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TRENDMACRO LIVE!

On the January Jobs Report

Friday, February 4, 2022

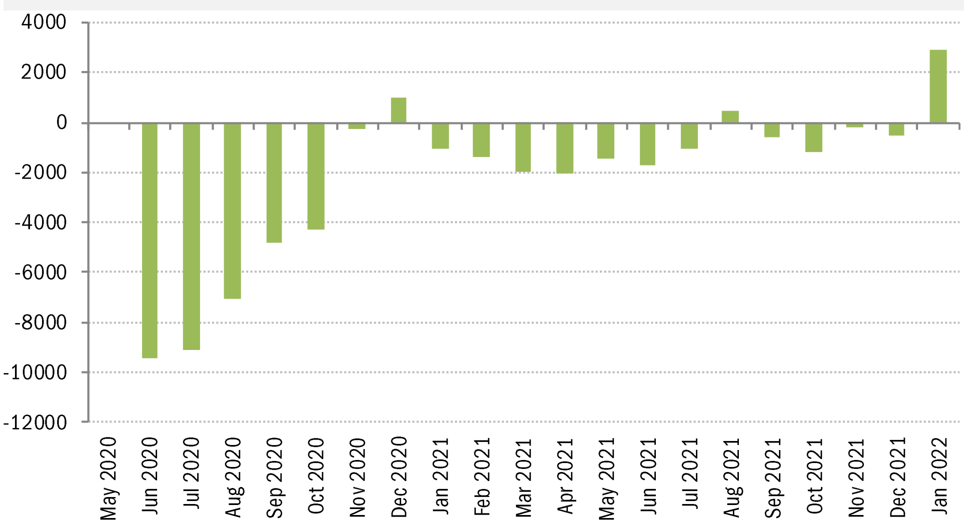
Donald Luskin

A payroll blowout is flatly contradicted by employment contraction in the household survey.

We have to begin by acknowledging that we were wrong in calling for a payroll contraction for January (see "War on Two Fronts: Ukraine and Inflation" January 24, 2022). *That said, the unemployment rate rose for the first time since June, and when we make appropriate adjustments for methodological changes to the "household survey", there was a contraction in both employment and in the labor force, and an increase in unemployment.*

The 467,000 payroll gains reported in this morning's January Employment Situation report fly in the face of consensus expectations for only 125,000, and our model's estimate, based on contemporaneous labor market data, of a contraction of 97,000 (for the model inputs and other labor market indicators, see "Data Insights: Jobs" February 4, 2022). There were also very large upward revisions to the prior two months' payrolls, possibly in part a function of the annual benchmark revision process (more on this in a moment).

- *What happened?*
- The "payroll survey" would have us believe the labor market is so strong *net* payroll growth could overcome *an increase of 689,000*



Update to strategic view

US MACRO, FEDERAL RESERVE: 467,000 net payrolls flies in the face of contemporaneous labor market data, including the fact that 689,000 more persons report they are shut out of the labor force due to Covid. When "population control" adjustments are taken into account, the household survey reported a 272,000 drop in employment, and a 135,000 gain in unemployment. If payrolls are an anomaly, it may be due to seasonal adjustments – without them, payrolls would have contracted by 2.3 million. The Fed can see both the good news in the payroll survey and the bad news in the household survey. But this is not the palpably weak headline that could deflect lift-off in March. Yet hawkish rhetoric is already dialing down, and when Powell is reconfirmed he will be free to focus again on inclusive maximum employment. One risk is that Powell's reconfirmation could be held hostage to the confirmation of Raskin, the controversial nominee for Vice Chair of Supervision.

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persons who report they are shut out of the labor force due to Covid, the largest increase in the history of the data (please see the chart on the previous page, and again see "Data Insights: Jobs" February 4, 2022)?

- An additional 2.9 million report they couldn't work because of Covid-related business closures. And 6.6 million were driven back to working from home. *Are we really to believe that payrolls grew 467,000 in a month in which these things happened?* It's possible, but we think it's not very likely – the magnitudes involved are a high bar.
- *Is it a technical glitch?* We hate to even suggest it, because it so easily can sound like an excuse for an inaccurate forecast. Nevertheless, it is a reality that seasonal adjustment factors were updated this month, and *without them payrolls contracted by 2.8 million*. January seasonal adjustments are always large, to compensate for winter weather – but this is the biggest January adjustment in history.

