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TRENDMACRO LIVE!

On the September Jobs Report: Dear God, What Does Powell Want?

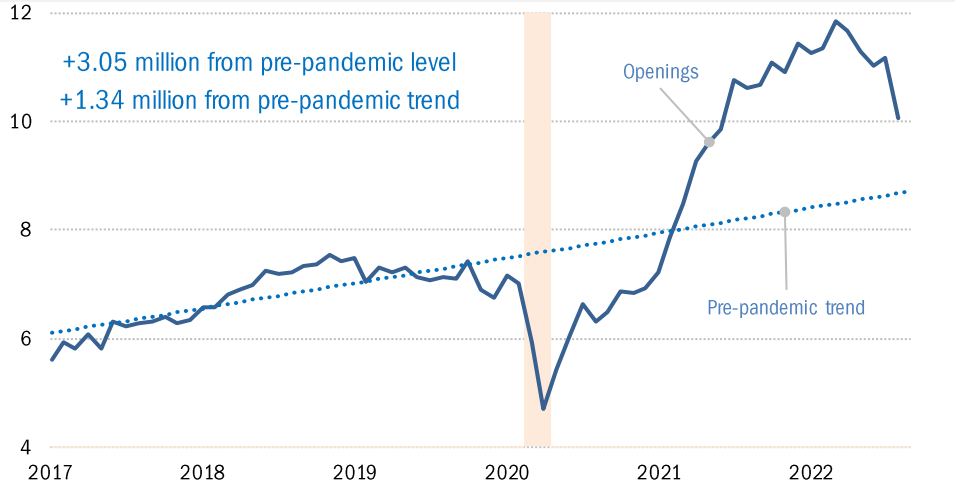
Friday, October 7, 2022

Donald Luskin

The weakest payrolls this year, and 1.8 million openings gone. Is the labor market still tight?

This morning's September Employment Situation report with 263,000 net payrolls gained is *the weakest this calendar year* and came in just slightly above the consensus calling for 255,000. But as of this writing markets are acting like that won't be enough weakness to satisfy Fed Chair Jerome Powell. He's quite mad if he believes that employment and prosperity cause inflation – quite the opposite, historically (see, among many, "Video: What you're not hearing about services inflation and the 'over-tight' labor market" August 16, 2022).

- *Markets were likely spooked by the drop in the unemployment rate by 16 bp to 3.49%.* But we should remember that Powell, at the September FOMC press conference, said that "the unemployment rate itself is" not the "single best indicator" as it has been in "other cycles." *He thinks now vacancies are "really very good ways to look at how tight the labor market is."*
- Actually, a gain of 263,000 payrolls tells you that the labor market isn't tight at all. After all, that's three times the month's growth in the likely-to-work adult population. But Powell constantly confuses a strong labor market for a tight one. One of the thousands of Ph.D. economists in the Federal Reserve System should tell him that



