THE ECONOMIC OUTLOOK GROUP

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ECONOMIC TALKING POINTS

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"Great employment news could be awful news for the economy." Welcome to the Twilight Zone!

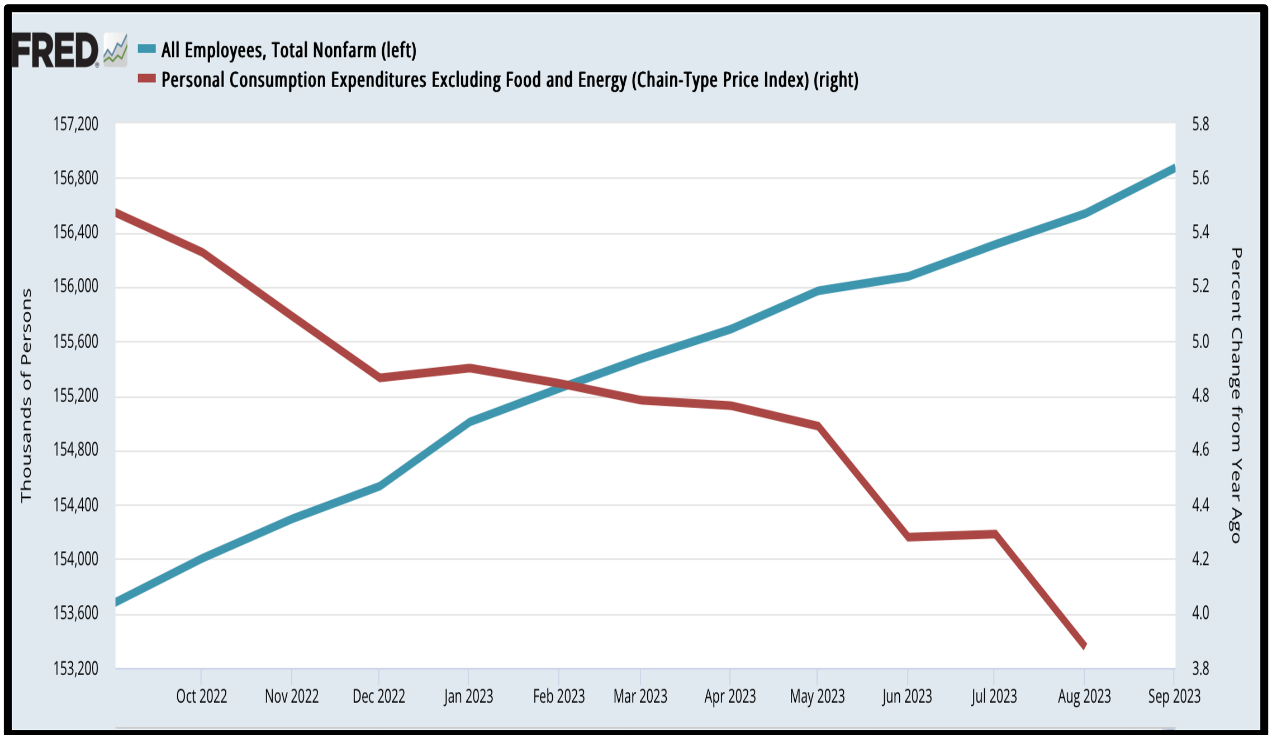
The 336,000 surge in nonfarm payrolls for September was a stunner. No question. It was a figure twice as high as analysts predicted and the biggest one-month leap since last January.

As expected, this blow-out number caused a massive sell-off in bonds, driving 10-year Treasury yields within reach of 5% --- and that is troubling. The higher yields go from this point on, the tighter the noose gets around the economy. If that's not enough to ponder, speculation is building that the Fed will now be more inclined to increase rates again in early November, and then keep rates higher for longer.

But before everyone gets caried away by the notion that a strong jobs report means the economy is still overheating, let's take a step back and view this labor market from a different perspective, one that I believe is more relevant.

Yes, the US economy certainly did add a massive number of new jobs last month, one that was above the average monthly gain of 267,000 over the prior 12 months! Moreover, the BLS revised up payroll numbers for July (+79,000 to 236,000) and August (+40,000 to 227,000). And yes, even in the midst of this powerful hiring drive, the number of job vacancies in August still swelled to 9.6 million, the most since last May!

At the same time, August's annual core PCE inflation, the Fed's favorite inflation metric, slipped to 3.9%, the smallest such increase since May 2021. And in this September employment report, we see wage inflation continuing to ease as well. Average hourly earnings rose just 4.2% over the past 12 months, the lowest pay increase since June 2021.



Those two simultaneous trends --- growing employment and declining inflation --- are the real story here. Bu that is the message I fear is getting lost from this report.

So what lesson is to be learned here?

