# FLASH MACRO UPDATE

U.S. JOBS | July 8, 2022

# What You Need to Know

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## 1 *Question #1: What are the implications of the June US jobs report?*

Sometimes there are jobs reports that don't matter that much. This one does. It signals several important trends that we have been highlighting at KKR:

1. **Higher rates are not yet slowing the labor market.** Our view remains that this inflationary bout is largely linked to supply issues. With the participation rate falling to 62.2% from 62.3% (and against an estimate of 62.4%) and average hourly earnings up 5.1% (and the prior month revised up to 5.3% from 5.2%), labor inputs remain inflationary. That means more Fed tightening ahead.

2. **So, we still do not think the tightening cycle is done, either.** We continue to see the short end of the curve hitting 3.375% this cycle. As we have been signaling, both the short end and the long end are moving structurally higher on the back of more volatile and sticky inflation, although the rate of change in bond market moves is now poised to slow as we shift from markets repricing inflation expectations towards investors having to do deal with the adverse consequences of inflation on consumer balance sheets and corporate profits.

3. **Do not forget the currency market...** The dollar is reigning supreme, and it is creating major shifts in key markets such as the euro, which is now almost at parity, the yen and the GBP. Most investors have focused only on the volatility in the bond market and stock market, but the repricing of currencies we are seeing is fairly historic. So, please stay focused on hedging.

4. **Revenge of services theme is booming.** We continue to see deflation and economic contraction in the goods economy, while services looks strong. All told, services employment reached 333,000, up from 278,000 last month. Professional services, education and health services, and leisure and hospitality are all booming. Such strength in services is why one can only be so bearish.

5. **Strong job reports do not change our view that we are going to see a profits recession, including also a potential technical economic recession.** Every cycle is different, and this one will likely be remembered for the reality that one of the supply side shocks is a shortage of labor. As such, this slowdown could look more like the 2001 slowdown. What happened then? Unemployment went up, but less than the 2.5% average for a recession, and growth slowed but did not collapse. For structural bears, we agree that we put too much money in the system and there are some supply-side issues on which to focus, but we just don't see the major de-leveraging that defined the 2008 crisis or the 1989/1990 downturn.

6. **What does this mean for markets?** We see rates moving a little higher, we see equities range bound, and we see the dollar still

strong. Our stronger-for-longer oil forecast has been challenged of late. However, we continue to think that China activity is bottoming, and we see both geopolitics and supply issues supporting higher prices in this unique downturn. From a thematic perspective, we still favor pricing power, automation, digitalization, security of everything, and buying complexity. Now is not the time to cut risks, with markets down dramatically. However, our models are still not saying to increase the pace of deployment – yet.

Some key details in the June report that caught our attention:

- **The data are becoming more noisy:** While job growth was strong per the official establishment survey of companies, employment actually fell by -315k in the household survey of workers. This suggests to us that that small businesses and the self-employed could be starting to come under some stress.

- **Participation remains disappointing…:** The Labor Force Participation rate fell to 62.2% from 62.3% last month, disappointing consensus that looked for an improvement to 62.4%.

- **…Which is holding unemployment at low levels…:** The unemployment rate held flat at 3.6%, in-line with consensus, as the decline in household employment was offset by the decline in labor force participation.

- **…and keeping wage growth elevated:** Average hourly earnings increased by 0.3% during June, in-line with consensus and down a tick from 0.4% in May. Upward revisions to prior months took y/y AHE growth to 5.1%, above consensus of 5.0% but down from 5.3% last month.

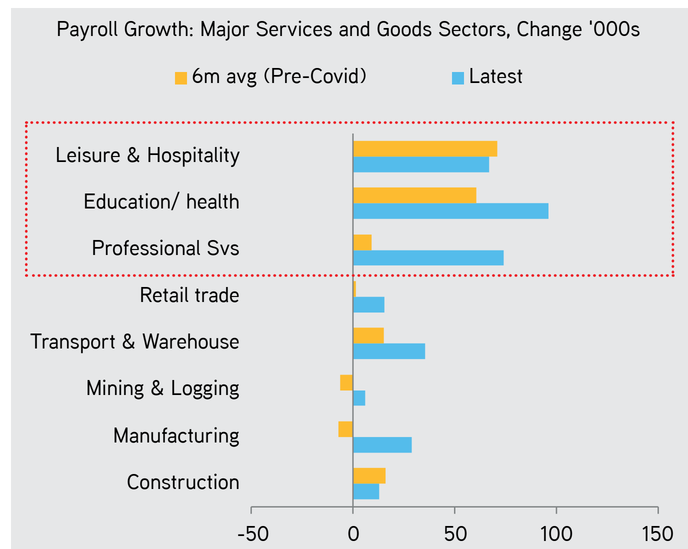
- **Sector data shows job growth and wage growth transitioning from goods to services:** Goods employment growth slowed to +48k in June from +58k last month, led by a slowdown in construction jobs. Meanwhile, services job growth accelerated to +333k from +278k in May, boosted by strong gains in education and health, professional services, and wholesale trade.

