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TRENDMACRO LIVE!

On the December Jobs Report

Friday, January 9, 2015

Donald Luskin

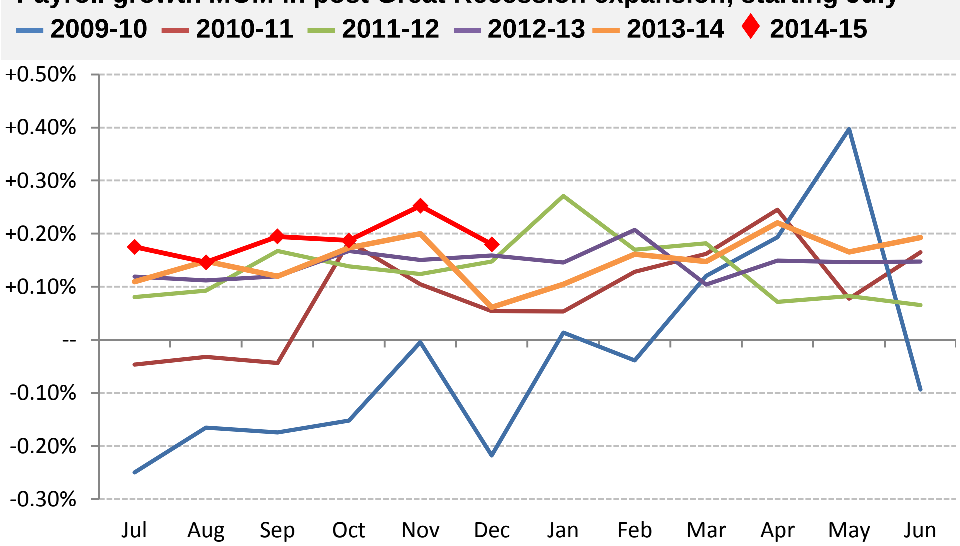
The best December in this business cycle -- but not 1999. The Fed can be "patient" until June.

This morning's Employment Situation report was the second beat in a row -- 252,000 net payroll jobs, versus consensus 240,000. And there was a large upward revision to last month's blockbuster payroll gains.

We're going to nitpick the jobs numbers in certain ways, but we don't mean to rain on this parade. It was a solid jobs report, indeed the best December since the official Great Recession trough (please see the chart below).

- But there seems to us to be some excessive hoopla going on. Many headlines have fastened on the idea that 2014 was "the best year since 1999" -- as though to liken our anemic recovery from the Great Recession to that boom of all booms.
- It's technically true, but payroll growth in 2014 was 2.1%, a far cry from 1999's 2.5%. We'd need to have added 468,000 more jobs last year -- almost two Decembers' worth -- to equal 1999's percentage gain. Furthermore, 1999 was the fourth big jobs year in a row. But it's become politically correct for the media to talk about how good the economy is now. Well… I knew 1999. 1999 was a friend of mine. Senator, you're no 1999.

Payroll growth MOM in post Great Recession expansion, starting July



Source: BLS, TrendMacro calculations

Update to strategic view

US MACRO, US FED: A strong jobs report, the best December since the official trough of the Great Recession. But media hoopla comparing 2014 to 1999 is a politicized exaggeration. This is not the end of a boom, but the mid-point in a very sluggish expansion with a great deal of unemployment still to be absorbed. By short-term unemployment, we are now all the way back to full employment. There remain over a million long-term unemployed to reabsorb. The "outflow rate" from unemployment -- the monthly job-finding probability -- has hit a new cycle high, implying the labor market's absorption capacity is still improving. The disappointing drop in hourly earnings, after the downward revisions to last month's, will help the Fed stay "patient." But with unemployment at 5.6% and the Taylor Rule calling for a 4.07% funds rate, we still think "lift-off" will be in June.

