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GLOBAL ECONOMICS

SCOTIA FLASH

August 2, 2024

# Why Markets Got U.S. Payrolls Wrong

- **Nonfarm payrolls seemed to disappoint…**
- **…driving a wildly negative market reaction…**
- **…but distorted pandemic-era seasonal adjustments appear to be the culprit…**
- **…such that after controlling for them, payrolls were about +200k**
- **Chair Powell is likely to apply the same cautions to jobs as he does to inflation data**

**US Nonfarm payrolls, m/m 000s // UR %, July, SA:**
Actual: 114 / 4.3
Scotia: 205 / 4.1
Consensus: 175 / 4.1
Prior: 179 / 4.1 (revised from 206 / 4.1)

Nonfarm payrolls disappointed expectations and increased by only 114k and the household survey registered just +67k. If that's accurate, then it signals a sudden deceleration of job growth to a pace that lies beneath estimates of the required breakeven pace in relation to the pick-up in population growth.

Markets reacted violently by pushing the S&P500 down 2½%, the two-year Treasury yield down by about 15bps, the dollar broadly weaker, oil prices sharply lower, and pricing for the FOMC's September decision toward a 50bps cut.

And yet we may have seen this movie before. Like a typical Disney flick, it's entirely possible that apparent initial adversity ends more positively after reading this note. I'll go over a few of the details in a moment after explaining why I'm calling bogus on the number.

## WHY PAYROLLS WERE DISTORTED

We are still being plagued by the distorting aftermath of the pandemic. Weak job growth in July 2024 is a repeat of the past pattern of reports at this time of year. On a seasonally unadjusted basis, this July was actually a little better than the pre-pandemic norm (chart 1). So why did SA job growth disappoint? The rub lies in the seasonal adjustment factors that were applied.

Charts 2 and 3 show that the pandemic era dominates the weakest seasonal adjustment factors applied to months of July in history. This means that the typical seasonally unadjusted decline in employment that happens in months of July has been serially undercompensated by seasonal adjustment factors during the pandemic era.

If instead of using the BLS SA factor for July 2024 that generated this morning's +114k print we were to apply the average SA factor for months of July up to and including 2019 before the pandemic struck the next year, then this July's nonfarm payrolls would have been up by about 200k instead of 114k.

By extension, SA factors were distorted in a way that arguably overstated nonfarm payrolls growth earlier in the year such as the 310k surge in March which was the month in


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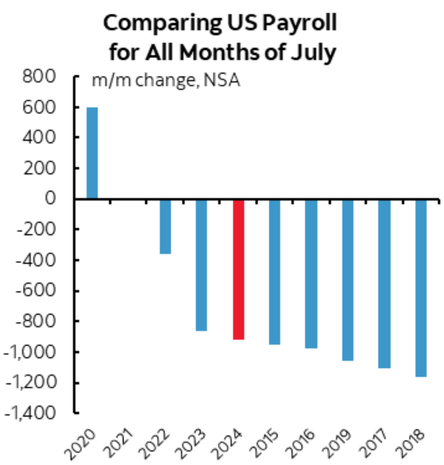
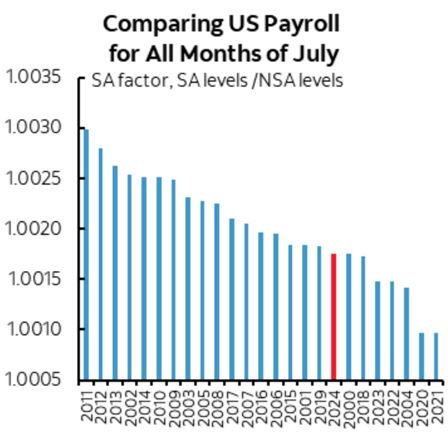
Chart 1



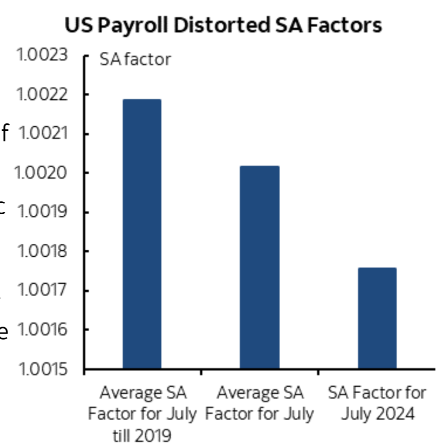

Sources: Scotiabank Economics, BLS

Chart 2




Sources: Scotiabank Economics, BLS

Chart 3




Sources: Scotiabank Economics.

2020 when all heck broke loose and economies began to shut down.

This is an extension of Chair Powell's point about inflation during his recent press conference and why he looks at full year data. In the inflation context, distorted seasonal adjustments may artificially inflate price increases earlier in the year and artificially deflate them later. Ergo, consider the totality of the year's evidence. The same argument applies to evaluating jobs.

Another way of looking at it is that the evolution of monthly changes in nonfarm payrolls in 2024 is looking similar to what we saw in 2023 (chart 4). The same is true for the household survey (chart 5). In both reports, job growth starts off strong at the beginning of the two years and then reaches a nadir in the summer.

There is also the issue that this is just one month by the way. And we've seen one-handled payroll changes in the past, such as 108k in April right after March's barn burner of a report. Or three months of 100k range prints last year.

