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MACRO MORNING BRIEFING

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US Job Market Coming Back Into Better Balance

- Top line nonfarm payrolls strong, but underneath signs of labor market cooling
- Business capex also set to tail off
- US dollar stands to weaken as rate cuts become more certain

Hot Nonfarm Payrolls, Lukewarm Details

Despite the strong headline print for US February nonfarm payrolls (NFP), the employment report was marginally weaker overall, adding more fuel to expectations that the Federal Reserve will indeed cut interest rates at some point this year, probably starting in June. Our call for a March cut – and then another in May – will probably prove too dovish, and we acknowledge that its June 11-12 meeting will likely offer the FOMC its first chance to reduce the federal-funds rate. The cumulative sum of rate-cut expectations through that meeting is now close to pricing in one full quarter-point cut.

Total new nonfarm jobs last month came in at 275k, well above the market's expectation of 200k. However, revisions to the previous two months subtracted 167k from the increases initially reported. In particular, the eye-popping January top line of 353k new jobs was revised down to 229k – still healthy, but less "hot" than the initial print implied a month ago. Several other details support the weaker-than-it-appears interpretation of the February data:

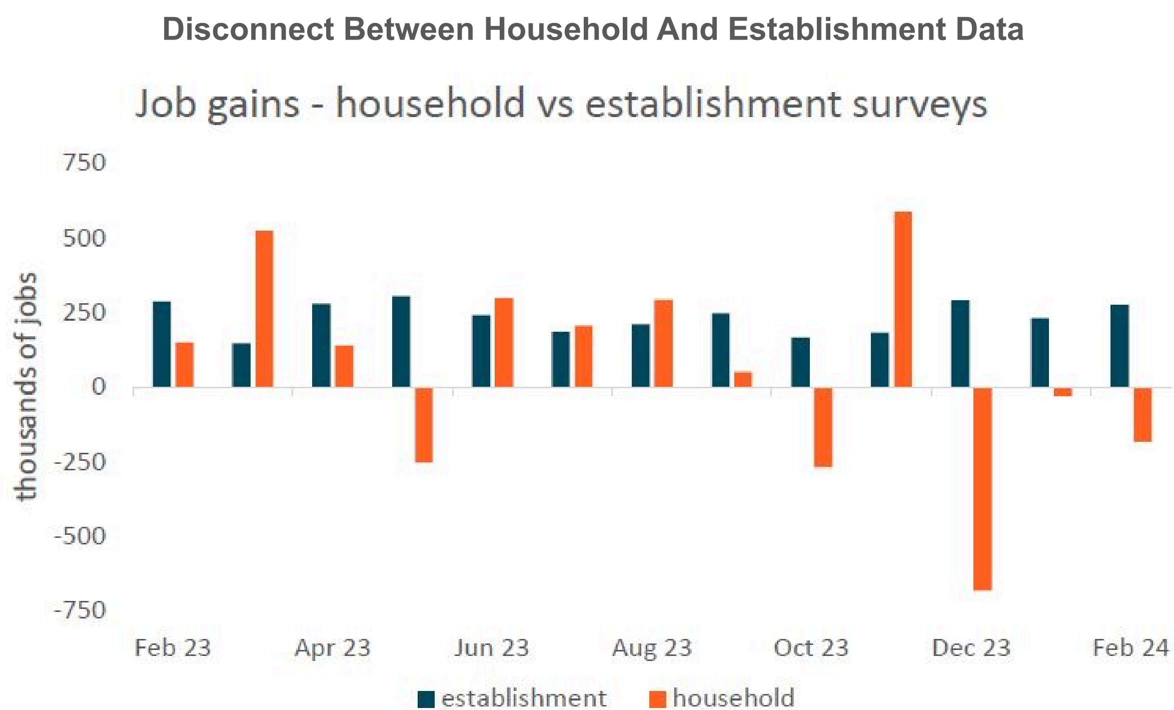
- The household survey, as distinct from the establishment survey (from which headline NFP is derived), showed a 184k decrease in the number of people working, the fourth month of negative household employment growth in the last five.
- The unemployment rate surprisingly increased to 3.9% from 3.7%, that owing to more people entering the labor force (+150k) but not necessarily finding jobs, leading to an increase in unemployed persons of 334k.
- Job gains were concentrated in three sectors, two of which are not related to the economic cycle, namely Medical Care Services (up 91k) and Government (up 52k). Subtracting these sectors, which are growing steadily, the NFP gain was just 91k.

