# Why the May Jobs Report Is No Argument for a Fed Rate Hike

By James Hickman Follow | 06/09/15 - 11:04 AM EDT

NEW YORK (TheStreet) -- The May jobs report has prompted a discussion that the economy is getting stronger.

But just as the contraction in first-quarter 2014 gross domestic product (and 2015, prospectively) and the anemic March jobs numbers failed to be harbingers of another recession, the so-called "strong" May jobs report has little predictive value.

Moreover, as a percentage of total jobs -- the only way to look at it -- new jobs added in May make the month the 404th strongest out of the 905 reports since 1940.

Put another way, if the U.S. economy created an average of 280,000 new jobs (May's number) every month going forward, the economy would not hit "full employment" of around 5.3% until the 37th month, June 2018.

"Full employment" is defined by **Federal Reserve** and policy experts as the unemployment rate at which inflation starts rising more than desired, with estimates falling in the 5%-to-6% range.

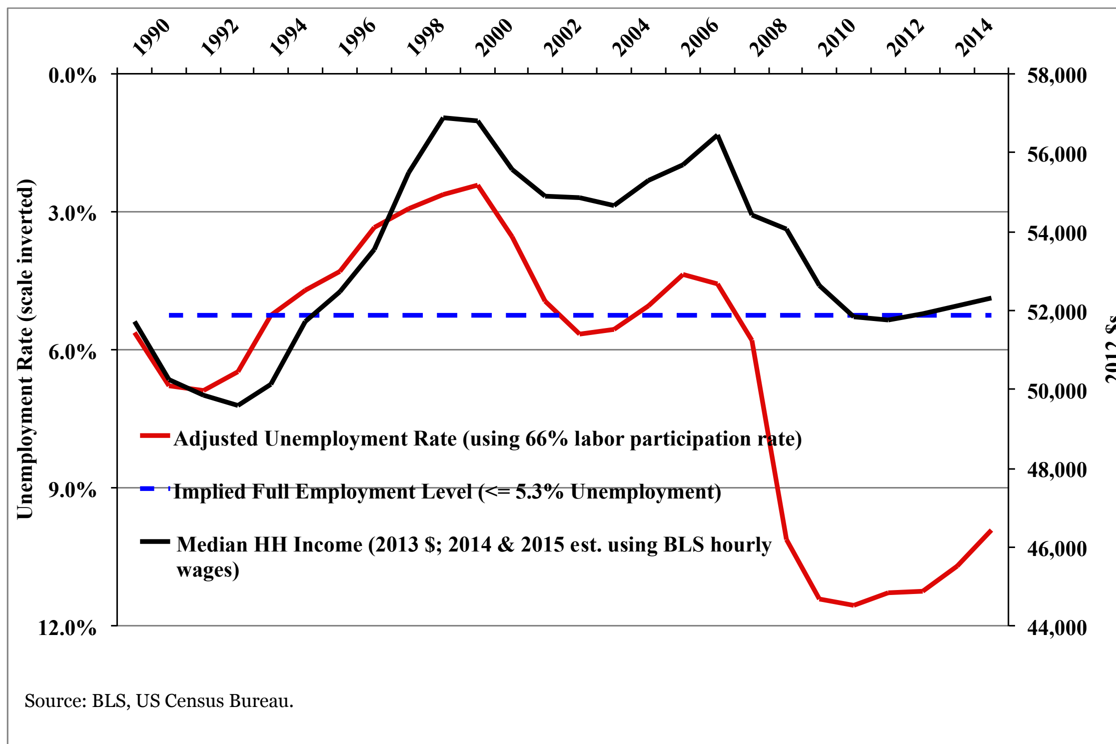
Historical data show that unemployment of 5.3% or less is generally necessary for sustained wage growth (see chart 1). The *official* unemployment rate sits at 5.5%, and chatter about wage growth is indeed on the rise.

First, the labor force participation rate remains at historic lows, even adjusted for baby-boomer retirement. After accounting for this reality, the real unemployment rate remains at 9.9% (see chart 2).

Second, household income remains at levels last seen in 1995, and in real terms, is up 0.4% through May vs. 2014. In fairness, when food and energy are included in the consumer price index (the Fed excludes them in its analysis), actual *deflation* has been observed so far in 2015, adding more than 2% to the year-over-year comparison.

Signs of wage recovery? Seriously? The real growth in 2013 and 2014 was 0.3%. The U.S. economy remains about 7.5 million jobs shy of full employment.

**Chart 1: Real Income and Unemployment Rate History**




Source: BLS, US Census Bureau.

Demographic trends, high and rising sovereign debt levels and the absence of a capital-friendly U.S. tax and regulatory landscape conducive to growth spending in the private sector over the past 14 years, particularly the last six, have been key factors behind significantly below-trend GDP growth over that period.

