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TRENDMACRO LIVE!

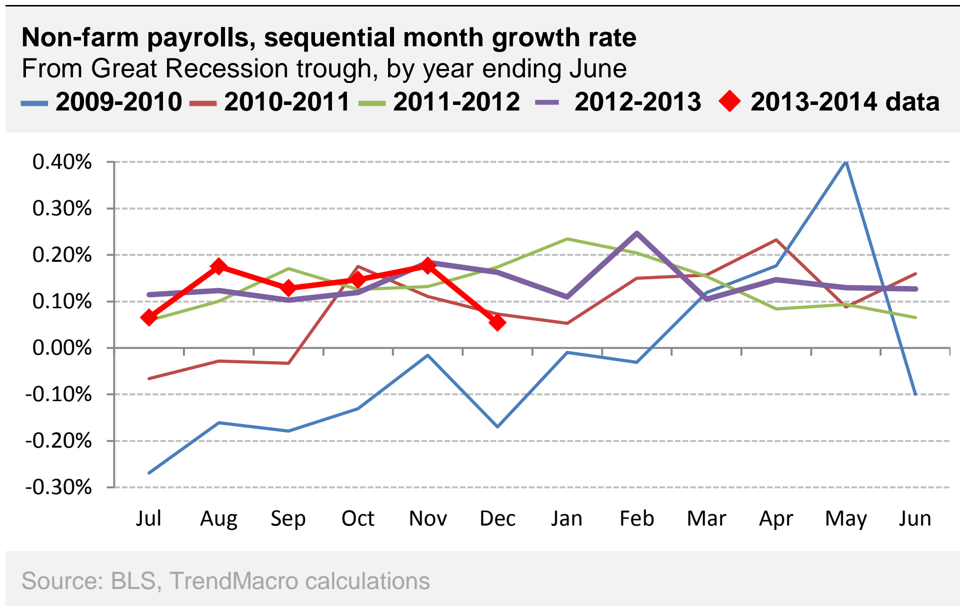
On the December Jobs Report

Friday, January 10, 2014

Donald Luskin

Too surprising and too out-of-pattern. It will be revised away, and won't deflect tapering.

This morning's Employment Situation report was a big miss, no question about it -- even when a big positive revision to last month's payrolls is taken into account. After four months of better sequential-month payrolls growth, this large move for the worse is so out-of-pattern (please see the chart below) that we can't disagree with the chatter this morning expecting it to be revised away.



Source: BLS, TrendMacro calculations

Even the drop to 6.7% unemployment isn't an unalloyed good, driven mostly by a net decline in the labor force. That decline drops the labor force participation rate to 62.8%, tying October's generational low. Adjusted for participation, the unemployment rate is 12.8% (please see the chart on following page).

Data this unexpected and this out-of-pattern raises deep epistemological questions for strategists like us, and for policy-makers like the Fed.

- The risk of revisions is always with us. In 2004 Fed Chair Alan Greenspan and then-governor Ben Bernanke kept rates too low for too long because of low core PCE inflation readings that were subsequently entirely revised away -- as Bernanke famously

Update to strategic view

US MACRO, US FED: A big miss for payrolls, and a big drop in unemployment thanks mostly to a drop in labor force participation back to generational lows. This datapoint is so unexpected and so out-of-pattern we expect it will get revised away. For the Fed, this further obsolesces the already moribund "Evans Rule." Given the strong possibility for revisions and the fact that the January FOMC will be Bernanke's last, we don't think it will be enough to deflect progress of the Fed's "measured" tapering of asset purchases. We expect another $5 billion shaved off of both sides of the program.

[Strategy Dashboard home]

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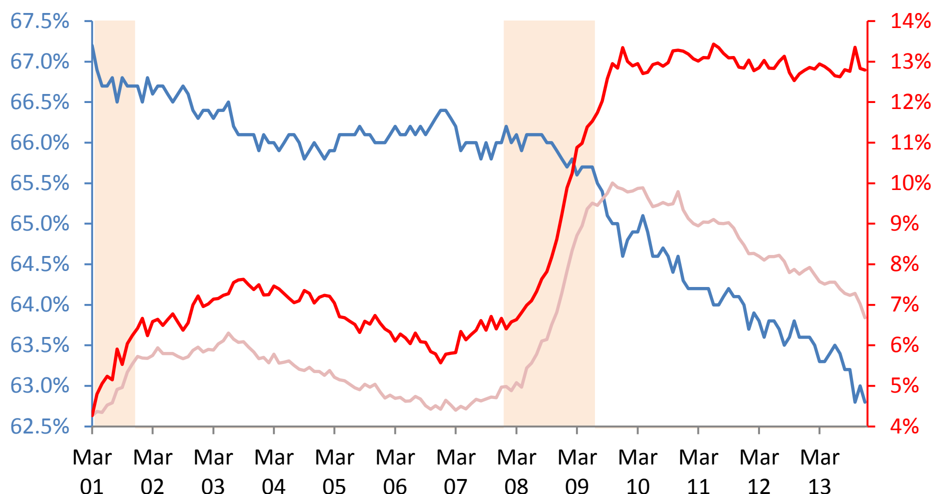

