KKR

Flash Macro Update

U.S. Jobs Report | March 2024

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What You Need to Know

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

In line with our 2024 Outlook, the February U.S. payrolls report shows a robust but not overheating labor market. Looking at the details, Nonfarm Payrolls grew +275k during the month, above consensus of +200k and up from +229k last month (downwardly revised). While the headline number was quite strong, many other components were more subdued. Job growth for the prior two months was revised down by a net -167k. Average hourly earnings moderated to 4.3% y/y, which was in-line with consensus but down from 4.4% last month.

Maybe even more importantly, the unemployment rate rose 20 basis points to 3.9% from 3.7%, vs. a consensus expectation for flat unemployment. A -184k decline in Household Survey employment drove the jump in the unemployment rate. Household Survey employment has been persistently lower than Establishment Survey employment for several months now, which we view as a signal that underlying job growth is a bit less robust than headline NFPs indicate.

WHAT DO WE THINK TODAY'S REPORT MEANS FOR MARKETS?

- **This report is a market friendly report**. Most importantly, revisions showed that there was an upward seasonal bias in the January data. At the same time, in February wage growth moderated meaningfully to 0.1% m/m versus an estimate of 0.2% and 0.5% last month. The unemployment rate also finally jumped to 3.9%, compared to an estimate of 3.7% and an actual of 3.7% in the prior month. Overall, we see consistent growth, not the re-acceleration that the January data showed, especially as it relates to jobs and inflation.

- **Our Services over Goods thesis continues**. Private services jobs came in at 204,000, which accounted for 91% of private sector jobs and 75% of total jobs growth. Within services, 70% of total job additions came from just two sectors: 1) Healthcare/Education and 2) Travel/Leisure. The goods sector, by comparison, had just 19,000 jobs, compared to 24,000 in the prior month. Looking at the bigger picture, we note that Healthcare/Education, Travel/Leisure, and Government jobs accounted for fully 73% of total job growth.

- **Level setting versus KKR estimates:** While we are in the camp that this cycle is different, we are still forecasting that unemployment does increase this cycle. Specifically, our forecasts have unemployment increasing to 4.1% or so, but we do not think it goes up the full 300-400 basis points that it typically does during normal tightening cycles. We will clearly need to watch the uptick in unemployment, but our basic message is 'so far, so good' in our long-tern view that this cycle will be different. On interest rates, we believe that the Fed eases three times in 2024, and we see the 10-year at 4.25%, 22 basis points above where the 10-year is currently trading.

- **What does this mean for markets?** We still think that the path of least resistance in equity and credit markets is higher. As we have been signaling, the technical backdrop for stocks and credit is as favorable as we have seen in decades. Key to our thinking is that buybacks are surging and could reach $1 trillion in the SPX this year, compared to $500 billion in 2020. At the same time, there is no issuance of High Yield, Leverage Loans, and IPOs. In fact, net issuance is at its lowest level since April 2009. On the economic front, the big news is that the Fed is not going to be tightening. Frankly, given the technical backdrop, we don't need the Fed to ease to have stronger global capital markets. In terms of key themes, we remain very constructive on productivity investments, especially as it relates to automation. We also still favor the intersection of surging data demand with the backdrop of limited power supply and energy transmission. Finally, we are bullish on the 'security of everything', including energy, data, transportation, cyber, and water/food.

KEY TRENDS IN THE FEBUARY DATA

- February data – as well as revisions to prior-month data – suggest job gains are running at a more normalized pace than the markets had feared, which should help alleviate market anxiety about labor demand and inflation running away to the upside. At the same time, the unemployment rate rose from 3.7% to 3.9% as hiring slowed. We continue to expect the labor market to cool further over the course of 2024, although labor hoarding makes a severe layoff/unemployment cycle less likely.

- Participation held flat at 62.5% and remains about 90 basis points below pre-COVID levels. We continue to think that participation will not rise enough to offset poor demographic growth this cycle, particularly now that job openings/hires have started to moderate.

- Private service-providing payroll (+204k, up from +153k in January) drove the bulk of private payroll gains this month, with elevated Services job gains in more stable categories like Education/Healthcare (+85k) and Government (+52k). Meanwhile, Temporary Help employment continues to contract (-15k) and is now ~120k below pre-COVID levels. We take that as an important signal that the labor market is coming into better balance as demand cools.

- Goods producing payrolls added 19k jobs, led by Construction (+23k), even as Manufacturing shed -4k jobs (remember that Manufacturing employment has been roughly flat over the past year amidst a long stretch of negative Manufacturing PMIs).

- By sector, employment across finance, tech, professional services, construction, manufacturing, transport/warehouse, education/healthcare, and retail and wholesale trade is back above pre-pandemic levels. By comparison, leisure / hospitality employment remains about 1% below its pre-COVID peak, although hiring in the sector has slowed following a period of extensive backfilling in the last two years.

- Month-over-month wage growth slowed to +0.1% m/m, and the year-over-year measure came in at +4.3% y/y (down from 4.4% y/y last month).

