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TRENDMACRO LIVE!

On the July Jobs Report

Friday, August 5, 2022

Donald Luskin

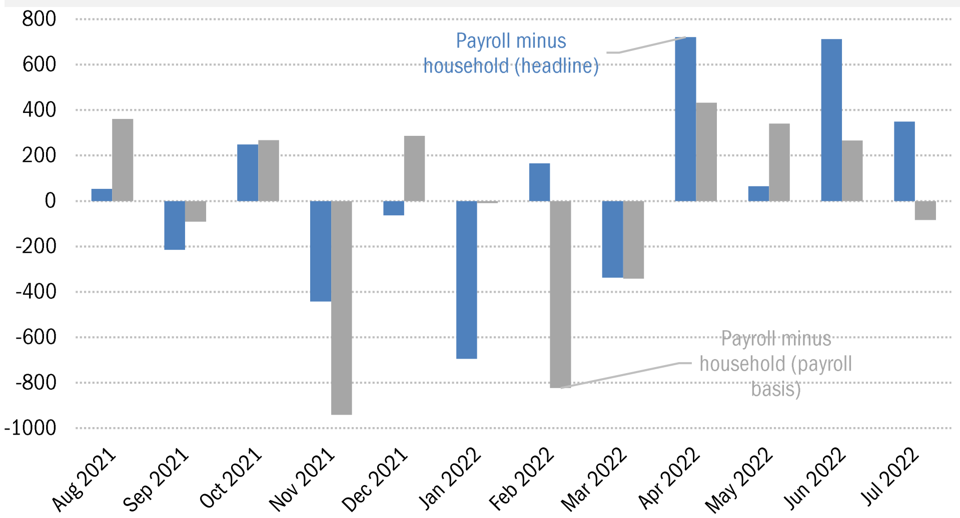
Big payrolls, but the real show is declining openings – off more than 1 million in three months.

This morning's July Employment Situation report with 528,000 net payrolls gained was a blockbuster versus consensus expectations for 250,000, which itself would have been a robust number. The unemployment rate fell to 3.46%, 1 bp below where it was before the pandemic.

We should be thrilled, but the immediate reaction in markets was an upgrading of futures-implied rate hike probabilities for the September FOMC to a 68% chance of a 75 bp move (up from 60% before the jobs report). The implied terminal rate in this hiking cycle was upgraded by 12 bp and moved out from February to March. *We think that won't last.*

- It's ironic, because this jobs report shows that the Fed continues to be relentlessly wrong about the labor market being "extremely tight" (see, among many, "On the July FOMC" July 27, 2022). *A tight labor market can't produce this many payrolls, when only about 90,000 persons join the adult population each month.* So if anything, this ought to cause the Fed to deflect its tightening cycle.
- That said, knowing the Fed under Chair Jerome Powell, they will likely rationalize this as *finally* proving them right – because (they will say) surely – *surely!* – this couldn't possibly happen again. But

Difference between "payroll report" and "household report" (thousands)



Source: BLS, TrendMacro calculations

Update to strategic view

US MACRO, FEDERAL RESERVE: A blockbuster payroll report with 528,000 new jobs. The unemployment rate fell to a new recovery low, 1 bp below where it was just before the pandemic. Markets have immediately assumed this will move the Fed to tighten more aggressively, but that won't last. The "household survey" confirms the payroll number, when adjusted to a "payroll basis" – though seasonal adjustments played a very large role. Large jobs gains prove the Fed wrong again – the labor market is not tight. Tuesday's JOLTS job openings fell again, now off 1.16 million from March's historic peak, the month the Fed lifted-off the funds rate from zero. The contraction of openings, in just three months, is more than half that seen in the last two recessions. That's Powell's go-to indicator for labor tightness. With that, and two CPI reports likely to show sharply decelerating inflation, we reiterate our call for only a 25 bp hike at the September FOMC.

