KKR

Flash Macro Update

U.S. Jobs Report | October 2023

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What You Need to Know

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

The October nonfarm payrolls report showed a distinctly moderating trend in job growth. Headline employment came in at +150k, below consensus of +180k, and down considerably from +297k in September. Importantly, this is the second lowest monthly payroll gain since the start of the pandemic recovery, which should give the Fed confidence that policy has now reached a sufficiently restrictive stance (consistent with our base case that they are done hiking).

Against this backdrop, we maintain our forecast for no more Fed hikes this year and three Fed rate cuts by the end of next year despite inflation remaining above-target, as well as our 10-year UST target of 4.75% this year and 4.25% next year.

However, let's not get overly optimistic that everything is working right. As wage growth remains robust on a YoY basis, the participation rate actually *fell* to 62.7% from 62.8% last month, and the UAW strike made this month's headline number look weaker than it really was. Finally, today's report has put major downward pressure on the USD, which is driving commodity prices up (i.e., for every action, there is an important reaction function that must also be considered). Said differently, we think there is still room for markets to be surprised by the resilience of U.S. growth and inflation. So, our message is to remain short to flat duration on a tactical basis but narrow the bet around our targets.

Bottom-line: We think today's report is bullish equities and bonds; it is similarly constructive for oil. By comparison, it is likely negative for the dollar. Overall, we think that risk markets still grind higher for the next few years. The bear market ended in

October 2022, and while we see GDP slowing in 2024, we do not see any signs of a deep recession. Maybe more importantly, we actually think that corporate earnings already bottomed in 2Q23.

WHAT DO WE THINK THIS MEANS FOR MARKETS?

1. **This report is a positive one for the Federal Reserve for several reasons**. First is that the total job gain is much closer to the Fed's comfort zone of 100,000-125,000. Second, revisions from last month reveals 297,000 jobs, compared to an initial print of 336,000. Third, the unemployment rate increased to 3.9% versus an estimate of 3.8% so will give the Fed more air cover not to increase rates again, which remains our base call.

2. **No change our interest rate calls**: 1) We already have the Fed ending its campaign, so no change to that view based on this report; 2) For the 10-year, we maintain our 4.75% target for this year and 4.25% for next year; 3) We have the Fed cutting three times by the end of next year, despite inflation not being below its 2.0% target. Against this backdrop, the technical picture for bonds is still not great, as we have lots of supply, Japan/China are selling our bonds, and financial institutions and the Fed hold material bond losses that they would like to sell. So, our message is to remain short to flat duration, but narrow the bet around our targets.

3. **However, optimism should be somewhat contained.** Consider the following: First, wage growth came in at 4.1%, compared to an estimate of 4.0% and a revised 4.3% from last month. Second, the participation rate actually *fell* to 62.7% from 62.8% last month. Third, if you add back auto jobs from the strike, we are closer to 180,000 jobs, which is still a stronger than the warranted number at this point in the tightening campaign. Finally, today's weaker report has put major downward pressure on the USD, which is driving commodity prices up **(i.e., for every action, there is an important reaction function that must also be considered).**

4. **Key drivers of growth remain: It is all about the government and services, not goods.** There were fully 89,000 jobs in Education/Healthcare and 51,000 from government jobs. **So, 90% of the net job growth came from two sectors, both of which have high wages and secular growth drivers (demographics and big government).** If there is good news, it is that Travel/Leisure slowed to just 19,000, as this sector has been the other area of strong wage and hiring tightness this cycle.

5. **We think markets will trade this data positively**. Today's report is bullish equities and bonds, in our view; it is similarly constructive for oil. By comparison, we believe it is negative for the dollar. Overall, we think that risk markets still grind higher for the next few years. The bear market ended in October 2022, and while we see GDP slowing in 2024, we do not see any signs of a deep recession. Maybe more importantly, we actually think that corporate earnings already bottomed in 2Q23.

KEY TRENDS IN THIS MORNING'S DATA:

- Headline job growth slowed in October, and the unemployment rate ticked up to 3.9% from 3.8% even as participation fell. Overall, today's report suggests that the labor market is starting to respond to Fed tightening, although we do not expect things to cool in a straight line given the amount of fiscal stimulus in the system and the fact key sectors of the economy are still running below trend.

