Market Update

Economic News

October 5, 2018

The September Employment Report missed on the headline jobs growth number (134,000 vs. 185,000 expected) but prior two-month revisions added 87,000 jobs thereby offsetting the 51,000 miss in today's report. Plus, the impact from Hurricane Florence in the southeast will get blamed for some of today's headline miss. The unemployment rate also hit a new cycle low of 3.7% (matching the Fed's year-end forecast) and that's putting some pressure on short-end yields this morning. Average hourly earnings increased 0.3% for the second straight month matching expectations and the 2.8% YoY rate also matched forecasts but was a dip from the cycle-high 2.9% YoY rate in August. While this rate remains shy of the 3.0%-3.5% pre-crisis levels the back-to-back monthly gains of 0.3% will keep the Fed on its quarterly rate hiking trek. That, in turn, will keep pressure on the short-end while the back-end remains spooked by whiffs of wage inflation. But as noted above, wage gains at 2.8% YoY remain under pre-crisis levels and with year-over-year CPI averaging 2.7%, real wages are barely above zero, hardly the stuff to engender runaway price inflation. That's one reason we think the back-up in Treasury yields looks more technically inspired, driven by the reversal of curve flattening trades, rather than a fundamental repricing due to gathering inflation/growth concerns. Thus, with the employment report now out of the way, we would be buyers at these seven-year high yield levels.

For the month, 134,000 jobs were created widely missing the 185,000 expected and well below the 270,000 jobs created in August (upwardly revised from 201,000). Over the past year monthly job gains have averaged 211,000 so September's results were below that average. Private payrolls increased 121,000 versus 180,000 expected and 254,000 in August (revised up from 204,000). Two-month revisions added 87,000 jobs from prior prints, more than offsetting the 51,000 miss this month. In addition, Hurricane Florence obviously impacted numbers as well in the southeast. Digging into the categories, 75,000 service-providing jobs were added during the month (62% of total job growth) versus 217,000 in August. Gains were led by health-care and social assistance (+30k) and transportation and warehousing (+24k). Meanwhile, 46,000 goods-producing jobs were added (38% of the total), which is up from the 37,000 added in August with construction (+23k) leading the gains in that sector.

The most important metric in the monthly jobs report are the wage gain numbers. For September, wages matched both the monthly and year-over-year pre-release expectations. Average hourly earnings for September rose 0.3% and the August initial print of 0.4% was revised lower to 0.3%. So with the August downward revision the largest monthly print in the last year was December's 0.4%. Year-over-year earnings were 2.8% matching expectation but down from August's 2.9% which was the highest since May 2009. While the YoY gain remains shy of the 3.0% to 3.5% pre-recession rate, the continued 0.3% MoM rates will still embolden the Fed to continue with quarterly rate hikes.

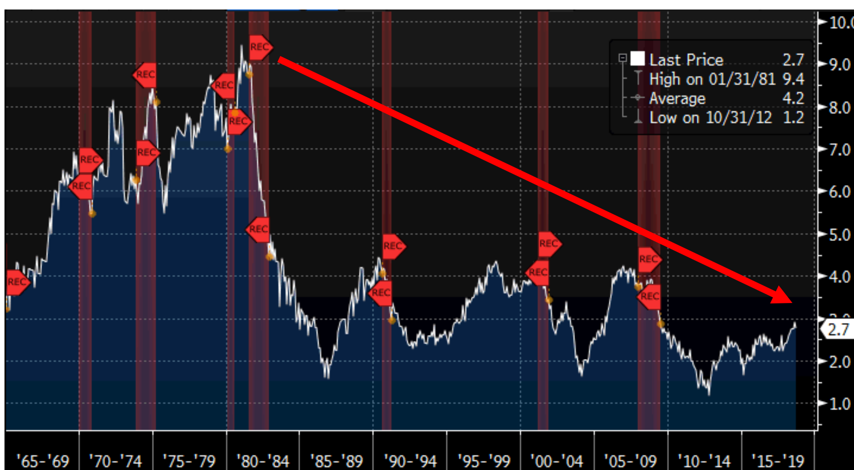
The unemployment rate dipped two-tenths to 3.7% (3.683% to be exact) beating the 3.8% expectation and a new cycle low print. The rate dropped two-tenths as the labor force denominator rose following a dip in August. The labor force increased 150,000 which, combined with the 270,000 drop in the ranks of the unemployed, moved the unemployment rate lower. Both elements are "good" in that the rate moved lower for the "right" reasons: more people entered the labor force and people left the ranks of the unemployed. That is helping put some pressure on yields this morning as the unemployment rate moves closer to the Fed's year-end projection.

The broader underemployment rate (unemployed plus part-timers seeking full-time work, plus the marginally attached divided by the labor force) ticked up 1/10th to 7.5% after hitting a new cycle low in August. The rate increase was due to a increase of 263,000 in part-time workers, an increase of 134,000 the ranks of the marginally attached (those willing to work but not actively looking). Partially offsetting those numerator increases was the aforementioned 150,000 increase in the labor force denominator. This rate bottomed in the 7.9% - 8.2% range prior to the recession, thus we are into new territory with the present underemployment rate and that's another indication we are operating at full employment.

The labor force participation rate (labor force divided by civilian population) dipped 1/10th to 62.7% as the 150,000 increase in the labor force was more than offset by a 224,000 civilian population gain leading to the dip in the participation rate. Despite the unrelenting gains in headline job growth, the current reading pales in comparison to the 66% level that prevailed pre-crisis but the 62.7% to 63.0% participation rate range of late may well be the new full employment normal given the aging of the working population and slowing population gains.

In summary, despite the headline miss this is another solid jobs report with the 0.3% MoM and 2.8% YoY wage gains the lead story. The headline miss is offset by revisions to August along with Hurricane Florence impacting the southeast. The wage numbers alone will keep the Fed firmly in hiking mode, The increase in market rates this week is partially a response to the unrelenting strength in the economy and jobs market, but those gains are not bearing fruit in the form of accelerating wage growth. This report, and most other releases of late, will keep the Fed on its quarterly hiking schedule for the foreseeable future.

Year-over-Year Change in Avg. Hourly Earnings



Average hourly earnings has become the most important metric in the monthly employment reports. With the unemployment rate setting new cycle lows, and well below the Fed's long-run equilibrium rate of 4.5%, wage gains rose 0.3% in September matching expectation and the August print. While current wage gains are shy of prior periods— with the average over the 53-year period at 4.2%—the back-to-back gains of 0.3% that will embolden the Fed to remain on its quarterly hiking schedule for the foreseeable future but we fail to see a major threat of gathering wage inflation and thus would be buyers of this back-up in long-term yields.

Market Rates

Treasury Curve	Today	Chg Last wk.	LIBOR Rates	Today	Chg Last wk.	FF/Prime	Rate	Swap Rates	Rate
3 Month	2.21%	+0.08%	1 Mo LIBOR	2.28%	+0.03%	FF Target Rate	2.00%-2.25%	3 Year	3.144%
6 Month	2.41%	+0.10%	3 Mo LIBOR	2.41%	-0.01%	Prime Rate	5.25%	5 Year	3.182%
2 Year	2.89%	+0.07%	6 Mo LIBOR	2.61%	+0.01%			10 Year	3.258%
10 Year	3.22%	+0.16%	12 Mo LIBOR	2.93%	+0.01%				