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TRENDMACRO LIVE!

On the January Jobs Report

Friday, February 1, 2019

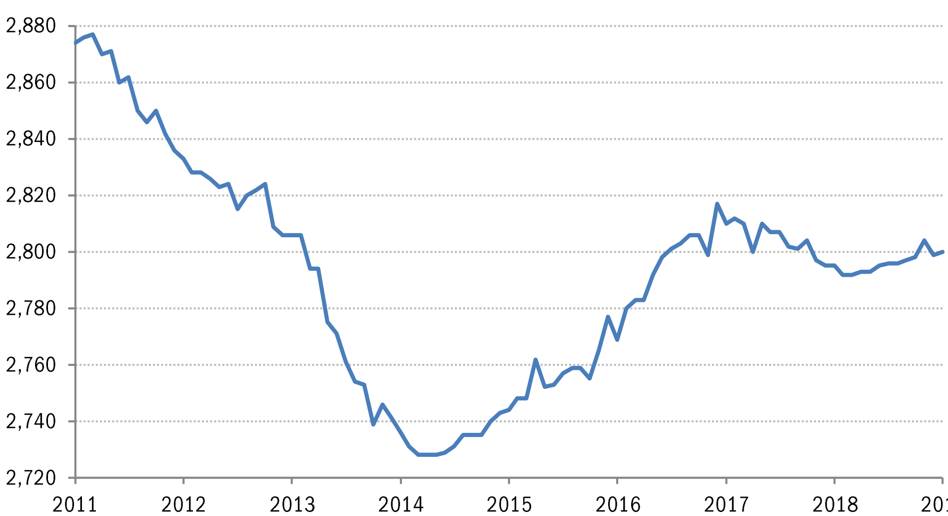
Donald Luskin

A messy beat, but a big one, showing the economy has been robust to the Q4 threats.

It's especially hard to separate signal from noise in this morning's January Employment Situation report, because of a number of reasons all coming at once. *But on the face of it, it was a huge beat*, with net nonfarm payrolls growing by 304,000 versus consensus expectations for only 165,000 (see "On the January FOMC" January 30, 2019).

- Because the report falls on the very first day of the new calendar month, we don't have the full panoply of alternate contemporaneous labor market indicators against which to benchmark this morning's payrolls. Based on what we do have, we were prepared for a beat – we were expecting something like 202,000 net payrolls – but nothing like what was actually reported.
- Most of the chatter this morning is about the possible impact of the partial government shutdown. Because federal workers continue to get paid while furloughed, if only in arrears, they are not counted as being off payrolls. Indeed, the number of federal payrolls actually increased in January by 1,000 (please see the chart below).
- However in the "household survey," where employment status is self-reported, they may mistakenly characterize themselves as unemployed, and this may have contributed to the uptick in the

