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TRENDMACRO LIVE!

On the May Jobs Report

Friday, June 1, 2012

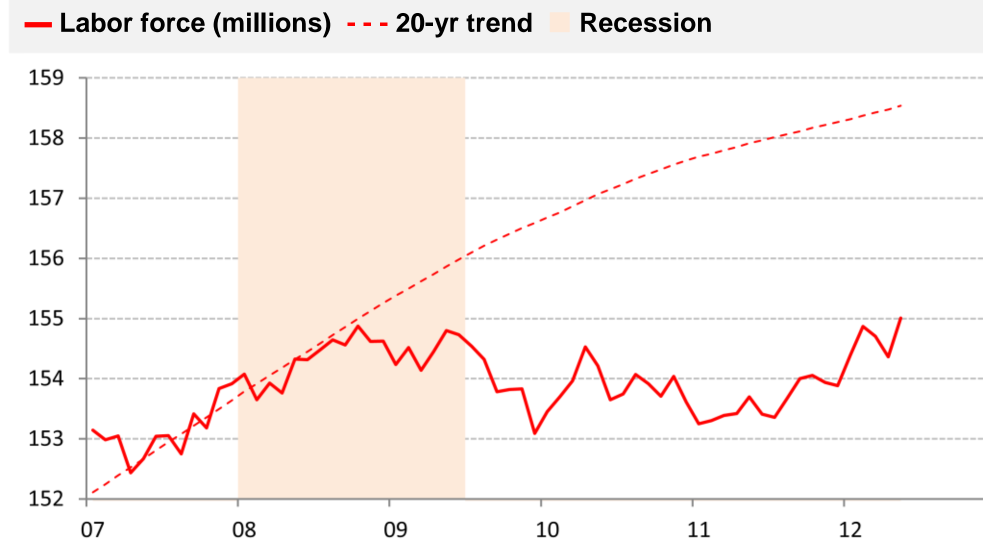
Donald Luskin

That's one, two, three strikes for the jobs market, and the Fed steps up to the plate.

This morning's May Employment Situation report is the third bad one in a row. This seals the deal: as we've been saying now for several months, the Fed will definitely act (see "On the March FOMC" March 13, 2012), and it will almost surely happen at the June meeting. This is completely consistent with our view early in the year that the US economy faced as much as a 50/50 possibility of recession (see "Risk Reappraisal" January 20, 2012), and the optimism about the labor market in the first quarter was misplaced (see "On the February Jobs Report" March 9, 2012).

There's no sugarcoating it, but let's not go overboard either. This jobs report has a mitigating context that needs to be understood. First, let's look at its microstructure.

- The headline payroll number was awful, coming in below the lowest estimate in the consensus -- and that with a big downward revision for the prior month. And the unemployment rate rose, taking away the one bright element from prior months.
- But the worst element of the prior two months completely reversed itself in May (please see the chart below). The labor force



Source: BLS, NBER, TrendMacro calculations

Update to strategic view

US MACRO, US FED: Today's jobs numbers had one saving grace -- the labor force recovered its losses of the prior two months and has moved to a new all-time high. But the headline numbers were awful. Fully contextualized, small changes in headline payroll gains like this morning's -- however disappointing -- are the new normal, and in that sense no big deal. Nevertheless, this makes three bad jobs reports in a row, and all the excuse the Fed needs to announce some form of new easing at the June FOMC meeting.

