SMBC

SMBC Group

US Macroeconomics

May 5, 2023

Joseph Lavorgna, Chief US Economist | 212.893.1528 | joseph.lavorgna@smbcnikko-si.com

The Slow Burn

Nonfarm payrolls rose a stronger than expected 253k in April, but this was after a large 149k in downward revisions to the previous two months. **Jobs are still trending lower, evident from the three-month moving average which fell to 222k from 295k in March**. This is the smallest gain since January 2021 (163k). Importantly, job creation will continue to slow both in lagged response to monetary tightening and the ongoing crisis in commercial banking which has not yet been felt in the broader economy.

Good-producing jobs were up 33k after falling 17k in March as construction (15k), manufacturing (11k) and mining (7k) all increased. Private service-producing jobs were up 197k led by the professional and business services category (43K), leisure and hospitality (31k) and financial activities (23k).

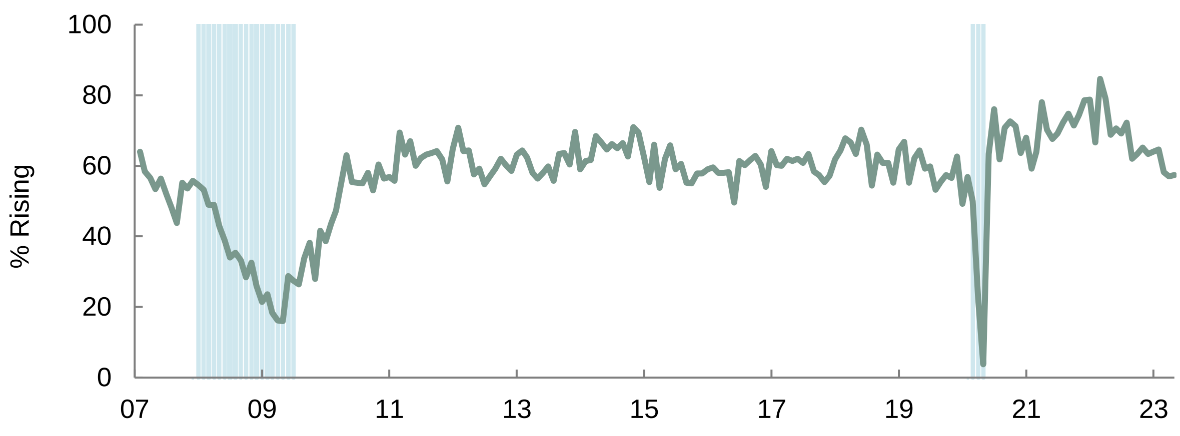
Government employment rose 23k which meant private payrolls increased 230k after increasing only 123k in March. Over the last three months, **private payrolls averaged 182k which is also the smallest increase since January 2021 (159k)**. We project this downward momentum to accelerate.

Furthermore, **it is worth highlighting the narrowness of recent payroll gains**. This weakening in job breadth can be seen in the diffusion index of employment (see chart below) which registered 57.4% last month compared to 57.0% previously. The current level is at the bottom end of a longer-term 15-year range. This speaks of weakening future labor demand, which is also consistent with temporary employment. **"Temps" fell 23k last month, the fifth decline in the last six months**.

For the Fed, an unexpected decline in the unemployment rate back to a five-decade low (3.4% vs. 3.5% previously) combined with an unexpected 0.5% in average hourly earnings compared to a 0.3% in March trumps the underlying fissures in the payroll data. Consequently, Fed policymakers will likely (for now) believe this past week's rate hike was warranted given a historically tight labor market and wage growth that remains well in excess to productivity growth. This leads us to our last and most important point.

Over the last five quarters, real GDP has risen a meager 0.9% annualized pace. Yet, the unemployment rate has declined half of percentage point during this time. This tells that **trend GDP growth has collapsed**, consistent with a record plunge in productivity growth. Given the Fed's fixation on the output gap as the primary determinant of inflation, policymakers may think they need to keep rates restrictive to open enough slack to push core prices lower. This would be a big policy error as it would produce a much deeper downturn.

