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TRENDMACRO LIVE!

On the September Jobs Report

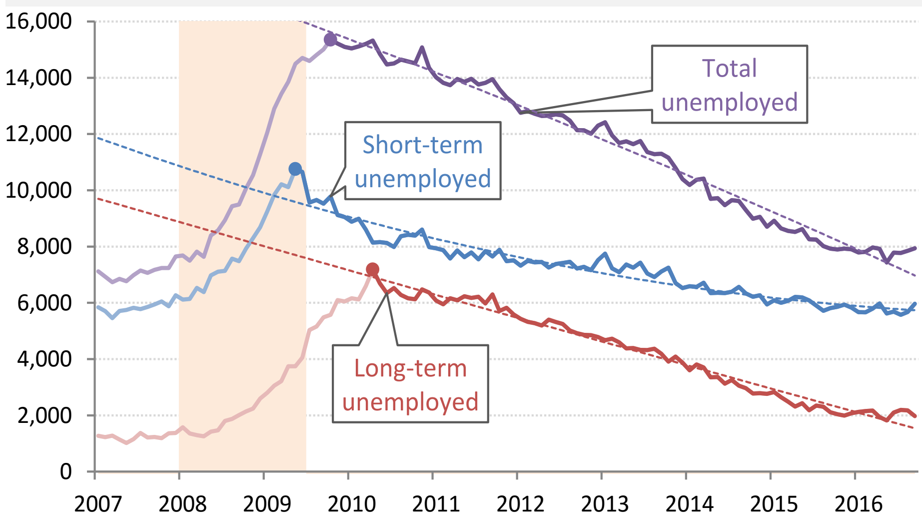
Friday, October 7, 2016
Donald Luskin

More proof of slack in the labor market – but Yellen isn't likely to be confused by such facts.

This morning's September Employment Situation report was a miss at 156,000 net payrolls, versus 172,000 expected. You can't blame revisions to the prior two months, small at negative 6,000, but in any event cutting the wrong way and making the miss bigger. The unemployment rate missed too, rising to 5.0% versus consensus of unchanged at 4.9%.

- This is hardly the "solid" labor market performance Fed Chair Janet Yellen was bragging about in the press conference after the September FOMC that "so far this year has been generating about 180,000 jobs a month" (see "On the September FOMC and BOJ" September 21, 2016).
- *In reality, this is now the second month in a row to come in under that average.*
- *It's the second uptick in three months for the unemployment rate, too.* Indeed, the raw number of unemployed persons has risen by 504,000 since the cycle low in May (please see the chart below, and "Data Insights: Jobs" October 7, 2016).
- We are by no means suggesting that this is evidence that the overall economy is slowing down, or that there is an elevation of

Unemployed persons Thousands



Source: BLS, TrendMacro calculations

Update to strategic view

US MACRO, US FED: Another not-"solid" jobs report – with the number of unemployed persons up by half a million since May, and the second uptick in the unemployment rate in three months. The good news is that this means labor force dropouts are coming back – which means the unemployment rate isn't as low as it looks, and there remains considerable slack in the labor market. Yellen herself acknowledges this, yet the Fed seems bound and determined to hike in December, which we feel strongly would be an error. It seems it will take a big negative shock – maybe a Brexit-like election surprise? – to stay the FOMC's hand. We're going to have to bow to what seems inevitable, but with a 63% market-implied probability for a December hike, we'll "take the under." It's a close call.

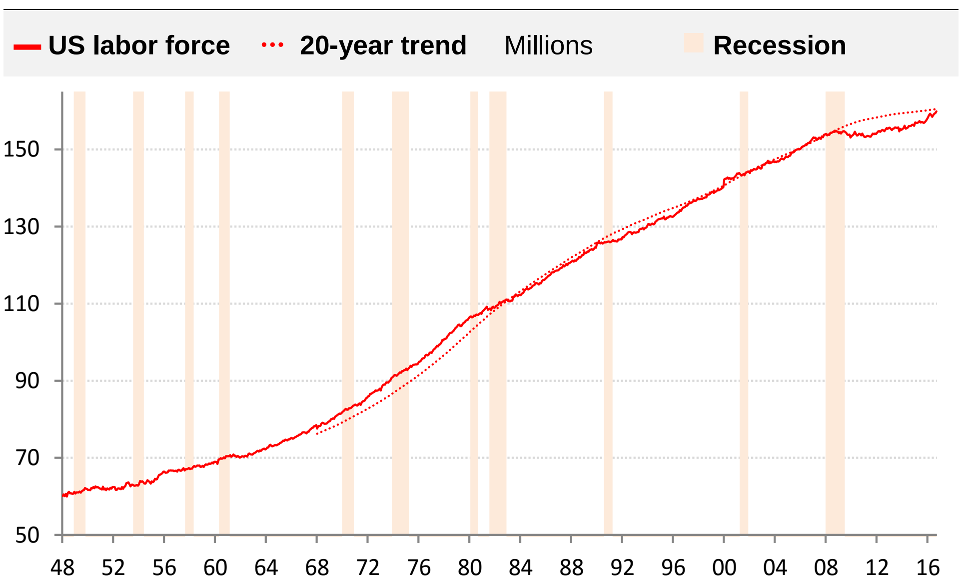
[Strategy dashboard]

