Financial Market Weekly

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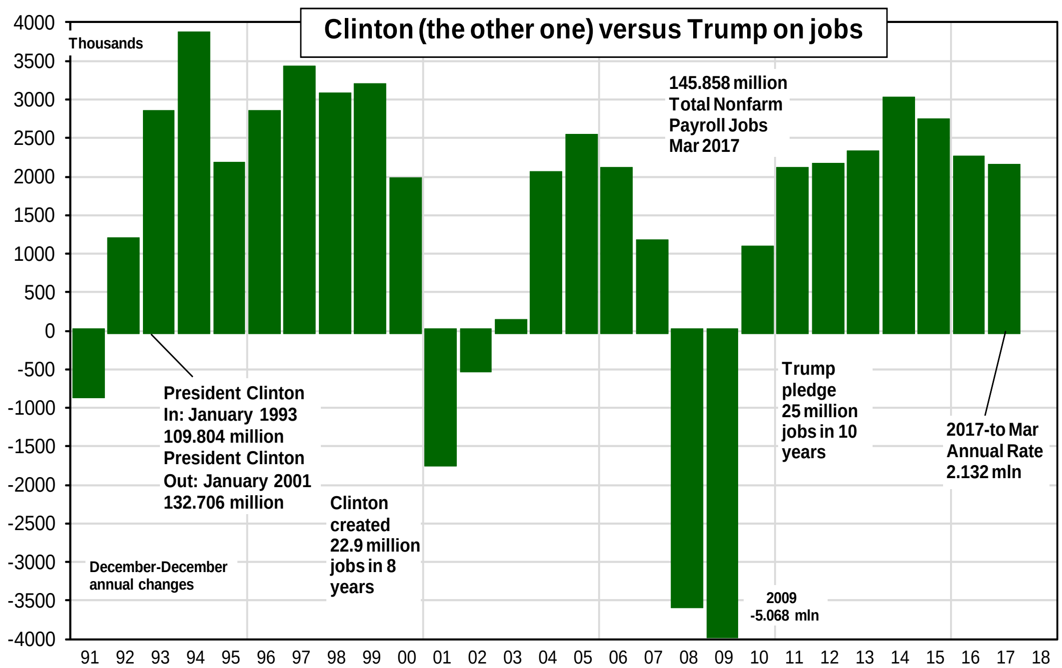
98K Ouch! Great American Jobs machine stops cranking under Trump

Breaking economy news. The all-important monthly employment report. 98K payroll jobs in March where 180K was expected. Ouch. Actually more jobs were expected than that after the ADP jobs on Wednesday "forecast" 263K. And Jobs in January and February were revised down 38K. Double ouch.



Jobs, jobs, jobs, or the lack thereof. Well, weekly jobless claims were elevated at 261K in the survey week for the unemployment rate (payroll jobs is the "pay period" that includes the 12th of the month), oh, but unemployment dropped two tenths to 4.5%. Oh, and the employment count that figures the unemployment rate rose 472K in March. So who do you believe? The Household measure of new jobs up 472K or the payroll jobs count of just 98K? Don't answer that. There is no right answer. Trick question.

	Mar	Feb	Jan	Dec	Nov	Oct
Payroll jobs (000s)	98	219	216	155	164	124
Unemployment rate %	4.5	4.7	4.8	4.7	4.6	4.8
Unemployment (3 decimal)	4.496	4.703	4.780	4.716	4.646	4.848
Average hourly earnings	$26.14	$26.09	$26.02	$25.98	$25.91	$25.90
MTM % Chg	0.2	0.3	0.2	0.3	0.0	0.3
YOY % Chg	2.7	2.8	2.6	2.9	2.7	2.7
Production Worker earnings	$21.90	$21.86	$21.83	$21.80	$21.74	$21.72
MTM % Chg	0.2	0.1	0.1	0.3	0.1	0.2
YOY % Chg	2.3	2.5	2.4	2.5	2.5	2.5

