

October 7, 2024

## Hot Jobs, Cooler Fed

- Friday's labor report was exceptionally strong, softening Fed rate cut expectations
- Markets' repricing of the Fed's easing cycle has driven the USD higher
- This is a good setup for risk assets; iFlow shows corporate bond demand relates to spreads

### **July's weak print is now in the rearview mirror; expected rate cuts dialed back**

July's employment report was surprisingly soft and recalibrated market views for the Fed's interest rate outlook. September's report was a surprise of the opposite kind; it was a very hot report, and it too has led to (at least in the short term) a reassessment of the policy outlook. There is almost no corner of the report that doesn't suggest the job market remains "solid," in Chair Powell's words. As for rates, we continue to expect a quarter-point move at the November 7 FOMC meeting.

As mentioned above, market pricing has also shifted. Before the release, implied pricing was somewhat split between a 25bp and 50bp easing. Since the data came out (and as of this writing), the market has not only eschewed the idea of a second consecutive jumbo hike by the Fed, but it is actually less than 100% convinced there will be a 25bp hike. Exhibit #1 shows the movement in the OIS futures implied rate curve, comparing September 19 (the day after the last FOMC meeting, which featured a 50bp cut) to last Friday afternoon's curve. Exhibit #2 shows the probabilities of a 25bp cut at the November, December and January meetings.

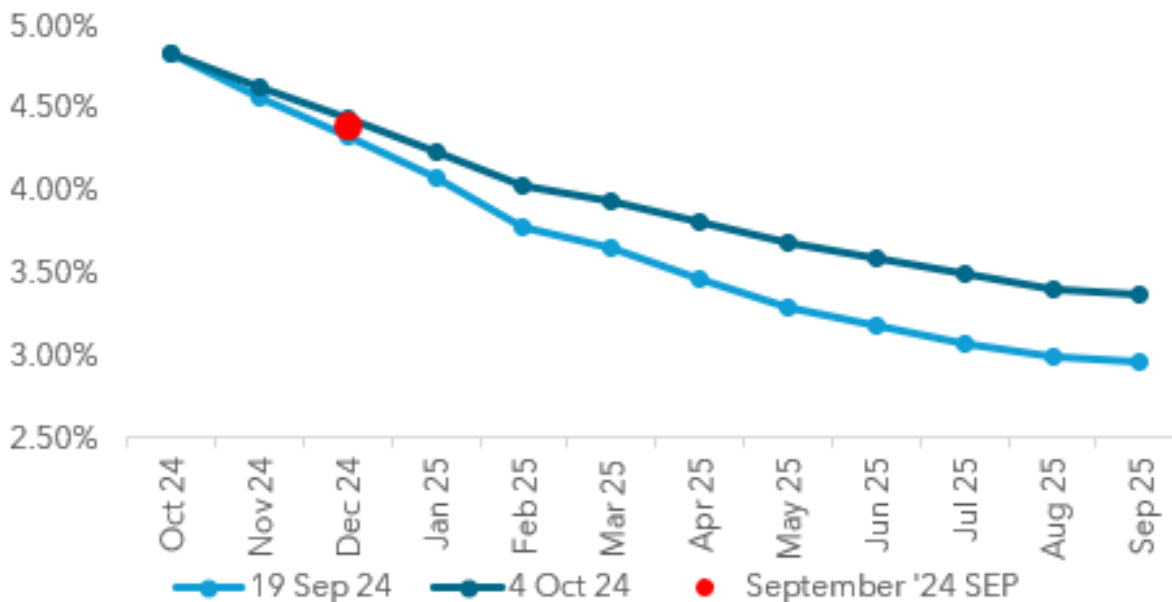
We reiterate that we don't think the 50bp cut in September was a policy error by any stretch, contrary to some commentators' views. As we wrote a few weeks ago after the FOMC

meeting, we strongly believe that had the Committee seen the jobs data for July (which came out two days after the July 31 meeting) they would have kicked off with a 25bp easing at that meeting. We view the jumbo September move as a catch-up for having held rates steady at that meeting. Furthermore, we still believe that at its current level, the real federal funds rate (2.5%) is still more than high enough to be reduced at a steady rate.

