THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.economicoutlookgroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

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Caution: June's Employment Report Can Lead To Excessive Exuberance

Let's get past the first obvious reaction to the latest jobs report. Whew!

The 287,000 spike in June payrolls was a big surprise and huge relief to be sure. But when it comes on the heels of a month that saw hiring slump to shockingly low 11,000, well...then perhaps a more sobering assessment is called for to better understand what is really going on in the US labor market.

The June rebound --- whether you look at total payrolls or just private sector hiring --- was the largest one month gain since last October. Business hiring alone shot up 265,000 in June, certainly a positive trend. But you may want to hold off on the Champaign! That hefty jump came after an net loss of 6,000 jobs in May, which was the first monthly drop in more than 6 year! Such wild swings are telltale signs of economy on an erratic course.

But let's go on. The unemployment rate did tick up to 4.9%. You could argue it was supposedly for good reasons: more people have entered the labor force (414,000) in June and are actively looking for work. Ah, but it follows two months that saw the work force shrink by a massive 820,000! How's that for statistical whiplash?

Then you have to wonder how many of June's 414,000 additions to the labor force represent students leaving class and seeking summer employment? Remember, June and September are notoriously difficult months to interpret given the seasonal adjustment challenges.

Chart 1. Unemployment rate, seasonally adjusted, June 2014 – June 2016

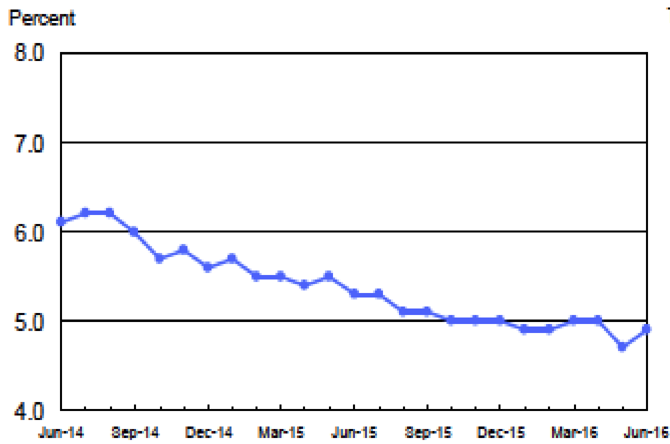
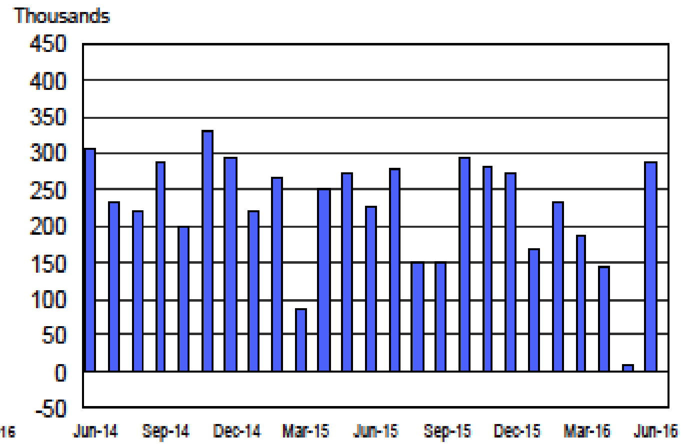


Chart 2. Nonfarm payroll employment over-the-month change, seasonally adjusted, June 2014 – June 2016



There's one other odd contrast to June's payroll bounce. While the establishment survey reported a 287,000 surge in new positions filled last month, the household survey claimed employment rose by a far less impressive 67,000, providing two sharply contrasting pictures on job gains. Yet both the average weekly hours at work and manufacturing overtime in June remained unchanged at 34.4 hours and 3.3 hours, respectively. Welcome to the tyranny of month-to-month statistics.

