U.S. Outlook

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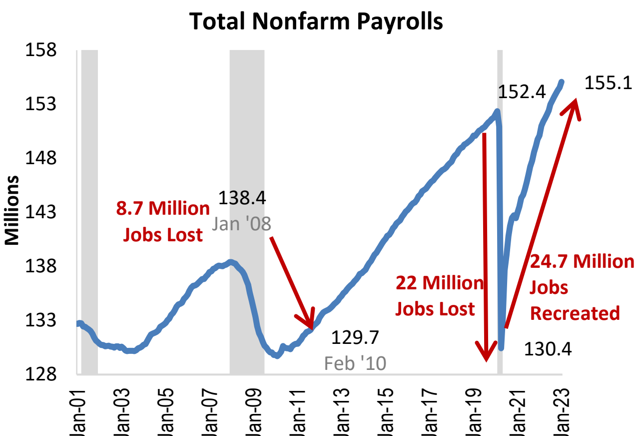
Date	Indicator	For	Estimate	Consensus*	Previous Period
07-Feb-2023	Trade Balance	Dec	-$68.0b	-$68.7b	-$61.5b
07-Feb-2023	Consumer Credit	Dec	$25.0b	$26.000b	$26.962b
08-Feb-2022	Wholesale Inventories MoM	Dec F	0.1%	0.1%	0.1%
09-Feb-2023	Initial Jobless Claims	Feb 4	195k	NA	183k
10-Feb-2023	U. of Mich. Sentiment	Feb P	62.0	65.0	64.9

The Jobs Bombshell Puts Markets On Edge

The markets recoiled as a much stronger than expected January Employment Report put stock and bond markets on notice that the Federal Reserve is not yet about to quietly move to the sidelines with an overheating labor market still very much in place. Bottom-line, Fed monetary tightening will continue in the months ahead.

A Jobs Boom Like No Other



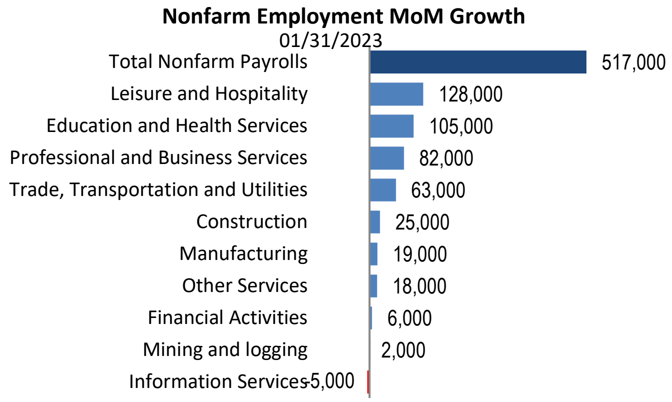
Source: U.S. Bureau of Labor Statistics

The dominant narrative on Wall Street has been that Fed's monetary tightening is nearly out of the picture for 2023. The story goes that a slowing economy, disinflation, and moderating earnings growth will soon lead to a Fed rate hike pause, setting up the central bank to begin cutting interest rates by as much as 50 basis points in the second half of this year. Stock markets have been absolutely buoyant with the NASDAQ up 17% and S&P 500 rising 9% since the beginning of the year as Treasury interest rates plunged. Alas, the January Employment Report threw ice cold water on that Goldilocks narrative and investors should probably throw that narrative right into the garbage can for 2023.

Markets appeared to be tone-deaf to Fed Chairman Jerome Powell's comments at the post-FOMC press conference this week that the Fed does not yet see "any meaningful weakening in labor market conditions" and went out of his way to mention that most economic forecasters think we need to see some meaningful weakening in labor market conditions to achieve a sustainable 2.0% inflation rate. The Fed believes it has "a lot of work left to do". To that point, we believe the Fed needs the U.S. labor market to cool down to a monthly job growth rate of below 100k per month for a sustained period of time along with further tightening of financial conditions for the Fed to achieve their inflation mandate of a stable 2.0% inflation rate.

So where was the U.S. labor market in January 2023? Red hot, if the January Employment Report is too believed. Nonfarm payrolls jumped another 517k on a seasonally adjusted basis in January, an acceleration from an upwardly revised 260k net jobs created in December. This blew away even the most optimistic forecasts of job growth for January that topped out at around 320k. Some more bearish economic analysts pointed to possible seasonal adjustment issues to help explain away the huge increase in nonfarm payrolls last month, but that is likely only a minor piece of the story. The real story of this jobs report is that the labor market was still way too hot for the Fed's liking if it has any hope of achieving its 2.0% inflation target in a reasonable amount of time. While a mild recession may still be in our economic future, it definitely didn't start in January.

