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TRENDMACRO LIVE!

On the October Jobs Report

Friday, November 5, 2021

Donald Luskin

On track to reattain the pre-pandemic unemployment rate by April 2022. But not "inclusively."

The 531,000 net payrolls reported in this morning's October Employment Situation report isn't quite the beat it seems versus the consensus expectation for 450,000. In fact, it's a miss considering the large upward revisions of 235,000 across September and August. At least that means those weren't the big misses they seemed to be at the time. The revision-adjusted 296,000 is very close to our model estimate of 317,000, so we tend to think it's real (for the methodology and the inputs, see "Data Insights: Jobs" November 5, 2021).

- What does this mean for the Fed's appraisal of whether the economy is at "inclusive maximum employment" – the criterion for lift-off from the near-zero funds rate that was discussed so intensely in the press conference following Wednesday's FOMC (see "On the November FOMC" November 3, 2021)?
- In terms of the unemployment rate, which fell overall to 4.60% from 4.76%, *today's jobs report is precisely on track with our projection for a return to the pre-pandemic unemployment rate of 3.48% by April 2022, the first-order criterion for lift-off* (see "Video: What you're not hearing about the Fed's liftoff from zero policy rates" October 26, 2021).
- *But that progress wasn't "inclusive"* – which means it isn't similarly on track to meet one of Fed chair Jerome Powell's important second-order criteria. *White unemployment fell by 0.20%, above the headline aggregate. But unemployment fell far less for blacks (0.09%), Latinos (0.04%) and Asians (0.04%), and for those with no college (0.05%)* (again, see "Data Insights: Jobs").
- These generally least-skilled most-disadvantaged segments of the labor market have been the ones most subject to the perverse incentives of enhanced and extended unemployment benefits. These effectively paid the lowest-wage workers more not to work than to work, at the same time as there are a record number of jobs available. These benefits have rolled off since June in 25 states (all with Republican governors) who opted-out before the national September 6 sunset date. *In September, the most recent month for which state-level data is available, those opt-out states gained net payrolls at more than three times the rate of those who did not opt out*. It's too soon to see the effects of the benefits expiring in the remaining states in September. We're sure that in the fullness of

Update to strategic view

US MACRO, FEDERAL RESERVE: The headline gain of 531,000 net payrolls is inflated by upward revisions of 235,000 to the prior two months, which means they were not the big misses they seemed at the time. The drop in the headline unemployment rate is precisely on track with our expectations for a return to the pre-pandemic level by April 2022. But that likely does not meet the Fed's "inclusive maximum employment" criterion for lift-off, with the improvement coming predominantly among whites. The 104,000 expansion of the labor force is also on track, implying pre-pandemic levels won't be reached until 2024. Wage gains moderated from last month's scorching pace, which should help inflation expectations to continue to relax (whether or not wages even have anything to do with inflation). Market-implied expectations for lift-off in September 2022 have already pushed out from July. They may be well-tuned for the post-pandemic boom we are forecasting, but at the present pace, they need to be pushed out further.

time we will see that this benefit policy played a large role in keeping the post-pandemic labor market recovery from being more inclusive.

- *The labor force grew by a mere 104,000*, despite having come into October 3.1 million below its pre-pandemic level. This, too, is on track with our projection – which would mean (if this pace continues) that the labor force won't fully recover for almost three years. If that's the definition of "maximum employment" – and on Wednesday Powell said that it was at least a part of it – *then market expectations for lift-off in September 2022 ought to be pushed out in time. Given our ongoing call for a durable post-pandemic boom, we're not saying lift-off will be deferred three years. But September 2022 (and markets were even implying July earlier this week) seems overly aggressive.*
- We note that market-based inflation expectations have fallen notably over the last week, even before the FOMC doubled down on its "transitory" call Wednesday. This, too, takes some pressure off expectations for the timing of lift-off. So does the fact that yesterday the Bank of England decided not to hike rates, with Governor Andrew Bailey voting with the 7-2 majority, despite having virtually promised a rate hike just two weeks ago (again, see "On the November FOMC").
- Inflation fears should calm further with the 0.36% growth in average hourly earnings reported this morning. That's a healthy 4.4% annual rate, down from September's more alarming 7.3%. Further, most of the wage gains occurred among workers who changed jobs – suggesting an increasingly *dynamic* economy actively optimizing its use of human capital, not just one in which firms must offer excessive wages to lure workers from subsidized unemployment (again, see "Data Insights: Jobs"). To be clear, we've never subscribed to the belief that higher wages are *ipso facto* inflationary – but that's something a lot of people in markets believe. So even if it's wrong, it may inform market-based expectations which themselves become self-fulfilling.

Bottom line

The headline gain of 531,000 net payrolls is inflated by upward revisions of 235,000 to the prior two months, which means they were not the big misses they seemed at the time. The drop in the headline unemployment rate is precisely on track with our expectations for a return to the pre-pandemic level by April 2022. But that likely does not meet the Fed's "inclusive maximum employment" criterion for lift-off, with the improvement coming predominantly among whites. The 104,000 expansion of the labor force is also on track, implying pre-pandemic levels won't be reached until 2024. Wage gains moderated from last month's scorching pace, which should help inflation expectations to continue to relax (whether or not wages even have anything to do with inflation). Market-implied expectations for lift-off in September 2022 have already pushed out from July. They may be well-tuned for the post-pandemic boom we are forecasting, but at the present pace, they need to be pushed out further.

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