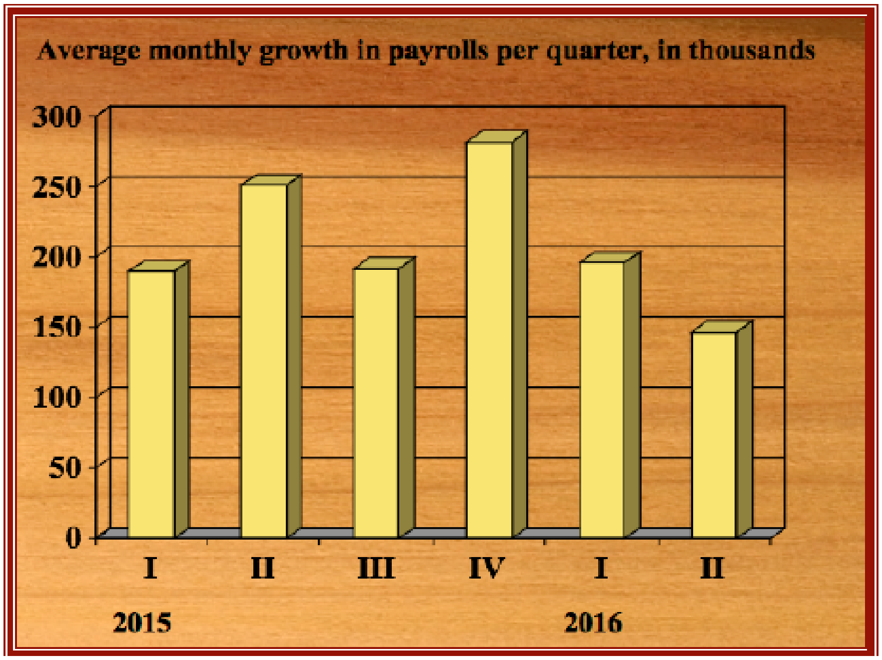
What of wages? Here again, the numbers are ambiguous. Average hourly earnings last month rose 2.6% over the year, the fastest clip so far in 2016. Yet average weekly pay increased by just 2.3%, well below that of January's 2.5%

Here's one more conflicting data point about June employment. The number of Americans forced into part time work because they could not find suitable full time positions fell to 5.84 million, the fewest since last October. OK, that's an encouraging sign. Yet the average number of weeks people were out of work but actively looking climbed to 27.7, compared with 26.7 in May.

So what does one do when confronted with such a volatile and conflicting series on employment?

The answer is to focus on quarterly employment trends. Doing so offers a clearer picture of the dynamics at work in the labor market.

What emerges is this: In spite of June's solid job numbers --- which will probably dominate the headlines tomorrow---there has been an unmistakable downtrend in hiring over the last three quarters (282,000 monthly average in Q4 of 2015, 196,000 in Q1 2016, and 147,000 this past quarter).



Could the best employment numbers already be behind us in this business cycle? Is a recession creeping closer? Or did the slowdown during the IIQ occur because the economic outlook became so much murkier?

After all, how can you estimate a return on investment in labor and capital when you have to contend with the wackiest US presidential campaigns in modern history, the consequences of the Brexit vote on the UK and Europe, a puzzling Federal Reserve interest rate policy, an emerging bond price bubble, another looming banking crisis in Italy, China's still shaky economy, the collapse of the Brazilian and Venezuelan economies, and at least half a dozen serious geopolitical threats that can erupt anytime?

You can't. And because labor is the biggest expense companies have to book, it is no secret that CEOs tend to proceed cautiously when there is so much uncertainty about the future. Rarely have they faced so many economic, political and geopolitical variables in flux, all at the same time.

So while many will breath a sigh of relief at June's better than expected job numbers. Our view is that we are just as likely to see hiring slack off again during the summer and fall. The rebound in June payrolls will not lead the Fed to increase the fed funds rate before the December meeting, and possibly not even if even then. Nor should we to expect any recovery in business capital spending the rest of this year.

What about 2017? The main determinant of how strong hiring, business investments, and consumer spending will be is the comfort level Americans have with who occupies the White House next year. In the interim, however, expect to see more signs of economic softness.