FAQs on the Markets and Economy

September 18, 2023

Has the labor market been responding to the Fed's interest rate hikes?

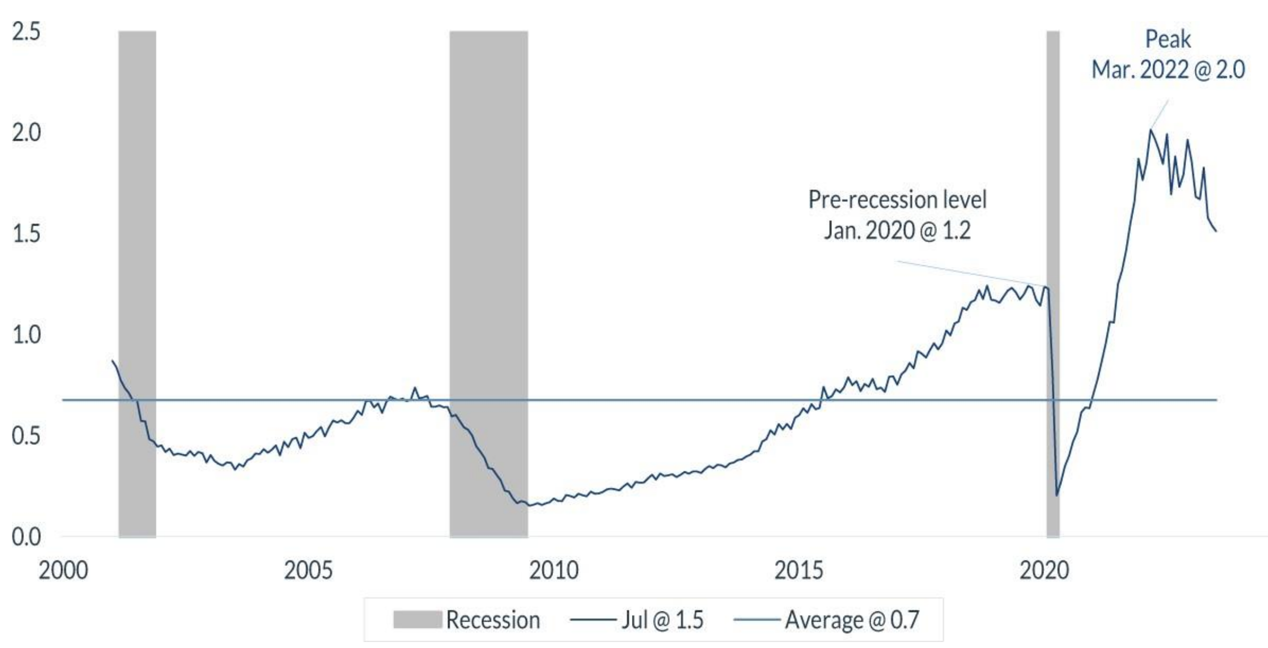
The higher level of interest rates does have the labor market moderating, just as the Fed wants. The monthly gain in the number of new workers is now about the same level it averaged in the five years before the pandemic, around 190,000. That is a sharp reduction from the extraordinary gains of 2021 and 2022, when monthly payroll gain averaged around 500,000 new jobs each month.

The improvement is welcome news by the Fed, but there is not complete harmony in the labor market; demand for workers continues to outpace the number of job seekers by a ratio of 1.5 to 1, meaning there are 1.5 jobs available for each person looking for a job (chart). But moderation is also being seen here; the ratio was at 2 to 1 in March of last year. Back then, the feverish demand for workers was putting upward pressure on wages, which was helping to lead to higher inflation. Since worker demand has declined, average hourly earnings have fallen to 4.3%, from a recent high of almost 6.0%.

We believe the Fed will need to keep short-term interest rates higher for longer to help ensure wage pressures continue to abate. In the five years before the pandemic, the yearly wage increase averaged around 2.7%.

Number of Job Openings per Job Seeker

seasonally adjusted



Source: Bureau of Labor Statistics, as of September 2023

Information is subject to change and is not a guarantee of future results.

Is the Fed done with raising interest rates?

