Nationwide Economics

Weekly Economic Review & Outlook

January 9, 2023

Labor demand remains unbent by higher rates

The labor market continues to be incredibly resilient despite the Fed's efforts to dampen the strong demand for workers. Nonfarm payrolls beat expectations and the unemployment rate fell to a cycle low, while firms continue to list open positions at a rate unprecedented prior to the current cycle. Conversely, the ISM surveys for both manufacturing and services showed contraction in December — the first time both surveys have been simultaneously in contraction in over 13 years outside of the Covid lockdown period — with reduced price pressures across the business sector.

Data continue to depict an extremely tight labor market

The labor market remained very tight at the end of 2022 with continuing signs of large imbalances between labor supply and demand. Nonfarm payrolls increased by 223,000, extending the trend of gradually slower payroll gains since July 2022. That said, it was still a sturdy increase in employment, and the unemployment rate fell back to its cycle and pre-Covid low of 3.5 percent — which had matched the lowest level since 1969. The decline in the unemployment rate last month was even more impressive since it occurred as the labor force participation rate ticked higher.

The job openings and labor turnover survey (JOLTS) echoed the tightness seen in the employment report. Job openings were essentially unchanged at 10.5 million in November and, although down from the record high seen in March, remain at a historically high level. The quits rate also ticked up and is only a tad below its all-time high, suggesting that even with a possible recession looming later in the year, many workers are finding good opportunities and likely higher pay by switching employers.

Still, there were early signs of some easing in the taut labor market. The annual growth in average hourly earnings decelerated to 4.6 percent, its slowest since August 2021. However, it remains far faster than the pre-Covid pace of around 3 percent. The average hourly workweek fell again and is now only marginally above levels seen during the Covid recession. This could be a precursor to slower (and eventually negative) job growth as firms might be cutting back hours for current employees to delay job cuts. The latest labor market data is likely to keep the Fed on course to lift the federal funds rate above 5.0 percent this year, but the signs of some labor market softening could provide room to dial back rate hikes to 25 basis points per policy meeting.

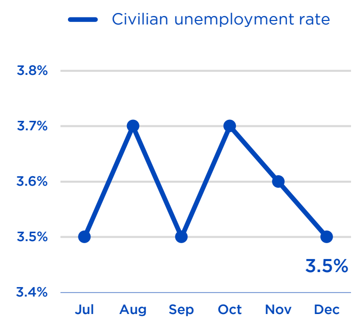
Both ISM surveys contracted in December

The ISM manufacturing index as anticipated fell further into contraction, registering a 48.4 reading, down from 49 in November. The new orders component of the manufacturing index (an important leading indicator for the overall index and the broader economy) is now deep in contraction territory having been below the 50 expansion-contraction mark for six of the past seven months. Following suit, the production index is also now in decline for the first time during this cycle.

Surprisingly, the ISM services index plunged from a solidly expansionary level of 56.5 in November to a contractionary reading of 49.6 in December. Outside of the Covid recession, it's the first time the services index has been in contraction since December 2009. In the details the business activity subindex remained in expansionary territory at 54.7, but it fell a steep 10 points from November, indicating significantly slower activity. The new orders index dipped well below the expansion/contraction line after experiencing its largest non-Covid one-month decline on record, falling 10.8 points to 45.2. The ISM surveys signal that businesses in the services sector are joining those in the manufacturing sector in cautiously cutting back on production heading into the new year as new orders slow and recession fears build.

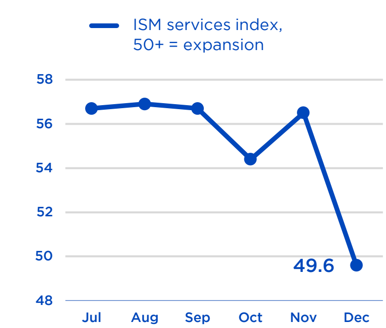
The silver lining is that the ISM reports showed continued progress on the inflation front. Supplier deliveries are back to normal for both sectors, while manufacturing prices paid index fell for the ninth straight month. Input prices for services continued to climb at a pace that is far higher than normal but posted the weakest reading since January 2021. The easing in these price measures are a contributor to slower consumer inflation. The December CPI report due this week should reveal continued gradual retreat in inflation, led by the goods sector. However, with the annual pace of headline CPI still running above 6 percent, much more progress is needed to get back towards the Fed's 2 percent target level.

Unemployment rate falls to cycle low



Despite the Fed's efforts to slow labor demand, the unemployment rate fell back to 3.5 percent in December.

Service sector plummets into contraction



The ISM services index fell sharply and is now in contraction. It is the first non-Covid contractionary reading since 2009.

