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Dutta’s Economic Daily

More workers see no wage change

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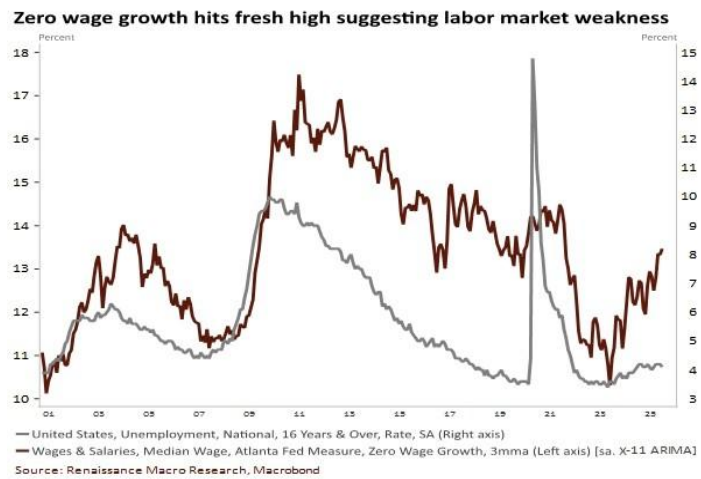
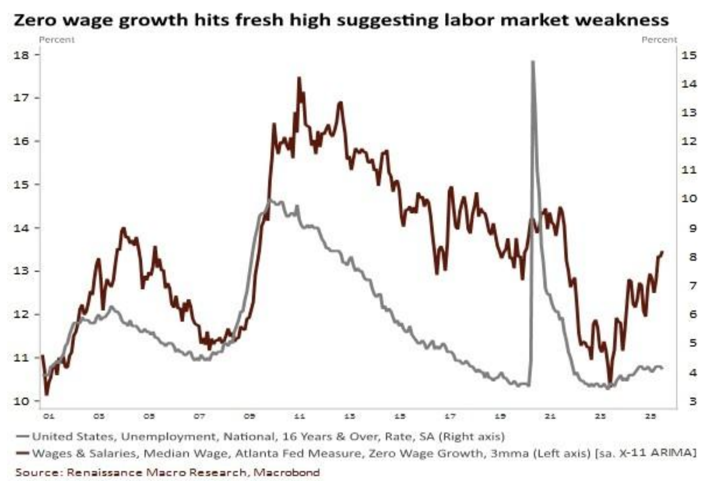
Labor conditions cooling

- The Atlanta Fed’s Overall Wage Growth Tracker (nonsmoothed) stood at 4.1 percent year-on-year in June, the lowest since January. The details reveal an ongoing cooling off in labor market conditions.



- First, the premium between job switchers over job stayers has evaporated. Wage growth for job-switchers has cooled to 4.0 percent, 0.2ppt below the pace for job stayers. If switching doesn’t pay, don’t expect folks to quit their jobs. Second, more workers see zero wage change compared to last year. Firms prefer to hold employee pay flat as opposed to cut outright (nominal wage rigidity). According to Atlanta Fed, in June, 13.6% of individuals saw no wage change in June, a fresh high.
- In both cases, the data imply that while the unemployment rate is low, that statistic overstates the degree of health in the jobs market.

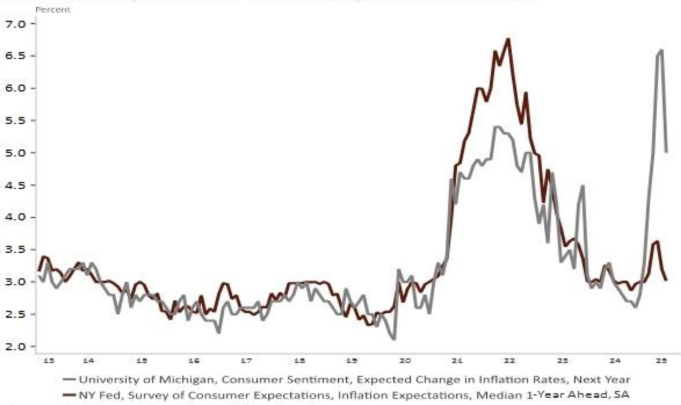


New York Fed SCE is the better measure of inflation expectations

For the Fed, rationalizing an on-hold policy because of a threat to inflation expectations is becoming increasingly difficult to justify.

