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TRENDMACRO LIVE!

On the July Jobs Report

Friday, August 2, 2013

Donald Luskin

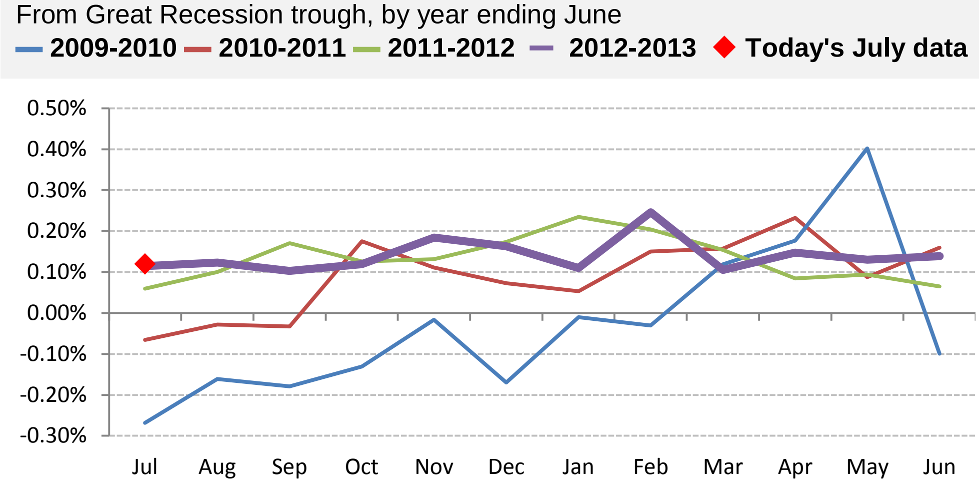
Despite a big jobs miss, today's data makes the Fed more likely to start tapering.

The tapering debate just got weirder. This morning's Employment Situation report was a big downside miss, and that would seem on the surface to make the Fed want to prolong Large-Scale Asset Purchases (LSAPs) at full strength. But the surface is misleading.

And today's Personal Income and Outlays report shows large upside revisions to core personal consumption expenditures inflation, pulling it well back from what had seemed before to be all-time historic lows. That relieves the key constraint cited at Wednesday's FOMC against getting started on tapering LSAPs (see "On the July FOMC" July 31, 2013).

- Yes, jobs were a big miss, leading with 162,000 net payrolls, when 195,000 had been expected. But that's more a function of unrealistic expectations than it is of poor labor market performance.
- The actual jobs numbers are *exactly* in pattern with the anemic but consistent growth we've seen with throughout the four years and one month of the Not So Great Expansion. In fact, month-over-month percentage growth in payrolls is *precisely* what it was a year ago (please see the chart below).
- Similarly, though today's drop in the unemployment rate was more

Non-farm payrolls, sequential month growth rate
From Great Recession trough, by year ending June



Source: BLS, TrendMacro calculations

Update to strategic view

US MACRO, US BONDS, US FED: This morning's jobs report was a miss versus too-high expectations, but was in fact perfectly in line with the progress of the labor market since the trough of the Great Recession. This morning's personal income report contained large revisions in core PCE inflation, lifting it off what had seemed to be all-time lows, and away from the brink of deflation. This was the revision Bernanke has been betting on, and it looks like he won. We are now less skeptical about tapering, though the market is more so today -- we now think it will happen in the autumn. Whether it does or not, Treasury yields will move higher for the rest of the year as the need for safe haven assets diminishes in a world increasingly free of global systemic risk.

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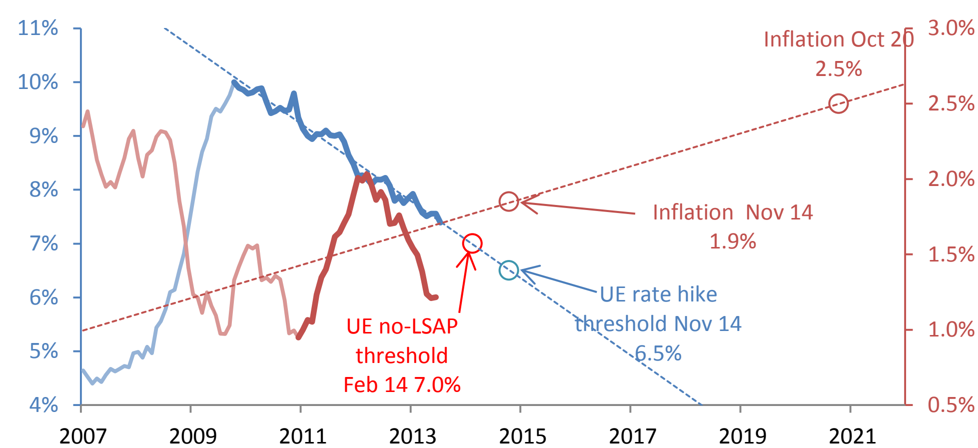
than entirely explained by shrinkage of the labor force, there's nothing out-of-pattern about that.

