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MACRO MORNING BRIEFING

September 9, 2024

Jobs Data Do Not Make Case for 50bp Cut

- To us, Friday's labor report confirms a 25bp cut later this month
- Layoffs remain low, and the unemployment rate moved lower
- Nevertheless, the labor market is still weakening, and we expect that to continue
- Market pricing is still aggressive, indicative of a recession forecast – we don't agree

Fed to cut 25bp later this month

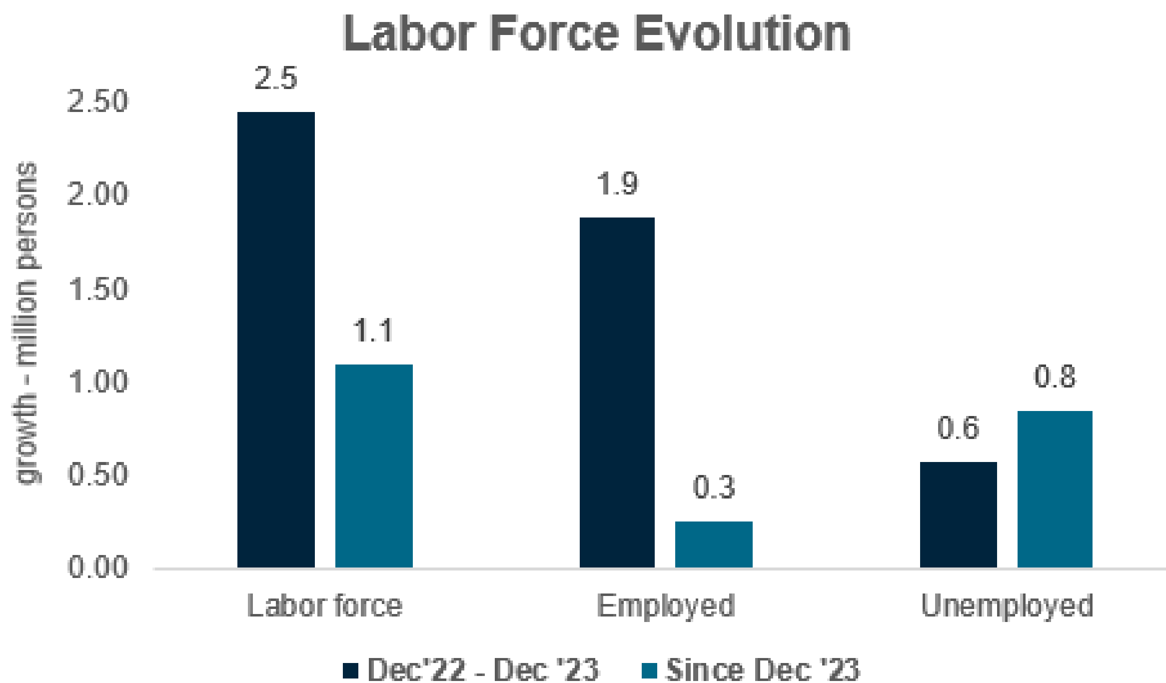
After weeks of anticipation, the August employment report, released last Friday, turned out to be something of an anticlimax. Total payrolls increased by 142k, less than consensus was expecting, but nearly within a standard deviation of all the estimates. Moreover, the unemployment rate, which had been a source of concern for us and others, actually fell from 4.3% in July to 4.2% in August. Overall, the jobs report leads us to lean in favor of a 25bp rate cut on September 18, although markets are still pricing in a nontrivial possibility of a 50bp cut.

As mentioned above, among the positive developments was a decline in the unemployment rate (UE). Readers will recall that the rise in UE to 4.3% last month triggered the Sahm Rule, which in the past has identified every recession since 1948 (see here). With UE down to 4.2% in August, the Sahm Rule calculation (which states that if the three-month average of UE is at least 0.5% above the lowest UE of the previous 12 months, a recession is at hand or close to it) is exactly 0.5%. While we're not out of the woods on this measure, it is an improvement.

