Financial Markets This Week

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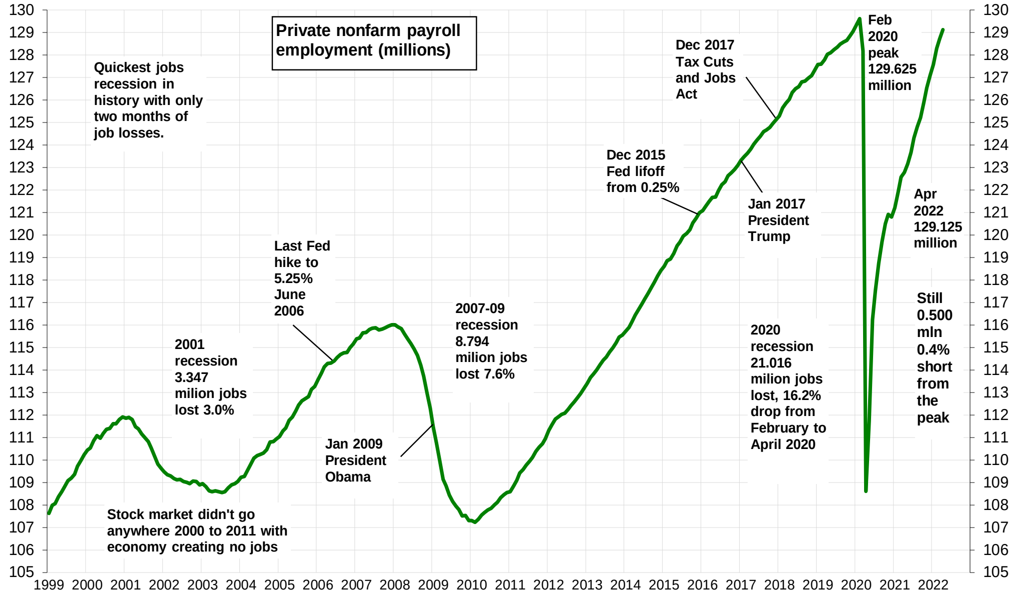
ECONOMY ISN'T SLOWING



Breaking economy news. The jobs report shows the economy hasn't stumbled yet with 428 thousand more jobs created in April and 39 thousand downward revisions to February/March. Unfortunately, this isn't what the doctor ordered for a red hot economy seeing the worst inflation outbreak in nearly 50 years. The unemployment rate stuck at 3.6% which is nearly at the 3.5% best economy in fifty years level before the pandemic. The markets and the nation's central bankers wanted a cool report and have to be disappointed they didn't get it. On the other hand, stocks crashed 3.6% yesterday so how low can they go. There were some labor force dropouts this month, rising 478 thousand to 99.513 million, but it can't be due to the fact that there are no jobs available after this month's latest record job openings data reported Tuesday. Wages or average hourly earnings were still high but only rose 0.3% in April to a 5.5% year-year rate from 5.6% year-year, the peak so far, in March. Working stiff wages, so-called production and nonsupervisory workers, saw a 0.4% increase, 6.4% year-year, to $27.12 this month, up from $24.03 in February 2020 as the pandemic hit.

Monthly changes (000s)	Apr	Mar	Feb	Jan	Dec
Payroll employment	428	428	714	504	588
Private jobs	406	424	704	492	561
Leisure/Hospitality jobs	78	100	124	138	186
HH Employment Survey*	-353	736	548	1199	651
Unemployment rate %	3.6	3.6	3.8	4.0	3.9
Not in labor force (mln)	99.513	99.035	99.333	99.516	99.842
... and Want A Job (mln)	5.859	5.737	5.355	5.704	5.713
Average hourly earnings	$31.85	$31.75	$31.60	$31.56	$31.38
MTM % Chg	0.3	0.5	0.1	0.6	0.5
YOY % Chg	5.5	5.6	5.2	5.4	4.9
* Household (telephone) Survey of employment behind unemployment rate					

Household employment weak: little else

The report cannot be music to the Federal Reserve's ears as the almost record low unemployment rate means wages are going even higher, shooting out more sparks to light inflation fires across the country which keeps Fed officials pumping the brakes. The market is in desperate need of seeing that the economy is slowing in response to the Fed taking away the punch bowl. Until the economy loses some forward momentum, meaning incredibly the Fed wants the unemployment rate to rise, the central bank will continue to jack up rates until it brings the economy, if not inflation under control.

