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All Signal, No Noise

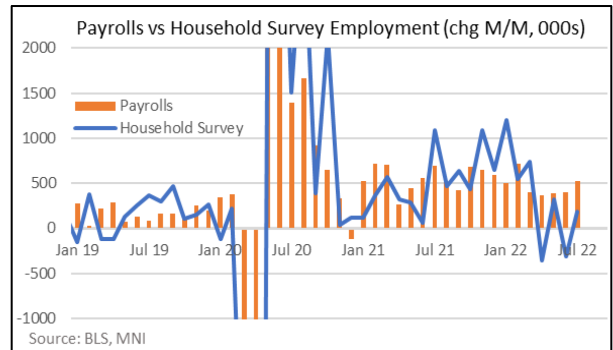
MARKET ANALYSIS

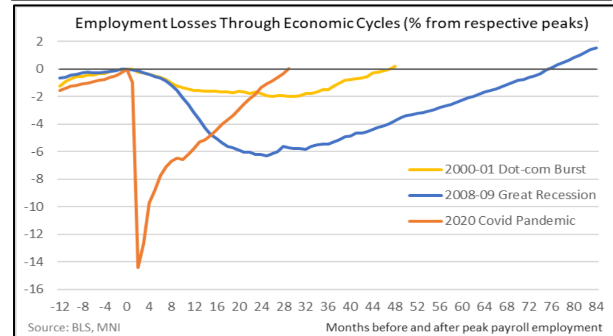
U.S. Employment Insight: July 2022

MNI View: Full Steam Ahead For The Fed

By Chris Harrison

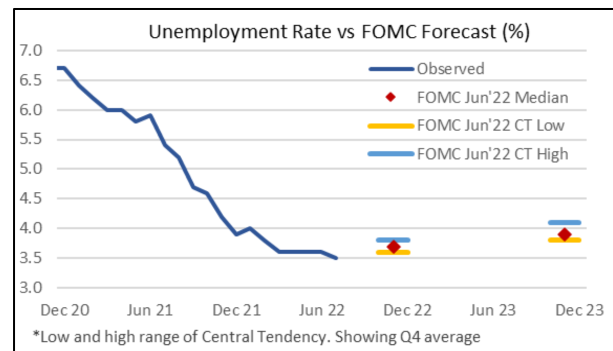
- *Payroll growth twice the pace expected, payrolls back above pre-pandemic levels*
- *U/E rate surprisingly falls to joint fifty-year low*
- *AHE growth accelerates from upward revision*
- *With CPI on Wed and plenty of data before the Sep FOMC, analysts are reluctant to formally change rate calls but see greater risk of a third 75bp hike*





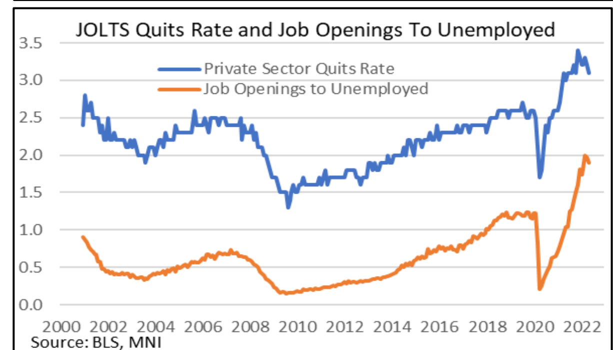
Surprising Resurgence In Payrolls Growth

We wrote after last month's June CPI report that inflation was stronger by almost every measure and the same is true for the July payrolls release. Nonfarm payrolls jumped 528k (consensus 250k) for a notable re-acceleration from the prior four months averaging 388k after small positive revisions. There had been an argument that payrolls growth was due to be revised down to better reflect the weakness in GDP growth through 1H22, but for now this report bolsters the countering arguments that the economy isn't in a genuine recession, a view pushed by various FOMC members of late. Labour data may be coincident/lagging indicators, but even so the gap to pre-pandemic payrolls levels has closed and the monthly contribution by sector was surprisingly solid with rate-sensitive sectors such as construction again holding up along with a sizeable increase in discretionary spending-heavy sectors such as food and drinking places – see chart pack. Pantheon does however note a particularly supportive seasonal adjustment in the analyst review further below- a 'normal' adjustment would have seen private payrolls of 280k.



