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TRENDMACRO LIVE!

On the December Jobs Report

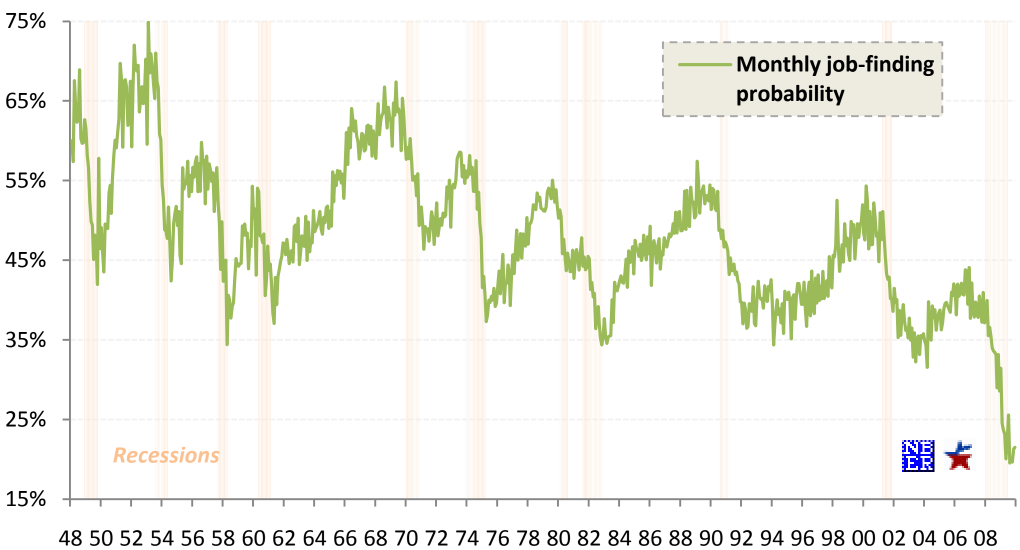
Friday, January 8, 2010
Donald Luskin

No V-shaped recovery, but some signs that dynamism is returning to the jobs market.

Update to strategic view
US MACRO: Hopes for a V-shaped recovery were dealt a blow with this morning's jobs report. We see the report as consistent with a gradual recovery, based on the beginning of the return of dynamism to the labor market.
[see Investment Strategy Dashboard]

With the hopes stirred by last month's surprisingly good jobs report (see "On the November Jobs Report" December 4, 2009), the December report was expected to feed mounting expectations of a V-shaped recovery. It didn't happen. This morning's report was a disappointment, with a headline of 85,000 payroll jobs lost. But under the headlines, we saw some small but important signs of structural improvement in the labor market, at the same time as there remain indicators of the headwinds that the economy still faces. All in all, it is consistent with our view that the economy is gradually repairing itself. We see no reason for interpreting this jobs report as evidence of an aborted recovery, or an incipient double-dip. It certainly shouldn't give the Fed any reason to move more aggressively toward an exit from its extreme monetary ease, despite considerable recent repricing in markets pointing to that (see "New Year, Same Old Fed" January 4, 2010).

Let's start with our favorite indicator of labor market health, the monthly job-finding probability -- the "outflow rate" from unemployment. It up-ticked to 21.5%, its second sequential gain, and a new recovery high above the scary all-time low at 19.5% in August (see the chart at left). This means that 21.5% of unemployed persons found a