Net, net, the labor market has returned nearly to where it was before the pandemic, but it turned out to be a pyrrhic victory as full employment and labor shortages have opened up a virtual Pandora's box of the most dangerous inflation outbreak seen since the 70s. It will be a miracle if the violent upward thrust in bond market yields from the Fed's sudden move to tighten monetary policy this year doesn't bring the economy back down into the depths of recession where job gains turn swiftly to job losses.

Payroll jobs fall from February 2020 peak as recession began

Data in thousands	Apr 22	Mar 22	Feb 22	26 months Feb 20 Apr 22	Apr 22	Feb 2020
Nonfarm Payroll Employment	428	428	714	-1,190	151,314	152,504
Total Private (ex-Govt)	406	424	704	-500	129,125	129,625
Goods-producing	66	67	114	-125	20,970	21,095
Mining	9	4	9	-71	567	639
Manufacturing	55	43	50	-56	12,729	12,785
Motor Vehicles & parts	6	4	-14	-8	981	988
Construction	2	20	54	4	7,628	7,624
Private Service-providing	340	357	590	-375	108,155	108,530
Trade, transportation, utilities	104	59	211	893	28,725	27,832
Retail stores	29	25	111	284	15,882	15,598
General Merchandise	12	3	56	298	3,298	3,000
Food & Beverage stores	24	13	22	128	3,184	3,056
Transportation/warehousing	52	10	74	674	6,468	5,795
Truck transport	13	-6	11	49	1,564	1,515
Air transportation	4	10	6	26	542	516
Couriers/messengers	15	1	11	259	1,133	875
Warehousing and storage	17	9	26	467	1,786	1,319
Utilities	0	0	0	-8	539	547
Information	12	21	0	48	2,951	2,903
Financial	35	12	29	71	8,941	8,870
Insurance	20	-2	6	-20	2,833	2,853
Real Estate	8	10	15	-16	2,348	2,364
Commercial Banking	-1	0	0	-56	1,342	1,399
Securities/investments	5	5	3	54	1,019	965
Professional/business	41	94	87	738	22,131	21,393
Temp help services	2	1	28	231	3,137	2,906
Management of companies	-1	1	9	-58	2,364	2,423
Architectural/engineering	4	6	4	65	1,613	1,547
Computer systems/services	4	20	5	182	2,409	2,227
Legal services	5	-1	-1	15	1,178	1,163
Accounting/bookkeeping	5	13	-1	52	1,082	1,030
Education and health	59	57	101	-409	24,189	24,598
Hospitals	5	5	7	-93	5,143	5,236
Educational services	18	12	10	-32	3,771	3,803
Leisure and hospitality	78	100	124	-1,438	15,545	16,983
Hotel/motels	22	23	24	-404	1,716	2,119
Eating & drinking places	44	59	79	-794	11,567	12,361
Government	22	4	10	-690	22,189	22,879
Federal ex-Post Office	-5	-1	-2	0	2,261	2,261
State government	7	-12	-7	-103	5,207	5,310
State Govt Education	-2	-10	-6	-33	2,572	2,606
Local government	21	18	18	-596	14,112	14,708
Local Govt Education	17	16	12	-317	7,747	8,064

If the Federal Reserve ever gets the chance to do a post-mortem once this is all over, they need to examine if their policies are too interventionist giving the economy too much gas with zero interest rates and money printing and then suddenly slamming on the breaks and so creating more problems than it solves. The pandemic brought job losses, then everyone found work and inflation took hold, and now we have come full circle to where Fed officials want to see job losses again. The Fed's oversteering and micromanagement of the macro economy may be doing more harm than good in the long run. Set interest rates back at 3%, make banks pay 3% on depositors risk-free savings, and then step back and do nothing. Let the economy manage the ups and downs of the business cycle naturally all on its own.

Unemployment at rock bottom lows means the Fed has a long, long way to go. Policy was going to return interest rates to 2.5% neutral, but now rates need to go to 3.5% at a minimum. There's tons more inflation than there was during the housing bubble in 2006, could the Fed return rates back to the 5.25% peak in 2006? Stay tuned. Story developing. Watch here while the stock market churns.