---

### Forward Curve Becomes More Shallow

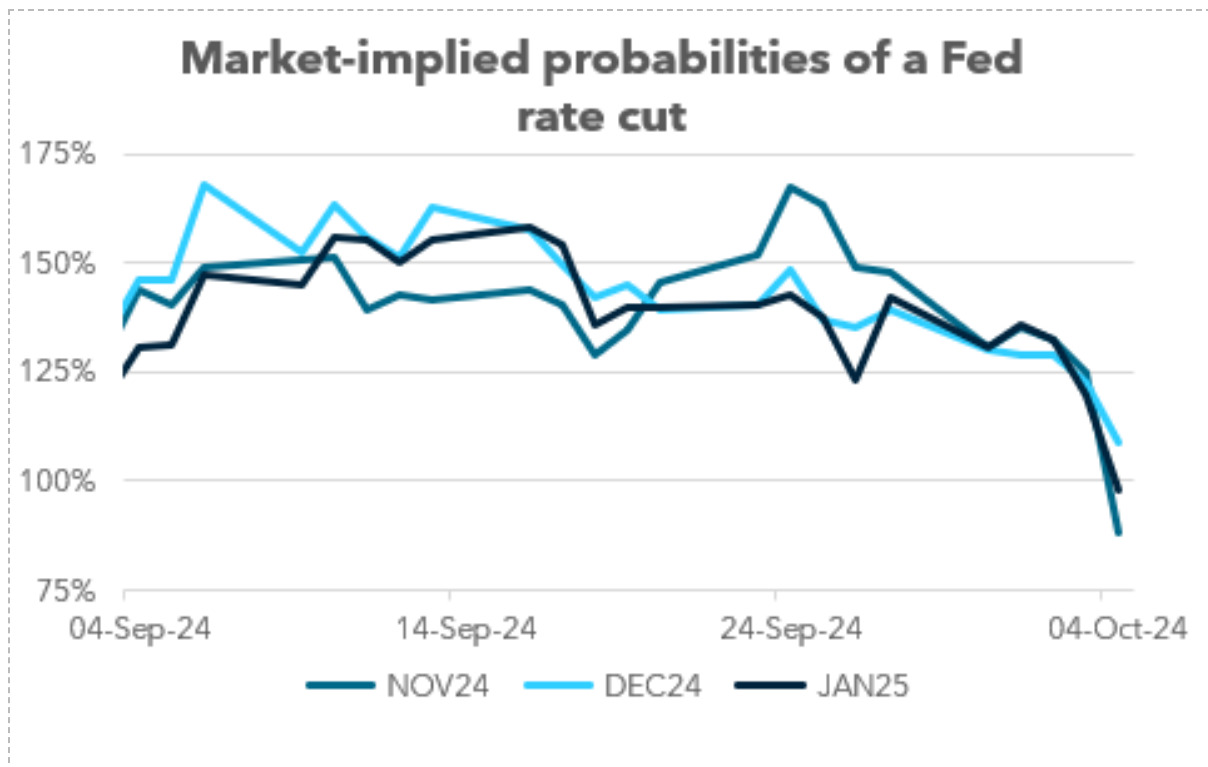
#### Fed funds futures implied policy rate



Source: BNY Markets, Bloomberg

---

### Rate Cut Probabilities Collapse



Source: BNY Markets, Bloomberg

Some color on the jobs report:

