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TRENDMACRO LIVE!

On the December Jobs Report, and Services PMI

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Donald Luskin

If you believe bad news is good news, this was a good morning. Or was it?

This morning's December Institute for Supply Management services PMI report was a shocker, falling to 49.8, just under the 50 bar to indicate contraction, from a very robust 56.5 in November. It's a shocker because the consensus was for 55, and because such a large drop just doesn't line up with very much other macro data. *This will surely get the Fed's attention, especially as Wednesday's minutes of the December FOMC were at pains to discuss the committee's sensitivity to "risk-management considerations" with regard to the trade-off between inflation-fighting and employment* (see "Data Insights: FOMC Minutes" January 4, 2022). *It reinforces our expectation that a rate-hike at the February FOMC will be one-and-done for this cycle* (see "Surprises of 2023 Volume 1: From Inflation to Deflation" January 3, 2023).

- *But it feels like a glitch to us.* Yes, maybe that's just confirmation bias, because we've been so confident that a recession isn't brewing despite the Fed's best efforts to cause one (see, most recently, "Recession? No Thanks, We've Already Had One" December 30, 2022).
- *We'd be fools not to take it seriously, though, particularly because unlike most macro data – which is backward-looking – PMI's are a real-time forward looking reading of what purchasing managers are seeing on the battlefield of the economy*. So it is especially concerning that the weakest part of today's number was its most forward-looking – the orders component, which took a very large fall to 45.2 from 56.0 the month before (see "Data Insights: Global PMI" January 6. 2023).
- That said, *of the 17 industries surveyed 11 reported growth*. The minority of 6 that reported contraction include those clustered around the housing sector.

That said, *this morning's December Employment Situation report showed no evidence of recession at all*, with 223,000 net payrolls. This is backward-looking, to be sure, but it's not *that* backward looking. A services-driven economy doesn't add 223,000 new payrolls in the same month when services purchasing managers are suddenly sensing the end of the world.

- And a high-frequency view of the labor market coming from weekly new jobless claims shows nothing but acceleration of employment throughout December (see "Data Insights: High Frequency Post-Virus Recovery Monitor" January 5, 2023).

Update to strategic view

US MACRO, FEDERAL RESERVE: An unexpected sharp drop in the ISM services PMI, pointing to slight contraction after pointing to strong growth last month, reinforces our call for a one-and-done rate hike at the February FOMC. It's a shocking recession warning from a forward-looking indicator we respect. But 11 of 17 sectors showed growth, and the 6 that showed contraction were concentrated in housing. And it is an outlier among macro datapoints, including this morning's jobs report with 223,000 net payrolls. That's the slowest growth this year, and wage growth was the slowest except for an anomalous February. But payroll gains were twice the growth of the eligible population, and the labor force grew by 439,000 workers to a new all-time high, more than all of whom were employed – bringing the unemployment rate back to precisely where it was before the pandemic. The labor force shows no weakness, and none of the tightness the Fed worries about.

[Strategy dashboard]

To be sure, the December jobs report was weak in the sense that 223,000 payrolls is the smallest net gain of the year. *And average hourly wage growth of 0.27% month-over-month was the slowest of the year* other than an anomalous month last February. Those two facts probably make *the report Fed-friendly, pointing as the PMI surprise does to one-and-done in February*.

- Our sense is that the Fed will focus on these signs of moderation, if not outright weakness in the labor market. But there is a lot more to see in this jobs report, and who knows what the Fed will choose to focus on?
- 223,000 payrolls, despite being the lowest this year, is more than twice the growth of the eligible adult population. Every month this year, including December, we've added more jobs than there are new people.
- *The unemployment rate fell to 3.47%, returning to the basis point to what was then a 51-year low from just before the pandemic*.
- The drop in the unemployment rate came despite *the addition of 439,000 people to the labor force, making a new all-time high*.
- The "household survey" – separate and distinct from the "payroll survey" showed 717,000 more people employed in December, which means that more than all the new entrants to the labor force got a job.
- How is that possible? By reducing the number of *un*employed by 278,000, of whom 217,000 came from the ranks of the long-term unemployed.
- By the way, this contradicts the narrative of the last several months that the labor market is covertly weak despite strong payroll numbers, because employment reported in the household survey has been generally weaker. For the year.
- And who knew *this* was possible? *The male unemployment rate fell by 30 bp, to where it is now lower than the female unemployment rate* (see "Video: A conversation with Nicholas Eberstadt on the post-pandemic 'flight from work'" September 13, 2022).
- All this means that *the labor market is not tight, despite Fed Chair Jerome Powell's endless hand-wringing. You don't take the labor force to a new all-time high and bring 217,000 people out of long-term unemployment, and actually get American men to work again in a tight labor market.*
- And it means that the labor market is not at all reflecting the bad news implied by this morning's services PMI.

Bottom line

An unexpected sharp drop in the ISM services PMI, pointing to slight contraction after pointing to strong growth last month, reinforces our call for a one-and-done rate hike at the February FOMC. It's a shocking recession warning from a forward-looking indicator we respect. But 11 of 17 sectors showed growth, and the 6 that showed contraction were concentrated in housing. And it is an outlier among macro datapoints, including this morning's jobs report with 223,000 net payrolls. That's the slowest growth this year, and wage growth was the slowest except for an anomalous February. But payroll gains were twice the growth of the eligible population, and the labor force grew by 439,000 workers to a new all-time high, more than all of whom were employed – bringing the unemployment rate back to precisely where it was before the pandemic. The labor force shows no weakness, and none of the tightness the Fed worries about.