FEDERAL RESERVE POLICY

***This was written real-time before Powell's 2:30pm ET press conference where he said 50 bps rate hikes were on the table for the June and July meetings, and at the same time saying QT of $60 billion/month or $720 billion/year is worth just one 25 bps rate hike of tightening. The market is discounting those two 50 bps rate hikes and the yield difference between the August and October Fed funds futures discounts a 41 bps rate hike at the September 20-21 meeting.

The Fed met on May 3-4, 2022 to consider its monetary policy. 50 bps rate hike to 1.0%. That's it. Federal Reserve the dragon slayer of inflation they are not. This isn't the Volcker Fed. What does 1.0% do to keep inflation down? Anyone, anyone? What a dud. 50 bps. The market gave them 150 bps of rate hikes over the course of the next three meetings. Nothing. 50 bps.

Whatever more hawkish moves the Committee had contemplated for today, the stock market rout the last week may have led them to a more measured, gradual pace of rate hikes. The trick is to tighten financial conditions, but not be too aggressive with too many rate hikes that precipitate a disorderly market meltdown that destroys business and consumer confidence. Public polling is showing inflation is the biggest worry right now, let's hope the Fed doesn't move rates up too quickly and shift the public's worry back to whether they can get a job. Kidding. 50 bps today is not moving too quickly.

They floored monetary policy in the first days of the pandemic, cutting rates twice in March 2020 by a total of 150 bps in between regularly scheduled meetings no less. By going only 50 bps today, inflation seems to be getting short shrift with Powell's dramatic actions of 2020, bending over backwards, to get the labor market back to where it was before the pandemic.

We wish the Fed luck in getting the inflation genie back in its bottle because unless interest rates rise above the rate of inflation, the real cost of borrowing is still free. It pays for corporations to borrow. Monetary theory suggests interest rates need to be higher than inflation and the million dollar question is where will inflation come down to after peaking in coming months. Core PCE inflation is 5.2% and if it comes down to 3.5 to 4.0%, does that mean the Fed funds rate needs to go to 4 to 5%. Interest rates at that level would be a disaster for the markets if not the economy. The S&P sell-off this year has been 15.7%, where in order to discount a recession, stocks need to sell off at least 20%.

No one knows if the Fed had acted more quickly to quit doling out free money whether inflation would have soared as much as it was going to do or not. Inflation is up all over the world so much of the inflation we are seeing in the U.S. may have more to do with forces that cannot be controlled by just trying to slow U.S. growth with interest rate hikes.

We do know that the Federal Reserve under past management believed the Fed funds rate needed to be normal when the labor market returns to normal. This means the Fed funds rate should be 2.5% neutral today, or at least today coming into today's meeting and instead it was 0.50%. The Fed funds rate should be 2.5% and the Fed raised rates 50 bps to 1.0% today. The Fed is still behind the curve. It's hard to thread the needle and get it exactly right, but today's action erred on the side of caution while inflation is robbing seniors and those with savings in the bank blind.

OTHER ECONOMIC NEWS

ISM manufacturing executives remain upbeat for now (Monday)

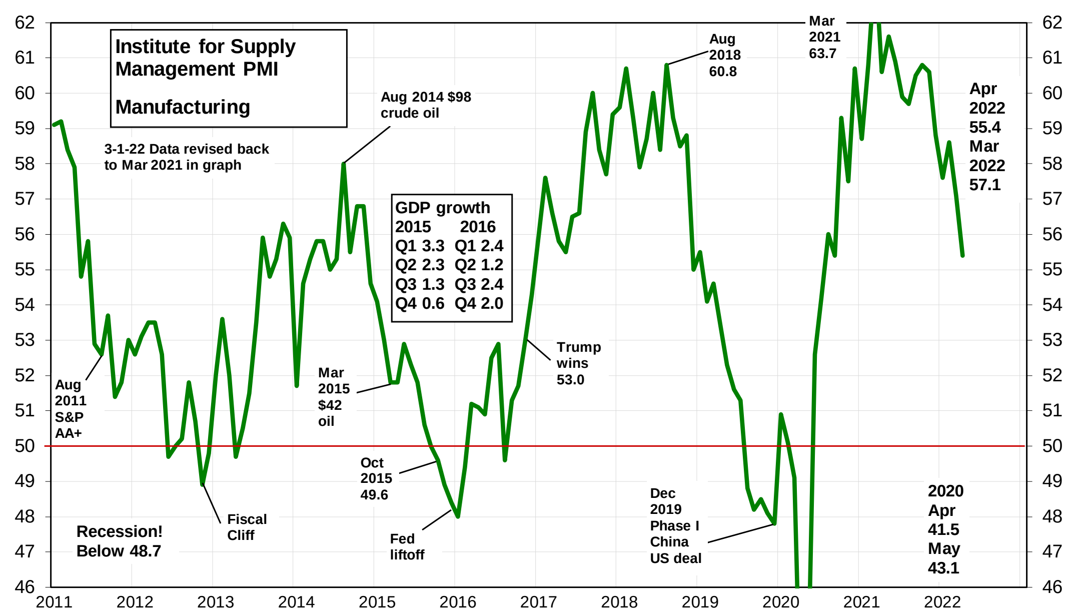
Breaking economy news. The ISM manufacturing index fell in April, but purchasing managers are not raising the alarm yet. Factory executives remain confident precisely because demand for their products remains robust, the only fly in the ointment being supply chain issues where the lack of key components is making it harder to get finished products out the door. Every industry is seeing growth in April except for Petroleum & Coal Products. Machinery, Computers, Food/Beverage, Transportation Equipment, and Chemicals are seeing moderate to strong demand.