U/E Rate Surprisingly Hits Joint Fifty-Year Low Of 3.5%

One of the very few softer areas was household employment increasing 179k as part of its notably weaker trend of late with a three-month average of just 62k. However, Goldman notes that the July rise was equivalent to 611k on a nonfarm-payroll-adjusted basis whilst it came with a second monthly decline in the labour supply (-63k after the -353k in June). The combination saw the u/e rate surprisingly fall a tenth to 3.5%, a joint fifty-year low only touched at the end of the last cycle just prior to the pandemic. This is the opposite direction to the FOMC median projection of 3.7% for 4Q22 from the June SEP having only just ditched the prior forecast of 3.5%. The underemployment rate meanwhile held at 6.7% as those working part-time for economic reasons bounced after a particularly large drop in June, but in doing so keeps to its 1994 series low after the surprise four tenth drop in June.



Pushing Back On Marginally Softer JOLTS

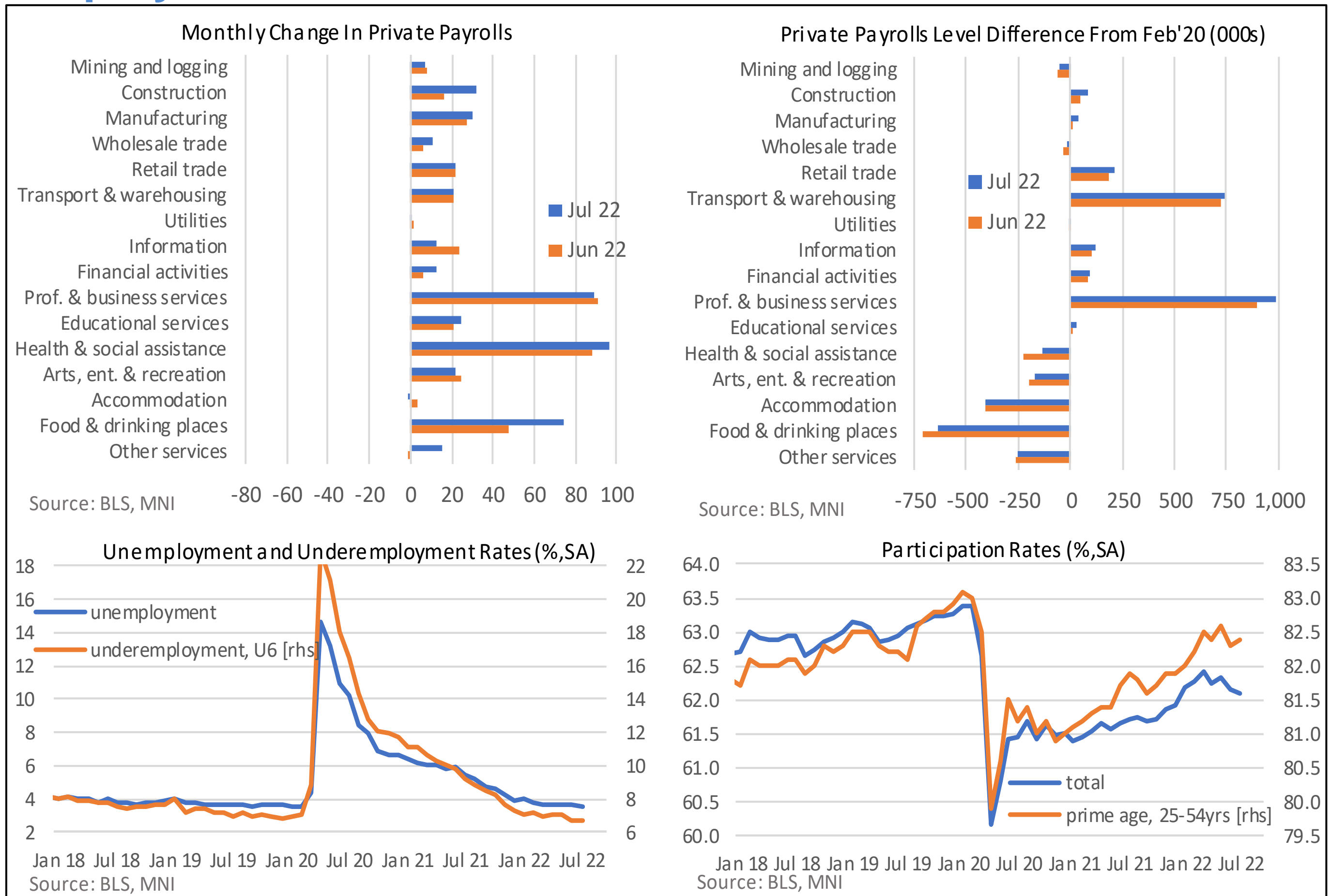
The decline in the labour supply came on a surprise dip in the participation rate to 62.1% (cons. 62.2%), the lowest this year in a further sign of the stalling in the recovery of labour supply. A small increase in the prime-age cohort is unlikely to appease the FOMC against the backdrop of the wider report, especially whilst two and seven tenths

below the post- and pre-pandemic peaks. Continuing the run of hawkish indicators, average hourly earnings (AHE) growth surprisingly re-accelerated to 0.5% M/M from an upward revised 0.4% (cons 0.3%) to leave annual growth at 5.2% Y/Y (cons. 4.9%). In doing so it pushed back against the notion that a small rolling over in JOLTS quits rates and job openings to unemployed could see marginally less upward pressure on wage growth.

