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TRENDMACRO LIVE!

On the March Jobs Report

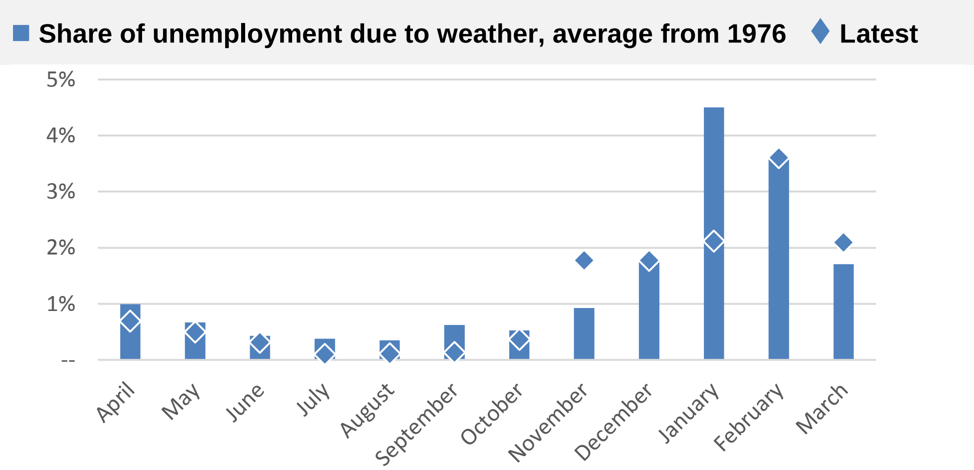
Friday, April 3, 2015

Donald Luskin

Payrolls fall to earth, while hourly wages climb. Will Yellen see this as "full employment"?

This morning's Employment Situation report was a major miss, with 126,000 net payroll jobs reported versus consensus expectations for 245,000. And there were significant downward revisions totaling 69,000 for the prior two months, which had seemed at the time like blockbusters.

- *There's no way around it. This was a lousy jobs report, and it confirms other signals that the US economy is going soft. It increases our concern that the rollover in S&P 500 forward earnings from its peak six months ago is pointing to heightened risk of recession* (see "Houston, You're the Problem" March 9, 2015).
- Our thesis has been that economic distress has been radiating out from the energy sector. Oddly, that isn't well supported in this morning's numbers, in which oil and gas production and pipeline transport jobs slightly increased.
- There could be some element of statistical noise here, too. We have been pointing out since the November jobs report that the strong payroll numbers feel "off" -- they haven't matched up in our prediction model with other employment indicators such as ADP payrolls or ISM employment indices (see "On the November Jobs Report" Friday, December 5, 2014).
- And weather is probably a factor here too (please see the chart below), with a greater than average share of unemployed persons



Source: BLS, TrendMacro calculations

Update to strategic view

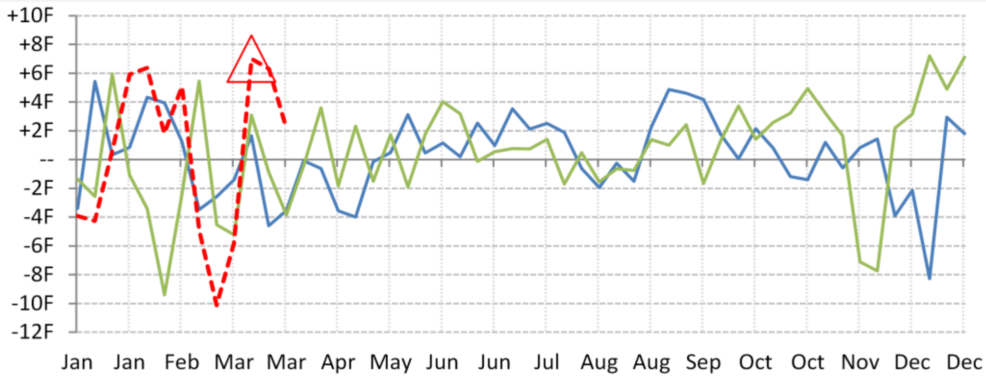
US MACRO, US FED: A big jobs miss, on top of sharp downward revisions to the prior two months. The big March miss may have been at least partially weather-related. But with the revisions, it brings payrolls back in line with other labor market indicators that had been less exuberant. Worryingly, it fits in with our fear that distress in the energy sector is radiating into the whole economy, heightening the risk of recession. The one bright spot was the uptick in average hourly earnings, which in tandem with the slowdown in the rate of payroll growth, could make Yellen think we're at "full employment." But in a speech last week she gave new forward guidance, setting liftoff at "later this year" -- which sounds too much like "late this year." We're backing off our long-standing expectation that the first hike would come in June.