Among the positive takeaways from the report is an increase in employed persons (as reported in the household survey) of 167k, while the number of unemployed persons fell by -48k. This is behind the decline in UE. Furthermore, the number of job losers (either via layoffs or having completed temporary employment) was up just 6k, after an increase of 39k

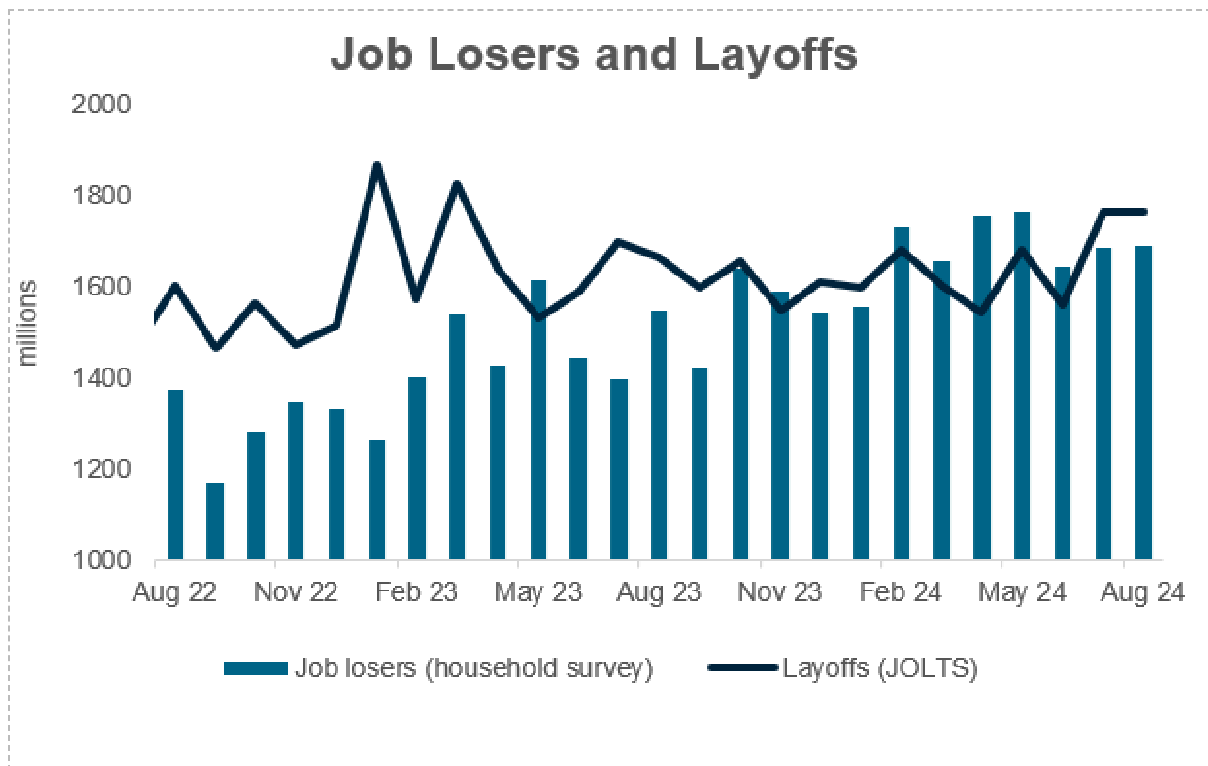
last month. As a whole, these data suggest that layoffs are not driving UE higher. Still, Exhibit #1 shows that the vast majority of new entrants into the labor force this year (1.1m) have not been able to find jobs; of that number, 800k are unemployed, while just 300k have found jobs. This is in stark contrast to what we saw in 2023, when most new entrants found jobs.

