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Strong Jobs Put Skip in Play

The much better than expected September employment report should give the Fed pause for cutting rates again at the November 7 meeting. **One reason we thought that the Fed would cut rates by 50 basis points in *September* was because it would give the Fed more optionality to skip future meetings if growth remained sturdier than baseline estimates**. Following the upward revision to national income and the latest jobs data, this does indeed appear to be the case.

Nonfarm payrolls increased by 254k in September after an upwardly revised gain of 159k in August. On average **over the last three months, nonfarm payrolls are up 186k versus 140k previously, which is a reasonably strong increase** that if sustained would put downward pressure on the unemployment rate. Private payrolls were up a sturdy 223k in September compared to 114k in August. Over the last three months, private payrolls are up by an average of 145k versus 103k previously.

Private education and healthcare was the largest contributor to job gains, up 81k last month. This was followed by leisure and hospitality which rose 78k. Since the latter only surpassed its pre-pandemic level this past May, the sector may still be playing catchup with its longer-term trend. Construction was the third largest contributor to September job gains, rising 25k which is a new cyclical high.

The only areas that shed jobs were temporary staffing (-14K), manufacturing (-7k), and transportation/warehousing (-6k). Consequently, **the diffusion index of hiring which measures job breadth jumped nearly six points to 57.6, its highest reading since January (62.2)**. Readings in the mid- to high-50s are considered healthy but when the index drops below 50, it generally signals the onset of recession. At the moment, the September improvement in the diffusion index arrested a freefall in the series, but it still remains to be seen whether the jobs market has found a floor. The trend is still pointing downwards.

The surge in September payrolls was corroborated by the unemployment rate which fell from 4.22% to 4.05%. This was due to a 430k increase in employment and 281k decline in unemployment. The former was the result of a massive 785k increase in government employment which clearly overstates strength since the Establishment Survey showed just a 31k gain in government hiring. The drop in the number of unemployed was the largest since March 2022 (-286k) and was behind the fall in the unemployment rate, not the big gain in Household employment.

Average hourly earnings rose 0.4% in September after August was revised a tenth to 0.5%. This had the effect of lifting the year-over-year rate to 4.0% from 3.9% and the three-month annualized rate of change by three-tenths to 4.3%, which is the fastest since January (4.9%). By itself, **the increase in average hourly earnings should not trouble the Fed because the 1.95% August quits rate fell to its lowest non-pandemic related reading since July 2015 (1.9%)**. The drop in quits leads the employment cost index by six months, which is the Fed's preferred metric for fully capturing labor costs. Thus, wage costs are likely to trend lower over the intermediate term.

The only negative news in the report was the one-tenth slip in the nonfarm workweek to 34.2 hours, which matches this year's earlier post-pandemic lows in January and July. However, even with a slight drop in hours, the gain in jobs and wages bodes well for personal income which should support a decent gain in September retail sales.

The most immediate effect of strong September employment is that it likely removes the possibility of a 50 basis point (bp) rate cut. If the Fed is truly data dependent, then policymakers should refrain from easing policy at next month's FOMC meeting. If the labor market re-weakens, as we expect, then the Fed could cut rates by another 50 bps at the December 18 FOMC meeting. In fact, this was the scenario we laid out back in August. In the meantime, the non-labor market related high-frequency data take on added significance, but the momentum is moving away from rate cuts at least for now.

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