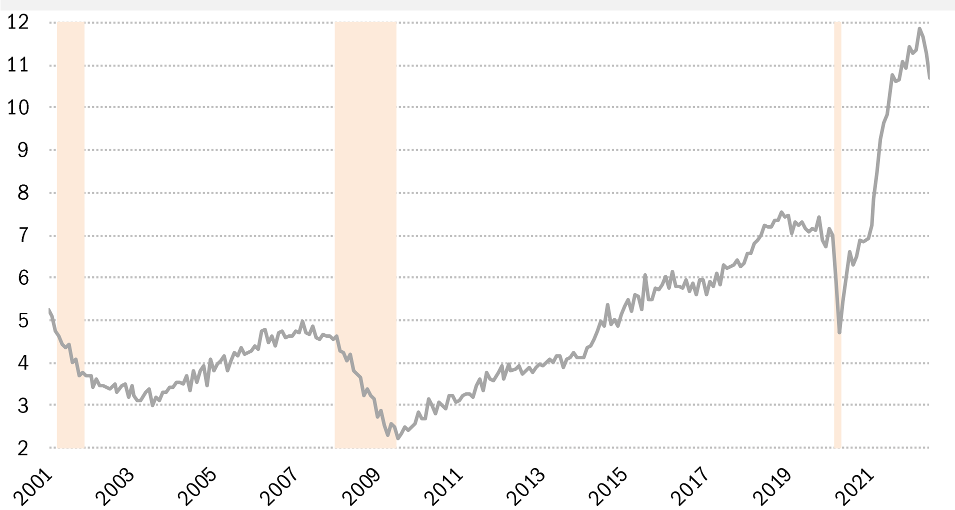
[Strategy dashboard]

then they've been saying that all year, and it just keeps happening (indeed, seven months into the year, and with 2.7 million new payrolls already, this is the second largest payroll gain).

- And perhaps we should be suspicious anyway considering that, *without seasonal adjustment, payrolls actually contracted by 385,000 in July* (a swing of a mere 913,000 – but ignore that man behind the curtain).
- What is reality? The "household survey" (that measures *people* – as opposed to the "payroll survey" that measures *payrolls*) showed only 179,000 new jobs, a strong but not astonishing number – and the fourth month in a row coming in below payrolls (please see the chart on the previous page). But adjusted to a "payroll basis" (among others, taking account of single workers with multiple jobs), the "household survey" showed 611,000 new jobs, broadly agreeing with the "payroll survey."
- By the way, our go-to method for settling differences is our model based on contemporaneous labor market indicators. For July it agreed more with the "household survey" with 129,000 jobs (see "Data Insights: Jobs" August 5, 2022). Unfortunately, this isn't entirely useful, because ADP has "paused" publication of its monthly payroll statistics, so our model is stuck using a key data-point now two months out of date.

But the labor market statistic we are most interested in right now – and perhaps the one Powell is focused on most intensely – was not included in this morning's report. It was released Tuesday – the Bureau of Labor Statistics' Job Openings and Labor Turnover Survey (JOLTS), updated with data through June.

- Powell just can't stop talking about the record number of unfilled job openings. It's supposed to be his drop-dead proof that the labor market is historically tight.
- *But openings are no longer at their recent highs.* In fact, the peak



Source: BLS JOLTS, TrendMacro calculations

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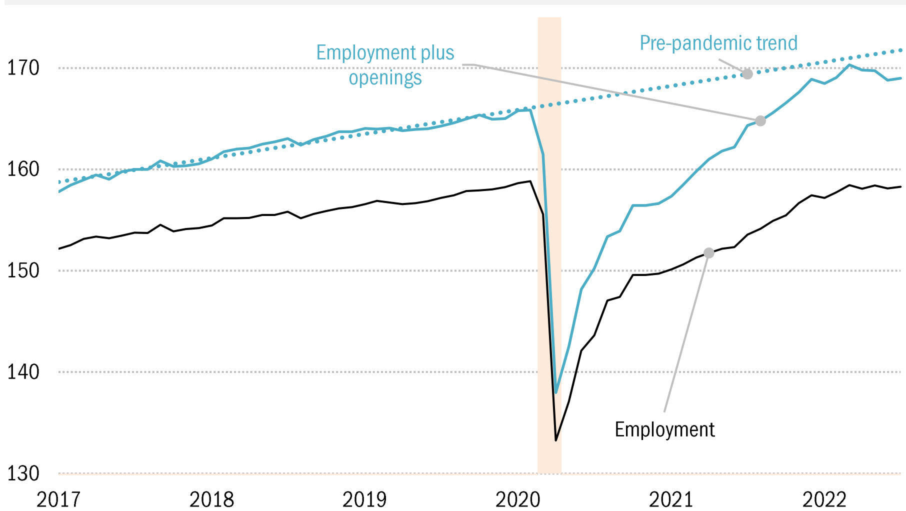
was in March at 11.85 million openings (please see the chart on the previous page). Maybe not so coincidentally that's the month the Fed lifted-off the funds rate from zero for the first time in two years (see "On the March FOMC" March 16, 2022). *Openings have now fallen all three months since, now at 10.70 million, off-peak by 1.16 million. That's already a little more than half the decline in openings seen in the pandemic lockdown depression of 2020.*

