BNY MELLON

iFlow

MACRO MORNING BRIEFING

April 1, 2024

US Inflation And Jobs -- Slowing

- Fed's Waller an inflation hawk
- Chair Powell too, but a jobs dove as well
- Macro indicators and iFlow both indicate slowing

Two important Fed speakers and a comforting inflation report

An interesting end to last week gives us plenty to consider this one. Where is inflation really going, and is it enough for the Federal Reserve? Or is it really too soon to think about a June rate cut? How much softening in the jobs market would persuade the Fed to cut even if inflation is sticky? We consider the evidence and still believe a cut is coming by mid-year.

Before examining the data and making our case, let's consider what we were told by two important Fedspeakers: Governor Waller on Thursday and Chair Powell on Friday. Waller seemed to pour cold water on rate cuts anytime soon; he wants to see a "at least couple of good months of better inflation data". His comments (text) were generally considered hawkish – especially in comparison to Chair Powell's March 20 press conference.

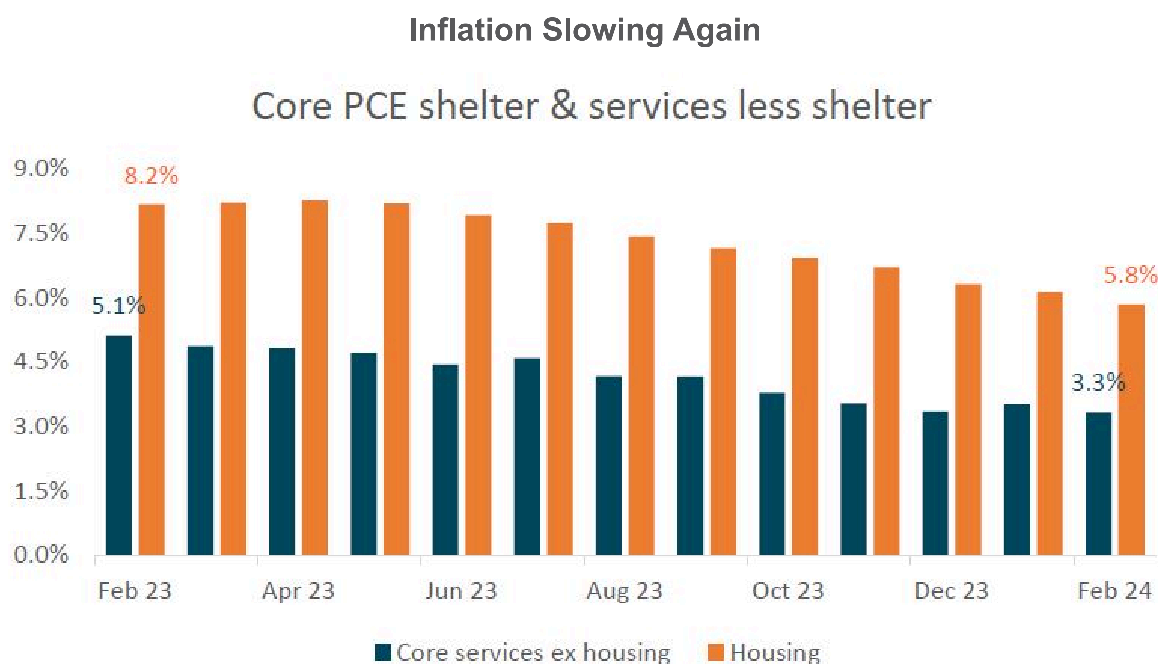
Indeed, Powell's remarks Friday at an event sponsored by the San Francisco Fed were similar, as far as the bar for inflation goes. He referred to the February PCE data released earlier Friday as "in line with expectations". He also was cautious on the prospect of rate cuts, stressing more good inflation data is needed. However, he did reference seeing more balance of risks between the labor market and the inflation picture.

Our impression is that while Waller is an inflation hawk, as is Powell, the Chair is more attuned to the other side (jobs) of the Fed's dual mandate than he has been in the recent past – and might relent on rates at signs of weakness on that front. Cumulative market implied probabilities price a 67% chance of a June cut (10% for May and 57% for June).