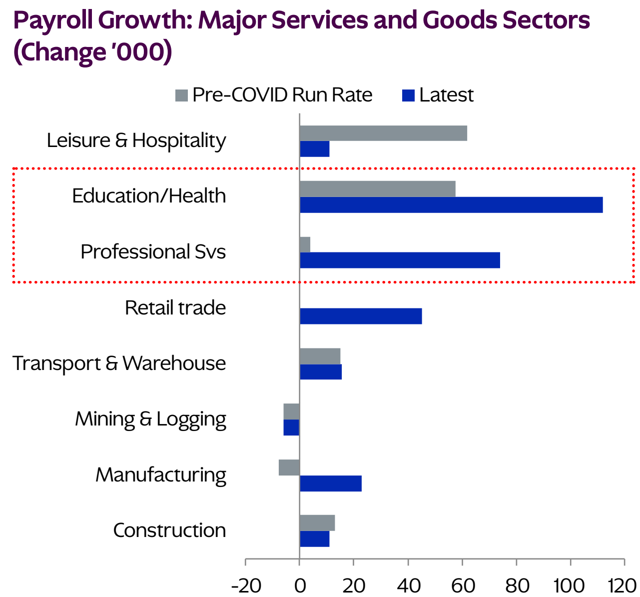
Importantly, elevated wage growth in recent months has largely been driven by a reduction in hours (as labor hoarding leads to more employees being kept on payroll) rather than a lack of available workers, which gives us more confidence that wage growth is not running away to the upside.

- **Interestingly, the unemployment rate is now just 10 basis points below the four percent level that would trigger the so-called 'Sahm rule,'** which signals nearby recession risk when the unemployment rate rises 50 basis points on a sustained basis vs. recent lows (3.5% in the case of this cycle). We remain skeptical of a hard landing narrative, though we do acknowledge the potential for a mild technical recession at some point in coming quarters.

This jobs report furthers our call for rising unemployment and a slower labor market in 2024 as growth slows sequentially (1Q24 GDP is tracking at around 2-2.5%, down from 3.5% last quarter and 4.9% in 3Q23). That said, non-cyclical sectors like government and education/healthcare are providing a ballast to overall hiring, while labor hoarding is helping to limit the 'tail risk' of widespread layoffs (with the exception of over-hired tech/information jobs).

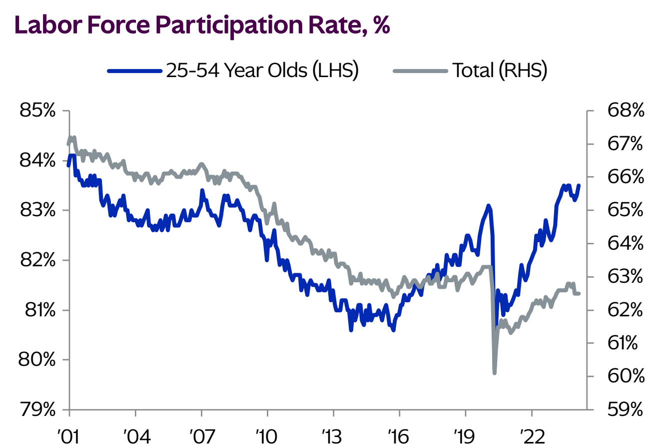
Against that backdrop, we continue to think the Fed will be more focused on its inflation mandate than its employment mandate in coming months (which is why we still see three cuts this year, versus consensus of four).

Exhibit 1: February Data Showed Job Gains Running at a More Normalized Pace, with Services Still Leading the Way



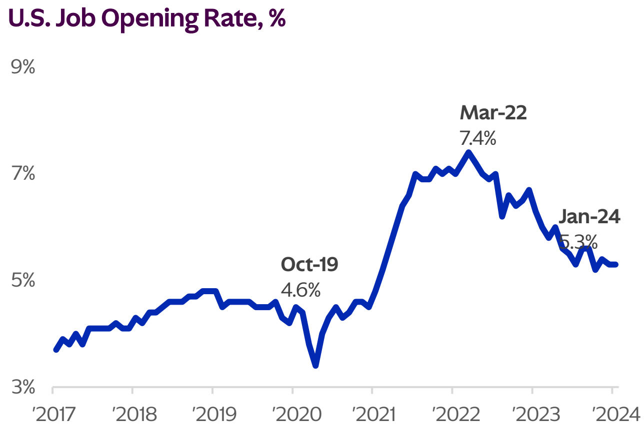
Data as at February 29, 2024. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Exhibit 2: Prime-Age Labor Force Participation Ticked Up 20 Basis Points to 83.5%, While Overall Labor Force Participation Remained Flat At 62.5%



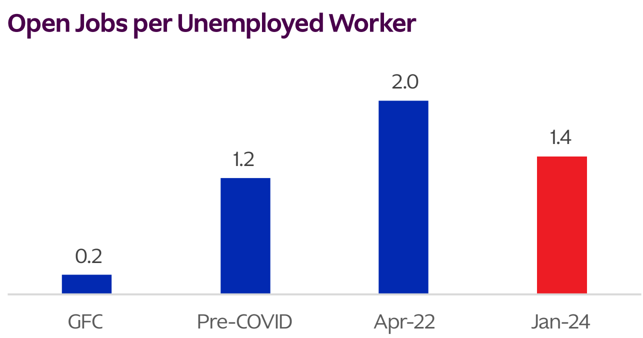
Data as at February 29, 2024. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Exhibit 3: Job Openings Are Falling...



Data as at January 31, 2024. Source: U.S. Bureau of Labor Statistics.

Exhibit 4: ...and Shows Labor Demand and Supply Are Coming Back in Better Balance



Data as at February 29, 2024. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Frankly, given the technical backdrop, we don't need the Fed to ease to have stronger global capital markets. In terms of key themes, we remain very constructive on productivity investments, especially as it relates to automation. We also still favor the intersection of surging data demand with the backdrop of limited power supply and energy transmission. Finally, we are bullish on the 'security of everything', including energy, data, transportation, cyber, and water/food.

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