RUBRICS

Payroll Puzzler

Fixed Income Macro View

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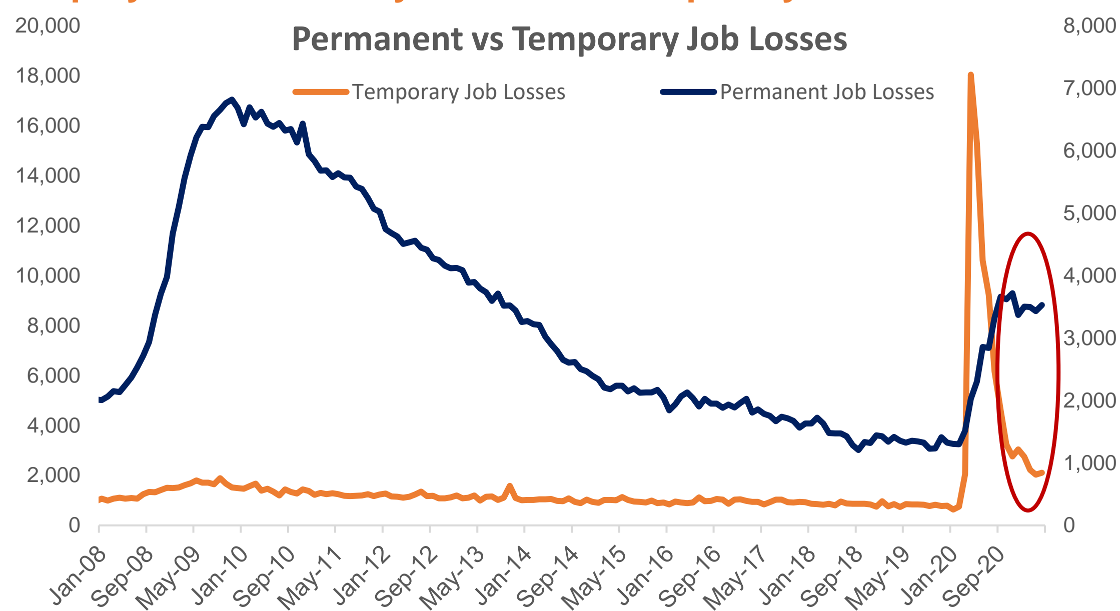
Introduction

The recent non-farm payroll data was, on the face of it, extremely disappointing. It certainly feels like the biggest jobs miss on record. Upon closer examination however, it appears to be more of a mixed bag - which poses very difficult questions for both the Biden administration and Fed Chair Powell.