- It keeps the unemployment rate *perfectly* on its well established trajectory to meet the 6.5% threshold of the so-called ["Evans Rule"] in November 2014, and the 7.0% threshold for ending LSAPs altogether in February, 2014 (please see the chart below).
- At the same time, Wednesday's [revolutionary revisions in the fundamental definition of GDP] now show core PCE inflation getting back toward the Fed's 2% target at about the same time, in mid-2014. It is now set to meet its "Evans Rule" threshold of 2.5% in 2020, when prior to the revisions that date with destiny was all the way out in 2053 (again, please see the chart below).

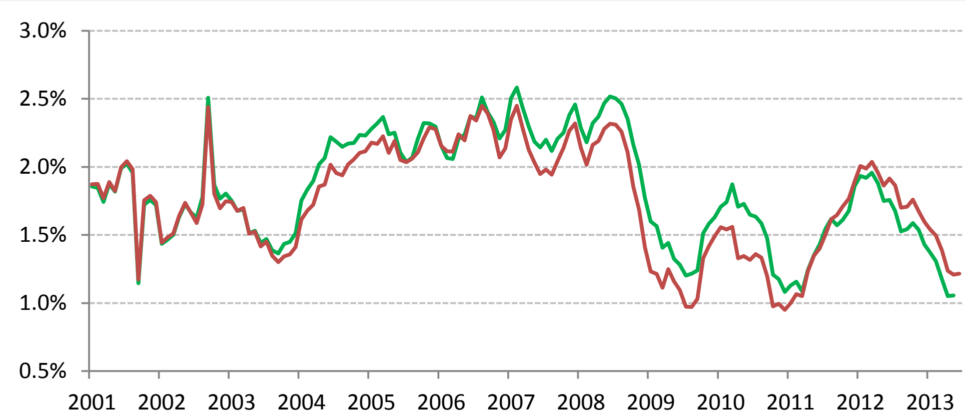
Unemployment rate — Core PCE inflation ··· Trend from peak/trough



Source: BLS, BEA, TrendMacro calculations

- *We have said the Bernanke's seeming insouciance about inflation at the lowest level in the history of data was based on an expectation that the data would get revised* (see ["To Taper or Not to Taper?"] June 7, 2013)*. Now it has. It seems the Bernanke has bet right* (please see the chart below).

Core PCE inflation, year-over year — Previous — Revised



Source: BEA, TrendMacro calculations

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[About us]

- *With no actual worsening of the labor market, and with low inflation no longer such a threat, we must now set aside our skepticism that the Fed will begin tapering this autumn, as the market has come to expect*.
- Our view all along has been that QE3 was put in place at the September 2012 FOMC because the Fed wished to take out an insurance policy in the face of multiple global systemic threats -- the fiscal cliff, the debt ceiling, hard-landing in China, and a breakup of the euro currency (see "Rethinking QE3" September 18, 2012). Those threats are now either behind us, or substantially off the table (see, among many this year, "On the August ECB Policy Decision" August 1, 2013).
- *So unless jobs or inflation data are outright awful, it makes sense now for the Fed to taper.*
- While disappointing, this morning's jobs report was not awful -- it was in-line with the consistent experience of the last four years. And this morning's inflation data was a relief -- a pull-back from the brink of deflation that Bernanke had surely been praying for.
- Today's big move down in Treasury yields suggests that the consensus thinks that tapering is now *less* likely. We think it is now *more* likely.
- Either way, we are convinced that LSAPs haven't been the driver of the move higher in yields over the last year anyway (see "US Fixed Income Strategy: The Fed Irrelevancy Hypothesis" July 2, 2013).
- What's been driving yields is the same thing that is about to drive a change in Fed policy -- the world is now a less risky place. Safe haven assets like Treasuries can no longer carry ultra-low yields, and the Fed no longer has to put $85 billion a month of foam on the runway.
- Tapering or no tapering, we continue to expect Treasury yields to move higher over the remainder of the year (again, see "To Taper or Not to Taper?").

Bottom line

This morning's jobs report was a miss versus too-high expectations, but was in fact perfectly in line with the progress of the labor market since the trough of the Great Recession. This morning's personal income report contained large revisions in core PCE inflation, lifting it off what had seemed to be all-time lows, and away from the brink of deflation. This was the revision Bernanke has been betting on, and it looks like he won. We are now less skeptical about tapering, though the market is more so today -- we now think it will happen in the autumn. Whether it does or not, Treasury yields will move higher for the rest of the year as the need for safe haven assets diminishes in a world increasingly free of global systemic risk.