PREVIEW: US Nonfarm Payrolls (Dec'22) to be released Friday Jan. 6th at 13:30GMT/08:30EST

The rate of payrolls growth is expected to cool, with the street looking for the addition of 200k nonfarm jobs in December, which would be beneath the prior 263k rise as well as recent averages. The unemployment rate is likely to be unchanged at 3.7%, although regional Fed activity surveys suggest there are upside risks. The Fed forecasts unemployment will rise to 4.6% by the end of this year, and the central bank is comfortable with seeing the tightness in the labour market ease as it tries to bring rampant inflation back under control. On that note, the street expects average hourly earnings to cool on an annual basis (by 0.1ppts to 5.0%). Traders will interpret the data as hawkish – and therefore a negative for risk assets – if the headline and wages numbers come in above expectations, and conversely, would likely react dovishly (positive for risk assets) if they miss consensus.

LABOUR MARKET PROXIES: The consensus expects 200k nonfarm payrolls to be added to the US economy in December, below the prior 263k, as well as recent averages (3-month 272k, 6-month 323k, 12-month 408K). Business surveys offer only a partial glimpse of labour market conditions in December (only the manufacturing surveys have been released so far – the services ISM will be released shortly after the jobs report); that said, employment in the manufacturing sector rose back into expansionary territory after a contraction in November, the Institute of Supply Management said. However, analysts note that the Fed's own gauges of regional activity make for a more sobering read, and in aggregate, imply a slowdown in jobs growth in December. Other gauges of the US labour market have generally alluded to continuing tightness: initial jobless claims for the week that corresponds to the jobs report survey window were little changed vs the November reference week, though continuing claims edged up; and while it is by no means a reliable indicator at this stage, monthly jobs data from ADP solidly surprised to the upside (at 235k vs a forecast range of 100-220k). Elsewhere, Challenger reported announced job cuts eased in the month to around 44k from around 77k, while the JOLTS data series declined by less than expected and the quits rate actually rose in the month (NOTE: the latest JOLTS data was for November, not December, but still features in traders' assessments of labour market tightness since the Fed monitors the series closely).

UNEMPLOYMENT RATE: The jobless rate is expected to be unchanged at 3.7%, although analysts have suggested that risks are to the upside given that continuing claims have edged up a little. The Fed is forecasting unemployment will rise to 4.6% by the end of this year – the central bank is engineering an economic slowdown by tightening policy in an effort to lower the currently high levels of inflation, and one of the consequences is going to be a hit to the labour market to cool demand. There will also be attention on the participation rate (last at 62.1%), which has fallen for three consecutive months; the Fed's December meeting minutes said that staff slightly lowered their estimates of potential output for the US economy in the coming years to reflect a lower expected path for labour force participation.

WAGES: Measures of consumer prices have been easing of late, and the street expects that wage growth will similarly cool. The consensus looks for average hourly earnings growth of +0.4% M/M in December (prev. +0.6%), while the annual measure is seen paring by 0.1ppts to 5.0% Y/Y. The ADP's monthly jobs data offered a mixed take on wage trends: the median change in annual pay fell for job stayers (from 7.6% Y/Y to 7.3%), though rose a little for job changers (to 15.2% Y/Y from 15.1%). The Fed's December meeting minutes said that services inflation tends to be closely linked to nominal wage growth, and therefore would likely remain persistently elevated if the labour market remained very tight; consequently, while there are few signs of adverse wage-price dynamics at present, bringing down this component of inflation to mandate-consistent levels would require some softening in the growth of labour demand to bring it back into better balance.

POLICY IMPLICATIONS: Traders will frame the jobs data within the context of Fed policy. The central bank is currently tightening monetary conditions aggressively in order to engineer lower consumer prices. To achieve that end, officials are comfortable in seeing some of the labour market tightness ease. The recent December meeting minutes noted that participants see the labour market had remained very tight, with the unemployment rate near a historically low level, robust payroll gains, a high level of job vacancies, and elevated nominal wage growth; they generally concluded that there remained a large imbalance between labour supply and demand, as indicated by the still-large number of job openings and elevated nominal wage growth.

MARKET REACTION: Traders will use the data to adjust expectations of how far the Fed will continue with rate hikes; currently, markets are pricing the terminal rate beneath the Fed's 5.1% SEP-implied estimate. After the ADP data, money markets were pricing a peak at 5.02% (vs a Federal Funds Rate target of 5.00-5.25%), up a little from the 4.75-

5.00% it had previously priced. Some Fed officials speaking recently have said that if inflation does not come back down towards target, the central bank could even lift rates up to 5.25-5.50%. Accordingly, any significant upside in headline payrolls relative to consensus expectations (and prior trends) would likely lead to traders expecting a more aggressive Fed reaction (higher terminal rate), which could weigh on risk assets like equities; additionally, upside in wages (against expectations of a decline) would likely be similarly received.