Employment Recovery Limited to Temporary Jobs

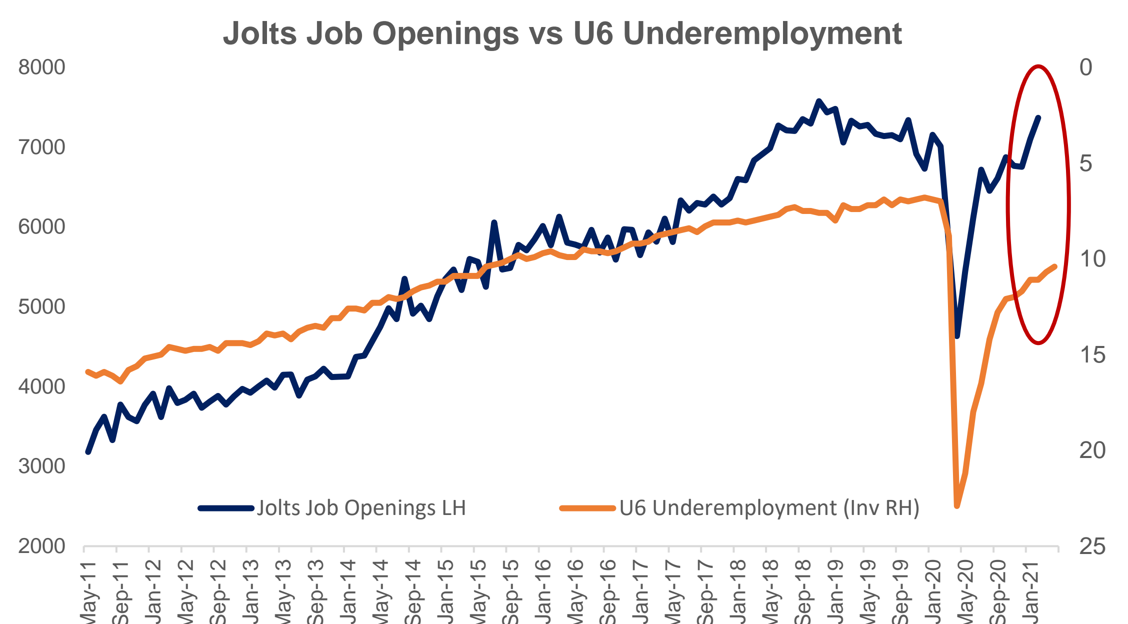


Source: Bloomberg as at 10/05/21

Buoyed by a strong employment report in March (notwithstanding the downward revision from 916k to 770k) and positive momentum from economic re-opening, over one million jobs were expected to be created in April. That a mere +266k increase is what actually transpired, unsurprisingly, registered as something of a shock to the system. The reality though was not quite as straightforward. The expected uptick in the services sector did in fact materialise with approximately 300k jobs created there, while the labour force participation rate increased by over 400,000 (moving the U3 unemployment rate back up to 6.1% on this technicality) as the U6 broader underemployment rate dropped to 10.4%. It was the loss of 225,000 covid related jobs, as well as the unexpected losses in supposedly booming sectors like lumber, transportation and warehousing that ultimately did the headline damage.

Even though it was quickly denied by the administration, it is perhaps evident that the Covid unemployment support pay outs - legislated to run until September - are discouraging people from taking up low paying service jobs. There is certainly significant anecdotal evidence to this effect with numerous reports across sectors in the US of job opportunities going unfilled. This phenomenon is not limited to the US. In Ireland, for example, full retail re-opening is also being hampered by the lack of take-up in job openings – leaving a number of stores in a difficult situation.

Job Openings at Odds with Wider Employment Picture



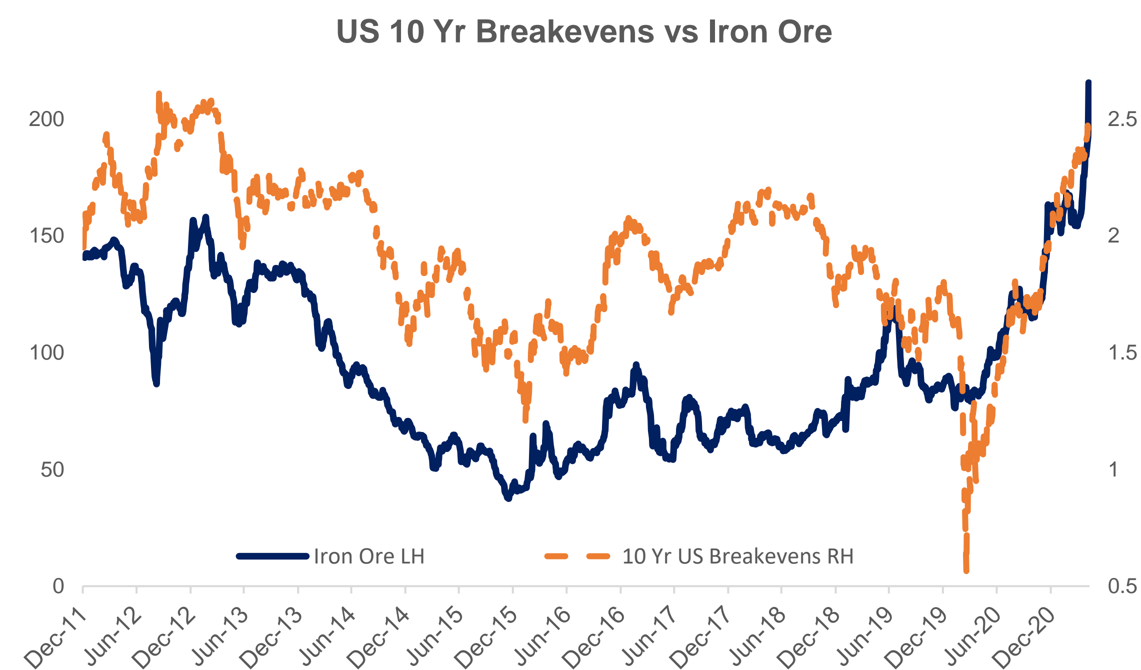
Source: Bloomberg as at 10/05/21

Of course the excess in job openings is not all about furlough payments and other covid supports. Childcare and other covid-related factors have played a part, while a significant proportion of females are yet to return to work post COVID. Having said this Biden will be concerned that the unemployment rates for minorities are trailing that of white Americans which is likely to encourage him to press on with current policies. The more centrist elements within the Democratic party, particularly in the Senate, are likely to use this recent data to point to the excesses of Biden's recent programmes.

