
Weekly Market Flash

The Strangest of Jobs Markets

June 2, 2023

Where do they all come from? Once again, the jobs market has confounded the experts. Economists expected today's Employment Situation Survey from the Bureau of Labor Statistics would show an increase of 188,000 nonfarm payrolls for the month of May; instead, we got a whopping 339,000 payroll gains. True, the unemployment rate ticked up to 3.7 percent from last month's 3.4 percent. But the higher unemployment rate probably reflects a larger cohort of active job seekers, rather than a sign of fewer openings. Indeed, according to a different report that came out earlier this week, the number of vacancies grew last month – also by more than the consensus forecast of economists.

A Flaw in the Models?

None of this is new. In just about every month so far this year, economists' predictions have underestimated the strength of the labor market. It's not unusual for the forecasts to be wrong – there is plenty of variance to be expected from surveys like the BLS report that collect sample sets of data from a defined point in time. But one would expect the variance to cut both ways – higher in some months, lower in others. When they always come in on the low side, that suggests a basic problem with the models.

One problem we can think of that might be affecting the models is the relatively sparse amount of relevant data available from past periods to supply clues as to what might be going on now. The conventional thinking would be that, sixteen months into a draconian monetary tightening program, credit conditions would be tightening, consumer spending would be decreasing and businesses would either be freezing new hiring or laying people off. And some of that is happening – tech and financial firms in particular have been at the forefront of layoffs, and there is some evidence that consumer spending has been slowing in the past couple months. But the jobs keep coming. Those tech layoffs may capture business news headlines, but there is evidence that those let go from Company ABC don't have much trouble in finding new employment from Company XYZ. Indeed, payroll gains in May were particularly strong in the category of professional and business services, which would include much of the tech and financial sectors.

A combination of factors – the disruption of the pandemic, all the government stimulus money, the combination of supply chain bottlenecks and surging demand that led to the highest inflation in forty years – all this makes it very difficult to put the predictive pieces in place for insightful macroeconomic estimates. The models need fixing – but how to fix them is likely to continue to confound the modelers. That is a problem with important implications for the rest of the year.

Growth, Rates and the Fed

In two weeks' time, the Federal Open Market Committee will meet again for what may be the most important monetary policy deliberation of the year. At the last FOMC meeting in early May Fed chair Powell left the distinct impression that the June meeting may result in a pause so that the Committee can evaluate the effect the rate increases to date are having on economic activity. Since then, there has been a perceptible hawkish turn to "Fedspeak" as various members have opined that it may be too early to pause, thus setting the stage for another potential 0.25 percent increase to the Fed funds rate at the June meeting. The last two key data points the Committee will have for that meeting will be today's jobs report and the May Consumer Price Index report, which comes out a day before the FOMC decides what to do.

On its own merits, today's jobs report probably nudges the needle a little towards another rate hike. One obvious takeaway from the results of the last year and a half is that the labor market has been able to withstand the most drastic increase in interest rates since 1980. That would give the Fed confidence that it can continue to take bold steps to quash inflation without risking a dramatic spike in the number of jobless Americans. What the Fed hopes to achieve, of course, is that fabled "soft landing" where bringing inflation back to its two percent target is achieved with the least amount of harm done as possible to the economy. If the unemployment rate is still under four percent by the time inflation comes back down, it would be a striking policy win for the central bank.

What remains to be seen is that last data point, the CPI report due out on June 13. Even while the headline CPI number has come down dramatically, thanks mostly to lower energy prices, the core inflation number the Fed focuses on has been stickier. If the June 13 report shows a similar trend from last month – around a 0.4 percent month-on-month increase translating to a year-on-year rate of 5.5 percent – that could be the final push towards another rate hike. Which will then set off another round of concerns about a policy error raising the likelihood of a recession. Which will then lead to more second-guessing as yet another month's worth of data continues to perplex the experts. Which brings to mind some wisdom from Yogi Berra: predictions are hard, especially when they're about the future.

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