TrendMacrolytics

Donald Luskin, Chief Investment Officer
David Gitlitz, Chief Economist
Thomas Demas, Managing Director

TRENDMACRO LIVE!

On The June Jobs Report

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David Gitlitz

For a **bond market** that has seized on soft-looking data to post impressive gains over the past several months, today's sour response to another seemingly disappointing **payroll report** indicates that a new appreciation for economic reality is gradually infecting the market. Perhaps taking a cue from the broad financial market resilience seen in the face of yesterday's **London terror strike**, suggesting that such event risk has been largely discounted while underlying conditions remain robust, the bond market today gave the bulls no room to run on a payroll number that came in some 50,000 jobs below expectations with a gain of 146,000. At the same time, there appears to be a dawning awareness that a **slowdown scenario** is difficult to accord with an **unemployment rate** of 5%, having fallen from 5.4% just since February.

Indeed, while this **labor market** may continue to disappoint those pining for a return to the halcyon days of 3.8% unemployment and **NASDAQ 5000**, the fact is that -- like **the economy** itself -- it deserves a lot more credit than it gets. **Private sector payrolls** have been growing at a rate of about 1.7% since the second half of last year. While that is below the exuberant late 1990s rates around 2.5%, it still exceeds **labor force growth** -- averaging about 1% -- by a significant margin, suggesting unemployment should continue to fall and **compensation** rise at a healthy rate. As well, growth of **aggregate hours worked** in the private economy has been steady in a range around 2.5% per year. Again, that pales against the best levels of last decade, which exceeded 4%, but at present levels the rise in aggregate hours is indicative of labor input growth that has historically been consistent with solid, sustainable **economic expansion**.

From our perspective, one of the more encouraging aspects of today's jobs report is that it provides no support for those calling for a premature end to **the Fed's policy normalization** campaign. While job growth may not be as strong as many would like, it's not nearly soft enough to deter the Fed from needed action. Reflecting that reality, with the modest sell-off in **interest rate futures markets** today, **December '05 Eurodollar futures** are now priced for about a 25% chance that the **fed funds rate target** will finish the year at 4%. Just two weeks ago, December Eurodollars were an even money bet between 3.5% and 3.75%. It strikes us as very good news that even as the **10-year Treasury** reversed early gains and settled at a **yield** of 4.08% in conjunction with the rate futures move, **equities** were able to post strong gains today. Despite all the wailing from those convinced the economic fate of mankind rests on the Fed maintaining a 3-handle funds rate, by far the greater risk is that the Fed remains behind the curve, allowing **core inflation** to break out to the 4%-plus levels last seen in the early 1990s. Since delivering its stay-the-course message following last week's **FOMC** meeting, that risk has receded at least somewhat, as seen in the decline in the price of **gold** from $440 before the meeting to a range around $425. But remember, even at $425 gold is still almost 30% above its ten-year average. The monetary metal is far from entirely confident that the Fed will, in fact, be able to get out from behind the curve. TM

http://www.trendmacro.com
don@trendmacro.com
dgitlitz@trendmacro.com
tdemas@trendmacro.com

Offices:
Menlo Park CA
Parsippany NJ
Charlotte NC

Phone:
650 429 2112
973 335 5079
704 552 3625