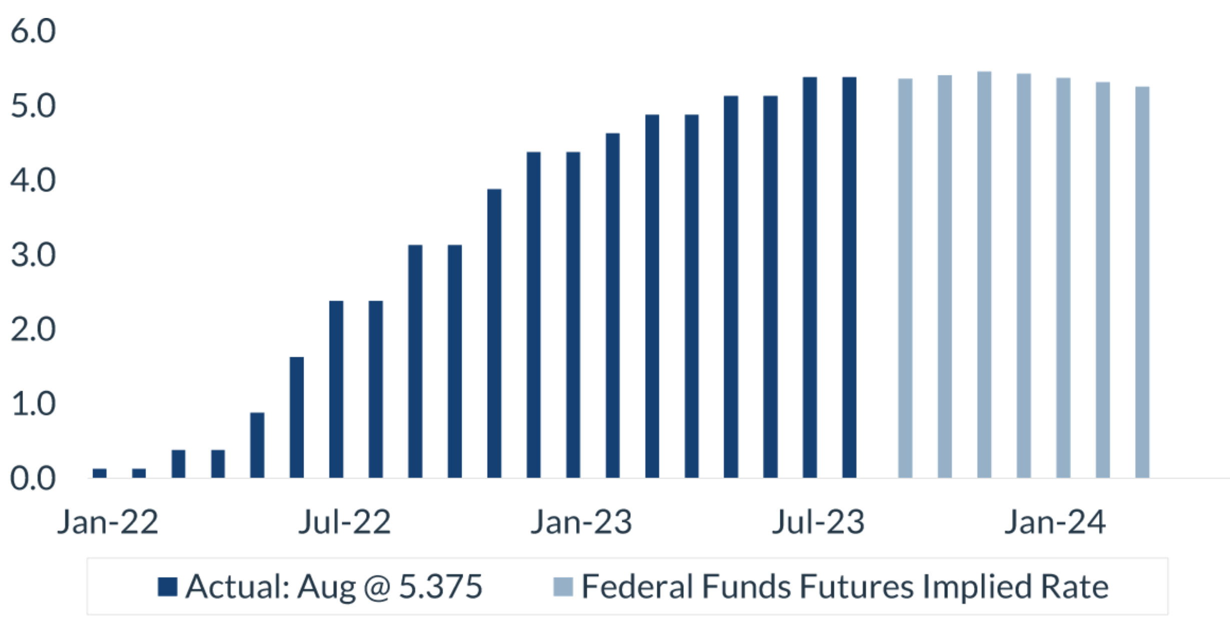
We believe the Fed is done with interest rate hikes in this cycle; we think there is just a very small probability of another 25-basis-point hike. The federal funds futures market applies just a 37.2% chance of a hike.

Although the Fed has yet to reach its target rate of 2.0% inflation, the trend is moving in the right direction. The Fed has implemented one of its most aggressive paths of interest rate hikes, a total of 525 basis points. The higher level of interest rates works its way into the system. Along with that, banks have been raising the standards for accessing credit. Combining the two is expected to slow the economy enough to bring inflation to target.

It will take time; Fed Chair Jerome Powell doesn't expect it to happen until 2025. But they will get there. Powell was very clear on this issue when speaking at the Fed's annual economic symposium in Jackson Hole, which covers all things that are macroeconomics. In a very stern tone, he said, "Two percent is and will remain our inflation target."

Federal Funds Rate

%, actual and expectations, as of August 31, 2023



Sources: Federal Reserve, Bloomberg as of August 31, 2023

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Why has the Fed's tightening not slowed the economy as expected?

