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Comments on Current Economic Indicators & Events—United States

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"Superstrong" Labor Market Spells Full Employment and "Green Light" for "Front-Loaded" Fed Tightening

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The March Labor Market was *Superstrong in all dimensions*—1) increased Jobs (431,000) and Persons Working (736,000); 2) a new Expansion low for the Unemployment Rate (3.6%); 3) Wage Compensation (Avg. Hrly. Earnings, 0.4%) at a new high 5.6% YoY; and 4) an easing and increasing Labor Supply; 418,000 rise in the Labor Force; increase in the Labor Force Participation Rate (LFPR) to 62.4 from 62.3 and increase in the Employment/Population ratio to 60.2 from 59.9.

The *Jobs increases were quite widespread*, not just in Restaurants and Leisure and Hospitality, like previously, but pretty much across-the-board in virtually all private sector categories. The drop in the Unemployment Rate (to 3.6% from 3.8%) came from big increases in both Demand (Hh. Survey, Persons Working, 736,000) and Supply (Hh. Survey, Labor Force up 418,000). Labor Supply has loosened with more-and-more persons entering, looking for and finding work. Earnings are rising nicely.

Jobs and the Unemployment Rate have been showing huge gains for some time. Wage inflation and Nominal Disposable Income have risen strongly, although weak in "real" or inflation-adjusted terms. Strong savings is offsetting this.

The March Labor Market Report caps a string of "Wow" readings on the labor market that signal *the strongest demand-driven fully employed U.S. economy since the 1980s and 1960s*.

Economy Implications—Strong Jobs, Strong Economy, Looks Like Full Employment

Off the March Labor Market data, ongoing track for Q1 Real GDP, recent and coming forecasted data, the Decision Economics, Inc. (DE) forecast of Q1 Real GDP remains at a 3%-to-5% annual rate and the Basic Prospect "Boomy Expansion" forecast still with a high 65% Probability. Alternative Macro Risk Scenarios include Stagflation (10% Odds), "Boom-Recession" (10% Odds) and Consensus and Federal Reserve forecasts, Odds 15%.

The "Boomy Expansion" indicates continuing mid- to-high single-digit inflation in all measures, decelerating beginning about midyear and beyond, but still far, far above the Federal Reserve average 2% Price Stability target. The Unemployment Rate is expected to bottom-out just above 3% by Q4, significantly overshooting Full Employment.

This Boomy Expansion prospect, too high inflation, and the achievement of more than full employment reflect a demand-driven business cycle upswing which, in retrospect,

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probably did not need so much stimulus as was provided by the Federal Reserve and Washington fiscal policy stimulus in the wake of the COVID-19 External Shock.

Fed Policy Tightening—Funds Rate and Quantitative Tightening (QT)—Direction "Front-Loading"

On the continuing "Boomy" Economy, "Red-Hot" Inflation, and "Superstrong" Labor Market, the Federal Reserve is moving rapidly to pivot monetary policy from Accommodation, now gone for the duration of this upcycle, to Tightening.

Two policy instruments will be used, the federal funds rate and Quantitative Tightening (QT). How, by how much, when, and the pace are questions on the federal funds rate and QT yet to be determined so remain uncertain, a market impediment because of the range of uncertainties with Chair Powell having indicated that he and his colleagues will "follow the data" and make decisions and recalibrate each Meeting. Although Chair Powell transparency and some Member messages have narrowed the range of options, they are still pretty wide until perhaps the FOMC Minutes on the March Meeting, to be released this Wednesday.

A lot of volatility is thus indicated, especially in short duration fixed income.

Clear and noted by Chair Powell and increasingly other Fed Members—

1) Price inflation Public Enemy #1; Price Stability chief among equals in the Dual Objective of Price Stability and Full Employment;
2) No significant concern about the economy given so much strength;
3) A labor market that can withstand Fed Tightening on the federal funds rate possibilities currently envisioned;
4) Not sure on Russia/Ukraine War Shock yet though a Stagflation risk.

On the economy, inflation, labor market data, comments by Chair Powell and other Members of the Federal Reserve, the quick pivot toward Tightening and away from Accommodation, still no peak yet to be seen for inflation, and the Russia/Ukraine War External Shock, the *DE forecasts on Fed policy, interest rates, and QT have moved toward more Tightening, sooner, more "Front-Loaded" than previously.*

For the federal funds rate—

- A 50 bp increase on May 4;
- 50 bp in the June 14-15 Meeting—60/40 odds;
- 25 bps subsequently at the July 26-27, September 20-21 and November 1-2 Meetings;
- Federal funds rate increases totaling another 175 bps that will take the funds rate to approximately 2% at yearend.

For QT—

- $100 Billion per month reductions in the Federal Reserve balance sheet through 2024 using mostly longer duration U.S. Treasuries;

- $300 Billion per quarter or $1.2 Trillion per year—some $3.6 Trillion through 2024 taking the balance sheet down to about $5.5 Trillion;
- "Open-ended" the QT process until achieving and maintaining the Dual Objective, particularly Price Stability—no specific calendar date nor balance sheet level as an objective;
- Multiyear reductions in the Federal Reserve balance sheet through 2024, given a Federal Reserve expectation that price inflation will remain above the average 2% target.

These are provisional forecasts subject to changes in actual data, implications for the forecast, reactions in markets and the economy to Fed actions and the actual laying-out of policy guidance.

Financial Markets—Interest Rates Rising and Equities (Correction in Longer-Run Uptrend)

On the current DE Basic Prospect forecast, assumptions on Fed policy vis-à-vis the federal funds rate and QT, and a winding-down of the inflation and economic impacts of the Russia/Ukraine War External Shock, *DE projections remain rising interest rates, on average a "Bear" Fixed Income Market and longer-run a continuing Equity Bull Market, although currently still within a Correction range*.

The federal funds rate yearend projection is near 2% and 10-Year U.S. Treasury yield now at 3-1/8%, increases from previously but still below the levels consistent with expectations. The "Terminal" federal funds rate circa 2024 is in the 3-1/2% to 4% range.