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TRENDMACRO LIVE!

On the September Jobs Report

Friday, October 8, 2021

Donald Luskin

Two payroll disappointments in a row won't deter tapering, but it will likely slow it down.

A gain of 194,000 net payrolls reported in this morning's September Employment Situation report was the second big miss in a row. Upward revisions of 169,000 to the prior two months makes the miss versus the consensus for 500,000 considerably less biting. But it's still a miss, and a large output gap still remaining in the US economy, 500,000 is actually a low bar to begin with – and we didn't jump it. For the second month in a row, our model based on contemporaneous labor market indicators nailed it, estimating 312,000 payrolls (for the methodology and the inputs, see "Data Insights: Jobs" October 8, 2021).

A large part of the miss is a contraction of 123,000 government payrolls, more than all of which were in the state and local education sectors. The Bureau of Labor Statistics explains it away as a pandemic-driven failure of their seasonal adjustment model (on an unadjusted basis, there were 654,000 payrolls gained last month – again, see "Data Insights: Jobs"). But *a miss is a miss, and puny payroll gains are puny payroll gains however you torture the data*.

There are many reasons for it, no doubt, but we continue to believe that *the most important driver is the fact that amidst the panic over the Delta*

Update to strategic view

US MACRO, FEDERAL RESERVE: A big miss versus a consensus that was a low bar to begin with. Much of it can be explained away by upward revisions to prior months, and to seasonal adjustment problems in the education sector. But with employment down 5 million from the pre-pandemic peak, there is still a large output gap that would command bigger payroll gains if the re-opening of the grassroots economy hadn't stalled out due to the Delta scare and the culture-war over vaccinations. We think two disappointing jobs reports in a row won't be enough to deter the Fed from announcing tapering at the November FOMC. It may be sufficient to cause the initial pace of tapering to be slower than would have otherwise been the case.

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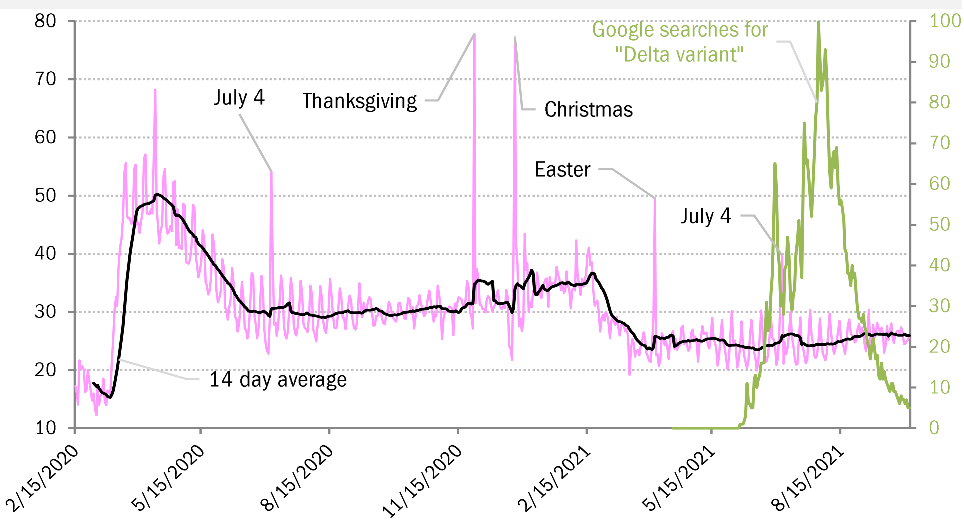
TrendMacro Social Distancing Index versus salience of Delta variant



Source: Google Mobility Reports, Google Trends, TrendMacro calculations *variant of Covid-19 and the culture-war for vaccinations, the reopening of the grassroots of the economy has stalled*. When we pointed out last month that our Social Distancing Index has stopped improving, and indeed has been slightly moving in the wrong direction – toward increased immobilization (please see the chart on the previous page, and "On the August Jobs Report" September 3, 2021) – several smart clients told us we were exaggerating tiny variations in the data. We stand by it: *the rate of change of remobilization drives the rate of change of job creation and economic growth, and it is even pointing slightly in the wrong direction, there will be consequences*.

- The leisure and hospitality sector, still 1.6 million payrolls below the pre-pandemic peak, gained a measly 74,000 in September. That's the canary in the mineshaft for the grassroots reopening of the parts of the economy that were most cruelly damaged in the pandemic shutdowns.

This is the last jobs report before the November FOMC meeting at which we, along with the consensus, expect the formal announcement of the tapering of asset purchases (see "On the September FOMC" September 22, 2021). The conditions set out for it are "substantial progress" toward the Fed's goals for the restoration of inflation and full employment. Chair Jerome Powell has been clear that the former has been met already (indeed, heading into the meeting, *inflation expectations have come back to the high end of this year's range*). Will he believe that two disappointing jobs reports in a row mean the latter condition has not been met?

- *We think tapering will still be announced in November. However, we expect that it's initial pace will be slower than it might have been otherwise, had we not just had two weak jobs reports*.
- Whatever transient sentiment effect this may have, *we don't think it matters one bit to the ongoing recovery of the labor market, or the ongoing expansion of the economy*. Based on Powell's remarks at the September FOMC's press conference, we're pretty positive he agrees with this (again, see "On the September FOMC").

