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TRENDMACRO LIVE!

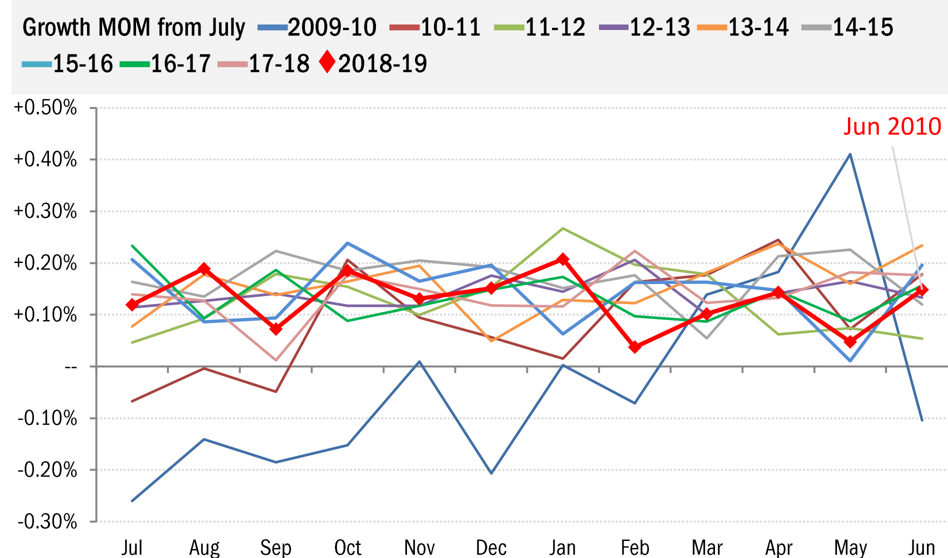
On the June Jobs Report

Friday, July 5, 2019

Donald Luskin

Reassuring, but too good to be entirely true. Nothing in it will put the Fed off its dovish course.

This morning's June Employment Situation report marks the tenth anniversary of this business cycle expansion with a big beat – 224,000 net payrolls versus consensus expectations for 160,000. Even after ten years and record-low unemployment, it's a strong middle-of-the-pack result among ten Junes (please see the chart below).



Source: BLS, TrendMacro calculations

- Last month's very weak report, with only 75,000 net payrolls, was not revised higher – indeed it was revised lower by 3,000 – confirming, as we judged at the time, that it was *not* a data anomaly (see "On the May Jobs Report" June 7, 2019).
- *This month's beat, while welcome news, and while not artificially lifted much by revisions – is more likely to be an anomaly. While May's weak result was consistent with other contemporaneous labor market data, June's strong result is not. Based on our model, June should have been a miss with only about 130,000 payrolls, and is likely to be revised at least somewhat lower.*
- *With that in mind, with the unemployment rate ticking up to 3.7% from 3.6%, and with year-over-year average hourly earnings printing at only 3.1% – the fourth monthly downtick in a row – there's nothing here that should deflect the Fed from its rate-cutting*

Update to strategic view

US MACRO, US FED, US BONDS: The tenth year of this business cycle expansion ends with a big payroll beat. It's reassuring after May's bust, which was revised even lower. But it is out of step with contemporaneous labor market indicators and will probably be downward-revised. Markets should not be concerned that this will put the Fed off its dovish course. This is the fourth month in the row of declining average hourly earnings year-over-year, and the unemployment rate ticked higher as the labor force expanded. This reveals considerable slack in the labor force, which we calculate could expand by 2.5 million prime-age workers before hitting maximum employment. The Fed's blame-Trump rationale for its dovish turn is durable, because for Powell to admit that "uncertainties" have cleared up would be effectively to admit that Trump was right. In the meantime, Powell knows that the inverted yield curve means "your policy's tighter than you think." So 10-year yields are right to back up, but for the wrong reason: a durably easy Fed points to higher growth.

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path.