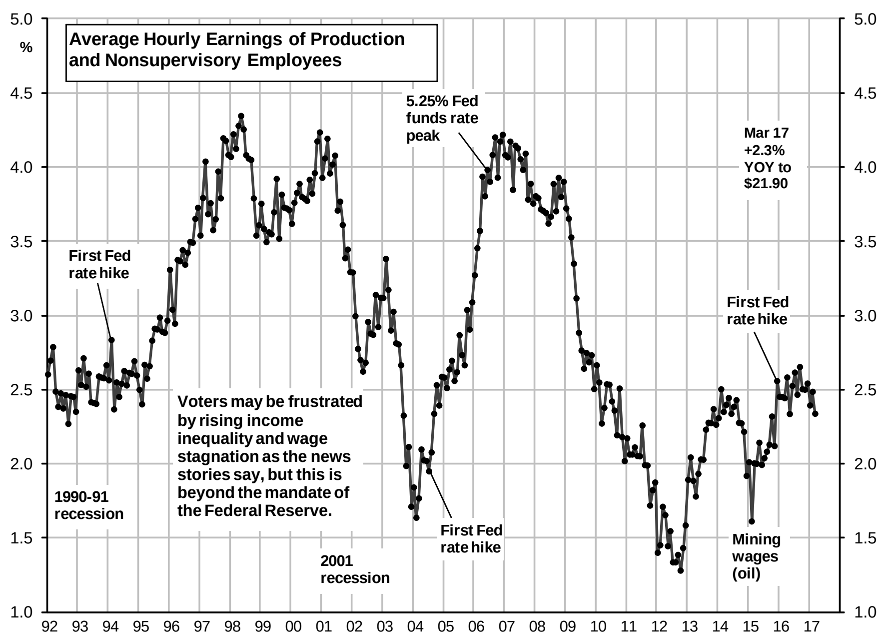
The market has spoken. The first reaction anyway. Markets moved on the softer 98K number. 10-yr Treasury yields were 2.31% at the 830am announcement time and traded as much as 4 bps lower in yield at 2.27%. Dow stock futures down 6 points at 830am and fell as much as 64 points ten minutes after the news. Stock traders are a little on the weary side so don't blame them, they were up late last night trading the news when the U.S. bombed Syria sending Dow futures down 143 points before recovering ahead of the jobs data.

What would the Fed do with these numbers today? 98K payroll jobs, 4.5% unemployment rate and 2.7% average hourly earnings (wages)? Well, there are two more monthly jobs reports to go before the next real opportunity to raise rates at the June 2017 meeting. We aren't even sure why they are bothering to meet in May as nothing is going to happen. We think the Fed would take this report today as a sign the labor market is continuing to tighten up with unemployment of 4.5% (4.496%) now well below "full employment." The deeper the unemployment rate falls into the danger zone for the economy the more the Fed's current policy setting looks to be in the twilight zone.

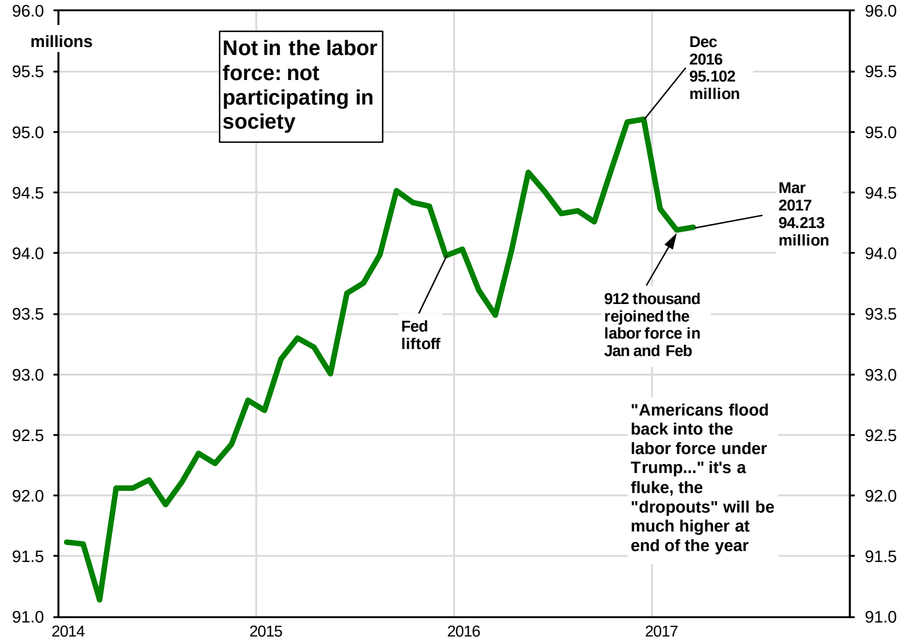
There is no role for monetary policy to play this late in the economic cycle. Rates should be at normal 3% levels right now not three years from now at the end of 2019. As far as the Fed's next move, it is not as if

