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On the December Jobs Report

Friday, January 7, 2011
Donald Luskin

ADP's crystal ball turned out to be cloudy. Jobs growth will have to wait for 2011.

This morning's December jobs report certainly didn't live up to the optimistic expectations created by Wednesday's record ADP payroll report (see "A Question of Sentiment" January 6, 2011). Even the surprise drop in the unemployment rate contained a disappointment -- it was exaggerated by a 260,000-person decline in the labor force. So Ben Bernanke was only being oblique -- not wrong -- when he opened his Senate Banking Committee testimony this morning by saying, in the very first sentence, that growth "has been insufficient to reduce the rate of unemployment significantly." Indeed, it was *lack of growth* that reduced the unemployment rate in December. *Strong* growth would have drawn people back into the labor force -- which experienced a record drop in the Great Recession (please see the charts below) -- making the unemployment rate *higher.*

This will be the key paradox of 2011 -- that better growth will *raise* the unemployment rate. It will put the Fed in a very strange position -- of wanting to tighten in response to economic growth, but not daring to because the unemployment rate remains high. In this paradox lies a bull

Update to strategic view

US MACRO: It was a disappointing jobs report, especially in light of Wednesday's very positive ADP payroll number and the generally improving tone of the economy. Not a great capper to 2010, but this doesn't change our outlook for better growth in 2011.

GOLD, FED FUNDS: Bernanke's testimony highlights the paradox that a falling unemployment rate is a sign of…

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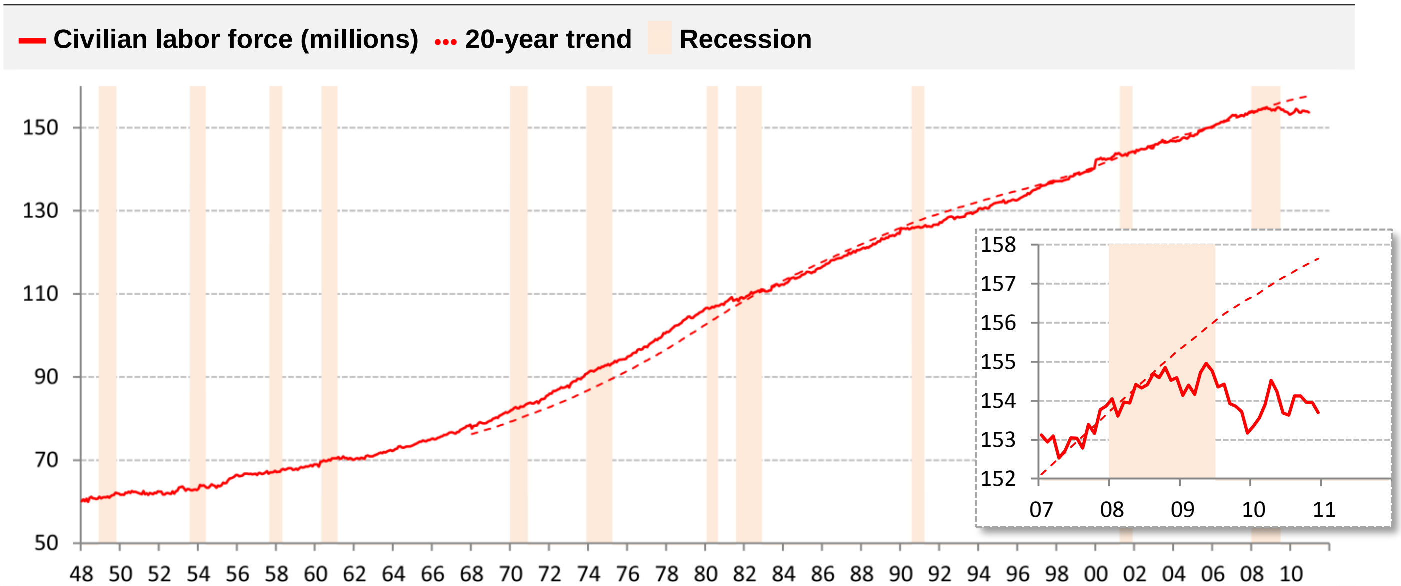