Our view on inflation is cautiously optimistic. The latest PCE data supported our suspicion that January data had beginning-of-year effects that appear to have relented. Core services

ex housing, otherwise known as the “Powell supercore” has been one of the stickiest of the three components of core PCE. After going the wrong way in January on both a monthly (0.7%) and yearly basis (3.5%), the supercore was down to just 0.2% on the month and 3.3% on the year, the latter the lowest observation since before the COVID lockdowns. Housing inflation is slowly but steadily and persistently cooling, (see chart below), and goods inflation remains near 0%. Messrs. Waller and Powell, who are looking for a couple of months’ worth of inflation to consider cutting, might be satisfied by the time June arrives.

Inflation Slowing Again



Source: BNY Mellon Markets, Bloomberg, Bureau of Economic Analysis

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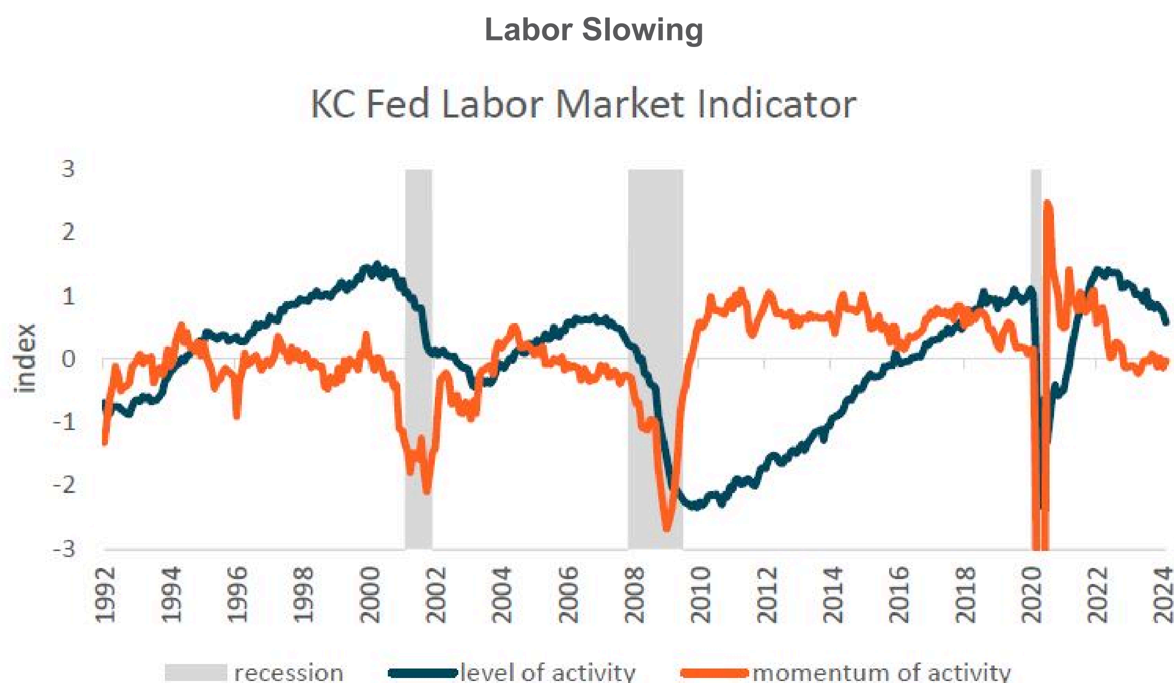
In our view, the jobs market appears to be – in the Fed’s parlance – coming back into better balance between supply and demand. Earlier this month we broke down the February jobs data, arguing that there were signs of slowing behind the headline. We also note that the quits rate is at its lowest level since the depth of the lockdowns in early 2020. Indeed, taken as a whole, we believe the majority of the data is pointing to slowing in the jobs market.