According to the latest data from the New York Fed Survey of Consumer Expectations (SCE), the median one-year ahead expected inflation rate slid to 3.02 percent in June, the lowest since January. The median three-year ahead expected inflation rate stands at 3.0 percent, where it was back in 2018. Finally, the median five-year ahead expected inflation rate remained at 2.61 percent, near the low end of its range of the last two years.

NY Fed survey is a better inflation expectation measure



Source: Renaissance Macro Research, Macrobond

What's notable is the gap between the New York Fed SCE data and the one from University of Michigan, which shows one-year expected inflation roughly 2ppts higher. I put more weight on the New York Fed data, and not just because it fits my priors. After all, the NY Fed SCE was firmer between 2021-2022. There are some important differences.

- **<u>Question framing and terminology</u>**: The NY Fed SCE asks for **the expected rate of inflation** and for specific point predictions while the UMich data asks about **the expected change in prices** and then for a percent estimate. The difference in terminology is important; using prices can lead respondents to focus on prices for specific goods as opposed to actual inflation.
- **<u>Sample:</u>** The NY Fed SCE has a much larger sample, roughly 1300 respondents compared to the UMich, which interviews about 600 people monthly. Moreover, the NY Fed series has a rotating panel, tracking the same people over time.
- **<u>Response type:</u>** The UMich respondent gives a point estimate. This makes for some pretty wild estimates of inflation. By contrast, the New York Fed series gives point predictions and density forecasts (respondents assign probabilities to inflation intervals).

In short, I pay attention to both of these measures; it's worth watching the University of Michigan data given its long survey history. However, **<u>if I had to pick one, I would go with the New York Fed SCE, it's probably the more accurate measure of household inflation expectations.</u>**

Minutes show three camps on rates this year

- In thinking about the outlook for monetary policy, the June FOMC minutes show three distinct camps: (1) "most" see some reduction in the federal funds rate as appropriate, (2) a "couple" are open to considering a cut as soon as July, and (3) some see "no reductions" this year. Thus, a reasonable baseline based solely on the calendar remains September. My guess is that July advocates will not be as noisy about it following the decline in the jobless rate in June.