Ironically, the only conclusion one can make is that this disappointing data makes Biden's fiscal programmes harder to achieve, not easier.

It has long been argued that the Fed is in a liquidity trap of its own making. This data further tightens the noose around their neck. The long-awaited fiscal support that central banks around the world have been begging for has finally arrived, which may give inflation the same shot in the arm that it has economic growth. Wages are certainly rising along with commodity prices with questions mounting over the Fed's interpretation of just how temporary these higher wages and prices really are. Will these supply-side shocks in the face of growing demand subside quickly or are we going to see a more sustained increase?

How Temporary is the Impact of Surging Commodity Prices on Inflation?



Source: Bloomberg as at 10/05/21

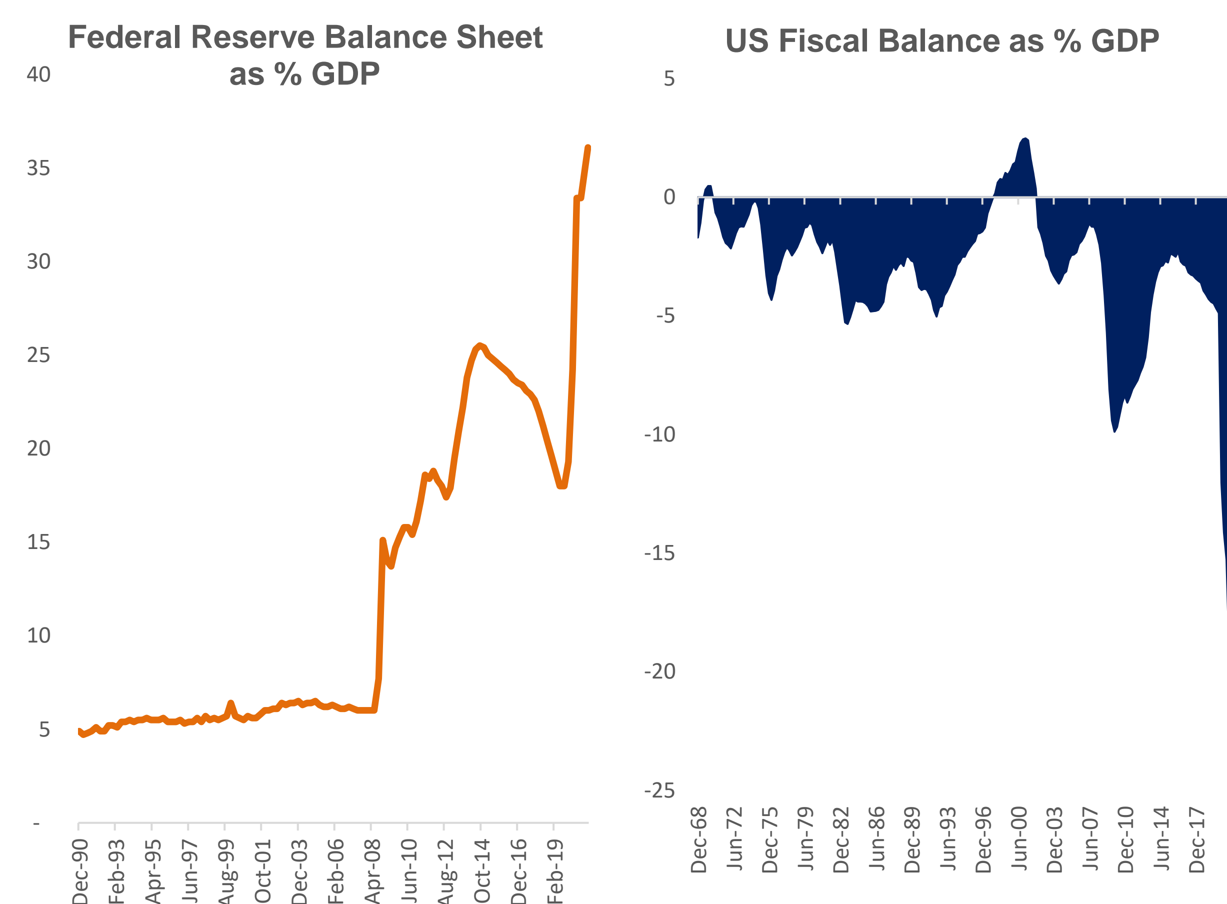
Inflation expectations are surging to pre-GFC levels (in the US anyway). Commodities are on fire with products like lumber hitting all-time highs, while others like copper are at levels not seen since the previous commodity peak in 2011. At the same time, due to the extreme excess in liquidity and unheralded looseness in financial conditions, asset prices are enjoying frenzied speculation.