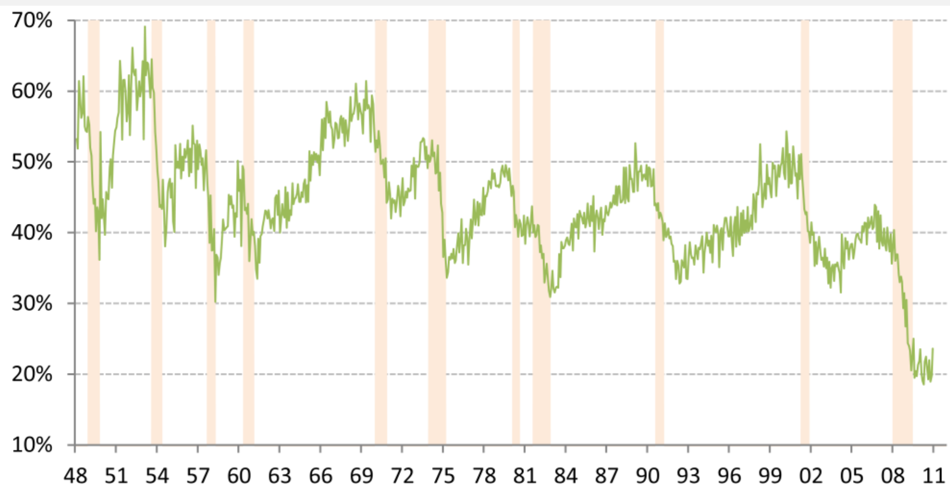
Source: BLS, NBER, TrendMacro calculations case for gold, even if one doesn't expect any more inflationary grand gestures from the Fed once QE2 runs its course. As the economy improves, the Fed will be getting increasingly easy *implicitly* simply by not acting. After touching key technical support this morning just before the jobs numbers were announced, gold rallied on the announcement, and then further on Bernanke's testimony. We continue to rate gold a "hold," maintaining our price target of $1500. The strongest bull case is potentially off the table, but it may well be that a decent secondary bull case remains.

Turning to stocks, we note that this morning's disappointing jobs report didn't trigger much downside action -- it would have if sentiment were as excessively bullish as it is advertised to be. This confirms our sense that sentiment is no barrier to a further slow-motion melt-up in stocks (again, see "A Question of Sentiment").

Turning to the particulars of the jobs report, beneath the surface there were some true bright spots:

- The 1-month job-finding probability -- the chance of an unemployed person getting a job within a month, the so-called "outflow rate" from unemployment -- grew sharply. It's still quite depressed by historical standards, but it's moved back up to the top of the range since the official trough of the recession (please see the chart below).

Monthly job-finding probability (per Shimer 2005) **Recession**



Source: BLS, NBER, TrendMacro calculations

- At the same time, the 1-month separation probability -- the chance that an employed person will lose his job within a month, the so-called "inflow rate" to unemployment -- fell. It remains where it has been for several months -- all the way back down to pre-recession levels.
- The percentage of workers employed part-time involuntarily fell.

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…economic weakness, and a rising one in 2011 will be a sign of strength. This is the bull case for gold despite a strengthening economy -- the Fed will get implicitly looser as a persistently high unemployment rate keeps it from tightening.

US STOCKS: If sentiment were too bullish, stocks would have reacted very badly to this morning's jobs report. They didn't -- so sentiment doesn't stand in the way of a further slow-motion melt-up.

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[About us]

- Payroll gains were revised upward by 95,000 for November and October.
- Job gains in reported in the "household survey" outperformed those reported in the "payroll survey" -- indicating better relative job-creation in the small-business sector, consistent with a revival in small-business confidence (see "How We Didn't Blow It in 2010" December 28, 2010).

This generally disappointing jobs report doesn't particularly change our view about better 2011 growth. It would have been encouraging to see a downpayment on it in the last month of 2010, particularly in the troubled labor market. But the factors we've identified as supporting better growth -- the Fed backing off its too-right posture via QE2, and the political realignment in favor of capital-friendly policy (see "Stock Outlook: Differences Make a Difference" November 10, 2010) -- only came into sharp focus late in 2010. They're already being reflected in forward-looking asset prices, and soon enough they'll show more visibly in the real economy.

Bottom line

It was a disappointing jobs report, especially in light of Wednesday's very positive ADP payroll number and the generally improving tone of the economy. Not a great capper to 2010, but this doesn't change our outlook for better growth in 2011. Bernanke's testimony highlights the paradox that a falling unemployment rate is a sign of economic weakness, and a rising one in 2011 will be a sign of strength. This is the bull case for gold despite a strengthening economy -- the Fed will get implicitly looser as a persistently high unemployment rate keeps it from tightening. If sentiment were too bullish, stocks would have reacted very badly to this morning's jobs report. They didn't -- so sentiment doesn't stand in the way of a further slow-motion melt-up.