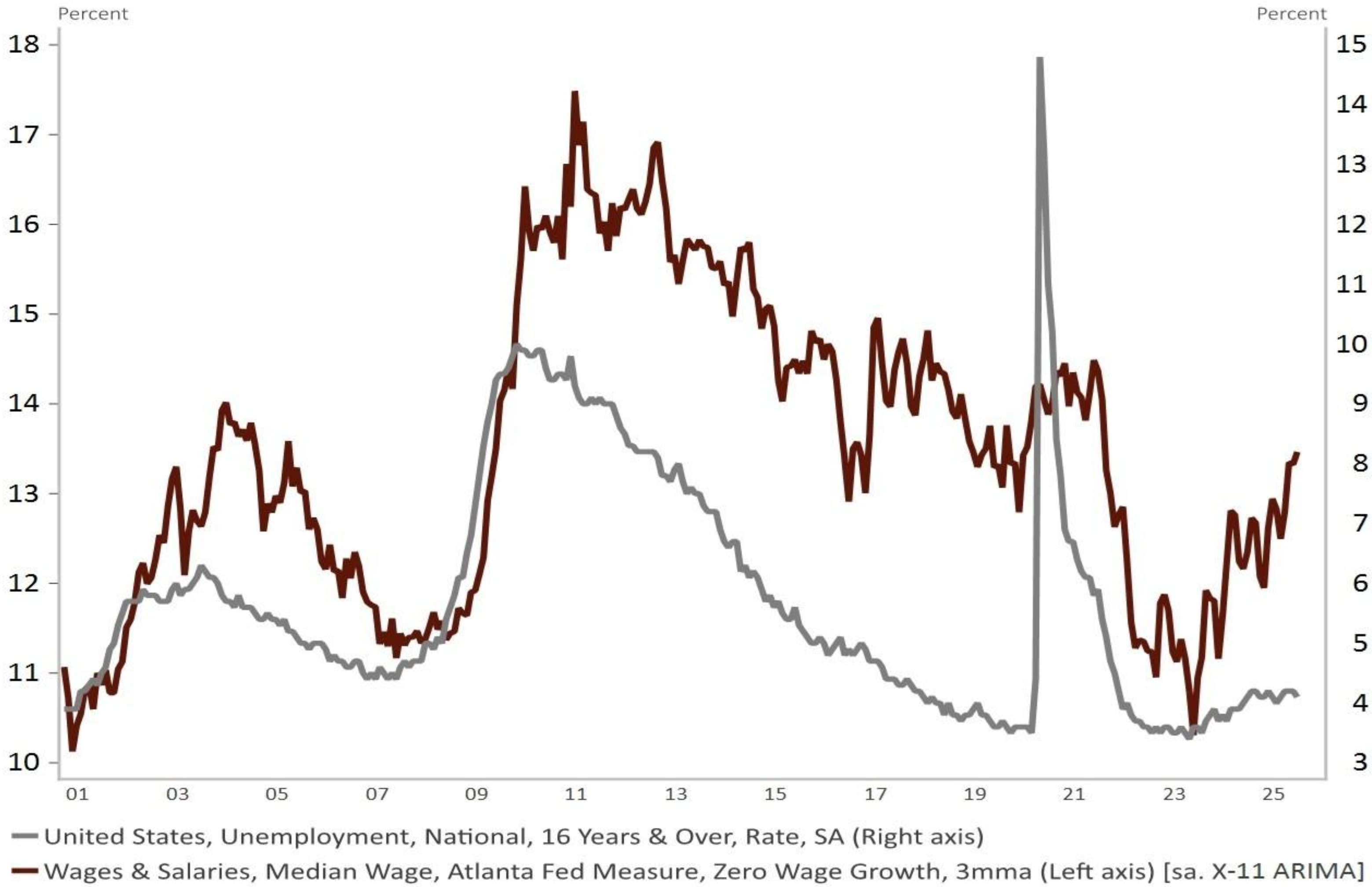
- Notably "several" participants see the level of the federal funds rate as not far above neutral. This implies that once the Fed resumes cuts, it will not be cutting all that much. I'm beginning to think about what participants think about neutral; next year, Lorie Logan, Beth Hammack and Neel Kashkari will be voting members, and they've been on the more hawkish side of the policy fence.

Employment weakness signals recessions before market declines

- A comprehensive analysis of U.S. recessions since 1960 reveals a counterintuitive relationship between employment weakness and equity market performance. By examining the first negative payroll change within 24 months before each recession and measuring S&P 500 performance in the preceding 6 and 12 months, we find that markets were typically resilient—not declining—when employment first showed weakness. Across seven qualifying recession episodes, equity markets averaged gains of 3.0% over six months and 10.2% over twelve months before the initial negative payroll print, with only 14.3% of cases showing negative six-month performance and zero cases displaying negative twelve-month returns.

- This pattern suggests that employment data may serve as a more reliable early recession indicator than market declines. The timing relationship proves particularly significant: first negative payroll changes occurred an average of 12 months before recession onset, providing substantial lead time. Even during the 2008 financial crisis, markets had gained 6.8% and 20.7% in the six and twelve months respectively before the first negative payroll reading in July 2007.

