

The “Great Resignation Wave” is recruiting another participant with the likely early retirement of the Federal Reserve’s massive bond-buying program. To be sure, like aging boomers accelerating their journey to the golden years, there’s always the chance of running into a roadblock that prompts a reversal, of course. In the case of boomers, it could be a case of running out of money or simply boredom. With the Fed’s journey, it’s more likely that it will hit a fork in the road rather than a roadblock, split by the emerging Omicron variant. One way leads to higher inflation, which would pave the way for a faster journey. The other leads to higher unemployment and slower growth, which could prompt a reconsideration of the pace of advance.

At this juncture, the Fed believes the economy is veering towards the inflationary path, and the more prudent course is to start pulling in the reins a little faster before things get out of control. At its November policy meeting, the plan was to cut its asset purchases by \$15 billion a month, which would wrap up the entire program by the middle of next year. However, since that early November meeting, signs that inflation was racing ahead faster – and likely longer – than anticipated has emerged, prompting the Fed to rethink its strategy. Hence, Powell indicated this week that Fed officials would seriously consider tapering its asset purchases at a faster pace at its upcoming meeting on December 14 and 15, leading to an earlier end to the program and, by extension, opening the door to an earlier rate hike.

Of course, a key factor underscoring this hawkish pivot is that the economy is also racing ahead, with growth tracking an eye-opening annual pace of almost 8 percent in the current quarter. Hence, the downside of sacrificing a bit of growth for the benefit of keeping inflation in check does not seem very onerous at this point. That said, recent history strongly suggests that it would also be foolhardy to underestimate the powerful – and abrupt – blow that a severe turn in the pandemic would inflict on the economy. Indeed, less than two months ago, Powell was keenly aware of Covid’s influence, noting that the economy’s path continues to depend on the course of the virus.

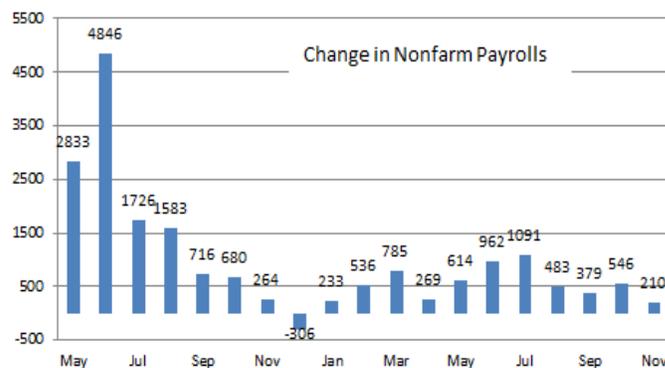
It’s too early to judge how serious the new Omicron variant will turn out to be. Still, its proximate impact is likely to crimp supply and reinforce inflationary pressures, particularly for goods. That, in turn, would seem to validate the Fed’s evolving plan to speed up its withdrawal of support for the economy. But it also runs counter to the notion that a tighter policy would do little to ease supply constraints, as it works mainly by suppressing demand. As noted, the economy is currently riding ahead of steam, so tapping the demand brakes does not seem like a bad plan. Remember that the demand side of the equation derives much of its firepower from the substantial fiscal stimulus coming out of Washington over the past year, and that energy source is fading.

The risk, therefore, is that the Fed would be turning less supportive next year just as the props to demand were already weakening. Importantly, Capitol Hill is not likely to reopen the fiscal spigot as the mid-term election looms, and deficits along with inflation will be key campaign issues. Simply put, the economy’s performance in the coming quarters will depend more heavily on the private sector and how the path of the virus influences households and businesses. As noted earlier, it’s much too early to forecast the course of the virus. The scant information available so far, both in the U.S. and overseas, is that Omicron is shaping to be more transmissible than previous variants, with the symptoms it imparts being less severe. The question of how much protection existing vaccines provide is still up in the air.

Indeed, health officials claim they need about two more weeks to get reliable data on vaccine protection, which is the time leading up to the December 14-15 policy meeting. Barring a shockingly negative result or swift upturn in cases driven by Omicron, the Fed’s less dovish tilt should remain intact. True, at first blush, Friday’s all-important jobs report for November suggests that policymakers should hit the pause button before taking any action. During the month, nonfarm payrolls increased by a disappointing 210 thousand, far less than the consensus estimate of 500-600 thousand and less than half the 546 thousand increase in October. But as they say, the devil is in the details; in this case, there are more angels than pitchforks lurking beneath the headline.

Usually, the establishment survey, which canvasses companies for the payroll tally, is given more importance than the Labor Department’s companion household survey, which generates the unemployment figures. However, in this instance, there are reasons to find the household survey more credible. For one, the payroll numbers are continuously revised, often substantially; the October payroll increase was revised up by 82 thousand from the original estimate. Conversely, the household

Slowing Job Growth

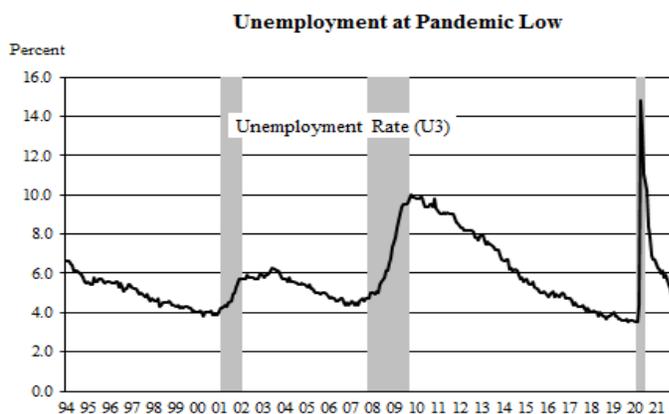


data tends to be firm from month to month, and the November survey showed a 1.1 million increase in employment, five times greater than that shown in the establishment survey and the most significant increase in more than a year.

