CenterState
CORRESPONDENT DIVISION

Market Update

Economic News

January 4, 2019

The December Employment Report was released this morning and came in much stronger than expected and the question will be is it the last hurrah before the expected downturn, or does the market have the slowdown wrong? Given the ongoing market volatility and more contemporaneous reports that paint a decided downturn in economic momentum, this stronger-than-expected jobs report may be painted as the lagging outlier by the market, but the Fed will likely use this report to reiterate their confidence in the economy with the planned two hikes likely staying in their forecasts for now. As we alluded to above, the December ISM Manufacturing Index experienced the steepest monthly decline in 10 years and the second largest monthly decline dating back to September 2001. Add in earnings warning from market titan Apple (along with Delta and others), investors have convinced themselves that rate hikes are off the table for all of 2019. In fact, fed funds futures are pricing in a larger probability of a rate cut in 2019 than a rate hike. In that environment the Fed has a monumental communications challenge if it sticks with its two-hike scenario. If the strong employment and wage gains from December are repeated in January and February the market will come around to the Fed's scenario, but for now the market is likely painting the December report as a one-off aberration.

For December, wages easily beat the monthly and YoY expectations. Average hourly earnings rose 0.4% for the month, and the highest since August, while year-over-year earnings rose 3.2%, beating the 3.0% expectation and matching October for the highest rate this cycle. The wage gain beats coupled with above-trend job gains will likely keep the Fed talking up the economy and less willing to walk back their two-hike 2019 scenario. That doesn't mean they won't pause in March, but they will need to see a reversal of December's strength in subsequent jobs reports in order to get on board with the markets' belief that a slowdown is imminent.

For the month, 312,000 jobs were created easily beating the 180,000 expected and the highest monthly gain since February. Over the past year monthly job gains have averaged 204,000 so December's results were so far above the average that it's likely the market will take it as an aberration rather than representing a leg higher in labor momentum. Two-month revisions added 58,000 jobs from prior reports adding to the reports strength. Digging into the categories, 227,000 service-providing jobs were added during the month (73% of total job growth) versus 146,000 in November. Gains were once again led by health-care and social assistance (+58k), with leisure and hospitality posting solid holiday-related gains (+55k). 74,000 goods-producing jobs were added (27% of the total), which is way up from the 27,000 added in November with construction (+38k) bouncing back after an unchanged November.

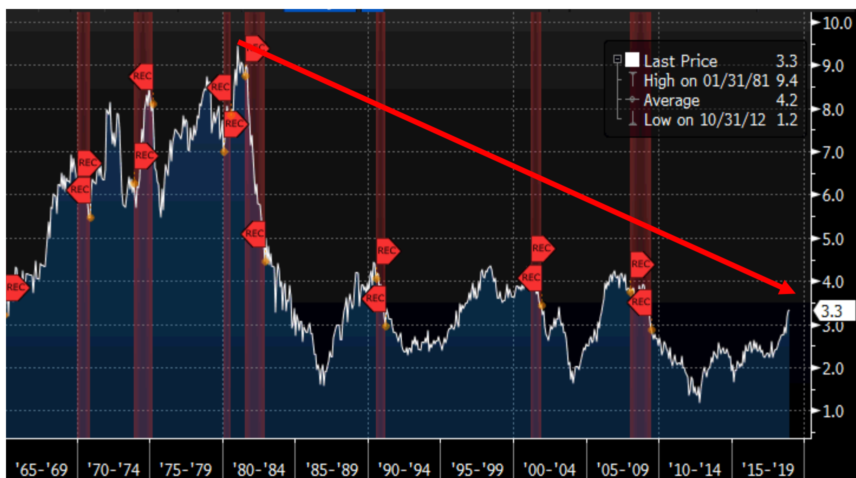
The one possible blemish on the report —and it has a silver lining—is that the unemployment rate rose two-tenths to 3.9% after three straight months at 3.7%. That missed both the market expectation and the Fed's year-end forecast of 3.7%. The silver lining is that the labor force increased 419,000 during the month with 276,000 of those people remaining in the unemployment line leading to the unemployment rate moving up. Despite that uptick, the gain in the labor force will be viewed positively by the Fed and will offset any concern over the unemployment rate increase.

The broader underemployment rate (unemployed plus part-timers seeking full-time work, plus the marginally attached divided by the labor force) remained at 7.6% matching the pre-release expectation. While unemployed persons increased 276,000, decreasing the numerator was a drop of 124,000 part-time workers and a decrease of 122,000 in the ranks of the marginally attached (those willing to work but not actively looking). Thus, a slight increase in the numerator was offset by the aforementioned 419,000 increase in the labor force denominator. This rate bottomed in the 7.9% - 8.2% range prior to the recession, so the current level represents something very near full employment.

The labor force participation rate (labor force divided by civilian population) rose to 63.1% after two months at 62.9% as the 419,000 increase in the labor force overwhelmed the 180,000 gain in the civilian population. Despite the labor force gain in December, and the continued gains in headline job growth, the current participation rate pales in comparison to the 66% level that prevailed pre-crisis but the 62.7% to 63.1% participation rate range may be the new full employment normal given the low unemployment rates, aging of the working population and slowing overall population gains.

In summary, this blockbuster jobs report will be viewed by the market as something of a one-off given more contemporaneous reports pointing to some slowing . However, the Fed is likely to feel a tad more comfortable with their forecasts given this report, but given it's outsized strength it will be viewed in the halls of the Fed with a grain of salt as well. Given employment is something of a lagging indicator, the signs of economic weakness elsewhere may take some time to manifest in the jobs reports. That being said, with fed funds futures pricing in a larger probability of a rate cut in 2019 than a rate hike, the Fed has a monumental communications challenge if it wants to hike in March. One way for that to happen, however, would be to see this stronger employment report repeated for January and February.

Year-over-Year Change in Avg. Hourly Earnings



Average hourly earnings has become the most important metric in the monthly employment reports. With the unemployment rate near cycle lows, and well below the Fed's long-run equilibrium rate of 4.4%, wage gains rose 0.4% in December beating the 0.3% expectation and well above the 0.2% November print. The YoY print remains in the 3.0%-3.5% pre-crisis range but still below the 50-year average of 4.2%. The back-to-back prints above 3%, however, will keep the Fed talking positively about the economy and not walking back their two-hikes-in-2019 forecast, despite the market angst and volatility.

Market Rates

Treasury Curve	Today	Chg Last wk.	LIBOR Rates	Today	Chg Last wk.	FF/Prime	Rate	Swap Rates	Rate
3 Month	2.42%	-0.01%	1 Mo LIBOR	2.51%	-0.01%	FF Target Rate	2.25%-2.50%	3 Year	2.559%
6 Month	2.51%	-0.05%	3 Mo LIBOR	2.79%	-0.01%	Prime Rate	5.50%	5 Year	2.538%
2 Year	2.48%	-0.04%	6 Mo LIBOR	2.87%	UNCH	IOER	2.40%	10 Year	2.672%
10 Year	2.64%	-0.08%	12 Mo LIBOR	3.00%	-0.01%				