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TRENDMACRO LIVE!

On the November Jobs Report

Friday, December 7, 2012

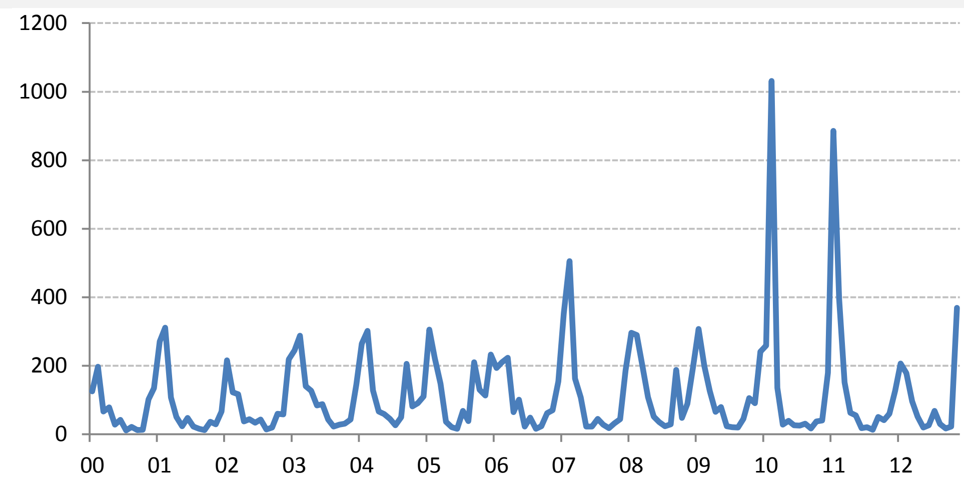
Donald Luskin

A seemingly stronger economy allows cliff brinksmanship, and makes a GOP cave likelier.

This morning's Employment Situation report was an upside surprise. We don't mean to dismiss it -- we'll take good news wherever we can find it -- but there is less to it than meets the eye.

- The reported gain of 146,000 payroll jobs was against a base lowered by a 49,000 downward revision to the two previous months. That said, the revisions were almost entirely in the government sector.
- The drop in the unemployment rate to 7.7%, a new cycle low, was achieved entirely by a reduction in labor force of 350,000. That reduction was the sum of 122,000 employed *and* 229,000 unemployed leaving the labor force.
- No doubt these numbers were impacted by Hurricane Sandy. 347,000 more persons than last month reported they were unable to work because of weather (please see the chart below). But though temporarily unemployed, it's not likely that they entirely dropped out of the labor force.

Persons not at work due to bad weather NSA



Source: BLS TrendMacro calculations

- The labor force is now 4.4 million below trend, and the participation rate has fallen to 63.6%, just 0.1% above the cycle low in August.

Update to strategic view

US MACRO, US FED: A good jobs report, but not the great one that the economy needs to pull out of the Not So Great Expansion and get back to trend output. At the margin, by giving the impression that the economy is strong, it encourages more brinksmanship in the fiscal cliff negotiations, and slightly blunts the argument that the economy is too weak to withstand higher taxes on top earners. We don't see it staying the FOMC's hand next week -- we expect the announcement of new asset purchases to replace the expiration of "operation twist."