Sources:
Bureau of Labor Statistics; Institute for Supply Management

Contributors: Daniel Vielhaber, Economist | Ashleigh Leonard, Economic Specialist

The Week Ahead

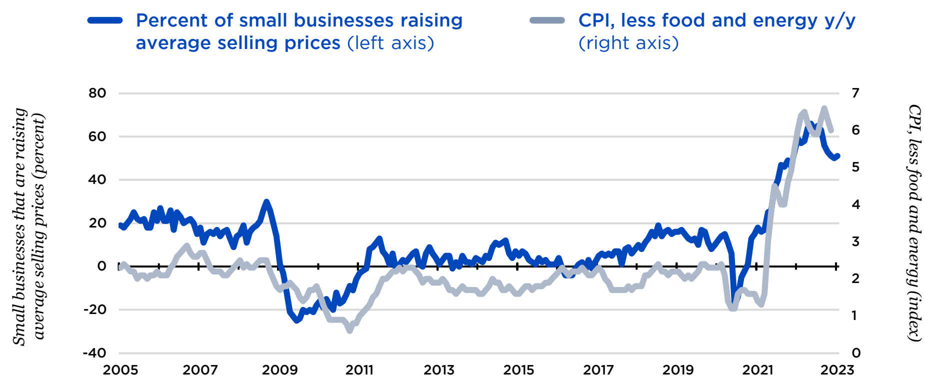
Here's what we are watching this week:

CPI & CPI less Food and Energy

Jan 12

CPI expected to continue cooling

The CPI report is the key indicator for the week given that inflation determines the course for Fed monetary policy. We look for a 0.1 percent decline in headline CPI and a moderate 0.3 percent advance in core CPI (excludes food and energy) in December. The 12.5 percent drop in gasoline prices on the month helps lower the headline reading, more than offsetting a moderating but still buoyant increase in food prices of around 0.5 percent. On a year-on-year basis, overall CPI should decelerate to 6.4 percent from 7.1 percent in November and the core CPI pace should slow from 6.0 percent to 5.7 percent. These readings would be encouraging for the Fed, however, with the rate of inflation still substantially elevated, policymakers should still be inclined to lift the policy rate above 5.0 percent by May.



Note: The percent of businesses raising their selling prices (left) leads core CPI (right) by two months.

Sources: NFIB and Bureau of Labor Statistics

NFIB Small Business Optimism

Jan 10

NFIB survey to underscore growth concerns

The NFIB small business survey provides a variety of readings on key economic activities beyond the headline optimism index, which consensus expects to remain little changed at around 91.5 in December. The share of firms raising their average selling prices is a proxy for broad-based corporate pricing power (beyond small businesses) and tends to be a leading indicator for changes in core inflation. This price metric has been trending lower but remains quite high with slightly over half of the surveyed companies raising prices. How this measure fares has implication for the near-term course of inflation. Further, small companies have reported that inventory levels are too high, echoing the same sentiment captured in the ISM manufacturing and non-manufacturing surveys. As such, companies will pull back on new orders which in turn depresses production activity.

University of Michigan Consumer Sentiment Index

Jan 13

Consumer sentiment likely improves with receding inflation

The University of Michigan consumer sentiment index should continue to improve with the sharp 12.5 percent drop in gasoline prices in December and the moderating advance in overall prices. Keeping with that theme, consumers' expectations for inflation over the next year should continue to trend lower, extending the decline from the recent peak of 5.4 percent in April to 4.6 percent in December. The key inflation expectations for the next five years remained elevated at 2.9 percent in December — any movement in this measure will be important to watch.

Additional Economic Indicators

Previous Week's Indicators

	Period	Actual	Previous
Construction Spending MoM	November	0.20%	-0.30%
ISM Manufacturing	Week ending December 30	48.4	49.0
Wards Total Vehicle Sales	December	13.31m	14.14m
Trade Balance	November	-$61.5b	-$78.2b
Change in Nonfarm Payrolls	December	223k	263k
Unemployment Rate	December	3.5%	3.70%
Average Hourly Earnings MoM	December	0.30%	0.60%
Average Weekly Hours All Employees	December	34.3	34.4
ISM Services Index	December	49.6	56.5
Factory Orders	November	-1.8%	1.0%

This Week's Indicators

	Release Date	Period	Forecast*	Previous
Consumer Credit	Monday	November	$26b	$27b
CPI MoM	Thursday	December	-0.10%	0.10%
CPI Ex Food and Energy MoM	Thursday	December	0.30%	0.20%
Initial Jobless Claims	Thursday	Week ending January 7	215,000	204,000
Monthly Budget Statement	Thursday	December	$-60b	-$248.5b
Import Price Index MoM	Friday	December	-0.80%	-0.60%
U. of Mich. Sentiment	Friday	January	60	59.7

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