- Average hourly earnings were up just 0.1% on the month, but steady on a yearly basis at 4.3%. That is well above the PCE inflation rate of 2.9%, indicating that real wages are rising, possibly owing to productivity gains.

The Fed will likely welcome signs of the labor market (to use Chair Powell's words) "coming back into better balance" between supply and demand conditions.

Meanwhile, there has of late been a growing chorus of market commentators suggesting the Fed will not cut rates at all this year. This view has been predicated on the notion that the economy is not slowing – indeed, may even be accelerating – and inflation is sticky. Regarding the former, we disagree – the economy is in fact slowing (not crashing by any means, to be sure). We think Friday's labor data confirms this view. The Fed doesn't mind a strong – but steady – economy, and we think Q1 GDP growth will come in around 2%, after breakneck paces of 4.9% and 3.3% in Q3 and Q4 2023, respectively.

Disconnect Between Household And Establishment Data

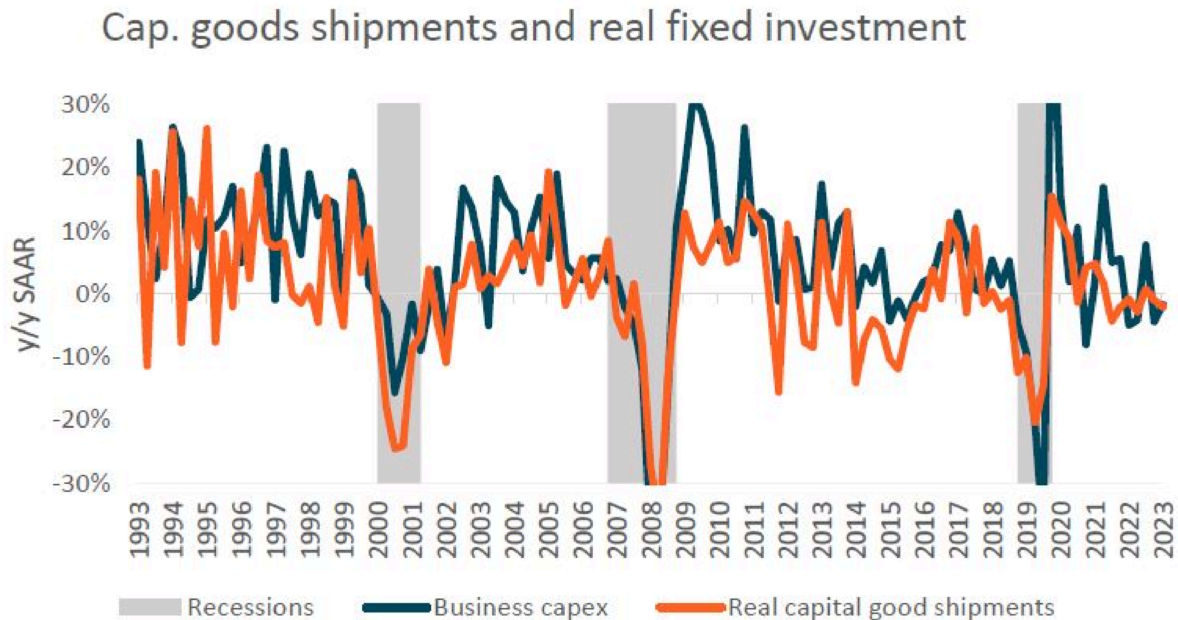


Source: BNY Mellon Markets, Bureau of Economic Analysis

It's not just the labor market that is slowing. We are also keeping an eye on business spending, which after a weaker Capital Goods report a few weeks ago is suggesting that business's capital expenditures will also tail off, especially for equipment and software. The chart below shows that after deflating the capital goods shipments series and transforming it into a "real" (i.e., not nominal) measure, it is now negative. This deflated real capital goods shipment series matches well with the Bureau of Economic Analysis's private fixed investment in nonresidential equipment – a broad measure of firms' capital investment.