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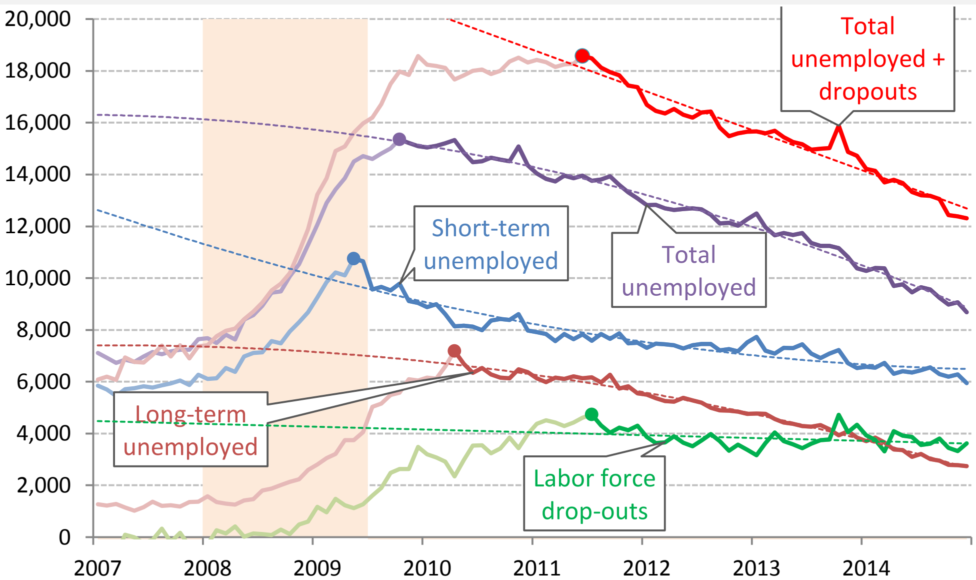
- *The problem with the hoopla is that it seems to treat 2014's labor market performance as "mission accomplished." But as a true comparison to 1999 shows, relatively little has been accomplished. Yet from our perspective that's not an indicator of how bad things are, but a token of how much room there remains for improvement now that the global economy is free from record-high oil prices and the risk of financial contagion* (see "A Major Upgrade to our Strategic Outlook" September 12, 2013 and "Don't Let a Good Oil Crisis Go to Waste" October 21, 2014)*. This business cycle expansion, now officially five and a half years old already -- and with an unemployment rate now at 5.6% -- is far from exhausted.*

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



Source: BLS, TrendMacro calculations

- For December the number of persons unemployed for less than 27 weeks fell by a remarkable 344,000 -- bringing it below the level seen at the peak of the prior business cycle expansion in 2007 (please see the blue line in the chart above). *By this metric, the economy is indeed back to full employment.*
- Happily, the number of persons unemployed for *more* than 27 weeks fell too (please see the second line from the bottom in the chart above). The drop was only 39,000, but it makes the tenth month in a row of improvement among persons widely believed to be unemployable. And it leaves about 1.4 million still to be re-employed before it gets back to levels seen at the top of the prior expansion (see "The Low Hanging Fruits of Our Labor" July 15, 2014).
- Because short-term and long-term employment *both* improved, but short-term improved more than long-term, there was a sharp uptick in the percentage of long-term unemployment -- however unpleasant, this is a statistical illusion.
- To fully appreciate the full dimensionality of this improvement in the labor market's ability to absorb the unemployed, note that the

