

## Jobs data and Fed's next move

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U.S. employment figures released by the Labor Department at October 9, 2007 showed U.S. payrolls added 110,000 jobs in September – the most in one month since last May. Wall Street has expected a gain of 100,000.

The added jobs were driven by gains in education and other service-sector hiring, as well as government work.

The Labor Department delivered a second helping of good news – August payrolls were revised sharply higher than the net loss of 4,000 that the government first estimated.

Meanwhile, the unemployment rate rose slightly in September to 4.7 percent, but is still near historical lows.

The healthy payroll numbers provide “further evidence that while the U.S. economy may slow a bit due to the housing crunch, it is likely to skirt an outright recession,” stated The Wall Street Journal.

The threat of a recession due to the housing bust forced the Fed to slash interest rates by 50 basis points to 4.75 percent in September – the first rate cut in more than four years.

CNN.com noted that, “the weak August (payrolls) report had opened the door for the Federal Reserve to cut its benchmark interest rate by a half-percentage point in September, the first cut in four years, as it attempted to save off an economic slowdown”.

But now that the jobs data is healthier than expected, will the Fed have room to cut further at its meeting at the end of this month?

The Wall Street Journal observed that, “Despite sings that the economy expanded more than 3 percent last quarter, financial markets nonetheless have until Friday expected the Fed to lower the Fed funds rate one – quarter point, 4.5 percent, when it meets Oct. 30-31, and are pricing in another quarter – point reduction by yearend.”

The Wall Street Journal offered that, The Fed's rate moves so far have been spurred by housing and credit-market difficulties and not current data, which have held firm.”

In the Fed's Sept.18 policy statement, officials omitted their longstanding reference to “high resource utilization,” the Journal added, “a nod to the tight jobs market, as an inflation risk.”

It further offered that, “One bright spot for the Fed in Friday's report was the downward revision to March 2006-March 2007 job growth. That implies productivity was stronger in 2006 and early 2007 than once thought, suggesting the economy can grow faster without inflation.”

However, Fed Vice Chairman Donald Kohn offered a hint of how the Fed may respond to the latest employment news. Speaking today to the Greater Philadelphia Chamber of Commerce, Kohn told attendees that the Fed's half-a-percent point rate cut last month may be enough to keep the economy from “sinking from the financial market turmoil.”

In fact, with recent favorable inflation news, Kohn reportedly said he believes the Fed could reverse the recent rate cut if it turned out to be larger than needed.

Service sector jobs – such as in banks, insurance companies, restaurants, and retailers – added 143,000 workers during September (although retailers saw job losses of 5,000). In contrast, goods-producing industries lost 33,000 jobs, including 14,000 cuts in the construction and 18,000 cuts in the housing sector.

Equity markets reacted favorably to recent jobs report. The Dow Jones Industrial average jumped 115 points. The S&P 500 Index rallied 16 points.

At the risk of being called a permabear – someone who’s unfailingly bearish on the market – I urge you not to get overly excited about the recent stock-market rally. Many pundits will point to today’s “healthy” jobs report as an indication that the U.S. economy is still strong, yet most economic statistics clearly indicate that growth will slow considerably in the months ahead.

Though the employment situation improved somewhat during September, job growth has slowed significantly since the beginning of this year (see chart).

Today’s supposedly “healthy” jobs report could give the Federal Reserve the ammunition it needs to keep-term in interest rates on hold at its next meeting on Oct.31. Unfortunately, recent advances in stock prices were largely the result of investors’ expectations that the Fed would continue lowering interest rates. I expect a halt to the equity price rally.

I urge you to be patient and to think twice before aggressively adding equities to your investment portfolio. My models indicate there’s trouble ahead for equities.