Last week's financial stability report released by the Fed clearly outlined a market detached from economic reality with significant downside potential.

Policy Dilemma

Herein lies the Fed's dilemma. Press ahead with policies which might or might not support the recovery but will almost certainly result in an increase in market instability that can ultimately threaten the whole system - just as it almost did in 2008. Or try to take some froth out of markets at the risk of upending financial markets and potentially de-railing the economic recovery. Powell will most certainly go bigger for longer with the unwavering belief (hubris?) that the Fed can deal with any potential market volatility down the line. Perhaps it is the self-reinforcing nature of the constant intervention that creates the greatest problem: the more the Fed does, the greater the instability and the harder the fall.

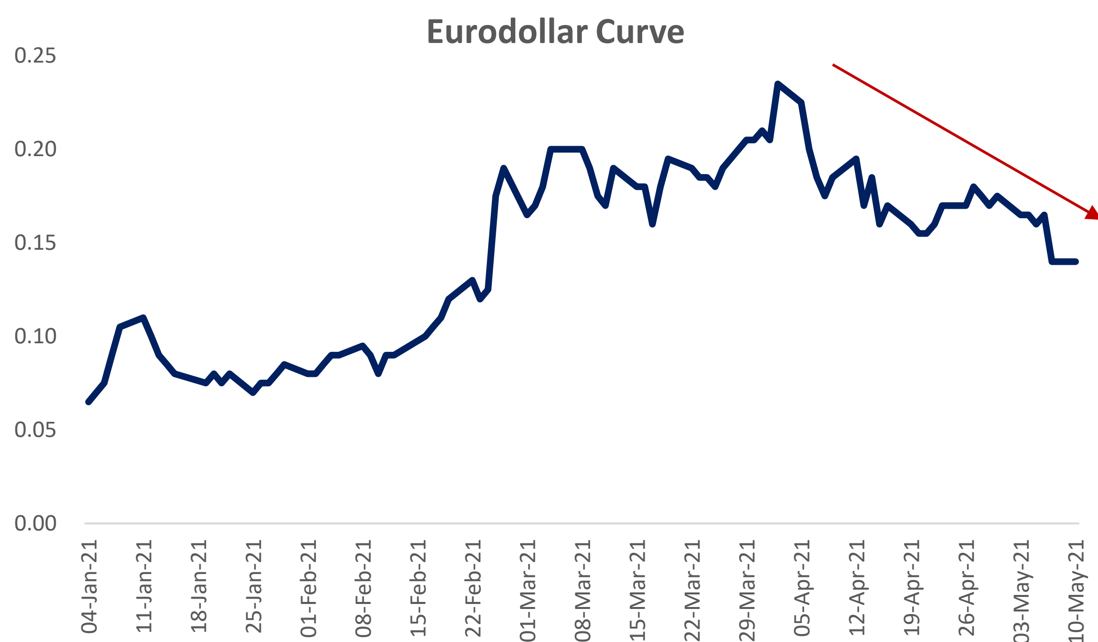
Federal Reserve and Fiscal now "All-in"



Source: Bloomberg as at 30/04/21

There was genuine belief that Fed discussions on QE tapering would be forthcoming during their June meeting, but recent events may have pushed that out to August and the Jackson Hole symposium. More significantly, any potential rate hikes in 2022 have been postponed to 2023 - unless of course the inflation genie is released from the bottle in which case all bets are off.

