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TRENDMACRO LIVE!

On the July Jobs Report

Friday, August 2, 2024

Donald Luskin

Recession dread is back, just when everyone had capitulated on the Magnificent Seven.

There was a palpable atmosphere of dread coming into today's June 2024 Employment Situation Report, which showed 114,000 net new payrolls.

- Yes, that's a miss versus the consensus for 175,000. But it's very close to the 129,000 our payrolls model led us to expect based on contemporaneous labor market indicators. The fact that it's a miss is a blow to sentiment. The fact that it's so near our model means it's not a blow to reality.
- Yes, 114,000 is the smallest monthly payroll gain since April (but April proved to be the first month of a quarter in which real Gross Domestic Product grew by 2.8% at an annual rate, while the Fed thinks it is capable of only 1.8%).
- Based on the growth rate of the adult population and the labor force participation rate, 90,000 net payrolls is the dial-tone now for a steady-state economic expansion.
- Yes, the unemployment rate rose to 4.25% from 4.05%. The increase in the unemployment rate was in large part due to the welcome expansion of the labor force by 420,000 (adjusted, the unemployment rate rose only 4 bp, not 20 bp).
- Interesting technical note: earlier this morning when we distributed "Data Insights: Jobs" shortly after the data release, we pointed out that the rise in the unemployment rate did not trigger the faddish "Sahm Rule" recession indicator. Clients have pushed back that with the three-month average of the unemployment rate 50 bp above its minimum of the last twelve months, the Rule is indeed triggered – barely so, because 50 bp is the trigger level.

Update to strategic view

US MACRO, FEDERAL RESERVE: 114,000 net payrolls misses the consensus, but it's right on our model estimate. Payroll gains were lower in April at the dawn of a very strong quarter for growth. The unemployment rate rose almost entirely due to a welcome expansion of the labor force. It triggers the Sahm Rule recession indicator – just barely – but only using rounded monthly numbers, not accurate unrounded ones. Recession dread is back. We think it is partly the psychological result of recent capitulation we have observed after years of fighting the strength of the Magnificent Seven. The extraordinary political environment encourages questioning previously unquestioned assumptions – and that's never good in a bull market for tech stocks. Immigration remains strong. Job-finding remains high-probability, and job separation remains low-probability. Elevated claims are the same as last year during a boom quarter, and far below historic norms. Nothing here will deflect coming Fed rate cuts.

[Strategy dashboard]

But if we're going to be so precise about it, then we should recognize that it's only triggered at the rounded 4.3% unemployment rate being reported, but not at the actual 4.25% rate (the ratio of unemployed persons to the number of persons in the labor force).

- *Where does the dread come from? Will recession fears never die?*
- There's nothing new about the dread. The consensus has been dreading the same recession ever since the yield curve first inverted all the way back on April Fools Day in 2022.
- We think the latest bout of dread has two particular origins.
- First, we have observed over the last three months in the client calls we have every day that *there has been some significant degree of capitulation about the Magnificent Seven* – having fought them (or participated in them skeptically and reluctantly) all the way up. No surprise then that this earnings season has been the occasion to see the dark side in their prospects for the future. That's just how markets work. *It's called a correction.*
- Second, we have observed that the current moment in *US politics is so freighted with events and circumstances that seem so unprecedented* (please see the meme on the previous page) – *triggering news cycles that are manifestly false and artificially manufactured* (see, most recently, "FOMC Preview: A Political Decision?" July 29, 2024). Such a milieu opens mental pathways that encourage reexamination of one's unconscious beliefs – and *bull markets (especially in technology stocks) do better when there's not a lot of reexamination of unconscious beliefs*.
- Meanwhile, this economic expansion continues.
- *Immigration continues to expand the size and scope of the economy* (please see the chart below) with an expansion of 228,000 in the foreign-born population, and 134,000 in foreign-born employment (an employment-to-population ratio of 59% preserving the pattern of the last two years – see, among many, "Open Borders Produced the Biden Economic Boom" May 24, 2024).
- *The monthly job-finding probability remains at a very high 29%* (consistent with economic expansion, an unemployed person has a 29% shot of getting a job within a month).

