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Shockingly Weak Labor Report; “Risk Off” Trades will Dominate

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A shockingly weak labor market report. Does this vindicate the Fed’s decision not to hike last month? Yes, but by accident. I do not think the Fed had an inkling that these numbers would be so bad. The high frequency indicators, such as weekly jobless claims gave no such indication. The only data that gave us a clue were the Q3 GDP forecasts, which plummeted this week due to an extremely bad trade report.

How bad was this report? Not only did payrolls fall short by 59k, but private payrolls missed by 79k. Furthermore, the August data, which were widely expected to be revised upward, were in fact revised downward, as both July and August were revised downward by another 59k. Average hourly earnings, instead of rising 0.2% as expected, actually fell a penny. Household employment fell236k and the only reason that the unemployment rate did not rise was that the labor market participation fell to 38-year low of 62.4%. Furthermore, average weekly hours fell one tenth. The only bright spot is that productivity growth in Q3 is now looking positive with the large reduction in hours worked implied by this employment report.

The Treasury market, which was poised for a strong report, rallied furiously. The ten year yield crashed below 2% to 1.92% and the Euro soared 1.13. The US had seemed immune to the increasing worries about global growth. Now that characterization will be called into question. Of course, domestic demand still appears strong, with blockbuster August auto sales. But the world slowdown has already impacted exports and that could spread.

Today’s numbers make it very unlikely the Fed will raise in October, although a December hike is not impossible. I realize that the standard models of forecasting Fed action from the funds futures market now predict a March liftoff, but as I have commented in the past, this is based on the Fed immediately going to the midpoint of their target range, which is not guaranteed. Nevertheless, there is no reason for the Fed to be in a hurry to raise rates now.

Worry about earnings growth will now accelerate. A key test for stocks will be the 1867 closing low of the S&P 500 reached on August 25. Lower bond yields and a lower dollar will help stocks, but I am not sure this support will hold. Investors will worry about a global recession sucking in a healthy US economy and central banks, at zero interest rate and many in full QE mode, will be powerless to prevent it. These fears are sending investors to gold even though commodity prices continue to plunge. I expect the defensive “risk off” trading to continue with risky assets, such as stocks, trading down and risk hedges, particularly US treasuries trading higher.
