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TRENDMACRO LIVE!

# On the March Jobs Report

Friday, April 7, 2023

**Donald Luskin**

### Why throw 1.6 million people out of work to lower wage growth that doesn't cause inflation?

This morning's Employment Situation report is based on data collected too early in March to have shown any aftereffects of the failures of Silicon Valley and Signature banks (see "It's Over For SVB – And the Fed" March 13, 2023). That said, the jobs report would surely reflect any of the conditions already in the economy that contributed to those failures. But *the fact that March showed 236,000 net payrolls, a drop in the unemployment rate, and expansion both in the number of persons employed and the size of the labor force, whatever caused the bank failures doesn't appear to be pointing to the end of this business cycle expansion*.

We'll get to what this means for our outlook on inflation and the Fed in a moment, but first a few data highlights (as always, the full deep-dive is in "Data Insights: Jobs" April 7, 2023).

Generative AI token: "Bank panic didn't stop jobs growth, comic book"


Source: DreamStudio running Stable Diffusion 1.5

**Update to strategic view**

**US MACRO, FEDERAL RESERVE:** It's too soon to see any effects from the Silicon Valley Bank failure, but this was a very solid jobs report with 236,000 net payrolls that slightly beat consensus expectations. The labor force expanded by 480,000 and employment expanded by even more, lowering the unemployment rate to 3.5%. Average hourly earnings grew, but barely more than the prior month's downward revisions. Powell's secret inflation index of "core services other than housing" peaked in November 2022, four months before average hourly earnings growth did – which starkly contradicts his claims that wage growth is feeding the sticky component of inflation he now focuses on. Job openings are down to a 22-month low, but since the Fed started tightening payrolls have grown more than twice as much as openings have contracted, demonstrating that concerns with labor market tightness have been overdone. We continue to think there will be no more rate hikes.

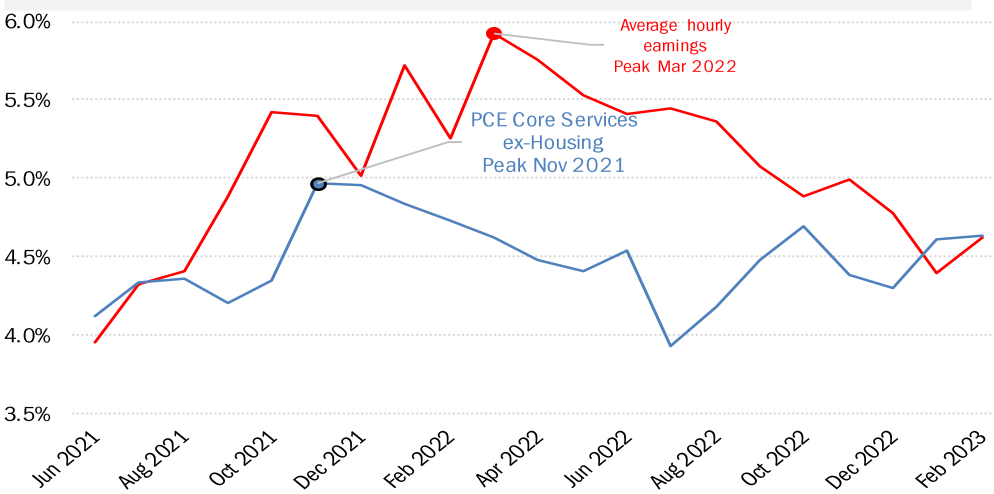
[Strategy dashboard]

- 236,000 net payrolls slightly beat the consensus for 230,000, but the bar was lowered by net downward revisions of 17,000 to the prior two months.
- In line with the biases manifested for many months in the Current Employment Statistics – the "payroll report" – 236,000 payrolls beat the 175,000 estimate of our model based on an array of contemporaneous labor market statistics.
- This time we can't potentially explain away payroll gains as an artifact of seasonal adjustments, as one might have done with January's blockbuster report (see "On the January Jobs Report, and US Services PMI" February 3, 2023). For March, the seasonal adjustment took away 284,000 payrolls.
- And unlike January, this month the gains were not contradicted by relatively poor performance in employment as measured by the alternative Current Population Survey – the "household survey" – which reported a gain of 577,000 jobs. The labor force grew by 480,000, which means every new entrant got employed (plus 103,000 previously unemployed).
- With that simultaneous expansion of the labor force and contraction in unemployment, *the unemployment rate fell 7 bp, from 3.57% to 3.50%*.

Which brings us to the Fed.

- *With an unemployment rate of 3.50%, the Fed's estimate for 4.50% at year-end in the FOMC's most recent Summary of Economic Projections means they are deliberately aiming policy at throwing 1.66 million out of work over the next nine months.*
- They believe this will reduce inflation by relieving tightness in the labor market, which will slow wage growth. They should take some comfort, then, in March's 0.27% gain in average hourly earnings, which does little more than overcome the downward revision by 0.22% in February.

