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TRENDMACRO LIVE!

On the June Jobs Report

Thursday, July 3, 2014
Donald Luskin

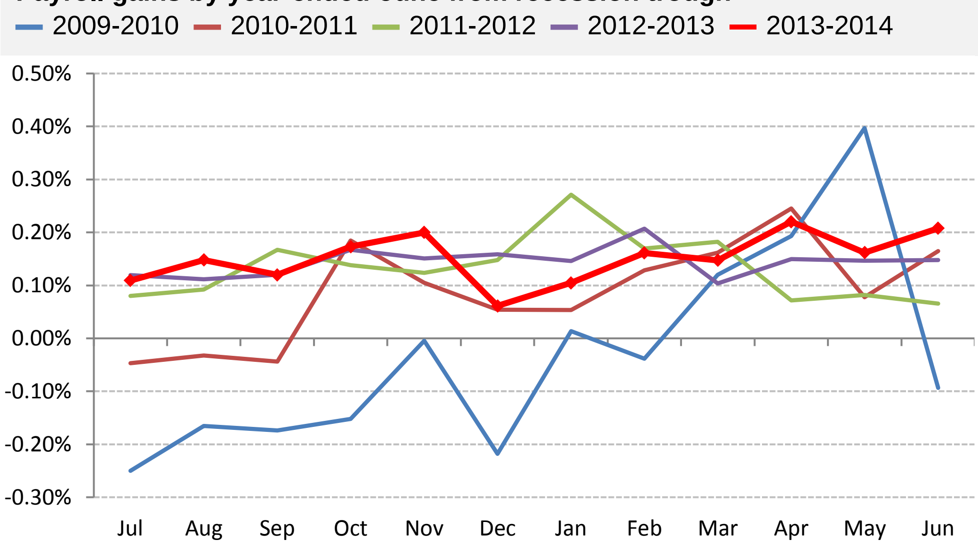
Mid-cycle? Five years into a sluggish expansion, the labor market is at its strongest so far.

This morning's Employment Situation report is a strong affirmation that the US economy has come out of a horrific winter, and is beginning to accelerate -- and the 2.9% reported drop in GDP for Q1 be damned.

- The unemployment rate fell form 6.3% to a new business cycle low of 6.1%, even though the labor force grew by 81,000. This means that every one of those 81,000 persons entered the labor force with a job -- which means, further, that the economy is producing jobs capable of enticing people back into the labor force.
- The "outflow rate from unemployment" -- think of it as the probability that a given unemployed person can get a job within a month -- rose to 30.4% (please see "Data Insights: Jobs" July 3, 2014). This means, simply, that one in three unemployed persons can now get a job quite quickly.

We have now closed the fifth year of the present official business cycle expansion with the strongest labor market so far -- at a point where, in an ordinary expansion, you'd expect labor market performance to be experiencing a mid-cycle deceleration (please see the chart below).

Payroll gains by year-ended-June from recession trough



Source: BLS, TrendMacro calculations

Update to strategic view

US MACRO, US FED, US BONDS: A big beat, and a great jobs report -- ending the fifth year of official business cycle recovery with the strongest labor market yet. This is the opposite of what you'd expect mid-cycle in a normal expansion -- but this has never been a normal expansion. Indeed we think it's just getting started, pulled forward by the promise of permanent easy Fed policy once rates rise above zero. Bonds haven't appreciated the second-order effects of that policy on growth and inflation -- we've seen the lows for yields.

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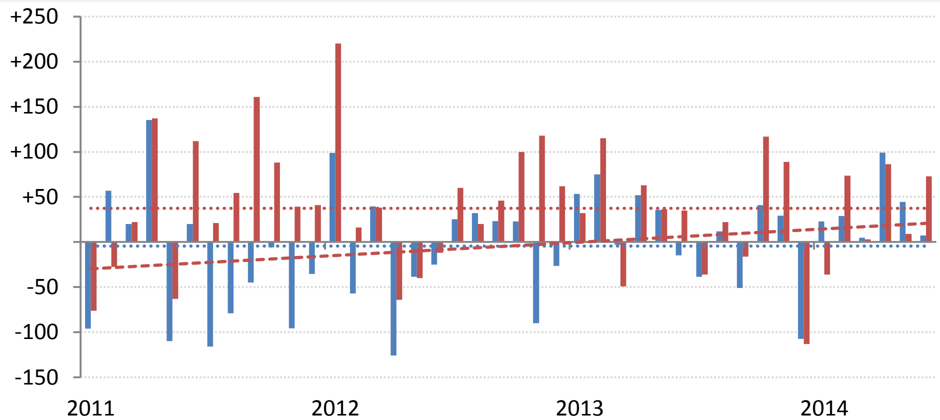
- Indeed, June's 288,000 net payrolls gain was a huge upside surprise -- at least to the Wall Street consensus that had been predicting 215,000, *and to the bond market*. Bonds have looked all year to the new world of permanent easy policy from the Yellen Fed, considering only the first-order effects of that policy on the path of interest rates *ceteris paribus*, without considering the second-order reflexive effect of that policy on growth and inflation (see "The Yellen Rule is Taylor Minus Two" May 19, 2014).
- Stocks, already at all-time highs, seem to be looking more clearly at the more complex and more positive realities of the turning point in policy that we're facing here.
- As a curiosum for strategists, yesterday's ADP payrolls at 280,000 pretty much nailed it. In fact, since January 2011 ADP has missed non-farm payrolls on average by only 4,000 on the optimistic side (please see the chart below). The Wall Street consensus, on the other hand, has missed on average by 38,000, and on the pessimistic side. *And as though refusing to learn, as the years have gone by the consensus has gradually gotten more negative* (again, please see the chart below).

Monthly nonfarm payrolls beat or miss ■ **Vs consensus** ■ **Vs ADP**
··· Consensus average ··· ADP average - - Consensus trend



Source: BLS, ADP, Bloomberg, TrendMacro calculations

All this reaffirms our view that the Not So Great Expansion in the aftermath of the Great Recession is gradually changing character (see "A Major Upgrade to our Strategic Outlook" September 12, 2013). After five years we are not mid-cycle, but probably closer to something that will feel like a new beginning.

Bottom line

A big beat, and a great jobs report -- ending the fifth year of official business cycle recovery with the strongest labor market yet. This is the opposite of what you'd expect mid-cycle in a normal expansion -- but this has never been a normal expansion. Indeed we think it's just getting started, pulled forward by the promise of permanent easy Fed policy once rates rise above zero. Bonds haven't appreciated the second-order effects of that policy on growth and inflation -- we've seen the lows for yields.

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[About us]

Recommended Reading

Deflation Skeptics
John Cochrane
The Grumpy Economist
July 1, 2014

Partisan Conflict
Marina Azzimonti
Federal Reserve Bank of Philadelphia Working Paper 14-19
June 2014

The Capitol Since the Nineteenth Century: Political Polarization and Income Inequality in the United States
Rajashri Chakrabarti and Matt Mazewski
Federal Reserve Bank of New York, Liberty Street Economics
June 23, 2014

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