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US jobs report is key to December Fed rate lift-off

Numbers just need to show economy is not decelerating further

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In the grand pecking order of monthly economic data releases, one reigns supreme: the US employment report.

Across major global trading hubs from Tokyo, Hong Kong, Frankfurt, London, New York to Chicago and beyond, investment professionals on the first Friday of every month stare at their news feeds and await the tidings from the US Department of Labor.

This Friday, non-farm payrolls takes on greater importance than usual given how the US Federal Reserve has signalled to the market that it wants to shift overnight borrowing costs higher in December.

Economists are forecasting job gains of 184,000 during October, while monthly payrolls averaged 231,000 during the second quarter, so one can be forgiven for thinking the central bank should keep policy anchored near zero per cent well into next year.

That has been the view of the bond market for some time, but confidence in such an outlook is eroding following the Fed's upbeat policy statement last week. No matter moribund inflation pressures, anaemic wage growth, a massive drop in US labour force participation, sluggish global activity, and much uncertainty over the outlook for China's economy; the Fed has reset the countdown clock for a rate lift-off.

Alan Ruskin, currency strategist at Deutsche, says a sense that the economy is not decelerating further will pave the way for a December rate rise. "The bar is quite low for a hike. Looking at the incoming data, the key determinant is that the economy has not slowed further."

Bond market odds of the Fed raising borrowing costs in December have duly shifted back over 50 per cent, up from around one-third a week ago. Sentiment was stiffened by Janet Yellen saying on Wednesday that policymakers would consider a December lift-off should the data support such a move.

Another illustration of bond market caution can be seen in the recent liquidation of five-year Treasury futures by asset managers. Such positioning benefits over time from the Fed keeping overnight rates anchored near zero. Over the past week, asset managers have been cutting their bets, with the risk that this trend gathers momentum after the payroll data arrives.

When rates rise

The most powerful central bank in the world is considering whether to raise its record-low interest rates for the first time in nearly a decade. Even before the US Federal Reserve makes a move, the effects are reverberating throughout the global economy. Our project explores how.

John Brady, managing director at RJ O'Brien, says a drop in the unemployment rate below 5 per cent will make the market nervous as "the barn door for a rate hike is open".

Firming the Fed's hand has been the recovery in US equities from their nadir in August. With the S&P 500 now back flirting with May's record close and rising oil prices bolstering emerging markets, the Fed has room to move, say many. The big fear from August that China's surprise currency regime shift was opening the door to a sharp depreciation has so far failed to materialise.

"Equities are sending a major signal to the Fed that a policy hike would be viewed as benign," says Mr Ruskin.

Against this backdrop a US economy generating even around 150,000 jobs per month into December can pave the way for the Fed ending some seven years of emergency near-zero borrowing costs.

Anthony Karydakis, chief economic strategist at Miller Tabak, says: "Our key point here is that payroll growth is likely to settle closer to the 150,000 or so range over the next six to 12 months and, in that context, we would be content even with a below 200,000 number on Friday as validating the healthy state of labour markets."

Even in the event of a weak payroll number for October, the window for lift-off will remain ajar, as the Fed has another month of data and revisions before its policy meeting in December.

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John Brady, managing director at RJ O'Brien

Ahead of several more big market swings before year-end, spare a thought for investors who have tried to time the Fed's normalisation of rate policy over the past year, only to have run out of steam.

Across the macro trading community there has been plenty of pain this year, with funds closing and activity being curtailed.

With December traditionally a tricky time for liquidity thanks to year-end balance sheet constraints, fewer people than normal may be around to trade Fed policy finally leaving the launch pad.

As Mr Brady puts it: "People have run out of bullets waiting for the Fed and it means plenty will be watching, rather than participating, should they make a move in December."

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