The overall index fell 1.7 percentage points to 55.4 in April. Employment dropped sharply by 5.4 percentage points to 50.9 in April which may have implications for Friday's all-important payroll jobs report. Finally, some more good news that inflation is nearing the peak with the Prices component of the index falling 2.5 percentage points to 84.6… keeping in mind 84.6 is sky-high which may indicate a peak in consumer inflation at 6 or 7 percent, but it does not mean it is going to fall all the way back to the Fed's 2.0% target very quickly. Interest rates will remain high if inflation is and that may mean a more aggressive Federal Reserve where market fears ahead of Wednesday's announcement is sending 10-year Treasury yields almost to the 3.0% level this morning.

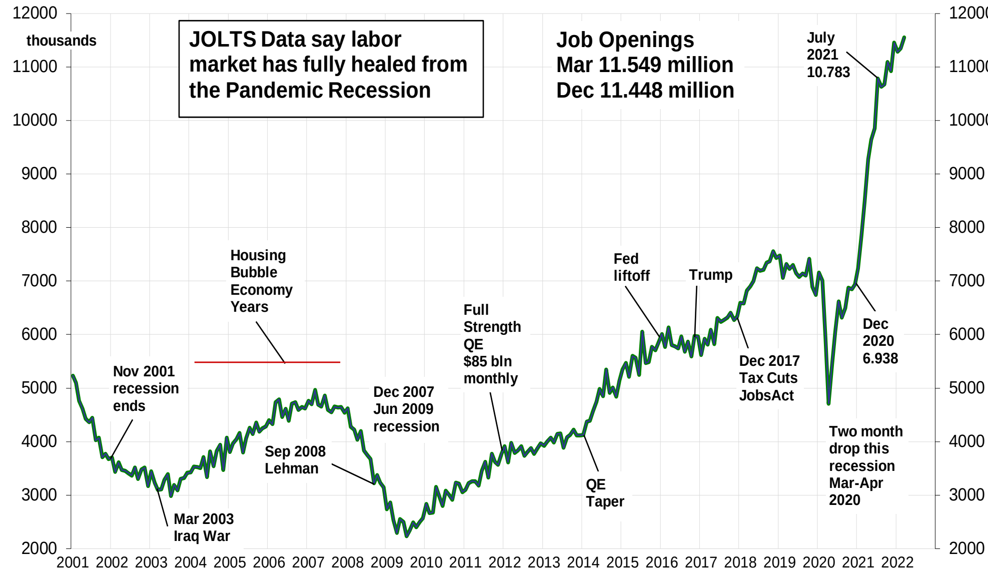
ISM manufacturing index

	Apr 22	Mar 22	Feb 22	Jan 22
PMI index	55.4	57.1	58.6	57.6
Prices	84.6	87.1	75.6	76.1
Production	53.6	54.5	58.5	57.8
New orders	53.5	53.8	61.7	57.9
Supplier deliveries	67.2	65.4	66.1	64.6
Employment	50.9	56.3	52.9	54.5
Export orders	52.7	53.2	57.1	53.7

