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TRENDMACRO LIVE!

On the October Jobs Report

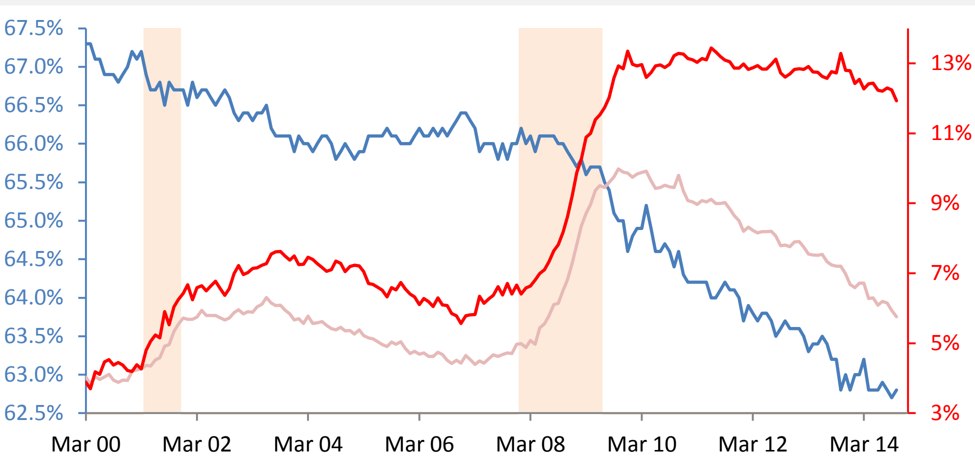
Friday, November 7, 2014

Donald Luskin

Unemployment down, labor force up -- that's "solid." And it makes the Fed effectively easier.

This morning's Employment Situation report with 214,000 headline payroll gains was a bit of a miss, versus expectations of 235,000. But upward revisions of 31,000 from last month's already very strong report more than explain the miss. And looking at the internals that we think are most important, today's report was actually quite, as the FOMC might say, "solid" (see "Data Insights: Jobs" October 7, 2014).

- According to the "household survey" component, employment expanded by 683,000 while unemployment contracted by 267,000. *Thus we see 416,000 new entrants into the labor force, more than all of whom entered with a job.*
- That means this morning's drop in the headline unemployment rate to an unrounded 5.76% -- the lowest since the summer of 2008, before the twin shocks of record oil prices and the Lehman failure triggered the Great Recession -- was the real thing. *No one can claim this improvement can be explained away by a contracting labor force. To be sure, unemployment adjusted for labor force participation is still high, but it's making cycle lows and its rate of improvement is increasing* (please see the chart below).