US payrolls: Federal government employees Thousands



Source: BLS, TrendMacro calculations

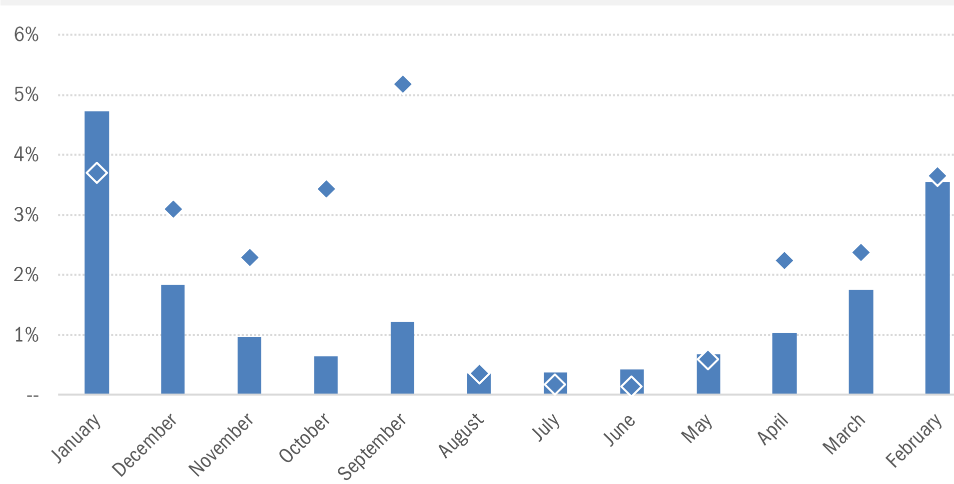
Update to strategic view

US MACRO, US FED: Today's 304,000 net payrolls were a big beat, that can't be explained away by revisions to prior months. But with the shutdown, the weather, benchmark revisions and changes in seasonal adjustment factors, there's as much noise as signal in these numbers. The uptick in the unemployment rate might be explained by mis-reporting of furloughed federal workers. And some payroll gains might be explained by lower-than-average unemployment due to weather, following four month of greater-than-average. Weak average hourly earnings only confirm the "patience" of the newly dovish Powell Fed. At least directionally, this all validates that the economy has been robust to the several large risk factors that emerged in the fourth quarter, and is good position as those factors continue to ameliorate as they have in January.

[Strategy dashboard]

unemployment rate to 4.0% from 3.85% (as was believed to have happened in the 2013 shutdown).

- *Revisions to the prior two months don't explain the big beat.* November payrolls were revised higher by 97,000 (including upward changes to earlier months, thanks to the annual benchmark revisions), taking some of the odor of recession off that dismal report (see "On the November Jobs Report" December 7, 2018). But adjusted for that, December's red-hot payroll gains (see "On the December Jobs Report" January 4, 2019) were revised *lower* by 90,000. So January's big gains seem like they stand on a platform that, on net, was hardly revised at all.
- Yet that seemingly stable platform was the result of a hodge-podge of new data, changed seasonal-adjustment factors and benchmark revisions.
- *If weather was a factor in January payrolls, it was a positive one.* It's hard to believe, writing this report from frigid Chicago. But the share of unemployment due to weather actually swung from far *above* average from September to December to notably *below* average for January (please see the chart below).



Source: BLS, TrendMacro calculations

- *We doubt Jerome Powell's born-again-dovish Fed will find much to fret about in this morning's big payroll beat* – especially as Wednesday's FOMC seemed to be turning its face from unfounded Phillips Curve notions that low unemployment causes inflation risks (see "On the January FOMC" January 30, 2019).
- But even for Phillips dead-enders, the uptick in the unemployment rate takes some of the edge off. More critical, average hourly earnings grew only 0.11% in January, and that off a December base that was revised lower by 0.04%. That's the worst monthly gain since October 2017. Powell's "patience" is not threatened.

All in all, this report strikes us as pretty much of a mess – an attractive mess on the surface, but still a mess. At least *directionally* it validates the

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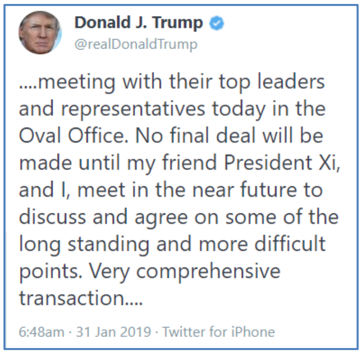
[About us]