Rate Hike Expectations Postponed

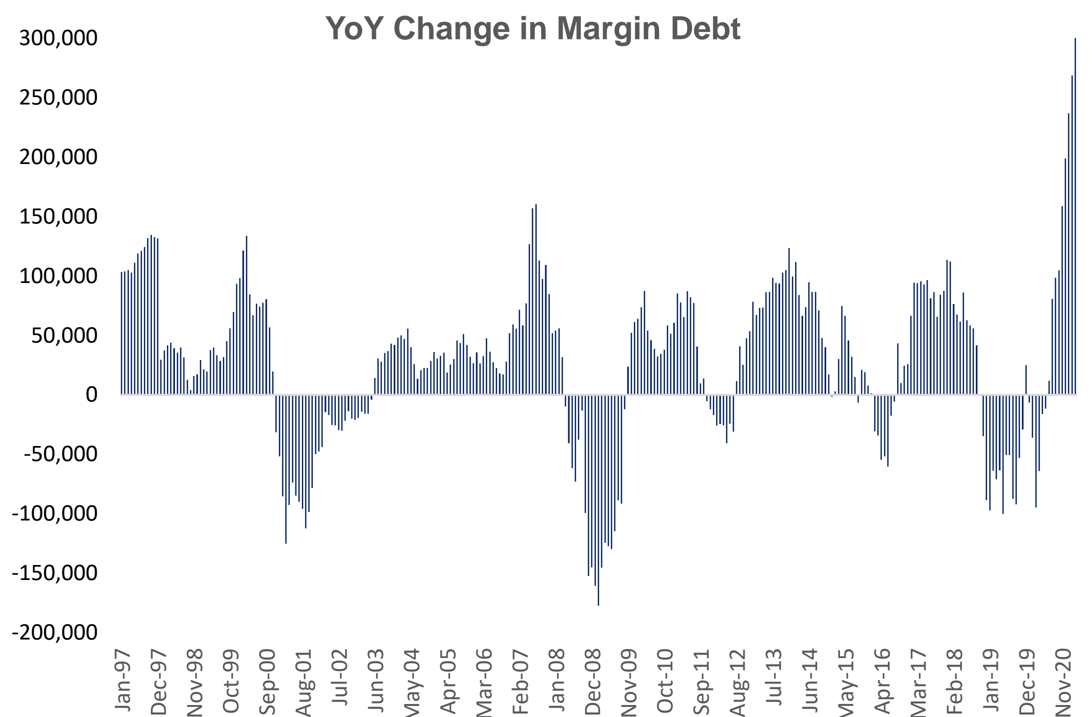


Source: Bloomberg as at 10/05/21

The law of unintended consequences clearly demonstrates how excess liquidity and financial excesses reduce productivity as opposed to increasing it. It has been argued that a reduction of QE would take pressure off the banks' excess reserves and free up more capital for lending and credit expansion into the real economy. The Fed has been happy to ignore these facts and the extent of Japanese style (and levels) of zombification will continue to have a large impact on US potential growth. The economy breached the threshold of diminishing marginal returns of credit a number of years ago (Powell openly admitted this is Sept 2019) and as such the balance of the recovery will continue to be skewed towards the unproductive asset bubbles of financial markets as opposed to productive gains in the real economy.

We don't feel the recent disappointing jobs number changes the outlook significantly and therefore still expect a strong recovery over the next number of months. However looking closely at the jobs numbers it looks as though the easy gains will last until the end of summer.

Increased Financial Stability Risks



Source: Bloomberg as at 30/04/21

The Death Star-like power of the US covid related stimulus packages may not create the lasting recovery everyone is expecting. Worse than that there could be a sting in the tail in relation to higher expected and realised inflation rates. This increase in inflation might not be fully reflected in the official CPI data but will certainly be felt and even perhaps accepted by an increasingly stratified population more reliant on government handouts than any time in US history (34% of US income over the last year was government transfers and payments). After more than a decade, could this finally be the factor that forces the Federal Reserve to move away from experimental monetary policy or will it force them to double down. It is still too early to tell how this picture will develop, but risks to the economy are rising just as the markets are becoming excessively complacent with risk premia at record lows. Where have we seen this movie before?

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