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Flash Macro Update

U.S. Jobs Report | August 2024

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What You Need to Know

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

Nonfarm payroll growth cooled notably in July, with jobs growing by +114k, below consensus of +175k and down from +179k (downwardly revised) in the prior month. This was the second-softest monthly payroll number since the pandemic recovery started unfolding in 2021 (only Apr-24 being lower at +108k).

Yes, job growth is in a soft patch, but this report does not change our thinking that the U.S. avoids a hard landing. Many cyclical parts of the economy added jobs on net last month (including Construction) and both Retail and Manufacturing held up reasonably well. On the other hand, Technology/Media lost 20,000 jobs, so the part of the economy that has the highest capex right now is one of the weaker sectors in terms of payrolls.

How does this affect our thesis? On days of uncertainty (especially ones when the bond market is signaling a recession is coming), it is always easy to want to sway one way or the other. We are not there. Our base view that we have rolling recoveries and rolling recessions is still intact. We just published a 2.8% GDP print, so it would make sense that the data turn down a little bit on growth. Our 2024 U.S. GDP growth forecast of 2.5% assumes 1.1% growth in both 3Q and 4Q. Said differently, our forecasts have always anticipated that growth would slow pretty sharply in 2H24. Second, we have just printed a nice 2.4% productivity year-over-year, so that part of the story remains solid (which helps to offset slower headline hiring). Third, we are in the disinflation part of the inflation cycle, and the lower wages this month give the Fed the ability to act, so help is on the way.

What does this mean for our forecasts? We are adjusting our Fed forecast in 2024/2025 to six cuts from five cuts, but inflation is still not down to such a level – nor is growth – where the Fed can cut with abandon. We stick to our longer-term 10Y UST forecast of 4.0% but see more risk that yields undershoot in the near-term, so we lower our 2024 target to 3.75% from 4.25% previously. Importantly, however, we continue to think risks skew to the downside (particularly in the near term), as the Fed will be inclined to cut rates more quickly in response to a prolonged soft patch in the data. We continue to emphasize that now is not the time to be short duration.

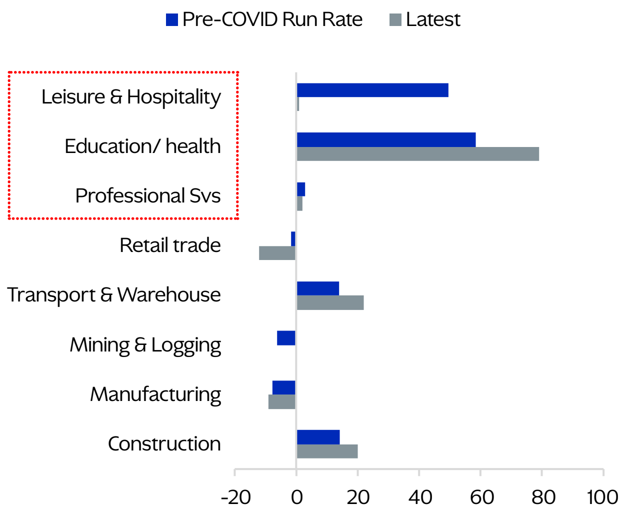
What does this mean for markets? We stick to our view that the market needs to shake out some excesses of high valuations and tight spreads (which typically happens in August and September), but we do *not* think the current bull market is over. From a currency standpoint, the dollar is likely to remain weak, and the 10-year may settle in closer to 3.75% than our prior forecast of 4.25% in the near term. As a result, yield becomes more important to all investors, and somewhat ironically, some of the excess cash on the sidelines may need to come back into the market. On equities, we think that the market may need to trade lower before it resumes its stance. We do not, however, buy into the notion that it will be either Tech or non-Tech that works. Both are likely to go down together and then come back together this fall once the current recession fears abate.

From a thematic standpoint, we continue to advocate for our productivity, security of everything, buy complexity/sell simplicity, and worker retraining themes. Beyond the strong underlying fundamentals, many of our themes serve as important foils to the risks we now see in the market, including heightened geopolitics as well as serious skills mismatches in a world where technological change is increasing at an accelerating rate.

