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MACROCOSM

A Greener Kind of Shoot

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A sign that the economy isn't just falling more slowly, but actually starting to grow.

We have four details to add to the self-evident good news of a better than expected jobs report this morning.

Update to strategic view
US MACRO: This morning's jobs report confirms the ongoing bottoming process for the economy, and confirms our long-standing call that the recession ended in May. A special glimmer of encouragement comes from a seemingly paradoxical improvement in the "job-finding probability" occurring simultaneously with a fall in the percentage of involuntary part-time employment. **FED FUNDS:** Tightening expectations have risen today with this morning's jobs report, but still not to the level seen in immediate reaction to May's report. This signals that while the Fed will surely acknowledge the ongoing emergence of "green shoots," it is unlikely to dare to aggressively signal new tightening intentions at next week's FOMC.
[see Investment Strategy Dashboard]

First, we note that there have now been now two months of back-to-back improvement in the "job-finding probability" -- that is, the chance that an unemployed worker will find a new job within a single month. In April, it hit what was by far an all-time low of 20.5%, symbolizing the unprecedented situation of an employment slump driven primarily not by outright job losses, but instead by an historic drop in the capacity to re-employ the unemployed. With this morning's data, the probability has risen to 26.0%, the best level since January (please see the chart on the following page). The significance of this is that, amidst so many "green shoots" indicating nothing more than that the rate of economic decline has slowed, here we have a sign that the economy is *actually growing* -- specifically, it has begun to create new jobs.

Second, we note that now there has also been two months of back-to-back improvement in the percentage of the employed labor force working part-time involuntarily. In April it flirted with new all-time highs at 6.5% (that was, in fact, probably the all-time high; the methodology has changed since the previous high in 1982). With this morning's report, it has fallen to 6.3%, the best level since February.

Recommended reading
In Fed We Trust David Wessel Crown Business, 2009
[Recommended Reading home]

- The combination of these two observations is potentially significant, and positive. We have pointed out previously that the high percentage of involuntary part-time workers could be a barrier to improvement in unemployment (see

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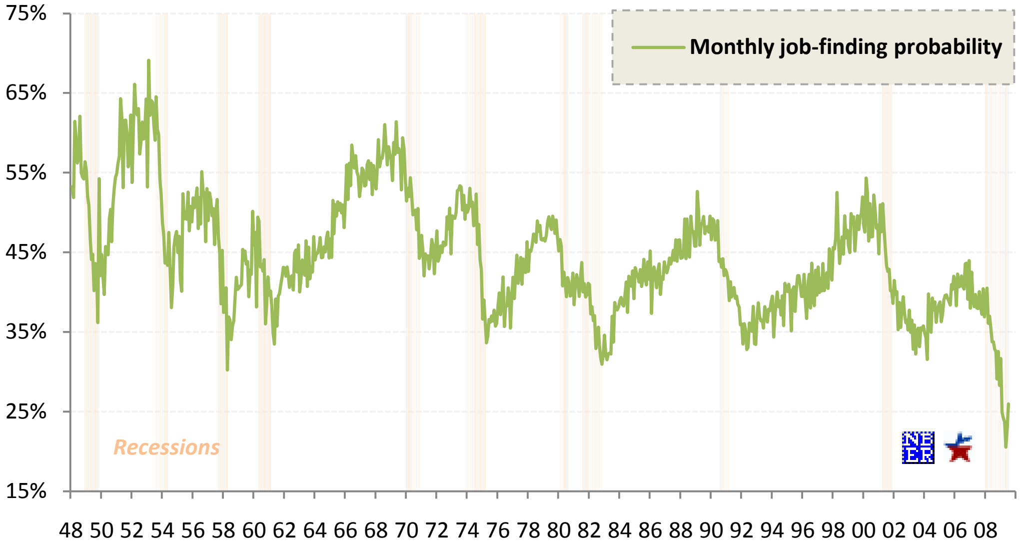
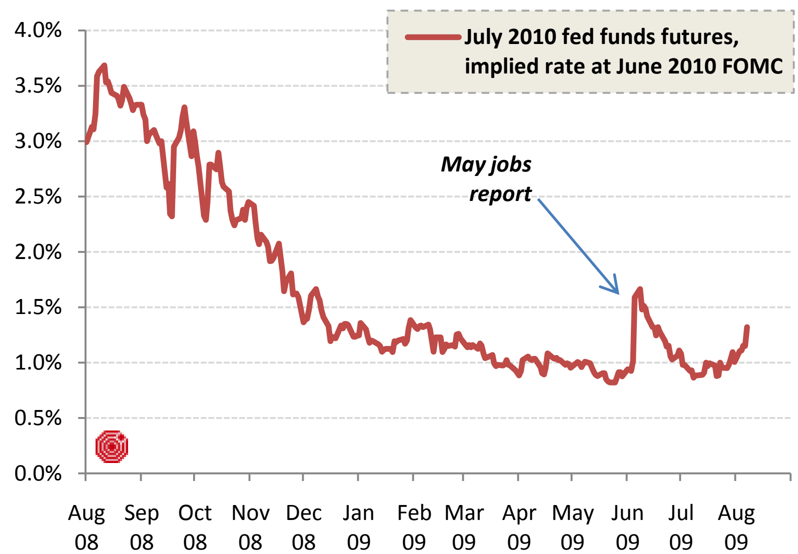
"The Case for Ambivalence" June 12, 2009). The logic is that firms would likely prefer to give more hours to existing part-time workers than go to the expense of recruiting entirely new workers. While such a situation would imply a recovery in overall hours worked in the economy, it would make it difficult for the unemployment rate to come down significantly. So it's good news to see in this morning's data that involuntary part-time employment can, in fact, contract at the same time as the job-finding probability markedly improves.