Relation of inflation to average hourly earnings growth (year-over-year)




Source: BLS, BEA, TrendMacro calculations

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[About us]

- Better, though, that they acknowledge the reality that *there is no relation between wage growth and inflation*.
- Chair Jerome Powell has, since late November, focused on an inflation measure that is unavailable to the general public – Personal Consumption Expenditures on "core services other than housing." We have worked with the Fed and the Bureau of Economic Analysis to exactly reconstruct this index, and it is shown in relation to average hourly earnings in the chart on the previous page.
- Powell's secret inflation index peaked all the way back in November 2021, a year before he started talking about it. He did so because, while goods inflation has fallen from an alarming 10.61% year-over-year in June 2022 to a fairly satisfactory 3.63% now, just eight months later, Powell's "core services other than housing" has been very sticky. We can't read his mind, but he seems to want to focus on the element of inflation that justifies a continuing state of emergency (see "Video: TrendMacro conversation with Nick Timiraos on Powell's crisis response and the inflationary aftermath" March 28, 2023).
- But what kind of pathetic little emergency is this, anyway? At peak a year and a quarter ago, Powell's secret inflation index only hit 4.97% year-over-year (again please see the chart on the previous page). To be sure, that's above the Fed's target of 2%, but not even half the peak in goods inflation. And now it has fallen to 4.63%.
- Overall, Personal Consumption Expenditures inflation (which the Fed has always preferred to the Consumer Price Index on methodological grounds, peaked at 9.91% in June 2022, when goods inflation peaked. It's down to 5.30%, which is to say it has made 58% of the journey back to the Fed's target.
- It would be nice, we suppose, for it to come down more and faster. *Does this justify an intention to throw 1.66 million people out of work? Does it justify raising rates so rapidly that 2022 was the single worst year in history for the performance of long-term bonds, blowing through the boundaries of even rigorous bank stress-tests, and leading straightforwardly to the collapse of one of America's largest banks?*
- Surely not. And especially because the purpose of doing so is to relieve wage pressure, *yet wage pressure shows no causal relation to Powell's secret inflation index*. Indeed, *average hourly earnings growth peaked in March last year, four months after Powell's secret inflation index did – and last time we checked, something purported to be a cause has to come before something purported to be an effect* (again, please see the chart on the previous page).
- And let us not overlook Tuesday's Job Openings and Labor Turnover Survey (JOLTS) report, showing *job openings falling 632,000 to 9.93 million, the first time under 10 million in 22 months, and down 2.1 million from the all-time peak at 12 million last March*. Powell constantly cites this large number of openings (still 0.98 million above the pre-pandemic trend) as evidence of the

labor market tightness that leads to the wage pressures he so fears.

- He should be delighted by this seeming erasure of opportunity for out-of-work Americans to get jobs. But the reality is that *over the same one-year period that openings have fallen by 2.1 million – a year, by the way, that began the same month the Fed began the present tightening regime – payrolls have grown by 4.15 million*. So those openings that Powell has told us can't possibly be filled in the post-pandemic labor environment have been filled twice over. *So the labor market isn't so tight after all, and never has been*.

While today's jobs report doesn't show any of the outright weakness that would surely stay the Fed from further rate hikes, neither does it contain any alarming signs of strength that would demand more. And surely it does not demand the re-acceleration of hikes that Powell foolishly signaled just days before Silicon Valley Bank failed (see "On Powell's Shocking Testimony" March 7, 2023) – which led, shortly after, to an FOMC meeting where reportedly even a 25 bp hike was a very close call (see "On the March FOMC" March 22, 2023).

- As of this writing, futures markets imply a 70% probability of a final 25 bp hike at the May FOMC, and then increasing probabilities of cuts at every meeting thereafter. That's probably about right, but we'll take the under. We continue to think that March was the last hike (again, see "On the March FOMC").

**Bottom line**

It's too soon to see any effects from the Silicon Valley Bank failure, but this was a very solid jobs report with 236,000 net payrolls that slightly beat consensus expectations. The labor force expanded by 480,000 and employment expanded by even more, lowering the unemployment rate to 3.5%. Average hourly earnings grew, but barely more than the prior month's downward revisions. Powell's secret inflation index of "core services other than housing" peaked in November 2022, four months before average hourly earnings growth did – which starkly contradicts his claims that wage growth is feeding the sticky component of inflation he now focuses on. Job openings are down to a 22-month low, but since the Fed started tightening, payrolls have grown more than twice as much as openings have contracted, demonstrating that concerns with labor market tightness have been overdone. We continue to think there will be no more rate hikes.