

Employment Report: Fed on Pause?

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The Payroll Employment Survey for May showed a surprisingly weak 75,000 increase in new jobs. Job creation slowed over the past 3 months to an average of 125,000 jobs per month from 158,000 over the last twelve months. However, the household employment survey gives a different view of the jobs market with 288,000 jobs created. The household survey has averaged 240,000 jobs over the last three months up from a 200,000 job average over the last year. Strong household job growth helped to push the unemployment rate to a new cyclical low of 4.6% and is down 0.5% over the last year.

Other measures of the labor market indicate some moderation. The Average Workweek fell slightly from 33.9 to 33.8 hours. However, with the exception of April, weekly hours have been stable fluctuating between 33.6 and 33.8 hours for more than 3 years. The Index of Aggregate Hours Worked declined by 0.2% and slowed to a 1.5% annualized growth rate over the last three month from 2.3% over the last year. In addition, the April/May average growth in hours has fallen to 1.9% (annualized) above its Q1 level, which is well below its 3.0% gain in Q1. Furthermore, Hourly Earnings rose only 0.1% in May and 3.7% over the last year. Hourly earnings suggest wage inflation is not accelerating.

On balance, employment measures suggest labor market strength is moderat-

ing but remains very healthy. The question is, "will this be enough moderation to push the Fed to the sidelines?"

The employment report initially gave the stock market a boost suggesting growth was easing and raising the odds that the Fed would pause in June. The market then sold off on a report that Iran will continue their uranium enrichment program and are not interested in either the recent US proposal for multinational talks or the Group of Six incentive package. This seems like more saber rattling and an attempt to cut a better deal but is an uncertainty that financial markets will have to deal with until it is resolved.

Some analysts also suggested that the weaker employment report (which wasn't that weak) expressed concern that slower economic growth will weaken the profit outlook. We have heard this concern for four years and earnings continue to beat expectations and have grown at a double digit pace for eleven consecutive quarters. Earnings growth probably will slow as the economy moderates and earnings revisions are coming down. However, this lowers the earning hurdle and we expect earnings to continue to surprise to the upside. In addition, if inflation is contained as we expect, this is good for profits and positive for sustained economic growth.

The other risk cited by some analysts is that the Fed will now stop tightening

and get behind the inflation curve. The Fed has arguably been behind the inflation curve and should have tightened earlier but at current rates they have attained neutrality. The greater risk is that the Fed continues to chase inflation ghosts and pushes rates higher once again putting them behind the inflation curve but this time on the downside. It is not unusual for the Fed to tighten until something breaks but we believe like in 1995 and 1985 they will pull back before they push the economy over the edge.

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