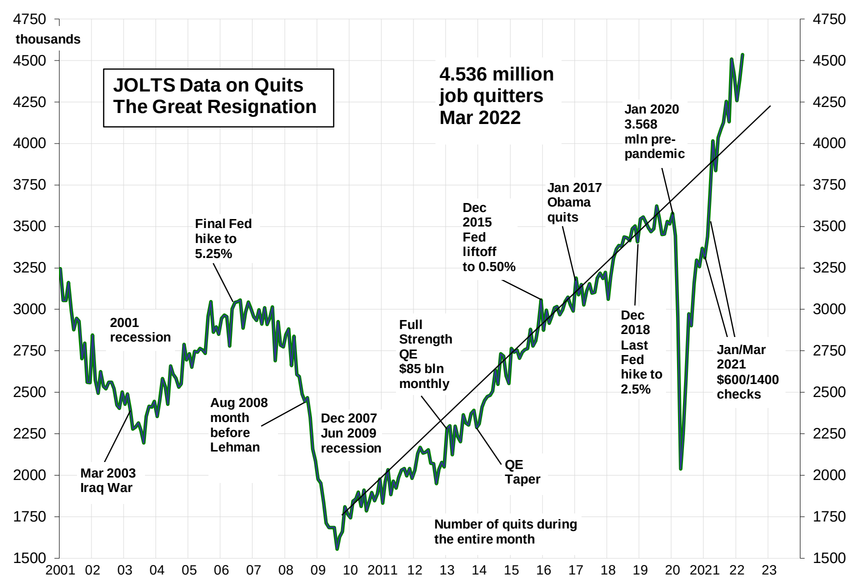
Net, net, manufacturing continues to move ahead albeit at a slower pace as component shortages and logistical problems continue to dog production. The Fed's industrial production index just made a new all-time high in March so purchasing managers remain sanguine in April about the economy's potential. The million dollar question is how long industry executives remain steadfast in their belief in growth as the headwinds to the expansion are intensifying looking at supply chain disruptions in China, war in Europe and the Fed taking the punchbowl away trying to slow growth which policymakers view as the cure for out of control inflation.



Record job openings for quitters at the end of March (Tuesday)



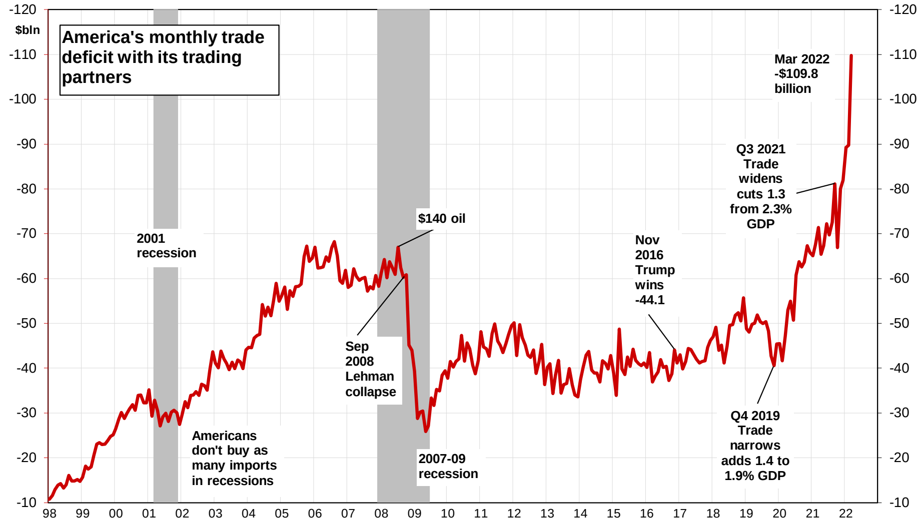
Breaking economy news. Job openings are at a new high for this recovery from the pandemic recession of 2020: 11.549 million jobs at the end of March eclipsing the old record of 11.448 million in December. Can the U.S. enter a recession if there is this much demand for workers? How can there be job losses and layoffs if companies need so much help? We are in uncharted waters and there is limited data on job openings going back a couple of decades only. Job openings were falling slightly before the December 2007 to June 2009 recession. Job openings were falling in 2019 before the sudden 2020 recession. It's different this time because of the huge jump from 6.938 million job openings at the end of December 2020 to 10.783 million in July 2021 a mere seven months later. It can't be because of those Economic Impact Payment checks, $600 in January and $1400 in March last year can it? Hard to explain. Hard to know what should happen to this series if there is indeed a recession coming. For today, with job openings at record highs there is no recession on the horizon certainly.



