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UNITED STATES

# Surprise US job weakness casts serious doubt on Fed rate hikes

The US lost jobs in July and while the unemployment rate fell, it was for bad reasons. Rate hike expectations have declined, but there is a lot happening before the 16 September FOMC meeting

Construction was one of the few bright spots in an otherwise weak US jobs report for July

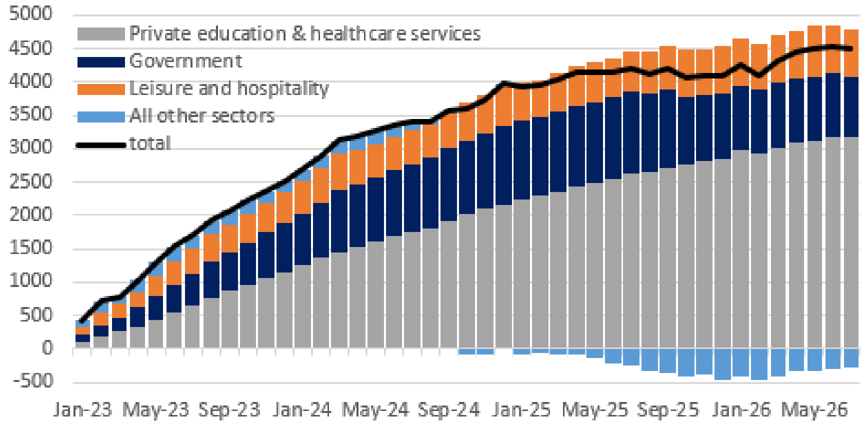
**-23,000** US jobs lost in July

## Employment fall highlights corporate caution

The US jobs report for July was surprisingly weak, with payrolls falling 23k while there were 103K of downward revisions to the past two months' data, leaving the 3M average at 20,000. The unemployment rate fell to 4.1% from 4.2%, but not for good reasons. It was primarily because of a further drop in the participation rate – unemployed people leaving the workforce entirely. Average hourly earnings growth slowed to just 3.2% year-on-year from 3.5%.

In terms of payrolls details, the leisure and hospitality sector lost 40k jobs, which may reflect the conclusion of the FIFA World Cup, but we had also seen a 43k drop in June when it was in full swing. The financial sector lost 14k roles while retail lost 19k. The offsetting strength was in construction (+22k) and, as usual, private education and healthcare services (+25k). The chart below shows the cumulative job creation since December 2022 and indicates that, after a decent March and April, we have reverted to the very weak trend experienced from January 2025-February 2026.

## Cumulative increase in US employment since December 2022 (000s)

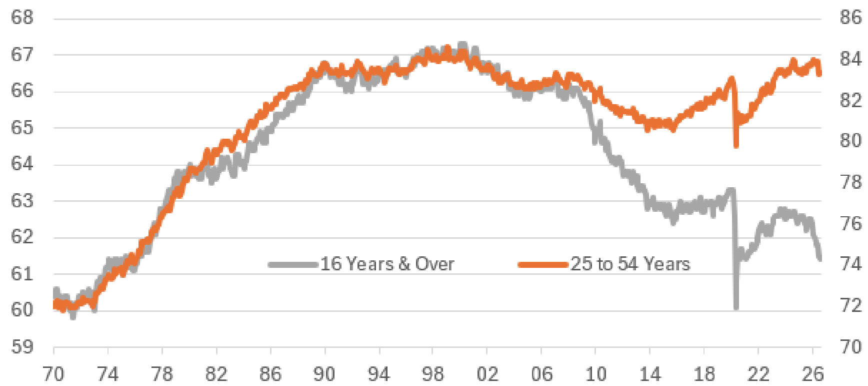



Source: Macrobond, ING

## Disengagement drives a fall in participation

Regarding the drop in the unemployment rate and why this isn't the great news it seems, we have to look at the participation rate. It fell to 61.4%, which, outside the pandemic, we must go all the way back to the mid to late 1970s to find a lower reading. A quarter of a million people left the labour force last month. Within that, the number of people classifying themselves as employed fell 87k while the number of people classifying themselves as unemployed fell 178k. Therefore, the fall in the unemployment rate was caused by disengagement rather than for any positive reason. You can see that the participation rate has fallen by more than a full percentage point over the past year. If it had held steady, we would have a US unemployment rate in excess of 5%, and we would not be talking about a possible September rate hike from the Federal Reserve.

## Labour force participation rates




Source: Macrobond, ING

## What it means for the Fed outlook

Reaction has been significant, with 2Y yields down 8bp and the dollar softening, while Fed funds futures contracts are now only pricing 10bp of a potential 25bp hike on 16 September. Today's outcome supports our call for a prolonged pause from the Federal Reserve, but remember that ahead of the September FOMC meeting we have a further jobs report, two inflation prints and the Federal Reserve's Jackson Hole Symposium.

In terms of jobs, we would tentatively suggest a rebound is possible for August, but the Fed's decision is more likely to come down to what happens on inflation. We expect next week's July CPI expected to show headline prices rising 0.1% month-on-month and core prices rising 0.2%. Cooling housing-related inflation should pull the shelter CPI component lower, while weak wage growth and tariff refunds provide a cash flow boost to US companies, which should all help offset higher costs elsewhere. Assuming we get a deal to reopen the Strait of Hormuz, that can feed through into lower gasoline prices and keep the disinflation trend in place through to year-end and beyond.

While nine members of the FOMC suggested in June they think the Fed will have to hike rates, nine said they didn't (plus, presumably, Kevin Warsh). Now of the nine that think they will hike, we strongly suspect only three are voters this year, and they are already voting for a 25bp hike. That would, in theory, mean to deliver a rate hike, we would need to see inflation come in hotter than the nine who didn't think they would need to hike were anticipating. Given we are expecting encouraging news on disinflation, we are consequently expecting the Fed to remain on hold well into 2027.

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