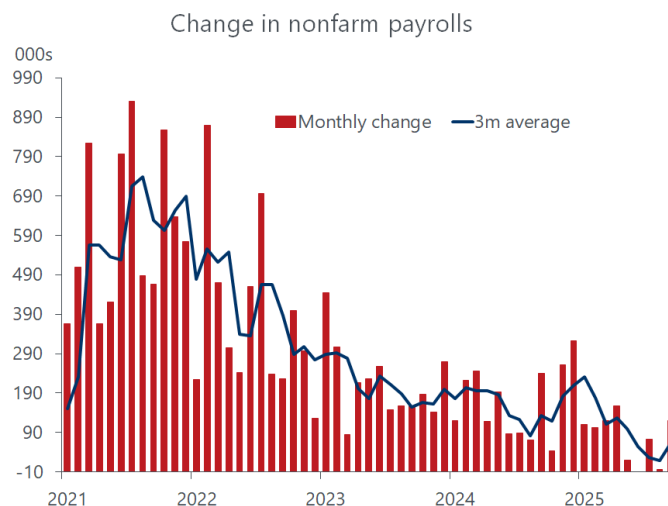


Better late than never. Nearly seven weeks behind schedule the Labor Department is back in business and has released the all-important employment report for September. That's ancient history for a job market that appears nearing a crossroads. But the report provides critical information on labor conditions before the government shutdown caused a data blackout. While a lot can happen in two months, the good news is that the job market looks to have had enough of a cushion to stay afloat in the face of headline-grabbing layoff announcements in October and November. That said, cracks in the foundation that appeared prior to the shutdown were very much in evidence in September.

It remains to be seen how the Fed interprets these crosscurrents at its policy meeting on December 9-10. At the very least, the September report provides grist for both the doves and hawks in their respective cases arguing for and against cutting rates for the third time since the September gathering. The 119 thousand increase in nonfarm payrolls in September was more than double the consensus forecast, indicating significant momentum heading into the shutdown. Unlike past initial jobs reports, this one is probably more reliable as the reporting delay enabled the BLS to collect more responses to its survey than is usually the case in preliminary tallies. The earlier estimates for July and August, for example, were revised down by 33 thousand jobs, including 26 thousand in August that transformed an initial increase of 26 thousand into a 4 thousand decline, marking the second negative reading in the past four months.

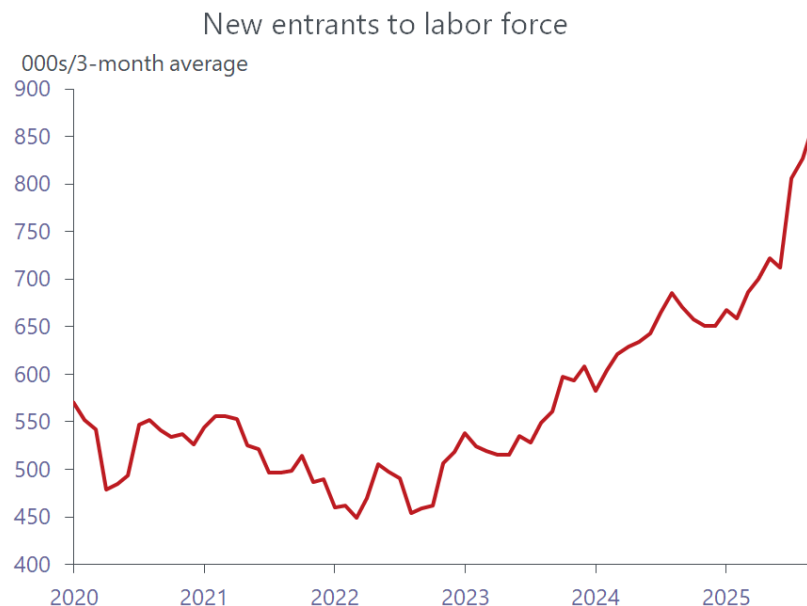
But the September leap of 119 thousand payrolls shifted the momentum back to the positive side, lifting the average gain over the past three months to 62 thousand from 18 thousand in August. So, if the Fed adheres to the “what have you done for me lately” Idiom, the payroll strength would argue for it to stay on the sidelines next month. From our lens, the gain indicates that there is enough muscle in the economy to allow the Fed to refrain from cutting rates, giving it more time to assess conditions as additional data trickles in later in the month. Still, while the



payroll data portrays strength, there are peculiarities in the jobs report that need to be addressed. Not only is the 119 thousand payrolls increase double the consensus forecast; it is also considerably greater than the increase widely viewed as needed to keep the unemployment rate steady. But that was not the case in September.

This breakeven rate has been shrinking ever since the government's stricter immigration policy kicked in, restricting the size of the labor force. We estimate that between the immigration crackdown and demographic trends (i.e. an aging population causing ever more retirements), only about 30 thousand net new jobs are needed to keep the unemployment rate steady. Yet the rate ticked up again in September, rising to a four-year high of 4.4 percent from 4.3 percent in August. That's still low by historical standards but combined with a 3 percent inflation rate the so-called misery index has been pushed up to 7.4 percent from 6.5 percent a year earlier. Coincidentally, household assessment of current economic conditions, as measured by the University of Michigan's sentiment survey, has plunged to an all-time low.