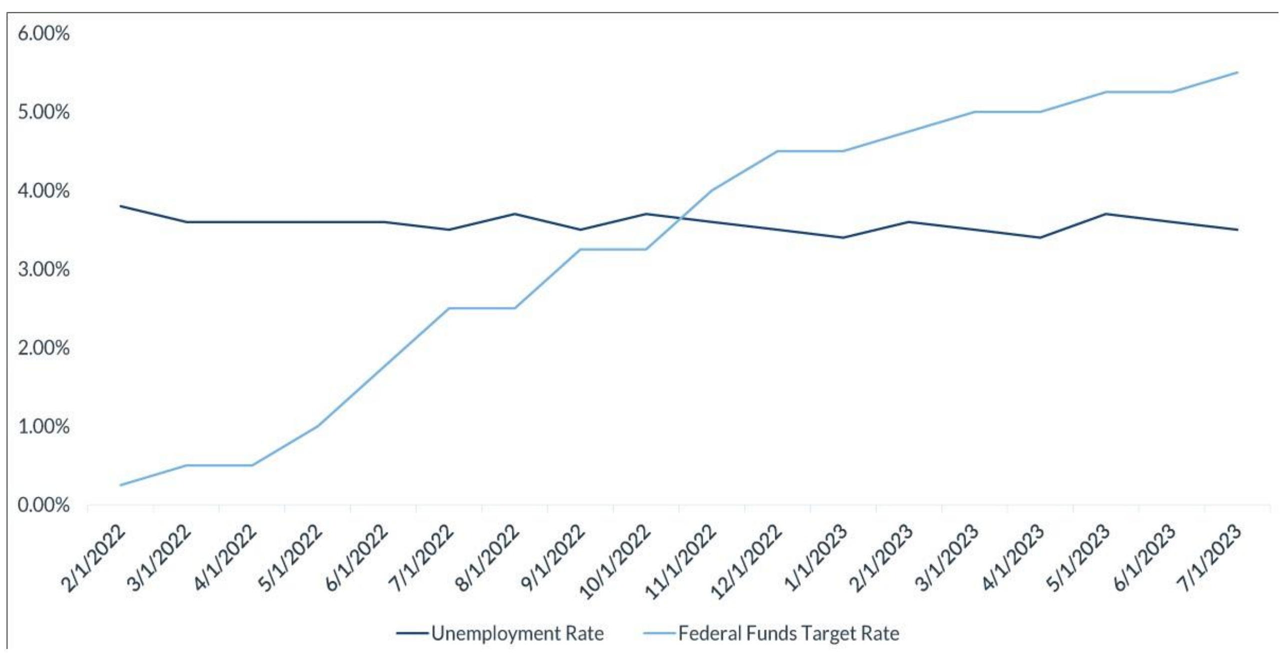
This increase has had little impact on the labor market however, as the unemployment rate remains near 3.5%. Job openings, while below cycle highs, remain historically elevated and above the number of current job seekers. This strength points toward an economy that should continue to grow.

The household sector benefited greatly from the COVID-19 relief stimulus in the form of the American Rescue Plan passed in March of 2021. Direct payments and additional spending programs have provided support to the economy and increased the federal budget deficit, further contributing to growth. Balance sheets remain healthy for both households and corporations. The economy has been protected to a degree from rising short-term rates due to a combination of low debt servicing costs and long duration liabilities. Bank balance sheets remain solid despite turmoil earlier in the year – especially for the largest and most systemically important banks. Excess liquidity is still high, which can be observed in inflows to money market funds and the approximately $1.6 trillion parked in the Fed's overnight RRP facility. Resilient equity markets, despite a steeply

inverted yield curve, are likely playing a role in keeping companies from laying off more workers as forward earnings expectations continue to call for growth in 2024.

All of these tailwinds have proved difficult for the Fed to combat. Until inflation is reduced to its target of 2%, the Fed will likely maintain its aggressive policy stance. Exactly when and how this dynamic will change is one of the main considerations for the path of the economy going forward. Given the precipitous rise of interest rates by the Fed, as well as the persistence of sticky inflation, CNR's thesis of rates being higher for longer should remain intact. This gives cash investors an opportunity to earn yields that have not been seen in nearly two decades and also provides attractive opportunities for investors willing to take duration and credit risk further out the curve.

Unemployment Rate and Federal Funds Target Rate Since Beginning of Hiking Cycle



Source: Bloomberg as of July 31, 2023

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INDEX DEFINITIONS

S&P 500 Index: The S&P 500 Index, or Standard & Poor’s 500 Index, is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S. It is not an exact list of the top 500 U.S. companies by market cap because there are other criteria that the index includes.

CPI: A consumer price index (CPI) is a price index; i.e., the price of a weighted average market basket of consumer goods and services purchased by households. Changes in measured CPI track changes in prices over time.

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