- The number of nonfarm jobs grew by a whopping 254k, the highest monthly print since January this year. It beat consensus expectations by over 100k. Job growth was solid across economic sectors, with just manufacturing posting a negative number (-7k, after last month's revised -27k).
- The unemployment rate actually declined by 0.1%, down to 4.1. Recall in July, this rate had reached 4.3%, triggering the Sahm recession rule. Even with the drop in the jobless rate, the Sahm rule is still pointing to recession, but just barely. If the unemployment rate stays at 4.1% next month, the Sahm rule would no longer be in effect.
- The labor force grew by 150k, but the total number of people who found jobs was up an impressive 430k, while unemployment fell by -281k. This is a reversal of the trends we had seen for most of this year.
- Manufacturing employment, as mentioned above, was one of the few weak spots in the report, falling by -7k. Year-to-date, manufacturing jobs have declined by -43k and have been weakening since the beginning of 2023.
- One potential source of concern is the increase of 4.0% y/y for average hourly earnings. This has raised some concerns that inflation is still not fully defeated, and could remain sticky – or, at the extreme, increase – in coming months, complicating the Fed's deliberations.

While the AHE increase might make some wonder if inflation will return to a prominent position on the Fed's list of concerns, we hasten to add that the monthly increase in wages

(0.4%) came in lower than it did last month. Furthermore, average weekly hours fell slightly, making the increase in aggregate, economy-wide wage growth look less severe. We think that as long as CPI (this Thursday) and PCE inflation (the last day of October) don't abruptly reverse their recent constructive trends, the Fed will be able to proceed with the easing cycle, albeit at a slower, more traditional quarter-point clip in November and December.

We note that our short-term dollar view has shifted as well. With Fed expectations now much less dovish than they had been until very recently, we no longer expect a gradual weakening of the currency, and instead see further upside. Rate expectations have played a large role in DXY movements for most of H2 this year, and with the current perceived federal funds path having readjusted, we see appreciation as the likely path for the USD. This positive view on the greenback is likely to be bolstered by potential haven buying should the conflict in the Middle East worsen over coming weeks. Exhibit #3 shows how well correlated the dollar has been with rate cut expectations (we use the federal funds rate implied by the ninth generic federal funds future). Note the jump in the currency just on Friday alone, rising with reduced rate cut expectations.



Source: BNY Markets, Bloomberg

---

Although rate cut expectations have been dialed back meaningfully on the release of the data, markets are likely to be buoyed, as they were already on Friday. A strong jobs market, supplemented by other strong economic results in recent weeks has allayed recession fears,

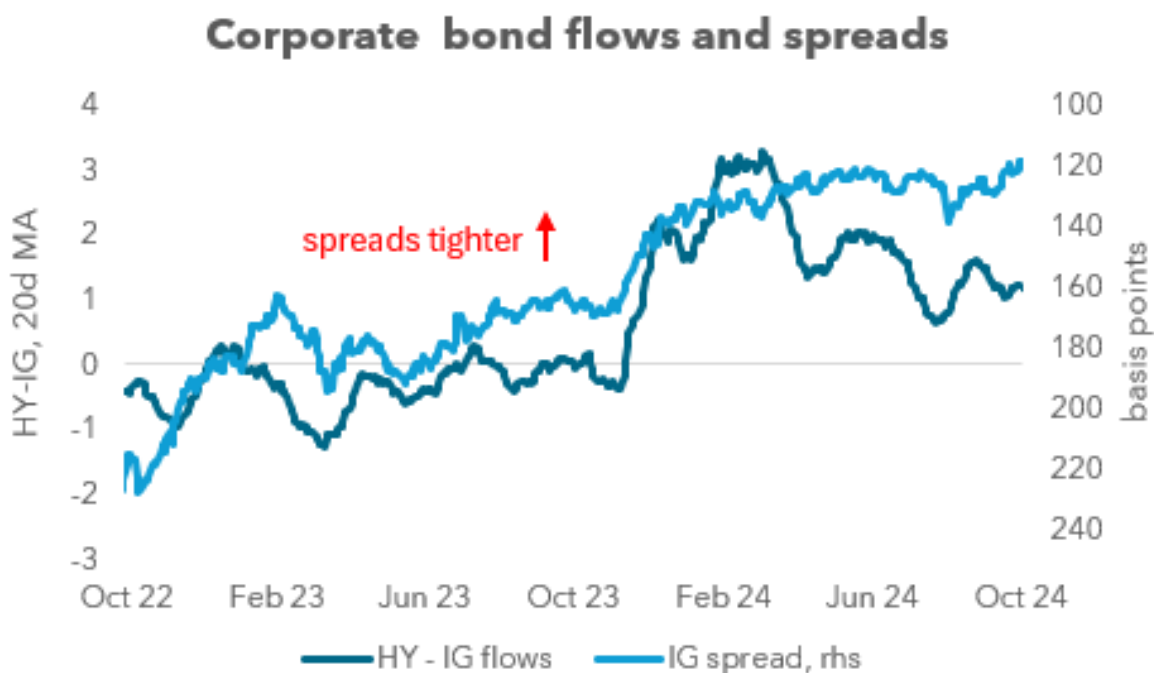
and the view that the Fed will still be cutting rates combine to paint a bullish picture for risk assets.