Source: BLS, TrendMacro calculations

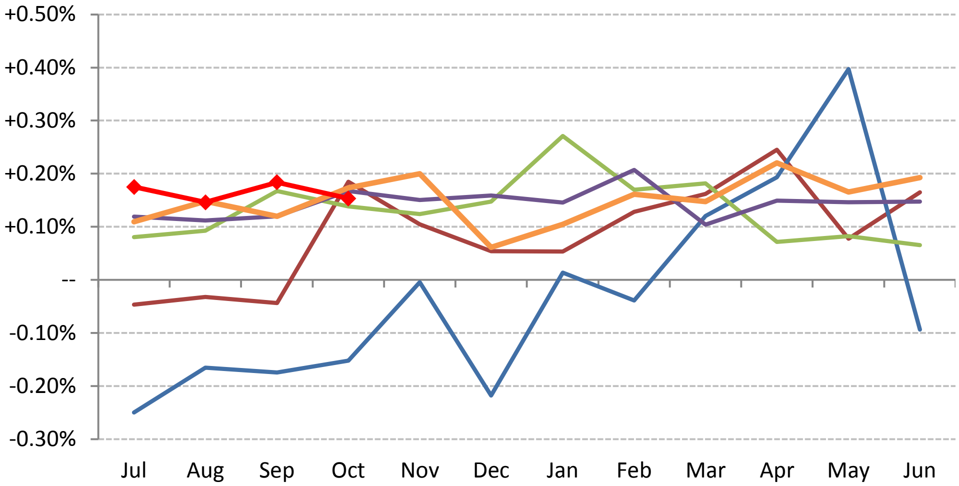
Update to strategic view

US MACRO, US FED: A headline miss, but this was an extremely strong jobs report under the surface. Total employment was up strongly at the same time as total unemployment fell -- which means there was a huge influx into the labor force, all of which was immediately employed. And supposedly persistent long-term unemployment fell even more than short-term unemployment. With each downtick in the unemployment rate while the fed funds rate stays at zero, Fed policy is rendered effectively easier and easier. So this already 5-year-plus business cycle expansion maybe at the end of its beginning rather than the beginning of its end.

[Strategy Dashboard home]

* The monthly rate of change in payroll gains was slightly below that of a year ago -- having been running for the prior four months at the best rates since the Great Recession's trough (please see the chart below).

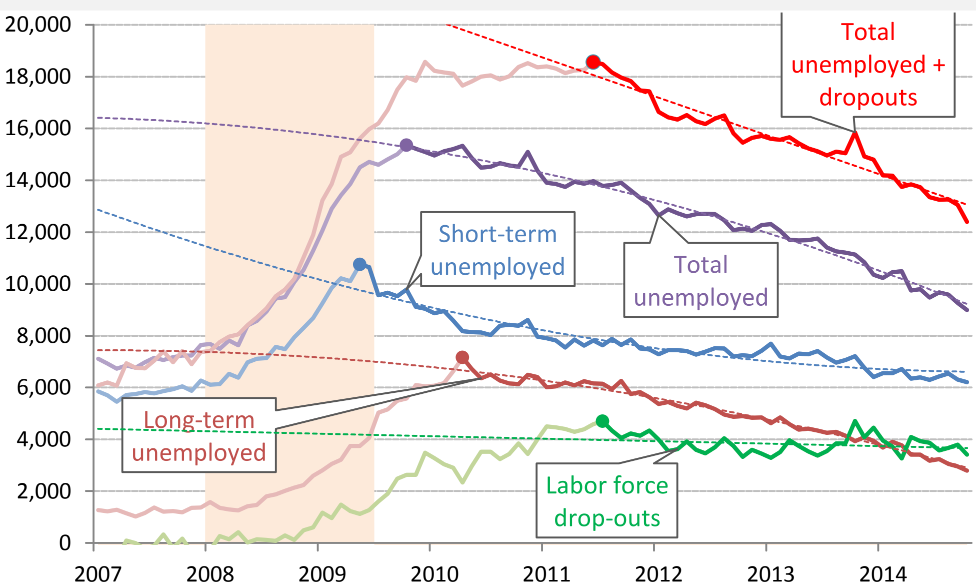
Payroll growth MOM, starting July



Source: BLS, TrendMacro calculations

* This slight relative fallback is not particularly alarming, considering that we are now more than five years into the present business cycle expansion, and at some point diminishing returns has to take its toll on jobs growth, as we approach full employment.
* *Indeed, we are arguably already at full employment in one sense -- having reduced the number of short-term unemployed persons to the levels since at the prior business cycle peak* (note the blue line in the chart below).

Unemployed persons Thousands ····**Trend from ● peak**



Source: BLS, TrendMacro calculations

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Recommended Reading

A Message Sent to a Grudging President
Peggy Noonan
Wall Street Journal
October 7, 2014

