Weekly Commentary **January 8, 2016**

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Ouch!, Great Jobs Report; the Fed Should be on Hold

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No way of sugar coating the start of this year, but the labor market report this morning is a bright light amid the bad news. Not only did we have blockbuster jobs growth, but the participation rate ticked up one tenth, allowing the unemployment rate to remain unchanged at 5.0%. I have long said that the participation rate, by influencing the unemployment rate, is far more important to the Fed than the payrolls. An increase in workers entering the job market will greatly reduce the threats of a tightening labor market, a prime determinant of Fed policy. To top off today's report, wages were unchanged and yoy increase was only 2.5% well below expectations.

I said at the end of my last newsletter that *if* we got stability in the commodity prices we would have a much better 2016. The news from China is not at all comforting on this point, as crude oil broke below its 2008 low and other commodities continued to sink. Of equal importance to the crash in oil prices is the sharp decline in the Chinese yuan. It was outrageous that the World Bank added the Chinese currency to its currency basket without first demanding that the Chinese stop manipulating the rate. Clearly the Chinese are letting their currency weaken because they want to stimulate the manufacturing sector. But how far down will it go? Another 5%, 10%, 20%? Nobody knows and this creates a destabilizing situation. It should be noted that by pegging the RMB to the dollar, The Chinese currency strengthened relative to the Euro, the yen and the rest of the world's currencies. I am not criticizing their right or wisdom to depreciate their currency, but by failing to allow the market to determine the rate, they are producing destabilizing capital flows as the Chinese try to get out before their money depreciates more.

A depreciated yuan and a slowing China will further lower inflation. The bottom line is that if China's slowdown continues and the trends in today's labor report (showing slowing wage increases and higher participation rate) persist, the Fed should put any further Fed Funds rate increase on a long-term hold and might even considering taking back December's increase. Recent statements by Fed officials have been interpreted by some to indicate that the Fed is on auto-pilot for 4 increases this year. Do not believe it. The minutes of the December meeting indicate that many FOMC members harbored doubts about an increase even though they voted in favor. The Fed is and will remain extremely data dependent. I expect there will be a healthy debate in the March meeting about the wisdom of a further increase.
DUE TO FAMILY VACATION, NEXT NEWSLETTER SUNDAY JANUARY 17