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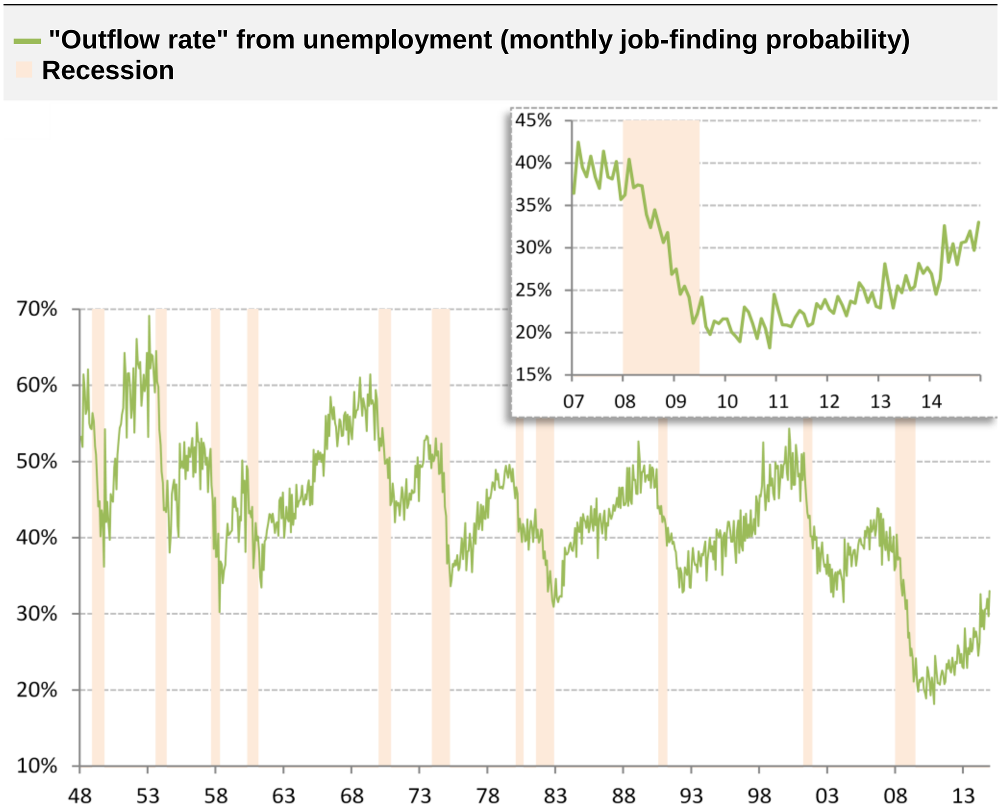
"outflow rate" from unemployment -- the probability of an unemployed person becoming employed within a given month -- has moved to new highs for this business cycle expansion (please



Source: BLS, TrendMacro calculations per [Shimer 2005]

see the chart below, and ["Data Insights: Jobs"] January 9, 2015).

- At the same time, this improvement only brings it back to levels that, in previous business cycles, are more associated with recession troughs than with mature expansions (again, please see the chart above). There is still plenty of room on the upside.

Now let's pick a few nits.

- Obviously, it was disappointing to see a contraction in average hourly earnings by 0.2%. All the worse, as last month's upside surprise 0.4% gain got revised lower to 0.2%.
- Earnings growth is not part of the Fed's [dual mandate] for maximum employment and stable prices, but in its Keynesian analytical framework, earnings mediates between the two poles of the mandate. So if the Fed wants to be extra ["patient"] before ["liftoff"] from the zero funds rate, this is all the ammunition it needs. With this in mind, we stand by our long-standing forecast that "liftoff" will occur at the June 2015 FOMC meeting (see most recently ["On the December FOMC"] December 17, 2014), not April as some commentators have been suggesting.
- The drop in the unemployment rate to 5.6% form 5.7% was, sadly, achieved the wrong way. Unemployment fell by 422,000, while

employment rose by only 155,000 -- meaning that 268,000 persons left the labor force.

- But abstracting from that, and treating the unemployment rate uncritically as a standard input into a standard Taylor Rule model, it is the case that the funds rate should be 4.07% now. Let's not be *too* patient.

Bottom line

A strong jobs report, the best December since the official trough of the Great Recession. But media hoopla comparing 2014 to 1999 is a politicized exaggeration. This is not the end of a boom, but the mid-point in a very sluggish expansion with a great deal of unemployment still to be absorbed. By short-term unemployment, we are now all the way back to full employment. There remain over a million long-term unemployed to reabsorb. The "outflow rate" from unemployment -- the monthly job-finding probability -- has hit a new cycle high, implying the labor market's absorption capacity is still improving. The disappointing drop in hourly earnings, after the downward revisions to last month's, will help the Fed stay "patient." But with unemployment at 5.6% and the Taylor Rule calling for a 4.07% funds rate, we still think "lift-off" will be in June.