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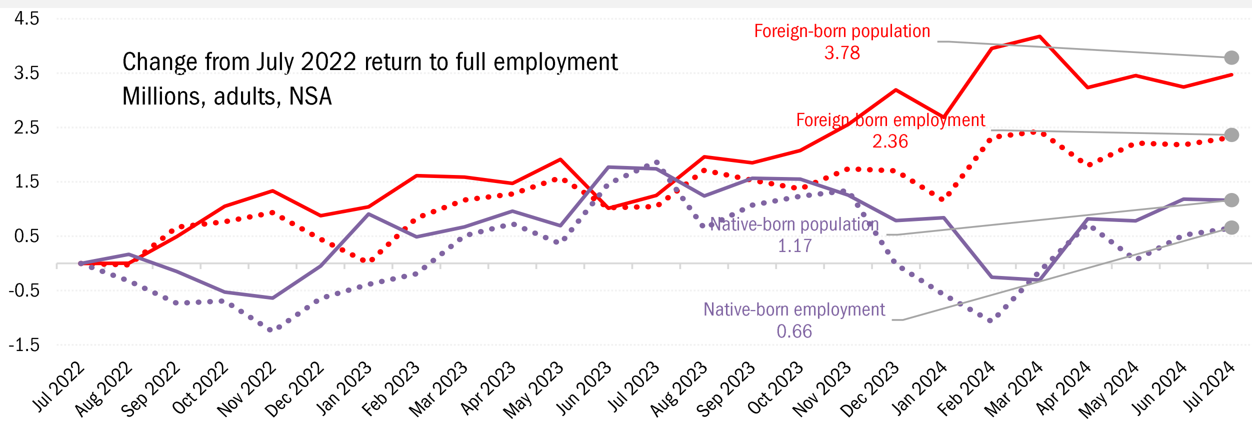
[About us]

Labor and population dynamics of immigration



Source: BLS, TrendMacro calculations

- *On the other side, the monthly separation probability is a tiny 1.7%.* Think of that as context when you consider this week's initial claims for jobless benefits at 249,000. Yes, that's the largest number of claims in a year. The August 2023 number was right in the middle of a quarter with 4.9% real GDP growth at an annual rate – if that level of claims is a recession indicator, it's a terrible one. And 249,000 claims is only 16 bp of overall payrolls. For most of the years of the last half century, claims have been more than twice that *during robust expansions.*
- And remember, *we now know that the Fed will start cutting rates at the September FOMC meeting* (see "On the July FOMC" July 31, 2024). We don't think the Fed has been as excessively tight as it has said, or as the markets have feared. But with inflation basically back to target, might as well not be tight at all. It can only help.
- *Today's jobs numbers won't deflect the Fed, especially with average hourly earnings growing only 0.23%.*
- As of this writing, recession dread is so strong that there is a futures-implied probability of 70% that the first rate cut in September will be 50 bp. We think that's ridiculous – but it captures the spirit of the moment. The spirit of dread, which we think is significantly overdone.

Bottom line

114,000 net payrolls misses the consensus, but it's right on our model estimate. Payroll gains were lower in April at the dawn of a very strong quarter for growth. The unemployment rate rose almost entirely due to a welcome expansion of the labor force. It triggers the Sahm Rule recession indicator – just barely – but only using rounded monthly numbers, not accurate unrounded ones. Recession dread is back. We think it is partly the psychological result of recent capitulation we have observed after years of fighting the strength of the Magnificent Seven. The extraordinary political environment encourages questioning previously unquestioned assumptions – and that's never good in a bull market for tech stocks. Immigration remains strong. Job-finding remains high-probability, and job separation remains low-probability. Elevated claims are the same as last year during a boom quarter, and far below historic norms. Nothing here will deflect coming Fed rate cuts.