Surprise ADP Plunge Hints at a Negative Non-Farm Payroll Number Friday

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This morning, the ADP employment report showed an unexpected -301k drop in business payrolls for January. Over 90% of the decline represented the service sector, specifically leisure and hospitality (-154k). Although a negative payroll print always raises eyebrows, some weakness was expected as an estimated 8.8 million Americans, or roughly 6% of U.S. workers, were unable to work in January because they (or someone they were caring for) had COVID-19. This is triple the number of absent workers from a month ago according to the U.S. Census Bureau.

The ADP report, although not especially well correlated with the more important employment report from the Bureau of Labor Statistics, still hints that January non-farm payrolls (scheduled for release on Friday) could also indicate jobs were lost. Because this virus-induced decline is expected to be temporary, Fed officials are unlikely to alter their near-term policy path. However, Powell has repeatedly said that COVID-19 remains the biggest risk to the economy. Daily cases are retreating, but remain elevated as the new month begins. It's likely that absenteeism spills over into the February non-farm payroll report, which the Fed will see 12 days before the March FOMC meeting.

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Fed officials already seem to be downplaying the possibility of a more aggressive policy stance. Several committee members have spoken this week and none have signaled a larger 50 bp hike for March. Atlanta Fed President Raphael Bostic (considered among the more hawkish members), speaking Monday to *Yahoo News,* said he still favored three quarter-point hikes in 2022, was not in favor of a larger hike for March and indicated he would be "laser focused on the next meeting." San Francisco Fed President Mary Daly (in the dovish camp) pointed to ongoing pandemic risks and told *Reuters* that the committee will need to be "gradual and not disruptive." And, Kansas City Fed President Esther George (also a hawk) said "you always want to go gradually; it's in no one's best interest to upset the economy with unexpected adjustments."

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Another argument for a gradual and data-dependent Fed is the expected committee shift in coming weeks. There are currently three vacancies to be filled on the Board of Governors; all seven governors vote at each FOMC meeting. The three new members are expected to have a more dovish lean.

The March FOMC meeting will include a fresh "dot plot," and given what existing members have indicated and the likelihood of a somewhat more patient committee mix, the March interest rate projection could fall short of current market expectations. The September dot plot did not indicate a full hike in 2022; the December dot plot showed three quarter-point increases for 2022, and the market has *currently* priced-in five.

Yesterday, the Institute for Supply Management (ISM) reported that U.S. factory managers had become a little less optimistic in January as the composite manufacturing index slipped from 58.8 to a still solid 57.6. Any number in this series above 50 indicates expansion. The current production index fell from 59.4 to 57.8, probably reflecting the recent Omicron surge, while new orders dropped from 59.4 to 57.8.

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The orders backlog index declined from 62.8 to 56.4, the lowest level in more than a year, and the supplier delivery times index slipped from 64.9 to 64.6. These decreases may indicate some easing of the bottlenecks that have plagued purchasing managers for much of the past year, but survey responses still mention *supply chain issues limiting production*. Despite fewer companies experiencing backlogs, the prices paid index actually climbed from 68.2 to 76.1. This inflation indicator is a bit troubling, simply because a larger percentage of factory managers reported higher prices when the trend seemed to be downward, but the January print was still well below the 92.1 peak from last June.

Market Indications as of 12:22 P.M. Central Time

DOW	Up 97 to 35,502 (HIGH: 36,800)
NASDAQ	Up 40 to 14,386 (HIGH: 16,057)
S&P 500	Up 33 to 4,579 (HIGH: 4,797)
1-Yr T-bill	current yield 0.74%; opening yield 0.74%
2-Yr T-note	current yield 1.15%; opening yield 1.17%
3-Yr T-note	current yield 1.36%; opening yield 1.38%
5-Yr T-note	current yield 1.59%; opening yield 1.62%
10-Yr T-note	current yield 1.75%; opening yield 1.80%
30-Yr T-bond	current yield 2.06%; opening yield 2.12%