Market Reaction: Outright Hawkish, Focus Now On CPI (Aug 10)
There is still one more payrolls report, two CPI reports and the Jackson Hole symposium to come before the Sept 21 FOMC, but it didn't stop Fed Funds futures closing 9bps higher with a 69bp hike priced for Sept – subsequently support by weekend Fedspeak from Governor Bowman and increasingly SF Fed's Daly ('24 voter). The terminal rate also jumped 22bps to 3.64% at the Mar'23 meeting and better tallies with the high 3s/low 4s per other recent Fedspeak although still had ~55bps of cuts thereafter to Dec'23. With July CPI coming on Wednesday, analysts have unsurprisingly been unwilling to formally change rate calls although do note an increased likelihood for a third consecutive 75bp hike in September.

A sizable bear flattening in Treasuries (2YY +18.3bps, 10YY +13.9bps) saw 2s10s hit fresh post-2000 lows at -44bps before closing at -40bps. TD note below they see potential for this to fall further to -80bps. Highlighting the sheer scale of recent swings in markets, the 2YY had a huge range of 49bps last week of 2.815-3.306% before closing at 3.226%. Those soaring yields pushed DXY up 0.8% on the day although it remains 2.5% off mid-July twenty-year highs.

Employment Chart Pack



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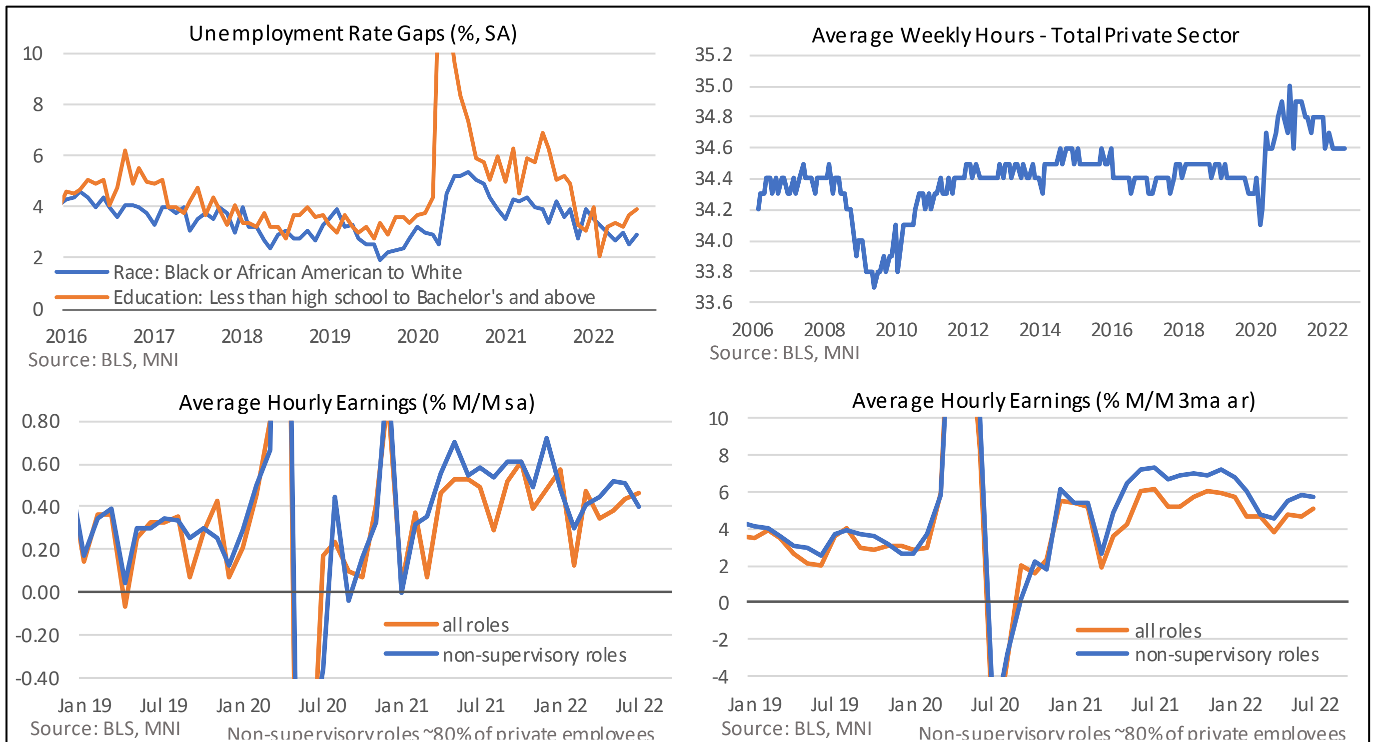