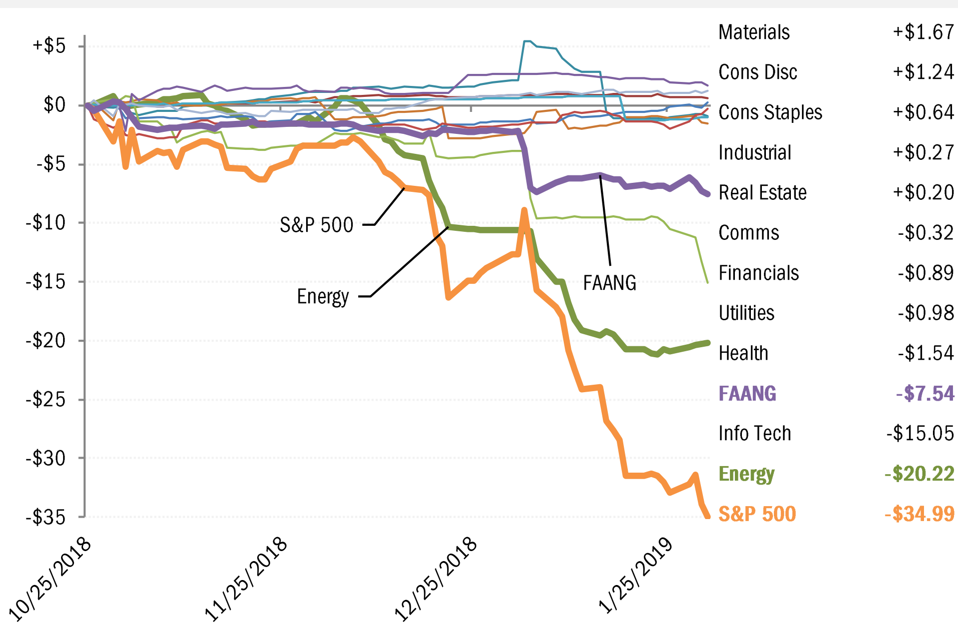
improved tone in markets in the New Year, which appears itself to validate our sense that we're moving toward positive resolution of the several significant risk factors that we've identified as conspiring to erode the confidence necessary for growth (see "2019 Outlook: Confidence Rots from the Head Down" December 31, 2018).

- Loose cannon Fed Chair Powell has definitely cut a deal with the Trump administration, or at least he's acting like he has (see "Next Stop on the Jay Powell Apology Tour" January 28, 2019).



- A trade deal with China seems to be coming increasingly into focus, with President Donald J. Trump now advertising another in-person meeting with Chinese President Xi Jinping to wrap things up – while Chinese Vice President Liu He stands in the White House, staring ahead compliantly, while US head negotiator Robert Lighthizer brazenly tells the press (twice) that the negotiations now are about "enforcement, enforcement, enforcement" (see "On the Margin: True Fake News on China Trade" January 18, 2019). It's pure opportunity that media reports claim this week's Washington negotiating talks "failed."
- After a 45% bear market, oil has enjoyed a 31% bull market, which has taken some of the pain out of credit spreads and inflation break-evens – significantly contributing to a loosening of financial conditions. Downgrades in the US energy sector have stopped, which takes the worst of the pressure off the rollover in S&P 500 forward earnings that, more than anything else, in our minds at least raises a specter of recession risk to late in 2019 (please see

Change in S&P 500 forward earnings from October 25 USD billions



Source: Bloomberg, TrendMacro calculations the chart below, and “Recession Risk at Last?” November 20, 2018).

- Some degree of confidence seems to be returning with respect to the FAANG stocks, and to the poster-children for over-leverage worries such as General Electric. Downgrades have stopped in the FAANG stocks, but they have continued for other companies in the tech sector. The critical test will be to see, as the risk factors we’ve identified continue to heal, whether all the downgrades stop and upgrades start to take their place.

Bottom line

Today’s 304,000 net payrolls were a big beat, that can’t be explained away by revisions to prior months. But with the shutdown, the weather, benchmark revisions and changes in seasonal adjustment factors, there’s as much noise as signal in these numbers. The uptick in the unemployment rate might be explained by mis-reporting of furloughed federal workers. And some payroll gains might be explained by lower-than-average unemployment due to weather, following four month of greater-than-average. Weak average hourly earnings only confirm the “patience” of the newly dovish Powell Fed. At least directionally, this all validates that the economy has been robust to the several large risk factors that emerged in the fourth quarter, and is good position as those factors continue to ameliorate as they have in January.