Economic highlights from the week ending on December 3, 2021

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Job growth was weaker than expected in November, but the unemployment rate still declined four tenths of a percent to 4.2%. We believe a variety of factors are keeping some workers out of the labor force, which has likely held back job growth despite strong demand from employers. These dynamics may remain in place over the near-term, though we tend to believe labor supply will improve as the health situation improves. U.S. nonfarm payrolls increased by 210,000 in November, versus the consensus forecast of 550,000. On a trailing 3-month and 6-month basis, payrolls increased an average of 378,000 and 612,000 per month, as job growth has decelerated from the summer months. The labor participation rate improved to 61.8% in November from 61.6% in October but remains lower than the pre-pandemic level of 63.4%. The employment-population ratio increased to 59.2% from 58.8%, but also remains below the pre-pandemic level of 61.1%. The U-6 underemployment rate, which includes those who are marginally attached to the labor force and employed part time for economic reasons, declined to 7.8% in November from 8.3% in October (versus 7.0% in February 2020). Annualized average hourly earnings were up by 4.8% in November (unchanged from October), reflecting strong wage growth driven in part by the ongoing imbalance in the supply and demand for labor. Although nearly 6.9 million people remain unemployed in the U.S., the labor market has made significant progress over the past year. We believe uncertainty related to the new Covid-19 omicron variant may prolong some workers' return to the labor force, and supply and demand for workers in high-touch service sectors in particular may remain unbalanced over the near- to intermediate-term, keeping upward pressure on wages.

Fed Chair Jerome Powell testified before the Senate Banking Committee earlier this week and indicated that the Federal Open Market Committee (FOMC) will consider accelerating the pace of tapering their asset purchases at the upcoming December 14-15 policy meeting. Fed Chair Powell previously indicated that the tapering process would likely be completed by mid-2022, but his comments this week suggest that process may be completed earlier in the year. This also indirectly implies that the timeline for potential future rate hikes may be pulled forward. Overall, Powell's tone was viewed as hawkish. His comments also come on the heels of the discovery of the new Covid-19 omicron variant which was first identified in South Africa last week and has subsequently been detected in other countries including the U.S. this week.

In reaction to news of the new variant and the Fed's more hawkish tone, financial market volatility has surged, with the CBOE Volatility Index (VIX) at its highest level since January 2021 (before vaccines became widely available), and the ICE BofA MOVE index climbing to its highest level since March 2020 (the beginning of the pandemic). Over the last six trading days, the 10-year Treasury yield has declined roughly 29 basis points to 1.35% (at the time of this report). The 2-year Treasury yield has declined five basis points to 0.59%. The spread between 2-year and 10-year Treasury yields has narrowed to 81 basis points, which is well below the 20-year historical average, as the yield curve has flattened. We believe financial market volatility is likely to remain elevated through year-end. Given

the high level of uncertainty regarding omicron's impact on the global health situation, supply chains, and the broader economy, a flight to quality may keep downward pressure on the longer end of the Treasury curve, at least over the near-term.

With inflation now appearing to be more elevated and prolonged than originally anticipated, we believe the Fed may accelerate the pace of their tapering process in order to give them the option of raising rates sooner, if needed. We do not believe that monetary policy is on a pre-set course and believe the Fed wishes to be positioned to respond to economic data as it evolves. We continue to believe that the Fed will take a gradual approach to normalizing monetary policy, given the ongoing uncertainties related to the pandemic, and we are not expecting a rate hike within the next six months. We expect the Fed to complete the taper process sometime in the first half of next year and announce the first rate hike in the second half of the year. In our view, inflation is likely to remain elevated over the near-term but may be at or near a peak as we enter 2022. Inflationary pressures are expected to stabilize as global vaccination rates increase, antiviral drugs enter the market, and supply chain bottlenecks ease. Our outlook assumes an improving global health backdrop, though risks to the downside remain. We anticipate that the Fed's gradual approach to rate hikes will put upward pressure on Treasury yields across the curve next year.

Next Week

International Trade, Productivity and Costs, Consumer Credit, CPI, Consumer Sentiment

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