Markets may have also had such a violent reaction to the payrolls estimate because, well, it's August. Pair data disappointment with holidays and you have the recipe for a violent reaction.

## DETAILS

The details may not even be worth covering in light of this point, but here we go anyway.

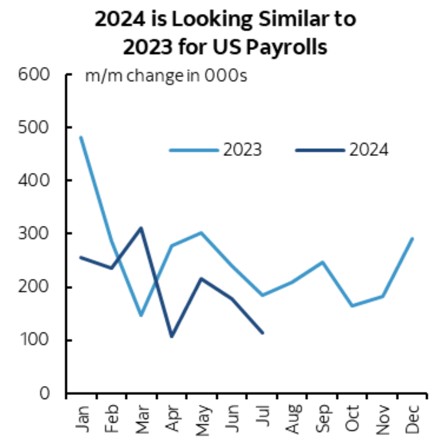
Chart 6 shows that there was high breadth to the softness in hiring.

Chart 7 shows that wage growth cooler but remains solid.

Chart 8 shows that hours worked are tracking quite softly which is a tentative negative for GDP growth in Q3 given that GDP is an identity defined as hours worked in aggregate times labour productivity. If productivity picks up, then GDP could be rescued. And the Q3 tracking is based very tentatively on just Q2 data and July with two-thirds of the quarter still ahead of us.

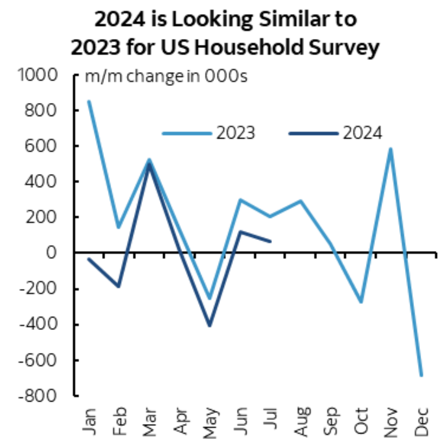
Chart 9 shows the gradual rise in the unemployment rate.

**Chart 4**



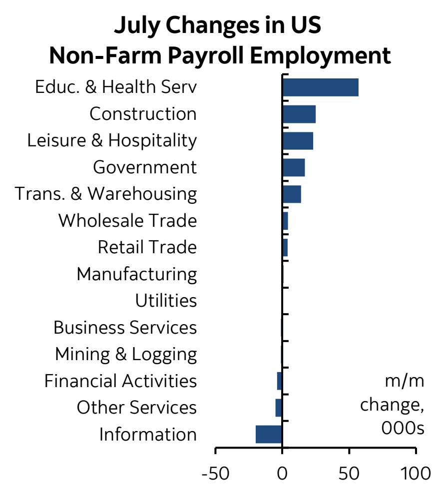

Sources: Scotiabank Economics, BLS.

**Chart 5**



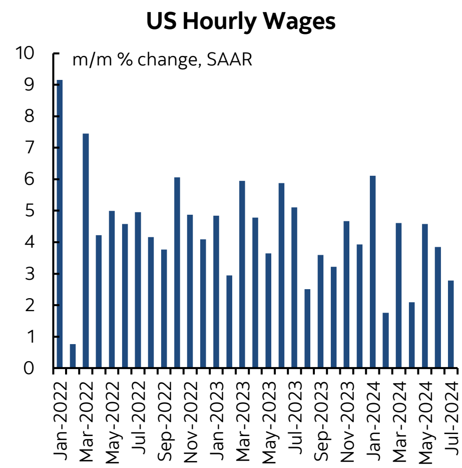

Sources: Scotiabank Economics, BLS.

**Chart 6**



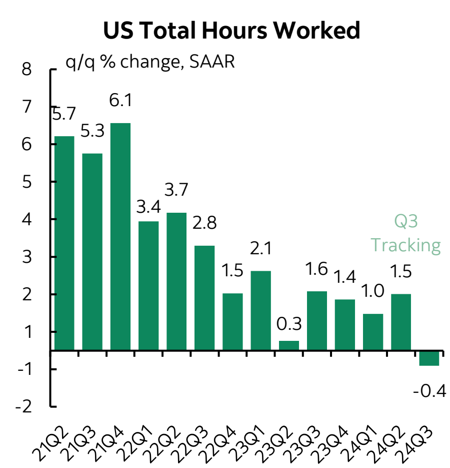

Sources: Scotiabank Economics, US BLS.

**Chart 7**



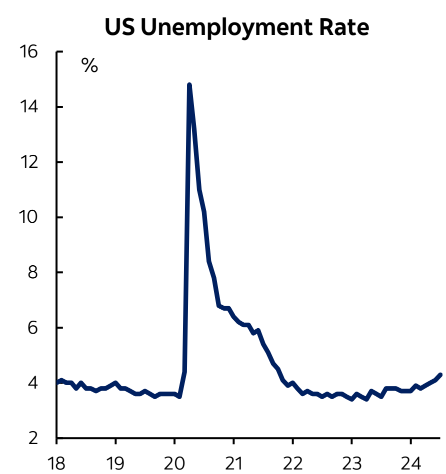

Sources: Scotiabank Economics, Statistics Canada.

**Chart 8**




Sources: Scotiabank Economics, BLS.

**Chart 9**




Sources: Scotiabank Economics, BLS.