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TRENDMACRO LIVE!

On the January Jobs Report, and US Services PMI

Friday, February 3, 2023

Donald Luskin

A blockbuster – or a "yes, but…"?

We want to take yes for an answer after this morning's December Employment Situation report, showing an astonishing 517,000 net payrolls gained. This is a huge beat versus expectations for only 188,000, and versus our model based on contemporaneous labor market statistics that estimated only 129,000 (see "Data Insights: Jobs" February 3, 2023). We don't care so much about the Wall Street consensus, but *when payrolls are at such variance with our model we ask questions. So will the Fed*.

- Let's say at the outset that the big payroll gains were dominated by service industries, especially travel and leisure. This is consistent with the welcome bounce-back this morning in the US non-manufacturing purchase managers index to strong growth at 55.2, from December's contraction at 49.2 (see "Data Insights: Global PMI" February 3, 2023). It's now restored pretty much to where it was in November, at 55.5. We argued that December was just an anomaly, and indeed it proved to be (see "On the December Jobs Report, and Services PMI" January 6, 2023).
- *But everything is made a little more difficult in any and every January jobs report*, because the "payroll survey" is distorted by the annual "benchmarking process," and the "household survey" is distorted by updated "population controls" for the prior December.
- The benchmark process revised 2022 payrolls, on net, up by 311,000. Of that, only 7,000 were in the first half of the year – after overheated worries last month that over a million jobs would be revised away in just the second quarter.
- Including prior years subject to the process, the total number of payrolls in December was revised up by 813,000, to 154.5 million from 153.7 million. *Simply, the labor market is now understood to be larger than previously thought, and by a lot.* That's a lesson in the error-bands that have to be put around macro data, but it doesn't change the fact the *January reported 517,000 additional payrolls on top of the revised higher number*.
- The population controls revisions similarly added 810,000 employed persons as of December – however the published data series are not revised for that. *So January's reported employment gain of 894,000 is spurious, and does nothing to ratify the large payroll gains*.
- Backing out the revision, *employment in fact rose by 84,000* – which is close to our model estimate. This repeats the pattern of the last year

Update to strategic view

US MACRO, FEDERAL RESERVE: A blockbuster payroll number, but full of ambiguities. Without the seasonal adjustments there was a large contraction. The "payroll survey" was distorted by annual benchmarking changes, and the "household survey" by annual population controls revisions. The benchmarking changes revised the total number of payrolls up sharply, but the 517,000 gains reported this morning already take that into account. The population controls revisions upwardly distorted the number of employed persons considerably. But abstracting from all that, it was a positive month, and recessions don't start until there are negatives. Even temporary payrolls gained. Hourly wages rose less than last month, despite large payroll gains. We think this will have little impact on the Fed, and reiterate our call that Wednesday's rate hike was the last in this cycle.

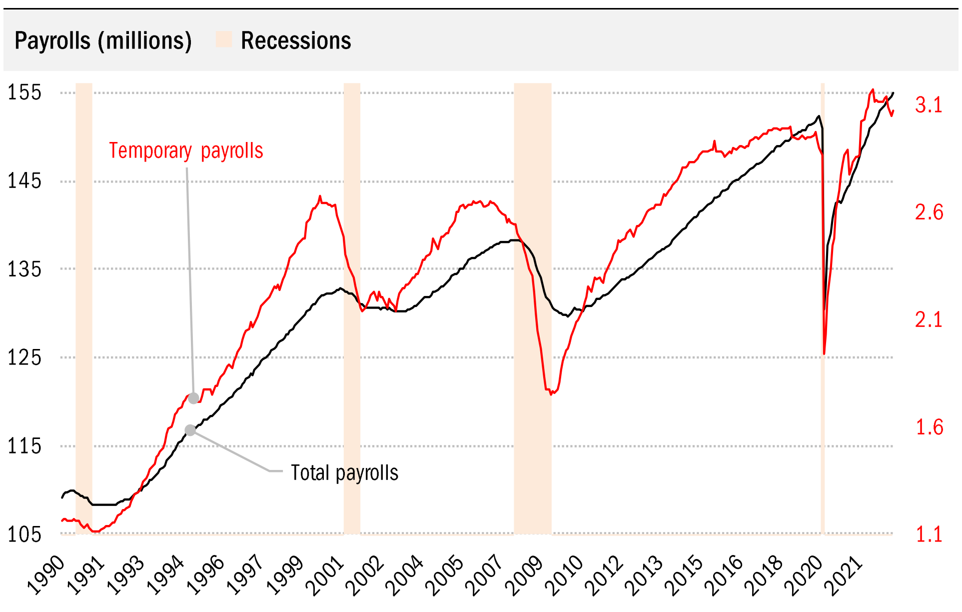
[Strategy dashboard]

