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TRENDMACRO LIVE!

On the May Jobs Report

Friday, June 3, 2022

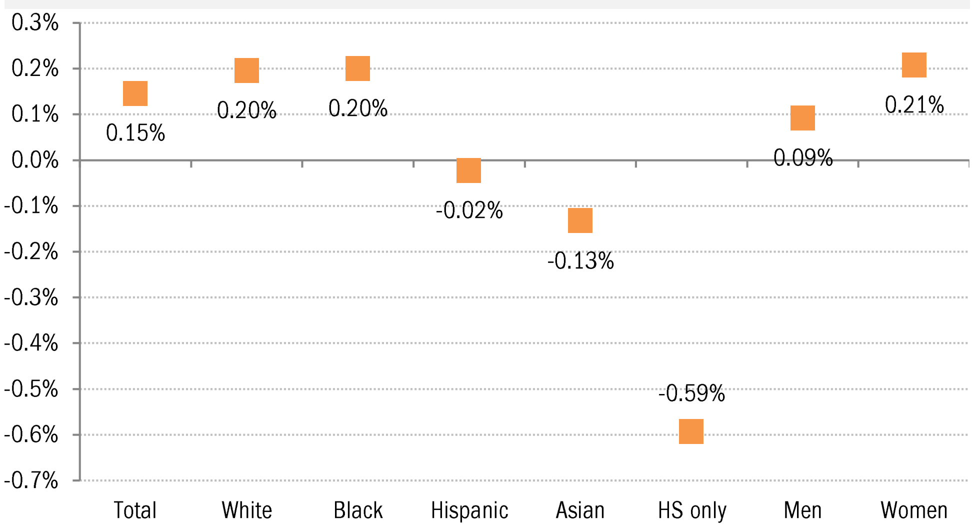
Donald Luskin

Fed-unfriendly? Fortunately the Fed isn't primarily watching jobs now.

This morning's May Employment Situation report with 390,000 net payrolls was a beat versus the consensus for 320,000. It's an even bigger beat versus our estimate for only 124,000 based on a range of contemporaneous labor market indicators (see "Data Insights: Jobs" June 3, 2022). This has become a regular thing – for several months now payrolls have come in significantly stronger than any labor market statistics sourced outside the Department of Labor would suggest.

- The dominant narrative this morning is that this report is not Fed-friendly. That is, yet another strong month for payrolls and wage growth supposedly gives the Fed more fear that the economy is overheating, or at least gives it the maneuvering room to tighten aggressively to fight inflation. We think that misses the mark in several dimensions.
- If it's true that this jobs report indicates a very strong economy, then *the Fed should surely continue toward at least a normal level of policy rates, even if inflation were not a concern*. With the unemployment rate at a post-pandemic low of 3.62%, basically all the way back to the extraordinarily low rate that prevailed before the pandemic (please see the chart below), any standard Taylor

Distance from pre-pandemic unemployment rates



Source: BLS, TrendMacro calculations

Update to strategic view

US MACRO, FEDERAL RESERVE: 390,000 net payrolls is a big beat versus the consensus. Markets are treating it as Fed-unfriendly because it indicates an over-heating economy and gives the Fed room to tighten in order to fight inflation. It only means that as the Fed progresses with its well-expected hiking cycle, that will only be normalizing policy to match a strong economic backdrop. It is expected to happen faster than usual, but then the deep Covid recession of two years ago was the shortest in history – economic time has simply sped up in this cycle. With Powell now safely confirmed as Chair, he has already backed off his pre-confirmation hawkish rhetoric, and announced that he is simply looking for "clear and convincing evidence" that inflation is moderating in order to avoid restrictive policy. The FOMC minutes signal the committee is on the same page. Despite an unusual number of retirements, population growth in young and prime-age cohorts suggests 1.5 million persons who could come back to work.

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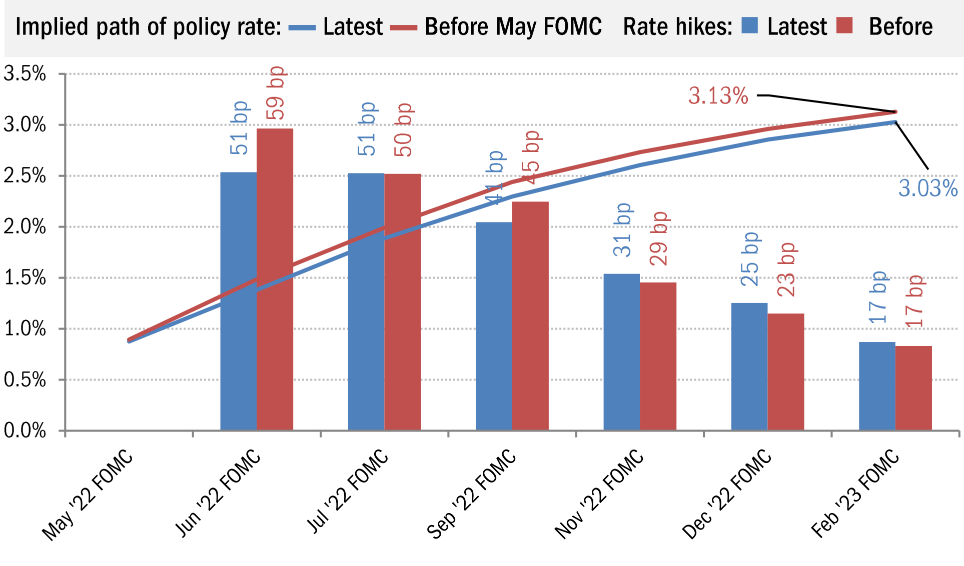
[Rule](#) is going to tell you that todays policy rate of 0.88% is ridiculously low – even if you lie to it and tell it that inflation is just 2% (not 8.2%, as it actually is – see [“Video: What you're not hearing about the coming Fed tightening cycle”](#) February 18, 2022).

