

## The Odds Favour A Nonfarm Disappointment That Is Probably Not Priced Into Rates

- A solid nonfarm payrolls report after the ADP shocker is highly improbable.
- The rates complex may be underpricing the odds.

How likely is it for US private nonfarm payrolls to come in decently tomorrow after ADP private payrolls grew by only 27k in May? **The shorter answer is not very likely at all.**

Markets are accustomed to ADP head fakes ahead of a nonfarm print. Chart 1 demonstrates that the initial ADP reading can undershoot (below the x-axis) and over-shoot (above) the initial private nonfarm payroll estimate by significant margins. In fact, since ADP revised its methodology in October 2012, the average of the absolute value of the monthly spreads between the readings has been about 50k which is non-negligible.

But how likely is it to get a material private nonfarm payroll upside after an ADP reading like this last one? That depends upon what you call 'material.' Let's say we define this as a private nonfarm reading of +150k or greater. *There has never been a private nonfarm upside to ADP of that magnitude or larger in the nearly seven year period since ADP revised its methodology to improve its tracking ability.* If it happens tomorrow—which is improbable but not impossible—then it would be a record outlier.

The previously largest downside miss for ADP relative to private nonfarm payrolls was a miss of 106,000 in November 2014. Back then, the initial reading for ADP was 208k and private nonfarm exceeded that with a print of 314k. In other words, relative to ADP's May reading of +27k, anything higher than a private nonfarm reading of 133k tomorrow would be a record gap between the initial prints for the two readings.

In fact, over this same period, there have been only five months when ADP has undershot private nonfarm payrolls by about 80k or more. Put another way, a private nonfarm reading of over roughly 110k tomorrow would be among only a half dozen such experiences.

If you're a betting person, then betting on a moderately strong private nonfarm print faces about a 6% chance of being right.

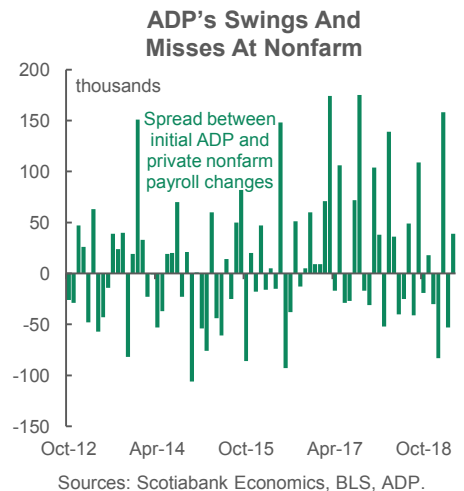
Also note that we haven't had an ADP print as low as last month's over the whole period since they revised their methodology in October 2012.

**Is the rates complex priced for such a disappointment?** Note that the two year Treasury yield has fully reversed the rally that occurred after the ADP shocker when it immediately plunged by about 8bps. Indeed, as this note is being printed, the two year yield is a little above where it was before ADP due to volatile headlines regarding Mexican tariff negotiations. The greater risk may be nearer term fed funds futures contracts that inform market probabilities for a rate cut in the nearer term.

In conclusion, regular readers know that I usually emphasize two things when it comes to estimating job growth. One is that ADP can be counted upon for significant nonfarm head fakes in either direction. Two is that nonfarm's large 90% confidence interval of +/-110,000 jobs always merits caution and considerable humility. Sometimes, however, evidence presents itself to give reason to warn of a material outlier and this may well be one of those occasions.

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