Exhibit#1: More Labor Market Entrants are Unemployed



Source: BNY Markets, Bureau of Labor Statistics

Exhibit #2: Layoffs Not Alarmingly High

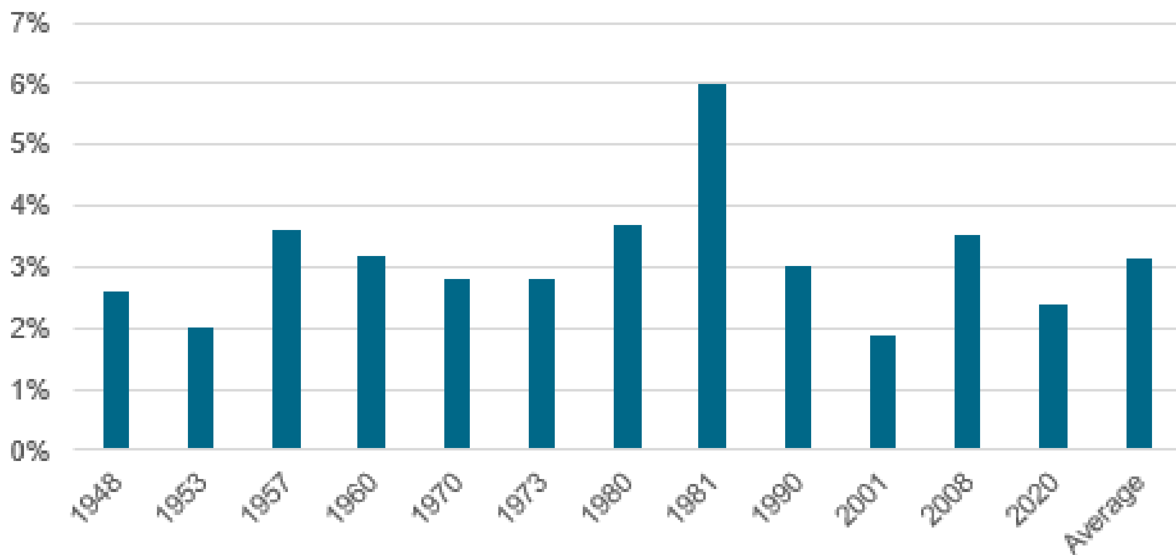


Source: BNY Markets, Bureau of Labor Statistics

July's payrolls data were revised lower (after an already weak initial print) to just 89k and in a month's time we'll be looking for revisions to the August report. Combined with a weak JOLTS report (last Tuesday) and a downbeat Beige Book (last Wednesday), we still see further weakening in the labor market ahead, even if this month's report was a welcome surprise. Exhibit #3 shows that typically – and this analysis covers all post-war US downturns – the unemployment rate increases by 2% or more within 12 months after the economy enters recession. Once it hits, the labor market declines rapidly.

The current cycle is somewhat different, however. Since reaching a low of just 3.4% in January 2023, UE is now 1.8% higher, even though we clearly haven't yet entered recession. We would ascribe this increase to the fact that the labor market was extraordinarily tight two years ago, as new entrants into the labor market were largely absent due to knock-on effects of the pandemic. As the labor force has grown – much in line with the Fed's view at the time – this tightness has been relieved, driving up UE in the process. At the moment, given the JOLTS and jobs data, we would conclude, as has the Fed, that the labor market is in equilibrium, removing some of the upward pressure on goods and services inflation.

Exhibit #3: Big Increases in Unemployment after Recession Starts



Source: BNY Markets, Bureau of Labor Statistics, NBER

We know that the Fed will be cutting rates in September, a view we've held since the beginning of the summer, and one confirmed by Chair Powell at his Jackson Hole appearance a few weeks ago. Of course, the outstanding question now centers on the size of the reduction of the federal funds rate, 25bp or 50bp?

Had Friday's report been weak, particularly if the unemployment rate increased, we would have revised our call for 25bp in favor of 50. However, given the actual print, we don't see the urgency for the jumbo cut. Our view is underscored by a still robust – even if cooling – macroeconomy. As such, we expect a 25bp reduction in the funds rate on September 18.

Influential Fed Governor Chirstopher Waller gave public remarks on Friday just a few hours after the labor data were released. His appearance was the final scheduled Fedspeak before the FOMC went on media blackout, so it was bound to be required listening. He didn't address the 25-vs-50bp debate directly but remained ambivalent. We suppose it was too much to expect Waller to be explicitly prescriptive in his comments, although he did indicate that that if appropriate, he would advocate "front loading" cuts to preserve the expansion and remained open to adjusting the pace further down the road.