Diffusion Index on Private Payrolls



Sources: BLS, Haver, SMBC Nikko

Disclaimer

This presentation is for discussion purposes only and is not intended to be an offer to sell or the solicitation of an offer to buy any securities, or any commitment to underwrite, subscribe for or place any securities, is not an offer or commitment to provide any financing or extension of credit or service, and does not contain any tax or legal advice. This presentation has been prepared by SMBC Group (which may include, collectively or individually, any of the following entities in the Americas Division: Sumitomo Mitsui Banking Corporation ("SMBC"), SMBC Nikko Securities America, Inc. ("SMBC Nikko"), SMBC Nikko Securities Canada, Ltd. ("Nikko Canada"), SMBC Capital Markets, Inc. ("SMBC-CM"), SMBC Leasing and Finance, Inc., JRI America, Inc., and SMBC Rail Services LLC) and is being furnished by SMBC Group solely for use by the client or potential client to whom such materials are directly addressed and delivered. This presentation is confidential and is the property of SMBC Group subject to copyright. Any reproduction of this presentation, in whole or in part, is prohibited, and you may not release these materials to any person, except to your advisors and professionals to assist you in evaluating these materials, provided that they are obligated, by law or agreement, to keep the presentation confidential. These materials do not constitute research, a recommendation or an offer or solicitation to any person to enter into any transaction or adopt any hedging, trading, or investment strategy. Prior to participating in any such transaction, you should consult your own independent, competent, legal, tax, accounting, and other professional advisors.

In preparing this presentation, SMBC Group has relied upon information available from third parties, including public sources, and we have assumed, without independent verification, the accuracy and completeness of such information. Specific prices, indices, or measures, including ranges, listed in this document were prepared at the time the document was prepared, and are subject to change without notice. SMBC Group makes no representations to and does not warrant this presentation's accuracy or completeness. SMBC Group expressly disclaims any liability for any use of the information set forth herein, including, without limitation, any use of the information set forth herein in the preparation of financial statements or accounting material.

Sources: BLS, NBER, Haver, SMBC Nikko

These materials may contain forward-looking statements, which may include projections, forecasts, income estimates, yield or return, future performance targets or similar analysis. These forward-looking statements are based upon certain assumptions. All forward-looking statements are based upon currently available information and SMBC Group is not obligated to provide an update. Actual events may differ from those assumptions. Opinions, projections, price/yield information and estimates are subject to change without notice. There can be no assurance that estimated returns or projections will be realized, that forward-looking statements will materialize or that actual results will not be materially lower than those presented. Past performance is not necessarily indicative of future results. Any transactions or strategies addressed may not be suitable for all parties. The value, price or income from transactions or strategies may fall as well as rise. SMBC Group or an affiliate may have a position in any of the underlying instruments, assets, indices, or rates mentioned in this document. You should make your own independent judgment or seek independent financial and tax advice with respect to any matter contained herein.

SMBC is subject to Japanese firewall regulations and therefore absent client consent, non-public client information may not be shared with SMBC Nikko Securities Inc.

SMBC Nikko is a U.S. registered broker-dealer of SMBC Group. Nikko Canada is a U.S. and Canadian registered broker-dealer of SMBC Group. SMBC-CM is provisionally registered as a U.S. swap dealer with the CFTC. Capital markets and other investment banking activities for SMBC Group are performed by a combination of SMBC Nikko, Nikko Canada, SMBC Nikko Securities Inc. and SMBC-CM. Lending and other commercial banking activities are performed by SMBC and its banking affiliates. Derivative activities may be performed by SMBC-CM or SMBC. SMBC Group deal team members may also be employees of any of the foregoing entities. SMBC Group does not provide tax advice. Accordingly, any discussion of U.S. tax matters contained herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with the promotion, marketing or recommendation by anyone unaffiliated with SMBC Group or for the purpose of avoiding U.S. tax-related penalties.