Source: BLS JOLTS, TrendMacro calculations

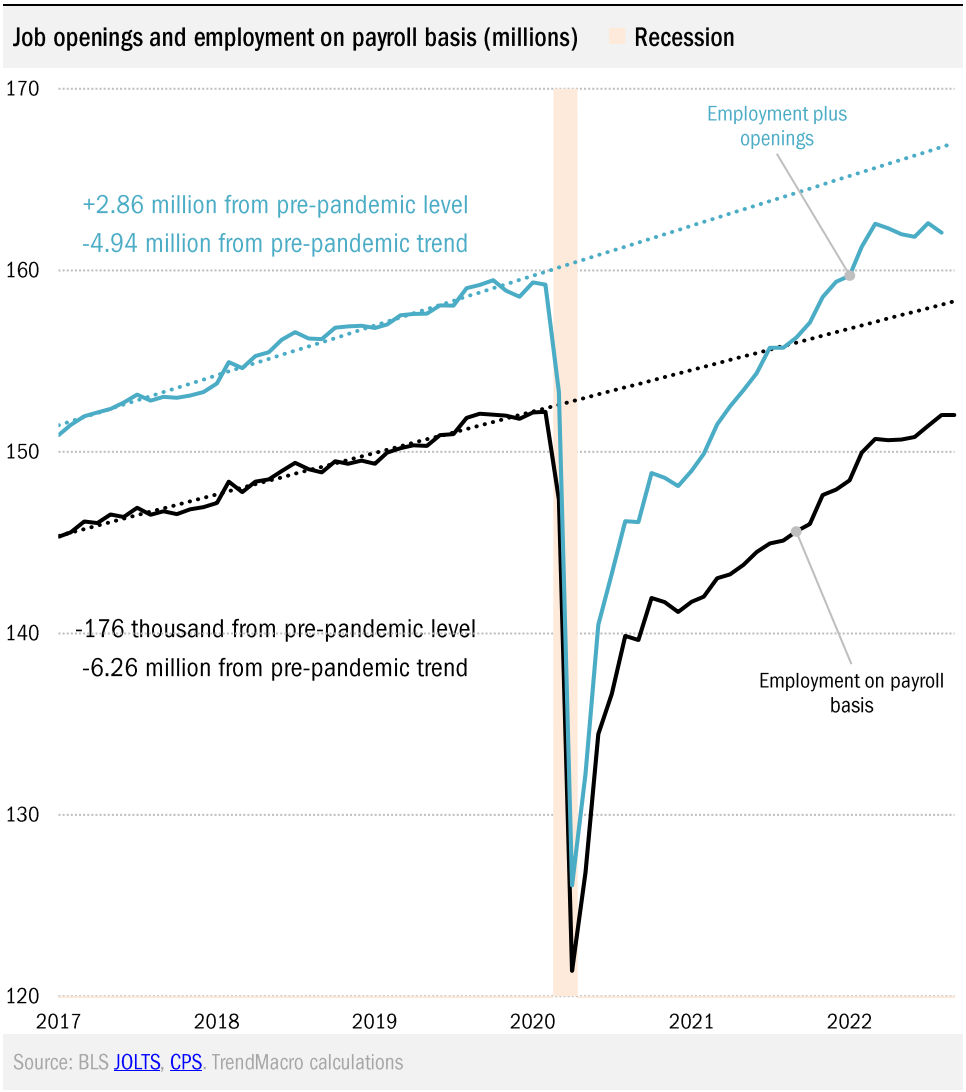
Update to strategic view

US MACRO, FEDERAL RESERVE: A slightly above-consensus 263,000 payrolls is the weakest this year, but still objectively strong, showing that the labor market is slack enough to grow well ahead of population growth, despite a drop in the unemployment rate. Powell says he is focused on job openings, which are now down 1.8 million from the March peak. Two thirds were filled, one third just went away. That's probably not enough for Powell. But the sum of employment plus openings – the potential jobs market – is far below the pre-pandemic trend, indicating a substantial output gap. We need more openings, not fewer. This report shows that the economy is "weirdly resilient" in the face of what has already been a harsh tightening cycle. But it's a death race between declining inflation, driven by declining money growth, and Powell pushing the economy into recession.

[Strategy dashboard]

when the labor market is tight, you get *less* payroll growth because everyone is already working.

- But let's set that aside and look at vacancies instead – if for no other reason than to see the world the way Powell claims he sees it (*this* month, at least – it remains to be learned how he will say he sees it *next* month, considering that his analytic framework seems to be, well, *transitory*). For that reason, starting today, we've added it to our monthly "Data Insights: Jobs" rapid-response report on page 3.
- Vacancies – or "openings" – are jobs that remained unfilled by employers. They are reported monthly with a two-week lag by the Department of Labor in the Job Openings and Labor Turnover Survey (JOLTS).
- At 10.05 million, openings are 3.05 million greater than they were just before the pandemic, and 1.34 million above their pre-pandemic trend (please see the chart on the first page). In many public statements, Powell has cited this as drop-dead proof that the labor market is "tight," because it indicates that there aren't enough workers to meet employment demand.



