US Macroeconomics

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

Tiny Cracks Emerging

The Fed is focused on the labor market because policymakers believe a tight labor market is the key determinant of inflation. As long as jobs are plentiful and the unemployment rate is low, the Fed will remain hawkish. However, small cracks in the labor market are beginning to emerge.

Initial jobless claims have been at 262k for two weeks in a row. Next week's report captures the survey week for June employment so claims will take on added significance. **If claims continue to hover around 260k, they will be up about 70k or nearly 40% from last September's record low** (191k on four-week moving average basis).

Our work has shown that **the change in jobless claims from its trough is more predictive than the level of claims in determining whether the employment turns down**. It is still too soon to say, but the weekly claims data continue to bear scrutiny. Persistent readings of 260k or above represent a large enough increase that the economy could be on the cusp of an inflection point. As the table below shows, we are already past that threshold.

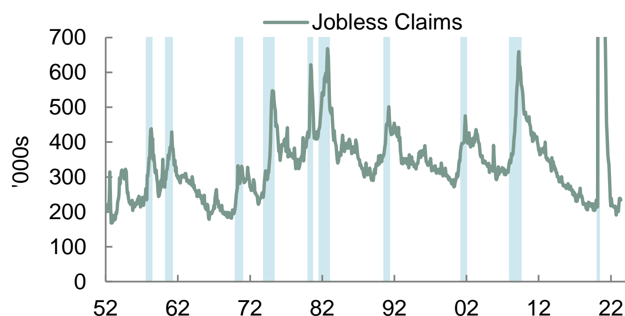
Another series to keep an eye on is hours. Last month, **the overall workweek edged down 0.1 to 34.3 hours, the shortest workweek since the government imposed pandemic lockdown**. The factory workweek, which is one of the 10 subcomponents in the Leading Economic Indicators, was unchanged at an historically low 40.7 hours. Because hours tend to lead hiring, their further decline would point to weaker hiring ahead.

Softer demand for labor may also be evident in temporary employment, which is also a leading indicator of hiring. **Temps were up modestly last month but this followed three consecutive negative readings and declines in five of the six previous months**. When temps decline, broader job losses often ensue.

Despite these fissures, the Fed predicts further rate hikes to come. The number of job openings remains well above the number of unemployed. Unit labor costs continue to expand more than targeted inflation. And while the unemployment rate rose three-tenths to 3.7% last month, the Fed still considers sub-4% unemployment as potentially inflationary. Chair Powell said this week that wage growth needs to moderate further, which is unlikely to happen until the unemployment rate moves substantially higher.

The problem with higher unemployment is that once it rises half of one percentage point from its cyclical low, it has always signaled recession. There are no exceptions. This means the Fed is likely to keep rates in restrictive territory until there is obvious labor loosening. But by the time that is apparent, the downturn will have begun.

The Level of Claims May be Low, But History Strongly Suggests the Change is What Matters



Source: Department of Labor, NBER, SMBC Nikko

Date	Claims at Recession Onset	% Change From Trough
Sep-52	207	23.2
Sep-54	235	15.2
Apr-59	294	20.5
Apr-66	221	23.5
Feb-73	255	14.9
Sep-78	413	27.5
Mar-81	438	7.4
Jan-89	367	26.6
Mar-00	388	42.6
Feb-06	380	30.1
Average >	320k	23%

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