The Good News

Historic Job Recovery Continues

The US economy as measured by Gross Domestic Product regained its pre-pandemic size last spring.

More about that later.

The Labor market continued its historic recovery from the depths of the Covid Recession.

- **The economy added 428,000 jobs in April,**
- **Employers have added at least 400,000 jobs to their payrolls for 12 consecutive months, a record going back to 1939**

- **Unemployment remained at 3.6%**
- **Near the lowest in 50 years**

- **Employers posted 11.5 million openings this spring, the highest in records dating to 2000.**
- **In March there were just under 6 million unemployed people seeking work**

- ***5.5 million more jobs than unemployed people***

Unemployment Claims

Filings for unemployment benefits have remained near historic lows since late 2021.

- **The 4 week average reached 170,500 last month, its lowest point dating back to 1967.**
- **Continuing claims declined to 1.4 million**
- **the lowest level since January 1970.**

Job openings were at record levels in March

- **There were nearly 2 job openings for every unemployed person that month.**

The broad-based gains suggest underlying demand in the economy—consumer & business spending—remained solid.

Slightly Good News on Inflation

- **Consumer prices were up 0.3% in March from a month earlier.**
- **That is the smallest monthly rise in the last 6 months –**
- **just a quarter of the 1.2% increase in March. (Independent)**

Core price inflation which excludes volatile food and energy prices (a gauge of underlying inflation trends) also dropped to 6.2% from 6.5% in April.
The decline suggests that the trend for inflation is downward.
Investor expectations for inflation over the next 5 years was at 3.01% Wednesday, May 11.

There are 3 main drivers of inflation, wages, oil prices and housing. These are not the only factors, continuing supply chain issues and rising commodity prices generally which have been exacerbated by the war in Ukraine also contribute but wages, oil and housing are the major factors. We've addressed these in detail separately but here is an update.

Wage Growth Slows

Wage growth would be good under most circumstances but with inflation running near 8%, workers are actually falling further behind so it is in the best interest of workers as well as consumers to get inflation under control.
Wage growth is one of the 3 biggest contributors to inflation.
The most recent monthly numbers offer some hope

- **Average hourly pay grew 0.3% in April, the slowest in all but 1 of the past 8 months**
- **5.5% over the past year**
- **That's slightly slower than in March, 5.6%.**

"That may be starting to suggest that the incremental pressure on wages, month to month, might be starting to ease a little bit." Brian Coulton, chief economist Fitch Ratings

"It suggests that labor costs are not likely to aggravate inflation pressures in the near term,

which are being largely driven by supply-chain problems & higher energy & food costs due to the war in Ukraine, Mr. Coulton said. WSJ

Oil

Oil prices are another of the biggest inflation factors. Unfortunately, oil prices are largely being driven by the war in Ukraine.
"Brent crude, the global oil benchmark, rose 4.9% this week extending a recent run of gains driven by expectations that the EU was set to ban imports of Russia's oil in response to its invasion of Ukraine."
WSJ 5/7/2022
The good news is that oil prices are down from their recent highs on March 8, $127.98 after the Russian invasion though still up from $80 before Russia's invasion of Ukraine.
Russia is the 3rd largest oil producer in the world.

While this recent rise in oil prices hurts at the pump, it is good news that the EU is set to ban imports of Russian oil putting more economic pressure on Russia

The 3 biggest oil producers are the US, Saudi Arabia & Russia.

It is important to remember that Saudi Arabia who could ratchet up oil production in weeks continues to refuse to do so because of an agreement they made last year with Russia (OPEC+) to control oil prices.

And US shale producers have intentionally decided to limit production in favor of short term profits.

US Shale Producers Choose Profits Over Production

"Oil prices are at their highest in years and politicians want companies to pump more. But most large American frackers are standing pat, or even letting production decline, and instead are handing investors cash."

