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TRENDMACRO LIVE!

On the February Jobs Report

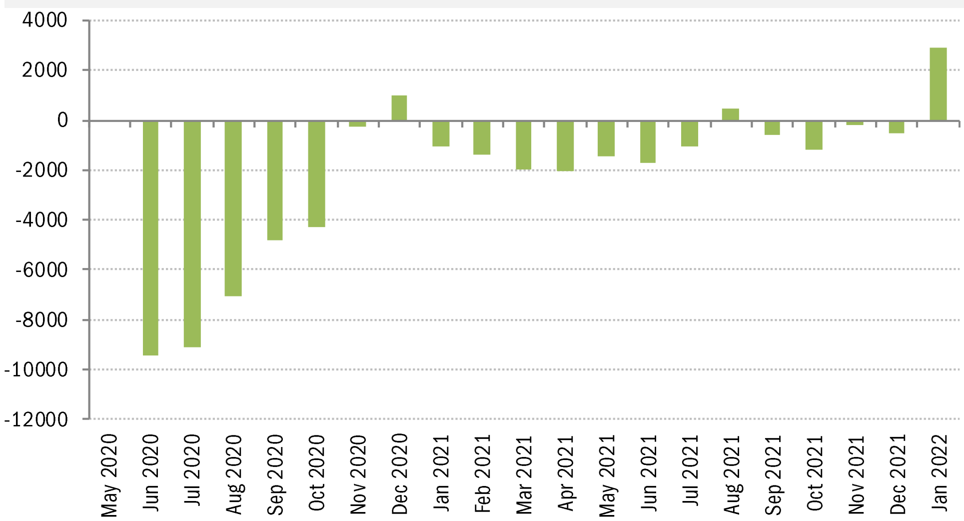
Friday, March 4, 2022
Donald Luskin

Inclusive maximum employment is achieved. Yet March lift-off is now in doubt.

This morning's February Employment Situation report with *678,000 net new payrolls is the second in a row that's too good to be true*. Not only did it far exceed the consensus for 423,000, but is more than doubled our model's projection of 310,000 based on objective contemporaneous labor market statistics (see "Data Insights: Jobs" March 4, 2022). What's worse, January's phantasmagorial gain of 467,000 payrolls in the face of millions sidelined from work due to the Omicron variant wave (see "On the January Jobs Report" February 4, 2022), wasn't revised lower – it was actually revised higher, by 14,000 payrolls.

- Just because it's too good to be true, that doesn't mean it isn't good.
- Compared to December at the height of the Omicron wave, 579,000 fewer workers said they were shut out of the labor force due the pandemic (please see the chart below). So the reported expansion of the labor force of 304,000 is more than reasonable.
- *It is also good news that average hourly earnings grew at only 0.03% on the month, the slowest rate since the worst days of the pandemic lockdown. Stop and consider the juxtaposition of these statistics: 304,000 persons joined the labor force without being*

Shut out of the labor force due to Covid, monthly change



Source: BLS, TrendMacro calculations

Update to strategic view

US MACRO, FEDERAL RESERVE: Another too good to be true payroll gain, with January's revised higher. The labor force expanded as the number of persons sidelined by the Omicron variant fell. Average hourly earnings barely grew at all, at the slowest rate since the trough of the pandemic recession. This is likely because all stimulus payments, unemployment benefits and tax credits ended in December, so firms are no longer in competition to attract labor against government income supports. This should alleviate concerns about a wage-price spiral when February inflation reports higher because of the run-up in oil prices. We are at "inclusive maximum employment." Yet the market-implied probability of Fed lift-off in March is now below 100%, when less than a month ago there was a very strong probability of a 50 bp hike. Powell said this week lift-off is on, but growing uncertainties in Ukraine may yet redeem our January call that lift-off would be deferred.