Source: BLS, NBER, TrendMacro calculations

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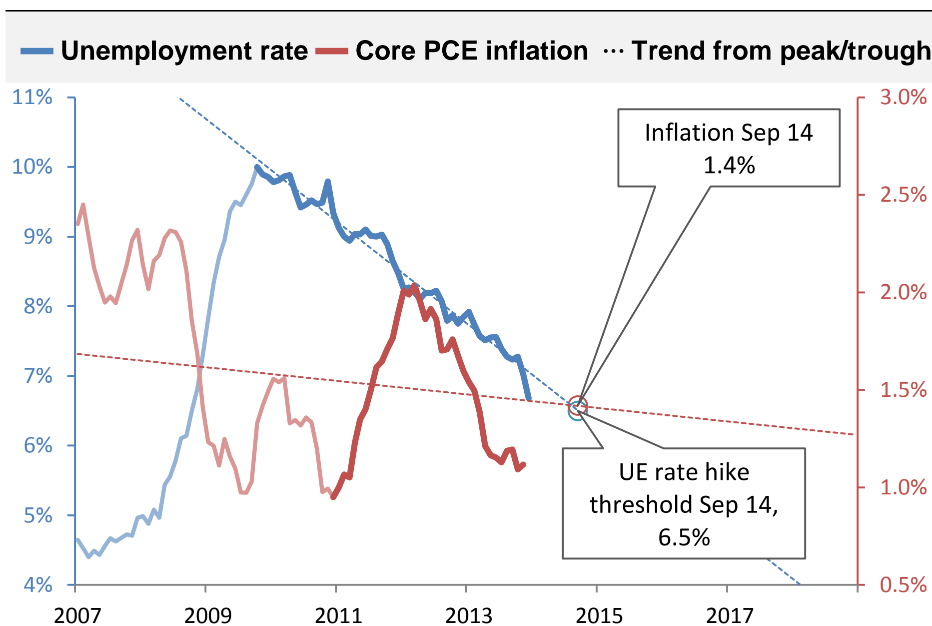
complained in a 2010 speech excusing the Fed's policy errors during the housing bubble.

- But even if the data were known in advance not to require revision, there are even larger questions about how to contextualize it. Throughout the Not So Great Expansion following the Great Recession, we routinely rejected seemingly positive data. The polarity has reversed since our view turned more optimistic last year (see "A Major Upgrade to our Strategic Outlook" September 12, 2013) -- now our first reaction is to reject seemingly negative data.
- Does that mean that data is irrelevant to us? No -- enough of it would change our mind. But this exact moment is trickier than that. Our more optimistic view on the global economy has never been based on data to begin with -- it's been based on a fundamental view that the preconditions for growth are in place now for the first time in six years. *So we expect that good data will follow -- and we've been clear that we're not already seeing it* (see "2013: The Year of Living Not Dangerously" December 31, 2013).
- *What would be the point of a prediction based on available data? If it's in the data, how is it even a prediction?*
- For the Fed, today's data will surely raise deep questions about its so-called "Evans Rule" threshold of 6.5% unemployment -- we're now only 20 bp away.
- In fact, today's large drop in the unemployment rate -- on top of last month's large drop -- brings forward by one month the date at which we expect to hit 6.5%. For many months the trend has pointed durably to October 2014 -- now it's September 2014 (please see the chart on the following page).
- To be sure, the Fed has often said that the "Evans rule" was not an automatic "trigger" for any policy move, but rather a discretionary "threshold" at which discussions would begin about hiking interest



rates. Moreover the December FOMC stated that policy will remain highly accommodative "well past" that threshold (see "On the December FOMC" December 18, 2013).

- So the "Evans Rule" has already been effectively obsolesced for the next FOMC meeting at month-end. That meeting will occur before any new jobs data or revisions to today's data can published, so this morning's jobs data will weigh on the proceedings as a cautionary note and yet another nail in the coffin of the "Evans Rule."
- But given the prospect of revisions, and the political reality that it will be Bernanke's last meeting, we don't expect any change in the *fait accomplis* of "measured" tapering that Bernanke set in place in December. That means that the FOMC will likely shave another $5 billion off both components of its Large-Scale Asset Purchases.

Bottom line

A big miss for payrolls, and a big drop in unemployment thanks mostly to a drop in labor force participation back to generational lows. This datapoint is so unexpected and so out-of-pattern we expect it will get revised away. For the Fed, this further obsolesces the already moribund "Evans Rule." Given the strong possibility for revisions and the fact that the January FOMC will be Bernanke's last, we don't think it will be enough to deflect progress of the Fed's "measured" tapering of asset purchases. We expect another $5 billion shaved off of both sides of the program.