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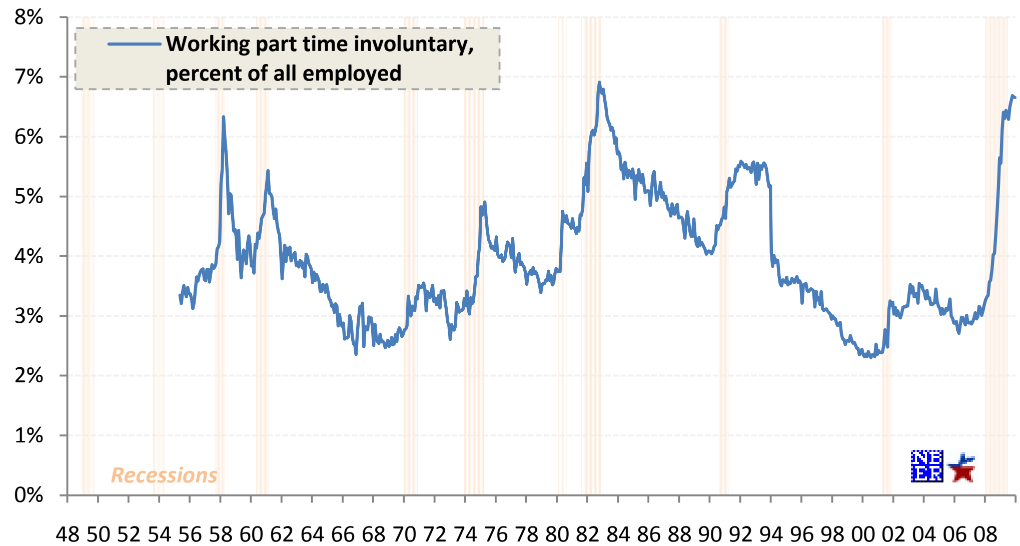
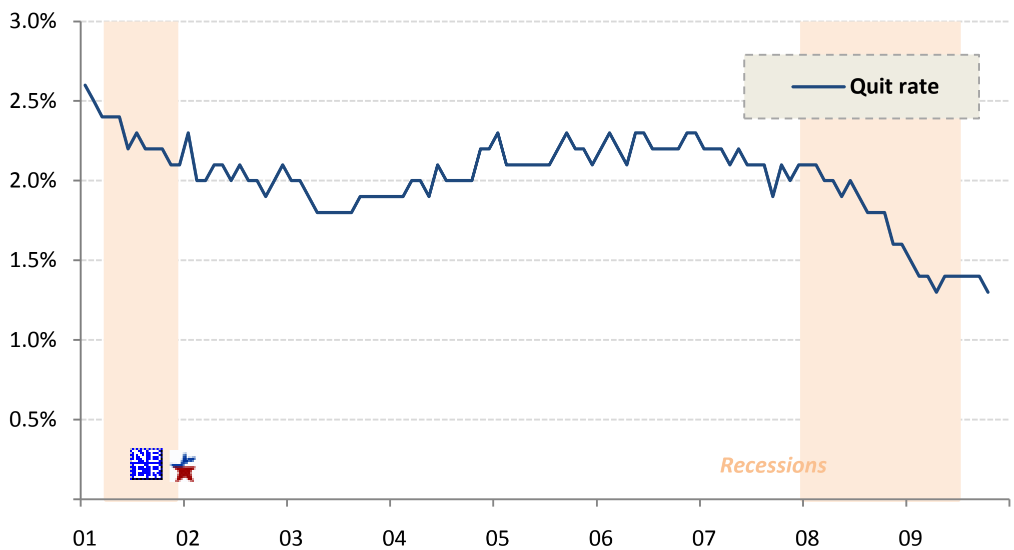
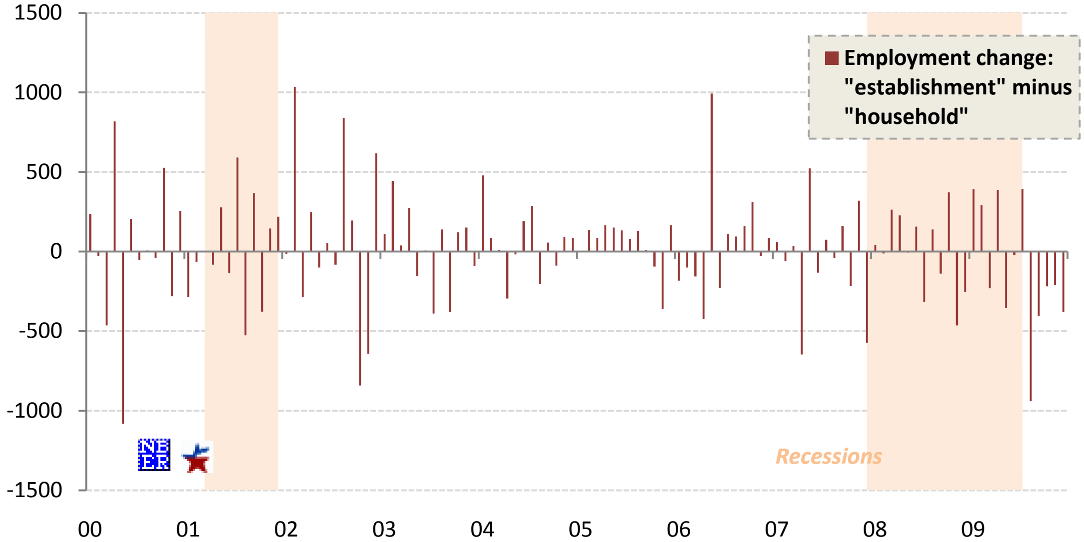
job in December, while only 19.5% did in August. This is a result of the *decline* in unemployed persons by 73,000, at the same time as the number of persons unemployed for five weeks or less *grew* by 155,000. This means that while there was a larger number of *newly* unemployed persons, the inventory of *previously* unemployed persons nevertheless cleared a bit during the month.