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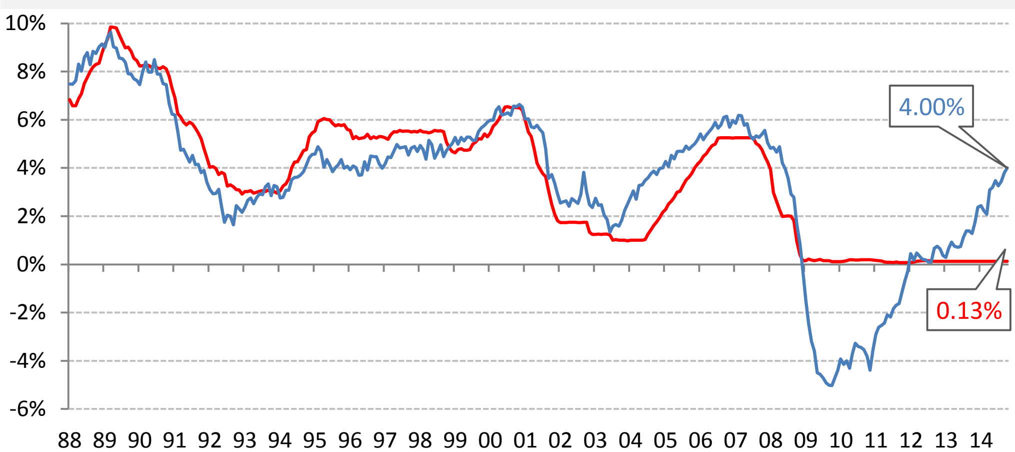
- So it is all the more remarkable that this month's gains in payrolls compares as well as it does to prior Octobers in this business cycle expansion. Not only did the number of short-term unemployed persons fall by 105,000, but *at the same time the number of long-term unemployed persons -- who have become virtually unemployable in the view of many analysts -- fell even more, by 162,000* (note the brown line in the chart at the bottom of the previous page).
- This means our fragile and disappointing Not So Great Expansion following the Great Recession has somehow built up enough steam to start reabsorbing these seeming orphans -- to pick the high-hanging fruit of the labor force (see "The Low Hanging Fruits of Our Labor" July 15, 2014).
- *And again, this is happening the right way -- true job creation, not just people dropping out of the labor force in disgust. The trend-adjusted number of labor force dropouts fell this month by 382,000* (note the green line in the chart at the bottom of the previous page).

How far can this go? When will diminishing returns set in?

- *Never, if the Fed has anything to say about it.*
- While falling unemployment depletes the ranks of the unemployed who might become employed in the future -- diminishing the prospects of future jobs growth -- so long as the Fed does nothing to tighten policy, that policy effectively gets looser and looser.
- *At last month's unemployment rate, the Taylor Rule benchmark for the funds rate was 3.81%. Now, with October's drop in the unemployment rate, that benchmark has inched up to 4.00%* (please see the chart below). *The actual funds rate hasn't changed -- so the improving labor market has automagically made Fed policy more accommodative.*
- So there is a tension here, or perhaps a virtuous cycle -- or perhaps a classic case of "reflexivity." Every tick down in the unemployment

Yellen's Taylor Rule (per Rudebusch 2009) **Actual funds rate**
Rule: 2.07 + 1.28 x 12-mo core PCE inflation - 1.95 x (UE - CBO natural rate)



Source: FRBSF, BLS, BEA, CBO, TrendMacro calculations rate makes the Fed effectively easier, which makes the unemployment rate fall further, which in turn makes the Fed easier still, and so on.

- *So don't think that necessarily just because this business cycle expansion is more than five years old -- or just because the unemployment rate has a 5-handle -- that we're closer to the beginning of the end than we are to the end of the beginning. The labor market is demonstrating both that the long-term unemployed can be employed, and that drop-outs from the labor market can drop back in. And the Fed isn't doing anything to stop it -- indeed, by doing nothing, the Fed is accelerating it.*

Bottom line

A headline miss, but this was an extremely strong jobs report under the surface. Total employment was up strongly at the same time as total unemployment fell -- which means there was a huge influx into the labor force, all of which was immediately employed. And supposedly persistent long-term unemployment fell even more than short-term unemployment. With each downtick in the unemployment rate while the fed funds rate stays at zero, Fed policy is rendered effectively easier and easier. So this already 5-year-plus business cycle expansion maybe at the end of its beginning rather than the beginning of its end.