Setting aside the irrelevancy of QE, *it is nevertheless difficult to understand whether this most unusual post-pandemic labor market is tight or slack*.

- At 153.7 million persons overall, the employment remains shrunken by 5.0 million from pre-pandemic levels. *That makes the labor market look very slack*.
- But 3.1 million of that 5.0 million is shrinkage of the labor force. So the number of actively unemployed persons is only 1.9 million more than before the pandemic. That produces a 4.76% unemployment rate, down from August's 5.19% (in majority part because the labor force shrank another 183,000 in September). *That makes the labor market look not so slack*.
- At the same time there is that record 10.9 million job openings and endless stories about firms being unable to meet their hiring needs (that will be the excuse *du jour* this earnings season for any

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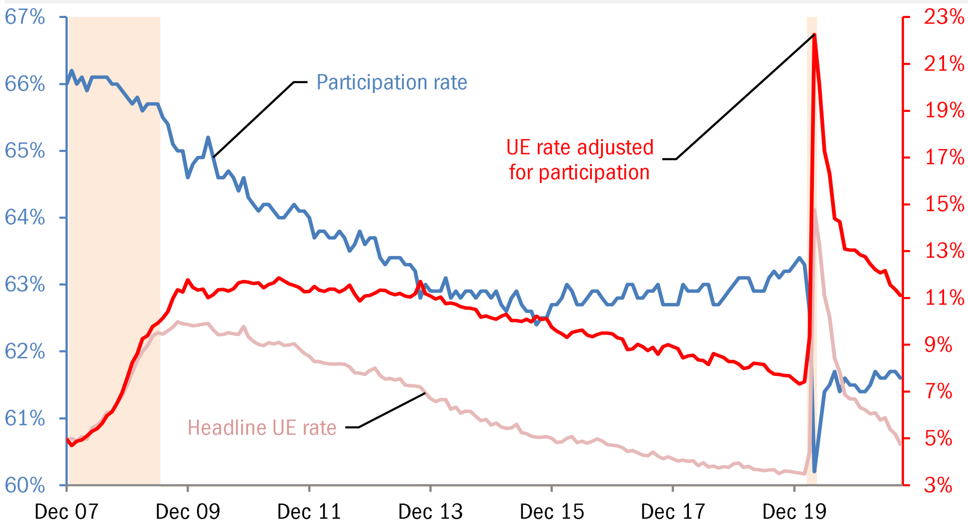
company that misses). And there's the rise in average hourly earnings (0.63% just in September, implying if sustained a 7.8% annual rate). Over the past 12 months, wage gains have been the highest for workers who switch jobs 4.8%, the most since 2007, at the business cycle peak just before the Great Recession. _That makes the labor market look very tight_.

- We can integrate these statistics in an unemployment rate adjusted for labor participation (please see the chart below). Now at 11.1%, it's not only far above the pre-pandemic low of 7.4% – it's at about the same levels that prevailed in the "new normal" "jobless recovery" years following the Great Recession, a level that we thought was impossibly and unsustainably high, and indeed turned out to be just that.

The unemployment rate and labor force participation



Source: BLS, TrendMacro calculations

- _Unless you want to posit that the people who have left the labor force during the pandemic won't ever come back (those who left during the Great Recession did!), there's slack in the labor market_.
- The national expiration of extended and enhanced unemployment benefits on September 6 will undoubtedly have a positive effect on bringing workers back into the labor force going forward. If it doesn't increase labor supply to stop paying people more not to work than to work, then we have to throw out the most basic axioms of economics having to do with the marginal effect of incentives.
- Those benefits have already stopped in 25 states that opted out at various points in June and July (on average, they have been opted-out for 81 days preceding the surveys taken for the September jobs report). But for the other 25 states – which in aggregate have larger populations and more pandemic-driven unemployment – the benefits were only ended for 6 days before the survey. We can't reasonably expect to see any effects in the data yet. We will.
- We acknowledge that if the definition of a tight labor market is that firms can't readily find workers, then we have a tight labor market.

But typically that happens at a business cycle top when labor force participation is rising, and the economy is physically running out of workers. This is not that. We are not physically running out of workers – we just temporarily don't have enough willing workers.

- GDP is already at all-time highs in Q2-2021, by almost 1% above the pre-pandemic peak. Q3-2021 will be the slowest quarter so far this year, but it will show growth, taking GDP to even higher new all-time highs. With so many workers on the sidelines – and the incentives keeping them there running off – we continue to believe the stage is set for a double-dip expansion.

Bottom line

A big miss versus a consensus that was a low bar to begin with. Much of it can be explained away by upward revisions to prior months, and to seasonal adjustment problems in the education sector. But with employment down 5 million from the pre-pandemic peak, there is still a large output gap that would command bigger payroll gains if the re-opening of the grassroots economy hadn't stalled out due to the Delta scare and the culture-war over vaccinations. We think two disappointing jobs reports in a row won't be enough to deter the Fed from announcing tapering at the November FOMC. It may be sufficient to cause the initial pace of tapering to be slower than would have otherwise been the case.