[Strategy Dashboard home]

attributing their joblessness to weather.

- The "reference week" for the Bureau of Labor Statistics' collection of employment data was the second week of March, during which national temperatures were considerably above the historical average. However that week followed three in which temperatures were extremely low, indeed even lower than in last year's frigid winter (please see the chart below).

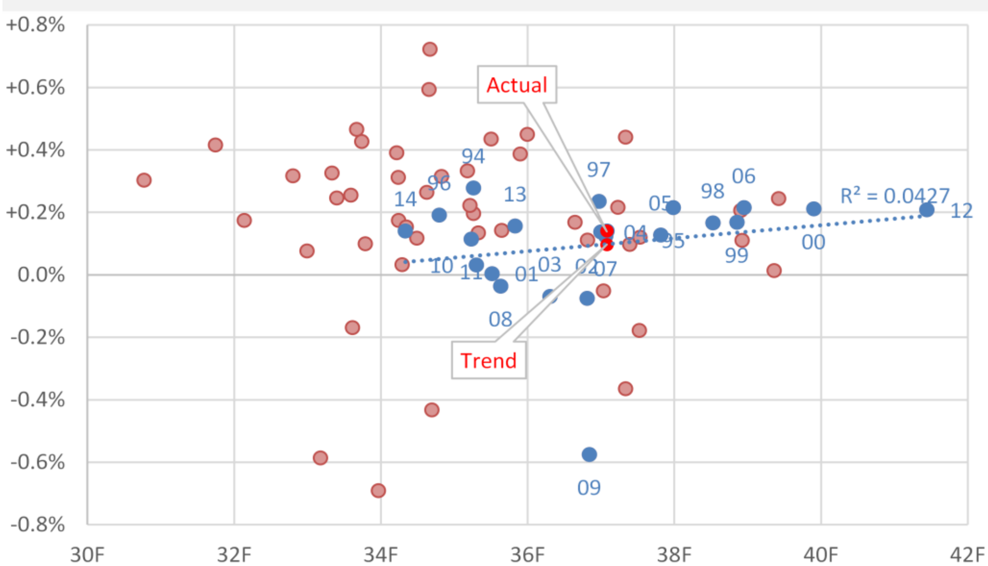
Weekly 48-state temperature versus 1981-2010 mean
— 2013 — 2014 --- 2015 △ Reference week



Source: National Climatic Data Center, TrendMacro calculations

- But looking across the entire quarter, the average temperature for was 37 degrees -- approximately normal, and warmer than last year's 34.4 degrees. After this morning's miss and the sharp downward revisions for January and February, payroll growth for the quarter overall remains at about what we'd expect given the weather -- just a bit above (please see the chart below).

Change in payroll jobs, Jan-Feb-Mar average versus year-end (Vertical)
Mean 48-state temperature Jan-Feb-Mar (Horizontal)
• 1994-2014 • 1948-1993 • Latest