- *In the immediate aftermath, the market-implied probability of a 50 bp fed funds rate cut at the July FOMC meeting fell to zero, from about 21% yesterday. Even a single 25 bp rate cut is no longer fully expected for July as of this writing (the probability is 98%). We think this is a very big over-reaction.*
- *And so it is for 10-year Treasury yields, up 11 bp as of this writing. To be clear, it is entirely proper that yields should rise on unexpected positive economic data, because real yields should be higher in a faster-growing economy. And we've always said the 10-year would, at least approximately, make a stand at 2%* (see "On the June FOMC" June 19, 2019).
- But markets today seem to be doing the right thing for the wrong reason. Yields were wrong to fall after the dovish FOMC (a dovish Fed is pro-growth, and so long-term will push yields higher). And they are wrong to rise today (a more hawkish Fed is anti-growth, and will push yields lower). *The overarching reality is that, over the last month, the Fed has become – and now, with today's jobs news, will remain – more dovish than before. That is good for growth, and points to higher 10-year yields once it all comes out in the wash.*
- The deeper the Fed looks at the data, the less it should put them off their easing plans. The uptick in the unemployment rate was not caused by the 87,000 newly unemployed – they were swamped by 247,000 newly employed. Together, they comprise an increase in the labor force of 335,000 persons. Computationally, that moves the unemployment rate up simply because 26% of the new entrants to the labor force were unable to be immediately employed.
- This demonstrates there is still considerable slack in the labor force. Indeed, while the labor force participation rate ticked up to 62.9% from 62.8%, the participation rate in each bracket among prime-age workers from 25 to 54 is still so far below historic benchmarks for "maximum employment" – to quote the language of the Fed's mandate – that we calculate there are still 2.5 million discouraged prime-age workers who could yet come into active participation in the labor force (see "Data Insights: Jobs" July 5, 2019).
- So even if the Fed remains hypnotized by demonstrably incorrect Philips Curve reasoning – leading it to worry that full employment causes too much inflation – and even if, after a decade of failure to hit its inflation target anyway, it still remains worried about too much inflation in the first place – there is nothing in this morning's report that should discourage a dove.
- Besides, the Fed has never staked its recent dovish turn on labor market statistics. It's a blame-Trump narrative around "uncertainties" due to "recent developments involving trade negotiations and other matters" (again, see "On the June FOMC").
- We believe that's a deceptive narrative, designed to conceal the Fed's own errors in policy (see "On the December FOMC" December 19, 2018) and communication (see "It's Not 'Quantitative Tightening' – It's Powell" December 20, 2018) in last year's fourth quarter, which has driven a yield curve inversion that, in Fed Chair

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Recommended Reading

The Phillips curve is still dead
John Cochrane
The Grumpy Economist
June 30, 2019

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Jerome Powell's own words, means "your policy's tighter than you think" (see "It's So Time to Cut Rates" June 3, 2019).

- To be sure, that narrative could be construed to be a trap, in which if the "uncertainties" start to clear up, the Fed would be obliged to deflect from its dovish course. But we think it's no trap at all. *Even with the swift vanishing of tariff threat against Mexico* (see "Video: What you're not hearing about Trump's tariff gambit with Mexico" June 9, 2019) – *which triggered Powell's dovish turn – Powell isn't about to change course if that means he must confess that he was unnecessarily worried about Trump policies which, in the end, turned out to be completely successful.*

Bottom line

The tenth year of this business cycle expansion ends with a big payroll beat. It's reassuring after May's bust, which was revised even lower. But it is out of step with contemporaneous labor market indicators and will probably be downward-revised. Markets should not be concerned that this will put the Fed off its dovish course. This is the fourth month in the row of declining average hourly earnings year-over-year, and the unemployment rate ticked higher as the labor force expanded. This reveals considerable slack in the labor force, which we calculate could expand by 2.5 million prime-age workers before hitting maximum employment. The Fed's blame-Trump rationale for its dovish turn is durable, because for Powell to admit that "uncertainties" have cleared up would be effectively to admit that Trump was right. In the meantime, Powell knows that the inverted yield curve means "your policy's tighter than you think." So 10-year yields are right to back up, but for the wrong reason: a durably easy Fed points to higher growth.