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TRENDMACRO LIVE!

On the March Jobs Report

Friday, April 1, 2011

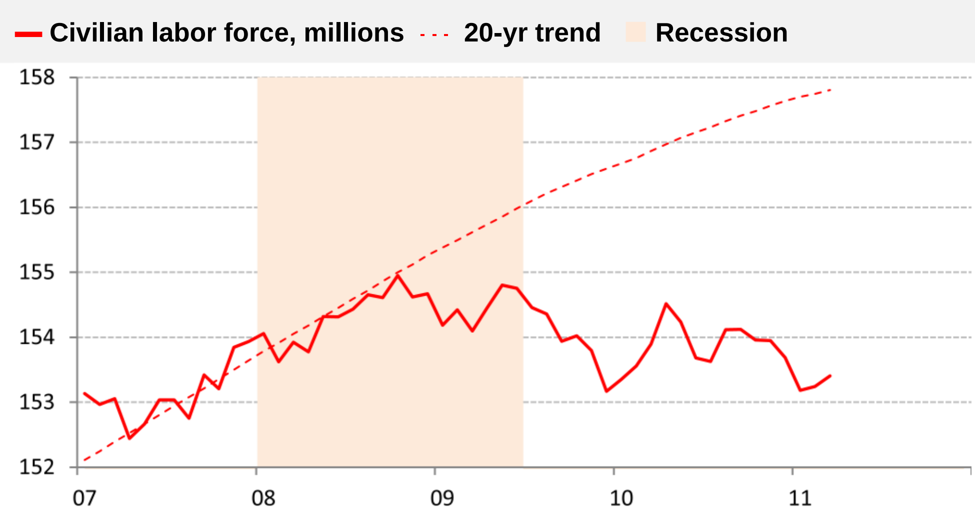
Donald Luskin

A solid, if not spectacular, jobs report. The economy is firmly in second gear.

No breakaway to the upside, but this morning's March jobs report was solid. The 230,000 gain in private payrolls was the biggest in five years (with the exception of last month's 240,000, but that number was only the result of a 44,000 upward revision this morning). It's evidence that the economy has gotten out of first gear and at least into second. That's some progress, especially against the backdrop of the current dominant narrative that high oil prices, MENA instability and the earthquake in Japan are derailing the recovery.

Another encouraging sign -- but again, not a breakaway -- is that as with last month's jobs report, the unemployment rate fell for all the right reasons (see "On the February Jobs Report" March 4, 2011). Specifically, the number of employed persons *grew* by 291,000, the number of *un*employed persons *fell* by 131,000, and at the same time the civilian labor force *grew* by 160,000 (please see the chart below). When the economy shifts into *third* gear, we expect the labor force will grow more rapidly and put pressure on the unemployment rate. But this is a downpayment at least, and all to the good.

After this morning's data, futures-implied expectations for the year-ahead



Source: Bureau of Labor Statistics, NBER, TrendMacro calculations

Update to strategic view

US MACRO: This morning's jobs report was solid, with the best private payroll gains in 5 years and a drop in the unemployment rate for all the right reasons. Despite threats from oil, MENA and Japan, the economy appears to have firmly upshifted to second gear.

FED FUNDS: Fed expectations got a little more hawkish after this morning's jobs data, but had already upticked based on yesterday's remarks by Kocherlakota. We still don't see any real chance of a rate hike this year, but make no mistake about it -- the economy is improving and inflation is rising, so the Fed's exit is within the strategic planning horizon.

[Strategy Dashboard home]

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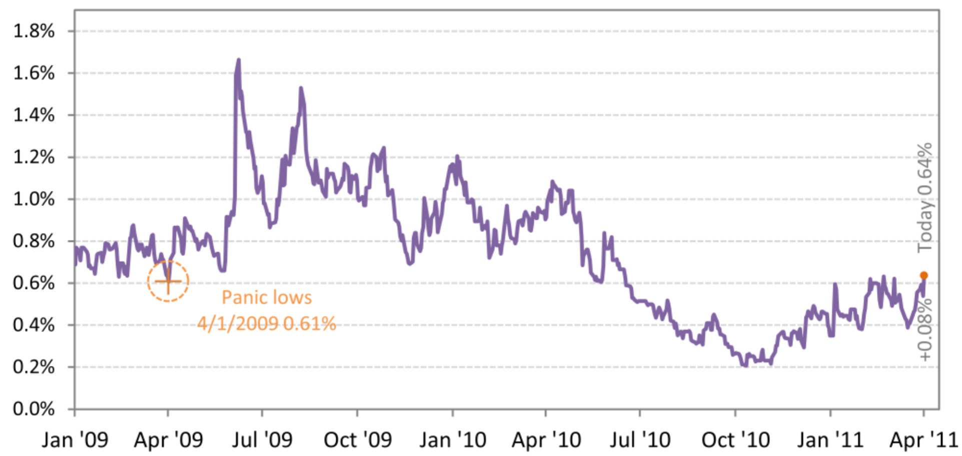
fed funds rate upticked only 2bp to 64 bp -- that said, they'd already upticked to 62bp, up 6bp, *before* the data (please see the chart below). This was no doubt driven by remarks yesterday by Minnesota Fed president Narayana Kocherlakota that were reported as advocating a 75bp funds rate by year-end. In fact, in an interview with Dow Jones, Kocherlakota only expressed the hypothetical that, based on core inflation rising by 50bp in 2011, his version of the Taylor Rule would call for a 75bp hike. Core inflation was at 0.7% at year-end, so it would only have to rise to 1.2% to fulfill Kocherlakota's hypothetical, and it's already at 0.9%. That will probably happen -- indeed, it's exactly what Bernanke is trying to engineer. We'd be surprised if the funds rate were hiked in 2010 -- but we

Year-ahead futures-implied fed funds rate



Source: CME Group, TrendMacro calculations

continue to think that the upshift in growth and inflation since the inception of QE2 finally brings the possibility of the Fed's exit within a feasible strategic horizon (see "Eyeing an Exit from 'No Exit'" November 18, 2010).

Bottom line

This morning's jobs report was solid, with the best private payroll gains in 5 years and a drop in the unemployment rate for all the right reasons. Despite threats from oil, MENA and Japan, the economy appears to have firmly upshifted to second gear. Fed expectations got a little more hawkish after this morning's jobs data, but had already upticked based on yesterday's remarks by Kocherlakota. We still don't see any real chance of a rate hike this year, but make no mistake about it -- the economy is improving and inflation is rising, so the Fed's exit is within the strategic planning horizon.

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