TrendMacro

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TRENDMACRO LIVE!

On the July Jobs Report

Friday, August 5, 2016
Donald Luskin

Three-in-a-row now – another jobs report that defies both expectations and evidence.

Update to strategic view

US MACRO, US FED, OIL: A third-in-a-row big surprise, with net payrolls not only confounding expectations, but standing starkly at variance with all the other contemporaneous labor statistics. But we think it is at least directionally correct, and should be taken as a useful antidote to recession fears that have been building up over the last couple weeks. Q2's weak GDP report was all inventories – just as we expected. And the sharp correction in oil remains a bull-market correction, with little risk that prices will slip back to the Q1 lows when they threatened to cause a recession. These squirrely numbers aren't enough make us change our minds on the Fed – no rate hike until at least December, and probably not even then.

[Strategy dashboard]

This morning's July Employment Situation report, was a second-in-a-row big upside surprise, with 255,000 net payrolls beating the consensus of 180,000. But including May's terrible *downside* surprise, this makes three-in-a-row in which the published data not only surprises the consensus but stands strongly at odds with other contemporaneous labor statistics. Based on regressing ADP payrolls, Challenger layoffs, unemployment claims, and purchasing manager indices, today's net payrolls should have only been 166,000 – a small miss, not a big beat. *Especially with only trivial revisions coming this morning to May's weirdly bad number and June's weirdly good number* (see "Data Insights: Jobs" August 5, 2016), *we have to conclude that something – we have no idea what – is broken in the Department of Labor's data collection and collation process.*

- There's not a lot of benefit to parsing the internals in this morning's report.
- What counts is that we think it is at least directionally correct. So it is a useful antidote to the sense of pessimism we've detected building over the last couple weeks, as we talk to clients. We are getting many questions about whether or not the present business cycle expansion, never strong to begin with, is rolling over in exhaustion into recession.
- Last week's big miss on Q2 gross domestic product, with a large downward revision to Q1 (see "Data Insights: GDP" July 29, 2016), played into a tone of fear set at the July FOMC (see "On the July FOMC" July 27, 2016), and reinforced by a substantial correction in the oil price.
- We stick with our view that oil bottomed reliably in mid-February, heading off what was shaping up to be a recession, and ushering in a mid-cycle refresh for the present expansion (see "Have We Suffered Enough?" February 26, 2016). We are carefully watching the oil price, because if it falls further, it could re-open the door to recession by widening credit spreads and strengthening the US dollar. But we fully expect oil's present correction to end about here, and then for crude to march to $65 by year-end, as the supply/demand balance inevitably shifts from glut to shortage (see "Oil's Brexit Crisis" July 26, 2016).
- The Q2 GDP report was no surprise to us. We've been pointing out to clients for several quarters (see, each month, "Data Insights:

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A Few of Our Favorite Things" most recently July 27, 2016) that inventories had risen to such high levels that output would have to sag for a couple quarters in order to work it off. Indeed, Q2 GDP growth was cut in half by a sharp decline in private inventories. Other than that, it was a reasonably strong quarter, at least by the standards of the present expansion.

Market-based expectations for a rate hike at the December FOMC have jumped up this morning back to where they were last week at the time of the July FOMC, putting a hike at just below fifty-fifty (again, see "On the July FOMC"). In the intervening ten days, expectations had pushed out the date of the next hike as far as October 2017.

- But we stand by our view that a December hike is highly unlikely, and we don't see how this morning's crack-pot jobs numbers really change that.
- If anything, as we said with last month's nutty numbers, they only contribute to the "uncertainty" that has become Fed Chair Janet Yellen's watchword (see "Yellen Adds 'Uncertainty'" March 30, 2016).

Bottom line

A third-in-a-row big surprise, with net payrolls not only confounding expectations, but standing starkly at variance with all the other contemporaneous labor statistics. But we think it is at least directionally correct, and should be taken as a useful antidote to recession fears that have been building up over the last couple weeks. Q2's weak GDP report was all inventories – just as we expected. And the sharp correction in oil remains a bull-market correction, with little risk that prices will slip back to the Q1 lows when they threatened to cause a recession. These squirrely numbers aren't enough make us change our minds on the Fed – no rate hike until at least December, and probably not even then.

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