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Flash Macro Update

U.S. Jobs Report | October 2024

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What You Need to Know

1 How are we thinking about the September U.S. jobs report?

The September nonfarm payrolls report was impressively strong. It reinforced our views that this expansion remains defined by rolling sector cycles and that job growth continues to be fueled by the Services sectors. Job growth came in at +254k, well above both consensus (+150k) and the prior month's change of +159k (upwardly revised). Beneath the surface, almost all other details of the report looked robust, including a declining unemployment rate (4.1%, vs. 4.2% both for consensus and the prior month) and a modestly accelerating rate of average hourly earnings growth (+4.0% y/y vs. +3.8% consensus and +3.9% in the previous month).

WHAT DOES THIS MEAN FOR MARKETS

1. **This report confirms our Services over Goods thesis, and underscores our rolling recession and rolling recovery thesis**. Just consider Services inflation is running around five percent, while Goods is close to zero. Meanwhile, the Services ISM surprised to the upside this week at 54.9, while manufacturing ISM has been below 50 for 22 out of 23 months. From a jobs perspective, Services jobs reached 202,000 this month, but Goods jobs totaled just 21,000 (and that included 25,000 construction jobs). *On a three-month average, that is 8.3x as many Services jobs relative to Goods jobs (388,000 Services versus 47,000 in Goods). So, if you are a manufacturing CEO you would argue we are in a recession, and if a Services CEO, you would see nearly 10% nominal growth and strong employment as a nice recovery.*

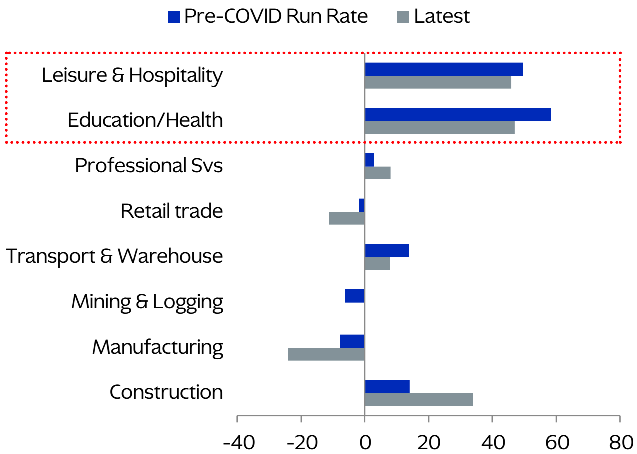
2. **Key drivers were Healthcare/Education and Leisure/Hospitality, which together were 79% of Services jobs this month.** On the more cautious side, Technology is essentially flat again this month, and Financial Services are also at stall speed too.
3. **On the Goods side, we are essentially in a manufacturing recession.** Total manufacturing jobs were -7,000, with both durable and non-durable Goods negative. China's stimulus may help these numbers, but we continue to forecast tepid growth in this area of the economy into 2025.
4. **We still think that the Fed will need to cut, even if it runs the risk of slightly higher inflation**. Monetary policy works with a lag, and we still think that the Fed wants/needs to get short rates below four percent in short order to help housing. At the same time, financial intermediaries will benefit from a steeper yield curve. We stick to our forecast for two more cuts in 2024 followed by five more cuts in 2025 at a once-every-meeting pace, and continue to see four percent as the right long-term target for Treasury bonds.
5. **We are still bullish on our Regime Change thesis.** This cycle is different, and we want more linkage to nominal GDP, upfront yield, and collateral-based cash flows. We do not see a 1970s-style inflation, but we also don't think we are going back to a period of tight fiscal, loose monetary, and low inflation conditions. If we are right, one needs to think about asset allocation differently.
6. **What does this mean for investors?** The idea that it is time to hunker down, buy defensive stocks and get long duration does not hold in the global macro environment we envision. We suggest a more balanced attack. This report is short-term bullish Japan Equities (JPY weakness), USD, and cyclical plays, especially housing. More importantly, our work on Fed cutting cycles when there is no recession suggests the current backdrop is highly positive for Equities, as recessions are the single most significant determinant of forward performance over a 12-month period. We continue to focus on thematic investing around long-term winners that dovetail with our Regime Change thesis, including collateral-based cash flows, consumption upgrades in Asia, the security of everything, and productivity.

DETAILS

- September's data and prior-month revisions show that run-rate job growth is more robust than markets had thought. The labor market is not cooling fast enough (or evenly enough) to tip the U.S. economy into recession. At the same time, however, there are clearly pockets of weakness in the U.S. economy (including Goods sectors) which validate the Fed's thinking that rates are too restrictive and need to come down. Said differently, today's report introduces the risk of slower cuts, but it does not change our view on the Fed's destination of 3.125% this cycle.
- Participation held flat at 62.7% and remains about 70 basis points below pre-COVID levels. That said, we think a surge in immigration is boosting labor availability for low-skill roles, creating a more disinflationary labor market backdrop. We stick to our forecast for two more cuts in 2024 followed by five more cuts in 2025 at a once-every-meeting pace, and continue to see four percent as the right long-term target for Treasury bonds.
- Private payrolls gains (+223k) were robust, following three months of very weak growth (June – August average was just +103k). That said, job growth was heavily concentrated in just two categories: Healthcare/Education (+81k) and Leisure/Hospitality (+78k), while Temporary help Services contracted -14k and Manufacturing employment contracted -7k.
- Month-over-month wage growth slowed to +0.4% m/m from a revised +0.5% m/m in August, while the year-over-year figure ticked up to +4.0% from +3.8% previously. This figure is on the higher end of the 3-4% range that we view as 'sustainable' given 2.5% inflation, but the weaker job prints in recent months mean that the Fed (and markets) still do not view the labor market as a source of inflation.

Exhibit 1: Education/Healthcare, Leisure & Hospitality, and Construction Drove Nearly All of September's Headline Job Gains

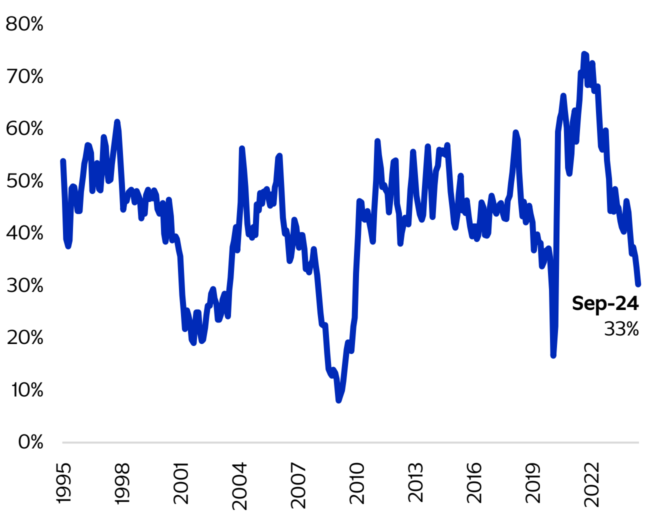
Payroll Growth: Major Services and Goods Sectors (Change '000)



Data as at September 30, 2024. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

Exhibit 2: The Breadth of Job Growth Is Increasingly Narrow

Percent of Sectors With Job Growth >2%



Data as at September 30, 2024. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

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