Robust Services Sector Job Creation Continues in Jan.



Source: Bureau of Labor Statistics. Bank of the West Economics

Looking at the nonfarm payroll data by sector, we particularly noticed the strength and resilience of the job creation still coming from the service sector side of the labor market. Private service providing employment jumped by 397k jobs in January, accounting for a whopping 77% of total nonfarm payroll growth last month. Leisure and hospitality continues to lead the way with a net gain of 128k jobs in January followed closely by the education and health services sector at 105k, and professional and business services at a solid 82k jobs. Even government added a net 74k jobs to start the year. Tech sector layoffs did show up in this report as a modest net decline of 5k jobs in the information services sector – a drop in the bucket compared to the job creation coming from other more traditional service sector firms.

The ISM Service Purchasing Managers Index also released in a separate report today confirmed the solid rebound in the U.S. service sector in January, jumping 6 points and back into solid expansion territory at 55.2. Any number above 50 indicates expansion. The new orders sub-index for service businesses increased to 60.4 from 45.2 in December. Strong service sector gains were also seen for new export orders (59.0) and business activity (60.4).

But the job growth engine coming from the goods side of the economy was no slouch either with manufacturing employment growth accelerating to 19k from 12k in December and construction employment adding another 25k jobs, nearly the same number of construction jobs that were created in December and November.

The U.S. unemployment rate dropped by a tenth of a percentage point to a fresh expansion low of 3.4% from 3.5% in December. To put this remarkably low unemployment rate into perspective, it is the lowest level of U.S. unemployment rate since 1969 and two tenths lower than when the Fed starting hiking interest rates in March 2022. Any lower unemployment rate and you would have to go all the way back to 1953's 2.5% unemployment rate low. The less closely watched household employment survey increased by a sizzling 894k jobs in January as the labor force increased by 866k. The strong labor market helped bring more folks back into the labor market with the labor force participation rate improving to 62.4% from 62.3%

Historically Low Unemployment Is The Big Take Away

Source: U.S. Bureau of Labor Statistics

The Fed and Wall Street have been hyper vigilant in looking for any signs of a softening labor market to herald a true sustainable turn for the better in the U.S. inflation outlook that could prompt a near-term pause and pivot from the Fed's restrictive monetary policy stance, but given the pent-up policy fueled demand for services, there is little for us to point to in this report. This is good news for Americans still trying to find a new job, but a big negative for a Fed that is trying to cool down consumer inflation and tighten financial market conditions.

We see at least two more quarter point rate hikes from the Fed through May and then a prolonged pause before possible modest rate cuts in 2024. Todays' Employment Report raises the odds the Fed may even have to raise rates even more than our baseline forecast assumes to break the back of this labor market boom.

Key Economic and Interest Rate Forecasts

	History				Forecast								Yr/Yr % chg or Annual Avg.			
Economic Data	**2022.1**	**2022.2**	**2022.3**	**2022.4**	**2023.1**	**2023.2**	**2023.3**	**2023.4**	**2024.1**	**2024.2**	**2024.3**	**2024.4**	**2021**	**2022**	**2023**	**2024**
Real GDP*	-1.6	-0.6	3.2	2.9	-0.8	-2.5	0.2	1.4	1.8	1.4	1.6	1.8	5.9	2.1	0.3	1.2
Personal Consumption Expenditures*	1.3	2.0	2.3	2.1	0.8	-0.5	0.5	1.2	1.4	1.4	1.7	2.0	8.3	2.8	1.0	1.2
Non-residential Fixed Investment*	7.9	0.1	6.2	0.7	3.0	-5.3	-1.0	-0.7	0.9	1.0	1.1	1.2	6.4	3.6	0.4	0.0
Private Housing Starts (000s units)	1,720	1,647	1,450	1,403	1,385	1320	1300	1280	1274	1320	1355	1390	1,605	1,555	1321	1335
Vehicle Sales (mill. Units, annualized)	14.1	13.3	13.3	14.1	14.0	12.6	12.8	13.0	13.3	13.8	14.0	14.1	15.0	13.7	13.1	13.8
Industrial Production*	4.7	5.0	1.8	-1.7	-2.2	-3.0	-0.8	0.5	1.3	1.2	1.8	1.9	4.9	3.9	-1.0	0.7
Nonfarm Payroll Employment (mil.)	150.8	152.0	153.3	154.3	155.3	154.7	154.3	154.3	154.4	154.8	155.1	155.4	146.3	152.6	154.6	154.9
Unemployment rate	3.8	3.6	3.6	3.6	3.5	4.0	4.4	4.7	4.8	4.7	4.7	4.6	5.4	3.7	4.2	4.7
Consumer Price Index* (percent)	9.2	10.5	5.7	3.1	3.7	3.1	3.0	2.5	2.4	2.3	2.2	2.2	4.7	8.0	4.0	2.5
"Core" CPI* (percent)	6.5	6.6	6.4	4.4	4.2	3.9	3.5	3.0	2.4	2.3	2.2	2.1	3.6	6.1	4.4	2.7
PPI (finished goods)* (percent)	6.5	6.6	6.4	4.4	4.1	3.9	3.5	3.0	2.4	2.3	2.2	2.1	8.9	13.5	3.0	2.0
Trade Weighted Dollar (Fed AFE)	108.5	113.7	119.0	120.0	115.0	113.3	112.4	111.8	111.8	111.9	112.1	112.3	104.6	115.3	113.1	112.0
Crude Oil Prices -WTI ($ per barrel)	91	104	89	83	79	77	74	73	72	71	70	70	67	92	76	71