One indicator in particular we like is the Kansas City’ Fed’s Labor Conditions Indicator (see here). It uses 24 data series ranging from the unemployment rate to the quits rate to survey data on employment and ease of job search. Extracting the first principal component from these two-dozen series gives an overall measure of labor market activity every month. The chart below (blue line) shows that the labor market is clearly cooling – well below where it was just a year and a half ago. In fact, the index is currently as low as it has been since the summer of 2021, and below where it was in 2019, when the Fed was actually cutting rates.

The second principal component – or labor market factor – is a momentum indicator; it tracks the pace and direction of change of the first factor described above. It too is showing deceleration and, moreover, has been for months. This labor market is indeed loosening,

although not one that we currently see deteriorating sharply. The Fed is no doubt aware of more data on the jobs market than just nonfarm payrolls. Thus, this coming Friday's employment situation will be the next major market event that could shed some light on the jobs picture – whether or not it is indeed cooling and coming back into better balance.

Labor Slowing



Source: BNY Mellon Markets, Federal Reserve Bank of Kansas City

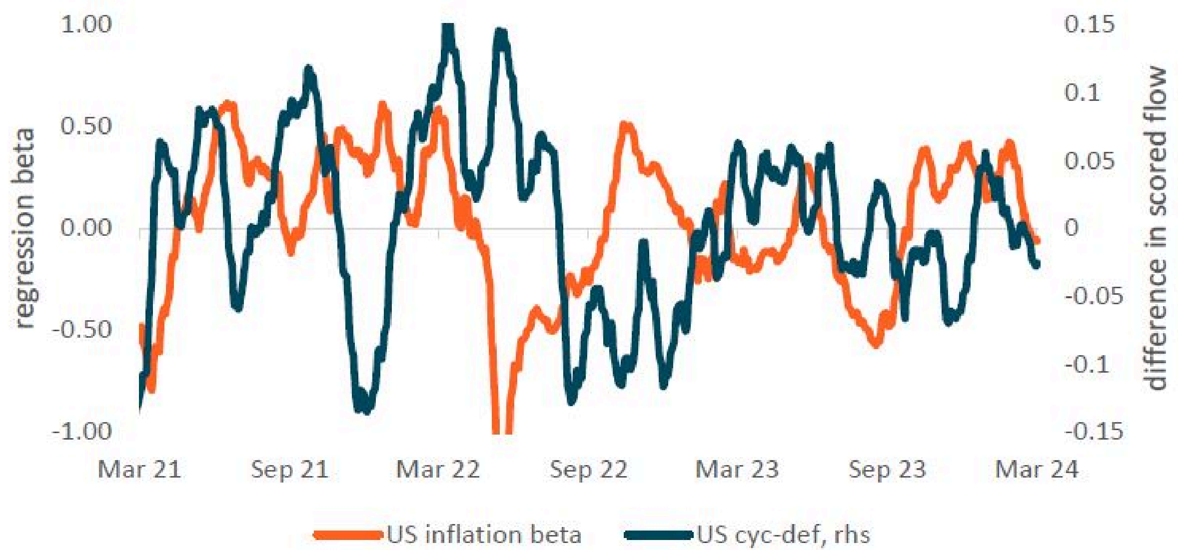
iFlow adds to the evidence

We think iFlow is also telling us a few things about the outlook. The chart below shows iFlow-derived measures for cyclicality in the economy and inflation expectations. They're both suggesting cooling in the economy is afoot.

The blue line is essentially the difference between real money flows into Cyclical equity industries versus those into Defensive industries, a measure of investor views about where we are in the cycle. They have turned neutral in recent weeks relative to their levels of just the beginning of the year ago.

The orange line is our measure of equity investors' preferences for industries whose stocks rise when inflation does and those which don't. If investors are buying stocks that appreciate with inflation, they're presumably hedging inflation risk in the equity market, or going long inflation. This measure, which had been somewhat elevated between last November and this February, has recently turned south and is showing no correlation between our flows and inflation proxies.

iFlow Says: Slowing



Source: BNY Mellon Markets, iFlow

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Please direct questions or comments to: iFlow@BNYMellon.com

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