

TRENDMACRO LIVE!

On the January Jobs Report

Friday, February 4, 2011

Donald Luskin

Look through the bad headline and the statistical distortions -- this was a strong report.

The upside surprise in jobs we hoped for yesterday (see ["Are We Running Out of Armageddons?"](#) February 3, 2011) didn't materialize in this morning's [January jobs report](#). At least not in the headlines -- but in reality this was a very strong report. As of this writing, with the 10-year Treasury yield having moved to the highest level since last May, markets are acting like they agree.

First, the drop in the unemployment rate from 9.4% to 9.0% was real, at least mostly.

- Yes, it seems at first glance that the labor force fell by 504,000 -- artificially flattering the UE rate by reducing the denominator, but in fact signaling an alarming worsening of sentiment. *But this entire drop in the labor force was due to the annual re-setting of "population controls" in the compilation of the "household survey," which always makes December-to-January comparisons difficult.* Without this statistical effect, the labor force was exactly unchanged.
- The same statistical effect made little difference in the number of unemployed persons, the numerator of the UE rate. Reported as a drop of 622,000, without the statistical effect it would still be a drop of 590,000 -- extremely positive either way.
- So abstracting from the statistical effect, the unemployment rate would be 9.01%, still a very positive development -- *and achieved the right way, with a drop in the number of unemployed, not a drop in the labor force.*
- All that said, we would have liked to see the labor force *expand*, not just remain unchanged. We think that as the economy grows at above-trend rates this year, it will. Employment will grow at the same time, but the unemployment rate is very unlikely to fall much from here, and may even rise.

Second, employment growth as reported in the "household survey" was drastically understated because of the same statistical effect.

Update to strategic view

US MACRO: No upside surprise in the headlines. But looking through year-end statistical shenanigans, this was a very strong report. The drop in the unemployment rate was real -- not simply a function of a reduction in the labor force. Abstracting from statistical effects, 590,000 people stopped being unemployed last month, and 589,000 became employed.

FED FUNDS, US BONDS:

The drop in the unemployment rate likely won't get repeated, as the labor force will probably grow as the expansion builds steam. The Fed will surely not raise rates this year, and will have a tough call after that -- when the economy will have very visibly improved, but the UE rate remains high. But we think this pretty much takes QE3 off the table for good, and frees Treasury yields to work toward our target at about 4% on the 10-year.

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- As reported, employment grew by only 117,000 -- better than the disappointing gain of 36,000 non-farm jobs in the "payroll survey," but still a disappointing number.
- Without the "population control" adjustment, employment would have been reported as growing by 589,000.
- Put the employment and unemployment number -- without the statistical effect -- together. We have a 590,000 drop in unemployment, and a 589,000 gain in employment. *That's a very strong result.*

Bottom line

No upside surprise in the headlines. But looking through year-end statistical shenanigans, this was a very strong report. The drop in the unemployment rate was real -- not simply a function of a reduction in the labor force. Abstracting from statistical effects, 590,000 people stopped being unemployed last month, and 589,000 became employed. The drop in the unemployment rate likely won't get repeated, as the labor force will probably grow as the expansion builds steam. The Fed will surely not raise rates this year, and will have a tough call after that -- when the economy will have very visibly improved, but the UE rate remains high. But we think this pretty much takes QE3 off the table for good, and frees Treasury yields to work toward our target at about 4% on the 10-year. ▶

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[Egypt's Economic Apartheid](#)

Hernando de Soto
Wall Street Journal
February 3, 2011

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Correction

In the "Update to strategic view" and "Bottom line" in yesterday's report, we inadvertently said "load demand" when we meant "loan demand." You may download a corrected version of the report by clicking [here](#).