Payroll jobs in year eight following the recession

Dec. 2016 Totals millions		Mar 17	Feb 17	Jan 17	3 months Dec 16 to Mar 17	12 months Dec 15 to Dec 16
145.325	Nonfarm Payroll Employment	98	219	216	533	2240
123.026	Total Private (ex-Govt)	89	221	204	514	2039
19.794	Goods-producing	28	96	51	175	64
0.617	Mining	11	10	6	27	-75
12.343	Manufacturing	11	26	12	49	-16
0.942	Motor Vehicles & parts	3	-5	4	2	17
6.783	Construction	6	59	34	99	155
103.232	Private Service-providing	61	125	153	339	1975
27.374	**Trade, transportation, utilities**	-27	-16	28	-15	331
15.881	Retail stores	-30	-31	35	-25	203
3.180	General Merchandise	-35	-23	-13	-71	37
3.097	Food & Beverage stores	2	-1	2	3	37
5.048	Transportation/warehousing	4	8	-13	-1	92
1.465	Truck transport	5	9	-2	12	10
0.668	Couriers/messengers	-1	-1	-14	-16	31
0.943	Warehousing and storage	0	-2	5	2	63
0.557	Utilities	-1	-1	-1	-2	0
2.762	**Information**	-3	-4	-8	-15	0
8.364	**Financial**	9	6	30	45	176
2.605	Insurance	1	3	7	10	46
2.169	Real Estate	1	4	12	17	59
1.311	Commercial Banking	1	1	4	5	17
0.933	Securities/investments	1	0	2	3	18
20.416	**Professional/business**	56	36	59	151	534
2.962	Temp help services	11	9	15	35	32
2.259	Management of companies	1	4	5	10	35
1.427	Architectural/engineering	7	5	8	20	27
2.032	Computer systems/services	5	6	9	19	87
1.126	Legal services	-2	-3	0	-4	5
1.000	Accounting/bookkeeping	1	-1	-5	-5	32
22.871	**Education and health**	16	66	17	99	553
5.077	Hospitals	9	7	3	19	119
3.604	Educational services	-1	30	-8	20	85
15.744	**Leisure and hospitality**	9	27	15	51	331
1.950	Hotel/motels	0	3	-3	1	11
11.549	Eating & drinking places	22	19	18	58	276
22.299	Government	9	-2	12	19	201
2.200	Federal ex-Post Office	-3	1	0	-2	30
5.085	State government	1	-10	10	1	-4
2.414	State Govt Education	0	-12	6	-6	3
14.395	Local government	9	8	4	21	160
7.945	Local Govt Education	10	5	9	23	69



they are making a decision to tighten policy and take away the punch bowl by lifting rates from 1.0 to 1.25%; a 25 bps rate hike from here means they are simply returning rates to normal at a glacial pace, we mean to say a gradual and cautious pace.



Still the 98K payroll jobs certainly stings and will make everyone in the markets who know all and those down in Washington who know less question the economic outlook. Is the economy going off the rails stuff. 98K jobs in March after 219K in February. Where was the slowdown? Well, almost every category was off in terms of hiring. Manufacturing jobs were 11K in March and 26K in February. The ISM manufacturing survey said hiring was through the roof. We guess this is it. 11K more new manufacturing jobs in March. 5K more in fabricated metal products and Detroit hired 3K more if you are interested. Doesn't look like those factory jobs from overseas are coming back in size yet.

98K jobs were also weaker due to retail jobs disappearing. There certainly have been a lot of store closures announced this year. Retail jobs fell 30K in March. The report said general merchandise store jobs dropped by 89K since October last year.

To conclude, this economy isn't setting any records for speed but it is getting ever closer to setting records for longevity. The unemployment rate drop to 4.5% shows the labor market is tight as a drum and the long expansion has largely drained the labor pool of skilled workers for this economy cycle. Don't ask why there are only 98K new jobs this month because this is how it is going to be from now on. When the Administration brings back those factory jobs from overseas there won't be anyone to man them. The change in technology has already reduced the numbers of humans needed to run the robots on shop floors anyway. 98K new payroll jobs is the headline number and while it is unlikely to change the hearts and minds of Fed officials looking for two more rate hikes this year, the data do not give us the confidence to predict a move by the Fed in June. Besides we have two more jobs reports to go before the June decision date and the Fed under Chair Yellen is data dependent. Will they or won't they? Will they stop, or will they go now? Stay tuned. Story developing.