*Quarterly Data Percent Change At Annual Rate; Annual Data Year-on-Year % Chg, or Annual Average.

	History				Forecast								Annual Average			
Financial Data	**2022.1**	**2022.2**	**2022.3**	**2022.4**	**2023.1**	**2023.2**	**2023.3**	**2023.4**	**2024.1**	**2024.2**	**2024.3**	**2024.4**	**2021**	**2022**	**2023**	**2024**
S & P 500	4,464	4,106	3,980	3,852									3,218	4,273		
Dow Jones Industrial Average	34,679	32,688	31,774	32,490									26,891	34,055		
Federal Funds Rate (effective)	0.21	0.96	2.63	3.64	4.63	5.04	5.13	5.13	5.04	4.79	4.54	4.29	0.09	1.86	4.98	4.67
Treasury-3 Month Bills (yield)	0.31	1.10	2.75	4.19	4.70	4.99	5.05	5.04	4.99	4.74	4.49	4.24	0.04	2.09	4.95	4.62
Treasury-2 Year Notes (yield)	1.46	2.72	3.38	4.39	4.24	4.67	4.82	4.83	4.81	4.66	4.56	4.37	0.26	2.99	4.64	4.60
Treasury-5 Year Notes (yield)	1.83	2.96	3.23	4.00	3.78	4.29	4.50	4.57	4.64	4.59	4.49	4.29	0.84	3.00	4.29	4.50
Treasury-10 Year Notes (yield)	1.95	2.93	3.10	3.83	3.73	4.24	4.40	4.43	4.44	4.38	4.32	4.14	1.45	2.95	4.20	4.32
Treasury-30 Year Notes (yield)	2.26	3.06	3.26	3.90	3.68	4.27	4.42	4.45	4.46	4.40	4.36	4.19	2.06	3.12	4.21	4.35
Prime Rate	3.33	4.08	5.75	6.82	7.75	8.16	8.25	8.25	8.16	7.91	7.66	7.41	3.25	4.99	8.10	7.79
SOFR Overnight Rate	0.09	0.69	2.15	3.60	4.40	4.82	4.93	4.96	4.90	4.69	4.44	4.19	0.04	1.63	4.78	4.56
SOFR 3-Mo. CME	0.34	1.32	2.84	4.24	4.68	5.09	5.18	5.19	5.10	4.86	4.61	4.36	0.05	2.19	5.04	4.73
Libor 3-Mo. U.S. Dollar	0.53	1.54	3.00	4.51	4.82	5.17	5.26	5.26	5.22	4.96	4.71	4.46	0.16	2.39	5.13	4.84
Mortgage-30 Year (yield)	3.82	5.27	5.62	6.63	6.43	7.04	7.20	7.18	7.14	7.03	6.92	6.64	2.96	5.33	6.96	6.93
BAA Corporate (yield)	3.97	5.02	5.35	5.98	5.83	6.49	6.90	6.93	6.94	6.83	6.77	6.59	3.39	5.08	6.54	6.78

Source: Bank of the West Economics, Bloomberg, Federal Reserve