Fed Shocker: US Nonfarm Payrolls Add To Cut Case

- US nonfarm payrolls and wage growth both disappointed expectations;
- ADP nailed it;
- Markets see a July cut as a near certainty and June as possible.

U.S., Change in Non-farm Payrolls SA (m/m 000s) / UR (%) / y/y wage growth (%), May:
Actual: 75 / 3.6 / 3.1
Scotia: 200 / 3.6 / 3.1
Consensus: 175 / 3.6 / 3.2
Prior: 224 / 3.6 / 3.2 (revised from: 263 / 3.6 / 3.2)

- Insurance against risks? This report says it may be too late for that in the face of the reality of a weaker employment market. This is a disappointing payrolls report across-the-board on the headline, revisions and underlying details. The case for a Fed rate cut is very strong.
- China is begging for a trade deal because its economy is in trouble but the US is doing very well? Not so fast with that either. In fact, this report stops that always-exaggerated argument dead in its tracks. Of note is that job creation soured well ahead of Mexican tariff headlines that added to uncertainty, given the nonfarm reference period which is the pay period that includes the 12th day of each month. Do you think hiring confidence improved since then as a warning for June payrolls?! This report is a striking warning to the Trump administration regarding its trade policies as the effects hit home through reduced hiring confidence. Not unexpectedly, Trump's twitter account is quiet.
- The credibility of the ADP report as an advance clue to nonfarm expectations just leapt higher. While I never revise a nonfarm call after ADP (and perhaps should have this time!), the statistical odds that were explained here performed very well. The updated chart 1 adds today's 63k spread between private nonfarm payrolls (+90k) and ADP private payrolls (27k) to the third from the left bucket in the category that shows the spread between the two in the 60–79k range of ADP undershooting nonfarm. In short, ADP predicted something weak, but the spread is one of the 8 smallest spreads since ADP revised its methodology in October 2012. Ergo, the statistical odds pointed to a weak nonfarm, but this is among the weakest it could have been. Respect for confidence intervals and revision risk to both reports still merits some degree of caution, but the Fed will still worry about this reading.
- The market reaction occurred in a nanosecond. Fed funds futures contracts are pricing about 85% odds of a cut in July and about three cuts for the year. June is a material risk in my view. The 2 year Treasury yield immediately sank by about 9bs to 1.79% and far below the Fed funds target rate range of 2.25–2.5% before clawing back a little of that. Equity futures initially took it negatively, but then rallied probably in sympathy toward the Fed implications and the cash market just opened 1/2 to 3/4% higher. The USD sank 0.4% on a DXY basis on the same Fed rate cut expectations.

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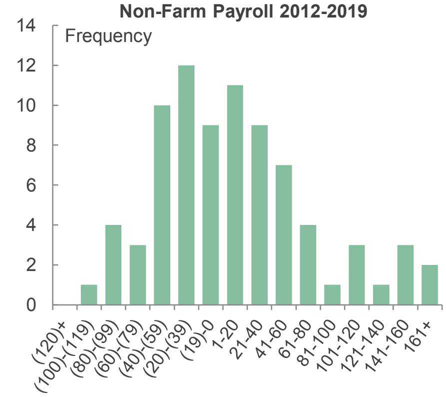
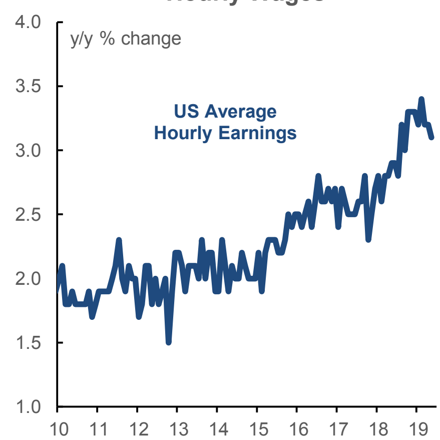
Differences Between Inital ADP And Private Non-Farm Payroll 2012-2019



000s; parentheses indicate negative values; postive values indicate ADP overshoots

Sources: Scotiabank Economics, BLS, ADP.

Hourly Wages



Sources: Scotiabank Economics, Bureau of Labor Statistics.

- Wage growth decelerated a tick to 3.1% y/y in keeping with Scotia's estimate (see chart 2).
- Revisions took out 75,000 jobs including 39,000 fewer jobs created in April and 36,000 fewer jobs created in March compared to prior estimates.
- The unemployment rate held steady at 3.6%. That's because it is derived from the companion household survey that registered a job gain of 113,000 and a roughly similar labor force gain of 176,000.
- The weak pace of job creation had breadth to it. Private industry jobs were up by only 90k with government down 15k at the state and local level with Federal hiring up only 4k despite the Census.
- By sector, construction was up 4k, manufacturing was up 3k and services were up by 82k. Within services, there were three mild bright spots: business services (+33k) but not due to temp help (+5k), education/health (+27k) and leisure/hospitality (+26k). Trade and transport hiring was flat including an 8k drop in retail sector hiring. IT fell 5k. Financial sector hiring was flat (+2k).
- Total hours worked were up by only 0.1% after a prior 0.2% drop. Soft job creation, soft hours worked and soft(er) wage growth add up to reinforce a weak picture for income growth when those figures land on June 28th. That likely means less in the tank for the month's consumption unless it came at the expense of the saving rate. Retail sales on June 14th will provide one clue to this effect and auto sales suggest a favourable headline that will shift the focus to sales ex-autos and gas and the retail sales control group.