LPL RESEARCH

WEEKLY ECONOMIC COMMENTARY

July 8, 2019

JOB MARKET STANDS STRONG

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KEY TAKEAWAYS

The June jobs report was unexpectedly strong, especially after a disappointing May.

Labor market strength could buoy otherwise moderate economic prospects.

However, the resilient job market could complicate the Fed's policy debate.

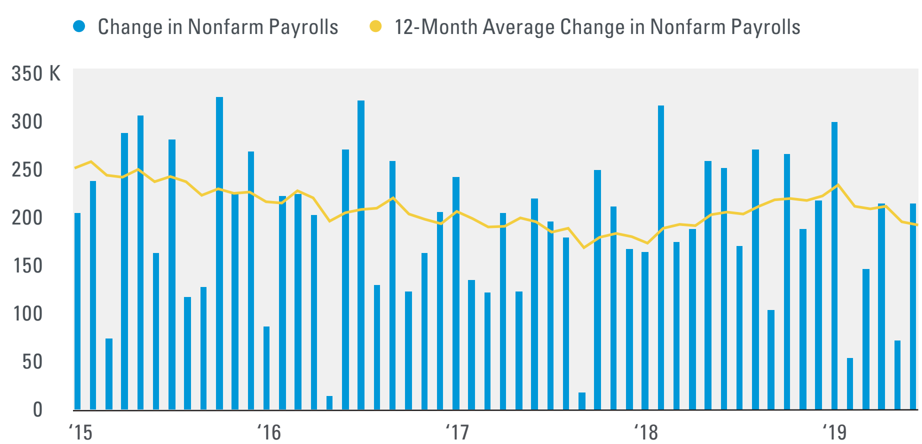
The June jobs report was solid. Labor market conditions rebounded last month from a disappointing May, easing market worries about the impact of trade tensions on corporate hiring. Nonfarm payrolls rose 224,000 in June, beating consensus estimates for a 160,000 gain [Figure 1].

The stronger-than-expected data caught investors off guard, though. The 10-year Treasury yield posted its second-biggest increase on a jobs report day since the beginning of 2016, and the S&P 500 Index briefly sold off as much as 1% intraday before ending the day unchanged. Markets were clearly prepped for a second month of disappointing jobs data, but there wasn't much to critique in June's report. Good economic news was bad news for risk assets.

ECONOMIC ENGINE

The jobs market plays a pivotal role in the U.S. economy and is the engine for consumer activity, which accounts for about 70% of economic output. It's also the primary focus for Federal Reserve (Fed) policymakers, whose dual mandate is to ensure maximum employment and stable inflation.

1 PAYROLLS REBOUND FROM A WEAK MAY



Source: LPL Research, Bureau of Labor Statistics 07/08/19

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Fortunately, the labor market has been nearly infallible in this economic cycle. U.S. companies have added jobs for 105 straight months, by far the longest streak on record. In June, the 12-month average payroll change was 192,000, a pace slightly above the expansion average of 175,000. Strong labor market conditions have buoyed the expansion for 10 years, and continuing strength could overpower late-cycle cracks in smaller parts of the economy. We also see several encouraging signs in other labor market data: a historically low unemployment rate, contained jobless claims, and solid (but manageable) wage growth.

To be fair, it has been tough to read the tea leaves in payrolls data recently, given the unusual volatility in data this year. Two of the six payroll reports this year have shown job gains less than 100,000, a level that has been breached only four other times since the end of 2013. Still, there have been some equally unusual strong payroll prints this year, including a blowout 312,000 gain in January.

POLICY IMPLICATIONS

Lately though, the job market's resiliency has muddied the case for looser monetary policy. The U.S.-China trade dispute has dragged on for more than a year without much progress, and trade uncertainty has weighed on pockets of the economy for several months. Now, financial markets have priced in multiple Fed rate cuts through the end of 2019, signaling a need for more than just a minor course correction in policy. The hopes for lower rates have boosted U.S. stocks to new records and pushed the 10-year yield to a 2.5-year low, plunging parts of the yield curve into inversion territory (long-term rates falling below short-term rates).

A month ago, May's jobs report was unexpectedly weak on multiple fronts, convincing investors that trade tensions had finally infiltrated corporate hiring. However, June's strong jobs report showed that May's weakness was likely an aberration instead of a trend and weakened the argument for a near-term rate cut. Even though sound labor market data point to an optimistic economic outlook, it could complicate Fed policymakers' debate over the future of policy. Right now, we think a Fed course correction is appropriate, as monetary policy appears to be too tight given the drawn-out U.S.-China trade dispute. The Fed set the stage for a rate cut at its June meeting, so we think a rate cut could happen as soon as this month. It's tough to predict what path the Fed will take beyond that initial rate cut, especially while trade uncertainty still lingers. We see low odds of a near-term recession, but the macroeconomic environment is still complicated, and trade tensions have proven to be a powerful weight on economic activity.

CONCLUSION

Overall, we remain encouraged by the U.S. job market's resiliency amid trade tensions. We still think the current pace of job creation is healthy, especially 10 years into an economic expansion. We would also expect to see some slowing in payrolls as the cycle matures, so slight moderation in job growth wouldn't be alarming to us.

The macroeconomic environment has been increasingly challenging to read, and anticipating the Fed's response has been key for financial markets. Right now, we're watching for clues from Fed officials on where policy could be heading beyond an initial rate cut. To us, there isn't a clear argument for anything more than a rate cut (maybe two) over the next several months. We'll get more context from a key policymaker this week, as Fed Chair Jerome Powell is scheduled to deliver testimony before Congress July 10 and 11, with the detailed minutes from the June policy meeting released the same day. ■

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