The shale industry is reporting higher profits but aren't investing in more production & some have let production slip ***"as they focus on paying investors."***

- **9 of the largest shelled out $9.4 billion to shareholders in the 1st quarter**
- **54% more than they invested in new oil development**

"Even as Biden administration officials urged shale executives to pump more to help ease high gasoline prices,
most reporting earnings this past week said they wouldn't alter spending plans in pursuit of growth, touting…

'We are not adding any growth capital due to higher prices. We are staying disciplined.'"
Marathon Chief Executive Lee Tillman

- **Marathon's stock price jumped about 67%**
- **its first-quarter production was down about 8% from the prior 3 month period.**
- **Pioneer's output was down about 2%,**
- **Devon Energy reported drops in their oil output, down between 2% to 8%.**

"Historically, this industry has reacted to the commodity price. Now, they're sitting on their hands."
Arun Jayaram, analyst JPMorgan Chase

"We're not doing what we've done before, which is getting really good at oversupplying the market and essentially crashing prices." Clay Gaspar, Devon's chief operating officer

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"Investors have rewarded companies that have taken a steadier approach on spending, and most have."

- **The S& P 500 energy sector is up about 45% this year**
- **the broader S&P 500 index has dropped about 14%.** WSJ 5/9/2022

WHIPLASH

If you don't already have your seat belt buckled, buckle up. It's already getting bumpy out there & it's likely to get worse.

The Federal Reserve cut interest rates to zero in early 2020 as Covid created a recession that sent unemployment to a post-Depression high of 14.7%.
But after President Biden was elected and additional stimulus was authorized by Congress:

- **the economy grew 6.3% in the first quarter. The Fed kept its foot on the gas pedal.**
- **The economy grew 6.7% in the 2nd quarter of 2021. The Fed kept its foot on the gas pedal.**
- **The economy grew 5.7% in 2021 & the Fed never eased up on the gas.**

In addition to keeping interest rates at 0%, the Fed was buying over $120 Billion in Treasury bonds every month in 2021 to keep interest rates down.

- **They doubled their balance sheet to over $9 Trillion. That's Trillion with a T!**

To offer perspective,

- **$9 Trillion is 40% of the size of the entire US economy.**

The economy was clearly recovering as far back as the 4th quarter of 2020.

The Federal Reserve created the inflation mess.
No less a source than the Wall Street Journal acknowledged as much:

The first reality to confront is that this is a mess largely of the Fed's own making.
Its historic exertions were needed in the emergency.
But it kept them in place for too long, even as the money supply exploded and clear signs of inflation began to appear. WSJ EDITORIAL 3/15/2022

Most economists and former Federal Reserve Governors agree.

Stopping QE (buying Treasury bonds &forcing interest rates down) altogether—even a few quarters ago—would have kept a lid on inflation . . .

. . . evidence that Chairman Jerome Powell and the Federal Reserve have made <u>a historic mistake.’</u>

Inflation surged last spring,
Yet Fed officials felt compelled to hold rates at zero and continue adding to their bond portfolio . . . “

Kevin Warsh

More recently:
“Christopher Thornberg, founding partner at Beacon Economics in Los Angeles, said policy makers are racing to fix a problem of their own making by waiting too long to remove stimulus.

‘The Fed put way too much cash into the economy. Preposterously large. We didn’t need it.’”

, WSJ 5/5/22

Maybe the best example of how the Fed overstimulated the economy can be seen in real estate prices which have skyrocketed over the last 2 years

- **Real estate prices were up 19.2% last year**
- **after rising over 16% the previous year.**

Remember real estate prices are one of the three biggest contributors to inflation.

You could see it in stock prices as well.

- **The stock market (S&P 500) doubled from its March 2020 lows.**

Now the Fed is slamming on the brakes.
They announced that they would be raising rates in March and signaled an aggressive schedule of future rate hikes.
The market took notice.
Last week they raised interest rates for the second time this year, this time by a half percentage point, the first time the Fed raised rates by that much in over 20 years.

The markets have noticed.

- **Mortgage rates have jumped from 3.22% to 5.27%**
- **The highest in 13 years**
- **The stock market has corrected by 16%**
- **The economy contracted by 1.4% in the first quarter**

To be fair, continuing supply chain issues caused by the war in Ukraine have added to the economic slowdown.

Higher rates have already slowed down the economy and a slower economy should bring wage inflation down and help get inflation under control.
Higher interest rates have already slowed down the real estate market.

Oil prices will remain a wild card with the war in Ukraine and US producers failing to increase production. Saudi Arabia remains in the catbird seat.

The economy will get bumpy although consumers who are responsible for 70% of the economy are in strong financial shape. New home buyers will find it very difficult to purchase a home at the higher rates.
But hopefully inflation will drop.
It just didn’t need to get this hard if the Fed had acted earlier.
Buckle Up!