recession risk. *This is a good thing, because over those four months the labor for has expanded by 1.4 million, of whom about two thirds are now working.*

- Its implications for monetary policy are subtle. But Yellen herself would seem to understand those implications, saying correctly in September's presser:

> *"…the labor market does have that potential to have people come back in without the unemployment rate coming down. So we 're not seeing strong pressures on utilization suggesting overheating, and my assessment would be, based on this evidence, that the economy has a little more room to run than might have been previously thought…"*

- Yes, persons who had dropped out of the labor force are indeed coming back to it – proving that, all along, the seemingly low unemployment rate was a deception, ignoring the vast gray-market army of potential workers not counted in the statistics.
- If we wanted to use this to tell an optimistic tale about the economy to support Hillary Clinton's candidacy, we'd say that the labor force has finally recovered back to its long-term trend-level. But if we wanted to cite a more pessimistic fact, less friendly to Ms. Clinton, we'd note that this is only so because the trend has flattened out, worn down by seven long years of declining labor force participation (please see the chart below).



Source: BLS, TrendMacro calculations

- *So let's review the bidding. By Yellen's own analysis, (1) labor market growth is slowing down, and (2) there is more slack in the labor market than "previously thought."*
- *And there was no big move reported this morning in average hourly earnings, the bug-bear of hawks who believe in and worry about "wage inflation."*

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[About us]

Recommended Reading

Yes, the early 1990s really were bad
Matthew C Klein
FT Alphaville
October 6, 2016

Wallace Neutrality and Balance Sheet Monetary Policy
Jérémie Cohen-Setto and Éric Monnet
Breugel Blogs Review
September 10, 2016

Why Unconventional Monetary Policy Works in Theory
Roger Farmer and Pawel Zabczyk.
Bank Underground
September 30, 2016

[Reading home]

- *<u>So why – dear God why! – would the Fed consider hiking the funds rate?</u>*
- Yet as of this writing, futures-implied probabilities for hikes at either the October or December FOMC meetings actually ticked up ever-so-slightly.
- This would suggest that the market's judgment is that while this jobs report doesn't really add any new evidence to the case for hiking – and may indeed slightly weaken the case – the Fed already has its mind made up, and doesn't wish to be confused by the facts unless they are extraordinarily negative. This jobs report is merely disappointing, not game-changingly negative.
- We continue to think that the Fed *should* not hike. Vice Chair Stanley Fischer would appear to feel the same way, at least based on his excellent speech on Wednesday discussing Wicksell's concept of the "natural rate of interest," which he acknowledges is extremely low – and Wicksell's policy rules, which he acknowledges don't call for a hike (see "Gundlach and Load" September 12, 2016). Yet while Yellen doesn't wish to be confused by the facts she herself cites, we fear Fischer doesn't want to be confused by the theories he cites.
- So with Fed officials not backing down, markets giving about a 63% probability of a December hike, and in the absence of a big negative event, we have to go along with the crowd and anticipate a December hike, whether or not we think it's the right thing.
- It's a close call, though. And it wouldn't take all that much of a negative event to stop it – and a Brexit-like surprise in the presidential election could be such an event (see "On the First Presidential Debate" September 27, 2016). So while we're bowing to the inevitable, if the market is at 63% we'll still "take the under." Again, it's a close call.
- In a future report we'll discuss what we think it will mean for the Fed to make this kind of mistake.

Bottom line

Another not-"solid" jobs report – with the number of unemployed persons up by half a million since May, and the second uptick in the unemployment rate in three months. The good news is that this means labor force dropouts are coming back – which means the unemployment rate isn't as low as it looks, and there remains considerable slack in the labor market. Yellen herself acknowledges this, yet the Fed seems bound and determined to hike in December, which we feel strongly would be an error. It seems it will take a big negative shock – maybe a Brexit-like election surprise? – to stay the FOMC's hand. We're going to have to bow to what seems inevitable, but with a 63% market-implied probability for a December hike, we'll "take the under." It's a close call.