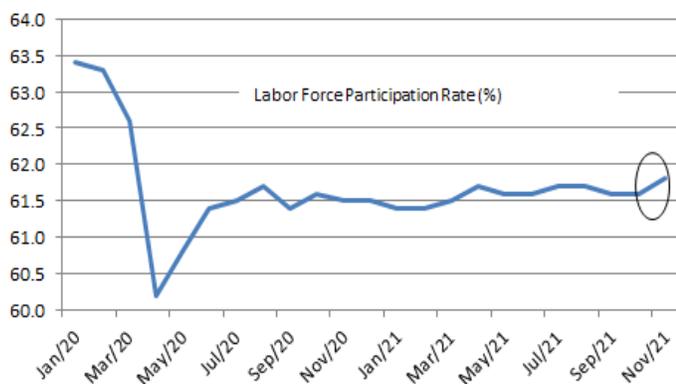
For another, virtually all other metrics in the employment report showed more strength than weakness. Most dramatically, the 1.136 million increase in employment shown in the household survey was about double the 594 thousand increase in the labor force, reducing the number of people out of work by 542 thousand. Hence, the unemployment rate fell a sizeable 0.4 percentage point to 4.2 percent. Throw in the decline in part-time workers who would prefer full-time jobs and those not counted as unemployed but want a job, and you get an even more significant 0.5 percentage point decline in the broader underemployment rate to 7.8 percent. Both metrics are at pandemic lows.

And while more workers found jobs than were looking last month, the fact that the labor force increased by 594 thousand – the largest increase since last October – indicates that companies are finally luring people off the sidelines. Hence, the labor force participation rate rose for the first time in five months, increasing two-tenths to 61.8 percent. That’s still well below the pre-pandemic level of 63.3 percent, but it is the highest since March 2020. Encouragingly, companies are dipping further down into the pool of the unemployed, hiring less-educated workers to fill open positions. The unemployment rate for workers with less than a high school diploma plunged from 7.4 percent to 5.7 percent.

Significantly, these newly hired workers are avoiding hamburger-flipping jobs, a sign that companies are willing to train incoming workers to upgrade their skills amid an ever-tightening labor market. Indeed, the biggest drag on the payroll gain last month was the tepid hiring among leisure and hospitality companies, including restaurants and bars. Employment in this sector edged up by a mere 23 thousand, the smallest since January. Not coincidentally, the Delta variant drove the virus case count sharply higher last month, which may have put a crimp in customer visits to places that attract social gatherings. Alternatively, many food and drinking places did not survive the pandemic, and the reduced number of such establishments translates into reduced demand for workers.



More People Joining Workforce



average hourly earnings was the smallest in six months. But the annual gain of 4.8 percent is still uncomfortably high and implies cost-covering price increases that the Fed is unwilling to tolerate for long.

Hence, we do expect the Fed to accelerate its tapering of asset purchases and wind up the program three months earlier than planned at the November policy meeting. It’s important to remember that tapering is not the same as tightening, as the Fed will still be adding additional liquidity to the system, albeit by diminishing amounts each month, until next spring. That earlier timetable also gives the Fed more flexibility in the timing of its first rate hike, which would not take place until after the bond-buying program ends. Assuming Omicron does not throw up a roadblock, we expect the first rate hike to take place next September.

The good news about the increase in the labor force participation rate last month is that an expansion in the supply of workers is needed to ease upward pressure on wages, which have accelerated markedly this year and is a driving force behind the inflation spiral that the Fed is striving to keep in check. The conundrum is that higher wages are needed to lure workers off the sidelines, but other forces may help fill that role, such as offering workers flexible hours, including increasing the time they can work remotely. That is already becoming an essential incentive to attract workers. Wage increases did cool last month, as the 0.3 percent increase in

FINANCIAL INDICATORS				
INTEREST RATES	December 3	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.06%	0.06%	0.06%	0.09%
6-month Treasury bill	0.10	0.09	0.08	0.1
3-month LIBOR	0.18	0.18	0.14	0.23
2-year Treasury note	0.60	0.50	0.40	0.16
5-year Treasury note	1.14	1.17	1.06	0.42
10-year Treasury note	1.36	1.48	1.45	0.97
30-year Treasury bond	1.68	1.83	1.89	1.73
30-year fixed mortgage rate	3.11	3.10	3.09	2.71
15-year fixed mortgage rate	2.39	2.42	2.35	2.26
5/1-year adjustable rate	2.49	2.47	2.54	2.86
STOCK MARKET				
Dow Jones Industrial Index	34580.08	34899.34	36327.95	30218.26
S&P 500	4538.43	4594.62	4697.43	3699.12
NASDAQ	15085.47	15491.66	15971.59	12464.23
Commodities				
Gold (\$ per troy ounce)	1785.10	1792.30	1819.50	1843
Oil (\$ per barrel) - Crude Futures (WTI)	66.40	68.17	81.42	45.37
ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
ISM Manufacturing Index (November)	61.1	60.8	61.1	64.2
ISM Services Index (November)	69.1	66.7	61.9	63.9
Nonfarm Payrolls (November) - 000s	210.0	546.0	379.0	612.0
Unemployment Rate (November) - Percent	4.2	4.6	4.8	5.0
Average Hourly Earnings (Nov.) - % chg	0.3	0.4	0.6	0.4

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