But what if the U.S. economy simply reached a level of productivity -- the result of outsourcing and technology-driven capital substitution for labor -- at which today's record-low ratio of employee headcount per unit of output is the new normal?

It appears all these factors have conspired to yield the worst 14-year (and counting) real-growth run, 1.8% compounded, since World War II.

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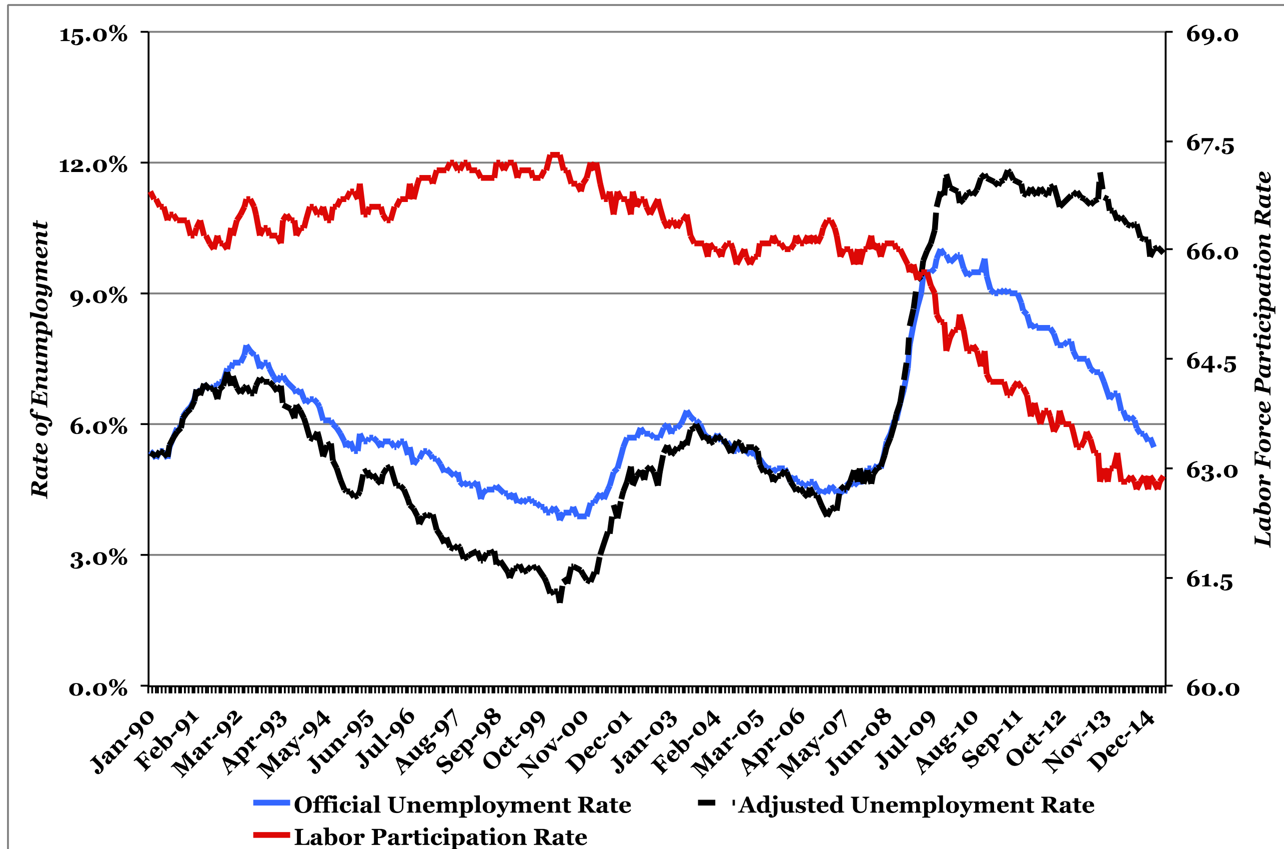
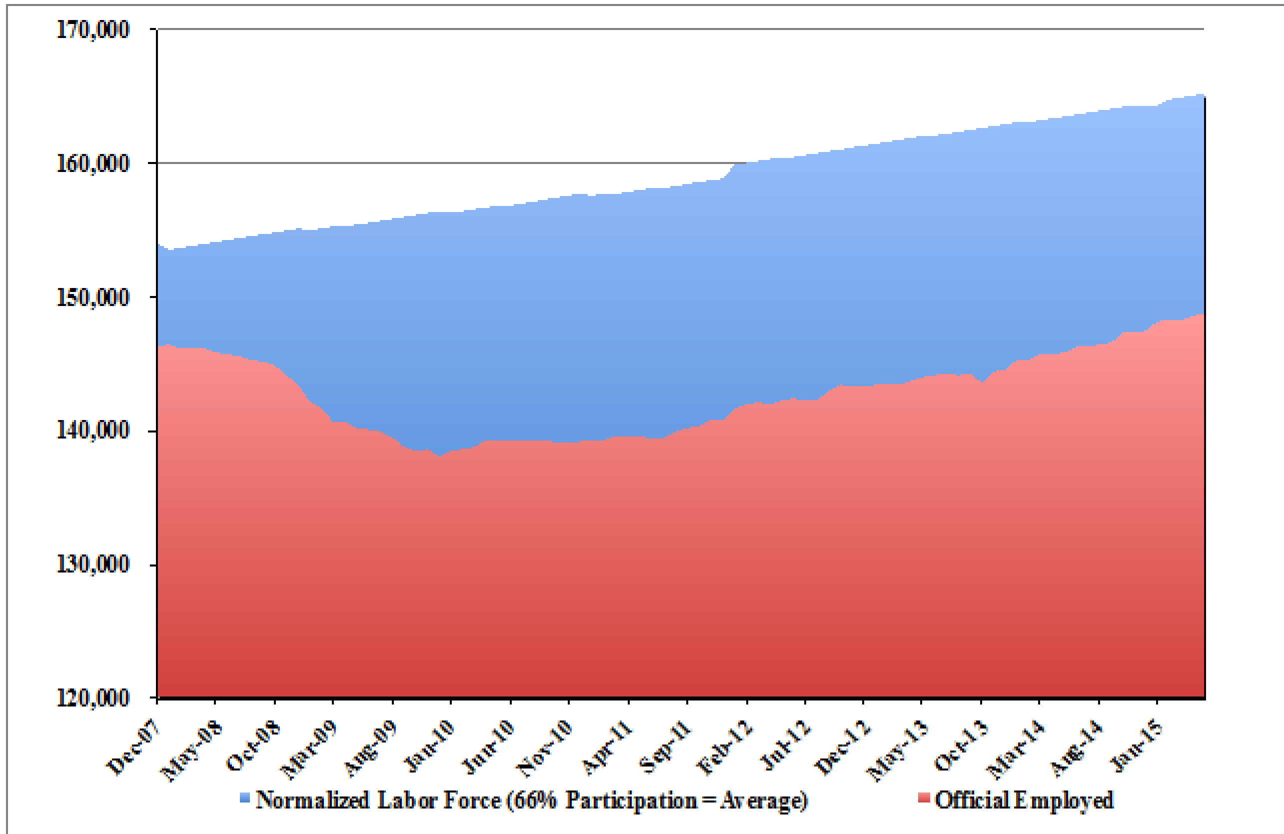
**Chart 2: Employment Adjusted for Normalized Participation Rates**




