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Macro Alert
Weaker Payrolls Will Reward Pent-Up Demand for Fed Pivot

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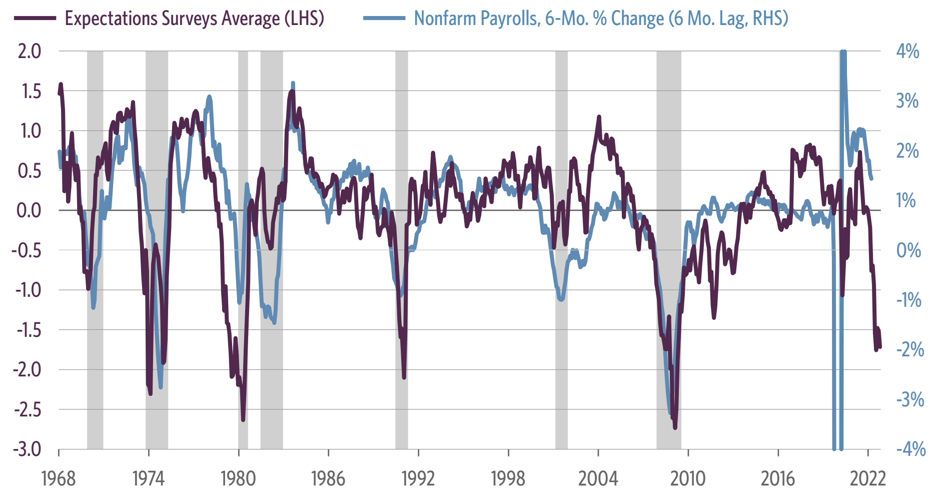
A major reason for the Federal Reserve's (Fed) relentless pace of rate hikes is the tight labor market that has been remarkably resilient in the face of weak economic activity and stressed financial markets. But that resiliency is about to turn. Expectations surveys across the economy have become quite pessimistic, with businesses expecting lower sales and consumers seeing bleaker personal finances. Last week's Beige Book from the Fed, with reports of hiring freezes and more cautious consumer spending patterns, confirmed preparation for a downturn. Historically, such a broad and deep deterioration in economic expectations has been a leading indicator for a decline in employment.

Negative Expectations Across the Economy Bode Poorly for Job Growth

Surveys Include: Consumer, Forecaster, Small Business, CEO, Manufacturing, Housing



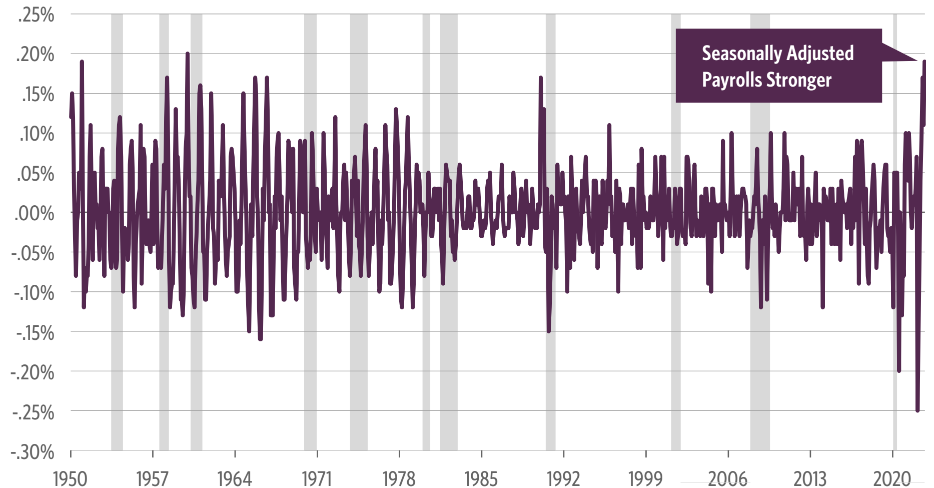
Source: Guggenheim Investments, Haver Analytics. Data as of 9.30.2022 for payrolls, 10.31.2022 for surveys. Survey average is average Z-score.

A more technical issue is also signaling an imminent change to weaker job growth. We're seeing the largest gap since the 1950s between the year-over-year change in seasonally adjusted nonfarm payrolls and non-adjusted payrolls, when

conceptually these measures should be equal. This gap is strongly mean reverting, adding additional downside risk to seasonally adjusted payrolls starting as soon as next month.

Seasonal Adjustment Boost to Payrolls Could Reverse in Coming Months

Nonfarm Payrolls: Gap Between Seasonally Adjusted YoY Change and Non-Seasonally Adjusted



Source: Guggenheim Investments, Haver Analytics. Data as of 9.30.2022.

With inflation still way too hot, and the Fed aiming for an unemployment rate around 4.4 percent, it will take some time before a weakening labor market causes the Fed to end rate hikes. But the correlation between our expectations survey aggregate and the labor market suggests that over the next six months the unemployment rate should rise to 4.2 percent with a cumulative decline in payrolls of over 800,000. As the jobs picture worsens, the Fed should gain confidence that tightening is having its intended effect.

That confidence should open up the door to a downshift in the pace of rate hikes at the December meeting. This downshift in rate hikes would be initially welcomed by markets, where there is huge pent-up demand for a Fed pivot. But as a recession continues to play out next year, risk assets would likely see renewed weakness, while interest rates would head lower.

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