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- But since the peak of openings at 11.855 million in March (the month when the Fed lifted-off from a zero policy rate), they are down by 1.8 million (again, please see the chart on the first page). *That should be very comforting evidence for Powell that the labor market is getting less tight – but still above trend, that's probably not enough for Powell.*
- That decline has occurred in two dimensions. On the good side, two thirds can be explained by 1.32 million new jobs since March, implying that the labor force was, to that extent able to absorb the demand. But on the bad side, one third is unexplained – that is, *481,000 opens just vanished*.
- Remember, Powell is a lawyer, not an economist. So it probably doesn't trouble him that 481,000 opportunities evaporated. After all, nobody actually lost his job. But if you don't have a job, you need an opportunity to get one – so for you the elimination of an opportunity is the elimination of your job. *Oh well.*
- But there's another way in which Powell's view of openings is too narrow. Consider openings in the broader context of the entire employment market – not just the jobs that employers can't fill, but also the ones they already have. Add the two together – the actual and the potential – and you have some idea of the total employment capacity of the economy.
- Looking at openings alone would indicate that there is no output gap in the economy – labor resources are more than fully utilized, so there is no scope for growth of output of goods and services (which, presumably, would lead to supply-and-demand imbalances that would be inflationary – at least that's the conventional narrative that Powell adheres to).
- *But consider the entire labor market, not just openings*. Add openings (jobs employers can't fill) to employment (jobs employers have filled). That total can be thought of as the potential labor market, if employers were all producing at levels they felt were commensurate with demand. *While that potential labor market is 2.86 million persons above its pre-pandemic level, it is 4.94 million below its pre-pandemic trend. So unless you think there is something about the pandemic experience that has permanently lowered the economy's potential to produce goods and services, the economy still has a huge output gap. In other words, there are not too many job openings (having already absorbed 1.32 million and maliciously extinguished 481,000) – there are too few.*
- This cuts to a fundamental problem with what the Fed is admittedly doing in this hiking cycle. It is trying, as Powell put it at the September FOMC, "to moderate demand so that it comes into better alignment with supply." *But in the labor market, it's not so clear where demand ends and supply begins. Powell seems to believe that workers are merely mouths to feed, and when they lose their jobs they'll starve and take pressure off the prices of the food they will no longer have any means to pay for. But workers are also hands – and brains. They don't just demand, they supply. Fewer workers mean there is less supply of food, too.*
- *So there is no reason to think that all the hardship Powell seems bound and determined to produce will, in the end, have any effect*

on inflation (the reduction of which is his stated reason for inflicting the hardship in the first place). Fortunately, we remain deeply convinced that inflation will take care of itself, and is already in the process of doing so. With the money supply now growing at normal levels – and seemingly headed to abnormally low levels – we have no doubt that inflation will be back at the Fed's target in a year.

- As a matter of investment strategy, though, all that matters is whether the Fed will throw the economy into recession before that lower inflation visibly materializes. We've described the situation as a "death race" (see "Demand and Supply and Things Like That" September 9, 2022), and with this jobs report that's what it remains.
- We think the post-pandemic economy is weirdly resilient (as today's payrolls, in the face of an already harsh tightening cycle, amply show). But this race is going to be a close one, and we don't have deep conviction about how it's going to turn out.
- We only wish there were a better equity risk premium to cushion the risk of optimistic bets.

Bottom line

A slightly above-consensus 263,000 payrolls is the weakest this year, but still objectively strong, showing that the labor market is slack enough to grow well ahead of population growth, despite a drop in the unemployment rate. Powell says he is focused on job openings, which are now down 1.8 million from the March peak. Two thirds were filled, one third just went away. That's probably not enough for Powell. But the sum of employment plus openings – the potential jobs market – is far below the pre-pandemic trend, indicating a substantial output gap. We need more openings, not fewer. This report shows that the economy is "weirdly resilient" in the face of what has already been a harsh tightening cycle. But it's a death race between declining inflation, driven by declining money growth, and Powell pushing the economy into recession.