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TRENDMACRO LIVE!

On the February Jobs Report

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Donald Luskin

What winning looks like. Dynamism returns to the labor market, and nothing to scare the Fed.

We hardly know where to begin. Along many dimensions this morning's February Employment Situation report was the most broadly encouraging that we've seen in years. A stroll through our monthly "Data Insights: Jobs" from this morning is even more rewarding than usual.

- The headline gain of 313,000 net payrolls blew away the consensus expectation for 205,000 – all the more so, considering that the bar was raised by upward revisions to the prior two months totaling 54,000. *It makes the best February for the payroll growth-rate since the present business cycle began in mid-2009, quite remarkable considering how long this cycle has been going on. It confirms us in our idea that there was an "undocumented recession" from Q4-2015 through Q1-2016 that served as a "mid-cycle refresh"* (see "The Recession Caused by Low Oil Prices" January 8, 2016).
- We must say that the big payroll number is way out of pattern with a range of other contemporaneous labor market indicators, which would have led us to expect a slight miss rather than this large beat. There's a lot of noise in the payroll numbers, and actually it's about time one of these out-of-pattern events happened on the upside (it's twice been the opposite over the last year). The important thing, really, is what happened in February in the internals of the labor market reported in the "household survey," not the "payroll survey."
- But before we get into that, we must say how sweet it is that for all the good labor market news this morning, the one labor statistic that the Fed follows most closely – average hourly wages – turned in an abysmal performance, with only 0.1% month-on-month growth, down from last month's 0.3%. For anyone on the Fed who either still believes in the Phillips Curve fallacy that rising wages lead to inflation, or for that matter for anyone who just uses wage growth as an indicator of labor market slack, *there was nothing in today's wage growth number that supports a more hawkish view*.
- But there's more good news along those lines. The "household survey" showed the labor force grew by 806,000 persons, jolting the labor force participation rate to 63% from 62.7%, where it had been pinned for the prior three months. That's why the unemployment rate remained unchanged at 4.1%, despite so much

Update to strategic view

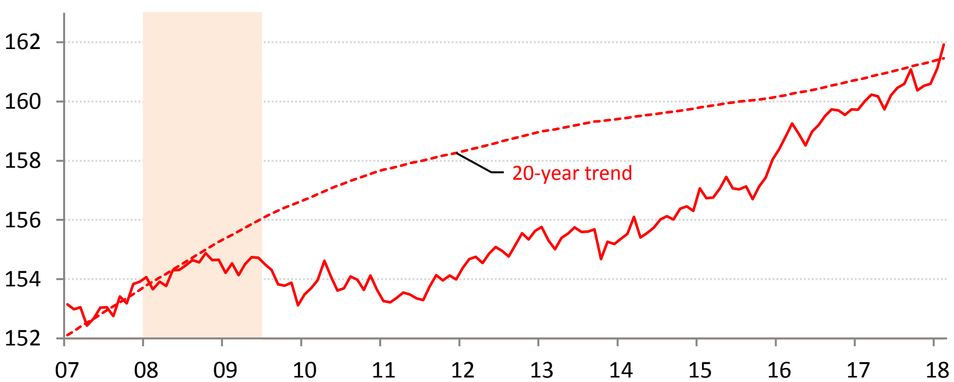
US MACRO, US FED: A big headline payroll beat, all the better given large upward revisions. The Fed will be comforted by sluggish hourly wage growth and a steady unemployment rate. The big news beneath the surface is the return of dynamism to the labor force, drawing many new participants into it – including many who might have been thought to have already aged out. We do not read this as a sign of business cycle exhaustion, but rather a signal that increasing dynamism can perpetuate the expansion.

[Strategy dashboard]

good news on job growth. Phillips Curve dead-enders will like that too.

