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Disappointing US May's employment report decreases the odds for a June hike

Olga Kosma
Research Economist
okosma@eurobank.gr

- US nonfarm payrolls for May fell short of market expectations, increasing by a mere 38k versus consensus estimates for a rise of 160k. The monthly gain was the lowest since September 2010, while the previous two-months payroll increase was downwardly revised by 59k. Some of the weakness in May's establishment report was due to the Verizon strike, with the Bureau of Labor Statistics (BLS) calculating that the said strike subtracted roughly 35k information sectors jobs. Even after excluding the Verizon strike effect, payroll gains have been remarkably weak and have actually been on a downward trend since February when employment growth rose by 233k (Figure 1).

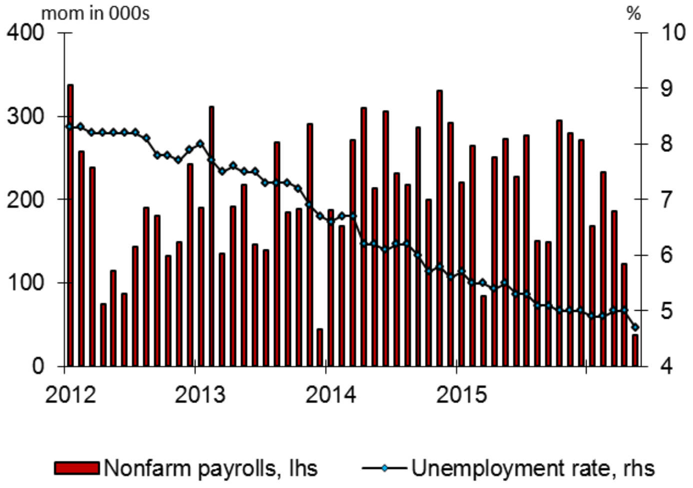
- Weakness in nonfarm payrolls was broadly based. The industrial sector continued its downturn amid slowing global demand, with manufacturing (-10K), mining and drilling (-11K), wholesale (-10K) and transportation/freight (-1K) all reporting declines. Construction reported the second worst month in the past five years (-15K), with nonresidential construction reporting the largest weakness. On the flipside, nonfarm payrolls in the service sectors increased 61k thanks to education and health while the remaining service sectors were relatively soft.

- As far as the May's household survey is concerned, civilian employment gained a modest 26k and the unemployment rate dropped to its lowest level since late 2007 of 4.7% from 5.0% in the prior month, taking advantage of a decline in the participation rate by two-tenths to 62.6%. Over the past two months, the participation rate has fallen 0.4pp cumulatively, reversing most of the 0.6pp increase recorded between September 2015 and March 2016. Average hourly earnings increased by 0.2%MoM in May, with the annual rate of growth remaining unchanged at 2.5% (Figure 2).

- Following the weak US payroll report, US Treasury yields tested fresh multi-week lows with the 10-yr paper hovering around 1.733% in the early US trade, within distance from a two-month trough of 1.697% recorded late on Friday. Fed Funds Futures contracts currently assign a 4.0% and 30.9% probability of a 25bp Fed interest-rate increase in June and July, respectively, compared to 22.0% and 54.8% last Thursday ahead of the release of the May's employment report. In FX markets, the USD remained under pressure against its major currency peers, with the DXY index standing around 94.058 in early US trade at the time of writing, not far from a near three-week trough of 93.855 recorded on Friday. The EUR/USD was trading around 1.1355/56 at the time of writing after increasing to a three-week high of 1.1374 on Friday.

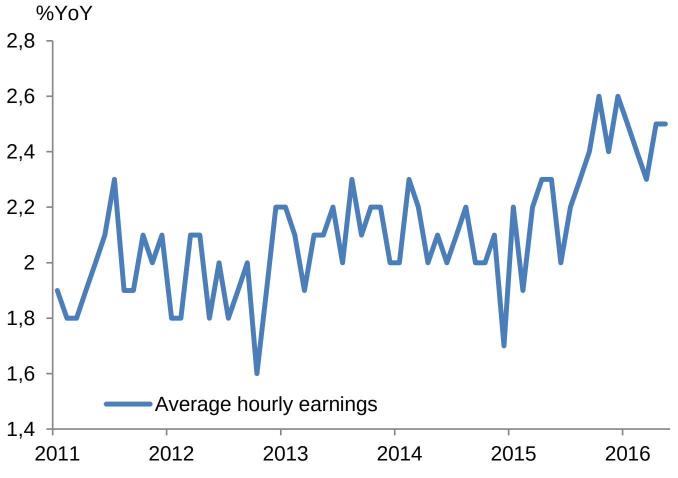
- Although several FOMC members have highlighted that an interest rate hike in June or July would be appropriate if data continue to prove in line with Fed's expectations, we believe that the weak payroll report in May will weigh remarkably on the Fed's short-term policy deliberations. Employment growth has historically been an important determinant for the state of the US economy and, consequently, the Fed's reaction function for the future interest rate path. Although we cannot exclude an interest rate hike in July, it is likely that the next interest rate hike will be delayed until December, when the uncertainty over the US November elections will have passed (November 8). All eyes are currently on Chair Janet Yellen's speech later in the day, where she is expected to reiterate the Central Bank's gradual tightening bias.

Figure 1: US nonfarm payrolls & the unemployment rate



Source: US Bureau of Labor Statistics (BLS), Bloomberg, Eurobank Economic Research

Figure 2: US average hourly earnings



Source: US Bureau of Labor Statistics (BLS), Bloomberg, Eurobank Economic Research

Eurobank Economic Analysis and Financial Markets Research

Dr. Platon Monokroussos: *Group Chief Economist*
pmonokrousos@eurobank.gr, + 30 210 37 18 903

Dr. Tassos Anastasatos: Deputy Chief Economist
tanastasatos@eurobank.gr, + 30 210 33 71 178

Research Team

Anna Dimitriadou: *Economic Analyst*
andimitriadou@eurobank.gr, + 30 210 37 18 793

Ioannis Gkionis: *Research Economist*
igkionis@eurobank.gr + 30 210 33 71 225

Stylianos Gogos: *Economic Analyst*
sgogos@eurobank.gr + 30 210 33 71 226

Olga Kosma: *Research Economist*
okosma@eurobank.gr + 30 210 33 71 227

Arkadia Konstantopoulou: *Research Assistant*
arkonstantopoulou@eurobank.gr + 30 210 33 71 224

Paraskevi Petropoulou: *G10 Markets Analyst*
ppetropoulou@eurobank.gr, + 30 210 37 18 991

Galatia Phoka: *Research Economist*
gphoka@eurobank.gr, + 30 210 37 18 922

Theodoros Stamatiou: *Senior Economist*
tstamatiou@eurobank.gr, + 30 210 33 7 1 228

Eurobank Ergasias S.A, 8 Othonos Str, 105 57 Athens, tel: +30 210 33 37 000, fax: +30 210 33 37 190, email: EurobankGlobalMarketsResearch@eurobank.gr

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