U.S. real GDP per employee rose in each year of the recent recession because jobs were cut faster than the economy's decline. If the U.S. could have only matched the *previous*-worst 14-year growth period (2.5% compounded over the 14 years ended in 1982), 2014 GDP would have been higher by *10%* or *$1.6 trillion*. Despite being a recovery off a very low starting point -- the bottom of the worst recession since the Great Depression -- the compounded growth over the last six years for the U.S. economy has not only been the worst *recovery* of the post-World War II era, it ranks as the 11th worst growth over *any* six-year period since 1948. That is *historic* weakness.

Guess how many times the U.S. economy experienced consecutive years of net jobs declines since World War II? Answer: *zero*. Except until three consecutive annual declines from 2007 to 2010. Moreover, every instance of jobs declines since World War II was followed by a surge in jobs growth in the following recovery years, typically taking 13 months from the employment trough back to peak. The recovery from 2010 to 2014 took 57 months to reach prerecession peak employment, during which *another 10 million civilians entered the labor force* (see Chart 3), notwithstanding official numbers failing to account for multidecade lows in participation rates.

**Chart 3: U.S. Employment and Labor Force Since Financial Crisis**




Anemic growth is not a monetary issue but instead relates to demographic trends in advanced economies, government deficits, the lack of confidence among those in the private sector who determine where capital should go and the lingering deflationary impact of the financial crisis.

If the Fed raises rates in the presence of below-normal GDP growth (domestically and globally) and below-normal inflation, it will be entering historically uncharted territory.

Not since then-Federal Reserve Chairman Paul Volcker's assault on inflation in 1979 and 1980 has the federal funds rate increased when GDP was growing slower than the trailing-three-year-average, and that was a historic policy decision to break double-digit inflation.

The Federal Reserve may very well raise rates as early as September, as most economists predict, but if it does, it likely will have more to do with fear of unintended consequences attending six years of zero-bound interest rate policies, and nothing to do with inflation or unemployment.

The Fed is likely to delay beyond September, but regardless of when it raises rates and by how much, long-term bond yields will not be rising meaningfully before 2016 or later.

*This article is commentary by an independent contributor. At the time of publication, the author held no positions in the stocks mentioned.*