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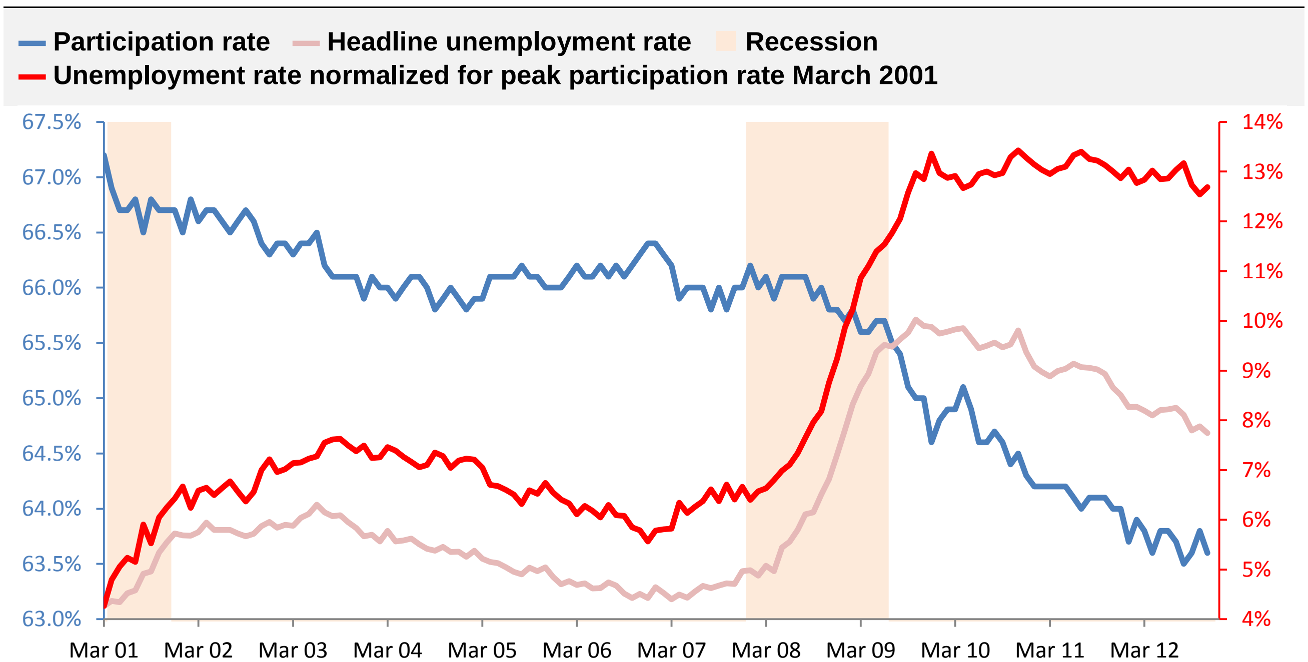
- Adjusting for the secular decline in participation from its peak in 2000, the unemployment rate can actually be understood as 12.7% (please see the chart below). This higher adjusted unemployment rate *does not include* discouraged workers, involuntary part-time workers and so on, which would make it higher still.
- The inescapable fact is that this is a *good* jobs report when we need a *great* jobs report. We had a Great Recession. Yet this is still a Not So Great Expansion. At this rate, we'll never catch up to trend output.

Perhaps the most meaningful element of this morning's jobs report is that it may have some influence on the outcome of the fiscal cliff negotiations. In the same sense, we watched the September and October jobs reports primarily for their impacts on our election forecast (please see "On the September Jobs Report" October 5, 2012, and "On the October Jobs Report" November 2, 2012).

- Yesterday Democrats indicated that this jobs report would determine their insistence on a so-called stimulus program being included in a negotiated package. As this report will generally be regarded as evidence of a strong economy, it would count against more stimulus.
- More critically, at the margin it blunts arguments that the economy is too fragile to withstand higher taxes on high earners, or for that matter withstand a protracted negotiation -- just the arguments used to extend the Bush-era tax rates in 2010 (see "Good Week for Growth" July 26, 2010). Sadly, then, this morning's data moves events in the direction of more brinksmanship in the negotiations, and toward higher likelihood that the GOP will ultimately cave (see "What If the GOP Caves?" December 3, 2012).



Source: BLS, NBER, TrendMacro calculations

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Finally, we doubt that this report will have much impact on the Federal Reserve at next week's FOMC meeting. We continue to believe that their purpose in engineering QE3 was to "put foam on the runway" ahead of a destabilizing fiscal cliff negotiation, or indeed ahead of a fall off the cliff (see "On the October FOMC" October 24, 2012). We would expect the FOMC to announce next week that it will replace today's $45 billion/month asset swaps under "operation twist" with outright purchases.

Bottom line

A good jobs report, but not the great one that the economy needs to pull out of the Not So Great Expansion and get back to trend output. At the margin, by giving the impression that the economy is strong, it encourages more brinksmanship in the fiscal cliff negotiations, and slightly blunts the argument that the economy is too weak to withstand higher taxes on top earners. We don't see it staying the FOMC's hand next week -- we expect the announcement of new asset purchases to replace the expiration of "operation twist."