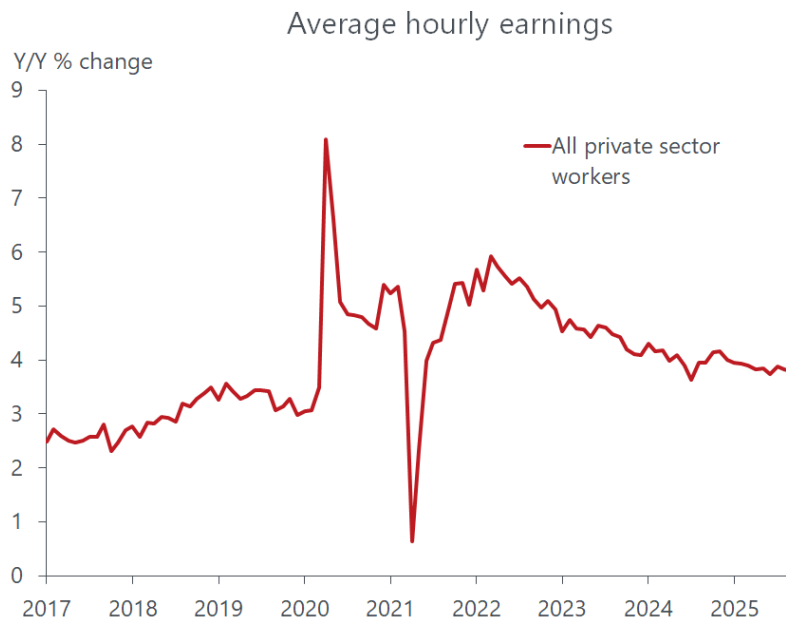
Underscoring the rise in the unemployment rate despite the strong gain in payrolls is that the labor force has grown even faster. Simply put, there has been a greater surge in people seeking jobs than there are job openings. The labor force participation rate ticked up for the second consecutive month, with women and the 16-24 age cohort accounting for all of the increase. It's unclear where the new entrants to the labor force is coming from or what is motivating them to come off the sidelines. The recent influx is the highest since 2016, but it is unlikely that job seekers are being lured into the labor market by attractive job opportunities. More likely, as suggested by the rising misery index, people on the lower end of the income ladder are struggling with high prices and uncertain income prospects and looking for paychecks to make ends meet. It's possible that fears over the pending removal of SNAP benefits due to the looming shutdown may also have contributed to a wave of job seekers.



Clearly, if the recent surge in the labor force is sustained, the unemployment rate would also increase more steeply than is currently expected, unless hiring also stages a surprising burst of strength. Neither is likely to occur, as we expect the low hiring/low firing narrative of recent

months to persist for a while longer. With the Fed devoid of hard data for October and November, its rate decision on December 10 will be heavily influenced by perceptions of officials rather than available evidence. A week ago, the markets had priced in even odds of a rate cut, but as of Friday those odds have increased to over 70 percent, based on the CME FedWatch tool.

It's unlikely that the September jobs report would have bolstered the position of Fed doves. Despite the uptick in the unemployment rate, there were as many items in the report that depicted strength. In addition to the leap in payrolls, average hourly earnings continued to increase at a solid pace, rising 3.8 percent over the past year. Not only is that virtually the same



as the previous five months it remains comfortably above the inflation rate, sustaining the purchasing power needed to keep consumption on a positive track. True, the September increase over August slipped to 0.2 percent, but that followed robust monthly increases of 0.4 and 0.3 percent, yielding an average annual increase of 4.02 percent over the latest three months, the strongest since last November.

It's possible that the increased market expectations of a rate cut at the upcoming Fed meeting has been influenced by the recent slump in the stock market, which was at least temporarily arrested by Friday's rally. Any severe market setback should not be downplayed as the wealth boost that upper-income households obtained from surging stock prices this year has contributed mightily to consumer spending. We note that the leisure and hospitality sector generated 40 percent of the payroll gain in September, an outsized contribution from an industry that accounts for just over 10 percent of total employment. It is also a sector that tends to draw wealthier customers with ample discretionary funds to spend. But the wealth effect cuts both ways, and any major dent in those funds from a severe market correction could have an outsized negative impact on the economy.

FINANCIAL INDICATORS

INTEREST RATES	November 21	Week Ago	Month Ago	Year Ago
3-month Treasury bill	3.83	3.88	3.86	4.53
6-month Treasury bill	3.77	3.83	3.76	4.49
2-year Treasury note	3.51	3.61	3.49	4.39
5-year Treasury note	3.62	3.73	3.61	4.31
10-year Treasury note	4.07	4.15	3.99	4.41
30-year Treasury bond	4.72	4.76	4.59	4.59
30-year fixed mortgage rate	6.26	6.24	6.19	6.84
15-year fixed mortgage rate	5.54	5.49	5.44	6.02

STOCK MARKET				
Dow Jones Industrial Index	46,245.41	47,147.48	47,207.12	44,296.51
S&P 500	6,602.99	6,734.11	6,791.69	5,969.34
NASDAQ	22,273.08	22,900.59	23,204.87	19,003.65

COMMODITIES				
Gold (\$ per troy ounce)	4,060.80	4,083.7	4,118.6	2,713.0
Oil (\$ per barrel) - Crude Futures (WTI)	57.98	60.02	61.50	71.20

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Nonfarm Payrolls (September) - 000s	119	(4)	72	59
Unemployment Rate (September) - Percent	4.4	4.3	4.2	4.2
Average Hourly Earnings (September) - % change	0.2	0.4	0.3	0.3

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