TheStreet

Dismal Jobs Report May Push Rate Hike Into Next Year

By Tim Mullaney I 10/02/15

.NEW YORK (TheStreet) -- It looks like a rate hike may be off the table for this year.

Friday's disappointing jobs report, which hammered the markets, suggested that the U.S. economy is not as robust as many were hoping, and gives the Federal Reserve even more reason to hold off on a rate increase.

The U.S. created 142,000 jobs in September, far below the 200,000 jobs that were expected. The unemployment rate remained at 5.1%, but hourly wages were flat at 2.2% instead of the 2.4% pickup that was forecast.

Job gains were also revised downward for August and July."This is unambiguously soft, especially with two months of downward revisions and a flat [average hourly earnings] rate," said David Ader, market strategist at CRT Capital, in a note. "There's nothing more to say. And if you thought the Fed might hike in October, forget it. December loses more potential."

Markets are now predicting the Fed will raise rates in March, which would be the first increase in nearly a decade.

Fed funds futures "showed December at somewhere in between 45% and 50% for the last couple of weeks," said Randy Frederick, Managing Director of Trading and Derivatives at the Schwab Center for Financial Research. "That's now showing about 28%. So it doesn't take it off the table but it certainly lessens the probability pretty substantially."

Expectations of a March rate hike are now over 50%, Frederick added.

The fed funds rate, an interbank lending rate that the Fed uses to influence other interest rates, has remained near zero since late 2008.

Economists, meanwhile, were baffled by the disappointing jobs report.

“I have no clue what is going on other than thinking that a lack of workers, not a lack of demand, is slowing job growth," Joel Naroff, president of Naroff Economic Advisers, wrote in an e-mail.

Others blamed the slowdown in China's economy and volatility in financial markets.

"We believe the weakness in payroll employment growth and hours worked reflect the deceleration in activity abroad and, more recently, the pickup in financial market volatility

domestically," Barclays economist Michael Gapen said. "Experience suggests that these episodes temporarily weigh on demand for labor...It takes more than just a few months for these pot holes in global growth and uncertainty to fade. Rate hikes will be deferred past year-end."

After dreading a rate increase for months, investors are now hoping for one to show the economy is getting back on track. Markets tumbled last month after the Fed held off raising rates.

"I believe a Fed interest rate hike would actually be stimulative to the market because it would show that the Fed has confidence in the economy," said Schwab's Frederick.

Now, the Fed's delay--which many criticized at the time--is being viewed more favorably.

"The fact that (the Fed) chose not to do that shows that they don't have much confidence," Frederick added. "And now when we see payrolls actually showing weakening quite a bit, that justifies that perspective."

Not all of the economic news has been bad, however.

The data continue to show steady progress on the non-traditional metrics Fed chair Janet Yellen has pushed to the forefront of the debate on rates, including middle-class incomes and the number of workers who hold part-time jobs because they can't find full time positions.

And data on consumer behavior suggests the new income, as well as the savings from lower gas prices, is getting spent.

"We have now recaptured all of the income losses that have occurred since June 2009, when the Great Recession ended," Sentier analyst Gordon Green wrote in the news report. "Median household income is still 1.5 percent lower than December 2007, when the Great Recession began and 2.7 percent below the level in January 2000.

"September U.S. auto sales were reported on Thursday and hit a blistering annualized pace of more than 18 million cars and trucks. New home sales rose 5.7% in August, for their highest level in seven years, as fundamentals like household formation continue to shake off torpor that settled in after the 2008 financial crisis.

Unemployment is still at nearly full employment levels despite the report, with a record number of open positions yet to be filled, economist Bernard Baumohl said. Today's Labor Department report said there were 400,000 fewer involuntary part-time workers in September, bringing the closely watched U-6 rate, which combines unemployment and underemployment numbers, to 10%.

The U-6 rate, which peaked at 17.1% in 2009, was last this low in May 2007 and only goes much below 8.5% in the most-robust periods of economic expansions. It has fallen by 1.7 percentage point in the last year.

All that improvement has fueled calls for the Fed to raise rates soon.

"We're way overdue for moving away from zero," said **Bernard Baumohl, chief economist at the Economic Outlook Group,** before the report was released. "I also

expect the stock market to respond favorably once the Fed acts, in large part because investors do not expect to see another rate increase for a while."

The Fed is likely to do little during the 2016 presidential campaign, in order to stay above the fray, **Baumohl** predicts. The central bank's quiescence will also send a signal to markets that Chair Janet Yellen and her colleagues think the economy is on solid footing after years of halting expansion that has forced repeated downward revisions of growth forecasts. Yellen herself has emphasized that the first rate hike won't necessarily set off a string of increases.

"Look, the Fed's mandate on the jobs front has been met," **Baumohl** says. "But it has not been credibly met yet on its inflation mandate. So I expect the Fed will rationalize [a December hike] by saying they expect inflation to move higher in the coming months with wage growth now accelerating faster than productivity."

The wage number will move toward the forefront as full employment moves closer, and Moody's Analytics chief economist Mark Zandi, who predicts an acceleration in wage growth next year. Wage pressure will let the Fed, which has seen inflation running well below its 2% annual target rate, sell the idea that inflation will rise soon enough to justify a hike, **Baumohl** said.

"All it takes is one business in each industry to begin raising wages and all others much follow to hold onto their employees," Zandi says. "We are getting close to this occurring in many industries."

###