- In fact, it's 57% of the decline in openings seen in the Great Recession of 2008-2009, and 117% of the decline in the dot-com bust recession of 2001.
- *If Powell's goal is to use rate hikes to cool off demand by cooling off an "extremely tight" labor market – and if openings are evidence of that tightness, and progress toward alleviating it, we'd say he ought to start thinking in terns of "mission accomplished" before he destroys the village in order to save it*.
- In post FOMC press conferences, he has said more than once that the Fed's intentional destruction of job openings is a case of no-harm-no-foul, because, after all, nobody actually loses their livelihood when an unfilled opening vanishes. *Oh, but people do – though it takes an economically sophisticated person to see why (Powell is a lawyer, not an economist).*
- Here's why. The US labor force remains 590,000 persons below its level just before the pandemic. *What's worse, and more telling, the labor force is 3.6 million below the level indicated by the pre-pandemic trend*.
- So there are 3.6 million people – earning *nothing* today – who could accept one of those jobs openings and start earning *something*. *But when one of those openings is extinguished by the Fed, that person is consigned to earning nothing instead of something. That's exactly what happens when you lose a job you already have. You are consigned to earning nothing instead of something*.
- Powell is also apparently missing another key fact: *the sum of employment and job openings (please see the chart below, and*

Employment and job openings (millions) Recession



Source: BLS JOLTS, TrendMacro calculations *think of it as the level of the total demand for labor resources) is, yes, at an all-time high – but it is below the pre-pandemic trend by 2.78 million workers*.

- In other words, *labor utilization is well below potential* – no matter how many anecdotes you adduce to convince yourself the labor market is tight.
- Indeed, if the definition of "recession" is the underutilization of existing resources, particularly labor resources, then we are already in a recession (indeed, maybe we were never *not* in one).

We'll have a Consumer Price Index report next week that will show headline inflation having collapsed in July – falling month-over-month gasoline prices alone dictate that, and the seasonal adjustments will just amplify it. Then another JOLTS report and another jobs report in early September – we fully expect openings to continue to fall. Then another CPI report, which if the first week in August is any indicator, will be mild. Then the September FOMC.

- We wish we could have as much confidence in the Fed's reaction function as we do in our data forecast. But we continue to believe that a 75 bp hike at the September FOMC is highly unlikely. We reiterate our call for just 25 bp ((see "On Inflation, If You Don't Study History…" June 13, 2022).
- But we expect the sin of pride will forbid them from doing zero – though that would be the right thing (see "Why Inflation Is on the Way Down" July 25, 2022).

Bottom line

A blockbuster payroll report with 528,000 new jobs. The unemployment rate fell to a new recovery low, 1 bp below where it was just before the pandemic. Markets have immediately assumed this will move the Fed to tighten more aggressively, but that won't last. The "household survey" confirms the payroll number, when adjusted to a "payroll basis" – though seasonal adjustments played a very large role. Large jobs gains prove the Fed wrong again – the labor market is not tight. Tuesday's JOLTS job openings fell again, now off 1.16 million from March's historic peak, the month the Fed lifted-off the funds rate from zero. The contraction of openings, in just three months, is more than half that seen in the last two recessions. That's Powell's go-to indicator for labor tightness. With that, and two CPI reports likely to show sharply decelerating inflation, we reiterate our call for only a 25 bp hike at the September FOMC.