Jul 2022 Employment Report: Analyst Reviews

(In alphabetical order):

Barclays: Unambiguously Strong Payrolls Report But Sticking To 50bp Sept Hike

- Defying mounting signals of slowing growth in recent weeks, this week's non-farm payroll data also come on top of the still very elevated ECI and sequentially accelerating core PCE. It leaves little room for the Fed to interpret risks of more persistent inflationary pressures.
- Commodity prices have come down from their highs, with oil now trading firmly below $100, but for central banks, the effect this will have on headline inflation rates cannot offset the consequences labor markets have for underlying inflation.
- We retain our call for a 50bp hike at the September FOMC meeting, even if the likelihood (including in markets' pricing) of a 75bp hike have risen following today's report.

BMO: Fed's Rate Hike Cadence To Likely Remain Hefty Next Month

- The 528k gain and 28k of net upward revisions propelled payrolls above their pre-pandemic peak. Although not all industries can claim complete recovery, it's noteworthy that July's job gain was broad based with gains led by the most lagging sectors such as education and health along with leisure and hospitality.
- The combination of strong job growth, an extremely tight labour market and stubbornly high wage inflation suggests the Fed's rate hike cadence will likely remain hefty next month.

CIBC: 75bp Hike In Sept If Labour Market Doesn't Cool In Aug

- This report clearly dispels the notion of the economy already being in a recession and is much too hot for the Fed. If the labor market doesn't cool in August, officials will likely have to consider a 75bp move at the September meeting.
- Even the interest-sensitive sectors of construction and real estate added to headcounts, while consumer resistance to higher prices didn't stop employers from hiring in the retail sector. Manufacturers added employees, particularly in the semiconductor and electronic components area, along with other durable goods, in a sign that some supply constraints easing are supporting activity.

- The employment-to-population ratio for 25-54 year-olds still sits 0.5%-points below February 2020 levels. That could reflect people still living off of excess savings accumulated during the pandemic, lingering Covid fears, or the choice to forgo commuting and childcare costs and to remain at home instead.

GS: Continue To Expect 100bps Of Hikes Over Next Three Meetings

- Payrolls rose 528k in July with strong hiring more than offsetting a restrictive seasonal factor in the month (57k seasonal hurdle for private payrolls compared to negative hurdles averaging -61k in 2017-19). The household survey also pointed to firm job gains, as employment increased by 179k and 611k on a nonfarm-payroll-adjusted basis.
- Our composition-corrected wage tracker stands at +5.5% in Q2, compared to +5.4% in Q1.
- Today's report indicates an overheated labor market that continues to tighten further. We continue to expect another 100bp of Fed funds rate increase over the next three meetings: +50bp in September and +25bp in both November and December, with risks skewed towards earlier or larger increases.

ING: Sticking With 50bp In Sept With A lot Of Data Still To Come

- Payrolls growth was twice that expected but more significantly, all the jobs lost during the pandemic have finally been fully recovered with total payrolls at an all-time high of 152.54mn.
- The fall in gasoline prices is set to boost household spending power, prompting an expected rebound in 3Q GDP of 3%+. With next week's CPI report set to show core inflation rising above 6%, market momentum is swinging towards a third consecutive 75bp hike.
- However, there is still a lot of data to come between now and the September 21st FOMC meeting so for now we are happy to stick with our 50bp Sept, 50bp Nov and 25bp Dec Fed hike call.

JPM: 75bp Hike In Sept Now Looks Likely

- Today's numbers should mollify recession fears but amplify concerns that the Fed has a lot more work to do, and we now think a 75bp hike in September looks likely.
- The inflation worries motivating the Fed will only be heightened by this jobs report whilst the only disappointing detail was the tick down in the participation rate to 62.1% (though that decline was due to the jumpy teenage participation figure).
- We continue to look for two more 25bp hikes in Nov and Dec, bringing the terminal rate to 3.5-3.75%. Unless the data stumble, a case could be made for going more than 75bp in Sep, though if the FOMC rejected that option in June and July it would seem they have an aversion to ripping off the bandage. So far they also seem averse to hiking inter-meeting.
- Unemployment declined 242,000 last month. With job vacancies down 1.157mn in the three months ending in June, the first round of the V/U rumble has gone to Waller.