We can see some of this playing out in our iFlow data, shown in Exhibit #4. Our corporate bond flow data show that demand for high-yield debt relative to investment grade corresponds to the behavior of IG spreads. When the former outpaces the latter, spreads tend to narrow. We interpret this relationship as a general measure of appetite for credit overall, with HY flows having a higher “beta” to IG flows, reflecting broad demand for spread product.

IG spreads may not be able to tighten much from here, but any fears of an impending – or even an eventual – slowdown which would drive spreads and default risk higher have been put aside for now. We continue to believe in a soft landing, with inflation slowly coming under control and economic growth settling to near trend, as the Fed follows a gradual cutting cycle. Markets seem to think so as well.

---

### iFlow Shows Corporate Debt Demand Relates to Spreads



Source: BNY Markets, iFlow, Bloomberg

---

### Disclaimer & Disclosures

Please direct questions or comments to: [iFlow@BNY.com](mailto:iFlow@BNY.com)

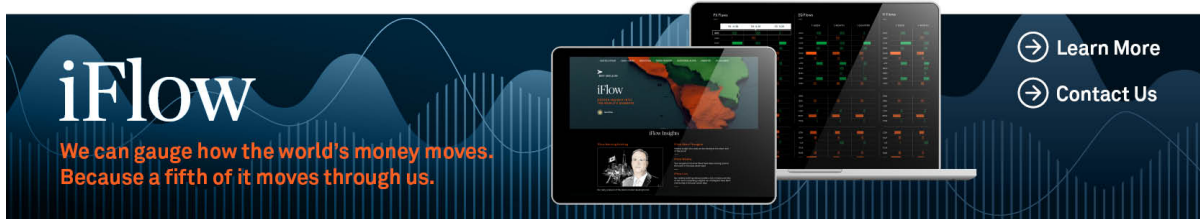


**John Velis**  
AMERICAS MACRO STRATEGIST

CONTACT JOHN



Can't see the email? [View online](#)



We take our data protection and privacy responsibilities seriously and our privacy notice explains how we collect, use, and share personal information in the course of our business activities. It can be accessed [here](#).

This email was sent to james.cohen@bnymellon.com, and was sent by The Bank of New York Mellon 240 Greenwich Street, New York NY 10286.

Your privacy is important to us. You can opt out from receiving future Newsletters by [unsubscribing via this link](#) at any time. You can also select the topics that you want to receive by [managing your preferences](#).

This message was sent from an unmonitored email box. Please do not reply to this message.

[Contact Us](#) | [iflow@bnymellon.com](mailto:iflow@bnymellon.com)

© 2024 The Bank of New York Mellon Corporation. All rights reserved.

This message was sent from an unmonitored email box. Please do not reply to this message.