Zero wage growth hits fresh high suggesting labor market weakness



Source: Renaissance Macro Research, Macrobond

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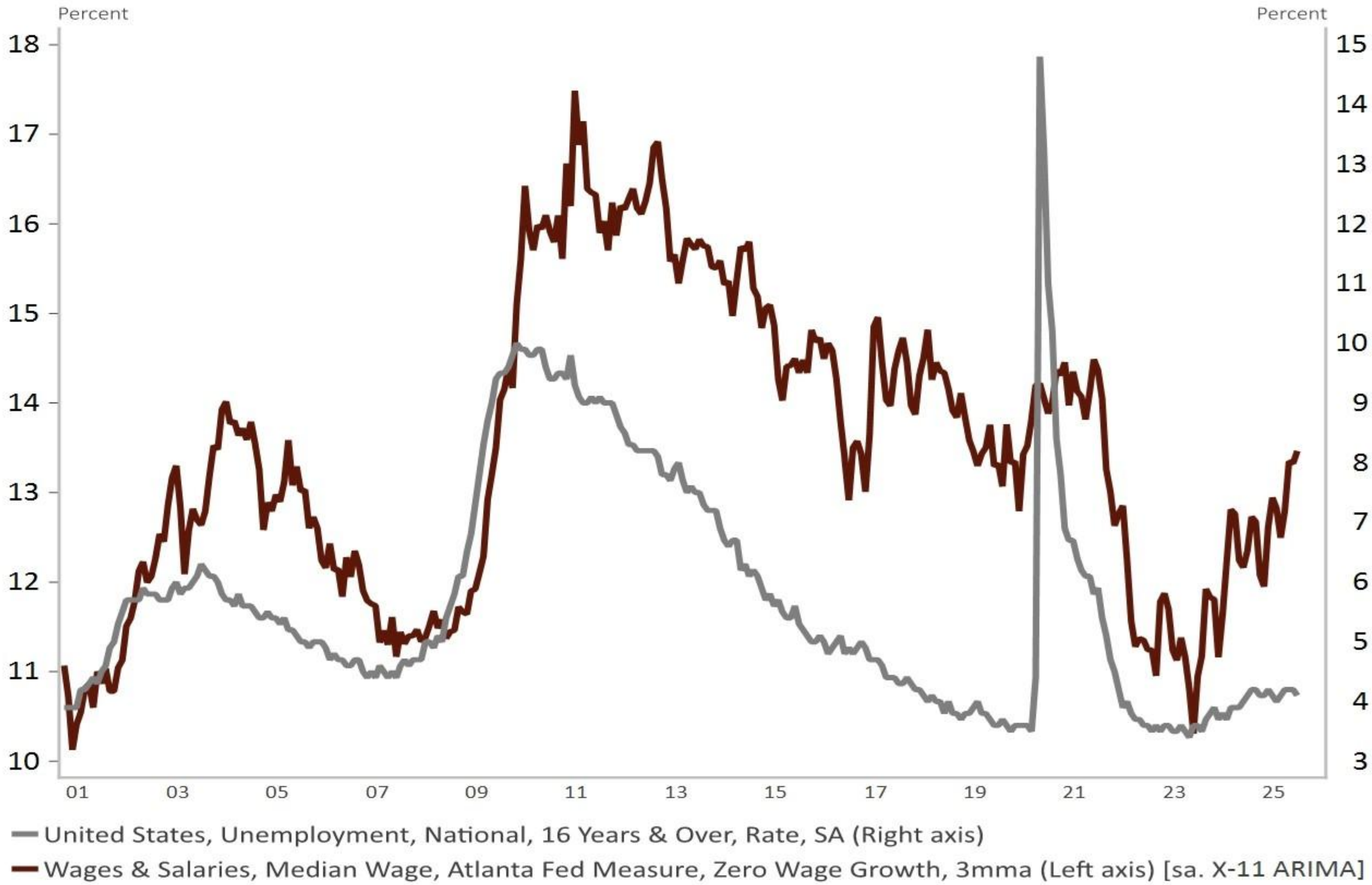