Significantly, the "household survey" tells a very different story than the "payroll survey," although you have to look under the surface to see it. This month the household survey underwent its annual adjustment of "population controls" which affect the number of persons estimated to be employed or unemployed, and in or out of the labor force. *Unlike the payroll survey's benchmark revision, the household survey's new population controls do not drive a restatement of past data, so there is always a discontinuity in looking at changes from December to January.*

- *As it turns out in this case, this morning's very strong January changes in all these metrics are illusions driven by this discontinuity* (please see the table below). We know this because the BLS, while not restating its data history, does disclose the magnitude of the discontinuity.

January-over-December change in key labor market metrics

	Employed	Unemployed	Labor force	Participation rate	Unemployment rate
As reported	+1,199	+194	+1,393	+0.3%	+0.9%
Population adjustment	+1,471	+59	+1,530	+0.3%	Unchanged
True change	-272	+135	-137	Unchanged	+0.9%

Source: BLS, TrendMacro calculations

- *Employment fell. Unemployment rose. The labor force contracted. The participation rate was unchanged.*

We had expected this jobs report to act, at least at the margin, as a damper on the Fed's insistence on lifting off from near-zero policy rates at the March FOMC, and as a rationale to continue to dial back their extremely hawkish rhetoric (see "A Turn Signal for the Fed's Off-ramp on the Road to Rate Hikes" January 31, 2022). *This strong payroll data just*

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doesn't help, unfortunately. Yes, the household data cuts the other way. But at the moment, markets seem to be assuming the Fed's course is not getting deflected here. If anything, the opposite. As of this writing, the money-market curve implies a 40% change that lift-off from the near-zero policy rate at the March FOMC meeting will be a double – 50 bp.

- The Fed staff is smart enough to look deeper than headline payrolls, just as we are doing here.
- But right now *it feels impossible to cling to our call that there will be no lift-off at all in March* (again, see (see "War on Two Fronts: Ukraine and Inflation").
- Fair enough – it looks like we got one wrong (we'll see, of course). *But our core prediction here is not for a given move at a given FOMC – it is for the downsizing of what could be a destructive tightening cycle into a mere adjustment cycle. We still stand by that, based in part on this week's significant dialing back of hawkish rhetoric, and emphasis on balance sheet run-off as a benign alternative to rate hikes* (see "A Turn Signal for the Fed's Off-ramp on the Road to Rate Hikes" January 31, 2022).
- That call was based in large part on the belief that the sudden frenzy of inflation-fighting zeal is the product of the need for Jerome Powell to position himself to get Republican support in the process of reconfirming him as Fed chair (see "Jay Powell: Inflation Justice Warrior" December 14, 2021).
- Once he's reconfirmed by the Senate, he's bullet-proof, and he can pursue his heart's true aim of "inclusive maximum employment" without having to act quite so afraid of inflation. *Unfortunately, his reconfirmation won't even be considered in the Senate Banking Committee until February 15, and then it will take place simultaneously with consideration of four other nominees, one of whom is highly controversial* (see "What you're not hearing about Biden's Fed nominees" January 14, 2022).
- We could find ourselves in a hostage-taking situation in which Powell's seemingly shoo-in reconfirmation is held up as leverage to force Republicans to confirm Sarah Bloom Raskin, President Joseph R. Biden Jr's nominee for Fed Vice Chair of Supervision. *The longer it takes, the longer the inflation-warrior talk has to go on – and pretty soon we'll find ourselves at the March FOMC.*
- Cutting against that, tomorrow is the last day of Powell's term as chair. The Federal Reserve Act provides that he can continue as chair *pro tem*, unless replaced, so long as he is a standing Federal Reserve Board Governor, which he will be until 2028. So there's no actually emergency here – the ship will have a captain. But it is unseemly, and provides some political pressure to get Powell reconfirmed, whatever happens to any other nominee.
- In the meantime, here we are, playing out the key risk we spotlighted at the beginning of the year (see "Boom On..." January 4, 2022) – the risk that the Fed will seek to use monetary policy as a blunt instrument to control an inflation that monetary policy didn't cause, and – whether or not the Fed can use this word – is, in fact, transitory.

Bottom line

467,000 net payrolls flies in the face of contemporaneous labor market data, including the fact that 689,000 more persons report they are shut out of the labor force due to Covid. When "population control" adjustments are taken into account, the household survey reported a 272,000 drop in employment, and a 135,000 gain in unemployment. If payrolls are an anomaly, it may be due to seasonal adjustments – without them, payrolls would have contracted by 2.3 million. The Fed can see both the good news in the payroll survey and the bad news in the household survey. But this is not the palpably weak headline that could deflect lift-off in March. Yet hawkish rhetoric is already dialing down, and when Powell is reconfirmed he will be free to focus again on inclusive maximum employment. One risk is that Powell's reconfirmation could be held hostage to the confirmation of Raskin, the controversial nominee for Vice Chair of Supervision.