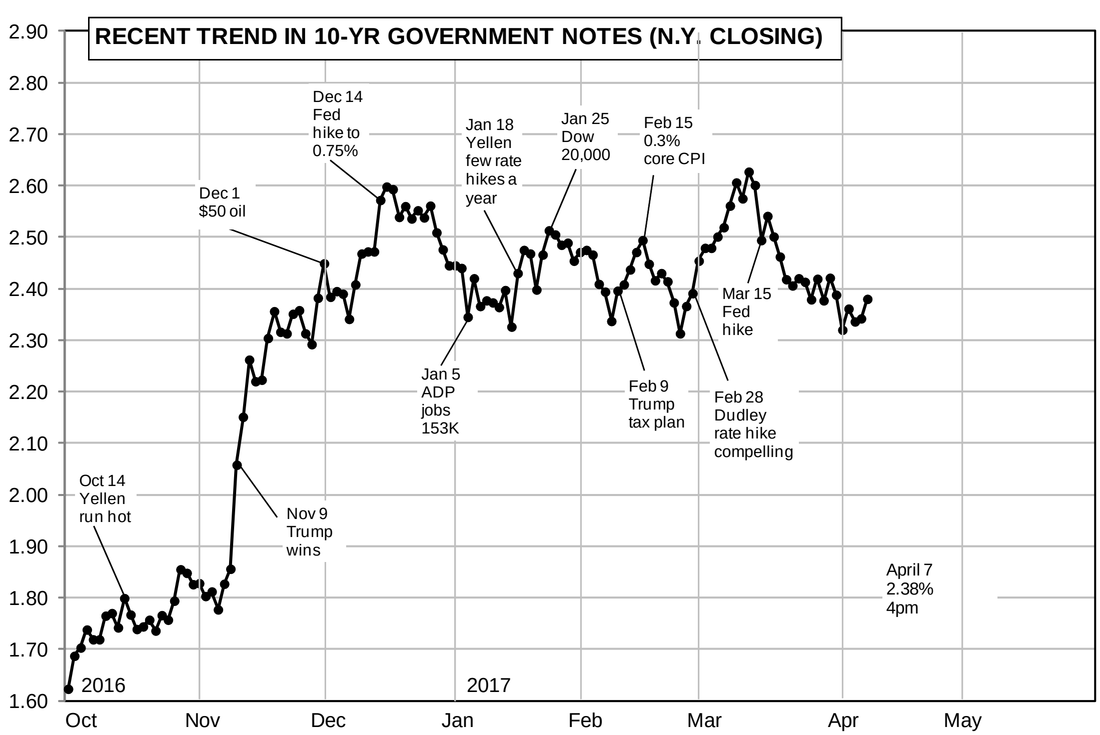
P.S. The market did recover later in the session, helped along by New York Fed President Dudley saying that the balance sheet might be wound down Question: How many times can the market react to Bill Dudley saying the words “balance sheet reduction?” Answer: Infinite number of times. We are still forecasting a Fed funds rate hike at the June meeting in the table on the next page… it’s complicated.

MARKETS OUTLOOK

Bonds were 2.31% before the 98 pound weakling payroll jobs report and fell all of 4 bps lower to 2.27% in the first ten minutes of trading. Yields were back above 2.30% by 9 o'clock after thirty minutes of trading: straight down and straight up pretty much. The rejection of the low side of the 2.30 to 2.60 percent 10-yr Treasury trading range the last three months has given traders confidence that 2.30% will hold for now. The jobs report doesn't give a definitive thumbs up or down on a June 14 rate hike because Yellen "we are data-dependent" could change her mind again given there are two more monthly employment situation reports and two more PCE inflation reports to sift through before the Committee needs to have Yellen make up their minds. [There are three vacancies at the Federal Reserve Board of Governors and National Economic Council head Gary Cohn told Bloomberg TV on Friday that these could be filled shortly or at least named.] The odds of a June meeting rate hike based on July Fed funds rate futures closed (3pm) at 60% on Friday, exactly unchanged from Thursday night's 60% close. (June meeting rate hike odds increased on Wednesday's 263K ADP jobs report, then held this level despite the 98K real jobs report on Friday.)

	31-Mar 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019
30-Yr Treasury	3.03	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.10	4.20
10-Yr Note	2.40	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	3.90	4.00
5-Yr Note	1.93	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	3.70	3.70	3.90
2-Yr Note	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.20	3.35	3.35	3.50
3-month Libor	1.15	1.50	1.70	1.95	2.20	2.45	2.70	2.95	3.20	3.45	3.45	3.70
Federal Fund Rate	1.00	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50
2s/10s spread	115	100	95	100	95	90	75	70	60	55	55	50
Libor/funds spread	15	25	20	20	20	20	20	20	20	20	20	20

Still, the two-tenths drop in the unemployment rate to 4.5% was the best finding in today's report. The economy is moving beyond the Fed's own guess at where full employment is-4.7%. We hate to point out that the lowest level of unemployment in the last cycle, the housing bubble years, was 4.4% as late as October 2006. The Bernanke Fed had a 5.25% Fed funds rate at that time. The Yellen Fed cannot even get the Fed funds rate to their definition of neutral-3%.