First, one should be encouraged to see companies continue to add workers and keep the unemployment rate a low 3.8%. Despite widespread talk of economic doom and gloom and recession among pundits, the fact remains corporate recruiters are on the front lines and see an economy that is healthy enough to justify more hiring. This is reinforced every week by the remarkably low number of layoffs.

Second, we need to get rid of this conceptional relic that the only way to get inflation down toward the Fed's 2% target is to harm the job market. That may have been the case in the 1960s and 1970s, but not in today's hi-tech economy. Simply put, we have to end our reliance on pre-pandemic economic

models where sustained periods of low unemployment invites high inflation, or that an inverted yield curve decrees a recession as inevitable.

It is true that adding to the downward pressure on inflation these days is China's depressed economy and Europe's recession, and we will obviously have to revisit the inflation outlook once those two regions come back on line. But we should be in a benign inflationary environment at least thru 2024.

Third, the only threat that could crack this resilient economy now is if bond investors fear the Fed will lean toward further monetary tightening simply because of the exceptionally strong job numbers. One could, and should, argue that robust employment and declining inflation is precisely what a goldilocks economy looks like. Instead of fearing it, market investors and the Fed ought to sit back and embrace it. As more Americans have jobs, they have more resources to save, spend and contribute to tax revenues. A larger workforce also increases the supply of goods and services produced which should also dampen inflation pressures.

What should we be on the lookout now?

Clearly there is a point where interest rates become so excessively high it can choke off economic activity, so we'll focus on three key economic red zones that spell trouble ahead.

1. Given the record high level of debt in the private sector, a 10-year yield that exceeds 5% for more than a quarter could shut down business and consumer spending.

2. A real (inflation adjusted) fed funds rate that lingers above 2% for six months would be enough to bring this business cycle to an end.

3. We know companies have fought tooth and nail to find and retain workers. But if layoffs were to climb and consistently surpass 350,000 a week, it would be an ominous sign that businesses have finally capitulated and are instead forced to focus on protecting profit margins.

It would truly be a shame if any of these materialized.

(Latest forecast below)

United States

	I 2022	II 2022	III 2022	IV 2022	I 2023	II 2023	III 2023	IV 2023	I 2024	II 2024	III 2024	IV 2024	I 2025	II 2025	III 2025	IV 2025
Real Gross Domestic Product (GDP):																
%	-2.0	-0.6	2.7	2.6	2.2	2.1	3.2	1.9	0.9	1.6	2.2	2.9	1.7	2.5	3.0	2.6
Personal Consumption Expenditures:																
PCE %	0.0	2.0	1.6	1.2	3.8	0.8	3.7	2.0	1.0	1.9	2.7	2.6	1.7	2.8	3.1	2.9
Inflation, end of period, year-over-year:																
CPI %	8.5	9.1	8.2	6.5	5.0	3.0	3.5	3.1	2.8	2.6	2.5	2.8	2.6	2.7	2.8	2.8
Unemployment Rate (end of period):																
%	3.6	3.6	3.5	3.5	3.5	3.6	3.8	4.1	4.3	4.0	3.8	3.8	3.7	3.7	3.5	3.5
Non-farm Payrolls, monthly avg. thousand:																
	561	329	423	291	297	201	266	170	145	175	185	200	200	210	215	225
Treasury 10-yr Note Yield % (end of period):																
	2.32	2.97	3.80	3.83	3.47	3.82	4.57	4.20	3.75	3.70	3.60	3.65	3.70	3.75	3.80	3.80
Federal funds rate % (end of period):																
	0.38	1.63	3.13	4.38	4.88	5.13	5.38	5.38	5.38	5.38	4.88	4.38	3.88	3.63	3.13	3.38

GDP Growth - Global Economy - Year over Year

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
US	2.6	1.6	2.2	1.8	2.3	2.7	1.7	2.2	2.9	2.3	-2.8	5.9	2.1	2.2	1.8	2.5
Eurozone	1.7	1.4	-0.9	-0.2	1.4	2.1	1.9	2.5	1.8	1.6	-6.2	5.3	3.5	0.8	1.3	1.7
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.7	1.7	-9.3	7.6	4.1	0.3	1.0	1.3
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	0.5	1.7	0.6	-0.2	-4.6	1.7	1.0	2.0	0.9	1.6
Canada	3.1	3.1	1.8	2.3	2.9	0.7	1.0	3.2	2.8	1.9	-5.1	5.0	3.4	1.5	1.3	1.8
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.4	3.8	-6.6	8.7	6.7	6.4	6.2	6.6
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.7	6.0	2.2	8.1	3.0	4.8	4.6	5.1
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	1.7	-3.6	5.3	3.0	3.1	2.2	3.1
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.2	-0.2	-8.2	4.9	3.0	3.3	2.2	2.7
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	1.8	-1.1	4.7	3.7	1.7	1.5	2.6
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.8	2.2	-2.7	5.6	-2.1	1.5	1.2	2.2
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.6	--3.1	6.0	3.1	2.3	2.0	2.9