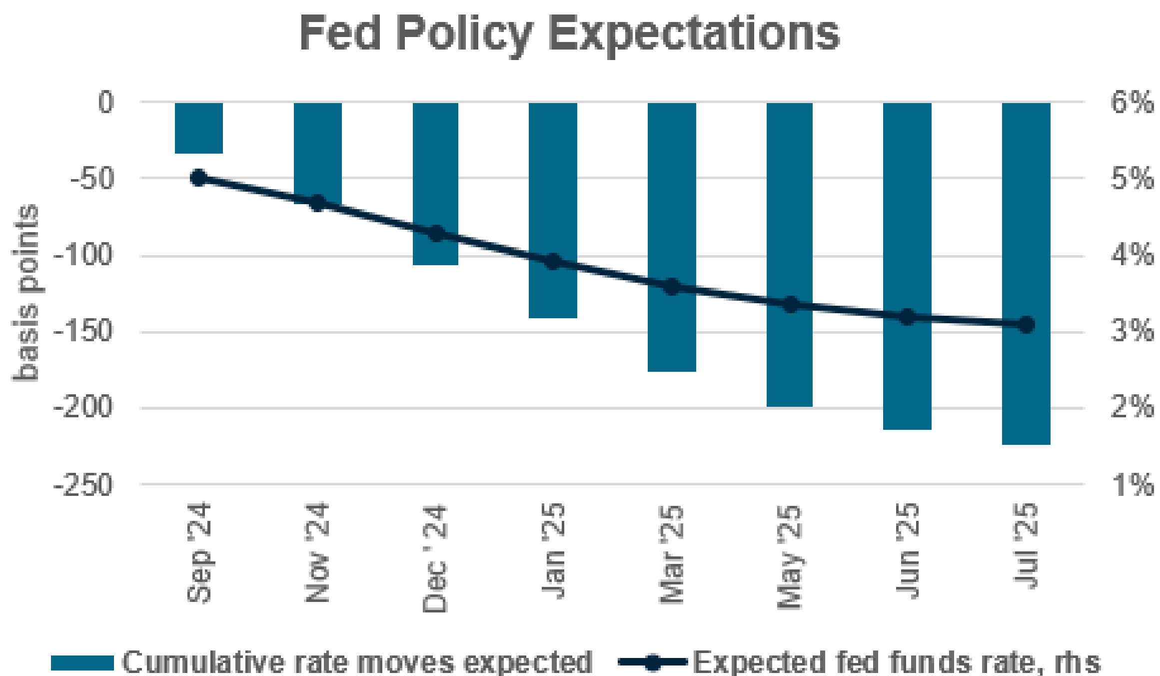
Still, given that there are now very few data releases on the calendar before the FOMC meeting on the 18th, we don't think there will be compelling evidence that would argue for a larger cut. The August CPI report is released this week, and we expect it to further indicate a

gradual but steady decline in inflationary pressures. However, it would take a really big drop in inflation to justify 50bp and we just don't see that in the cards. The labor market – as evidenced by the Chair's Jackson Hole comments – is now the primary concern for the Committee.

It's interesting to note the fixed income market's reaction to the data. Initially bonds rallied across the curve, although more so at the front end, and the 2y10y yield slope is now positive (which we discussed in a recent piece, see here). Nevertheless, odds for a 50bp cut in September fell to about 22% as of this writing, whereas they were much higher right into the release, about 35%. However, the market-implied odds of a jumbo hike in November did increase and are now higher than for September. This suggests the market is anticipating more labor slowing into the autumn months, leading to a stronger policy response.

All told, the market still has a total of 100bp priced in by the end of the year. With only three meetings left this year (including September), a 50bp cut is expected at some point. Further out the curve, there are now 225bp in cumulative rate reductions seen by July next year, again implying one cut of 50bp somewhere along the way (see Exhibit #4). To us, this is recession pricing, and we just don't believe we're at a point to consider that.

Exhibit #4: Recessionary Fed Pricing?



Source: BNY Markets, Bloomberg

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Please direct questions or comments to: iFlow@BNY.com

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