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TRENDMACRO LIVE!

On the July Jobs Report

Friday, August 1, 2014

Donald Luskin

Markets are in a tantrum about the end of QE and ZIRP -- this jobs report won't slow the Fed.

Before we get to today's jobs data, a brief word on the global equity market sell-off that started yesterday.

- A correction has been very long overdue. From the April lows to all-time highs last week, the S&P 500 went 75 trading days without a correction of greater than 3%. That exactly ties the record for this bull market, set by the run from December 2011 to April 2012.
- There are so many potential triggers. A non-exhaustive list would include European companies warning of losses due to sanctions against Russia, a massive loss at Portuguese Bank Espirito Santo, disappointing earnings reports, ongoing violence in Gaza, Argentina on the brink of default, and the announcement that two Americans infected with Ebola will be flown to the US.
- But we're not inclined to accept any of those, or even all of them together, as the explanation. This is no typical event-driven risk-off event. While stocks sold off yesterday, long-term Treasury yields were steady -- holding on to the large back-up Wednesday following a better than expected GDP report (see "Data Insights: GDP" July 30, 2014) and an FOMC meeting with the first hawkish dissent since last October (see "On the July FOMC" July 25, 2014).
- Now, in the immediate aftermath of this morning's slightly disappointing jobs report, long-term yields have eased a bit.
- *This suggests that the global sell-off has been driven by the sudden appreciation of what we've been saying all along -- the inevitability that the Fed will complete tapering asset purchases in October and begin raising rates early next year* (see "On the July FOMC" July 25, 2014).
- Even though this indicates a salutary return to normality, it is nevertheless a regime change -- it will create winners and losers, and risks for all. For example, banks are going to have to reconfigure themselves for a world of positive rates in which the Fed is effectively a competitor through its reverse repo facility.
- *We'll leave it at that for now. We regard this is a correction and nothing more, driven by jitters about developments that are, on balance, very strongly positive.* Now, on to the jobs numbers.

This morning's Employment Situation report missed headline expectations, with net gain in non-farm payrolls 209,000 versus consensus at 230,000.

Update to strategic view

US FED, US MACRO, US STOCKS, US BONDS: For all the various crises that are besetting the world, long-term yields are telling us that the global equity sell-off -- a long overdue correction, really -- has been triggered by full realization of the inevitability of the end of QE and the zero fed funds rate. This is regime change that will create winners and losers, and risk for all, especially among banks. This morning's jobs report, while a slight disappointment, will do nothing to slow down the Fed. This was the best July payroll growth since the end of the Great Recession, and the unemployment rate only ticked up because the civilian labor force expanded significantly.

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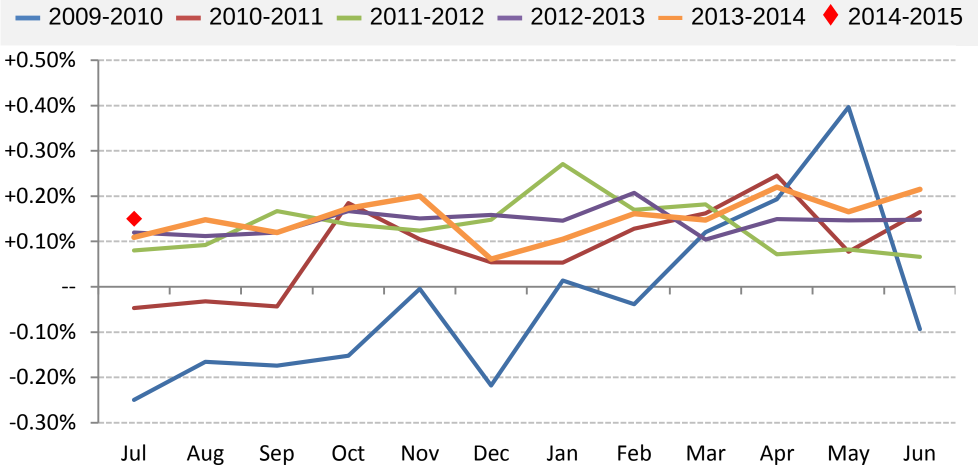
- A small disappointment perhaps, but nevertheless this is the best July payroll growth since the end of the Great Recession (please see the chart below).