Source: National Climatic Data Center, TrendMacro calculations

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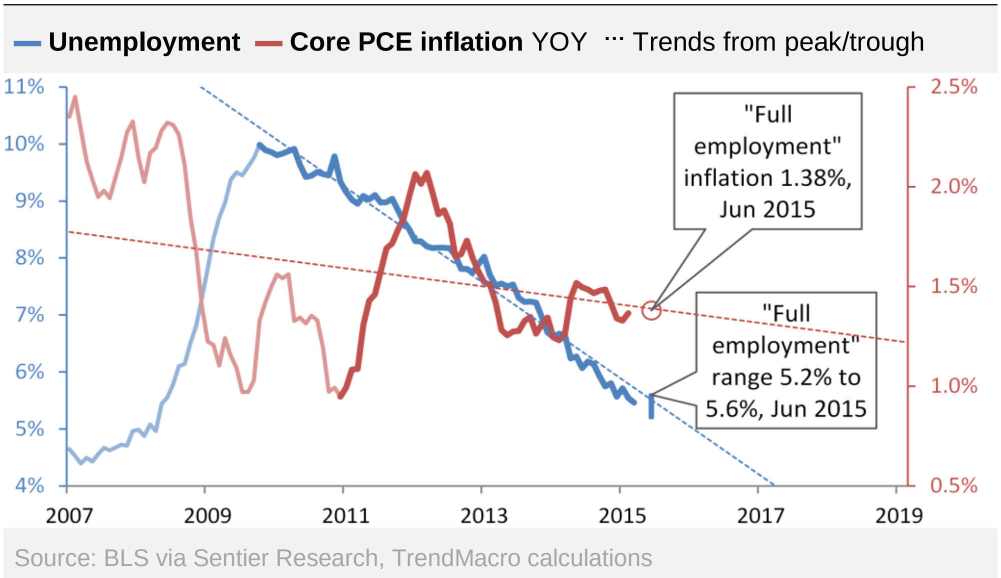
So what does this mean for the Fed?

- By the numbers -- unemployment and core PCE inflation -- all the trends are perfectly intact for "liftoff" at the June FOMC, as we've long expected (please see the chart below).



Source: BLS via Sentier Research, TrendMacro calculations

- But as has been discussed *ad nauseam*, the unemployment rate is only as low as it is because of poor labor force participation. Indeed in this morning's report, the unemployment rate fell slightly, reported unchanged as a rounded 5.5% -- but that's only because the labor force contracted by 96,000, more than all of whom were unemployed (see "Data Insights: Jobs" April 3, 2015).
- In a speech by Fed Chair Janet Yellen a week ago, she almost seemed to wave away this element of concern, saying that labor force participation was only "somewhat lower than I would expect."
- *Yellen seemed more interested in the possibility that "continued improvement in the labor market" would bolster her "confidence in the inflation outlook" through rising wages. And as it turns out, about the only sign of strength in this morning's report was the one datapoint the Fed probably cares the most about -- there was a nice increase of 0.3% in average hourly earnings.*
- There could be a narrative going on in her head that this morning's slower payroll growth, in combination with that uptick in hourly earnings, is exactly what you'd expect see in the neighborhood of "full employment."
- But that's probably overthinking it. Her speech last week was virtually a hymn to "secular stagnation," and appropriately enough it was given at a San Francisco Fed conference ominously titled "The New Normal Monetary Policy."
- She couldn't have made it clearer in the speech that she and the bulk of the FOMC are deeply bought into the need for a permanently lower-than-normal funds rate even when, by the numbers, the economy appears to be fully normal (see, among many, "The Yellen Rule is Taylor Minus Two" May 19, 2014, and "The Fed's Growth-Friendly 'Dot' Gap" September 19, 2014).

- And four times in the speech -- plus one more time in the extensive footnotes, just for good measure -- she referred to liftoff as coming "later this year." How can we not regard this as a strong form of extra-curricular forward guidance? *And "later this year" sounds to the ear a lot like "late this year" -- especially on the fifth hearing.*
- *All in all, this morning's jobs data -- in combination with our heightened sensitivity to the risk of recession* (again, see "Houston, You're the Problem") *and Yellen's new forward guidance -- is leading us to think that liftoff will now likely be deferred until some FOMC meeting after June's.*

Bottom line

A big jobs miss, on top of sharp downward revisions to the prior two months. The big March miss may have been at least partially weather-related. But with the revisions, it brings payrolls back in line with other labor market indicators that had been less exuberant. Worryingly, it fits in with our fear that distress in the energy sector is radiating into the whole economy, heightening the risk of recession. The one bright spot was the uptick in average hourly earnings, which in tandem with the slowdown in the rate of payroll growth, could make Yellen think we're at "full employment." But in a speech last week she gave new forward guidance, setting liftoff at "later this year" -- which sounds too much like "late this year." We're backing off our long-standing expectation that the first hike would come in June.