

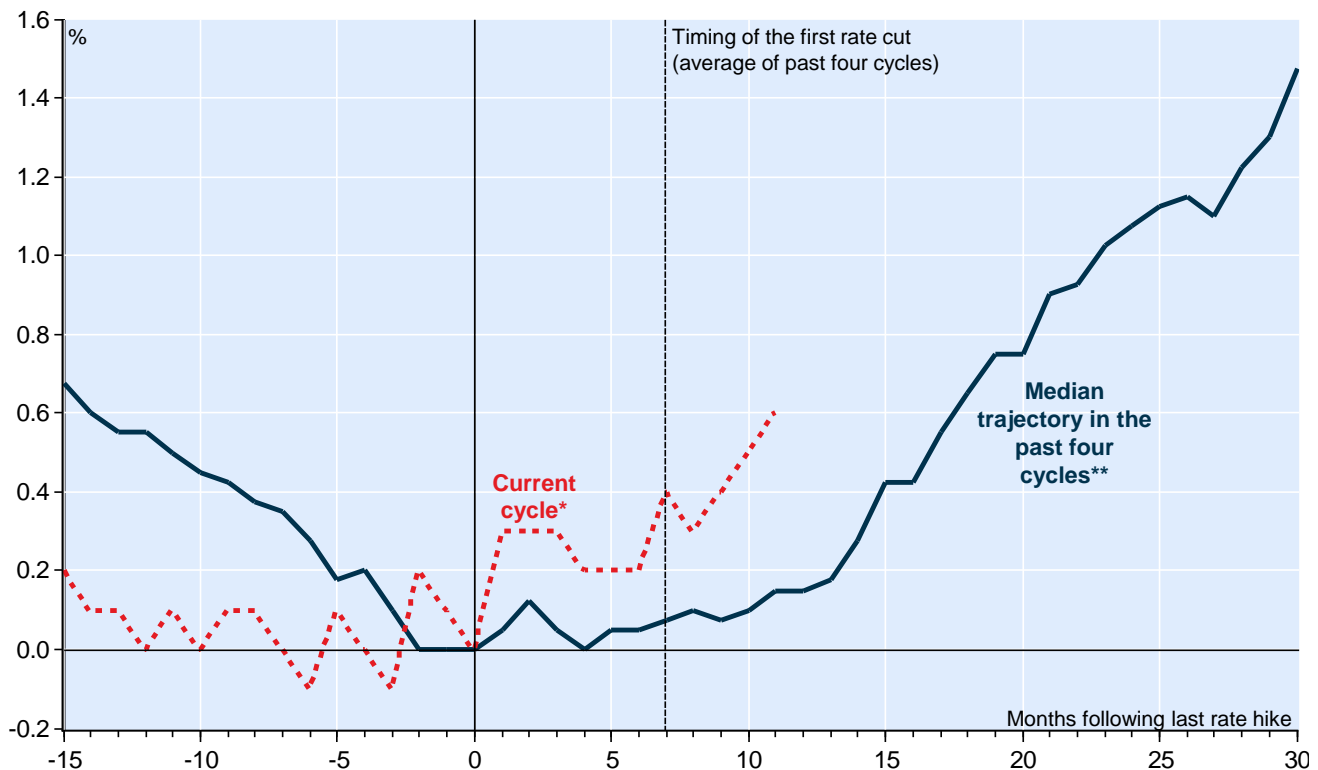
U.S. Watch

By Jocelyn Paquet

Friday's employment reports were rather disappointing. Non-farm payrolls indeed came in stronger than expected, but this positive surprise was more than offset by a significant downward revision to previous months' data. The household survey, meanwhile, showed much weaker job gains. The details were not very encouraging either, especially when it comes to *leading* indicators with proven track records. Employment in the temporary help services category, for instance, dropped sharply, while the number of long-term unemployed (27 weeks+) jumped higher. Despite these apparent signs of weakness, stock markets posted gains, spurred on by the logic that earlier rate cuts made a soft landing more likely. But are markets – and economists for that matter – expecting too much out of the first rate cuts? We think so. Looking at the last four cycles of monetary tightening (three of which ended in recession), we can see that the unemployment rate generally begins to rise several months after the last interest rate hike. The increase even tends to *accelerate* after the first rate cuts, as the latter are generally insufficient to return monetary policy to an accommodating stance. There's no reason to believe it will be any different this time around. Not to mention that the first cut in the current cycle is likely to come later than usual from a labour market perspective. Note that, in 1990, 2000 and 2008, the Fed had already eased monetary policy by an average of 250 basis points by the time the unemployment rate had increased 0.6% from its trough... and the economy still tipped into recession. Although the unemployment rate has already risen by this much in the current cycle, we are still waiting for the first rate cut. This leads us to believe that the long-awaited easing will come too late to prevent a major slowdown in growth in the second half of the year.

U.S.: Are markets expecting too much out of the first rate cuts?

Change in unemployment rate following the last rate hike of a cycle



*Assuming the last rate hike took place on 26 July 2023.

**Cycles which ended in 1989M05, 1995M02 (soft landing), 2000M05 and 2006M06, excludes the tightening cycle that ended with the pandemic.

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