

Nonfarm Reins In Bets On Fed Cuts

- Payroll growth rebounded in June...
- ...as ADP predicted only a 4% chance of such a nonfarm reading
- Wage growth was firm at 3.1%
- A cut in July is not guaranteed...
- ...as nonfarm and G20 have been favourable developments...
- ...to Powell's near-term watch list
- The focus shifts to FOMC minutes and Powell's Congressional testimony

U.S., Change in Non-farm Payrolls SA (m/m 000s) / UR (%) / y/y wage growth (%), June:

Actual: 224 / 3.7 / 3.1

Scotia: 100 / 3.6 / 3.1

Consensus: 160 / 3.6 / 3.2

Prior: 72 / 3.6 / 3.1 (revised from: 75 / 3.6 / 3.1)

- **Nonfarm payrolls rebounded and that lessens the chances for the Federal Reserve to cut its policy rate on July 31st. Alternatively, this could position markets as excessively pricing cumulative easing with three cuts priced by the end of 2019.** Markets reacted by pumping short-term yields higher with the two year Treasury yield up 10bps on the day and half of that since payrolls and the USD firmer against all major currencies on overall lessened conviction toward the cumulative amount of easing that is priced in.
- **Private payrolls (+191k) were up by less than headline payrolls because of strong government hiring.** Government added 33,000 jobs in June, but not because of Census related hiring. All of the hiring was at the state/local level (+31k) and overall temp hiring was only up 4k. I don't have a good explanation for the surge in state/local government hiring.
- **ADP was a head fake this time.** ADP had recorded 102,000 new private payroll jobs and private nonfarm payrolls were up by 191k. That spread of 89k is the 3rd biggest undershoot of ADP to private nonfarm payrolls since ADP revised its methodology to more closely follow nonfarm starting in October 2012. The odds were in favour of ADP guiding a weaker nonfarm, but this was the third biggest ADP downside miss out of 81 observations which means **there was about a 4% chance for a private nonfarm payroll reading like this one.**
- **Sector breadth was solid.** Goods producing sectors added 37,000 jobs and services were up 154k. Within goods, construction was up 21k and manufacturing added 17k. Within services, education/health added 61k, business services added 51k (but again, not due to temp that was only up 4k), trade/transport added 20k despite a 6k drop in retail hiring, and the leisure/hospitality sectors only added 8k.

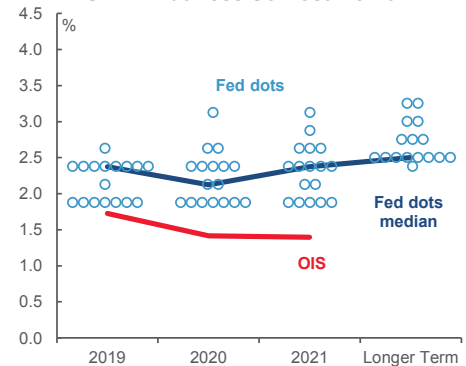
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Markets Still More Aggressive Than The FOMC - But Less So Post-Nonfarm



Sources: Scotiabank Economics, Bloomberg.

- **Wage growth was unchanged at 3.1% y/y** against consensus expectations for an up-tick. Scotia's estimate was surprised on the high side for jobs but wage growth met Scotia's expectations.
- **The rise in the US unemployment rate to 3.7% should be faded.** It's always derived from the household survey, which posted +247k for jobs but a larger 335k increase in the labour force. These are very volatile readings.

On the Fed's decision in July, what maintains reservations are the following points. **Recall that Powell conditioned all of the talk around cutting rates by emphasizing that he was focusing upon near-term developments. Those near-term developments have been generally positive** and should give him more confidence that some key risks are fading.

- Obviously a starting point is the jobs rebound that plays to the transitory over-reaction to May's deceleration;
- The dots showed no cuts for this year, and one rate cut for next year as the FOMC was divided in such fashion as to net out to such median expectations. They didn't collectively sound like they're in a hurry to ease. Markets post-nonfarm remain more rate bullish than the FOMC, but less so as OIS measures of cumulative easing shifted higher after the release (see chart).
- Powell's presser was full of conditionality and focused upon near-term developments. That's key. Nonfarm surprised higher and the US-China/G20 outcome was favourable to markets.
- It seems to me that with July 100% priced, the obvious positioning is a modest chance that the Fed gives a donut on the 31st but jawbones the risks.
- Wednesday's minutes will focus upon one word: 'soon'. If in, they're going on the 31st.
- Thursday's testimony by Powell is also key as he has much of the information that he said he was waiting for in the near-term to potentially come off the fence compared to all of the language he employed at the June FOMC.
- A 50bps reduction was already ruled out before the G20 and jobs so forget that. Not even the most dovish of the doves (Bullard) says he supports a 50bps reduction in one shot. There isn't likely to be any consensus whatsoever on the FOMC in favour of a half point cut in one swoop.

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