- The participation gains came from the younger end of the prime-age population (ages 16 to 19, and 25 to 29), and from those both on the oldest end, and entirely outside, of that population (ages 50 to 65).
- We've been saying that the labor force could easily grow by 2 million persons (see "The Demographics Myth" March 20, 2017), and this proves us about half-right. It puts the labor force above-trend for the first time since before the Great Recession (please see the chart below). But that trend has been bending down for a decade, so there is actually still plenty of slack – and the best news is that the trend has started to bend *up* over the last year. *If both labor force participation recovers as we expect, and unemployment falls to the lows seen in recent expansions, there's still room for 2.7 million job gains.*

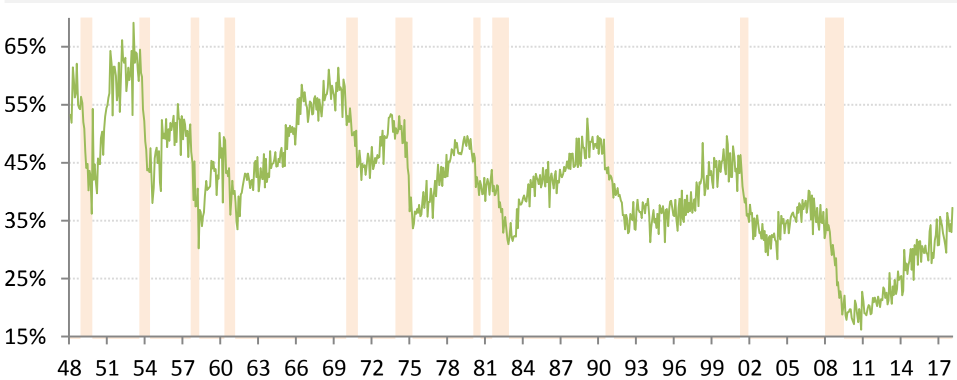
US labor force **Recession**



Source: BLS, TrendMacro calculations

- *The single element of this morning's report that most cheers us, though, is the evidence of increasing labor market dynamism.*
- In February, the probability of getting a job within a month (the "outflow rate from unemployment") surged to 37.2%, very much a new high since the Great Recession (please see the chart below).

Monthly "outflow rate" from unemployment to employment **Recession**



Source: BLS, per Shimer 2005, TrendMacro calculations

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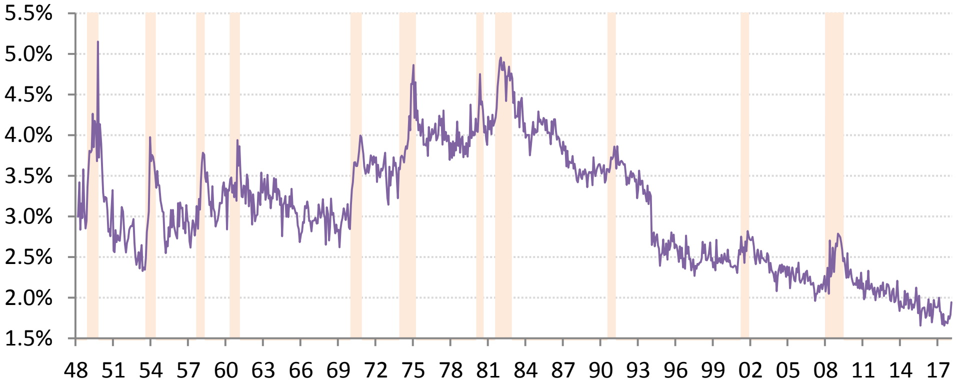
- At the same time, the probability of losing a job within a given month (the “inflow rate to unemployment” also surged, to 1.9% – not a new cycle high, and still a very low reading by historical standards, but a level not seen for a year (please see the chart below). At first it seems perverse to cheer rising probability of losing a job – but “losing a job” often happens for good reasons, including various forms of upward mobility.

Monthly “inflow rate” from employment to unemployment **Recession**



Source: BLS, per Shimer 2005, TrendMacro calculations

Yes, we know. On the back of a report like this morning’s, one reaction might be to conclude: this is as good as it gets. No, it’s not. There’s still slack in the labor force, and the return of dynamism is enough to both employ that slack, and even replenish it. This isn’t over yet.

Bottom line

A big headline payroll beat, all the better given large upward revisions. The Fed will be comforted by sluggish hourly wage growth and a steady unemployment rate. The big news beneath the surface is the return of dynamism to the labor force, drawing many new participants into it – including many who might have been thought to have already aged out. We do not read this as a sign of business cycle exhaustion, but rather a signal that increasing dynamism can perpetuate the expansion.