- And why shouldn’t the Fed move expeditiously to raise it to a more appropriate level? Markets now expect a 3% funds rate less than a year out, with 50 bp hikes for sure at the next two FOMC meetings (please see that chart below). But *why shouldn’t we have the fastest normalization cycle in Fed history*? Didn’t we just have history’s shortest depression? The world’s clock-speed is just faster now, it seems.



Source: Bloomberg, TrendMacro calculations

- But the Fed’s not primarily looking at jobs reports to set its policy path anyway. Now that Chair Jerome Powell is safely ensconced for a Senate-confirmed second term, he’s already backing off the hawkish rhetoric that earned him that confirmation, as we have long anticipated (see [“Was That Another Powell Bottom?”](#) May 16, 2022). Now he is just watching the inflation rate like a good monetarist of the [19th century Knut Wicksell school](#), looking for “clear and convincing evidence” that it is in the process of moderating (as he said in his first post-confirmation public appearance; see [“Video: What you're not hearing about when inflation is finally going to be transitory”](#) May 24, 2022).
- And then there are the [minutes of the May FOMC meeting](#) – documenting after Powell’s confirmation the discussion at a meeting that took place prior (see [“Data Insights: FOMC Minutes”](#) May 25, 2022). As has become the usual practice for the Powell Fed, the minutes are used to make policy announcements that you’d think would have been mentioned in a given meeting’s statement, or at least in the post-meeting press conference. In this case, the minutes reveal that “clear and convincing evidence” is apparently already on the horizon for a “number of participants [who] observed that recent monthly data might suggest that overall

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price pressures may no longer be worsening."

- Even more significant, there was this in the very last paragraph:

  "In light of the high degree of uncertainty surrounding the economic outlook, participants judged that risk-management considerations would be important in deliberations over time regarding the appropriate policy stance."

- *<u>In other words, after months of foaming at the mouth about inflation as the one and only objective for the Fed now, it turns out that there are balancing interests – such as not destroying the economy with restrictive interest rates in order to save the economy from inflation</u>*.

<u>If the Fed avoids a restrictive policy error – as it looks increasingly to us like it will – there is still plenty of room for the labor market to run.</u>

- It is often said that the labor market is very tight, and that employers can't find enough workers. But if that's true, how could we have added 390,000 payrolls with the eligible population only growing by 90,000?
- Yes, as a headline matter, there are only 410,000 fewer employed persons today than there were before the pandemic. That suggests on the surface that we get one more jobs report like today's, and then we're done. But it's not that simple. In the more than two years since the beginning of the pandemic, the US adult population has grown by 4.1 million persons.
- We understand the offsetting argument that, for some reason, the pandemic experience seems to have driven an unusual number of retirements – shrinking the labor force from what it might have otherwise been. We can infer that clearly enough from the fact that, since just before the pandemic, the US population above age 54 grew by 2.5 million persons, yet the number of labor force participants in that age bracket shrank by 401,000. Comparing that to historical trends, it seems that there were about 800,000 out-of-pattern retirements. By the way, we can't rule out that some of these might be Covid deaths, rather than retirement, considering that fatalities were heavily concentrated among the old.
- Yet at the same time, the number of persons aged 16 to 24 has grown by 406,000 since before the pandemic, with 401,000 fewer of them in the labor force. So that's about 800,000 right there, to replace the 800,000 retirees (and then work a lifetime, not just a few extra years).
- And the number of "prime-age" persons, aged 25 to 54, grew by 1.2 million, with only 469,000 more in the labor force. That's another 700,000 available workers.
- Looks like another 1.5 million potential payrolls. Let's see – with additional normal population growth, that's another five jobs reports as strong as May's.

We say all this to emphasize that there's still plenty of labor market fuel for the productivity-led boom we still believe we are in. And from the Fed's perspective, if one wishes to be worried that a tight labor market *ipso facto* leads to additional inflation, well, it's not quite as tight as it looks.

Bottom line

390,000 net payrolls is a big beat versus the consensus. Markets are treating it as Fed-unfriendly because it indicates an over-heating economy and gives the Fed room to tighten in order to fight inflation. It only means that as the Fed progresses with its well-expected hiking cycle, that will only be normalizing policy to match a strong economic backdrop. It is expected to happen faster than usual, but then the deep Covid recession of two years ago was the shortest in history – economic time has simply sped up in this cycle. With Powell now safely confirmed as Chair, he has already backed off his pre-confirmation hawkish rhetoric, and announced that he is simply looking for "clear and convincing evidence" that inflation is moderating in order to avoid restrictive policy. The FOMC minutes signal the committee is on the same page. Despite an unusual number of retirements, population growth in young and prime-age cohorts suggests 1.5 million persons who could come back to work.