend? If so, this would be big **positive** for the economy because consumption would remain robust.

The nonfarm workweek fell 0.1 to 34.3 hours, its lowest non-pandemic reading since January 2020. When hours are combined with wages and jobs, **the implied increase in December income is just 0.2%**, the smallest gain in nearly two years (February 2021). The implied weakness in personal income points to less consumer spending given the fact the household savings rate is close to an all-time low. This is a big potential **negative** for the economy.

How these crosscurrents are resolved is central to the economic outlook. Our view is that the large cumulative increase in the fed funds rate alongside a sizeable surge in the real rate well above R-Star will meaningfully dampen the jobs market and the broader economy in the months immediately ahead. **Recession risk remains high**.

Meanwhile, the Fed is committed to further raising interest rates. But given the mixed December employment results, investors may have to wait until the outcome of the December consumer prices report before there is confidence in the Fed's next move. Stay tuned.



Source: BLS, Haver, SMBC Nikko

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