# Back to the Future

Is the soft landing for the US economy, that even the US Federal Reserve had doubts could be achieved, coming into view for 2023? US Treasury Secretary, Janet Yellen, seems to think so, cementing last week that she sees a path in which the US economy avoids recession, helped by a significant decline in inflation and a strong labour market.

She proclaimed you don't have a recession when you have 500,000 jobs added in a month and "the lowest unemployment rate in more than 50 years". Her comments came after US non-farm payrolls unexpectedly expanded by 517,000 in January, well above the 185,000 consensus forecast, with the unemployment rate dropping to 3.4%, the lowest level since 1969.

Both the Household survey and data from Homebase also showed very strong growth in employment in January. It could well be that the January data are an outlier, possibly impacted by favourable weather, and February delivers very soft numbers. Even allowing for a correction in February, though, the data point to continuing strong labour market conditions.

We note also that weekly jobless claims have remained very low into early February, while the latest JOLT report showed a big jump in job vacancies at the end of 2022. Thus, a broad array of data are pointing to a continuing very strong US jobs market. Meanwhile, the ISM Services PMI rebounded strongly in January also, rising to 55.5 from 49.2 in December, suggesting the biggest sector of the US economy is regaining momentum after a weak finish to 2022.

The Fed may be continuing to hike rates thereby dampening activity, but other factors that support growth are coming into play. Longer term interest rates have moved lower in recent months, with ten year Treasury yields declining to a 3.5-3.75% range from a peak of 4.25% in the autumn. Mortgage rates have fallen by 1% since the autumn, with mortgage applications rising in January. This should provide some support to the under-pressure housing market.

Meanwhile, US stock markets are also up by around 15% in the past three months. At the same time, as noted by Janet Yellen, the US CPI inflation rate has fallen from a peak of 9.1% last summer to 6.5% at end 2022, with the downtrend set to continue in 2023, alleviating the pressure on real household incomes.

The strong labour market data have seen interest rate futures contracts harden, with the markets moving into line with the Fed view that the funds rate will rise to a 5.0-5.25% range in the coming months. Fed Chair Powell does not seem overly concerned about the strong January employment data, noting that both wage growth and inflation have slowed in recent months even with continued strong job gains.

He did repeat, though, that the data show why the Fed thinks the process of getting inflation back down to 2% will take some time. The Fed has been actively dampening down market expectations for rate cuts. Markets see US rates being cut to 3.25% by early 2025. However, if there is a soft landing by the economy and it remains close to full employment, why would the Fed lower rates significantly, even if inflation falls to 2%. Could we be returning to the 1990s, when interest rates of around 5% were the norm in the US?

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