Why It's Premature To Postpone Tapering After US Payrolls Disappoint

- **Job growth slowed below everyone's expectations in August…**
- **...but remained positive while hours worked increased**
- **Delta, acute supply chain challenges and less labour slack than often assumed all probably contributed to the slowdown…**
- **...some of which may be transitory, some of which may feed further wage-price spiral effects**
- **Why it's premature to push-out Fed tapering**

US nonfarm payrolls, m/m 000s // UR (%), SA, August:
Actual: 235 / 5.2
Scotia: 625 / 5.2
Consensus: 733 / 5.2
Prior: 1053 / 5.2 (revised from 943 / 5.4)

SUMMARY

Clearly it's disappointing that 235k jobs were gained in August that fell below *everyone's* expectations and that was only partly offset by positive revisions of 134k and with poor breadth. Markets were nevertheless mixed in their reaction as the USD slightly depreciated, the Treasury curve *steepened* by quite a bit because the 10 year yield increased by 3bps and the US S&P500 is little changed so far on the day.

I don't, however, think that one payrolls print derails taper plans for this year and with a December announcement remaining our call. This is more downside risk than had been anticipated, but I wouldn't say one should be totally blown away by the slowest pace since January given the activity readings we've been getting amid the rise of the Delta variant and with the distinct possibility of recurring waves in future causing further volatility along trends in the economy.

PREMATURE TO RE-WRITE TAPER CALLS

One reason why it's highly premature to write-off tapering the Fed's bond purchases this year is that hiring could rebound if Delta cases subside, especially as the jobless benefit extensions expire shortly and reduce financial choice over whether to accept large numbers of unfilled positions.

Further, about 17 million jobs have been recouped to date with about another 5¼ million to go and so tapering can still rest on achieving 'substantial' progress in my view (chart 1). It's not like a first taper means monetary policy suddenly turns tight as opposed to a bit less wildly stimulative!

Third, the debate over whether job markets are already tight and hence how it's getting progressively difficult to find workers may be further ignited by this print. Personally I still don't think it's realistic to target full employment back to February 2020 when the number on payrolls was a record high and the unemployment rate

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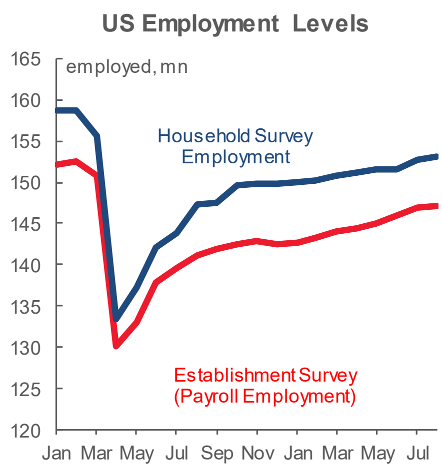
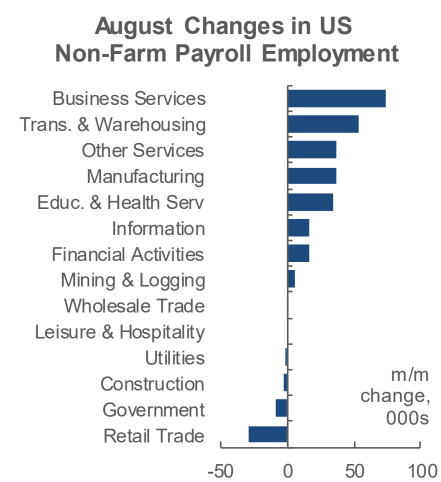
Chart 1



Sources: Scotiabank Economics, US BLS.

Chart 2



Sources: Scotiabank Economics, US BLS.

was roughly tied for a record low. I still think some types of jobs may never fully come back and some with be increasingly transient forms of labour in the face of COVID-19 waves. **It may be that difficulty finding workers will further ignite wage pressures and further pass through into inflation readings as supply chains struggle to get product out into the economy.**

Fourth, hiring may have also slowed because of increasingly acute supply chain challenges that have disrupted and delayed production. As these issues are slowly worked out we'll get choppy jobs data.

But the calm debate here is whether this is a speed bump that policy should look through with the expectation that activity in the context of choppy data gets punted forward, or whether it's recession stuff. The latter kind of talk is ridiculous in my view. **Choppy data is to be expected as covid waves hit damaged supply chains with the expectation that the trend recovery still lies intact.** At the margin, a positive could arise if the Dems' minds get focused on getting on with their stimulus and budget/funding package with an eye on soon transitioning toward mid-term campaigning.

THE DETAILS

All of the small rise in jobs was in the private sector (243k) as government slipped a touch (-8k, all state/local).

Chart 2 provides the sector breakdown. By sector, goods were up 40k while services added 203k. Within goods, manufacturing was up 37k and construction was flat (-3k).

Within services, the biggest area of weakness was in leisure and hospitality. After seeing massive monthly gains stretching back to February, this category was dead flat (0k). There has been little breadth in employment gains across sectors outside of this leisure and hospitality sector for months now, so the fact it dropped out entirely last month continues to demonstrate the dominant role played by high contact, relatively low paying jobs in the services sector and namely restaurants and bars.

Chart 3 shows the cumulative recovery in employment by sector since February 2020 with the high contact jobs in leisure/hospitality still faring the worst.