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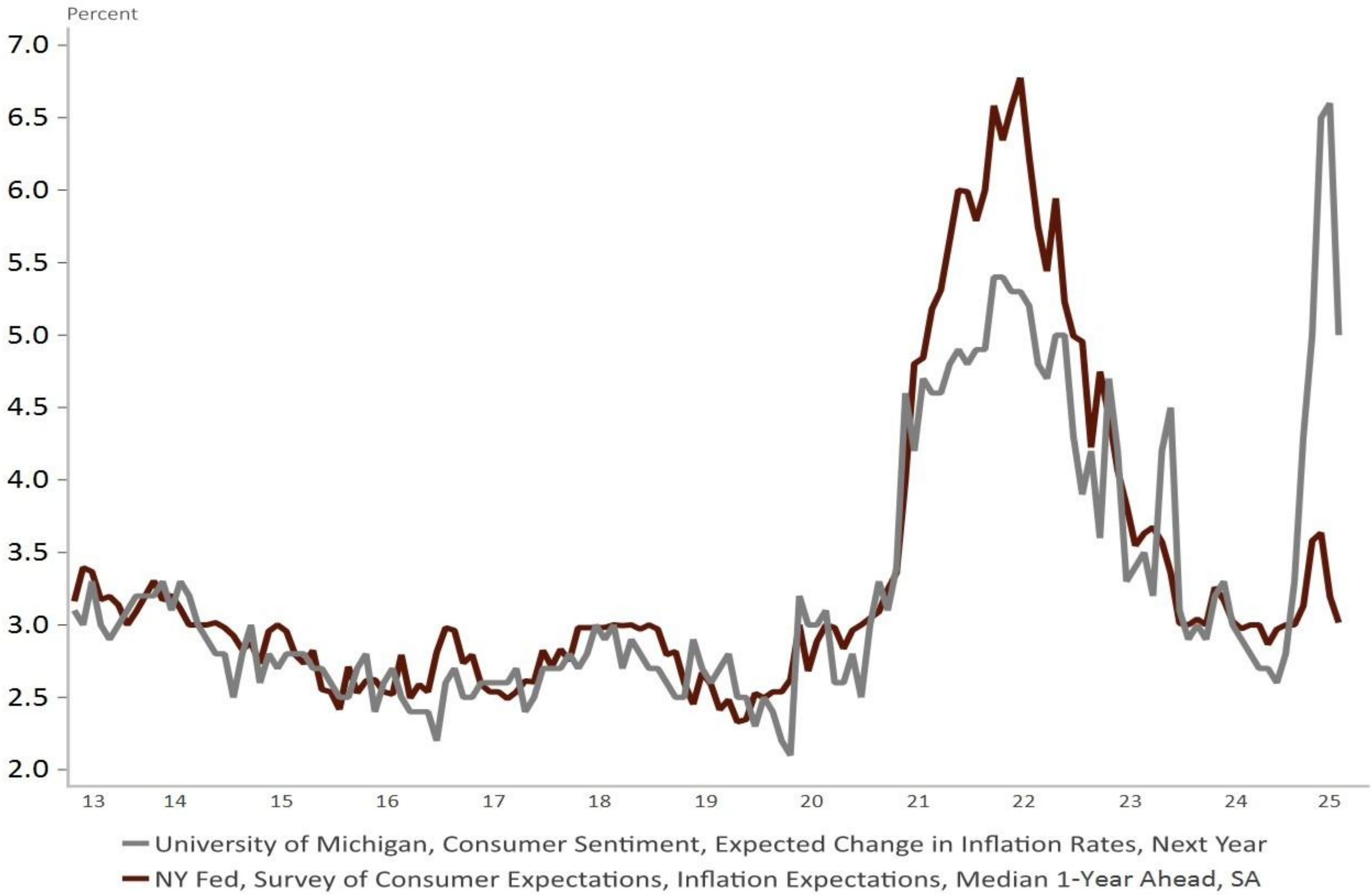

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