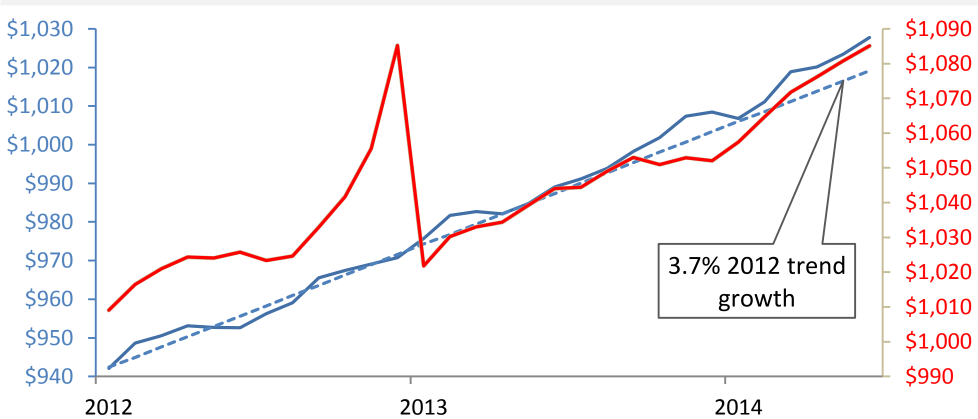
Monthly payroll gains by year-ended-June from recession trough



Source: BLS, TrendMacro calculations

- The unemployment rate ticked up slightly. But this was a consequence of the happy event of 329,000 new entrants to the civilian labor force -- 131,000 of whom found jobs, and 197,000 of whom haven't yet (please see "Data Insights: Jobs" August 1, 2014).
- Much has been made in the chatter this morning that average hourly earnings were flat -- and for some reason there is an assumption being bruited about that this is the key statistic that will stay the Fed's hand and defer "liftoff" from the zero funds rate.
- But in this morning's June Personal Income and Outlays report we learn that per capita disposable personal income -- along personal consumption, with which it is tightly correlated -- continues to run well ahead of trend (please see the chart below).

Per capita disposable personal income **Personal consumption**
USD nominal billions, monthly, SA



Source: BEA, TrendMacro calculations

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[About us]

Recommended Reading

Bair and Reserves for All
John Cochrane
The Grumpy Economist
July 27, 2014

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Correction

In our report Wednesday "On the July FOMC" we mistakenly said that the most recent hawkish dissent prior to Charles Plosser's on Wednesday had been that of Eric Rosengren at the December 2013 FOMC. That was, in fact, a *dovish* dissent. The most recent prior *hawkish* dissent was that of Esther George at the October 2013 FOMC. We apologize for any confusion. Please click here to download a corrected version of the report.

We see nothing in today's jobs report that is likely to hold the Fed back.

- Further, we continue to think that the obsession with "liftoff" is an insignificant event -- a future inevitability that has become the object of irrational fear, something like the Y2K scare.
- What matters is what happens *after* "liftoff" -- and what we have come to call "the Yellen Rule" is perfectly clear on that. Even when the economy reaches maximum employment (call that 5% unemployment) and stable prices (remember, under "optimal control" Fed chair Janet Yellen will want to overshoot), the funds rate will still be lower than what would historically have been deemed normal (see "The Yellen Rule is Taylor Minus Two" May 19, 2014).

Bottom line

For all the various crises that are besetting the world, long-term yields are telling us that the global equity sell-off -- a long overdue correction, really -- has been triggered by full realization of the inevitability of the end of QE and the zero fed funds rate. This is regime change that will create winners and losers, and risk for all, especially among banks. This morning's jobs report, while a slight disappointment, will do nothing to slow down the Fed. This was the best July payroll growth since the end of the Great Recession, and the unemployment rate only ticked up because the civilian labor force expanded significantly.