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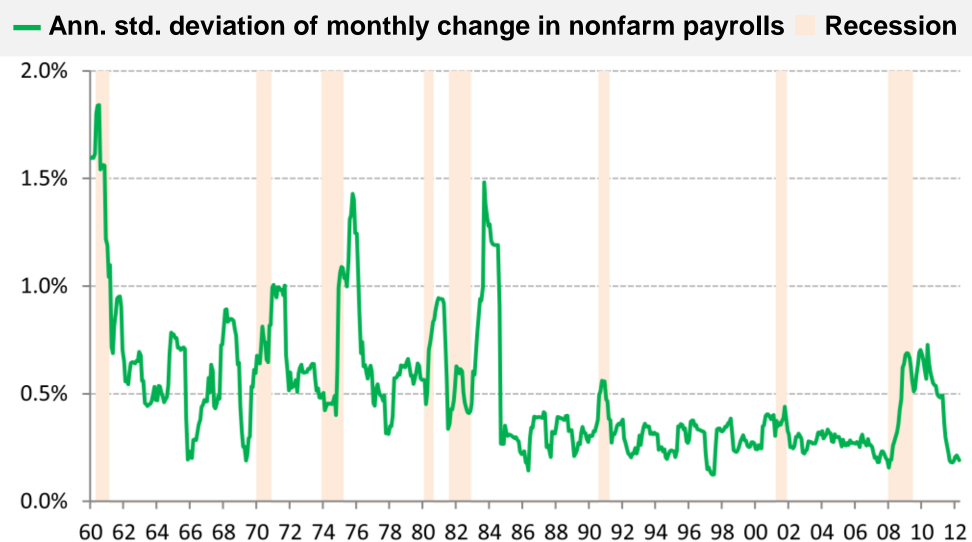
expanded by 642,000, erased March and April's losses, and moving to new all-time highs.

- Of the new entrants to the labor market, 34% of them came in without a job. That's why the unemployment rate went up. But that's a very good sign: it means either that 642,000 people now feel they *can* get a job, or that they now feel they *must* get a job. Either way, for the supply side of the economy to kick in, we need a greater supply of labor, and we got it in May.
- This is so critical because even as the labor force achieved a new all-time high today, it remains 3.5 million below trend. The trend will keep rising due to the demographic flow of 80,000 new candidates for the labor force every month, so we should expect the labor force to grow along with it. *When it shrinks instead, as it did in March and April, it is a very worrying sign.*

In a wider context, this morning's report -- while disappointing and far from positive -- can be understood as a non-event. Yet most analysts have fallen into the habit of treating very *small* differences from month to month as though they all have *enormous* implications. The most significant implication can be drawn from accepting the reality of how consistently small the differences have become.

- The volatility of the change in nonfarm payrolls has fallen to near the lowest level in history -- a level that, historically, has been consistent with expansion (please see the chart below).
- And yet there is no expansion.



Source: BLS, TrendMacro calculations

- So as we've been saying all year, the problem with the jobs picture *isn't* that it's *bad* -- it's that it's *not good* (again, see "On the February Jobs Report" March 9, 2012). *This* is the "new normal."
- In that same spirit, we wouldn't say that this morning's jobs report indicates that the US economy is sliding into recession -- or that it doesn't. What it tells us is that words like "recession" have become meaningless now. We're scraping along the bottom, with an