Third, with a less positive flavor, we note an unwelcome discrepancy between the seasonally adjusted and the non-seasonally adjusted measures of the overall size of the labor force. On an adjusted basis, the labor force *contracted* by 422,000, which feeds into an improved unemployment rate of 9.4%. But on an unadjusted basis, the labor force *expanded* by 334,000, which leaves the unemployment rate unchanged at a cycle high of 9.7%. The implication is that the seasonal expectation was that 756,000 people would have entered the labor force in July, but didn't. We don't know *why* so many workers would fail to enter the labor force, but a sensible guess is that they were discouraged by the still low job-finding probability. This is partially confirmed by this morning's rise in the official count of "discouraged workers" to a new cycle high.

Finally, we note that markets this morning have heightened their expectations for Fed tightening, but are well off the level attained in reaction to the May jobs report two months ago, which was the first fully unmistakable statistical indicator that the economy was beginning to recover from recession (see "On the May Jobs Report" June 5, 2009). This is consistent with the idea that, at next week's FOMC, the Fed will surely acknowledge the ongoing fulfillment of its own intuition that the economy is bottoming -- yet at the same time, with so much so-called "slack" remaining in the economy, it is highly unlikely to signal any real tightening intentions.



With the economy recovering and the Fed unlikely to change its hyper-accommodative posture, the prospects remain strong for continued build up of inflation pressures. So this morning, as of this writing, while we see the 2-year Treasury yield up by 11 bp (signifying rising funds rate tightening expectations) we see the 2/10 spread unchanged and gold off by a mere $5 -- both near all-time highs (signifying no substantial associated change in inflation expectations).

BOTTOM LINE: This morning's jobs report confirms the ongoing bottoming process for the economy, and confirms our long-standing call that the recession ended in May. A special glimmer of encouragement comes from a seemingly paradoxical improvement in the "job-finding probability" occurring simultaneously with a fall in the percentage of involuntary part-time employment. Tightening expectations have risen today with this morning's jobs report, but still not to the level seen in immediate reaction to May's report. This signals that while the Fed will surely acknowledge the ongoing emergence of "green shoots," it is unlikely to dare to aggressively signal new tightening intentions at next week's FOMC.