Fade the Jobs Report

The January employment report was super strong. Most major categories surprised the consensus of forecasters. **Nonfarm payrolls increased 517k after 71k in net upward revisions to the prior two months**; the unemployment rate fell a tenth to a 3.4%, a new multi-decade low and the nonfarm workweek lengthened 0.4 to 34.7 hours, a near record large gain. The one area of moderation was average hourly earnings (0.3%) whose three-, six- and 12-month rates of changed continued to decelerate.

As strong as the January data were, **one month never makes a trend. In fact, forward looking measures of output, best proxied by the Index of Leading Economic Indicators (LEI), are shrinking.** This tells us that the huge gain in January employment was an outlier and that the weakening underlying trend in job growth evident late last year will soon reassert itself. The chart below shows the year-over-year growth rate in the LEI and nonfarm payrolls. Notice the yawning gap between the two series.

**Over the 12-months ending December 2022, the LEI was in recessionary territory at -6% compared to a 3.2% increase in employment.** The resulting nine-point spread is the largest since the deep 2008-09 downturn. According to our calculations, the current gap is the fifth largest on record. In the past, the spread collapsed with employment initially moving sharply lower. History is likely to repeat and should first become evident in the construction sector.

Despite the fastest and largest rise in the funds rate since the early 1980s and a more than doubling in mortgage rates, **construction jobs continue to grow.** Employment is up 12 months in a row to a record high. Yet during this time, builder sentiment, housing starts, and home sales have plunged, spending on commercial structures has shrunk and banks have been tightening lending standards. Given the lags between changes in monetary policy and interest sensitive spending, construction employment will slow in the months immediately ahead.

**We do not expect the Fed to be more hawkish** in response to the January employment data because a pivot back to larger than 25 basis point (bp) rate hikes would damage policymakers’ credibility. Instead, the Fed will lift the level of the funds rate a bit more (another 25 bps) and then leave it there until inflation (or the economy) sufficiently slows. The LEI tells us that we are getting close to peak fed funds and that rate cuts, notwithstanding January jobs data, remains in the picture later this year. Stay tuned.
Disclaimer

This presentation is for discussion purposes only and is not intended to be an offer to sell or the solicitation of an offer to buy any securities, or any commitment to underwrite, subscribe for or place any securities, is not an offer or commitment to provide any financing or extension of credit or service, and does not contain any tax or legal advice. This presentation has been prepared by SMBC Group (which may include, collectively or individually, any of the following entities in the Americas Division: Sumitomo Mitsui Banking Corporation (“SMBC”), SMBC Nikko Securities America, Inc. (“SMBC Nikko”), SMBC Nikko Securities Canada, Ltd. (“Nikko Canada”), SMBC Capital Markets, Inc. (“SMBC-CM”), SMBC Leasing and Finance, Inc., JRI America, Inc., and SMBC Rail Services LLC) and is being furnished by SMBC Group solely for use by the client or potential client to whom such materials are directly addressed and delivered. This presentation is confidential and is the property of SMBC Group subject to copyright. Any reproduction of this presentation, in whole or in part, is prohibited, and you may not release these materials to any person, except to your advisors and professionals to assist you in evaluating these materials, provided that they are obligated, by law or agreement, to keep the presentation confidential. These materials do not constitute research, a recommendation or an offer or solicitation to any person to enter into any transaction or adopt any hedging, trading, or investment strategy. Prior to participating in any such transaction, you should consult your own independent, competent, legal, tax, accounting, and other professional advisors.

In preparing this presentation, SMBC Group has relied upon information available from third parties, including public sources, and we have assumed, without independent verification, the accuracy and completeness of such information. Specific prices, indices, or measures, including ranges, listed in this document were prepared at the time the document was prepared, and are subject to change without notice. SMBC Group makes no representations to and does not warrant this presentation’s accuracy or completeness. SMBC Group expressly disclaims any liability for any use of the information set forth herein, including, without limitation, any use of the information set forth herein in the preparation of financial statements or accounting material.

These materials may contain forward-looking statements, which may include projections, forecasts, income estimates, yield or return, future performance targets or similar analysis. These forward-looking statements are based upon certain assumptions. All forward-looking statements are based upon currently available information and SMBC Group is not obligated to provide an update. Actual events may differ from those assumptions. Opinions, projections, price/yield information and estimates are subject to change without notice. There can be no assurance that estimated returns or projections will be realized, that forward-looking statements will materialize or that actual results will not be materially lower than those presented. Past performance is not necessarily indicative of future results. Any transactions or strategies addressed may not be suitable for all parties. The value, price or income from transactions or strategies may fall as well as rise. SMBC Group or an affiliate may have a position in any of the underlying instruments, assets, indices, or rates mentioned in this document. You should make your own independent judgment or seek independent financial and tax advice with respect to any matter contained herein.

SMBC is subject to Japanese firewall regulations and therefore absent client consent, non-public client information may not be shared with SMBC Nikko Securities Inc.

SMBC Nikko is a U.S. registered broker-dealer of SMBC Group. Nikko Canada is a U.S. and Canadian registered broker-dealer of SMBC Group. SMBC-CM is provisionally registered as a U.S. swap dealer with the CFTC. Capital markets and other investment banking activities for SMBC Group are performed by a combination of SMBC Nikko, Nikko Canada, SMBC Nikko Securities Inc. and SMBC-CM. Lending and other commercial banking activities are performed by SMBC and its banking affiliates. Derivative activities may be performed by SMBC-CM or SMBC. SMBC Group deal team members may also be employees of any of the foregoing entities. SMBC Group does not provide tax advice. Accordingly, any discussion of U.S. tax matters contained herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with the promotion, marketing or recommendation by anyone unaffiliated with SMBC Group or for the purpose of avoiding U.S. tax-related penalties. © 2022 SMBC Group. All rights reserved.