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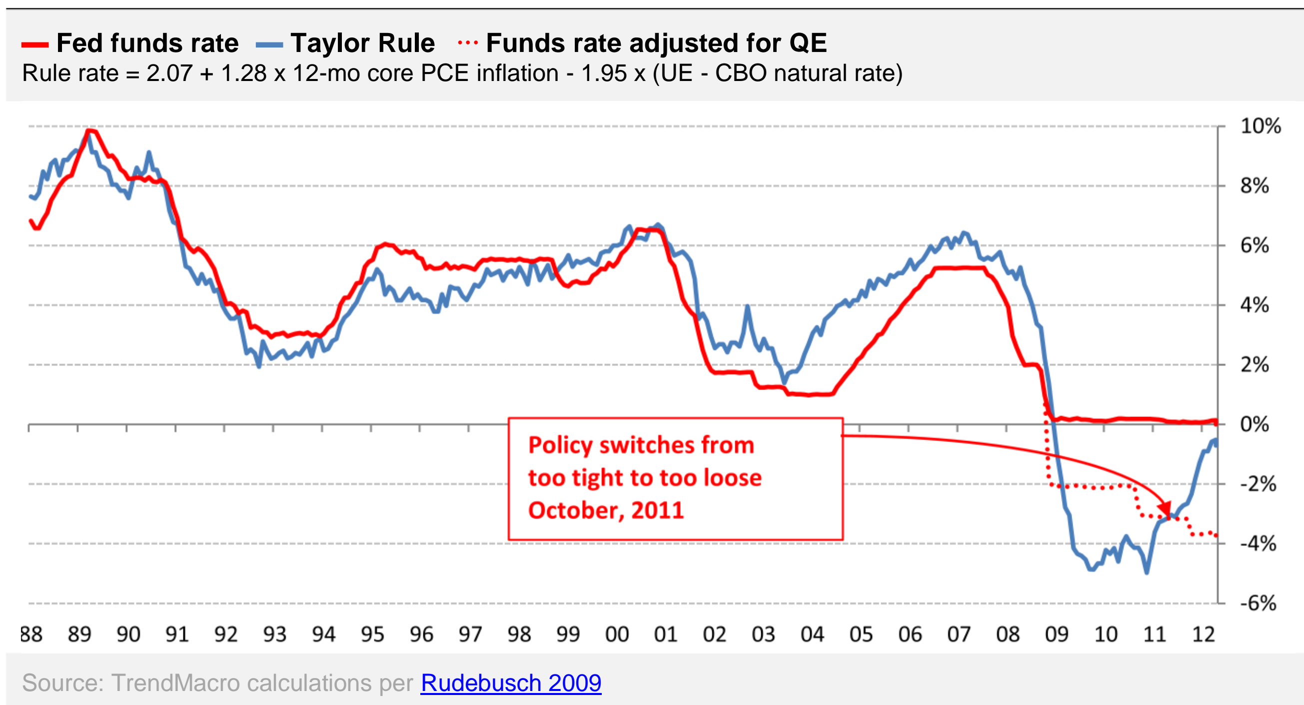
enormous and persistent output gap (see "Testing 1, 2, 3" September 7, 2011) -- and from that position, it's hard to actually *fall* absent some kind of major systemic shock.

At the same time, obviously, it's hard to actually *rise* -- and that brings us to the Fed. Gold rising $70 following the jobs report says it all (see "Is Gold Changing Its Mind?" May 18, 2012) -- QE3 is coming, and probably this month. All the pieces -- macroeconomic and political -- have been in places for some time (again, see "On the March FOMC"). Now it's official -- this is the third strike for the labor market (see "On the April Jobs Report" May 4, 2012 and "Bad Friday for Jobs" April 9). The only thing in doubt is the details.

- Today's uptick in the unemployment rate to 8.2% from 8.1% lowers the fed funds rate prescribed by the version of Taylor Rule that the Fed now uses (please see the chart below). With inflation rates falling in the US and worldwide, we would expect that the FOMC will think of the prescribed rate as even lower.



- But none of those details matter. It's an election year, and highly influential ultradoves Janet Yellen and William Dudley -- both Democrats -- have had their minds made up for some time already.
- Last week some headline reports of a CNBC interview with Dudley had him saying that QE is currently unnecessary. But the same day Dudley gave a speech in which be lovingly defended the Taylor Rule's prescription -- by way of justifying past QE -- but with respect to the future went on to proclaim it irrelevant: "I do not believe that simple policy rules can take the place of in-depth analysis of economic conditions… they cannot capture all information that is relevant for policymaking. For example, such rules cannot easily incorporate asymmetric risks or financial stability issues."

- That "example" was no coincidence. For Fed critics who argue -- not without merit -- that monetary policy can't create jobs, three back-to-back lousy employment reports isn't enough to justify the extraordinary step of even more QE. But the renewed bout of "financial stability issues" triggered by the threat of Greece leaving the euro is a *force majeure* that perhaps we can all agree to. The Fed has prepared the ground for this, with every FOMC statement since last September's warning of "significant downside risk" arising from strains in global markets.

Bottom line

Today's jobs numbers had one saving grace -- the labor force recovered its losses of the prior two months and has moved to a new all-time high. But the headline numbers were awful. Fully contextualized, small changes in headline payroll gains like this morning's -- however disappointing -- are the new normal, and in that sense no big deal. Nevertheless, this makes three bad jobs reports in a row, and all the excuse the Fed needs to announce some form of new easing at the June FOMC meeting.