MS: A Very Strong Employment Report, With Positive Details Across The Board

- For the Fed, the combination of strong payroll and wage growth coupled with continued declines in participation and the unemployment rate is a clear signal that tightening will continue to be appropriate.
- It also strengthens the belief espoused by FOMC members that the economy is clearly not in recession, supporting the Fed's steep tightening path through the rest of the year.

Pantheon: Beware The Seasonal Boost

- Construction and manufacturing jobs were solid which looks odd, given every manufacturing and construction indicator we know has fallen in recent months, to say nothing of the slowing in consumers' spending growth to just 1.0% in Q2.
- Our model, based on the Homebase small business employment data, nailed the unadjusted private payroll number, but we were undone - along with most other forecasters - by a much more generous seasonal adjustment than in July last year.
- If last year's seasonals for June and July been used again this year, the increase in private payrolls in July would have been 280K (vs 471k), making us nervous about the chance of a substantial swing in the other direction over the next few months; the seasonals even out over the year as a whole.
- We had been hoping that the Fed would be able comfortably to pivot to 50bp in Sept or even 25bp, but the latter is now off the table, and the policy decision will be 50bp or 75bp. We still hope for the former, but the data over the next seven weeks will need to be more or less uniformly on the soft side for that to happen.

Scotia: Supporting At Least A 4-Handle For Fed Funds But Productivity A Concern

- The US is amazingly 32k above the level of nonfarm payrolls from just before the pandemic in what is now a full job market recovery whilst the household survey is only 576k below pre-pandemic levels which for all its wonkiness is as good as even
- Our view remains that real wage growth will turn positive later in the year into next and with consumers currently bridging the effects of inflation through tapping wealth and liquid cash and near-cash holdings.
- Labour productivity is tanking after a 7.3% q/q SAAR drop in Q1 and probably another ~5% drop in Q2. That often doesn't end well and so be on guard toward the real possibility that jobs will eventually get hit even if they are currently exceeding expectations.
- Jobs and wages say hello to 75bps in September for a data-dependent Fed that is obsessed with looking over its shoulder at the latest prints. Numbers like these support the narrative that the Fed is going at least 4-handled on the policy rate and could be there by Q4.

TD: Fed Not Close To Being Done On The Hiking Cycle

- The payrolls report shows the labor market remains tight and supports the view that the Fed is not close to being done on the rate hiking cycle and much less close to "pivoting" on policy.
- Rather the report is likely to enhance the Fed's inclination to front-load interest rate hikes until the policy rate overshoots neutral by a good margin over the next few months. We look for a terminal rate of 3.50%-3.75% by the Dec FOMC.
- We took profit on our short Jan 2023 Fed funds futures position but think the 2s10s curve could invert toward -80bp as the long-end is likely to pencil in a greater likelihood of a downturn as the Fed continues to hike rate aggressively. We also remain long 30y real rates.
- With a Fed dovish pivot premature, the USD will be hard to beat. While we are wary of price action on a summer Friday, USDJPY should be trading with a 136-handle while EURUSD will continue to languish in the shadow of the Fed and energy crisis. We think legging into CAD shorts is appropriate into the fall.

Unicredit: 75bp Hike In Sept Is Probably Now The Base Case

- Importantly, the current pace of payroll gains is many times what would be required to simply absorb new entrants into the labor market (around 100-150k per month).
- The labor market report adds pressure to act more forcefully in tightening monetary policy. Notwithstanding the importance of Wednesday's July CPI report, it seems clear that another 75bp rate hike will be very much on the table at Sept FOMC, and probably is now the base case.
- The Fed will be particularly concerned about the reacceleration in AHE growth after signs of some moderation in recent months. Wage growth is simply too high to be consistent with the inflation target, requiring Y/Y wage growth around 3.5% vs currently over 5%.

Wells Fargo: White-Hot Payrolls At Odds With Other Data Points

- Broadly speaking, the economic data are sending mixed messages at present, and the white-hot payroll numbers look increasingly out-of-line with other data points.
- That said, employment growth of more than half a million jobs per month and a falling unemployment rate are hard to ignore, and we suspect this data will give the FOMC the confidence it needs to push ahead aggressively with its fight against inflation.
- At least a 50 bps rate hike at the Sept FOMC seems likely at this point in time, and yet another 75 bps hike could be in store if inflation over the next two CPI reports shows no signs of trending lower.