- Participation ticked down to 62.7% from 62.8% this month and is now about 70 basis points below pre-COVID levels and around 200 basis points below the 65+% level that would be needed to sustain job growth of +200k over the next several years. A lack of available workers is helping put downward pressure on the unemployment rate; while we see unemployment rising further in 2024, we think it will remain fairly low on an absolute basis this cycle.

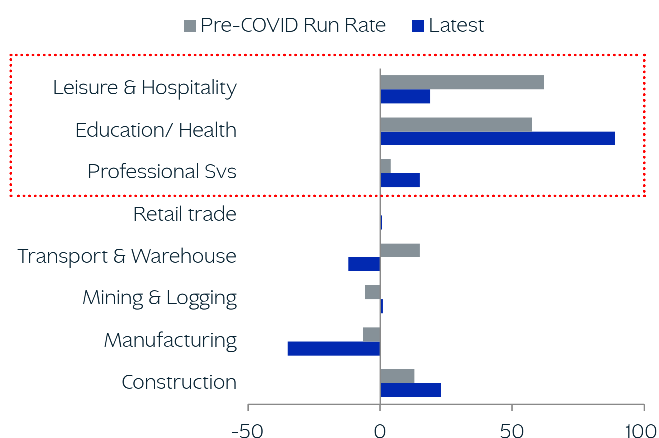
- Service-providing payroll (+110k, down from +218k in September) drove the bulk of private payroll gains this month, thanks to Education/Healthcare (+89k), Leisure/Hospitality (+19k, but down from +74k last month), and Professional Business Services (+15k). Tech and Information employment continued to stagnate (-9k) as layoffs announced in 2H22/1H23 flow through to the official data. Additionally,

government continues to drive an outsize share of headline job gains (+51k for the third month in a row).

- Goods producing payrolls shed -35k jobs, but job losses were almost entirely concentrated in the auto sector (where UAW strikes are driving job losses); construction employment actually added +23k jobs, up from +13k last month.
- 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.
- **Key dynamics at the sector level included 1) a ~30-40k drag from UAW strikes, 2) a softening of leisure & hospitality job gains, and 3) continued robust health care, education, and government job gains.** Ex UAW strikes, payrolls would have been closer to +180-190k, which is actually not too far below the trailing six-month NFP average of +210k. What is different in this report, however, is that Leisure/Hospitality job gains slowed considerably to +19k, well below the recent trend closer to +50k. At the same time, however, the steady growth sectors of healthcare, education, and government continued to generate significant job gains – in October, they collectively generated +140k jobs, or fully 90% of the headline NFP number.
- Importantly, although year-over-year wage growth remains elevated, month-over-month wage growth held steady at +0.2% m/m in October, though revisions show stronger wage growth in 3Q. Overall, we think the direction of travel on wages matters more for markets at this point and should give the Fed more confidence that labor market dynamics have become less inflationary.
- **Average hourly earnings came in at +0.2% m/m, below the consensus and prior-month level of +0.3%.** On a y/y basis AHE moderated to +4.1% from +4.3%.
- **Average weekly hours fell a tenth to 34.3 from 34.4.** Hours worked continues to trend near post-GFC lows, suggesting that labor hoarding is holding employment somewhat higher than it would be otherwise.

Exhibit 1: Job Gains Are Slowing, But Non-Cyclical Sectors Like Education and Healthcare Are Still Growing at a Healthy Pace...

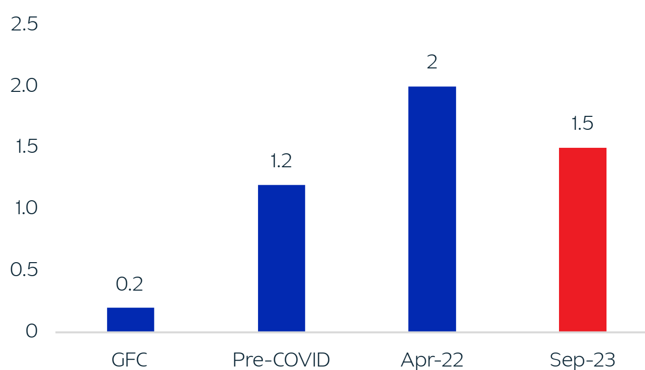
Payroll Growth: Major Services & Goods Sectors (Change '000)



Data as at October 31, 2023. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Exhibit 2: ...And the Overall Labor Market Backdrop Is Less Inflationary Than It Was in 2022

Open Jobs per Unemployed Worker



Data as at September 30, 2023. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis..

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