



Sweet Spot Economics: Striking the Right Balance

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The Goldilocks scenario for the economy and markets continued to play out nicely in Friday's labor market report. Friday's data came in strong, with a slight upward revision to the previous two months of payroll reports. The unemployment rate dropped to 3.8%, backing right into a sweet spot for unemployment between 3.6% - 4%. I was also happy to see the average hours worked bounced up to 34.4, which is a positive sign. We're back up to the 24-year average after a dip earlier this year. There was also a slight tick up in the participation rate, which is very good for labor market slack and wage pressure concerns.

Our other favorite indicator, the unemployment claims, ticked up to the exact middle of our desired range of 200k - 240k. So, both the unemployment rate and jobless claims moved to the center of our sweet spots—not too hot or cold.

The question now is how these reports feed into the Fed policy. The Consumer Price Index (CPI) and Producer Price Index (PPI), to be released this week, will be even more important. We look at the shelter component of inflation because we think that this is now overstated by the Bureau of Labor Statistics (BLS), which has been two-thirds of the increase of the CPI year over year. The early call is for year-over-year core CPI to decelerate to 3.7%, which would be the lowest level since the COVID-19 pandemic began. A lower reading, which is very possible, will bring a nice equity rally.

Is there anything to worry about? One of the things I am watching with slight unease is the rise in commodity prices. While some of it is due to oil and the situation in the Middle East, price increases are also spreading to other commodities. I don't think that this is a precursor to another inflationary period, but rather it's from the strength of the economy. However, as we have been saying for weeks, all the commodity indexes have broken out from their down trends and have started upward. This week was one of the strongest weeks for commodity price rises in many months. This bears watching but is not yet a negative.

The trend of equity prices is upward, and the momentum is still there. The strength in the economy with a 2.5% trend for first quarter GDP should be very positive for earnings in this quarter. We believe that this bull market in equities is not over.

Glossary

Bureau of Labor Statistics (BLS): A unit of the United States Department of Labor that measures labor market activity, working conditions, price changes, and productivity in the U.S. economy to support public and private decision making.

Bull market: A market in which share prices are rising, encouraging buying.

Commodity: A raw material or primary agricultural product that can be bought and sold.

Consumer Price Index (CPI): A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living. Core CPI excludes food and energy costs.

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States.

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Producer Price Index (PPI): A weighted index of prices measured at the wholesale, or producer level.

Past performance is not indicative of future results. You cannot invest in an index.

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