The employment report: almost perfectly anticipated

All elements of the report came exactly as anticipated, wage growth, hours worked, labor force participation and the unemployment rate. The only surprise was the 56K below expectation payroll. However, that was more than "compensated" by the upward revisions for the previous two months.

Once again, many generally referred to the report as "solid" or "strong". I have previously argued against that view. Here, I want to concentrate "fire power" on some other misconceptions regarding the labor market.

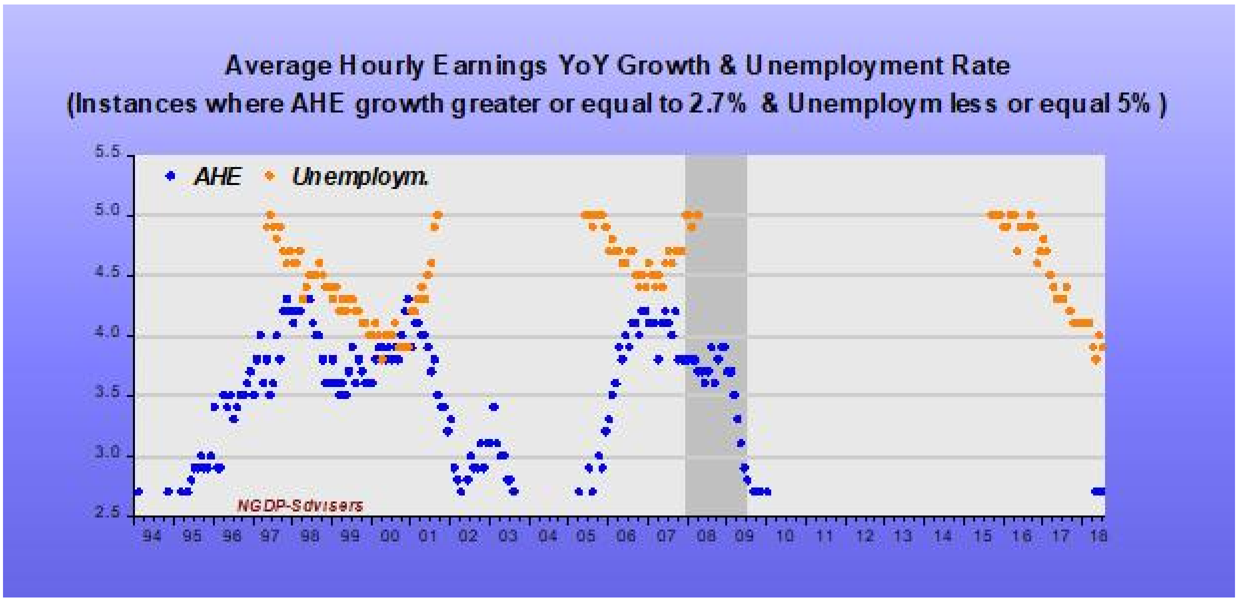
Recently, Chairman Powell said:

> "Everywhere we go we hear about labor shortages. But where's the wage reaction? "
>
> "So it's a bit of a puzzle. I wouldn't say it's a mystery, but it is a bit of a puzzle."

According to the conventional wisdom, if unemployment falls to "low" levels, wage growth should pick up, and then inflation should rise. That´s the old "wage-price spiral" view of inflation.

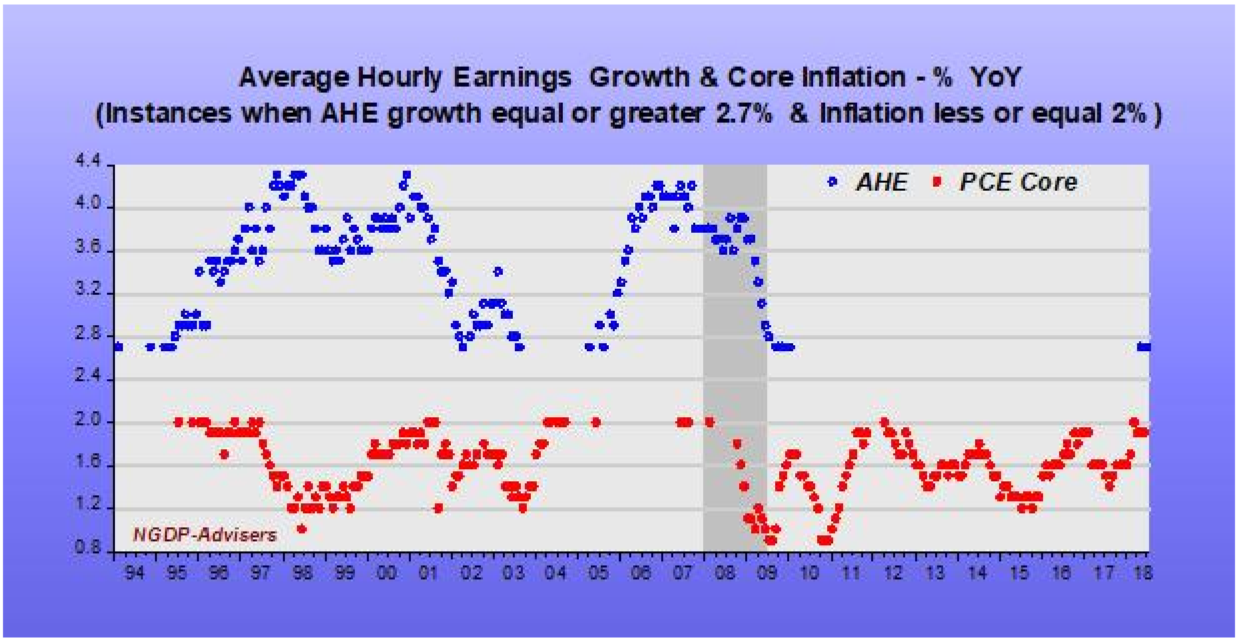
Is that a reasonable view? If it´s not, by concentrating on it the FOMC will make **bad decisions**.

The chart below shows how wage growth has behaved with varying rates of unemployment. I plot wage growth for instances when that growth was equal to or greater than the present 2.7% together with the unemployment rate when that rate was equal to or less than 5% (an arbitrary but acceptable definition of "low" unemployment rate).



Note that prior to the 2008-09 recession, there is a noticeable negative correlation between the rate of unemployment and wage growth. That correlation, however, has disappeared in the past 10 years. In the past few years, with the unemployment rate falling significantly below 5%, wage growth has barely reached 2.7%

The other part is to see how wage growth above 2.7% has related to inflation for those instances where inflation is at or below the 2% target.



There´s no correlation. For the most part, inflation has remained at or below the 2% target level, independently of wage growth. If you ignore the fall in inflation during the recession, the behavior of inflation has been very similar before and after the recession, even if the behavior of wage growth has been markedly different in the two periods.

Bottom line: Our previous conclusion that the labor market is far less “strong” or “solid” than is actually believed stands. Moreover, by letting itself be led by misguided “principles”, the Fed is “leaving a lot of bills lying unclaimed on the streets”.