We also saw a small improvement to 6.65% in the percentage of the labor force working part-time involuntarily. Here too, it is the second improvement in a row (albeit a very small one), from October's worst-ever reading of 6.7%. These part-timers who would prefer full-time work represent an inventory overhang in the labor market that must be cleared before fully unemployed persons will likely be hired. We're seeing microscopic evidence, but evidence nevertheless, that such clearing is beginning.



There was a small worsening in the monthly separation probability, the "inflow rate" to unemployment, to 2.4%. In other words, an employed worker faced a 2.4% chance of separating from his job in December. Oddly, this is a statistic that we would like to see get a lot worse. It has been at extremely low levels, both in the recession and in the previous expansion -- seemingly good, apparently indicating job security for the employed. This, in combination with the drop to all-time lows in the job-finding probability, has formed our view that the sharp rise in the unemployment rate in the recession and its aftermath has not been caused by an unusually *large* number of job *losses*, but rather by an unusually *low* number of *hires*. What we may be learning here is that, seemingly paradoxically, a higher number of job losses would have been healthy for the labor market, to the extent that it implied dynamism in employment. Indeed, the rate at which employees voluntarily quit work was low throughout the previous expansion, and started falling from there a year before recession onset -- and with recession, only intensified (see the chart on the previous page). This indicates that for a long time workers have lacked the confidence to venture out to new employment opportunities. Two things happen if nobody quits -- not only are there no places for newcomers, but also the growth prospects of the economy are damped by the failure of labor resources to migrate to higher and better uses.



On a slightly darker note, we must point out that there continues to be a negative divergence between the Bureau of Labor Statistic's "establishment survey" and its "household survey" since the recession end, which we date to May, 2009 (see the chart above). The household survey is statistically unreliable in a number of ways, but it has the virtue of picking up in real-time a much broader sample of employment, better representing the small businesses that have historically been responsible for the majority of job growth. Using the BLS's conversion of the household numbers to a "payroll basis," we can compare monthly employment changes between the two methods, and in their divergence potentially gain some insight into the relative performance of big business and small business. The last five months have seen consistent large job losses in the household survey -- in this morning's report, it was 465,000 jobs, the worst in three months, and far worse than the loss of 85,000 jobs reported in the establishment survey. We continue to believe that the recession ended last May, but with this kind of relatively poor performance in the small business domain, recovery will only gradually turn into expansion (see "Small Change" November 9, 2009).

BOTTOM LINE: Hopes for a V-shaped recovery were dealt a blow with this morning's jobs report. We see the report as consistent with a gradual recovery, based on the beginning of the return of dynamism to the labor market.