FEDERAL RESERVE POLICY

The Fed meets May 2-3 to consider its monetary policy. The jobs report giveth and the jobs report taketh away. The employment picture was compelling for New York Fed President Dudley ahead of the March 15 decision to hike rates. Maybe 98K payroll jobs today and the sudden drop in car & light truck sales makes a rate hike less compelling in June. But it's early yet, and the 4.5% unemployment rate is the better indicator of where the labor market stands now.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	5-Apr	29-Mar	22-Mar	15-Mar	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2464.454	2464.335	2463.974	2463.812	479.782
Federal agency debt securities	13.329	13.329	13.329	13.329	0.000
Mortgage-backed securities	1769.122	1769.118	1777.645	1771.184	0.000
Primary credit (Discount Window)	0.000	0.000	0.001	0.010	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TALF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	1.718	1.707	1.707	1.707	29.287
Maiden Lane II (AIG)	0.000	0.000	0.000	0.000	0.000
Maiden Lane III (AIG)	0.000	0.000	0.000	0.000	0.000
Central bank liquidity swaps	5.075	1.007	1.019	0.917	62.000
Federal Reserve Assets	4520.8	4515.7	4524.5	4515.9	961.7
3-month Libor %	1.15	1.15	1.16	1.15	2.82
Factors draining reserves					
Currency in circulation	1540.054	1536.334	1533.834	1531.006	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	174.644	260.357	251.013	226.510	0.000
Reserve Balances (Net Liquidity)	2337.776	2269.984	2313.962	2368.120	24.964
Treasuries within 15 days	0.460	13.559	13.559	0.000	14.955
Treasuries 16 to 90 days	59.336	46.911	46.910	60.469	31.549
Treasuries 91 days to 1 year	201.689	183.368	183.363	183.357	69.272
Treasuries over 1-yr to 5 years	1194.547	1216.893	1216.867	1216.841	170.807
Treasuries over 5-yrs to 10 years	380.988	376.236	376.203	376.170	91.863
Treasuries over 10-years	627.435	627.368	627.071	626.975	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

When Dudley used the word compelling in a CNN interview on February 28 he really meant the case for tightening (his word, he should not be calling a move from 0.75 to 1.0 percent Fed funds "tightening") had risen with "the very large increase in household and business confidence," rising stock market and narrowing credit spreads, and expectation for fiscal policy to provide stimulus. The picture of payroll jobs was perhaps not quite as compelling on February 28 when the New York Fed President spoke with three recent months changes of: 227K Jan, 157K Dec, Nov 164K. But the next month's employment picture sealed the deal on the case for a March 15 rate hike: 235K Feb, 238K Jan, 155K Dec.

Balance Sheet reduction: The Fed's balance sheet is $4.5 trillion and it is hard for us to argue against this being an important market factor when you have Dudley saying the Fed might pause on its rate hikes while it reduces the balance sheet. He is viewing rate hikes and balance sheet reduction as "tightening" apparently. Our view is when the Fed stops reinvestment and allows the balance sheet to shrink (unfortunately Dudley said they might "taper" the reinvestment, talk about dragging out every single exit from excessive accommodation), the balance sheet will not be coming down fast enough to raise interest rates one would not think. The power of the QE purchases that added securities to the balance sheet in the first place came in the Fed's "announcement effect," their intervention was going to help us and would count as monetary stimulus that would "improve financial conditions" just like interest rate cuts do. It was the announcement effect of the Fed riding to the rescue that was more important than having the actual purchases driving market yields lower. Let's hope the Fed never has to do QE again because it just may not work: fool me once, but not twice stuff.

Anyway, what if the reinvestments come to a full stop, then what happens a year later? Well, their Treasury holdings that mature over the next year on April 5 in the table above were about $260 billion and these will go away. Their $1.769 trillion of MBS might fall as much as another $300 billion on prepayments over the next year when reinvestment stops. It is unclear why 10-yr Treasury yields would go up when the Fed takes this balance sheet reduction step. The mortgage markets are different though. If the Fed is no longer buying MBS it could alter the market's liquidity where market functioning could deteriorate somewhat. While it may not make it harder for home buyers to obtain financing at least in the first year of non-reinvestment, it is not impossible for market spreads to eventually widen further against would-be homeowners or refinancers. In the April 6 week mortgage rates were 4.10% against 10-yr Treasury yields of 2.34% for a spread of 176 bps. Not impossible for this spread to widen further.

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