This leaves inflation as the major factor in the Fed's mind. Chair Powell, in Thursday's semiannual testimony before the US Senate Banking Committee, said that the central bank is "not far" from gaining the greater confidence needed to cut rates. While February CPI to be released this Tuesday will therefore be important, we still think core PCE inflation is the major inflation variable to watch. That's next due on March 29.

Business Spending To Slow?



Source: BNY Mellon Markets, Bureau of Labor Statistics, Bureau of Economic Analysis

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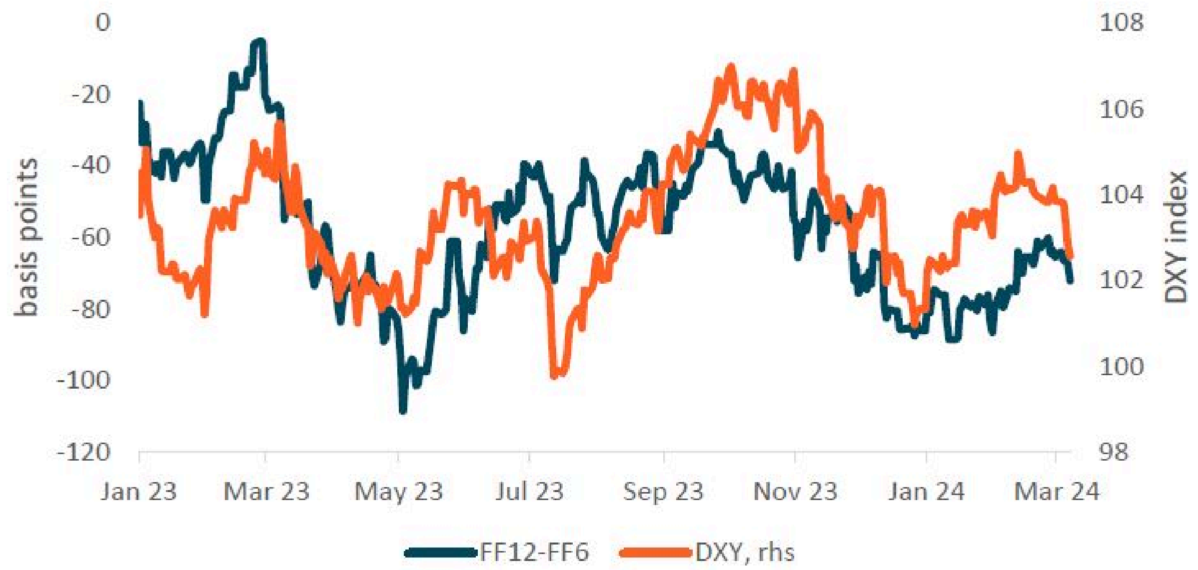
Dollar Waiting On The Fed

We have argued that if and when Fed rate-cut expectations rise, the dollar would start to weaken. The chart below bears that out: as expectations for a lower Fed funds rate increase, the DXY (US Dollar Index) falls. We show the difference between the generic 12-month futures-implied Fed funds rate and the generic 6th contract, an indication of where rates are seen headed. As this difference falls, the dollar tends to weaken, and vice-versa. Since last autumn, the DXY and our FF12-FF6 time series have been closely correlated.

Now, once the Fed does start to cut rates, probably in June, we think the dollar should be poised to rally back. Other central banks like the ECB, Bank of England, and Bank of Canada will likely be entering their own rate-cutting cycles around the same time. This, combined with what we expect to be continued "US exceptionalism" in terms of growth outperformance vs. the rest of the world, should see the dollar – at that point somewhat cheaper and positioning in it likely underweight – regain supremacy.

Dollar Dances With Rate Expectations



Source: BNY Mellon Markets, Bloomberg

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