KEY TRENDS IN THE DATA

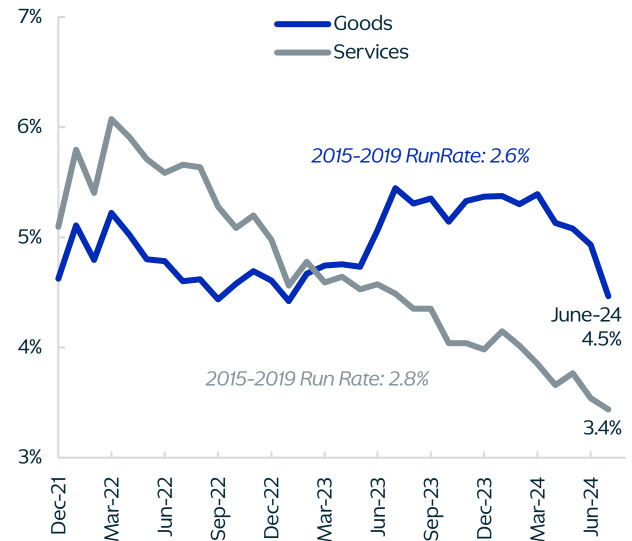
- July's reading suggests job growth is finally starting to reflect the weakness reflected in 'soft' economic data. Importantly, we look for more signs of slowing as a 'stagnant' labor market (in which hires, quits, and turnover are at low levels) means that cooler labor demand will increasingly be reflected in weaker headline data.
- Participation rose 10 basis points to 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, which is creating a more disinflationary labor market backdrop.
- Private payrolls (+97k, down from +136k in June) posted their weakest reading since March 2023. We think this number will attract more concern among Fed policymakers that rates need to come down sooner, rather than later.
- Services drove the bulk of job gains (+72k, down from +125k last month), but growth was concentrated in two categories: Education and Healthcare (+57k) and Leisure & Hospitality (+23k).
- Goods producing payrolls added +25k jobs, up from +12k last month, driven entirely by Construction (+25k), while Manufacturing employment was essentially flat (+1k). Overall, we think the Construction employment picture remains a bright spot relative to the weak data on residential activity.
- Month-over-month wage growth slowed to +0.2% m/m from +0.3% m/m in June, while the year-over-year measure fell to +3.6% from +3.7%. Importantly, improving productivity supports our view that the U.S. can sustain wage growth in the 3-4% range this cycle even as Core CPI settles in the 2.5% range, which gives us more of an indication that the labor market is no longer putting upward pressure on inflation.

Exhibit 1: Labor Demand Is Slowing, Though Productivity Should Help the U.S. Avoid a Severe Downturn



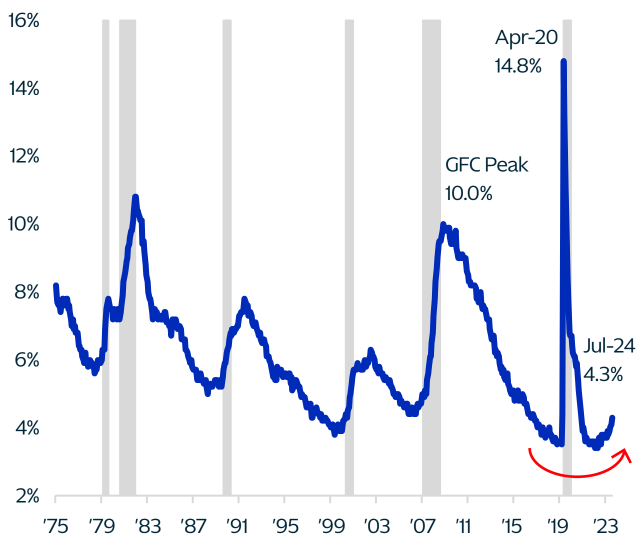
Data as at April 30, 2024. Source: Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Exhibit 3: Wage Growth Is Now Consistent With Our 2.5% 'Run-Rate' for Core CPI



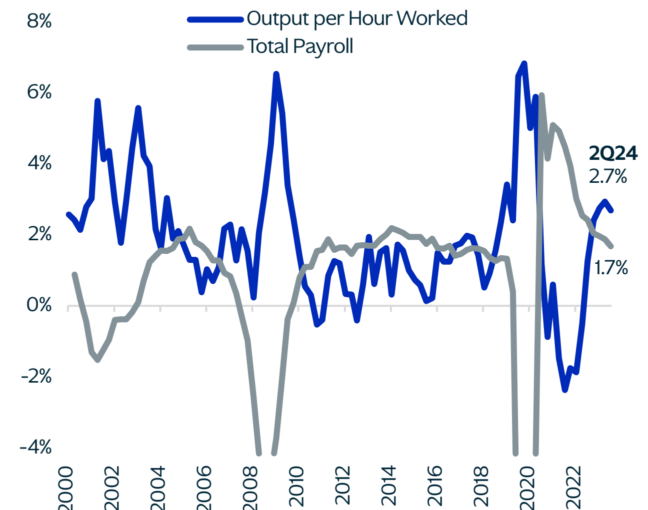
Data as at July 31, 2024. Source: U.S. Bureau of Labor Statistics, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 2: The Headline Unemployment Rate Jumped to 4.3% in July from 4.1% in June



Data as at July 31, 2024. Source: U.S. Bureau of Labor Statistics, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Exhibit 4: An Increase in Productivity Is Helping to Offset Slower Headline Hiring



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

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