**Bottom line:** Headline job growth remains strong, but unemployment, household job growth, and labor force participation are showing signs of peak labor market strength. Bigger-picture, the underlying composition in job growth is now shifting from the goods sector, where we think employment will contract, toward the services sector, where we still expect employment to remain fairly resilient to slowing GDP growth. We think that overall wage growth will remain strong for the time being as workers demand higher pay in the face of rising food, energy, and shelter costs. Longer-term, we think that wage growth will slow relative to recent levels, but remain above-trend. Key to our thinking is that slowing activity in the goods sector is offset by a shortage of workers in the services sector.

**The pandemic has hit lower income workers the hardest, as they continue to lag the broader recovery**. The long-term unemployed cohort – defined as those without a job for more than 26 weeks — ticked down from 1.36 million to 1.34 million, accounting for 23% of the total unemployed. The BLS calculates the probability of reemployment by duration of employment. The probability drops from ~27% for 5-14 weeks to ~23% for 15-26 weeks and ~20% for 27-52 weeks. Remember that two-third of excess pandemic savings have accrued to the top income quintile, while low-income households have seen their savings *decline* vs. pre-COVID levels.

**Exhibit 1**

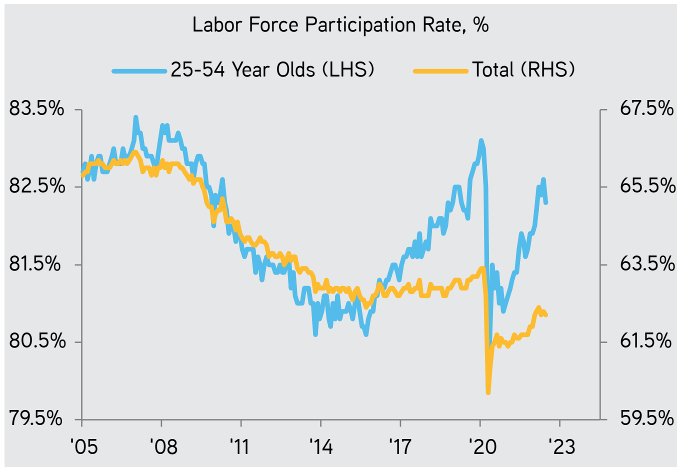
**Job Gains This Month Were Broad-Based, With Leisure/ Hospitality, Professional Services, and Education/ Healthcare Leading the Way**




Data as at July 8, 2022. Source: Bureau of Labor Statistics, Haver Analytics.

## Exhibit 2

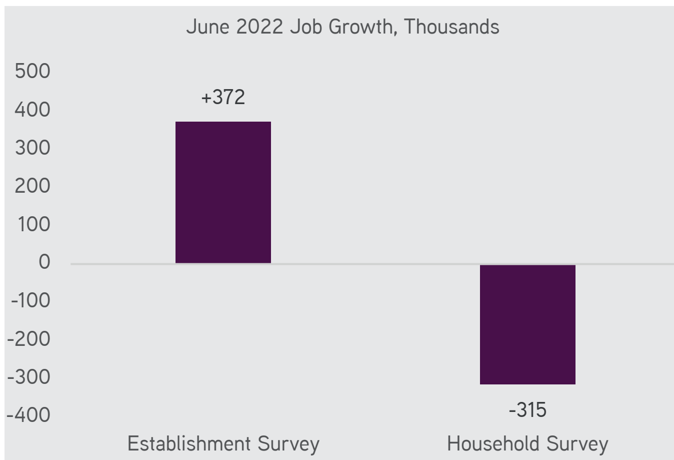
**Overall Labor Force Participation Edged Lower in June, from 62.3% to 62.2%**




Data as July 8, 2022. Source: Bureau of Labor Statistics, Haver Analytics.

## Exhibit 3

**We Think That Small Businesses and the Self-Employed Could Be Starting to Come Under Some Stress**

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