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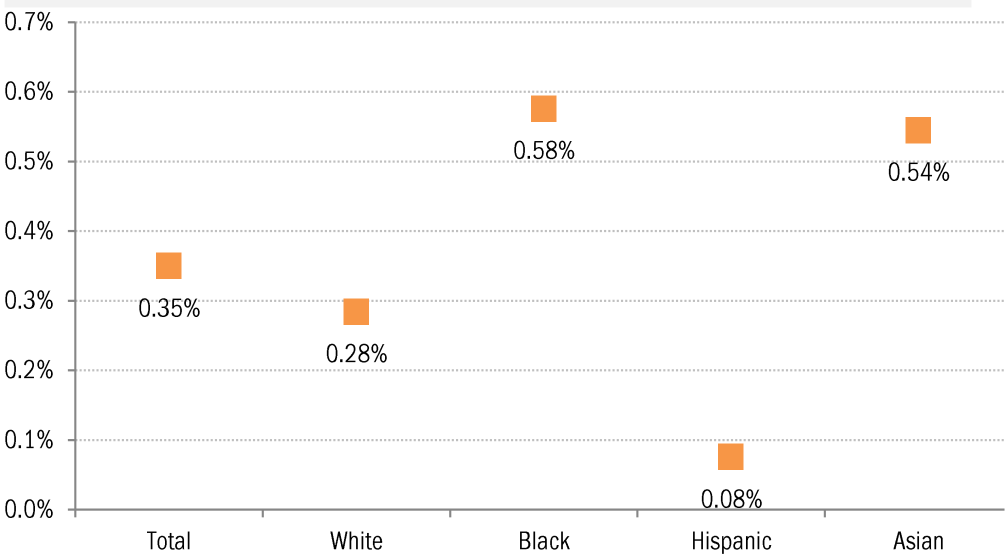
- *bribed by the extravagant wage growth that has characterized the post-pandemic economy.*
- *Astonishing – we are now at "maximum employment" where you'd think wage growth would be the hottest as employers compete with each other for scare workers.*
- *But no. Because now, for the first time since the pandemic, employers are no longer competing with the government.*
- *In December, the last vestiges of pandemic relief and stimulus payments ceased – no stimulus payments, no expanded unemployment benefits, no refundable child credits.*
- *We haven't seen February inflation statistics yet, and they're not likely to be pretty considering the recent run-up in oil prices. Too bad for workers who will pay more but not earn more. But at the same time, it's going to be at least one month's data point in defiance of expectations of a wage-price spiral.*

Of course this all seems strangely irrelevant in light of the potentially highly consequential events unfolding in Ukraine (see, most recently, "More Thoughts on the Ukraine Crisis" March 1, 2022).

- At the Fed – for whom this will be the last jobs report before the March FOMC – *surely today's 3.82% unemployment rate achieves not only mandated "maximum employment" but also the relatively new goal of "inclusive maximum employment."* Overall, the unemployment rate is only 35 bp from its very low level in early 2020 just before the pandemic. It's not much further away for blacks and Asians – indeed, for Hispanics, it's closer (please see the chart below).
- *Even if you still believe (as we do) that inflation is "transitory," the complete recovery of the labor market – and real GDP 3.2% higher than it was in Q4-2019 before the pandemic – justifies a March lift-*

Distance from pre-pandemic unemployment rates



Source: BLS, TrendMacro calculations

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off from what will have been two years of zero policy rates. Any monetary policy rule – even if you input a 2% inflation rate – is going to tell you it's time to lift off (see "Video: What you're not hearing about the coming Fed tightening cycle" February 18, 2022).

- Fed Chair Jerome Powell said the same thing twice this week, first in testimony in the House and again in the Senate.
- *Yet as of this writing, the futures market-implied probability of a March lift off is only 86%, the lowest since January 11. As recently as February 10 it was 180%, implying a drop-dead certainty of lift-off, and indeed a further probability of a 50 bp hike about as great as today's for only a 25 bp hike.*
- Everyone quite reasonably thought we were insane in January when we predicted no lift-off in March when the Ukraine crisis was just beginning to brew up (see "War on Two Fronts: Ukraine and Inflation" January 24, 2022). It's still nothing like an odds-on bet – but it's coming our way.
- We should say: *unfortunately* it's coming our way. *We very much hope we are wrong.*

Bottom line

Another too good to be true payroll gain, with January's revised higher. The labor force expanded as the number of persons sidelined by the Omicron variant fell. Average hourly earnings barely grew at all, at the slowest rate since the trough of the pandemic recession. This is likely because all stimulus payments, unemployment benefits and tax credits ended in December, so firms are no longer in competition to attract labor against government income supports. This should alleviate concerns about a wage-price spiral when February inflation reports higher because of the run-up in oil prices. We are at "inclusive maximum employment." Yet the market-implied probability of Fed lift-off in March is now below 100%, when less than a month ago there was a very strong probability of a 50 bp hike. Powell said this week lift-off is on, but growing uncertainties in Ukraine may yet redeem our January call that lift-off would be deferred.