Hours worked were up by 0.2% m/m after a prior gain of 0.6% m/m. That's also encouraging because recall that when the Delta virus first hit it immediately took hours worked down in March and April 2020. That's not happening this time—at least not yet—as hours haven't fallen since February. This might suggest that employers are looking through the Delta variant by increasing hours a bit and still hiring at a slower pace. Q3 is tracking a 4.4% q/q seasonally adjusted and annualized pace of increase so far and based on Q2 and two-thirds of Q3 while assuming September is flat until we get the data so as not to artificially skew the tracking in either direction. See chart 4.

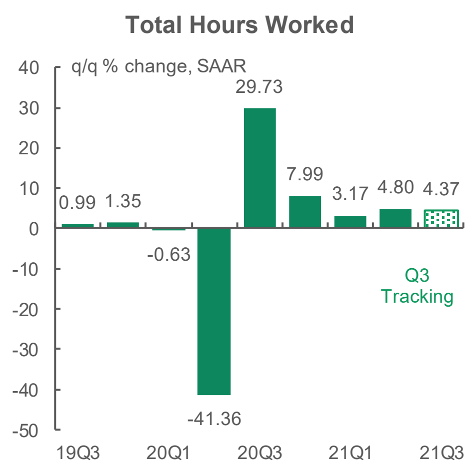
The point on hours is also encouraging for GDP since GDP is an identity defined as hours worked times labour productivity (output per hour worked).

Wage growth picked up but view some of that skeptically (chart 5). Wages were up 0.6% m/m on a seasonally adjusted basis which raised the year-over-year rate to 4.3% from a slightly upwardly revised 4.1% the prior month. At least some of this is

Chart 3

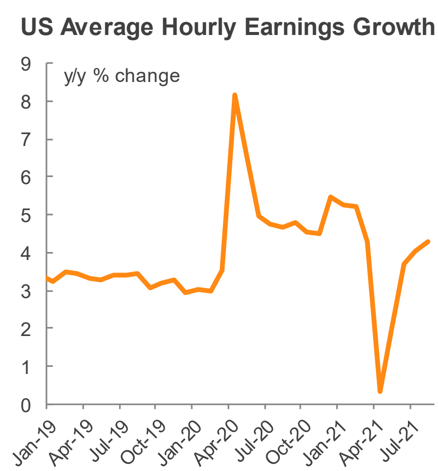
Sources: Scotiabank Economics, US BLS.

Chart 4



Sources: Scotiabank Economics, StatsCan.

Chart 5



Sources: Scotiabank Economics, BLS.

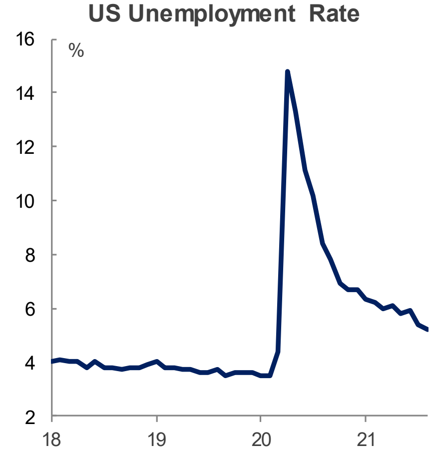
a compositional effect as there were fewer jobs created in lower paying sectors than higher paying sectors last month. Still, not all of the gain can be dismissed and we've been seeing monthly seasonally adjusted gains of 0.4–0.7% m/m since April even as the hiring numbers shifted toward clawing back lower wage workers.

The unemployment rate fell to 5.2% (from 5.4%) because it is derived from the household survey that registered a job gain of 509k with a smaller gain in the labour force of 190k (chart 6). The labour force participation rate was unchanged at 61.7% given the modest expansion of the labour force relative to population changes.

Last, chart 7 reinforces the point about how the low hanging fruit of the labour market expansion has been picked in that most lower-wage workers have already returned. Parents have also likely already returned to the workforce over the summer rather than waited for the return of the school year as previously argued.

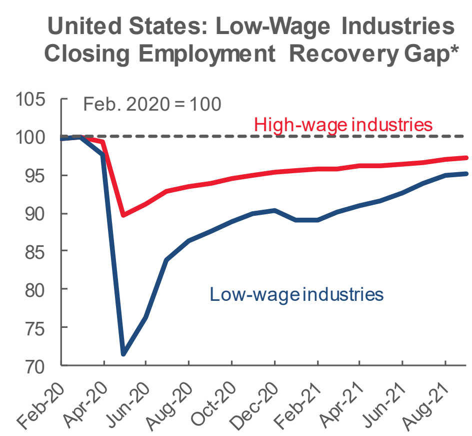
In all, what if we've already had something that resembles a full labour market recovery in the context of struggling supply chains? The net effect could still be a powerful mixture of solid GDP growth, softer trend job gains than the initial impulses, but rising inflationary pressure that the Fed may have seriously underestimated. It seems to me that when faced with this risk, you'd likely want monetary policy to be a bit more balanced by acknowledging this risk and stepping back.

Chart 6



Sources: Scotiabank Economics, BLS.

Chart 7



*Low-wage (high-wage) industries classified based on wages below (above) the total industry average wage.
Sources: Scotiabank Economics, BLS.