in which payrolls have outperformed employment. We don't assign any particular meaning to that, except that it ought to cool perceptions – such as those at the Fed – that the labor market has been unambiguously red hot, and a cause (spurious, we think) of inflation pressures.

- There are other sources of ambiguity. The 517,000 payroll gains would have been a contraction of 2.5 million without seasonal adjustments. Fair enough – those adjustments are there to filter data noise from January's typically adverse weather. As it happens, this particular January was slightly milder than usual, overall – which we estimate could have exaggerated the number of reported jobs by about 41,000 through over-adjustment.*
- Oh, and the Fed should be delighted that with the biggest reported payroll gains in six months, average hourly earnings grew at only 0.30% for the month, down from 0.39% in December. Don't worry Phillips-curvers – ordinary working stiffs aren't getting rich, so you don't have to cause a recession to keep them in their place in the name of inflation-fighting.
- If such people want to worry anyway, they can look at the unemployment rate – which fell a tiny 0.4%, but which was enough to notch a low not seen since 1969. That was not distorted by the population controls revision.

All that said, for all the ambiguity, the payroll number was positive. The employment number was positive. Our model estimate was positive. *Business cycle expansions don't end, as a strict rule, until payrolls go negative* (please see the chart below, and see "Video: What you're not hearing about the recession signal in temporary payrolls" January 30, 2023).

- In fact, we're delighted that even temporary payrolls were positive – adding 25,900. After all the chatter (including a howler yesterday called "Temp Workers Are Losing Their Jobs. What That Means for a



Source: BLS, NBER, TrendMacro calculations

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Recession"), this is a welcome sign of confirmation.

- Another such sign was Wednesday's Job Openings and Labor Turnover Survey (JOLTS), showing the total number of open jobs – or vacancies – rose by 572,000 to 11.01 million in December (the data lags by one month). *With openings rising – and remember, there are more than half-again as many as there were just three years ago before the pandemic – there's no chance of the wholesale layoffs, or even a wholesale hiring hiatus – that is a necessary precondition of recession.* Recessions happen when there is fat in the labor force that can be painlessly cut. We're at bone.

As far as the Fed is concerned, we suppose this is not helpful. But given the Fed's new admission that the inflation emergency has passed (see "On the February FOMC" February 1, 2023), and all the ambiguities in this jobs report, *we're not going to change our call that Wednesday's hike to the funds rate was the last in this cycle*. How quickly the market consensus has turned since we initially said "one and done" (see "Surprises of 2023 Volume 1: From Inflation to Deflation" January 3, 2023). Before the jobs report this morning, the money market curve was implying only a 72% probability of a hike at the March FOMC, despite Chair Powell's musings that there will be several. After the jobs report, as of this writing, it's still only 93%.

Bottom line

A blockbuster payroll number, but full of ambiguities. Without the seasonal adjustments there was a large contraction. The "payroll survey" was distorted by annual benchmarking changes, and the "household survey" by annual population controls revisions. The benchmarking changes revised the total number of payrolls up sharply, but the 517,000 gains reported this morning already take that into account. The population controls revisions upwardly distorted the number of employed persons considerably. But abstracting from all that, it was a positive month, and recessions don't start until there are negatives. Even temporary payrolls gained. Hourly wages rose less than last month, despite large payroll gains. We think this will have little impact on the Fed, and reiterate our call that Wednesday's rate hike was the last in this cycle.

* Due to a computational error, as originally posted, we said the overadjustment could be 1.1 million. The smaller 41,000 virtually removes the seasonal adjustment factor as a source of falsification of the headline payroll number.