Meanwhile, the sheer number of jobs (we hope the government is counting them correctly) is emboldening Millennials to quit. Actually, we don't know who is quitting their jobs but someone is. In March 2022, a new record 4.536 million quit their jobs. The old record was 4.510 quitters in November 2021. Unlike job openings, the level of quitters has been on the same upward trend since the end of the Great Recession in June 2009 even if it makes for a good story about how people are changing their lives post-pandemic.

The bottom line is the labor market is tight as a drum sending wages higher and higher with no relief for inflation in sight. It will cost nothing to borrow in real terms for years if the Fed doesn't get interest rates higher than inflation. Bet on it.

Record red-ink for trade deficit (Wednesday)



Breaking economy news. When it comes to the economic laws of supply and demand, don't forget the trade deficit where the demand for goods coming into the country overwhelms the amount of goods being shipped out. Maybe the economy has a demand problem not a supply or shortage problem because there is no shortage of imported goods coming into the country by the boatload. If America is getting ripped off with its growing trade imbalance with the rest of the world, this month's data set a new all-time record. The March trade deficit was $109.8 billion (89.8 February) with imports of $351.5 billion up 27.0% the last year and exports of $241.7 billion up 17.7% from year ago levels.

This imports story isn't about a recovery from postponed purchases of overseas goods during the pandemic because imports are up 33.4% from March 2019 long before the lockdowns. Imports from China are $47.373 billion 17.8% higher than a year ago, warts and all, we mean tariffs and all.

There's exchange rate effects and nonfuel imports prices are up 7.5% the last year, but it is undeniable that the U.S. is more dependent than ever on foreign-made goods. The physical amount of goods coming into the country is setting new records as well, not just the dollar amount.

U.S. Imports of Goods from the Rest of the World

Millions of dollars	Mar 2022	Feb 2022	2022 YTD	2021 YTD
Total *	296,309	264,832	823,835	671,669
Foods, feeds, beverages	17,610	16,558	51,228	40,920
Industrial supplies, materials	76,377	65,054	203,066	139,372
Crude oil	16,813	15,624	46,130	25,458
Finished metal shapes	10,011	3,204	16,316	9,437
Capital Goods ex-autos	75,092	69,851	213,736	182,926
Computers	10,788	9,255	29,204	27,112
Computer accessories	7,515	6,189	20,362	15,693
Semiconductors	6,651	6,399	18,931	16,417
Electric apparatus	7,223	6,883	20,750	16,035
Telecom equipment	6,526	5,964	19,228	16,350
Medical equipment	4,894	4,594	14,189	14,404
Auto vehicles, parts, engines	32,824	29,649	95,000	90,369
Consumer goods	83,060	73,108	228,746	189,673
Pharma preparations	15,771	15,102	46,576	43,083
Cell phones	12,069	12,005	37,217	28,993
Toys, games, sporting goods	6,860	5,718	18,048	14,635
Furniture, household goods	5,722	4,420	14,249	11,875
Household appliances	4,499	3,941	12,464	10,726
Other goods	11,346	10,612	32,058	28,409
* Total Imports of goods on Census Basis				

Net, net, there may be tariffs, logistical-problems with shortages and delays, and higher shipping costs, but somehow billions and billions of dollars of goods are making it to American shores. The trend of globalization where goods and inputs to U.S. production are manufactured in factories offshore is not over yet, not by a long shot. Those arguing for an economic retreat from China may need to think it through more carefully. China and the U.S. are inextricably linked for now and bringing factories home will take decades not years. Globalization and the reliance on China's factories built up steadily over two decades and cannot be undone by simply snapping one's fingers. Don't ask what American company has operations or products made in China, they all do, every last one.

The rising tide of imports doesn't lift the economy's boats. It subtracts from real GDP, 2.4 percentage points in Q1 2022 and 2.2 percentage points in Q4 2021, but what the huge demand for imported goods does show is that America may have more of a demand problem than a supply problem. As long as import demand keeps setting records it shows the Federal Reserve has to keep pushing interest rates up and up because American consumers and businesses are not done buying yet and strong demand keeps the inflation fires burning. Bet on it.

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